Council Reference: **ECM 3657534 - Local Government Reform - Fit for the Future**

Your Reference:

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The Chair
Independent Pricing and Regulatory Tribunal (IPART)
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Dear Sir

Submission - Methodology for Assessment of Council Fit for the Future Proposals

Tweed Shire Council (Council) welcomes the opportunity to make a submission to the Independent Pricing and Regulatory Tribunal (IPART) on the Methodology for Assessment of Council Fit for the Future Proposals.

Council would like to make the following comments in relation to the questions for stakeholder feedback put forward in the consultation paper:

1. ***How should the key elements of strategic capacity influence our assessment of scale and capacity? Are there any improvements we can make to how we propose to assess the scale and capacity criterion, consistent with OLG guidance material?***

Council believes the assessment of strategic capacity will prove to be the most problematic and hotly debated within the proposed reforms. Unlike the objective, measurable and verifiable components of some of the other criteria, the assessment of strategic capacity is largely subjective.

Without specific threshold measures the State Government could run the risk of being accused of manipulating this criterion to achieve a predetermined outcome. Indeed, some of the elements involved are considered challenging;

- More robust revenue base is hampered by the combination of both rate pegging and regulated fee setting by the State Government.
- Ability to employ wider range of skilled staff is constrained by salary structures and state awards that negate the ability to compete for higher skilled employees from the employment market.
- Knowledge, creativity and innovation can be limited by the requirement and governance structure defined within the existing Local Government Act.

Whilst Tweed Shire Council has been identified as having a low merger potential this criteria would benefit from more objectivity for those Councils proposed to be affected by potential amalgamations.

2. *Which of the 'Rural Council Characteristics' are the most relevant, considering a council must satisfy a majority of the characteristics to be considered a rural council?*

Council generally agrees with the characteristics used to define a Rural Council and has previously supported the redistribution of Financial Assistance Grants to improve the financial position of these areas. Whilst most of the characteristics are closely linked, a low rate based coupled with high operating costs associated with a dispersed population, would be fundamental requirements before seeking higher levels of assistance.

3. *Are there any improvements we can make to how we propose to assess the sustainability, infrastructure management and efficiency criteria, consistent with OLG guidance? Are there issues that we need to consider when assessing councils' proposals using the measures and benchmarks for these criteria?*

Council supports the use of objective, measurable and verifiable data to make assessments on the multiple measures for the criteria proposed. The objective and composition of ratios are also well intended, however a number of issues are worthy of note for the assessment methodology:

Operating Performance Ratio

a) Council are required to meet the 'greater or equal to break-even' benchmark over a 3 year average by 2019-20. This effectively means that surplus operating results need to be implemented by 2017-18 or that the later surplus results (eg. 2018-19 and 2019-20) need to be large enough to compensate for any prior period deficit/s.

The operating deficit result has been entrenched in local government for some time with the only solutions available to meet the required benchmark being an increase in taxation on the community or a reduction in service levels.

Depending on the degree of the deficit results faced by individual Councils and the resultant changes required, the community may benefit from a more staged implementation of any solution with the first year of the surplus being in 2019-20 and applying the 3 year average beginning 2021-22.

b) Another consideration for the operating performance ratio relates to depreciation expense and the Local Government Cost Index (LGCI):

Assume a Council has a current break even operating result and the LGCI for the year is 3% generating additional rate revenue of $1,500,000.

AASB116 - Code of Accounting Practice and Financial Reporting:

i. Councils need to assess at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the council determines the asset's fair value and revalues the asset to that amount. It is recommended that full revaluations occur at least every five years, so councils should develop a plan for assessing the need for any revaluations, allowing sufficient time to undertake the revaluation process and meet reporting requirements.

The Council indexes Transport and Drainage assets in line with the Institute of Public Works Engineering Australasia (IPWEA) Road and Bridge Construction Costs Index with the following results:

Current fair value Transport & Drainage	$961,713,000
IPWEA Index	4.5%
Increase in asset values	$43,277,085
Average network depreciation	1.82%
Increase in depreciation expense	$787,643

For Council to maintain a break even operating result, and assuming the $1,500,000 rate increase is used to match increased expenditure (which is the intent of the LGCI), Council will need to generate additional revenue, or a corresponding savings by reduction in service levels, of approxiametly $787,643 every year to maintain the break even operating result.

In addition, as the depreciation expense has increased, the additional revenue/savings of $787,643 would need to be spent on renewal to maintain the building and asset renewal ratio at 100%.

