

A Review of the Financial Sustainability of Local Government in Tasmania

A Report for the Local Government Association of Tasmania
by Access Economics Pty Limited

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FOREWORD

We were asked by the Local Government Association of Tasmania (LGAT) to address the following seven issues:

- ❑ the present condition of Council finances (their financial position, their financial performance and their infrastructure-related financial obligations), measured in terms of appropriate key financial indicators and assessed relative to applicable benchmark values;
- ❑ the outlook for Council finances over the next 10 years under present and alternative infrastructure and service provisioning scenarios;
- ❑ the financial capacity of Councils to fund their service and infrastructure obligations, and the additional own-source financial capacity available under alternative revenue raising options;
- ❑ the present standard of Council financial governance policies and processes relative to good practice;
- ❑ the financial sustainability of individual Councils;
- ❑ the adjustments that may be necessary to current policy directions, including how any deficits – current or emerging – might be addressed; and
- ❑ possible improvements to financial governance.

Caveats and disclaimers

We have relied upon financial data supplied by Councils and/or gathered by the Local Government Office. This information has not been subjected to an audit on our part. While we have made our best efforts both to ensure that the information provided meets our requirements and to maintain the accuracy of this information after it is received, we accept and use the information provided in good faith. We are unable to provide any warranties about the accuracy or completeness of the information provided to us by or in relation to individual Councils.

Where key data are missing or inadequate, we only really have two choices: we can say that the data is suspect in certain respects, be overly cautious and not draw any conclusions, or we can use the data and rely on our own estimation procedures implemented without any particular result in mind. We always prefer the second option.

Where we have exercised judgment (as is always necessary to complete an analysis of this kind), we have done so based on our experience with these types of assessments. If anything, we believe our findings are more likely to understate – rather than overstate – the overall challenge facing local government in Tasmania.

We also acknowledge that – notwithstanding the obvious focus of our review – not all challenges to the sustainability of Tasmanian local government have a financial context, with capacity, skills, demographic and environmental dimensions also being important.

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Post-review development

After we commenced our review, we became aware of the State Government's creation of a task force to examine long-term improvement in Tasmania's water and sewerage services and infrastructure. One possible outcome of this process is that responsibility for water and sewerage infrastructure is transferred in time from local government to the State government.

We considered excising the water and sewerage activities of Councils from our analysis, but the financial information we obtained was not sufficient for this purpose.

In the end, we are comfortable that including water and sewerage activities within our analysis will not invalidate our broad conclusions were a decision eventually made to transfer such activities out of local government in Tasmania. By rights, any transfer should be on terms that are financially neutral to local government, which would leave our analysis (inclusive of water and sewerage activities) just as relevant to a local government sector that is relieved of such responsibilities. Whether any such transfer were to take place on terms that are financially beneficial or damaging to Councils is a matter quite independent of the current financial impact of these activities on Councils.

Acknowledgements

We are grateful to LGAT officers and Council officers across the State for providing the financial and related data necessary to undertake our analysis, and for assisting with the interpretation of these data. In a number of instances, this assistance has prevented us from making a number of mistakes. All remaining errors are our own responsibility.

Access Economics
March 2007

EXECUTIVE SUMMARY

THE CHALLENGE FACING TASMANIAN COUNCILS

Under existing policies, Tasmanian Councils generally exhibit:

- ❑ **operating deficits**; and
- ❑ on preliminary estimates, **annual renewals gaps**

that are well above the high end of their respective target ranges. This is evidence of significant under-performance against benchmarks.

While preliminary indications are that their **infrastructure backlogs** currently are quite manageable, some Councils are running the risk that these backlogs will become significant as their sizeable annual renewals gaps accumulate over time.

Councils generally have comfortable strong balance sheets – with minimal debt.

ONE IN FIVE TASMANIAN COUNCILS MAY BE FINANCIALLY UNSUSTAINABLE

Based upon the best information we can muster at this stage, we categorise the current finances (and financial policies) of six Tasmanian Councils (or 20%), which serve 8% of the State's population, as 'unsustainable'. This does not mean these Councils are in imminent danger of defaulting on their debt service obligations or that their financial viability is being called into question. Rather, what is being flagged is that – if the long-term finances of such Councils are to be put onto a sustainable footing – substantial or disruptive revenue (or expenditure) adjustments appear inevitable.

Improvements in the quality of the underlying data may result in better assessments for some Councils. Just as likely, some of the financial imbalances facing Tasmanian Councils today may well be larger and more challenging than we have described.

Rather than singling out particular Councils, to our mind of more importance is the macro perspective provided by our assessments as to the condition of local government as a whole.

In this regard, the proportion of the State's population being served by Councils which we categorise as unsustainable (8%) is less than the 20% plus figures apparent in SA, NSW and WA in those States' Inquiries.

Councils '**feeling the pinch**' are most likely to be those, as characterised by PricewaterhouseCoopers in its recent National Financial Sustainability Study of local government for ALGA, that exhibit:

- ❑ minimal (or negative) revenue growth;
- ❑ for a small proportion of Councils, limited access to rate revenue due to relatively small populations reducing the size of the rates income stream coupled with constraints on the size of annual rates increases;

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- ❑ limited access to the strong financial and asset management skills which are critical to identifying sustainability problems, optimising renewals expenditure and improving revenue streams;
- ❑ expanding service provision due to rising community demands, coupled with a related tendency by some Councils to step in to provide a non-traditional service; and
- ❑ a tendency to run operating deficits creating a need to defer or underspend on renewal of infrastructure, particularly community infrastructure.

EXPENDITURE SAVINGS WOULD HELP

Expenditure cutbacks may have a role to play in addressing the operating deficit and renewals gap problems facing many Tasmanian Councils.

Tasmanian Councils could improve the sustainability of their long-term finances by pursuing short- to medium-term savings through **further operational efficiencies** and the **reordering of service priorities**.

If reliance was placed entirely on cutting back spending on services, we estimate that one percentage point or so would need to be knocked off the annual growth rate in operating expenses (other than depreciation, interest and maintenance) each and every year over the next 10 years – implying an (ongoing) annual savings of around \$4 million – to put Councils on average into the minimal desired operating surplus and renewals gaps positions. Anything less than this would imply a role for revenue increases.

It is also apparent that halting future infrastructure expansion for the next decade alone could put Councils' operating surpluses on average into the target operating surplus range. However, this would come at the cost of greater pressures on infrastructure in future.

It may be that a combination of **more modest and targeted infrastructure expansion** over the next decade and a program of operational efficiencies and the reordering of service priorities can make significant inroads into the operating deficit and renewals gap problems currently evident in Tasmanian local government. Whether this is the approach taken depends upon a comparison with the alternative – increasing Councils' own-source revenue effort.

A GREATER REVENUE-RAISING EFFORT MAY ALSO BE NEEDED

If the extra resources needed were to be tapped only from Council's own-source revenues, the *average annual rates of growth* in the main revenue items on a *real-terms per-property basis* would need to be as follows each year for the next 10 years:

- ❑ **rates** (including annual water and sewerage charges): to grow at 1.1% per annum, up from 0.5% per annum under existing revenue policy;
- ❑ **fees and user charges**: to grow at 1.7% per annum, up from 0.9% per annum under existing revenue policy; and
- ❑ **developer charges**: to grow at 6.2% per annum, up from a decline of 0.6% per annum expected under existing revenue policy.

These indicative annual increases are only ballpark numbers since the precise funding package necessary for achieving sustainability requires further modelling work once Tasmanian Councils have resolved what mix of revenue raising and expenditure savings options they are prepared to consider.

INCREASED REVENUE COULD SERVICE NEW DEBT TO OVERCOME THE INFRASTRUCTURE BACKLOG

In addition to a mix of revenue raising and expenditure savings necessary to tackle the operating deficit and renewals gaps problems, **increased borrowings** has a role to play in overcoming the infrastructure backlog and renewing assets coming to the end of their useful life. Such funding would:

- ❑ better share infrastructure costs between existing and future ratepayers; and
- ❑ reduce upfront debt servicing costs and thereby allow Councils to be more ambitious in tackling their infrastructure problems.

WHAT'S THE NEXT STEP?

Based upon our financial governance survey, the current financial governance policies and processes of Tasmanian Councils – on average – appear just to meet minimum acceptable standards. There is clear **scope for improvement in financial governance policies and processes**.

That there are shortcomings in existing financial governance policies and practices of Tasmanian Councils is evident from the operating deficits and renewals gaps that have been documented in this report.

Where financial governance is not well developed in Councils, it is not surprising that there is a lack of understanding on the community's part of the true costs of current infrastructure and service commitments. Other governments too are unlikely to be convinced that increasing grant funding to local government would be a prudent use of their taxpayer funds.

The Commonwealth and State governments increasingly expect partners in their specific purpose programs to demonstrate rigour and sound operating frameworks in order to attract assistance on a continuing basis. What is required is a sector-wide determination to strengthen financial governance arrangements across local government in Tasmania – and the adoption of associated policy directions and performance – in order to shape and inform better policy and funding outcomes.

Particular areas identified for improvement are:

- ❑ establishing internal structures that provide for independent review of processes and decision-making to assist councillors meet their accountability to ratepayers and the community, including with an **audit committee** overseeing and advising on matters of accountability and internal control;
- ❑ embedding spending and revenue decisions in a **multi-year framework**, and against the background of long-term financial rules; and
- ❑ improving coherence and uniformity in **external financial reporting**.

It is also recommended that Tasmanian Councils develop appropriate long-term spending, asset management, revenue and borrowings strategies to overcome their infrastructure and services challenges within sustainable financial limits.

At the very least, each Council should develop a **rolling 10-year financial plan** to:

- ❑ rehabilitate infrastructure that is already dilapidated;
- ❑ renew infrastructure when it degrades below an acceptable standard in future;

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- expand the total infrastructure stock by enough to adequately cater for residential and business growth;
- develop services in line with population growth and changing community needs;
- generate additional resources from revenue measures, operational savings, re-ordering of spending priorities, infrastructure enhancement deferrals, asset leases or disposals and extra borrowings that would be sufficient to fund such a program; and
- ensure that the outcome complies with sustainable financial targets (e.g., the recommended minimum operating surplus ratio and maximum annual renewals gap ratio) during this period.

GLOSSARY

All financial terms used in this report have the meaning given in AAS27, with the following additions and exceptions. All *italicised terms* below are defined elsewhere in this Glossary.

actual maintenance expense	means the amount of <i>maintenance expense</i> actually, or expected to be, undertaken in a particular year
actual renewals capital expenditure	means the amount of <i>renewals capex</i> actually, or expected to be, undertaken in a particular year
annual maintenance deficiency/(surplus)	means the <i>desired maintenance expense</i> in a particular year less the <i>actual maintenance expense</i> undertaken in that year
annual renewals deficiency	means the <i>desired renewals capex</i> in a particular year less the <i>actual renewals capex</i> undertaken in that year
capital employed	means the sum total of the written down value of a Council's <i>non-financial assets</i> and the value of its holdings of restricted cash and securities
capital expenditure (or capex)	means amounts expended on the purchase or construction of <i>non-financial assets</i>
capital transfers	mean the grants and contributions provided to a Council for capital purposes
desired maintenance expense	means the annual amount of <i>maintenance expense</i> that is necessary in a particular year to keep an asset's service capacity at the same level as it was at the beginning of the year
desired renewals capital expenditure	means the annual amount of expenditure (in addition to <i>desired maintenance expense</i>) that is necessary to keep the service capacity of a class of <i>infrastructure assets</i> at an optimal level
developer charges	mean (cash) capital contributions and (non-cash) asset donations made to a Council
enhancement capex	means <i>capital expenditure</i> on the extension or expansion of a Council's <i>non-financial assets</i>
financial assets	mean assets that are in the form of financial claims on other sectors of the economy
financial governance	means the process by which an elected Council meets its accountability obligations to its ratepayers for the sustainability of the Council's long-term finances
financial performance	means the state of a Council's annual operating statement, essentially involving the surpluses or deficits between its annual revenue and spending
financial position	means the state of a Council's balance sheet, and so the relative level – and composition – of its assets and liabilities
financial sustainability	means the extent to which a Council's <i>financial capacity</i> is sufficient – for the foreseeable future – to allow the Council to fund the spending that is necessary to meet both its existing statutory obligations and any associated spending pressures and financial shocks without having to introduce substantial or disruptive revenue (and expenditure) adjustments
infrastructure assets	means <i>non-financial assets</i> excluding any holdings of land

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infrastructure backlog	means past <i>annual maintenance gaps</i> and <i>annual renewals gaps</i> accumulated to a particular point in time
maintenance expense	means expenditure on an existing asset which is periodically or regularly required to ensure that the asset achieves its economic life or period of service between renewal
net borrowing	means the situation where a Council's annual transactions are financed by an increase in the Council's <i>net financial liabilities</i>
net debt	means the total of a Council's interest-bearing liabilities less its holdings of unrestricted cash and securities
net interest expense	means a Council's total interest expense less any interest income on its holdings of unrestricted cash and securities
net financial liabilities	mean the net financial obligations of a Council to other sectors of the economy, being total liabilities less both its holdings of unrestricted cash and securities and its receivables
net lending	means the situation where a Council's annual transactions give rise to negative <i>net borrowing</i> and so a decrease in the Council's <i>net financial liabilities</i>
non-financial assets	mean a Council's inventories, land, buildings, roads, bridges, storm water & drainage network, equipment, furniture, fittings and the like
operating deficit	means a situation where a Council's total annual expenses (excluding losses on disposal of non-financial assets and losses made on the revaluation of financial and non-financial assets) in a particular year exceed its total annual <i>operating revenue</i> in that year
operating revenue	means a Council's total annual revenue excluding <i>capital transfers</i> , physical resources received free of charge, gains made on the disposal of <i>non-financial assets</i> and gains made on the revaluation of <i>financial assets</i> or <i>non-financial assets</i>
operating surplus	means the extent to which a Council's <i>operating revenue</i> in a particular year exceeds its total annual expenses (excluding losses on disposal of <i>non-financial assets</i> and losses made on the revaluation of <i>financial assets</i> and <i>non-financial assets</i>) in that year
own-source revenue	means revenue that is not received in the form of grants from the other tiers of government
renewals capex	means <i>capital expenditure</i> on the renewal or replacement of a Council's existing system of <i>infrastructure assets</i>

1. COUNCIL FINANCES UNDER EXISTING POLICIES

This chapter provides our assessment of the financial position and performance of Tasmanian Councils, currently and over the next 10 years, based upon *no-policy-change* assumptions. The impact of possible policy changes is dealt with in chapters 3 and 4.

By '*no policy change*', we mean the situation where a Council's revenue-raising effort and its expenditure standards both continue on in future in line with currently-observable levels. Essentially, such an assumption enables a Council's financial outlook to be assessed were the Council in effect to 'sit on its hands' and leave its existing policy settings unchanged.

1.1 FRAMEWORK

1.1.1 BENCHMARKS

The key financial indicators, and associated benchmark values, that we use are set out in Table 1-1.

**TABLE 1-1: KEY FINANCIAL INDICATORS AND BENCHMARKS VALUES
TASMANIAN COUNCILS**

Indicator	Denominator	Target range	
		low	high
Net financial liabilities ratio	Capital employed	3%	12%
Net interest expense ratio	Operating revenue	2%	5%
Operating surplus ratio	Own-source operating revenue	2½%	7½%
Net borrowing ratio	Enhancement capex	25%	50%
Annual renewals gap ratio	Desired renewals capex	-10%	10%
Infrastructure backlog ratio	Infrastructure assets	0%	5%

Each of these financial indicators is based upon a generally-accepted key analytical balance with a strong predictive relationship to the degree to which a Council's finances are likely to be sustainable in the long term.

A Council should set target values for these financial indicators based upon the following broad principles:

- A Council's *financial position* is in a healthy state if its net financial liabilities (and associated debt) and any infrastructure backlog are at levels where the resultant and prospective net interest expense can be met comfortably from annual income (i.e., by current ratepayers) at the existing rating effort.
- A Council's *operating financial performance* is satisfactory if it is running a modest operating surplus before capital revenues, indicating that costs incurred in the year in question (including both routine maintenance and annual depreciation of non-financial assets) are at least being met by today's ratepayers and not being transferred to tomorrow's ratepayers, with revenues sufficient to finance current operations.

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- A Council's *capital financial performance* is satisfactory if both:
 - its actual renewals capex broadly matches the annual desired levels of such expenditure, and
 - its annual net borrowing does not put any long-term pressure on achievement of the Council's targeted net financial liabilities ratios.

The benchmarks shown in Table 1-1 are based upon those suggested by the NSW Inquiry.¹ The NSW Inquiry 'low' and 'high' target values were those applying to an 'average' NSW Council. The benchmarks shown in Table 1-1 have been adapted to Tasmanian circumstances, and applied depending upon a Council's general circumstances (growth, size, grants dependency).

Finally, it should be noted that the low and high target values used are not absolutes. They may be breached but ideally only for a limited period. Hence, these low and high values define a band of desirable medium-term values for the indicator concerned.

1.1.2 DATA

We have analysed the financial position and performance of Tasmanian Councils using financial data provided by or for each Council, including:

- operating statement and balance sheet information; and
- preliminary projections of the current infrastructure backlog and the prospective annual renewals gaps, as compiled for a recent sector-wide asset gap analysis undertaken by Councils.

The data and the adjustments we have made are explained in **Appendix A**.

Appendix B re-presents the local government sector's finances into a summary format.

1.2 THE FINANCIAL POSITION OF COUNCILS

Rather than a conventional examination of assets and liabilities, our analysis of a Council's financial position is based upon re-arranging balance sheet items into the sources and uses of 'capital', where capital involves all the financial resources employed by a Council, being resources which could be employed elsewhere in the economy.

Table 1-2 indicates the level and composition of capital employed by Tasmanian Councils as at 30 June 2006.

¹ NSW Inquiry (2006), pp.273-4. We have not referred to the net debt ratio indicator, as there is a very close relationship between it and the net interest expense ratio we have used.

**TABLE 1-2: LEVEL AND COMPOSITION OF CAPITAL EMPLOYED
TASMANIAN COUNCILS, 30 JUNE 2006**

	\$M	%
Non-financial assets	5,356.651	99.5%
<i>plus</i>		
Financial assets ^(a)	26.034	0.5%
<i>equals</i>		
Total capital employed	5,382.685	100%

^(a) Restricted cash and securities only

On this basis, the average capital employed per rateable property by Tasmanian Councils at 30 June 2006 was \$21,440. Overwhelmingly, capital employed is in the form of non-financial assets.

1.2.1 NET FINANCIAL LIABILITIES RATIO

THE OVERALL PICTURE

Table 1-3 shows our calculation of Tasmanian Councils' net financial liabilities ratio as at 30 June 2006.

**TABLE 1-3: NET FINANCIAL LIABILITIES RATIO
TASMANIAN COUNCILS, 30 JUNE 2006**

Net debt ^(a) (\$M)	-117.693
<i>plus</i>	
Other liabilities ^(b) (\$M)	87.264
<i>equals</i>	
Net financial liabilities (\$M)	-30.429
<i>divided by</i>	
Capital employed (\$M)	5,382.685
<i>equals</i>	
Net financial liabilities ratio (%)	-0.6%

^(a) Total interest-bearing liabilities less unrestricted cash and securities

^(b) Provisions plus payables less receivables plus other liabilities n.e.i.

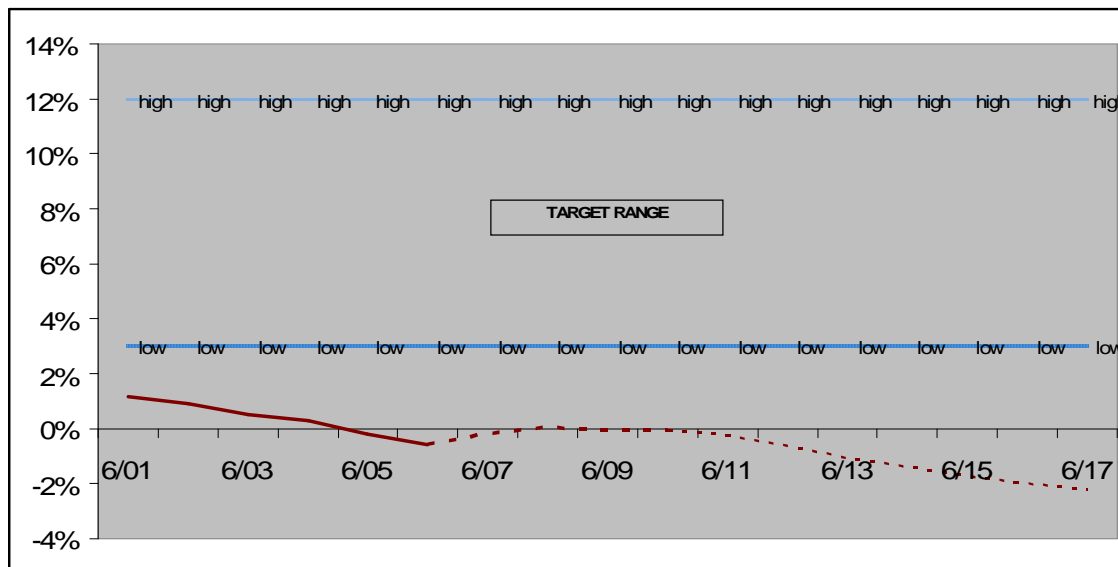
Chart 1-1 shows the time series of Tasmanian Councils' net financial liabilities ratio, including projections on a 'no policy change' basis. It should be noted that in this chart, as in all similar charts in the rest of this chapter:

- ❑ the *solid* line shows the actual figures for recent years;
- ❑ the *dashed* line shows the budgeted figure for the current year and Tasmanian Councils' no-policy-change projections to 2009-10 where available (or our projections where not available from individual Councils); and
- ❑ the *dotted* line beyond 2009-10 shows our longer-term projections based upon the policy settings apparent in the Council's no-policy-change projections to 2009-10.²

² This involves assuming revenue effort and expenditure growth rates continue at the same levels as evident in Tasmanian Councils' own financial projections.

Also shown are the relevant low and high target values from Table 1-1.

**CHART 1-1: NET FINANCIAL LIABILITIES RATIO
TASMANIAN COUNCILS, 30 JUNE 2001 TO 30 JUNE 2017**



In recent times, Tasmanian Councils’ reliance on borrowings – in all forms – has fallen well below a level that we consider to be warranted in the circumstances.³ Under no-policy-change assumptions, only a slight uptick in borrowings is expected in the near term before a further gradual decline is likely.

On inter-generational equity grounds, we consider it appropriate that additional borrowings be used to fund *enhancement* capex, as such capex gives rise to infrastructure services benefiting future as well as current ratepayers. Only *renewals* capex should be funded wherever possible by past and present ratepayers, with additional borrowings not being relied upon to finance such capex except in exceptional circumstances.⁴ Fully funding depreciation is the most equitable (in an inter-generational sense) means of funding renewals capex. Borrowing to fund renewals capex should only be tolerated where depreciation has been under-funded in the past.

For this reason, a zero public debt policy is not appropriate in local government as it implies current ratepayers are expected to meet the full cost of infrastructure assets, most of the benefits of which accrue to future ratepayers. Zero debt is not favoured in the private sector because of the opportunity cost of equity (retained capital) and the fact that debt capital can be obtained more cheaply as a result. In practice, our observation is that – to cushion the impact otherwise on current ratepayers – a zero debt policy usually results in under-investment in a Council’s infrastructure assets.

³ The average 10% target net financial liabilities ratio for Tasmanian Councils compares with a 12% target adopted by Auckland City for example. It is aligned with the net interest expense target discussed later, on the basis of a normalised operating revenue-to-capital employed ratio of 8% and a normalised debt-to-net financial liabilities ratio of 50%.

⁴ Our view that annual depreciation be regarded solely as a source of funding future renewals brings with it a possible role for spreading the borrowed cost of existing assets over generations of taxpayers through a debt principal repayment component of a Council’s operating surplus. Some within local government hold an alternate view, namely that depreciation should be regarded instead as itself funding the repayment of debt (i.e., returning debt-sourced capital employed). Under this minority view, additional/new debt is required to finance asset renewals as well as new assets.

