

BRIEFING PAPER: AUSTRALIAN LOCAL GOVERNMENT FINANCIAL REFORM – A FEDERAL PERSPECTIVE

Prepared for the ANZSOG Institute of Governance and the Australian Centre of Excellence for Local Government

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Purpose

Australia's 565 local governments face financial challenges in meeting their communities' expectations for improved services and in funding infrastructure renewal from current revenue.

This briefing paper chronicles the thinking at the Australian Government level which led to current efforts to enhance local governments' long term financial sustainability. The federal journey began with the immediate task of delivering a fair and substantial level of funding to local government, but evolved over time to include a strategy to improve the state of local roads and bridges, then to improvements to local government infrastructure more generally, and finally to bolstering the long term financial sustainability of local government and building strategic capacity.

This briefing paper was first prepared as the factual basis for a presentation made in March 2013 to the ANZSOG (Australian and New Zealand School of Government) Institute for Governance's Local Government Leadership Program on the financial sustainability of local government. It's my story of the work that we did in the Australian Government over almost two decades, in partnership with the Institute of Public Works Engineering Australia, state governments, and state local government associations to bolster local governments' financial and asset management practices. It provides an overview of these issues and points to further sources of data and research on the topic. As the instigator of many of the reforms at a national level, this paper is a personal (rather than academic) view of local government policy development, and is suitable for those wanting quick insight into local government finances.

The paper complements recent research by John Comrie on behalf of the Australian Centre of Excellence for Local Government (ACELG) *In our hands – Strengthening Local Government revenue for the 21st Century* (Comrie 2013) – which covers the issue in greater depth and charts the practical next steps to improve local government's long term financial sustainability.

About the author

The author, Mervyn Carter, worked for 17 years in the federal government developing policies and programs to fund and reform local government and build local government's capacity to meet the needs of local communities. He is the author or co-author of many of the policies and most of the \$7.6 billion of new local government funding programs that have been developed in that time, including:

- Roads to Recovery Program to upgrade local roads
- Supplementary Funding for South Australian Local Roads

- Local Government Reform Fund
- Local Government Development Program
- Local Government Incentive Program
- The Community Infrastructure Program.

Mervyn has also contributed to:

- Local Government and Planning Ministers' Financial and Asset Management Frameworks
- 13 editions of the annual Local Government National Report
- Chairing Local Government National Awards judging panels
- The establishment of the Australian Council of Local Government (ACLG).

In January 2009, Mervyn won an Australian Government Australia Day Achievement Award for providing key policy advice and facilitating the inaugural ACLG meeting. In 2011-12, Mervyn was seconded to the Australian Centre of Excellence for Local Government to kick-start national data collection and analysis of local government's financial sustainability and workforce development.

The five pillars of local government sustainability

For local government to be sustainable in the long term, it needs five pillars of strength. First, it needs a strong and ethical governance structure with authority to set the agenda and facilitate local solutions to local problems. Second, it needs to engage with its community through leadership, planning, communication and participation, and to lead the economic development of its region. Third, it needs a strong knowledge and database and the technological capacity to use the data to meet community expectations and solve business problems. Fourth, it needs a skilled workforce, with community involvement and a mastery of new technology. Finally, it needs effective long-term financial and asset management. Local governments with these characteristics will be resourceful, resilient and respected by their communities and by other spheres of government.

Over the last 20 years Australian local government has made great advances in this direction, particularly in structural reform and in financial and asset management, and some progress has been made in using local government data to diagnose and solve business problems. It has made progress in long term planning and in community engagement. However, at least a decade of reforms and productivity improvements remain to be accomplished if local government is to meet community expectations within existing resources. Most of these productivity improvement hinge upon up-skilling its workforce and translating data, knowledge and technology into plans and actions.

This short briefing paper does not tackle all of these issues. It focuses on one of them – local government funding and financial and asset management sustainability. What do we know about this issue? What steps have been taken to bolster the sectors financial sustainability and what remains to be done? What's the link between sound asset management and financial sustainability? This is a practitioner's view of the thinking behind the evolution of local government financial and asset management reforms over the last two decades.

How is local government funded?

Local government is funded by a mix of rates, user charges, infrastructure levies and government grants. Local government is largely income self-sufficient with most of its revenue raised from rates and user charges. In aggregate, grants provide only about 10 per cent of income but these are stable and secure and they are an important source of income, particularly for small rural and remote councils with limited endogenous revenue-generating capacity.

In 2011-12 Australian local governments raised \$37 billion in revenue, spent \$31 billion, and invested a net additional \$5 billion in its infrastructure assets.¹

Local general government revenue in 2011-12 (totalling \$37 billion) comprised of:

- \$13.2 billion in tax revenue (36 per cent)
- \$9.2 billion in 'other', e.g. capital grants, infrastructure levies for new/upgraded assets (25 per cent)
- \$9.0 billion in sales of goods and services (24 per cent)
- \$4.3 billion in current grants and subsidies (12 per cent)
- \$1.2 billion in interest (3 per cent).

