



LOCAL GOVERNMENT ACT REVIEW ►► DELIVERING FOR THE COMMUNITY

Consultation report — Financial management

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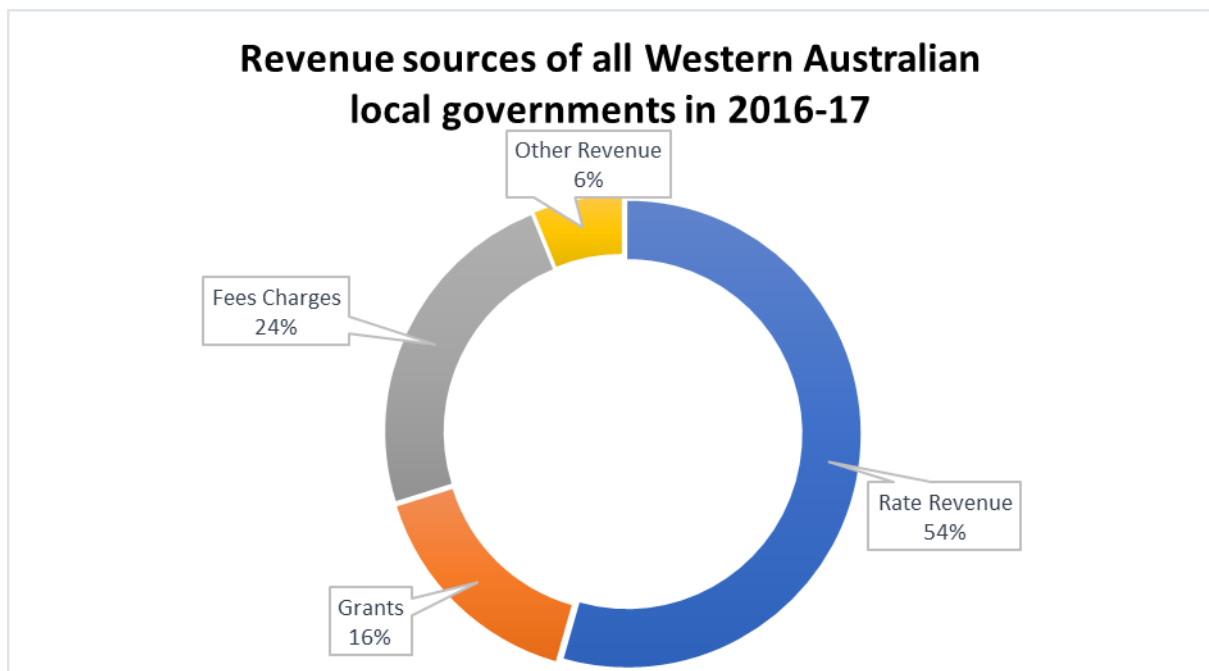
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Introduction

The local government sector's operating expenditure exceeds \$4 billion annually and local governments manage an asset base worth more than \$40 billion. To deliver services efficiently and effectively, local governments must be prudent users of public funds. Local governments must be transparent and accountable and strike a balance between community expectations and the practical limitations of revenue and expenditure.

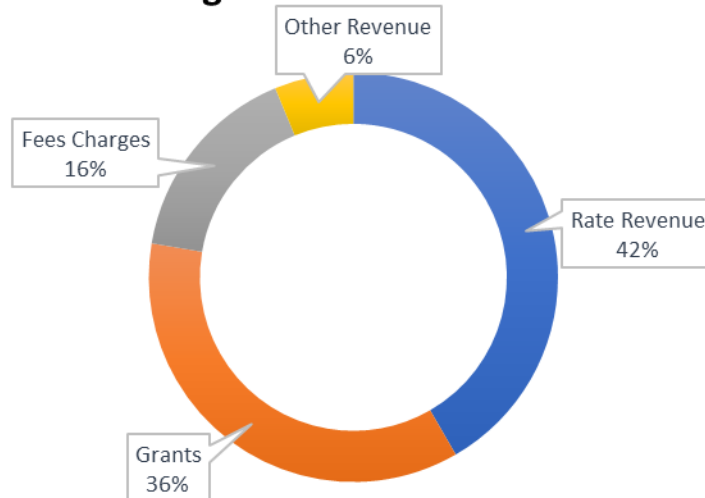
Local government revenue is principally drawn from rates, fees and charges, and grants from the State and Commonwealth Governments. Financial Assistance Grants from the Commonwealth, administered by the Local Government Grants Commission comprise approximately 40 per cent of the grants received by the local government sector, with the remaining 60 per cent allocated from State Government grant programs.

In the last two years, rates have made up approximately 55 per cent of local government operating revenue, with grants from the State and Commonwealth Government making up around 15 per cent of local government operating revenue.



