Controller and Auditor-General

Tumuaki o te Mana Arotake

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Parliamentary paper

Matters arising from the 2012-22 local authority long-term plans

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Matters arising from the 2012-22 local authority long-term plans

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Glossary

Asset management plan (AMP) is a plan for managing a local authority's infrastructure and other assets to deliver an agreed level of service.

Consumer Price Index (CPI) is a measure of changes in the price of goods and services purchased by private New Zealand households.

Department of Internal Affairs (DIA) is the department responsible for providing support to the Minister of Local Government.

District means the district of a local authority.

Financial year means a period of 12 months ending on 30 June.

Gross Domestic Product (GDP) is New Zealand's official measure of economic growth.

Local authority means a regional council or territorial local authority.

Local Government Act 2002 (the Act) is the primary legislation for local authorities.

Local Government Cost Index (LGCI) is a price index that includes a general goods and services index, the transport capital expenditure index, and the "three waters" (wastewater, stormwater, and freshwater) capital expenditure index. The Society of Local Government Managers commissioned Business and Economic Research Limited to forecast inflation/price changes for 2012-22 for local authorities as a basis on which to prepare their forecast financial information.

Local Government Funding Agency Limited (LGFA) is a council-controlled organisation operating under the Local Government Act 2002, the Companies Act 1993, and the Local Government Borrowing Act 2011. It is an initiative to collectively raise finance for member local authorities.

Local Government New Zealand is the organisation that represents the national interests of local authorities and their elected members.

Long-term plans (LTPs, formerly long-term council community plans) are 10-year plans required by the Local Government Act 2002. The plans were renamed as part of amendments to the Local Government Act in 2010. In this report, we use "LTPs" to refer to the 2006-16, 2009-19, and 2012-22 plans.

Regional council means a local authority named in Part 1 of Schedule 2 of the Local Government Act 2002. Regional councils are primarily concerned with environmental resource management, flood control, air and water quality, pest control, and, in specific instances, public transport, regional parks, and bulk water supply.

Society of Local Government Managers (SOLGM) is the professional organisation for local government management in New Zealand.

Territorial authority means a city council or a district council named in Part 2 of Schedule 2 of the Local Government Act 2002.

Transparency, Accountability, and Financial Management (TAFM) refers to the amendments made to the Local Government Act 2002 that became law in November 2010. The amendments introduced some changes that were effective immediately and others that applied from the 2012-22 long-term plans onwards. TAFM introduced a requirement for a local authority to disclose a financial strategy and certain other financial information, including activity-based funding impact statements.

Unitary (local) authority means a territorial authority that has the responsibilities, duties, and powers of a regional local authority conferred to it under the provisions of any Act or an Order in Council giving effect to a reorganisation scheme.

Auditor-General's overview

The long-term plans (LTPs) that local authorities prepare every three years provide an insight into the position and future intentions of the local government sector. The recently completed 2012 round of 10-year plans coincides with the *Better Local Government* initiative, which seeks a local government sector that is leaner and more aligned to national economic needs.

This year, my office is focusing on the public sector's ability to meet the future needs of the nation. This report on LTPs is, by its very nature, our most significant contribution to that focus on future needs for local government.

The LTPs are formal documents that are subject to my office's audit. In their LTPs, local authorities should be planning for the delivery of important community services in prudent and sustainable ways. At the heart of the 2012-22 LTPs was the sector's response to the new requirement for each local authority to be clear on its financial strategy. A good financial strategy gives the local community a better basis for assessing the prudence and long-term financial sustainability of the local authority's plans.

Generally, I am satisfied with the response of local authorities to this challenge. The "direction of travel" is positive. However, a question remains about what specific information in the LTPs (and in the audited annual financial statements) is most helpful for informing judgements about the financial prudence and long-term financial sustainability of an individual local authority or the sector as a whole.

What constitutes prudence and long-term financial sustainability is a matter of judgement, and there are currently few agreed methods of analysis. As a result, it is difficult to be definitive about the state of an individual local authority or the sector.

Without a general consensus, my staff used a set of nine specific indicators to help describe the financial prudence of local authorities. I have included the set of nine indicators in this report to facilitate wider debate about financial prudence.

The set of indicators does not constitute an "audit test". My intention is that the set of indicators is debated in the coming months and used, refined, or superseded. We need consensus on how to better judge local authority and sector financial prudence and, ultimately, long-term financial sustainability.

I strongly believe that assessing the long-term sustainability of a community cannot be derived from financial analysis alone. Because of the importance of high-quality service delivery in the public sector, measures of those services are critical. However, the new requirement to include a financial strategy in LTPs and the need for a productive debate on prudence and sustainability mean that this report concentrates on those matters rather than service delivery.

Overall, local authorities are planning to live within their means, and they are not raising rates to unreasonable levels to do this. They are planning to raise more debt during the next 10 years to fund capital expenditure. This capital expenditure is often associated with the need to upgrade systems to meet new standards (for example, for water quality and the development of public transport systems). However, many local authorities are also expecting to repay some or all of this debt during the 10-year period of the LTPs. Net income almost always stays positive, and local authorities stay well within the golden rule of fiscal policy that governments should borrow only to invest.

Local authorities have a diverse range of circumstances and community requirements, each with its own demands. Local circumstances have led to arrangements that might appear unusual (for example, levels of debt). However, on closer examination, these arrangements are generally fit for purpose rather than imprudent.

My auditors issued audit reports on all the LTPs. Three of the audit reports contained modified opinions. Eight audit reports contained emphasis-of-matter paragraphs, pointing out significant risks that my auditors considered were fundamental to the local communities understanding the challenges and uncertainties those local authorities face in achieving their plans. None of the audit reports raised concerns about the financial prudence of local authorities' forecasts.

As part of the *Better Local Government* initiative, the Local Government Efficiency Taskforce is considering the nature of planning, accountability, and decision-making of local authorities. We have offered our insights (consistent with those outlined in this report) to the Taskforce. We have also suggested that local authorities present a more strategic focus on the main issues (including prospective financial information and level-of-service intentions), and provide access to supporting data and policies through the local authority's website.

I continue to encourage local authorities to consistently invest in preparing shorter, clearer, and more informative LTPs, so the community is able to take part in more informed and effective consultation on a local authority's intentions.

The future sustainability of local government services such as roads, water, libraries, and rubbish disposal are critical to our communities. Delivering on these LTPs in an effective and efficient manner is the next challenge.

Lyn Provost
Controller and Auditor-General

3 December 2012

Part 1
Introduction and summary

1.1 This report sets out matters arising from our audits of the 2012-22 long-term plans (LTPs) prepared by local authorities. The purpose of this report is to:

- tell Parliament and the local government sector about matters arising from our audit of the LTPs;
- discuss the quality of information in the LTPs; and
- allow Parliament and the local government sector to assess the effect and implications of changes resulting from the transparency, accountability, and financial management (TAFM) reform of the Local Government Act 2002 (the Act).

1.2 The process for preparing and consulting on an LTP is well known, and has now been carried out four times since 2002, when the Act introduced the requirement to produce LTPs. Appendix 1 summarises the main requirements for LTPs.

1.3 Local authorities are next due to prepare their LTPs for the 10-year period 2015-25. However, we note that the Government's advisory Efficiency Taskforce is considering, among other matters, the nature and content of LTPs. This may give rise to changes in the long-term planning environment.

1.4 Some of the matters discussed in this report assume a working knowledge of the wider local government environment, so we have included a glossary at the start of this report.

1.5 Some of the analysis in this report is most useful when readers can compare the forecasts in the 2012-22 LTPs with current and actual figures. Where appropriate, the text and graphs include 2009/10 and 2010/11 actual figures and 2011/12 forecasts[1] as base years alongside the forecasts for 2012/13 to 2021/22.

Main features of the 2012-22 long-term plans

1.6 Local authorities have a wide range of circumstances and requirements, and each local situation has its own demands.

1.7 The primary purpose of an LTP is to outline the financial and non-financial circumstances faced by the local authority and the local authority's proposed response to those circumstances. An LTP provides a basis for consultation and decision-making, and also helps the community to hold the local authority to account.

1 The figures for 2011/12 come from the comparative figures that local authorities had to include in their 2012-22 LTPs.

The new requirement to publish financial strategies was helpful

1.8 Helping generate the "right debate" (see paragraph 1.27) was the new requirement to include a financial strategy in the 2012-22 LTPs. We consider that this requirement improved the way local authorities presented the financial issues in their LTPs. This helped communities to assess the implications of proposed financial decisions during the consultation process.

1.9 The main themes evident in the financial strategies were:

- reducing or deferring expenditure;
- an increased use of district-wide funding to spread the costs of infrastructure upgrades for small communities;
- the need for a number of large infrastructure projects to meet legislative requirements;
- a focus on stabilising or reducing overall debt; and
- delaying capital projects because of lower or uncertain growth.

1.10 Although financial strategies are useful in increasing the quality of information in LTPs, we consider that local authorities could incorporate more assessment of the long-term view, beyond the 10-year scope of the LTP. In our view, local authorities could also explicitly consider the implications of trends, using a wider range of indicators of their long-term financial and non-financial sustainability.

Local authorities generally are preparing financially prudent LTPs

1.11 The global financial crisis and central government focus on restraint in public sector expenditure clearly influenced the LTPs. Overall, we saw a strong focus on affordability.

1.12 Local authorities, by and large, are cautious rather than drastic in their forecast approach to cost containment. Some have forecast "no frills" and "just in time" approaches to infrastructure development that will need very good asset management planning to ensure that current and forecast service levels are not put at risk.

1.13 Rates are forecast to increase at an average of 5% annually during 2012-22. Rates are forecast to increase relative to the underlying index of consumer costs (CPI), but decrease relative to overall income growth (as measured by GDP). Operating expenditure, meanwhile, is forecast to increase at an average of 4%, meaning that local authorities are planning to live within their means and with small operating surpluses during the period of their LTPs.

1.14 In the last two years, local authorities have been good at budgeting for their operational expenditure, but overestimated their likely levels of capital expenditure. We consider this under-expenditure indicative of the challenges of delivering a diverse range of projects each year. However, there is scope for the sector to improve reporting in this area so that it is easier for the users of local authorities' annual reports and LTPs to understand whether forecast projects have been delayed, whether there is a tendency for conservative overestimating, or whether cost savings have been achieved. In the LTPs, capital expenditure for 2012-22 is forecast at $37 billion. Of this, 59% is to meet increasing demand (often as a result of growth) or to improve levels of service.

1.15 The overestimation of likely levels of capital expenditure in the past two years raises questions about the realism of local authorities' longer-term assessments of the cost of their asset renewal and expansion programmes, as forecast in the LTPs. This emphasises the importance of robust asset management plans (AMPs) as the foundation of every LTP.

1.16 Our view is that local authorities generally show good stability and resilience to short-term uncertainty, with relatively low levels of interest expense and fixed costs.

1.17 Levels of debt are forecast to nearly double during the 10-year period of the LTPs, reaching $18.7 billion in 2021/22. Auckland Council, Greater Wellington Regional Council, and a small group of other local authorities serving our largest urban communities plan to use increased levels of debt to fund large infrastructure projects. Their LTPs forecast doing this within reasonable financial limits and expectations of income.

1.18 However, we are concerned that a small number of non-metropolitan local authorities are planning large increases to their debt levels. We assessed these local authorities as financially prudent, but they face greater risks in the accuracy of their forecasting, growth patterns, and ability to deal with the unexpected as their capacity to respond to shocks reduces.

1.19 Conversely, a number of mostly smaller local authorities are planning for little or no debt during the 10-year period. If these local authorities are carrying out large capital projects, this raises some questions about the appropriateness of their financial strategies and equity between ratepayers in paying for long-term infrastructure projects. These two contrasting approaches demonstrate the importance of a clearly described financial strategy that enables the community to understand the current and long-term implications of the local authority's forecast use of debt, particularly in the context of asset condition and forecast capital expenditure levels.

1.20 In the longer term, the LTPs suggest that the financial sustainability of the sector is reasonable, with small operating surpluses, reasonable debt levels, and provision for an increasing proportion of expenditure on renewing and improving assets. However, some individual local authorities are at greater risk than others.

1.21 Overall, we concluded that all local authorities had prepared LTPs that are financially prudent. For eight LTPs, we used an emphasis of matter paragraph in the audit report to highlight certain assumptions or risks related to the financial strategies that those local authorities are using to achieve their plans.

Each local authority has its own story

1.22 The broad findings summarised above are about the sector as a whole. Later in this report, we provide detailed information about local authorities whose circumstances have led to uncommon arrangements (such as levels of debt).

1.23 For example, Auckland Council, with a forecast population of 1.7 million, is on a different scale from every other local authority in New Zealand. As a new body expecting significant population growth, it faces challenges on every front. Its financial strategy is centred on a number of substantial investment projects, mostly relating to transport and economic activity, while balancing the budget. This inevitably leads to a high, but not unsustainable, level of debt. However, we considered that one project, the City Rail Link, was of such scale and significance, and had enough uncertainties associated with it, that we needed to draw attention to the associated risks in our audit report.

1.24 Like Auckland Council, Queenstown-Lakes District Council faces significant challenges in planning for the effects of growth. We issued a qualified audit report on its LTP for 2009-19, based on the Council's inability to fund its forecast capital expenditure. The Council addressed this issue, and, although it still faces risks associated with its planned levels of capital expenditure and debt, we consider that the Council's 2012-22 LTP is financially prudent.

1.25 There are some emerging differences between local authorities based on population size, reflecting their response to the influences and pressures they face. The differences suggest that further analysis is warranted within a wider debate on sector performance.

1.26 In our view, the uncommon situations that some local authorities find themselves in are suitably addressed in their LTPs. The arrangements they propose are fit for purpose, given their circumstances.

Consultation processes were generally suitable

1.27 Local authorities need to seek community views on the LTP as a whole. This is usually achieved by asking the community to focus on the major issues facing their community. We call this engaging in "the right debate".

1.28 In our view, the LTPs presented important issues to communities. In some situations, the choices for how a local authority might address those issues were less clear than in previous LTPs, and not in keeping with guidance issued by the Society of Local Government Managers (SOLGM) and our Office.

1.29 Not all local authorities took the opportunity offered by changes to the Act in 2010 to produce shorter LTPs. Those that did, on the whole, provided more accessible documents to their communities.

1.30 In our view, local authorities still need to find a suitable middle ground in LTPs between a high-level description of strategy and a detailed record of management intentions. Most local authorities provide too little of the first and too much of the second. Whether this is an inevitable response to current legislative requirements is debatable.

1.31 The processes that local authorities used to consult on their LTP were, by and large, suitable.

Part 2
New requirement for a financial strategy

2.1 In this Part, we:

- discuss the legislative context for a financial strategy and our views on what makes a good financial strategy;
- highlight common themes we saw in the 2012-22 LTP financial strategies;
- focus on the use of debt in the sector; and
- discuss the legislative framework for the requirement to produce a financially prudent LTP and consider the broader drivers of financial sustainability.

Legislative context

2.2 Local authorities are required to comply with the financial management provisions set out in sections 100 to 111 of the Act. The TAFM changes implemented in November 2010 made some minor changes to the content, review, and publication requirements of local authorities' financial policies. The most substantial change was the addition of section 101A, which introduced the requirement for local authorities to prepare a financial strategy as part of their LTPs.

2.3 The TAFM changes recognised the merits of transparently presenting a local authority's financial strategy in the LTP. This was to make it easier for the reader of an LTP to understand the local authority's financial intentions and, more importantly, to provide a better link to the local authority's service delivery intentions than had previously been required.

2.4 The purpose of the financial strategy is described in section 101A(2) of the Act. The financial strategy is to facilitate:

(a) prudent financial management by the local authority by providing a guide for the local authority to consider proposals for funding and expenditure against; and

(b) consultation on the local authority's proposals for funding and expenditure by making transparent the overall effects of those proposals on the local authority's services, rates, debt, and investments.

2.5 Section 101A sets out some specific content requirements for the financial strategy, including:

- the factors expected to be significant during the period of the LTP;
- expected changes in population and the use of land, and the capital and operating costs that any changes would require;
- the expected capital expenditure on infrastructure required to maintain current levels of service; and
- other significant factors affecting the local authority's ability to maintain existing levels of service and to meet additional demands for service.

2.6 Local authorities must also include some specific statements in the financial strategy on:

- their quantified limits on rates, rate increases, and borrowing; and
- their ability to maintain existing levels of service and to meet additional demands within the rates and borrowing limits.

2.7 The local authority also has to state its policy on providing security for its borrowing, its objectives for holding and managing investments and equity securities, and quantified targets for returns on investments and equity securities.

2.8 As we have supported more transparent disclosure of financial strategies since the 2006-16 LTPs,[2] it was important for us to focus on this new requirement in the 2012-22 LTPs.

2.9 The financial strategy sets out the overall financial goals of the local authority and where the local authority wants to be positioned during, and at the end of, the LTP period.

2.10 This links closely to the requirement in section 101(3)(b) of the Act for the local authority to make adequate provision for the needs identified in the LTP, taking into consideration the overall impact on the current and future well-being of the community. It also ties clearly to the purpose of local government, as set out in section 10.[3]

2.11 We were pleased to see the financial strategy included as a compulsory disclosure. We had some concerns that the sector might simply adhere to the specific requirements of section 101A and not focus on the broader intention of increased transparency. If this happened, the change would not reach its potential nor meet the underlying intentions of section 101A – helping the community to better understand the implications of a local authority's strategy and its position.

2.12 Every entity has a financial strategy, whether it has been documented or not. The financial strategy can be inferred from decisions and actions. The new requirements of the Act did not ask local authorities to produce something that had not already been present – the requirement was to document and transparently present that strategy for consultation with the community.

2.13 Most local authorities made their financial strategy a key consultation issue in their 2012-22 LTPs. Some provided particularly clear messages about future implications for ratepayers.

2 *Matters arising from the 2006-16 Long-Term Council Community Plans* (2007), page 85, and *Matters arising from the 2009-19 Long-Term Council Community Plans* (2010), pages 15 and 17.

3 The *Better Local Government* reforms are proposing changes to the purpose of local government as currently defined in the Act.

2.14 In general, we consider that the financial strategy disclosure requirement improved the information contained in the LTPs and helped communities to assess the implications of decisions they were consulted on.

2.15 A review of the financial strategy disclosures has reinforced our view that the greatest value is obtained when the local authority provides a broad discussion of the implications of the chosen strategy rather than limiting itself to the specific disclosure requirements of section 101A(3).

2.16 We continue to encourage local authorities to base their approach to disclosing their financial strategy on the intention of the Act – rather than as an exercise in complying with the letter of the law. We also caution against any further prescription of disclosure requirements in this part of the Act, which could lead the sector to address the financial strategy requirements in a mechanistic way.

2.17 Before the financial strategy requirements were added to the Act, few local authorities attempted to document their financial strategy. The former Manukau City Council was one of the exceptions – it included a financial strategy in its 2009-19 LTP. Although the strategy was not fully aligned to the requirements of the subsequently enacted section 101A, it still provides a useful example.

Assessing what makes a good financial strategy

2.18 In preparing for auditing the 2012-22 LTPs, we worked with Thames-Coromandel District Council, which was the first local authority to fully develop its draft financial strategy. Based on that work, we prepared brief guidance (see Figure 1) to help other local authorities to prepare their financial strategy. We circulated the guidance in late 2011, so local authorities could assess the adequacy of their financial strategy before completing their draft LTP for consultation.

Figure 1
Financial strategy guidance

	Principal criteria
1	Does the strategy adequately explain/summarise the intended level of service (including consideration of the renewal profiles evident within asset management plans) and associated cost implications for both operating and capital expenditure?
2	Does the strategy adequately explain/summarise the intended revenue flows (all key funding flows including rates, development contributions, and other key revenue items), the use of debt (including internal borrowings), and associated funding implications?
3	Does the financial strategy clearly set out a strategic "destination"/end point? If the strategy is designed to achieve a particular financial position with implications for the community, are these made clear?

4	In drawing the first three criteria together, does the financial strategy demonstrate an overall cohesion of these three elements and demonstrate the prudence and sustainability of its approach?
5	Does the financial strategy include the information requirements of section 101A of the Act?
	Presentation preferences
6	Does the financial strategy form part of the "right debate" – in other words, is it presented as a key issue "upfront" in the LTP? The upfront disclosures may be a summary of the financial strategy found elsewhere within the LTP.
7	Is the financial strategy presented in one place? Our preference is for one coherent strategy that, if it contains cross-references to other areas of the LTP (for example, growth assumptions), will need cross-references to discrete sections that can be clearly linked and are able to support the clarity of the financial strategy disclosures.

2.19 With criterion 4 in Figure 1, it is important for a local authority to consider whether the underlying strategy is truly long term and sustainably aligned to the future needs of the community. These needs are largely, although not completely, assessed with reference to the AMP. The renewal, replacement, and development needs of infrastructure systems are essential to the uninterrupted delivery of services to the community.

2.20 It is important that every local authority consider the long-term picture provided in its AMPs (as well as assessing the robustness of the AMPs) and appropriately factor the information about the profiles (peaks and troughs of spending needs) into the presentation of the LTP. This is because infrastructure systems primarily have useful lives of more than 50 years, while an LTP addresses only a 10-year period – a small part of the assets' service delivery to the community.

2.21 SOLGM noted in its guidance *Dollars and Sense* that:

> *A robust financial strategy must be grounded in sustainability of service and therefore draws on (among other matters) ... asset information and activity management plans. A strategy that does not adequately reflect activity plans will struggle to demonstrate prudence and will probably be frequently breached.*[4]

4 SOLGM (August 2011), *Dollars and Sense guidance,* page 36.

Financial strategy themes in the 2012-22 long-term plans

Themes arising

2.22 A financial strategy is much more than a plan to address current issues. However, we found that the effects of the current economic environment, particularly the prolonged global financial crisis, clearly featured in the financial strategies set out in the 2012-22 LTPs.

2.23 The main issues affecting the chosen financial strategies that we observed repeatedly in local authority LTPs were:

- reducing or deferring spending;
- an increased use of district-wide funding to spread the costs of infrastructure upgrades for small communities;
- the need for a number of large infrastructure projects to meet legislative requirements;
- a focus on stabilising or reducing overall debt; and
- delaying capital projects because of lower or uncertain growth.

Reducing spending

2.24 The theme of reducing spending was reflected in a variety of ways. We saw projects that had previously been included in long-term forecasts reclassified as “nice to have” rather than essential to core service delivery. Some community facility projects were removed from the LTP or delayed, and the local authorities’ contributions to some community-led projects were reduced.

2.25 This theme also manifested in forecast reductions in the level of renewals compared with the level signalled in AMPs. This approach is sometimes described as “sweating the assets” and has a greater risk in terms of possible asset failure than a renewal programme based on AMPs. This strategic approach is not without risk to the community.

2.26 The risks include a weakening in the social fabric of the community because there are fewer community facilities or a major infrastructure breakdown due to delayed renewal work. A breakdown could lead to environmental damage, loss of service delivery to the community for a period of time, or the need to carry out more expensive, urgent, and unplanned replacement or renewal projects.

2.27 On the other hand, reductions in previously forecast expenditure could signal that AMPs might have been “gold plated” by forecasting asset replacements either earlier or to a higher standard than necessary. We note that local authorities are unlikely to specifically state that AMPs have previously been “gold plated”. However, changes to forecast expenditure that are accompanied by explanations that there will be little effect on levels of service may be an indicator of this.

2.28 We acknowledge that most local authorities applying this approach will usually carry out visual inspections and testing of assets close to the end of their useful lives rather than relying solely on AMP data. In our view, this type of physical inspection should accompany decisions to deviate from programmes signalled in AMPs.

2.29 We saw some instances where local authorities disclosed the potential implications of reduced expenditure on levels of service, so the community could evaluate those implications. However, most LTPs focused narrowly on the ability to restrain rate increases in the short term. This is an aspect where we consider that the sector needs to improve the clarity of its discussion with the community.