'Other' revenue sources have become increasingly important, growing from 16 per cent to 25 per cent of general government revenue over the decade 2002-03 to 2011-12.

In 2011-12, local general government expenditure of \$31 billion² included:

- \$7.3 billion on transport and communications (24 per cent)
- \$6.9 billion on housing and community amenities (22 per cent)
- \$5.6 billion on general public services (18 per cent)
- \$4.6 billion on recreation and culture (15 per cent)
- \$1.7 billion on social security and welfare (5 per cent)
- But only \$633 million in debt repayments (2 per cent).

Over the last decade, local government has been spending a greater proportion of its income on human services and a smaller share on infrastructure. For example, local general government spending on recreation and culture rose by 96 per cent over the decade to 2011-12, but transport and communications spending was up by only 62 per cent.² However, expenditure on transport and communications did stage a recovery in the last five years of the decade compared with the first five years of the decade, due perhaps to implementation of recent local government financial sustainability reforms (see later).

Local government is asset rich but income poor. The assets include roads, cycle paths, footpaths, water and sewerage networks, levees, dams, stormwater drains, entertainment centres, sports stadiums, libraries, art galleries and museums. Many of these assets underpin the basic services we take for granted each day. These assets are subliminal in our consciousness until water supply is interrupted, bridges are closed or weight-limited, townships are flooded, or we crash on an unsealed road.

¹ Australian Bureau of Statistics (ABS), "Table 1, Total Local General Government Operating Statement," in *Government Finance Statistics Australia, 2011-12* (Canberra: ABS, 2013), cat. no. 5512.0, ABS, viewed 4 September 2013, <<http://www.abs.gov.au/ausstats/abs@.nsf/mf/5512.0>>.

² ABS, *op. cit.*, Table 4, Total Local General Government Expenses by Purpose.

In 2009-10, councils owned \$302 billion in land and fixed assets³, with land worth about \$88 billion. The other major assets – buildings, roads and other construction infrastructure – were worth about \$213 billion. Local government is responsible for the construction, upgrade, renewal and maintenance of 660,235 km of local roads, which account for over 80 per cent of Australia's road network.⁴

Local government's income of about \$37 billion a year is dwarfed by the \$213 billion in fixed assets it needs to manage and maintain. Transport and communications account for almost a quarter of local government expenditure. It is therefore *crucial* that local government be *expert* in financial and asset management.

Federal government grants

Government grants account for only about 12 per cent of aggregate local government income but provide a significant, predictable and secure source of income for councils. The principal grant is the Federal *Local Government Financial Assistance Grants* (FAGs) payment. Since it was first established in 1974-75, the FAGs have provided \$38 billion to local government, including \$2.14 billion in 2012-13.⁵

The FAGs have two components; a local roads component, and a general purpose component. The grant is provided under the *Local Government (Financial Assistance) Act 1995* (the Act), and is not normally subject to routine budgetary review processes. The grant is indexed annually to growth in population and the consumer price index. However, the Commonwealth treasurer can, if need be, vary the extent to which the grant is indexed. This happened once in 1997-98 when local government grants were increased for inflation, but not population growth.⁶ This change was justified as local governments' contribution to restoring the federal budget to surplus. The FAGs have two components:

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

Both components of the grants are distributed to local government within each jurisdiction according to their relative revenue raising and expenditure needs, and upon the recommendations of state local government grants commissions. The grants are untied in the hands of local government, allowing councils to spend the grants according to local priorities. Every council gets a grant, but councils with higher relative needs receive more of the grants. The FAGs are a lifeline for small rural and remote councils. For 20 per cent of councils, grants comprise 48 per cent or more of income.⁷

The Act specifies that the FAGs are provided: to improve the financial capacity of local governing bodies and their certainty of funding; to improve their capacity to provide equitable services to residents including to Aboriginal and Torres Strait islander communities; and to improve the efficiency and

³ Australian Centre of Excellence for Local Government (ACELG), *Local Government Fact Sheet 3: Local Roads, Buildings and Land* (Sydney: ACELG, 2013), accessed October 28, 2013, <http://www.acelg.org.au/upload/documents/1326955643_3.pdf>.

⁴ Jenny Cook (ed.), *2007-08 Local Government National Report* (Canberra: Australian Government – Department of Infrastructure and Regional Development, 2010), 7.

⁵ "Financial Assistance Grants to Local Government," Australian Government – Department of Infrastructure and Regional Development, accessed 26 June, 2013, <<http://www.regional.gov.au/local/assistance/>>.