More generally, Table 1-4 indicates the sources of capital employed by Tasmanian Councils.

**TABLE 1-4: LEVEL AND COMPOSITION OF SOURCES OF CAPITAL
TASMANIAN COUNCILS, 30 JUNE 2006**

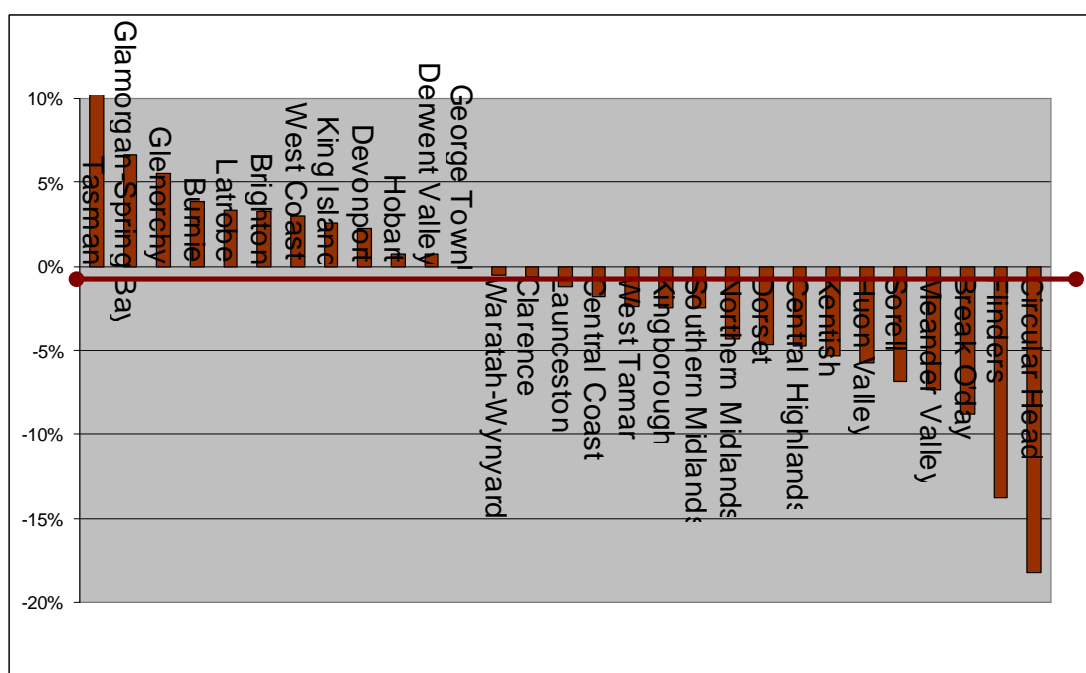
	\$M	%
Net financial liabilities (or 'debt' capital)	-30.429	-0.6%
<i>plus</i> Ratepayer equity (or 'equity' capital)	5,413.114	100.6%
<i>equals</i> Total sources of capital	5,382.685	100%

Overwhelmingly, ratepayer equity (contributed in the form of retained earnings) is the principal source of Tasmanian Councils' capital employed.

DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their net financial liabilities ratios as at 30 June 2006 are shown in Chart 1-2, which portrays the financial gearing of each Council ranked in descending order. The horizontal line in this chart, and in all similar charts in this chapter, shows the average ratio for all Tasmanian Councils.

**CHART 1-2: NET FINANCIAL LIABILITIES RATIO
TASMANIAN COUNCILS, 30 JUNE 2006**



Evident is quite a spread in the net financial liabilities ratio across Councils. Eleven Councils had a positive ratio as at 30 June 2006. Only two Councils had ratios within the target range. One Council had a ratio that lay above the 'high' target ratio shown in Table 1-1.

Table 1-5 compares the average net financial liabilities ratio of Councils across council groupings.

**TABLE 1-5: NET FINANCIAL LIABILITIES RATIO, BY TYPE OF COUNCIL
TASMANIAN COUNCILS, 30 JUNE 2006**

	%	no of Councils
Cities	0.8%	4
Rural – medium	-1.2%	12
Rural – small	-3.1%	13
All Tasmanian Councils	-0.6%	29
<i>of which:</i>		
Above-average growth	-1.2%	12
Declining population	-2.6%	9

The smaller the Council, the lesser appears to be the reliance on debt.

1.2.2 NET INTEREST EXPENSE RATIO

THE OVERALL PICTURE

Table 1-6 shows our calculation of Tasmanian Councils' net interest expense, and associated ratio, for 2005-06.

**TABLE 1-6: NET INTEREST EXPENSE RATIO
TASMANIAN COUNCILS, 2005-06**

Interest expense (\$M)	8.234
<i>less</i>	
Interest income on unrestricted cash & securities (\$M)	15.105
<i>equals</i>	
Net interest expense (\$M)	-6.871
<i>divided by</i>	
Operating revenue ^(a) (\$M)	593.154
<i>equals</i>	
Net interest expense ratio (%)	-1.2%

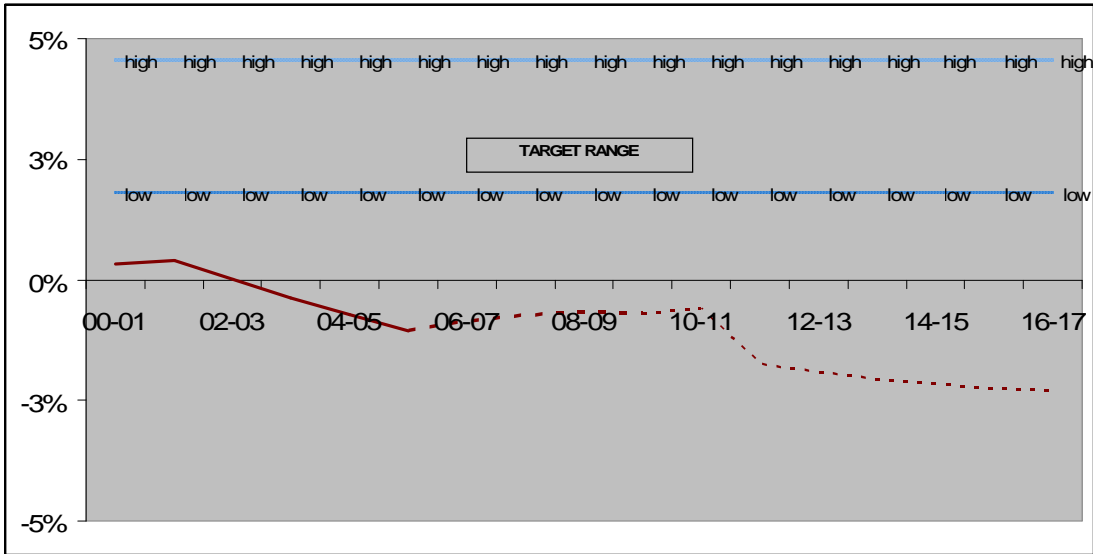
^(a) Before capital transfers, interest on unrestricted cash & securities and realised gains on asset sales

Chart 1-3 shows the time series of Tasmanian Councils' net interest expense ratio, including projections on a 'no policy change' basis.

On average, Tasmanian Councils' net interest expense has recently been – and prospectively on a no-policy-change basis is – only a fraction of operating revenue. Consistent with the picture presented by the net financial liabilities ratio, Tasmanian Councils' debt burden is well below benchmark levels.⁵

⁵ The average 4% target net interest expense ratio for Tasmanian Councils is based on a 60% debt-to-total revenue ratio warranting a single-A credit rating for a typical Tasmanian Council, on the basis of a normalised operating revenue-to-total revenue ratio of about 90% and a normalised interest-to-debt ratio of about 6%.

**CHART 1-3: NET INTEREST EXPENSE RATIO
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



Under such circumstances, higher debt will not necessarily result in a need for additional revenue – at least over the short- to medium-term – to meet the extra debt servicing charges. Other things being equal, higher borrowings will free up cash flows that are otherwise paying for asset acquisitions. Such freed-up cash flow can contribute to servicing the additional debt involved.

DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their net interest expense ratios for 2005-06 are shown in Chart 1-4.

Only six Councils had positive net interest expense ratios in 2005-06. Only one Council had a ratio within the target range suggested in Table 1-1.

**CHART 1-4: NET INTEREST EXPENSE RATIO
TASMANIAN COUNCILS, 2005-06**

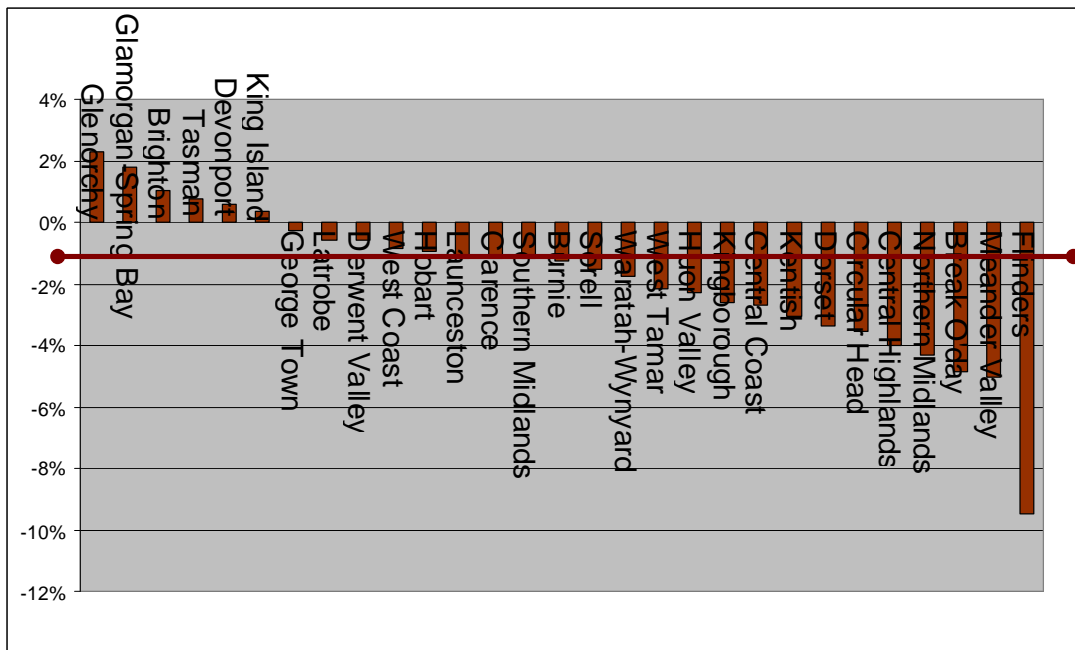


Table 1-7 compares the average net interest expense ratio of Councils across council groupings.

**TABLE 1-7: NET INTEREST EXPENSE RATIO
TASMANIAN COUNCILS, 2005-06**

	%	no of Councils
Cities	-0.4%	4
Rural – medium	-1.7%	12
Rural – small	-1.9%	13
All Tasmanian Councils	-1.2%	29
<i>of which:</i>		
Above-average growth	-1.3%	12
Declining population	-1.9%	9

1.2.3 INFRASTRUCTURE BACKLOG

THE OVERALL PICTURE

A raft of obligations come with a Council’s non-financial assets. Any cumulative backlog in a Council’s past maintenance and renewals effort in effect is a ‘liability’ facing the Council just as much as borrowings but one that does not show up on its balance sheet.

Our use of the term ‘infrastructure backlog’ covers two forms of backlog, namely:

- the accumulation of past annual renewals gaps up to the current point in time; and

- any infrastructure maintenance backlog, where assets have prematurely degraded because they have not been routinely maintained.

This backlog measure of infrastructure condition is retrospective – reflecting the ‘catch up’ needed to return infrastructure to acceptable condition today. It does not take account of new infrastructure needs generated by a growing and shifting population, likely changes to building and construction standards or rising community expectations and demands. The average annual maintenance costs/expense and renewals capital expenditure needed in future years are addressed in section 1.3.

A recent asset gap analysis undertaken across the sector has compiled *preliminary* estimates of the current infrastructure backlog of Tasmanian Councils.⁶ We use these estimates cautiously, as for many Councils they do not appear to have been vetted across the entire organisation. Nevertheless, the information contained in these preliminary estimates is too important to ignore. As discussed in chapter 6, refining these estimates must be a priority for all Councils in Tasmania going forward.

Table 1-8 shows our calculation of Tasmanian Councils’ infrastructure backlog, and associated ratio, at 30 June 2006.

**TABLE 1-8: INFRASTRUCTURE BACKLOG RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 30 JUNE 2006**

	Total
Infrastructure backlog (\$M)	100.256
<i>divided by</i>	
Infrastructure assets ^(a) (\$M)	8,662.645
<i>equals</i>	
Infrastructure backlog ratio (%)	1.2%

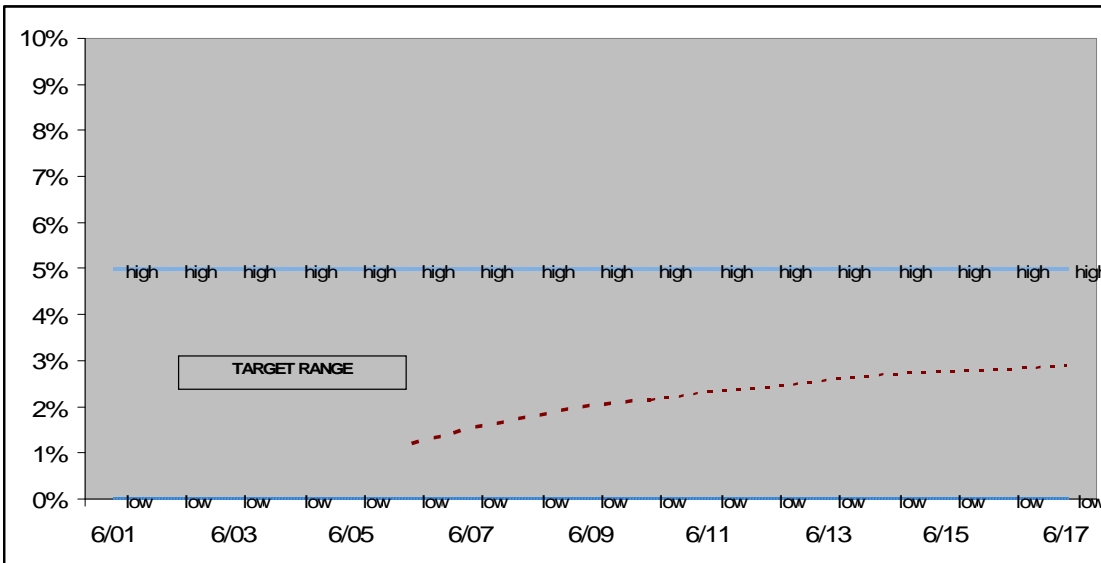
^(a) The current replacement cost of all non-financial assets except land.

Chart 1-5 shows the time series of the average infrastructure backlog ratio of Tasmanian Councils, including projections on a ‘no policy change’ basis.

It is evident that, on average (and based upon the preliminary asset gap results), Tasmanian Councils currently appear to have manageable infrastructure backlog ratios, with the average ratio falling well within the target range of 0% to 5%. This contrasts with our findings in other States, and may be a reason to wonder how complete the preliminary estimates are in Tasmania.

⁶ The figures we use for the infrastructure backlog are described as the “Total Value in \$ Above Intervention Condition” in output from the Moloney model used by the asset gap analysis for Tasmanian Councils. This figure is shown in row no. 765 of the “All Assets by Asset Group” sheet of the Moloney model output.

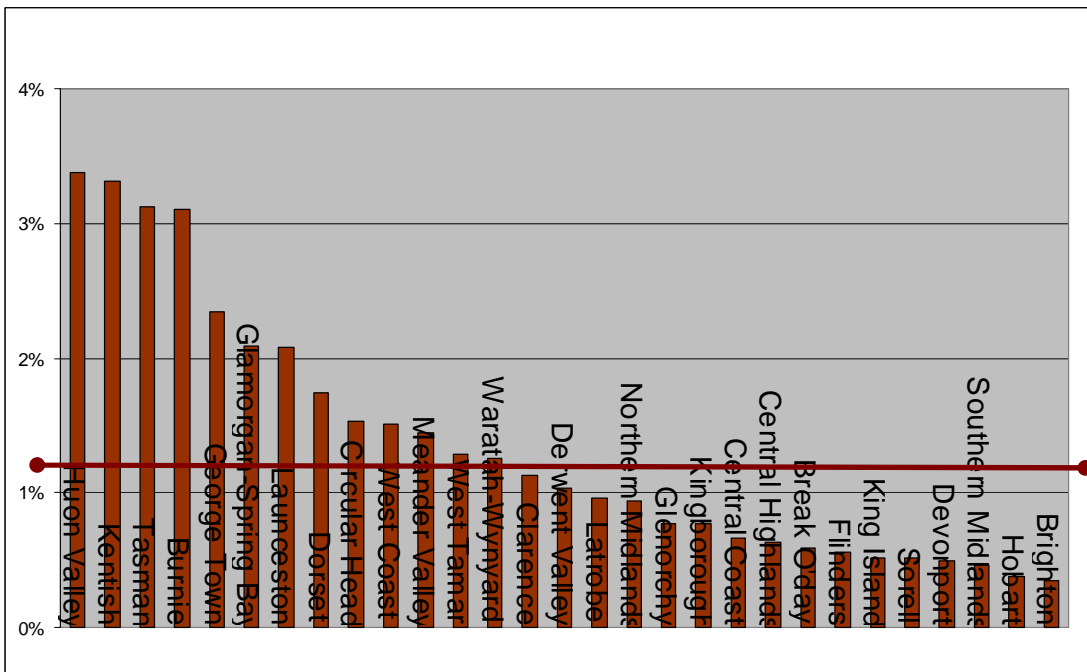
**CHART 1-5: INFRASTRUCTURE BACKLOG RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 30 JUNE 2001 TO 30 JUNE 2017**



DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their infrastructure backlog ratios as at 30 June 2006 are shown in Chart 1-6.

**CHART 1-6: INFRASTRUCTURE BACKLOG RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 30 JUNE 2006**



While a considerable disparity is evident among Councils in the preliminary value of their current infrastructure backlog ratios, all Councils currently have ratios that fall within the target range.

Table 1-9 compares the average infrastructure backlog ratio of Councils across council groupings.

**TABLE 1-9: INFRASTRUCTURE BACKLOG RATIO, BY TYPE OF COUNCIL
TASMANIAN COUNCILS, 30 JUNE 2006**

	%	no of Councils
Cities	12%	4
Rural – medium	12%	12
Rural – small	13%	13
All Tasmanian Councils	12%	29
<i>of which:</i>		
Above-average growth	1.1%	12
Declining population	12%	9

What differences there are among Councils in their current infrastructure backlog ratios, little explanatory role can be attributed to their size or growth characteristics.

1.3 COUNCILS' ANNUAL FINANCIAL PERFORMANCE

1.3.1 OPERATING SURPLUS RATIO

THE OVERALL PICTURE

Choices regarding the measurement of an operating surplus/(deficit) arise for two general reasons, namely the appropriate treatment of:

- ❑ capital grants and contributions (we use the Australian Bureau of Statistics *National Accounts* term of “capital transfers” for short); and
- ❑ changes in net worth due to external factors such as general price movements and the like.

When measured *after* taking account of capital transfers, an operating surplus/(deficit) is equal to the change in a Council's net worth. All transactions that increase a Council's net worth are classified as revenue. In general, transactions that increase net worth result from current operations. Capital transfers are the exception. When negative, the surplus/(deficit) measured after capital transfers indicates that a shortfall has been incurred on current operations and that it has been necessary to incur net financial liabilities or to increase equity in order to finance those operations.

When measured *before* taking account of capital transfers, an operating surplus/(deficit) is equivalent to the 'net saving' aggregate in the *National Accounts*. When negative, it indicates the portion of a Council's costs incurred in the year in question that is being transferred to tomorrow's ratepayers rather than being met by today's ratepayers.

Our position is that the surplus/(deficit) measured *before capital transfers* is the relevant indicator for the purposes of assessing the sustainability of government operations because it sheds light on inter-generational equity considerations crucial for determining appropriate taxation levels.

Financial Sustainability Review

When examining intergenerational issues, we also prefer to focus on the component of the operating surplus/(deficit) that is *due to 'transactions'* as opposed to 'other flows', where:

- 'transactions' represent changes to balance sheet items that come about as a result of policy and managerial decisions; and
- 'other flows' represent changes to balance sheet items that do not result from a transaction (e.g., revaluations which arise from price movements, including exchange rate and interest rate movements).

We therefore consider the primary indicator of a Council's *operating* financial performance to be its surplus/(deficit) from transactions before capital amounts (or operating surplus/(deficit) for short). When measured in this way, any operating deficits are indicative of services consumed by current ratepayers being paid for – one way or the other – by future ratepayers.

As a general principle, operating expenses plus a fair measure of annual depreciation represent spending on outputs the consumption of which gives rise to benefits derived wholly in the current period. Capital spending results in benefits beyond the current period. When the operating surplus – appropriately measured – is positive, operating revenue is more than sufficient to finance current operations. When the operating surplus is negative (indicating an operating deficit), operating revenue is insufficient to finance current operations.

In general, operating deficits should be avoided over the business cycle, by increasing own-source revenue effort (or reducing service levels). However, cyclical (as opposed to structural) deficits can be tolerated to ensure that tax smoothing occurs for ratepayers.

Current operating deficits should be corrected mainly by current ratepayers.

(Additional) future operating deficits should be the responsibility of future ratepayers.

However, it may be that current operating deficits are too sizeable to be addressed entirely by current ratepayers. If so, it may be necessary to see a proportion of the current operating deficit offset by future ratepayers – to, in effect, phase out any operating deficit in a manageable way over time.

Table 1-10 shows the relationship between our calculation of the total operating surplus of Tasmanian Councils and the total surplus/(deficit) after capital amounts as calculated in accordance with AAS27.⁷

Evident is the critical role in measuring operating surpluses and deficits played by the apportionment of grants from other governments between 'operating' and 'capital' categories. In fact, we have opted to take a reasonably conservative approach in our analysis, restricting capital grants to a proportion of specific purpose (or tied) grants made to Councils. All general purpose (or untied) 'capital' grants are treated as being for operating purposes including to finance asset renewal and maintenance.⁸

⁷ Australian Accounting Standard AAS 27, *Financial Reporting by Local Governments*.

⁸ While there may be a case instead for apportioning these grants between 'operating' and 'capital' grants in proportion to the maintenance/renewal and enhancement components of expenditure, we have opted to take the conservative approach so as not to risk exaggeration of any resultant operating deficit.

**TABLE 1-10: OPERATING SURPLUS CALCULATION
TASMANIAN COUNCILS, 2005-06**

	\$M
Surplus/(deficit) after capital amounts [as per AAS27]	25.909
<i>less</i>	
any gains from asset sales net of any losses	-0.670
<i>less</i>	
any gains from asset revaluations net of any losses	0.000
<i>less</i>	
the portion of annual capital grants from other governments intended to finance upgrading and expansion as opposed to asset renewal and annual maintenance expenses	35.028
<i>less</i>	
the portion of 'contributions' intended for capital purposes	2.102
<i>less</i>	
any other capital receipts	0.000
<i>equals</i>	
Operating surplus/(deficit)	-10.551

Chart 1-7 compares the time series for Tasmanian Councils for these two surplus/(deficit) concepts, including projections on a 'no policy change' basis.

