SOLGM

Local government funding and financing

The Society of Local Government Managers' submission regarding the Draft Productivity Commission Report, *Local Government Funding and Finance*

August 2019

leadinglearninglinking

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4. That the Commission recommend that the value of building work put in place be used as the allocation mechanism for such a fund. Stability and certainty should be promoted by using three to five year rolling averages.
5. That the Commission clarify whether its intent is that all territorial authorities receive a portion of this fund, or that funding would be by application.

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Recommendation: Rating powers

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9. That the Commission amend its recommendation 6.1 to invite SOLGM to develop guidance on the setting of development contributions in consultation with the Department of Internal Affairs and representatives from the development industry.

10. That the Commission note the four recommendations around development contributions in the SOLGM response to the issues paper and:
    - agree that the Crown should pay development contributions on all developments it undertakes.
    - agree that local authorities be able to recover development contributions assessed for community infrastructure on land that is not owned or controlled by the local authority.

11. That the Commission amend its report to include a recommendation supporting the restoration of financial contributions under the Resource Management Act.

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20. That the Commission recommend that local authorities be legally required to prepare asset management plans, with the content of an asset management plans being specified in regulations rather than legislation.
21. That the Commission recommend that sector organisations prioritise the development or redevelopment of resources in asset management concepts for elected members, and enhanced guidance on prioritising investment in asset condition and performance information.
22. That the Commission recommend that sector organisations develop a robust, scalable and user-friendly methodology or methodologies for capital business cases.
23. That the Commission not accord proposals to introduce a capital charge further priority.

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24. That the Commission abandon work on changing the frequency of long-term plans to five years.
25. That the Commission note SOLGM's recommendations to the 2012 Efficiency Taskforce regarding the content of LTPs.

Recommendations: Performance reporting

26. That the Commission recommend that the current set of mandatory measures of non-financial performance be repealed.
27. That the Commission note SOLGM is currently redeveloping its guidance on the setting of levels of service, performance measures and targets.
28. That the Commission recommend the complete repeal of the Local Government Financial Reporting and Prudence Regulations 2014.

Recommendations: The future role of audit

29. That the audit mandate for consultation documents and long-term plans be simplified by removing the requirement for the auditor to attest to the documents 'fitness for purpose'.

30. That the requirements for consultation documents be amended to require local authority's presentation of major matters to disclose only the reasonably practicable principal options as determined by the local authority on reasonable grounds.

Recommendations: Audit and risk committees

31. That the importance of the risk and assurance function be incorporated into the principles set out in *section 14* of the *Local Government Act 2002*.

32. That Equip be encouraged to enhance its offerings around risk and assurance for local government (especially elected members).

Recommendations: Hardship

33. That the Commission recommend that LGNZ and SOLGM develop a national template of a rates postponement policy for extreme hardship.

INTRODUCTION

The Society of Local Government Managers (SOLGM) thanks the Productivity Commission (the Commission) for the opportunity to comment on its *Draft Report into Local Government Funding and Financing*.

SOLGM provided the Commission with a substantive response to its issues papers and has held discussions with the Commission (or its agents) on matters such as cost drivers, training and guidance for staff and elected members and the planning requirements. We've also assisted the Commission by providing it with temporary access to our kit of tools and resources and running an online survey on the prevalence of audit and risk committees.

We generally agree with much of what the Commission has said although we have a number of questions of a second order nature. We see no need to respond to the recommendations and questions in a point by point manner. We have confined ourselves to those matters where:

- we disagree with what the Commission has said or
- we consider that the Commission could usefully amplify what it has said or
- we have further information or comments to offer (in some cases this is an expansion on matters from the original SOLGM response).

Unless we expressly comment otherwise the Commission should assume that:

1. we agree with the recommendations that the Commission has made and
2. the recommendations that we made in our response to the issues paper stand unmodified (i.e. this submission should be read in conjunction with the earlier response). However, we want to further note our disappointment that the Government expressly excluded non-rateability from the terms of reference for the inquiry, and renew our recommendations from our earlier response that the be removed in toto.

We have followed a similar structure to that we followed in our response to the issues paper. Part One of this submission therefore responds to those recommendations and other matters relating to funding tools and sources. Part Two discusses other matters such as hardship, asset management, engagement and long-term plans.

PART ONE: FUNDING TOOLS AND SOURCES

In this part of the submission we consider the findings and recommendations that the Commission has made with respect to current funding tools and sources. We start with the two areas where the Commission has specifically asked for views:

- taxation of vacant land and
- payments based on the value of building work put in place.

We also consider the following additional topics:

- funding policy (we include this in Part One because funding policy is strongly linked to tool selection)
- rating tools
- development contributions and financial contributions
- other tools for funding growth
- climate change fund.

Taxation of vacant land

SOLGM notes that the Minister of Finance had asked the Commission to consider the merits of a tax on vacant land, and in particular *"whether a tax on vacant land would be a useful mechanism to improve the supply of available housing for New Zealanders"*. It seems that the Minister viewed this more as a means of improving the supply of land than as a funding or financing tool for local government.

The theory underpinning a tax of this nature is relatively simple. Decisions to develop land are made on the basis of the expected return from developing the land, as opposed to the ongoing costs of holding vacant land. If the cost of holding vacant land increases that provides more of a spur to develop.

We note the Tax Working Group considered taxation of vacant land as part of its recent inquiry. We note that the relatively few overseas jurisdictions that tax in this way tend to take definitions of vacant land that go wider than land that is undeveloped and extend this to housing that is a second home and/or unoccupied for a set portion of the year.

Undertaking property development, especially at the scale needed to have a significant effect on housing supply is a significant cost. This suggests that any tax on vacant land would have to be set at a substantial rate to provide any real incentive to develop. For example, we are aware that local councils in the UK have the power to levy a surcharge on vacant land of up to 100 percent of the normal rate of council tax (i.e. the owners of vacant land could be assessed up to twice the level of council tax). Similarly, Vacant Dwelling Tax in France can be set as a surcharge of 60 percent in Paris, and between 5 and 60 percent elsewhere in France.

A Working Paper prepared for the Tax Working Group highlighted a number of implementation issues with such a tax including a demonstration of the complexity of some of the rules that apply in overseas jurisdictions. For example, would a 'second home' brought in expectation of retirement in the medium-term be regarded as vacant in the short-term? Would an investment property that is being used a rental and is vacant for three months be seen as vacant etc? New Zealand taxes tend to be relatively efficient because they are designed with the intent of having few exemptions – yet something as emotive as property will test the intent of policy-makers.

That same Tax Working Group paper commented that:

"Vacant dwelling taxes have been introduced in a small number of countries and cities. It appears it is early days for these taxes and there is very little evidence to determine if the tax is increasing the supply of housing."[1]

There are many factors that influence the supply of housing. While we do not doubt that tax policy is an influencing factor, we suspect that allowing a tax on vacant land is likely to have an influence only where there is significant land banking and where the tax is set at a punitively high rate. Any impact is likely to be at the margin – where people with more than one home rationalise their holdings of property in response to the tax.

The officials supporting the Tax Working Group recommended that the Government should monitor overseas experience for evidence of the effectiveness of these taxes. We agree.

We note that the Tax Working Group asked the Department of Internal Affairs whether a local authority could impose a differential on vacant land under current legislation. We are also aware of a local authority that has looked at such an option as a deterrent to land banking.

Leaving aside the lack of 'fit' with other recommendations the Commission makes, we concur that vacant land could be regarded as a use of the property for the purposes of *schedule 2* of the *Rating Act*. We also understand that undeveloped land could be identified from information on rating information databases – either as land where the improved and unimproved value are the same, or through vacant property use codes. This does not identify unoccupied residential homes.

Under present legislation local authorities are obliged to rate on the factors and matters that apply to a rating unit on 1 July (i.e. the roll is frozen at 1 July). Only those properties vacant at 30 June would be liable for the tax under present law.[2] We concur with the Department that the administrative difficulties in identifying vacant properties at 30 June, and the degree to which this could be 'gamed', make the transactions cost prohibitive.

We suspect that councils would also struggle to justify differential rates at the level necessary to provide incentives to develop under the *Local Government Act*. It would take some heroic assumptions under *s101(3)(1)(b)* -the well-being clause to be able to justify this.