⁶ "Financial assistance grants to local government," Australian Government – Department of Infrastructure and Regional Development, accessed 18 October, 2013, <http://www.regional.gov.au/local/publications/reports/2002_2003/C2.aspx>.

⁷ Productivity Commission, *Assessing Local Government Revenue Raising Capacity* (Canberra: Australian Government – Productivity Commission, 2008), 33.

effectiveness of local governing bodies. The Act also requires that a report (the Local Government National Report) be prepared on the operations of the Act in conjunction with state ministers and local government representative bodies. The work done to prepare this report is one of the main sources of federal knowledge and expertise.

One of the objects of the Act (Section 2(d)) is to provide grants to improve ‘the efficiency and effectiveness of local governing bodies’.⁸ Since the FAGs are untied and the federal government has no direct authority over local government (which is ‘a creature of the states’), this purpose has not been easily achieved through the FAGs alone. This limitation has been addressed in part by running small scale specific purpose grant programs alongside the FAGs. There have been a series of programs of this kind: the Local Government Development Program, the Local Government Incentive Program, the Community Infrastructure Program, and most recently the Local Government Reform Fund, that fund projects to build capacity in local government and improve local services, especially for rural and regional communities. For many of these communities, local government is the only sphere of government physically present in their community. Apart from this interest in efficiency and effectiveness of local services, the federal government’s other major ongoing concern is to ensure that local roads and bridges are in a sound condition, providing both access for rural and regional communities and facilitating the rapid movement of freight between rural and regional communities and the key rail, port and airport sites in cities and regional centres.

The most enduring of the specific purpose grant programs for local government, the Roads to Recovery (R2R) program, has just this objective in mind. The program provides an additional \$350 million per annum in grants to local government to hasten the renewal and upgrade of local roads. The R2R grant is arguably the simplest, fairest and most popular of all federal grant programs. But R2R also has a strategic purpose. The original purpose of R2R was to help councils grapple with a widening local road deficit, a deficit between what councils spent on local roads and what they needed to spend to keep them in sound condition. In November 2000, when the program was announced, the federal ‘in-house’ estimate of the national local road deficit was about \$630 million, and the \$300 million provided under the program would bridge about half this gap, giving councils a head start in erasing the deficit. The thinking was that local roads were part of a network of arterial roads and highways, and the weakest links in this network were at both ends – the farm gate and the ports and airports. To make the transport network more efficient and equitable, we had to make local roads more efficient and more accessible. More systemic reforms aimed at improving councils’ overall financial and asset management were to follow. In other words, R2R was an ‘in good faith’ deposit on the financial and asset management reforms to be pursued over the next decade (see below).

Payments under the R2R program commenced in March 2001. To make the grants more visible, R2R projects were clearly branded and signposted, a move which has ensured the program’s popularity and its longevity. R2R funds were distributed between jurisdictions broadly according to their population and local road length share, with particular care taken to ensure South Australia had a fairer share than under the local road FAGs (marking the first step in redressing a long standing anomaly that had seen the state receive an abnormally low 5.5 per cent of local road FAGs). R2R funds were distributed between councils according to their relative need, with each council receiving a multiple of their independently assessed local road FAGs shares. Apart from the requirement that R2R funds be spent on local roads and that councils maintain their own funding efforts, councils exercised practical autonomy in selecting the roads they considered to be in the most urgent need of attention. This gave local government the

⁸ *Local Government (Financial Assistance) Act 1995* (Cth).

respect it deserved, as a separately elected sphere of government, to select which local roads to fund. Since councils did not need to submit detailed grant applications, both local government and the federal government found the program simple to comply with and administratively efficient and effective. Over 30,000 R2R projects were completed and the visibility of the signage made the program's continuation politically attractive. In the 2012-13 budget, the Government announced it would provide a further \$1.75 billion (\$350 million per annum) to extend R2R for a further 5 years from 2014-15 to 2018-19.⁹

In the 2012-13 budget, the Government also announced an allocation of \$59.5 million per annum to 2013-14 for road safety projects under the Black Spot program, and that it would provide \$300 million (\$60 million per annum) to extend the Black Spot Program for a further five years from 2014-15 to 2018-19.¹⁰ A large percentage of Black Spot Program funds go to local councils.

2008 Productivity Commission research report into local government revenue raising capacity

Despite the extra funds provided under R2R, local government continued to claim that its revenue base was not growing fast enough and that other spheres of government should provide more funding to local government. The Australian Government then asked the Productivity Commission to assess whether local government's own-source revenue raising capacity was adequate. From a federal perspective, some of the key findings from the Commission's Report were¹¹:

- 1) Local governments were raising about 88 per cent of their assessed potential own-source revenue
- 2) For 20 per cent of councils, grants comprise 48 per cent or more of income
- 3) Rates fell as a share of GDP by 10 per cent over 1990/91-2005/06
- 4) Urban communities have the capacity to pay higher levels of rates.

