



Auditing the future: 2009

PROJECT UPDATE #2

May 2008

The Auditing the future project was established to work with local government to put in place the resources, standards, and know-how to successfully and credibly audit Long-Term Council Community Plans (LTCCPs) from 2006 onwards. The project also aims to share and promote good practice in long-term planning.

A word from Kevin Brady, Controller and Auditor-General

This newsletter sets out in detail the approach we are taking for the audit of the Long-Term Council Community Plans (LTCCPs).

By the start of April, we had completed a long but fruitful update of our audit approach. We recognised that, along with the sector, we had much to learn from the 2006-16 LTCCP round. I was keen for my staff to ensure that we incorporated those lessons in our approach to the audit of the 2009-19 LTCCPs.

The intent of this newsletter is to let you know the broad outcomes of that work – and, in particular, to be transparent about the main audit objectives. My staff have focused the audit approach around planning based on a thorough knowledge of your council’s individual circumstances and the broad audit objectives, known more generally as the “audit 10”. These objectives are outlined below.

There is nothing new in these objectives, but clearly we have learnt from the 2006-16 LTCCP round. This approach brings some re-orientation of focus on:

- establishing how councils are responding to their statutory responsibility to “take a sustainable development approach”;
- establishing whether the council has a comprehensive performance management framework linking levels of service to financial estimates;
- assessing transparency on the council’s financial strategy and assessing the financial prudence of that approach; and
- assessing how the council is enabling the “right debate” with its community by transparently disclosing the strategic issues, choices, and implications it faces.

I have long signaled to the sector that councils will be asked to pay the full audit costs in 2009-19. I have no latitude to write off audit fees in the manner I was able for the 2006-16 LTCCP audits. We were then able to bear the costs of implementing the LTCCP audits and also some of the audit hours associated with the actual audit. That is neither possible in 2009 nor ultimately equitable to councils or the other organizations I audit. This means that audit fees will increase substantially for your local authority. It places added importance on your current planning, and discussing with your auditor the

issues and estimated time it will take to complete the audit – particularly if there are actions you can take now to limit the level of audit input required.

By being transparent about our audit objectives in this newsletter, I aim to help you understand the requirements of our work. However, there is no substitute for directly discussing the audit approach and work areas of focus with your appointed auditor. I encourage you (and my auditors) to meet early.

Kevin Brady

Introduction

One of our main objectives throughout the 2009-19 LTCCP project is to be open about our audit objectives and the focus areas of our audit approach. Our desire is to ensure a “no surprises” approach. We have already been talking with the sector about the “audit 10” for some time, and this newsletter contains more details about the focus areas related to each of these audit modules.

The amount of our work and the consequential size of our fees is very much determined by the ease with which our auditors can complete these audit objectives. Therefore, we encourage you to discuss these audit objectives and how your appointed auditor plans to tailor their audit approach to the specific circumstances, issues, and risks of your council as early as possible.

Appointed auditors should have already been in contact with you about completing the self-assessment and will soon (after doing some preliminary planning and risk assessment) be meeting with you to begin negotiating the LTCCP audit fee. These discussions will provide an opportunity to discuss the audit objectives and to plan how you are going to work through the audit process and your own development plan for the LTCCP. The appointed auditor is expected to discuss these objectives with you to ensure that you understand them and you are not “blind-sided” later by unknown audit expectations.

Details of the audit approach

The approach, outlined below, is based on our much publicised “audit 10” – the core 10 audit objectives we will conclude on in our audit of the 2009-19 LTCCPs. We have developed these core 10 audit objectives from the lessons learned in the audit of the 2006-16 LTCCPs. We recognise we were not as explicit about our approach as we would have wished in 2006.

The following sections summarise the information that will come to you shortly from your appointed auditor in your audit arrangements letters. As noted in our introduction, we encourage you to discuss these objectives with your appointed auditor. The quality of your council’s approach to the LTCCP is pivotal to the extent of audit work required and therefore to the fee for the audit.

The general audit approach

Where possible, our auditors plan to rely on the planning systems and processes the council applied in preparing the LTCCP and developing the underlying information. The nature and extent of detailed testing to be performed will depend on the auditor’s assessment of the main controls around LTCCP

processes. Where the auditor can rely on controls or when detailed testing procedures alone would not provide enough appropriate audit evidence, they will perform tests of controls to ensure that the controls are operating effectively at relevant times during the period under audit.

Where the controls over the planning systems and processes applied in preparing the LTCCP cannot be relied on, this will add to the resource required to complete the audit and may potentially affect the overall audit timing. Additional resource to complete extended levels of testing is likely to increase the overall cost of the audit.

Auditors will also need to consider whether it is possible or practical to gain audit assurance to an acceptable level by performing solely detailed testing (substantive) procedures. If this is not possible, the appointed auditor will need to consider their reporting response.

