

Auditing The Future: Project Update #7

April 2005



Office of the
Auditor-General

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 word from Kevin Brady, Controller and Auditor-General

In this newsletter, we provide 2 key components of our approach to the LTCCP audit:

- The self-assessment that we are asking all Councils to complete, to assist us with understanding and considering the governance, decision-making, consultation, and performance management frameworks underlying the preparation of the LTCCP. We are asking you to prepare the self-assessment and return it to your Auditor by **15 July 2005**.
- Our expectations of the key controls applied in the preparation of the LTCCP. Your auditor will review these key controls later this year. Ahead of our more detailed review later in the year, we will provide Councils with feedback during May/June - to help with preparation for our LTCCP audit, and reduce possible costs and audit opinion issues.

These 2 components will allow us to understand the approach of Councils to both the top-down framework and bottom-up compilation of the information forming the LTCCP. The documents are available on our website, and will also be sent to each Council's Chief Executive. Your Auditor will be happy to discuss with you any aspect of these 2 components of our LTCCP audit.

As we move into a more intense phase in the development of 2006 LTCCPs, I want to assure you that, because of my interest in local government, which spans more than 30 years, I appreciate the importance of Auditors providing timely and useful advice to Councils. We all know that the upcoming months will not be without challenges - for your teams and for mine - as we embark on this work.

While the times ahead may test the very good relationships that exist between the local government sector and my Office, we must all continue to work co-operatively, and remembering, when we do face challenges, that we are all ultimately serving the same communities. Therefore, my highest priority is to add value by working with Councils as they prepare well-developed LTCCPs that communities can be confident about.

- Kevin Brady

Key items in this newsletter

- We discuss our preferred approach to prudent financial management and the balanced budget test;
- We release our LTCCP information video;
- We outline SOLGM work on best estimates as they relate to LTCCP assumptions;
- We ask you to prepare your Council's self-assessment by 15 July 2005;
- We outline our expectations of key controls relating to the preparation of the LTCCP.

Key milestones to look out for

18 April - 2 May, SOLGM will run a seminar series on preparing LTCCPs, during which we will outline in more depth our approach to the audit.

From May, Appointed Auditors will contact Councils to finalise arrangements for their LTCCP audit.

From May, Appointed Auditors will review LTCCP preparation control systems at a high level and discuss any issues, or potential for improvements, with Councils.

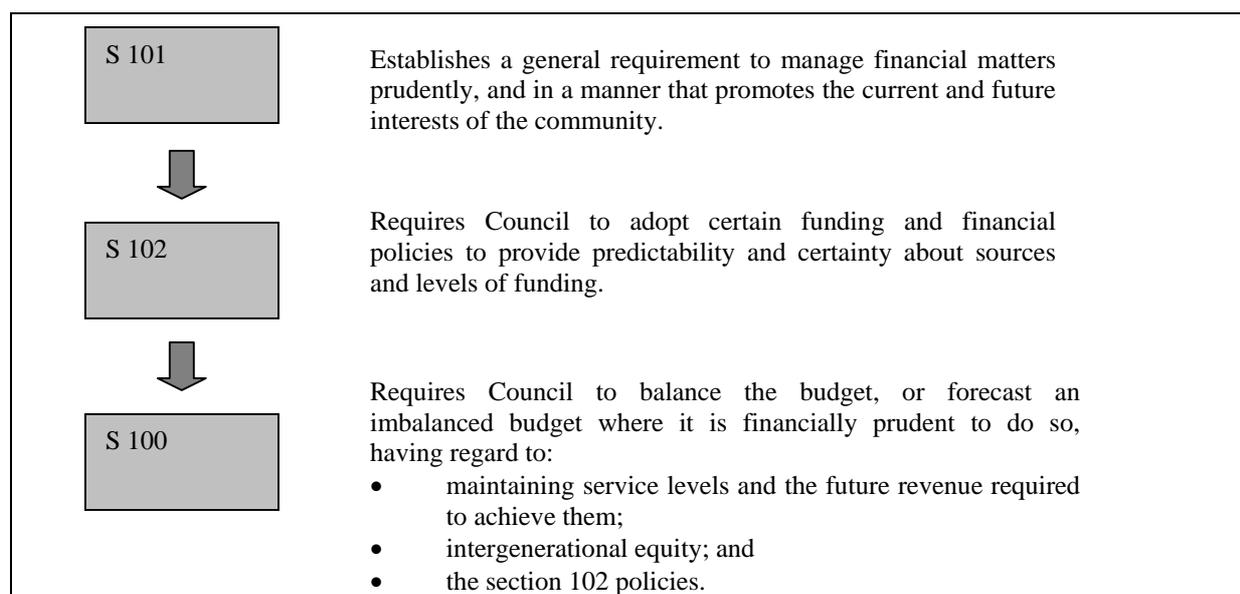
15 July - Councils' completed self-assessments to be forwarded to Auditors.