It was clear from this report that many councils had some capacity to increase their revenue raising efforts, but about 100 to 120 smaller rural and remote councils would require additional grants or other revenue sources to be sustainable in the long term.

Financial and asset management reforms – identifying the problem

During the decade to 2011, steps were taken by the federal government and by local government stakeholders to assess the status of council financial and asset management, but these efforts were hindered by a lack of national data. Some information could be pulled together from state based data and extrapolated to create national data. Some stakeholders had already embarked on initiatives to improve local government financial and asset management and we used these as stepping stones towards developing a national approach to the issue. Some of the key initiatives included:

- 1) The establishment in 1998 of the Municipal Association of Victoria's (MAV) Step Asset Management Program. This project was championed by the MAV's John Hennessy. It was funded

⁹ "Roads to Recovery Program Funding Allocations 2009-2014," Australian Government – Department of Infrastructure and Regional Development, accessed 28 October, 2013, <<http://investment.infrastructure.gov.au/funding/r2r/>>.

¹⁰ "Black Spot Program," Australian Government – Department of Infrastructure and Regional Development, accessed 28 October, 2013, <<http://investment.infrastructure.gov.au/funding/blackspots/>>.

¹¹ Jenny Cook (ed.), *op. cit.*, 53-4.

under the Local Government Development Program and drew from New Zealand's experience of reforming asset management. This was the first state-wide attempt to address the need to renew local government built infrastructure. By 2007-08, all 79 of Victoria's councils had financial plans covering a period of at least four years and almost all had basic or advanced asset management plans for most asset categories. Between 2005 and 2008, Victorian councils had narrowed the asset renewal gap from \$300 million pa to \$190 million per annum.¹²

- 2) MAV's Step Program was soon followed in 2002 by the Local Government Association of South Australia's (LGA of SA) Step by Step program. In 2005, the LGA of SA commissioned an independent inquiry into the financial sustainability of local government in South Australia. The report urged local government to accept responsibility for improving its financial and asset management. From a federal perspective, this was a breakthrough. Up until that point, local governments had argued that their infrastructure deficits were due to insufficient state or federal funding. But South Australia had already benefitted from substantial additional funding assistance – first from a fairer share of R2R and then also from supplementary funding for South Australian local roads (to redress the state's anomalously low share of the local road FAGs)¹³, but it still had a local road deficit. So it was clear that if the problem was to be solved, councils would need to accept greater responsibility for long term stewardship of council assets. In 2007-08, the LGA of SA introduced its Financial Sustainability Program supported by new requirements incorporated in its *Local Government Act 1999*. The Program aimed to train and support councils in implementing measures to improve financial sustainability, asset management, annual business plans and long term financial plans, and the introduction of audit committees.¹⁴ As a result of implementing the findings of the report, South Australian local governments are now more financially sustainable. In the last three years, South Australian local governments have:
 - a) Undertaken asset renewal expenditure at 3.5 times the levels of 10 years ago in real terms
 - b) Improved annual financial performance from a collective \$100 million operating deficit in 1999/2000 to an operating breakeven result.¹⁵
- 3) The inauguration of the Moree Local Roads Congress in 2000. This was the first national attempt to inform the public about the state of decay of Australia's local road network. This became an annual event – the Australian Local Government Association's National Local Roads Congress. The Congress enabled all local government stakeholders to interact, to understand the initiatives occurring in each jurisdiction, and to build trust and collaboration.

¹² Jenny Cook (ed.), *op. cit.*, 56-7.

¹³ South Australia's share of the R2R grants was set with careful deliberation in 2000 to ensure the state received a fairer share of local road grants. Once the funding anomaly had been acknowledged, the door was open to also redress South Australia's low share of local road FAGs, but only when federal finances improved. In 2004-05, the anomaly was addressed by providing South Australia with supplementary funding for local roads via a grant program. Grant programs usually lapse after 3-4 years and require a re-bid process in the context of competing government priorities. This temporary solution, although not entirely satisfactory, was the only one which could be achieved within the tight funding and political constraints of the time. A longer-term solution is desirable and could involve rolling the supplementary funding into the local road FAGs and hypothecating that extra funding to South Australia. Such a change would require an amendment to the FAGs Act.

¹⁴ Jenny Cook (ed.), *op. cit.*, 59.

¹⁵ John Comrie, *In Our Hands: Strengthening Local Government Revenue for the 21st Century* (Sydney: ACELG, 2013), 27.