**CHART 1-7: SURPLUS/(DEFICIT) ALTERNATIVES, \$ MILLIONS
TASMANIAN COUNCILS, 2000-01 TO 2009-10**

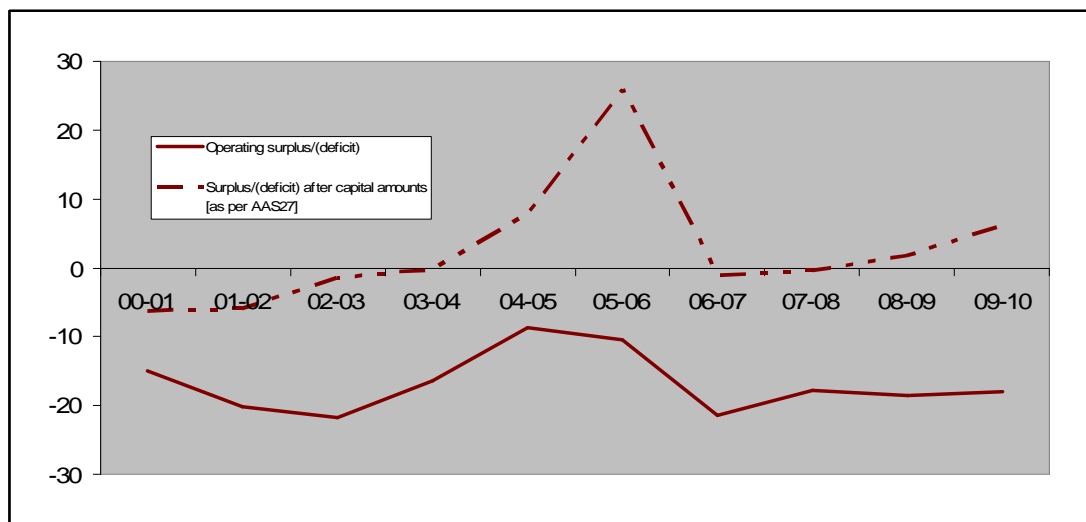


Table 1-11 shows our calculation of the operating surplus/(deficit) Tasmanian Councils, and the associated operating surplus ratio, for 2005-06 from the relevant financial aggregates.

**TABLE 1-11: OPERATING SURPLUS RATIO
TASMANIAN COUNCILS, 2005-06**

Operating revenue (\$M)	593.154
<i>less</i>	
Operating expenses (\$M)	459.267
<i>less</i>	
Net interest expense (\$M)	-6.871
<i>less</i>	
Depreciation expense (\$M)	151.309
<i>equals</i>	
Operating surplus/(deficit) (\$M)	-10.551
<i>divided by</i>	
Own-source operating revenue (\$M)	513.029
<i>equals</i>	
Operating surplus/(deficit) ratio (%)	-2.1%

It is apparent that Tasmanian Councils ran a small operating deficit in 2005-06.

It is notable that, if Tasmanian Councils did not have any infrastructure backlog, their maintenance spending would only be \$0.5 million lower thereby reducing the operating deficit.

**TABLE 1-12: OPERATING DEFICIT AND MAINTENANCE EXPENSE
TASMANIAN COUNCILS, 2005-06**

Actual operating surplus/(deficit) (\$M)	-10.551
<i>plus</i>	
Maintenance deficiency/(surplus) (\$M)	0.518
<i>equals</i>	
Potential operating surplus/(deficit) (\$M)	-10.033

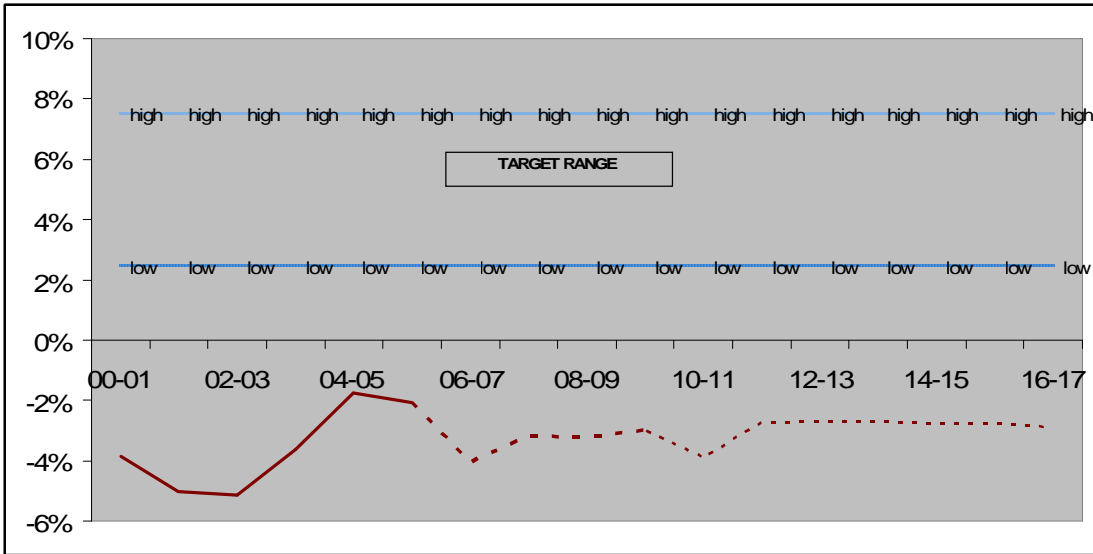
Of more significance is the extent to which the cash flow retained from the full funding of depreciation exceeds the desired renewals capex by more than the amount of the operating deficit.

**TABLE 1-13: OPERATING DEFICIT AND MAINTENANCE EXPENSE
TASMANIAN COUNCILS, 2005-06**

Annual depreciation expense (\$M)	151.309
<i>less</i>	
Desired renewals capex (\$M)	102.640
<i>equals</i>	
Depreciation funding surplus/(deficit) (\$m)	48.669

Chart 1-8 shows the time series of the average operating surplus ratio of Tasmanian Councils.

**CHART 1-8: OPERATING SURPLUS RATIO
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



Tasmanian Councils have been consistently running operating deficits, and a slight improving trend has been apparent in recent years. Table 1-14 shows that this marginal improvement has been due mainly to operating revenues growing slightly faster than expenses. In contrast with significant increases in Tasmanian Councils' non-rate own-source income, rates revenue has grown less than expenses. Operating grants from other governments have in fact been declining in real per-property terms.

**TABLE 1-14:
AVERAGE ANNUAL REAL-TERMS PER-ASSESSMENT PERCENTAGE INCREASES
TASMANIAN COUNCILS, 2000-01 TO 2005-06**

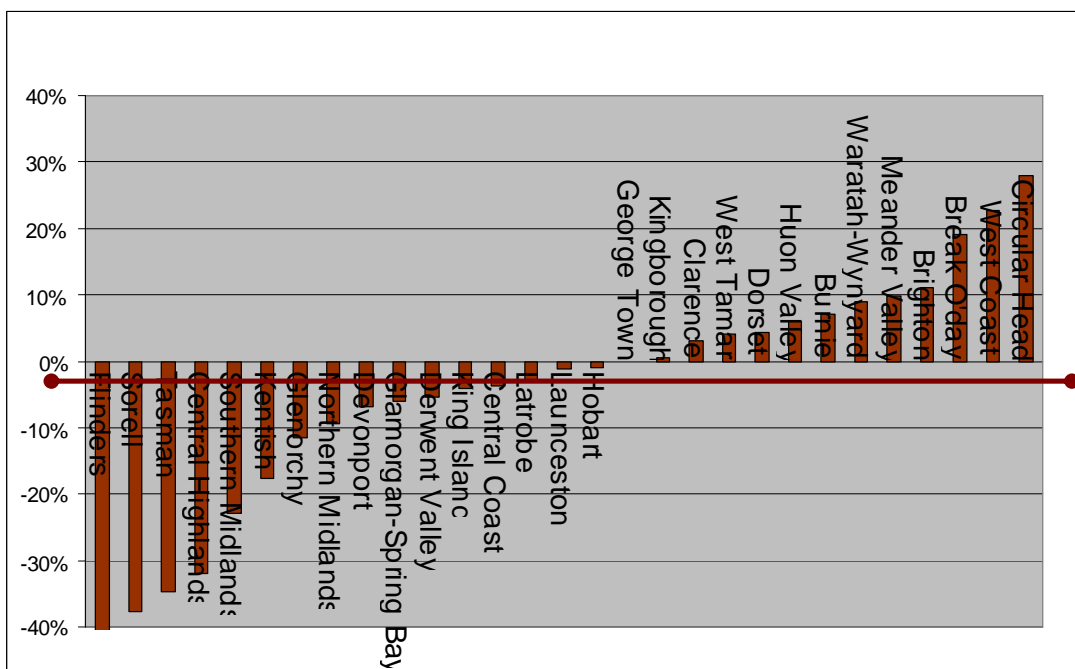
	2000-01 to 2005-06
Operating expenses	1.2%
Operating revenue	1.5%
Own-source revenue	1.9%
Rates revenue	1.0%
Non-rates own-source revenues	4.7%
Operating grants from other governments	-0.8%

Also notable about Chart 1-8 is that the smaller deficit evident in 2005-06 seems to be short-lived. Under no-policy-change conditions, the average operating deficit of Tasmanian Councils looks set to settle in the 3% to 4% range in future years.

DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their operating surplus ratios for 2005-06 are shown in Chart 1-9.

**CHART 1-9: OPERATING SURPLUS RATIO
TASMANIAN COUNCILS, 2005-06**



Significant differences are evident in the operating surplus ratios of Councils, with the small average operating deficit in 2005-06 obscuring much larger deficits and surpluses recorded by individual Councils.

Table 1-15 compares the average operating surplus ratios of Councils across council groupings.

**TABLE 1-15: OPERATING SURPLUS RATIO, BY TYPE OF COUNCIL
TASMANIAN COUNCILS, 2005-06**

	%	no of Councils
Cities	-2.3%	4
Rural – medium	-2.9%	12
Rural – small	0.9%	13
All Tasmanian Councils	-2.1%	29
<i>of which:</i>		
Above-average growth	-2.8%	12
Declining population	4.3%	9

1.3.2 NET BORROWING RATIO

THE OVERALL PICTURE

Net borrowing/(lending) is the key analytical balance in relation to a Council’s overall annual financial performance, encapsulating annual ‘capital’ as well as ‘operating’ financial performance.

Under our measure of net borrowing (which accords with ABS as well as international (IMF) government finance statistics standards), positive net borrowing can occur even if a Council does not increase its interest-bearing liabilities (or debt). Instead, any financing transaction that increases a Council's net financial liabilities is classified as 'net borrowing'. This can be a draw-down of financial assets as much as a run-up of debt or other liabilities.

Table 1-16 shows our calculation of the net borrowing ratio of Tasmanian Councils for 2005-06.

**TABLE 1-16: NET BORROWING RATIO
TASMANIAN COUNCILS, 2005-06**

Net acquisition of new and upgraded assets ^(a) (\$M)	-2.611
<i>less</i>	
Annual renewals deficiency/(surplus) (\$M)	29.163
<i>equals</i>	
Capital deficit/(surplus) (\$M)	-31.773
<i>less</i>	
Operating surplus/(deficit) (\$M)	-10.551
<i>equals</i>	
Net borrowing/(lending) (\$M)	-21.222
<i>divided by</i>	
Enhancement capex (\$M)	105.546
<i>equals</i>	
Net borrowing ratio (%)^(b)	0.0%

^(a) Enhancement capex plus the acquisition of additional financial assets less capital transfers, where capital transfers equals proceeds from the disposal of non-financial assets plus capital grants from other governments plus capital contributions plus other capital receipts (net)

^(b) Constrained to 0% for years where there is negative net borrowing

Alternatively, as Table 1-17 shows, a Council's net borrowing/(lending) can be calculated by subtracting the net increase in ratepayer equity in a particular year from the net increase in total capital employed in that year.

**TABLE 1-17: NET BORROWING RATIO
TASMANIAN COUNCILS, 2005-06**

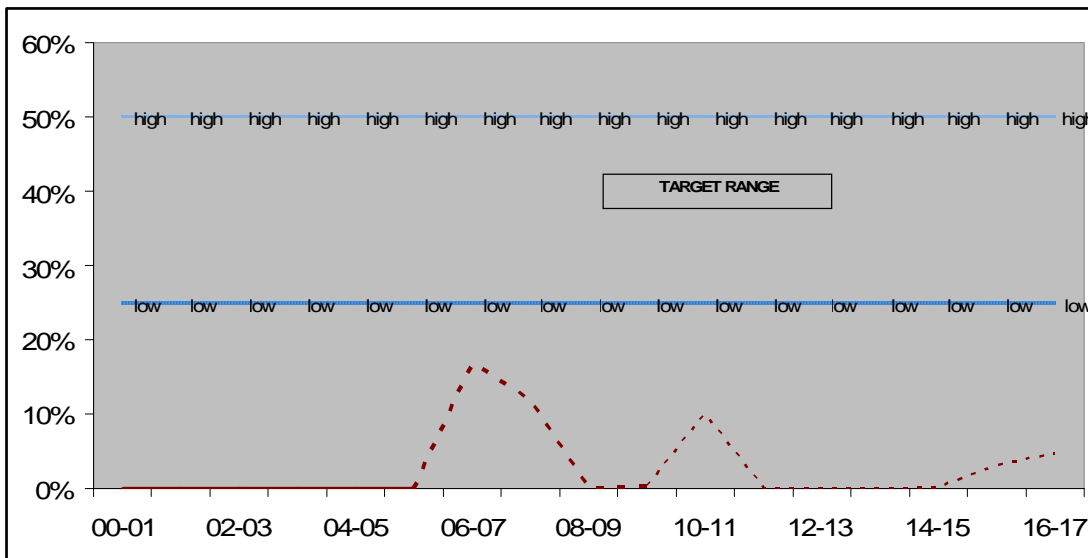
Net increase in capital employed ^(a) (\$M)	422.693
<i>less</i>	
Net increase in ratepayer equity ^(b) (net worth) (\$M)	443.916
<i>equals</i>	
Net borrowing/(lending) (\$M)	-21.222

^(a) Capital expenditure plus other additions to capital employed (includes increased holdings of financial assets in the form of restricted cash and securities) plus assets donated less depreciation expense less disposals of non-financial assets (book value)

^(b) Operating surplus/(deficit) plus capital transfer sources of increases in net worth. capital transfer sources of increases in net worth comprises capital grants from other governments plus capital contributions plus assets donated plus net gain on disposal of non-financial assets plus other capital receipts

Chart 1-10 shows the time series of the average net borrowing ratio of Tasmanian Councils, including projections on a 'no policy change' basis.

**CHART 1-10: NET BORROWING RATIO^(a)
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



^(a) Constrained to 0% for years where there is negative net borrowing

The net borrowing ratio can be quite volatile, due to the volatility of the denominator used (enhancement capex). On average over the period shown in Chart 1-10, net borrowing is well below the low end of the target range.⁹

DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their net borrowing ratios for 2005-06 are shown in Chart 1-11.

Only ten Councils were net borrowers in 2005-06. Of these Councils, only three were within the target net borrowing range. Because of the volatility of net borrowing noted earlier, it is not unusual – or exceptional – to see a Council’s ratio in any particular year exceeding the high end of the target range. Such an occurrence over a number of consecutive years would be the only source of concern.

⁹ The average target net borrowing ratio for Tasmanian Councils is aligned with the targeted 10% net financial liabilities ratio, on the basis of a normalised enhancement capex-to-additions to capital employed ratio of about 30%.

**CHART 1-11: NET BORROWING RATIO
TASMANIAN COUNCILS, 2005-06**

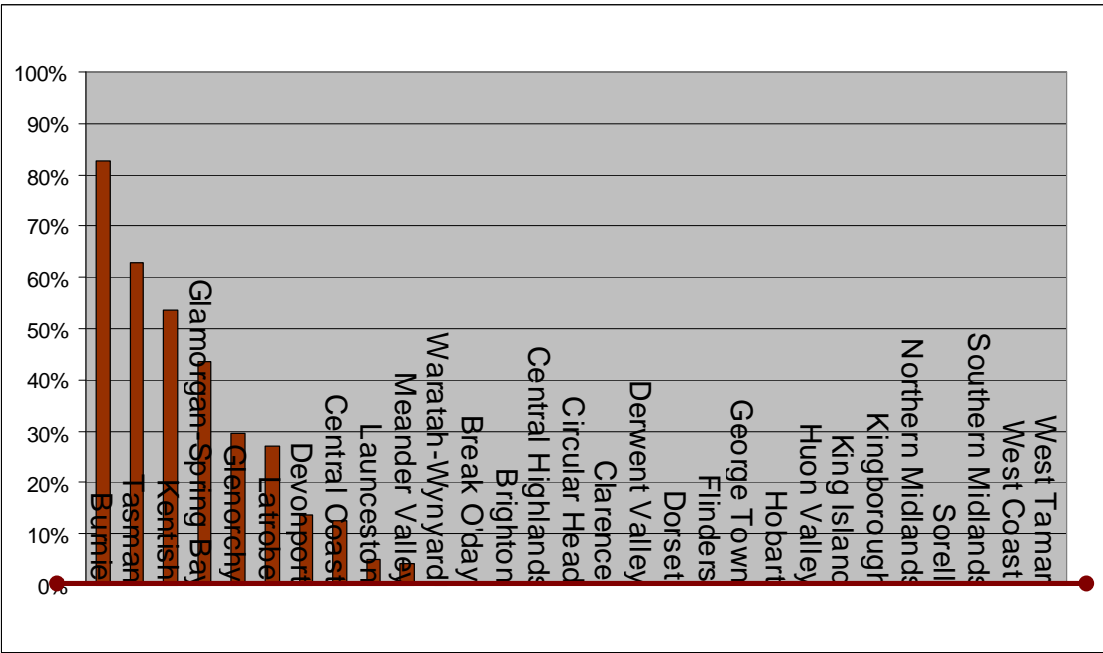


Table 1-18 compares the average net borrowing ratios of Councils across council groupings.

**TABLE 1-18: NET BORROWING RATIO, BY TYPE OF COUNCIL
TASMANIAN COUNCILS, 2005-06**

	%	no of Councils
Cities	0.0%	4
Rural – medium	0.0%	12
Rural – small	0.0%	13
All Tasmanian Councils	0.0%	29
<i>of which:</i>		
Above-average growth	0.0%	12
Declining population	0.0%	9

1.3.3 ANNUAL RENEWALS GAP RATIO

THE OVERALL PICTURE

The *annual renewals gap* is defined as the difference between:

- ❑ the amount of capital expenditure that would have kept the service capacity of a Council’s non-financial assets at a required standard (“*desired renewals capex*”); and
- ❑ the renewals capex actually undertaken – or proposed to be undertaken – in a particular year (“*actual renewals capex*”).

Financial Sustainability Review

The recent asset gap analysis undertaken across the sector also compiled preliminary estimates of Tasmanian Councils' annual renewals gap.¹⁰ As with the infrastructure backlog estimates, we use the estimates of each Council's annual renewals gaps cautiously, as for many Councils they do not appear to have been vetted across the entire organisation. Nevertheless, the information contained in these preliminary estimates is too important to ignore. As discussed in chapter 6, refining these estimates must be a priority for all Councils in Tasmania going forward.

Table 1-19 shows our calculation of the annual renewals gap for Tasmanian Councils for 2005-06 based using the preliminary data estimated by the recent asset gap analysis undertaken by Councils.

**TABLE 1-19: ANNUAL RENEWALS GAP RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 2005-06**

Desired renewals capex (\$M)	102.640
<i>less</i>	
Actual renewals capex (\$M)	73.477
<i>equals</i>	
Annual renewals gap (\$M)	29.163
<i>divided by</i>	
Desired renewals capex (\$M)	102.640
<i>equals</i>	
Annual renewals gap ratio (%)	28.4%

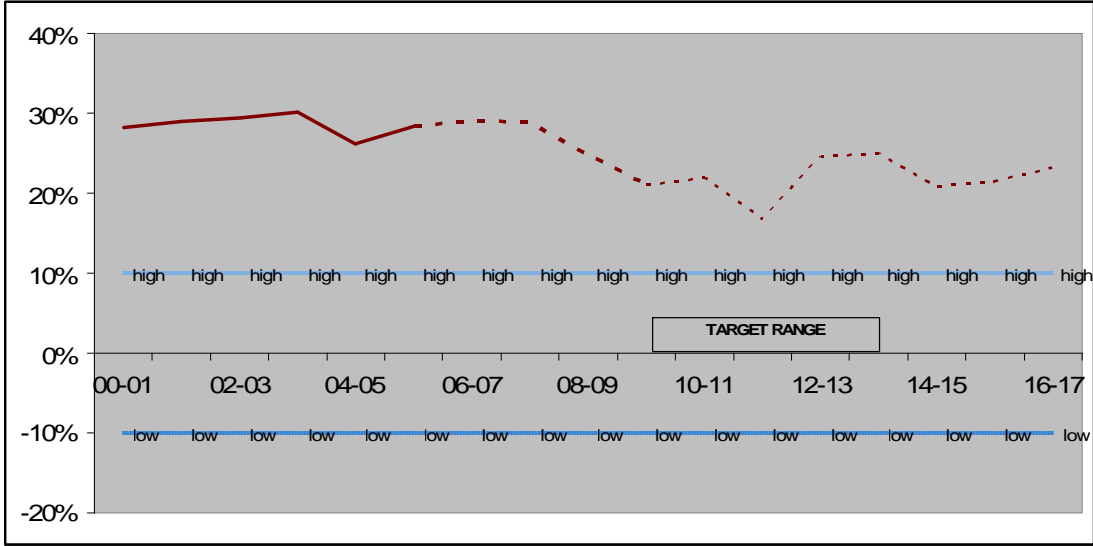
Chart 1-12 shows the times series for Tasmanian Councils' annual renewals gap ratio, including projections on a 'no policy change' basis.

The preliminary estimates of Tasmanian Councils' annual renewals gap ratio are on average well in excess of the targeted range. Under no-policy-change conditions, this ratio is projected to decline only very slowly over time. If these preliminary estimates are confirmed, no policy change is clearly unsustainable.

¹⁰ The figures we use for actual renewals capex are described as the "Proposed Renewal Expenditure \$" in output from the Moloney model used by the asset gap analysis for Tasmanian Councils. This figure is shown in row no. 762 of the "All Assets by Asset Group" sheet of the Moloney model output.

The figures we use for desired renewals capex are described as the "Predicted Renewal Expenditure Requirement" in output from the Moloney model used by the asset gap analysis for Tasmanian Councils. This figure is shown in row no. 605 of the "All Assets by Asset Group" sheet of the Moloney model output.

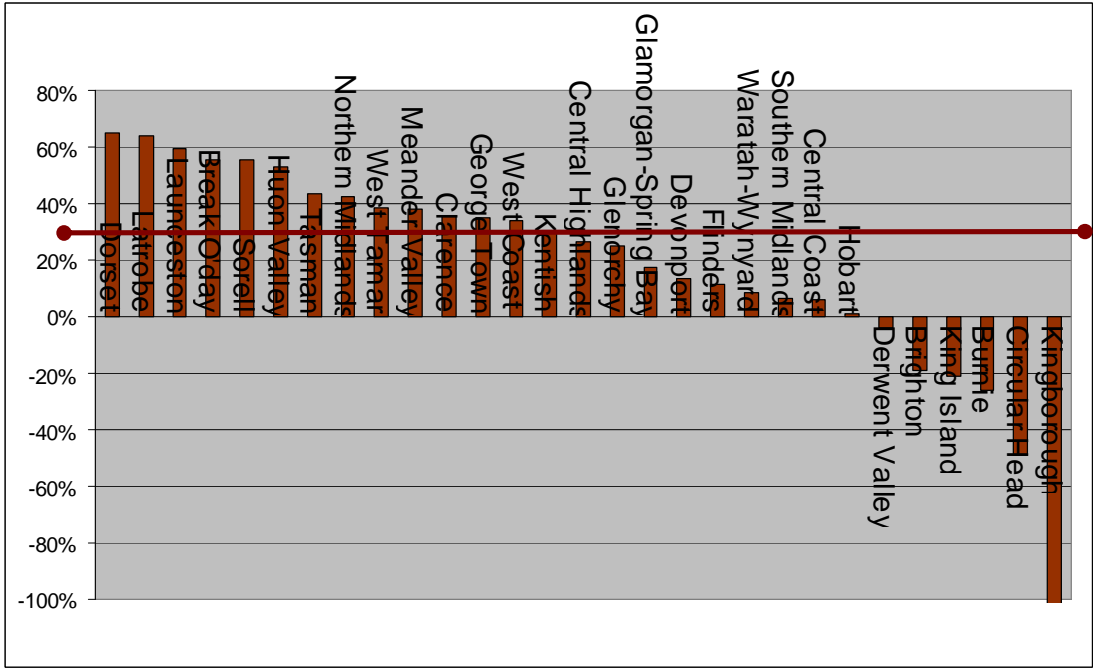
**CHART 1-12: ANNUAL RENEWALS GAP RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



DIFFERENCES WITHIN THE SECTOR

Differences evident among Tasmanian Councils in their preliminary annual renewals gap ratios for 2005-06 are shown in Chart 1-13.

