

# **Rising To The Challenge**

**Towards  
Financially Sustainable  
Local Government  
in South Australia**

Volume 1: Overview

Financial Sustainability Review Board  
August 2005



## ***About this Overview (Volume 1)***

This first volume sets out our main findings, interpretations and recommendations. It is capable of being read on a stand-alone basis.

The ***Key Points*** section highlights the main conclusions arising from this Inquiry.

The ***Executive Summary*** section outlines our key findings, and our interpretations of those findings, and outlines our main recommendations.

The ***Findings*** section provides a listing of all our findings. Our ‘findings’ involve, on either an empirical basis or on the basis of our judgment/opinion, a conclusion regarding the degree to which circumstances or policies of SA councils depart from those that would ensure a council’s financial sustainability.

The ***Recommendations*** section provides a listing of all our recommendations. Our ‘recommendations’ involve a program of actions to be implemented in South Australia, either by the LGA or by councils individually or collectively, aimed at correcting circumstances or policies that depart significantly from those that would ensure a council’s financial sustainability.

## ***About Volume 2***

Details of the descriptions and analysis underpinning the views expressed in this Overview volume are provided in a second volume of our report.

Volume 2 includes discussion of:

- ❑ the meaning and importance of financial sustainability;
- ❑ the key indicators of a council’s financial sustainability;
- ❑ data sources and deficiencies;
- ❑ the current state of council finances;
- ❑ the outlook for council finances;
- ❑ the extent of any financial sustainability problems;
- ❑ limits imposed on council revenue raising;
- ❑ cost pressures from other spheres of government;
- ❑ shortfalls in grants from the other spheres of government;
- ❑ council revenue and financing policies;
- ❑ council service provision policies;
- ❑ council asset and liability management policies;
- ❑ financial governance; and
- ❑ first steps.

## ***About the Inquiry***

This Inquiry into the sustainability of the long-term financial performance and position of councils in South Australia has been commissioned by the State's Local Government Association (LGA).

The full text of the Inquiry's Terms of Reference is provided at Appendix A of the volume 2.

The Inquiry commenced on Monday, 14 February 2005.

On 8 March 2005, the Review Board published a Discussion Paper. 42 submissions were received from councils and other interested parties.

On 30 May 2005, the Review Board published an Interim Report. 23 submissions were received from councils and other interested parties.

During June 2005, public hearings/forums were conducted with councils and other interested parties focussing on the findings and opinions put forward in the Interim Report.

## ***About the Review Board***

The Inquiry was undertaken at arm's length from the LGA by the Financial Sustainability Review Board, comprising:

- ❑ Bill Cossey, chairperson;
- ❑ Juliet Brown; and
- ❑ Wayne Jackson.

By undertaking our investigations independently of the LGA, and with a membership that has no direct involvement with local government in the State, we have sought to act as an 'honest broker' on key matters where different positions are evident about, and within, local government.

## ***Acknowledgement***

We acknowledge, with great appreciation, the contribution of the local government sector in South Australia to the Inquiry.

Local government is a complex entity. The complexity makes it difficult to write a report that addresses the sector as a whole. There are councils in South Australia that are already pursuing the directions proposed in this report; there are others that are not. The sector-wide nature of the Inquiry has meant that it is not appropriate that we single out individual councils for praise or criticism.

The criticism made of the sector in this report in no way aims to decry the commitment of people involved. We recognise that, in many councils, elected members have not had the benefit of the type of information they need to develop the policies necessary to ensure the financial sustainability of their councils.

The dedication shown by elected members and senior managers in serving their communities has been evident to us throughout this Inquiry. Their task is a challenging one, particularly given the complex set of legislative, policy and financial arrangements applying to local government and the fact that not all councils are alike.

