

INQUIRY INTO ABILITY OF LOCAL GOVERNMENTS TO FUND INFRASTRUCTURE AND SERVICES

Organisation: New England Greens Armidale Tamworth

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Inquiry into the ability of local governments to fund infrastructure and services: New England Greens Armidale Tamworth Submission

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.*

Thank you for the opportunity to share our views on this important topic. Many of the issues listed above were covered in our recent submission to IPART concerning the financial model of NSW councils (see Appendix).

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

As explained by the Australian Local Government Association, [Federal Financial Assistance Grants \(FAG\) have declined from one per cent of Commonwealth taxation revenue in 1996 to just 0.5 per cent today.](#)

This has hit rural and regional councils much harder than those in major metropolitan centres. Much of Australia's road network is maintained by rural and regional councils; they receive an unfair and disproportionately small proportion of the local roads component of the FAG - see example (Appendix 2, point 4) comparing the \$1,461 per km received by Armidale Regional Council (ARC) with the \$3,008 per km for the Northern Beaches Council (NBC), despite much lower median incomes, a higher proportion of the population with chronic health conditions and less favourable life expectancy statistics.

The \$400+ million cost to repair the Armidale-Kempsey Road illustrates the same problem. Why was it ever considered reasonable to impose on a local council (with total annual rates revenue below \$20 million) the responsibility of maintaining this road?

Recommendations for (a)

- 1) This Inquiry should make strong representations to the Commonwealth government to reinstate the FAG to 1% of Commonwealth taxation revenue
- 2) The Inquiry should consider better funding models for rural and regional roads, including a higher proportion of the local roads component of the FAG, to cover the increasing cost of road maintenance, which is likely to be exacerbated by increasingly frequent droughts and floods due to global warming.

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

The rate peg is calculated by a very complicated formula that ignores key factors such as forced amalgamations.

Recommendations for (b)

- 4) The Inquiry should note the impact of the forced amalgamations on the costs to affected councils and consider possible remedies.

(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

Cost shifting from other levels of government is an increasingly important issue. The latest cost shifting report produced by independent consultants Morrison Low on behalf of LGNSW for the 2021/2022 financial year (www.lgnsw.org.au/costshifting) shows that \$1.36 billion of expense has been passed on to councils. This is an increase of \$540 million since the last report from the 2017/2018 financial year.

Recommendations for (c)

- 5) The Inquiry should note the evidence in the Morrison Low report commissioned by LGNSW and confirm that cost shifting has indeed increased over time.

6) The Inquiry should also remove the accounting requirements for depreciating RFS assets, noting that the Accounting Standards Board Conceptual Framework does not necessarily define control as a legal ownership right, but rather:

“... the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it. Control includes the present ability to prevent other parties from directing the use of the economic resource and from obtaining the economic benefits that may flow from it. It follows that, if one party controls an economic resource, no other party controls that resource.”³

Recommendation for (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

7) The Inquiry should note the many submissions received by IPART when Armidale Regional Council applied for a Special Rate Variation and consider whether IPART’s decision reflected the will of the people, including those who took the time and trouble to send in submissions.

(g) any other related matters.

As explained in Appendix 3, the Audited Financial Statements are hard for councillors to understand because there is no upfront information on capital expenditure. In the case of Armidale Regional Council, capital expenditure of \$27.2 million is listed in note B3-2, page 25, despite this sum of \$27.2 million being a similar order of magnitude to council’s total rates and annual charges of \$39.4 million.

Recommendation 6) above of the requirements for councils to depreciate RFS assets highlights the unsuitability of current audited financial statements to meaningfully reflect the financial situation of councils in NSW. The same is true for depreciation of other assets that were purchased using grant funding and for which there is a reasonable expectation that further grant funding will be available. For this reason, the NSW Government should consider a revised format for the Audited Financial Statements that includes a summary of capital expenditure on the same page as depreciation and a summary of the condition of all important assets.

The Inquiry should also consider whether it would be more efficient and cost-effective to provide a higher proportion of councils’ funds in the form of untied grants, allowing staff and councillors to use their local knowledge and expertise to spend the money where it will do the most good. Devoting substantial staff time to writing grant applications diverts councils’ resources away from direct action to serve the needs of the community.

Recommendations for (g)

8) Consider a revised format for the Audited Financial Statements that includes a summary of capital expenditure on the same page as depreciation and a summary of the condition of all important assets.

