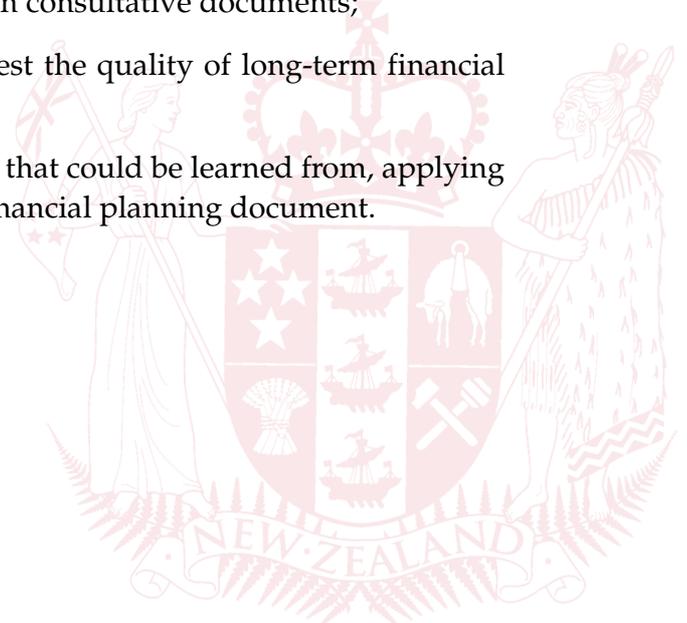


## WHY DID WE UNDERTAKE THE PILOT AUDIT AND WHAT DID WE LEARN?

### Our Reasons and Objectives

- 101 During 1998, Opotiki District Council (the Council) approached us seeking additional assurance about the quality of its Long-term Financial Strategy (LTFS). In preparing its LTFS, the Council was concerned to improve the reliability of its forecasting. Improving reliability is significantly dependent on the quality and robustness of the underlying assumptions used to develop models and scenarios in the LTFS.
- 102 Auditing prospective public sector financial and non-financial information is not a new idea. In the United Kingdom the Comptroller and Auditor General was asked by the Exchequer to audit some of the assumptions used for Budgets in 1997 and 1998, to provide independent assurance for Parliament on the Treasury's projections.
- 103 In New Zealand, an examination of prospective financial information is required in certain circumstances for entities issuing securities under the Securities Act 1978. However, the Local Government Act 1974 does not require an audit opinion to be issued on local authority planning documents.
- 104 We agreed to the Council's request to undertake a pilot audit of its LTFS (the pilot project) because we wished to:
- assist the Council in achieving legislative compliance with the objectives of Part VIIA of the Local Government Act 1974;
  - support the provision of a mechanism for communities to participate in decision-making about the long-term vision for their district, by providing independent assurance on consultative documents;
  - develop methods of assurance to test the quality of long-term financial planning by local authorities; and
  - assess the feasibility of, and lessons that could be learned from, applying audit techniques to a prospective financial planning document.



## WHY DID WE UNDERTAKE THE PILOT AUDIT AND WHAT DID WE LEARN?

### What We Learned

105 In our and the Council's view, the audit was a valuable exercise because it tested (with a particular focus on the financial aspects) the Council's long-term strategic planning. The audit report (see pages 48-49) provided assurance on the LTFS and:

- improved the quality of the 1999-2009 long-term forecasting;
- enhanced the relevance and reliability of the asset management plans;
- encouraged rigour (where otherwise there was uncertainty) in the assumptions and cost estimates of scenarios;
- generated free and frank debate within the Council about strategies and policies, and their linkage, leading to more robust policies underlying the LTFS; and
- provided an external review of financial policy and advice for the elected members of the Council.

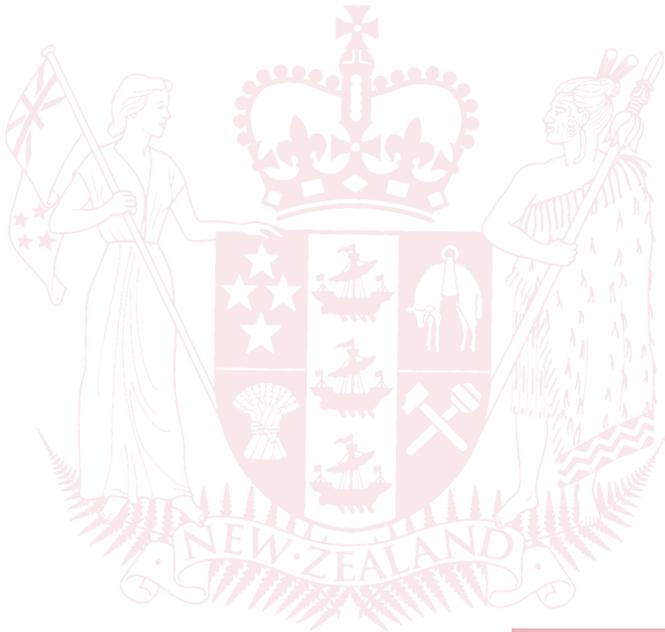
106 We suggest to every council reviewing its LTFS that:

- Good project management is essential. This includes a planning framework (that, for example, sets out the documents required, responsibilities, and timelines for preparing components of the LTFS).
- Processes need to be established for –
  - the recording and retention of information necessary for preparing the LTFS (to ensure that the Council has valid and complete data to incorporate into the LTFS);
  - ensuring that all key assumptions are disclosed and information is provided about the consequences of these assumptions (including identifying those assumptions that involved a high level of uncertainty); and
  - undertaking formal quality assurance.
- Financial policies need to be determined for the 10-year period – such as for internal borrowing and overhead expense allocation.
- Levels of service underlying the LTFS objectives and Annual Plan targets should be specified.

## WHY DID WE UNDERTAKE THE PILOT AUDIT AND WHAT DID WE LEARN?

- A linkage between outcomes, strategies and outputs should be identified to ensure that –
  - strategies in the Strategic Plan are reflected in the objectives of the LTFS and targets in the Annual Plan; and
  - objectives and targets in the LTFS and the Annual Plan are reflected in the Strategic Plan.

107 The timing of the pilot audit meant that, as far as possible, the Council could make changes to the LTFS before it was released for public consultation. In our view, timing the audit to enhance public participation is an important consideration – thus, an audit is best performed before public consultation takes place.





## KEY ELEMENTS OF A LONG-TERM FINANCIAL STRATEGY

- 201 The LTFS is a central feature of Part VIIA of the Local Government Act 1974 (the Act). Every local authority is required (not less than once every three years) to prepare and adopt, through the special consultative procedure, an LTFS relating to 10 or more financial years. An outline of the LTFS is to be included in the annual plan.
- 202 Local authorities own and operate essential community assets, resources and services, and they have responsibilities for maintaining and protecting the quality of the environment. The LTFS should demonstrate how these responsibilities are going to be met. It gives communities assurance that their local authority is planning for the long-term maintenance and sustainability of their environment, key services, and major assets.
- 203 The LTFS is required to address:
- estimated expenses, including an allowance for debt servicing and the decline in the service potential of assets, and the proposed sources of funds to cover the expenses;
  - the reasons why activities are engaged in;
  - estimated cash flow projections;
  - estimates of the creation and realisation of reserves, investments, and assets;
  - estimated changes in the levels of equity and long-term borrowing requirements;
  - estimates of commitments and contingencies for future events;
  - other financial and non-financial information as necessary; and
  - all significant forecasting assumptions and risks underlying the financial estimates and, where these involve high levels of uncertainty, the uncertainty and its potential effects.
- 204 Therefore, we expect any local authority's LTFS to:
- reflect the authority's strategic goals, objectives and performance measures;
  - provide background information on community circumstances;
  - state the assumptions made about, and reflect, changes in community needs and aspirations as these occur or are anticipated – such as through legislative, environmental or technological changes;

## KEY ELEMENTS OF A LONG-TERM FINANCIAL STRATEGY

- indicate options or scenarios that might be expected as a result of change and choices that may be required to be made in the future;
- provide for all legislative obligations to be met;
- outline for ratepayers the role that the local authority anticipates taking and the activities it proposes to engage in over the short term as well as over the duration of the LTFS; and
- provide accurate financial information about activities and proposals for the period (including outlining for ratepayers the impact on rates), which should be reflected in other local authority policies – including the funding, borrowing and investment policies.