Recommendations: Taxation of vacant land

4. That the Commission agree that the Government should monitor overseas experience for evidence of the effectiveness of taxation of vacant land.
5. That the Commission note SOLGM's conclusion that local authorities could theoretically set a differential rate on vacant land, but that such an approach would face significant administrative and legal issues.

1 Inland Revenue and Treasury (2018), *Taxing Vacant Property – Position Paper for Session 23 of the Tax Working Group*, page 22.
2 Ironically, it may have been easier to use rating legislation as a tool for targeting vacant land under the preceding *Rating Powers Act 1988* which did allow for change in factors and matters during a year and allow for apportionment of liability on a time basis.

Payments based on building work put in place

The Commission has asked:

What would be the advantages and disadvantages of a system of payments to territorial authorities based on new buildings work put in place in each territorial authority? What would be the best design for such a mechanism? Would it be effective in incentivising councils to keep the supply of consented land and local infrastructure responsive to growth pressures?

SOLGM supports the establishment of such a fund 'in principle' but notes there are a great many first and second order questions that have been dismissed with the phrase "these are policy choices for government". The Commission is right to describe the proposal to provide local authorities with some additional funding based on the level of building activity as novel (we use the term Growth Fund as a shorthand). We have been unable to find any similar scheme elsewhere in the world. Schemes to incentivise growth related infrastructure usually involve the sharing of a portion of income, sales or consumption tax revenues.

Probably the highest order question about such a scheme would be "where's the funding for this coming from?". We doubt that a levy on the building sector would be acceptable for several reasons. First, there is the equity or inequity of one being made to contribute for services others benefit from. Second, and more topically, such a levy would directly contradict the Government's housing affordability objectives. Third, such a levy would discourage compliance with the Building Act by avoidance of consents, taking compliance 'shortcuts' and so on. Although the Commission does not say so directly it appears that the revenue source for the Growth Fund will be from the Government's general revenues.

The Commission suggests that "relatively modest payments could have quite strong incentive effects". We respond – that depends both on the level of such a fund and the means for distribution. In a fund that relies on the level of development as the allocation mechanism – the higher the level of development the stronger the incentive for the high-growth and the weaker the incentives for the low-growth. Our read of the current statistics suggests slightly more than half the fund would be allocated to two councils if value alone is the allocation mechanism.[3] On the other hand some of smaller councils might receive little or even no funding at all. We add that this Fund will recognise any growth after it has taken place, when the growth supporting infrastructure will be provided before the growth takes place.

It appears the Commission envisages the fund would be distributed to all territorial authorities "as of right". This would be a departure from other Government initiatives to support the production of growth-related infrastructure – which have required applications.[4] We are also uncertain how this would sit alongside our public finance legislation.

We also note that this does not sit well with the intent that the fund support investment in growth infrastructure. Smaller local authorities or local authorities with static or declining populations may have limited need to make such an investment – their levels of demand being well within capacity. If the intent is that all territorial authorities receive a portion of the Growth Fund, then it may be better to view this as a 'top-up' for an existing fund such as that which NZTA distributes for road maintenance. If the intent is to specifically support growth and housing then applications may be the way to go.

We consider that the value of building work put in place to be the best available measure. It is based on already collected official statistics for which there appears to be a robust and defendable methodology (the information is supplied by the consenting authorities from the

3 The latest available statistics (the year ended March 2019) show that the value of building work in place for the Auckland area was some $9.7 billion, and for Canterbury it was some $3.7 billion (most of the latter would be in Christchurch City). With the national total of approximately $23.6 billon it appears Auckland Council and Christchurch City Council would be allocated just over half the fund.

4 Experience from the Housing Infrastructure Fund also tells us that an application process too 'administration heavy' discourages applications, especially if the fund is in fact a loan.

building consents themselves). At present there are only official series for each of Auckland, Waikato, Wellington, other North Island, Canterbury and other South Island. As far as we are aware all consenting authorities participate in this collection, maintenance of data to territorial authority level should not require extensive redevelopment of methodologies. We are not aware of any other current collection of data.

The official statistics include all residential, commercial, industrial and infrastructural developments. It seems appropriate that allocation of any Growth Fund include these developments – commercial and industrial developments require network infrastructure to function as well. But these developments and even Milldale sized residential developments can mean marked shifts in the value of building work put in place from year to year. It may be prudent to base the level of funding on a moving average of the value over the medium term (three-five years) to provide some degree of stability in funding.

Recommendations: Funding by value of building work put in place

6. That the Commission note SOLGM's support for a central government administered fund based on the value of building work put in place.
4. That the Commission recommend that the value of building work put in place be used as the allocation mechanism for such a fund. Stability and certainty should be promoted by using three to five year rolling averages.
5. That the Commission clarify whether its intent is that all territorial authorities receive a portion of this fund, or that fund would be by application.

Funding policy

The Commission considers the present set of legislation *"provides only weak support for allocating rates primarily according to who benefits from council services"* and comments that funding decisions be made first on an objective assessment of benefits and efficiency and second on an assessment of ability to pay.

Our involvement in the development of 1996 and 2002 amendments that first created and then amended what we know as the revenue and financing policy leaves us with a unique perspective on Parliament's intention. The Minister of Local Government at the time of the most recent amendments certainly considered that the preceding legislation gave too strong a focus to 'user pays', so we would concur the legislation was intended to weaken the incentives to a 'beneficiary pays' policy.

For all that, we work with revenue and financing policies a lot, and observe that the distribution of benefits across the community and over time are the two criteria that are universally applied (based on what we see documented in the policies). What is often not clear is what weighting is applied to these criteria vis-à-vis the others – which under the existing legislation is a perfectly valid policy decision (as long as all criteria have been demonstrably considered).[5]

5 The decision of Chisholm J in Neill Construction and Others vs North Shore City Council (2007) dealt with a challenge to the validity of the council's revenue and financing policy and the decision that development should meet 95 percent of the cost of a busway. The Court found that the council had considered the exacerbator pays criteria but could not demonstrate that it had considered the other beneficiaries of the service. The Court invalidated the part of the revenue and financing policy that dealt with the busway and the relevant parts of the development contributions policy.

Based on the way local authorities document their decisions, it is also not usually clear whether and how councils have applied the second step of the process (the well-being step). We suspect that it is this step that the Commission has described as 'local politics'. We see some benefit in more assistance for councils in documenting their policies clearly – be it statute and/or better guidance.

The Commission quite correctly recommends that councils continue to have powers to determine, on reasonable grounds, the appropriate allocation of rates within their district or region. Few services that local government provides are wholly public or private goods. For example, the operation of a regulatory function has elements of both. The regulated agent receives either the right to undertake some act / or certification that their action is undertaken safely that is a private benefit. At the same time the community as a whole benefits from that information being available or the protection provided.

The Commission cites evidence provided by Professor Claudia Scott in a judicial challenge to a rating decision in the mid-1990s. Professor Scott observed, quite correctly, that there is no uniform technical answer to determining what is a public or private good. To take the example she cited in full – a swimming pool in an area where there are a great deal of other leisure and recreational facilities available might easily be seen as providing a higher degree of private benefit, a swimming pool in an area with no other recreational facilities might have a value in keeping young people 'off the street' and then quite reasonably be assessed as having a higher degree of public good.

The Commission's own conclusions about the importance of scale and the ability to 'network price' for three waters provides another example. That is to say that while water has a strong element of private good – there's also a public health argument that suggests some national minimum standard is desirable. That is a public good argument.

There are two further concepts that emphasise the public good function of local authority provided infrastructure. Facilities have an option value and a bequest value. An option value exists when a ratepayer might value something they may never use, but gain value from having it available if needed. Examples might include the provision of a public transport network or a facility such as Wellington Stadium. A bequest value is something placed on a resource that today's community might not use but which is left for future generations – for example protection of the environment, historic heritage or some cultural facilities.

We noted several submitters have referred to the funding policy process as it applied in 1996 with something akin to fondness. That process, started with an application of the benefit principle, allowed for modifications on the grounds of fairness and equity, lawful policy objectives, and transition, and then linked to tool selection with consideration of transparency, practicability and efficiency. The thing is, that this process also included statutory recognition that the assessment of benefit was subjective and a matter for policy judgement.

In our earlier response to the Commission we recommended that explicit recognition of ability to pay be incorporated into the funding policy process. We understand that some local authorities, such as Kāpiti Coast District Council have provided an example of a council that incorporated consideration of affordability into their last rating review. These analyses need to draw on good local household incomes data.