**CHART 1-13: ANNUAL RENEWALS GAP RATIO (PRELIMINARY)
TASMANIAN COUNCILS, 2005-06**



All but six Councils appear to have positive annual renewals gaps in 2005-06. Of these, all but four Councils had ratios above the 'high' end of the target range.

Table 1-20 compares the average (preliminary) annual renewals gap ratios of Councils across council groupings.

**TABLE 1-20: ANNUAL RENEWALS GAP RATIO, BY TYPE OF COUNCIL
TASMANIAN COUNCILS, 2005-06**

	%	no of Councils
Cities	40.3%	4
Rural – medium	5.7%	12
Rural – small	33.1%	13
All Tasmanian Councils	28.4%	29
of which:		
Above-average growth	35.2%	12
Declining population	30.0%	9

On the preliminary figures, high annual renewals gap ratios are just as evident among the largest Councils as they among the smallest.

1.4 KEY FINDINGS

Under existing policies, Tasmanian Councils generally exhibit:

- operating deficits; and
- on preliminary estimates, annual renewals gaps

that are well above the high end of the respective target ranges. This is evidence of significant under-performance against benchmarks.

While their infrastructure backlogs currently appear quite manageable, some Councils are running the risk that these backlogs will become significant (i.e., above the high end of the target range) as their sizeable annual renewals gaps accumulate over time.

Fortunately, Councils generally have very strong balance sheets – with minimal debt.

2. THE FINANCIAL SUSTAINABILITY OF INDIVIDUAL COUNCILS

This chapter provides our findings regarding the financial sustainability of individual Councils.

Chapter 1 provided a comparison of Council performance relative to benchmarks separately for a range of financial KPIs. This chapter pulls these together into a single assessment.

2.1 DEFINITION AND MEASUREMENT ISSUES

WHAT DOES FINANCIAL SUSTAINABILITY INVOLVE?

The Commonwealth Government defines fiscal sustainability (with ‘fiscal’ sustainability and ‘financial’ sustainability being inter-changeable in a public sector context) as:

“...a government’s ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.

...One of the key requirements for sustainable government financial arrangements is a balanced budget over the medium to long term, given a reasonable degree of stability in the overall tax burden.” (Commonwealth Government, Intergenerational Report, May 2002)

The NSW Government defines fiscal sustainability as follows:

“Fiscal sustainability requires that the Government be able to manage financial risks and financial shocks in future periods without having to introduce significant and economically or socially destabilising expenditure or revenue adjustments in those future periods. What is considered consistent with fiscal sustainability will vary depending on the strength and outlook for the economy, the structure of expenditure and revenue of the budget, the outlook for the State’s credit rating, demographic and social trends that will affect the budget, and the nature of financial risks faced by the Government at any given time.” (NSW Government, Fiscal Responsibility Act 2005, section 3(1))

Local Government and Planning Ministers’ Council (in its Advice to COAG on Local Government Financial Sustainability Frameworks) has more recently proposed that:

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

If a Council’s long-term finances are sustainable in this sense, then the rating burden is being shared fairly between current and future ratepayers and the stability or predictability of a Council’s rates is not at risk.

HOW DOES FINANCIAL ‘SUSTAINABILITY’ DIFFER FROM ‘VIABILITY’?

It is important to note that a Council being classified as financially ‘unsustainable’ does not imply the Council’s financial *viability* is necessarily in question.

As we use the term, ‘unsustainable’ finances in the long term refers only to the unsustainability of a Council’s current policies, both revenue-raising and spending. Council finances can

Financial Sustainability Review

almost always be corrected with substantial rating increases and/or expenditure cutbacks, albeit at a considerable cost to ratepayers and the community being served.

By contrast, the term 'financial viability' is used in the private sector in relation to whether an entity's financial performance and position does not jeopardise the interests of its creditors. In the local government context, this implies allowance can be made for whatever increases in tax effort may be necessary for a Council to stave off defaulting on its debt service obligations. As political sustainability may be reached beforehand, with tax increases jeopardising an elected Council's position, financial sustainability is a higher hurdle, focussing primarily on protecting the interests of a Council's ratepayers rather than only its creditors.

Besides, there can be no doubt that the local government sector is, and will always be, financially 'viable' in the sense that it will always be able ultimately to meet its debt service obligations. Ratepayers are bound to meet all outstanding obligations under the *Local Government Act*.

Hence, in contrast to the meaning given to 'financial viability' in a corporate context, financial sustainability in the sense that we – and governments generally – use the term focuses on the prevention of *tax 'shocks'*. A Council's finances can be judged to be sustainable in the long term only if they are strong enough – currently and in the foreseeable future given likely developments in the Council's revenue-raising capacity and in the demand for and costs of its services and infrastructure – to allow the Council to manage financial risks and financial shocks over the long-term financial planning period without having to introduce substantial or disruptive revenue (or expenditure) adjustments during that period.

FINANCIAL SUSTAINABILITY ASSESSMENT FRAMEWORK

Translating Council finances into an assessment of the sustainability of those finances requires assessments at the individual Council level.

For this purpose, we have opted to use the financial sustainability rankings generated by algorithms developed by a third-party company (FiscalStar).¹¹ The methodology involved is an extension and refinement of the approach used by Access Economics for the WA, NSW and SA inquiries.

In effect, the methodology:

- first, combines the outcomes from the key financial indicators surveyed in chapter 1 into an equivalent overall financial shortfall expressed as a percentage of a Council's annual revenue from rates and charges; and
- secondly, converts this overall financial shortfall ratio into an estimate of the average annual increase in the Council's per-property rates and charges relative to annual inflation that, in addition to no-policy-change increases, would be necessary to eliminate any overall financial shortfall over the next 10 years.

The 'overall financial shortfall' concept used for this purpose is the gap (if any) between a Council's desired (or equilibrium) revenue from rates and charges based upon the latest information and the Council's actual collections of such revenue. The larger this gap, the greater the required percentage increase in rates and charges in order to close the gap.

¹¹ FiscalStar Services Pty Ltd, *Ratings Assessment Methodology, version 2.3*, Technical Paper No 1, March 2007, pp.17-26. This paper can be downloaded from www.fiscalstar.com.au.

Persistent shortfalls are indicative of a Council's revenue-raising effort being too low. Likewise, sizeable surpluses can indicate that a Council's revenue-raising effort is too high. Overall financial shortfalls cannot persist over the long term, as they involve services consumed by current ratepayers being paid for by future ratepayers either by borrowing or by avoiding essential renewal of existing assets.

FiscalStar's algorithms in effect convert deficiencies against benchmarks for the most relevant financial KPIs surveyed in chapter 1. A greater overall financial shortfall results (other things being equal):

- ❑ the larger is a Council's operating deficit;
- ❑ the larger is the amount by which the Council's annual depreciation charge falls short of its required annual renewals capex;
- ❑ the larger is the Council's (current) infrastructure backlog, and the larger the amount by which its annual maintenance expense exceeds required maintenance expense were asset condition at appropriate levels;
- ❑ the higher is the Council's debt, the larger is the amount by which the Council's (current) debt exceeds a nominated debt ceiling, and the lower is the Council's debt ceiling;
- ❑ the larger is the Council's required enhancement capex ; and
- ❑ the larger is the proportion of the Council's non-financial assets that requires a commercial rate of return, and the larger any gap between target and actual rates of return on those assets.

Effectively, most emphasis is given to the operating deficits shown in Chart 1-9 and the infrastructure backlog amounts underlying Chart 1-6. In Tasmanian Council circumstances, other rankings play only a small role because:

- ❑ the indebtedness revealed in the net financial liabilities ratio chart (Chart 1-2) puts no upward pressure on rates & charges;
- ❑ the net interest ratio chart (Chart 1-4) effectively repeats Chart 1-2;
- ❑ the net borrowing ratio chart (Chart 1-11) also has little on-going implications because of low Council indebtedness; and
- ❑ the annual renewals gap ratio chart (Chart 1-12) has little effect except for those Councils where the funding provided by their annual depreciation charge is insufficient to fund their desired annual renewals capex – as any under-spending on renewals capex because of under-funding of depreciation is already effectively picked up in the Chart 1-9.

We have applied the output of this methodology using two key judgments:

- ❑ that the no-policy-change average annual increase in per-property rates and charges for Tasmanian Councils over the coming years involves increases that are around 140% of the State's annual CPI increase; and
- ❑ that a prospective annual increase in excess of 200% of (i.e., two times) the annual CPI increase implies a Council's long-term finances are 'unsustainable' and in excess of 175% (but less than 200%) the annual CPI increase implies a Council's long-term finances are 'vulnerable'.

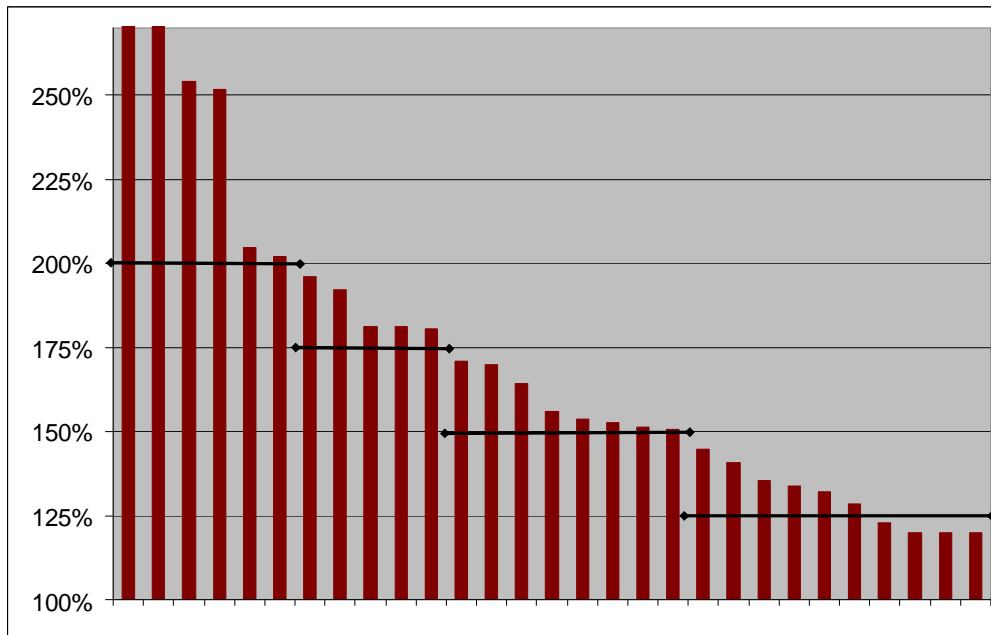
On this basis, with expected annual inflation in the order of 2½%, a financial imbalance of (in round terms) 1½% of annual rates and charges (= 60% of 2½%) can be eliminated over a 10 year period with annual increases in per-property rates and charges up to but not exceeding 200% of annual CPI increases. This translates into a current financial imbalance of around 15% of annual rates and charges (= 10 x 1½% p.a.) being capable of being eliminated over a 10 year period (if a Council so chooses) with annual increases in per-property rates and charges less than increases considered in the ‘substantial’ range (i.e., >200% of annual CPI increases).

Accordingly, we classify only those Councils with overall financial shortfalls in excess of 15% of their annual rates and charges revenue as being ‘financially unsustainable’ and in excess of around 10% of such revenues as being ‘vulnerable’.

2.2 INDIVIDUAL COUNCIL RESULTS

Chart 2-1 shows the resultant estimates of differences among Councils in the average annual increase in rates and charges to be expected (as a percentage of the annual inflation rate) were each Council to phase out its current overall financial shortfall completely over the next 10 years.

**CHART 2-1: LIKELY UPWARD PRESSURE ON RATES AND CHARGES^(a)
TASMANIAN COUNCILS, NEXT 10 YEARS**



^(a) As indicated by the estimated average annual percentage increase in per-property rates and charges (relative to annual CPI-based inflation) necessary if a Council's overall financial shortfall evident in 2005-06 and 2006-07 was to be eliminated (phased-out) over the next 10 years on top of expected no-policy-change increases

Consistent with our approach in other State reviews, we have chosen not to identify individual Councils and their financial sustainability status.

We acknowledge that the assessments inherent in Chart 2-1 rely importantly on the quality of the underlying data as well as the methodology used (and the judgments involved).

Indeed, some Councils may be incorrectly assigned substantial upward pressure on their rates and charges due to abnormal items in years under review (2005-06 and 2006-07) or reporting errors. However, these are likely to be offset by Councils that (unjustifiably) find themselves assigned with moderate pressures on their rates and charges including because of imbalances not yet in evidence.

However, it is our judgment that the methodology is appropriate to obtaining a *macro perspective* of the condition of local government finances as a whole.

Where appropriate, we have applied a conservative bias in the treatment of variables or where estimates are made. On balance, this is likely to result in an understatement rather than overstatement of the financial imbalances facing Tasmanian Councils.

Based on the results summarised in Chart 2-1, there are six Tasmanian Councils (or around 20%), which serve 8% of the State's population, facing the prospect of increases in per-property rates and charges over a prolonged period of more than double the annual inflation rate if their currently sizeable overall financial shortfalls are to be addressed. We categorise these Councils' current finances (and financial policies) as '**unsustainable**'.

That said, it is important to repeat that being classified as unsustainable does not mean a Council is in imminent danger of defaulting on its debt service obligations. That is, the Council's financial viability is not necessarily being called into question. Rather, what is being flagged is that substantial or disruptive revenue (or expenditure) adjustments appear inevitable if imbalances in the long-term finances of such a Council are to be corrected – either that, or for the smaller Councils involved, additional grant funding from other governments.

This compares with our earlier assessments for the WA, NSW and SA Inquiries where:

- in WA, just over 50% of that State's Councils were assessed as financially unsustainable, with such Councils serving 21% of the State's population;
- in NSW, 25% of that State's Councils were assessed as financially unsustainable, with such Councils serving 17% of the State's population; and
- in SA, 50% of that State's Councils were assessed as financially unsustainable, with such Councils serving 50% of the State's population.

Additionally, a further five Tasmanian Councils (17%) which serve another 14% of the State's population face the prospect of increases in per-property rates and charges between 175% and 200% of the annual inflation rate if their current financial imbalances are to be eliminated over time. We would categorise these Councils' current finances (and financial policies) as '**vulnerable**'.

Altogether, therefore, there are 11 Tasmanian Councils in the 'unsustainable' and 'vulnerable' categories.

There are eight Tasmanian Councils (28%) facing the prospect of increases in per-property rates and charges between 150% and 175% of the annual inflation rate if their current financial imbalances are to be eliminated over time. We consider these Councils' current finances (and financial policies) to be '**financially sustainable with a minimum margin of comfort**'.

There are six Tasmanian Councils (21%) facing the prospect of increases in per-property rates and charges between 150% and 125% of the annual inflation rate in view of their modest current financial imbalances. We consider these Councils' current finances (and financial policies) to be '**financially sustainable with a moderate margin of comfort**'.

Financial Sustainability Review

Finally, there are four Tasmanian Councils (14%) facing the prospect of increases in per-property rates and charges less than 125% of the annual inflation rate because of their current financial surpluses. We consider these Councils' current finances (and financial policies) to be **'financially sustainable with a significant margin of comfort'**.

It should be noted that being classified as financially sustainable in some cases appears to reflect good luck as much as good management. Those Councils whose finances reflect fortuitous circumstances are advised not to rest on their laurels because, more likely than not, these circumstances will only be transitory.

2.3 DIFFERENCES AMONG COUNCIL TYPES

The Tasmanian Councils which we assess to be either financially unsustainable or vulnerable have a range of structural characteristics.

Small sized and declining population Councils are disproportionately represented among the unsustainable or vulnerable Councils. Larger Councils and/or above-average growth Councils are under-represented in this group of Councils.

As in the WA inquiry, but in contrast to SA and NSW inquiries, our finding is that structural factors are at work in explaining the sustainability of a Council's long-term finances in Tasmania as well as financial governance and policy deficiencies.

2.4 KEY FINDINGS

Based upon the best information we can muster at this stage, we categorise the current finances (and financial policies) of six Tasmanian Councils (21%), which serve 8% of the State's population, as 'unsustainable'. This does not mean these Councils are in imminent danger of defaulting on their debt service obligations or that their financial viability is being called into question. Rather, what is being flagged is that substantial or disruptive revenue (or expenditure) adjustments appear inevitable if the long-term finances of such Councils are to be corrected.

Improvements in the quality of the underlying data may result in better assessments for some Councils. Just as likely, some of the financial imbalances facing Tasmanian Councils today may well be larger and more challenging than we have described in chapter 1 (and so in the assessments summarised in Chart 2-1).

Rather than single out the particular Councils categorised as financially unsustainable, to our mind of more importance is the macro perspective regarding the condition of local government as a whole provided by our assessments.

In this regard, the proportion of the State's population being served by Councils which we categorise as unsustainable (8%) is less than evident for the other State inquiries (SA, NSW and WA).

Councils "feeling the pinch" are most likely to be those, as characterised by PricewaterhouseCoopers in its recent National Financial Sustainability Study of local government for ALGA, that exhibit:

- minimal (or negative) revenue growth;

- ❑ for a small proportion of Councils, limited access to rate revenue due to relatively small populations reducing the size of the rates income stream coupled with constraints on the size of annual rates increases;
- ❑ limited access to the strong financial and asset management skills which are critical to identifying sustainability problems, optimising renewals expenditure and improving revenue streams;
- ❑ expanding service provision due to rising community demands, coupled with a related tendency by some Councils to step in to provide a non-traditional service; and
- ❑ a tendency to run operating deficits creating a need to defer or underspend on renewal of infrastructure, particularly community infrastructure.

3. THE IMPACT OF ALTERNATIVE SERVICE AND INFRASTRUCTURE DELIVERY OPTIONS

Other tiers of government could give serious consideration to injecting extra funding into Tasmanian local government. But until there is a change of heart at State and the Commonwealth levels, Councils have no choice but to solve their own problems.

This chapter provides our assessment of the impact of possible expenditure policy changes going forward aimed at improving the sustainability of a Council's long-term finances. This contrasts with the no-(expenditure) policy-change assumptions underlying the analyses in chapters 1 and 2.

In doing so, aside from additional borrowings, we leave all other aspects of a Council's revenue-raising effort unchanged on the no-policy-change conditions. Revenue policy changes are the focus on chapter 4.

3.1 COMPONENTS OF SPENDING

SPENDING ON SERVICES

The components of our focus on expenses incurred in providing a Council's services are set out in Table 3-1 as they relate to 2005-06.

**TABLE 3-1: TOTAL EXPENSES
TASMANIAN COUNCILS, 2005-06**

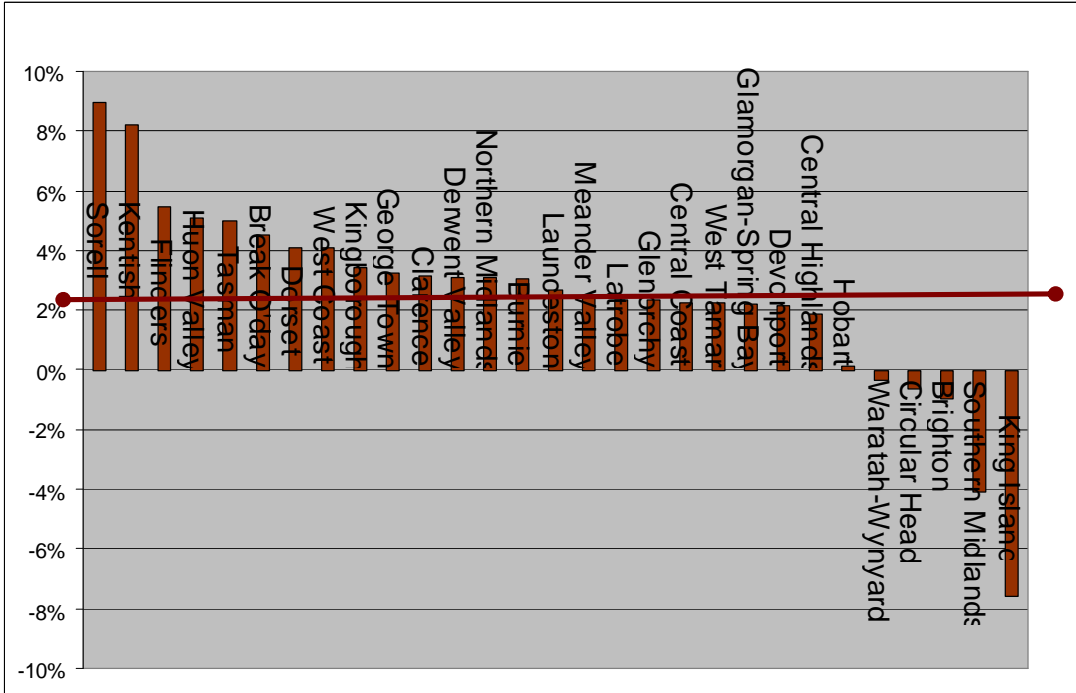
	2005-06 (\$M)	2005-06 (%)	Avg real-terms per-property % increase over previous 5 years
Maintenance expense	45.213	7.3%	2.6%
<i>plus</i>			
Other operating expenses	414.054	66.9%	2.7%
<i>plus</i>			
Depreciation expense	151.309	24.5%	2.6%
<i>plus</i>			
Interest expense	8.234	1.3%	-8.3%
<i>equals</i>			
Total expense	618.810	100.0%	2.3%

One-quarter of such expenses in 2005-06 were in the form of the annual depreciation charge, which represents the assets consumed in providing services during the year. Maintenance and interest expenses together account for another 10% or so of total expenses. Two-thirds of total expenses are in the form of employee costs and materials and contracting expenses.

Financial Sustainability Review

Differences evident among Tasmanian Councils in their average real-terms per-property percentage increases in total expenses over the five years to 2005-06 are shown in Chart 3-1.

**CHART 3-1: ANNUAL REAL-TERMS PER-PROPERTY GROWTH IN TOTAL EXPENSES
TASMANIAN COUNCILS, 2005-06**



Significant differences among Councils in the average real-terms per-property percentage increases in total expenses are evident. Some of this, especially for the smaller Councils with the more extreme annual increases and decreases, is likely to be due to abnormal or once-off transactions either in 2005-06 or in the base years.

CAPITAL EXPENDITURE

The components of our focus on a Council’s capital expenditure (capex) are set out in Table 3-2 as they relate to 2005-06.

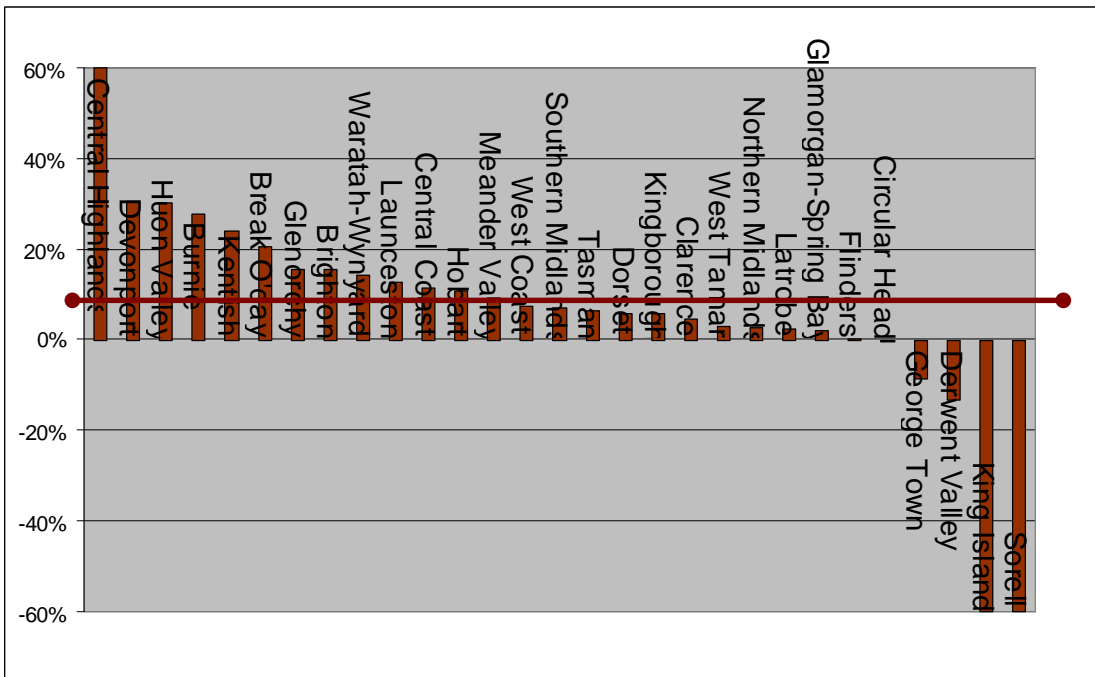
In 2005-06 at least, it is evident that – on the preliminary data available at this time – the enhancement component of capex exceed the renewals component.