The split in revenue sources varies considerably across the State which reflects the diversity of local government. In 2016-17, grants from the State and Commonwealth were the primary source of funding for 27 per cent of the State's local governments. In over half of the State's local governments, revenue from State and Commonwealth grants made up more than one-third of their total operating income.

Revenue sources of the median Western Australian local government in 2016-17



Across the sector, expenses are generally divided evenly between salaries, materials and replacement costs for assets. Again, the proportion spent on each category varies considerably between local governments.

To manage their finances, local governments are required to prepare a budget annually. The Act requires a local government is to, having regard for its Integrated Planning and Reporting documents, prepare an estimate of its upcoming expenditure, the revenue and income it will receive independent of rates, and the amount in rates required to make up any deficiency. This approach means that local governments are required to establish their budget by first determining the amount they wish to spend, and then estimating the revenue sources required to fund this outlay.

How we consulted

Following the release of discussion papers in September 2018, over 100 workshops, forums and meetings were held with community, local governments and stakeholders. This consultation included 28 community workshops across Western Australia and 'pop-up' stalls in shopping centres and community halls. Multiple workshops were held in all Western Australia's regions.

The workshops provided an opportunity for attendees to discuss topics that were of interest to them. All attendees were also encouraged to provide a submission.

Individual council members, local government staff, peak bodies, community organisations, councils and community were invited to have their say by completing online surveys or providing a written submission.

The objective of the consultation was to seek the views of as many interested people as possible, rather than scientifically sampling the population. As a consequence, responses are from people with a keen interest in local government, either because of their working relationship or because of their experiences with local government (often their own).

Responses received

Overview

A total of 3,151 responses to the review were received. This was made up of surveys on each of the 11 discussion papers released, written submissions and informal 'post card' responses collected during workshops.

For every topic residents/ratepayers provided the largest number of responses.

The gender balance amongst survey responses was reasonably representative (55% male, 45% female), but the sample was skewed heavily towards older age groups. Around 75 per cent of respondents were aged 46 years or over, with nearly half over 55. Less than 12 per cent were aged 35 or under.

Breakdown on responses on financial management

A total of 294 responses addressed the topic of financial management, which included 204 survey responses and 90 written submissions.

The 294 responses were drawn from private individuals and residents/ratepayers groups (101); local government councils and zones (68); council members (31); local government staff and chief executive officers (56); government agencies (2); peak bodies (3); and stakeholders from business and civil society (13).

What we heard

The following sections summarise the feedback received on the topic of local government financial management.

As with other topics addressed in the discussion papers, responses to the topic of financial management generally featured a split between the viewpoints of members of public who wanted greater oversight, and the collective viewpoints of local government who want greater autonomy.

Several local governments took the opportunity to reiterate the Western Australian Local Government Association's (WALGA) position on financial management, namely that:

- an additional, separate review into Part 6 of the Act (Financial Management) be conducted;
- an increase of the tender limit to \$250,000 with prescription of the maximum contract of one year;
- delete the financial threshold limit for disposing of property via trade-in (phase one topic);
- delete the requirement to publicly advertise the intention to borrow outside of the annual budget;
- allow local governments to use freehold land as security when borrowing;
- exempt council members from the related party transactions requirements of the Australian Accounting Standards (phase one topic);
- reduce the number of financial ratios to three (operating surplus ratio, net financial liabilities ratio and asset renewal funding ratio);
- permit Building Upgrade Finance; and
- include renewable energy infrastructure as a permitted service charge.

Other issues raised by local governments included:

- changing the minimum period for asset revaluation to every five years;
- clarifying and amending the role of the audit committee to provide greater separation of council and administration;
- introducing greater flexibility for local governments to use cash reserves; and
- greater prescription regarding the use of the municipal fund in section 6.8 of the Act.

The community highlighted issues about the overall efficiency of local governments, salary expenditure, and a call for better tools for elected members to understand local government finances with the intent of driving efficiency.

These concerns were raised in a handful of written submissions, and there was a common feeling expressed during workshops with the community.

Investments

Section 6.14 of the Act allows local governments to invest surplus funds. Many local governments hold significant amounts in cash reserves, including those obtained

through development contributions. To ensure the public receives the benefits of these reserves, local governments need to invest these funds wisely.

The types of investments that local governments are permitted to make are restricted by regulation 19C of the *Local Government (Financial Management) Regulations 1996*. This regulation states that local governments may not invest in:

- Deposits with an institution except an authorised institution;
- Deposits for a fixed term of more than three years;
- Bonds that are not guaranteed by the Commonwealth Government or a State or Territory government;
- Bonds with a term to maturity of more than three years; or
- A foreign currency.

The current approach to regulating investments has been criticised by the sector as overly restrictive. It was informed by incidents in 2007 when multi-million dollar losses were suffered by a number of Western Australian local governments who had invested in Collateralised Debt Obligations (CDOs) with Lehman Brothers.