In short, the Commission should take a more nuanced approach to its discussion of the benefit principle. It is never a mechanistic, 'paint by numbers' process.

One last comment on funding policy. The Commission's box 7.2 criticises the use of the tax status of business as a rationale for constructing a differential. We concur entirely with the Commission and have previously advised local authorities that:

"The validity of these arguments (the tax treatment of rates for businesses and their alleged ability to 'pass on' is well and truly open for debate, most local authorities have moved away from using these as justification for their policies. SOLGM Financial Management Working Party believes these arguments are an irrelevance. These arguments have not been tested in court since the introduction of the section 101(3) process in 2002. Local authorities are advised to engage robust legal and economic advice before attempting to construct a differential using these as arguments."[6]

Recommendations: Funding policy

6. That the Commission supplement its discussion of the benefit principle with the above discussion about the complexity of assessments of benefit and the mixed good nature of most infrastructure and services provided by local authorities.
7. That the Commission amend its recommendation 7.2 to include efficiency and transparency in the first step of any amended process.

Rating tools

The Commission has recommended the abolition of differentials and the uniform annual general charge.

It has noted previous research we undertook to respond to the Commission's recommendations along these lines showing these recommendations could create significant shifts in the incidence of rates.

In particular the incidence of rates will shift away from the business sector and low value residential property to the farming sector and higher value residential property. The exact shift will vary from local authority to authority, depending on the valuation system, the mix of fixed and value based rates, the use of targeted rates and the like. We have advised local authorities to model the impacts in their own jurisdictions and add that to their own responses. The Commission sensibly added a recommendation allowing for transition over five years.

The Commission has proceeded on an assumption that there is more scope for many local authorities to employ user charges, targeted rates etc. In essence, the general rate would become a true tax to fund those activities that are either wholly or partly deemed to be public good, or where its impractical or inefficient to use some other mechanism. That may well be a higher proportion than commentators, such as the Commission, expect.

The Commission has not mentioned one of the common uses of differentials on the general rate in the regional sector. Valuation is done at the territorial level, and in most regions, the different territorials value at different dates for logistical reasons. The relative shares of regional rates in each territorial would then alter from year to year depending on where they are in the cycle. Regionals use differentials based on location as a means of controlling (or equalising) for this – so that the 'share' allocated to each territorial is not affected simply by where the territorial falls in the cycle.

It is true to say that differentials and the UAGC are both tools to enable councils to adjust the incidence of rates to meet local needs and preferences. A serious application of an ability to pay criterion (recommended elsewhere by the Commission) ought not only apply to those services deemed private good but also to those deemed public good. Previous work done in the Shand Inquiry suggests that both land and capital value have high correlations with income.

6 SOLGM (2009), *Developing Local Authority Revenue Systems – Principles and Guidelines* (withdrawn) – this guide is currently down for review.

One additional point that is relevant both to the Commission's view that local authorities should make more use of targeted rates is that there is an increasing willingness to challenge decisions in this area. To take a current, and very topical example, Auckland Council's targeted rate on accommodation providers has been challenged by the local accommodation sector in terms of the Council's application of the funding policy and other procedural requirements. Other councils have retreated from similar approaches or other applications in the face of similar representations. In short, in addition to the cost of generating the necessary data for targeted rates there is often a one-off cost that might loosely be called a 'legal cost'.

Recommendation: Rating powers

8. That the Commission recommend no change to the general rating powers.

Development contributions and financial contributions

The Commission has recommended that Local Government New Zealand and SOLGM develop standardised development contributions (DC) policies and council assessments of DC charges for individual developments.

With the Commission also recommending that councils would have to follow these templates they will effectively have the status of a regulation.

We agree that DC policies are complex. There is a trade-off between:

- the simplicity of the policy approach (as might be the case if local authorities set one rate of contribution across their entire jurisdiction)
- efficiency (in the allocative sense, a simple approach might create situations where some catchments subsidise others) and
- transparency.

That is to say that the complexity of DC policies is in large part a result of the disaggregation that is very much a practical necessity and in keeping with the spirit of the legislation. We also note that the report that Insight Economics provided to the Commission has endorsed this level of disaggregation both at a catchment level and by type of development.

SOLGM can see a role for itself in developing a good practice guide for local authorities (either on its own or in partnership with other agencies). However, this could have no status that would 'bind' a local authority to follow it – indeed we are surprised that the Commission has not identified the conflicts of interest inherent in sector bodies setting a de-facto regulation. We would draw on the expertise in the Department and in the Development Contributions Working Group (a specialist committee of practitioners who work with DC policies on a day-to-day basis), as well as within the development industry.

While we renew all of the four recommendations we made in our original response to the Commission, we particularly want to remind the Commission of two of these recommendations.

The first is the Crown exemption – which if anything appears likely to be broadened to include developments undertaken by Kāinga Ora Homes and Communities as the Bill that establishes this entity currently stands. A development such as the so-called Carrington development in Auckland is expected to have some 4,000 homes when that development is at full capacity – a community the size of Te Awamutu. It is unclear why the rest of the community is (or should be) expected to subsidise the community. We remind the Commission that development contributions are not a tax – they are more of a targeted charge for a service.

The second is the treatment of development contributions where the infrastructure is provided on land that the local authority does not own or control. This is becoming an increasingly common way of providing community infrastructure in a cost-effective way. We had expected the Government would address this issue in the last set of amendments to the *Local Government Act* (May 2019) but it chose to defer the issue for further consideration.

Local authorities currently have the power to assess a financial contribution from developers towards the costs of addressing the environmental effects of development. As legislation currently stands this power (which is under the *Resource Management Act*) has been repealed and will be phased out in 2022. These are intended to operate separately from development contributions, are set under a different process and statute, and have quite different rights of appeal. A council cannot assess both a development and a financial contribution to fund the same project.

We did not mention financial contributions because the Government announced its intention to restore financial contributions in an upcoming *Resource Law Amendment Bill*. Nine months on from that announcement and there has been no sign of the amendment (or the Bill).

Recommendations: Development contributions

9. That the Commission amend its recommendation 6.1 to invite SOLGM to develop guidance on the setting of development contributions in consultation with the Department of Internal Affairs and representatives from the development industry.
10. That the Commission note the four recommendations around development contributions in the SOLGM response to the issues paper and:
    - agree that the Crown should pay development contributions on all developments it undertakes.
    - agree that local authorities be able to recover development contributions assessed for community infrastructure on land that is not owned or controlled by the local authority.
11. That the Commission amend its report to include a recommendation supporting the restoration of financial contributions under the Resource Management Act.

Other tools for funding growth

The Commission's finding 6.7 that value capture, congestion charges and volumetric wastewater charges would give councils additional means to recover the costs of growth without burdening existing residents largely echoes its conclusions from its *Using Land for Housing* report. There is one significant difference that has gone unremarked in this current report. In *Using Land for Housing* the Commission recommended the introduction of road-pricing (including on existing roads).

SOLGM supports the addition of all three of these tools to the funding toolkit – though we'd prefer a recommendation to introduce full 24/7 road pricing (on an anywhere/anytime basis) to one that covers only congestion charging. Done properly, road pricing sends the user an economic signal as to the true costs their road use imposes on society. That signal and its impacts on road use have wide application to a variety of public policy issues:

- managing the level of road use defers the need to invest in additional capacity; and decelerates the road-use related 'wear and tear' on the network
- reducing the level of road use reduces emissions – one of the objectives of any robust plan for climate change mitigation and adaptation

- likewise lowering the level of road use is likely to have a payoff in terms of lower numbers of accidents as for example the Road to Zero policy package advocates for and
- encouraging people onto public transport is an important step to encouraging intensification and a more sustainable urban form.

It is therefore no accident that the current Minister of Transport, Urban Development and Economic Development has referred to road pricing as 'the silver bullet'. We'd only add road pricing won't encourage modal shifts in the absence of a mode to shif too. Current policy settings for passenger transport funding requires 50% fare box funding of Public transport operations. This may be appropriate (arguably) when you have mature systems in low growth areas, but may be less effective where there is up-front investment needed for what are inter-generational/ long run assets.

We have considered the Government's response to the Using Land For Housing report and frankly, take issue with the low quality of some aspects of this response.