Project management, reporting deadlines, and audit progress

A successful LTCCP process is heavily reliant on effective planning of the LTCCP project. Developing an LTCCP is a significant and complex project, and a comprehensive project plan is required. It is essential that there is a commitment from throughout the organisation for the project, from top to bottom, starting with the councillors.

The LTCCP draws together plans, policies, decisions, and information from across the organisation and its community. The plan has complex and inter-related information needs. We recognise that councils will prepare their LTCCPs over an extended period. We anticipate that the audit approach will require a series of visits leading up to each reporting deadline, using an “auditing as you go” approach.

Our auditors expect that councils are approaching their preparation on a project basis and recognise that their audit work should “shadow” that project timetable. The success of this “auditing as you go” approach will largely depend on the council’s project management of the LTCCP process.

Management control environment

The primary approach is to review the council’s management control environment to identify, confirm, and assess the council’s main processes and controls over information gathering, budgeting, development of the performance framework, review of policies required by the Act, and ultimate production of the LTCCP Statement of Proposal (SOP) and adopted LTCCP.

Our auditors will place additional emphasis on meeting with a selection of elected representatives during the course of the audit planning to understand the focus and direction of the council from the perspective of all those involved in developing the strategic direction of the council.

The auditor’s review of the council’s self-assessment response and main controls over the underlying information and development of the LTCCP is critical to their initial assessment of the management control environment, audit risk, and the nature and extent of overall audit work.

Self-assessment

We expect your appointed auditor to have provided you with a copy of the self-assessment by the time you receive this newsletter. Our aim is to allow councils about two months to complete the self-assessment (but this will vary depending on the size and complexity of the council). The target date for councils to complete the self-assessment and return it to their appointed auditor is late May/early June, but this date will need to be agreed between each council and their appointed auditor.

The self-assessment requires each council to reflect on the systems that support the working with outcomes, decision-making and consultation, and financial management provisions of the Local Government Act 2002 (the Act), and to identify where the council would like to improve.

The self-assessment will provide our auditor with information to assess the quality of council systems and project planning, assist in understanding how groups of activity information is being assembled, and assist in understanding how the council's performance framework operates. Our auditors also intend to use this information to assist them to understand how the council is implementing the requirement of section 14(1)(h) of the Act. The statutory principle is whether the local authority has "taken a sustainable development approach". Our auditors will not be forming an assessment of whether the council is sustainable.

Once the council has completed the self-assessment, appointed auditors will analyse this information and use it to complete planning and risk assessments. Our auditors will discuss the information contained in your self-assessment with you after you have completed it.

Audit approach to specific reporting requirements

The audit is based on the three "themes" of sections 84 and 94 of the Act:

Local Government Act 2002 sections 84(4) and 94	Auditor "question" of the Council
Quality of underlying information and assumptions	Do your underlying processes support robust and relevant financial and non-financial information going into the LTCCP Statement of Proposal?
Performance information	Will the performance information provide a meaningful assessment of the service provided to the community?
Legislative compliance	Have you done what the Act requires in respect of the plan?

Satisfactory answers to these questions enable our auditors to positively conclude on the LTCCP's robustness and usefulness to the reader. The concluding paragraph in our opinion states:

In our opinion the Statement of Proposal for the adoption of an LTCCP ... provides a reasonable basis for long-term integrated decision-making by the Council and for participation in decision-making by the public and subsequent accountability to the community about the activities of the Council.

As well as control and substantive testing, our auditors will complete the audit modules detailed below and consider the council's approach to the issues and risks addressed by each module.

The “audit 10” modules are structured around the three themes (underlying information, performance information, and compliance) required by sections 84(4) and 94 of the Act. However, as the LTCCP is an integrated planning document, the audit impacts of an issue arising in any one module will not necessarily be limited to that particular opinion leg.

The themes and modules are:

Theme – Underlying information (s 84(4)(b))

- Module 1 – Asset and activity management
- Module 2 – Levels of service
- Module 3 – Linkages of information and consistency with other plans and policies
- Module 4 – Assumptions
- Module 5 – Generally accepted accounting practice (GAAP)

Theme – Performance information (s 84(4)(c))

- Module 6 – Performance framework

Theme – Legislative compliance (s 84(4)(a))

- Module 7 – Decision making and consultation
- Module 8 – Document presentation
- Module 9 – Financial prudence
- Module 10 – The right debate

Module 1 – Asset and activity management

This is the first of the five modules in the theme underlying information. The modules that make up this theme are highly interrelated and reflect the integrated nature of the LTCCP.

This part of the audit will focus predominantly on examining the detail of a selection of groups of activities that the audit planning process has identified as key activities. Our auditors will overview the remaining activity areas.

