

## 'Best Practice' no longer good enough In New Zealand

(with implications for asset managers everywhere)

The outcomes focus of the new Local Government Act (2002) in New Zealand is set to change the engineering mindset of Asset Managers and change the way they do business.

In brief, the change to an outcomes focus will mean

More community input  
In selecting service levels *and*  
In how the council complies

Asset Management Information becomes an essential communication channel  
More rigour will be *expected*  
And *demanded* (the new Community Plans will be audited)

### Why is this relevant to you?

New Zealand is the first country to mandate an outcomes focus in legislation but it is clear that this is the way that asset management is moving in developed countries. In England, where asset management has been imposed on councils as a means of stricter financial control, nevertheless there is a strong outcome focus. In Victoria, the Department of Victorian Communities, working together with councils, has developed an asset management outcome performance model that is being voluntarily adopted. **Consider an outcome focus the way of the future.**

In this issue, Peter McKinlay\*, of McKinlay Douglas Ltd, explains some of the key differences in the new NZ Act and the impact that they will have on the strategic linkages between the Asset Management Plan and the new 'Long Term Council Community Plans'

(Readers can access Peter McKinlay's full paper to the Conferenz 6<sup>th</sup> Annual Local Government Asset Management Conference, Auckland 6&7 May 2003 "Analysing the strategic links between asset management plans and long term council community plans" in the Virtual Asset Management Community Resource Library at [www.amqi.com](http://www.amqi.com)) (Emphases in the current text are the editor's)

*Researched and written by Dr Penny Burns, AMQ International.  
Published fortnightly. Subscription, Comment, or Inquiries to*

AMQ Intenational  
PO Box 75 Salisbury South Australia  
Tel 618 8281 5795

## To Start the Story at the Beginning.....



### Until 2002, Asset Management in New Zealand has had a **FINANCIAL FOCUS**

The Local Government Amendment Act No. 3 1996 brought in the financial management provisions under which **local authorities were required, amongst other things, to prepare a long term financial strategy (LTFS).**

That resulted, in large part, from concerns expressed by the Controller and Auditor General that he was unable, in a number of cases, to form a “going concern” opinion on local authorities because he simply did not have adequate information on the state of major infrastructure assets and was thus unable to form a judgement on the local authority’s ability to meet future costs.

Although asset management planning is not specifically mentioned in the required contents of a long term financial strategy, it has always been quite clear that **a local authority cannot prepare a proper LTFS unless it has asset management plans in place.**

Without those, it would simply not be able to develop the kind of information required to satisfy the requirements for the content of the LTFS such as: *“The estimated expenses, including an allowance for the cost of debt servicing and for the decline in the service potential of assets, necessary to meet the identified needs of the local authority over the period of the strategy”.*

At its heart, **asset management is concerned with the least cost means of meeting service level standards over time.**

*Asset managers are continually addressing the question of what mix of assets with what performance characteristics will be required to deliver the standard of service required and what measures will be needed to ensure that standards can be met not just now but in the future.*

**The LTFS is focused almost exclusively on financial information.**

There is a requirement to give reasons for being engaged in the activities set out in the LTFS but there is no requirement, other than that the LTFS be adopted through the special consultative procedure, for significant community input.’

## Now, Asset Management has a clear OUTCOME FOCUS

The LGA 2002 is quite explicit that the purpose of local government includes

- *“to enable democratic local decision-making and action by, and on behalf of, communities”*; and
- *to promote the social, economic, environmental and cultural well-being of communities in the present and for the future (the “four well-beings”)*



Generally, the LGA 2002 provides greatly enhanced provisions for community involvement through new provisions regarding decision-making, more detailed requirements around the special consultative procedure, **and effectively turning long-term planning on its head**. It is no longer the financial emphasis of the former long-term financial strategy. Instead the local authority’s principal planning document, the long term council community plan, is now to be prepared around community outcomes.

