Organisational Sustainability of Small Councils

Victorian Auditor-General's Report

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VAGO

Victorian Auditor-General's Office

Auditing in the Public Interest

The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Ken Smith MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report on the audit *Organisational Sustainability of Small Councils*.

Yours faithfully

Dr Peter Frost
Acting Auditor-General

12 June 2013

Contents

Audit summary

There are 79 local governments in Victoria. Of these, 21 are classified as small councils with populations of less than 20 000 people. These councils are located in rural areas and administer 89 893 square kilometres, or 40 per cent of Victoria's total area, and serve 217 000 people—4 per cent of the population.

Small councils are heavily dependent on government grants to continue operating. In 2011–12, small councils generated operating revenue of $701 million, with government grants accounting for $360 million, or 51 per cent, and rates and charges contributing $216 million or 31 per cent. In contrast, government grants account for around 22 per cent and rates around 49 per cent of total revenue across all 79 councils.

Organisational sustainability means that councils have the capacity to function efficiently, effectively and economically to meet the current and future needs of their communities to an acceptable standard. Small councils should have a sound understanding of the issues and challenges impacting their sustainability and develop appropriate strategies to mitigate their impact as much as possible. Council operations should be underpinned by effective financial planning and asset management, and effective and efficient service delivery.

The audit assessed whether councils had:

- a sound understanding of the sustainability challenges and issues
- developed appropriate strategies that consider a range of options for addressing sustainability issues and challenges
- evaluated how effective sustainability strategies have been
- been provided with appropriate guidance and support by Local Government Victoria (LGV).

Conclusions

Over the past five years, the reliance of audited councils on government grants has grown substantially. While rates and charges have increased in real terms, this has not been enough to keep pace with councils' increases in costs. Several audited councils are projected to have deteriorating positions against key financial indicators, which places them at a higher risk of short-term and immediate sustainability concerns.

The audited councils generally have a sound understanding of the sustainability challenges they face and have implemented a range of strategies to address these. However, the councils generally cannot demonstrate the effectiveness of strategies and actions and whether these are having a material impact on improving their sustainability.

While four of the audited councils have recently developed long-term financial plans, and all have made some efforts to improve asset management, further work is required in these areas. Councils' existing asset management plans contain out-of-date information, which provides limited assurance that asset management requirements are being appropriately considered. Councils have not undertaken comprehensive service reviews and cannot demonstrate that they are delivering services effectively and efficiently, or that they have exhausted all opportunities to introduce or increase user fees and charges. While improving long-term financial planning, asset management and service delivery may not provide assurance that a council will be sustainable, these actions are still necessary in order to remain viable in the medium to long term.

Common sustainability issues and challenges across the audited councils include:

- having effective financial planning and asset management
- effectively and efficiently delivering services
- recruiting and retaining qualified and skilled staff
- dealing with the impact of population ageing and/or population change—such as high growth or decline
- dealing with the defined benefits superannuation shortfall.

LGV provides a range of general guidance and support, which is applicable to small councils in addressing some sustainability concerns, and it has implemented actions to assist small councils at high-risk of sustainability issues. However, LGV could more proactively target small councils with appropriate support and advice before their situation becomes critical. LGV is developing a performance reporting framework to provide a common suite of sustainability indicators for councils. This may provide an opportunity for LGV to more closely monitor councils' sustainability and respond appropriately to support them on a timely basis.

Findings

Financial trends

Over the past five years, the reliance of audited councils on government grants has more than doubled from $33.766 million in 2007–08 to $72.434 million in 2011–12. This equates to an average increase of 25 per cent per year for the audited councils. The increase in grants as a proportion of total revenue averaged 1.9 per cent a year. Over the same period, rates and charges, and user fees and charges increased from $35.714 million to $49.083 million and $7.275 million to $8.810 million respectively. While rates and charges have increased in real terms, they have decreased as a proportion of total revenue, with councils’ reliance on these declining over the same period by 1.4 per cent per annum and 0.3 per cent respectively. Therefore, while councils have increased the amount of own-source revenue they generate through rates and user charges, it has not been enough to keep pace with their increase in costs. Given current Commonwealth and State Budget positions and the economic climate, the audited councils' increasing reliance on grants may be unsustainable.

Buloke and Yarriambiack are projected to have deteriorating positions against key financial indicators related to short-term and immediate sustainability concerns. Strathbogie has some worrying financial indicators, but others are projected to improve. Several longer-term financial sustainability indicators are projected to deteriorate for Golden Plains and one for Towong, although Towong is projected to improve against all other indicators.

Effective financial planning and asset management

Effective long-term financial planning and asset management is crucial to sustainability and these should be appropriately integrated so that asset management needs are adequately considered in financial planning. All audited councils except Yarriambiack have recently developed long-term financial plans, but these vary in quality and are not sufficiently integrated with asset management. While the plans—particularly Strathbogie's—reflect a number of better practice elements, further work is needed by all councils to address deficiencies and effectively plan their finances over the long term to support their sustainability.

Effective and efficient service delivery

Councils deliver a wide range of services to their communities. Even within the context of necessary expenditures, there is scope to decide the services and service levels there should be. The *Local Government Act 1989* sets out the Best Value Principles that should inform council decisions on services. Other than narrow reviews of specific services—such as to identify cost savings—none of the audited councils have undertaken comprehensive reviews of services in accordance with these principles, or reviewed service levels to assess the effectiveness and efficiency of service delivery. The current approaches provide limited assurance that expenditure on service delivery is informed by an adequate understanding of community needs or the effectiveness and efficiency of council services. All councils have committed to maintaining existing service levels.

Recruiting and retaining qualified and skilled staff

Small councils in regional and rural areas face challenges in attracting and retaining appropriately qualified and skilled staff. All audited councils except Yarriambiack identified this as an issue and some have implemented strategies to address these challenges.

Golden Plains has developed a workforce plan, which contains a number of better practice elements, including identifying future workforce needs and strategies to address workforce issues. While there have been no formal evaluations of the plan itself, council advised it has been effective in informing decisions about staff levels, identifying gaps, career planning for existing staff and potential replacement of key staff.

Strathbogie completed an organisational review in 2011, which included voluntary redundancies, the creation of several new positions and the development of a new organisation structure. While the review recommended that Strathbogie develop a workforce plan, council has not yet done so.

Councils also outsource some positions, including statutory roles, such as building surveyors and planning officers. While Yarriambiack advised that staff recruitment was not an issue, it too outsources these statutory positions. Councils advised that these roles can be difficult to fill and that this may be due to their remuneration being uncompetitive, potential applicants not wanting to relocate to regional areas or because councils only require part-time positions.

Outsourcing may address the issue in the short term and maintain ongoing service delivery. However, councils have not assessed whether this is more cost effective than employing staff directly, and sustainable in the long term.

Population ageing and/or population changes

Population ageing and/or population changes—such as high growth or decline—can present challenges to small councils. Population changes affect councils' rating base and change service delivery needs. With the exception of Towong, there are consistent trends facing the audited councils across the 30-year period—2001 to 2031—of either increasing (Golden Plains and Strathbogie) or decreasing populations (Buloke and Yarriambiack). All audited councils except Yarriambiack have developed, or are developing, strategies related to population change. However, these are relatively new or in development.

Defined benefits superannuation shortfall

A sharp increase in employee benefit expenses in 2012 for all audited councils is due to the funding call on the Local Authorities Superannuation Fund Defined Benefits Plan. In 1998, state legislation governing the scheme was repealed and it became a ‘regulated fund’ under Commonwealth Government legislation, which introduced a requirement for it to be fully funded. Of the audited councils, Yarriambiack, Buloke and Towong’s liability is the highest in real terms, and as a proportion of their rates revenue. Councils have adopted a range of different strategies to meet their liability. The impact of this shortfall highlights the vulnerability of small councils to unplanned events and their limited capacity to absorb this expenditure.

Support and guidance

It is important that appropriate support and guidance is provided to small councils to assist in addressing specific sustainability issues and improving the efficiency and effectiveness of council operations. This includes driving the adoption of better practices, improving their capability and providing targeted support or intervention when required.

While LGV does not have strategic priorities targeting the organisational sustainability of small councils, it provides a range of guidance and support broadly related to sustainability that is applicable to them. This includes developing and disseminating better practice guides that cover areas such as asset management, procurement and Best Value service delivery, delivering programs, and developing a performance management framework. However, there are opportunities to make this guidance and support more directly targeted to areas of challenge for small councils and to build their capability and resilience.

