



Auditing the Future

PROJECT UPDATE #9

March 2006

The Auditing the Future Project will 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 message from Kevin Brady, Controller and Auditor-General

This project update is perhaps the last that we'll issue because it's likely that the 2006 LTCCPs will all be completed before we have time to prepare another newsletter. Of course we're a little way from that now and it could be said that the real work has only just begun. At the beginning of March, we have either issued or are in a position to issue opinions on 10% of the 85 LTCCP Statements of Proposal (SOP) and are close to issuing opinions on a further 10%. As you are telling us that we should expect to review about half of all LTCCP SOPs during the next 2 weeks, we are drawing breath before the main rush to make some observations on those we have considered so far.

We have always known the period for issuing opinions on LTCCP SOPs would be logistically challenging. As we have all anticipated, there is time-slippage between when many Councils hoped to have their LTCCP SOP prepared and the actual date they look likely to achieve. My Office has the resources in place to do the job and, to date, has risen to the challenge. However, as

adoption planning slips back for more Councils, there is potential for a bottleneck that could slow down our ability to issue opinions. We are doing our best to manage this and are grateful for ongoing information from you about the timing your Council is expecting. Your information helps us to programme our resources to achieve a reasonable turnaround. You will recall that we discussed the potential implications of adoption timing breaches in Newsletter 8.

I'm conscious that some Councils may find it frustrating that, in addition to having your Auditor review your draft LTCCP SOP, we have a "hot review" team in my Office completing a high-level desk review. I want to remind you why we have taken this step and to tell you about this team's focus. One of the concerns the sector has raised with

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me since the passing of the Local Government Act (the Act) is how, with such a new and demanding audit requirement, the Office would ensure consistency between Auditors in reaching its opinion for each Council. We have often assured you that the Office would be consistent in so far as possible, bearing in mind that the Act reinforces the relevance of size and scale in many areas of planning and decision-making. We have attempted to provide such consistency through our standard methodology (that all our Auditors have been required to use in undertaking your LTCCP audit). In addition, as we now issue opinions, through an 'issue-based' hotline to support our Auditors and the hot review team.

The hot review team provides a 48-hour turnaround of feedback for Auditors on each LTCCP SOP from the time a full set of draft LTCCP SOP papers is received. If there are serious bottlenecks later in March or April we may not achieve this – but it will remain our intention. However, be aware that, if you miss the indicative date that your Council has committed to with your Auditor, the team will need to prioritise the commitments we have already made to Councils which are keeping to their schedule.

The hot review team's focus is to review the draft LTCCP SOP and the Auditor's observations by looking at a handful of key questions (see following discussion on 4 of the key questions). This is to assess the consistency of our reporting – bearing in mind size and scale. This is not easy to do, given that we cannot assess all LTCCPs together at once. Each Council has different dates at which they need feedback and their opinion issued – so we cannot be rigidly or absolutely consistent. However, because the hot review team is reviewing all 85 LTCCP SOPs, we are using this as our main strategy for achieving consistency in this phase of our work.

I know this is a demanding time for us all. When it passes, I'm confident we will all be able to look back and feel justifiably proud of what we collectively have achieved to improve local government's operational and financial planning.

– **Kevin Brady**

1 What's in a performance framework?

Setting up a performance framework is one of the more demanding requirements of the Act - after all, performance management is vexed internationally as well as here at home. The framework needs to take account of each Council's overall well-being context and community outcomes, and reflect the achievements intended by the Council (and the associated risks and negative effects).

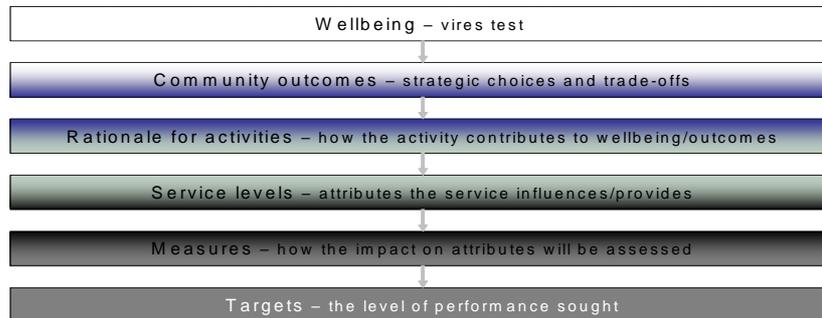
For different reasons, assessing performance frameworks for the purpose of issuing LTCCP opinions is vexed for the Office as well. Until the LTCCP audit, the Auditor's role in considering performance information was related to the annual report. This provided a

limited opportunity for the Auditor to form views on the appropriateness or meaningfulness of the framework on which the reporting of performance was based. The LTCCP audit has placed the question of meaningfulness at the centre of our opinion on the performance framework.

You will recollect that our emphasis in considering performance frameworks has been in 3 main areas:

- understanding the logic flow;

Logical Flow in the Performance Framework



- confirming that the performance measures reflect the Council’s rationale and service levels for the activity by providing reasonably complete coverage of what it is trying to achieve, and the risks or negative effects it is trying to avoid; and
- confirming that the performance targets are reasonable. As with the financial estimates, our expectation is that performance targets should reflect best estimates based on the Council’s best information and judgement.