## BACKGROUND TO THE PILOT PROJECT

- 301 Under the Public Finance Act 1977, the functions and duties of the Audit Office include undertaking such examinations as we consider necessary to ascertain whether resources of local authorities have been applied effectively and efficiently, consistent with their applicable policies.
- 302 At the end of the financial year, local authorities are required to include in their annual report information about achievement of and variations in the LTFS, and the funding, investment and borrowing management (treasury) policies. This information is not covered by our audit report, but the auditor considers the information to the extent necessary to verify that it is not inconsistent with the audited financial statements.
- 303 We were interested in examining the feasibility of auditing and issuing an opinion on an LTFS because of the opportunity to contribute to the two important issues we discuss in paragraphs 304-308.

### Assurance on Local Authority Infrastructural Asset Management

- 304 Since 1992, we have expressed a number of concerns about the management of local authority infrastructure. Our most serious concern has been the lack of reliable information on infrastructural assets.
- 305 In 1993, most local authorities did not know accurately the condition of assets such as sewerage and water systems, and few had formal procedures to monitor and manage these assets. There have also been changes in environmental and accounting standards, meaning that local authorities are required to identify, remedy and mitigate environmental hazards. Preparation of LTFSs should help to ensure that local authorities are aware of, and prepared to fund, the full costs of their activities.
- 306 The pilot project would (we believed) give us the opportunity to develop methods to test the quality of the LTFS. This is important in achieving best practice in local authority financial management planning and compliance with the objectives of Part VIIA of the Act.

## BACKGROUND TO THE PILOT PROJECT

### Enhancing Accountability and Transparency to Communities

- 307 Every business should plan for the future. However, forward planning is of greater importance for local authorities because it involves community needs and aspirations. The LTFS encapsulates the authority's strategic vision and aligns this vision with preparing and budgeting for the future.
- 308 For the Council, the pilot project would provide independent audit assurance on the LTFS. This would support the provision of a transparent and accountable mechanism for communities to participate in decision-making, and give those communities assurance that their Council is planning for the long term.

### Why We Conducted the Pilot Project with Opotiki District Council

- 309 The Council first discussed with us the possibility of our undertaking an LTFS audit at the conclusion of the 1998-99 annual audit.
- 310 Local authorities' asset management plans (AMPs), prepared in the course of the LTFS, are part of the information auditors consider in forming an opinion on the accuracy of the financial statements in the annual report. The Council's Chief Executive observed that an opinion on the annual report alone did little to reassure readers of the robustness and quality of the Council's planning for the future – particularly for key infrastructural assets where component lives may be well in excess of 75 years.
- 311 The Council took the view that an independent audit was vital to give assurance on the appropriateness, completeness, relevance, accuracy and reliability of the LTFS. An audit of assumptions and data used in preparing the LTFS would enhance community confidence in the document and add value to the consultative process with local communities. The significant overlap with audit work on the annual report provided a cost-effective option to explore what assurance we could offer on the LTFS.

## BACKGROUND TO THE PILOT PROJECT

312 Other factors that supported our decision to undertake the pilot project with this particular Council were:

- The Council had complied early with Part VIIA of the Act, producing an LTFS in 1997. Our verification of the financial information for the 1998 audit involved examining some of the information used for developing the LTFS and meant that the base information for undertaking the audit was available.
- The Council had improved its knowledge of its infrastructure through the AMPs. Substantial recent water and sewerage infrastructure upgrading meant that services were much better understood compared to five years earlier (although there was potential for further refinement as the requirements for AMPs were being developed).
- The nature, stability and size of the Council's activities (relative to other local authorities) made establishing and quantifying risks when forming an opinion or providing assurance more manageable.
- The costs of developing an audit programme for a smaller local authority would be low and the programme more adaptable as new audit issues arose.
- There was a track record of a positive working relationship over the past six or seven years between our approved auditor and the Council, and an enthusiasm by the Council to meet best practice standards. The Council's approved auditor was already familiar with the Council's business, infrastructural assets and key policies.





- 401 For the Council to derive optimum value from the pilot project, production of the LTFS and the audit needed to be concurrent. After we agreed to conduct the pilot project, we met the Council's management team and agreed that:
- the draft LTFS would be substantially completed before we began our work;
  - constant communication would be required for effective co-operation between the auditor and Council management;
  - issues identified during the audit would be immediately discussed and mutually resolved;
  - reference to the audit would be made in the draft LTFS provided for public consultation, to provide independent assurance on the reliability of the document; and
  - after the public consultation process was complete, we would ensure that the effects of the consultation were properly reflected in the final documented LTFS. (Once this had been completed, we would be in a position to issue a formal audit opinion on the LTFS.)

## The Audit Plan

- 402 In accordance with auditing standards, we were required to appropriately plan the audit. This included establishing:
- levels of materiality for financial and non-financial information; and
  - key risk areas.

### *Materiality and Significance Levels for Financial and Non-financial Information*

- 403 When determining the financial materiality levels we considered:
- the users of the LTFS (such as ratepayers or bankers); and
  - the types and amounts of capital and operating expenditure over the period of the LTFS.

## PREPARATION FOR THE PILOT PROJECT

- 404 When determining the significance of non-financial information we considered:
- the degree of change associated with the item (such as changes in level of service);
  - the effect of the item on the LTFS;
  - the extent of public interest in the item; and
  - the associated risk to the Council.
- 405 Because the LTFS covers a 10-year period we also considered how materiality should be dealt with on a cumulative as well as a single-year basis. Over the term of an LTFS, errors can amount in aggregate to a significant error, even though errors in any individual year may not be material in relation to the sums involved in that year.

### *Key Risk Areas*

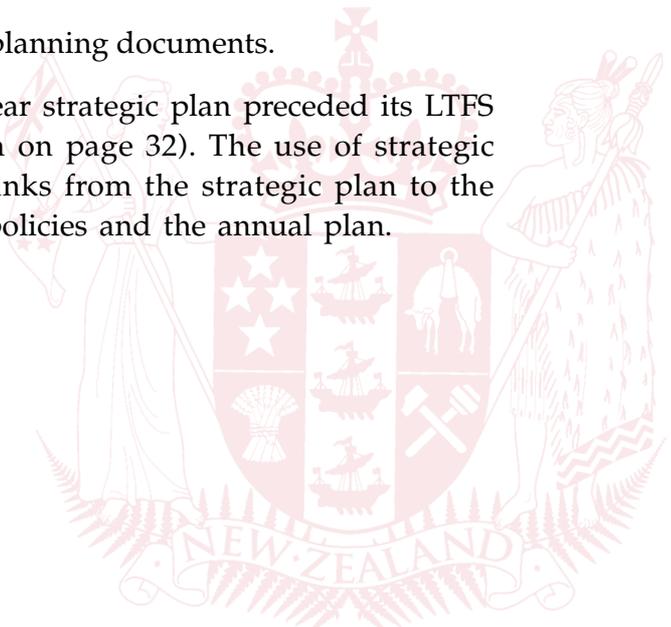
- 406 In identifying key risk areas we considered factors such as:
- integration and linkage with other strategic documents;
  - historical growth trends;
  - robustness of underlying assumptions and compilation processes;
  - completeness of information and underlying data;
  - compliance with legislative requirements and Council policies;
  - the rationale underlying the decisions and strategies reflected in the LTFS; and
  - desired levels of services.
- 407 Planning the audit identified the areas of audit importance and, in effect, laid the foundation for the pilot project.

## AUDITING THE LONG-TERM FINANCIAL STRATEGY

- 501 An audit of an LTFS is different from a normal financial audit. While the information on which an LTFS is based can be tested by techniques that would be used in a financial audit, the information is prospective rather than historical. This requires additional tests of the assumptions made (both financial and non-financial) in preparing the LTFS.
- 502 The assurance that can be given as a result of the audit testing is therefore different from that given through a normal audit. The audit opinion on financial statements states whether they properly reflect – in accordance with generally accepted accounting practice – the financial position, results of operations, and cash flows of the entity for the period. In contrast, our audit of the pilot project sought to form an opinion on whether key elements had been appropriately identified and addressed in the preparation of the Council’s LTFS.