The asset and activity management module focuses on assessing the control environment that the council has established around the development and recording of the activity and activity information underlying the groups of activities. The extent of detailed review of asset and activity management plans will be based on the robustness of the control environment and may be able to be reduced if controls are found to be reliable.

Module 2 – Levels of service

This module is principally focused on identifying levels of service, as they are reflected in the performance management framework and disclosed in the LTCCP SOP, and confirming that the council has applied them consistently when developing the underlying information on which the LTCCP is based – particularly how levels of service relate to assumptions and asset-based information.

This module is closely related to the requirements of module 6, although the focus in this module is on confirming the links between levels of service and the financial estimates to deliver the described level of service. In contrast, the focus in module 6 is on the structure of the performance framework around those levels of service as a meaningful assessment of planned performance.

Module 3 – Linkages of information and consistency with other plans and policies

The focus of this module is on confirming that the council has consistently applied its other plans and policies in developing the LTCCP. The purpose of this work is to ensure that the LTCCP (particularly the financial forecasts) is consistent with the commitments that the council has made through its adopted plans and policies.

Our auditors will not just check the flow of numerical data from other council plans to the LTCCP but will also consider the consistency of the policies and strategies reflected in the narrative of these plans with the LTCCP.

Our auditors will also consider the presentation of the council's financial information in the groups of activities statements in this module.

Module 4 – Assumptions

In developing an LTCCP, a council has to make assumptions about the future and take positions on various issues, which affect the financial and non-financial estimates. The disclosure of assumptions allows the reader of the LTCCP to make their own judgement as to the assumptions' quality and reliability.

Our auditors' expectation is that councils will consider assumptions that are broader than just financial in nature. Councils will also need to consider many other assumptions of a more complex and strategic nature dealing with the uncertainties surrounding environmental, social, economic, and cultural changes in the future. Many of these more complex and strategic assumptions will relate to issues or events that may arise much further into the future than the term of the LTCCP but for which preparatory steps may be needed in the current LTCCP timeframe.

The audit will focus on evaluating whether the forecasting assumptions and risks identified by the council in accordance with clause 11 of Schedule 10 of the Act are appropriate and complete. Our auditors will also consider how the council has applied the adopted forecasting assumptions and risk classifications when developing the underlying information in the LTCCP.

Module 5 – Generally accepted accounting practice (GAAP)

The focus in this module is confirming that the prospective financial statements comply with the requirements of GAAP and in particular the requirements of FRS-42: *Prospective Financial Statements*.

Incorporating the most recent developments of NZ IFRS as it relates to the council over the life of LTCCP is also a critical part of developing GAAP-compliant forecasts.

Module 6 – Performance framework

Councils are required to provide services that meet the needs of their communities in an efficient and effective way (section 14(1)(a)(ii) of the Act). To demonstrate accountability for delivering these services, councils need to provide enough robust performance information in the LTCCP to show:

- the services that will be carried out and why;
- the service levels required to meet the needs of their communities or other duties and intentions of the council; and
- the planned level of service intended to be delivered.

Specifically, the LTCCP must include “a statement of the intended levels of service provision for the group of activities, including the performance targets and other measures by which actual levels of service provision may meaningfully be assessed” (clause 2(a) of Schedule 10 of the Act).

The forecast service performance information is made up of the levels of service, the performance measures and the performance targets. These should be set within the broader context of social, economic, environmental, and cultural well-being, community outcomes, and the council’s strategic objectives and duties.

Effective performance reporting expresses useful, appropriate performance information in a structured, systematic, and logical way, allowing the reader to readily understand and link the achievement of performance targets to the overall aims of the council.

Our auditors’ focus will be on assessing whether the council has a comprehensive, systematic approach to performance management. In this work, we will assess the performance management framework and consider the main elements of the framework: the links, context, logical flow, and consistency with which the council has applied the framework across groups of activities. Our auditors will also consider the quality of the forecast service performance information – particularly whether it will provide an appropriate basis for understanding and measuring the performance achievements of the council in the future.

Module 7 – Decision-making and consultation

This section of the audit will assess the quality and effectiveness of the council’s decision-making and consultation processes in the years leading up to the LTCCP, as well as those decisions proposed within the LTCCP SOP itself. The auditor will also evaluate selected decision-making and consultation processes against the requirements set out in the Act.

Our auditors will focus predominantly on the decision-making and consultation processes employed by the council, and they will review a sample of decisions and consultation processes in making their assessment.

Module 8 – Document presentation

This module focuses on the legislative compliance of the LTCCP SOP document. This relates primarily to the public face of the document and focuses on the elements that the Act requires to be

present within an LTCCP and the logical links that should be made between those elements to enhance the readability of the document.

Our auditors' expectation is that the council will have a specific quality assurance check to confirm the compliance of the SOP and adopted LTCCP SOP summary so that it can be confident that the LTCCP has met all the presentation requirements.

