In Confidence

Office of the Minister of Local Government

Chair
Cabinet Economic Growth and Infrastructure Committee

LOCAL GOVERNMENT FINANCIAL PRUDENCE REGULATIONS

Proposal

1. This paper recommends the details of financial prudence benchmarks for local government and requests approval to issue drafting instructions for financial prudence regulations. It also proposes processes for publication, presentation and interpretation of the results.

Executive Summary

2. One element of the Better Local Government programme is the introduction of regulations setting financial prudence benchmarks for local authorities. The regulations will encourage better local authority financial governance and management. They will foster a culture of continuous improvement across the local government sector and showcase best practice and excellence in local authority financial management. Conversely, they will also assist me to determine whether, in the case of any particular local authority, financial management problems are such that I should initiate any of the four assistance and intervention options in the Local Government Act 2002 (LGA02).

3. I propose seven benchmarks organised around three elements of financial prudence – affordability, sustainability and predictability. These would be complemented by two indicators of affordability.

4. The most desirable outcome from this proposal is that local government sees this as an opportunity to showcase excellence and to share best practice. This would result in a lift in local authority performance for ratepayers across the local government sector and would help avoid the need for central government intervention in individual local authorities.

5. For this outcome to be achieved it will be necessary for the results to be collated, published, and interpreted in a manner that is credible to local authorities. The diversity of the local government sector means that the context of each local authority's situation must be considered when making comparisons between authorities.

6. I intend that my officials work collaboratively with Local Government New Zealand (LGNZ) and the Society of Local Government Managers (SOLGM) to develop the format of publication, an evaluation framework for the results, and protocols for release. This will ensure that both the local government sector and individual local authorities are not surprised when results are published.

7. I propose that the first requirement for local authorities to disclose performance against the benchmarks be in their annual reports for 2013/14. These are due to be published by 31 October 2014.

Background

8. On 19 March 2012, Cabinet approved a local government reform programme including introduction of local government "fiscal responsibility requirements" [CAB Min (12) 9/4 refers]. The requirements are necessary because the current legislative framework lacks sufficient incentives for local authorities to keep costs down and avoid unacceptable expenditure, rates and debt increases. The requirements are to set financial benchmarks for local authorities in respect of income, expenditure and prudent debt levels. Cabinet agreed that they be set in regulations developed in consultation with LGNZ.

9. Subsequently Cabinet agreed that the phrase "fiscal responsibility requirement" be renamed "financial prudence requirement" [LEG Min (12) 5/5 refers].

10. Cabinet has also agreed to require local authorities to disclose information about the number of rating units and the rateable capital and land values of their districts in long-term plans, annual plans and annual reports [EGI Min (13) 16/9 refers]. This requirement will be included in a Local Government Act 2002 Amendment Bill (the Bill) to be introduced into the House shortly. The availability of this information will create options for a wider range of financial prudence benchmarks than is currently feasible.

11. The financial prudence regulations interact with assistance and intervention powers inserted into the LGA02 in 2012. The LGA02 includes in its definition of "problem", a failure by a local authority to demonstrate prudent management of its revenues, expenses, assets, liabilities, investments or general financial dealings. If the Minister of Local Government is satisfied that a serious problem exists in any local authority, the Minister may initiate any of the four assistance and intervention options provided in the LGA02.

Comment

12. The proposals in this paper are consistent with the Government's priorities to responsibly manage government finances and to deliver better public services within tight financial constraints. Developing financial prudence benchmarks for New Zealand local government is groundbreaking. This is because of a lack of standardisation in local authority financial reporting in New Zealand and the diversity of local authorities. To date there has been very little discussion within the local government sector about how to give operational meaning to the duty to manage finances prudently.

13. A common set of financial prudence measures will improve transparency. This will promote more informed debate locally and nationally about the prudence of local authority financial management. Consistent local authority comparisons will also provide insights and questions that will enable elected members and council managers to better manage their local authority. However, some level of context will need to be provided to allow insightful comparisons.

Proposed benchmarks

14. I propose seven benchmarks organised into three financial prudence elements – affordability, sustainability and predictability. These would be complemented by two affordability indicators. Table One summarises the proposal.