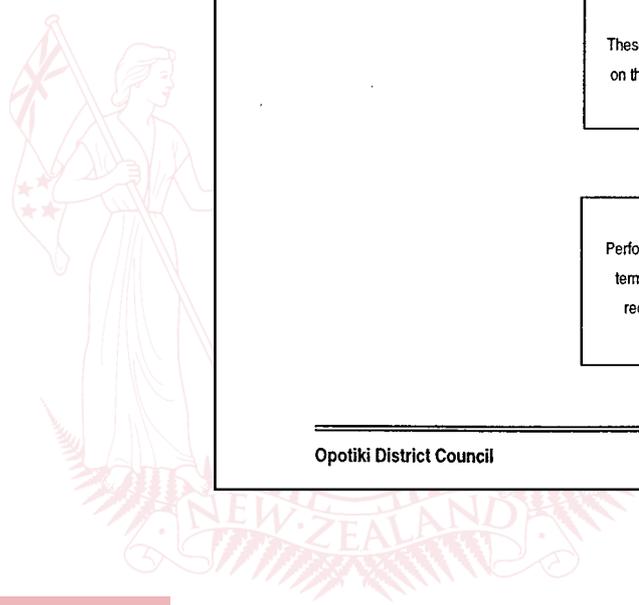
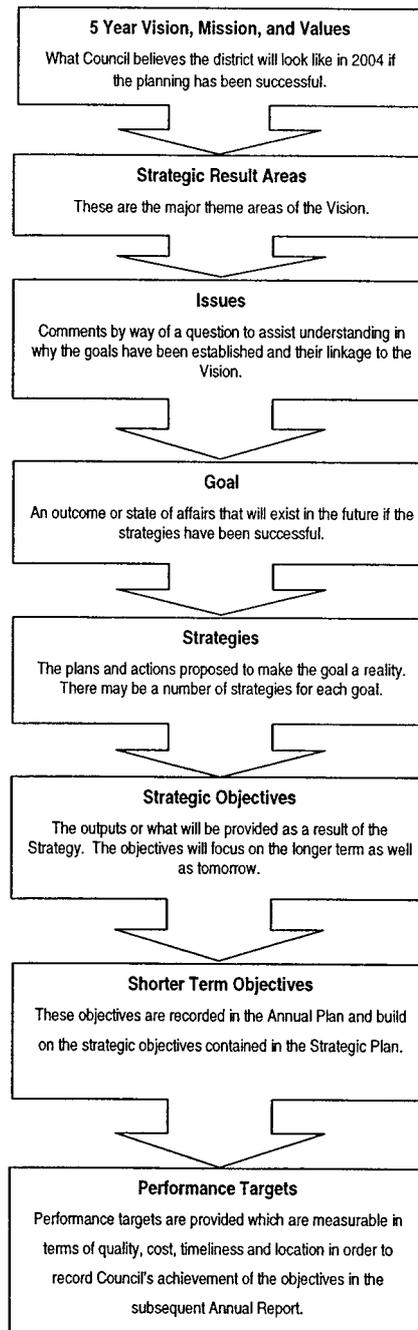
### Strategic Goals, Objectives, and Performance Measures

- 503 The LTFS translates the Council’s strategic direction into an implementation plan for the next 10 years. In determining this strategic direction the Council needs to assess costs and benefits of different options. Once the desired option has been selected, the Council needs to establish formal performance measures to enable the success of the option to be judged.
- 504 We tested whether the strategic goals, objectives and measures were:
  - reasonable;
  - linked together; and
  - consistent with the Council’s other planning documents.
- 505 The Council’s preparation of a five-year strategic plan preceded its LTFS development (using a process shown on page 32). The use of strategic result areas (SRAs) ensured strong links from the strategic plan to the LTFS and subsequently the treasury policies and the annual plan.



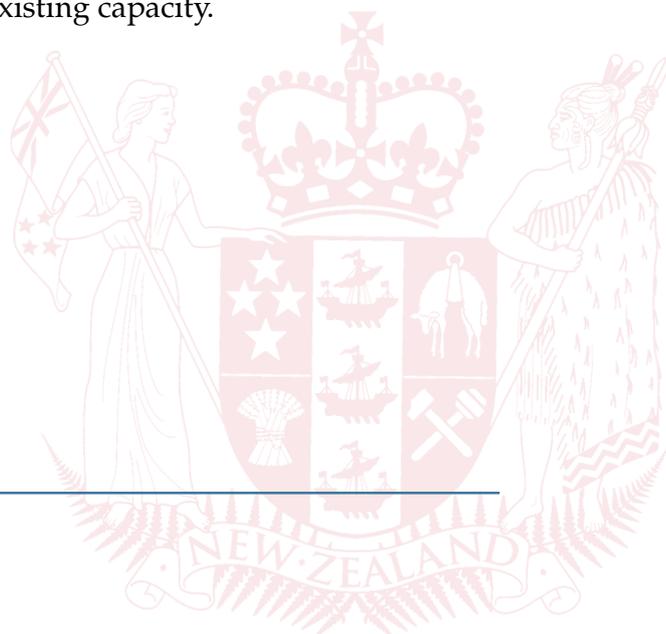
# AUDITING THE LONG-TERM FINANCIAL STRATEGY

For each of the SRA's, Council has identified a number of major issues which are briefly discussed in the following sections on each SRA. A goal has been established that helps to address the issues and contribute towards the vision. The following diagram helps to explain how the process works.



## Background and Statistical Information

- 506 To provide the context within which the LTFS is set, it is important that the document communicates the key environmental factors (such as population demographics and growth) within which the Council operates. We needed to have a comprehensive understanding of this information to ensure that we were aware of the background and other factors affecting the Council.
- 507 The analysis that supported the Proposed District Plan notified in September 1998 provided much of the evidence we used to ensure that the Council had considered the environmental issues facing the district. Environment Bay of Plenty<sup>1</sup> provided data on flood risks to urban areas and significant natural features, and supporting literature was provided by the Department of Conservation. Other initiatives that provided supporting analysis included a Council review of landfill and waste management options.
- 508 Three growth scenarios for the LTFS were developed based on Statistics New Zealand’s high, medium and low population projections for the district. The Statistics New Zealand growth assumptions are based on retrospective data. Accordingly, these projections do not take account of local growth strategies that the Council or other organisations may initiate (such as retirement villages, sports academies, added value processing of forest products, industry development, and other land use initiatives).
- 509 For the purposes of the five-year Strategic Plan and the 10-year LTFS, the “high growth” rate was used for planning. The main reason for this was to demonstrate that the impact of high growth on infrastructural services could be accommodated within their existing capacity.



1 i.e. Bay of Plenty Regional Council.

### About Opotiki District

- 510 The Opotiki district extends over 3,077 square kilometres of the eastern Bay of Plenty, from Ohiwa Harbour in the west to Cape Runaway in the east. The district stretches for 160 kilometres in length with an extensive coastline. A significant area of the district remains in native forest, and much of the rugged hinterland is protected and in public ownership.
- 511 The district's population increased 8% in the five years to 1996, and is projected to grow by over 31% to 12,900 by the year 2021. Approximately 54% of the population are Maori and are represented by three Iwi – Whakatohea Iwi, Ngaitai Iwi, and Te Whanau a Apanui.
- 512 The district economy is based on rural land use, including dairy and beef herds, sheep and kiwifruit. The climate could support a range of horticultural opportunities. Forest plantations have increased and the early plantings are beginning to be harvested, with associated transport issues. Tourism also has potential for development.
- 513 On pages 35-37 are extracts from the Council's LTFS showing examples of the issues considered in the preparation of the LTFS:
- a high level overview of the district's environmental issues; and
  - an excerpt from the growth assumption commentary on the Council's assets.

### Assumptions

- 514 Disclosure of the assumptions underlying the LTFS is fundamental to enable the reader to understand the information contained within it. We tested whether the assumptions were complete and reasonable, and whether their implications were appropriately reflected in the LTFS.
- 515 For that purpose, we needed evidence of a more rigorous analysis of the risks associated with assumptions than that undertaken for the first LTFS in 1997. The Council needed to establish objectively which assumptions involved a high level of uncertainty and to quantify that uncertainty. To that end, for all areas in which assumptions were made, the Council identified:
- the probability of occurrence of the risk;
  - the financial significance of the risk; and
  - the controllability of the risk by the Council.