2.30 Some local authorities plan to cut costs through operational efficiencies. Wellington City Council will try to find efficiencies of $219 million during the period of its LTP.[5] The savings are to come from various operational areas but also from substantial reductions in the level of renewals. The LTP discloses the risks associated with this approach. In the Council's view, the feedback from community consultation acknowledged a willingness to accept this risk to obtain the resulting reduction in rate increases.

2.31 Auckland Council is forecasting cumulative efficiency savings of $1.7 billion during the period of its LTP. The savings are expected to start at $131 million annually and rise to $188.2 million.[6] Auckland Council's savings are expected to come from improved procurement practices as contracts are progressively rationalised after amalgamation, process automation, system rationalisation, resource optimisation, and enhanced commercial management.

Increased use of district-wide funding

2.32 Another theme of the 2012-22 LTPs was that local authorities – primarily the small and rural local authorities – looked for ways to spread the costs affecting small communities. We saw a move away from the use of targeted rates (to attribute the costs of core infrastructure to particular communities) to district-wide funding of projects.

2.33 We saw this most often with infrastructure systems needed to meet higher performance levels required by legislation, such as drinking water supply and wastewater disposal schemes. Local authorities often assessed that the costs for the communities receiving the service were not affordable for that community. Several local authorities were grappling with issues of fairness in the context of the realities of affordability.

5 Wellington City Council, *Long-term plan 2012-22*, page 200. Forecast savings equate to just under 5% of operating expenditure.

6 Auckland Council, *Long-term plan 2012-22*, Volume one, Chapter 2, Section 2.4, page 38.

2.34 In many small communities where core systems need to be upgraded or replaced, there is no scope to achieve the economies of scale of a more densely populated or less isolated area.

2.35 The increase in district-wide funding of infrastructure reflects a significant change in philosophy. In the past several decades, local authorities have focused on funding infrastructure projects from those who generated the cost and received the benefit of the asset's service.

2.36 Many of these legislatively driven upgrade schemes come with a penalty regime for non-compliance. Evaluating whether to incur the cost of the upgrades or the penalties is a challenge for some local authorities:

- When preparing its draft LTP, Central Hawke's Bay District Council considered moving to a district-wide funding approach. The Council discussed the approach extensively in workshops. However, despite the significant targeted rates expected to be imposed on some small communities, the Council decided it was not yet prepared to move to a district-wide funding model.
- Mackenzie District Council presented a district-wide funding model in its draft LTP, to help spread the costs of necessary upgrades to essential infrastructure in several of its small townships. After a substantial and unfavourable response from the communities that would shoulder a share of the cost of upgrades for other communities' schemes, the proposal was removed from the final LTP.
- Rangitikei District Council proposed a move to a district-wide approach to rates, with the goal that all urban ratepayers in the district would pay the same amount for the provision of equivalent services, aligned to their property values, and that capital upgrades would be smoothed across the district. The change of approach was accepted during consultation, and it is now being applied.

Large infrastructure projects required to meet legislative requirements

2.37 Local authorities are concerned about the high costs associated with upgrading core infrastructure to meet legislative requirements, particularly compliance with drinking water standards. We noted that this pressure appearing as a theme in the 2009-19 LTPs, particularly for the smaller rural local authorities, and it continued to feature strongly in the 2012-22 LTPs. The significance of the costs of these compulsory upgrades has led many local authorities to conclude that they cannot comply with the legislative requirements other than by adopting the district-wide funding approach discussed above.

2.38 Many of the affected local authorities' LTPs have stated that the significant costs of meeting legislative standards might outweigh the expected benefits from the improved service delivery. We are aware that this issue continues to be of major concern to much of the sector.

Focus on debt reduction

2.39 Throughout the sector, financial strategies prominently featured the stabilisation or reduction of debt through the 2012-22 period. Despite this focus, debt is forecast to increase for the sector as a whole. The increase is attributable to a few local authorities with high debt. When Auckland Council is excluded, sector debt begins to decrease from 2019/20 onwards.

2.40 Overall, 25 local authorities plan to reduce their debt during the period of the LTP. There was a lot of narrative in LTPs explaining the focus on reducing indebtedness. In paragraphs 2.91 to 2.97, we discuss a widely used measure of indebtedness – the ratio of debt to revenue, which shows a largely downward trend during the period. However, we also note that, in our view, this measure is not considered high quality or usefully indicative of organisational health.

2.41 Local authorities that do not like to use debt are not necessarily following a risk-free financial strategy. Not using debt can delay important infrastructure projects, which can have significant flow-on effects. For example, traffic congestion can stifle economic growth.

2.42 Used in an appropriately prudent manner, debt is an effective way of spreading the costs of long-life assets. This approach applies the cost of the asset to the generations receiving the benefits more effectively. There is a risk that focusing on debt reduction without accurately evaluating whether debt is being managed within prudent levels could compromise investment and future needs.

A cautious approach to growth

2.43 Although the 2009-19 LTPs forecast some effects from the global financial crisis, local authorities still expected to grow during the 10-year period – but with less growth in the initial two or three years.

2.44 The 2012-22 LTPs are more cautious about growth predictions. Financial strategies are generally based on low or no expectation of growth, or a desire to respond to growth or prepare for growth close to the time it might occur. This reduces the risk of spending to expand infrastructure for growth that does not eventuate.

2.45 Strategies that include descriptions of "just-in-time" responses to growth are common in the 2012-22 LTPs. Part 5 discusses the example of Queenstown-Lakes District Council, which has taken this approach.

2.46 Delaying work to address growth needs can also have a significant effect on the community. For example, new properties might not be able to connect to core systems when they need to because the systems do not yet have the necessary capacity.

Overall assessment on the quality of financial strategies

2.47 In our view, local authorities provided better information to their communities in the 2012-22 LTPs because of the requirement to present a financial strategy. The sector used the presentation of financial strategies to address some important issues through the LTP consultation process.

2.48 Most local authorities did a more thorough analysis of their current approach and what they would do in the future than they had in previous LTPs. In the current financial environment, that analysis is helpful and provided local authorities with a framework to present the community with options for how to proceed.

2.49 However, some local authorities have not fully grasped the concept of a financial strategy. The financial strategy in their LTPs is largely a description of the financial picture that results from fitting together many individual planning decisions. This can be described as a "bottom-up" presentation of the financial strategy and often lacks overall coherence.

2.50 In contrast, our recommendation – and what we consider the legislators intended – is for local authorities to determine and clearly present their long-term goals, or strategic destinations, and to prepare the individual building blocks to achieve those goals – from the top down.

2.51 We acknowledge that preparing a financial strategy is always going to be iterative. The complexity of the factors that need to be taken into account, such as making decisions in a political environment, will result in a mixture of a top-down and a bottom-up process.

2.52 In our view, Hamilton City Council's LTP presents a good financial strategy. It provides a clear description of the current situation and sets clear goals that will enable the Council to work towards being in the position it wants to be in by 2022. The whole LTP uses plain language, which makes it easy for the reader to understand the issues. The financial strategy, in particular, presents the issues and the options to address the issues. It is not lengthy; nor does it describe the issues in an unnecessarily complex way. It uses graphs effectively to reinforce and support the messages.

2.53 In our view, Hamilton City Council showed that, even when the financial situation is complex, a financial strategy can be presented in an effective way (see Figure 2).

Figure 2

Our summary assessment of Hamilton City Council's financial strategy

Hamilton City Council's issue was that a prolonged period of rapid growth had required the Council to invest in new infrastructure, facilities, and services. Much of this investment had been funded through the use of debt, which was reaching unsustainable levels in 2012. Growth had slowed, which reduced the income anticipated from developers and delayed expansion of the ratepayer base.

The Council's financial strategy clearly sets out the approach it has chosen to address these issues. The approach includes a fixed level of rating increases for existing ratepayers during the LTP period, increasing "user pays" through increases in fees and charges for various services, reductions in some grants and service levels, and some asset sales.

The focus for debt is on containment. Debt had been forecast in the 2009-19 LTP to move as high as $700 million, but during the period of the 2012-22 LTP it is forecast to remain instead near $440 million (after a small rise in the first two years, to meet contracts already committed to).

Although the level of debt during the 2012-22 period increases by 2%, the Council's financial strategy is predominantly about debt containment and how to manage the ongoing need for infrastructure development without increasing the rates burden or creating an unsustainable future rates burden (by borrowing).

Despite this, the Council is still well outside the normal range in terms of our debt-related resilience indicator. Hamilton City Council's ratio of interest to rates revenue ranges from 16% to 23% during the LTP period, with an average of 18%. The sector average is 9% (see paragraph 4.52). For our other resilience indicator associated with debt (interest to debt), the Council is at or slightly below* the average for the sector (reflecting its membership of LGFA). There is also a reduction in the Council's own measure of debt to revenue, which moves from 250% to 180%. In terms of our sustainability measure of debt to assets, Hamilton City Council sits within the normal range throughout the period of the 2012-22 LTP.

* Hamilton City Council's interest rates range from 5.4% to 6.0%, with an overall average of 5.8%.

Debt trends in detail

Introduction – funding sources available to the sector

2.54 Section 103(2) of the Act sets out the funding sources that are available to local authorities. They include general rates, targeted rates, lump sum contributions, fees and charges, interest and dividends from investments, borrowing, proceeds from asset sales, development contributions, financial contributions, grants and subsidies, and any other source.

2.55 Although section 103(2)(j) refers to "any other source" being used, in reality a local authority could not normally use other means of raising revenue without legislative changes (see our discussion at paragraph 5.22 about Auckland Council's LTP).

2.56 An important part of the financial strategy and funding approach of every local authority is the choice of rating system. This includes the choice of valuation system, and whether and how to apply differential rating and uniform annual general charges. These choices are policy matters for the local authority, which can result in significant variations in the total amount of rates revenue raised and, in particular, the distribution of the rating burden throughout the community.

2.57 The increased use of district-wide project funding in the 2012-22 LTPs reflects the choice of some local authorities to spread the cost of infrastructure upgrades across the rating base instead of using targeted rates. This is a philosophical choice that has implications for ratepayers. It is also a choice that can affect the amount of revenue that needs to be generated from other sources available to the local authority.

2.58 The approach to rating, and how it is integrated and balanced with the other sources of funds, is set out in the local authority's revenue and financing policy.

2.59 We note that the proportion of revenue from rates is forecast to be stable at 52% of total operating income for the sector as a whole. However, there is a wide variability between individual local authorities.

2.60 Some of the sources of funding set out in section 103(2) of the Act are not available to all local authorities. For example, not all local authorities have returns from investments or assets to sell, or development and financial contributions (which are a significant source of revenue only if the local authority is undergoing substantial growth).

2.61 Practices vary widely. We have already discussed Hamilton City Council's approach. We have also seen increases to fees and charges in the 2012-22 LTPs from local authorities focusing on identifying and attributing the costs they incur more directly to the driver or beneficiary of those costs, to limit the general effect on rates.

2.62 Local authorities have limited scope to significantly alter the amount of revenue available through these sources. This limitation is usually on the grounds of affordability of the full costs of services to which fees and charges might apply (such as fees for library books or dog registration).

2.63 After rates, the next most significant source of funds available to a local authority is debt. Rates and debt provide the most significant and, arguably, the most flexible sources of funds to a local authority. The extent to which local authorities use rate increases and debt directly affects the levels of service delivered to the community – they are inextricably linked.

2.64 The next section discusses the main points about the use of debt by local authorities. Appendix 2 sets out the 2011/12 and 2021/22 forecast debt balances for all local authorities. We have focused on the "extreme" local authorities – those with LTPs that plan either no debt or a high use of debt. We chose to examine these outliers to see whether there is an issue with how the sector is using debt.

The no debt/low debt group

2.65 Five local authorities plan to have no debt during the 10 years of the 2012-22 LTP:

- Bay of Plenty Regional Council;
- Northland Regional Council;
- Southland Regional Council;
- Taranaki Regional Council; and
- Waikato Regional Council.

2.66 These are all regional local authorities. Regional local authorities usually have less debt because they have fewer large infrastructure systems. In general, the sector uses debt to finance the development and renewal of large long-life infrastructure systems (such as water supply schemes) that require substantial upfront investment. The systems are usually funded by debt to spread costs and achieve equity between ratepayers over time.

2.67 We note that most of the regional councils continue to benefit from dividends from large funds vested through restructure processes of the past.

2.68 The exceptions within the regional local authority grouping are Greater Wellington Regional Council and Hawke's Bay Regional Council. These two local authorities have a high level of debt because they are involved in high-cost infrastructure projects that are not typical of regional local authorities. Figures 3 and 5 describe the situations of Greater Wellington and Hawke's Bay Regional Councils.

2.69 Other regional councils with debt, but at much lower levels, are Environment Canterbury, Otago Regional Council, and West Coast Regional Council.

2.70 Environment Canterbury's debt arises from the Waimakariri flood protection project and the Clean Heat programme. West Coast Regional Council has a very low level of debt that is expected to remain reasonably stable during the LTP period, and this is also for flood protection and Clean Heat projects. Otago Regional Council expects to repay the outstanding debt for its share of the construction costs of the Forsyth Barr Stadium in 2013/14, and the diminishing amount of remaining debt is primarily for flood protection work.

2.71 Most regional councils use debt for flood protection schemes, which is consistent with using debt primarily to fund infrastructure systems.

2.72 We note that, compared to previous LTPs, fewer smaller district councils are operating without using any debt.

The high or rapid growth of debt group

High debt

2.73 Of all the local authorities, Auckland Council is planning to have the most debt during the LTP period. The forecast closing debt balance in 2021/22 is $12.5 billion. This accounts for 68% of the sector's total debt in 2021/22. Five other local authorities, each with forecast closing debt greater than $300 million, account for another 12% of the total.

2.74 It is notable, although unsurprising, that the six local authorities expecting to hold 80% of the sector's debt are mainly those servicing our largest urban communities. Using debt is highly correlated to servicing the needs of our largest urban populations and the growth in these areas, such as meeting transport needs in Auckland and Wellington. Figure 3 provides our summary assessment of Greater Wellington Regional Council's financial strategy.

Figure 3

Our summary assessment of Greater Wellington Regional Council's financial strategy

The 2012-22 LTP for Greater Wellington Regional Council (Greater Wellington) forecast the highest regional council debt and fifth-highest local authority debt. Greater Wellington has also forecast the second-highest change in amount of debt (after Auckland) during the LTP period. Its proportion of debt to total assets is outside the normal range for all 10 years of the LTP period and is the highest for the sector (at an average of 30%, compared to the sector average of 6%).

Why is Greater Wellington so different from other regional councils?

Greater Wellington began investing in substantial transport infrastructure upgrades in 2007 after the Crown approved a $500 million package for upgrading the Wellington rail network. This was followed in July 2011 with a funding package to address deferred renewals. Greater Wellington has commitments to further upgrade regional transport infrastructure during the period of its LTP. This investment is to address and reverse a previous lack of investment over several decades. The forecast includes investing in integrated ticketing and improving the reliability and frequency of the public transport network.

The LTP also forecasts significant investment in upgrades to flood protection schemes and the need for a new water storage facility near the end of the LTP period.

The financial strategy is based on borrowing for initial capital investment. Operating revenue is to be used to fund interest on debt and to repay the principal amount borrowed. Greater Wellington intends to promote intergenerational equity by using debt.

Greater Wellington forecasts receiving significant government subsidies from the New Zealand Transport Agency during the LTP period. In contrast to Auckland Council, most of this support is confirmed.* Central government grants are forecast to contribute between 50% and 60% of annual operating costs.

Greater Wellington is a founding member of LGFA, so it can reduce debt costs. Its LTP states that it has an AA credit rating.

The debt limits set out in Greater Wellington's financial strategy are calculated based on net debt, and that is how the debt is presented. At the end of the LTP period, Greater Wellington's forecast gross debt is $100 million more than net debt.

The limits Greater Wellington has set out in its LTP are:

Limits set out in financial strategy	Highest ratio in LTP period	Highest ratio in period calculated on a gross debt basis
Net interest/total revenue < 20%	6.4%	7.0%
Net debt/total revenue < 250%	106.2%	138.0%
Net interest/annual rates < 30%	11.1%	17.0%

This shows that Greater Wellington is well within its limits and is not obscuring matters by presenting the figures based on net debt.

Greater Wellington plans to use the greatest proportion of rates revenue to fund the transport activity. We note that Greater Wellington does not rate for depreciation – rates fund only debt repayment and the cost of financing Greater Wellington's share of capital expenditure. We consider this reasonable, given that the upgrades are current, the assets are long-lived, the projects are jointly funded, and any future replacement will most likely be possible only with central government support. It can be argued that funding for depreciation on these assets would penalise current ratepayers and adversely affect intergenerational equity.

The rate limits set out in the financial strategy include a split limit. Rate increases for new services are limited to 5.5% on average, while average rate increases for existing services are limited to the LGCI. This means an average increase of 3% each year. Greater Wellington does not expect to breach either of these limits during the LTP period.

* Because most of the support is confirmed, we did not modify our audit opinion for Greater Wellington (in contrast to our opinion for Auckland Council, where we emphasised the matter of this uncertainty).

2.75 Christchurch City Council, a large metropolitan local authority, is missing from our data set because it was not required to prepare and adopt an LTP for 2012-22. When we examined the 2009-19 LTP for Christchurch City Council, we noted that the closing debt forecast for 2018/19 was $868 million. Before the earthquakes, the forecast debt position of the Council was consistent with the pattern of other metropolitan local authorities.

2.76 Had circumstances not changed, Christchurch City Council would also have been in the group that plans to hold most of the sector's forecast debt. This again illustrates that the highest level of debt is linked to the largest populations and highest levels of economic development and growth.

2.77 An area of greater concern lies with local authorities that have high debt but are not metropolitan, such as Tasman District Council. Tasman District Council forecasts a closing debt of $311 million. This is higher than the debt expected by local authorities in more metropolitan or densely populated urban areas, such as Dunedin and Palmerston North.

2.78 Figure 4 provides our summary assessment of the risks of Tasman District Council's financial strategy, which is linked to its funding philosophy and its growth challenge.[7]

Figure 4
Our summary assessment of Tasman District Council's financial strategy

Tasman District Council's LTP states that its financial strategy is to fund capital and renewal expenditure through borrowing. The Council has adopted this approach instead of setting aside funds to replace assets as they wear out – that is, cash funding depreciation. As a result, by the time the asset needs to be replaced, the Council will normally have repaid the loan for the original asset and can borrow for the replacement of the asset. Under its current approach, Tasman District Council will always have a substantial amount of debt. The Council has a financial strategy of rating enough to repay only existing debt. It will incur asset renewal expenditure every year, which it will continue to fund through debt.

The renewal-related debt will continue to increase because of cost increases, such as bitumen prices, and the timing of asset renewals. Also, many of the Council's assets are comparatively new, meaning that there is likely to be more renewal work required in years to come.

Debt levels are exacerbated where growth continues and levels of service increase, which requires more debt funding. This is evident in the Council's LTP, where levels of service improvement in water treatment are forecast to significantly affect the Council's debt levels.

Typically, other local authorities fund renewal work out of rates and New Zealand Transport Agency subsidies. Local authorities take this approach because they consider that:

- depreciation should be funded because it reflects the consumption of value in the assets and should be paid for by the people who have used the assets; and
- a whole-of-network view should be used when considering how to fund new assets (including renewals). Under this view, borrowing is used only for asset expenditure that will improve rather than maintain the operational capacity of the network (that is, borrowing should be used only for improving levels of service or growth).

We note that, when considered from a whole-of-network perspective, the cost of renewals is relatively consistent each year. Tasman District Council's approach means that it is incurring interest on renewals, which other local authorities do not incur, and the cost incurred does not improve the performance of its infrastructure network.

Tasman District Council's approach has increased its risk in the following areas:

- The accuracy of financial forecasts – the Council's approach means that it has limited cash reserves. The Council could be affected significantly in terms of cash flow if its budgets are not achievable or if a factor in determining costs, such as the interest rate, changes in an unanticipated way.
- Growth – the Council is borrowing to construct assets required for existing and future growth. There is a risk that the growth does not eventuate, which would leave existing ratepayers servicing the debt for underused assets.
- Its ability to deal with the unexpected, such as adverse interest rate movements, lower growth, a disaster, or unexpected critical asset failure (or a combination of events).

7 We seriously considered whether to include an emphasis-of-matter paragraph in the audit report of Tasman District Council. However, we did not do so because we considered that the issues the Council faces as a result of its current strategy do not have an immediate effect on the Council. The longer-term risks of the current strategy were addressed through management reporting.

Typically, a local authority has four main financial "levers" to approach any financial issue – increasing revenue, lowering costs, using debt, and changing levels of service. Because it forecasts being near its treasury limits at the end of the 2012-22 period, Tasman District Council will have little scope to use debt to protect it from future shocks.

Tasman District Council recognises the risks of its proposed debt. In its LTP, it notes the intention to review major capital projects and its policy to fund renewals through debt. This review is due for completion in mid-2013.

We also note that, at present, Tasman is experiencing high growth. For the year to June 2011, its growth rate was as high as Auckland's. Tasman District Council has a comprehensive and regularly reviewed growth strategy, which is detailed across its 17 settlements. The LTP assumptions note that projects will be moved to meet any changes in growth rates.

Highest debt movements – most significant increases in debt

2.79 Auckland Council's LTP includes the biggest change in debt. The Council is proposing to incur $7.5 billion of additional debt between 2011/12 and 2021/22. This is 87% of the total debt movement for the sector.

2.80 The other local authorities with high debt movements forecast during the LTP period are also mainly those with the highest closing debt balances. The exception to this pattern, moving from a relatively low base, is Hawke's Bay Regional Council (see Figure 5).

2.81 We also note that other local authorities with high gross debt increases are metropolitan local authorities, such as Wellington City Council and Tauranga City Council, or local authorities facing growth, such as Kapiti Coast District Council, Queenstown-Lakes District Council, and Tasman District Council.

2.82 The highest percentage movement in debt reveals a slightly different picture. Hawke's Bay Regional Council is forecasting the greatest percentage increase in debt from 2011/12 to 2021/22 – 530%.

Figure 5
Our summary assessment of Hawke's Bay Regional Council's financial strategy

Hawke's Bay Regional Council's debt is forecast to grow from $15.7 million to $99.3 million during the LTP period. This puts it seventh in terms of greatest debt movement and first in debt percentage movement (at 530%).

Based on an analysis of the forecast financial statements alone, Hawke's Bay Regional Council has an implied interest rate throughout the LTP period that is outside the normal range of 3.1% to 8.8% – its interest rate moves between 11.3% and 16.9%, and averages 13.1%.

Hawke's Bay Regional Council has the highest proportion of average interest expense to rates, at 38%. During the period of the LTP, the percentage of rates used to pay interest costs ranges from 13% to 56%.

Why does Hawke's Bay Regional Council appear so different?

There are two components that explain Hawke's Bay Regional Council's situation. The finance costs included in the main financial statements include interest on borrowings and fees associated with the transfer of Napier leasehold properties to an investor. This is an important part of Hawke's Bay Regional Council's financial strategy. When these fees are extracted from finance costs, the interest rate range reduces to between 5.8% and 7.7%, with an average of 7%. Interest as a proportion of rates ranges from 6.5% to 38.5%, with an average of 23%.

Hawke's Bay Regional Council's financial strategy has several substantial investment projects. Its economic development goals are mainly linked to improving land use and increasing exports in the region. The investments will be managed through the Council's holding company, Hawke's Bay Regional Investment Company Limited. The projects are all subject to a strict business case regime where the viability of each project must be proved.

The main projects are:

- a $47 million forestry programme to help farmers stabilise slopes vulnerable to erosion, in exchange for a share of future carbon credits;
- $107 million in water storage/harvesting projects to make land more productive through irrigation; and
- $32 million in port logistics, to enhance storage and turnaround facilities at the Port of Napier.

Hawke's Bay Regional Council will borrow then lend funds to its subsidiary to support the start of these investment projects only when the business cases prove that the investment pay-back is realistic. The intention is for these projects to be largely facilitated by the Council. However, the long-term costs will be met by those benefiting directly, such as the farmers farming where forests will be planted and those who will connect to the enhanced irrigation schemes.