Balanced budget and prudent financial management

At previous forums, such as SOLGM seminars, we have discussed the changed basis of the balanced budget test under section 100 of the Local Government Act 2002 (the Act) and the greater emphasis on judgement and prudent financial management underlying this change.

We consider that the Act's reframed balanced budget test provides a conceptually better approach that operates in the wider context of a Council's broader environment, its intended services, and its financial operations. However, we have been conscious that the balanced budget test relies on greater judgement by Councils, and, as a result, there is a greater need for Auditors to understand that context and the judgements made by Councils.

The basic hierarchy of the balanced budget requirements of the Act can be viewed as:



We prefer to take a "whole of Council" view to the balanced budget test for each year of the LTCCP, which we feel best reflects the provisions of the Act. For us to be able to do this, Councils will need to be confident that 3 underlying items are in place:

- service levels, performance measures and targets, and financial estimates that are best estimates;
- a robust set of policies that provide an effective framework for the management of the Council's financing activities, and for giving effect to the indicators of financial prudence set out in section 101 of the Act; and

- coherent information in LTCCP groups of activity information about the revenue and expenses for each group of activities that can be reconciled to the Council's financial estimates.

We plan to consult further with SOLGM and our External Reference Group for the LTCCP project about our proposed approach.

LTCCP information video - "How do we know?"

Your Auditor will soon be providing your Council with an LTCCP information video, which has recently been prepared for our Office. We have been fortunate to have the assistance of Vidmark in preparing this video. As you may know, Vidmark produced the recent National Asset Management Steering Group (NAMS) video. The purpose of our video is to assist key Council staff involved in preparing the LTCCP, and our Auditors, to communicate the role of the LTCCP and the audit to Councillors, Council staff, and community groups, or other interested residents and ratepayers. The video asks the question "How do we know?" to discuss the planning platform that the LTCCP provides for a Council, and the reassurance provided on this platform by the audit process. We hope you will find our video as easy and helpful to view as other similar productions for the sector.

Best estimates and assumptions

Many of you will know that there has been debate at the SOLGM Financial Management Working Party about the place of assumptions in ensuring that LTCCP information is based on best estimates. Most of this debate relates to how robust information is developed and applied to address external factors that affect a Council's estimates, such as population change and inflation. We are all aware (particularly at present) of the impact factors, such as rising construction and maintenance costs, can have on a Council's rates' line. We expect that each Council's LTCCP will signal the effect of such pressures on the Council and its community, in order to support choices about future activities and service levels. However, we are also aware that generating and applying such information can be difficult in practice.

SOLGM is leading work to:

- identify options to secure, for the sector generally, information for forecasting growth and price change assumptions with a view to preparing information that would be available for use by all Councils. We expect that Councils will find such general information useful and will look to see if Councils have chosen to use the data provided by SOLGM or have applied their own more locally relevant data where such data is available; and
- identify options to resolve issues about the application and presentation of forecast growth and price change assumptions within the context of Councils presenting best estimates.