In 2016, the Department considered a new approach to regulate investments. The review noted that the types of investments prohibited by the regulations did not necessarily correlate to risk. For example, while local governments are not permitted to invest in long term deposits for a period greater than 12 months (which is considered on balance a low-risk investment) there was nothing in the regulations preventing local governments from investing in shares or investments like the CDOs that were in part responsible for the Global Financial Crisis.

Within the discussion paper, the approaches suggested involved the possible introduction of a mandatory requirement for local governments to have an investment policy which would be endorsed by council and regularly reviewed, and creating a tiered approach to managing investment.

Workshops

The current restrictions on investments was a popular topic from local government staff involved in the financial aspects of their local government. The general view held by staff (and generally supported by councillors) was that the restrictions on investment should be removed and local governments should develop their own investment policies.

While financial management was raised in community forums, generally the details concerning investments were not discussed.

Surveys and written submissions

Several local governments including the Shire of Augusta-Margaret River and the cities of Joondalup, Swan and Greater Geraldton supported the preparation of an investment plan or policy. The concept of an investment plan was also supported by

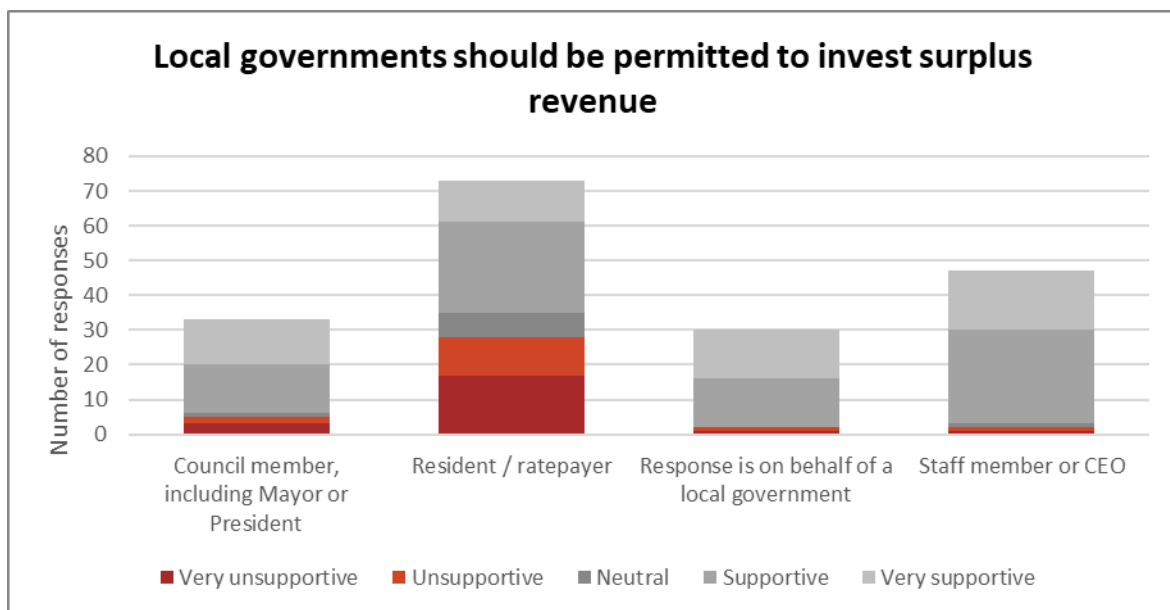
the Australian Government's Department of Infrastructure, Regional Development and Cities.

While a number of local governments advocated for greater freedom in investments, others, like the Cities of Belmont and Stirling, suggested that no change was required, in effect calling for the maintenance of the status quo.

Some concerns were raised concerning local government being able to invest and as such, the State Government should underwrite the investments made by local governments.

The topic of debt and investments was discussed by some members of the public with some responses expressing concern and a belief that surplus funds should be returned to the residents. There was also a call for local governments to only be able to invest ethically.

The ability to invest was almost universally supported in responses provided on behalf of local government (93 per cent), staff (93 per cent) and council members (81 per cent) but only about half (52 per cent) of residents stated that they supported local governments being able to invest.



Interestingly, when asked about imposing fewer restrictions on a local government's ability to invest, only 46 per cent of responses sent on behalf of local government, and 45 per cent of council members supported a relaxation of investment rules. This stands in contrast to feedback received through the workshops and written submissions.

Additionally, through the survey there also appeared to be very little support for differentiating local government investment powers based on the size, scale and capability of the local government.

Peak Bodies and other stakeholders

While the submission from WALGA was silent, the Local Government Professionals Australia WA (LG Professionals) submission proposed that the investment restrictions imposed by regulation 19C should be removed.