9) Consider whether it would be more efficient and cost-effective to provide a higher proportion of councils’ funds in the form of untied grants, allowing staff and councillors to use their local knowledge and expertise to spend the money where it will do the most good. Devoting substantial staff time to writing grant applications diverts councils’ resources away from direct action to serve the needs of the community.

Appendix 1: Submission to IPART on the draft Terms of Reference Financial model

for NSW councils: New England Greens Armidale Tamworth Comments

Thank you for the opportunity to comment on [this important topic](#).

1) Consider the financial impacts of forced amalgamations and possible remedies

Any review of the NSW council financial model must consider the financial impact of the forced amalgamations. Finance professional and accountant and Brian Halstead concluded that mandatory mergers, ostensibly to save money, resulted in a sea of red ink (see box, left).

Another [expert peer-reviewed article of the finances of the 44 local authorities coerced into amalgamation in May 2016](#), written by Drew, McQuestin and Dollery, was published in the Aust J of Public Administration in 2021. The researchers' graph (below) is strong evidence of the big increase in costs after amalgamation.

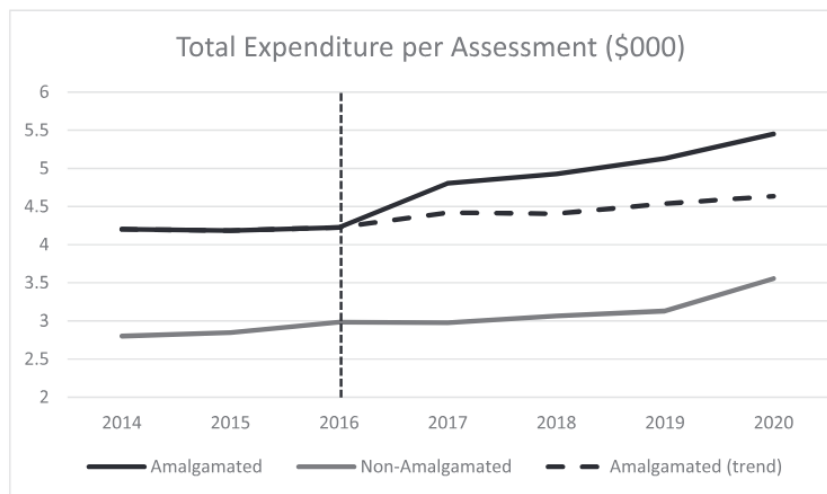
The NSW Government has a moral obligation to mitigate the impacts of the increased costs it imposed on local communities. Prof Drew's article discusses possible ways to achieve this, including de-amalgamation, or for the NSW Government to "consider new additional grant funding specifically designed to compensate communities for the ... effect of amalgamation, in line with the empirical evidence we have presented in this paper."

Drew's article also recommends mandatory reviews of consultants' work relied upon for public policymaking, because it "might encourage consulting firms to base future work on a stronger evidential foundation and to be more temperate with respect to their assumptions. Indeed, reviews of this kind might provide affected communities with a sound basis for seeking remedies for costs incurred where negligence can also be shown."

- The TOR should consider the financial and other impacts of forced amalgamations and possible remedies

Merged Councils	Total Govt Grants	Proposal Savings Per annum	General Fund Council Operating Plan 18/19	Consolidated Fund Operating Plan 18/19 variation from actual 14/15
	\$000	\$000	\$000	\$000
Armidale Regional	15,000	700	(3,458)	(3,804)
Cootamundra – Gundagai	15,000	400	(6,725)	(2,527)
Snowy Valleys	15,000	600	(3,794)	(1,309)
Snowy Monaro	20,000	1,200	(8,311)	892
Dubbo	15,000	1,500	1,543	2,466
Edward River	15,000	500	(1,915)	(3,064)
Federation	15,000	300e	(825)	(419)
Hilltops	20,000	1,000	(2,740)	(2,502)
Murrumbidgee	15,000	300e	(995)	(7)
Murray River	15,000	500	(1,681)	(4,378)
Queanbeyan-Palerang	15,000	1800e	1,851	2,779
Central Coast	20,000	10,000	(4,853)	23,306
Mid Coast	20,000	4000e	(16,423)	(12,339)
Total	215,000	16,400	(48,326)	(47,518)

Country and Non Metro Council Operating Results Before Capital Grants (p17, "Council Amalgamations, a sea of red ink", by accountant and finance professional Brian Halstead).