Module 9 – Financial prudence

The focus of this module is on evaluating the council's financial strategy and assessing whether that strategy, as presented in the LTCCP SOP, is financially prudent and transparent. This module is focused on the financial management principles and requirements that are set out in sections 101 and 100 of the Act.

Financial strategy is an important element of the right debate. For consultation processes to be effective, it is important that the reader of the LTCCP SOP is able to understand the financial strategy the council is employing. This should not require the reader to have expertise in analysing financial statements.

Although there is an inherent complexity in developing and applying a financial strategy, at the broadest level, we expect a council to be able to articulate its financial strategy in terms of the following questions:

What position are we aiming for Council to be in at the end of the LTCCP period?

Why do we want Council to look like this in the future?

It is also important that the council is clear about their financial strategy – *Who pays what, when, and why?*

Our auditors' focus in working through this module is on developing an understanding of the council's answers to the above questions, to evaluate whether that strategy is prudent and is being presented in a transparent way to the readers of the LTCCP. It is not the auditor's role to "second guess" the policy decisions of the council. Our auditors' focus will be on assessing whether the council's policy is financially prudent.

Councils have been encouraged since the 2006 LTCCP round to be clearer in their articulation of financial strategy. We expect councils to consider how they will express their strategy as they develop the LTCCP. We also encourage early discussion with your appointed auditor about your council's approach to the balanced budget requirements of the Act.

Module 10 – The right debate

The role of the LTCCP SOP and the SOP summary, in particular, is to help the "right debate" occur in the community. For this debate to occur, and for it to be focused on the right issues, the LTCCP SOP document must provide the community with enough balanced information about the strategic and other important issues, choices, and implications facing them. This will allow the community to

effectively evaluate the issues and therefore participate in the decision-making process led by the council.

The SOP summary prepared under section 89(a) of the Act is required to be a “fair representation of the **major matters** in the statement of proposal”. It has a pivotal role in ensuring that the right debate occurs, as it is the primary consultation document for the community. Therefore, it is essential that the summary is not only a fair reflection of the overall content of the LTCCP SOP document but that it also makes the strategic and other important issues, choices, and implications reflected in the LTCCP SOP accessible to the community.

Our auditors’ focus will be on assessing whether the LTCCP SOP and the SOP summary documents achieve an appropriate standard of readability and clarity for a moderately informed reader and whether the information presented is complete.

While there is no specific legislative requirement to adopt the summary at the same time as the LTCCP SOP, we recommend developing the summary alongside the LTCCP SOP rather than as a separate exercise after completing the SOP. Getting the messages in the summary right is crucial to the success of the consultation process. Our auditors will need to assess the effectiveness of the SOP summary when they consider the consultation process, and any issues arising as a result could affect the opinion on the adopted LTCCP.

The adopted LTCCP

Consistent with section 94 of the Act, our auditors are also required to report on the adopted LTCCP after your consultation on the LTCCP SOP. Our auditor’s focus will be to assess the council’s consultation process on the LTCCP SOP, including the LTCCP SOP summary. The extent of our work will be dependent on:

- the audit conclusions reached on the LTCCP SOP;
- the audit conclusions reached on the summary of the LTCCP SOP; and
- the effect of consultation on the adopted LTCCP.

An update on phases of the 2009 LTCCP audit

As noted in our first newsletter, it is desirable that councils plan to interact with their appointed auditor throughout the development of the 2009 LTCCP. “Auditing as you go” spreads the workload and also helps early identification of issues. Our methodology is designed to facilitate this approach where appropriate. Below we set out the broad phases of the audit and show where we are up to at the moment.

To 31 July 2008		
Planning the audit	Self-assessment sent to councils for completion.	
	Formal audit arrangements established, including fee negotiations.	
	Completion of planning and risk assessments.	
	Auditors submit a selection of audit plans for hot review by OAG to support auditors in consistent risk identification across the sector.	<input type="checkbox"/>
August 2008 to February 2009		
“Auditing as you go”	Based on project plan of council audit work where appropriate and possible.	<input type="checkbox"/>
To June 2009		
LTCCP SOP audit	Audit fieldwork on the SOP (the draft LTCCP) and the summary of the SOP.	<input type="checkbox"/>
	Hot review of all SOPs for consistency.	<input type="checkbox"/>
	Delivery of SOP opinions.	<input type="checkbox"/>
Final LTCCP audit	Audit fieldwork on the final LTCCP.	<input type="checkbox"/>
	Hot review of all final LTCCPs.	<input type="checkbox"/>
	Delivery of final LTCCP opinions.	<input type="checkbox"/>

 = phase is under way now

= phase completed

= phase is yet to begin

For more details contact Bruce Robertson on 917 1610 or Sarah Lineham on (04) 917 6096.