We understand that there will be an opportunity to discuss the practical implications at the LTCCP Jigsaw Seminars later this month.

Our view is that best estimates are required to be applied in preparing an LTCCP - both by the Act and through the requirements of generally accepted accounting practice - and that assuming no reflection of price changes during the 10 years of the LTCCP is unlikely to meet the test of a best estimate. We are working with SOLGM to help us understand the constraints applying to forecasting information and the application and presentation issues.

We would also be interested in hearing from any Council that currently does or intends to build inflation into financial estimates in their LTCCP, to help us work through and understand specific application and presentation issues.

Self-assessment

The self-assessment is one of the key components of the standard modules in our methodology that we are asking you to help us complete early. A copy of the self-assessment is available on our website at www.oag.govt.nz. The self-assessment asks you to answer the following key questions:

- *How good is your Council at getting input from residents and users of services, and integrating that input into decision-making?* Our purpose is to assess the extent to which consultation with interested and affected people and organisations is inclusive and effective, including assessing:
 - how the Council identifies stakeholders that may be interested in or affected by decisions, so that consultation is inclusive;
 - whether the Council has a policy for consultation, and how the Council decides in each instance whether or not to consult;
 - how the Council provides relevant information to assist the public to meaningfully participate in decisions that the Council has assessed as having a high degree of significance;
 - how the Council ensures that communities understand the reasons why a particular decision was made;
 - how the Council evaluates the accessibility and effectiveness of the various consultations and methods it uses; and
 - the processes the Council uses to meet its obligations to seek the views of M ori in consultation.
- *Does the Council understand the needs and aspirations of its district, and what it and other stakeholders can achieve?* Our purpose is to help assess the extent to which the outcomes process provides a sound basis for Council decisions about its role and activities, including assessing:
 - the role the Council played in facilitating the development of community outcomes with communities and other stakeholders;
 - how the Council communicated with stakeholders about the outcomes purpose, process, and the roles of the various parties involved in the process;
 - how the Council interpreted and reconciled the community outcomes with its own views, and existing policies or strategies on key long-term sustainability and wellbeing issues; and
 - how the proposed monitoring arrangements provide a good approach for measuring progress toward community outcomes.
- *Do elected members and staff understand their respective roles and share a common purpose of achieving the intentions set out in the LTCCP?* Our purpose is to assess the extent to which constructive relationships exist between the elected and administrative arms of the Council in the development of the LTCCP, including:
 - how the Council ensures that members and officers are clear about their respective roles and responsibilities in the development of the LTCCP; and
 - how the community outcomes and other Council objectives have been communicated to staff?
- *Is there clarity about which things are and are not the Council's priorities, and how does the Council assess whether its activities are achieving their objectives?* Our purpose is to assess the extent to which the LTCCP is based on and reflects the community outcomes or other priorities of the Council, and is clear about how the Council activities achieve their objectives, including:

For more details contact your Appointed Auditor or Ann Webster at the Office of the Auditor-General, Wellington (04) 917-1517 or see our website: www.oag.govt.nz

- how the Council ensures it understands and has a realistic approach to the rationale for its activities, and how these deliver value to the community and promote long-term well-being; and
- how confident the Council feels about the robustness of the internal plans and strategies, underlying the LTCCP, and its processes for drawing these into the LTCCP.
- *Does the Council have good information to help it make decisions?* Our purpose is to assess the extent to which the Council has embedded relevant principles of the Act into its decision-making processes, including:
 - how the Council ensures it has robust systems for understanding and assessing the effect of decisions; and
 - how the Council makes decisions about service levels.
- *How well do the Council's actions, decisions, and practices connect intentions to results, so the Council knows whether its activities are achieving their objectives?* Our purpose is to establish that service levels and performance management systems are meaningful, relevant, reliable, and complete and will allow the Council to effectively monitor the performance and effect of its activities, including:
 - how the Council determines and organises its groups of activities and services to allow it to understand and monitor the effects of services on outcomes and well-being;
 - how the Council, through systems and controls, enhances the likelihood that its activity objectives and targets will be achieved, and enables members and managers to understand the reasons for performance variations against targets, so the Council sustains its focus on ensuring the desired effect is achieved;
 - whether the Council continually reviews progress against priorities to ensure that it is aware of where it has not achieved its contribution to desired outcomes, or where priorities have changed, and where the Council reviews plans in the light of this information;
 - how the Council assesses the effectiveness of its activities and methods of service delivery to maximise its contribution to sustainable well-being and community outcomes, including through collaboration with the private, voluntary, and community sectors; and
 - whether the Council's performance monitoring focuses on priorities and cascades down from outcomes to the services and performance targets.