### Decision-Making

Sections 76-79, dealing with decision-making, require a local authority to seek to identify all reasonably practicable options for the achievement of the objective of the decision, to assess benefits and costs in terms of the “four well-beings” and the extent to which community outcomes would be promoted or achieved in an integrated and efficient manner by each option. Section 78 requires a local authority to give consideration to the views and preferences of persons likely to be affected by or to have an interest in the matter, with that consideration to be given at each of four separate stages through the decision-making process. Section 79 does give a local authority some discretion in how to apply those requirements, but it is not a carte blanche power to disregard them.

### Detailed Rules for Consultation

This impression is further reinforced by the now very extensive provisions relating to the special consultative procedure. The few lines of Section 716A in the Local Government Act 1974 have been replaced by nearly six pages of rules in the LGA 2002.

### What does this mean in practice?

What changes under the LGA 2002? Initially, probably very little but over time there is scope for very significant change indeed. In Peter McKinlay’s assessment, there will be two principal drivers of change as the new power of general competence and associated constraints begin to impact.

The two drivers will be:

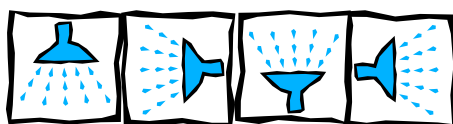
- The new emphasis on community outcomes and sustainable development.
- The requirement that the long-term council community plan be audited.

## WHAT WILL CHANGE? - (1) SERVICE LEVELS & THEIR ACHIEVEMENT

Over time, for asset management, this is likely to mean that the process of defining service level standards will change quite markedly. Rather than being drawn primarily from “best practice” and from minimum standards set by regulators and/or emerging from discussions within professional bodies and the work of local authority staff, they will increasingly be influenced by community views. These are likely to affect both the standards and the means of achieving them. A couple of examples will make the point.

### Example 1.

#### Water—and Insistence on consideration of a wider range of options



The first is the new requirement for the assessment of water and other sanitary services. This process includes a requirement that a territorial authority must consider

- (a) *The full range of options and their environmental and public health impacts, including (but not limited to)—*
- (i) *on-site collection and disposal; and*
  - (ii) *grey water and stormwater reuse or recycling; and*
  - (iii) *demand-reduction strategies, including public education, information, promotion of appropriate technologies, pricing, and regulation; and*
  - (iv) *the full range of technologies available”*

#### Sustainability

This provision has its origins in concerns held by the Green Party that, too often, water and wastewater projects were driven by conventional engineering solutions imposed by people who had relatively little understanding of alternative and more environmentally friendly options. (Whether that was in fact the case is a separate issue. The point to note is the political driver behind the legislation.)

#### Community determined

In essence, what this section is proposing is that both service level standards themselves, and means of compliance, should be very much open to public input and the search for alternative solutions – especially as the assessment is to be adopted through the special consultative procedure – either on its own or as part of the LTCCP which itself must go through that procedure.

## WHAT WILL CHANGE – (2) JUDGEMENT CRITERIA ( “Best Practice” and Engineering Standards will no longer dominate)

### Example 2.

#### Allocating Road Expenditure Amongst Ratepayers

[Peter McKinlay's second example comes from his] recent involvement in providing advice to a provincial local authority on the very vexed question of how the cost of meeting its share of expenditure on roading should be allocated amongst different categories of ratepayers. The district concerned is one that has been experiencing relatively rapid growth with a high level of rural subdivision – some for horticulture, some for so-called “lifestyle” blocks. The council concerned used a mixture of land value rating and a uniform annual charge with a 2:1 differential on the rate affecting industrial and commercial property.



It also had in place a very detailed asset management plan that spelt out the circumstances under which roads would be upgraded. The priorities were driven, essentially, by safety with some recognition of amenity impacts - as traffic volumes increased, so would required road width. Volumes also determined the point at which an unsealed road would be sealed.

