4.17 To measure the variability among the indicators, we differentiate outliers that lie close to one standard deviation from the average and outliers that are more than two standard deviations from the average. We then analysed these figures collectively.

4.18 As with all analyses of financial performance, there are limitations to what we can infer. Our approach focuses on the potential for uncertainty and does not comprehensively assess local authorities' performance. We are not trying to rank local government entities. Moreover, what is shown as the normal range assumes a regularity that may not always be there. The outliers are not necessarily more uncertain in delivering on their objectives – they may simply warrant further investigation.

4.19 Figure 6 summarises the set of indicators that we have used. Paragraphs 4.20-4.26 explain the information that these indicators reveal.

Figure 6
Our indicators of financial performance

Stability	Resilience	Sustainability
Actual to budgeted net cash flows from operations	Interest expense to rates revenue	Interest expense to debt
Actual to budgeted debt	Net cash flows from operations to capital expenditure	Capital expenditure to depreciation
Actual to budgeted capital expenditure	Working capital	Gross debt to total assets

Stability indicators

4.20 For stability, we compare local authorities' actual net cash flows from operations, the debt balance, and the capital expenditure with what was originally budgeted.[9] A result of 100% indicates that planning was reliable, budgeting was accurate, and financial resources were used as intended.

Resilience indicators

4.21 The interest expense to rates revenue indicator shows the proportion of rates revenue that is required to service debt. A higher percentage means less flexibility to respond to unexpected events.

To calculate this indicator, and the interest expense to debt indicator, we have used interest expense as stated on the face of the statement of comprehensive income/income statement. The sector uses different terms to express this item, including finance cost, finance expense, or interest expense. In some instances, interest expense might include finance cost/expense items other than interest relating to borrowing, such as unrealised losses and gains on financial derivatives.

4.22 The indicator comparing net cash flows from operations with capital expenditure shows the cash surplus available for capital expenditure. A higher percentage indicates a local authority's better ability to pay for capital expenditure using internally generated funds rather than relying on external sources. For inter-

9 Capital expenditure is expenditure on property, plant, equipment, and intangible assets.

Summary observations about stability

4.40 Overall, in the last three years, local authorities were more accurate in budgeting their net cash flows from operations, debt level, and capital expenditure. Average results for all three indicators vary between 75% and 96%. The improving results during the last three years are evidence that local authorities are getting better at forecasting.

4.41 The relationship between the three indicators of actual to budget net cash flows from operations, debt levels, and capital expenditure are linked and important to understanding the actual funding position that local authorities seek to achieve. We expect there to be annual variations in local authorities' actual to budget results, although explanations of the variations was not always obvious from the annual reports.

4.42 We have raised with the sector, on a number of occasions, the need for clarity about these key decisions – particularly decisions about the level of capital expenditure achieved (which is not necessarily unrelated to the cash and debt required). General reasons we have been given include:

- efficiencies obtained in the procurement of actual capital projects;
- deferrals of capital expenditure because of other events (for example, a flood event drawing on cash funds available);
- changed priorities; and
- financial pressures.

4.43 In our view, explanations like this should be more transparent in the annual report because they are critical to understanding why actual to budgeted variances are occurring. There is an opportunity to address this in future annual reports.

The last three lines of this paragraph were not as clear as they could have been, so we have deleted them.

Resilience indicators and trends

4.44 We looked at three indicators of resilience that consider how well local authorities can respond to short-term shocks. For the interest expense to rates revenue indicator we considered results for two years – 2010/11 and 2011/12. We did not readily have available the interest expense information from the 2008/09 to 2009/10 annual reports. For net operating cash flows to capital expenditure and working capital indicators, we considered results for four years, 2008/09 to 2011/12.

Interest expense to rates revenue

Average value	
Direction	
Variability	

4.45 This comparison looks at the proportion of rates revenue used to service debt. A high percentage means less flexibility to respond to unexpected events.

4.46 The average interest expense to rates revenue was 7.8%. We reported that the average in the long-term plans was 9%. Thirty-two percent of the results were outliers, including 4% that were outside two standard deviations from the average. Although this indicates low variability, the result is affected by some local authorities with no debt – they did not incur any interest expense. On the other hand, there are some local authorities that have high debt balances and a high proportion of rates revenue is used to cover the interest expense. These local authorities have greater potential or risk of not being able to respond to short-term events compared to other local authorities.

4.47 We saw the following notable outliers:

- Kaipara District Council had interest expense to rates revenue of 23% in 2010/11 and 35% in 2011/12. Kaipara District Council's largest infrastructure project is the Mangawhai Community Wastewater Scheme.
- Tauranga City Council had interest expense to rates revenue of 26% in 2010/11 and 2011/12. Tauranga City Council's debt has increased each year for the last three years, reflecting its borrowing to fund capital projects.
- Western Bay of Plenty District Council had interest expense to rates revenue of 23% in 2010/11 and 32% in 2011/12. The Council includes unrealised losses on financial derivatives within its interest expense (labelled "finance costs"). When the unrealised losses are removed from interest expense, the interest expense to rates revenue is 19% in 2010/11 and 20% in 2011/12.

See Western Bay of Plenty District Council, *Annual Report 2011/12*, page 89, 4(a) Finance income and finance costs.

Net cash flows from operations to capital expenditure

Average value	
Direction	
Variability	

4.48 This comparison looks at the local authority's cash surplus (or deficit) from normal business-as-usual operations that has been or could be used towards capital expenditure requirements. Apart from cash surplus from normal operations, a local authority can fund capital expenditure by selling investments or assets or borrowing to pay for the long-life assets. A higher percentage indicates that the local authority is funding capital expenditure with internally generated funds rather than external funding (debt).