There has been no increase to the general rate in the last three years. During the LTP period, rates as a proportion of revenue are in the 29% to 35% range, which is below the sector average of 52%. This shows that the planned investment activity of the Council will not directly affect ratepayers.

2.83 Other local authorities near the top of the list for percentage debt movement do not have high dollar value debt. Three of these are small local authorities – Grey, Opotiki, and Rangitikei District Councils.

2.84 Although these three small local authorities have large percentage increases (139%, 229%, and 445% respectively), their closing debt balances are still small in comparison to their asset bases and to the rest of the sector.

2.85 Grey District Council is incurring more debt for its wastewater scheme upgrade. Opotiki District Council has proposed higher debt for its wastewater renewal and expansion projects and its harbour development project. Rangitikei District Council's debt is for wastewater and water supply upgrades.

2.86 In Opotiki, the Council clearly states in its LTP that this expenditure has been allowed for by "reducing debt over time in order to have capacity to invest in growth opportunities when they present themselves".[8] The harbour development project, which is intended to bring economic and social benefits to the district, will go ahead only if the forecast level of external funding support is obtained. We highlighted the high level of uncertainty associated with this assumption in our audit report, using an emphasis-of-matter paragraph (see Appendix 3).

2.87 Again, the sector is using debt to facilitate substantial projects.

Highest dollar value decreases in debt

2.88 Two local authorities have forecast large decreases in debt. Dunedin City Council's debt is forecast to decrease by $34 million, largely because of the completion of a number of large capital projects early in the LTP period. From 2013/14 onwards, Dunedin City Council repays more debt than it borrows. Western Bay of Plenty District Council's debt is forecast to decrease by $41.5 million as the local authority focuses on debt repayment.

2.89 Again, large movements are strongly correlated to high 2021/22 debt balances. Both of these local authorities forecast 2021/22 debt balances in the top 20 of the sector – their debt is forecast to be greater than $100 million, despite these substantial debt reductions.

Highest percentage decreases in debt

2.90 There are also some local authorities forecasting substantial percentage reductions in the amount of debt held from 2011/12 to 2021/22. The highest declines are primarily, but not exclusively, in smaller local authorities. Other than the five local authorities that had debt at the start of the 2012-22 LTP period and expect to have fully repaid this debt before 2022 (a 100% decrease in debt – see Appendix 2), the greatest decreases are forecast by Otorohanga District Council (85%), Otago Regional Council (84%), Waimate District Council (78%), Hauraki District Council (66%), and Whakatane District Council (63%). We consider that this reflects the tradition of small local authorities preferring not to use debt. It may also be because of a low level of new capital projects.

8 Opotiki District Council, *Long-term plan 2012-22*, page 21.

Using debt to total revenue to assess the prudence of local authority debt

2.91 Local authorities often use debt as a proportion of total revenue (sometimes based on net debt) as a key limit against which they limit debt increases. Auckland Council has the highest stated limit at 275% (which is calculated on a net debt basis). The financial strategies of the local authorities with the highest dollar value debt generally focus on reducing their proportion of debt to revenue during the LTP period.

2.92 We calculated a proportion for the sector using gross debt to total revenue by year, because using gross rather than net debt is a more conservative measure. The local authority with the highest proportion was Taupo District Council. In 2012/13, Taupo District Council's proportion of debt to total revenue is 258%. It is forecast to steadily decline during the LTP period to 154% by 2022. Hamilton City Council also begins with a high proportion of 237% in 2012/13, declining to 166% by 2022.[9]

2.93 In contrast, Auckland Council has forecast the highest proportion of debt to total revenue in 2021/22 at 246% – an increase from 193% in 2012/13.

2.94 We understand that the general intent of the measure of debt to total revenue is to assess the amount of annual revenue required to repay debt at a point in time. However, we question the value of this as a measure. In many instances, there are items within total revenue that do not reflect actual cash that could be made available to repay debt (such as vested assets). Also, most of the revenue received from rates and government subsidies is required to meet the costs of either agreed projects or annual operational costs for delivering essential services (such as the costs of electricity to operate wastewater pump stations). These costs could not be diverted to fully repay debt in any one year without cutting off essential services.

2.95 We acknowledge that many local authorities nevertheless use this measure because it is employed or required by credit rating agencies, including LGFA (see paragraphs 4.49-4.50).

2.96 In our view, it is important for the sector to consider other ways of measuring the effect of debt on the local authority. We consider that possible measures include those that assess the level of control debt has over the organisation, so that undue control can be monitored. This may be by measuring the interest effect on revenue, or debt as a proportion of assets. The other main concern is that the local authority remains capable of meeting interest and principal payments as they fall due. Measures to assess this area would usually focus on cash flow capability and

9 Taupo District Council's net debt to total revenue will decline from 134% to 43% during the LTP period. Hamilton City Council's net debt to total revenue will also decline from 250% to 180%. See Figure 2.

whether it is enough to cover expected outflows. A possible set of indicators is presented in Part 4.

2.97 Local authorities usually borrow funds for an extended period, to achieve intergenerational equity, and to facilitate longer-term investments that would not be possible with existing resources. For these reasons, assessing how debt relates to total revenue is not helpful. Any reduction in the proportion of debt to total revenue during the period of the LTP does not necessarily indicate an improving or declining debt situation, but needs to be considered with other measures and the individual circumstances of the local authority.

Financial prudence and sustainability

2.98 In our view, two aspects of prudence are important for the sector:

- prudence as it is defined in section 101 of the Act with a financial focus; and
- prudence in the broader context of sustainable and long-term delivery of services.

Prudence

2.99 Section 101 of the Act sets out a general requirement for local authorities to manage financial matters prudently and in a manner that promotes the current and future interests of the community.

2.100 Assessing whether a local authority has a balanced budget provides a starting point for assessing financial prudence, but further analysis is required.

2.101 The Act requires each local authority to answer for itself, within its own context, whether the budget presented in the LTP is financially prudent. Auditors are required to form an independent opinion on whether the forecast is financially prudent. Both the local authority and the auditor make an informed judgement on this point. Assessing financial prudence is not a science but a matter of judgement. The primary sources of assurance for the auditor are considering the process the local authority used to complete its prudence assessment, and the quality of the information provided to the local authority so it could consider the relevant factors.

2.102 Importantly, the Act requires financial prudence to be considered on the basis of current and future interests of the community. Therefore, the useful life of assets and, in particular, future capital requirements must be considered during the LTP period – not just the forecasts. Consequently, any analysis of the financial strategy and consideration of its implications for prudence must consider the entire life cycle of a local authority's assets. The local authority ought to demonstrate that it should be able to deliver services sustainably for years to come.

2.103 It is not only the long life cycle of assets and the need to maintain essential services in perpetuity that have an effect on prudence. There are also significant implications for financial prudence in land-use planning decisions – particularly those that commit a local authority to extend the boundaries of land available for development and require the extension of infrastructure systems. These decisions can, by implication, commit the local authority to take on the risk of predicting the timing of this development, which can have significant effects on debt levels and rates.

Our conclusion about local authorities' financial prudence

2.104 Our 2012-22 audit reports concluded that the LTPs of all local authorities indicated that they were financially prudent. In eight reports, we highlighted certain assumptions or risks that those local authorities faced in achieving their plans, but did not call the local authorities' financial prudence into question (see Appendix 3).

2.105 However, the assessment of financial prudence remains a substantial challenge for local authorities. To make and act on the best assessment of financial prudence for the sake of the community, local authorities must consider financial prudence in a wide, robust, and long-term manner.

Broader drivers of sustainability

2.106 We recently commissioned a research report on indicators of public sector financial sustainability.[10] The report suggested that, to assess prudence and sustainability, indicators should cover not only financial areas but also social, environmental, and public sector factors. These factors are the long-term drivers of demand for, and effective delivery of, services to the public or the ratepayer.

2.107 Although the report had a largely national focus, the findings are relevant for local government. We have incorporated some of the report's findings in the discussion in Part 5. Here, we set out our view of the broader drivers of sustainability in local government.

Considering the longer term

2.108 LTPs cover a 10-year period, which is a long time for detailed planning but a short time in the life of the major assets that local authorities have stewardship of. New Zealand's central government and many overseas jurisdictions are now looking 40 to 50 years ahead when planning.

2.109 When preparing their LTPs, local authorities also have to consider irregular peaks and troughs in their capital expenditure (because different projects will have cost

10 Anderson, B (2012), *Research report on public sector financial sustainability, stability and resilience*, unpublished report commissioned by the Office of the Auditor-General.

peaks at different times) beyond the 10-year planning period, and how those peaks and troughs might affect decisions and financial prudence now and in the long term.

Tailoring indicators

2.110 The research report we commissioned lists 21 headline indicators that might be used to assess financial sustainability in central government. It also points out that indicators used internationally show as much local variation as they do commonality. We have not attempted to separately devise a set of indicators tailored to local government, but have considered the relevance of the 21 indicators and where variations or different indicators might be appropriate.

Contextual indicators

2.111 A number of the indicators are for areas that are primarily either private or central government responsibilities, such as income disparity, labour productivity, and business innovation. Tracking such indicators might be useful contextual information for local authorities, but is not likely to directly affect planning.

Important non-financial drivers

2.112 There are several important social and environmental drivers of long-term financial sustainability, and their trends should be taken into account in planning. Section 101A of the Act recognises this, stating that financial strategies in the LTP should include a statement on "factors … expected to have a significant impact … during the … years covered by the strategy". These factors include expected changes in population and land use, expected capital expenditure, and "other significant factors" affecting the local authority's ability to maintain existing levels of service and to meet additional demands for services.

2.113 The research report we commissioned suggests that life satisfaction, civic engagement, biocapacity,[11] net greenhouse gas emissions, and solid waste production are important indicators of social and environmental drivers. The report proposes that current trends in these be projected for 40 to 50 years. Some or all of these are already taken into account, either explicitly or implicitly, in the LTPs, but it might be useful to use these or similar indicators more explicitly as part of local authorities' future long-term planning.

Important financial drivers

2.114 Business and household income and wealth are important determinants of the ability to pay rates and other charges. It would be useful (and feasible) to track trends in income, particularly in low-growth or depopulating areas. Many local authorities already do this. Housing availability and affordability also affect the ability to pay rates and need to be considered.

11 Biocapacity is short for biological capacity – the calculated ability of ecosystems to produce useful biological materials and absorb carbon dioxide emissions.

Nature of local authority spending

2.115 The research report tentatively suggests that spending could be re-categorised as "redistribution", "investment", "defensive", and "other", to help get beyond the categories of "consumption" and "capital" expenditure used in traditional accounting. The underlying idea is that governments invest in capability (not just through capital expenditure), but also spend money that does little more than prevent or ameliorate bad situations. Our long-term preference is an upward trend in the first type of expenditure and a downward trend in the second, or at least an upward trend in the first relative to the second.

2.116 The suggestion seems broadly applicable to local authorities, which do very limited amounts of redistribution, have high levels of capital investment, perform a range of regulatory activities that have both investment and defensive aspects, and do some defensive spending, mainly through regulatory activities.

Local authority capability

2.117 We discuss the financial capability of local authorities in Part 4. In summary and in relation to the research report's indicators:

- **Net income** almost always stays positive, and local authorities, in the main, stay well within the golden rule of fiscal policy, that governments should borrow only to invest.
- **Financial condition**, as measured by both gross and net debt levels, is usually sound, with credit rating and default risk low to negligible in most local authorities.
- We found that **buffer capacity** is built into local authorities' operations, partly through low debt levels and partly through their ability to meet unplanned costs through insurance and other mechanisms. We note that local authorities are learning to leave some buffer capacity in their plans to cope with unexpected day-to-day expenditure. For example, the Local Authority Protection Program Disaster Fund (LAPP Fund) is an explicit insurance agreement with central government to provide partial funding for spending shocks.[12]

2.118 The research report suggests two indicators of non-financial capability:

- A general measure of capability to deliver into the future. This is a very important issue for local government, particularly for small, usually rural, local authorities. They have serious limits on their capacity to employ or access relevant expertise (for example, at chief financial officer or engineer levels), and to deliver services to desired quality levels and on time.

12 We acknowledge that, after the Canterbury earthquakes, the LAPP Fund will require several years to be built back up.

- A more specific measure of fiscal governance. In Parts 3 and 4, we describe how local authorities vary enormously in their situation and underlying capacity but are broadly fiscally conservative. Local authorities should, generally, be considered more at risk from their circumstances (such as depopulation) than from poor fiscal management.

Conclusion on the broader drivers of local authority sustainability

2.119 Many local authorities are already tracking some or all of these or similar indicators. However, we consider that local authorities could do more to build a much longer-term view into their planning, and to explicitly track and project trends in key drivers of their financial sustainability.

Part 3
Financial trends and financial information

3.1 In this Part, we discuss:

- the main features of local authorities' financial forecasts; and
- broad financial performance trends in the LTPs.

3.2 Our financial analysis includes 77 local authorities. Christchurch City Council is excluded because it elected not to prepare and adopt a 2012-22 LTP (legislation enacted after the Canterbury earthquakes gave the Council that option). Christchurch City Council will be preparing and adopting an LTP before 1 July 2013. The plan will cover a period of not less than nine years, starting on that date.[13]

3.3 All local authorities except Auckland Council prepared an LTP that included council-only financial forecasts. Auckland Council chose to prepare an LTP that covers the Council and its group of council-controlled organisations.[14] Auckland Council's group financial forecasts are significant. For some of our analysis, we have shown the Auckland Council group separately or made adjustments to see the trends arising from all of the other local authorities without being dwarfed by the Auckland Council group.

3.4 Although Kaipara District Council is receiving publicity for the issues it is currently dealing with, the forecasts in its LTP do not have any significant effect on the sector-wide results discussed in this Part and Part 4.

3.5 The Department of Internal Affairs (DIA) collated all of the financial information in the final 2012-22 LTPs and made the information available to us for further analysis.

3.6 In Part 4, we assess the financial performance of local authorities more comprehensively, looking at their financial performance in terms of stability, resilience, and sustainability.

Main features in the financial forecasts

3.7 The following is our summary of the main features in the financial forecasts:

- Total rates income during the 10 years is forecast at $54.2 billion, and makes up 52% of the total forecast operating income.
- Total rates income is forecast to increase from $4.1 billion[15] in 2011/12 to $6.6 billion in 2021/22. The year-on-year movement is, on average, 5%. (For Auckland Council, the average is 6.1%, and for all other local authorities

13 See Canterbury Earthquake (Local Government Act 2002) Order (No 2) 2011, clause 7(3).

14 See the Local Government Act 2002, Schedule 10, Part 1, clause 12(2). An LTP may include, for each of the financial years covered by the plan or for any of those years, forecast financial statements for any council-controlled organisation or any other entity under the local authority's control.

15 We collated this number from the 2012-22 LTPs because local authorities were required to include 2011/12 comparative information in their LTPs.

combined the average is 4.3%). The sector-wide average exceeds the forecast increases in the Consumer Price Index (CPI)[16] and the Local Government Cost Index (LGCI)[17]. However, forecast GDP[18] growth exceeds the forecast rate increases in every year but 2014/15 and 2015/16.

- Total operating expenditure is forecast to increase from $7.7 billion in 2011/12 to $11.3 billion in 2021/22. The year-on-year movement is, on average, 4%.
- Net operating income[19] is forecast to steadily increase from $414 million in 2011/12 to $979 million in 2021/22.
- Local authorities plan to spend $36.8 billion on capital works in the 10 years to 2021/22. Of this, $7.1 billion is because of additional demand (19%), $14.7 billion is to improve the levels of service (40%), and $15.0 billion is on asset replacement or renewal (41%).
- Gross debt is forecast to increase from $9.8 billion in 2011/12 to $18.7 billion in 2021/22. Auckland Council's group debt is significant – for each year, it represents more than half of the whole sector's total debt.
- Total local authority assets are forecast to rise from $106.1 billion in 2011/12 to $156.3 billion in 2021/22.

Broad financial performance trends

Forecast trends in rates revenue

3.8 Local authorities plan to collect $54.2 billion in rates during the 10 years to 2021/22. This rates income makes up 52% of the total forecast operating income of $103.8 billion. For Auckland Council, the proportion is 43%, and for other local authorities it is 58% overall. The other main sources of operating income are subsidies and grants of $10.1 billion (10%), development and financial

16 Increases in rates are often compared with the movement in the CPI. The CPI is heavily weighted to household goods, such as food and alcoholic beverages. The average level of price inflation over the forecast period is expected to remain consistent with the current Policy Targets Agreement between the Minister of Finance and the Governor of the Reserve Bank of New Zealand. The relevant phrase in this agreement, which targets inflation as measured by the CPI, states "… the policy target shall be to keep future CPI inflation outcomes between 1 per cent and 3 per cent on average over the medium term, with a focus on keeping future average inflation near the 2 per cent target midpoint."

17 Local authorities typically apply the LGCI to forecast their expenditure, rather than the CPI. The LGCI includes a general goods and services index, the transport capital expenditure index, and the "three waters" (wastewater, storm water, and freshwater) capital expenditure index. Therefore, the LGCI is a more accurate measure of costs local authorities face than the CPI. SOLGM commissioned Business and Economic Research Limited to forecast inflation/price changes for the 2012-22 period for local authorities to use as a basis for preparing their forecast financial information.

18 The GDP is New Zealand's official measure of economic growth.

19 Net operating income is the net position calculated by deducting total operating expenditure from total operating income.

contributions and vested assets[20] of $4.5 billion (4%), and other income, mainly fees and charges, of $34.9 billion (34%).

3.9 Rates revenue, at 52% of total operating income, is consistent with historical results – 53% in 2008/09, 52% in 2009/10, and 54% in 2010/11.

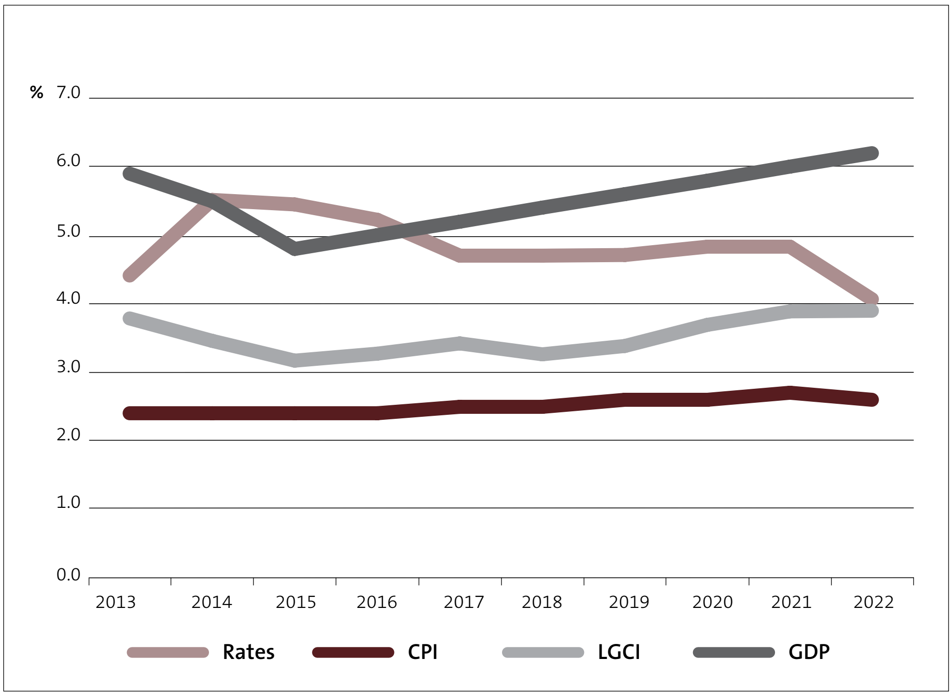
3.10 Rates revenue is forecast to increase 4.4% from 2011/12 to 2012/13, 6% from 2012/13 to 2013/14, 5% year-on-year in the next seven years, and 4% from 2020/21 to 2021/22. This compares with the 2009-19 LTPs, where the year-on-year increase in total rates ranged from 4% for the lowest increase to 7% for the highest increase.[21]

3.11 The forecast rate increases continue to be more than forecast increases in the CPI and the LGCI. However, when we compare the forecast rate increases to projected GDP increases, the projected GDP increases exceed the forecast rate increases in all years except 2014/15 and 2015/16 (see Figure 6). On a sector-wide basis, and given that improvements to service are expected, the forecast rate increases do not appear to be unreasonable compared to GDP. However, we acknowledge that affordability for individual ratepayers is affected by factors other than national GDP results. These factors include movements in food prices reflected in the CPI and housing affordability.

20 Vested assets are assets that are transferred to a local authority at nominal or zero cost. Typically, they might result from a situation where a developer has installed assets when developing a site and, after completion, the developer passes them to the local authority. The fair value of these assets has to be determined and is then recognised as revenue in the year of transfer. The assets are then integrated into the local authority's asset information system so that they can be appropriately managed.

21 *Matters arising from the 2009-19 long-term council community plans*, page 25, paragraph 3.10.

Figure 6
Forecast rate increases compared with projected CPI, LGCI, and GDP increases from 2012/13 to 2021/22



3.12 In the LTPs, local authorities used a number of approaches to set their limits on rate increases (as required by the new financial strategy section of the Act – see paragraph 2.6). These included capping rate increases to CPI, LGCI, or LGCI increases with a percentage added.

3.13 Figure 6 shows that the sector as a whole has forecast overall rate increases above the LGCI. Although many local authorities in their LTPs have used forecast LGCI increases as the rates cap in their financial forecasts, the overall sector position is affected by some local authorities using the LGCI plus a percentage and by some forecasting to go beyond their stated limits on rate increases in one or more of the years of the 2012-22 LTP. Where this has occurred, they have disclosed why in their financial strategy. Some of the reasons include a requirement for higher rates to fund a particular project in those years. The disclosures made by individual local authorities play an integral part in explaining a local authority's funding approach and financial risk management practices.

3.14 Although the level of rates revenue as a proportion of total operating income is 52% on average, there is wide variability between individual local authorities. Eight local authorities have forecast rates revenue that is 70%-84% (on average) of their total operating income.

3.15 On the other hand, three local authorities are forecasting that less than 40% of their total operating income will come from rates. Local authorities with lower proportions of income funded from rates typically have other major sources of funding – such as income from investments.

3.16 At the extreme end, Chatham Islands Council forecasts that 6% of its operating income will come from rates. This local authority has about 600 residents and relies heavily on central government funding for its operational and capital expenditure.

3.17 Each local authority has different revenue and financing policies and investment structures, which significantly affect the mix of its income.

Forecast trends in operating expenditure

3.18 Total operating expenditure for the sector is forecast to rise from $7.7 billion in 2011/12 to $11.3 billion by 2021/22. The average year-on-year increase is 4% during the period of the LTPs.

3.19 Total operating expenditure is made up of four items: depreciation (23%), employee costs (18%),[22] interest expenses (10%), and other operating costs (49%).