Debt

Debt is a contentious issue. Some people believe that debt should be avoided wherever possible. Another perspective is that the prudent use of debt serves a 'user pays' philosophy by enabling multiple generations to contribute to infrastructure projects they will use into the future. Section 6.20 of the Act provides local governments with the power to borrow money or obtain credit.

Local governments in Western Australia do not need to seek external approval to borrow although financial indicators, including a debt service ratio, must be reported in their annual report.

Currently, local governments are required to give one month's public notice if they are seeking to borrow money that has not been included in the annual budget.

Local governments may only secure borrowings by giving security over their income from general rates or untied Government grants, and not freehold property.

Workshops

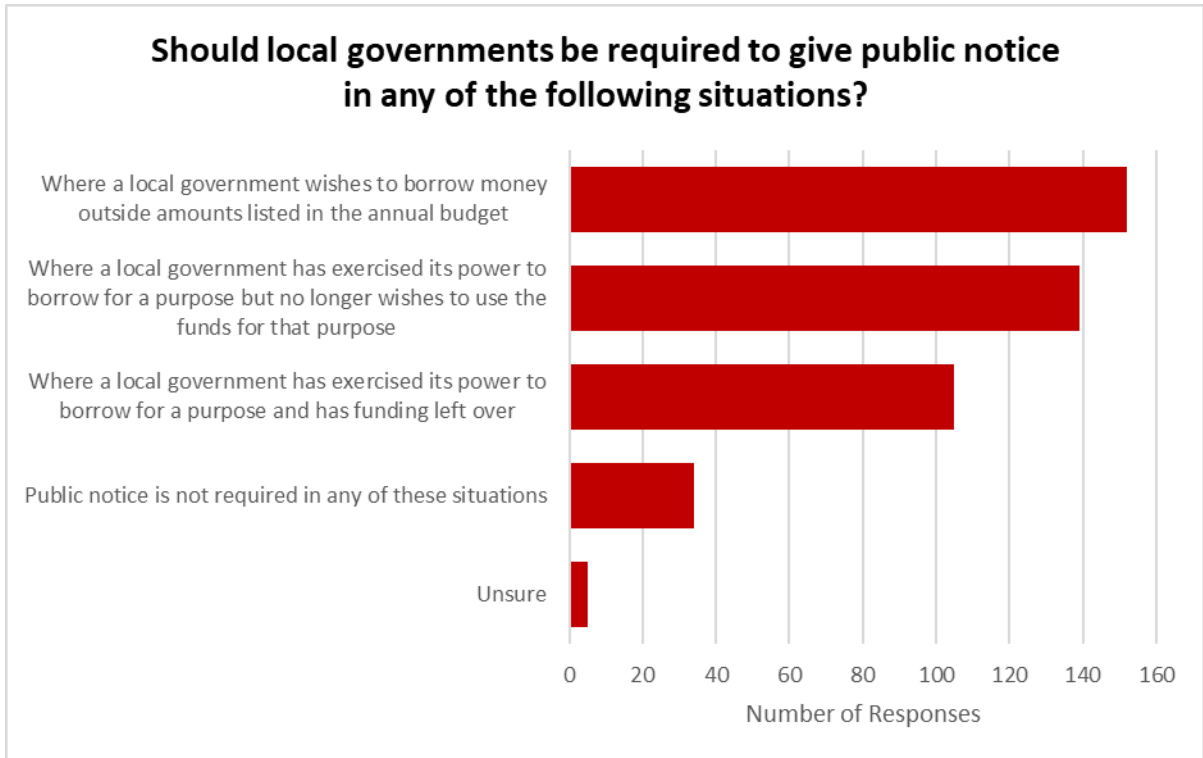
The use of debt was raised at several local government workshops, where the prevailing view held by staff (and generally supported by councillors), was to remove the requirement to advertise prior to borrowing (as an administrative efficiency measure). Likewise, there was some support for the removal of the restriction on the use of freehold land as security on borrowings.

While not discussed often at community workshops, the community in the main advocated for the retention of the requirement to advertise, and the prohibition on using freehold land as security.

Surveys and written submissions

There was broad support for local governments to continue to issue public notices when a local government wishes to borrow money outside amounts listed in the annual budget and where a local government has exercised its power to borrow for a purpose but no longer wishes to use the funds for that purpose.

There was less support however, for requiring public notice when a local government has exercised its power to borrow money for a purpose and has funding left over.



Security of Freehold

Unsurprisingly, most responses provided on behalf of local government (83 per cent), council members (71 per cent) and staff (63 per cent) supported local governments being permitted to use freehold assets as security. One-third (33 per cent) of responses from residents supported the concept with almost 18 per cent stating that they were unsure.

Peak Bodies and Other Stakeholders

WALGA supports the removal of the requirement to advertise and the restriction on using freehold assets as security of borrowings. In their submission, LG Professionals only support the removal of the requirement to advertise (and were silent on the issue of the use of freehold land as security).