In our earlier response we noted that true value-capture would require some redesign of the manner in which rates are set. Local authorities cannot levy any tax or charge on the incremental value alone. Assuming that local authority revenues increase as the tax base increases is to confuse the way rates are set with the property taxes the Commission has dismissed elsewhere in its report.

The Treasury is on firmer ground with its comments about wastewater charging. We concur that these charges could be levied under the authority of section 12 of the Rating Act. Our understanding though is that the use of this authority effectively requires a local authority to enter into service agreements with each new consumer, and to write enforcement mechanisms (e.g. penalties etc) into the agreement. The transactions cost of such an approach are such as to make this impractical other than at scale.

We consider the Commission should be bolder in its findings in this area, and should make recommendations in support of these tools., particularly road pricing (including existing roads).

Recommendation: Other funding tools

12. That the Commission amend its report to include recommendations specifically supporting the extension of value-capture tools, road-pricing and the addition of volumetric charging for wastewater to local authorities.

Forestry roading

We earlier identified the impacts of forestry on the road network as a significant cost driver in provincial and rural local authorities. We were pleased to note your finding 4.14 that read:

"Rates of afforestation will increase as New Zealand transitions to a low-emissions economy. This increase in forested land will result in considerable new pressure on many local roads, particularly at harvest time. This will, in turn, lead to a need for more frequent maintenance and replacement of roads, resulting in increased costs. The cost pressure this creates for some councils may indicate a need to re-examine how funds from Road User Charges are distributed."

We were surprised that the Commission hasn't supported that finding with a recommendation, and suggest that this gap be filled.

Recommendation: Forestry roads

13. That the Commission amend its report to include a recommendation that supports increased financial assistance for roads that support high forestry volumes.

Climate Change

The Commission's findings in this area very much replicate the stance we took. We concur with the Commission assigning this the highest priority of all of its recommendations in the area. The comments we make below are matters of emphasis and interpretation rather than disagreement.

The Commission's six recommendations in this area would see a total of three potentially new agencies established. Two of these would be centres of excellence – one for data and climate science and one for "policy, planning, risk management. legal issues and engagement" relating to climate risk adaptation and mitigation. It appears the third would administer the fund for the adaptation of wastewater and stormwater assets.

We support the need for each of these functions. Indeed our 2016 publication *Climate Change: Local Government Can Make a Difference* calls for the sharing of more science and data on the local impacts of climate change. What we are concerned about is that the multiplicity of new agencies may create some duplication or overlap in role. We consider that the first and third of the new roles could be given to an existing organisation. For example, NIWA has probably the most expertise in climate science in the county. Alternatively, both roles could be given to the Climate Change Commission – though we would expect this to be dealt with through an addition to its baseline resourcing and not in a manner that would distract focus from its functions in undertaking risk assessments and advising central government.

Each of the two funding recommendations is grounded in a recognition that council assets are going to need a greater level of resilience built into them, be moved etc. The Commission is quite correct to say that funding should reward approaches that are both flexible and anticipatory. In our estimation though the leading edge of climate change is with us and there should be recognition "anticipatory" is not always possible.

We also agree that defending existing assets would be funding only where that option is superior to other options by a significant margin. Local government applies a particular legal context to the terms significance and significant that may not be what the Commission has in mind. It will be interesting to see how that might be interpreted in future - we suggest the Commission might usefully spell out some criteria or processes for assessing what a significant margin is.

By the way, the use of this concept also acts as a strong pointer to assign the third of the new roles (the funder) to a body with some independence from central government. And finally, in this section we are unsure why drinking water assets have been excluded from the coverage of the proposed Climate Change Resilience Fund.

Recommendations: Climate change

14. That the Commission amend its report to recommend that the data and science centre role and the funder role be assigned to the Climate Change Commission.
15. That the baseline resourcing for the Commission be increased to allow it to undertake these two additional roles without risk of distraction to its roles preparing risk assessment and advising the Government on climate change matters
16. That the Commission define the criteria or procedures that will be used in assessing the merits of defensive options vis-à-vis other options for managing the risks climate change poses to infrastructure.
17. That the Commission include drinking water assets within the scope of the proposed Climate Change Resilience Fund.

PART TWO: OTHER ISSUES

In this section, we discuss those matters that did not directly relate to a funding tool or source. These include the following:

- price change
- asset management (including asset planning, asset information, business cases and capital charging)
- long-term plans (including frequency, contents, and performance reporting)
- audit
- audit committees
- central/local government relationships and
- hardship.

Price change

While the Commission has made no recommendations in this area, the Commission has asked a consultation question:

"Is the current methodology for preparing the Local Government Cost Index sufficient for forecasting the prices that local authorities are likely to face? If not, should the methodology be improved, such as by one or more of:

- *carrying out more frequent reweighting*
- *including output indices*
- *disaggregating by council type."*

Since 2005 SOLGM have commissioned BERL to produce the adjustors and Local Government Cost Index. A check of our records has revealed that our then Financial Management Working Party, BERL and representatives from the Office of the Auditor-General discussed the approach we proposed to take at the time.

We have asked BERL to respond to the above points and attach their full response to this submission. In short, they indicate no objections to the suggestions contained in their report – but have questioned the scale of the potential benefits arising out of any refinements when set against the costs. Sapere's own analysis did not suggest the forecasts were markedly overstated or understated.

SOLGM will consider the case for a more frequent rebasing of the adjustors and cost index to the three years that Statistics New Zealand use with indices such as the CPI. It is also our understanding that three years is regarded as 'best practice'.

We note BERL's reservations about the range of regional price data that is publicly available and may act as a limit on the production of data disaggregated by council type. SOLGM occasionally receives requests for regional indices and declines them for similar reasons.

So why do local authorities adjust for price change? *Section 111(1)* of the *Local Government Act* requires that:

All information that is required by any provision of this Part or of Schedule 10 to be included in any plan, report, or other document must be prepared in accordance with generally accepted accounting practice if that information is of a form or nature for which generally accepted accounting practice has developed standards.

The only exception are the so-called funding impact statements which are expressly excluded under *section 111(2*).

Generally accepted accounting practice has the same meaning as in the *Financial Reporting Act 2013*, which refers to applicable financial reporting standards and in relation to matters for which no provision is made in applicable financial reporting standards, an authoritative notice.

The preparation of most of the financial information in local authority plans and reports etc have been governed firstly by International Financial Reporting Standards (IFRS) and (from 2015) by the New Zealand Public Benefit Entity (PBE) standards. The PBE standards are prepared by the External Reporting Board and are generally modelled on practice and standards developed by the International Public Sector Accounting Standards Board.

The PBE set of standards includes a standard covering the preparation and presentation of prospective financial information[7], which has been carried forward from the pre-2015 (IFRS) standards. That standard requires local authorities and other public sector bodies to prepare prospective financial information on the basis of the best information and assumptions available at the time of preparation.

Applying that test logically then leads us to ask whether an assumption of no change in input prices over the planning horizon truly represents the best available information to local authorities at the time they prepare their forecasts. The reasonable person would conclude that any reasonable attempt to recognise the impact of price change represents better information than no assumption at all.

The difference can be material. The Office of the Auditor-General noted that:

Failure to include price change was one of the main deficiencies noted in the 2004-14 LTCCPs. It meant that forecast costs in the later years of the LTCCPs were significantly lower than the probable costs that a local authority was going to incur in that year. This made the resulting funding sources, such as rate and debt levels, less meaningful. It also meant that the LTCCPs could not be relied on as a tool for long-term planning or, at least, made them less relevant to decision-making.[8]

We noted the Commission's comments that rates are commonly set by adjusting last year's budget by the forecast LGCI with an additional adjustment for growth. It is common practice to set the rates and debt limits disclosed in the financial strategies in this way. Although practice varies amongst local authorities it would generally be wrong to think that allowing for price change in the 'out-years' of an LTP means that level of budget is guaranteed come annual-plan time.

In the words of a finance manager:

"Budgets in LTPs are set to take into account anticipated activity levels and the LGCI.

It would be impossible to maintain an expanding water, sewerage and Stormwater network at an LGCI increase level alone in growth councils.

At the other end of the spectrum expenditure allocations for community grants as an example may not be inflated at all.

Then there is the middle ground, where the focus is on maintaining a level of service. In an LTP the first year is closely scrutinised, but may be inflated in out years as per the LGCI.