# AUDITING THE LONG-TERM FINANCIAL STRATEGY

**Part C – Long-Term Financial Strategy** 

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**5 STATEMENT OF ENVIRONMENTAL ISSUES**

The environmental issues facing the district include:

- **Maintenance of high environmental quality**  
The district's environment is of a high quality much of it is in its natural state untouched by development. This environmental quality has the potential to be compromised and deteriorated by adverse effects of land use activities.
- **Coastal Resources**  
The natural character of the coastal environment includes many important habitats of flora and fauna. These sensitive resources can be adversely affected by and land use activities particularly activities and development that are not undertaken in a planned and coherent manner.
- **Coastal Development**  
Opotiki district has the largest coast line of any local authority in the Bay of Plenty. The resident population along the coast is small in comparison to other Bay of Plenty local authorities. The environmental quality of the coast can be adversely affected by the demand for residential development and through the inadequate provision and supply of services.
- **Urban Growth**  
The high growth projection by Statistics NZ shows the district's population is expected to increase to 12,900 by 2016. The location of residential growth areas, and the effects on the surrounding environments needs to be considered. The effects of servicing residential activities also requires consideration.
- **Flood Risk in the Opotiki Township**  
Opotiki township is located at the confluence of the Waioeka and Otara Rivers. The part of the town located on the river flats is very susceptible to flood events. While the risk of severe flooding to the town has been reduced the combination of high tide and high rainfall events could result in flooding in the town.
- **Natural Values of the District**  
Areas of the district provide habitats for many flora and fauna, both indigenous and introduced. The district also has a number of important landscapes in the district. Land use activities can depreciate these resources either by alteration, modification, or destruction of the flora and fauna habitat, or by alteration to the land that houses the habitat.

Council is addressing these and other environmental issues through strategic planning and the District Plan.

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Strategic Plan 1999 – 2004 80 Opotiki District Council



## AUDITING THE LONG-TERM FINANCIAL STRATEGY

### Part C – Long-Term Financial Strategy



The UAGC for 1999/2000 is proposed to be \$250:00 and if continued to be used through to 2009, the general rates rating base would increase 21% over that time. This percentage is based on the 1999/2000 general rates revenue required.

The reason there is a difference between uniform annual general charges and the number of rates assessments is that properties which are adjoining and used for the same purpose by the same occupier can be considered contiguous and amalgamated for rating purposes and then only one UAGC is charged. This occurs frequently in rural areas for farming activities. It is also prevalent in new subdivisions until the individual lots are sold by the developer.

The additional housing requirements for the projected population growth will lead to additional subdivision, although there is a stock of existing undeveloped lots in the urban and rural area.

Any subdivision will require reserve contributions and may see the transfer to Council of infrastructural assets such as roading, water supplies, sewerage schemes and reserves. However, no provision has been made in the LTFS for the value of any assets that may be vested because:

- Roads  
The current network of local roads and state highways is likely to be sufficient for future subdivision. Also most local road vehicle counts are currently relatively low and will not require upgrade for any additional traffic volumes caused by subdivision.
- Water and Sewerage  
There will be little new subdivision in the Opotiki urban area outside the existing reticulated area and thus no new water supply infrastructure required.

The Opotiki sewerage scheme has capacity for 100 additional residential connections and the treatment system can accommodate 50% more volume of effluent.

Minimum lot sizes of new subdivisions in the Opotiki urban area that are not reticulated for sewerage (i.e. Woodlands) will be restricted to ensure on-site effluent disposal (septic tank) is practical and thus avoid the need to extend the Opotiki sewerage reticulation to the Woodlands area during the next 10 years.

It has been assumed that any large scale rural subdivision requiring a community water supply or sewerage scheme will be owned and operated privately by the property owners being served by those schemes.



# AUDITING THE LONG-TERM FINANCIAL STRATEGY



## Part C – Long-Term Financial Strategy

Subdividers are also required to provide recreation reserves and in some instances esplanade reserves. No allowance has been made for the vesting of these assets in Council. An allowance of \$20,000 per year has been made for cash in lieu of reserve contributions where the subdivider has been unable to provide reserves.

Some future projects such as rural seal extension, urban kerb and channel, reserve developments, new public toilets, etc require the local economy to continue at its present level or better. Any decline will cause future Councils to revisit some projects and services.

### 6.3 Economic Outlook

In preparing strategies and financial projections beyond 3 – 5 years, there is a need to factor in some economic stability so that inflationary factors do not mask changes in real costs projected over that period. However, some view of futures costs of funds i.e. interest on investments and debt, is important if the treasury policy is to have any importance in the planning process.

A summary from the February 1999, Bay of Plenty Economic Monitor is useful to glean an overview of the economy.

#### Summary

New Zealand's economy had a good beginning in 1999, which has been reflected by a series of recent positive economic data, such as retail sales, car registrations, property sales, and international arrivals. Consistent with the upbeat trend was the national Bank's latest business confidence survey results. Propelled by low interest rates, business confidence surged again to its highest level since March 1994, with a net 68% of respondents to the February survey expecting better times in the next 12 months, up from a net 44% in December. The improved confidence was spread across manufacturing, construction, service and retail firms, leaving only agriculture dragging behind, due to low commodity prices and drought. Exporters are the most optimistic since mid 1994, with a net 52% respondents expecting to ship more products in the year ahead. Despite a number of positive factors, there are risks that challenge the economy, including the high domestic debt, the deteriorating current account deficit, the appreciating pressure on the Kiwi dollar this year, and likely imbalanced economic growth. Overall however, the scene is positive as we move towards the millennium.



## AUDITING THE LONG-TERM FINANCIAL STRATEGY

516 The Council's analysis of the assumptions underlying the LTFS resulted in the following risk matrix:

Assumption Headings	RISK CATEGORIES		
	Probability of Occurrence	Financial Significance	Controllability
1 Growth	Medium	Low	External
2 Economic outlook	Medium	Low	External
3 Inflation	High	Low	External
4 Interest rates	High	Low	External /Internal
5 Debt and sinking funds	High	High	Internal
6 Marketable securities	High	Low	Internal
7 Roothing	High	High	External
8 Local government	Medium	Low	Internal
9 Insurance	Low	High	External
10 Organisation	Low	Medium	Internal
11 Taxation	Low	Medium	External
12 Decline in service potential	Low	Medium	Internal
13 Solid waste	Medium	High	Internal
14 Cemetery	Medium	Low	External /Internal
15 Pensioner housing	Medium	High	Internal
16 Resource consents	Medium	High	Internal
17 Asset management plans	Medium	High	Internal
18 Year 2000 readiness	Low	Medium	External /Internal
19 Loan guarantees	Low	Medium	External
20 Information systems	Low	Medium	Internal

## AUDITING THE LONG-TERM FINANCIAL STRATEGY

- 517 As a result of this analysis, the Council identified that high levels of uncertainty were involved with the assumptions for roading, solid waste, and debt and sinking funds.
- 518 The risks associated with roading arose because the draft LTFS was prepared during a period of high uncertainty about proposed roading reforms. The Council had a comprehensive discussion with us about the assumptions on which the LTFS was to be based. While the status quo and the alternative of roading reform were both assumptions that carried risks, the assumptions associated with the status quo were less uncertain.
- 519 The assumption made was that the Council would continue to manage local roads directly and that the Transfund New Zealand subsidy and property rates would continue to be the major funding sources. Explanations were provided in the LTFS about the high risk associated with this assumption and its potential effect on the financial estimates.
- 520 There were three sources of risk associated with the assumptions in relation to solid waste:
- that the community would not support the “zero waste” philosophy adopted by the Council and, therefore, that waste disposed of in landfills would not decline as projected;
  - that costs of removal, reduction, recovery, reuse, recycling and disposal associated with the zero waste policy would exceed the Council’s projections; and
  - that no landfill site could be found in the Eastern Bay of Plenty for the district’s residual waste.
- 521 Pages 40-42 show the additional information that was provided in the LTFS in relation to these assumptions and risks.



Part C – Long-Term Financial Strategy



Any change in management and funding is likely to take over three years to implement. This is based on a year to introduce the new legislation and 2½ years implementation programme set out in “Better Roads, Better Transport”.

