LGFA NEW ZEALAND LOCAL GOVERNMENT FUNDING AGENCY

Best Practices in Council Financial Management

LGFA is the largest lender to the New Zealand Local Government sector with almost 90% share of sector lending to sixty-four councils with loans outstanding to the sector as at 30 June 2019 of $9.3 billion. LGFA undertakes an ongoing review of each individual council borrowers' financial position and that of the wider sector. As part of that review and monitoring process we have summarised what we believe to be best practice in financial management. We encourage all councils to follow best practice where possible.

Number 1: Develop a Strategic Plan:

Strategic planning is important to any organisation as it provides a sense of direction and outlines measurable goals. It will help guide council discussions and decision making in determining resource and budget requirements to accomplish the set objectives. A good example is Palmerston North City Council. Prior to 2018, the Council had 28 strategies. The Council created a vision from which the 28 strategies were reduced to 5. Having a good strategic plan helps create more buy-in from both elected officials and council officers as well as forming a basis for having conversations with the community. When there is general agreement about what the local authority is trying to achieve, it makes the task of preparing the LTP easier.

Number 2: Coordinated Infrastructure and Financial Strategies

LTP's are long and complex and councils and it can be challenging in meeting all the legally required content. This often results in different people or departments within a council writing components of the LTP. However, it is critical that the infrastructure strategy and financial strategy link together. The financial sustainability and affordability of projects in the infrastructure strategy need to be made clear. There also need to be explanations about how demographic changes will be addressed. Wellington City Council is an example of a council that produced as integrated infrastructure and financial strategy as part of the 2018-2028 LTP. This resulted in a good overall strategy. However, we would not recommend councils attempt this unless they can commit sufficient time and resources to this task.

Number 3: Good Knowledge of Asset Conditions

Many councils have made good progress in gaining a better understanding of the condition of their infrastructure since amendments to the Local Authority Act in 2014 required councils to prepare infrastructure strategies as part of their LTP. However, in the 2018-28 LTP's around one third of councils had little knowledge of the condition of their assets. A comprehensive understanding of critical assets will help elected members in making informed decisions about managing the assets. It will also help councils in accurately conveying to the community the costs of the infrastructure strategy and options around this.

Number 4: Maintain a Balanced Budget

Section 100 of the Local Government Act 2002 states that a local authority must ensure each year's projected revenue. In some cases, there may be exceptions to this where it is prudent to do so. Over the long term it is important councils balanced their budget over the cycle so that borrowing is not used to fund operational expenditure. This will assist in ensuring long term sustainability of a local authorities' finances. It is also an important component of inter-generational equity.

Number 5: Focus on the Material Issues

The internal financial reporting that a council produces needs to be fit for purpose. This is important as this information is part of what will be used by elected officials and management to make key longer-term decisions. While some detail can be relevant, it is often the sum of the detail that is most important. Reporting should be well laid out and relatively easy to understand. Provide good summaries and spell out what assumptions are being used. Readers need to be informed whether things are tracking in the right direction.

Number 6: Audit and Risk Committees

Audit and Risk committees have become more common place at councils over recent years. Currently 72 councils have A&R committees or a version of this. While recognising the progress that the sector has made in this area, it is important that A&R committees are more than a box ticking exercise. LGFA have a preference that the Chair of the committee is an independent member. Not only can this bring an additional skill set to the committee, but it can also assist in removing some politics. It is interesting to note that the Productivity Commission recommended an in independent chair and ideally one other independent member.

Number 7: Maintain Financial Flexibility

LGFA believe it is important to maintain some level of financial flexibility to cope with unexpected events. In particular, some headroom needs to be kept under LGFA financial covenants and the council's own internal financial limits. Examples of unexpected events include natural disasters, cost overruns on infrastructure projects and revenue shortfall. When looking to the longer term, incorrect demographic forecasts, changes in government legislation and the possibility a council may not be able to obtain insurance can impact on council finances. The amount of financial flexibility will differ between councils. Councils need to consider what flexibility is appropriate for them.

Number 8: Improving the Accuracy of Project Estimates

Historically there has been a number of examples of projects where costs have significantly exceeded forecasts when they have been completed. This is not an issue unique to New Zealand. An analysis of 58 rail projects across 28 countries showed the average cost overrun was 47% while average passenger traffic was less than half of what was forecast. Accurate forecasting is an important part of a councils longer term financial strategy. It is also important to provide communities with accurate information upon which they can provide feedback. Finally, in an environment where funding is limited, it is important elected officials have accurate information to make decisions as to which infrastructure projects will deliver the greatest benefit.

Number 9: Good Project Management

When undertaking infrastructure projects, it is important that they are managed well. Good planning, good execution and good monitoring are key components of this. Independent reports into council infrastructure projects that did not go well often identified culture as being very important. People need to be open to being challenged on plans. Good communication within a local authority is important so key people are aware of how things are progressing. When things do not go to plan, good communication is important so that the best decision can be made.

Number 10: Have an Appropriate Depreciation Policy

The depreciation charge reflects the use or consumption of an asset over its useful life. Companies in the private sector are motivated to maximise their depreciation charges in order to minimise tax. The considerations for local authorities are different. The most important consideration is that the depreciation policy adopted by the local authority will achieve long term financial sustainability ie: will it provide sufficient funding for the local authority to complete all of its renewals. Ensuring ratepayers pay their fair share of consumption of assets should also be a consideration. There are a number of different options available to local authorities. They can opt to fund depreciation, fund renewals or fund debt. All of these can produce appropriate long-term outcomes. Each local authority needs to decide what is appropriate for them.

For further information please contact:

Andrew Michl

Senior Manager Credit and External Relationships

Email: andrew.michl@lgfa.co.nz

Mobile: 021 662 434