From a technical perspective, this was a very impressive piece of work. From a ratepayer's perspective, there was strong anecdotal evidence that it was seen as an arbitrary way of ignoring the interests of ratepayers who may have paid very substantial rates for a number of years. As an example, if you happened to have a relatively high value property on an unsealed road with relatively low traffic volumes, your chances of having the road sealed in the near future, regardless of the amount you were paying in rates, were virtually zero.



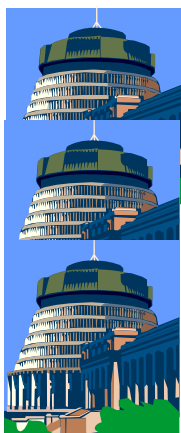
There was a widespread view that one of the problems the council faced was the growth in the number of lifestyle blocks, which other ratepayers complained were getting something of a double benefit.



Closer subdivision meant higher traffic volumes and therefore a greater likelihood of an upgrade, but smaller properties meant lifestyle ratepayers were paying less in rates (a proposition that was more correct on an individual basis than for lifestyle properties as a whole).

It seems very clear that, as that council goes through the community outcomes process, the pressure to move away from a purely technical approach to setting priorities for roading upgrades will be intense. Whether this will produce a genuinely better result is entirely another matter. People with any experience in roading will know how difficult it is to arrive at any system of allocating costs and setting priorities that is likely to have significant majority support.

## WHAT WILL CHANGE – (3) AUDIT and an Emphasis on the robustness of assumptions



The audit requirement will come into effect for the second LTCCP – the one to operate from 1 July 2006. The audit requirement is set out in Section 94 of the LGA 2002, as follows:

### **“94 Audit of long-term council community plan**

*(1) The long-term council community plan must contain a report from the local authority’s auditor on—*

*(a) the extent to which the local authority has complied with the requirements of this Act in respect of the plan; and*

*(b) the quality of the information and assumptions underlying the forecast information provided in the plan; and*

*(c) the extent to which the forecast information and performance measures provide an appropriate framework for the meaningful assessment of the actual levels of service provision.*

*(2) A report under subsection (1) may be in the form of confirmation or amendment of the report made by the auditor under section 84(4).*

*(3) For the avoidance of doubt, a report under subsection (1) must not comment on the merits of any policy content of the plan.”*

### **Quality of Information**

For asset managers, the most important provision is the requirement to report on *“the quality of the information and assumptions underlying the forecast information provided in the plan”*. The requirement is a new one. The LTFS itself was not audited (although one or two councils did voluntarily seek an audit – the Audit Office report on the audit of the Opotiki LTFS is well worth reading).

### **Robustness**

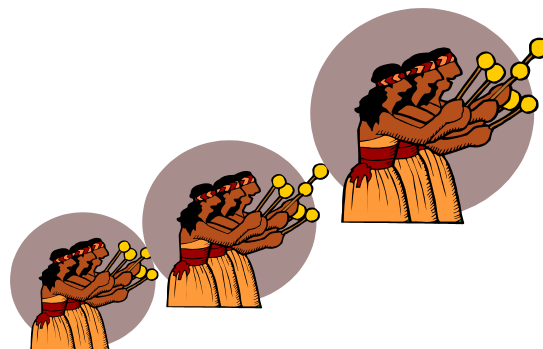
One consequence of the absence of an audit requirement has been that the assumptions on which the LTFS was developed were not always as robust as might be desired. In particular, there was a tendency to concentrate on the first three years (those on which the annual plan was based) and pay less attention to assumptions for years four onwards. In my experience, it was not uncommon to see a long-term financial strategy simply assume a series of constants.

### **Pressure on Information where significant changes are expected**

Expect a considerable amount of latitude in the early application of this requirement, at least in respect of non-core services. But also expect, where there is pressure on a particular service or district, that the Audit Office will be looking for robust information. If you are in an area that is under going major development or significant changes in population or the nature of economic activity, the Audit Office will probably want to see professionally developed forecasts of key variables – population, business activity by sector, expected land use demand, etc.