The implications of this reform, if introduced, would see roading staff transferred to the local roading company, and the removal of rates from roading in 2003. The financial implications have been calculated as at \$1.4 million or 38% reduction in general rates. However, Council will still need to have some involvement in roading through share ownership of the local roading company and negotiations of the terms and conditions of a corridor management agreement. The reduction in general rates above has been calculated before any accompanying overhead reduction which will be offset by the need to retain some degree of expertise in roading matters

6.9 Local Government

The current units of local government remain substantially unaltered since 1989. The Local Government Commission has recently made determinations in respect of proposals for Hawkes Bay and Christchurch/Banks Peninsula. These have been at the request of communities in those areas rather than any particular government policy for reducing the number of units of local government. The emphasis continues to be on communities of interest and efficiency and effectiveness.

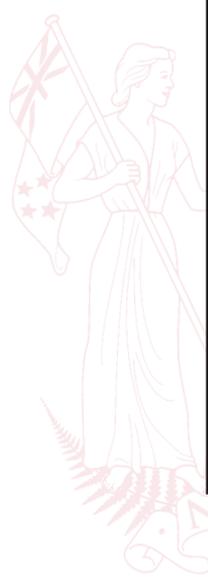
There are opportunities for efficiencies from joint ventures and contracting out to adjoining local authorities. However, it is contested that Opotiki District Council, as a body of elected members, needs to continue in existence if, because of the rural nature of the area, there is to be any practical representation of the 10,000 people in an area covering 3098 km<sup>2</sup> i.e. 3.3 people per km<sup>2</sup>. This need to preserve the representation through a uniquely Opotiki District Council identity is a theme of the Strategic Plan and reinforced in the LTFS and Annual Plan.

6.10 Insurance

Council has in excess of \$120 million of infrastructural assets. Risks are associated with damage to assets, either through accident, disaster, fire, fidelity and negligence.

Council has a range of insurance practices to protect it from these risks, including:

- membership of Risk Pool, a mutual liability fund
- member of Local Authority Protection Plan, a mutual scheme established to provide for 40% replacement of infrastructural assets in the event of a natural disaster and where a civil emergency is declared. The other 60% is funded by the government if it is satisfied Council has made the appropriate protection arrangements prior to the disaster.
- various general insurances such as business interruption, material damage, vehicles, computers, personal accident, civil defence emergency costs etc





# AUDITING THE LONG-TERM FINANCIAL STRATEGY

## Part C – Long-Term Financial Strategy



The risks are therefore threefold:

- that the community does not embrace the “zero waste” philosophy and waste to be disposed of in landfills does not decline as projected
- that the economics of removal, reduction, recovery, reuse, recycling, residual disposal are not efficient and the costs of the processes are in excess of Council’s projections
- that no landfill can be found in the Eastern Bay of Plenty for the district’s residual waste

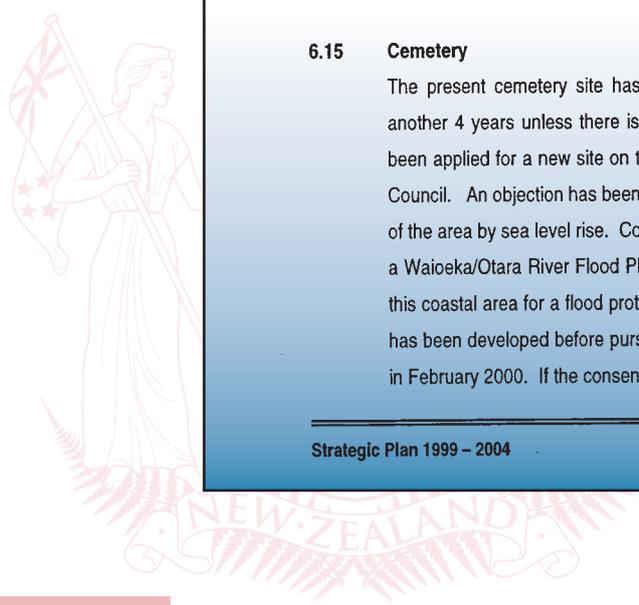
The table below shows the sensitivity of daily residual waste disposal costs of distance, weight and landfill gate charges:

Variables	Our	Most	Most
	Prediction	Optimistic	Pessimistic
Volume per day of residual waste in 2003	9.59 tonne	5 tonne	22 tonnes
Distance to landfill	50kms	50kms	400km
Cost per tonne per kilometre for transport is projected at 10 cents per km	\$ 5	5	40
Land fill charge per tonne	\$ 36.43	30	100
Total daily landfill charges	\$ 349.36	150	2,200
Total daily cost of residual waste disposal including transport and charges	\$ 397.31	175	3,080
Total Annual costs	\$ 145,000	63,875	1,124,200
Costs per population per year in 2003	\$ 13.88	6.08	107.07
Costs per ratable assessment per year in 2003	\$ 35.71	15.73	276.90

Part of the waste management strategy requires a resource recovery facility in Opotiki. Designs are at a preliminary stage and full costings have not been completed. The facility is budgeted to cost \$240,000. There are also some risks about the after care closing costs of the Woodlands Road dump. However, these are not considered high given that most of the refuse has been household by nature.

### 6.15 Cemetery

The present cemetery site has sufficient plots for 150 further interments and is estimated to last another 4 years unless there is a change in weighting towards cremation. A resource consent has been applied for a new site on the recreational coastal reserve east of town (Snells Beach) vested in Council. An objection has been received from Environment Bay of Plenty concerned about inundation of the area by sea level rise. Council has obtained contrary advice from an expert. In addition, there is a Waioeka/Otara River Flood Plain Management Plan being prepared which may consider the use of this coastal area for a flood protection spillway. Council has decided to wait until the Flood Plain Plan has been developed before pursuing the cemetery consent application further. This is expected to be in February 2000. If the consent application is declined or Council decides not to pursue the cemetery



## Financial Information

- 522 The LTFS must translate strategic and operational decisions into financial consequences. It is, in effect, the Council's budget for the next 10 years – reflecting the expected operational and capital costs (together with the associated financing) required to deliver the agreed levels of service.
- 523 We assessed the budget preparation process and, when we had determined that it could be relied on, we undertook specific detailed testing. The purpose of the tests was to form a conclusion on whether the financial information was soundly based and fairly reflected in the LTFS.
- 524 Local authorities are increasingly using debt to achieve the intergenerational equity principle of the Act. An audit report attesting to prudent financial management can therefore be important for demonstrating wise stewardship by a local authority.
- 525 Particular commentary in the LTFS focused on debt management information. Over the previous five years and the forthcoming two, the Council would spend some \$8 million on deferred maintenance and new infrastructure. This would give rise to a substantial increase in debt, which six years ago amounted to less than \$0.5 million. For this reason, the community needed reassurance that these levels of debt were still prudent. Comprehensive debt profiles with supporting treasury policy were used as evidence for the audit.
- 526 Pages 44-46 show extracts from the LTFS presenting:
- forecasts of financial performance and financial position; and
  - net debt information.

## Legislative Compliance Disclosures

- 527 The Act requires the LTFS to include a number of specific statements and disclosures. We looked at whether all the legislative requirements had been appropriately complied with.