- 4) Graphic presentations by Chris Champion, CEO of the Institute of Public Works Engineering Australia (IPWEA), alerting us to the deterioration of the ageing local road network and of the urgent need to renew local government infrastructure.
- 5) The publication by the Western Australian Local Government Association (WALGA) of its annual *Local Government Road Assets and Expenditure Report* which provided time series data quantifying the gap between what was spent and what needed to be spent on local roads to bridge the renewal gap (\$102.7 million in 2011-12).¹⁶ This was good data and WA was potentially in a strong position to lead reforms to bridge this gap. Apart from having time series data to measure its progress, it had regional road groups drawn from neighbouring councils to prioritise road renewal projects and councils received substantial state government funding for local roads. This funding was provided under the *State Road Funds to Local Government Agreement* which gave councils a share of motor vehicle registration fees amounting to about to \$100 million a year (\$575.5 million over the five year period from 2007-08 to 2011-12).¹⁷ The latest WALGA report shows 'expenditure on maintenance and renewal of the existing road network [\$540.3 million in 2011-12] has increased 61.5 per cent in the five years between 2007-08 and 2011-12'.¹⁸
- 6) The publication in the *2002-03 Local Government National Report* of the Australian Government's first tentative estimate of the gap between what councils spent and needed to spend to keep our local roads in a sound condition: \$644 million per annum.¹⁹ This estimate was made by extrapolating state funding gaps in NSW, Victoria, WA and SA to a national funding gap. Quantifying the national gap for the first time was a milestone in building momentum for reform and in justifying renewal of the Roads to Recovery Program. Now we had a target at which to aim.
- 7) In 2006 the Australian Local Government Association's (ALGA) PriceWaterhouseCoopers Report provided a more comprehensive estimate, not just of the national local road deficit, but of the renewal deficit for *all local government assets* and the impact that was having on the financial sustainability of local government. The *National Financial Sustainability of Local Government Report* estimated that local government had a \$14.5 billion infrastructure renewals backlog and an annual underspend on asset renewals of about \$1.1 billion per annum.²⁰ To rectify the situation, councils would also need to spend *another* \$900 million per annum to clear the backlog, so they would need to spend in total an extra \$2 billion per annum to be sustainable. Largely as a result of the asset renewal gap, the report found that 25 per cent of local governments were financially unsustainable. This didn't mean that councils would go broke, but it did mean that their assets would become unserviceable over time. The Report called for the Australian Government to inject an additional \$200 million to \$250 million a year into councils to assist them renew ageing infrastructure. The report was significant at the federal level from three perspectives: first it reinforced the message from the estimate made in the National Report that there was a serious funding gap; second, it broadened the scope of the debate from

¹⁶ Western Australian Local Government Association (WALGA), *Report on Local Government Road Assets and Expenditure 2011/12* (Perth: WALGA, 2012), 3.

¹⁷ WALGA, *op. cit.*, 19. NB: includes some state funding for flood damage and grain haulage routes in 2011-12.

¹⁸ WALGA, *op. cit.*, 3.

¹⁹ "Local government infrastructure," Australian Government – Department of Infrastructure and Regional Development, accessed 18 June, 2013, <http://www.regional.gov.au/local/publications/reports/2002_2003/C4.aspx#_3>.

²⁰ See summary of PriceWaterhouseCoopers report in Jenny Cook (ed.), *op. cit.*, 50.

local roads to all local government assets, and from asset management to financial sustainability; and third, it was clear that the \$1.1 billion annual gap represented only about five per cent of local government revenues (of \$24 billion in 2005-06²¹). A consistent strategy to make savings of about one per cent a year could erase the gap within five years (though there would still be *individual* councils with insufficient own-source revenue to meet that goal). In short, the challenge seemed do-able, so our response was, ‘let’s do it’.

The progress made by councils in South Australia was ‘proof of concept’ that with the right guidance councils could narrow or erase their local road deficits. It also became clear that the various state initiatives could be welded into an overall financial and asset management strategy. So how *could* we make the South Australian reforms national? How *could* we encourage local government in other states (except Victoria which had already made substantial inroads through its own reforms) to adopt or adapt the SA reforms? A strategic approach was essential and it would need to encourage a cultural change in councillor behaviour with regard to long term stewardship of council finances and assets.

Encouraging a cultural change in councillor behaviour towards long-term stewardship of assets

Until recently, many local government budget processes have had a short-term forward planning horizon, the goal often being to balance next year’s budget (though as a result of this predisposition, local government has negligible net debt). During the mid-1990s amendments to local government acts obliged councils to change from cash accounting to accrual accounting. Accrual accounting values assets according to their replacement cost, not their historical cost, and it requires councils to value contingent liabilities and make provisions for the cost of restoring ageing assets to a sound operating condition. The adoption of accrual accounting exposed a big gap between what council spent and what they needed to spend to keep their existing assets in a sound condition. Typical asset costs include:

- Purchase of asset: 20 per cent of the initial costs
- Operating the asset (e.g. a pool): 40 per cent
- Maintaining and renewing the asset: 35 per cent
- Disposing of the asset: 5 per cent.²²

Provisioning for asset renewal was not relevant under an historical cost approach, unless the asset renewal was to occur during the current year’s budget.

