Submission
No 83

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: Country Mayors of NSW

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SUBMISSION

NSW GOVERNMENT INQUIRY: ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Presented By
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TERMS OF REFERENCE

That the Standing Committee on State Development inquire into and report on the ability of local governments to fund infrastructure and services, and in particular:

(a) the level of income councils require to adequately meet the needs of their communities

(b) examine if past rate pegs have matched increases in costs borne by local governments

(c) current levels of service delivery and financial sustainability in local government, including the impact of cost shifting on service delivery and financial sustainability, and whether this has changed over time

(d) assess the social and economic impacts of the rate peg in New South Wales for ratepayers, councils, and council staff over the last 20 years and compare with other jurisdictions

(e) compare the rate peg as it currently exists to alternative approaches with regards to the outcomes for ratepayers, councils, and council staff

(f) review the operation of the special rate variation process and its effectiveness in providing the level of income Councils require to adequately meet the needs of their communities

(g) any other related matters.

The terms of reference for the inquiry were referred to the committee by the Hon Ron Hoenig MP, Minister for Local Government on 8 March 2024 and adopted by the committee on 14 March 2024.

The Country Mayors Association of New South Wales And Its Broad Financial Sustainability Concerns

The Country Mayors Association of NSW (CMA) represents 88 Local Councils throughout non-metropolitan NSW. The Association exists because of city-country inequities. On a per capita basis, Country Councils have far higher expense to income ratios than their city counterparts and few revenue growth opportunities. Country Mayors and their Councils are much more connected to their communities and are a vital employer. They are the front line for government service delivery in regional communities, as seen since 2019, when the NSW Government partnered with Local Government to recover from a barrage of disasters across the State. Country Mayors and their councillors give a great deal for their constituencies and their staff are often underappreciated dedicated professionals.

Despite the clearly important roles of Local Government in NSW, Country Mayors are under ever-mounting pressure, due to financial sustainability barriers.

If State required council plans are to be adhered to, if councils are to retain stressed staff in challenging recruitment areas, if infrastructure is to be maintained or renewed as required and if councils are to maintain expected levels of service delivery and solvency, funding for non-metropolitan councils must be increased and made more consistent. It is also imperative that funding to Country NSW Councils be delivered through more streamlined, efficient processes. It is contradictory when the complexity and demands of funding application requirements are beyond the capacities of a small rural Council and they are forced to engage costly consultants. Councils also needlessly spend money when the assessment of grants they expect to receive takes an unpredictably long time.

Country Councils advocate for indexed baseline structured funding methodology from the NSW Government. Additional grants on a needs/project basis are appreciated by Country Mayors. However, the extent to which funding is variable and unpredictable from one year to the next renders plans, financial or otherwise, redundant.

The financial sustainability of Local Government in country NSW is under constant threat, with operational, service delivery and planning consequences. There is a distinct country city divide, with rural and regional councils being twice as reliant on government grants than their big budget city cousins. Individual Councils have little influence over major revenue streams and the externally determined variability of grants means that financial planning beyond year-to-year is limited in integrity. The lack of consistency in funding programs undermines the value of mandatory 10-year plans.

Country Councils in NSW have been affected by a rapid rise of operational costs in recent years, the ad hoc and insufficient funding models in place, cost shifting from State and Federal Governments and rate pegging. Country NSW Councils generally have greater costs and less revenue capacity per capita than city councils. This is a key concern of country mayors in NSW.

Regional NSW Councils are responsible for the delivery of a broad range of essential services, including road maintenance, waste management, water and sewerage, development determinations, public amenities such as parks and toilets, through to libraries, museums and community events. Increasingly, country Councils are the back-up supplier of economically and socially important services, such as childcare and aged-care. Communities are more engaged with their local council in regional areas compared to city areas. They see their Council as more than a civic authority and expect more from it.

The revenue raising capacities of regional Councils are much lower and operational costs much higher per capita than their metropolitan counterparts. The cost burden of their roads alone constitutes a liability that threatens financials sustainability because of dramatically rising costs, unpredictable external funding and the shifting of costs that are the responsibility of State or Federal Governments onto Local Governments.

There are distinct differences between city and country community expectations and perceptions of Local Government. Country Mayors in NSW must contend with community stakeholders who perceive the local Council to be a community/public service provider. Metropolitan councils are generally not expected to provide nearly as much for free by their communities. They are a civic authority but small regional Councils are much more than that to their communities. In many LGAs with a population under 10,000 the Local Council is one of the three largest employers in the area, making them an integral community member.

Analysing two specific Councils provides revealing examples of how divergent their approaches and revenue streams are.

Hay Shire Council is one of the State's smallest and financial sustainability challenged remote rural Councils, with a population of 2,979 and an area of 11,326 km². Their website published fees and charges document is 20 pages in length. Bayside Council covers the Botany Bay area in Sydney. It has a population of just over 170,000 and an area of 50 km². The fees and charges document on their website is 118 pages in length. In cases where the same charges exist in the two Councils, they are much higher in the metropolitan Council, unless they are a standardised fee, such as Development Application assessments. The number of application fees Bayside Council receives is far greater than what would be seen in a rural council like Hay and that business/revenue is growing as the population does. Many small Country Councils in NSW are almost stagnant, while some have negative growth, further reducing Council revenue earning capacities. Dramatic City/Country Council disparities range from the smallest examples to larger revenue sources that do not exist for small rural Councils. Charges at community libraries are set on a cost recovery basis, but Country Councils charge exactly half as much for nominal services like photocopying.