Procurement

Local governments are significant procurers of goods, services and capital supplies. In 2016-17, local governments spent more than \$1.1 billion on materials and services.

The *Local Government (Functions and General) Regulations 1996* establish procurement rules for local government.

Currently, Western Australian local governments are exempt from the requirement to invite tenders in relation to contracts involving an estimated expenditure or receipt of an amount of less than \$150,000.

Under regulation 24AD, local governments are also permitted to establish a panel of pre-qualified suppliers. In this case the local government is required to issue an invitation to apply to join the panel.

Local governments have consistently advocated for raising the threshold where public tenders must be advertised. Some local governments have argued that council should have discretion in setting their own rules for procurement, including tender thresholds.

Throughout this review, local governments both large and small have called for less prescription in procurement rules because of the investment required to comply with open tender rules. These concerns must be balanced with the need for a procurement framework that provides confidence for suppliers and the community.

Workshops

Local government procurement was a popular topic for local government staff. The view held by most staff (and generally supported by councillors), was the tender threshold for local government should be aligned with the State Government.

While a tiered approach to procurement was supported, it did not receive as broad or universal support as the concept of aligning the tender threshold with that of the State.

While procurement was discussed by members of the public, feedback was general in nature, and did not relate to the specific procurement rules.

Surveys and written submissions

Alignment of local government procurement rules with the State Government

State Government procurement rules are set by the State Supply Commission (SSC) under its own legislation. Currently, there are six procurement policies covering matters such as value for money, open and effective competition, procurement planning and contract management (these processes are currently under review by the Department of Finance). These policies also establish tender thresholds for State Government agencies.

Most residents (76 per cent) responding to the survey supported procurement rules being aligned between state government and local government. Respondents were split with just over half of council members (54 per cent), 48 per cent of local governments and 46 per cent of staff in favour.

There was some support for alignment with State Government procurement rules in submissions from individual local governments, and the Department of Infrastructure, Regional Development and Cities.

However, a number of submissions (such as the City of Joondalup and Small Business Development Corporation) highlighted concerns with the wholesale adoption of the SSC regime. Notably, the Small Business Development Corporation (SBDC) believed any requirement for local governments to abide solely by the State Government Common Use Agreement (CUA) could detrimentally impact small businesses, particularly in regional areas. This view was mirrored by some smaller local governments who suggested restrictions on purchasing could create problems, such as the ability to use local trades and business[es] which provides crucial support to the local economy.

Tender Thresholds

There was significant support from local governments, the Department of Infrastructure, Regional Development and Cities, WALGA, and LG Professionals to lift the public tender threshold in line with the State Government's \$250,000 threshold.

While the SBDC and Civil Contractors Federation did support increasing the threshold to \$250,000, they also proposed, in lieu of a blanket increase, that there should be some consideration of tiered increase dependent on the size of the local government.

As the SBDC noted, that – on face value – aligning the local government tender threshold with State Government agencies could potentially deliver a simplified, streamlined approach to public procurement in Western Australia, making it easier for small businesses to tender to both levels of government.

Some ratepayer associations were not supportive of any changes to the tender thresholds, without clear assessment of the risks and an emphasis on open tendering being maintained for all public tenders.

Tiered Approach to Local Government Procurement

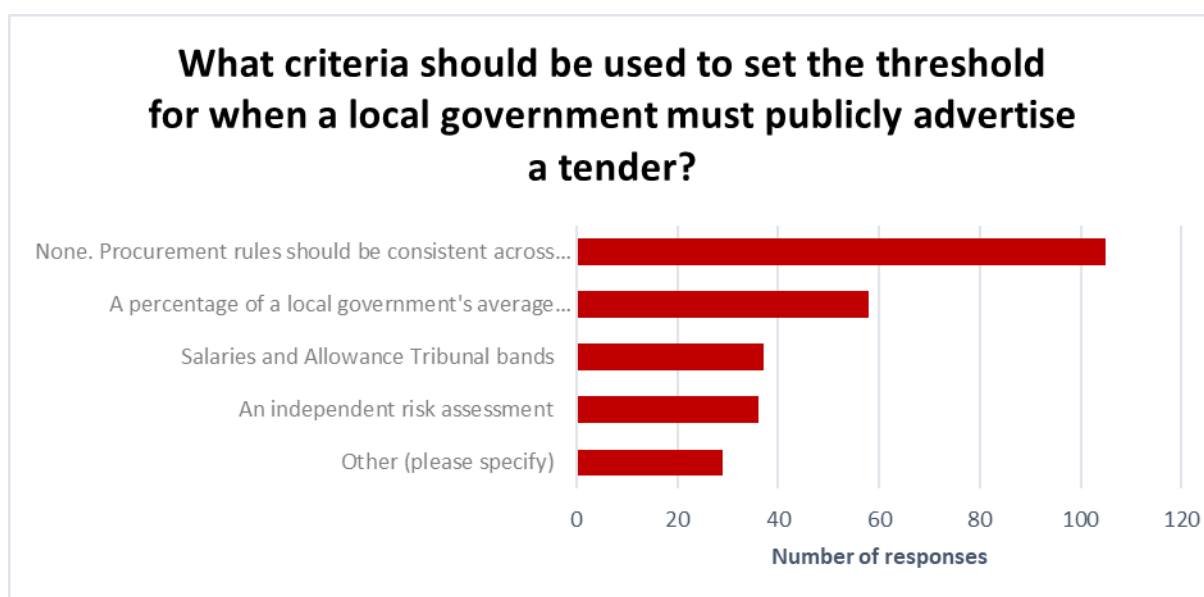
The discussion paper canvassed views on the introduction of a 'tiered approach' to local government, with tender thresholds scaled to local government size and capacity. Proposed options included:

- **Expenditure:** Requirement for local governments to advertise tenders with an anticipated value that is greater than a prescribed percentage of that local government's average annual operating expenditure.
- **Assigned bands:** Banding currently used by the Salaries and Allowances Tribunal to set the remuneration of council members and local government Chief Executive Officers.
- **Risk assessment:** Assigning a local government's tender threshold according to risk. Currently, local governments are assigned a risk category by the

Department annually based on their financial performance and general governance.

Half of the responses to the survey provided on behalf of local governments (50 per cent) indicated support for applying different procurement rules to different local governments. Support from local governments for different procurement rules came almost exclusively from country local governments. Just one of the nine local governments who stated support was a metropolitan local government.

Just over half of local government staff (54 per cent) supported the concept. There was less support for a 'tiered approach' from residents (25 per cent) and council members (24 per cent).



As previously mentioned, both the SBDC and the Civil Contractor's Federation support the introduction of a tiered model if the tender threshold is raised.

For those organisations supporting the introduction of a tiered approach, additional protections were cited as essential to reduce the possibility of non-compliance or incorrect procedures occurring unnoticed, or to minimise risk of misconduct in procurement processes.

Preferred Supplier Panels

Under existing regulations, a local government is exempt from being required to invite tenders if it obtains goods and services through the WALGA Preferred Supplier Program (PSP). WALGA's PSP is designed to enable member local governments to obtain advantages from a bulk purchasing arrangement for the benefit of local government in Western Australia.

Several respondents highlighted matters which could improve the current operations of preferred supplier panels:

- **Transparency:** Several respondents noted the need for consistency and transparency in the operation of any preferred supplier scheme, and proposed

measures which could provide greater clarity for local governments and contractors.

- **Competition:** The current regulations only provide for the use of WALGA's PSP (though it should be noted that there is nothing preventing local governments from accessing the State Government's CUA). Procurement Australia noted that this restricts the ability of other entities to provide similar bulk-purchasing services to local government in Western Australia.
- **Local Content:** Some respondents noted that the use of preferred supplier panels (and the State Government's CUA) may exclude local suppliers from tender opportunities

Regional Price Preference

The current regulations enable a non-metropolitan local government to offer a regional price preference. The regional price preference encourages governments to use locally sourced suppliers allowing local governments to assess a tender from a regional supplier as if the price bids were reduced.

Respondents including the SBDC, Civil Contractors Federation, and Regional Chambers of Commerce and Industry, supported proposed increases in the regional price reduction cap to \$250,000, in line with State Government tendering rules.

In respect to Regional Price Preferences, several responses called for a general expansion of the scheme and greater prescription on circumstances where it can be used. However, some respondents did note the need for caution suggesting that buying local should not occur at the additional expense of greater cost to the local government.

It is noted that the Department of Jobs, Tourism, Science and Innovation and the Department of Finance, are currently reviewing the State Government's Regional Price Preference Policy, and any changes will need to be considered in this context.

The Department of Jobs, Tourism, Science and Innovation also highlighted an opportunity to align local governments with the State Government's Western Australian Industry Participation Strategy (WAIPS). The WAIPS was developed under the *Western Australian Jobs Act 2017* and applies to all State Government departments, statutory authorities and Government Trading Entities when procurement is undertaken over the value of \$500,000 regionally and \$1 million in the metropolitan area.

Annual Reporting

Financial reporting is not a unique requirement to local government. All State Government and Commonwealth department financial reports are audited by their respective Offices of the Auditor General. Likewise, in the private sector, audited financial reports for many types of companies must be submitted to the Australian Securities and Investment Commission and prescribed types of charities must submit a general purpose financial statement.

Local governments are required to prepare an audited financial statement annually. The statement is required to meet the Australian Accounting Standards (AAS) as modified by the Act and Regulations.