7 The official title for the standard is *PBE IFRS 42 Prospective Financial Information*.
8 Office of the Auditor-General (2006), *Matters Arising from the Audit of 2006-16 Long-Term Council Community Plans*, page 36. The 2006-16 plans were the first plans that required an audit opinion and were the first where local authorities were required to adjust forecasts for the impact of price change

The second part of the equation is the Annual Planning process. All costs for the Plan year are very closely scrutinised and where possible reduced. Also if CAPEX proceeds more slowly than planned the related operating budget will in most cases be reduced (e.g. treatment costs, depreciation and interest).

In the Annual Plan process the pressure is on to reduce the forecast rates increase to either reduce the impact on the community or allow 'room' for some of the increases in LOS promoted by staff/ requested by councillors and or required by central government.

My council adopts the approach of preparing an existing LOS budget and then having 'extras' and their rates increases clearly identified and approved individually.

In summary, an LTP operating budget does not guarantee that level of operating budget in out-year Annual Plans."

Recommendations: Price change

18. That the Commission note SOLGM will consider more frequent rebasing of the adjustors and Local Government Cost Index.
19. That the Commission note that the common sector practice is to remove inflation from the LTP budgets before starting an annual plan round.

Asset management

The Commission asks for alternative ways of encouraging more effective asset management practice.

The Commission is correct when it says that the preparation of asset management plans is a practical rather than a legal necessity. There is a requirement in the Local Government Act, albeit indirect, to undertake asset management planning. One of the *section 14(1)* principles of local government is that *a local authority should ensure prudent stewardship and the efficient and effective use of its resources in the interests of its district or region, including by planning effectively for the future management of its assets*.[9]

This was one of changes made in the 2014 amendments to the Act and was intended to support the requirements to prepare an infrastructure strategy. The Cabinet papers of the time drew a clear and deliberate distinction between the process (i.e. asset planning) and any output (i.e an asset plan). The papers did not recommend making the preparation of a plan mandatory as the authors considered this would stifle innovation.

We have never found this rationale convincing. Legislation could easily specify the requirement to prepare asset plans. Any content and process requirements could be specified in regulations and would thus be easier to change as practice evolves. The Commission should recommend that the preparation of asset management plans be made mandatory.

9 *Section 14(1)(g), Local Government Act 2002*

Asset information

The Commission has recommended that councils *"should prioritise improving their knowledge of the condition and performance of their assets"*. There are few councils that are not making some effort to improve their stock of information about their assets – asset condition in particular. During the 2018 LTP round one council received a qualified audit report on their LTP, and several others came close. This will provide a spur to make renewed efforts.

It can be difficult to make the necessary business case to elected members (and sometimes senior managers) for funding that in some of the larger local authorities can run into the millions of dollars. A more universal understanding of asset management concepts such as the asset lifecycle would pay dividends, as would a stronger guidance on where the priorities for asset management should lie.

Business cases

Most local authorities have some form of business case methodology. These can vary greatly in their degree of rigour. In some of the larger local authorities the processes are very similar to the Better Business Case methodologies that central government have adapted for use. Some local authorities have gone so far as to support staff to gain accreditation as Better Business Case 'trainers'.

Of course, all NZTA funded capital works undergo a full project evaluation process that is externally set (by the NZTA) – though we agree that this is partly a project evaluation process and partly a capital rationing process.

This is an area where the sector would benefit from a methodology that is robust common, scalable and user-friendly. In the words of one asset manager *"don't develop something that requires 30 pages to answer a single aspect of the case"* (referring to the full Better Business Case methodology). It would also assist if central government developed a common approach to its own methodologies – Better Business Cases and NZTA are different (despite attempts to align the two).

It should also be noted that, like central government, the final decisions as to which projects proceed and which do not are political ones, just as is the case with the 'budget bid process' in central government.

Capital charging

The Commission asks for views on a capital charge. As we understand it the rationale for a capital charge is that this reflects the opportunity cost of the funding for a particular investment decision of holding of assets. The intent is to ensure firstly that elected members and managers are provided with an understanding that capital is not costless, and that local authorities are able to more readily compare the cost of keeping services 'in-house' as opposed to private sector delivery.

It is our understanding that capital charging has applied in government departments and some other Crown entities since 1991. It appears to be applied to the net worth of these entities in the accounting sense. We also understand that, *"on introduction departments were compensated for the charge; their appropriations were increased by an amount equal to the charge, but that after an initial phase Crown agencies are not compensated for any increase in their asset holdings."*[10]

10 Taken from *Charging for Capital* – article in an online publication The Spirit of Reform: Managing the State Sector in a Time of Change, last retrieved from http://www.ssc.govt.nz/node/1332 on 16 July 2019.

We understand that the capital charge was initially set at 13 percent and now sits at 11.5 percent of the net worth of Government departments (whose assets tend to be more plant, equipment, and cash rather than infrastructure). To put the above amounts into a local authority context, local authorities held some $144 billion in assets as at 30 June 2018.[11] An 11.5 percent capital charge on that amount is some $16.6 billion (or about three times the current rate take). Even a 1 percent capital charge would be some $1.44 billion or about a third of the current rate take. We suspect that an initial adjustment to the existing appropriations strategy is not practicable – especially in the short-medium term.

As we understand it, departments remit the capital charge to the Treasury twice a year. What's not clear to us is how those proposing a capital charging regime would see this operating in local government – presumably as some form of internal charging.

The Commission suggests that a capital charge could be a tool for encouraging better management of assets. Experience from central government suggests that minimising any charge payable to central government has acted as a spur to rationalise the holding of assets e.g. dispose of surplus land etc.

We could see a capital charging regime factoring into decisions such as whether a council chooses to lease or own its council accommodation, and the rationalisation of community facilities. These are decisions at the periphery of the total portfolio – we remain uncertain that disposal of an entire road network (as opposed to an individual component such as a bridge) is being contemplated by the Commission (or that it even fits within the terms of reference).

One of the primary authors of this submission took part in the 1996/7 Land Transport Pricing Study, which considered the application of a capital charge as part of the full economic cost of the road network. The conclusion to that debate appeared to have been that it was not economically efficient to incorporate a capital charge on sunk costs in an efficient pricing regime.[12]

In short, we suspect the Commission's interest in the capital charge comes more from the perspective of enhanced capital budgeting/business case methodologies. The concept should be familiar to any person who is ACA or equivalently qualified (it's a core concept of any Introduction to Finance course). As we've noted the training in this area could be greatly enhanced and more could be done to assist local authorities with a set of standard tools. We consider this should be the priority.

11 Source: Statistics New Zealand, Local Authority Financial Statistics

12 For example, see the Business Roundtable (1996), Submission – The Land Transport Pricing Study's Discussion Documents for a somewhat dry and technical discussion of these pricing principles, available at https://nzinitiative.org.nz/reports-and-media/submissions/submission-the-land-transport-pricing-studys-discussion-documents/ . We recall that Local Government New Zealand reached broadly the same position. The suspicion at the time was the Government intended to use the justification of a capital charge to divert revenues from the fuel excise to the general revenues (as was then commonplace).

Recommendations: Asset management

20. That the Commission recommend that local authorities be legally required to prepare asset management plans, with the content of an asset management plan being specified in regulations rather than legislation.
21. That the Commission recommend that sector organisations prioritise the development or redevelopment of resources in asset management concepts for elected members, and enhanced guidance on prioritising investment in asset condition and performance information.
22. That the Commission recommend that the sector organisations develop a robust, scalable and user friendly methodology or methodologies for capital business cases.
23. That the Commission not accord proposals to introduce a capital charge further priority.

Long-Term Plans

Frequency

SOLGM has previously considered options such as reducing the planning horizon to five years, moving to rolling ten-year forecasts, and reducing the frequency of plans as means of reducing compliance costs. At face value, each has something to commend it, but on closer analysis and consideration of the practical issues each does not offer any clear or compelling "efficiency gain" while resulting in a loss of accountability.

The Commission specifically asks for feedback on reducing the frequency of the LTP to once every five years. Our previous consideration of this option concluded that

"The assumed cost reduction in this simply comes from doing LTPs less often – over a ten-year period a local authority would prepare two LTPs, as opposed to the three it would produce under the current legislation. However, it is unclear whether the reduced frequency of LTPs would translate into a '33 percent cost saving'. The reduced frequency also means the degradation of institutional knowledge and systems (staff leave, things are 'forgotten' etc) may be greater.