**TABLE 3-2: CAPITAL EXPENDITURES
TASMANIAN COUNCILS, 2005-06**

	2005-06 (\$M)	2005-06 (%)	Avg real-terms per-property % increase over previous 5 years
Enhancement capex	105.546	63.3%	9.2%
<i>plus</i> Renewals capex	73.477	44.1%	2.6%
<i>equals</i> Total capex	179.023	100.0%	7.9%

Differences evident among Tasmanian Councils in their average real-terms per-property percentage increases in total capex over the five years to 2005-06 are shown in Chart 3-2.

**CHART 3-2: ANNUAL REAL-TERMS PER-PROPERTY GROWTH IN TOTAL CAPEX
TASMANIAN COUNCILS, 2005-06**



As for total expenses, significant differences among Councils in the average real-terms per-property percentage increases in total capex are evident. The more extreme annual increases and decreases are likely to be due to the lumpy nature of capital expenditure.

3.2 EXPENDITURE POLICY CHANGE SCENARIOS

In order to identify the possible impact of expenditure policy adjustments open to Councils, we have chosen to focus on two illustrative expenditure policy change scenarios for a Council, namely:

A 'responsive' scenario: Any infrastructure backlog is eliminated within five years and future renewals and maintenance are undertaken when they fall due. Real spending on services continues to increase in line with current policy. Enhancement capex is such that the non-financial asset base increases in line with current policy or population growth, whichever is the greater.

A 'cutback' scenario: Any infrastructure backlog is eliminated within five years and future renewals and maintenance are undertaken when they fall due. There are no increases in the non-financial asset base (i.e., enhancement capex is zero). Real spending on services is reduced sufficiently to achieve the low end of the Council's operating surplus target range within five years, with such spending increasing thereafter in line with expected population growth.

We compare the financial outcomes under these expenditure policy change scenarios with those under the no-policy-change scenario at the basis of the analysis in chapter 1.

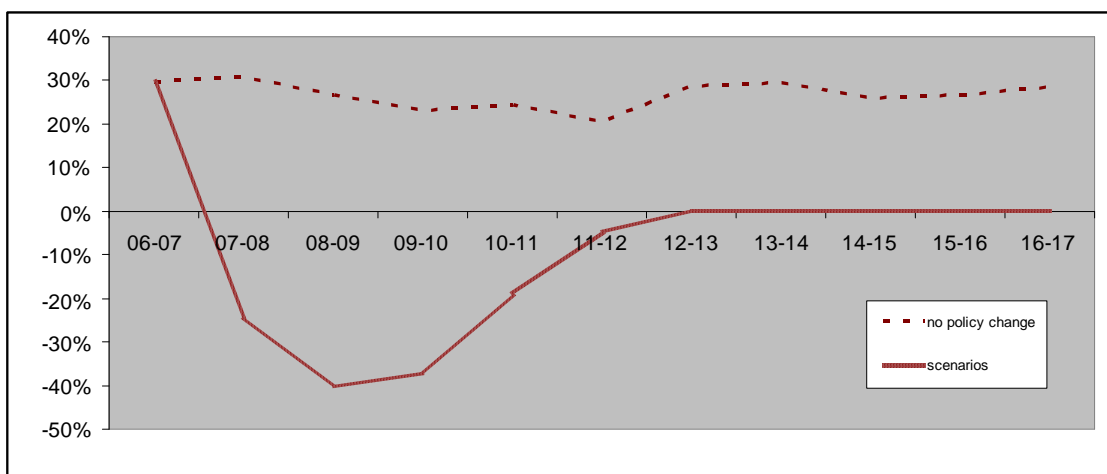
At issue is whether – under no-policy-change *revenue* conditions – this plausible range of infrastructure and service policy options available to Tasmanian Councils gives rise to financial outcomes that fit within the target ranges for each of the key financial indicators. The purpose is to provide a platform upon which Tasmanian Councils can make choices for their own long-term planning purposes. Provided these scenarios generally result in financial outcomes that lie within benchmark ranges, this analysis indicates the expenditure policy 'degrees of freedom' that a Council might have in the absence of any revenue-raising policy changes.

3.2.1 EXPENDITURE POLICY CHANGES

Central (and common) to both expenditure scenarios is the unwinding of the infrastructure backlog and the closing of the annual renewals deficiencies. We consider both these policy changes to be desirable and inevitable.

Chart 3-3 shows the common assumptions about Tasmanian Councils' annual renewals gap ratio under the two alternative expenditure policy scenarios compared with the preliminary no-policy-change projections discussed in chapter 1.

**CHART 3-3: ANNUAL RENEWALS GAP RATIO
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



The surplus of actual over desired renewal capex until 2011-12 reflects the extra renewals capex necessary to eliminate Councils’ infrastructure backlogs as well as to meet all future renewals commitments.

Chart 3-4 shows the common assumptions about Tasmanian Councils’ infrastructure backlog ratio under the two alternative expenditure policy scenarios compared with the preliminary no-policy-change projections discussed in chapter 1.

**CHART 3-4: INFRASTRUCTURE BACKLOG RATIO
TASMANIAN COUNCILS, 30 JUNE 2007 TO 30 JUNE 2017**

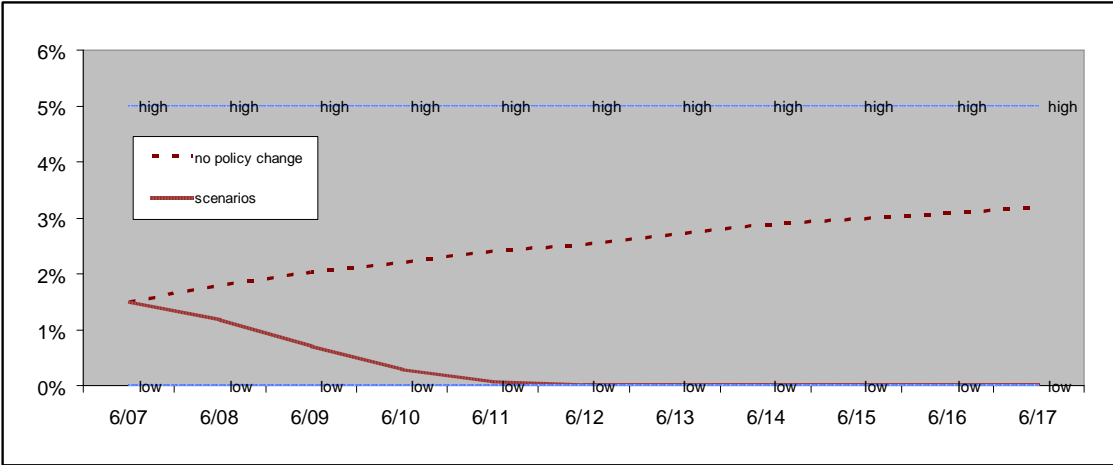


Chart 3-5 shows the *contrasting* assumptions regarding Tasmanian Councils’ annual real-terms rate of growth in spending on services under the two alternative expenditure policy scenarios compared with the no-policy-change projections discussed in chapter 1.

**CHART 3-5: ANNUAL REAL-TERMS PER-PROPERTY GROWTH IN SPENDING ON SERVICES (%)
TASMANIAN COUNCILS, 2006-07 TO 2016-17**

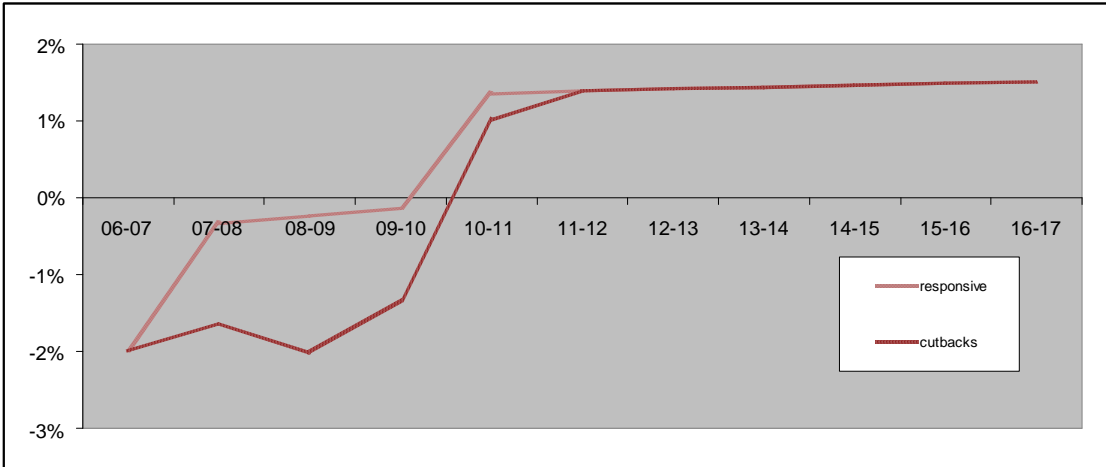
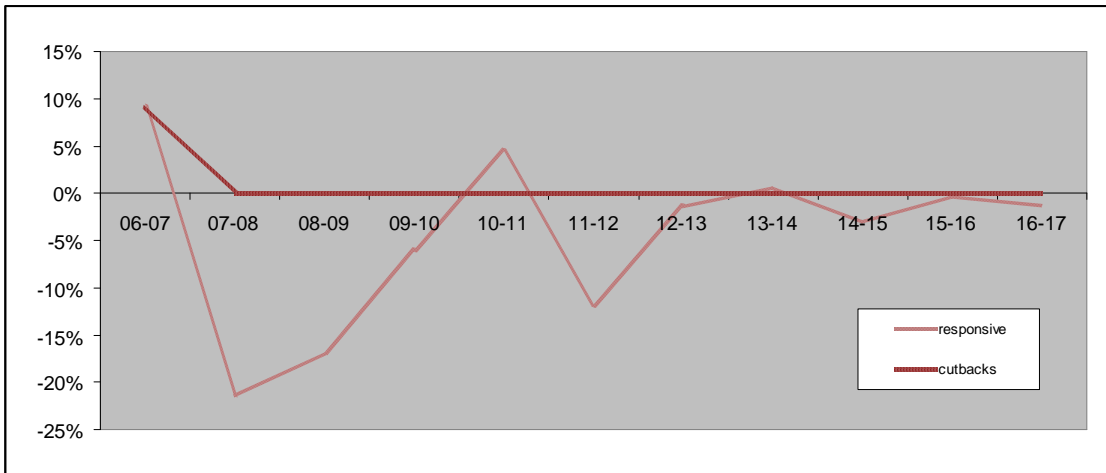


Chart 3-6 shows the contrasting assumptions about Tasmanian Councils’ annual enhancement capex program under the two alternative expenditure policy scenarios compared with the no-policy-change projections discussed in chapter 1.

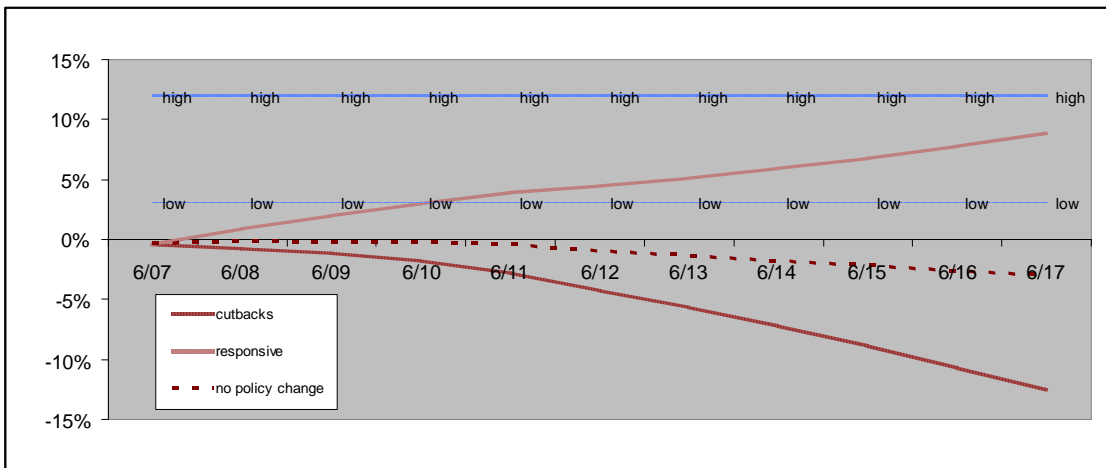
**CHART 3-6: ANNUAL REAL-TERMS PER-PROPERTY GROWTH IN ENHANCEMENT CAPEX (%)
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



3.2.2 IMPACT UPON KEY FINANCIAL INDICATORS

Chart 3-7 shows our projections of the average net financial liabilities ratio for Tasmanian Councils under both of the alternative expenditure policy scenarios as well as under the no-policy-change scenario.

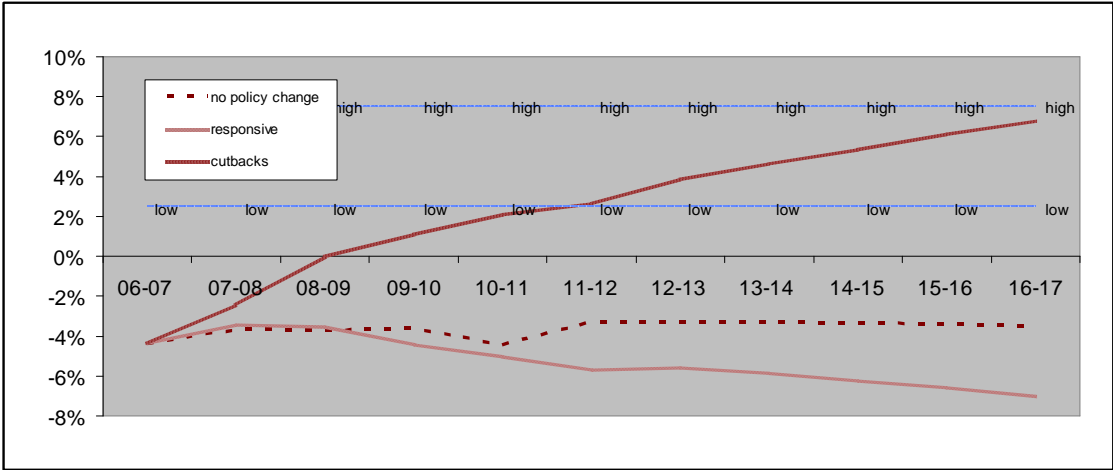
**CHART 3-7: NET FINANCIAL LIABILITIES RATIO
UNDER ALTERNATIVE EXPENDITURE POLICY SCENARIOS
TASMANIAN COUNCILS, 30 JUNE 2007 TO 30 JUNE 2017**



In the absence of any revenue-raising policy change (or in any reduction in spending on services to accommodate increases in capex spending), it is evident that – on average – Council net borrowings would rise significantly under the responsive scenario although not to the extent that net financial liabilities would exceed the high end of the target range.

Chart 3-8 shows our projections of average operating surplus ratio for Tasmanian Councils under both of the alternative expenditure policy scenarios as well as under the no-policy-change 'baseline' scenario.

**CHART 3-8: OPERATING SURPLUS RATIO
UNDER ALTERNATIVE EXPENDITURE POLICY SCENARIOS
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



In the absence of any revenue-raising policy change, it is evident that Tasmanian Councils’ operating deficits would deteriorate under a responsive expenditure scenario. Only cutbacks in services (and enhancement capex) would put the sector’s operating surplus ratio into the target range.

3.3 KEY FINDINGS

As addressing the operating deficit and renewals gap problems are more pressing than the problem associated with Councils’ under-reliance on debt, expenditure cutbacks may have a role to play.

It is apparent that halting future infrastructure expansion for the next decade alone would put Councils’ operating surpluses on average into the target operating surplus range. However, this may come at the cost of greater pressures on infrastructure in future.

Tasmanian Councils could improve the sustainability of their long-term finances by pursuing short- to medium-term savings through further operational efficiencies and the reordering of service priorities.

If reliance was placed entirely on cutting back spending on services, we estimate that one percentage point or so would need to be knocked off the annual growth rate in operating expenses (other than depreciation, interest and maintenance) each year over the next 10 years – implying an (ongoing) annual savings of around \$4 million – to put Councils on average into the minimal desired operating surplus and renewals gaps positions. Anything less than this would imply a role for revenue increases.

It may be that a combination of more modest and targeted infrastructure expansion over the next decade and a program of operational efficiencies and the reordering of service priorities can make significant inroads into the operating deficit and renewals gaps problems currently evident in Tasmanian local government. Whether this is the approach taken depends upon a political comparison of the alternative – increasing Councils’ own-source revenue effort.

4. THE IMPACT OF INCREASES IN OWN-SOURCE REVENUE EFFORT

This chapter provides our assessment of the impact of possible revenue policy changes going forward aimed at improving the sustainability of a Council's long-term finances. In particular, the focus is on the scope for an increase in Councils' own-source revenue effort (rates, fees and charges, and own-source capital transfers).

4.1 COMPOSITION OF REVENUE

4.1.1 OPERATING REVENUE

Table 4-1 summarises the sources of operating revenue available to Tasmanian Councils in 2005-06.

**TABLE 4-1: COMPONENTS OF OPERATING REVENUE
TASMANIAN COUNCILS, 2005-06**

	\$M	%	%
Rates revenue ^(a)	383.446	74.7%	
<i>plus</i>			
Fees and charges	105.397	20.5%	
<i>plus</i>			
Other own-source operating revenue ^(b)	24.186	4.7%	
<i>equals</i>			
Own-source operating revenue	513.029	100.0%	86.5%
<i>plus</i>			
Operating grants from other governments	80.125		13.5%
<i>equals</i>			
Total operating revenue	593.154		100.0%

^(a) Includes annual water and sewerage charges

^(b) Includes any operating contributions and all investment income

Own-source operating revenue is much more important to Tasmanian Councils than operating grants from other governments.¹²

4.1.2 RATING EFFORT

In 2005-06, Tasmanian Councils' ratepayers each paid an average \$1,527 in rates (including annual water and sewerage charges).

¹² In part, this highlights the small contribution that other tiers of Government are making to Tasmanian Councils' financing task. Tasmanian Councils believe that unfunded cost shifting by other tiers of Government is an important factor contributing to the difficulties they may be experiencing currently in fully funding infrastructure-related expenditure.

Financial Sustainability Review

Differences evident among Tasmanian Councils in their average per-property rates revenue in 2005-06 are shown in Chart 4-1.

**CHART 4-1: AVERAGE RATES REVENUE, \$ PER PROPERTY, ALL RATEPAYERS
TASMANIAN COUNCILS, 2005-06**

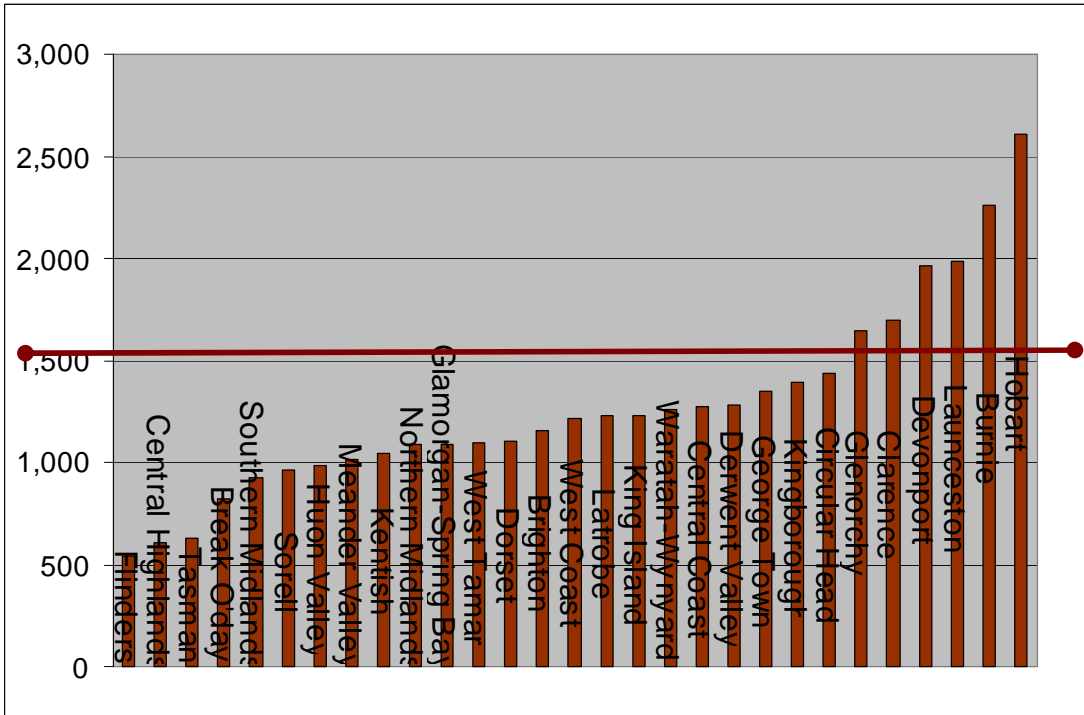
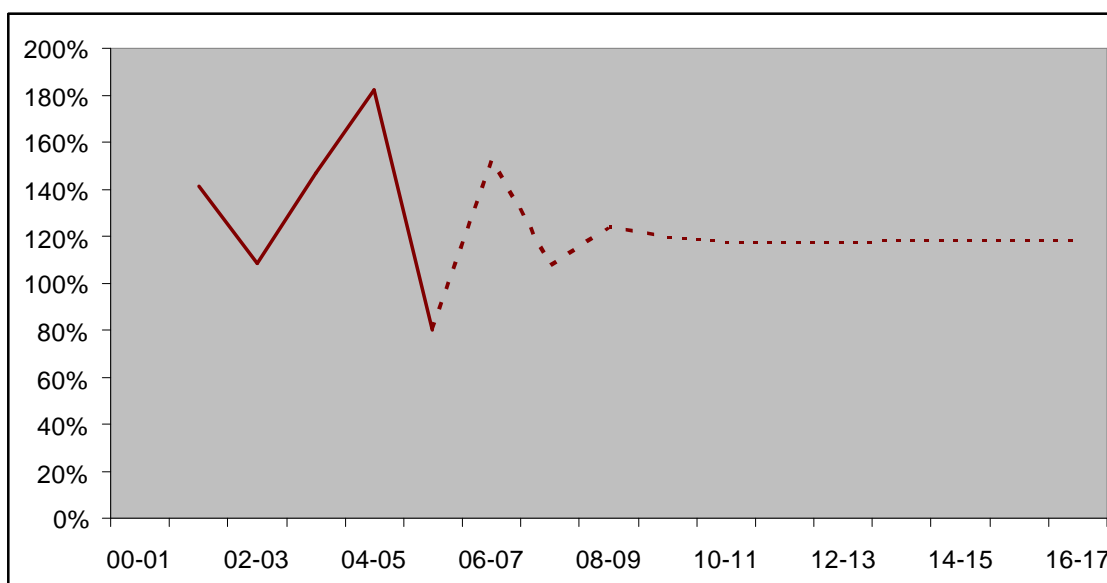


Chart 4-2 shows the trend in the real-terms rating effort of Tasmanian Councils on a no-policy-change basis.