Legislation requires that local governments calculate and publish seven financial ratios in their annual financial statements. Financial ratios are used across Australia as an important performance indicator for public sector entities, including local government.

Across Australia, local governments are required to calculate and publish different ratios. The lack of consistency makes the comparison of financial performance across local governments around the country more complex.

Likewise, methods of valuation used to calculate ratios under the International Valuation Standard can vary, which means that ratios are a guide or indicator rather than a definitive account of financial health.

Workshops

Council members tended to express a general concern that the current reporting requirements are onerous.

Local government staff highlighted issues with the existing ratios. Although their concerns did differ, they primarily requested the ratios be completely reviewed, with an aim to provide a realistic idea of where their local governments stand, better guidance on what numbers comprises each ratio, and developed so they cannot be as easily manipulated.

When discussing financial reporting outside of the ratios, local government staff generally advocated for less reporting with the manner, form and the amount of information provided being up to the local government to decide.

This view, especially the consideration of a reduced level of reporting was not supported by the community, who largely advocated for increasing the level of oversight and reporting.

While a couple of community members had a particularly keen interest in financial health ratios, generally members of the community, did not raise them as an issue.

Written submissions

Financial Ratios

In line with the feedback received during workshops, local governments called for changes to the financial ratios that local governments are required to calculate.

Submissions from local governments were generally calls for a total review of the ratios used and did not offer any alternatives. Although some submissions did raise specific issues.

Issues raised included:

- The effectiveness of the operating surplus ratio;
- Asset renewal ratio;
- The effect of early payment of Commonwealth Financial Assistance Grants;
- The current ratio not including restricted assets;
- The need to have notes that provide context on why a ratio may have a score lower than the benchmark;
- Comparisons should only be undertaken between local governments with similar circumstances;
- Manipulation of the ratios and
- A review of the Financial Health Indicator, and the weighting of ratios under that score.

The City of Swan provided a great deal of detail and analysis of the current financial ratios, and provided the ratios should have five main themes:

- Underlying operating performance;
- Debt management;
- Liquidity;
- Asset performance; and
- Financial capacity

Financial reporting

The format of financial reporting was raised with some responses calling for simpler financial reporting or a move away from the Australian Accounting Standards.

This view was contrasted by one submission that argued that increasing the standard of financial management required a stronger alignment between local government finances and the accounting standards.

This was echoed by members of the public who generally called for greater transparency and consistency between local governments in all financial information, including beyond annual financial statements.

Another suggestion provided, allowing an extension to the time allowed to present the budget to council from 30 days to 60 days to assist country local governments.

Peak Bodies and Other Stakeholders

WALGA suggested that there be only three ratios, with a tailored approach to target ratios for local governments be considered, in line with the size and scale principle. The WALGA proposed ratios are:

- Operating surplus ratio
- Net Financial Liabilities ratio; and
- Asset renewal funding ratio

Support for a reduction in the reported financial ratios was also provided by the Chamber of Minerals and Energy, where the information provided is not useful or meaningful in providing a true and fair view of the local government's financial performance or position.

The Chamber of Minerals and Energy also raised concerns about the financial statements and other plans and reports produced by local governments. These concerns included:

- Revenue and rate setting strategies;
- Corporate business and strategic community plans;
- Detail of financial information for each significant asset; and
- Improved transparency concerning investments.

Building Upgrade Finance

Building Upgrade Finance (BUF) is a scheme whereby a local government administers loans issued by financiers to non-residential building owners to upgrade their buildings. The local government uses a levy on the building owner to recover the funds on behalf of the financier.

The approach has been used in Victoria, South Australia and New South Wales as a mechanism to encourage non-residential property owners to invest in environmentally conscious building upgrades.

BUF involves three parts:

- The building owner agrees to undertake works;
- A financier agrees to finance the works; and
- The local government agrees to recoup the loan (known as a building upgrade charge).

The arrangement means that the loan is tied to the property, rather than property owner. Responsibility to pay for the loan shifts if the ownership of the property changes.

In other Australian jurisdictions, the local government is by law not financially liable for any non-payment by the building owner. Local governments are required to use their best endeavours to recover the loan. As the loan is recovered via the same powers as rates or a service charge, in the event of non-payment, local governments have the same powers available to recover unpaid rates or service charges. This can include taking possession of the land and selling the property.

The City of Perth and the Property Council of Australia have also advocated that in addition to building upgrades to achieve environmental outcomes, there is an opportunity to use this approach to finance general upgrades to increase the commercial appeal of buildings for potential tenants.