LGV conducts monitoring and reporting activities to identify councils at high risk of sustainability issues. It has advised the Minister for Local Government about these councils and implemented actions to address issues when they have become critical. LGV could more proactively target small councils with appropriate support and advice before their situation becomes critical. The development of LGV's local government performance management framework provides an opportunity to more closely monitor councils' sustainability and respond appropriately to support them on a timely basis.

Recommendations

Number	Recommendation	Page
1.	Councils should clearly identify and publicly report their sustainability challenges and associated strategies and actions, including how they will monitor, report and evaluate their effectiveness, using relevant and appropriate performance indicators.	30
2.	Yarriambiack Shire Council should develop a long-term financial plan and all councils should update their existing plans in accordance with better practice.	30
3.	Councils should review service planning and delivery in accordance with Best Value Principles as a priority, including: • assessing overall service delivery levels to determine appropriate levels and provide the rationale for their decision • consulting with their communities on their ability and willingness to pay for desired services in the development of the council plan • developing a plan to regularly review all services over time.	30
	The Department of Planning and Community Development should:	
4.	review and update its asset management guidance	36
5.	consider making the development of a long-term financial plan mandatory and provide support and guidance in the development of these	36
6.	routinely review the guidance and support it provides so that it is aligned with areas of highest need and addresses gaps in councils' capability and capacity	36
7.	expedite implementation of the planned local government performance reporting framework and make sure it includes appropriate sustainability indicators.	36

Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to the Department of Planning and Community Development and to the following five councils, with a request for submissions or comments:

- Buloke Shire Council
- Golden Plains Shire Council
- Strathbogie Shire Council
- Towong Shire Council
- Yarriambiack Shire Council.

Agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments are included in Appendix B.

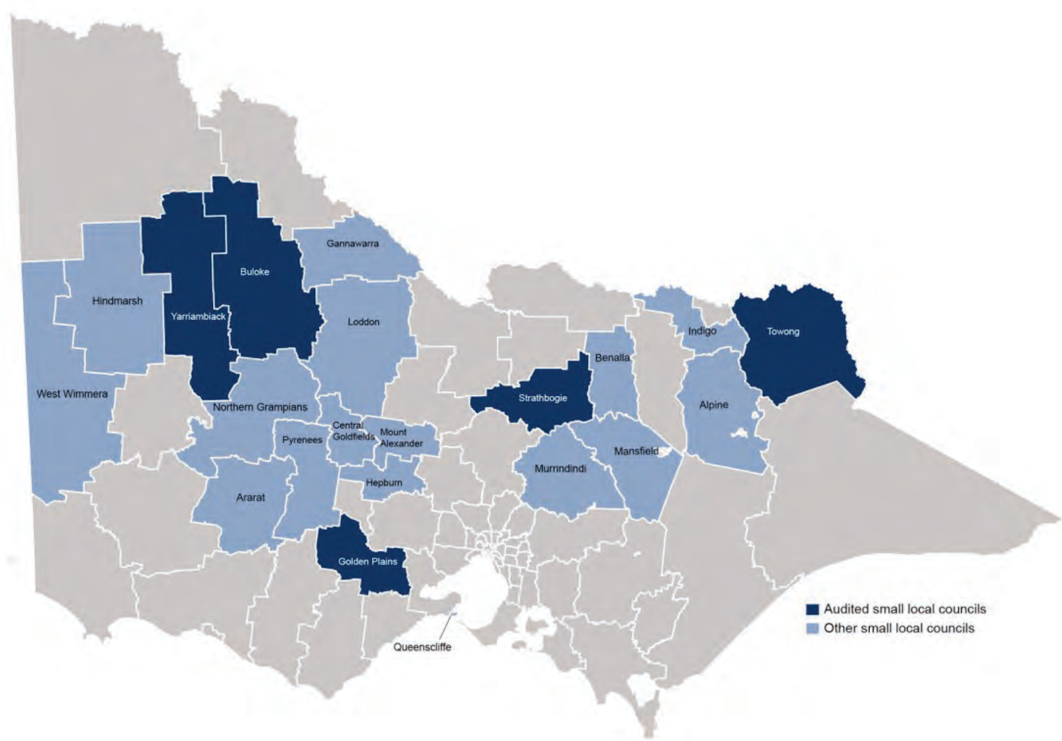
1 Background

1.1 Small councils

There are 79 local governments in Victoria. Of these, 21 are classified as small councils with populations of less than 20 000 people. These councils are located in rural areas and administer 89 893 square kilometres, or 40 per cent of Victoria's total area, and serve 217 000 people—4 per cent of the population.

Figure 1A shows the location of the 21 small councils in Victoria with the five audited councils highlighted.

Figure 1A
Location of 21 small councils



Source: Victorian Auditor-General's Office.

1.1.2 Small council funding

Small councils are heavily dependent on government grants to continue operating. In 2011–12, small councils generated operating revenue of $701 million, with government grants accounting for $360 million, or 51 per cent, and rates and charges contributing $216 million or 31 per cent. In contrast, government grants account for around 22 per cent and rates around 49 per cent of total revenue across all 79 councils.

1.1.3 Organisational sustainability of small councils

Organisational sustainability means that councils have the capacity to function efficiently, effectively and economically to meet the current and future needs of their communities to an acceptable standard. Core attributes of organisational sustainability include:

- sound governance to guide effective delivery of council activities
- effective planning to support current and future council operations
- sound financial management to meet current and future financial commitments
- optimum use of available resources
- use of community engagement to enable prioritisation of services and asset management according to community needs
- effective workforce planning and management.

Small councils face a range of issues and challenges that impact organisational sustainability, some of which may be outside of their control. These include:

- population decline and demographic changes such as ageing populations
- their location within regions including proximity to large regional towns
- recruiting and retaining qualified or skilled staff
- large networks of roads and other infrastructure to maintain
- increasing service delivery costs and servicing large geographic areas
- dealing with major unplanned events, such as the recent defined benefits superannuation shortfall, where the extent of liability was unknown.

1.2 Legislation and better practice

Local Government Act 1989

The *Local Government Act 1989* (the Act) stipulates the primary objective of a council is to endeavour to achieve the best outcomes for the local community, having regard to the long term and cumulative effects of decisions. In seeking to achieve its primary legislative objective, a council must have regard to the following facilitating objectives:

- to promote the social, economic and environmental viability and sustainability of the municipal district
- to ensure that resources are used efficiently and effectively, and services are provided in accordance with the Best Value Principles to best meet the needs of the local community
- to improve the overall quality of life of people in the local community
- to promote appropriate business and employment opportunities

- to ensure that services and facilities provided by the council are accessible and equitable
- to ensure the equitable imposition of rates and charges
- to ensure transparency and accountability in council decision-making.

Under the Act, councils are required to develop planning and accountability reports, and apply sound financial management and Best Value Principles, as shown in Figure 1B.

Figure 1B
***Local Government Act 1989* requirements**

Planning and accountability reports
(a) *Council Plan* including the strategic objectives, strategies for at least the next four years and strategic indicators
(b) *Strategic Resource Plan* setting out the required financial and non-financial resources for at least the next four years to achieve the strategic objectives
(c) *Budget* containing a description of the activities and initiatives to be funded and how they will contribute to achieving the strategic objectives
(d) *Annual Report* containing a report of its operations during the financial year, audited standard and financial statements for the financial year.
Sound financial management principles
A council must:
(a) manage financial risks faced by the council
(b) pursue spending and rating policies consistent with a reasonable degree of stability in the level of the rates burden
(c) ensure that decisions are made and actions are taken having regard to their financial effects on future generations
(d) ensure full, accurate and timely disclosure of financial information.
Best Value Principles
(a) All services must meet the quality and cost standards
(b) All services must be responsive to the needs of its community
(c) Each service must be accessible to those whom the service is intended for
(d) A council must achieve continuous improvement in the provision of services for its community
(e) A council must develop a program of regular consultation with its community
(f) A council must report regularly to its community on its achievement in relation to the principles set out above.

Source: Victorian Auditor General's Office based on information from the *Local Government Act 1989.*

Better practice and sector guidance

Better practice guidance material and other support is available to councils from a range of sources. This includes material developed by Local Government Victoria (LGV), the Municipal Association of Victoria (MAV), Victorian Local Governance Association (VLGA), Local Government Professionals (LGPro) and organisations such as the Institute of Public Works Engineering Australia (IPWEA) and the Australian Centre of Excellence for Local Government (ACELG). Key better practice guidance material is set out in Figure 1C.