Graph from an [analysis published in 2021 in the Aust J of Public Administration](#) comparing the financial performance of the 44 local authorities coerced into amalgamation in May 2016.

2) Consider the impacts of cost shifting from other levels of government

Cost shifting from other levels of government is an increasingly important issue. The latest cost shifting report produced by independent consultants Morrison Low on behalf of LGNSW for the 2021/2022 financial year (www.lgnsw.org.au/costshifting) shows that \$1.36 billion of expense has been passed on to councils. This is an increase of \$540 million since the last report from the 2017/2018 financial year.

- The TOR should ask for an investigation of how increased cost-shifting in the current funding model affects councils' ability to sustainably support the needs of communities, and how this can be addressed.

3) Consider whether it would be more efficient to provide a higher proportion of councils' revenue in the form of untied grants instead of having to devote substantial staff time to writing grant applications

- The TOR should require an investigation of whether it would be more efficient and cost-effective to provide a

higher proportion of councils' funds in the form of untied grants, allowing staff and councillors to use their local knowledge and expertise to spend the money where it will do the most good. Devoting substantial staff time to writing grant applications diverts councils' resources away from direct action to serve the needs of the community.

4) Include the unfair burden on rural and regional councils of maintaining large road networks

Much of Australia's road network is maintained by rural and regional councils, which receive an unfair and disproportionately small proportion of the local roads component of the Financial Assistance Grant (FAG) - see example in the Appendix comparing the \$1,461 per km received by Armidale Regional Council (ARC) with the \$3,008 per km for the Northern Beaches Council (NBC), despite much lower median incomes, a higher proportion of the population with chronic health conditions and less favourable life expectancy statistics.

- The TOR should require an investigation into the impact on regional and rural communities of the unfair and disproportionately small proportions of the FAG local roads component. The \$400 million cost to repair the Armidale-Kempsey Road illustrates the problem. Why was it ever considered reasonable to impose on a local council (with total annual rates revenue below \$20 million) the responsibility of maintaining this road?

5) Consider additional OLG resources to prevent delays & ineffective responses to queries & complaints

The OLG needs adequate resources to investigate and respond in a timely manner to serious problems before they result in unnecessary financial burdens. Such problems include serious code-of-conduct complaints and breakdowns of important relationships. For example, three Armidale Regional councillors complained to the OLG about serious governance issues from September to November 2019. Answers provided in the [NSW Government Budget Estimates](#) show that, apart from acknowledgements, the councillors received no communications about these major issues from the OLG in the 9.5 months from September 2019 to June 2020. Timely responses by the OLG might have avoided an expensive and damaging legal case on 11-12 June 2020, in which council staff and the CEO took legal action against 5 councillors to prevent them voting on a motion to pay out her contract, including the 3 complainants. Elected councillors were suspended on 12 June, first for 3, then another 3 months. On 23 June, Justice Preston dismissed what he described as a topsy-turvy Alice in Wonderland case and awarded costs against the council and CEO. The CEO submitted her resignation on 1 July and the following day (2 July) two of the 3 councillors received responses from the OLG which, as outlined in an [answer to a Question on Notice](#) simply advised them to take up the issue with the administrator, who wasn't even provided with any details of the complaints in the preceding 10 months. [More information on the events](#) is available for anyone who is interested.

- The TOR should include consideration of what additional resources the OLG needs to provide the timely responses that would have prevented this and other costly incidents.

6) Consider the impact of current regulations on costs, efficiency, proper scrutiny and exposing corruption

Some rules and their interpretation seem incomprehensible. For example, the OLG advised that Local Government (General) Regulation 221, Section 229, "[Loans to council to be charge on the council's income](#)" prevents councils from using property as security for a loan, because (despite many cases where councils have sold surplus property), council property is owned by the community and therefore can't be sold! So, a council with sufficient income to pay off a loan to acquire a property that will improve efficiency, save money or generate substantial benefits can't do so unless another form of security can be found. An extremely unlikely event of a council not being able to meet the repayments and losing the property outweighs the certain loss of benefits and efficiency from never being able to acquire the property in the first place!

Another problematic rule was explained to newly elected Armidale Regional Councillors, who were advised by a legal firm at their induction training in an 2017 about the rule to "*not bring council into disrepute*". They were told that even *bringing corrupt conduct to public attention would likely to break this rule*.