Figure 1. Hay Shire Council's Construction Certificate Charges (per construction cost estimate) (2023/24):

Exceeding $100,000 but not exceeding $250,000	$350.00 plus $3.00 per $1,000 or part thereof by which the cost exceed $100,000	No	CR	N/A
Exceeding $250,000	$650.00 plus $2.00 per $1,000 or part thereof by which the cost exceeds $250,000	No	CR	N/A

Figure 2. Bayside City Council's Construction Certificate Charges (2023/24):

$100,001 to $300,000	$1,325.00	$1,425.00
$300,001 to $400,000	$1,505.00	$1,620.00

Figure 3. The proportions of key revenue streams for City/Country NSW Councils

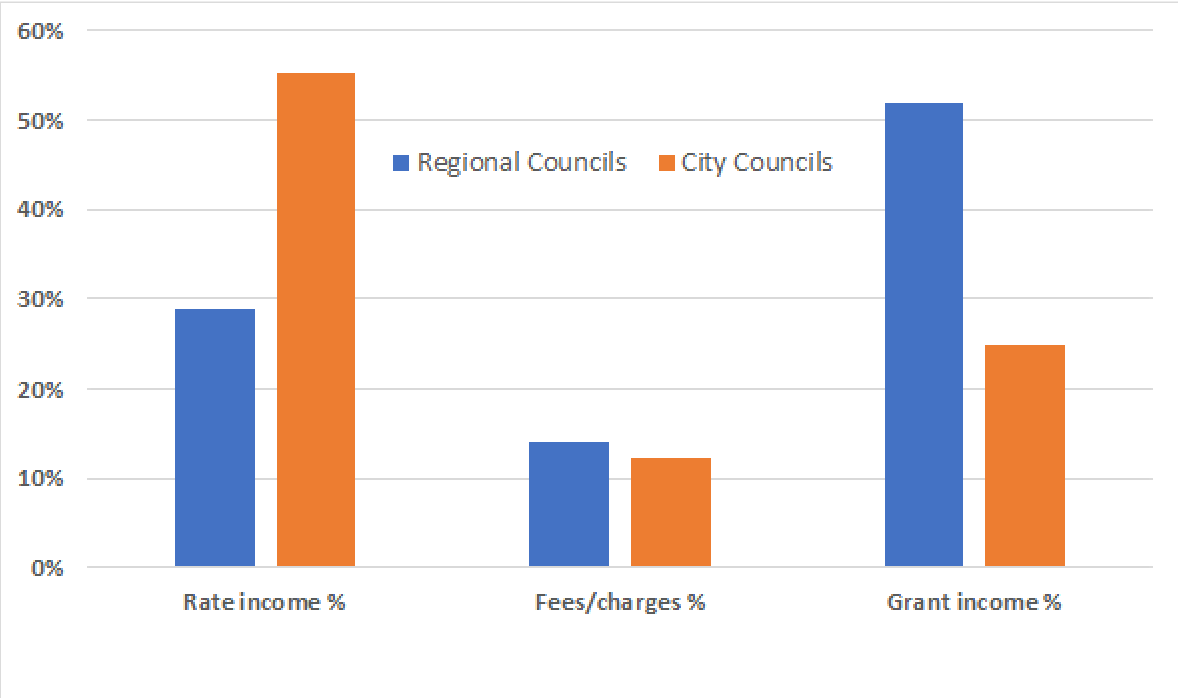


Figure 3 illustrates some key revenue disparities between regional and city councils. While fees and charges make up a similar proportion of total income for each, city councils obtain a much higher proportion of their revenue from rates, due largely to a higher population. Regional councils in contrast relay much more heavily on uncertain and variable income from state and federal grants, making planning for services and infrastructure more difficult.

Data Snapshot

Key Data from The Country Mayors Association of NSW:

A Majority of Country Councils Operating at A Loss

In the 2021/22 year, 43 of 85 country NSW Councils recorded operating losses in their General Fund.

In the 2022/23 year, 38 of 77 Councils (8 councils with Financial Statements not available) reported operating losses in the General Fund, even accounting for the Financial Assistance Grants being paid 100% in advance.

In 2021/22 the Combined Operating losses in the General Funds of 85 country NSW Councils was $109mil. (even allowing for those that had a surplus). In 2022/23 the total losses had grown to $143mil. from the 77 councils with completed financials.

Depreciation to Rates Revenue

In 2021/22 Eight Councils of 85 reported that depreciation was greater than 100% of their rate income.

In 2022/23 18 Councils of 77 reported that depreciation was greater than 100% of their rate income.

Own Source Revenue

When comparing this it is best to simply compare General Fund Figures, as some councils do not have separate Water and Sewerage.

The Australian Local Government Association's National Conference brochure promoted that Councils have own source revenue of 90%. The benchmark from Office of Local Government is 60%.

In Regional NSW the average across 85 Councils was 46.44% in 2021/22.

The 15 Sydney Councils' own source revenue average for the same period was 66.83%.

In 2022/23, of the 77 country Councils with Financials Completed it is 43.94% and the 15 City Counterparts have averaged 61%.

Regional and Rural Councils Have Higher Borrowings

Regional Borrowings in 2023 of 77 country NSW Councils totalled $1,099,904,000. This is inclusive of Water and Sewerage Borrowings, as only 25% of required funds were provided through Safe and Secure Water.

Of the 15 City Councils in 2023, the total borrowings were $195,086,000

In 2021/22 the regional borrowings of 85 Councils was $1,170,657,000, compared to the 15 Sydney Councils borrowing a total of $112,117,000.

Cash Reserves

Cash reserves in Local Government are another indicator of the need to view (and fund) regional and Sydney Councils differently.

In 2022/23 unrestricted cash reserves from 85 country NSW councils amounted to less than 40% of the unrestricted cash reserves of the 15 Sydney Councils. A total of 15 country Councils has zero unrestricted cash reserves and three had negative reserves.

In 2022/23, the City of Sydney Council received Capital Grants totalling $148mil. when they had over $400mil in unrestricted cash reserves.