## WHAT WILL CHANGE – (4) Demand Forecasting

The new rules require an evidence-based approach to estimating future demand



### Key drivers behind growth in demand

The first point, and one that asset managers should already be familiar with, is the importance of understanding the key drivers behind growth in demand. This will need to include getting to understand how the drivers themselves operate. Assume, as an example, a service for which demand is driven largely by population growth. At a simple level, you may have treated the impact on demand as simply a function of the percentage growth in population. However, if you want robust information, then you may need to put aside the simple assumption that the percentage increase in population translates to the percentage growth in demand and replace it with an understanding of factors such as:

- Growth in household numbers versus population growth. It may be that the key variable driving demand is actually household numbers so that you could have increasing demand, even in a district in which population is static or declining. Note that, generally, average household size is decreasing across New Zealand.
- Does the age composition of the population matter? For some services, it will. Older people may have a lesser demand for sporting facilities but a greater demand for library and cultural facilities. At the last census, the percentage of the population aged 65 or over was 12.1% for New Zealand as a whole but ranged from 6.9% in Porirua City to 22.3% in Kapiti Coast District. Expect older people, who are comparatively more politically active, to play a major role through the community outcomes process in seeking the types of services they prefer.

Industry composition will also be a key driver. Forecasting future demand will require an understanding both of the impacts of different industry sectors, as they are currently configured and operate, and the potential for changes in technology (an obvious one is the increasing use of irrigation) as well as likely changes in industry composition.

### Coordination between different kinds of forecasts and planning

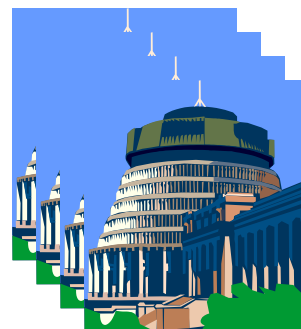
It will be important in forecasting demand to ensure coordination between the different kinds of forecasts and planning with which the council is involved. As one example, does it make sense for asset managers and the council's economic development arm to be adopting different assumptions about or targets for population growth? It is noteworthy that most, if not all, of the economic development strategies prepared recently with Industry New Zealand assistance appear to include targeting increased population as one objective. Demographic information for New Zealand as a whole suggests that, although some districts/regions will enjoy significant population growth, for a number of others the population will stabilise or decline.

(For more ideas on demand forecasting, see Peter McKinlay's full paper in the Resource Library at [www.amqi.com](http://www.amqi.com))

## IN SUMMARY,

### Asset management planning under the LGA 2002 will:

- Be significantly driven by community outcomes as a significant (but not the only) means of determining service level standards and, for at least some services, the preferred means of achieving those standards.
- See the technical means of compliance approach to determining the least cost solution remaining important but, increasingly, either needing to be consistent with the way community outcomes are expressed or have a clear reason for departing from what the community has expressed.
- Through the new requirement for audit, requiring asset managers to ensure that their forecasts of activity levels etc are based on robust information, especially in respect of core services in areas that are undergoing significant change.



(and don't forget that there is more in Peter McKinlay's paper in the Resource Library, [www.amqi.com](http://www.amqi.com))

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## WHAT TO WATCH FOR IN NEW ZEALAND

- **How communities respond to the new demands on *them*,**

Sound community input requires both community understanding and community willingness to take the lead. (cf SAM # at the way in which Boroondara worked with their community to achieve a greater level of understanding)

- **Transitioning**

To shift from a financial focus to an outcomes focus requires a lot of re-orientation. How will councils achieve this shift? Fortunately, the NZ Auditor General's Department has always taken a pragmatic and encouraging approach to change, but this will also require a shift in the way they audit.

- **New Techniques and Measurement Tools**

Expect to see new techniques for measuring service levels, more reliable demand forecasting, evaluation techniques that move beyond simple cost benefit or cost effectiveness; Triple bottom line and Quadruple bottom line (economic, social, environmental *and cultural*) reporting.

- **Experience in Community Consultation**

As the new rules apply, New Zealand councils will generate a wealth of case study experience.