3.20 The graphs in Figure 7 show the increasing expenditure and the year-on-year percentage movement for each of these four expenditure items during the period of the LTPs. We observe that:

- Depreciation is forecast to be, on average, 1.8% of the property, plant, and equipment balance. As well as being affected by large asset purchases, depreciation reflects a cyclical trend consistent with the requirement to forecast asset revaluations. Asset revaluations are required to be done regularly enough to ensure that the asset value disclosed is not materially different to the fair value.
- Employee costs are forecast to increase annually by between 2.5% and 3.0%. This is slightly higher than the inflation movement projected for staff costs in the LGCI forecasts, which are between 2.4% and 2.7% annually.
- Interest expenses are forecast to increase annually, but the year-on-year changes show a decreasing trend. This is consistent with the forecast debt movement.
- Other operating expenditure shows an increasing trend with annual fluctuations. The percentage change between 2011/12 and 2012/13 is negative because of the timing of Greater Wellington Regional Council's

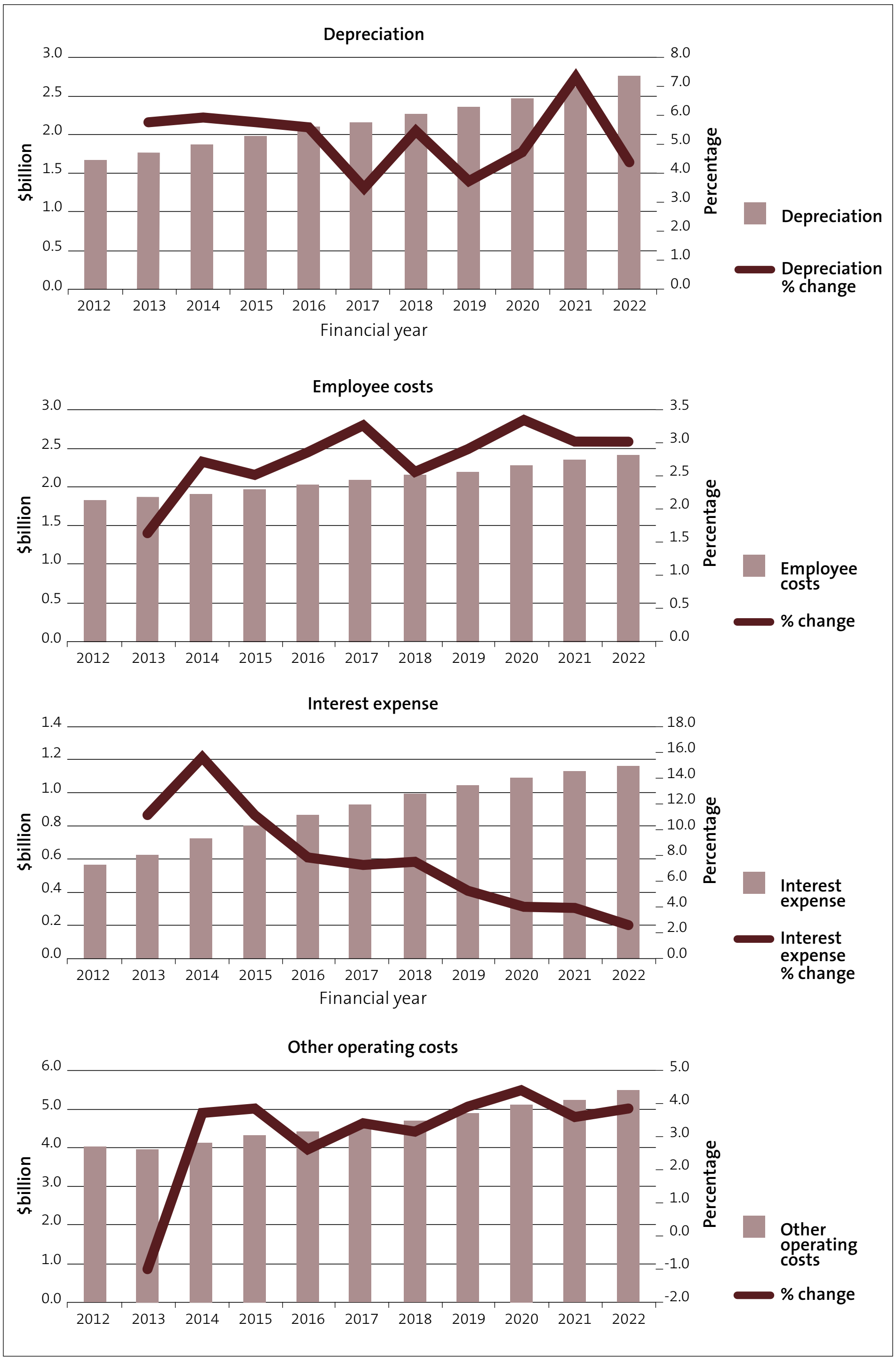
22 Sixteen local authorities did not split out employee costs in their 2012-22 LTPs. Therefore, employee costs are understated and other operating costs overstated in this section because this information was not available from the main financial statements used for this analysis.

transport expenditure,[23] which decreases from $265 million in 2011/12 to $176 million in 2012/13. Without this $89 million decrease, the percentage change between 2012/13 and 2013/14 would have been 2.4% rather than the 4.6% reflected in the graph.

23 Greater Wellington Regional Council receives transport improvement grants and subsidies from central government. This is accounted for as operating income when the Regional Council receives it. It is then disbursed as operating expenditure to the subsidiary that owns and maintains the train infrastructure (Greater Wellington Rail Limited).

Figure 7

Trends in depreciation, employee costs, interest expenses, and other operating expenditure

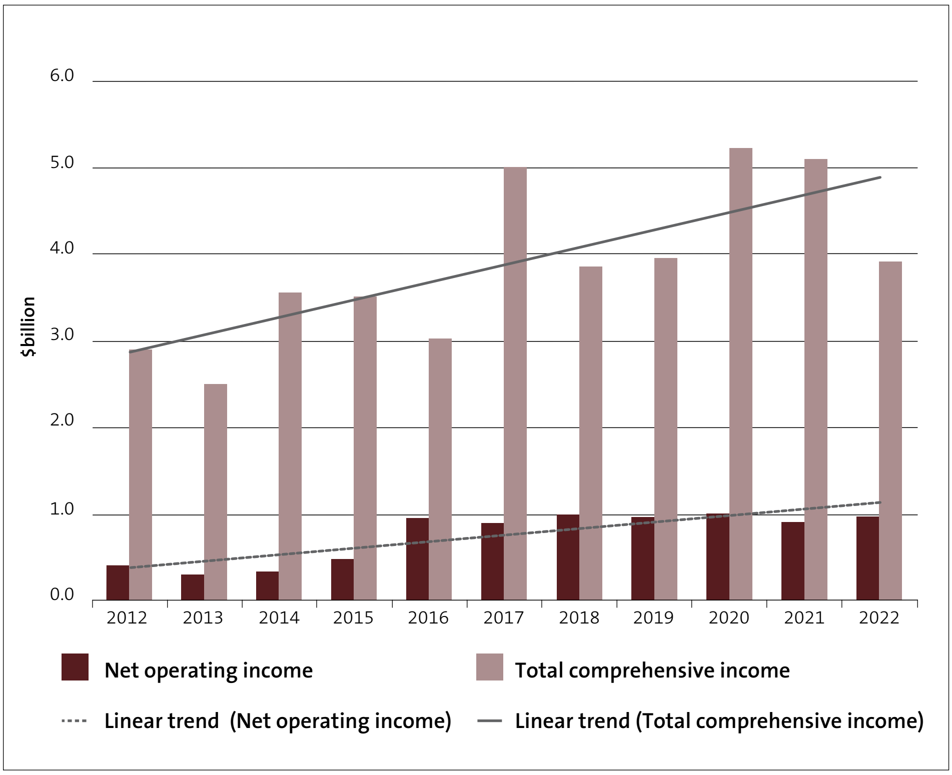


Forecast trends in net operating income and total comprehensive income

3.21 Forecast net operating income for all local authorities steadily increases during the 10-year period of the LTPs (see Figure 8). This is because several local authorities are setting more aside to provide for asset renewal during the 10 years. The depreciation charge is used as a proxy for renewal funding needs because it reflects the annual consumption of an asset. Local authorities fund some or all of the depreciation, and the funds are used for asset replacement or renewal and debt repayment.

3.22 Forecast comprehensive income (net operating income plus asset revaluations) fluctuates during the 10-year period because of asset valuations (usually every three years). Figure 8 shows that, on average, surpluses are increasing during the 10 years. This is because the underlying value of the depreciable assets is increasing over time. This is an expected trend because capital expenditure exceeds depreciation in each of the 10 years of the LTPs and asset revaluations are also forecast to be positive during that period.

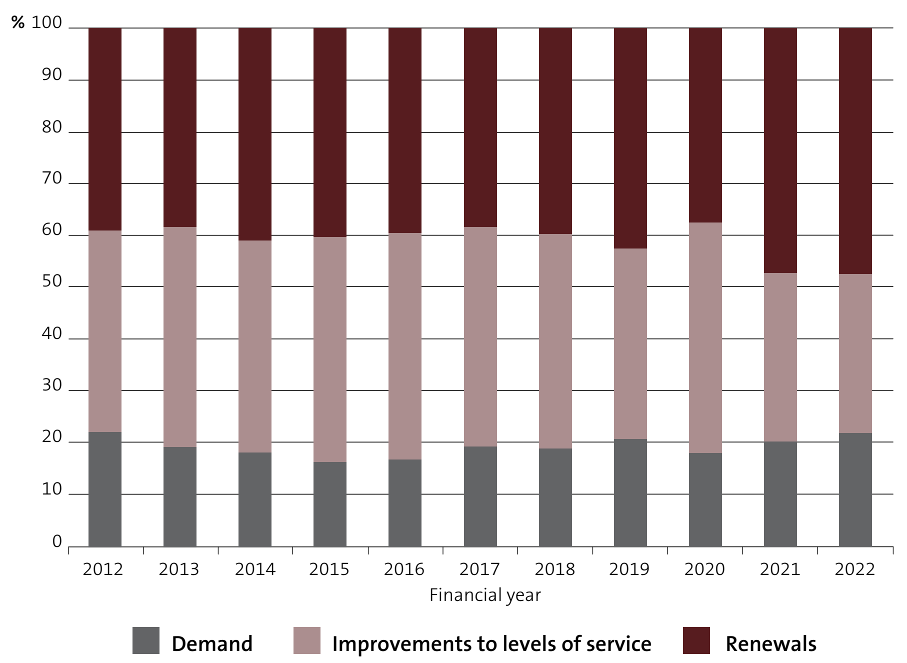
Figure 8
Net operating income and total comprehensive income trends



Forecast trends in capital expenditure

3.23 Local authorities plan to spend $36.8 billion on capital works in the 10 years to 2021/22. Of this, $7.1 billion (19%) will be for new assets to meet additional demand, $14.7 billion (40%) is to improve service levels, and $15 billion (41%) is to replace or renew assets. However, Figure 9 shows that the proportion spent on these three types of capital works varies during the 10 years. Of the total sector forecast, Auckland Council plans to spend $20 billion in total, with $4.5 billion for new assets to meet additional demand (63% of the total sector expenditure), $9.7 billion to improve service levels (52% of total sector expenditure), and $5.8 billion to replace or renew assets (39% of total sector expenditure).

Figure 9
Percentage of capital works to be spent on additional demand, improvements to levels of service, and renewals from 2012/13 to 2021/22



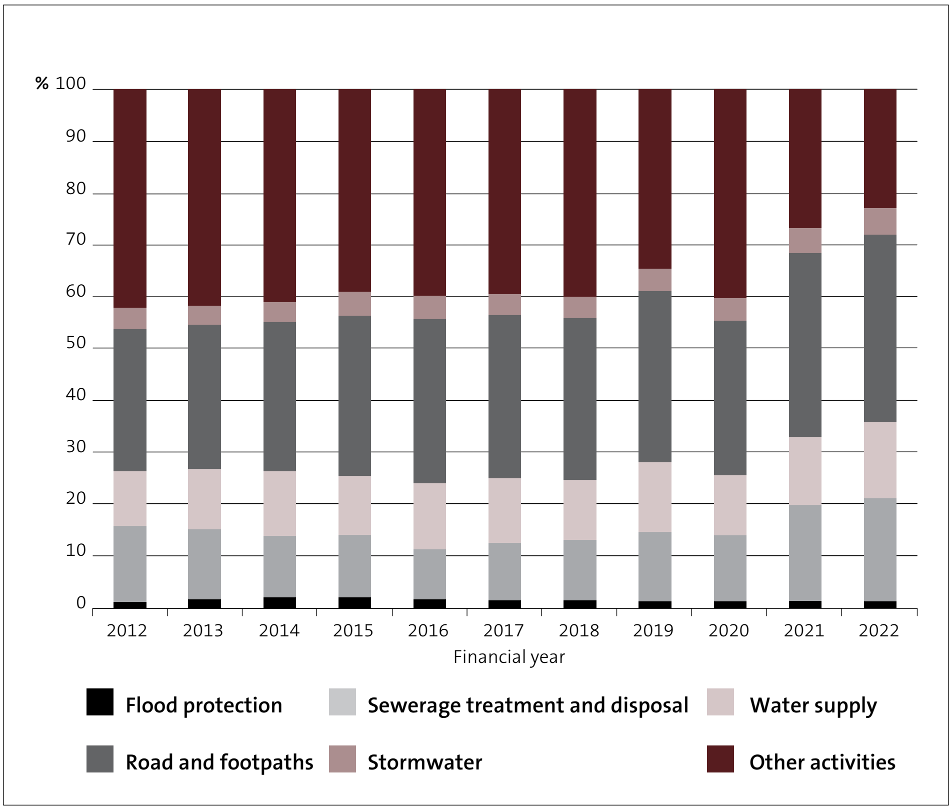
3.24 Local authorities are facing increased spending to meet regulatory standards (for example, water supply standards); community expectations on service levels; changing demographics, population, and land use; and having to balance these against what is reasonably affordable for their communities. Figure 9 shows that, in the last two years of the LTPs, the proportion spent on renewals is forecast to increase, while the proportion on improving levels of service will decrease. This is consistent with the dollar value expenditure in the last two years of the LTPs, where the amount to be spent on renewals increases from $1.6 billion in 2019/20 to $1.7 billion in 2020/21 and to $1.8 billion in 2021/22. The forecast expenditure on improving levels of service falls from $1.9 billion in 2019/20 to $1.2 billion in 2021/22.

3.25 We consider that this largely reflects local authorities moving to more fully fund depreciation. Auckland Council is an example of this. It is progressively moving to fully fund depreciation during a 13-year period. It has forecast expenditure on renewals to jump from $626 million in 2019/20 to reach its highest level during the LTP period of $725 million in 2021/22. Auckland Council's forecast expenditure on renewals for 2021/22 represents 40% of the sector total.

3.26 The proportion of all local authority capital expenditure on five infrastructure groups of activities[24] is forecast to rise from 58% in 2011/12 to 77% by 2021/22, mainly in the last two years. Generally, the split of capital expenditure for these five activities is shared in a reasonably uniform way (see Figure 10).

Figure 10

Forecast capital expenditure by the five infrastructure groups of activity and other



24 These activities had to be separately identified by all local authorities in the 2012-22 LTPs.

3.27 About one-third of the total capital expenditure is expected to be for roading and footpaths. Most local authorities rely on subsidies from the New Zealand Transport Agency to support the funding of their transport capital expenditure programmes. The subsidies are not the only source of funding for roading and footpaths, but they are significant.

3.28 Capital expenditure on sewage treatment and disposal is between 10% and 14% for the first eight years, then increases to 19% and 20% in 2020/21 and 2021/22. This reflects significant forecast spending for certain local authorities in the last two years of the LTP. Those local authorities include Auckland Council, Tauranga City Council, Thames-Coromandel District Council, Waimakariri District Council, Hutt City Council, and Queenstown-Lakes District Council. We are aware that, for a number of these local authorities, such as Thames-Coromandel District Council, the projects forecast for the end of the LTP period are dependent on growth and will be deferred if growth slows or does not eventuate.

3.29 Capital work on other non-infrastructural asset activities will account for about 40% of the total capital expenditure in most of the years and then drop to 27% and 23% in the last two years, mainly as a result of the large increases in roading and sewage expenditure. Based on the information in LTPs, this capital work reflects forecast investment in economic development activities and a combination of community and/or discretionary projects.

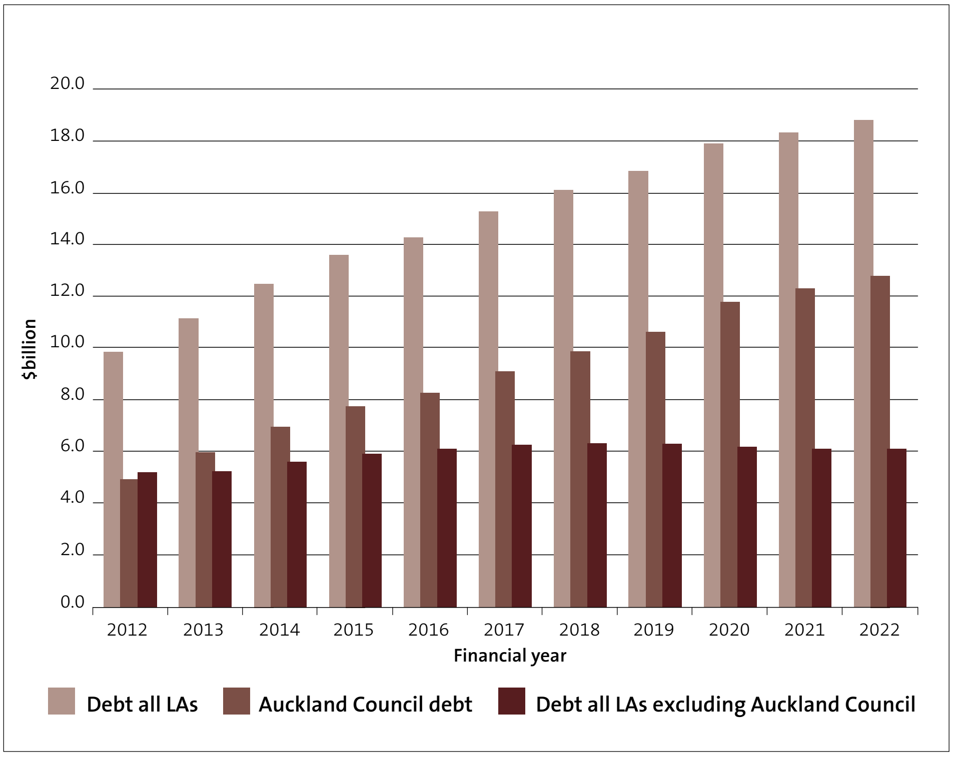
Forecast trends in debt

3.30 The gross debt for local authorities is forecast to increase from $9.8 billion in 2011/12 to $18.7 billion by 2021/22. Five of the 77 local authorities forecast no debt during the 10 years.

3.31 Figure 11 shows that debt is forecast to increase consistently during the 10 years and is significantly influenced by Auckland Council's group debt. Auckland Council's group debt starts at $4.8 billion in 2011/12 and is forecast to reach $12.5 billion in 2021/22 (see the discussion about Auckland Council at paragraphs 5.4-5.25).

3.32 Total debt for all other local authorities is forecast to increase from $5 billion in 2011/12 to $6.2 billion in 2017/18 and then drop to $6.0 billion in 2021/22. Many local authorities are looking to reduce their debt in the later years of the LTP, which Figure 11 shows.

Figure 11
Debt at the end of each financial year from 2011/12 to 2021/22



3.33 Local authorities use debt to fund long-life assets. As a general principle, debt should not be used to fund operations. We identified a few local authorities that did not fully adhere to this principle in the 2012-22 LTPs. However, the amounts were not considered significant and the approach was not used long term. Furthermore, local authorities usually use debt to fund new assets to meet demand or to increase levels of service, rather than using debt to fund renewals. However, local authorities can choose to use debt to fund any type of capital expenditure. Given the evidence of increased surpluses in the LTP period, we expect decreasing proportions of debt to be used to renew or replace existing assets.

3.34 Figure 11 shows that debt is forecast to continue increasing, but at a slowing rate in later years.

3.35 In Part 4, we consider debt and debt servicing from a risk perspective. Appendix 2 sets out a table of forecast debt by local authority.

Part 4
Using financial statements to understand financial performance

4.1 In this Part, we describe:

- the set of indicators we have applied to financial data in local authorities' LTPs and annual reports to further understand their forecast financial performance; and
- our analysis using these indicators of the potential for financial uncertainty and risk in the local government sector.

The purpose of applying a set of indicators to understand financial performance

4.2 Two matters led us to consider a more comprehensive approach to assessing either the sector's or an individual local authority's financial performance based on financial statements.

4.3 We have started to review the cumulative financial results of all local authorities and reported this to Parliament after the 2009/10 and 2010/11 audits.[25] Our approach has been to consider the financial data, primarily on the basis of trends, without a complete method for interpreting, analysing, and assessing the information. Our discussion in Part 3 is based on trends directly extracted from financial statements, and it provides a sound basic picture of the sector's financial performance.

4.4 The second matter is that the sector – partly in response to the *Better Local Government* reforms[26] and policy-makers – has increasingly been considering what constitutes sound financial performance and whether there is any suitable benchmarking regime.

4.5 Any method for assessing extracted financial data is, and will remain, a matter of judgement. However, we consider that there is a need for a consensus within the sector and with policy-makers on what financial data is useful and reasonably reflects the performance and position of the sector and individual local authorities.

4.6 In our view, any method of assessing financial information in a more in-depth way should shed light on a local authority's financial sustainability and help with assessing whether a local authority is operating in a financially prudent way.

4.7 Currently, there is no approach that the sector, policy-makers, and local government commentators have agreed on. In this Part, we describe one possible approach using a set of indicators that builds on the analytic work we have been doing during the last couple of years.

25 We will be reporting the 2011/12 annual audit results in March 2013.

26 See www.dia.govt.nz/better-local-government.

4.8 The set of indicators is not an "audit test". It is one possible way of looking at a local authority's financial performance and position (and its financial sustainability). To consider the overall performance, position, and prospects of the sector or individual local authorities, broader non-financial information must be considered along with the financial information.

4.9 We are publishing our set of indicators to inform the debate about local authorities' financial performance, position, and prospects. Although the set represents our thinking to date, we are open to debate and discussion about the usefulness and the basis of this set of indicators.

4.10 Our intent in setting out our analysis of the 2012-22 LTPs using this set of indicators is to stimulate debate among interested parties and to help in reaching a consensus. We have already outlined the indicators and the way we use them to DIA, Local Government New Zealand, and SOLGM.

4.11 We welcome any opportunity to discuss and debate the framework and possible refinements or different approaches.

Explanation of our set of financial indicators

4.12 Performance is about achieving objectives in an uncertain environment. It is about striving for something that is attainable but not certain. Therefore, measuring and analysing performance in a comprehensive way requires understanding a local authority's objectives, the risks to achieving those objectives, and the relationship between these two elements.

4.13 The financial statements have an important role in assessing performance. Although they say little about many of the non-financial objectives of public sector organisations, they describe and summarise many of the factors that reflect the risk associated with achieving objectives (for example, through the underlying revenues, costs, liabilities, and assets).

4.14 An important part of the usefulness of financial statements lies in their ability to help a reader understand financial uncertainty[27] in a standardised and comparable way. This is a fundamental part of a local authority's performance story.

27 The terms risk and uncertainty can mean different things. For simplicity, we use the terms interchangeably to mean the potential for variation on either side of what is expected or considered normal. For instance, in a public sector entity, a large operating surplus can be as much an indicator of uncertainty (or risk) as a large operating deficit.

Understanding and assessing the potential for financial uncertainty

4.15 Our approach to understanding the financial uncertainty of local authorities is based on our role of providing independent assurance about the performance of public sector entities to Parliament and the public. We do this through our annual audits of local authorities' financial and non-financial information.