From the LTCCPs that we have reviewed, we’ve noticed that completeness of performance measures in individual activity areas is not generally critical for our assessment. On the other hand, use of a coherent framework that shows logic flow and allows service levels to be understood, is critical. Where there is not a coherent approach to the presentation of the performance framework that allows the service levels to be identified or inferred from the performance measures and targets, it is not possible for us to conclude on the completeness of the performance measures or the reasonableness of the targets.

Where service levels and the activity rationale are not clearly stated, they can often be inferred from the performance measures and targets used. However, where this approach is taken, it’s important that the measures and targets used are clearly consistent with, and address other information about, the nature and issues associated with the service, including the trends set out in financial information.

We are taking an 80:20 approach to the completeness of performance measures - particularly where activities are not directly contributing to the achievement of community outcomes and have low resourcing effects.

Because of the complexity of the judgements that Councils need to make, and the lack of agreed standards or sector good practice about the form of good performance reporting, we are working hard to give the benefit of the doubt in our assessment of each Council's information – while trying to be broadly consistent overall. The good news is that already we think we've seen some exciting good-practice work emerging from the effort that has gone into the development of the 2006 LTCCPs that will provide a strong base for future improvements in performance management in the sector.

2 Having the right debate

An area that has been a core focus of our review work is trying to understand whether, based on the issues in terms of the operations and financing of the Council, there is a good framing of the debate for the purpose of public consultation. Such debate is about analysing the aggregated result of the:

- external factors and drivers that are affecting the Council, such as growth, statutory change, and environmental state;
- consequent service choices the Council is proposing and the effect of these choices; and
- the Council's financial strategies, including its financial management policies.

Presenting the right debate is about being able to set out the expected effect of services in achieving those things that are important to communities, while giving confidence that the Council is responsibly managing its finances. This can be difficult because service choices and the financing of these are made in the context of activity-by-activity discussions, which then need to be related to the financing of the Council as a whole. However, ultimately, this is also the key question to consider in determining whether the Council has produced a balanced budget that is financially prudent.

When undertaking your completeness and consistency checks on your draft LTCCP SOP before adoption, it's worth asking – “what are the key messages that should be emerging from the plan?” and “are these messages being consistently conveyed by the detail in each part of the contents?” This means taking a top-down view of the LTCCP. In particular, it's important to be clear about the key messages as you come to identify the major matters in your LTCCP summary. Your summary should be a fair reflection of the major matters in the plan, and should provide a synopsis of the collective effects of the proposals about services, and how these proposals are being managed in the prudent

financing of the Council. The SOLGM Good Practice Guidance for the Preparation of Summaries continues to be a useful resource, providing both guiding principles and suggestions for presentation.

3 Capital expenditure and planning intentions in the out-years

A trend in previous LTCCPs and long-term financial strategies that has tended to generate questions, has been the tendency for capital expenditure to fall away markedly in the last few years of the financial forecasts, with large surpluses and debt reductions forecast in these years. Such trends, on the basis of experience, have appeared unlikely; causing doubt about the robustness of the plan and whether they represent estimates that are based on best information. In extreme cases, such financial trends could create community concerns about over-rating, and, for us in auditing the plan, raise questions about the balanced budget and financial prudence.

In the past, it has been unclear whether reducing capital expenditure /increasing surplus trends have been a result of poor asset management information that has not allowed longer-term asset capacity and growth needs to be forecast, or because the Council had other spending intentions that were not included in the plan.

We hope that, as a result of the effort Councils have been putting into asset management plans, declining capital expenditure and large surpluses in out-years will not be a result of poor asset information. However, this does not mean that such a trend will not or should not occur in any specific instance. Generally, such surpluses are likely to be a result of factors such as:

- large capital expenditure requirements coming online just outside the 10-year horizon of the plan, with Councils smoothing rates' burden effects in the run-up years;
- Councils being conscious that capital expenditure is likely to be required but the work is subject to complex decision-making and legal requirements, negotiations with other parties, and a range of options including doubt over whether a decision will proceed at all. As a result, a Council may not be able to identify the most probable outcome for the purpose of the LTCCP – but may choose to maintain rating levels in order to begin making provision for work and to smooth the effect of possible rates changes;
or
- genuine intentions to decrease debt as a capital-expenditure -intensive period tails off in order to generate a more favourable financing situation.

In any of these instances, we suggest that Councils set out the story behind the financial trend that the LTCCP reflects so that communities can understand and have confidence in the information being presented.

4 Inflation and presentation of information

In Newsletter 8, we set out our views, and the reasons for these views, on the appropriateness of preparing LTCCPs that are based on reasonable estimates and therefore include the effect of change from factors such as growth and price change. However, we know that many Councils will want to provide additional information that may not, for example, include inflation, and think it can be helpful in some circumstances for such information to be made available. In particular, such additional information might be useful in discussing specific proposals, so that, by eliminating the effect of inflation, the specific change factor driving the need for a decision or change can be highlighted.

Where Councils wish to present a mix of inflation and non-inflation adjusted information, the following is important:

- the primary financial statements and the revenue and expenditure information within Groups of Activities should be inflation-adjusted consistent with the key assumptions;
- any non-inflated information should be clearly labelled as being so – that is, as supplementary information;
- all discussions in the document should be on the inflated numbers with non-inflated information provided as supplementary where considered beneficial.