In particular, this chart shows the percentage increase in each year's average per-property revenues from rates expressed as a percentage of that year's percentage increase in the State's consumer price index (CPI). A value greater than 100% indicates that rates (expressed in \$-per-property terms) are increasing faster than the CPI.

**CHART 4-2: ANNUAL REAL-TERMS RATING EFFORT (NO-POLICY-CHANGE PROJECTION)
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



The spike evident in 2004-05 resulted from the reform of State and local government financial relations in that year which saw the State government pay general rates and Councils pay land and payroll tax in particular. That impact aside, recent years have seen per-property rates increase on average at around the 140% mark, although going forward on a no-policy-change basis these rates increases looks set to settle at around the 120% mark.

4.1.3 COST-RECOVERY EFFORT

Table 4-2 shows our calculation of the extent to which Tasmanian Councils’ revenue from fees and charges recovers their own-purpose operating (and depreciation) expenses, with ‘own-purpose’ expenses defined as total expenses net of the portion of expenses funded by operating grants from other governments.

**TABLE 4-2: COST RECOVERY RATIO
TASMANIAN COUNCILS, 2005-06**

Fees, fines and user charges (\$M)	105.397	82.3%
<i>plus</i>		
Other income (not including investment income) (\$M)	22.708	17.7%
<i>equals</i>		
Fees and charges (\$M)	128.105	100.0%
<i>divided by</i>		
Own-purpose expenses ^(a) (\$M)	530.105	
<i>equals</i>		
Cost recovery ratio (%)	24.2%	

^(a) Total expenses net of those expenses funded by operating grants from other governments

Financial Sustainability Review

In 2005-06, Tasmanian Councils was recovering around 24% of their own-purpose expenses through just their fees and charges (as opposed to rates).

Differences evident among Tasmanian Councils in their cost recovery ratios in 2005-06 are shown in Chart 4-3.

**CHART 4-3: COST RECOVERY RATIO
TASMANIAN COUNCILS, 2005-06**

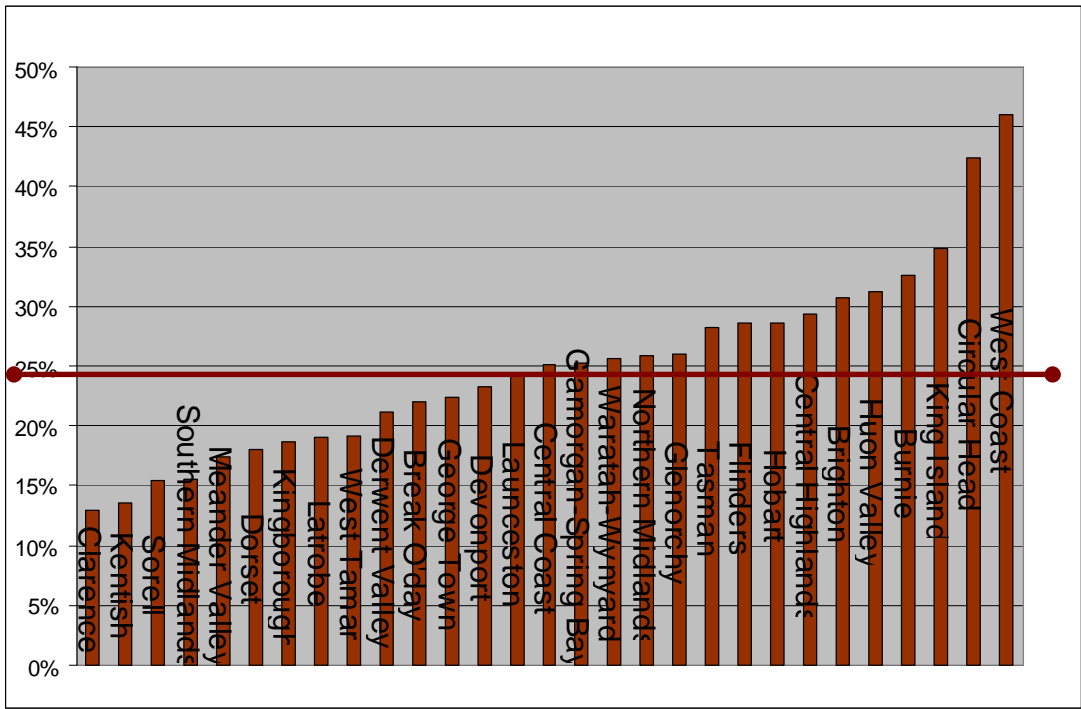
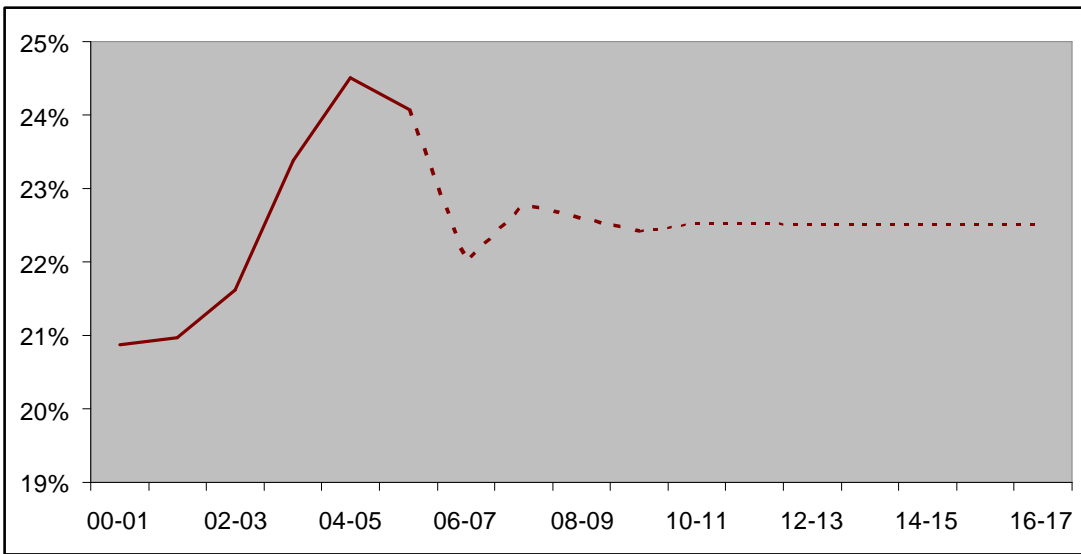


Chart 4-4 shows the time series for Tasmanian Councils' cost recovery ratio.

**CHART 4-4: COST RECOVERY RATIO (NO-POLICY-CHANGE PROJECTION)
TASMANIAN COUNCILS, 2000-01 TO 2016-17**



It is evident that Tasmanian Councils have been increasing their cost recovery effort steadily over recent years. However, after peaking at around 25% in 2004-05, this effort is projected to fall back somewhat in the next year or two before stabilising just below 23%.

4.1.4 CAPITAL TRANSFERS

Table 4-3 summarises the sources of capital transfers available to Tasmanian Councils in 2005-06.

**TABLE 4-3: COMPONENTS OF CAPITAL TRANSFERS
TASMANIAN COUNCILS, 2005-06**

	\$M	%	%
Developer charges ^(a)	36.238	43.0%	
<i>plus</i>			
Net gain on disposal of non-financial assets	-0.670	-0.8%	
<i>plus</i>			
Other capital receipts ^(b)	48.669	57.8%	
<i>equals</i>			
Own-source capital transfers	84.237	100.0%	70.6%
<i>plus</i>			
Capital grants from other governments	35.028		29.4%
<i>equals</i>			
Total capital transfers	119.265		100.0%

^(a) Comprises both any (cash) capital contributions and (non-cash) asset donations

^(b) Includes the surplus/(deficit) of cash inflow from the funding of depreciation over cash outflow from the required spending on renewals capital expenditure

We proxy the level of developer charges effort by expressing revenue from both any (cash) capital contributions and (non-cash) asset donations as a percentage of total additions to non-financial assets (both assets acquired (capital expenditure) and assets donated).

Table 4-4 shows our calculation of Tasmanian Councils' developer charges effort ratio in 2005-06.

**TABLE 4-4: DEVELOPER CHARGES EFFORT RATIO
TASMANIAN COUNCILS, 2005-06**

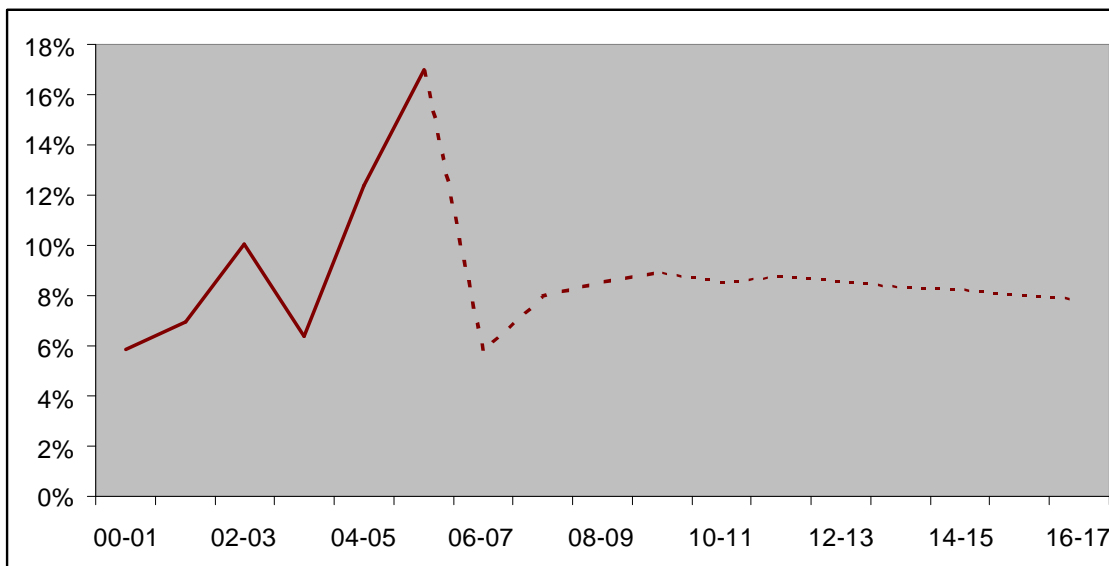
	\$M	%
Capital contributions (i.e., cash)	2.102	5.8%
<i>plus</i>		
Assets donated (i.e., non-cash)	34.136	94.2%
<i>equals</i>		
Developer charges	36.238	100.0%
<i>divided by</i>		
Total additions to non-financial assets ^(a)	213.160	
<i>equals</i>		
Developer charges effort ratio	17.0%	

^(a) Total capital expenditure plus assets donated

In 2005-06, on average, around 17% of total annual additions to non-financial assets in that year were financed by developer charges.

Chart 4-5 shows the time series of Tasmanian Councils' developer charges effort ratio, with projections based upon no-policy-change assumptions.

**CHART 4-5: DEVELOPER CHARGES EFFORT RATIO
TASMANIAN COUNCILS, 2000-01 TO 2009-10**



The developer charges effort ratio looks to have peaked in 2005-06. This ratio is projected to fall to the 6% to 8% range in coming years on a no-policy-change basis.

4.2 OUTCOMES UNDER AN AMBITIOUS REVENUE OPTION

This section provides our assessment of the possible impact of own-source revenue policy adjustments open to Councils.

We have chosen to focus on a single illustrative revenue policy option for Councils, which effectively offers an upper bound, namely:

Ambitious Option: Any below-par cost recovery effort and developer charges effort are eliminated within five years. Rates effort is increased to achieve the low end of the Council's operating surplus target range within five years, thereafter with per-property rates revenues growing in line with inflation.

We compare the financial outcomes associated with the alternative expenditure policy scenarios explored in chapter 3 under this alternative revenue policy option.

Under this option, a different level of additional borrowings can also occur compared with that under no-policy-change conditions.

At issue is whether the range of revenue-raising effort options available to Tasmanian Councils (from 'no-policy-change' to 'ambitious') gives rise – under the various expenditure scenarios explored in chapters 1 and 3 – to financial outcomes that fit within the target ranges

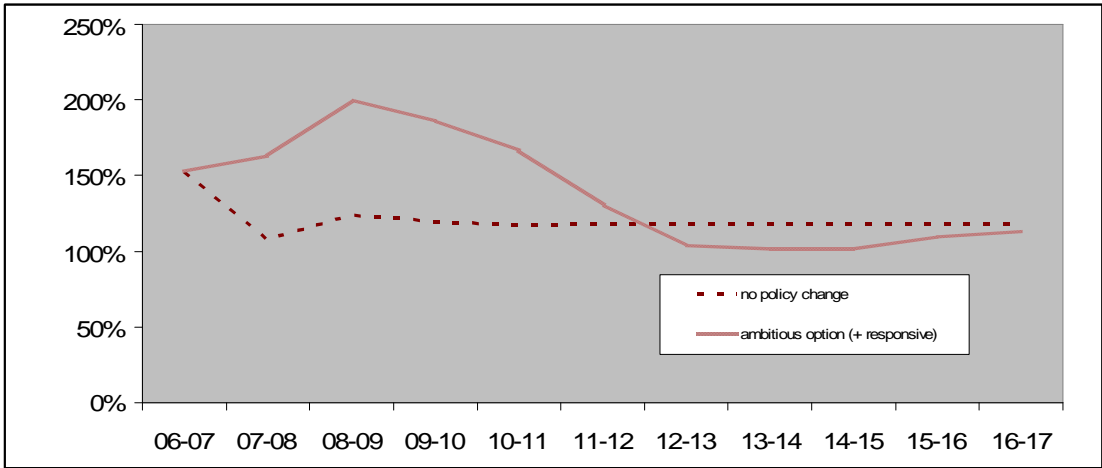
for each of the key financial indicators. Once again, the purpose is to provide a platform upon which Tasmanian Councils can make choices for their own long-term planning purposes. Provided this option generally results in financial outcomes that lie within target ranges, this analysis indicates the revenue policy ‘degrees of freedom’ that Councils might generally have in the absence of any spending policy changes.

4.2.1 REVENUE EFFORT POLICY CHANGES

Under the ‘ambitious’ revenue policy option, the rating effort of Tasmanian Councils would be increased sufficiently to achieve the low end of the operating surplus target range within five years and thereafter rates revenues would keep pace with growth in both assessable properties and inflation.

Chart 4-6 shows our assumptions about Tasmanian Councils’ annual real-terms rating effort under the ambitious revenue policy option compared with no-(revenue) policy-change conditions.

**CHART 4-6: REAL-TERMS RATING EFFORT
UNDER THE ‘AMBITIOUS’ AND ‘NO-POLICY-CHANGE’ REVENUE POLICY OPTIONS
TASMANIAN COUNCILS, 2006-07 TO 2016-17**

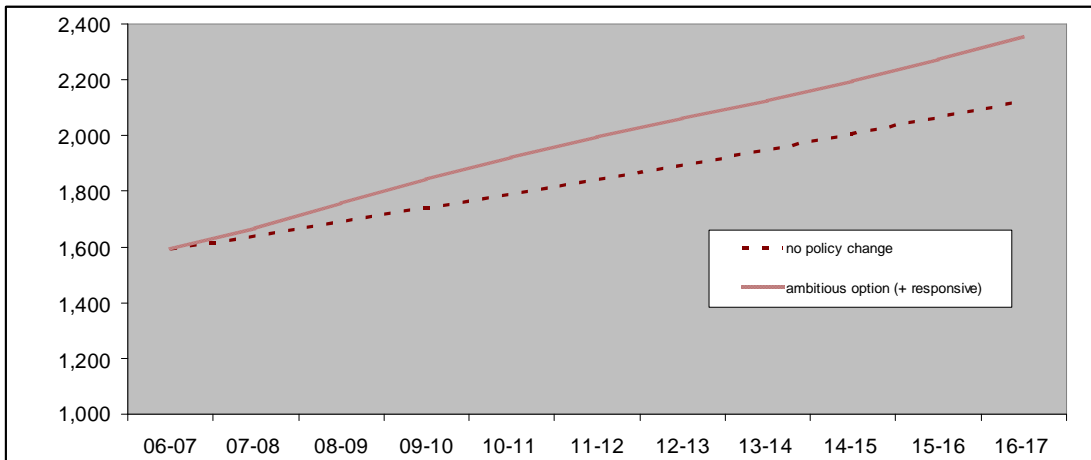


The actual (per-property) rating effort under the ambitious option depends upon the assumed expenditure conditions, with the latter changing the operating surplus targets.

On average, the annual percentage increase in per-property rates collections by Tasmanian Councils would be rise strongly over the first five years, including a couple of years in excess of twice the annual increase in the CPI.

Put another way, under the ambitious revenue policy option, per-property rates collections are assumed to increase under the responsive expenditure scenario at an annualised *real-terms* rate of 1.1% over the next 10 years. This compares with the projected real-terms increase of 0.5% per annum under no-policy-change conditions.

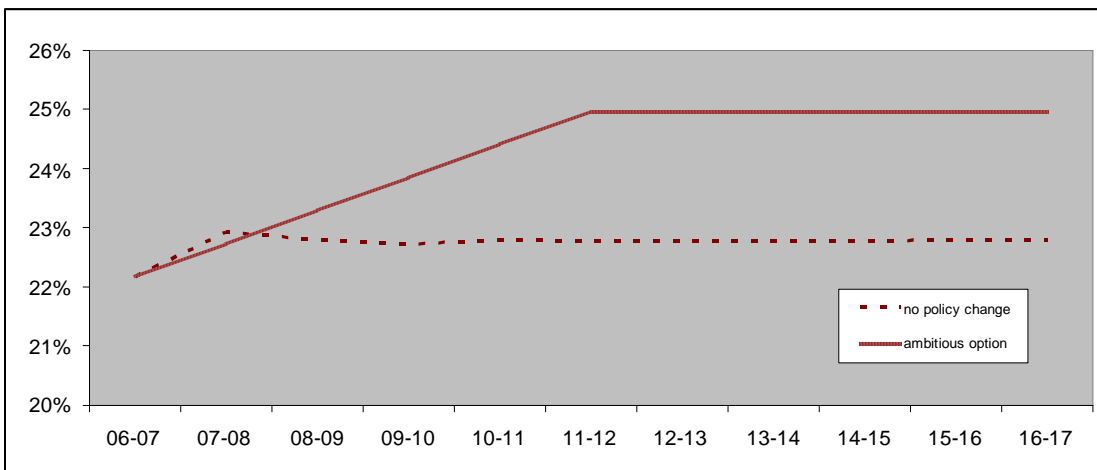
**CHART 4-7: AVERAGE RATES, \$ PER PROPERTY
UNDER THE 'AMBITIOUS' AND 'NO-POLICY-CHANGE' REVENUE POLICY OPTIONS
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



Under these ambitious revenue policy option conditions, rates per assessment could rise in 10 years' time to the equivalent of \$2,247 per assessment (compared with the current average of \$1,527 per assessment). In real-terms, this increase is the equivalent of an increase of about \$1 per rateable property each and every month over a 10 year period.

Chart 4-8 shows the assumptions about Tasmanian Councils' cost recovery ratio under the ambitious revenue policy option compared with no-(revenue) policy-change conditions.

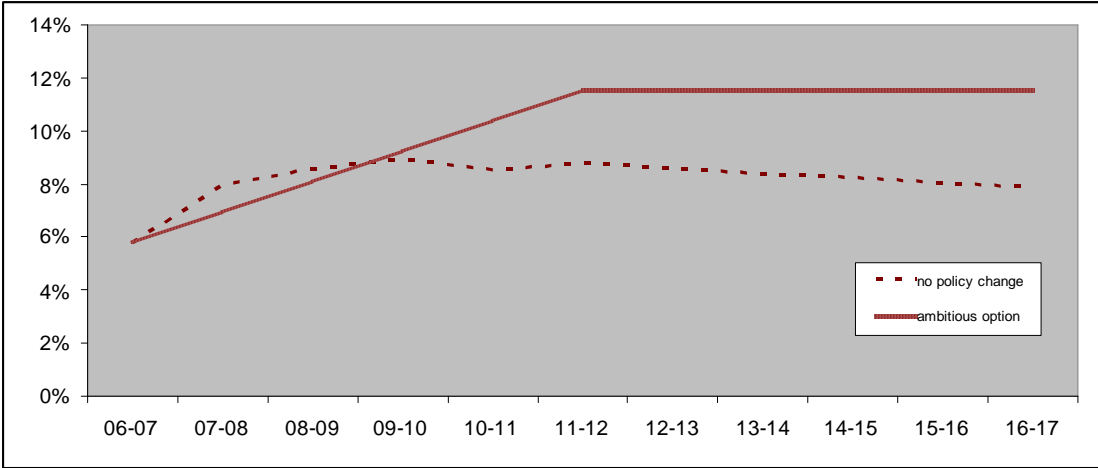
**CHART 4-8: COST RECOVERY RATIO
UNDER THE 'AMBITIOUS' AND 'NO-POLICY-CHANGE' REVENUE POLICY OPTIONS
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



Under the ambitious revenue policy option, revenue from fees and charges is assumed to increase at an annualised real-terms rate of 1.7% over the next 10 years. This compares with an annualised rate of 0.9% projected under no-policy-change conditions over the next 10 years.

Chart 4-9 shows the assumptions about Tasmanian Councils’ developer charges effort ratio under the ambitious revenue policy option compared with no-(revenue) policy-change conditions.

**CHART 4-9: DEVELOPER CHARGES RATIO
UNDER THE ‘AMBITIOUS’ AND ‘NO-POLICY-CHANGE’ REVENUE POLICY OPTIONS
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



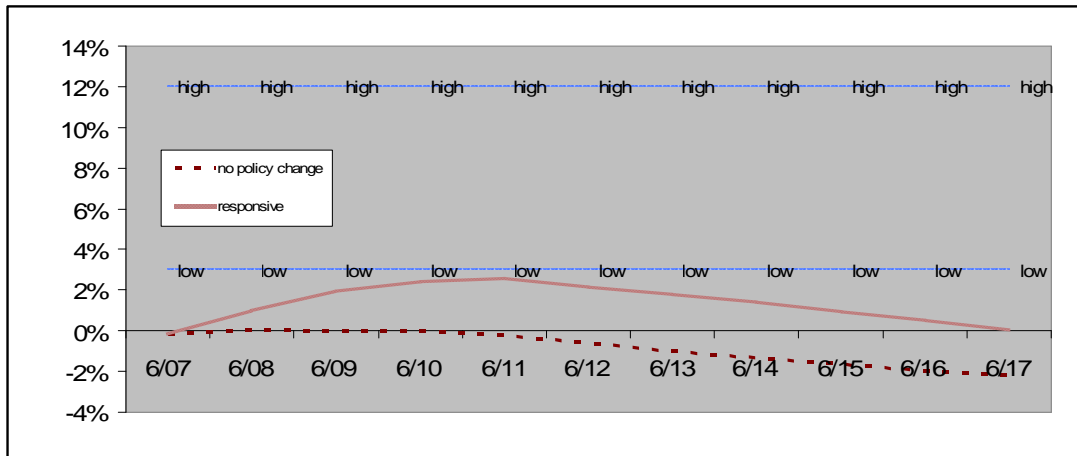
Under the ambitious revenue policy option, revenue from develop charges is assumed to increase at an annualised real-terms rate of 6.2% over the next 10 years. This compares with an annualised rate decline of 0.6% projected under no-policy-change conditions.