4.16 Financial uncertainty arises from many different sources and can include economic, political, and structural changes within and outside of the local authority. We have not tried to identify or understand the root causes of uncertainty. Instead, we use the financial statements to help assess the aggregate effect on three aspects of a local authority's ability to deliver on its objectives. The three areas are:

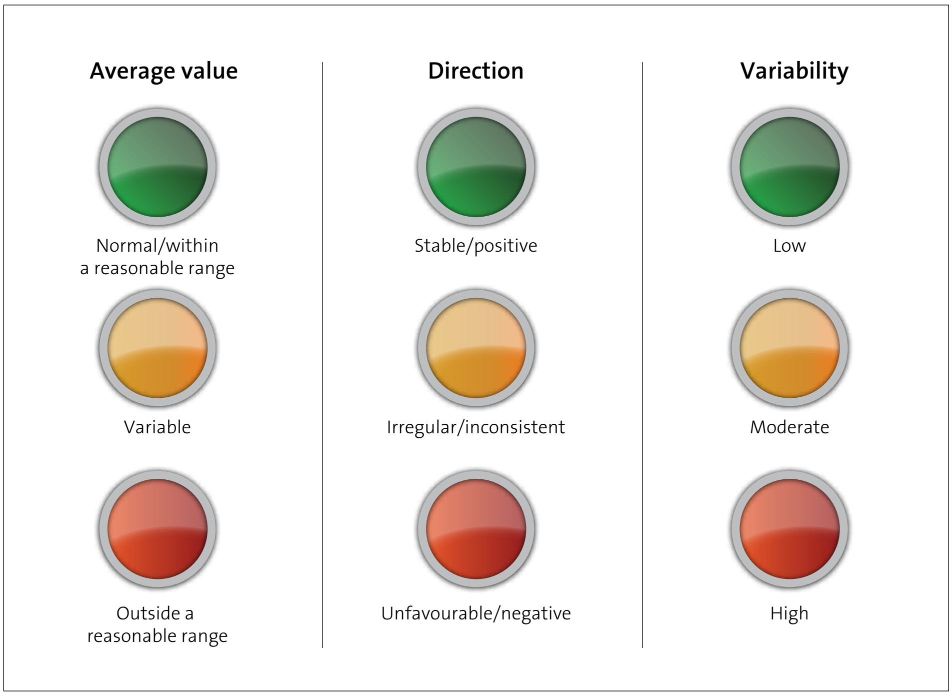
- The **stability** of a local authority's activities (operations, capital, investing, and financing) is about how reliable an entity is in planning, budgeting, and delivering services using its financial resources. To help understand this component, we focus on financial statement data that indicates the consistency and accuracy of these activities (for example, by comparing actual performance with budget/forecast).
- The **resilience** of a local authority to short-term unanticipated events reflects how well the entity can "bounce back". To help understand this component, we consider financial information that indicates the entity's ability to respond without major structural or organisational change. For example, we look at fixed costs, interest payable, and surplus/deficit in the cash flow statement and income statement.
- The **sustainability** of a local authority looks at how prepared the entity is for long-term uncertainties and to maintain itself indefinitely. To help understand this component, we consider financial information that indicates how longer-term uncertainties are being managed. We focus, for example, on balance sheet items such as assets, liabilities, and debt, together with related items such as capital expenditure, and expenditure on asset renewals.

4.17 To assess the potential for uncertainty throughout the sector and the ability to cope with that uncertainty, we analysed the results of the indicators for these three areas over time, considering:

- whether the average values are within what we consider is a reasonable range;
- the direction the average values are taking (improving, declining, or constant);
- the variability in these average values over time (whether local authorities are diverging or converging); and
- the characteristics of outliers.

4.18 Because a degree of judgement is involved in this forecast-based assessment, we have used a traffic light system to summarise the sector's results (see Figure 12).

Figure 12
Traffic light assessment of local authorities' financial performance

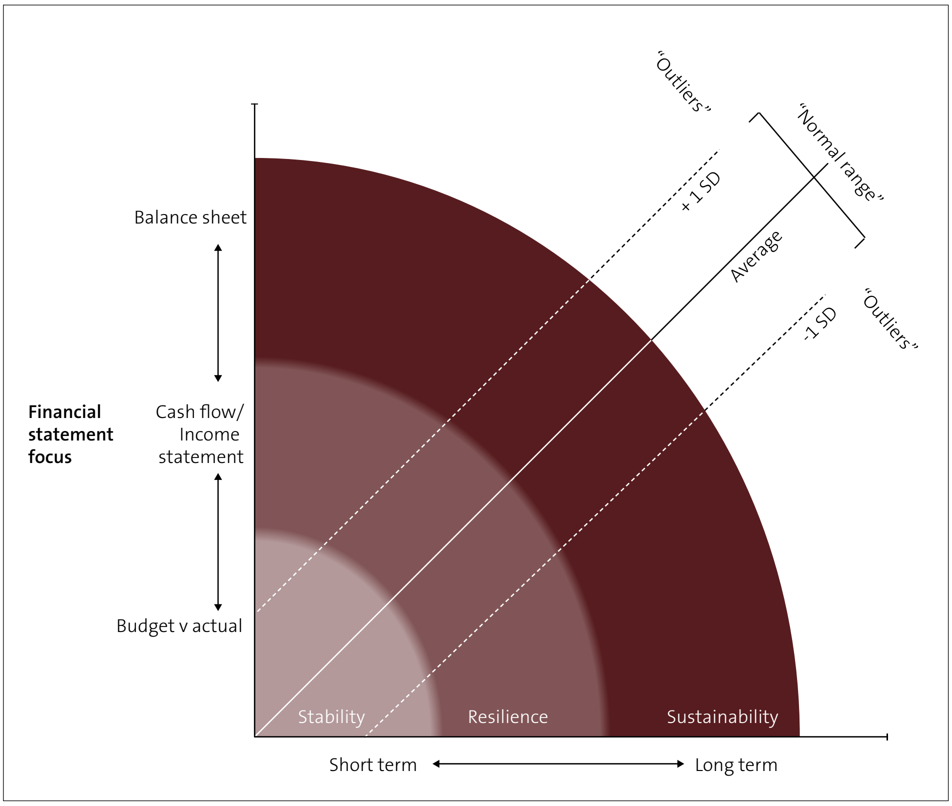


4.19 Figure 13 provides a visual presentation of our approach. It shows how sustainability builds on the stability and resilience of an organisation, and how we portray the "normal range" throughout the sector by using a standardised measure of variation on either side of the average[28] – in other words, plus or minus one standard deviation.[29] In the rest of this Part, we use the term "sector norm" to refer to this range of one standard deviation either way from the average for the measure concerned.

28 The average is generally close to the middle of the data range. It is calculated by dividing the sum of the total data set by the size of the data set.

29 Standard deviation is a statistical measure of how far the data points are spread out. A small standard deviation indicates that the data points tend to be close to the average. A large standard deviation indicates that the data points tend to be further from the average.

Figure 13
Understanding and assessing potential financial uncertainty



4.20 As with all analysis of financial performance, there are limitations to what can be inferred. Our approach focuses on the potential for uncertainty only and is not a comprehensive assessment of an entity's or the sector's performance. It is not an attempt to rank entities in the local government sector or between sectors. Moreover, what is shown as the normal range assumes a regularity that may not always be correct. The outliers are not necessarily more uncertain in delivering on their objectives – they may simply warrant further investigation.

4.21 Figure 14 summarises the set of indicators we have used, followed by an explanation of the information that is revealed by each.

Figure 14
Financial statement assessment framework – indicators by assessment category

Stability	Resilience	Sustainability
Actual to budgeted net cash flows from operations	Interest expense to debt	Capital expenditure to depreciation
Actual to budgeted debt	Interest expense to rates revenue	Renewals expenditure to depreciation
Actual to budgeted capital expenditure	Fixed costs to operating and investing cash outflows	Gross debt to total assets

The stability indicators

4.22 For stability, we compare local authorities' actual net cash flows from operations, debt levels, and capital expenditure with what was originally budgeted. A result of 100% indicates reliable planning, accurate budgeting, and robust delivery.

The resilience indicators

4.23 The interest to debt indicator shows the annual cost of funding local authorities' activities through debt. A higher interest rate indicates less flexibility in responding to unexpected events. It can also reflect a higher perceived risk of repayment by the debt provider.

4.24 The interest expense to rates revenue indicator shows the proportion of rates revenue that relates to the interest cost of debt. A higher percentage means less flexibility and fewer available resources in responding to unexpected events.

4.25 The fixed costs (defined as including interest expense, employee costs, and expenditure on renewals) to operating and investing cash outflows indicator shows the proportion of operating and investing flows that are not able to be easily adjusted in changing times. A higher fixed cost structure indicates less flexibility in responding to unexpected events. The lower the percentage, the more adaptability the local authority has for change.

The sustainability indicators

4.26 Relating capital expenditure to depreciation to indicate sustainability assumes that depreciation is a reasonable estimate of the capital expenditure needed to maintain the existing asset base. (This type of capital expenditure is referred to as renewals in the local authority sector.) Therefore, the assumption is that a result where capital expenditure is above depreciation (more than 100%) indicates sustainability. However, because capital expenditure also includes spending on new assets, we expect the indicator value to be over, and possibly well above, 100% in growing sectors.

4.27 The comparison of renewals expenditure to depreciation assumes that depreciation is a reasonable estimate of the capital expenditure needed to maintain or renew the existing asset base. Therefore, a result where renewals expenditure is equal to depreciation (100%) usually indicates sustainability.

4.28 The proportion of gross debt to total assets indicates a local authority's capability to manage its longer-term financial uncertainties. A result of, for example, 10% means that a local authority has debt equivalent to 10% of the value of its assets. This indicator also looks at the level of debt as a source of funding assets.

Detailed analysis using our set of financial indicators

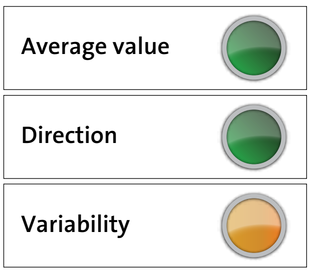
4.29 We used the indicators described in paragraphs 4.21 to 4.28 to analyse the forecast financial statement data and assess the aggregate effect they have on the three main areas of financial uncertainty. We also comment on the local authorities that appear outside the calculated sector norms.

Stability indicators

4.30 As LTPs contain only forecast information, we looked at the actual versus budgeted results for two financial years – 2009/10 and 2010/11 – using the 2009-19 LTP financial forecasts as the budget. We will continue to collect and report on these items, as well as the other indicators described below.

4.31 With only two years of data, it is too soon to identify trends or draw firm conclusions.

Actual to budgeted net cash flows from operations



4.32 The cash flows from operations reflect a local authority's cash surplus (or deficit) from normal, business-as-usual operations.

4.33 When we calculated the sector norm for the proportion of actual to budgeted net cash flows from operations, it ranged between 58% and 131% for 2009/10 and between 47% and 144% for 2010/11.

4.34 A sustained or consistent result of 100% indicates reliable planning, accurate budgeting, and robust delivery. A result below 100% means that the local authority had achieved less than it had budgeted, and a result higher than 100% means that the local authority exceeded its budget (for example, 120% means exceeding the budget by 20%).[30]

30 We noted that a few local authorities had budgeted for negative net cash flow from operations in one or both years, which is unusual for local authorities.

4.35 As sector norms, these percentages reflect moderate variability between individual local authorities, with higher variability in 2010/11. The average in both years was 95%, which means that local authorities spent less, or that their revenue was higher than what they budgeted for, but that they still achieved a positive net operating cash flow. Most local authorities had results within the sector norms.

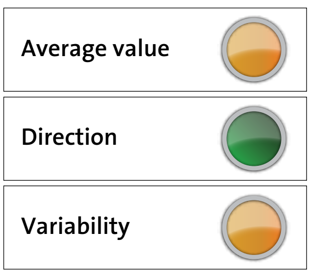
4.36 We consider an overall sector average of 95% to be a very good result, given the large and diverse operations that local authorities manage. However, there is room for any organisation that is not fully meeting its budget to improve performance. We encourage local authorities to work on reducing the variance, but we consider that the performance demonstrated by this small two-year sample does not indicate a significant issue for the sector.

4.37 Local authorities that fell outside the sector norm (significantly exceeding their budgets in both financial years) were Greater Wellington Regional Council and Kapiti Coast District Council. We did not identify a common reason for this, but a slowdown in growth-related capital expenditure might have influenced the level of interest on debt and also amounts paid to suppliers. Greater Wellington Regional Council's results reflected the timing of when it received central government subsidies for its public transport activities. Otago Regional Council was below the sector norm in those financial years because it budgeted for negative cash flows.

4.38 Christchurch City Council was the only local authority that had a negative net cash flow from operations in 2010/11, and this was because of earthquake-related payments to suppliers. In general, local authorities had not budgeted for negative net cash flow from operations, which is an expected and sensible approach that is consistent with prudent financial management given their need to fund capital renewals on infrastructure assets.

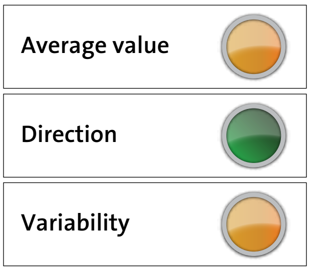
Actual to budgeted debt

4.39 In general, local authorities borrowed less than they budgeted for. The sector norm for the proportion of actual to budgeted debt was 48% to 128% for 2009/10 (average 88%) and 41% to 139% for 2010/11 (average 90%).



4.40 The sector norm shows moderate variability in the results for comparing actual to budgeted debt. Southland District Council's result was at the extreme end – 3% in both financial years. This local authority budgeted to have debt of $19 million at 30 June 2010 and $13 million at 30 June 2011, but had a debt balance of less than $1 million at the end of both financial years. Its planned capital expenditure was largely not carried out or was funded without using debt, mainly because maturing investments became available.

Actual to budgeted capital expenditure



4.41 We calculated that the sector norm for the proportion of actual to budgeted capital expenditure was 11% to 153% in 2009/10 (average 82%) and 49% to 113% in 2010/11 (average 81%). Again, the sector norm shows moderate variability in local authorities' results and a consistent inability to fully deliver the forecast capital programme.

4.42 Consistent with our analysis of debt, local authorities tended to spend less than they budgeted for. The reasons included changes in priorities and/or timing of projects. Hawke's Bay Regional Council and Taupo District Council significantly exceeded the sector norms (they spent much more than they had budgeted for) in both financial years. Both of these local authorities made changes to their capital expenditure programmes.

Summary observations about stability

4.43 In summary, we consider that local authorities are delivering against their budgets in a manner that shows a moderate level of stability. Local authorities' ability to plan for, budget, and deliver on operating cash flows was good. There was less stability in their results for budgeted debt and budgeted capital expenditure.

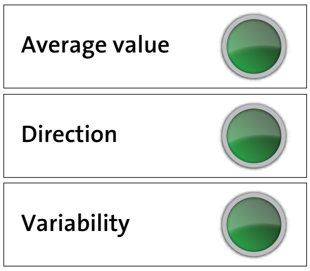
4.44 Capital expenditure drives the level of debt required, so the actual results compared to budget of these two items were quite similar. There is evidence of a moderate level of variability throughout the sector and from year to year. The results indicate that there is likely to be scope for the sector to improve budgeting practices in these areas. We encourage all local authorities to strive to achieve a higher correlation between actual results and budget. We consider that the sector should also focus on better reporting of the reasons for budget under-expenditure so that it is clearer to the reader whether projects have been delayed, budgets were overestimated, or cost savings have been achieved.

4.45 We note that the two years we have considered are likely to have been affected by the global financial crisis and a related reduction in growth-related projects. Local authorities' capital works programmes are also affected by uncontrollable events, such as extreme weather events, which make the exact achievement of budgets extremely challenging.

Resilience indicators and trends

4.46 We looked at three indicators of resilience that consider local authorities' ability to respond to short-term shocks.

Interest expense to debt



4.47 In the LTPs, the average interest rate that local authorities forecast is 5.9%, and it varies between 5.8% and 6.5% during each of the 10 years. In our view, this is reasonable given the current and forecast market interest rates.

4.48 We calculated the sector norm at between 3.1% and 8.8%. Most local authorities are within this range, with little variability. There are a few local authorities forecasting interest rates that are frequently above the norm. For example, Hawke's Bay Regional Council's LTP forecasts show an average interest rate of 13.1%. This appears high, but the Council included a fee for transfer of its leasehold portfolio in its financial forecast along with interest costs. When this fee is removed, the interest rates for Hawke's Bay Regional Council return to levels within the sector norm. (See Figure 5).

4.49 At the time of writing, 18[31] local authorities are shareholders of LGFA. Part of LGFA's purpose is to obtain favourable interest rates for the sector. Members need to adhere to certain conditions of borrowing from LGFA,[32] as shown in Figure 15.

Figure 15
Conditions of borrowing from LGFA

	Unrated Council or Council with credit rating below A	Council with credit rating A or above
Net debt to total revenue	Less than 175%	Less than 250%
Net interest to total revenue	Less than 20%	Less than 20%
Net interest to rates revenue	Less than 25%	Less than 30%
Liquidity	Greater than 110%	Greater than 110%

31 The 18 local authorities are Auckland Council, Bay of Plenty Regional Council, Christchurch City Council, Hamilton City Council, Hastings District Council, Masterton District Council, Greater Wellington Regional Council, New Plymouth District Council, Otorohanga District Council, Selwyn District Council, South Taranaki District Council, Tasman District Council, Taupo District Council, Tauranga City Council, Waipa District Council, Wellington City Council, Western Bay of Plenty District Council, and Whangarei District Council.

32 It is possible for local authorities to negotiate individual financial covenants with the LGFA Board. The LGFA definition of total revenue excludes some revenue sources, including development contributions and vested assets.

4.50 LGFA said in its 2011/12 annual report that:

> *The pricing improvement obtained has enabled LGFA to provide considerable savings in interest costs to participating local authorities. By (2011/12) financial year end, LGFA was estimated to be saving AA rated local authorities approximately 30 basis points (bps) in annual interest costs on a five year security. For unrated local authorities, the estimated savings was approximately 40 bps. By 30 June 2012, 14 out of the 18 participating local authorities had borrowed a total of $819 million (principal value) from LGFA.*[33]

Interest expense to rates revenue

Average value

Direction

Variability

4.51 This comparison looks at the proportion of rates revenue used to service debt. A higher percentage means less flexibility and fewer resources available for responding to unexpected events.

4.52 In the LTPs, the average is 9%, and it varies between 9% and 10% during each of the 10 years. We consider this reasonable for the sector. The sector norm is between 2% and 17% and reflects a moderate level of variability.

4.53 Several local authorities are below the sector norm because they have no debt or because they have little debt and will move to no debt within the LTP period.

4.54 There are more local authorities above the sector norm in the early years, with percentages close to 17%, compared to the later years of the LTPs. However, some percentages in the later years are much higher than 17%. In the last five years of its LTP, Hawke's Bay Regional Council forecasts moving from 33% and peaking at 56%. Auckland Council also forecasts 24% in 2012/13 and that increases to 32% from 2017/18 to 2021/22. These higher levels of interest expense are likely to leave those local authorities less able to respond to unexpected events.

Fixed costs to operating and investing cash outflows

Average value

Direction

Variability

4.55 We have defined fixed costs as including interest expense, employee costs, and expenditure on renewals. With this indicator, the lower the percentage, the more adaptability the local authority has for change.

4.56 In the LTPs, the average proportion is 37%. It increases from 34% in 2012/13 to 38% by 2016/17 then fluctuates between 37% and 38% from 2017/18 to 2021/22. This shows that local authorities have quite a high proportion of funds available to use to respond to

33 New Zealand Local Government Funding Agency Limited, *Annual Report 2011-12*, page 6.

operational changes. The sector norm is between 24% and 50%, and shows low variability.

4.57 There are a similar number of outliers above and below the normal range. Local authorities often above the sector norm include Kawerau District Council, Hamilton City Council, Hauraki District Council, Rotorua District Council, Wanganui District Council, and Waikato District Council. They all have an average above 50%, with the highest being 57%. We have not been able to identify any factors common to each of these local authorities.

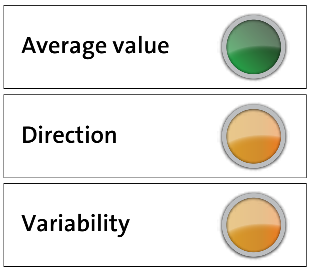
Summary observations about financial resilience

4.58 Overall, the three indicators of financial resilience show that local authorities have high short-term resilience. The average percentages for each indicator were relatively low. This means that, based on the LTP forecasts, local authorities are planning on a basis that will make them financially adaptable to short-term changes and shocks.

Sustainability indicators and trends

4.59 We looked at three indicators of sustainability that consider how durable a local authority is to longer-term uncertainties and in maintaining itself indefinitely.

Capital expenditure to depreciation



4.60 With this indicator, capital expenditure at a level above depreciation (that is, more than 100%) indicates sustainability, and percentages well above 100% are indicative of high growth or may reflect a peak period in the life cycle of a local authority's assets.

4.61 Overall, the average is 135%, but it decreases during the 10 years from 207% in 2012/13 to 111% in 2021/22. This shows that local authorities are forecasting to invest and/or to reinvest more in the earlier years compared to later years.

4.62 There is more variability between local authorities in 2012/13 and 2013/14 and less in 2016/17 and 2017/18. The highest proportions are 349% for Hawke's Bay Regional Council and 323% for Opotiki District Council, which reflect large projects in both of these local authorities.

4.63 Fourteen local authorities forecast an average of less than 100%. This is most common in smaller local authorities.

4.64 The proportions below 100% ranged from 72% to 98%. The level of capital expenditure forecast should be driven from the AMPs and, depending on the circumstances and asset life cycles, a lower proportion for a period of time might be appropriate. However, for these local authorities, the lower proportion could indicate that they are deferring their capital investment and will need to "catch up" on that spending at a later date. This could have significant effects on rating levels in the future.

4.65 Capital expenditure includes spending on new assets because of increased demand and spending to improve levels of service, so looking at renewals expenditure and depreciation provides a better indicator of asset sustainability when the overall proportion is higher than 100%.

Renewals expenditure to depreciation

Average value
Direction
Variability

4.66 With the renewals expenditure to depreciation indicator, results of 100% suggest sustainability. However, the average proportion is 75%, with a decreasing trend from 92% in 2012/13 to 73% in 2021/22. This shows that local authorities' forecast expenditure on maintaining assets may be less than sustainability might require.

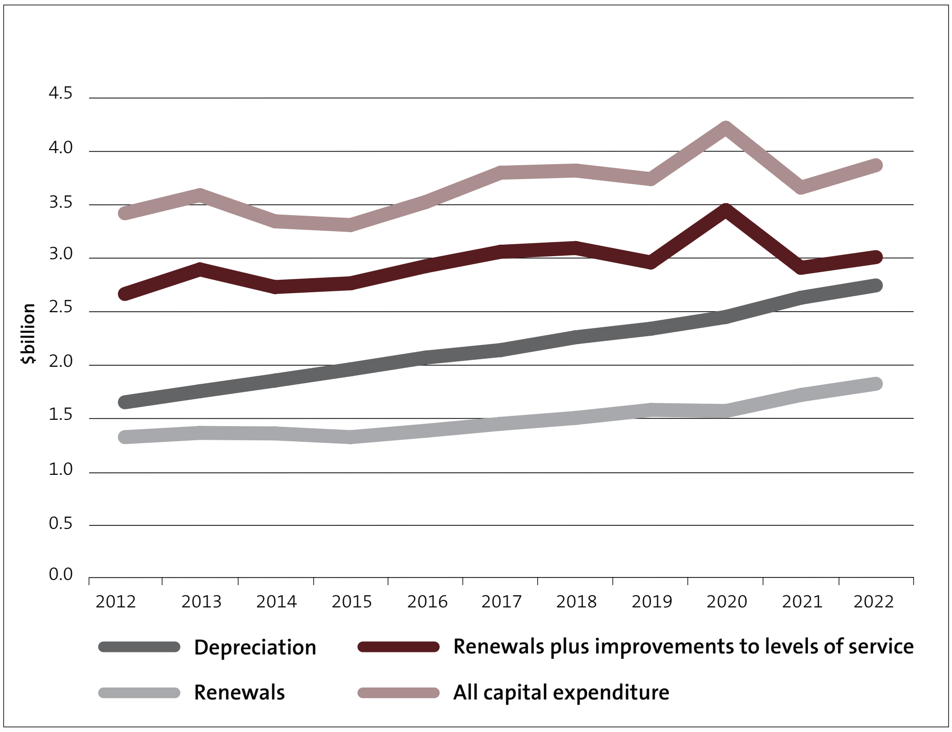
4.67 The forecast reduction could be because:

- the assets might be new and not need renewing until later in their useful lives;
- replacement materials or technology might be cheaper than the materials needed for construction; or
- local authorities might choose not to renew some assets.

4.68 There is moderate variability in results for the early years of the LTPs and less in later years. Nine local authorities have average results of more than 100%, and another nine have average results of less than 50%. It is important to consider the life cycle renewal requirements for infrastructure systems in the context of each local authority to assess whether local authorities, those within the normal range as well as those outside it, are managing their assets on a sustainable basis.