Cost Shifting

The broad trend of offloading expenses from State and Federal Governments onto Local Government

Cost shifting has been harmful to bottom lines and country NSW Councils' efforts to build brighter futures for their communities. Funds allocated for Council infrastructure can suddenly be diverted when the NSW Government declassifies a road as arterial and makes it a local responsibility, for example. Multi-million dollar impacts of cost shifting are impeding the viability of Councils in country NSW and the variability of those impacts make planning and adhering to plans impossible.

LGNSW released a report in November 2023, showing that cost-shifting from the state government is equivalent to more than $460 per ratepayer.
https://lgnsw.org.au/Public/Public/Advocacy/Cost-shifting.aspx

Cost shifting is a major factor in Country NSW Councils' financial sustainability but so to is the impact of undelivered promises of support for Government required Council services, programs or infrastructure.

Neither the CMA, nor its' individual member Councils seek to play politics. In working to deliver services and infrastructure, they expect to be able to work with Ministers, Local Members, Senators and Government Departments professionally. This bipartisan approach makes it difficult to raise awareness within the Government and local communities of the unfulfilled NSW Government financial commitments to Country Councils (to further understand of Councils' financial sustainability hurdles).

As most regional Councils have an ageing population, Councils are increasingly, unfairly burdened by NSW Government mandated pensioner rebates. The legislation for pensioner rate rebates in NSW is now so outdated that it no longer makes sense. The pensioner council rate rebate was legislated in the *Local Government Act 1993 (NSW)*. The legislation stated that pensioners should receive a concession of one-half of the rate of charge for their Council rates but that concession should be no greater than $250. Over 30 years since the legislation was introduced, $250 is very far from a 50% rate rebate for pensioners. This long out-of-date pensioner concession has resulted in Councils often supporting those in financial hardship with payment/instalment plans, impacting cashflow and negatively reflecting upon Council performance.

Councils provide the following pensioner rate rebates stipulated on the Services NSW website (as per the above 2024 link):

- $250 on ordinary council rates and charges for domestic waste management services
- $87.50 on annual water rates and charges (where the service is provided by council)
- $87.50 on annual sewerage rates and charges (where the service is provided by council).

On 24 August 2023 Minister for Local Government the Hon Ron Hoenig distributed a media release entitled: “Concessions now available to pensioners for council rates” [attached]. In line with Services NSW information, this promoted the pensioner concessions to show that “… the NSW Government understands people are doing it tough right now, with pensioners especially vulnerable to rising cost of living”. The NSW Government is not providing the concessions, Councils are. They directly reduce Council rates revenue but the NSW Government only reimburses Councils for 55% of the concessions cost.

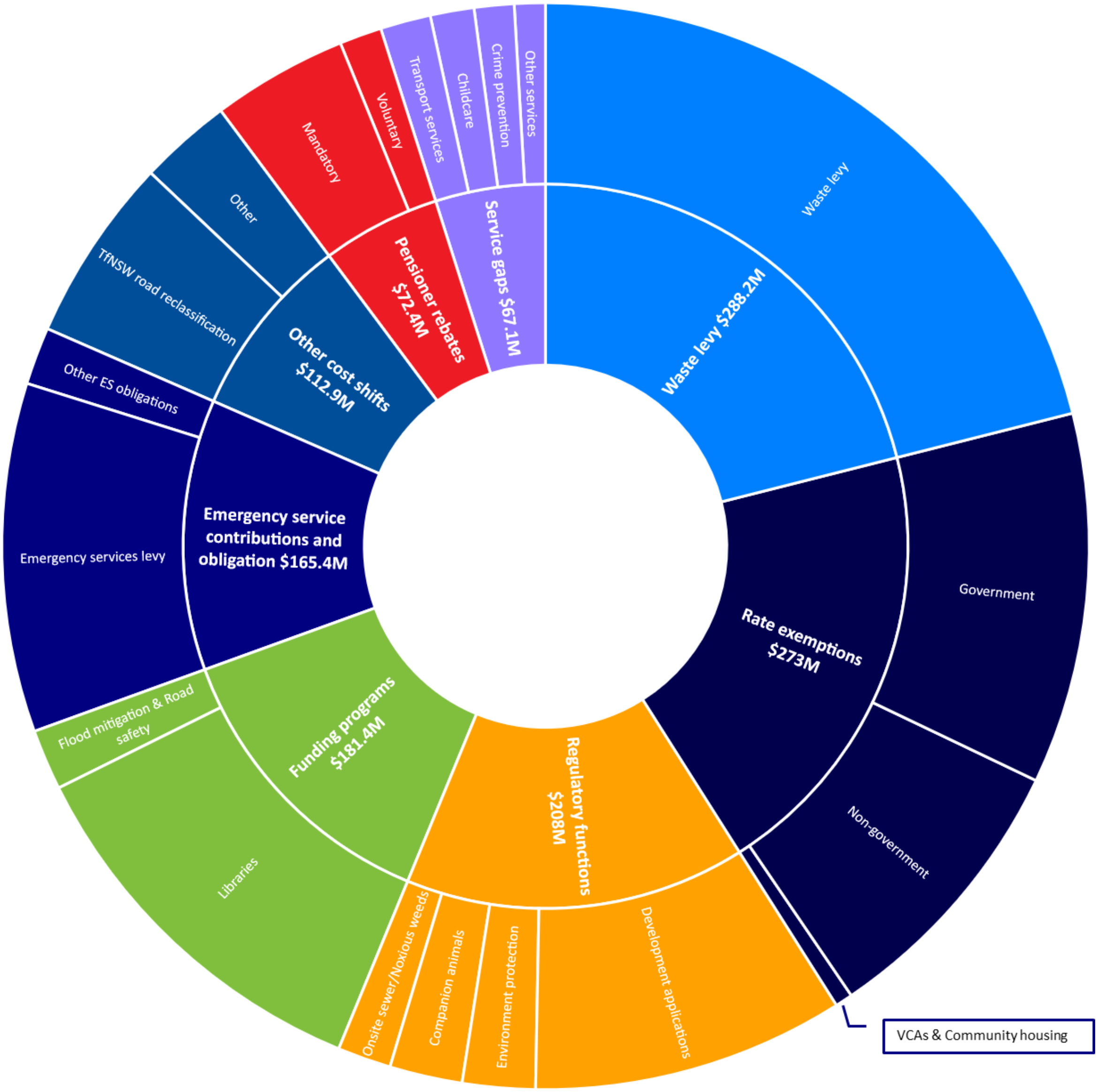
The CMA advocates that pensioner rate concessions must be fully funded by the NSW Government.