Current rules concentrate a great deal of power in the hands of a few individuals, especially the general manager (GM or CEO) of a council. Consequently, a council can get into serious trouble if powerful individuals withhold information from the elected council. For example, the [Central Coast Council Inquiry Report](#) states (para 142) "*The investment reports from October 2019 until the financial crisis, were designed to obfuscate rather than elucidate. The staff of CCC responsible for those reports bear a significant responsibility for the lack of knowledge on the part of the councillors for the unlawful use of restricted funds.*"

In these circumstances, a good mayor and committed councillors working with the mayor to fully understand important issues, might be able to ask deep and meaningful questions and steer the council away from the worst problems. However, favourable outcomes would be more likely under a more relaxed regulatory regime where if a council loses confidence in the ability of the mayor, a replacement can be elected before the end of the 2-year term. Councillors should also be fairly remunerated for their time and effort, rather than the current situation where those who take the time and trouble to read and scrutinize information in sufficient detail needed to do it justice are paid well below the

minimum hourly rate. While it is totally appropriate to ensure that councillors never tell staff what to do, rules preventing councillors from even talking to staff create an unhealthy situation where all the information is filtered through a few powerful well-paid individuals without appropriate checks and balances.

It is also unhealthy if mayors (who are deemed to be principal spokespeople for Councils and like GM/CEOs have privileged access to council's media team to present their points of view) end up being the sole spokespeople for the council. In the interests of free speech, councillors should be able to freely report why they voted against an issue, without being considered in violation of the rule of upholding council decisions.

A thorough review of all the rules is therefore required to ensure they are in best interest of good government. An adjournment debate by Dr Amanda Cohn, MLC, highlighted some of the problems with the Code of Conduct and other regulations that [currently hinder effective, cost-effective government](#).

- The TOR should include a review of the current rules that in some cases have prevented or discouraged councillors from fairly representing the interests of the community and scrutinizing financial information. The rule about not bringing council into disrepute should be reworded to ensure councillors are allowed to bring corrupt conduct to public attention. Councillors should be able to freely report why they voted against an issue, in the interests of free speech, without being considered in violation of the rule of upholding council decisions. Councillors who lose confidence in the ability of the Mayor to fairly represent the community should also be able to vote for a replacement without waiting until the end of the Mayor's 2-year term.

Appendix 2: unfair road maintenance burden of rural & regional councils

Armidale Regional Council (ARC) received \$1,461 per km of road under the [Local Roads Component \(LRC\), 2022-23 FAG](#), compared to \$3,008 per km for the Northern Beaches Council (NBC), despite much lower median incomes, a higher proportion of the population with chronic health conditions and less favourable life expectancy statistics. Is this fair?

Armidale Regional vs Northern Beaches Council	ARC	NBC
Km of local & regional Roads	1858.0	843.9
Local Roads Component (LRC), 2022-23 FAG	\$2,714,175	\$2,538,590
Local Roads Component of FAG per km of road	\$1,461	\$3,008
Average residential rate, 2020-21	\$1,044.04	\$1,506.05
Median weekly household income	\$1,404	\$2,592
Percent of households with income below \$650/week	20.3	10.8
Percent of people reporting a long-term medical condition	45.8	33.6
Male life expectancy, years#	78.8	84.7
Female life expectancy, years#	83.8	86.9
Median Age	37	41
Percent of people with:	ARC	NBC
No long-term health condition(s)	54.2	66.4
Mental health condition including depression, anxiety, dementia	10.2	7.1
Asthma	9.4	6.8
Arthritis	8.9	6.9
Heart disease (including heart attack or angina)	4.2	3.6
Diabetes (excluding gestational diabetes)	4.1	2.9
Cancer (including remission)	3.3	3.1
Lung condition (including COPD or emphysema)	1.9	1.1
Stroke	0.9	0.8
Kidney disease	0.8	0.6
Any other long-term health condition(s)	8.1	6.7

Sources: 2021 Census data for [ARC](#) & [NBC](#), [Your Council website](#) (average residential rate 2020-21, km of roads in NBC and ARC).

#Life expectancy is for New England North West (which contains ARC) and Northern Beaches, from ABS: 3302055001DO002_2019-2021 Life tables, 2019-2021, mean of years 2016-21.

b) Local Roads Component of the Financial Assistance Grant (FAG) 2022-23 (ARC: \$1,870,678 early payment + \$843,497 to be paid in 2022-23 = \$2.71 million; NBC: \$1,832,234+ \$706,356 = \$2.54 million), \$1,461/km (ARC), \$3008/km in NBC.