A five-year shelf life may also mean that more amendments are made between LTPs. Over five years the degree of divergence between the world the local authorities and others assumed, and the 'real world' is likely to increase and amendments become necessary. Two or three substantive amendments and any cost savings are greatly reduced.

This advantage does not sit well with the triennial election cycle, over any given ten-year period there would be at least one, and possibly two elected councils that would be bound by decisions of the previous council (unless they adopt an LTP amendment that overwrites the whole plan). It is highly likely that in any given local authority, at least one incoming set of elected members would elect to prepare a 'zero based' LTP amendment – and in that case the assumed cost savings evaporate. On a five-year cycle, once every 15 years, LTPs would coincide with local election year.

We are unconvinced that reducing the frequency of LTPs offers any clear-cut savings over time. Any savings from doing fewer LTPs are likely to be reduced by a greater frequency of LTP amendments – including, in all probability, more LTP amendments that rewrite an entire plan."

In honesty, SOLGM considers that the frequency of a long-term plan cannot practically be separated from the term length for local authorities, which in turn cannot be separated from the electoral cycle for central government. We suspect the latter probably falls outside the terms of reference for this inquiry!

Content

We concur with the Commission's recommendation that the Local Government Act be reviewed to clarify and streamline the required contents of LTPs so as to reduce duplication, ease the compliance costs and help make them more accessible documents.

An LTP was intended to discuss the issues a community faces and the choices before the community and the local authority. The final plan is a statement of medium-term intent. But the legislation has been framed in a way that disciplines such as asset management are made practical necessities by requiring disclosure of information in the LTP. The result is an LTP that is lengthy, and contains detail many ratepayers do not need or want.

Some first principles that might inform a review might include:

- *the purpose of a long-term plan is first and foremost as a basis for the local authority's accountability to the community*
- *a disclosure in an LTP should be only that which is essential to an understanding of the local authority's short-medium term intention* – that is to say disclosure in an LTP should not be viewed as a back-door method of legislators requiring local authorities to undertake particular discipline. We also note that the information disclosed In the LTP should be a (generally very) small subset of the information necessary for operating each activity
- *disclosures should provide a clear communication to the community of strategic priorities, policies and proposed actions* – the 2014 amendments drew a distinction between information to serve as the basis of engagement and supporting information. There is potential to take a similar approach to the final LTP
- *professional standards (such as accounting standards) apply to the production of information in an LTP, unless specifically overwritten by a legislative requirement*. There can be cases where the legislation and standards do not align. For example, the disclosures around performance information differ in the Act and the relevant accounting standard – this has been a bone of contention in the past. It should also be acceptable for a local authority that wishes to disclose to higher standard to do so at its discretion.

SOLGM undertook an internal review of the contents of LTP documents in 2012 and presented its findings to the Efficiency Taskforce appointed by the then Minister of Local Government.[13] This report and the issues it raised served in part as a spur for the 2014 amendments – which saw the development of the consultation document as the basis for engagement. While the world has moved on since 2012, many of the findings remain relevant and are summarised below.

The Act provides local authorities with an option to disclose its activity information, performance information, and capital expenditure in detail for the first three years, and in outline for the following years. In practice very few, if any, local authorities make significant use of this option with anything other than performance measures (and even that sparingly). The most commonly cited reason for this is that auditors have insisted on the full ten years of detail.

We think this requirement is legislative recognition that plans become more statements of intention as one moves further away from the base year. Getting this balance right is one means of keeping the costs of the LTP "under control". Further work is needed to reach a common understanding of what this means.

13 SOLGM (2012), *Better Local Accountability – A Submission to the Efficiency Taskforce.*

At the time we recommended removal of the following disclosures from the LTP:

1. *disclosures specifying the significant negative effects of activities*
2. *statements disclosing variations from the assessments of water and sanitary services and waste management plans from the LTP*
3. *policies on developing the capacity of Māori to participate in the decision-making process* – local authorities should still prepare such a statement, but this is more appropriately located in the Governance Statement or the Significance and Engagement Policy
4. *funding impact statements* (or to be more specific the part regulated by the *Local Government Financial Reporting and Prudence Regulations 2014*, the disclosures around rate-setting are critical)
5. *disclosures around financial reserves* – this was added in response to a particular practice issue relating to the way a single local authority used a reserve the community considered was targeted for a particular purpose
6. *the balanced budget statement* – key elements of this could be woven into the financial strategy requirement.

Some disclosure requirements, such as those around assets, could be removed as there is already a practical requirement to prepare asset management plans. Asset disclosures should focus on the envelope for capital spending in each group and significant capital projects.

Section 101A contains a blanket provision that requires local authorities to disclose any factor that will have a significant financial impact during the life of the strategy. It then lists a set of mandatory disclosures. The risk with this approach is that local authorities treat the list as exhaustive and miss something important (although audit mitigates this risk somewhat) or alternatively that some councils may not find the list relevant to their business. We consider that items i) – iii) should be removed from the list and the choice of issues should be left to the local authority (with audit as the check). Taken as a whole the above discussion leads to a provision that might look something like this:

A financial strategy adopted under this session must include:

a) a statement of the factors expected to have a significant financial impact on the local authority and its ability to meet the levels of service indicated in its long-term plan

b) a statement of the local authority's

   i) quantified limits on rates increases and borrowing

   ii) assessment of ability to meet the levels of service indicated in the long-term plan, and meet any additional demands for services with those limits.

LTPs must disclose performance targets, ownership objectives and the like for every Council-Controlled Organisation (CCO). We consider that this should be amended to require disclosure for significant CCOs – and noting that some alignment with the definition of Auckland's "substantive" CCOs would be necessary. CCOs come in different shapes and sizes, yet the Act does not differentiate. We doubt that disclosing ownership objectives for a Santa Parade Trust with an annual turnover of $10K fits with the strategic intent of an LTP.

We comment further on performance information and performance reporting below.

Recommendations: Long-Term Plans

24. That the Commission abandon work on changing the frequency of long-term plans to five years.
25. That the Commission note SOLGM's recommendations to the 2012 Efficiency Taskforce regarding the content of LTPs.

Performance reporting

We endorse the Commission's headline finding that the reforms aimed at improving transparency have been counterproductive. We comment specifically on the matters raised by the Commission below.

Service performance reporting

The Commission correctly notes the existence of a set of 19 performance measures for the five core groups of network infrastructure. Under *section 261B* of the *Local Government Act* the Secretary for Local Government must:

(a) consider whether an existing performance measure is suitable for the purpose; and
(b) have regard to whether a performance measure—
(i) measures the level of service for a major aspect of the group of activities; and
(ii) addresses an aspect of the service that is of widespread interest in the communities to which a service in relation to the group of activities is provided; and
(iii) contributes to the effective and efficient management of the group of activities.

We suspect that the current set of measures as a set fall below the standards set above. We don't consider that these measures provide a complete picture of the levels of service associated with these activities. Some measures such as *"the percentage of the sealed local road network that is resurfaced"* make a dubious contribution to the effective and efficient management of an activity in that they could incentivise activity for activity's sake. Others, such as various measures of customer response time (which we agree is important) require investment in systems development.[14] Others appear to be simple binary statements such as:

"The major flood protection and control works that are maintained, repaired and renewed to the key standards defined in the local authority's relevant planning documents (such as its activity management plan, asset management plan, annual works program or long term plan)."[15]

We acknowledge our concerns are shared both within the sector and by other agencies, for example the Office of the Auditor-General remarked that *"(it) has previously remarked that some of the mandatory performance measures do not provide a meaningful indication of a council's performance. In our view, it is timely for the Department of Internal Affairs review the current suite ... "*[16]

The then Minister of Local Government (Hon Rodney Hide) announced the Government's intent to develop a suite of measures for the five network groups of activity as one of a set of measures to "encourage a greater focus on core services".

14 As a result, several local authorities receive modified annual report opinions because they have not, as yet, been able to justify the investment in systems to their communities.
15 Levels of service for flood and river control are notoriously difficult to define and measure – if a level of service is not met then the local authority and community might have higher priorities to concern themselves with. SOLGM advised the Department to leave a requirement to set performance measures for flood and river control out of the legislation.
16 Office of the Auditor-General (2019), *Matters Arising from the 2018-28 Local Government Long-Term Plans,* pages 24.

That is to say that by setting up a mandatory regime that covered some, but not all, services the Minister's intent was to direct investment to some activities deemed core and not others.