The same lack of State Government financial support has been the case with public libraries, the operational costs for which are underappreciated. Councils see a small portion of funding required for libraries come from the NSW Government, when an established convention was that 50% of public library operating costs would be met by the State Government.

Another example is the waste levy. Almost all Country NSW ratepayers believe when they pay their rates, inclusive of the rates levy, it is all Council revenue. Few could believe that the waste levy goes to the State Government, which in returns a discretionary proportion of a Council’s levy total to them.

In a further example, a new interment and cremation levy was introduced by the NSW Government in 2024. The State Government made this decision without consultation with Country NSW Councils. In a time of cost-of-living increases, it is another blow to regional communities that Councils have been forced to convey and administer, with no Council benefit.

Figure 4 2021–22 cost shifting components
(LGNSW Cost Shifting Report – How State Costs Eat Council Rates)



The Red Fleet

Country NSW Councils have now been forced by the NSW Government to include depreciation costs for Rural Fire Service (RFS) assets in their financials. This has become known as 'The Red Fleet'. Councils have no control over these assets, no ownership and little to no involvement with the RFS overall. Councils are essentially given an asset value figure (by the NSW Government) and are required to incorporate that into their books, forced to accept the validity of that figure.

The RFS website has webpages detailing its' official structure and governance, with Councils in NSW not mentioned in either. As per official records, the liabilities and overall governance of the RFS fall under the jurisdiction of the NSW Minister for Emergency Services. Forcing councils to include RFS asset depreciation in their books is shirking a responsibility from

State to Local Government, diminishing a council's financial position in the process. Since 2021, there has been a substantial increase in 'qualified' council audits, impacting on their ability to source loans or grants.

The NSW RFS is headed by the Commissioner, who is appointed by the NSW Minister for Emergency Services, and has responsibility for the management of the NSW RFS. The Commissioner has responsibility for determining strategic priorities, the organisation's policies and service standards and exercising its functions, responsibilities and obligations under the *Rural Fires Act 1997*. [NSW RFS website, 2024]

The NSW RFS comprises almost 2,000 rural fire brigades, with most having multiple assets.

The administration of the NSW RFS is part of the larger NSW Public Sector. Our Chief Executive Officer (CEO) is the Commissioner. Employment of staff members is governed by the *Government Sector Employment Act 2013* (the Act), the *Crown Employees (Rural Fire Service 2009) Award* (the Award) and the *Crown Employees (Public Service Conditions of Employment) Award 2009*. [NSW RFS website, 2024]

Councils do not receive any proceeds from trade-ins or sales of RFS assets, which ordinarily compensate somewhat for depreciation liabilities. An accurate asset register is not provided to Councils, nor do they get naming rights for the assets they have a financial interest in. The NSW Minister for Emergency Services generally announces to the media the granting of the new costly firefighting appliances arriving in a Local Government Area but only through searching for fire truck sales online might dispersals be learned of.

RFS asset depreciation diminishes a country NSW Council's financial position considerably. Responsible managers work to redress negative drivers in Profit and Loss sheets but nothing can be done in relation to The Red Fleet because it is entirely external.

There are dozens of used fire trucks being sold online by local retailers around NSW. Local councils have no knowledge of when new appliances are acquired or old truck trade-ins.

Country NSW Councils have no place in the official structure or constitution of the NSW Rural Fire Service (RFS). So, cost shifting here has had no regard for pre-existing policies

Special Rate Variations and Rate Pegging

The increases to operational costs faced by regional Councils has far exceeded what they have been able to increase their rate-based revenue by, due to the NSW Government's rate pegging system. Since 2015, all Council operational costs, particularly costs associated with road construction and maintenance have increased more rapidly than experienced in decades. A majority of regional NSW Councils consider their financial sustainability to be under constant threat by rising costs and heavily restricted revenue growth (particularly where there has been minimal population and/or economic growth). Operational costs are exacerbated by the distances that regional councils are responsible for and their remoteness, which increases asset construction and maintenance costs exponentially.

The Independent Pricing and Regulatory Tribunal of NSW (IPART) released its final report from a "Review of the rate peg methodology" in August 2023 (IPART, 2023). This 228-page document is the result of a great deal of work, yet it is inherently flawed because the calculations behind IPART's new Base Cost Change (BCC) Model and the NSW State Emergency Service levy imposed on Councils do not account for obvious variables. There is an underlying assumption that all rural and regional Councils and their financial challenges can be viewed as X and Y in the modelling and methodology that leads to a rate increase pegged percentage.

The reality is that local Councils in country NSW can vary much more than metropolitan councils in terms of changes to financial challenges. Industries can impact on Council infrastructure years before they have an upward impact on Council revenue. Individual Councils are unique and rate pegging methodology will never be perfect, as one size does not fit all. If rural and regional Councils must have their rate revenue increase limited by an external body, the process for Special Rate Variations needs to be simplified and accepted as individual local Government bodies needing to respond to rising costs.

Rate pegging has failed because it has been based on historical data. Current, emerging and future circumstances must be considered on an individual basis.