While the legislation changed, councils were slow to move from the ‘balanced budget’ mindset. One could characterise the then prevailing short term councillor view as something like this:

- Building a new heated swimming pool may help me get elected and is more visible than spending money to re-line our stormwater drains, so I’ll promise a new swimming pool;
- Because we acquire more assets every year and do not provide for asset renewal, we find we haven’t the revenue when we need it for asset renewal;
- Therefore we need more grants from other levels of government to restore our assets and finances to a stable condition.

²¹ ABS, *op. cit.*, Table 1.

²² Chris Champion, “Sustainable management of community infrastructure” (presentation to the KTC Conference on Infrastructure and Asset Management, Copenhagen, May 31, 2012).

The modern councillor view, which takes a stewardship approach to assets is:

- Our council will consult our community on the standard of services they need and can afford
- Our council will make an inventory of our assets and we will understand their condition so we can deliver service at the standards our community expects
- Our council will consider the long term costs of acquiring, maintaining and disposing of assets and we will renew assets over their lifecycle to minimise our long term costs
- Our council will prepare our financial plan and asset management plan together and ensure that a change in one plan mandates a change in the other plan.

How could these ideas be encapsulated and 565 local governments be galvanised into action nationally?

Local Government and Planning Ministers' Council Nationally Consistent Frameworks

In 2007, I drafted some 'Frameworks' with assistance from Chris Champion, CEO of IPWEA, and with input from my manager Barry O'Neill. We put these forward to the Local Government and Planning Ministers' Council (LGPMC) for consideration. The three Frameworks were:

- Criteria for assessing financial sustainability
- Asset planning and management
- Financial planning and reporting.

The Frameworks required councils to:

- Engage with their community about the level of services they want and are prepared to pay for
- Identify the type and quality of assets required to provide those services
- Adopt a lifecycle approach to managing their assets and link their asset management and long term financial plans
- Establish and link their longer term strategic plans, annual budgets and annual reports
- Identify and adopt performance indicators to measure and report on progress.

LGPMC agreed to implement the Frameworks. The next challenge was to find funds to implement them – funds that eventually came through the Local Government Reform Fund.

Below is a summary of the Frameworks.²³

Framework 1 – Criteria for assessing financial sustainability (May 2007)

This Framework aims 'to develop a nationally consistent approach to criteria for assessing financial sustainability'. It adopts the following definition of financial sustainability:

A council's long-term financial performance and position is sustainable where planned long-term service and infrastructure levels and standards as prioritised through community engagement

²³ "Local Government Sustainability Frameworks," last modified November 4, 2009, <http://www.lgpmcouncil.gov.au/publications/sus_framework.aspx>.

and consultation are met without unplanned increases in rates and charges or disruptive cuts to services.²⁴

Local government finance expert John Comrie has put it another way, defining financial sustainability as ‘the ability to maintain financial capital and infrastructure capital over the long term.’²⁵

This Framework proposes a number of indicators that could be used to assess local governments’ financial sustainability, covering revenue raising efforts, community engagement, financial sustainability and asset renewal, but in the first phase of implementation three indicators have been adopted in-principle for immediate application (see below).

Framework 2 – Asset planning and management

This Framework aims ‘to develop a nationally consistent asset management framework, including the elements of an asset management plan, to support improvement in local governments’ asset management performance and sustainability’.²⁶ The assets of concern are infrastructure, such as roads, bridges, footpaths, water and sewerage facilities, buildings, recreational centres, stadiums, art galleries and so on. These assets deliver basic services to local communities and management of ageing assets – their renewal, upgrading and replacement – present funding challenges.

The Framework requires councils to develop an asset management policy that: integrates asset management with financial planning; is supported by community engagement, financial reporting and training in financial and asset management; and adopts a whole of life approach to asset condition and service levels. It requires councils to document the assets they own, to forecast future needs and funding sources, and to establish a strategy consistent with the council plan to deliver a defined level of service in a cost effective manner. Council managers will have clearly assigned roles and responsibilities for asset management strategy and planning. A key step is for asset managers to document the quality and cost of services required from assets, based upon defining service levels in consultation with the community. Lack of data has inhibited progress on asset management in the past, so the Framework puts an emphasis on measuring asset performance, identifying funding gaps, and benchmarking performance across the sector and on training of councillors, managers and staff in financial and asset management.