# AUDITING THE LONG-TERM FINANCIAL STRATEGY

Part C – Long-Term Financial Strategy

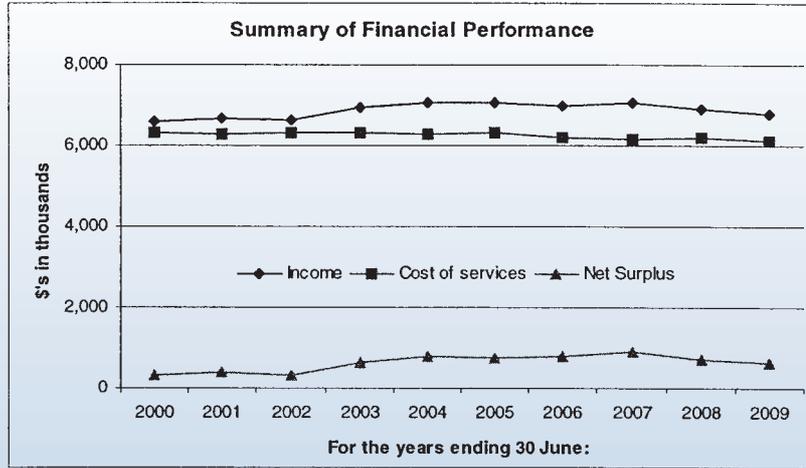


3 SUMMARY OF LONG-TERM FINANCIAL STRATEGY

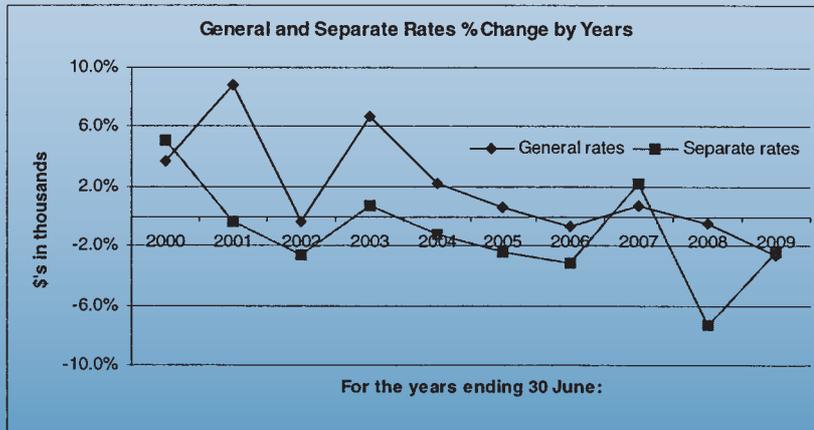
3.1 Financial Performance Summary

For the year ending 30 June:	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
\$'s in thousands										
Income	6,606	6,669	6,641	6,937	7,042	7,060	7,000	7,056	6,900	6,781
Cost of services	6,308	6,290	6,313	6,297	6,277	6,302	6,205	6,161	6,205	6,134
<b>Net Surplus</b>	<b>298</b>	<b>379</b>	<b>328</b>	<b>640</b>	<b>765</b>	<b>759</b>	<b>795</b>	<b>895</b>	<b>695</b>	<b>647</b>

Income will exceed costs of providing services in all of the next 10 years of this LTFS. The surplus will range from \$298,000 in the first year of this LTFS to a high of \$895,000 in 2007.



General rates are proposed to increase 3.76% in 1999/2000. They will increase by 9% next year which has been caused in part by the deferral of capital expenditure from 1999/2000. The LTFS then predicts a just over 6% increase for 2003 and from then on less than 2% over the remaining 10 years of the period of the LTFS.



# AUDITING THE LONG-TERM FINANCIAL STRATEGY

Part C – Long-Term Financial Strategy										
<b>3.2 Analysis of Surplus</b>										
The surplus each year is used to fund a number of balance sheet items such as capital expenditure, loans repayments, increase in reserves etc. The table below shows how the surplus has been used.										
<i>For the year ending 30 June:</i>	Budget	Indicative	Indicative	Forecast						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>\$'s in thousands</i>										
Net Surplus on Operations	298	379	328	640	765	759	795	895	695	647
Represented By:										
Interest & Contributions to Reserves	32	37	50	63	64	60	56	58	61	66
Contribution to Roading Expenditure	75	-	-	-	-	-	-	-	-	-
Roading funded by Transit Subsidy	120	289	247	293	306	292	319	320	295	288
Capital Expenditure Rates	-	25	-	-	12	15	15	115	-	-
Provision For Non Collection	128	130	133	139	141	141	140	140	140	136
Doubtful Debt Adjustment	-71	-106	-106	-71	-26	-9	-9	-9	-9	-9
1998/99 Dogs control deficit C/F	16	-	-	-	-	-	-	-	-	-
Loan Repayment from Rates	4	-	-	-	-	-	-	-	-	-
<b>Net Surplus</b>	<b>298</b>	<b>379</b>	<b>328</b>	<b>640</b>	<b>765</b>	<b>759</b>	<b>795</b>	<b>895</b>	<b>695</b>	<b>647</b>
<b>3.3 Analysis of Use of Depreciation</b>										
Council is required to ensure income exceeds expense and expenses must include a provision for depreciation. This means that depreciation is funded. The resultant funds can be used for capital items such as capital expenditure and renewals, loans, leases etc and transfers to reserves. The table below shows how the depreciation will be used for each of the next 10 years.										
<i>For the year ending 30 June:</i>	Budget	Indicative	Indicative	Forecast						
	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>\$'s in thousands</i>										
Capital Expenditure	939	817	794	814	825	954	821	866	891	891
Loan repayments	174	202	214	253	232	213	213	213	176	176
Transferred to reserves	12	126	150	122	122	21	171	134	164	174
<b>Total Depreciation</b>	<b>1,125</b>	<b>1,145</b>	<b>1,158</b>	<b>1,189</b>	<b>1,179</b>	<b>1,188</b>	<b>1,205</b>	<b>1,213</b>	<b>1,231</b>	<b>1,241</b>
<b>3.4 Financial Position Summary</b>										
<i>As at 30 June:</i>	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
<i>\$ in thousands</i>										
Fixed Assets	119,800	120,484	120,639	120,818	121,045	121,422	121,642	121,994	122,151	122,248
Other Assets	2,039	1,964	1,913	2,277	2,209	2,236	2,345	2,371	2,774	3,062
<b>Total assets</b>	<b>121,839</b>	<b>122,448</b>	<b>122,552</b>	<b>123,095</b>	<b>123,254</b>	<b>123,658</b>	<b>123,987</b>	<b>124,365</b>	<b>124,925</b>	<b>125,310</b>
Liabilities	8,628	8,857	8,634	8,537	7,930	7,575	7,108	6,593	6,458	6,195
<b>Total equity</b>	<b>113,211</b>	<b>113,591</b>	<b>113,918</b>	<b>114,559</b>	<b>115,324</b>	<b>116,082</b>	<b>116,878</b>	<b>117,773</b>	<b>118,467</b>	<b>119,115</b>
Opotiki District Council										
75										
Strategic Plan 1999 – 2004										



# AUDITING THE LONG-TERM FINANCIAL STRATEGY

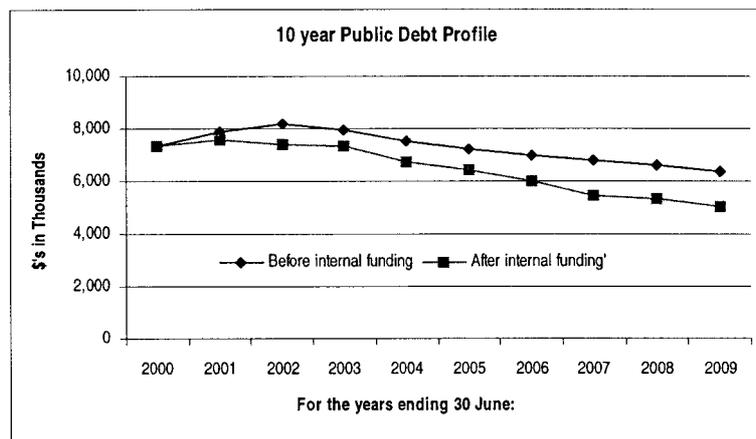


## 16 LONG TERM DEBT

### 16.1 Overview

Council has borrowed money to be repaid over the longer term from 5 years to 50 years. There are a number of valid reasons why Council has chosen to use debt for funding assets that are used in providing services to the district. They are:

- To assist and ensuring that the costs of assets that will provide benefits through service over many years are funded in a similar manner so that the costs of the asset are recovered at the time the benefits of the purchase accrues. This is in line with the first Funding Policy Principle.
- There is a community expectation for a service but the assets required to provide the service are in excess of what is perceived as affordable in a single year and that it has been proven through the Long-Term Financial Strategy as affordable over the longer term by using debt. Affordability is a relative term and is determined by elected members and community through the consultative process for Council's planning activities.
- The transaction costs of Council raising a single loan are likely to be significantly lower than the collective costs of ratepayers making their own financial arrangements to make lump sum contributions to long term assets. Council has a Treasury Policy that provides specific policies, practises and guidelines for the management of borrowing and its repayment. This Long-Term Financial Strategy shows that debt will increase to \$7.6 million in year 2001. However, Council will be holding cash reserves during the period of the LTFS which are to be used to fund part of the debt. This has the advantage of reducing the cost of debt and increasing returns on investments i.e. a high interest rate on investment but a lower interest rate on debt. The graph below shows the debt before and after using internal funding.