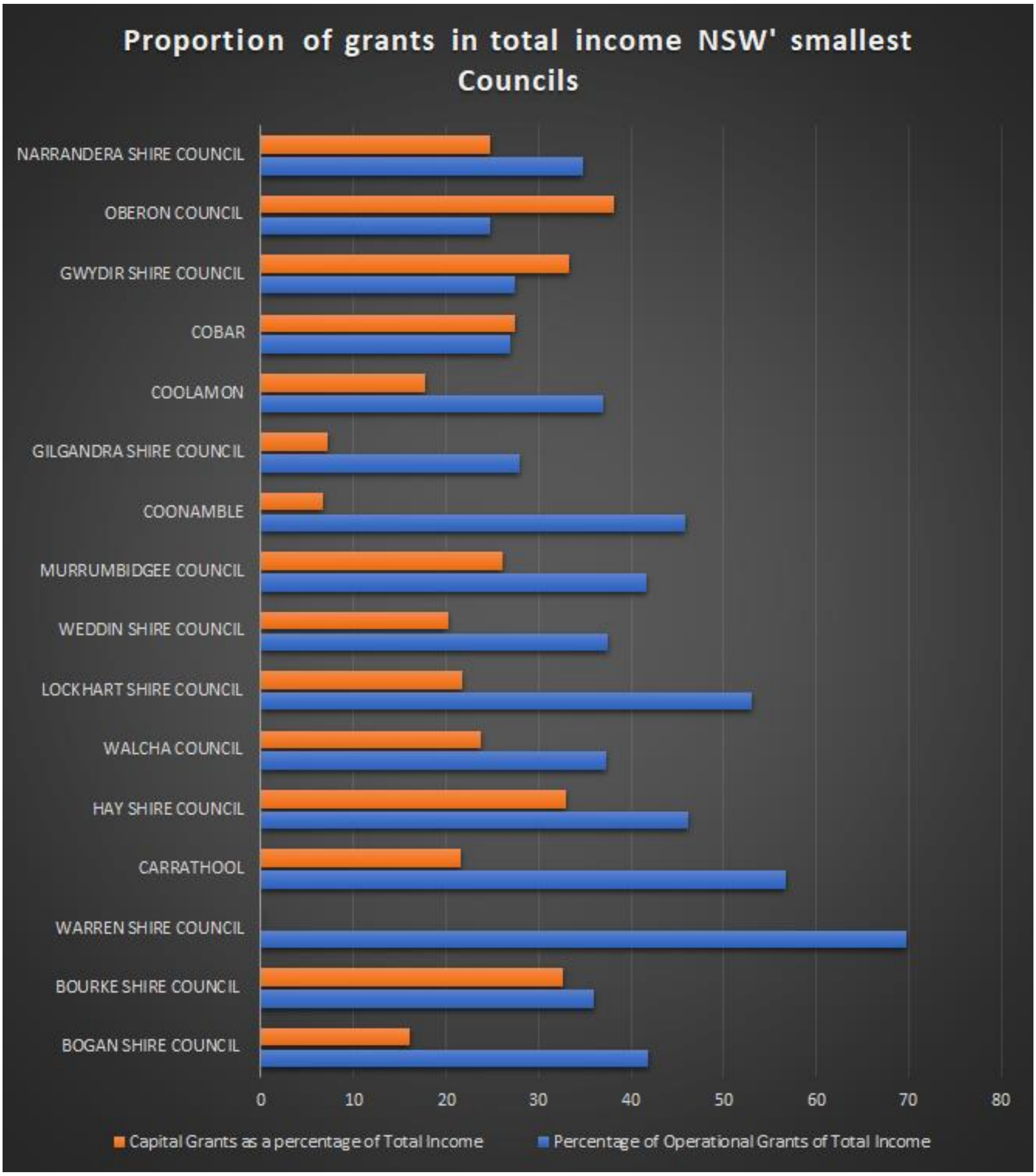
IPART and the NSW Government demonstrated a negative view of country councils' financial struggles through public comments made in 2023. The relationship needs to be strengthened and NSW Government must have greater understanding of the unsustainable financial challenges country mayors face, if financial sustainability and growth is to be nurtured and achieved in regional NSW.

Local Government is among the most transparent of organisations in Australia. In NSW, financial reporting, audits and plans are required of Local Councils by the State Government and they are all publicly accessible on council websites.

Grant Dependence / Borrowings

In 2020-21, the average grants contribution to total revenue across all NSW Councils was 18.3% (Australian Bureau of Statistics). Figure 2 illustrates how much smaller rural councils differ from this State average, with smaller rate bases and higher per capita expenses leading to councils relying on up to 70% of their revenue coming in the form of grants.

Figure 5. The smallest NSW Council populations (under 6,000) rely on variable grant revenue.



Local Councils are required to develop and work to 10-year plans. This is impractical, given that funding for road works and other essential services comprises close to three-quarters of the total revenue in some regional Councils and that results from discretionary allocations and individual grant applications for designated projects.

Such ad hoc funding cannot be planned for.

The Australian Government's annual Financial Assistance Grants (FAGS) to Councils have a General (untied) component and a local roads component, which comes to Local Councils via State Governments.

The Federal Department of Infrastructure website states that the Australian Government will have provided over $67 billion under the Financial Assistance Grant program to local government since 1974–75 (including 2023–24). The grant is provided under the Local Government (Financial Assistance) Act 1995 (the Act).

The Financial Assistance Grant program consists of two components:

- a general-purpose component which is distributed between the states and territories according to population (i.e. on a per capita basis), and
- an identified local road component which is distributed between the states and territories according to fixed historical shares.

Both components of the grant program are untied in the hands of local government, allowing councils to spend the grants according to local priorities. (Dept. of Infrastructure, 2024)

The value of Financial Assistance Grants provided to local government has declined over the past three decades from one percent of Commonwealth taxation revenue to just over half a percent.

Local governments only collect approximately 3.5 percent of taxation nationally and need support from other tiers of government to provide the services and maintain the infrastructure their communities need, such as swimming pools, playgrounds, sports facilities, regional airports, and roads. The Australian Government's figure of $67 Billion forms an impressive opening line on a webpage, however split between 537 councils nationally, over the past half-century is an average or just under $2.5mil per council annually.

