Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

19 FEBRUARY 2013

Meeting Status: **Public**

Purpose of Report: For Information

AUDITOR GENERAL'S REPORT TO PARLIAMENT ON LONG TERM PLANS

PURPOSE OF REPORT

1 To report to the Audit and Risk Subcommittee on the Auditor General Report to Parliament on matters arising from the 2012-22 Long Term Plans.

SIGNIFICANCE OF DECISION

2 The Council's significance policy is not triggered by the report.

BACKGROUND

3 The Auditor General reports to Parliament on its various audit processes each year and has presented a report on matters arising from the 2012-22 local authorities' long term plans attached as Appendix 1.

4 The purpose of the report to Parliament as stated in the report was to *(page 6 clause 1.1):*

- *"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)".*

CONSIDERATIONS

Issues

5 This report will cover the main features and summary of key findings as quoted by the Auditor General which is followed by Council management commentary on how the Kāpiti Coast District Council considers it is addressing those findings where relevant.

6 Also within the detail of the report, Kāpiti Coast District Council is mentioned on three occasions along with other Councils with similar growth profiles. The background behind the identification of Kāpiti Coast District Council is also explained in this report.

7 Key Issues and summary of findings as quoted by the Auditor General in the report are as follows *(page 9 clause 1.6 – 1.7):*

i) "Local authorities have a wide range of circumstances and requirements and each local situation has its own demands.

ii) *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.*

Summary of key findings

<u>The new requirement to publish financial strategies was helpful (page 10, clause 1.8)</u>

iii) *Helping generate the "right debate" 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.*

iv) *(clause 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."*

(a) This Council received good feedback from Audit on our Financial Strategy. Our Council is the only Council that has prepared a 20 year Long Term Plan and shows the long term impacts of Council's new capital and asset renewal programme over a 20 year period. Also shown are the impacts of council's aggressive debt repayment programme from year 5 which reduces our total debt from peaking at $196 million in year 12 and reducing to $77 million at year 20.

(b) When the debt peaks in year 12 at $196 million, the projected debt/equity ratio is $12.6% which is well within the 20% debt/equity limit.

<u>"Local authorities generally are preparing financially prudent LTPs (clause 1.12 to 1.14)</u>

v) *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.*

vi) *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 the LTPs."*

(a) Kapiti Coast District Council's rates are projected to increase by an average of 4.9% over the 20 year period.

vii) *"In the last two years, local authorities have been good at budgeting for their operations expenditure, but overestimated their likely levels of capital expenditure.*

viii) *(clause 1.17 to 1.18) 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.*

ix) *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."*

(a) The Kāpiti Coast District Council does have a large increase in debt levels in the first 10 years which peaks in year 12 (2023/24) at $196 million. At that point Council's debt/equity ratio is 12.6% which is well within the 20% limit for debt/equity, as set its Treasury Management Policy.

(b) Council's net debt to operating income ratio is well within the industry standard set by the Local Government Funding Agency of 250%. Also this Council excludes vested assets and development contributions from the total operating income used in this calculation in line with credit rating agency standard practice.

(c) This Council has been very conservative in its projected levels of growth and also the level of development contributions it has budgeted to receive. Generally these budgets have been set at the lower end compared to trends in prior years and they are only forecast to increase on a very gradual basis as growth returns slowly in the economy.

(d) With Council's aggressive debt repayment programme from year 5 the peak debt of $196 million reduces to $77 million at the end of 20 years. This increased debt repayment programme can be funded while still holding rates increases at an average of 4.9% over the 20 year period (1.6% above the Local Government inflation of 3.3% on average).

x) *(clause 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."*

(a) The Kāpiti Coast District Council had a clear Audit opinion for the 2012 LTP.

xi) *(clause 1.31) "The processes that local authorities used to consult on their LTP were, by and large, suitable."*

8 The Auditor General's Report specifically mentions Kāpiti Coast District Council on three occasions. Council's management commentary is provided in the background and explanations as appropriate.

<u>Analysis of the Financial Data - Comparison of actual to budgeted net cashflows from operations.</u>

9 The Office of the Auditor General (OAG) compared the actual net cashflow from operations for the 2009/10 and 2010/11 year with the budgeted net cashflows as per the 2009 LTCCP) from operations.

10 The 2010/11 year was year two of the 2009 LTCCP and circumstances had changed over that period. The OAG quote *(page 58, clauses 4.35 – 4.37)*:

"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.

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.

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."

11 The KCDC Net Operating Cash flows were in excess of budget for both 2009/10 and 2010/11. The net cash surplus only shows the cash surplus as at 30 June each year and does not include the expenditure accruals invoices for work completed by 30 June but not paid until July.

12 It is difficult to understand why the OAG has analysed the cash position as at 30 June rather than the accrual because the accrual position reflects what expenditure is being committed and actioned up until 30 June and revenues that needed to be recognised in the period up to 30 June each year. The cash position just tells you the cash situation as at one date, 30 June it does not tell you what the financial position of councils are in terms of the actual end of the financial year which must include accruals.

13 Nevertheless the reason for the excess cash flow compared to budget in 2009/10 related to unbudgeted revenue associated with the old Western Link expressway of $1.7m received from NZTA. These funds related to investigation works associated with the 'best' route through the district.