Figure 1C
Better practice guidance material

Title	Description	Published by
Local Government Planning and Reporting Better Practice Guide (2013)	A guide to assist councils to meet statutory planning and accountability requirements, including guidance in the development of the council plan and reporting performance	LGV
Long-term Financial Planning (2012)	Developed to assist organisations that are involved in service delivery and long-term asset management in preparing a long-term financial plan	IPWEA and ACELG
Asset Management Policy, Strategy and Plan (2004)	Guidelines for developing an asset management policy, strategy and plan	LGV
'STEP' asset management improvement program (since 2003)	A program for councils covering asset management and planning as essential for effective delivery of services	MAV
Victorian Local Government Best Practice Procurement Guidelines 2013	Guidelines for dealing with the procurement cycle (planning, implementation, management and performance evaluation), reporting on procurement and meeting obligations under the Act	LGV
Embedding Community Priorities into Council Planning (2008)	A set of guidelines for involving the community in development of the council plan	LGPro
A guide to achieving a whole of organisation approach to Best Value (2006)	Designed to assist in developing or enhancing formal or informal improvement and planning frameworks to effectively incorporate the Best Value Principles	LGV developed in partnership with LGPro Corporate Planner's Network and the Best Value Commission

Source: Victorian Auditor-General's Office.

1.3 Roles and responsibilities

1.3.1 Local Government Victoria

LGV, a division of the Department of Planning and Community Development (DPCD), supports and advises the Minister for Local Government in administering the Act. The role of LGV also includes overseeing, supporting and encouraging local government and providing advice and support to councils in relation to their roles and responsibilities under the Act. LGV also works in partnership with the local government sector and other parts of government to improve and reform business, governance and funding practices to maximise value and accountability.

1.3.2 Local councils

Councils deliver a wide range of services to their communities including child and family day care services, meals on wheels, waste collection, planning and recreational services. Councils also build and maintain community assets and infrastructure, including roads, footpaths and drains, and enforce various laws. Councils are required by the Act to promote the sustainability of the municipal district and to ensure effective and efficient use of resources. Councils are also expected to provide services in accordance with Best Value Principles to best meet the needs of the local community.

1.3.3 Victoria Grants Commission

The Victoria Grants Commission's primary function is to allocate revenue provided by the Commonwealth Government to municipal councils in Victoria according to the *Local Government (Financial Assistance) Act 1995* and a set of national distribution principles. All funds allocated by the Commonwealth are distributed to councils. The commission is funded by the Victorian Government through DPCD.

1.4 Previous audits

1.4.1 *Local Government: Results of the 2011–12 audits*

VAGO's *Local Government: Results of 2011–12 audits* report presents the results of our financial audits of 103 entities within the local government sector, including Victoria's 79 councils. It provides a detailed analysis of council financial reporting, performance reporting, financial results, financial sustainability and internal controls. It analyses trends in six key financial sustainability indicators (underlying result, liquidity, self-financing, indebtedness, capital replacement and renewal gap), reflecting both short- and long-term sustainability, over a five-year period and includes forecasts over a three-year period.

1.4.2 Related performance audits

Other reports relating to organisational sustainability that VAGO has tabled over the past few years include:

- *Ratings Practices in Local Government* (February 2013)
- *Business Planning for Major Capital Works and Recurrent Services in Local Government* (September 2011)
- *Fees and Charges—cost recovery by local government* (April 2010).

1.5 Audit objective and scope

The objective of this audit was to assess the effectiveness of the planning and management undertaken by small councils to support their long-term organisational sustainability. It also assessed guidance and support provided by LGV and aimed to identify practices that could help drive improvements across the local government sector.

The audit focused on the following five selected councils:

- Buloke Shire Council
- Golden Plains Shire Council
- Strathbogie Shire Council
- Towong Shire Council
- Yarriambiack Shire Council.

It assessed whether they have:

- a sound understanding of the sustainability challenges and issues facing their council
- developed appropriate strategies that consider a range of options for addressing sustainability issues and challenges
- evaluated how effective sustainability strategies have been
- been provided with appropriate guidance and support to address sustainability issues by LGV.

1.6 Method and cost

The audit was conducted in accordance with section 15 of the *Audit Act 1994* and Australian Auditing and Assurance Standards. Pursuant to section 20(3) of the *Audit Act 1994*, any persons named in this report are not the subject of adverse comment or opinion.

The cost of the audit was $385 000.

1.7 Structure of the report

The report is structured as follows:

- Part 2 examines the financial position of councils
- Part 3 discusses sustainability issues, challenges and strategies
- Part 4 examines support, guidance, monitoring and reporting undertaken by LGV.

2 Financial sustainability

At a glance

Background

To be financially sustainable, councils need to be able to meet their current and future expenditure requirements. They also need to be able to absorb foreseeable changes and materialising risks, and manage the impact of their changing revenue and expenditure requirements. Assessing trends in key financial indicators provides insight into the risks to small councils' financial sustainability.

Conclusion

In 2011–12, Buloke had high-risk, immediate to shorter-term sustainability concerns, while the remaining four audited councils were classed as having a low risk. However, several councils are projected to have deteriorating positions against key financial indicators, which places them at an increased risk of short-term and immediate sustainability concerns.

Over the past five years, the reliance of the audited councils on government grants has increased substantially. While councils have increased the amount of own-source revenue they generate through rates and user charges, it has not been enough to keep pace with their increased costs. Given current Commonwealth and State Budget positions and the economic climate, the audited councils' increasing reliance on grants may expose them to significant financial risk if the number and value of grants are reduced.

Findings

- On average, government grants have increased significantly as a proportion of total revenue over the past five years across all of the audited councils.
- In 2012, a superannuation defined benefits plan funding shortfall had a significant impact on employee expenses for all of the audited councils.
- Councils have generally not reviewed whether there is scope to introduce or increase user fees and charges.

2.1 Introduction

To be financially sustainable, councils need to be able to meet current and future expenditure as it falls due. They also need the ability to absorb foreseeable changes and materialising risks without significantly changing their revenue and expenditure policies.

Financial sustainability should be viewed from both short- and long-term perspectives. Short-term indicators relate to the ability of a council to maintain positive operating cash flows in the near future, or the ability to generate an operating surplus in the next financial year. Long-term indicators focus on strategic issues such as the ability to fund significant asset replacement or reduce long-term debt. Councils are unlikely to remain viable without effective expenditure management and revenue maximisation practices to underpin long-term organisational sustainability.

An assessment of trends in key financial indicators, based on councils' projections, provides insight into the risks to small councils' financial sustainability that may warrant attention. Similarly, examining trends in the composition of revenue and expenditure highlights potential issues and risks with particular patterns of revenue and expenditure for high-risk councils.

2.2 Conclusion

Over the past five years, the reliance of audited councils on government grants has increased substantially. While rates and charges have increased in real terms, they have decreased as a proportion of revenue over the same period, and this increase in rates and charges has not been enough to keep pace with councils' increase in costs.

In 2011–12, Buloke had high-risk, immediate to shorter-term sustainability concerns, while the remaining four audited councils were classed as having low risk of financial sustainability concerns. However, several councils are projected to have deteriorating positions against key financial indicators, which places them at an increased risk of short-term and immediate sustainability concerns.

Given current Commonwealth and State Budget positions and the economic climate, the audited councils' increasing reliance on grants may expose them to significant financial risk if the number and value of grants are reduced.

2.3 Councils' financial sustainability

2.3.1 Current and future trends

VAGO's six key financial sustainability indicators, which reflect short-and long-term sustainability over the past five years, provide an insight into the financial sustainability of councils. The indicators are:

- **underlying result**—councils generate enough revenue to cover operating costs, including the cost of replacing assets reflected in depreciation expense
- **liquidity**—councils have sufficient working capital to meet short-term commitments
- **self-financing**—councils generate sufficient operating cash flows to invest in asset renewal and repay any debt that may have been incurred in the past
- **indebtedness**—councils do not overly rely on debt to fund capital programs
- **capital replacement**—councils replace assets at a rate consistent with their consumption
- **renewal gap**—councils maintaining existing assets at a consistent rate.

Appendix A describes the sustainability indicators in more detail, including the risk assessment criteria and the significance of these. The indicators are used to evaluate each council and provide a financial sustainability risk assessment. A high risk of short-term and immediate financial sustainability concerns is indicated by either a high-risk underlying result or liquidity indicator. A medium risk of longer-term financial sustainability concerns is indicated by a high-risk assessment for either of the remaining four indicators—self-financing, indebtedness, capital replacement and renewal gap. A low risk of financial sustainability concerns means there are no high-risk indicators.