Your Auditor will review your self-assessment and discuss it with you, to help him or her understand the processes used in developing the LTCCP, in performing other standard audit modules, and in identifying any risks that may warrant further enquiries.

You should involve whomever you think appropriate in completing the self-assessment. Indeed, we consider it unlikely that one member of staff will be in a position to respond to all the questions. We ask that one person be responsible for co-ordinating the response, and that the Chief Executive and the Chair of a relevant Council Committee (such as the LTCCP Co-ordinating Committee, the Audit Committee, or the Finance and Planning Committee) review it before it is sent to your Appointed Auditor.

The information will also be reviewed by a central group convened by us comprising both audit and sector representatives, to:

- identify good practice approaches within the local government sector, taking size, scale, and environment of Council into account; and
- locate each Council as it stands in relation to sector good practice.

Systems and controls for LTCCP preparation

Our checklist for Auditors on the identification of key systems and controls in the preparation of the LTCCP is on our website. The checklist covers:

- key characteristics of a good overall control environment for the planning systems and processes applied in LTCCP preparation;
- high-level processes and controls that should be implemented over the financial modelling system; and
- potential risks and issues with less-integrated IT applications such as spreadsheets.

Areas that the checklist covers include:

- *Project Management Process:* How the Council ensures that there is clear accountability for the integrity of the information, and for meeting deadlines.
- *Legislative Compliance:* The procedures that the Council has in place to ensure that both the contents of the LTCCP and the decision-making process comply with the requirements of the Act, and to ensure that good project management underlies the various stages of consultation and decision-making.
- *Development of Key Policies:* The Council's key funding and financing policies and strategies established to achieve the objectives of these policies, and the controls that the Council has in place to ensure that the content of each policy meets the requirements of the Act, and that the policies are consistently and accurately applied.
- *Establishment of Service Levels:* The controls in place to ensure that intended service levels are linked to the rationale for the activity, and are supported, where appropriate, by Asset Management Plans.
- *Development of Asset Management Plans and Work Programmes:* The controls in place to ensure the Asset Management Plans are aligned with the Council's overall objectives and strategic approach.
- *Asset Management Plan Systems Controls:* The controls in place to ensure the integrity of the Asset Management Plan data/information.
- *Development of Operating Divisions Business Plans and Budgets:* The controls in place to ensure that each operating division's business plan and budget align with the statutory policies and plans of the Council, and that the budgeting process is robust.
- *Performance Monitoring and Reporting:* The controls in place to ensure the performance measures are effective, measured, and monitored.
- *Assumptions:* The controls in place to ensure that assumptions are applied consistently, accurately, and completely to all relevant data.
- *Systems Documentation:* The procedures in place to provide clear guidance to system users.
- *Systems Controls:* On key systems used to generate LTCCP estimates such as access, input, change, and version controls, integrity checks, and back-up procedures.

Your Auditor will review the effectiveness of these key controls later this year as part of our LTCCP audit. However, ahead of our more detailed review, we will review these controls at a high level and provide feedback to Councils during May/June, to help with preparation for our LTCCP audit, and reduce possible costs and audit opinion issues.