Table One: Proposed financial prudence benchmarks and indicators

	Benchmark name	**Description**
Affordability benchmarks	Rates benchmark Debt benchmark	Rates income complies with the limits set in the council's financial strategy Debt complies with the limits set in the council's financial strategy
Affordability indicators	*Rates indicator* *Debt indicator*	*Rates per rating unit* *Net debt per rating unit*
Sustainability benchmarks	Balanced budget benchmark Essential services benchmark Debt servicing benchmark	Revenue, excluding income from development and financial contributions, revaluations and vested assets, exceeds operating expenditure Capital expenditure on the five network infrastructure services equals or exceeds depreciation on those five services Borrowing costs are less than 10 per cent of operating revenue (as defined in the balanced budget benchmark) for all local authorities, except those with projected growth at or above the New Zealand average. For those local authorities, the benchmark would be borrowing costs being less than 15 per cent of operating revenue
Predictability benchmarks	Operations control benchmark Debt control benchmark	Net cash flow from operations equals or exceeds budget Net debt is less than or equal to forecast net debt in the local authority's long-term plan

Affordability indicators and benchmarks

15. Affordability benchmarks are intended to help assess the affordability to present and future ratepayers of each local authority's expenditure and financing activities.

16. I considered three approaches to affordability benchmarks:

- a movement approach;
- a directive approach; and
- a development approach.

I recommend Cabinet proceeds with the development approach.

17. A movement approach would set benchmarks for rates and debt increases, for example, that rates should not increase by more than the growth in population and the consumers price index in any year. Adopting this approach would

punish local authorities that have been thrifty in the past and reward those that have been profligate. This is because a local authority with already high rates would be assessed as being just as prudent as a local authority with very low rates, if they increased rates by the same percentage amount.

18. A movement approach could also result in the perverse outcome of judging a lower rating local authority as less prudent than a higher rating local authority, because the lower rating local authority had a higher percentage rate increase in a particular year.

19. The directive approach would require rates and debt measures that reflected the size of the local authority. For example, these could be rates per resident, per rating unit or per million dollars of rateable value. At present the latter two options are not practical as rating valuation information is not publicly reported.[1] This means there is no data available to set benchmarks using these bases.

20. However benchmarks set on a per resident basis have an inherent bias against districts with many holiday homes. This would include districts such as Thames-Coromandel, Kaikoura, and Taupo. Table Two illustrates the effect of the different options on a sample of six territorial authorities. For example, within this sample, Kaikoura has high rates per resident, but the lowest rates per rating unit.

Table Two: Illustration of different methods of measuring rates

Rates 2011/12	$ per resident	$ per rating unit	$ per $m capital value
Dunedin	***836***	1,946	5,162
Palmerston North	839	***2,260***	***5,828***
Tauranga	857	1,966	3,694
Matamata-Piako	869	1,945	***2,751***
Kaikoura	1,210	***1,339***	3,088
Taupo	***1,365***	2,029	3,384

Source: DIA analysis of data supplied by the named local authorities.

21. Other issues with the directive approach include risks:

- that any benchmark becomes a target instead of a limit for local authorities;
- of criticism by local authorities because there is no rational basis for setting the benchmarks; and
- that some local authorities may not be able to meet the affordability benchmarks without breaching sustainability benchmarks, or vice versa.

22. Under the proposed development option, affordability benchmarks would develop over time. Initially the benchmarks would be the local authorities' compliance with the targets in their financial strategies for rates and debt limits.

[1] Cabinet has agreed to amend the LGA02 so that this information will in future be disclosed in council plans and reports. This will take place commencing with the annual report for 2013/14 [EGI Min (13) 16/9 refers].

23. In parallel, the Department of Internal Affairs would report on two indicators of local authority affordability – rates per rating unit and net debt per rating unit. The indicators would not have particular targets associated with them. No further regulation will be required to derive these indicators. Publication of these indicators will clearly identify those local authorities with high and low rates and debt.

24. Once a database of information about rate and debt levels has been built up, and if local authorities do not respond to the incentives created by a more transparent environment around rates and debt levels, it will be possible to set absolute benchmarks.