VAGO's *Local Government: Results of the 2011–12 Audits* report presents the results of financial audits of Victoria's 79 councils based on the six financial sustainability indicators. Figure 2A shows the results for the audited councils.

Figure 2A
Financial sustainability risk assessment results, 2011–12

Audited councils	Underlying result (%)	Liquidity (ratio)	Indebtedness (%)	Self-financing (%)	Capital replacement (ratio)	Renewal gap (ratio)	Risk assessment
Buloke Shire Council	-7.85	0.93	12.37	25.23	1.02	0.9	High
Golden Plains Shire Council	12.7	2.38	23.86	26.74	2.41	1.17	Low
Strathbogie Shire Council	4.13	1.76	28.75	26.49	1.28	0.82	Low
Towong Shire Council	4.35	3.01	9.77	32.92	1.24	0.98	Low
Yarriambiack Shire Council	0.17	2.83	9.32	31.62	1.1	0.8	Low

Source: Victorian Auditor-General's Office.

Figure 2A shows that as at 30 June 2012 Buloke had a high risk of short-term and immediate sustainability concerns. This is highlighted by indicators suggesting it has a risk of long-term run-down to cash reserves, inability to fund asset renewals (underlying result) and insufficient current assets to cover current liabilities (liquidity). The remaining four councils in the audit were classed as having a low risk of financial sustainability concerns in 2011–12.

The Minister for Local Government appointed an Inspector of Municipal Administration (the Inspector) to independently assess Buloke's financial health in response to VAGO's qualification of its financial accounts in 2010–11—this is discussed further in Part 4.4. A qualification means that the financial report is materially different to the requirements of the relevant reporting framework or accounting standards, and is less reliable and useful as an accountability document.

Figure 2B shows the projected trend for five of the six indicators, based on councils' budget projections, for the period 2012–13 to 2014–15. Projected data is not available for the renewal gap indicator.

Figure 2B
Financial sustainability indicator projections, 2012–13 to 2014–15

	Underlying result	Liquidity	Indebtedness	Self-financing	Capital replacement
Buloke Shire Council	↓	↓	→	→	→
Golden Plains Shire Council	→	→	↓	→	↓
Strathbogie Shire Council	↑	↓	↓	→	↑
Towong Shire Council	↑	↑	↓	↑	↑
Yarriambiack Shire Council	↓	↓	↓	↓	→

Note: Key: ↓ downward trend → no substantial trend ↑ upward trend
Source: Victorian Auditor-General's Office.

Buloke's underlying result and liquidity is projected to deteriorate over the next three years and it is expected to remain at high risk of short-term and immediate sustainability concerns. Its underlying result improves in 2012–13 due to forecast capital grants from the Natural Disaster Recovery Fund, but it is projected to return to a worse-than-current position by 2015. Other audited councils also show deteriorating results against some indicators over the next three years.

The results suggest Yarriambiack is at risk of potential short-term and immediate financial sustainability concerns due to the deteriorating position of its underlying result and liquidity indicators, while it also has deteriorating indebtedness and self-financing indicators. Similarly, Strathbogie has a deteriorating liquidity indicator, but its underlying result is projected to improve. Its indebtedness indicator is also projected to deteriorate, however, its underlying result and capital replacement indicators are projected to improve.

Golden Plains' capital replacement and indebtedness indicators are projected to deteriorate. Towong's indebtedness indicator is also projected to deteriorate, although its other indicators are projected to improve. The deteriorating indicators for Golden Plains and Towong suggest they are at increased risk of longer-term sustainability concerns if these indicators became high risk.

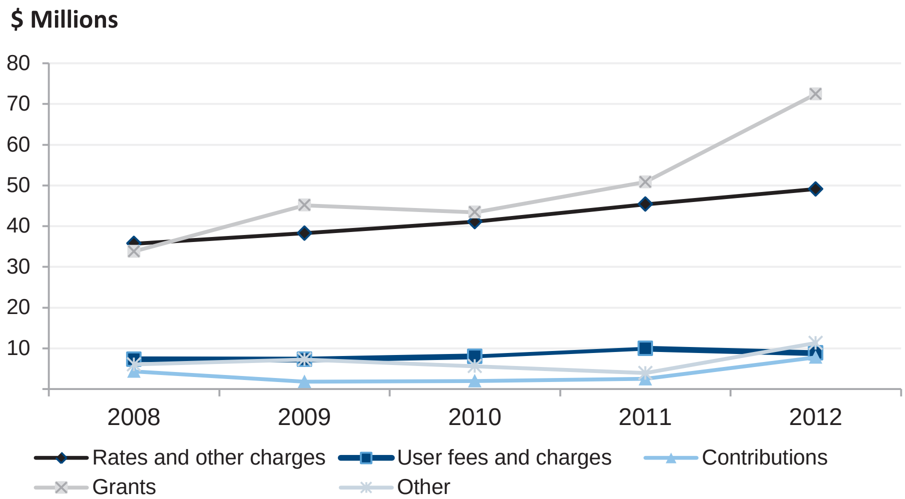
2.3.2 Council revenue

Councils generate revenue directly from rates, user fees and a range of charges—known as own-source revenue—and from other sources such as state and Commonwealth Government grants and developer contributions. The main types of revenue are:

- **Rates and other charges**—property taxes including general rates, the municipal charge, service rates or charges, and special rates or charges.
- **User fees and charges**—fees and charges for compulsory services, such as statutory planning fees, or discretionary services, such as recreation services, child care or applications for planning and building permits.
- **Contributions**—payments or in-kind works, facilities or services provided by developers towards the supply of infrastructure such as roads, storm water run-off management systems, open space and community facilities required to meet the future needs of local residents in new land developments.
- **Grants**—financial assistance grants provided by the Commonwealth or state governments. The Commonwealth Government provides general purpose and local roads grants, and councils may also receive grants following natural disasters or other emergency events. The Department of Planning and Community Development administers a range of state government grant programs available to local governments, such as community facility funding, community works grants, country football and netball facilities grants, fire ready community grants and library infrastructure grants.

Figure 2C shows the revenue raised from key sources for the period 2007–08 to 2011–12.

Figure 2C
Total revenue for the five councils



Source: Victorian Auditor-General's Office.

While Figure 2C shows that the amount of grants and rates and charges have increased, grants are the main source of revenue that is increasing as a proportion of total revenue. Figure 2D shows that on average councils' rates and charges, and user fees and charges have decreased as a proportion of total revenue. This implies an increasing reliance on grants to fund expenditure requirements compared to other revenue sources, which is concerning given the current Commonwealth and State Budget positions and economic climate.

Figure 2D
Revenue sources for the five councils as a percentage of total revenue, 2008 to 2012

	Rates and other charges (%)	User fees and charges (%)	Contributions (%)	Grants (%)	Other (%)
2008	41.0	8.3	5.0	38.7	6.9
2009	38.4	7.3	1.9	45.2	7.3
2010	41.1	8.0	2.0	43.4	5.6
2011	40.3	8.8	2.2	45.2	3.5
2012	32.8	5.9	5.2	48.5	7.6
Average rate of change per year	–1.4	–0.3	0.1	1.9	–0.3

Source: Victorian Auditor-General's Office.

The amount of grants for the audited councils has more than doubled over five years from $33.766 million in 2007–08 to $72.434 million in 2011–12. This equates to an average increase of 25 per cent per year. The increase in grants as a proportion of total revenue averaged 1.9 per cent a year. Over the same period, rates and charges and user fees and charges increased from $35.714 million to $49.083 million and $7.275 million to $8.810 million respectively, but councils' reliance on these has declined over the same period by 1.4 per cent and 0.3 per cent per annum respectively. This means that despite increases in real terms, councils' own-source revenue has decreased proportionally by an average of 1.7 per cent per year.

Therefore, while councils have increased the amount of own-source revenue they generate through rates and user charges, it has not been enough to keep pace with their increase in costs. Despite all five audited councils having committed to maintaining existing service levels, there is limited evidence that they have comprehensively reviewed their services or service levels. Councils have generally not reviewed whether there is scope to introduce, or increase user fees and charges to at least partially address their revenue requirements. Golden Plains advised it conducted a review of user fees and charges during the 2012–13 budget process, and that an outcome of the review was to increase non-statutory fees by 9.5 per cent. However, it was unable to provide documentary evidence of this review to show the analysis and rationale underpinning the decision to increase fees.