Appendix 3: Example of audited financial statements (AFS) that are hard for ordinary people to understand – would the net operating results of Armidale Regional Council (ARC) have been a \$10 million surplus if previous years Kempsey Rd work had been correctly recorded?

The audited financial statements (AFS) are confusing to ordinary people because there is no up-front information on capital expenditure. In ARC's AFS to 30 June 2023, the main source of information is note B3-2, page 25.

Total materials and services	74,826	60,081
Less: capitalised costs	(27,232)	(28,935)
Total materials and services	47,594	31,146

Page 25 shows expenditure of \$28.93 million in FY21-22 and \$26.23 million in FY22-23 on materials and services for capital works. It is vitally important for anyone scrutinising the financial statements to know where this money comes from: how much is funded from capital grants and how much from surplus cash? Highlighting this information in the initial income and expenditure page would make it easier for councillors to ensure that the [insolvency problems of Central Coast Council](#) are never repeated.

The counter-intuitive treatment of capital expenditure also leads to confusion about whether ARC's 2022-23 AFS would have shown a \$10 million surplus net operating result, and that the reported \$0.294 deficit is really an artefact of a previous accounting treatment that had no impact on any prior net operating result – see screenshot overleaf.

The key summary income and expenditure page – the first table in the AFS - from ARC's AFS (screenshot below) confirms that capital costs are omitted from this key summary table, i.e. materials and services expenditure is reported as \$47.594 and \$31.146 million, not the total including capitalised costs of \$74.826 million in FY22-23 and \$60.081 million in FY21-22.

There is a big increase in depreciation, amortisation and impairment of non-financial assets from the budgeted \$21.789 million to \$34.291 million. The explanation on page 30 is that *"In 2021-22 costs for Kempsey Road natural disaster work were capitalised and shown as capital work in progress. Due to the change in treatment of most of this work, the whole of the carrying work in progress amount of \$10 million was written off as a current year impairment."*

This table does not cover capital expenditure, so all prior net operating results remain unchanged.

However, if the \$10 million had not been shown as a capital work in progress in FY21-22, but instead reported as carrying work for repairing the road, instead of a \$0.294 million deficit in FY22-23, ARC would have reported a \$10 million surplus.

If the above is correct, it implies that there is an urgent need to change the reporting requirements to a much more user-friendly approach based on income and actual expenditure, including capital expenditure and provide a second table describing depreciation, any increases in the value of assets, and the proportion in a satisfactory condition, defining the latter as the condition which the average resident would describe as satisfactory.

Armidale Regional Council

Income Statement

for the year ended 30 June 2023

Original unaudited budget 2023 \$ '000		Notes	Actual 2023 \$ '000	Restated Actual 2022 ¹ \$ '000
	Income from continuing operations			
38,804	Rates and annual charges	B2-1	39,371	37,609
28,485	User charges and fees	B2-2	27,729	30,622
4,409	Other revenues	B2-3	4,436	3,593
12,102	Grants and contributions provided for operating purposes	B2-4	34,579	15,782
75,794	Grants and contributions provided for capital purposes	B2-4, G4-1	28,220	20,581
1,534	Interest and investment income	B2-5	4,026	466
–	Other income	B2-6	855	794
–	Net gain from the disposal of assets	B4-1	1,041	230
<u>161,128</u>	Total income from continuing operations ¹		<u>140,257</u>	<u>109,677</u>
	Expenses from continuing operations			
28,846	Employee benefits and on-costs	B3-1	26,638	26,309
32,452	Materials and services	B3-2	47,594	31,146
1,385	Borrowing costs	B3-3	1,704	1,349
21,789	Depreciation, amortisation and impairment of non-financial assets ¹	B3-4, G4-1	34,291	23,262
1,858	Other expenses	B3-5	2,104	1,681
<u>86,330</u>	Total expenses from continuing operations ¹		<u>112,331</u>	<u>83,747</u>
<u>74,798</u>	Operating result from continuing operations ¹		<u>27,926</u>	<u>25,930</u>
<u>74,798</u>	Net operating result for the year attributable to Council ¹		<u>27,926</u>	<u>25,930</u>
<u>(996)</u>	Net operating result for the year before grants and contributions provided for capital purposes ¹		<u>(294)</u>	<u>5,349</u>

(¹) Prior years restated, refer note G4-1

The above Income Statement should be read in conjunction with the accompanying notes.