4.69 Over time, it will be particularly interesting to watch the performance of the local authorities with low results because, in dollar terms, there is a widening gap between forecast renewals expenditure and depreciation (see Figure 16). However, the local authorities might be spending on renewals rather than spending on improving service levels. In Figure 16, the forecast expenditure on renewals and levels of service is forecast to be higher than depreciation but to converge towards it by 2021/22.

Figure 16
Forecast of all capital expenditure, renewals expenditure, and depreciation



Gross debt to total assets

Average value	
Direction	
Variability	

4.70 With the gross debt to total assets indicator, a value higher than 100% would indicate that a local authority has more debt than the value of its assets. The forecast proportion of average debt to assets is 6%, and this is consistent for all 10 years of the LTPs. We calculated the sector norm as 1% to 11%, with more variability between local authorities in later years.

4.71 This average does not give any particular cause for concern because 6% is reasonable, given that the assets are large, generally long-lived, and primarily used to deliver essential services. This is an area where consensus as to an appropriate relationship between debt and assets could be a valuable monitoring tool for the sector.

4.72 It is worth noting that many local authority assets are not easily realisable because they are infrastructure, such as roads and water supply, wastewater, and storm water systems. The main security for servicing and repaying debt is the ability to rate. In our earlier discussion about financial resilience, we said that local authorities' interest expense to rates revenue was reasonable and averaged 9% (see paragraph 4.52).

4.73 Greater Wellington Regional Council has the highest percentage of debt to assets for the sector, with an average of 30% forecast during the period of the LTP. Auckland Council has an average of 20%. Both local authorities have specific projects that explain these higher forecast levels of debt. In the case of Greater Wellington Regional Council, certain large assets are outside the Council while debt that helped fund those assets is held by the Council.

4.74 Again, there is a high correlation between the local authorities that have the highest dollar value of debt and those that have the highest forecast debt movements.

4.75 Overall, in our view, this comparison does not reveal any local authorities with debt at abnormally high levels in comparison to their asset base. That said, we emphasise that the ability to service debt is paramount, because these assets are not easily sold.

Summary observations about financial sustainability

4.76 The level of forecast investment (all capital expenditure to depreciation) and reinvestment (renewals to depreciation) is higher in the earlier years than in the later years of the LTPs. We also saw variability, with some local authorities forecasting to invest significantly more or less on their capital works in the early years but converging in the later years. We expect local authority forecasts to be less reliable in the later years of the LTP.[34]

4.77 Overall, the debt to total assets percentage is forecast to be low, which indicates that local authorities generally have a low debt-loading risk in comparison to the volume of assets held.

Overall conclusion

4.78 Our assessment of the potential for financial uncertainty and risk in individual local authorities (and, by implication, for the whole sector) is that it is mainly related to the ability of local authorities to be sustainable in the longer term. This is based on what appears to be declining capital investment toward the end of the 10 years and shorter-term difficulties in forecasting capital and funding needs. These results serve to emphasise the importance of robust asset management planning for the local authority sector.

4.79 However, local authorities' planning and budgeting for their operational activities is reliable, and local authorities are resilient to short-term uncertainties.

34 Clause 2(1)(d) of Schedule 10 of the Act requires detailed information in the LTP for each of the first three years and outline information about each of the subsequent years. In practice, readers see minimal difference between any of the 10 years – but the level of refinement and accuracy of the forecasts will inevitably be less for later years.

Part 5
Uncommon aspects of some long-term plans

5.1 In this Part, we consider some local authorities with uncommon aspects to their LTPs. We have considered the context in which these local authorities have prepared their LTPs and the risks they might face as a result of the approach they have taken.

5.2 These local authorities might sometimes fall outside the normal range when assessed against our set of indicators (see Part 4), but that is not why we focus on them in this Part. We focus on them because of the issues they face or the approach they have taken in their LTPs.

5.3 We chose to discuss these local authorities' situations because:

- **Auckland Council** is a large entity, structured in a new way. It is so dominant when sector information is consolidated that it warrants separate consideration.
- **Queenstown-Lakes District Council's** 2009-19 LTP audit report included a qualified opinion because the LTP was not financially prudent. We describe what this local authority has done to address this in its 2012-22 LTP and the issues it faces.
- **Timaru District Council** was the only local authority to receive qualified opinions in audit reports on each of its LTPs, for failing to adjust its forecasts for inflation. We examine the risks that not doing this poses to the Council. Timaru District Council is also the only local authority that does not revalue its assets for financial reporting purposes.
- We also carried out a preliminary analysis of local authorities based on their **population size**, looking for insights into the differences and similarities that such an analysis might reveal.

Auckland Council

5.4 Auckland Council is substantially larger than any other local authority in New Zealand. It faces significant challenges to address the needs of its community because of unco-ordinated investment in the past and high levels of expected growth in the future.

5.5 Although Auckland Council is very different in scale from other local authorities, there are aspects of its approach to the challenges of long-term planning that are relevant for the wider local government sector as a whole.

Context

5.6 The Local Government (Auckland Council) Act 2009 created the largest local authority in New Zealand. The change brought seven territorial authorities and one regional local authority together, with the goal of better meeting the needs of the large and growing population of Auckland (forecast to be 1.7 million people by the end of the 2012-22 LTP period). The new legislation provided a platform for the Mayor to set out a clear vision for Auckland to be the world's most liveable city.

5.7 The Auckland Transition Authority was tasked with bringing into one document the 2009-19 LTPs of the amalgamated local authorities. That document served to guide the Auckland Council until it prepared its own LTP for 2012-22.

5.8 The scale of Auckland Council makes it unique among local authorities. Here we set out the important aspects of Auckland Council's 2012-22 LTP, including:

- the link to the Auckland Plan;
- the preparation of a group LTP;
- the financial picture;
- important focus areas of the financial strategy, particularly the use of debt; and
- the opinion we issued on the LTP.

The Auckland Plan

5.9 Section 79 of the Local Government (Auckland Council) Act 2009 requires Auckland Council to prepare a spatial plan. The goal of the spatial plan, known as the Auckland Plan, is to set the strategic direction for Auckland – defining its shape in 30 years' time and providing a guiding path during that period.

5.10 The Auckland Plan sets out seven outcomes that describe what Auckland will be like in 2040 and six transformational shifts that are required to achieve the outcomes and the Mayor's vision.

5.11 The Auckland Plan was the clear driving force for the LTP. The LTP seeks to operationalise the goals of the Auckland Plan for the first third of its life cycle. Likewise, as Auckland Council starts to prepare a unitary plan to define its resource management approach, the spatial plan is the foundation for that work.

First group LTP

5.12 Auckland Council's LTP is the first to be prepared on a group basis. The group approach was used because of the significance and economic substance of activities provided through the Council's council-controlled organisations. The LTP explains that because of:

> *... the relevance and importance of information related to these activities for Auckland ratepayers, the council has decided to prepare its LTP 2012-2022 on a full group basis. The group comprises the ultimate parent entity, being the Auckland Council and its subsidiaries, associates and joint ventures. ... The council considers that full group information enhances the transparency of information about the cost of services provided to Auckland ratepayers and enables ratepayers to make more informed decisions about the impact of delivering on the Auckland Plan.*[35]

A summary of the financial forecast for Auckland Council

5.13 Auckland Council's LTP for 2012-22 has forecast:

- total rates revenue of $19.7 billion during the period;
- total operating revenue of $44.7 billion during the period;
- total operational expenditure of $38.7 billion during the period;
- total capital expenditure of $20 billion during the period;
- total gross debt increasing from $4.8 billion to $12.5 billion during the period; and
- total assets of $58.2 billion at 30 June 2022.

5.14 Auckland Council's rates comprise 34% of New Zealand's total rates during the 2012-22 period. Its closing debt comprises 68% of total local authority debt, and it holds 37% of all local authority assets.

5.15 Although Auckland Council forecasts very large increases in debt, its financial strategy limits are not out of alignment with the rest of the sector. Also, the limits are not breached during the LTP period (see Figure 17).

35 Auckland Council, *Long-term plan 2012-22*, Volume 3, Section 2.5, page 17, Notes to the financial statements.

Figure 17
Comparison of Auckland Council's financial strategy limits and forecast highs and lows

Financial strategy limits*	Lowest value during LTP period	Highest value during LTP period
Net debt to total revenue is less than 275%	164.1% (2012/13)	225% (2019/20)
Net interest to total revenue is less than 15%	9.2% (2012/13)	13.6% (2020/21)
Net interest to rates income is less than 25%	15.9% (2012/13)	22.5% (2020/21)

* Auckland Council, *Long-term plan 2012-22*, Volume 3, Section 2.5, page 36, Notes to the financial statements. We note that Auckland Council's debt and interest limits are set on a net basis, taking into account any financial assets the Council is able to offset against gross debt and interest balances when calculating results against these limits.

5.16 Gross debt is $4.8 billion in 2011/12 and peaks at $12.5 billion in 2021/22. Excluding the debt of Watercare Services Limited (Watercare), the council-controlled organisation responsible for water in Auckland, the Council's debt is $3.5 billion in 2011/12, increasing to $8.9 billion in 2021/22. Auckland Council calculated the statistics in Figure 17 with Watercare's debt excluded because Watercare does not rely on Auckland Council to fund its operations.[36]

5.17 Auckland Council's debt is primarily being raised to fund growth and transformational projects. Auckland Council has access to several different debt facilities, including local retail bonds, LGFA, and an offshore debt programme. Unlike other local authorities, Auckland Council is allowed to borrow in foreign currencies.

5.18 Auckland's population is forecast to increase by 15.6% (235,800 people) during the next 10 years,[37] which means that there will be a need for 99,000 new dwellings. In turn, this is forecast to lead to 14% growth in industrial and commercial floor areas. This growth will require $4.5 billion of capital expenditure and $2.3 billion of operational expenditure by the Council to provide for the population growth and necessary land use changes. The growth is not evenly spread over the 10 years, so the Council will need to incur costs ahead of the increase in the rating base to ensure that essential services are available when the population needs them.

36 Auckland Council's approach to exclude Watercare debt from debt calculations is unique in the sector. It could be argued that this approach could be applied by other local authorities where repayment of debt is funded on a user-pays basis. The issue of debt segmentation for financial monitoring purposes requires further consideration by the sector.

37 Auckland Council, *Long-term plan 2012-22*, Volume 3, Chapter 4. The significant forecasting assumptions at pages 84 to 92 note a population growth rate beginning at 1.57% in 2012/13 and decreasing to 1.34% by 2021/22, and growth in the rating base of between 0.73% and 1.85% each year.

5.19 Forecast population and economic growth are key drivers of Auckland Council's spending through the LTP period. This is typical for a metropolitan area. The lack of ability to reach investment consensus before amalgamation now sees the region in catch-up mode, particularly in transport infrastructure, which adds to the forecast growth challenge for Auckland.

Main focus areas of Auckland Council's financial strategy

5.20 The LTP contains a substantial number of projects, with the largest projects for investment in new assets. The Mayor describes the main focus areas within the LTP as projects to address the region's transport issues, projects to increase economic activity (focused on job creation), fiscal prudence through careful financial management (primarily linked to savings and efficiencies gained through the amalgamation process), and changing to a unified rating system.

5.21 The approach to achieving these projects includes a financial strategy focused on balancing the budget; investment in new assets generally funded by borrowing, changing during the next 13 years to fully funding depreciation;[38] and limiting average general rate increases to 4.9% each year.

5.22 The other important component of the Auckland Council's financial strategy is the assumption that central government will provide $1.2 billion for the City Rail Link project (which has a total cost $2.86 billion, after allowing for the sale of surplus land) and that $344 million of funding for transport projects will come through sources not currently used (and some that are currently not allowed by legislation). At the time the LTP was completed, there was no final agreement with central government on either of these assumptions, which are disclosed extensively in the LTP as high-risk assumptions.[39]

5.23 Auckland Council has a credit rating of AA, based on the forecasts set out in the LTP. This is a higher credit rating than the major domestic banks have. The LTP forecasts assume that Auckland Council will retain its AA rating.

Our audit opinion on Auckland Council's LTP

5.24 Our audit report on Auckland Council's LTP drew attention to the significant uncertainty associated with the forecasting assumptions for the City Rail Link project (see Appendix 3). We drew attention to the assumptions based on the size and cost of the project and the significance for the Council's whole transport and

38 The net financial position inherited from the former councils funded only about 63% of depreciation. Auckland Council considers that funding 100% of depreciation is preferable to raising operating revenue to cover the cash cost of replacing assets as they fall due, because asset renewal costs tend to spike in certain years while depreciation is smoother over time. For more information, see Auckland Council, *Long-term plan 2012-22*, Volume 1, Chapter 2, Section 2.4, page 35.

39 Auckland Council, *Long-term plan 2012-22*, Volume 3, Chapter 4, pages 84 and 87.

economic development strategy if the assumptions on which the forecasts are based are not realised.

5.25 The main risks to the City Rail Link project are that central government will not agree to provide direct funding nor enable Auckland Council to access alternative funding sources.

Queenstown-Lakes District Council

5.26 Queenstown-Lakes District Council faces a significant challenge to address the effect of growth in its district. This is not a new problem, and the Council's successive 10-year planning documents have outlined this challenge and its implications.

5.27 The Queenstown-Lakes district was the fastest growing area in New Zealand between 2001 and 2006. This is expected to continue, with Statistics New Zealand's recently released projections showing that the Queenstown Lakes district is expected to grow at a faster rate than Auckland between 2006 and 2031.

5.28 The Council's LTPs have forecast significant increases in expenditure, both capital and operational, to accommodate the anticipated growth in the district. This growth includes not only resident population growth, but also the effect of tourists and visitors to the district on peak days, such as New Year's Eve. Determining how to fund this expenditure has been a challenge for the Council.

5.29 To deliver a financially prudent LTP, the Council has had to consider the accuracy of its growth forecasts and anticipated expenditure, and then determine the best way to fund it.

Growth forecasts

5.30 Growth forecasts are necessary to determine the size of population that will need services and the timing of the ongoing programme of investment.

5.31 Queenstown-Lakes District Council derives its growth forecasts using a methodology prepared in 2004, which it has refined over time. Growth forecasts incorporated into the 2012-22 LTP incorporate historical growth trends, projections from Statistics New Zealand, census data (where appropriate), tourism statistics, and the Council's own knowledge of the district.

5.32 Queenstown-Lakes District Council uses two different approaches for the Wakatipu and Wanaka areas because it considers that different factors drive the growth in those areas.

5.33 In Queenstown-Lakes District Council's 2006-16 LTP, projections showed that, on peak days (when visitor numbers are highest) in 2026, the number of people in the district would rise from 75,000 to 148,800.[40] Figure 18 compares the Council's 2009-19 and 2012-22 growth projections.

Figure 18
Comparison of QLDC's 2009-19 and 2012-22 population growth forecasts

Measure	2009 LTP		2012 LTP		Difference	
	2011	2021	2011	2021	2011	2021
Usually resident population	27,150	35,649	28,440	35,905	1,290 4.8%	256 0.7%
Average day population	41,889	55,463	46,612	56,517	4,723 11.3%	1054 1.9%
Peak day population	89,785	114,547	89,346	108,970	(439) (0.5%)	(5577) (4.9%)

5.34 Projections in the 2012-22 LTP showed that the average day population would rise from an estimated 46,612 in 2011 to 56,517 in 2021. In 2021, the peak day population is expected to be 108,970.[41]

5.35 Queenstown-Lakes District Council also has to understand where growth is likely to occur. Residential growth is predicted using a dwelling capacity model that looks at consents issued for residential housing and their effect. The Council also has to understand industrial and commercial growth. New businesses require a workforce, for their construction and future operations, and the workforce needs both somewhere to live and access to services.

Anticipated expenditure

5.36 In its LTP for 2006-16, Queenstown-Lakes District Council reported that it was well placed to provide the necessary infrastructure for growth.

5.37 In its LTP for 2009-19, Queenstown-Lakes District Council noted that its challenge to address growth in the district had not changed. However, to establish its financial forecasts and determine the level of investment required, the Council reviewed its infrastructure network. It concluded that there was a need to complete more work than anticipated in the 2006-16 LTP to ensure that assets were not used past their capacity to deliver services without risk of failure.

5.38 New projects were also forecast in the 2009-19 LTP. They included new investment in infrastructure to enable Queenstown-Lakes District Council's assets to meet new water standards and quality standards for sewerage discharge, as well

40 Queenstown-Lakes District Council, *Council Community Plan 2006/2016*, page 4.

41 Queenstown-Lakes District Council, *10-Year Plan 2012-2022*, page 10.

as investment in new facilities. The Council forecast $832 million of capital expenditure between 2009 and 2019.

5.39 Queenstown-Lakes District Council's capital expenditure forecast of $552 million for the 2012-22 period was much lower than the previous forecast ($832 million for 2009-19). To find savings in the capital programme proposed in the 2009-19 LTP, the Council carried out much work and revised its AMPs, factoring in the latest growth projections.

5.40 The decrease in forecast capital expenditure is a result of Queenstown-Lakes District Council reviewing every item of expenditure and revisiting its "must do" projects, and an anticipated decrease in the rate of growth. Spending on community services has been restricted to what the Council can afford.

5.41 The forecast decrease in growth has enabled Queenstown-Lakes District Council to spread the timing of its capital expenditure work over a longer period of time. However, it is the Council's review of its anticipated spending that has had the largest effect. The Council was able to remove about $70 million of forecast expenditure from its 2009-19 plan based on better knowledge and cost restraint.

5.42 Furthermore, Queenstown-Lakes District Council has a list of projects that are directly related to growth. If the growth does not happen, the projects will not proceed.

Effect on funding

5.43 The investment in facilities and infrastructure to accommodate the anticipated growth in the region, as well as the requirement for Queenstown-Lakes District Council to meet increased standards for water and sewerage discharges, has posed significant funding questions for the Council.

5.44 In its 2006-16 LTP, the debt levels of Queenstown-Lakes District Council were forecast to rise to $129 million. The Council had a policy that the costs of growth were to be placed on those that created the demand (that is, developers), so much of the debt was forecast to be repaid through development contributions.[42]

5.45 In its 2009-19 LTP, Queenstown-Lakes District Council maintained a policy that the cost of growth should be met by those who created the demand. However, when projects were built, the Council would fund the initial expense. The Council's policy, like those of many local authorities, was to borrow for this investment, which would be repaid over time through development contributions. The Council was forecasting to borrow a large amount to accommodate the significant infrastructure renewal and new development to respond to the district's growth. However, the Council stated that the forecast debt level was not a realistic proposition; nor did it have any alternative sources of funding.

42 Queenstown-Lakes District Council, *Council Community Plan 2006/2016*, page 4.

5.46 Although debt can be repaid through other sources of income, such as development contributions, ratepayers will have to bear the cost if that income is not forthcoming. Queenstown-Lakes District Council's interest and debt indicators anticipated in its 2009-19 LTP were significantly higher than levels generally seen in the sector.

5.47 The financial projections in Queenstown-Lakes District Council's 2009-19 LTP reflected the borrowing forecast matching the capital expenditure programme, but it was the Council's and the auditor's view that the plan was not financially prudent.

5.48 We expressed a modified opinion on the Council's 2009-19 draft and final LTP. We drew the readers' attention to the fact that the community faced a fundamental issue in the Council's ability to fund its forecast capital expenditure over the long term. The Council needed to balance the requirement to deliver services that accounted for the anticipated level of growth and to fund that growth in a financially prudent manner, specifically in years four to 10 of the plan.

5.49 Queenstown-Lakes District Council noted that it would consider the situation it faced in its 2012-22 LTP, which it did. As noted above, the Council revised its AMPs and, with the combined decrease in growth and anticipated spending, was able to prepare a financially prudent LTP. Figure 19 shows a comparison of forecast interest expense and debt indicators between Queenstown-Lakes District Council's 2009-19 and 2012-22 LTPs.

Figure 19
Comparison of QLDC's forecast interest expense and debt indicators between the 2009-19 and 2012-22 LTPs

Debt indicators	2009-19		2012-22	
Interest expense as % of total expenditure	14%		10%	
Interest expense as % of total income	11%		8%	
Interest expense as % of rates	22%		15%	
	2009/10	2018/19	2012/13	2021/22
Debt as % of total assets	12%	24%	13%	12%

5.50 In the 2009-19 LTP, the net borrowing position was forecast to peak in 2013/14, when the net debt position would have increased by $67 million. The level of debt repayment was forecast to consistently increase from 2015/16 onwards, but Queenstown-Lakes District Council expected to remain a net borrower through to the end of 2018/19.

5.51 In the 2012-22 LTP, Queenstown-Lakes District Council's debt as a proportion of total assets is expected to peak in 2015/16 before decreasing gradually. It is 13% in 2012/13 and forecast to reach 16% in 2015/16 before decreasing to 12% in 2021/22. Although debt repayments are forecast during the 2012-22 period, the Council expects to remain a net borrower during the period of the LTP, forecasting an increase in net debt position of $56 million.

5.52 This is not surprising, because Queenstown-Lakes District Council still has a large capital expenditure programme to complete during the next 10 years. As outlined in its 2012-22 LTP, the Council expects to fund a large portion of this programme through debt, at least in the first instance.

5.53 The level of debt and the ratios proposed in the 2012-22 LTP provide a plan that, in our view, is financially prudent. We did not modify the opinion in our audit report. However, this does not mean that Queenstown-Lakes District Council does not face any risk. The LTP is compiled using assumptions, including growth and expenditure forecasts. If there is a negative effect on these forecasts, such as an infrastructure system failure or a growth spurt, then the Council will need to manage this carefully.

Queenstown-Lakes District Council compared with other local authorities

5.54 Larger metropolitan local authorities are expecting to hold the highest levels of debt. Queenstown-Lakes District Council has a high debt increase. We considered the level of debt in relation to population and found that, along with Auckland Council, Queenstown-Lakes District Council is an outlier. The Council has 16% higher debt per head of population than the local authority with the next highest level of debt per head of population.

5.55 When we calculate debt in relation to population, Queenstown-Lakes District Council is an outlier for several indicators:

- The Council's forecast rates are above the trend line of other local authorities.
- Operational and capital expenditure is higher compared with other local authorities.
- Much of the operational and capital expenditure is so the district can accommodate expected growth. The increase in rates might reflect an increase in levels of service in particular activities, but much of the increase is for servicing debt.

5.56 Although residents have higher average incomes, Queenstown-Lakes District Council knows that it needs to manage the affordability of its rates, especially because the rates each person pays are already higher than the rates paid elsewhere.

Timaru District Council

5.57 Timaru District Council is unusual compared to all other local authorities because it:

- makes no inflation adjustment to the financial forecasts in its LTP beyond the first year of the plan; and
- records its fixed assets at deemed cost in its forecast and historical financial statements.

Inflation

5.58 In our view, LTPs should be based on best estimates and a complete set of assumptions about the foreseeable future. This gives the reader the best information on the estimated cost to, and funding implications for, the community.

5.59 LTPs are future-focused documents and everything in the document is a projection. We accept that there will always be unexpected reasons why individual costs might rise faster or slower in a particular year.

5.60 Given that LTPs incorporate 10 years of financial information, it is widely accepted that inflation is an important assumption in preparing the best estimate of costs. Inflation generally refers to the rate of price increases. The sector has used generally accepted estimates of inflation in local government costs, produced by Business and Economic Research Limited, since 2006.

5.61 Inflation is significant. In our view, excluding inflation from financial forecasts could distort decisions made by the local authority to save, borrow, and invest in the long term.

5.62 It could also distort ratepayers' interpretation of the level of rates that the local authority is forecasting to collect.