The then Associate Minister of Local Government responsible for developing the authorising legislation saw these as a means of identifying best practice and providing communities with a common language for expressing levels of service. In fact there's been a marked lack of interest on the part of local communities in the measures – at the time of writing we are unaware of any ratepayer or sector group that has shown any interest in the measures or in compiling any 'league table' or 'composite index of performance'.

We see little value in the current suite and would recommend that the current rules be repealed.

This is not to say that the setting of levels of service, and the associated performance measures and targets is not a critical part of good local governance, or that robust comparisons with others are not a valuable information source. Our own guidance *Your Side of the Deal* (which the Commission cites in its report) highlights both. We consider that a lot more can be done to encourage the sector to select a few relevant, customer-focussed measures. The next edition of Your Side of the Deal will include a great deal more worked examples, and we will look to include more worked examples (including some of the trickier functions) in the guide and implementation workshops.

Funding impact statements

The funding impact statement (FIS) is a reporting requirement that is unique to local government. It applies at two levels – the whole of council and for each group of activities.

The FIS is a non-GAAP disclosure (as per section 111 of the Act). The presentation is regulated under the *Local Government Financial Reporting and Prudence Regulations 2014*. These contain a sample of the statement for each of the whole of council and group level FIS – no variation in presentation is permitted.

The FIS differs from GAAP statements in two key respects:

- it is intended to deal only with cash items – transactions such as the vesting of assets (especially common in growth councils) or revaluations are excluded
- a whole of council FIS must balance.

The FIS was introduced on the rationale that *"most ratepayers do not understand the principles of accrual accounting and therefore find council accounts incomprehensible"*. Anyone who has ever had to explain to an elected member or a ratepayer that the fact the council made a surplus in the Statement of Comprehensive Income does not mean that there's cash available for a rate cut will have some sympathy with this statement.

We are unconvinced that having two sets of financial information each prepared on a slightly different basis actually provides transparency for the reader.

In three LTP cycles, local authority finance managers and LTP project managers report that there was no lesser or greater level of interest in financial information as a result of producing the FIS. Several report that there was some confusion as to why reporting formats had changed or why their local authority had prepared a second set of financial statements.

For example:

"We didn't receive any submissions on the information in the FIS or quoting information in the FIS. We did however have a member of our community ring up our (local TV news) show and ask why they were set out differently from previous years cost of service statements, how they compared with financials that are prepared subject to standard accounting practices and why we had changed

them. He felt that they didn't offer consistency with what we had previously done (although noting we had provided the comparisons) and that creating things in two different formats, such as we did was not helpful to the community."

– An LTP project manager

We are aware that some local authorities do find the cash orientation of the FIS useful and have built their reporting to elected members around the FIS. But in general this appears to be a low value financial disclosure.

The whole of council FIS has a second element. Local authorities must set out specific details of their rating and other revenue mechanism. For example, the general rate requires disclosure of the valuation base and whether the rate is set differentially. This is a useful signal to the ratepayer as to what they can be expected to pay and details of how the rates will be calculated. This aspect is the link between the strategic intent and the annual setting of rates. This should be retained – though the requirement would need a review against other recommendations the Commission makes.

Fiscal prudence reporting

The *Local Government Financial Reporting and Prudence Regulations* also introduced a second element, the so-called financial prudence benchmarks. These were designed to:

"encourage greater financial discipline in the local government sector, and will meet concerns about rising rates and council debt. They will foster a culture of continuous improvement across the sector, and showcase best practice and excellence in local authority financial management. The regulations will also provide information about councils' financial health. They will make it easier for ratepayers to assess their council's financial state and will promote better financial decision making."[17]

The Commission has considered these in its review and appears to consider there is room for improvement with at least one of these – the Essential Services Benchmark.

Considering the set as a whole it is difficult to see how the benchmarks meet the above tests:

- there's no linkage to any measures of service or service improvement i.e. they are financial indicators only
- the so-called 'rates affordability' and 'debt affordability' benchmarks are nothing more than whether the local authority met the limits on rates and debt that were set in their own financial strategy. That is to say that the benchmarks are self-determined. These may send perverse incentives i.e. knowing that a reporting requirement exists may encourage local authorities to leave more headroom, undermining the intent that these limits act as a strategic control[18]
- the inclusions and exclusions from some may not be readily understandable to many of the general public. For example, the debt servicing benchmark excludes the following items from the definition of revenue: development contributions, financial contributions, vested assets, gains on derivative financial instruments, and revaluations of property, plant, or equipment. All those make sense to a person with some knowledge of finance but limit this measure's usefulness to the layperson.

17 Department of Internal Affairs, *Finance Prudence Regulations*, last retrieved from https://www.dia.govt.nz/Implementing-the-2012-Amendment-Act#implementing2 on 17 July 2019.

18 The Cabinet papers that sought authority for these benchmarks also discuss the Department's intent to collect information on two indicators (emphasis supplied) of affordability: rates per rating unit and net debt per rating unit. While imperfect, these probably bear a closer relationship to affordability. As far as we are aware neither has ever been collected by the Department.

Recommendations: Performance reporting

26. That the Commission recommend that the current set of mandatory measures of non-financial performance be repealed.
27. That the Commission note SOLGM is currently redeveloping its guidance on the setting of levels of service, performance measures and targets.
28. That the Commission recommend the complete repeal of the *Local Government Financial Reporting and Prudence Regulations 2014*.

The future role of audit

The role of audit and the content of long-term plans are closely linked in determining the overall level of cost in an LTP. Having said that local authorities can do more to keep the cost as low as practicable with some attention to their underlying systems and controls, and meeting agreed key milestones in their project planning.

As far as we are aware New Zealand is the only jurisdiction where local authorities are required to seek an audit opinion on prospective information. The modern LTP audit is an attest to two things:

1. the quality of the information and assumptions that have been used to prepare the consultation document or plan and
2. whether the document is fit for its intended statutory purpose. In the case of the consultation document the opinion attests to whether the document provides a basis for engaging the community on the major matters for inclusion in the LTP. In the case of the LTP itself its an attest to the document being a basis for ongoing accountability to the community.[19]

The requirement for an audit of long-term plans was added to the then Local Government Bill at the Select Committee stage. It was intended as a 'fence at the top of the cliff' and was intended as an assurance that plans were prepared using sound information and judgement.

In our view the audit most readily achieves Parliament's intended purpose when auditors focus on the quality of the underpinning information and assumptions. Most of those who provide public sector audits financial and accountancy backgrounds with some law and asset management. That this to say, the skill sets of most auditors sit well with a requirement to consider matters such as the completeness and robustness of the underpinning information, the reasonableness of forecasting assumptions and the translation of each into a robust set of financial forecasts.

We are less convinced that auditors are in a position to attest to the engagement and communications aspects of an LTP. While the auditor has a role in ensuring information is presented in accordance with Generally Accepted Accounting Practice and with applicable regulations, we are unconvinced that the auditors' involvement in presentational matters adds much to the overall result.

We are aware that even the most experienced auditors occasionally fall into the trap of getting involved in issues around the presentation of information in an LTP (and not from the compliance standpoint). For example, the primary author of this submission was once asked to provide a council with the 'pantone numbers' for the shades of green and red in the Financial Reporting and Prudence regulations because an auditor had told a local authority that their disclosure had

19 A third component of the opinion, that the documents met legal requirements was removed in 2014. It was noted then, quite reasonably, that auditors do not generally have the requisite skills to give such an opinion.

to match the colours in the regulation exactly. And we are aware of at least two local authorities that wished to disclose annual financial information in an infrastructure strategy for all thirty years, and were told they could not, despite this being both more transparent and a higher standard than the legislation requires.[20]

The 2014 set of amendments introduced the consultation documents and appropriate supporting information as the basis for engagement. The intent was to provide a more focussed basis for consultation (by focussing on the major matters). The decision as to what is included in an LTP is a matter for the local authority to determine having had regard to its significance and engagement policy and the importance of other matters to the community (emphasis supplied). This is important because it establishes the primacy of a local authority's judgement in these matters. Auditors must take care that in suggesting some matter is or isn't for inclusion in the CD, or that there are other options, they are not replacing their own judgement for that of the local authority.

We too have received feedback from local authorities that wished to put an issue or matter in a CD and claim to have had to include options that may not truly have existed. This has included some cases where the auditor has prescribed a number of options – three. We consider that it would be a rare circumstance where there is only one option for resolving a major matter – generally there's at least a 'do it' or 'don't do it' choice. Level of service improvements may come in increments etc.