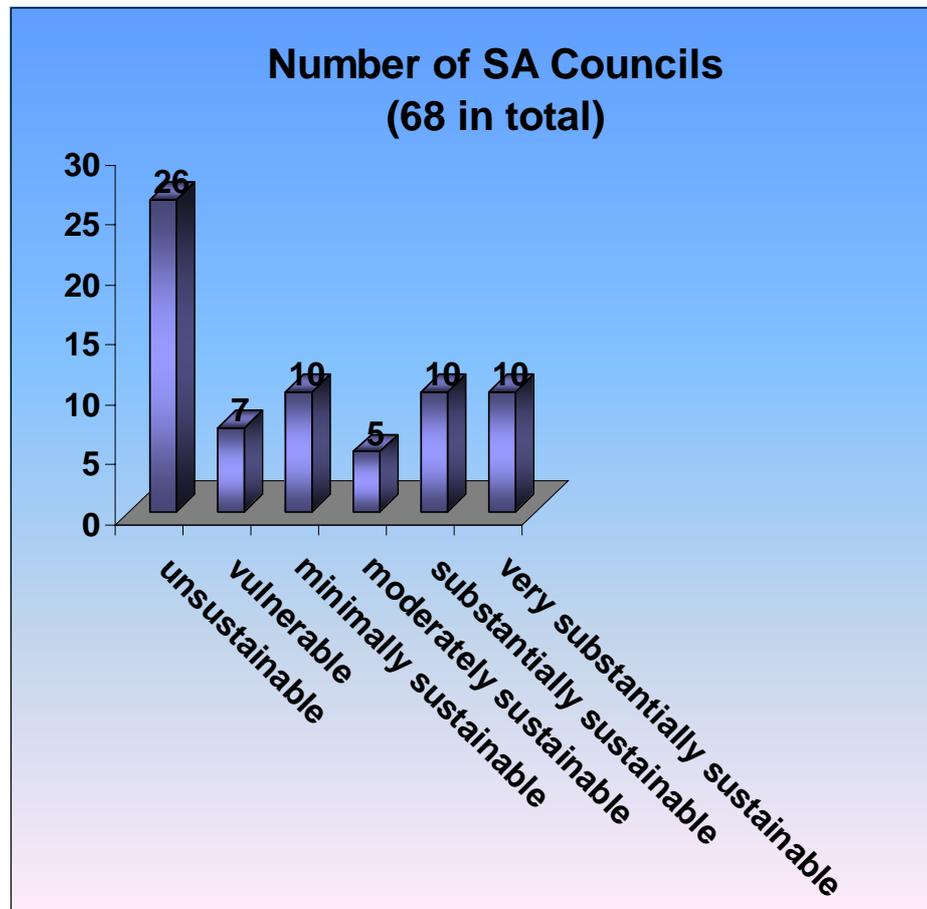
## Key Points

- The financial sustainability of councils is vital in the interests of ratepayers, the community and the State. It is an important pillar of efficient and effective local government.
- Of those SA councils whose long-term finances are sustainable, only some seem to have the types of policies and practices in place that lock-in their financial sustainability. We commend these particular councils for their efforts, as they provide the example that all councils should follow.
- Of most concern to us is our finding that the long-term finances of many SA councils are not sustainable, as evidenced by their:
  - high operating deficits (which look set only to get bigger in future); and
  - substantial infrastructure renewal and replacement backlogs.
- Independent advice prepared for the Inquiry suggests that 26 of South Australia's 68 councils are in the financially unsustainable category, covering about one-third of the State's population. *[See chart on next page.]*
- For these councils, unless their spending is cut or other governments come to the rescue, rates increases – which should always be the last resort – are inevitable. And the increases would need to be substantial. The current or prospective financial performance and position of these councils is not strong enough to absorb likely future developments and unanticipated financial shocks.
- As these councils include both larger and smaller ones, we do not see further amalgamations as a panacea. Amalgamation of itself does not necessarily address the more fundamental problems currently impacting on council finances.
- More equitable funding arrangements with the other spheres of government are warranted, but may go only part way to putting council finances onto a sustainable basis.
- We are convinced too that the Commonwealth and SA governments are more likely to 'come to the party' after councils have made a substantial start towards securing their own long-term financial futures.
- More strategic expenditure decisions by local government – and more rigorous funding policies – are at least as important as increased grants revenue.
- The same is true of financial governance reforms. A widespread need exists to increase expertise and understanding regarding financial governance among elected members as well as at the officer level. A cash accounting mindset and a short-term (one-year) planning horizon both still overwhelmingly prevail.

- Strengthened policy frameworks and improved financial governance are essential across the local government sector if:
  - ratepayers are to get the stability and predictability in per-property rates they expect;
  - the community is to understand the true costs of current infrastructure and service commitments;
  - councils are to have the financial capacity to deliver on those key outcomes in South Australia’s Strategic Plan that are reliant on an efficient and effective local government sector; and
  - the local government sector is to be positioned to negotiate with the State government on level terms, including to clarify roles and responsibilities and to agree joint activities.