Remote Councils have much lower revenue raising capacity and are more reliant on Financial Assistance Grants to cover their costs. This is not taken into account by State or Federal Governments; only perceived need, based on factors such as road usage and population growth. That this has been the case was conceded by the Queensland State Government, with its Local Government Grants Commission 2021 Methodology Review promising the following features of that State's new approach to distributing grants to local Councils:

- focusing on the difference between a council's potential to raise revenue and its actual capacity to raise revenue in acknowledgement of the revenue raising challenge faced by many councils;
- allowing for the difference in costs in providing services (on a per capita basis);
- including cost factors that better reflect an individual council's operating environment (remoteness, dispersion and socio-economic conditions);
- reducing the sensitivity of the model to road network input data, which means road length and related information is not as influential in determining grant allocations;
- establishing four more councils as minimum grant councils given their higher revenue raising capacity when compared to other Queensland councils.

Audit Assessments

The Country Mayors Association reports that numerous member Councils have had their tight finances further stretched by a NSW Government imposed centralised auditing requirement that has proven to be inefficient. While many impacts upon Country NSW Councils are complex and do not have overnight solutions, this is an issue that the NSW Government can address.

Since the NSW Audit Office (AO) took over all NSW Council audits, costs for Councils have faced considerable increases in auditing costs. Local Government service provider LG Solutions undertook analysis of the increases and determined there has been a cumulative $21.7mil in extra audit costs across the sector.

This is funded by general revenue that could have been spent on infrastructure replacement by Country Councils. (Source: October 2023 LG Debits and Credits Newsletter).

CMA Member Councils have also experienced delays in the AO meeting reporting obligations which is influencing the compliance rates for submission. The AO is a failed experiment. It has driven up auditing costs for councils by close to one-third in the past year. The AO has also reduced the timely transparent reporting and publishing of CMA Members’ financials, with more Councils being late with their financials than ever before, due to the centralised auditing process forced upon them.

auditoffice

OF NEW SOUTH WALES

Cost Indices for Roads

Recent years have seen an annual average increase in road construction and maintenance costs of close to twice what country NSW Councils have been able to increase their rates revenue, due to rate pegging.

The CMA perceives little grounds for improved optimism that has presumably led to substantially improved cost increase projections from Transport for NSW (TfNSW). (Transport for NSW Road & Rail Cost Escalation Indices, July 2023 Update).

There has been escalating destabilisation in the Middle East, the Russia-Ukraine war continues, the US economy has a positive veneer over endemic issues and debt beyond compare. Regional commodity concerns have improved in the past 12 months but the cost of living and business escalation drivers (such as oil prices) have not disappeared like TfNSW projections for the 2024/25 financial year and beyond suggests.

Country NSW Councils have struggled to maintain their roads to satisfy public expectations or even optimal safety standards for many years. A triage approach has had to be governed by grant funding (State and Federal) that has been unpredictable and declining year-to-year.

If Council Councils in NSW are to be financially sustainable while meeting their infrastructure obligations, a new model for providing country road funding to Local Government must be achieved. The CMA has holistic Country NSW Council insights, as such the organisation respectfully and strongly requests a seat at the table to assist in any review.

The rising costs of maintaining local road networks represent the biggest barrier to financial sustainability for Local Government in country NSW. Road infrastructure is vital in social and economic terms and Country Mayors are ever conscious of the life-and-death safety implications of maintaining roads or restoring them after natural disasters.

The Grattan Institute's report "Potholes and Pitfalls - How to fix local roads" (November 2023) concluded that major funding changes are needed to enable local Councils to meet their road responsibilities.

Modelling from the Grattan Institute showed that the road maintenance cost per resident in regional and remote Councils is at least three times the cost to metropolitan Councils.

Due to agriculture, mining and transport industries, country councils face greater road maintenance cost burdens. Heavy vehicles cause the most damage to road infrastructure.

“Most road damage is caused by trucks and truck operators pay for this through the Heavy Vehicle Road User Charge. This Charge is intended to cover the share of road construction and maintenance costs attributable to trucks; the mechanism is a 28.8 cents per litre tax on fuel consumption, and vehicle registration fees that vary by vehicle type and state. The amount that freight operators pay is calculated based on the share of expenditure on roads that can be attributed to heavy vehicles, though the final decision on the heavy vehicle road user charge rests with the Federal Minister. But even though local government road expenditure attributable to heavy vehicles is included in the calculation of freight charges, the Federal Government does not pass that revenue back to the road managers who remediate the damage.”

Across the three ties of Government in Australia, the Grattan Institute identified a $1 billion gap in road funding.

“The federal government should establish a $200 million per year fund to assess and upgrade local roads identified as priority freight routes, in exchange for affected councils providing permit access to compliant heavy vehicles as of right.” (Grattan Institute, 2023)

Local Councils are required to set funds aside for infrastructure maintenance / renewal, contributing significantly to the expenses column in their financials, while also being required to include depreciation for road and plant assets as an expense. This means that costs associated with maintaining capital items are being counted twice and this impacts on perceived performance and borrowing capacity of a council.

Despite the vital roles they play, local Councils are not included in the Australian Constitution. This means that there is no mandate for structured funding channels from the Federal Government and funding comes to regional communities in the form of grants, resulting from considerable work and often, consultancy expenses. The unpredictability of this puts extreme pressure on regional councils in NSW and prohibits genuine economic growth plans.

Financial sustainability of country councils in NSW is no more promising in the recently amalgamated councils, as demonstrated by the financial data that illustrates revenue streams and the reliance on highly variable grants.

The Snowy Monaro Regional Council was formed on 12 May, 2016 through a forced amalgamation of the Bombala, Cooma-Monaro and Snowy River shires. Their 2021-22 financial figures show an operating loss of over $1 million, if the revenue streams of rates and fees/charges are calculated without including grants, which are a relatively low proportion of revenue compared to other country councils in NSW.