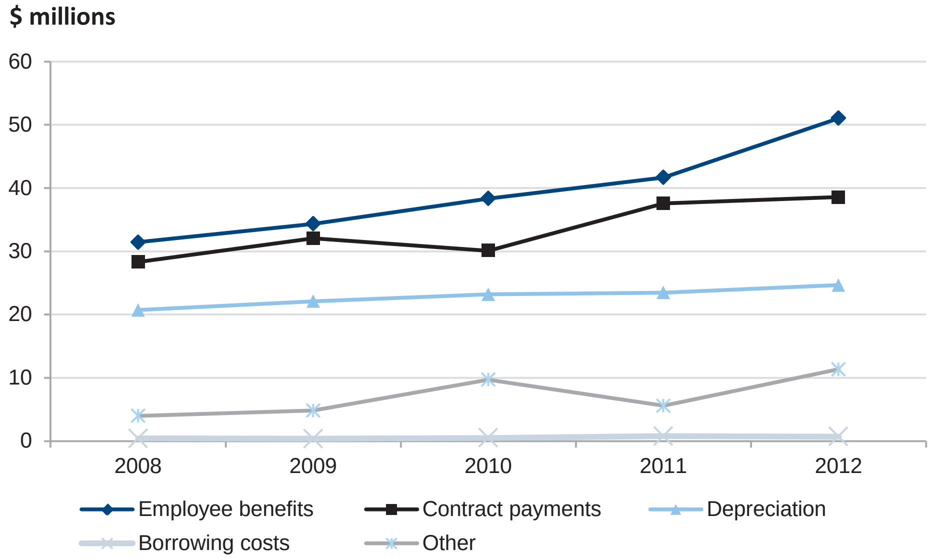
2.3.3 Council expenditure

Councils have a range of operating expenses, including the following key expenses:

- **employee benefits**—includes wages and salaries, leave entitlements, redundancy payments and superannuation contributions
- **contract payments**—includes payments for services delivered by contractors, such as waste collection or parks and gardens maintenance, and council staff positions that are filled by contractors
- **depreciation**—the systematic allocation of a fixed asset's capital value as an expense over its expected useful life to take account of normal usage, obsolescence, or the passage of time
- **borrowing costs**—costs such as interest associated with borrowings taken out to fund council expenditure.

Figure 2E shows the trend in key expenses for the period 2007–08 to 2011–12.

Figure 2E
Total expenses for the five councils



Note: 'Other' includes a range of expenses such as travel costs and printing.
Source: Victorian Auditor-General's Office.

Figure 2F shows the councils' key expenses over the period 2007–08 to 2011–12 as a proportion of total expenses.

Figure 2F
Expenses for the five councils as a percentage of total expenditure, 2008 to 2012

	Employee benefits (%)	Contract payments (%)	Depreciation (%)	Borrowing costs (%)	Other (%)
2008	37.0	33.4	24.4	0.5	4.7
2009	36.7	34.2	23.6	0.4	5.1
2010	37.7	29.6	22.8	0.5	9.5
2011	38.2	34.5	21.5	0.7	5.1
2012	40.4	30.5	19.5	0.6	9.0
Average rate of change per year	0.8	–0.5	–1.2	0	0.9

Source: Victorian Auditor-General's Office.

Overall, increasing expenses for the audited councils are largely being driven by higher employee benefits and contract payments. Employee benefits have risen from $31.429 million in 2008 to $51.053 million in 2012, which represents an average increase of 0.8 per cent per year as a proportion of total expenses. Advice from LGV to government suggests that local government recurrent expenditure has increased by more than twice the rate of inflation over the past decade, and aggregate expenditure on salaries and wages has increased by almost three times the national average in public sector wages and salaries over the same period.

The sharper increase in employee benefit expenses in 2012 is due to the funding call on the Local Authorities Superannuation Fund Defined Benefits Plan. In 1998, state legislation governing the scheme was repealed and it became a ‘regulated fund’ under Commonwealth Government legislation, which introduced a requirement for it to be fully funded. Of the audited councils, Buloke, Towong and Yarriambiack’s liability is the highest in real terms and as a proportion of their rates revenue. The funding liability will have an impact on councils' liquidity, and may worsen this indicator. Councils have adopted a range of different strategies to meet their liability—these are discussed in section 3.3.6.

Contract payments, such as waste collection services, increased from $28.293 million in 2008 to $38.375 million in 2012, but decreased in terms of the proportion of total expenses by an average of 0.5 per cent per year. There was no change in borrowing costs as a proportion of total expenses. Depreciation expenses decreased as a proportion of total expenses, however, this is due to other expenses such as employee benefits increasing by a much greater amount. In real terms depreciation expenses increased fairly uniformly, by an average of 4.5 per cent per year. While there have been some changes with regard to how much key expenses represent in terms of overall expenses—particularly the increase in employee benefits—the mix of different expense categories has remained relatively stable over the past five years.

Given the risks to the audited councils' financial sustainability, it is essential that they effectively plan their long-term financial management and their management of assets. They should also efficiently and effectively deliver services and maximise the revenue they generate from service delivery so that this contributes to meeting their revenue requirements. These elements are discussed further in Part 3.

3 Sustainability issues, challenges and strategies

At a glance

Background

Small councils should have a sound understanding of their sustainability issues and challenges and develop appropriate strategies to address these and mitigate their impact as far as possible. They should also have effective long-term planning and asset management, deliver services effectively and efficiently and position themselves to remain viable in the medium- to long-term.

Conclusion

The audited councils generally have a sound understanding of sustainability issues and challenges and have implemented a range of strategies to address them. However, in some instances actions do not address the core problem. Councils generally cannot demonstrate the effectiveness of strategies or actions and whether these are having a material impact on improving their sustainability. There is scope to improve in financial, asset and service planning and management, and to better link actions to sustainability challenges and outcomes.

Findings

- Audited councils generally face common sustainability issues and challenges.
- All councils except Yarriambiack have recently developed long-term financial plans, but these vary in quality and are not sufficiently integrated with asset management.
- Councils cannot demonstrate that service delivery is efficient and effective.

Recommendations

- Councils should clearly identify and publicly report their sustainability challenges and actions, and how they will monitor, evaluate and report on their effectiveness.
- Yarriambiack Shire Council should develop a long-term financial plan and all councils should update their existing plans in accordance with better practice.
- Councils should review service planning and delivery as a priority.

3.1 Introduction

Small councils face a number of issues and challenges that impact organisational sustainability. They should have a sound understanding of the particular issues and challenges impacting their sustainability and develop appropriate strategies to address these to mitigate their impact as much as possible.

It is important that small councils' operations are underpinned by effective financial planning and asset management, and effective and efficient service delivery. Councils also need to be vigilant in monitoring risks and factors likely to significantly affect sustainability. This may not in itself provide assurance that a council will be sustainable; however, it will position councils better to remain viable in the medium to long term.

3.2 Conclusion

The audited councils generally have a sound understanding of the sustainability issues and challenges they face. However, it is not evident that all of their strategies and actions are effectively addressing the identified issues. While some council strategies are supported by analysis and are well informed, other responses have been reactive and are not underpinned by a strategy that addresses the core problem.

While councils have made some efforts to improve planning for long-term financial sustainability, managing assets, and delivering services effectively and efficiently, further work is required in these areas. Four of the five councils have developed long-term financial plans; however, these vary in quality and are not adequately integrated with asset management plans. Councils generally do not plan or deliver services in accordance with Best Value Principles and cannot demonstrate they are delivering services efficiently and effectively. Consequently, councils cannot demonstrate they are operating as efficiently and effectively as possible.

3.3 Organisational sustainability challenges, issues and planning

Councils should have a sound understanding of the sustainability challenges and issues they face, and develop and implement strategies to address these. Issues and challenges are generally identified in council plans, strategic resource plans, annual reports, annual budgets and rating strategies. There are a number of common sustainability issues and challenges across the audited councils, including:

- having effective financial planning and asset management
- effectively and efficiently delivering services
- recruiting and retaining qualified and skilled staff
- dealing with the impact of population ageing and/or population changes
- dealing with the defined benefits superannuation shortfall.

3.3.1 Long-term financial planning

Effective long-term financial planning is crucial to sustainability and is particularly important for councils that are responsible for managing and generating service from a large stock of long-lived assets relative to their annual income. Councils need to deliver services that meet community needs in a financially sustainable manner, and plan for the needs of current and future generations. In the past, councils have relied on a short-term financial planning horizon, which was essentially limited to the annual budget processes. This approach limits councils' ability to adequately plan for their long-term financial sustainability.