25. I considered a third indicator of affordability - payments for services per rating unit. Payments for services would be total operating expenses excluding finance costs and depreciation. The rationale for including this indicator is that there is considerable variation between local authorities in their reliance on rates. High rates per rating unit may be a consequence of a lack of other income sources, rather than high expenditure. A payments for services indicator would more directly show the level of cost control being exhibited by each local authority.

26. I do not propose to publish this indicator at this time. I consider it is important not to confuse users of the data with too much information. From a ratepayers viewpoint the reason for high rates is less important than the result. This is a matter which Ministers may wish to discuss and I have included alternative recommendations to facilitate that.

27. However, since affordability indicators do not require formal regulation, further indicators could be added at any time, if appropriate.

Sustainability benchmarks

28. Sustainability benchmarks are intended to discourage local authorities from short-sighted decisions which keep rates low by:

- allowing debt to increase to excessive levels; or
- neglecting necessary investment in network infrastructure.

29. The proposed balanced budget benchmark refines the statutory obligation in section 100 of the LGA02. It is designed to ensure that local authorities are genuinely matching their operating revenues and expenses. It will make transparent those local authorities that are implicitly using debt to fund operating expenses. The benchmark will do this by excluding from its calculation items of revenue that do not generate financial resources available to pay operating expenses. These items are revenue from:

- vested assets – the value of assets transferred to local authorities at the time of subdivision (roads, reserves, and reticulated water services);
- revenue that must be applied to capital expenditure – development and financial contributions; and
- revenue from asset revaluations.

30. The debt servicing benchmark will compare each local authority's interest expense with its revenue. A high level of debt servicing indicates a local

authority with little flexibility to undertake unplanned capital investment in its community and that is vulnerable to increases in interest rates.

31. I propose that the debt servicing benchmark be split to take account of projected population growth. Local authorities with growth at, or above, the New Zealand projected growth rate would have a higher benchmark, to recognise their greater need to invest in infrastructure and facilities to support growth in their communities. They will also have stronger future rating bases from which to service that debt.

32. The essential services benchmark is designed to identify any local authority that is allowing its network infrastructure[2] to run down. It does this by comparing the depreciation expense each local authority incurs with its capital expenditure for those services.

33. The diverse circumstances of different local authorities means this indicator does have limitations. For example, a local authority with modest growth could be investing in new infrastructure to meet growth demands while neglecting other elements of its network infrastructure. This indicator would not necessarily identify that situation. Conversely, there may be circumstances where it is appropriate for a local authority to invest less than depreciation in its network infrastructure. For example, it seems likely that once the rebuild of Christchurch is complete, the city's infrastructure will be in a state where low levels of expenditure may be appropriate.

34. Interpretation of this benchmark will be improved when local authorities produce their first infrastructure strategies in 2015. This initiative will be included in the Bill to be introduced to the House shortly [EGI Min (13) 19/4 refers].

Predictability benchmarks

35. Predictability benchmarks are intended to identify any local authority where poor cost control creates risks to the containment of rate and debt increases.

36. Predictability issues arise in two circumstances. The first is where operating cash flows are poorly managed. I propose an operations control benchmark that net cash flow from operations equals or exceeds budget to monitor this risk. Poor management of operations may result in unexpected deferrals of capital works, or using debt to fund capital works which were originally intended to be funded from operating revenue. Ultimately, poor operating cost control may lead to unexpected rate increases. A recent example is the Westland District Council which had to cut services and increase its rates by 12 per cent this year as a result of poor operating cost control in previous years.

37. The second circumstance where predictability issues arise is the control of capital expenditure. I propose a debt control benchmark that net debt is less than or equal to forecast net debt in the local authority's long-term plan to monitor this risk. The reason for focusing on debt rather than capital expenditure is that capital expenditure is frequently subject to timing lags. Therefore in any given year capital expenditure in excess of budget can easily relate to timing issues rather than cost control issues. Major capital projects

[2] Network infrastructure means roads, water supplies, sewerage treatment infrastructure, stormwater drainage and flood protection works.

inevitably involve a significant level of debt funding, so debt being greater than projected is the most reliable indicator of weak capital expenditure control.