The Kempsey-Armidale Road Example

With no warning or consultation, the NSW Government can reclassify a road, shifting the cost and responsibilities for that road onto a Local Council. This happened to the former Armidale Dumaresq Council, when the liabilities for the Kempsey Armidale Road was handed over to it by the State Government, shifting hundreds of thousands of dollars onto its expenses. The road is the most direct route between the two centres but it traverses a particularly rugged landscape and storms have forced its closure on numerous occasions. Remoteness and Council capacities have meant road closures have been for extended periods, often trapping primary producers.

In late 2019 and in February 2020, bushfires then storms and flooding rains damaged the road well beyond the Council's financial capacity to restore. The subsequent $408 million reconstruction of the Kempsey Road back to pre-disaster conditions was jointly funded by the Australian and NSW Government. It was the largest single road project undertaken by a NSW Council, restoring over 48km of road. In addition to the restoration work, the NSW Government approved three improvement projects to be carried out at the same time and to build back better in order to improve the road's resilience in case of future natural disasters. These projects were funded through the Fixing Local Roads and Fixing Country Roads programs.

State Government monitoring and improvements might have reduced the extent of the damage but it certainly would have meant the Council would not have spent considerable time and money on grant applications and lobbying and those impacted would have seen the work started and completed sooner, with completion forecasted for mid-2025. Armidale Regional Council has publicly indicated its desire to return management of the Kempsey Armidale Road to the NSW Government after the major restoration works are complete.

The Kempsey Armidale Road after storm damage in February 2020.

Disaster Funding Claims – Timeframes of Payments

Up until 2019, regional NSW was economically and spiritually depressed by the worst drought on record. Since, then record breaking natural disasters have included bushfires, floods and severe storms. Country NSW Councils are on the front line of disaster recovery. The system of partnering with NSW Government Departments (as funding bodies) has been effective but not efficient and delays in processing claims from country Councils has had compounding impacts, financially and in terms of the recovery process. CMA data collated from member Councils in early 2024 revealed that almost two-thirds of claims/applications were still pending (from submission periods dating back to January 2021). [see attached disaster funding report].

Feedback from member councils described the Disaster Recovery Funding Arrangements (DRFA) as a crucial funding mechanism for Local Government in the aftermath of extreme events. However, the guidelines are interpreted to exclude water and sewer assets damaged in disasters.

Clearly, the cost of repairing or potentially replacing such vital infrastructure as water treatment plants damaged or destroyed during these extreme events is well beyond the means of most country councils. By way of example, one western NSW Council had $19mil. of damage to water supply assets in November 2022. Without direct government intervention, the Council has not had a suitable funding mechanism to restore the infrastructure. While the large municipal water utilities may be able to self-fund these repairs, the cost on country councils is completely unaffordable. Such limitations to vital disaster recovery funding is a considerable barrier to financial sustainability for a country NSW Council.

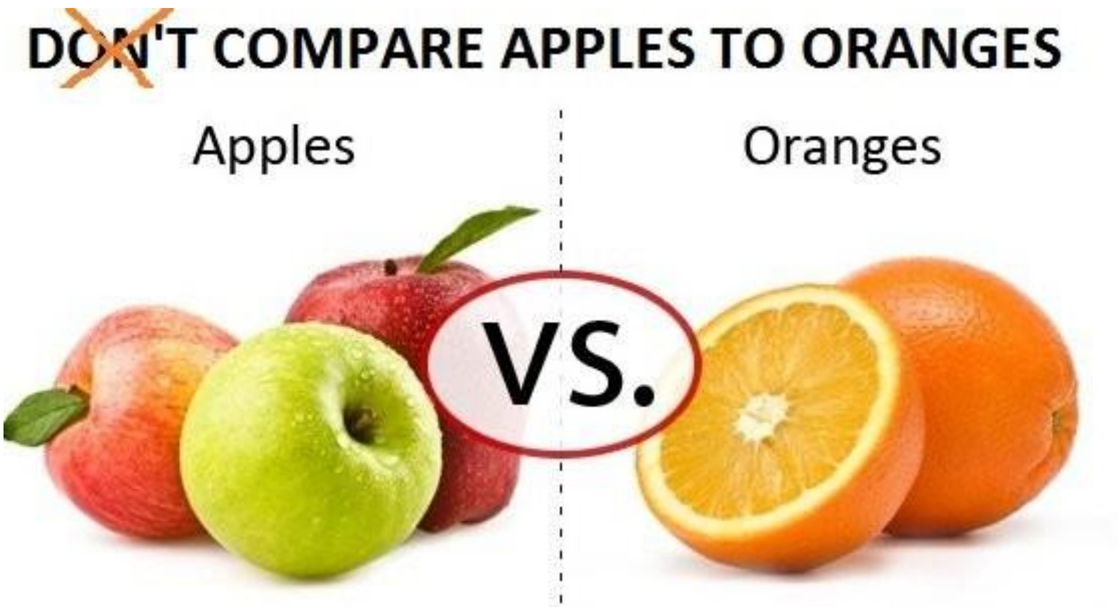
Ratios – Lack of Uniformity in Local Government Accounting Systems

As Local Government finance professionals will know, looking solely at the "CONSOLIDATED RESULT" for Councils makes no sense when trying to assess a Council's true financial performance.

Given that NSW Councils have specific activities that require specific funding and statutory requirements which limit the use of those specific funding sources…the ONLY way to view and judge Councils' performance is on a FUND-BY-FUND basis.

A better ratio would be operating profit to rate income. As previously stated, the grant income must be spent for the intended purpose; grants help Councils to meet their infrastructure obligations but they often do not impact significantly on financial performance. Grants are extremely variable from year-to-year and Council-to-Council (some remote NSW Councils have grants as making up close to 70% of their total revenue, while in others grants comprise less than 20%).