4.2.2 IMPACT ON KEY FINANCIAL INDICATORS

Chart 4-10 shows our projections of the net financial liabilities ratio of Tasmanian Councils under the ambitious revenue policy option for both the ‘no-policy-change’ and ‘responsive’ expenditure scenarios.¹³

¹³ This analysis does not include the ‘savings’ expenditure scenario as, like the ambitious revenue option, it is defined to achieve operating surplus targets, so the ambitious scenarios/options are alternatives not complements

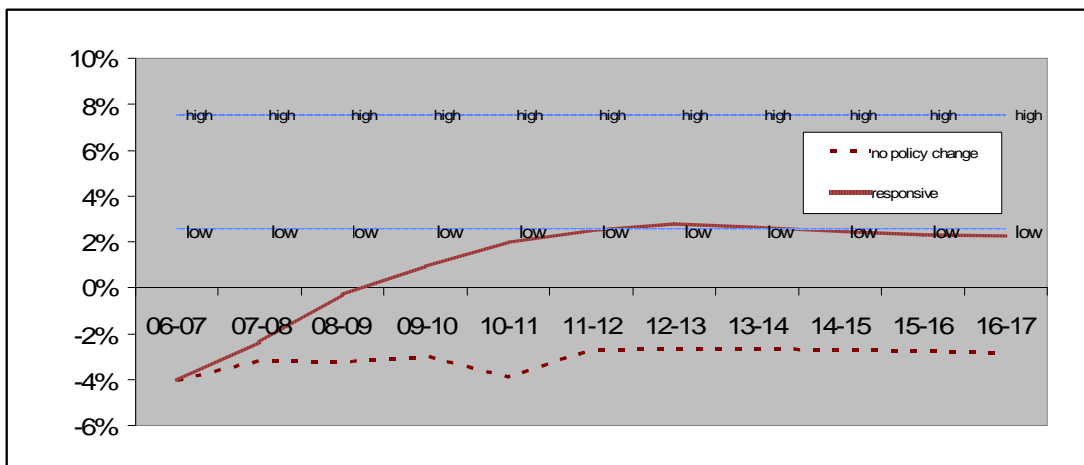
**CHART 4-10: NET FINANCIAL LIABILITIES RATIO
UNDER THE 'AMBITIOUS' REVENUE POLICY OPTION
TASMANIAN COUNCILS, 30 JUNE 2007 TO 30 JUNE 2017**



The additional borrowings necessary to finance the increased renewals capex expenditure under the responsive scenario would not be sufficient to raise the net financial liabilities ratio up to the low end of the target range.

Chart 4-11 shows our projections of the operating surplus ratio of Tasmanian Councils under the ambitious revenue policy option for both the 'no-policy-change' and 'responsive' expenditure scenarios.

**CHART 4-11: OPERATING SURPLUS RATIO
UNDER THE 'AMBITIOUS' REVENUE POLICY OPTION
TASMANIAN COUNCILS, 2006-07 TO 2016-17**



In line with the assumptions made under the ambitious revenue policy option, Tasmanian Councils would experience operating surpluses around the 'low' end of the target range under the responsive expenditure scenario in five years' time. Thereafter, as (higher) per-property rates revenues keep pace with inflation, the operating surplus would be maintained just within the target range.

4.3 KEY FINDINGS

Unless the Commonwealth or State governments were to increase their grants to local government dramatically, the revenue effort required by Tasmanian Councils to eliminate their operating deficits and annual renewals gaps – without any spending cutbacks – lies somewhere between the existing revenue policy and the ambitious revenue option.

If the extra resources needed were to be tapped only from Council's own-source revenues, the *average annual rates of growth* in the main revenue items on a *real-terms per-property basis* would need to be as follows each year for the next 10 years:

- ❑ rates (including annual water and sewerage charges): to grow at 1.1% per annum, up from 0.5% per annum under existing revenue policy ;
- ❑ fees and user charges: to grow at 1.7% per annum, up from 0.9% per annum under existing revenue policy; and
- ❑ developer charges: to grow at 6.2% per annum, up from a decline of 0.6% per annum expected under existing revenue policy .

These indicative annual increases are only ballpark numbers since the precise funding package necessary for achieving sustainability requires further modelling work once Tasmanian Councils have resolved what mix of revenue raising and expenditure savings options they are prepared to consider.

To the extent that Councils find extra money through new revenue opportunities (e.g., leases) or pruning existing costs (e.g., efficiency savings), any increases in rates and charges could be less than those shown above.

In addition to a mix of revenue raising and expenditure savings necessary to tackle the operating deficit and renewals gaps problems, increased borrowings will have a role to play in overcoming the infrastructure backlog and renew assets that are coming to the end of their useful life. Such funding would:

- ❑ better share infrastructure costs between existing and future ratepayers;
- ❑ reduce upfront debt servicing costs and thereby allow Councils to be more ambitious in tackling their infrastructure problems; and
- ❑ enable Councils to better match their liabilities to its long-life infrastructure assets

5. CURRENT FINANCIAL GOVERNANCE ARRANGEMENTS

This chapter provides our findings regarding the present standard of Council financial governance policies and processes relative to good practice.

Whether it is appropriate for Tasmanian Councils to undertake the higher revenue-raising effort and/or the additional borrowings identified in the previous chapters depends importantly upon the robustness of its financial governance policies and processes. Inadequacies in financial governance increase the likelihood that any additional resources may be squandered, leaving future ratepayers to pick up the tab.

5.1 METHODOLOGY AND DATA

Financial governance comprises the policies and processes by which councillors meet their accountability obligations to ratepayers and the community for their Council's financial (and so policy) sustainability.

As for other areas of governance, good governance is about:

- ❑ planning for the future ('vision');
- ❑ setting goals;
- ❑ securing the resources necessary to achieve these goals;
- ❑ periodically ensuring that the organisation is well-maintained and progressing toward its destination ('monitoring'); and
- ❑ reporting progress and detours to stakeholders ('accountability').

Good governance has specific requirements when it comes to a Council's finances. We consider the following policies and processes to be particularly important.

Roles and responsibilities: councillors, sitting as Council, are responsible and ultimately accountable for a Council's finances. To be effective in this regard, councillors must set – and be accountable for – the Council's financial goals (and associated financial principles) embodied in the Council's annual budget and its long-term financial plan, and be satisfied that these goals are being met and the Council's finances are in order.

Budgetary framework: Financial sustainability is best ensured by the adoption of a medium-term budgetary framework. Annual budgeting may exacerbate the natural short-term focus of political decision-makers and cause Councils to lose sight of future costs of decisions, the best allocation mix and the appropriate timing of spending. A multi-year framework obliges councillors to recognise the implications of current budgetary decisions for Council finances in the future.

Financial principles and methods: To be successful in facilitating financial discipline, a Council's budgetary framework must be supported by principles and methods

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(frameworks) aimed at rigorously assessing the financial impact of new or varied policies and programs.

Financial targets and rules: Integral to effective financial governance is the setting of appropriate financial goals or targets for the Council. While there are many possible target variables, a few key performance indicators are critical from a financial governance perspective. Emphasis on other possible financial KPIs to the neglect of these key indicators runs the risk of delaying recognition of emerging challenges to a Council's long-term financial sustainability.

Internal financial monitoring: Financial reports to Council are a critical aspect of good financial governance. They are the prime means by which councillors receive the information they require to meet their own accountability requirements. This enables the Council's progress to be monitored and reported against key goals or targets, and appropriate decisions made about the adjustments necessary to keep its finances on track. Even if they are not financial experts, councillors need to be armed with sufficient and appropriate financial information to ask the questions that need to be answered in order for them to be satisfied that they know and understand the financial situation.

Audit committee: Independent review of processes and decision-making should be undertaken regularly to assist the Council meet its accountability to ratepayers and the community, including with an audit committee or the like overseeing and advising the Council on matters of accountability and internal control.

Public availability of information: For ratepayers and the community generally to be satisfied about the sustainability of a Council's long-term financial position and performance, transparency in external financial reporting is vital.

To ascertain the status of Tasmanian Councils' financial governance, we surveyed Councils using a questionnaire aimed at systematically reviewing a Council's financial governance arrangements against what we consider to be good practice.

Respondents were asked to describe each of the key aspects of financial governance by scoring the financial governance arrangements operating over the last 12 months using a 1 to 5 scale. We subsequently weighted and aggregated the questionnaire scores.

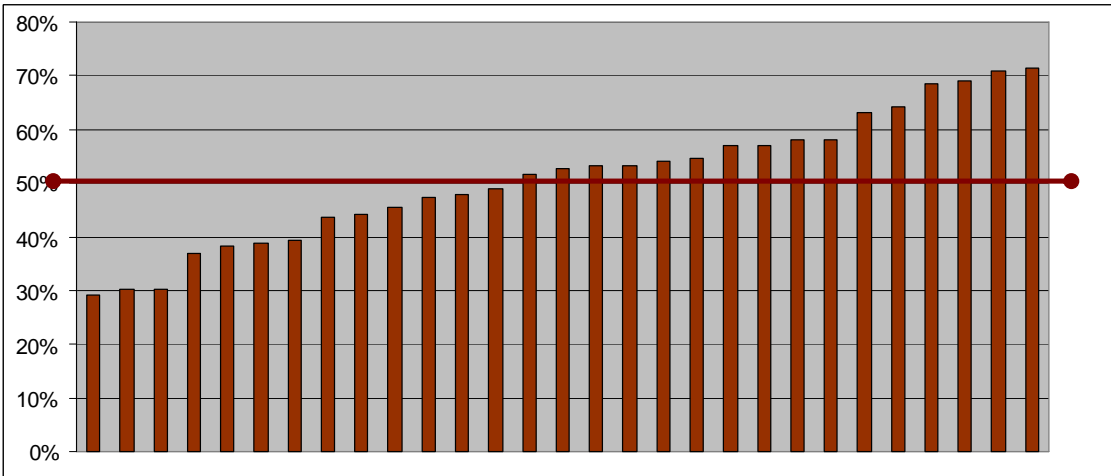
5.2 ASSESSMENT

Overall, based upon the financial governance survey, our assessment is that Tasmanian Councils' current financial governance policies and processes – on average – just meet minimum acceptable standards.

Chart 5-1 shows differences in the scores assigned to individual Councils.

We have opted not to identify individual Councils in this chart because of differing sources of the data involved for each Council. Some surveys were compiled by the Council's General Manager, some by its governance officer(s) and others by its finance manager.

**CHART 5-1: FINANCIAL GOVERNANCE, OVERALL SCORE
TASMANIAN COUNCILS, 2006**

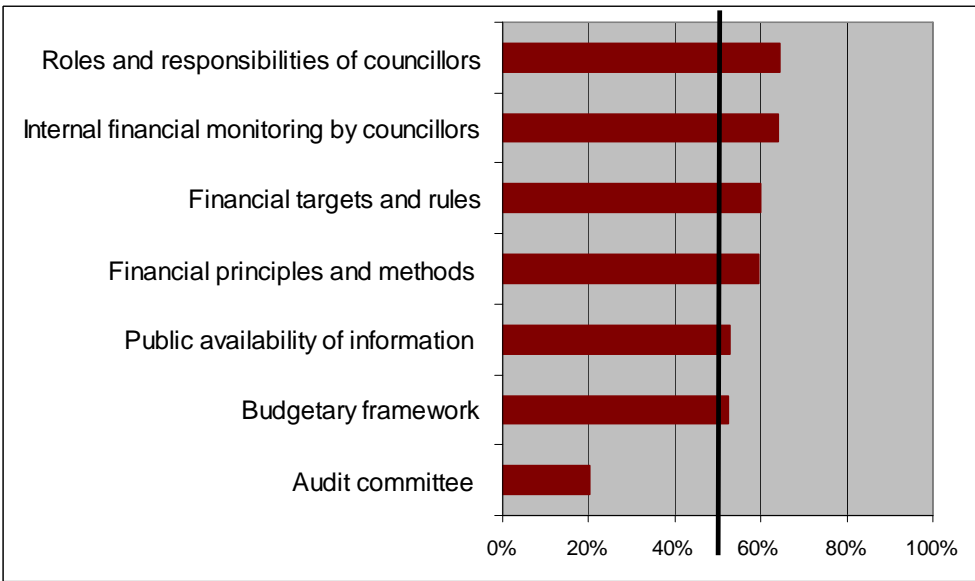


In almost one-half of Tasmanian Councils, there is scope for improvement in financial governance policies and processes to shift their financial governance into the ‘meets minimum standards’ territory.

More generally, there is scope for improving financial governance into ‘good practice’ territory (resulting in scores >70%) in the vast majority of Tasmanian Councils. This is necessary to provide greater confidence in the effectiveness of Tasmanian Councils’ financial governance policies and processes.

Chart 5-2 shows differences in the scores assigned among the main components of financial governance.

**CHART 5-2: FINANCIAL GOVERNANCE, SCORES BY ITEM
TASMANIAN COUNCILS, 2006**



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The areas where there is most scope for improvement are:

- ❑ audit committee;
- ❑ budgetary framework; and
- ❑ public availability of information.

ROLE FOR AN AUDIT COMMITTEE

Best practice financial governance at the local government level involves Councils establishing internal structures that provide for independent review of processes and decision-making to assist councillors to meet their accountability to ratepayers and the community, including with an audit committee overseeing and advising the council on matters of accountability and internal control.

The overall function of an audit committee is to provide an independent check on key Council activities. This usually includes checking the integrity of the financial system and financial management, but it should also cover a broader picture of assessing whether stakeholders are receiving value for the money spent on systems, services and projects. That is, the audit committee asks if the Council is doing what it said it would do and for the cost which was anticipated.

Reports from the audit committee support elected members in meeting their responsibility to use community resources for the overall benefit of the community.

As indicated by the CPA Australia/LGMA *Excellence in Governance* guide, best-practice features of the composition of the audit committee are as follows:

- “ • *It should include both councillors and independent members. Independent members should not have, or should not have recently had any employment, contractual or material relationship with the council.*
- *The CEO and the CFO should not be members of their own council's audit committee but are to attend relevant aspects of audit committee meetings by standing invitation.*
- *The chairperson of the audit committee should generally be one of the independent members so as to support the concepts of independent review and transparency.*
- *The mayor should not be the chairperson of the audit committee. The council has the overall accountability for the financial health of the municipality. Therefore the mayor, as leader of the council, should not be the chair of the body which is part of the independent verification process.”*

A Council's ability to support and service an audit committee will be influenced by its size and financial resources. Rural councils, especially smaller ones, may need to give consideration to establishing regional or joint audit committees aimed at pooling scarce resources and increasing the level of expertise available to individual Councils.

We recommend that:

- ❑ *each Council establishes an audit committee that has external membership and does not include the Council's mayor as chair or its general manager as a member;*
- ❑ *LGAT takes on responsibility for developing a template for the establishment, conduct and scope of audit committee activities in the Tasmanian context;*
- ❑ *that one of the functions assigned to the audit committee be the review of the effectiveness of: (a) the Council's financial governance arrangements, and (b) the Council's planning and monitoring processes in ensuring the sustainability of the Council's long-term finances; and*
- ❑ *rural councils or smaller councils give consideration to establishing regional or joint audit committees.*

BUDGETARY FRAMEWORK

Best practice financial governance at the local government level also involves spending and revenue decisions being taken in a multi-year framework, and against the background of long-term financial rules. Otherwise, the natural short-term focus of political decision-makers may cause Councils to lose sight of future costs of decisions, the best allocation mix and the appropriate timing of spending. A Council's budgetary forward estimates should be the first three to five years of its long-term (10 year) financial plan.

The SA, NSW and WA Inquiries concluded that, at the individual Council level, regular reviews of existing programs and of the consistency of new policy proposals with a Council's accepted roles and functions seem to be the exception rather than the rule. As a result, Councils generally are likely to be too prepared to accommodate operating spending pressures. This seems to be associated with an inadequate understanding of the ongoing financial impact of such decisions, and insufficient scepticism about expanding the role of Councils – at least without commensurate increased access to the necessary financial resources.

In this context, consideration should be given to targeting a balanced budget along the lines of section 100 of the NZ *Local Government Act 2002*, namely that a Council's annual income (excluding capital grants) in any financial year must be set at a level that covers all expenses. Such a balanced-budget 'golden rule' would put at the top of Councils' agenda the fostering of intergenerational equity, and so:

- ❑ ensure that each year's ratepayers meet the full cost (including depreciation) of that year's use of services and infrastructure; and
- ❑ provide for the maintenance and replacement of infrastructure assets.

We recommend that:

- ❑ *Councils adopt a multi-year budgeting framework, with a Council's budgetary forward estimates being the first three to five years of a long-term (10 year) financial plan;*
- ❑ *LGAT develops and publishes guidance for Councils in the conduct of efficiency audits, being reviews aimed at assessing the effectiveness of service delivery and infrastructure programs; and*
- ❑ *LGAT promotes a best-practice model advocating a balanced budget as the standard for individual Councils.*

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EXTERNAL FINANCIAL REPORTING

Our experience with this review confirms that *external* financial reporting for the Tasmanian local government sector is not without its deficiencies.

Best practice financial governance involves:

- ❑ information about a Council's finances, whether reported externally or internally, being *relevant* in the sense that it has the capacity to make a difference in its informational or accountability role;
- ❑ the information reported being *timely*, and having the capacity to confirm or correct prior expectations about past events or to assist in forming, revising or confirming expectations about the future; and
- ❑ financial information also being *consistent* (where the information reported enables valid comparisons to be made for the Council over periods of time), *comparable* (where the information reported enables valid comparisons to be made between different Councils) and *reliable* (where the information reported corresponds with the actual underlying transactions and events, is capable of independent verification and is reasonably free from error and bias).

Development of uniform accounting policies could take the form of LGAT taking responsibility for developing an accounting policy code similar to the Local Government Association of South Australia's *A Framework for Local Government Financial Management* or the NSW Department of Local Government's *Code of Accounting Practice and Financial Reporting*.

Such a code could also make it mandatory, like the NSW code, that where there is a change in Council policy which affects the calculation of performance ratios, the change in policy must be stated, and ratios under the new policy provided for the current period and the three previous years.

Relevant financial information should be provided in forecast form as well as in historical form. Prospective information should be available in both narrative and quantitative form. To ensure uniform forecasts, a standard approach to developing mandatory long-term (10 year) financial plans should be developed. Some Councils already recognise the value of long-term planning for determining revenue setting and strategic infrastructure decisions.

In Tasmania, the State government in conjunction with LGAT already publishes annual comparative statistics. LGAT should seek a review of the indicators so published with a view to promoting use of a comprehensive list of financial KPIs. This would put local government in control of devising necessary financial targets and rules, as well as provide the maximum degree of flexibility in choosing and explain the suggested financial targets and rules. The financial KPIs used should have a strong predictive relationship with the degree to which a Council's finances are likely to be sustainable in the long term, and be based upon generally-accepted key analytical balances. Councils should be encouraged to set target values, and where appropriate also minimum (floor) and maximum (ceiling) values, for each of these financial KPIs.

Comparative financial KPIs should be provided on an estimates basis for the current year, actuals for the last three previous years, and projections for at least the coming three years based on continuation of current policies, allowing users to undertake meaningful analysis of Council finances.

LGAT should also consider promoting and facilitating State of the State reporting using routinely generated, consistent financial KPIs. Indicators to improve whole of sector performance and transparency. As canvassed by the WA Inquiry, the information should be assembled in a simple, web-based format where individual Councils populate the data sets and where the information is available to all in the industry to encourage a strong performance culture and to ensure the focus is kept on best practice themes.

We recommend that:

- ❑ *LGAT takes on responsibility for developing an accounting code aimed at encouraging a greater degree of uniformity in accounting policy and practice across Councils;*
- ❑ *to ensure uniform forecasts, a standard approach to developing mandatory long-term (10 year) financial plans be developed under LGAT's leadership, drawing on the experience of those Councils who already recognise the value of long-term planning for determining strategic spending and funding decisions; and*
- ❑ *LGAT establishes a working group, including representation from the State Government, to develop an on-line State of the State financial reporting framework, including to define the key data sets to ensure a best practice framework is developed and embraced by Councils across the State.*

5.3 KEY FINDINGS

Based upon our financial governance survey, the current financial governance policies and processes of Tasmanian Councils – on average – appear to just meet minimum acceptable standards. There is clear scope for improvement in financial governance policies and processes.

That there are shortcomings in the existing financial governance policies and practices of Tasmanian Councils is evident from the operating deficits and renewals gaps that have been documented in this report.

Where financial governance is not well developed in Councils, it is not surprising that there is a lack of understanding on the community's part of the true costs of current infrastructure and service commitments. Other governments too are unlikely to be convinced that increasing grant funding to local government would be a prudent use of their taxpayer funds.

The Commonwealth and State governments increasingly expect their program partners in specific purpose programs to demonstrate rigour and sound operating frameworks in order to attract assistance on a continuing basis. However, local government has some particular exposures in the coherence and effectiveness of its financial governance arrangements. What is required is a sector-wide determination to strengthen these arrangements – and associated policy directions and performance – in order to shape and inform better policy and funding outcomes.

Particular areas identified for improvement are:

- ❑ establishing internal structures that provide for independent review of processes and decision-making to assist councillors meet their accountability to ratepayers and the community, including with a role for an audit committee or the like overseeing and advising on matters of accountability and internal control;

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- ❑ embedding spending and revenue decisions in a multi-year framework, and against the background of long-term financial rules; and
- ❑ improving coherence and uniformity in external financial reporting.

6. RECOMMENDED CHANGES IN POLICY DIRECTION

Besides improvements in financial governance arrangements, also needed are certain changes in revenue, spending and asset management policy directions.

This chapter provides our recommendations on the adjustments that may be necessary to current policy directions, to address any deficits – current or emerging.

In our view, the prevalence of operating deficits and their frequent co-existence with infrastructure backlogs and/or annual renewals gaps are symptomatic as much of deficiencies in Council spending and revenue policy directions – compounded by poor information and understanding of asset management – as they are of shortfalls in the level and escalation of grants from other governments and any past cost shifting.

Our focus in this chapter is therefore on policy changes within the control of each Council.

6.1 REVENUE AND FINANCING POLICIES

Central to the financial sustainability of local government is the ability of Councils to raise the necessary funds. Our view is that a prerequisite for an autonomous local government sector is that it is able and willing to fund its services. Without this capacity, the sector remains captive to the political will of the other tiers of government.

The local government Inquiries in the other States have concluded that few Councils appear to have developed or implemented a rigorous policy framework for funding their services and infrastructure. This is undoubtedly the case also for Tasmanian Councils. As a result, the current funding approach relies heavily on the use of rates revenue to fund the difference between estimated operating expenses and non-rates revenue each year. Limited consideration is given to the linkage of service beneficiaries to the funding source for each service provided by council through greater application of user charges.

We recommend that:

- *each Council be encouraged to develop and publish a ‘revenue and financing policy’ statement (similar to the statement required of councils by law in New Zealand), which ensures the adoption of a comprehensive and ‘economic’ approach to funding decisions. Such a statement would state (for example) the role to be played by ‘user pays’ and how any grants shortfalls are to be covered for services provided through grants funding. It would also provide the basis to examine the role to be played by developer charges.*

RATING EFFORT

Rating decisions can be politically challenging. This is the nature of politics and the challenge of leading and governing in a community context.

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Councils are best placed where they establish long-run directions and plans, and apply revenue and rating frameworks to ensure these goals are achieved. Establishing a medium-term rating policy, perhaps relative to movements in the State's CPI, can – to a degree – depoliticise the annual rating decision by linking rating effort and settings to a Council's long-term financial plan. No-policy-change increases in (per-property) rates revenue should keep pace with annual expenses (over the business cycle), where expenses are prudently managed. Policy-change increases in (per-property) rates should be explicitly linked to increases in service standards or quantities.

Such an approach can create better fiscal discipline and planning certainty, and community engagement focussed on the long-run vision for the Council and the services, assets and amenities it aspires to provide, develop and maintain.

Whether own-source revenue increases materialise – on average – depend upon the policies adopted by Councils themselves. Much depends upon the willingness of Councils to responsibly address opportunities to improve their revenue-raising effort and the extent to which they are prepared to contain rates disciplines in future. Financial sustainability begins with the principle that Councils themselves must be able to raise at least a fair slice of the revenue they need to cover the costs of providing services to their communities. If they cannot, service standards must fall, or financial sustainability may be compromised – or both.

While decisions on rates rises must be left to the discretion of individual Councils, it is critical that Councils have a sound strategic financial plan which addresses the issue of the long-term sustainability of Council finances.