Given that depreciation expense is typically 20% to 30% of the total expenses on the income statement, coupled with the requirement to index/revalue infrastructure at periodic intervals, the indexing of infrastructure resulting in increased depreciation expense, should be a component of the LGCI.

c) The mismatching of grant income to grant expenditure can have a large impact on the operating result for the year. The recent advanced payments of the Financial Assistance Grants (FAGs) and the subsequent withdrawal of the advanced payment contributed to better than normal results in 2011-12 and worse than normal results in 2013-14.

Other mismatched funding can also appear in other programs. Tweed Shire Council received $8m in funding (operating grant) from the Federal Government for the Building Better Regional Cities program (BBRC). These funds were to be used to create affordable housing opportunities with Council acting in an oversight role to the developer. The $8m was received in prior years to the funds being transferred to the developer.

Again, Tweed Shire Council recently constructed a $17m off-ramp to the Pacific Highway at Tweed Heads. At the conclusion of the project $7m had to be expensed on the Income Statement as certain elements of the off-ramp are under the control of the RMS.

Council is not advocating for a change in the framework for the Financial Statements and also acknowledges that a 3 year average may assist in flattening the effect of these mismatched funding, however further consideration/elimination of entries could be given to help 'normailising' the operating result for the purposes of the Fit For The Future reporting, perhaps with Auditor approval.

Building and Asset Renewal Ratio, Infrastructure Backlog Ratio and Asset Maintenance Ratio

All three of these ratios have a degree of subjectivity (and/or the potential to be manipulated) that requires standardisation over time.

The Building and Asset Renewal ratio will be dependent upon asset capitalisation thresholds, assumptions on what costs can be classified as renewals and the estimated useful lives of assets, which will vary from council to council.

The Infrastructure Backlog Ratio has no established calculation to determine the amount, does not factor in those assets that have been determined to be maintained at a lower standard (when using the Office of Local Government default condition of "good") and the use of the written down value as the denominator overstates the extent of the backlog ratio.

Again, the Asset Maintenance Ratio is based on the subjective view of what is the required maintenance.

Although the above ratios are considered relevant to the assessment process, more objective and defined measures are needed. This may eventuate as the industry's asset management knowledge and practices mature.

Real Operating Expenditure

Council acknowledges that the measurement of efficiency is useful but also problematic.

Several factors can influence this result including:

The numerator in this calculation is inclusive of depreciation expense which may range from 20% to 30% of the total operating expense. Increased efficiency of this notional amount, if correct, is not possible.

In addition and as outlined above in the operating performance ratio discussion, indexation of infrastructure values and the subsequent depreciation expense onto the income statement will result in efficiencies having to be greater than the index just to maintain the status quo if the population remains static.

Council policies on population density (height level restrictions on development) will also increase the cost and maintenance of infrastructure per capita over time.

4. ***How should councils engage with their communities when preparing FFTF proposals? Are there other factors we should consider to inform our assessment of council consultation? Please explain what these other factors are, and why they are important.***

The principal issue regarding the FFTF proposals is the lack of time allowed to formulate plans to improve/meet the required benchmarks and the consequent education and engagement with communities by the 30 June 2015 deadline.

Whilst Council will complete the template as required, it is our intention to undertake a more rigorous and considered approach to the issues put forward under the FFTF proposals over the next 15 to 18 months. This will coincide with the next term of the Council and the mandatory review of the Community Strategic Plan, Delivery Program and Operational Plan, thereby allowing for more permanent and informed changes to be introduced.

5. ***Should council performance against FFTF proposals be monitored? If so, are there any improvements we can make on the approach outlined for councils to monitor and report progress on their performance relative to their proposals?***

Most of the measures within the criteria are already reported in the Financial Statement of Council:-

Scale and Capacity	Not readily available
Operating Performance Ratio	Note 13
Own Source Revenue Ratio	Note 13
Building and Asset Renewal Ratio	Special Schedule 7
Infrastructure Backlog Ratio	Special Schedule 7

Asset Maintenance Ratio	Special Schedule 7
Debt Service Ratio	This was historically in Note 13 up until 2012/13 and could be reinstated.
Real Operating Ratio	Not currently reported - but could form part of the Financial Statements

As the Special Schedules are to be audited from 2014/15 onwards it would appear that monitoring of performance against benchmark is a relatively easy exercise.

It is accepted however that interested stakeholders may find it difficult to navigate through the Financial Statement to access the desired information and consideration could be given to centralising the required information within a specific section of the Annual Report.

Council appreciates the opportunity provided by IPART to make a submission on the Methodology for Assessment of Council Fit for the Future Proposals and is confident that the issues raised by the industry through the submission process will be given appropriate consideration.

Yours faithfully

[redacted]

Troy Green
GENERAL MANAGER