14 The reason for the excess cash flow compared to the budget in 2010/11 related to a higher level of accruals which are unpaid invoices that relate to 2010/11 period. This has the effect of increasing the Net Operating Cash flow because we have not released the cash to the relevant suppliers. This is a timing issue.

15 Discussions will be held with the OAG as to why they are undertaking financial analysis on a cash basis rather than an accrual basis.

16 Debt Increases *(page 30, clause 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 Kāpiti Coast District Council, Queenstown-Lakes District Council and Tasman District Council."

17 The Kāpiti Coast District Council is grouped with other higher growth local authorities who are facing higher gross debt increases over the period 2012/13 to 2021/22 due to the impact of growth.

Non-Financial Issues

18 The Audit Office commented on incorporating a long-term view. They said *(page 10, clause 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."*

19 This Council has considered a longer-term view and this was incorporated by producing a 20-year LTP.

20 The Audit Office also commented on the length of LTPs *(page 96, clause 6.31)*:

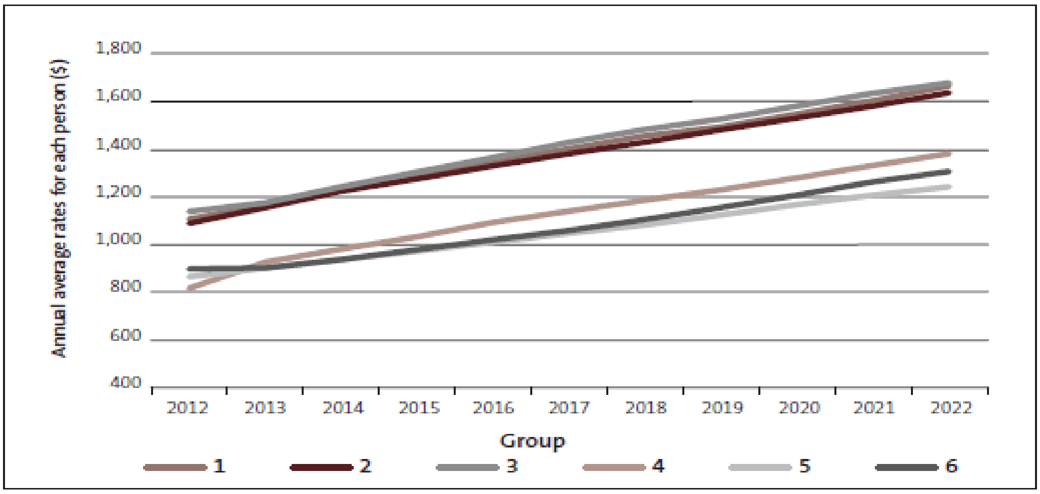
> *"Not all local authorities took advantage of the TAFM changes that allowed them to produce shorter LTPs. Some local authorities kept the full policies in the LTP because they were consulting on changes to them or were integral to a consultation issue in the LTP. For others, it was not clear why local 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."*

21 This Council kept the full policies in the LTP. The primary reasons were: the updated polices required consultation; the inclusion of policies was in keeping with the principle of absolute transparency; and it enabled easy access to all relevant information (without relying on internet access). In addition restructuring the LTP into three parts produced a more focused document with clear access to information.

22 This Council is grouped with other higher growth Councils which are projecting to have higher rates due to the impact of growth on the provision of additional infrastructure.

Further comment by OAG *(page 84-85, clauses 5.97-5.98)*

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



24 *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.

25 *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."*

26 Using debt to total revenue to assess the prudence of local authority debt *(page 33, clauses 2.91- 2.95)*
"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.

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]

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.

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.

We acknowledge that many local authorities nevertheless use this measure because it is employed or required by credit rating agencies, including LGFA."

27 The Kāpiti Coast District Council in its calculation of net debt to total operating revenue excludes vested assets and development contributions from the total operating revenue. This is because the credit rating agencies also do not include these when they assess Councils for credit rating. If other Councils are including non-cash assets and revenue that could not be used to repay debt then they are understating their net debt to operating revenue ratios.

Financial Considerations

28 The financial considerations are covered in this report.

Legal Considerations

29 There are no legal issues.

Delegation

30 The Audit and Risk Subcommittee may make a decision under the following delegation in the Governance Structure, Section C.4.6:

Without limiting the generality of this delegation the Subcommittee has the following functions, duties and powers:
Internal Reporting
6.4 To review the processes for ensuring the completeness and quality of financial and operational information, including performance measures, being provided to Council.

Consultations

31 There is no need to consult on the issues raised.

Policy Implications

32 There are no policy implications to be considered.

Tāngata Whenua Considerations

33 There are no issues for consideration relating to iwi.

Publicity Considerations

34 There are no publicity issues to be considered at this stage.

RECOMMENDATIONS

35 That the Audit and Risk Subcommittee note the matters raised in the Office of the Auditor General Parliamentary Report on the ‘Matters arising from the 2012-22 local authorities long term plans’.

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Appendix 1 – Office of the Auditor General Parliamentary Report on ‘Matters arising from the 2012-22 local authority long-term plans’.