Publication, presentation and interpretation

38. The most desirable outcome from this proposal is that local government sees this as an opportunity to showcase excellence and to share best practice. This would result in a lift in local authority performance for ratepayers across the local government sector and would help avoid the need for central government intervention in individual local authorities.

39. For this outcome to be achieved it will be necessary for the results to be collated, published, and interpreted in a manner that is credible with local authorities. Interpretation must consider the context of each particular local authority.

40. Credible interpretation is also critical to the constructive application of the benchmarks. Poorly applied benchmarking systems can encourage perverse behaviour designed to meet benchmarks at the expense of making good long-term decisions. This behaviour will be minimised if local authorities have confidence that the results are being interpreted constructively and that any intervention that flows from the benchmarking is justified and appropriate.

41. To achieve this, an agreed analytical framework and good engagement with local government is also necessary. Overseas examples of such publications include:

- an explanation of the methodology;
- identification of relevant contextual information; and
- grouping of local authorities into classes with similar issues for comparative purposes.

42. I intend that my officials work collaboratively with LGNZ and SOLGM to develop the format of a publication, an evaluation framework for the results, and protocols for release. This will ensure that both the local government sector and individual local authorities are not surprised when results are published.

43. It is also important for public understanding that the benchmarking results are consistently presented by each council. The regulations may prescribe the manner in which the results are presented. I intend that the regulations require all local authorities to present the planned and actual performance of the local authority against the benchmarks in identical manner.

Dashboard or league table presentation

44. I propose a 'dashboard' approach to presenting and interpreting the results. Each local authority's results would be published in full, showing its performance on each indicator. However, there would be no attempt to create a single composite performance result for each local authority, and no attempt to rank local authorities from best to worst.

45. Local authorities would also be grouped according to appropriate characteristics. These could include matters such as rates of population growth, size, population density, and average household incomes.

46. Under this approach it would be a matter of judgement as to whether, in any particular case, failure to meet benchmarks warrants activating the assistance and intervention framework in the LGA02. This approach has three strengths:

- it highlights the nature of the problem with any particular local authority;
- it allows each local authority's situation to be assessed in the context of its district. For example, a high-growth district may need, and can tolerate, a higher level of debt than a stable or declining district; and
- it permits the possibility that all local authorities are managing prudently, even if some manage their affairs better than others.

47. The alternative approach is to apply formal weightings to each of the benchmarks and from that construct a league table of local authorities from best performing to worst. This issue is of particular concern to the local government sector. I do not support this approach at this time.

48. My preference is to publish the results in a traffic light format, that distinguishes local authorities with prudent management practices from others:

- Green - financial management appears prudent;
- Orange – financial management appears prudent, but is close to prudent benchmarks and may lack resilience to unexpected events;
- Red – financial management breaches some prudential benchmarks and corrective action may be needed/is underway.

This format would not be adopted until a minimum of two cycles of reporting had been undertaken, allowing understanding and context to be built at the community level.

Relationship with Auditor-General

49. Some commentators may consider that departmental analysis and commentary on the affairs of individual local authorities overlaps with the role of the Auditor-General. This is not the case. There is a well-established convention that the Auditor-General may not comment on the merits of local authority policies. The consequence of this is that unsound financial management practices will go un-remarked until they have placed a local authority in a very difficult financial situation. This constraint will not apply to a departmental report on benchmarking results.

Technical matters

50. There are a number of technical matters that need Cabinet decision so that appropriate drafting instructions can be provided. These are:

- group or parent local authority reporting;
- the definition of rates – inclusion of metered water charges;
- the definition of net debt;
- revenue exclusions from the balanced budget test; and

- periods covered by the disclosure requirements.

Group or parent local authority reporting

51. Many local authorities use subsidiary organisations to deliver some or all of their services. An analysis of local authority 2011/12 annual reports showed that only 30 of New Zealand's 78 local authorities had no subsidiaries. Legislation and accounting standards requires entities with subsidiaries to report two sets of accounts. "Group" accounts consolidate the transactions of the parent entity and its subsidiaries to present financial reports as if the group was one entity. "Parent" accounts report only the financial results of the local authority.