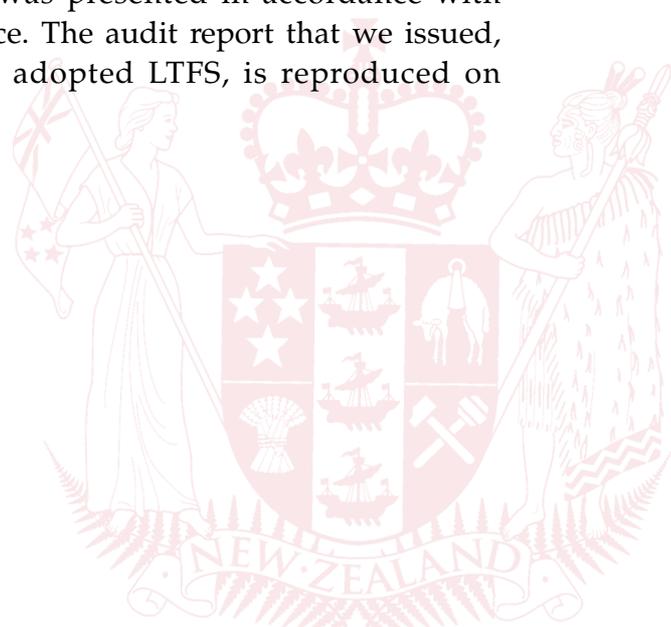


## Linkage with Policy and Other Documents

- 528 Most local authorities have comprehensive internal systems for the development and implementation of strategies, goals and action plans. The outputs of these internal systems are documents such as AMPs, feasibility studies for planned capital works, and the treasury policy. It is essential that the key considerations and financial implications of these internal documents be properly reflected in the LTFS.
- 529 The AMPs form an essential source of much of the financial information. The infrastructure for which the Council is responsible gives rise to a significant element of Council spending. Consequently, determining the reliability and completeness of the AMPs was a critical part of the pilot project.
- 530 We confirmed that these internal documents, including the AMPs, linked to the financial and non-financial information disclosed in the LTFS. We also sought to establish whether significant issues identified in these documents were clearly explained in the LTFS text, and appropriately reflected within the financial forecasts.

## Result of the Pilot Project

- 531 The result of the pilot project was the issue of an audit report on the LTFS. We were able to give a “negative assurance” on whether key elements had been appropriately addressed and identified in the LTFS.
- 532 We were also able to form an opinion that the LTFS had been properly prepared on the basis of the assumptions adopted, and that the financial information contained in the LTFS was presented in accordance with generally accepted accounting practice. The audit report that we issued, which was included as part of the adopted LTFS, is reproduced on pages 48-49.





**REPORT OF THE AUDIT OFFICE**

**TO THE READERS OF THE LONG-TERM FINANCIAL STRATEGY OF  
OPOTIKI DISTRICT COUNCIL  
FOR THE TEN YEARS 1 JULY 1999 TO 30 JUNE 2009**

We have examined the long-term financial strategy on pages 73 to 172. The long-term financial strategy provides information about Council's:

- < estimated expenses, and the reasons why the activities giving rise to these expenses are to be engaged in;
- < proposed sources of funds to cover the estimated expenses;
- < estimated cashflow projections;
- < estimated changes in the level of equity;
- < estimated long-term borrowing requirements;
- < estimated commitments and contingencies; and
- < and other financial and non-financial information necessary to meet the requirements of section 122C of the Local Government Act 1974;

for the period 1 July 1999 to 30 June 2009.

**Responsibilities of the Council**

The Local Government Act 1974 requires Council to prepare a long-term financial strategy. Council is responsible for the long-term financial strategy, including the assumptions (set out in pages 81 to 91) on which it is based.

**Audit Office's Responsibilities**

We have agreed with the Opotiki District Council that our responsibility is to express an independent opinion on the long-term financial strategy and to report our opinion to you.

**Basis of Opinion**

In this context an examination includes assessing evidence relevant to the amounts and disclosures in the long-term financial strategy. It also includes assessing:

- < the significant assumptions, estimates and judgements made by the Council in the preparation of the long-term financial strategy; and





- < whether the accounting policies adopted in the long-term financial strategy are appropriate to Council’s circumstances, consistently applied, and adequately disclosed.

We conducted our examination in accordance with the relevant professional standards in New Zealand applicable to the examination of prospective financial information. Our examination procedures were restricted to assessing the reasonableness of the assumptions and reviewing documentary evidence and analytical procedures to determine if the long-term financial strategy was properly prepared on the basis of the assumptions adopted. In forming our opinion, we also evaluated the overall adequacy of the presentation of information in the long-term financial strategy.

The long-term financial strategy is based on a mixture of best-estimate and hypothetical assumptions about future events and management actions. Consequently, readers of the long-term financial strategy are cautioned that the forecast and projected financial information may not be appropriate for purposes other than those described above.

**Opinion**

Based on our examination of the evidence supporting the assumptions, nothing has come to our attention that causes us to believe that:

- < the assumptions set out in pages 81 to 91 do not provide a reasonable basis for the long-term financial strategy of Opotiki District Council on pages 73 to 172; and
- < the strategy does not comply with current Council policies.

Further, in our opinion the long-term financial strategy is:

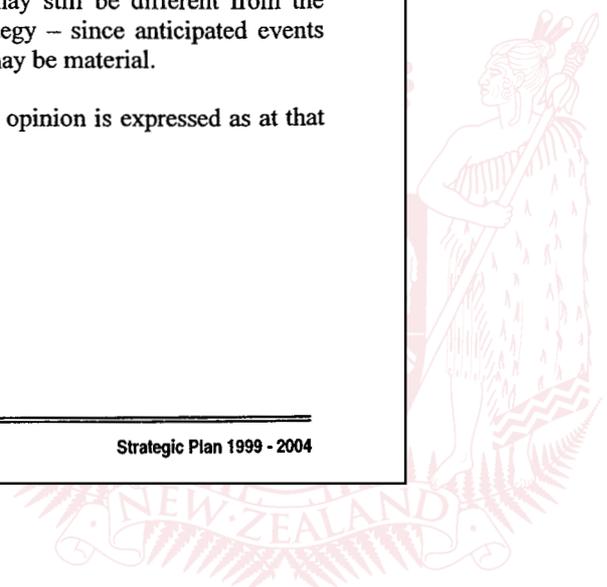
- < properly prepared on the basis of the assumptions adopted; and
- < the financial information contained therein is presented in accordance with generally accepted accounting practice.

Even if the events anticipated under the best-estimates and hypothetical assumptions described in pages 81 to 91 do occur, actual results may still be different from the forecast and projections in the long-term financial strategy – since anticipated events frequently do not occur as expected – and the variation may be material.

Our examination was completed on 6 July 1999 and our opinion is expressed as at that date.

*Laurie Kemble*

Laurie Kemble  
Audit New Zealand  
On behalf of the Controller and Auditor-General  
Tauranga  
New Zealand





## BENEFITS AND RISKS OF INDEPENDENT ASSURANCE

601 A key objective of the pilot project was to provide independent assurance on the LTFS as a consultative document. The Council reported that it found participating in the pilot project a very valuable exercise. In its view, the audit tested the Council’s long-term strategic planning, with a particular focus on the financial aspects.