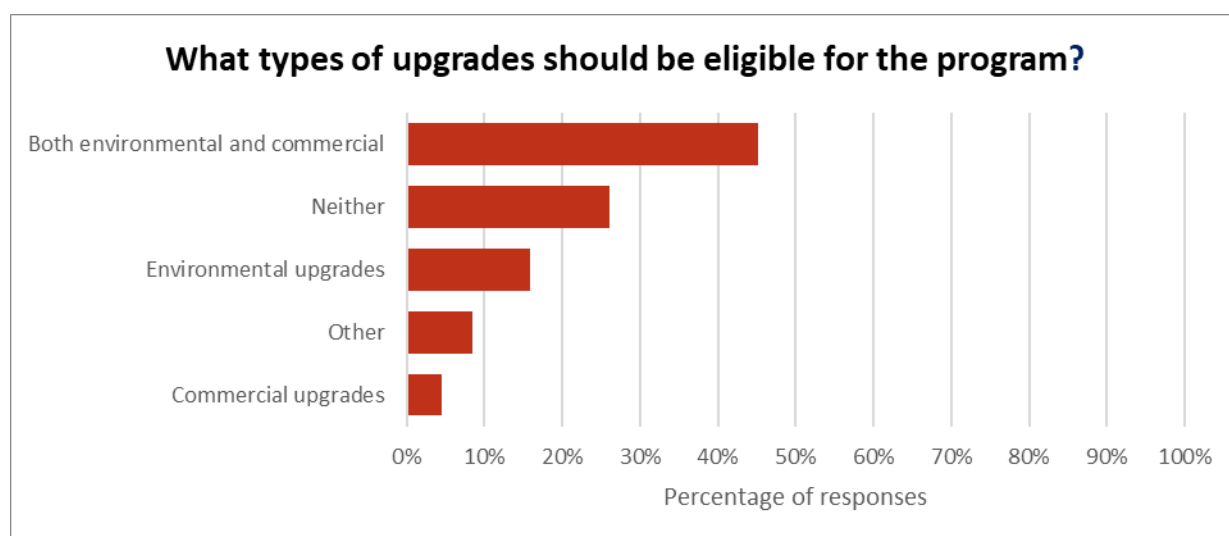
Surveys and written submissions

Through the written submissions, the strongest support for BUF came from the City of Perth and the Property Council who are the primary advocates for the scheme. Strong support for the scheme came from a number of other entities including the Strata Community Association WA (who requested that BUF be available to non-commercial buildings), property investment firm JLL, and from a number of local governments.

Notably, the Hon Tim Clifford MLC also provided his support for the scheme.

The survey responses provided mixed support for permitting BUF. Responses provided on behalf of a local government generally supported the concept (63 per cent), as did most staff (55 per cent). Council members (39 per cent) and residents (36 per cent) tended not to support the idea. Due to the technical nature of the concept, and possibly a lack of an overall awareness of the detail of such a scheme, a high proportion of respondents selected unsure (31 per cent)

When asked what types of projects should BUF be used for respondents tended to support both environmental and commercial projects being eligible. Respondents selecting 'other' advocated consultation in decision-making and heritage projects.



Peak Bodies and Other Stakeholders

While LG Professionals did not provide a submission on this topic; the WALGA submission simply stated it supported the introduction of the scheme.

Additional Matters Raised

A number of submissions contained ideas concerning the introduction of provisions that promote positive environmental outcomes.

The City of Canning advocated to promote sustainability through community financing models and bulk-buy schemes for renewable energy. Likewise, there was support for local governments to be empowered to develop renewable energy projects through a loan scheme.

Several other responses advocated for legislation to empower a solar savers scheme that would allow long-term, low interest loans to be offered by local government to encourage people to install rooftop solar panels.

One respondent noted the BUF and Solar Savers schemes present a unique opportunity to encourage and incentivise building owners to make improvements that do just this, while also making our buildings accessible for everyone. While one community member noted the Solar Savers model allows support for and inclusion of members of the community who have previously been excluded from certain technological or other developments. By targeting low income homeowners this initiative expands the reach of household solar systems increasing community equity.

Similarly, WALGA recommended the regulations be amended to include a 'renewable energy infrastructure' prescribed charge on land (similar to underground electricity).

Summary

An analysis of feedback received through the consultation workshops and submissions has identified the following key themes:

- Legislation will need to adopt a balanced approach to ensure appropriate transparency, accountability and probity which addresses community expectations, and removes any unnecessary administrative burden on local governments;
- Opportunities to align some State and local government procurement practices could potentially deliver a simplified, streamlined approach to public procurement in Western Australia, making it easier for small businesses to tender to both levels of government;
- The financial ratios and associated benchmarking should be reviewed; and
- Further consideration of Building Upgrade Finance and other similar schemes to promote green energy should be undertaken.

Where to from here

Feedback and suggestions received during the consultation period will be used to inform the new Local Government Act.

Consideration will be given to how best to balance the governance and oversight expectations of the State Government and the community while ensuring the requirements are not an excessive burden to local governments.