52. Most financially significant local authority subsidiaries are commercial enterprises, for example, port companies and civil contracting companies. The only local authority which has a significant amount of services delivered directly to ratepayers by subsidiaries is the Auckland Council. It has subsidiaries delivering water services, roading, recreational facilities and events. The Auckland Council is also the only local authority which prepares long-term and annual plans with financial forecasts on a group basis.

53. I propose that the benchmarks apply to the Auckland Council on a group basis and to all other local authorities on a parent basis. If other local authorities shift significant service delivery to subsidiaries in the future, then the regulations could be amended to also apply to those local authorities on a group basis.

Definition of rates – inclusion of metered water charges

54. LGNZ has requested that the definition of rates used for the affordability benchmarks and indicators include metered water charges assessed under the Local Government (Rating) Act 2002 (LGRA). LGNZ's concern is that the present definition makes comparisons of rates between a local authority that universally water meters and a local authority that does not meter unfair.

55. The Local Government (Financial Reporting) Regulations 2011 (the Financial Reporting Regulations) define rates for financial reporting purposes as all rates except rates for metered water supply.[3] Metered water charges were excluded from the regulatory reporting definition for three reasons:

    - ratepayer perception – as metered water charges are separately billed, they do not appear on a rates account;

    - consistency with statistical reporting practice – Statistics New Zealand data on local authority rates income excludes metered water charges; and

    - consistency with financial reporting definitions – the new financial reporting standards to apply from 1 July 2014 distinguish between "exchange" and "non-exchange" transactions.[4] The DIA's view is that metered water charges will fall within the definition of exchange

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3 Metered water supply charges can be assessed as rates under the LGRA. The benefit to local authorities of this treatment is that they can use the penalty provisions and coercive collection powers of the LGRA to ensure outstanding bills are paid.

4 An exchange transaction is one where an entity provides a good or service and receives approximately equal value (usually in the form of cash) in exchange.

transactions, while other rates will be "non-exchange" transactions. This would require local authorities to separately report metered water income in their accounts. However, it is not yet clear whether standard setters and auditors will apply that view.

56. However the regulations define rates, Auckland Council will be different from other local authorities. This is because, in Auckland, water and wastewater charges are made by Watercare Services Ltd outside the authority of the Local Government (Rating) Act 2002.

57. At the time the Financial Reporting Regulations were prepared it was not contemplated that rates comparisons might be made between local authorities for affordability purposes. When considering affordability perspectives, I am of the view that including metered water charges with rates gives a more balanced comparison between local authorities.

58. I therefore propose that the definition of rates for the financial prudence regulations include metered water charges. I also recommend that a consequential amendment be made to the Financial Reporting Regulations so that the same definition of rates is applied for financial reporting. However, having good information on the use of water metering is also valuable and I recommend that the Financial Reporting Regulations require disclosure of metered water income by way of note to the local authority's accounts.

Definition of net debt

59. I have recommended that the affordability debt indicator and the predictability debt control benchmark both measure net debt. Gross debt represents the total borrowings of the local authority. To define net debt it is necessary to determine what assets may be offset against gross debt.

60. I propose that the assets to be included in the calculation of net debt be limited to financial assets. These are cash, investments that will be repaid in cash, and equity investments in companies.

61. I consider it necessary to include equity investments in companies as some councils have significant equity holdings entirely for investment purposes. For example, at 30 June 2012 South Taranaki District Council had equity investments valued at $51.794 million being managed on its behalf by professional fund managers. At 30 June 2013, the Auckland Council group held listed shares valued at $53 million and $274 million in unit trust investments, which may include equity investments.

62. However, including all equity investments means that the value of local authority shareholdings in unlisted companies such as port companies and council contracting companies will be offset against local authority debt, even though local authorities are generally reluctant to dispose of shareholdings in such companies. I considered excluding shareholdings in companies held for service delivery or strategic reasons, rather than for investment returns, but concluded that making this distinction was not practical.

63. I also considered whether other local authority assets should be offset against debt. For example, some local authorities have commercial forestry investments and others have investment property portfolios. I have not recommended this as it:

- would dilute the incentives for local authorities to restrain borrowing; and
- would create definitional issues about the purposes for which assets are held e.g. is a particular forest owned for commercial or catchment management purposes.