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### **SA Councils by Financial Sustainability Category**



# Executive Summary

This Final Report sets out our findings regarding the state of the local government sector's finances in South Australia and our recommendations for ensuring that council finances become – and remain – sustainable in the long term.

## The conditions necessary for a council's finances to be sustainable

Ultimately, a council's finances are sustainable in the long term only if they are strong enough to allow the council to manage likely developments and unexpected financial shocks over the long-term financial planning period without having to introduce substantial or disruptive revenue (or expenditure) adjustments during that period.

This requires the council's finances:

- to be currently or prospectively in good shape; and
- to be likely to remain in good shape if the council's present spending and revenue policies continue unchanged; and
- to involve a margin of comfort sufficient to absorb the impact of any unexpected developments without the necessity for substantial increases in rates.

## The state of SA's local government finances

At first glance, council balance sheets in South Australia are strong because of the low level of council debt.

But their annual operating statements tell a different story.

Currently, significant operating *deficits* predominate among councils, and there appear to be substantial infrastructure renewal/replacement backlogs.

Moreover, without any policy adjustment on the part of councils, we believe that the sector's annual financial performance – and eventually its financial position – will only deteriorate further in future with population shifts and ageing along with increasing environmental imposts, even if impacts on individual councils may differ.

Based on the advice we have received from our independent advisers, the current annual financial performance and position of 26 of South Australia's 68 councils appear unsustainable over the medium- to long-term. Only about one-third of SA councils are in a moderately comfortable (or better) position.

We are not certain, however, that the local government sector universally shares this view. We think that the local sector as a whole needs to develop a common understanding of the general state of the council finances before it can meet the challenges involved.

Our **financial sustainability analysis** recommendations focus on:

- the SA local government sector adopting:
  - a standard definition of 'financial sustainability';
  - the achievement and maintenance of the financial sustainability of SA councils, both collectively and individually, as one of its key objectives; and
  - a standard set of key financial indicators for financial sustainability (and financial governance) purposes;

- ❑ the LGA encouraging and supporting soundly-based depreciation and other asset accounting policies that promote comparability in the measurement of councils' financial performance and position;
- ❑ the LGA developing and publishing a statement providing guidance to elected members on the setting of quantitative target values for the key financial sustainability indicators;
- ❑ the LGA developing and publishing a "Financial Sustainability Checklist" for the guidance of individual councils; and
- ❑ annual performance monitoring to include reporting of the latest value, a recent history and the three-year projections of the key financial sustainability indicators, and a comparison of actual values with targeted or benchmark values.

### **The factors contributing to the state of council finances**

To us, there appear to be a number of factors contributing to the prevalence of operating deficits and their frequent co-existence with substantial infrastructure renewal/replacement backlogs:

- ❑ relatively low (and falling) levels of Commonwealth and State government funding;
- ❑ cost pressures on councils as a result of the increasing cost of complying with escalating regulations and real or apparent cost shifting primarily by the State government;
- ❑ a State-government freeze on council rates revenue in the late 1990s;
- ❑ ratepayer pressure for rates increases below those necessary to fund increasing service levels;
- ❑ past policies responsible for service levels and standards in excess of those which could be sustainably funded by councils themselves;
- ❑ deficiencies evident in asset management practices and associated depreciation and asset valuation policies; and
- ❑ a widespread reluctance to borrow even when it is prudent to do so.

Many of these contributing factors are the consequence of deficiencies in council spending and funding policy frameworks which in turn typically reflect weaknesses in what we term a council's 'financial governance' practices and policies.

Differences in council size (and whether a council was formed by amalgamation or not) and location (urban/rural) seem to play a relatively minor role in explaining the incidence of operating deficits and substantial infrastructure renewal/replacement backlogs.

### **The role of other spheres of government**

Financial assistance grants from the Commonwealth are below levels necessary to equalise the financial capacities of councils. And their annual growth falls short of that of both local government costs and tax collections at the national level. Recent welcome increases in Commonwealth road funding have only partially addressed such deficiencies.

The net result is that SA councils are unable to deliver levels of services similar to those possible by councils in the more populous States unless per-property rates are higher than in those States.

Funding from the State government in South Australia is also among the lowest in the nation. This is explained only in part by differences in the responsibilities assigned to local government across the States.

Of as much importance is the role played by State government restrictions on council revenue raising and in lifting council spending through increased compliance burdens and real or apparent cost shifting. The confusion that exists on the respective roles of the different spheres of government also results in some duplication in service delivery among the governments.