Operating profit to rate income is the stable, consistent measure of Country NSW Councils. Adopting this ratio across Country NSW Councils and improving consultation with them will improve outcomes, through more accurate comparative tracking of performance.



Depreciation

The NSW Government financial reporting requirements of Local Government currently necessitate depreciation to be double-counted in financials. This included the Red Fleet of Rural Fire Service Assets. This negatively impacts on a Council's financial position and borrowing capacity, plus (importantly) it's public image of financial management competency.

Background

Depreciation expenses are a material amount in all NSW local government councils' financial statements and as such have a significant impact on councils' bottom lines and the financial performance measures (namely the Operating Performance Ratio).

Due to the adverse and distorting impact on Operating Performance Ratios it is essential that a critical review be undertaken to ascertain the relevance of the inclusion of depreciation expenses.

Discussion

General purpose financial statements for both commercial entities and local government councils determine depreciation expenses in accordance and compliance with AASB 116.

AASB 116

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation can be described/explained as follows:

"*Depreciation is a planned, gradual reduction in the recorded value of an asset over its useful life by charging it to expense. Depreciation is applied to fixed assets, which generally experience a loss in their utility over multiple years. The use of depreciation is intended to spread expense recognition over the period of time when a business expects to earn revenue from the use of the asset*."

It is also accepted that in commercial environment depreciation expenses are integral in determining the profit distribution through dividends.

An August 2022 report to Murray River Council by a retired Local Government Auditor detailed how depreciation is meant for commercial operations and is largely irrelevant to Local Government:

- There are no distribution of profits
- Most Council assets are not intended to generate and/or maximise revenue.
- Numerous assets are externally funded (partially or fully) through grants and contributions.
- Some councils have brought to account and depreciated assets which they neither own nor control, nor have any financial obligations for asset maintenance or replacement (e.g. Rural Fire Service 'Red Fleet' assets).
- Arguments persist that certain asset categories e.g., roads, do not lose value should maintenance be adequate.
- Assets of council are subject to rapidly changing demographics, global trends, changes in Community Strategic Plans, legislation, and technology.
- In some cases, council determines that assets will not be replaced at the end of their useful life e.g., community halls due to changing demographics, community expectations etc.

Consequently, it is apparent that depreciation expenses as defined by Australian Accounting Standards and adhered to by commercial entities are not necessarily compatible nor applicable for local government assets.

As stated earlier 18 NSW Regional Councils Depreciation cost of General Fund Assets exceeded their rate income.

Consequently, it is apparent that depreciation expenses as defined by Australian Accounting Standards and adhered to by commercial entities are not necessarily compatible nor applicable for local government assets.

This situation was recognised **as far back as 1922** when a Committee of Enquiry into Local Government Accounts stated:

"*In Local Government Accounts a charge for depreciation means a provision for replacements. What local government bodies are concerned with are the cash and funds available for expenditure, so that unless depreciation written off is actually set aside in a special bank account no advantage is gained by writing it off*."

"depreciation means a provision for replacement".

For the reasons enunciated earlier most councils' assets have been externally funded (partially or fully) through grants and contributions (roads/sewerage/water etc) and Council will never be in a position, nor expected, to fully fund these assets when they are fully depreciated.

Additionally, some assets will never be replaced and 'assets' such as Rural Fire Service 'Red Fleet' are required to be depreciated even though Council has neither control nor obligation to fund nor replace. These factors are unique to local government and need to be accounted for as such.

This situation was recognised and addressed by the NSW Local Government Electricity County Councils in the late 1980's when their financial statements (audited by the NSW Audit Office) effectively **only depreciated the equity that County Councils had contributed to the asset. This was achieved by amortising capital grants and contributions against the annual depreciation expenses.**

Consequences of Local Government Financial Sustainability Barriers in New South Wales

In more remote councils where the rate base is small, the costs are increases and the general expense to income per capitata is greatest, solvency is threatened by the broad financial sustainability barriers. The CMA also projects localised consequences of worsening financial positions among Member Councils will include (already occurring in some cases):

- Reducing road maintenance (pothole patching, maintenance grading).
- Reduced level of service in parks mowing and maintenance, toilet cleaning.
- Reducing hours at libraries, swimming pools, Council customer service counters and museums and galleries.
- Closing some sporting fields and parks to reduce maintenance costs.
- Reduced activity in tourism marketing and events.
- Reducing the economic development and regional activation programs.
- Refusing grants for new assets (due to lack of funds to match grants/maintain assets).
- Ceasing the community grants program.

Potential Council responses that will have short-term benefit but will further diminish capacity include:

- Disposing of property and public assets.
- Cost recovery of services: Increasing fees for services such as aged-care and preschool facilities, Airports, Home Support Services etc.
- Increasing commercial and community lease fees.
- Decommissioning community buildings and facilities.

Further Recommendations

If SRVs are to continue as they have in recent years, there must be a simplified, streamlined process. The time and money that Councils must invest into a case for more money through a higher rate increase is an ironic contradiction.

As outlined above, Country NSW Councils are struggling financially due to many factors out of their control but performance is often better than financials erroneously indicate. A simple, yet significant change to reporting requirements would improve the bottom line in Councils' financials and the level of trust in their competence among their communities.
Depreciation expenses are a material amount in all NSW local government councils' financial statements and as such, have a significant impact on councils' bottom lines and the financial performance measures (namely the Operating Performance Ratio).

Due to the adverse and distorting impact on Operating Performance Ratios it is essential that a critical review be undertaken to ascertain the relevance of the inclusion of depreciation expenses.

The CMA advocates for the elimination of all depreciation expenses from the calculation of the Operating Performance Ratio or the elimination of roads depreciation expenses and depreciation expenses applicable to asset equity funded from grants and contributions from the calculation of the Operating Performance Ratio.

The CMA advocates for an increase in Federal Assistance Grants to 1% of Australian tax revenue, as long advocated for by LGNSW and the ALGA. Support with this from the NSW Government is keenly sought by the CMA.