602 The audit report provided assurance on the LTFS and:

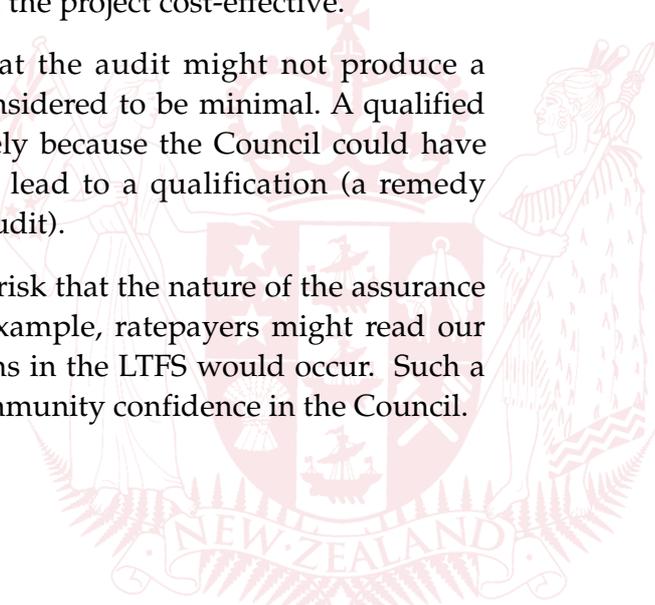
- improved the quality of the 1999-2009 LTFS forecasting;
- enhanced the relevance and reliability of the AMPs;
- encouraged rigour in the assumptions and cost estimates of scenarios in areas of uncertainty;
- generated free and frank debate within the Council about strategies and policies and their linkage, leading to more robust policies underlying the LTFS; and
- provided an external review of financial and policy advice for elected members.

603 Some of the benefits of this pilot would accrue from any external review of the LTFS. However, the Council felt that an Audit Office report was more credible to the public than a report which could be provided by other external appropriately qualified and skilled consultants.

604 There were also advantages arising from an overlap of the annual audit and LTFS audit work. Our audit staff already had an appreciation of the Council’s systems and structures as they applied to the pilot project. The Council saw this as making the project cost-effective.

605 The main risk to the Council was that the audit might not produce a positive result for it. This risk was considered to be minimal. A qualified opinion, although possible, was unlikely because the Council could have remedied any circumstances likely to lead to a qualification (a remedy not always possible in a retrospective audit).

606 From our perspective, there was also a risk that the nature of the assurance given might be misinterpreted. For example, ratepayers might read our opinion as assurance that the projections in the LTFS would occur. Such a misinterpretation could undermine community confidence in the Council.





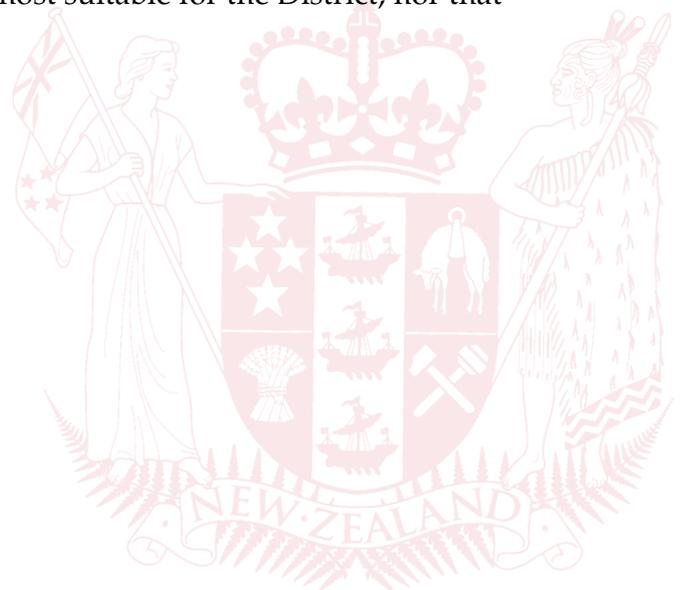
- 701 A final objective of the pilot project was to assess the feasibility of, and lessons that could be learned from, applying audit techniques to a prospective financial planning document. A number of issues arose from the pilot project.

### Timing the Audit to Enhance Public Participation

- 702 An LTFS audit aids transparency in public consultation and decision-making. However, the final audit report could not be released until the Council had adopted the LTFS. Audit assurance in the form of the audit report could not be available before consultation with the public and decision-making by councillors.
- 703 For the pilot project, the draft LTFS made reference to the pilot project being undertaken. One option may be to issue an interim audit report on the draft LTFS document before it is issued for public consultation.

### The Nature of the Assurance

- 704 There are questions around the type of assurance or audit report we should issue and how users of the financial statements and the local community may interpret it. The nature of the assurance given by the report must be clear and not susceptible to misinterpretation.
- 705 As already noted, the assurance that can be given on prospective information is based on ensuring that key elements in its preparation have been appropriately identified and addressed. It does not provide an assurance that the specific plan is the most suitable for the District, nor that it will be implemented.



### Legislative Requirements in Relation to Options and Assumptions

706 Section 122M of the Act requires that, in preparing an LTFS, a local authority identify significant forecasting assumptions. However, section 122c(1)(c) also requires that a local authority assess the cost and benefit of options in making decisions with significant financial consequences. This latter requirement suggests that a council:

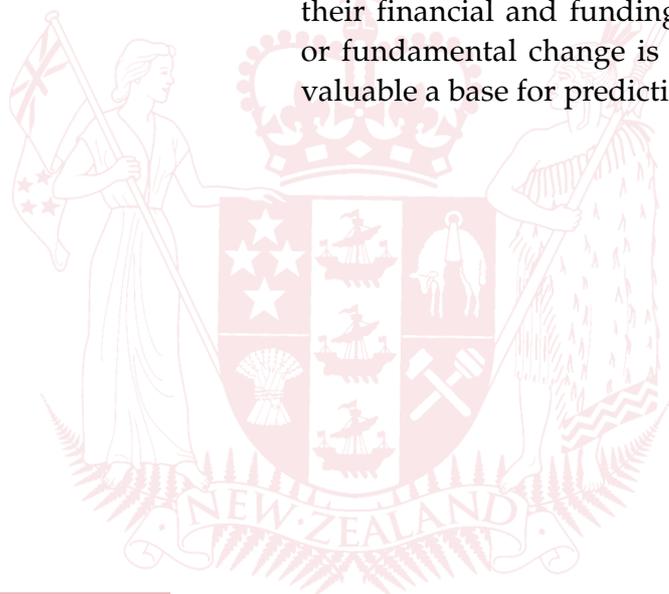
- needs to develop a policy to help its staff identify what is significant in any situation for a range of requirements; and
- should implement a programme to determine regularly whether services and activities ought to be reviewed in order to allow it to assess the costs and benefits of its options.

707 The pilot project focused on dealing with the identification of assumptions and the significance of those assumptions. Other work being undertaken this year in relation to the review by the early nine of their LTFS and funding policies will also look at how the requirements of sections 122c(1)(c) and 122M, in terms of significance, can be addressed.

### Usefulness of Historical Information

708 Auditing an LTFS relies on the premise that assumptions and information drawn from historical data can be used to form estimates for the future. Given high uncertainty and rapid change, future projections based on historical data may decline in usefulness.

709 Further, local authorities are democratic organisations – elected representatives and communities are constantly making choices about their financial and funding decisions that affect the future. Where major or fundamental change is being considered, historical data will not be as valuable a base for prediction as in times of more incremental change.



## Translating Strategic Objectives into the LTFS

- 710 Local authorities' strategic plans provide the direction on which the LTFS is based. The relationship between strategic outcomes and activities is complex, and is based on assumptions and judgements made by local authorities. Some local authorities may see them as too complex to be quantified or predicted. However, the relationship between outcomes and activities should be monitored (such as through research information and indicators) – and the results of council activity evaluated because of their importance in the strategic plan and as the basis that underlies the LTFS.
- 711 The pilot project involved ensuring that the Council's LTFS reflected the directions and priorities indicated in the Strategic Plan. However, the pilot project did not test the relationship between outcomes and the activities selected as a means of achieving them.

## The Interaction of Strategic and Financial Planning

- 712 Frequently, a council may be required to choose among a number of options in preparing its LTFS. To allow the public to participate in these choices, strategies might need to indicate the underlying scenarios – making the information potentially complex for the public to understand. Therefore, where we identified uncertainty in the Council's assumptions about the future of services, we noted this uncertainty – potentially leading to the Council selecting the scenario that could most easily be quantified.
- 713 However, the most easily quantified option will not always be best or preferred. To this extent, the process of attempting to provide a high level of assurance about the information presented in the LTFS and its purpose – to promote transparency in local authority decision-making – may conflict.

## The Next Pilot Project

- 714 Among the reasons we selected the Council for the pilot project were its stability and relatively small size. The next step in the development work is to test our methods in a local authority strategic planning environment where more change is being experienced. The Western Bay of Plenty District Council agreed to participate in a second pilot project and we will be reporting on the results later this year.