We have no doubt that, if these various deficiencies in inter-governmental financial relations were addressed, then the long-term financial performance and position of the local government sector would improve, at least in the short term.

Our **inter-governmental reform** recommendations focus on:

- ❑ the LGA pursuing with the State Government both the progressive deregulation of council fees and charges and the development of a legislative framework under which councils have direct access to a fair share of developer contributions;
- ❑ the LGA documenting further the various revenue-raising constraints associated with the ‘wealth tax’ and ‘single tax’ nature of the local government sector’s tax power relative to the sector’s range of expenditure responsibilities;
- ❑ the LGA seeking the State Government’s agreement to a systematic review of overlapping service delivery activities between the State and local government sectors in South Australia;
- ❑ the LGA developing a bilateral inter-governmental agreement with the SA Government, as a basis for progressing consideration of reform of the State government’s funding of local government;
- ❑ the local government sector actively committing to South Australia’s Strategic Plan and the State Government’s Strategic Infrastructure Plan, in exchange for a commitment on the part of the State Government to work towards strengthening councils’ financial capacities so that local government can be an effective partner in achieving State-wide objectives and outcomes; and
- ❑ establishing a legislative basis for high-level negotiations between the State and local government (such as the Minister’s Local Government Forum) and for the resultant State-Local agreements.

### **Responses within the control of local government**

No matter how strong the case may be, we are convinced that the Commonwealth and the State government are likely to inject additional resources into the local government sector only after councils have first taken significant steps to secure their own long-term financial futures.

Councils need to take the initial steps along the path of improved financial sustainability.

With the exception of a couple of years in the late 1990s, council rates have grown strongly in recent years.

But ramping up rates revenue should be the last resort, in recognition of the importance to ratepayers of the stability and predictability of rates.

Expenditure decisions by local government that are more strategic and which lower the cost of providing core services are at least as important as increased grants or rates revenue.

Nor do we see further amalgamations at this stage as a panacea. They are unlikely to be effective by themselves in addressing the current financial sustainability challenge facing SA councils.

Fundamentally, there is a need to address shortcomings in the *financial governance* policies and practices evident throughout much of the local government sector. In many councils:

- ❑ a cash accounting mindset still prevails;
- ❑ the planning horizon remains predominantly short term, with the setting of appropriate long-term financial goals and targets in its infancy and budgetary frameworks, and associated internal reporting and monitoring, not having the requisite medium to longer-term focus; and
- ❑ the transparency of financial reporting is not at a standard achieved at other spheres of government.

Complementing reforms in these areas, councils need to adopt a policy framework for service provision which clearly specifies their policies regarding the number and nature of services to be delivered and the methods for delivery. Councils can deliver services directly, resource share with neighbouring councils, advocate to the other spheres of government for services to be delivered, contract out services to the private or community sector or fund community groups.

Likewise, councils need to adopt a more rigorous policy framework for funding their services and infrastructure, to guide council decisions regarding revenue and financing. Such a framework should address issues such as ‘user pays’, and how any grants shortfalls will be covered in relation to services provided through grants funding.

We believe that local government has everything to gain by embracing a raft of financial governance and related policy reforms, and nothing to lose.

Our **financial governance and policy framework** recommendations focus on:

- ❑ possible amendments to the *Local Government Act*:
  - stating the principal role of councils and of members of councils to include ensuring the sustainability of their council’s long-term financial performance and position; and
  - obliging councils to target both an annual operating surplus and a net infrastructure renewal/replacement balance, to be achieved by all councils over their planning cycle and within a set time frame, say five years;
- ❑ each council developing and publishing both:
  - a ‘service provision and delivery policy statement’ regarding the number and nature of services to be delivered and the methods for delivery, and
  - a ‘revenue and financing policy statement’ regarding the funding of both operating expenses and capital expenditures, along the lines of the statements required under law of councils in New Zealand;
- ❑ councils considering further resource-sharing initiatives, especially involving the smaller councils, ranging from working together more effectively to more formalised regional groups, area integration and whole-of-sector initiatives;
- ❑ incorporating into the LGA’s governance principles adherence to best-practice financial governance policies and procedures contained in the CPA Australia/LGMA’s *Excellence in Governance* manual; and
- ❑ the local government sector accepting that elected members require specific training in support of their financial governance responsibilities.

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