Better practice

A long-term financial plan expresses in financial terms the activities and level of services that a council proposes to undertake or provide over the short, medium and long term to achieve the objectives in its council plan. It should guide future strategies and confirm that the council can remain financially sustainable.

It is not mandatory in Victoria for councils to develop a long-term financial plan and there is no existing statewide guidance to assist councils. However, in January 2012 the Commonwealth Government released a better practice guide (*Institute of Public Works Engineering Australia Practice Note No. 6 – Long-Term Financial Planning – Version 1.0*, January 2012). Based on this guide, a long-term financial plan:

- is a high-level document that can be easily understood by the community, rather than a series of complex spread sheets—although councils may develop these for internal use
- includes a brief narrative overview to help the reader understand the purpose of the plan, the basis of its preparation and the key conclusions that can be drawn from the financial data
- has robust and reliable financial data at a summary level based on accrual accounting financial statements, including projected income and expenditure, balance sheet and cash flow statement—accrual accounting is important for financial sustainability since it measures the performance and position of a council by recognising economic events regardless of when cash transactions occur to give a more accurate picture of the current financial condition
- has a clear financial strategy on which the plan is based, such as a rating strategy and borrowing strategy, for achievement of financial sustainability
- has a small number of key performance indicators for measuring financial sustainability that are relevant and appropriate—a relevant indicator has a logical and consistent relationship with the plan's objectives and an appropriate indicator is one that is underpinned by sufficient information to assess its achievement against objectives, outcomes and outputs—and include targets that are clearly linked to objectives
- has a sensitivity analysis that highlights key factors most likely to materially impact on the achievement of the plan's financial targets, such as anticipating a significantly high level of population growth in its area which may affect operating revenue and expenses

- is integrated with a council's asset management and capital works statement—see Section 3.3.2 Asset management planning
- is reviewed and updated at least annually
- is publicly reported.

Assessment of current plans

Golden Plains developed a long-term financial plan in 2006, while Buloke, Strathbogie and Towong developed their plans in the past two years. Yarriambiack has committed to developing a long-term financial plan in its last three annual budgets, but has not yet done so. While Yarriambiack advised that it prepares 10 years of financial projections as part of the development of its strategic resource plan, these do not contain the key elements of a long-term financial plan. Yarriambiack advised that it plans to engage an external party to develop a long-term financial plan.

Figure 3A summarises our assessment of existing council long-term financial plans against key attributes from the Commonwealth Government better practice guide, which sets out the recommended elements of a long-term financial plan.

Figure 3A
Assessment of long-term financial plans against better practice

	Council			
Key attribute	**Buloke**	**Golden Plains**	**Strathbogie**	**Towong**
Plan developed	2011	2006	2011	2012
Time period covered	10 years	10 years	10 years	10 years
High-level document	✓	✓	✓	×
Brief narrative overview	✓	✓	✓	×
Financial data	✓	Not cash flow	✓	✓
Financial strategy	✓	✓	✓	×
Performance indicators for measuring financial sustainability	✓	✓	✓	×
Relevant and appropriate	×	×	✓	n.a.
Clear targets	×	×	Partially	n.a.
Small in number	×	✓	✓	n.a.
Sensitivity analysis	×	×	×	×
Reviewed at least annually	✓	n.a.	✓	✓
Publicly reported	✓	✓	✓	Partially

Source: Victorian Auditor-General's Office.

Golden Plains and Strathbogie’s plans are high-level, stand-alone documents that are publicly available, while Buloke’s plan is incorporated into the council’s strategic resource plan. Towong’s plan consists of a series of spread sheets and, while four years of financial projections from the plan were reported in its strategic resource plan in the annual budget, the rest of the plan is not publicly available.

All of the plans contain the recommended financial data at a summary level based on accrual accounting financial statements, except Golden Plains which does not include a cash flow statement. Without this, it is difficult to measure some performance indicators, such as cash balance and discretionary retained earnings.

Buloke, Golden Plains and Strathbogie’s indicators measure factors that define financial sustainability; including, operating surplus and underlying result. However, only Strathbogie's indicators are relevant and appropriate as they have a logical and consistent relationship with the plan's objectives. Strathbogie's is also the only plan that contains clear targets against indicators—such as those for asset renewal investment and borrowings—although it does this for only two of the six indicators. Buloke uses a large number of indicators, which could make it difficult for decision-makers and stakeholders to interpret results and gain a clear understanding of outcomes or the council's position.

It is important that monitoring, evaluation and reporting of performance indicators is conducted routinely and remedial action is taken where performance targets or expected results are not achieved. Most of these plans have only recently been developed, so it is too early to say whether councils are doing this. The plans do not provide any information about whether the councils propose to review and/or report publicly on these indicators and if so, how often.

All of the councils have reviewed and updated their plans at least annually. However, they have not explained in their plans what, if any, changes have been made from the review process. For example, Buloke deleted, without explanation, one of the 2011–12 plan’s objectives to ‘achieve a break even operating result within five years’. Buloke has advised that this objective was removed due to substantial costs relating to flood recovery impacting on the council's ability to achieve it. However, removing the objective without providing an explanation reduces transparency and does not represent good practice in performance monitoring and reporting.

While the plans, particularly Strathbogie’s, reflect a number of better practice elements, work is needed by all councils to address deficiencies, and effectively plan their finances from a long-term perspective to support their sustainability.

3.3.2 Asset management planning

Effective asset management planning is also crucial to long-term sustainability. Councils’ infrastructure assets represent a vast investment that has been built up over many generations and includes roads, bridges, drainage, buildings, parks and recreational facilities. Assets are acquired for their service delivery potential, so service delivery needs should form the basis of all asset management practices and decisions.

Robust asset management planning is required for councils to effectively manage their significant stock of assets. This planning is necessary to guide the scheduling of maintenance, refurbishment, renewal and replacement of assets and to achieve specific service levels, while minimising asset life cycle costs. Asset management plans should also set out expenditure projections as input for the long-term financial plan. Councils have more than one asset management plan because they generally develop separate plans to cover each major asset class.

A standard statement of capital works sets out actual against planned capital expenditure that relates to larger assets, including property, plant and equipment.

Current status

All of the audited councils had asset management policies, strategies and plans, and have made efforts to improve asset management through training and support programs, such as participation in the Municipal Association of Victoria's Asset Management Improvement 'STEP' program. As part of this program, each council completed self-assessments of their asset and financial management, and used these to develop a prioritised improvement plan. These assessments indicate that there is still scope for improvement, particularly in relation to asset management plans.

Integration with long-term financial plans

It is important that asset management plans and capital works statements are appropriately integrated with long-term financial plans so that these needs are adequately considered in financial planning. Of the four councils with long-term financial plans, each committed in their asset management policy or strategy to integrate their asset management plans with their long-term financial plans.

A key aspect of integrating asset and financial planning is for councils to develop 10-year expenditure projections in asset management plans and then use these to populate the capital works statements in the long-term financial plan. While all long-term financial plans contain a capital works statement, which covers material assets and their expenditure forecasts over the next 10 years, none of the asset management plans contain up-to-date 10-year expenditure forecasts. Councils' asset management plans either contain out-of-date figures (Buloke and Strathbogie), short-term projections (Golden Plains), and/or plans are still under development (Towong, Golden Plains and Strathbogie). This provides limited assurance that each council's asset management requirements were appropriately considered in developing the figures in the capital works statements. However, Buloke has advised that its plans have not been updated due to uncertainty related to the timing of funding for flood recovery.

3.3.3 Efficient and effective service delivery

Councils deliver a wide range of services to their communities. Some local government service delivery is mandated or unavoidable—for example, statutory obligations—while some is essentially discretionary to meet the needs of communities, such as providing swimming pools and family day care. Even within the context of necessary expenditures, there is scope to decide what the appropriate nature of the service and service levels should be.

Service reviews

The *Local Government Act 1989* requires councils to provide services in accordance with the Best Value Principles, which include considering service cost and quality standards, value for money, and community expectations and values. The principles also call for balance between affordability and accessibility of services.

Councils should conduct regular service reviews in accordance with the Best Value Principles to assess the effectiveness and efficiency of their services, and to take action where necessary so that their services continue to meet the community's needs and prevent creating an unnecessary impost if inefficient.