Revenue exclusions from the balanced budget benchmark

64. The purpose of the balanced budget benchmark is to ensure that local authorities are genuinely matching their operating revenues and expenses. In specifying this benchmark there is a trade-off to be made between the accuracy of the benchmark and the complexity of its specification. My preference is for a simple benchmark test that has low compliance cost and is easily explained.

65. Two issues in particular need to be considered in designing the benchmark. The first is the treatment of subsidy income, which is almost exclusively a transfer from central to local government. Many subsidies are provided to fund capital expenditure. At first glance these should be excluded from revenue for the purposes of this benchmark, since capital subsidies do not fund operating expenditure.

66. However, much subsidised capital expenditure is to replace existing assets - for example, road resealing, road reconstruction, and bridge renewals. The consumption of these assets is included in operating expenditure through depreciation. Subsidy revenue for their replacement matches the depreciation expenditure and should therefore be included in the benchmark.

67. Table Three illustrates the situation using the Matamata-Piako District Council roading activity as an example. If subsidies were included in the balanced budget test, it would overstate the Council's funding requirement by $2.458 million.

Table Three: Effect of subsidies on balanced budget benchmark

	$000s
Capital expenditure to improve the level of service	237
Capital expenditure to replace existing assets	5,707
Total capital expenditure	5,944
Roading depreciation	5,658
Capital roading subsidies	2,744
Subtotal	8,402
Difference	2,458

Source: Matamata-Piako District Council Annual Report 2012/13.

68. This problem could be overcome by separating subsidy income for asset replacement from subsidy income for new assets. However, this would add to compliance costs, especially where projects have elements of both renewals and improvements and diminish the transparency of the benchmark. I propose

for simplicity that all subsidy income be recognised as revenue for the purposes of this benchmark.

69. The second issue is the treatment of revenue and expenditure from asset and liability revaluations. Generally accepted accounting practice requires the inclusion in revenue and expenditure of numerous such revaluations. They fall into three groups:

- the revaluation to market values of assets that are held for the purposes of deriving revenue, for example council forests. This simply shifts the point in time at which particular revenue and expense items are recognised;
- the revaluation of assets that are held to deliver services and are unlikely to be sold, for example parks, roads, and reticulation systems. This creates "revenue" which will never be translated into cash and therefore provides no resources for councils to meet expenditure; and
- the revaluation to market values of financial instruments used to manage risks, for example derivatives used by local authorities to hedge interest on floating rate loans. These transactions create items of revenue and expenditure that, over time, cancel each other out.

70. Ideally the revaluation of assets held to deliver services and of financial instruments used to manage risks would be excluded from the balanced budget benchmark, while all other revaluations would be included. However, this would result in a highly complex test that is both difficult to specify in regulation and would lack transparency to ratepayers.

71. The biggest revaluation item is the recognition of revenue arising from the revaluation of property plant and equipment. This includes revenue from the revaluation of network infrastructure and local authority landholdings such as reserves and land under roads. I propose for simplicity that all revenue and expenditure from the revaluation of property plant and equipment be excluded from the balanced budget benchmark.

72. I also seek Cabinet's approval to exclude from the balanced budget benchmark revenue and expenditure arising from the revaluation of financial instruments, provided I am satisfied that the exclusion can be clearly specified and is transparent. My officials would consult further with LGNZ, SOLGM and the Office of the Auditor-General to see if this is feasible. All other revenue and expenditure revaluations would be included in the benchmark.

Periods covered by disclosure requirements

73. I propose that local authorities be required to disclose:

- in annual reports, actual performance against the benchmarks for the year of the report and the four previous years; and
- in long-term and annual plans, projected performance against the benchmarks for each year of the plan.

74. This is because financial prudence is indicated as much by the direction of travel of a particular local authority as by its position at a particular point in time.

At the time the benchmarks are introduced, there will be some local authorities dealing with legacy situations they have inherited. The disclosure of projected performance in long-term plans will show ratepayers whether those local authorities have effective plans to deal with those inherited situations.