We recommend that:

- ❑ *each Council establishes its rating effort with appropriate regard to peer effort and on a multi-year basis, to ensure that own-source revenue contributions to a financially sustainable local government sector are maximised; and*
- ❑ *each Council links its rating effort and other own-source revenue settings to a long-run (at least 10 year) financial plan.*

FEES AND CHARGES

Fees and charges provide Councils with an important source of revenue.

Generally, the basis for determining a fee or charge is not limited to the cost of providing the service or goods. However, in prescribed circumstances, regulations may prohibit the imposition of a fee or charge or limit the amount of a fee or charge. In New Zealand, legislation requires that Councils identify the beneficiaries of services that they provide and attribute costs to them. Councils are then expected to raise funds according to these cost attributions, albeit with some modifications in the light of factors such as affordability, market neutrality, acceptability and consistency with strategic policies.

We recommend that:

- ❑ *Councils develop an output-based reporting framework for activities to more clearly enumerate the costs and beneficiaries of services, as a basis for a mechanism for pricing that reflects the true costs and relevant externalities associated with local government services.*

DEVELOPER CHARGES

Developer charges are lump-sum charges designed to recover costs incurred in the provision of infrastructure from the beneficiaries of that infrastructure. They are typically levied on the owners/developers rather than the occupiers of land or the users of specific services.

The main reasons for imposing developer charges are:

- ❑ to augment Council funding by taxing those who benefit directly from infrastructure improvement; and
- ❑ on economic efficiency grounds, to levy those responsible for the development so that infrastructure costs are included in development decision-making.

Ideally, developer charges should involve full net cost recovery from the beneficiary, reflect variations in the cost of servicing different development areas, result in new developments meeting no more than the cost of the services provided through developer charges, cover infrastructure expenditures which can be clearly linked to the development and be reliably forecast, and be calculated in a transparent manner so that developers can understand and assess the calculated charges.

Tasmanian Councils typically do not make as much use of developer charges as their peers in some of the other States. There is considerable merit in reviewing the policy framework in Tasmania to ensure appropriate use of developer contributions in developing infrastructure.

We recommend that:

- ❑ *greater use of developer charges (where appropriate) be applied throughout the State by Councils to assist the creation of new community infrastructure.*

MOBILISING DEBT FOR LOCAL GOVERNMENT INFRASTRUCTURE

In Tasmania, as in other States, ratepayer equity is the principal source of capital employed by Councils. Debt capital is little used by Councils.

For Councils (as for corporations and other governments), there is no right or wrong level of financial gearing. It is more a question of the level of gearing that can be supported by a Council's revenues and net cash flows.

External borrowing can be an appropriate financing source in the right circumstances, especially to fund the acquisition of new non-financial assets or the upgrading of existing assets (as distinct from funding routine maintenance and the renewal of existing infrastructure assets which both should be funded out of internal cash flows). Use of borrowing to finance upgrading or expansion of infrastructure would then free up internally-generated funds which should be devoted to financing maintenance (and servicing any increased debt).

The long-term decline in Councils' reliance on borrowing needs to be reversed to allow more flexibility in local government funding. Any limits on borrowing for the purpose of acquiring new infrastructure assets within the local government sector should be set – based upon expert advice and accepted standards of prudence – by reference to a Council's long-term financial capacity to service debt, rather than an anti-debt mindset.

Defining a best practice debt policy is warranted. However, in developing such a policy it is important to recognise the differing capital requirements of individual Councils and changes to their economic environments that make the use of debt either more or less attractive.

On the liabilities management side, credit foncier and fixed interest borrowings still seem to predominate. Councils should avoid undertaking separate or specific borrowing to finance particular projects or assets, and rely instead on taking a coordinated approach to managing their borrowings and financial investments. Associated with this, Councils should be managing their interest rate exposures in an up-to-date and deliberate fashion.

We recommend that:

- ❑ *individual Councils reassess their debt funding levels so that a modern and efficient capital management approach can be adopted; and*
- ❑ *a best-practice guide for debt funding of infrastructure be developed and that training in modern capital market principles for councillors and staff be introduced along with other capacity-building measures designed to improve treasury management expertise and techniques.*

6.2 ASSET MANAGEMENT

Asset management refers to a process for 'whole of life' asset management from planning, purchase, maintenance and disposal of assets.

Underspending on the renewal of existing infrastructure by Tasmanian Councils is evidence in part of inadequacies in asset management policies. Only a small proportion of Councils seem to have asset management policies in operation, or plans to establish asset management practices. Too little consideration is given to the extent to which future generations are expected to pick up the tab for renewing Council-provided infrastructure.

Improving asset management and unifying infrastructure accounting is critical to addressing infrastructure problems, including by giving both councillors and the community a better understanding of the infrastructure challenge.

ASSET RECORDING AND MEASUREMENT

Introduction of accrual accounting required the establishment of asset registers to record asset values. The quality of these registers is likely to vary, with the structure and detail of information in these registers being neither uniform nor incomplete.

Unlike the cases in NSW and SA, there seems to be minimal accounting requirements for Councils to group assets into uniform classes and sub-categories. This reduces both consistency and comparability in the asset data reported by Tasmanian Councils themselves.

In addition, a range of useful life estimates for (apparently) similar assets seems to exist, with Councils not obliged to use consistent depreciation rates for identical assets. This results in depreciation charges that also show wide variation with consequential impacts upon Council operating surpluses/(deficits).

There are no reporting requirements in Council annual reports covering the reporting of a Council's current infrastructure backlog or its prospective annual renewals gap.

As a consequence, much of the asset data available to the sector cannot be reliably used by Councils for strategic decision-making or for comparing performance throughout the sector. Unifying infrastructure accounting is critical to addressing infrastructure problems, including by

giving both councillors and the community a better understanding of the infrastructure challenge.

Accounting inconsistencies need to be resolved by requiring:

- ❑ a standard format for asset registers;
- ❑ regular valuation of infrastructure at 'fair value';
- ❑ a standard depreciation schedule for assets whose total life has not been independently verified by a recognised assessment process or service; and
- ❑ common definitions to enable the maintenance, renewal, upgrading and expansion of assets to be distinguished.

We recommend that:

- ❑ *the accounting policy code being developed under the leadership of LGAT includes requirements that provide for: (a) a standard format for asset registers and classification of assets, (b) a regular valuation of infrastructure at 'fair value', (c) standard lives being applied for depreciation purposes for those assets whose total life has not been independently verified by a recognised assessment process or service, and (d) common definitions as a basis for distinguishing between the maintenance, renewal and upgrading/expansion of assets; and*
- ❑ *additional reporting requirements be introduced for Council annual reports providing for consistent and comparable external reporting on a Council's infrastructure backlog and its annual renewals gap.*

ASSET MANAGEMENT PLANS

A formal and more rigorous approach to managing infrastructure is necessary, and this must involve the establishment of long-term asset management plans. Without accounting for the formal long-term asset management needs, a long-term financial plan will only be of limited value.

As proposed by the recent Local Government and Planning Ministers' Council (in its Advice to COAG on Asset Planning and Management), each Council should be working towards adoption of a total asset management system for the whole-of-life planning, funding, acquisition, registration, accounting, operation, maintenance, disposal, and renewal or enhancement of each component of its infrastructure. Minimum asset management requirements should be mandatory, although phased-in over time and with additional requirements added progressively.

An asset management framework that meets accepted industry standards should include:

- ❑ a clear definition of the services to be provided by each of its classes of infrastructure;
- ❑ a detailed knowledge of the assets held (thereby allowing predictions to be made about performance);
- ❑ the risks associated with managing the infrastructure being well understood;
- ❑ asset-related spending distinguishing between spending on the maintenance, renewal, upgrading and expansion of assets; and
- ❑ the cost of long-lived assets over their useful lives being accurately recognised.

The establishment by LGAT of the Tasmanian Asset Management Improvement (TAMI) Program is a step in the right direction for improving asset management understanding and practices in Councils. However, the voluntary nature of the take-up by Councils does not achieve the maximum results possible from such a scheme. The Municipal Association of Victoria's staged asset management improvement program has been building infrastructure asset management capacity over recent years by promoting awareness-raising of asset management obligations to all Councils, and by providing tools and templates to assist in developing asset management policies, asset management strategies, asset management plans and operational plans. This program is funded by the Councils and is delivered through six-monthly visits to them by MAV-appointed consultants who identify priority deficiencies in asset management and rate each Council in respect to asset management adequacy through a series of questions and provide targeted training and improvement recommendations to be completed by the next visit.

We recommend that:

- ❑ *LGAT further develop its Asset Management Improvement Program, perhaps in partnership with the Institute of Public Works Engineers and the State government's Local Government Office, with a view to achieving full participation by all Councils and creating templates to assist Councils in preparing their asset management plans; and*
- ❑ *each Council work towards establishing a comprehensive 10-year asset management plan – addressing the issues of infrastructure renewal, upgrade and replacement – that is integrated within their long-term (10-year) financial plan.*

REDUCING THE INFRASTRUCTURE BACKLOG

Adopting proactive asset management will require a considerable change in policies and practice within the sector, supported by community engagement of the choices available to the industry and better techniques and tools applied to asset management, planning and funding.

Annual renewals gaps and the resultant infrastructure backlogs are a consequence of a long-term neglect of such issues. Depending upon their magnitude, they may well be beyond the capacity of many Councils to resolve.

We recommend that:

- ❑ *a State-wide campaign be undertaken to update and revise each Council's preliminary estimates of its current infrastructure backlog and prospective annual renewals gap, aimed at ensuring accurate, consistent baseline information on asset condition and renewal requirements to assist tighter definition of the infrastructure challenge;*
- ❑ *LGAT develop a standardised methodology for local government to engage the community in asset management issues and in the process of establishing service levels and their funding arrangements; and*
- ❑ *LGAT develop a campaign strategy to leverage funding to eliminate the infrastructure backlog in conjunction with improved asset management practices, recognising that sustainable progress will not be made on reducing the backlog unless additional annual funding is secured.*

6.3 SERVICES POLICIES

IMPROVING SERVICE DELIVERY OUTCOMES

Councils in New Zealand are required by law to develop and publish a ‘services policy’ statement clearly stating the roles and functions that they are prepared to adopt and specifying their policies regarding the number and nature of services to be delivered and the methods for delivery. Such a statement can then be the basis for:

- ❑ all new policy proposals being subject to rigorous analysis; and
- ❑ a regular cycle of program reviews being in place.

We recommend that:

- ❑ *each Council develop and publish a ‘services policy’ statement similar to what is mandatory in New Zealand.*

IMPROVING RESOURCE SHARING

Just as we eschew increased funding from other tiers of government as the sole solution on the revenue side, our starting point on the services side is a recognition that forced amalgamations have limited prospects for achieving lasting community benefit.

Amalgamation is usually advocated on the grounds that:

- ❑ small Councils lack administrative and technical capacity compared with larger Councils; and
- ❑ Council amalgamations will generate a greater range of services and improved quality of service.

However, the main benefits of amalgamation can usually be obtained by methods other than enforced structural reform.

Securing economies of scale and scope is an argument for shared services. In the local government context, a great deal of the back-office activity has the potential for significant cost savings provided service arrangements focus on standardised processes, appropriate service expectations and the best use of enabling technology.

Better depth and capacity for skills is an argument for resource sharing and pool-style arrangements. The growing depth and complexity of the local government task is readily acknowledged with an inevitable consequence that economies based on capacity and skills seem likely to provide the key imperative for further structural change.

Among the models for service delivery described by Dollery that are generally acknowledged throughout the local government sector are:

- ❑ resource sharing on an *ad hoc* basis, aimed at avoiding the potential problems associated with more formal arrangements and allowing for maximum flexibility;
- ❑ regional organisations of Councils to promote cooperation;
- ❑ area integration/joint board models which retains existing local government but with a single employing body with shared administration and joint operations, overseen by a joint board of elected members; and

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- agency models where services are provided by State government agencies at levels established by locally-elected officials.

The WA Inquiry made two suggestions which either build on the models mentioned above or are applications of approaches in other domains.

- The first is a 'State/Territory' model involving a two-tier local and regional government with certain services provided at local level (and largely funded from own-source revenues) and others on a regional basis with elected arrangements in place for both systems. Funding for a regional council would be principally sourced from specific purpose payment sources and, where individual Councils consent to provide funds for shared services, provided on a regional basis.
- The second is to place greater emphasis on regional service efficiencies. Here the option is focussed on a sector-owned service provider that provides regional services at each Council's discretion. This is a variant of the agency model in that the service provider could be a specially-established sector entity, a single council operating under contract to other Councils, a private sector provider, LGAT or a regional council.

We recommend that:

- *LGAT explore the role which additional or extended examples of resource sharing and cooperation among Councils could play in the Tasmanian context, including facilitative mechanisms to commence/enhance discussions and processes between Councils and the adoption of a business case approach to resource sharing opportunities.*

6.4 KEY RECOMMENDATIONS

We have made a series of recommendations that involve Tasmanian Councils developing appropriate long-term spending, asset management, revenue and borrowings strategies to overcome their infrastructure and services challenges within sustainable financial limits.

At the very least, we urge each Council to develop a rolling 10-year financial plan to:

- rehabilitate infrastructure that is already dilapidated;
- renew infrastructure when it degrades below an acceptable standard in future;
- expand the total infrastructure stock by enough to adequately cater for residential and business growth;
- develop services in line with population growth and changing community needs;
- generate additional resources from revenue measures, operational savings, re-ordering of spending priorities, infrastructure enhancement deferrals, asset leases or disposals and extra borrowings that would be sufficient to fund such a program; and
- ensure that the outcome complies with sustainable financial targets (e.g., the recommended minimum operating surplus ratio and maximum annual renewals gap ratio) during this period.

APPENDIX A

FINANCIAL DATA USED UNDER NO-POLICY-CHANGE CONDITIONS

Financial data provided by the Council

For the years 2000-01 to 2004-05, we ended up using the database of financial information for individual Councils at the basis of the “Measuring Council Performance in Tasmania” annual publication prepared under the auspices of the State’s Office of Local Government. This database is based on annual returns provided by Councils to the State government, including for Local Government Grants Commission purposes. Some discrepancies in this data mainly as it relates to balance sheet items were identified by a few Councils, and we made revisions to this data where advised by the Council concerned.

For 2005-06, the latest year of actual financial information, we used information provided directly by Councils, either in the audited financial statements and notes or as summarised by them in a financial questionnaire we provided. This information was available for all Councils, and is the focus of most of our comparative charts in chapter 1.

For 2006-07, the current/budget year, we again used information provided to us directly by Councils, although 4 Councils were unable to provide any budget year financial information and a further 5 Councils were not able to provide comprehensive balance sheet as well as operating statement estimates. For these latter Councils, we substituted our own projections based upon the continuation of policies evident in their previous years’ financials.

For the years 2007-08 to 2009-10, the forward estimates period, we used Council projections where provided to us by Councils. However, 15 Councils were not able to provide any forward projections and a further 2 Councils were not able to provide comprehensive balance sheet projections. Again, for these latter Councils, we substituted our own projections based upon the continuation of policies evident in their previous years’ financials.

Access Economics financial projections

For projection purposes, our modelling focuses on making projections of annual financial flows, which can then be used to generate projections of financial stocks. Only a few, relatively minor financial stock items are directly projected.

Very generally, our modelling approach to annual financial flows can be summarised as follows:

- year 1 value (“base”), expressed in nominal terms
- *multiplied by* an external quantity escalation factor (“quantity driver”), typically showing the relationship based on past patterns between the annual percentage change in the transaction variable expressed in real-terms and the annual percentage change in the quantity driver variable
- *multiplied by* an external unit cost escalation factor (“price index”), typically showing the relationship based on past patterns between the annual percentage change in the

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per unit value of the transaction variable and the annual percentage change in the price index variable

- equals year 2 value.

That is, the year 2 value is derived typically as follows:

year 1 value

$\times [1 + (\% \text{ change in quantity driver in year 2} \times \text{quantity elasticity factor})]$

$\times [1 + (\% \text{ change in price index in year 2} \times \text{unit cost elasticity factor})]$.

Asset condition data

We also used the following preliminary data prepared as part of a recent sector-wide asset gap analysis:

- for the years 2007-08 and beyond, projected and desired maintenance expense;
- for the years 2007-08 and beyond, projected and desired renewals capex; and
- at 30 June 2007, an estimate of a Council's infrastructure (renewals and maintenance) backlog.

It is evident that, for many Councils, the current infrastructure backlog and prospective annual renewals gap numbers coming out of the recent asset gap analysis are very preliminary indeed, and not owned by all in the Council (financial managers as well as the engineers). This is an area where a good deal further work is required by many Councils.

To make this data consistent with the other financial data use in this report, we converted all future annual renewals and maintenance numbers from their constant-dollar value (as provided by the output of the asset gap analysis) into current-dollar values by applying our projections of annual CPI increases.

For the years 2007-08 and beyond, projected enhancement capex under no-policy-change conditions was taken to be the difference between total capital expenditure under no-policy-change conditions and the projected renewals capex component.

APPENDIX B

SUMMARY TABLES

The no-policy-change financial data used in our analysis of Tasmanian Councils are re-presented in this Appendix into the same summary format that we have used earlier in our reports for the SA, NSW and WA Inquiries.

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All Tas Councils	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions
	actual	actual	actual	actual	actual	actual	budget	projection	projection	projection
FINANCIAL PERFORMANCE										
Operating grants from other governments	68.5	70.7	75.9	70.7	74.0	80.1	74.0	73.2	74.2	75.3
Rates revenue	301.2	311.6	325.5	340.9	367.4	383.4	403.7	420.5	438.4	456.7
<i>plus</i> Fees and charges	70.3	72.4	83.0	92.5	100.9	105.4	123.9	132.7	136.7	141.4
<i>plus</i> Other own-source operating revenue	15.1	16.4	15.5	19.2	24.4	24.2				
Own-source operating revenue (before interest and realised gains on asset sales)	386.6	400.4	424.1	452.5	492.7	513.0	527.6	553.2	575.1	598.1
Total operating revenue	455.1	471.1	499.9	523.3	566.7	593.2	601.6	626.4	649.3	673.4
<i>annual % increase</i>		3.5%	6.1%	4.7%	8.3%	13.4%	6.2%	5.6%	7.9%	7.5%
Interest expense	10.9	9.7	8.9	8.6	8.3	8.2	8.1	8.7	9.2	9.1
<i>less</i> Interest income on unrestricted cash & securities	9.3	7.7	8.8	10.8	12.7	15.1	13.7	13.8	14.0	14.2
Net interest expense	1.7	2.0	0.0	-2.2	-4.4	-6.9	-5.6	-5.2	-4.8	-5.1
<i>% of total operating revenue</i>	0.4%	0.4%	0.0%	-0.4%	-0.8%	-1.2%	-0.9%	-0.8%	-0.7%	-0.8%
Operating expenses (before any realised losses on asset sales)	352.1	365.8	389.2	405.5	436.1	459.3	469.8	487.0	504.8	524.1
<i>plus</i> Depreciation expense	116.2	123.4	132.4	136.4	143.7	151.3	158.9	162.4	167.9	172.4
Other expenses (before any realised losses on asset sales)	468.4	489.2	521.6	541.9	579.9	610.6	628.7	649.3	672.7	696.5
Total expenses (before any realised losses on asset sales, and net of interest income)	470.0	491.2	521.7	539.7	575.4	603.7	623.1	644.2	667.9	691.4
<i>annual % increase</i>		4.5%	6.2%	3.5%	6.6%	11.9%	8.3%	6.7%	7.2%	7.3%
Operating surplus/(deficit)	-14.9	-20.2	-21.8	-16.4	-8.7	-10.6	-21.5	-17.8	-18.6	-18.0
<i>% of own-source operating revenue</i>	-3.9%	-5.0%	-5.1%	-3.6%	-1.8%	-2.1%	-4.1%	-3.2%	-3.2%	-3.0%
Actual renewals capex	56.5	58.8	62.8	64.8	71.2	73.5	76.6	80.1	81.8	83.7
<i>less</i> Desired renewals capex	78.8	82.7	88.8	92.7	96.4	102.6	107.8	112.7	108.8	106.1
Annual renewals excess/(deficiency)	-22.3	-23.9	-26.1	-27.9	-25.2	-29.2	-31.3	-32.5	-26.9	-22.3
<i>Annual renewals deficiency as % of status quo renewals capex</i>	28.3%	28.9%	29.3%	30.1%	26.2%	28.4%	29.0%	28.9%	24.8%	21.1%
Enhancement capex	59.9	74.6	79.0	82.5	98.2	105.5	119.2	96.9	84.0	81.9
<i>plus</i> Other asset acquisitions	-8.4	-10.5	-10.5	-4.2	-22.5	-12.4	-11.9	2.4	4.8	19.2
<i>less</i> Capital receipts										
Carrying amount of non-financial assets sold	8.1	12.4	13.6	16.0	16.7	10.7	6.0	6.0	6.0	6.0
<i>plus</i> Net gain/(loss) from the disposal of non-financial assets	-1.8	-2.3	-4.3	-3.2	-3.9	-0.7	-0.5	-1.7	-1.8	-1.8
<i>plus</i> Capital grants from other governments	10.3	16.4	24.5	19.3	20.2	35.0	19.9	18.1	21.5	24.9
<i>plus</i> Capital contributions	0.0	0.0	0.0	0.0	0.2	2.1	0.9	0.9	0.7	1.0
<i>plus</i> Other capital receipts (net)	37.4	40.7	43.6	43.7	47.3	48.7	51.1	49.7	59.1	66.4
Net acquisition of new and upgraded assets	-2.5	-3.1	-8.8	2.5	-5.0	-2.6	29.9	26.2	3.4	4.6
Net borrowing/(lending)	-9.9	-6.9	-13.2	-9.0	-21.5	-21.2	20.1	11.5	-4.9	0.3
<i>where applicable, % of net increase in capital employed (excluding valuation effects)</i>	10.3%	5.9%	..	0.1%

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All Tas Councils	30 June	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
		\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions	\$ millions
		actual	actual	actual	actual	actual	actual	budget	projection	projection	projection
FINANCIAL POSITION											
Non-financial assets (adjusted onto an approximate current cost basis)		3,583.2	3,810.0	3,974.7	4,169.2	4,936.1	5,356.7	5,511.6	5,753.5	5,848.5	5,996.2
<i>plus</i> Cash and securities restricted		15.5	15.8	16.8	18.3	23.8	26.0	28.5	15.9	15.6	15.4
Total capital employed		3,598.8	3,825.8	3,991.6	4,187.5	4,960.0	5,382.7	5,540.1	5,769.3	5,864.0	6,011.5
<i>annual % increase</i>			6.3%	4.3%	4.9%	18.4%	28.5%	11.7%	7.2%	5.8%	4.2%
Interest bearing liabilities		150.8	149.2	140.7	140.1	136.7	130.8				
<i>less</i> Cash and securities unrestricted		137.5	147.8	163.6	181.0	213.4	248.5				
Net debt		13.3	1.4	-22.9	-40.9	-76.7	-117.7	-89.3	-79.3	-85.2	-85.9
<i>% of total operating revenue</i>		2.9%	0.3%	-4.6%	-7.8%	-13.5%	-19.8%	-14.8%	-12.7%	-13.1%	-12.8%
Provisions		31.1	35.1	40.9	45.9	49.9	59.3	58.5	58.4	58.8	59.2
<i>plus</i> Payables less receivables		-7.6	-10.9	-8.4	-1.5	4.7	18.6	10.7	12.0	12.2	12.4
<i>plus</i> Other liabilities (nei)		4.5	8.8	11.8	8.7	12.9	9.3	9.7	10.0	10.4	10.8
Other net liabilities		28.0	33.0	44.2	53.1	67.5	87.3	79.0	80.5	81.4	82.4
Net financial liabilities/(worth)		41.3	34.4	21.3	12.3	-9.2	-30.4	-10.3	1.135	-3.8	-3.5
<i>% of total capital employed</i>		1.1%	0.9%	0.5%	0.3%	-0.2%	-0.6%	-0.2%	0.0%	-0.1%	-0.1%
Net worth		3,557.5	3,791.4	3,970.3	4,175.2	4,969.2	5,413.1	5,550.4	5,768.2	5,867.8	6,015.1

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