Framework 3 – Financial planning and reporting

This Framework aims ‘to develop a national approach to financial planning and reporting...’.²⁷ The approach aims for greater consistency of approach in two ways. First, it encourages councils to focus on financial management at both the strategic longer-term level and in annual reporting so the community can assess the progress the council is making towards its longer-term goals and can understand why any variances arise. Secondly, it seeks to achieve greater consistency in financial planning and reporting across local governments, so that there can be an informed debate about local government’s financial situation. This permits other spheres of government to assess council needs and to accelerate capacity building measures, the aggregate financial needs of the sector and the relative financial needs of each of

²⁴ Local Government and Planning Ministers’ Council (LGPMC), *Criteria For Assessing Financial Sustainability: Framework 1* (Canberra: LGPMC, 2007), 2.

²⁵ John Comrie (Principal, JAC Comrie P/L). In discussion with the author.

²⁶ LGPMC, *Asset Planning and Management: Framework 2* (Canberra: LGPMC, 2009), 2.

²⁷ LGPMC, *Financial Planning and Reporting: Framework 3* (Canberra: LGPMC, 2009), 2.

the 565 local governments. Financial data about capital expenditure and the allocation of funds between maintenance, renewal and upgrading of assets is particularly critical to the long-term financial sustainability of each local government.

In short, the Framework requires that councils report through:

- A strategic longer-term plan
- An annual budget
- An annual report.

Together these documents chart the council's direction and resource allocation.

The strategic plan, which should be developed in consultation with communities, should assess the council's current position, its longer-term goals, the means to achieve those goals, the performance measures to be used to assess progress, and the hypothecation of resources to longer term goals. The annual budget will contain the usual estimates of revenue and expenditure, and of the financial position of the council. It will, however, also require documenting of assumptions and of the connection to the strategic plan. The annual report will require an explanation of variations between the budget and actual results, and of the impact of these on the achievement of the strategic plan.

For many councils the Framework will be routine and unremarkable, it will just formalise existing practice. But for a minority of councils, this formal and systematic approach to husbandry of council resources will be new and it will mandate community consultation about long-term council plans.

In some states, such as NSW and SA, legislation consistent with the Frameworks is in place and funding from the Local Government Reform Fund (LGRF) is being used to roll out training and implementation in councils. Other states are also making progress in implementing reforms consistent with the Frameworks.

To assist councils, IPWEA has, with funding from the Australian Government, developed manuals and guidelines including:

- *Australian Infrastructure Financial Management Guidelines*
- A practice note on Long Term Financial Planning.

IPWEA will be releasing a 'National Assessment Framework' to all councils to enable them to self-assess their level of skill and comfort in implementing the Frameworks and to diagnose areas for improvement.

Performance measures

Jurisdictions have since debated and agreed in-principle to adopt a number of performance measures on a sector-wide basis to measure council financial sustainability. The measures are as follows²⁸:

- **Operating surplus ratio:** 'The percentage by which the operating surplus or deficit varies from revenue.' There is some debate over whether to limit revenue to own source revenue or whether FAGs and R2R are sufficiently assured to be include as long government revenue).
- **Net financial liabilities ratio:** 'The significance of the net amount owed compared with the period's income.'

²⁸ ACELG, *National Minimum Data Sets for Local Government Scoping Study* (unpublished), 16-7.

- **Asset renewal funding ratio:** ‘The ratio of the net present value of asset replacement funding accommodated over a 10 year period in a long term financial plan relative to the net present value of projected capital renewal expenditures identified in an asset management plan for the same period. It assesses the entity’s financial capacity to fund asset renewal.’

ACELG is leading a project to gather nationally consistent asset and financial data. The idea is to collect nationally consistent data which can be used by all parties to assess the state of play of council financial and asset management, whether progress is being made by the sector, and which councils or groups of councils need more capacity in building support. If the data is sufficiently robust, it could also help identify the relative local funding needs of each local governing body across jurisdictions, and indicate whether a supplementary local government FAGs program is needed.

Assessment of progress made in improving local government financial sustainability

The ALGA commissioned an assessment of the progress councils are making in bridging the local roads funding gap and in implementing the financial and asset management reforms. In the *Local Roads Funding Gap report*²⁹, expert consultants Jeff Roorda and Associates found that:

- The funding gap is stabilising but still in deficit
- The gap between what councils spend and need to spend to maintain and renew local roads was about \$860 million per annum in 2010
- Councils spent 79 per cent of what they needed to spend to maintain and renew local roads. But this was an improvement from the 74 per cent recorded in 2004-05.

In the ALGA’s most recent assessment, its *National State of Assets Pilot*³⁰ found that:

- From a selected sample of 55 councils:
 - 80 per cent of councils had asset management plans
 - 70 per cent had long term financial plans
- The 55 councils had \$18.9 billion of sealed roads with the following seen as ‘poor’ or ‘very poor’:
 - By quality: \$2.2 billion
 - By functionality: \$1.6 billion
 - By capacity \$2.1 billion
- A large proportion of unsealed roads and timber bridges are in a poor condition.