Implementation

75. I propose that the first requirement for local authorities to disclose performance against the benchmarks would be in their annual reports for 2013/14. These are due to be published by 31 October 2014.

76. Theoretically, it would be possible to require local authorities to disclose planned performance against these benchmarks in their annual plans for the 2014/15 financial year. These plans will be published in draft form between February and April 2014 and must be adopted by 30 June 2014. However it is unlikely that the regulations will be drafted and published before the end of February 2014. This would give local authorities very little time to comply with the regulations. Also annual plans are not audited. Having the first disclosure in the 2013/14 annual report ensures that an external quality assurance process is applied to that disclosure.

77. It would not be practicable for local authorities to disclose four years historic data in the first annual report for all benchmarks. I propose a transition provision requiring that this disclosure be made as far as reasonably practicable, with a requirement to provide no more than four years', but a minimum of one year's, data.

78. There are also situations where because of local authority boundary adjustments or reorganisations, historic data may have discontinuities. I propose a provision requiring the effect of those discontinuities to be identified and estimated to the extent that is reasonably practicable.

Consultation

79. The Ministries of Business Innovation and Employment, Health and Transport, the Ministry for the Environment, the Canterbury Earthquake Recovery Authority, Te Puni Kōkiri and the Treasury were consulted upon this proposal. The Office of the Auditor-General was also consulted. The Department of the Prime Minister and Cabinet was informed.

80. The recommendations in this paper were developed in consultation with Local Government New Zealand. The Society of Local Government Managers was also consulted.

Financial Implications

81. There are no financial implications from this proposal.

Legislative Implications

82. The proposals in this paper would be implemented by an Order in Council made under the authority of section 259(1) of the LGA02. Section 259(4) of the LGA02 requires that my recommendations be developed in consultation with LGNZ. I certify that LGNZ has been consulted in preparing this paper.

83. I propose that I be delegated authority to make, as required, decisions on any subsequent minor issues arising from regulation drafting that align with the overall policy intent of this paper.

84. I recommend that the committee invite me to submit drafting instructions to the Parliamentary Counsel Office for these regulations. I also request approval to consult with LGNZ and the Society of Local Government Managers on the draft regulations before they are submitted to the Cabinet Legislation Committee.

Regulatory Impact Analysis

85. Regulatory impact assessment requirements apply to this proposal. A Regulatory Impact Statement has been prepared by the Department of Internal Affairs and is attached.

86. The Regulatory Impact Analysis Panel at the Department of Internal Affairs has reviewed this RIS and considers that the information and analysis it contains meets the quality assurance criteria.

Human Rights

87. The proposals in this paper are consistent with New Zealand Bill of Rights Act 1990 and the Human Rights Act 1993.

Publicity

88. The proposals in this paper are of considerable interest to local authorities. It will assist officials in drafting the regulations if the proposals are publicly available to interested stakeholders. I therefore intend to proactively release this paper and related Cabinet decisions online, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982.

Recommendations

89. The Minister of Local Government recommends that the Committee:

Background

1. **note** that an element of the Better Local Government reform programme is to introduce financial prudence regulations prescribing parameters or benchmarks for assessing whether a local authority is managing its financial dealings prudently [CAB Min (12) 9/4 refers];

2. **note** that the financial prudence regulations interact with assistance and intervention powers recently included in the Local Government Act 2002 (LGA02);

3. **note** that a set of common measures of local authority financial prudence will:

   3.1. improve transparency and promote more informed debate about the prudence of local authority financial management; and

   3.2. help showcase best practice and excellence in local authority financial management;

Proposed benchmarks and indicators

4. **agree** that the benchmarks be organised around three elements – affordability, sustainability and predictability;

5. **agree** that the affordability benchmarks be:

   5.1. rates income complies with the limits set in the local authority's financial strategy; and

   5.2. debt complies with the limits set in the local authority's financial strategy;

6. **EITHER** (preferred option)

   6.1. **agree** that in parallel with the affordability benchmarks, the Department of Internal Affairs report on two indicators of local authority affordability – rates per rating unit and net debt per rating unit;

   OR (alternative option)