5.63 Timaru District Council has a different view. The Council applied inflation in its LTP for only the 2012/13 year. Although the Council acknowledges that inflation is inevitable, it lists the following reasons in its LTP for not including inflation in its financial estimates beyond the first year:

- *the inherent unreliability of inflation predictions*
- *the ability in individual years to more transparently expose the impact of inflation on the base costs of Council services*
- *the ability to show the cost of increases in service levels in individual years, without distortion by an inflation component*
- *improved transparency for the community on the impact of inflation*

- *the ability to achieve efficiencies in delivery of Council services to mitigate the effects of inflation*
- *achieving better and tighter financial management that is not obscured by an inflation component*
- *the belief that it is more fiscally prudent not to apply inflation beyond Year 1*[43]

5.64 Timaru District Council has taken this approach when preparing all of its previous LTPs. As we did for previous LTPs, we issued a modified audit opinion on the Council's latest LTP (see Appendix 3). The audit opinion referred to the requirement for the Council to prepare its forecast financial information using the best information available at the time of determining the assumptions. We do not consider an assumption of no inflation after 30 June 2013 to be based on the best information available or to be reasonable and supportable.

5.65 In our view, however, the Council's approach does not comply with section 111 of the Act, which requires the forecast financial information to be prepared in accordance with generally accepted accounting practice. This means following the requirements of Financial Reporting Standard 42: *Prospective Financial Statements* to adjust its forecasts for inflation.

5.66 We note that other local authorities had concerns that the application of inflation, particularly in the later years of the LTP, can make it more difficult for readers to identify service level and new capital expenditure changes. However, all other local authorities apply an inflation adjustment in recognition that price level change is a reality.

Risks to the Council and how these are being managed

5.67 If Timaru District Council were setting its funding requirements based on the financial forecasts in the LTP, there would be a risk of a funding shortfall for the Council's activities. This is because funding would not be sought for the inflation component of the financial forecasts, except for the first year of the plan. However, the Council holds the view that it manages this risk by setting its rates, and considering its other funding streams, through its annual plan.[44] The Council's annual plans consider the effect of inflation.

5.68 In taking this approach and revisiting its budgets each year, Timaru District Council is managing its short-term cash flow requirements. In the Council's view, this helps to drive efficiencies in delivery of services and achieve better and tighter financial management. The Council told us that its community supports this approach. It is our view that there are risks in such an annualised approach.

43 Timaru District Council, *Long Term Plan 2012-22*, page 29.

44 In the years that the Council does not prepare an LTP, it prepares an annual plan.

5.69 This approach is contrary to the intentions of the Act, which requires local authorities to prepare a 10-year forecast plan and, in particular, to signal to the community through that plan the rating implications of the forecast activity.

5.70 We considered the actual financial results for Timaru District Council for the years ended 30 June 2006 to 2012, compared with the results forecast in its 2006-16 and 2009-19 LTPs and the annual plans it has produced. Timaru District Council's actual financial results often closely matched the financial forecasts in the annual plans. Annual plans include forecast financial information for only one year, as opposed to the 10-year nature of LTPs. There were several large variances between the actual results and what Timaru District Council had forecast in its LTPs. However, it is unclear whether this is from not providing for inflation beyond the first year of the LTP or because of other changes to the forecasts.

Long-term focus of the LTP

5.71 The Act notes that, among other requirements, the purpose of the LTP is to provide a long-term focus for the decisions and activities of the local authority.

5.72 We have acknowledged that Timaru District Council is managing its funding requirements in the short term. It is also important to note that a large portion of the Council's spending and associated funding is on infrastructure assets, for which the Council has good AMPs to support decisions to invest in its long-term infrastructure. The Council discloses supplementary financial information in its LTP that incorporates the effect of inflation on the core financial statements.

5.73 Despite this, we consider that Timaru District Council is not providing its readers with transparent information about the level of funding required, particularly the level of rates the Council is proposing to collect during the LTP period. Nor is the Council preparing a plan based on the best estimate of costs during this period.

Deemed cost valuation of fixed assets

5.74 Timaru District Council accounts for most of its fixed assets at deemed cost. Deemed cost is an estimate of cost at a given date. For Timaru District Council, this date is 1 July 2005.

5.75 All local authorities began preparing their financial statements in keeping with New Zealand equivalents to International Financial Reporting Standards (NZ IFRS) for the year beginning 1 July 2005.

5.76 In changing to NZ IFRS, local authorities had the option to use either deemed cost or fair value to account for their fixed assets. Previously, Timaru District Council had regularly revalued most of its assets, but on the transition date the Council decided to use deemed cost. After 1 July 2005, Timaru District Council has recognised new assets and renewal expenditure at cost.

5.77 We understand that there were two main reasons for this decision. The first was to avoid the cost of regular revaluations. The second reason was that some councillors consider that, if debt is used to fund capital expenditure and if depreciation is used as a measure of how much to provide for future asset replacement based on revalued assets, it could be argued that current ratepayers are paying twice. Timaru District Council is the only local authority to choose this option. All other local authorities revalue most of their assets regularly and record this value in their financial statements.

Risks to the Council and how these are being managed

5.78 Although Timaru District Council has avoided the cost of regular revaluations, using this approach has other implications. Without revaluations, the Council is likely to be understating the true value of its assets. It is important that the Council understands the value of its assets so its depreciation charge, and its funding for depreciation, is fair – which means that those using the asset are paying for its use.

5.79 Under the current approach, users of Timaru District Council's services are probably not paying the full costs of some of the services they receive. This could defer costs to future users and increase the funding challenge when the assets need to be replaced.

5.80 Figure 20 shows the implications of the deemed cost and fair value models, using an asset with a deemed value of $300,000 and a useful life of 10 years (after which it has to be replaced).

Figure 20
Comparison of accounting treatment of an asset under the deemed cost model and the fair value model

Year	Deemed cost model			Fair value model (with revaluations every three years)			
	Opening value $000	Depreciation $000	Closing value $000	Opening value $000	Depreciation $000	Revaluation movement* $000	Closing value $000
1	300	30	270	300	30	0	270
2	270	30	240	270	30	0	240
3	240	30	210	240	30	60	270
4	210	30	180	270	45	0	225
5	180	30	150	225	45	0	180
6	150	30	120	180	45	45	180
7	120	30	90	180	45	0	135
8	90	30	60	135	45	0	90
9	60	30	30	90	45	10	55
10	30	30	0	55	55	0	0
Total		**300**			**415**	**115**	

* Revaluations are assumed at the end of the financial year and are for illustration purposes only.

5.81 Under the deemed cost scenario, assuming the local authority has provided for the depreciation expense each year, it will have raised $300,000, plus interest earned, to fund the replacement of the asset during the 10 years. However, it is unlikely that the cost of replacing the asset in year 11 will be the same as the cost in year one. In fact, under a regular revaluation model that takes account of inflation and market movements, we can see that the value of the asset has increased over time. This is the funding challenge or risk that Timaru District Council could face.

5.82 Under a revaluation model, and again assuming the local authority has funded the depreciation expense each year, the local authority will have funded $415,000, plus interest earned, towards the asset's replacement.

5.83 Under NZ IFRS, local authorities can use either a deemed cost or fair value model. However, a deemed cost approach increases the risk that, if a local authority is using depreciation as a proxy of the funds required to replace the asset in the future, it will not have raised adequate funds. This could contribute to an additional burden for future ratepayers.

5.84 It is unclear whether Timaru District Council has been adequately rating for the anticipated cost of replacing assets. If it has not, future ratepayers in Timaru will be faced with a funding shortfall or could be forced to accept a decrease in the level of service they receive.

Observations by size of local authorities

5.85 In this section, we provide some analysis and observations on differences and similarities between local authorities in different size groups.

5.86 We have grouped the local authorities into six size groups, by population. We excluded Christchurch City Council because it did not prepare an LTP this year, Wairoa District Council because its data was not available when we did this analysis, and Chatham Islands Council because it is very small compared with the other local authorities. Although Auckland Council is significantly larger than other local authorities, we included it for some but not all of the analysis to minimise distortions.

5.87 The six groups, along with the categories Local Government New Zealand uses to distinguish their nature, are:

- Group 1 – Smallest 11 (population less than 10,000, all rural, and would have normally included Wairoa District Council and Chatham Islands Council);
- Group 2 – Next 12 (population 10,000-20,000, all rural);
- Group 3 – Next 13 (population 20,000-35,000, one rural and 12 provincial);
- Group 4 – Next 12 (population 35,000-50,000, seven provincial, three unitary, and two metropolitan);
- Group 5 – Next 9 (population 50,000-80,000), one metropolitan and eight provincial); and
- Group 6 – Largest 8 (population greater than 80,000, all metropolitan, would have normally included Christchurch City Council).

5.88 We compared the LTP data with separately obtained information on population size,[45] area,[46] and personal income.[47] Our comparisons are based on the whole population, not just ratepayers.

5.89 An important assumption in our analysis is that local authorities' forecasting offers a reasonably reliable guide to their actual results. The analysis earlier in this report suggests that there is some variation in the quality of forecasting, and capital expenditure tends to be at lower levels than forecast. Given our audit work on LTPs, we consider that the forecasts reflect the best estimates available at the time the LTP was adopted.

5.90 One of our more significant observations is that there is more variation between individual local authorities than there is between the six size groups. In other words, when comparisons are made, there are likely to be significant outliers in any one group that overlap with other groups.

45 Based on Statistics New Zealand projections for 2012.

46 Based on Local Government New Zealand's *Contacts* directory for 2010/11.

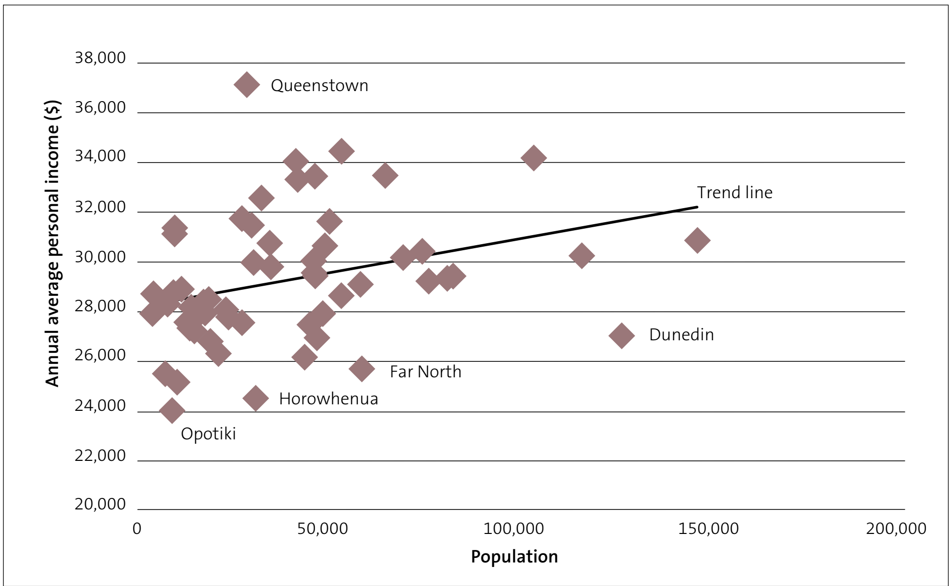
47 Based on Statistics New Zealand census data from 2006.

5.91 When comparisons are made by size group, much clearer trends emerge (see Figures 21 and 22).

Operating revenue and expenditure

5.92 There is little correlation between individual local authority population sizes and personal incomes (see Figure 21).

Figure 21
Average personal income and local authority size

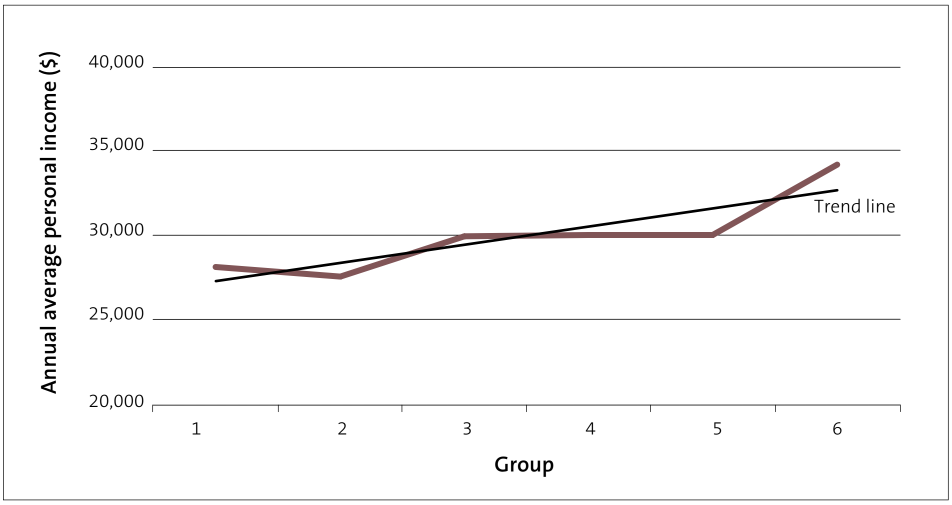


Note: Auckland Council and Wellington City Council are excluded from this graph for clarity, but make no material difference to the result.

5.93 The most significant high outliers are Queenstown-Lakes District Council and Wellington City Council (which has been excluded from the graph for clarity), with average personal incomes much higher than $35,000.[48] Opotiki District Council, Horowhenua District Council, Far North District Council, and Dunedin City Council are distinctive low outliers in Groups 1, 3, 5, and 6 respectively, with incomes 15% to 25% below the group averages.

48 The average personal income of individuals in the Queenstown-Lakes District Council area is $37,000, and in the Wellington City Council area it is $43,000.

Figure 22
Average personal income by group size



5.94 When local authorities are put into size groups, a clear trend emerges. Average incomes of individuals in the two smallest rural groups are $28,000 (2006 data), 7% or $2,000 lower than the averages of the three middle-sized groups, and a further $4,000 (in total, 21%) lower than Group 6, the large metropolitan local authorities.

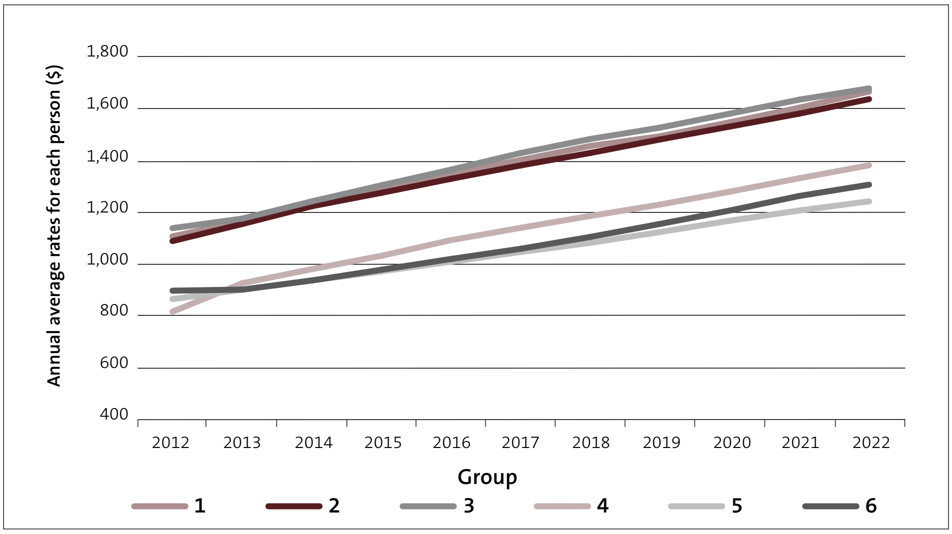
5.95 On average, each person in smaller local authorities pays higher rates, so an even higher proportion of their personal income is needed to pay rates. There is an increase in rates for each person between the three smaller and the three larger groups, with the smaller local authorities rating at about $1,400 per person on average during 2012-22, and the larger local authorities rating 18% lower at an average of about $1,150 per person.

5.96 Thames-Coromandel District Council, Queenstown-Lakes District Council, Waitomo District Council, and Wellington City Council are well above the average in rates charged when this is considered on a per head of population basis. We expect this to be primarily attributable to growth, except for Waitomo District Council (where the Council is addressing past financial issues). In the case of Wellington City Council, a large proportion of its total rates income is collected from the commercial sector.

5.97 Trends in rates charged for each person during the 10 years of the 2012-22 LTPs are broadly consistent between size groups, but the smaller local authorities start from a slightly higher base (see Figure 23). Group 4 has the highest growth trend (particularly in the early years), because it includes some non-metropolitan areas experiencing growth, such as Selwyn District Council, Upper Hutt City Council, Nelson City Council, Tasman District Council, Waimakariri District Council, and Kapiti Coast District Council.

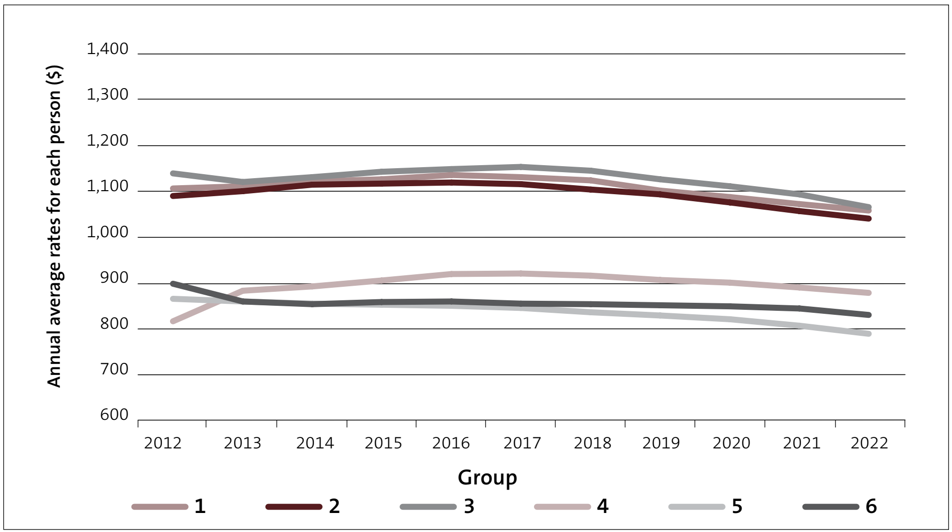
Figure 23

Trends in average rates per head of population, by group size



5.98 When we adjust for GDP growth, which is our best proxy for growth in income, the trend reverses. Figure 24 discounts rates by increases in GDP, and shows a flat or downward trend in all but Group 4 (and even Group 4 is flat after the first year). In other words, rates might not take up an increasing proportion of personal income during the LTP period.

Figure 24
GDP-adjusted trend in rates, by group size

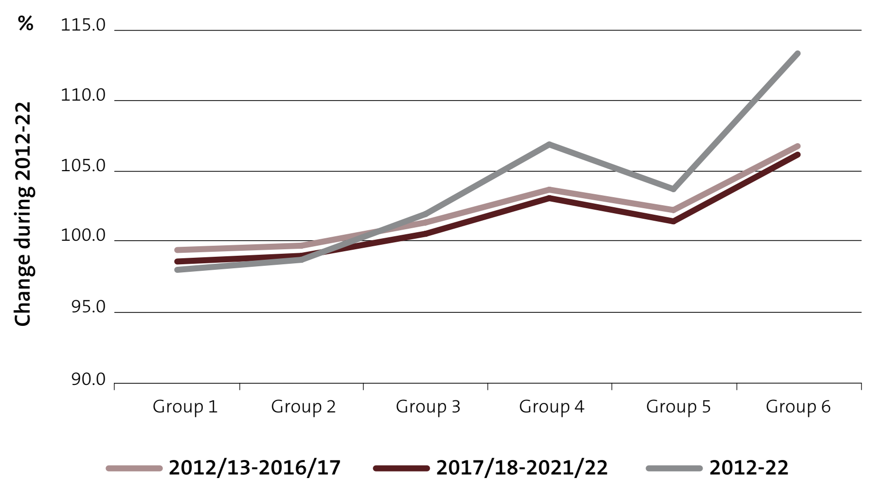


Note: This Figure deflates rates using BERL's 2011 GDP growth forecasts, adjusted for Statistics New Zealand's 2012 population growth forecasts.

5.99 These trends are similar regardless of the growth patterns of the local authorities, where there is a significant difference between the smaller and the larger groups. Figure 25 shows that the two smallest groups are predicted to have negative population growth during the planning period, with Group 4 and the large metropolitan local authorities (dominated by Auckland Council) having the most growth.

5.100 It is important to note that local authorities have taken local population trends into account when preparing their LTPs, and should not be caught by surprise by either depopulation or rapid growth.

Figure 25
Population change by group size



5.101 Our analysis shows that the operating expenditure of local authorities and groups is broadly consistent with rating patterns. This is also consistent with the fact that public equity in local authorities is increasing rather than decreasing. In other words, local authorities are not spending more than they earn.

Fixed assets and debt

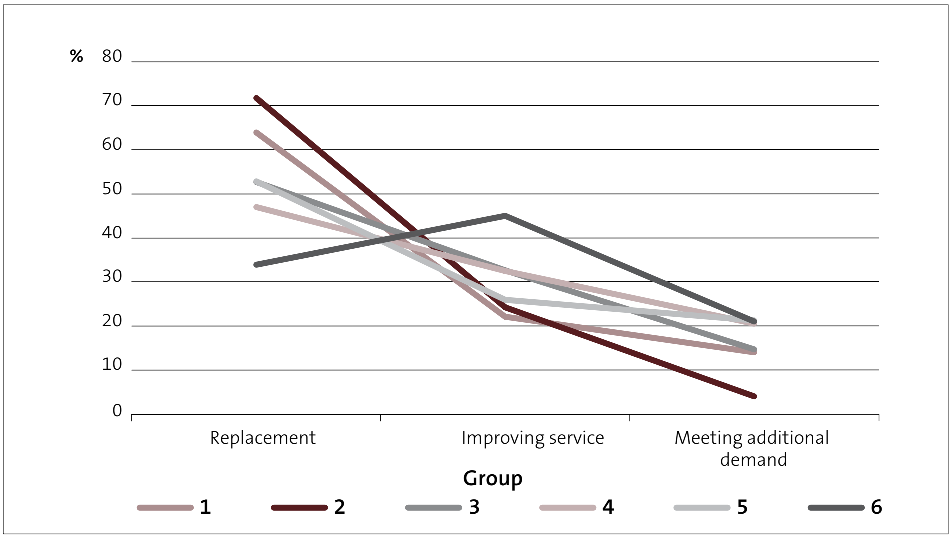
5.102 The most important long-term assets local authorities hold are fixed assets (property, plant, and equipment), rather than investments or other assets. Fixed assets are more than 90% of the total value of non-current assets in all but five local authorities, and no local authority holds less than 84%. Most fixed assets held by local authorities are infrastructure assets.

5.103 Per head of population, smaller local authorities hold higher levels of fixed assets than larger local authorities. It is unclear why this is so. In our view, it is likely to relate to the need for multiple schemes to service more widely dispersed populations in rural areas and large roading networks to join dispersed communities. A likely consequence of this is that servicing costs per head of population will also be higher, and this may contribute to the higher levels of other operating expenditure.

5.104 Overall levels of, and trends in, capital expenditure per head of population are largely consistent between groups (excluding Auckland Council, which is significantly higher). However, smaller local authorities are spending proportionately less on improving services and meeting additional demand than the larger authorities (see Figure 26).