Other than narrow reviews of specific services, such as to identify cost savings, none of the audited councils have undertaken comprehensive reviews of the services they provide in accordance with Best Value Principles. They have also not reviewed service levels to assess the effectiveness and efficiency of service delivery. This provides limited assurance that expenditure on service delivery is informed by an adequate understanding of community needs or the effectiveness and efficiency of council services. Nevertheless, all councils have committed to maintaining existing services and the independent review of Buloke's finances found that the council's commitment to maintaining existing service levels was unsustainable.

Only Towong has completed a service review based on the Best Value Principles, but this was only for one service—the councils' records management service. This review was facilitated by LGV in June 2012 in connection with the Local Government Reform Fund and was part of the Building Best Value Capacity Project in collaboration with four other councils—Alpine, Campaspe, Indigo and Moira. This is discussed further in Part 4.3.

Other reviews by the audited councils have been primarily limited to cost analysis and do not constitute a comprehensive service review in accordance with Best Value Principles. Examples of the reviews conducted include:

- Towong recently secured funding from the state government through the Sustainability Fund for a Demand Reduction Program that is currently being undertaken with Indigo Shire Council. This aims to achieve environmental and efficiency savings of $250 000 per year and such a program could be replicated across other councils.
- Buloke has conducted a number of reviews of services to identify cost savings. In response to recommendations from the Inspector of Municipal Administration's review, it has committed to undertaking a comprehensive analysis of services, which it suggests will be progressively implemented as resources allow. This is based on the Inspector’s finding that it is financially unsustainable to maintain existing service levels. Work will include a cost-benefit analysis of discretionary services to determine which should be ceased, deferred or continued.

Consulting with the community about service delivery

Councils use a variety of mechanisms to engage with their communities to provide feedback on services and projects. However, the community consultation that occurs tends to be related to new projects, infrastructure or proposed services that councils plan to deliver, or to seek feedback on the draft council plan. Councils could not demonstrate they had adequately sought, considered and analysed community needs in relation to council services when initially formulating their council plans.

Better consultation with communities on their ability and willingness to pay for both existing and new services and assets when developing council plans could be used to assess overall service delivery levels. This could help councils to determine required levels and to prioritise the delivery of services appropriate to the needs of communities. The current approach provides limited assurance that council plans adequately reflect residents' needs as the community is not involved in the initial development.

Strathbogie is currently conducting community consultation to inform the development of its council plan, which includes conducting a survey that asks respondents to rank council services in importance. However, it is too early to assess the effectiveness of this in prioritising services and informing overall service levels.

Shared services

All audited councils participate in shared services with either neighbouring councils or other organisations in their region. This includes both internal operational activities and the delivery of council services. These arrangements generally involve sharing a component of the activity or service, such as information sharing to plan services, or sharing a resource, rather than the full delivery of a service. The main current and proposed shared services arrangements and the councils participating in them are shown in Figure 3B.

Figure 3B
Main types of shared services at audited councils

Shared service	Councils				
	Buloke	**Golden Plains**	**Strathbogie**	**Towong**	**Yarriambiack**
Operational activities					
Business improvement				✓	
ICT		✓		✓	
Payroll			✓		Proposed
Procurement		✓			✓
Council services					
Aged and disability	✓	✓			
Building services		✓		Proposed	
Child/family/youth	✓	✓			
Environment		✓		✓	
Emergency management		✓	✓		✓
Health	✓	✓		✓	
Library	✓	✓	✓	✓	✓
Roads	✓	✓	✓		
Transport	✓	✓			✓

Note: Some councils also use the same contractor to deliver services, but not through a formal arrangement and this is not considered a shared service. These types of arrangements are not included in the table.
Source: Victorian Auditor-General's Office based on information from audited councils.

The necessary rationale for councils adopting shared services is generally not clearly documented and is therefore difficult to assess. Although it is reasonable to expect there to be savings and efficiencies through sharing these activities, there have been no evaluations of the arrangements and so the extent of this is not known. Therefore, it is not clear that sharing these services is improving the sustainability of these councils. With some exceptions, such as libraries, these arrangements are not mature or undertaken on a large scale.

3.3.4 Recruiting and retaining qualified and skilled staff

Small councils in regional and rural areas can face challenges in attracting appropriately qualified and skilled staff and may also experience difficulty in retaining staff. A council's location within the region and its proximity to large regional towns can also affect this.

This can be a particular problem when positions that are hard to fill and have a high turnover are critical to service delivery and council operations.

The State Services Authority (SSA) has identified common challenges for the public sector located in rural and regional Victoria, which also apply to small councils, including:

- a low interest or even no response to particular job advertisements
- a reliance on people needing to relocate to take up critical roles
- prospective candidates being unfamiliar with their region or living in a regional and rural area
- negative perceptions of rural and regional living
- no local tertiary institutions supplying graduates with the required qualifications
- private and not-for-profit organisations offering more attractive remuneration or conditions
- partners of applicants or new staff needing to find work in the area
- limited accommodation for staff or few options that meet their expectations.

Strategies

Workforce planning is one strategy that may assist councils to identify workforce needs, the barriers to attracting and retaining staff, and approaches to address the problem. SSA's 2006 *Workforce Planning Toolkit* for small to medium sized Victorian public service organisations recommends that a workforce planning framework include the following six elements:

- **workforce analysis**—analyse the workforce against organisational direction, internal workforce characteristics and capabilities, external labour market and environmental factors
- **forecast future needs**— identify future business needs, scenarios and workforce characteristics and capabilities
- **analyse gaps**— identify and analyse the gaps between future workforce needs and current workforce profile
- **develop strategies**—develop integrated business and human resources strategies to address the gaps between current and future workforce needs
- **implement strategies**—invest in strategies and change management processes to address workforce planning issues
- **monitor and evaluate**—evaluate the effectiveness of strategies to determine success of planned changes and impact on business performance.

All audited councils except Yarriambiack identified recruiting and retaining appropriately qualified and skilled staff as an issue, and some councils have implemented strategies to address these problems.

Golden Plains developed a workforce plan in 2009. This plan contains a number of elements recommended by the SSA's guide, including a workforce analysis, forecast of future needs, analysis of gaps and development of strategies. These strategies include succession planning for high priority positions, flexible employment arrangements, and working with regional universities to identify engineering students interested in a career in local government. However, there is no evidence that these strategies have been implemented or evaluated for their effectiveness. While there have been no formal evaluations of the plan itself, council advised it has been effective in informing decisions about staffing levels when preparing the annual budget, identifying gaps, career planning for existing staff, and potential replacement of key staff—due to pending retirement, for example.

Strathbogie completed an organisational review in January 2011, which included voluntary redundancies, the creation of several new positions and the development of a new organisation structure. The review recommended that Strathbogie develop a workforce plan, initially for outdoor staff, and then the whole organisation. However, council has not yet done so.

Councils also outsource positions, including statutory roles, such as building surveyors and planning officers. Councils advised that these positions can be difficult to fill and that this may be due to the remuneration offered being uncompetitive in the current employment market, applicants not wanting to relocate to regional areas, or only requiring part-time positions for these professions. While Yarriambiack advised that staff recruitment was not an issue, they also outsource these statutory positions. Outsourcing may address the issue in the short term, and maintain ongoing service delivery, however, councils have not assessed whether this is more cost effective than employing staff directly. It is also not addressing the core problem of recruiting and retaining staff and may not be sustainable in the long term.

3.3.5 Population ageing and/or population changes

Population ageing and/or population changes—such as high growth or decline—can present challenges to small councils. Population changes can impact on councils' rating base and change service delivery needs. Population decline can also result in higher unit costs of service delivery because of the fixed nature of some costs. Rapid population growth can place significant financial pressure on councils to put new or expanded services in place. Given declining and ageing populations, continuing to increase rates and charges may not be sustainable for some councils.

Figure 3C summarises the trends and forecasts in population changes for the audited councils from 2001 to 2031. It shows that with the exception of Towong, there are consistent trends for these councils across the 30-year period of either increasing (Golden Plains and Strathbogie) or decreasing (Buloke and Yarriambiack) populations.

Figure 3C
Past, current and projected populations, 2001 to 2031

Council	Population in 2001	Population in 2011	Percentage change 2001–11	Projected population in 2031	Percentage change 2011–31
Buloke	7 331	6 925	–5.5	6 519	–5.8
Golden Plains	15 101	19 014	+25.9	26 870	+4.1
Strathbogie	9 648	10 060	+4.3	11 085	+10.2
Towong	6 331	6 276	–0.9	6 552	+4.4
Yarriambiack	8 311	7 498	–9.8	6 900	–8.0

Source: Victorian Auditor-General's Office.