Clearly, progress has been made over the last decade. In the context of the 2002-03 federal estimate of a local roads funding gap of \$644 million per annum (3.6 per cent of 2001-02 local government revenue of \$17.895 billion³¹), the latest local road deficit estimate at \$860 million per annum, is only 2.5 per cent of aggregate local government revenue.³² The backlog is still growing, but more slowly. There are many

²⁹ Jeff Roorda and Associates, *The local roads funding gap: study of local roads funding in Australia 1999–2000 to 2019–2020* (ACT: Australian Local Government Association, 2010), 5.

³⁰ Jeff Roorda and Associates, *National State of Assets: Pilot 2012* (ACT: Australian Local Government Association, 2012), 4-6.

³¹ ABS, *op. cit.*, Table 1.

³² Note for clarity, the focus here is on local roads. The PricewaterhouseCoopers report *op. cit.* identified a funding gap of \$1.1 billion, but that was for *all* local government assets, including local roads. The focus on progress in narrowing the local roads deficit is relevant to the future of the R2R program. There is also limited data on other assets.

ways to bridge the gap, including through sale of underutilised assets, and efficiency improvements, rate increases, debt, expenditure restraint or additional grants.³³

Why does local government financial and asset management matter?

If Australia succeeds in boosting the financial and asset management capability of local government, how does the community benefit?

First, local government will be certain it is providing services the community actually needs and is prepared to fund, and it will meet those needs at the most efficient price based on life cycle asset management. Sound local roads, bridges and footpaths provide for safe and efficient travel for the community and for freight. Councils will be able to quantify and justify their revenue needs by reference to community needs. There will be fewer unexpected rate hikes. Local government may gain more autonomy – less need for state government oversight or rate capping. Federal and state governments will better understand council financial needs and can target assistance to where it's most needed.

The local government financial and asset management reforms are part of the work of the federal government to improve the performance of all sectors of the economy (local government is about two per cent of GDP) and to promote the effective use of its FAGs and R2R grants. All governments are under pressure to meet community needs more efficiently, effectively and equitably. If local government does not improve its performance, it could see its responsibilities eroded by the voluntary and private sectors – some social needs could be provided by the voluntary sector (e.g. aged care) and some economic needs (water and sewerage, car parking, caravan parks, sale yards etc.) by the private sector. For local government to continue to thrive it will need to be able to demonstrate that it is performing well.

Current state of play

In 2013, local government is in a strong position to improve its financial sustainability and its asset management. The three spheres of government agree about how to achieve improvement. The Frameworks outlined above embrace the ideas and the practical steps necessary to achieve this. In some states, legislation is in place to mandate these improvements. The Local Government Reform Fund is providing the funding to provide the training and support councils need to implement reforms. The reforms are supported by a team of contributors – the federal and state governments, the ALGA (through its annual local roads congress and its periodic data collection on the state of local roads by consultants Jeff Roorda and Associates), state local government associations, IPWEA, and ACELG. There are many champions for the cause: John Hennessy in the MAV; consultant John Comrie, Principal of JAC Comrie P/L; John Wright, Office for State Local Government Relations, South Australia; Chris Champion from IPWEA; John Howard; and Jeff Roorda from consulting firm Jeff Roorda and Associates. Some states have made significant progress in trimming (Victoria) or erasing (SA) their infrastructure deficits, and ABS data confirm that local government spending on transport and communications has grown significantly over the last five years.³⁴

³³ Options are discussed in detail in John Comrie, "In Our Hands," *op. cit.*

³⁴ ABS, *op. cit.*, Table 4, Total Local General Government Expenses by Purpose. In the five years 2007–08 to 2011–12, spending on transport and communication grew by 41 per cent (from \$5,169 million to \$7,297 million), compared with the preceding five years (2002–03 to 2006–07) which only grew by 7 per cent (from \$4,500 million to \$4,822 million).

If local government continues to make progress towards financial and asset management sustainability, what's left to be done? While local government can make progress in aggregate, there will be a minority of councils, perhaps in the order of 100-150, which even with their best efforts cannot be financially independent. These councils will typically have an extensive local road network and a small and/or shrinking population. These councils could be supported either by the federal government through a supplementary funding program for selected rural, regional and remote local governments to renew critical infrastructure. Alternatively, the FAGs could be even more tightly targeted to these councils. These councils could also be supported by state governments through a share of motor vehicle registration fees, as is done in WA.

If Australia is to succeed in improving sustainability in local government financial and asset management, there will be a need for continued collaboration across all spheres of government. The recommendations in John Comrie's paper calling for a national working party (or parties) to enhance legislative provisions and guidance material with regard to local government revenue raising, financial strategy and service level planning and training, and support for councils are welcome.³⁵ A small federal funding program in the order of \$10 million over three years would provide an incentive for ongoing state participation and help catalyse implementation of reforms in councils.



³⁵ John Comrie, "In Our Hands," *op. cit.*, 46.