In the cases where there is only one principal option, we are uncertain that the matter sits well as an 'issue for consultation' and would therefore be included in a consultation document. We could see that an issue such as upgrading drinking water to meet an increased standard may have no reasonably practicable option (the 'don't do it' option leaves a local authority open to prosecution) but might then be presented as another matter of importance due to its financial significance.

We consider the legislation should refer to those options that are reasonably practicable in the local authority's judgement. Of course, there should be reasonable ground for such a judgement. This should not be seen as a signal to skimp on generating and analysing reasonably practicable options!

SOLGM is about to review its guidance on the preparation of consultation documents. It will strengthen the content of the disclosure of options, including those matters where there are no reasonably practicable options.

Recommendations: The future role of audit

29. That the audit mandate for consultation documents and long-term plans be simplified by removing the requirement for the auditor to attest to the documents 'fitness for purpose'.

30. That the requirements for consultation documents be amended to require local authority's presentation of major matters to disclose only of the reasonably practicable principal options as determined by the local authority on reasonable grounds.

20 The Act requires production of thirty years forecast information for each of the activities in the infrastructure strategy. To reduce compliance costs Parliament inserted a provision that requires disclosure for years 11-30 in five year blocks e.g. years 11-15, 16-20 etc. The two councils concerned wanted to separate financials for years 11, 12 , 13 etc.

Audit and risk committees

SOLGM agrees with the need to ensure that the governance arrangements within local authorities include adequate governance of the audit and risk functions of, and related to, each local authority,

We support the principle of independence within the governance of audit and risk functions for the reasons set out by the Commission. However legislation should not go so far as to dictate elements of council committee structures and who can and cannot be a member of such a committee. What is considered good practice is continually evolving – legislating a particular approach might constrain innovation and choice.

We also have a practical concern. Our examination of the membership of the current audit and risk committees reveals that there is a degree of interlocking membership amongst independent members. For example, we are aware of one person who serves as an independent member on 10 committees, and another who serves on seven committees.[21] We are concerned that the skills, and particularly the willingness to be provocative and challenge the status quo may be in short supply (both in terms of the amount of skills available and the attractiveness of such a role to some potential applicants). Interventions that might help this include:

- stronger incorporation of local governance into the training for auditors and training offered by bodies such as the Institute of Directors
- stronger emphasis on risk management training in the offerings of bodies such as Equip (growing risk and assurance skills 'from within')
- maintenance of a register of interested people and their skills and qualifications to assist local authorities locate skilled folk.

We agree risk and assurance is important. While we don't support legislating for committee structures, we do agree that legislation could do more to signal the importance of risk and assurance. The legislation could elevate the importance of risk and assurance to one of the fundamental operating principles as set out in section 14 of the Act (alongside sustainable development, asset management, open and transparent conduct of business), Alternatively risk and assurance might be woven into the fabric of governance through its incorporation into the principles of governance set out in *section 39* of the *Local Government Act*. Our suggestion is that risk and assurance goes beyond governance and therefore should be incorporated into *section 14*.

Recommendations: Audit and risk committees

31. That the importance of the risk and assurance function be incorporated into the principles set out in section 14 of the Local Government Act 2002.
32. That Equip be encouraged to enhance its offerings around risk and assurance for local government (especially elected members).

21 This is not a criticism of either individual – both are well known to SOLGM as careful and competent people not afraid to challenge the status quo, Our point is that we need more like them.

Central/Local government relations

The Commission suggests that developing means for enhancing the working relationship between central and local government should be one of the highest priorities. Having recommended more of a joining up of thinking and action in our earlier response, we can only agree.

The Commission returns to the recommendation from its Local Government Regulation report that central and local government agree on a Partners in Regulation Protocol. As we recall that recommendation was aimed partly at allocating regulatory responsibilities and generating improvements to the way that Government policy around local government is made. We support both and add that this should extend to the implementation of policy using the SOLGM eight principles of effective implementation in the Appendix.

Hardship

Rates rebates

SOLGM supports retaining a scheme that provides assistance for low income folk to pay local tax. The first principles review we advocated was to better target the scheme and improve its administration (e.g. moving it into an online environment, addressing some borderline issues such as the treatment of water/waste levied by CCO etc).

Rates postponement

SOLGM is not opposed to a national rates postponement scheme 'in principle' - although it does appear similar to the home equity release schemes that are available in the private sector. The Office of the Auditor-General's 2007 report on a performance audit of council schemes Residential Rates Postponement made a number of recommendations that would assist the design of such a scheme.

The Commission may not be aware that the sector historically operated a form of national postponement scheme through a consortium. As best we can recall there were between 15 and 20 councils that were members of a scheme that was locally marketed to a set of criteria and procedures determined by the collective and administered by a private agency.

As we understand it the scheme was not well taken up at national level. While many of the councils that were involved still have policies that appear quite similar to that which applied, it appears the consortium no longer exists. We suggest a first step might be to promote a common policy approach in local authorities – perhaps based on those of the former members of the consortium.

We see this as a supplementary form of assistance as opposed to a replacement for a Rates Rebate Scheme.

Recommendations: Hardship

33. That the Commission recommend that LGNZ and SOLGM develop a national template of a rates postponement policy for extreme hardship.

APPENDIX: EIGHT PRINCIPLES OF EFFECTIVE IMPLEMENTATION

1. ***Start early*** – officials should not turn up in the office the day after the enactment of the legislation and start thinking about what to do about implementation. While the roll-out of implementation support programmes necessarily follows enactment (which in turn follows the policy advice), the design and development of the implementation programme should start earlier. Elements of this should be concurrent with the policy and legislative processes. Indeed, it is difficult to see how a rigorous assessment of policy options can be undertaken without commencing the identification of the costs and practicalities of their being implemented.

2. ***Work with the stakeholders*** – for any legislative initiative impacting on local government there will be a range of groups with a stake in successful implementation. This includes not only the national sector organisations such as LGNZ and SOLGM but also related professional organisations, and a variety of occupational institutes and associations. Engagement with these stakeholders can do a lot towards achieving effective implementation.

3. ***A separate process*** – SOLGM has been pleased to see the increasing willingness of central government to engage with local government during the process of policy development. While engagement with local government on implementation is likely to involve many of the same stakeholders, it should be set up as a separate project.

4. ***A single shared plan*** – SOLGM and other sector stakeholders will often see it as part of their role to support the implementation of the new legislation by local authorities (they may for instance have existing good practice guidance they will need to revise). If the actions of central government agencies and local government sector organisations are not co-ordinated in some way however, then there are risks that some work on some issues will be duplicated while others fall between the cracks. A single agreed common plan of action around the implementation process avoids these risks and is likely to lead to the most effective use of the available resources.

5. ***Use the proven technology*** – stakeholder organisations will generally have established and effective channels of communications with their constituents within local authorities. They may already have tools and guidance material that are widely known, recognised and used within local authorities. Government agencies should be encouraged to use these rather than establishing competing channels and tools.

6. ***Clarity about audiences and needs*** – there are a range of audiences, spanning elected local authority members, managers, and hands on practitioners in the specific affected areas of work. Their needs and the best means of addressing them are likely to differ. For instance, we would argue that the technology developed by our Legal Compliance Programme would often be the best available technology for meeting the needs of managers and practitioners, but it does not address the needs of elected members.

7. ***Linkage to Select Committee process*** – if work on developing guidance material as part of an implementation programme is started early enough there are opportunities for this to feed back in a positive way into the Select Committee process. This reflects our experience with the development of the legal compliance programme modules. The detailed work undertaken to identify the practical means of complying with legislation sometimes highlights technical shortcomings in the legislation that is being worked on – gaps and disconnects, inconsistencies and contradictions, and areas requiring clarification. If the effort is made to start this work early, there is the opportunity for these sorts of issues to be addressed prior to enactment.

8. ***Life-cycle approach*** – once legislation is enacted there is a necessary ongoing maintenance task for the administering department. New issues may arise, areas of uncertainty or contradiction may come to light, provisions may be interpreted in unexpected ways by either practitioners or the Courts or both. The ability of a department to respond effectively and properly maintain the legislation depends on the strength of its feedback systems from users. Engaging openly with stakeholders on implementation can assist this by establishing the foundation of relationships that can ensure open information flows into the future.

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