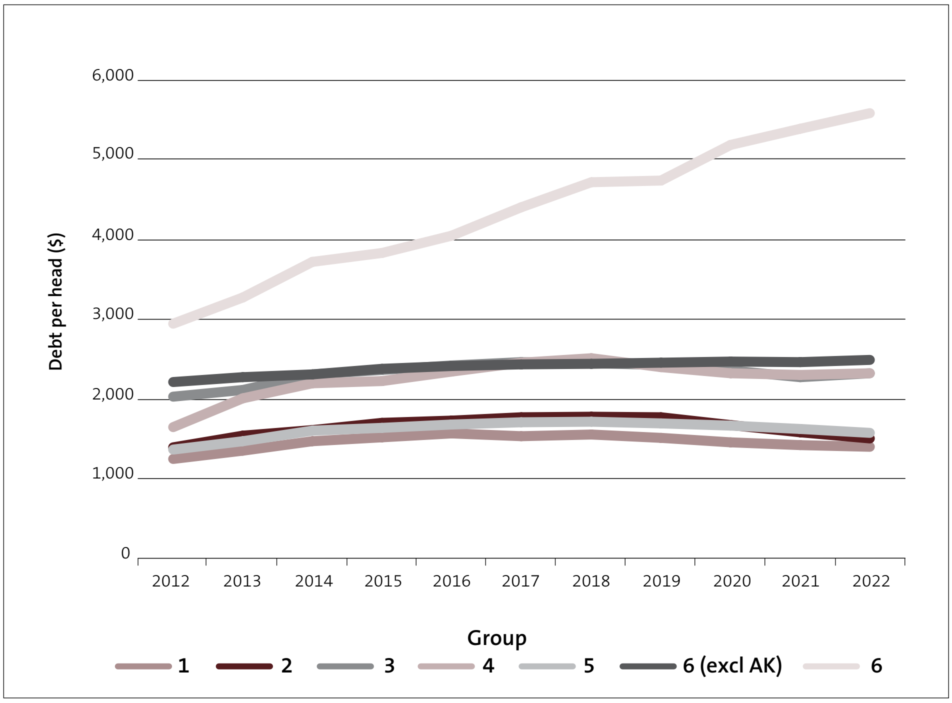
Figure 26

Types of capital expenditure by group size



5.105 There is no correlation between assets and debt at an individual local authority level, but Groups 1 and 2 (rural local authorities) and Group 5 (the large provincial local authorities) show a significantly lower debt base and trends than the other local authorities (see Figure 27).

Figure 27
Trend in debt per head of population, by group size



Concluding comment

5.106 Our analysis indicates that there are differences between groupings of local authorities based on their population size, caused by the various influences and pressures they face. The initial insights that these observations provide warrant further exploration by the sector as part of the wider debate we encourage on sector performance.

Part 6
Consulting the community on major issues

6.1 In this Part, we discuss how local authorities consulted with their communities about the most important issues in the 2012-22 LTPs. We discuss:

- the major issues presented for consultation in the 2012-22 LTPs;
- the opportunity local authorities had to produce shorter, more "user friendly" LTPs after the TAFM changes to the Act;
- the link between presenting major issues to the community and the financial strategy;
- legislative compliance issues arising in the consultation process for the 2012-22 LTPs; and
- our views on the need to make the LTP more accessible to ratepayers.

Importance of engaging with the community on major issues

6.2 Communities elect local representatives to make decisions on their behalf but expect to be consulted on significant decisions that affect them. Communities also expect that councillors and staff will take account of their views. The LTP is an important part of this. One of its main purposes is to:

> ... *provide an opportunity for participation by the public in decision-making processes on activities to be undertaken by the local authority.*[49]

6.3 Every three years, the draft LTP and summary give local authorities the opportunity to seek community views on the major issues facing the community. Local authorities must use the special consultative procedure to seek comments on the draft LTP and summary.

6.4 Each local authority can use its own judgement about how much information and detail to put in the LTP, having regard to the significance of the issues that it seeks views on and its resources. LTPs tend to be large documents, containing a great deal of detail. Local authorities need to think carefully about how to communicate the strategic and major issues, choices, and implications, so they are readily apparent to their communities.

6.5 The summary must be a "fair representation of the major matters in the statement of proposal". The summary is the key consultation document for the community. Therefore, it is essential that the summary is not only a fair reflection of the overall content of the draft LTP but also that it presents the strategic and other key issues, choices, and implications contained in the draft LTP to the community in an accessible way.

49 Section 93(6)(f) of the Act.

6.6 In September 2011, SOLGM issued updated guidance on preparing a good LTP summary called *Telling Our Stories 2012*. The key message is that the LTP summary is not an add-on or the "thing that's last on the list", but is an integral part of the process. The guidance contains examples from the local authorities that produced four of the five best LTP summaries in 2009.

6.7 The TAFM changes to the Act were partly intended to reduce the size of LTPs. Previously, the LTP had to include the funding and financial policies that a local authority had adopted under section 102 of the Act. After the TAFM changes, the 2012-22 LTPs had to include only the local authority's revenue and financing policy, although the financial strategy should reflect the more strategic elements of other policies (such as the liability management and investment policies).

6.8 The Act requires the auditor to consider the extent to which the draft LTP and final LTP comply with the requirements of the Act. As part of auditing legislative compliance, our auditors consider:

- whether the draft LTP clearly presents strategic and other important issues, choices, and implications to the community; and
- whether the summary fairly represents the major matters in the draft LTP.

6.9 Our auditors also consider whether local authorities have complied with the Act's consultation requirements in seeking community views on their draft LTPs.

6.10 Our auditors consider and make judgements on the following questions:

- Are the draft LTP and summary readable and clear for a moderately informed reader?
- Are the issues that the local authority has focused on and presented in the draft LTP complete?
- Are these the strategic and other key issues and choices that the community needs to consider?
- Are the implications of different options fully disclosed, including options for rates, debt, and levels of service?

6.11 This part of the audit process is strongly focused on reaching an overall conclusion based on our completed audit work. It is evaluative and relies on knowledge of the local authority and professional judgement, rather than being based on technical audit procedures.

6.12 Overall, our auditors found that the most significant issues were presented to the community. However, we noted that the way in which local authorities presented the issues, choices, and implications for how they could address the issues was less clearly set out than in either the 2009-19 LTPs or the recommendations of the SOLGM guidance and our previous reports.

Major issues presented in the 2012-22 LTPs compared with the 2009-19 LTPs

6.13 In our report on the 2009-19 LTPs, we noted that the issues that local authorities presented for community consideration were clearly affected by the global recession. A dominant theme of those LTPs was affordability, although there was optimism because it was unclear at that time how significant the recession would be.

6.14 Against this background, the specific issues raised by local authorities in 2009-19 LTPs were wide ranging. They included proposals for:

- large infrastructure asset development and upgrades;
- community facilities, such as stadiums and events centres;
- relocating and renewing libraries;
- developing and amending the approach to providing community housing;
- creating and disestablishing council-controlled organisations; and
- preparing policies to guide responses to the effects of climate change.

6.15 The initial effects of the global recession, as seen in 2009, did not result in local authorities significantly reducing their activities. In general, local authorities presented a strong argument to their communities about the importance of ongoing prudent management of core infrastructure and long-term, progressive development of other infrastructure and facilities.

6.16 Since the 2009-19 LTPs, there has been increasing focus by central government on financial restraint in the public sector. In the local government sector, this has led to greater focus and interest by the Government and ratepayers on the levels of expenditure, rates, and debt. It is also a reflection of community feedback on their sense of the economic constraints they feel and the need for local authority plans to consider the community's ability to pay increasing rates.

6.17 The *Better Local Government* reform proposals were announced in March 2012, when local authorities were finalising their draft LTPs for consultation. In introducing the reforms, the Minister of Local Government said:

> *These local government reforms are part of the Government's broader agenda. We are rebalancing the New Zealand economy away from the increased public spending and debt of the previous decade. We are building a more competitive and productive economy. This requires that both central and local government improve the efficiency of delivering public services. It is also critical to New Zealand's future that both government and councils take a prudent approach to public debt.*[50]

50 Department of Internal Affairs, *Better Local Government*, Minister's foreword.

6.18 The general environment in which local authorities were preparing their 2012-22 LTPs was one of economic restraint and close scrutiny of spending and debt. The fact that local authorities had to publish their financial strategy in their LTPs for the first time further focused them on core economic considerations.

6.19 The major issues for consultation were all inherently linked to the local authority's financial strategy. We discussed the main financial strategy issues in Part 2, including how several local authorities took what they described as a "no frills" approach in their LTPs.

6.20 This approach is understandable in the economic environment. However, "no frills" and "just in time" approaches do require very good asset management planning. Without good asset planning, the risk is that a local authority will defer necessary expenditure too long and that assets will fail or cost more to replace. This also defers problems so future ratepayers have to pay for them. Our auditors needed to consider whether the LTPs were prudent in this regard.

Consultation issues in preparing the 2012-22 LTPs

Local authorities consulted on the major issues

6.21 Auditors did not have any significant concerns that local authorities were not consulting on the major issues in the 2012-22 LTPs. Instead, auditors tended to suggest improvements to completeness or presentation rather than raise substantive issues. We partly focused on how well the LTP summary reflected the financial strategy, because the financial strategy was a new requirement.

Issues with the consultation process

6.22 The Act sets out the steps that local authorities must go through when using the special consultative procedure, specifying what they must tell people when acknowledging submissions.

6.23 The Act is very prescriptive in this regard. The steps include ensuring that a person who makes a submission:

- is sent a written notice acknowledging receipt of that person's submission; and
- is given a reasonable opportunity to be heard (if that person so requests).

6.24 The written notice must:

- tell the person about their opportunity to be heard; and
- explain how the person can exercise that opportunity.

6.25 As noted earlier, our audit report on the draft and final LTP must comment on the extent to which a local authority has met the requirements of the Act, including the consultation procedures. Auditors consider whether the local authority complies with the Act *in all material respects*. If so, the auditor can issue a clear audit opinion.

6.26 Some local authorities did not meet these procedural requirements in all respects. Kaipara District Council provided a submission form in its LTP summary asking people to indicate whether they wanted to be heard, and giving information about how they could exercise that right, but did not include all of the required information in the standard acknowledgement letter. There were also problems with people not receiving letters telling them about hearings. We considered that the Council had not complied with the Act in all material respects and referred to the breach of the consultation requirements in our audit report.

6.27 Wanganui District Council also included information in the LTP summary about the right to be heard, and asked people to indicate whether they wanted to be heard. Those that said they did not want to be heard received an acknowledgement letter noting that, and telling them that their submission would be considered. This was a different approach from that prescribed by the Act, but we considered that the Council had complied with the requirements in all material respects because people who had said they wanted to be heard were given that opportunity.

Using rates remissions policies to mitigate rates changes

6.28 Another legislative compliance issue that arose concerned proposed changes to rating systems and using rates remissions and postponement policies to soften the unintended effects of the proposed changes on some ratepayers. In these instances, each local authority decided to use its rates remission policy to mitigate the unintended consequences.

6.29 The issue that arose for four local authorities was whether further consultation was required on the proposed changes to the rates remissions policies, or whether changes to these policies could be made in response to comments on the draft LTP without further consultation.

6.30 In three cases, the local authorities decided on further consultation because they had not sought specific comments on their rates remissions policies in the LTP process. A rates remissions policy can be amended only by using the special consultative procedure. Two of these three local authorities did this after they adopted their LTP, and the other local authority consulted further before adopting its LTP. The fourth local authority decided not to consult further. That local authority had included some proposed changes to its remissions policy in its LTP, but not the change that it wished to make after consultation. We accepted that this approach was reasonable in the circumstances.

The opportunity to produce shorter LTPs

6.31 Not all local authorities took advantage of the TAFM changes that allowed them to produce shorter LTPs. Some local authorities kept the full policies in the LTP because they were consulting on changes to them or were integral to a consultation issue in the LTP. For others, it was not clear why local authorities kept them in. We have assumed that it might have been convenient for the local authority to partly roll over the content of the 2009-19 LTPs than to change the structure of their LTP to match the changes to the legislation, particularly if the policies had not changed. It is more challenging to produce a concise and focused LTP than a long one.

6.32 Our understanding is that the *Better Local Government* reform programme might lead to changes that enable local authorities to produce shorter, more focused LTPs. This should help to make the LTP document, along with the LTP summary, more suitable for consultation.

6.33 Those local authorities that made the effort to reduce the size of their LTP generally gave more accessible documents to their communities. We have already noted that Hamilton City Council produced a clear and well-presented financial strategy (see Part 2). This reflected the tone of the entire LTP, which we considered to be concise and written in a ratepayer-focused way. At 181 pages, it was one of the most concise LTPs produced and follows in the footsteps of the concise LTP prepared by the former Manukau City Council in 2009.

Accessibility of LTPs

6.34 The sector has now completed four rounds of LTP preparation and adoption. The first round in 2003 and 2004 did not require an audit but, as now required by the Act, we have audited the LTPs prepared for 2006-16, 2009-19, and 2012-22.

6.35 Since our involvement in 2006, we have considered the purpose of an LTP. In 2006, we noted the criticism by some in the sector that there was an apparent contradiction in the role of the LTP between a high level description of strategy and a document to record detailed management intentions. We commented that we considered there was a middle ground between the two roles:

> *This would be where the* [LTP] *articulates a local authority's strategy (informed by both community desires and the reality of the community's circumstances) and also provides an integrated view of the policies and actions required to support the strategy.*[51]

51 *Matters arising from the 2006-16 Long-term Council Community Plans*, page 5.

6.36 Broadly, we still hold this view. However, we are concerned by the practice that has emerged where the strategy and associated plans have become focused on detail, complexity, and prescription. LTPs are documents that are largely meaningful only to well-informed and special interest groups. With some exceptions, LTPs are not focused on communicating clearly to ratepayers.

6.37 We are disappointed that few local authorities have taken the opportunity that the TAFM reforms offered to reduce the size and some of the complexity of their LTPs. We are reminded of a comment by an experienced senior corporate planning manager who prepared an LTP in 2003, who said that, if he had had another month to prepare the local authority's LTP, he would have spent it on improving the summary – that is, the information that can make the LTP most accessible to ratepayers and help them to understand a local authority's plans.

6.38 As we were preparing this report, the Local Government Efficiency Taskforce was considering the nature of the planning, accountability, and decision-making of local authorities. After four rounds of LTPs, we support this process. Further, we have offered insights consistent with the observations in this report and suggested consideration of a move to a more strategic document. We would like to see planning and accountability documents that focus on the important issues (including prospective financial information and level of service intentions), and provide access to supporting data and policies through each local authority's website.

6.39 We consider that, until the Act's disclosure requirements are based on principles and not prescription and until local authorities invest in preparing clearer and more informative LTPs, most communities will miss out on better informed and more effective consultation about their local authority's intentions.

Appendix 1
Summary of requirements for long-term plans

An LTP is a 10-year plan. Under the provisions of the Act, all local authorities are required to prepare an LTP every three years. Section 93(6) of the Act sets out the purposes of an LTP, which are to:

- describe the activities of the local authority;
- describe the community outcomes of the local authority's district or region;
- provide integrated decision-making and co-ordination of the use of the local authority's resources;
- provide a long-term focus for the decisions and activities of the local authority;
- provide a basis for the local authority to be accountable to the community; and
- provide an opportunity for the public to participate in decision-making processes on activities to be carried out by the local authority.

There are several steps that a local authority must take to meet the requirements of the Act in preparing the LTP. These steps include consultation with the community, development of key policies and plans, and putting in place financial strategies and a performance framework.

Two important documents in the LTP process are the draft LTP and the final LTP. Local authorities are also required to prepare a summary of the draft LTP for use as a public consultation document.

Section 84(4) of the Act requires the draft LTP to include a report from the Auditor-General. Local authorities are also required to consult with the public on the draft LTP, using the special consultative procedure outlined in sections 84(1) and 83.

Section 94(1) requires the final LTP (adopted after the local authority has considered the results from the consultation) to include the Auditor-General's report.

For both the draft LTP and the final LTP, the Auditor-General is required to report on:

- the extent to which the local authority has complied with the requirements of the Act; and
- the quality of the information and assumptions underlying the forecast information provided in the plan.[52]

52 The Auditor-General's requirement to report on the extent to which the forecast information and proposed performance measures will provide an appropriate framework for the actual levels of service provision to be meaningfully addressed was repealed, on 27 November 2010, by section 14(2) of the Local Government Act 2002 Amendment Act 2010.

Appendix 2
Local authority debt

The following table sets out the forecast 2011/12 and 2021/22 debt[53] balances for each local authority during the 2012-22 LTP period. The table is sorted reflecting the highest to lowest forecast debt balance at 2021/22.

Local authority	Debt 2011/12 $000	Debt 2021/22 $000
Auckland Council (Group)	5,000,595	12,695,212
Wellington City Council	375,306	542,443
Tauranga City Council	410,207	458,934
Hamilton City Council	433,274	454,606
Greater Wellington Regional Council	186,653	375,436
Tasman District Council	154,022	310,807
Dunedin City Council	249,982	215,846
Palmerston North City Council	165,478	201,250
Kapiti Coast District Council	103,863	192,915
Rotorua District Council	150,000	183,033
New Plymouth District Council	140,750	173,490
Queenstown-Lakes District Council	128,475	170,970
Whangarei District Council	154,505	165,929
Taupo District Council	178,963	169,156
Nelson City Council	100,168	144,105
South Taranaki District Council	91,553	142,058
Far North District Council	120,342	124,421
Western Bay of Plenty District Council	151,517	110,017
Timaru District Council	80,547	96,944*
Selwyn District Council	97,520	100,688
Hawke's Bay Regional Council	15,767	99,294
Waimakariri District Council	59,857	95,222
Waikato District Council	26,722	93,724
Marlborough District Council	42,149	91,158
Wanganui District Council	92,507	87,589
Hastings District Council	82,615	81,097
Thames-Coromandel District Council	70,391	74,499

* This is the non-inflation adjusted debt balance for Timaru District Council. The inflation-adjusted amount disclosed in the Council's additional schedules is $102,820.

53 The debt figures in this table are made up of current and non-current debt, and derivative financial instruments. Derivative financial instruments (such as interest-rate swaps) are used to hedge exposure to interest-rate risk arising from financing activities. Derivative financial instruments are recognised at fair value in the balance sheet. In the body of this report, references to individual debt balances do not include derivatives if narrative in the LTP allows the debt amount to be separately derived. For example, references to debt for Auckland Council elsewhere in this report refer to the 2011/12 balance as $4.8 billion and the 2021/22 balance as $12.5 billion, which is only the external borrowing.

Local authority	Debt 2011/12 $000	Debt 2021/22 $000
Matamata-Piako District Council	44,353	72,041
Horowhenua District Council	41,500	66,000
Kaipara District Council	86,850	61,688
Invercargill City Council	51,572	57,742
Ashburton District Council	61,795	57,295
Hutt City Council	77,709	56,255
Masterton District Council	40,788	54,174
Waipa District Council	35,335	53,544
Porirua City Council	45,414	52,499
Upper Hutt City Council	24,669	50,154
Ruapehu District Council	31,627	45,459
Waitomo District Council	44,642	34,498
Grey District Council	14,397	34,464
Buller District Council	29,621	32,860
Manawatu District Council	19,726	32,668
Rangitikei District Council	5,833	31,781
Southland District Council	14,622	24,623
Gisborne District Council	42,402	23,562
Whakatane District Council	51,750	19,079
Opotiki District Council	5,436	17,908
South Wairarapa District Council	9,349	16,711
Central Hawke's Bay District Council	12,274	14,816
Westland District Council	11,305	13,981
Canterbury Regional Council (Environment Canterbury)	6,823	13,163
Hurunui District Council	13,500	12,000
Carterton District Council	6,507	10,989
Hauraki District Council	31,160	10,673
Gore District Council	11,607	10,430
Tararua District Council	9,967	10,363
Wairoa District Council	-	10,315
Kaikoura District Council	6,505	8,588
Stratford District Council	5,666	6,868
South Waikato District Council	8,102	6,010
Mackenzie District Council	-	4,803
Otago Regional Council	26,403	4,124

Local authority	Debt 2011/12 $000	Debt 2021/22 $000
West Coast Regional Council	2,261	2,825
Central Otago District Council	3,625	2,339
Otorohanga District Council	13,318	1,948
Waimate District Council	3,675	815
Chatham Islands Council	754	490
Bay of Plenty Regional Council	-	-
Clutha District Council	11	-
Kawerau District Council	3	-
Manawatu-Wanganui Regional Council (Horizons Regional Council)	20,000	-
Napier City Council	4,028	-
Northland Regional Council	-	-
Southland Regional Council	-	-
Taranaki Region Council	-	-
Waikato Regional Council	-	-
Waitaki District Council	8	-
Total debt	**9,840,620**	**18,691,388**

Appendix 3
Summary of non-standard audit reports on the 2012-22 LTPs

Local authority	Draft LTP	Final LTP
Adverse opinion		
Timaru District Council	Prime financial statements were not reasonable estimates, giving no allowance for inflation. The supplementary information included was incomplete.	Qualification carried forward unchanged.
"Except for" qualification		
Wairoa District Council	N/A	Overall opinion – unmodified. "Except for" qualification for non-compliance with the Act – Council did not adopt its LTP before the statutory deadline.
Dual – Emphasis of matter paragraph and "except for" qualification		
Kaipara District Council	**Emphasis of matter** Suitability of the reforecast Statement of Financial Position as at 30 June 2012, risks due to legal issues with targeted rates, and the implications of financial strategy.	**Emphasis of matter** Financial strategy could be jeopardised should any of the six risks and uncertainties listed in the audit opinion eventuate. **"Except for" qualification** Non-compliance with the Act – the Council did not comply with all the consultation principles, and did not adopt its LTP before the statutory deadline.
Emphasis of matter paragraph		
Auckland Council	Assumptions and uncertainty – related to the significant forecasting assumptions associated with funding for the City Rail Link project.	Non-standard audit report from the draft LTP carried forward.
Chatham Islands Council	Long-term plan assumes ongoing central government support for the delivery of core services, and reliance on unconfirmed central government financial assistance.	Non-standard audit report from the draft LTP carried forward.

Local authority	Draft LTP	Final LTP
Dunedin City Council	Financial strategy – drawing attention to the risks in the Council's financial strategy arising from four related matters that have significant implications for affordability.	Non-standard audit report from the draft LTP carried forward.
Grey District Council	Financial strategy – The Council does not fully fund depreciation on core infrastructure and port assets and had not included needed projects in the LTP for rural water supply drinking water supply upgrades.	Non-standard audit report from the draft LTP carried forward in respect of core infrastructure and port assets. Rural water supply projects were provided for in the final LTP.
Opotiki District Council	Financial strategy – significant forecasting assumptions associated with the Harbour Transformation project.	Non-standard audit report from the draft LTP carried forward.
Ruapehu District Council	Financial strategy – highlight the risks associated with delaying renewal of infrastructure and delay of planned capital projects.	Non-standard audit report from the draft LTP carried forward.
Waimakariri District Council	Assumptions and uncertainty – related to the uncertainty of impact of any further earthquakes.	Non-standard audit report from the draft LTP carried forward.

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Other publications issued by the Auditor-General recently have been:

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- Response of the New Zealand Police to the Commission of Inquiry into Police Conduct: Third monitoring report
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- Effectiveness of arrangements to check the standard of services provided by rest homes: Follow-up audit
- Inquiry into aspects of ACC's Board-level governance
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- Fraud awareness, prevention, and detection in the public sector
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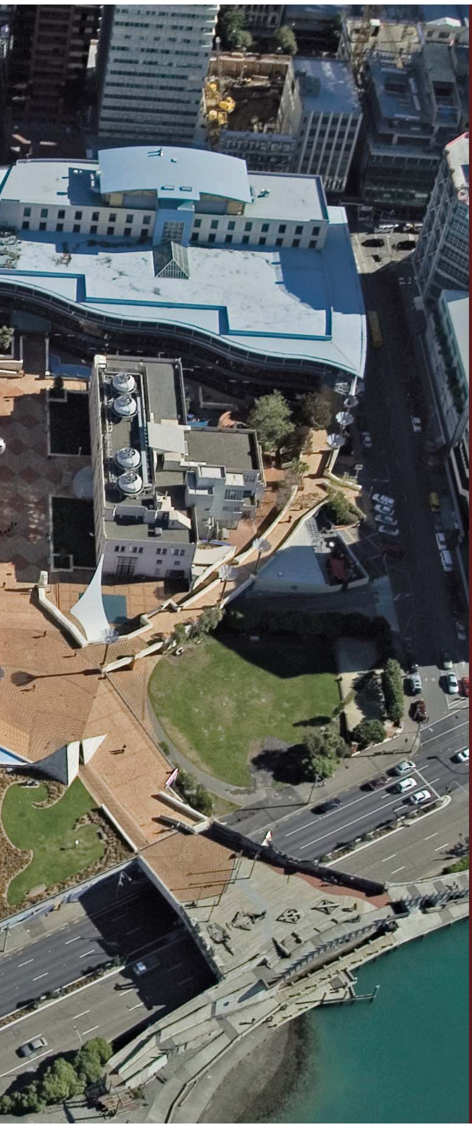

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