   6.2. **agree** that in parallel with the affordability benchmarks, the Department of Internal Affairs report on three indicators of local authority affordability – rates per rating unit, net debt per rating unit and payments for services per rating unit;

7. **agree** that the sustainability benchmarks be:

   7.1. a balanced budget benchmark that revenue, excluding development contributions, financial contributions, income from revaluations and vested assets, exceeds operating expenditure;

   7.2. an essential services benchmark that capital expenditure on the five network infrastructure services equals or exceeds depreciation on those five services; and

   7.3. a debt servicing benchmark that borrowing costs are less than 10 per cent of operating revenue (as defined in the balanced budget benchmark), except for those local authorities with projected population growth at or above the national projected growth rate. For those local authorities this benchmark would be 15 per cent;

8. **agree** that the predictability benchmarks be:

   8.1. an operations control benchmark that net cash flow from operations equals or exceeds budget; and

   8.2. a debt control benchmark that net debt is less than or equal to forecast net debt in the local authority's long-term plan;

Publication, presentation and interpretation

9. **note** that benchmarking results will need to be collated and published to encourage local authorities to improve their own financial governance and management;

10. **note** that I intend that my officials work collaboratively with LGNZ to develop the format of a publication, the analytical framework used to evaluate the results, and protocols for release;

11. **agree** that the regulations require all local authorities to present the planned and actual performance of the local authority against the benchmarks in identical manner;

12. **agree** to a 'dashboard' approach to presenting and interpreting the results, rather than a 'league-table';

13. **note** that, after a minimum of two cycles of reporting has been undertaken, I intend to publish the results in a traffic light format that distinguishes those local authorities with prudent management practices from others;

Technical matters

14. **agree** that the benchmarks apply to the Auckland Council on a group basis and to all other local authorities on a parent basis;

15. **agree** that:

    15.1. the definition of rates for the financial prudence regulations include metered water charges;

    15.2. a consequential change be made to the Local Government (Financial Reporting) Regulations 2011 so that the same definition of rates is applied for financial reporting; and

    15.3. the Local Government (Financial Reporting) Regulations 2011 require disclosure of metered water income by way of note to local authority accounts;

16. **agree** that net debt be measured as gross debt less financial assets (cash, investments that will be repaid in cash, and equity investments in companies);

17. **agree** that for the purposes of the balanced budget benchmark:

    17.1. all revenue from revaluations of property, plant and equipment be excluded from the benchmark;

    17.2. revenue from the revaluation of financial instruments be excluded from the benchmark if the Minister of Local Government is satisfied that the exclusion can be clearly specified and is transparent; and

    17.3. all other revenue and expenditure from revaluations be included in the benchmark;

Periods covered by disclosure requirements

18. **agree** that local authorities be required to disclose:

    18.1. in annual reports, actual performance against the benchmarks for the year of the report and the four previous years; and

    18.2. in long-term and annual plans, projected performance against the benchmarks for each year of the plan.

Implementation

19. **agree** that the first requirement for local authorities to disclose performance against the benchmarks would be in their annual reports for 2013/14;
20. **agree** that transition provisions require initial disclosure of historic data to be made as far as is reasonably practicable, with a requirement to provide no more than four years', but a minimum of one year's, data;
21. **agree** that the regulations require local authorities to identify and estimate the effect of discontinuities arising from local authority reorganisations to the extent that is reasonably practicable.

Legislative implications

22. **note** that, in accordance with section 259(4) of the LGA02, the recommendations in this paper have been developed in consultation with LGNZ;
23. **authorise** the Minister of Local Government to make, as required, decisions on any subsequent minor issues arising from regulation drafting that align with the overall policy intent;
24. **invite** the Minister of Local Government to issue drafting instructions to the Parliamentary Counsel Office for local government financial prudence regulations;
25. **agree** that LGNZ and the Society of Local Government Managers may be consulted on the draft regulations;

Publicity

26. **note** that the Minister of Local Government intends to proactively release this paper and related Cabinet decisions online, subject to consideration of any deletions that would be justified if the information had been requested under the Official Information Act 1982.

Hon Chris Tremain
Minister of Local Government

28 / 12 / 2013