Buloke and Yarriambiack have ageing populations, which together with population decline, raises particular sustainability issues for these councils. Growth rates in Golden Plains will result in it no longer being classified as a small council in the future.

Strategies

Buloke has developed a draft Positive Ageing Strategy 2013–19 to guide it in responding to the projected rapid growth of its aged population, but it does not address continuing population decline. While Yarriambiack had a *2009–12 Economic Development Strategic Plan* that aimed to promote economic development in the shire, this plan contains limited analysis on population decline and does not directly link actions to address this issue.

Golden Plains has implemented strategies to deal with both a growing and ageing population. The council's *2012–16 Ageing Well in Golden Plains Strategy and Action Plan* provides a detailed analysis of the shire's population demographics. The main aims of the plan are to enable the council to effectively respond to population growth, and to inform the direction, development and delivery of its aged services and programs. To assist in meeting growth in the number of young families, Golden Plains has implemented service improvement plans for kindergarten clusters and maternal and child health services.

Strathbogie is currently developing an *Economic Development Master Plan 2013–17* to guide the future of economic development in the shire. The plan is expected to include strategies to promote consistent population growth.

Towong has investigated opportunities to encourage population growth in specific localities—Peninsula area, Corryong and Tallangatta—and developed a number of long-term strategies for individual township development, including *Tallangatta Tomorrow* (complete), *Our Bellbridge* (project underway), and *Upper Murray 2030* (funds committed but not commenced).

The strategies discussed above are relatively new or in development and have not been evaluated or reviewed, therefore it is not yet possible to assess their effectiveness in dealing with the population issues the councils are facing.

3.3.6 Defined benefits superannuation shortfall

As discussed in Part 2.3.3, funding calls to address shortfalls in the councils' defined benefits scheme has impacted on councils, and different strategies have been adopted by councils based on the super fund's (Vision Super) payment options to meet their liability. The impact of this shortfall highlights the vulnerability of small councils to unplanned events and their limited capacity to absorb impacts of this magnitude without compromising financial sustainability.

The payment of the shortfall could potentially result in additional borrowings, changes to service delivery, increases in rates, and the deferral of capital projects. While all audited councils noted the shortfall payment in their annual budget, only Buloke and Strathbogie made information publicly available about the financial impact of the payment on council. Buloke indicated there would be delays in some planned projects of at least 12 months and some changes to service delivery plans. Strathbogie does not expect a noticeable impact due to several grant applications for capital works projects being unsuccessful, which made funds the council had set aside to contribute to these projects available to pay the liability. Yarriambiack has only recently made a decision on its payment strategy. Figure 3D shows each council's liability as a percentage of total rates revenue and their strategy to address the liability.

Figure 3D
Council strategies to address superannuation funding shortfall

Council	Liability ($ million)	Liability (as percentage of total rates revenue)	Council strategy to address liability
Buloke	1.90	22	Council took out long-term borrowings for the full amount and is paying over a three-year period
Golden Plains	0.42	2.7	Council is paying over a five-year period
Strathbogie	1.26	8.9	Council paid early to receive a discount
Towong	1.04	16.6	Council paid early to receive a discount
Yarriambiack	2.11	23.2	Council took out long-term borrowings for part of the amount and is paying over a five-year period. Council proposes to fund the balance through long service leave cash investment and budget cuts of 2.5 per cent in 2012–13.

Source: Victorian Auditor-General's Office based on information from audited councils.

The Municipal Association of Victoria identifies that there are actions councils could take to reduce future calls on councils, such as making greater efforts to set aside capital that could be used to top up the scheme, and being mindful of the impact that large employee pay rises have on increasing the size of the benefit.

3.3.7 Effectiveness of strategies

Most existing performance indicators of the audited councils relate to financial sustainability and performance and asset management. Councils do not have relevant and appropriate performance indicators for specific actions or to measure sustainability beyond financial parameters. The material impact of specific actions and strategies adopted by councils on their sustainability is unclear. Strategies have either only been recently implemented, or councils have not undertaken adequate monitoring, reporting and evaluations of actions and the outcomes achieved to determine their impact.

For all of the audited councils, a small number of sustainability strategies are linked to performance measures in the council plan, such as the development of long-term financial plans or strategies to deal with population issues. These measures relate to developing the strategies themselves and not their effectiveness, and they do not constitute relevant and appropriate performance measures.

Recommendations

1. Councils should clearly identify and publicly report their sustainability challenges and associated strategies and actions, including how they will monitor, report and evaluate their effectiveness, using relevant and appropriate performance indicators.
2. Yarriambiack Shire Council should develop a long-term financial plan and all councils should update their existing plans in accordance with better practice.
3. Councils should review service planning and delivery in accordance with Best Value Principles as a priority, including:
   - assessing overall service delivery levels to determine appropriate levels and provide the rationale for their decision
   - consulting with their communities on their ability and willingness to pay for desired services in the development of the council plan
   - developing a plan to regularly review all services over time.

4 Support, guidance, monitoring and reporting

At a glance

Background

Providing appropriate support and guidance is important to assist small councils to remain sustainable. Local Government Victoria's (LGV) role includes overseeing, supporting, and encouraging local government and providing advice and support to councils in relation to their roles and responsibilities under the *Local Government Act 1989*.

Conclusion

While LGV provides a range of general guidance and support that is applicable to small councils addressing some of their sustainability concerns, there are opportunities to directly target support to areas of challenge for them to support building their capability and resilience. LGV monitors and reports on the sustainability of councils and has implemented actions to address specific issues at small councils who are in critical situations. However, there are opportunities to more proactively target small councils with appropriate support and advice before their situation becomes critical.

Findings

- LGV does not have strategic priorities targeting sustainability of small councils, although it provides a range of guidance and support related to sustainability.
- LGV's guidance on asset management needs to be reviewed and updated.
- LGV has committed to implementing a performance reporting framework to provide a common suite of sustainability performance indicators for councils.

Recommendations

The Department of Planning and Community Development should:

- review and update its asset management guidance
- consider making the development of a long-term financial plan mandatory
- routinely review the guidance and support it provides so that it is aligned with areas of highest need and addresses gaps in councils' capability and capacity
- expedite the implementation of the planned performance reporting framework and make sure it includes appropriate sustainability indicators.

4.1 Introduction

Local Government Victoria's (LGV) role includes supporting and advising the Minister for Local Government in administering the *Local Government Act 1989* (the Act). It is also responsible for overseeing, supporting and encouraging local government and providing advice and support to councils in relation to their roles and responsibilities under the Act.

It is important that appropriate support and guidance is provided to small councils. This includes driving the adoption of better practices, improving their capability and providing targeted support or intervention when required.

4.2 Conclusion

LGV provides a range of general guidance and support, which is applicable to the sustainability of small councils, including developing and disseminating better practice guides, delivering programs and developing a local government performance management framework. However, there are opportunities to directly target support to areas of challenge for small councils to support building their capability and resilience.

LGV conducts various monitoring and reporting activities to identify councils at high risk of sustainability issues. It has advised the minister about these and implemented actions to address issues once they have become critical. LGV could more proactively target small councils with appropriate support and advice before their situation becomes critical. The development of LGV's performance management framework provides an opportunity to more closely monitor councils' sustainability and respond appropriately to support councils on a timely basis.

4.3 Guidance and support to councils

While LGV does not have strategic priorities targeted specifically to the organisational sustainability of small councils, a number of priorities in its 2012–13 business plan are directly relevant to small councils and sustainability, including to:

- strengthen the capacity of the sector to plan strategically with the community and allocate available resources in a sustainable manner
- strive for long-term financial sustainability in the sector with growth in revenue raising levels matched to each municipality’s demand for services and consideration of their capacity to pay.

Under the plan, LGV is accountable for 28 key deliverables that will contribute towards the achievement of the strategic priorities, including the delivery of various programs and the development of the local government performance reporting framework.

LGV provides a range of guidance and support to councils broadly related to sustainability. This includes issuing better practice guides covering areas, such as asset management, procurement and Best Value service delivery, including:

- *Asset Management Policy, Strategy and Plan* (2004)—guidelines for developing an asset management policy, strategy and plan
- *Victorian Local Government Best Practice Procurement Guidelines* (2013)—guidelines for dealing with the procurement cycle (planning, implementation, management and performance evaluation), reporting on procurement and meeting obligations under the Act
- *A Guide to Achieving a Whole of Organisation Approach to Best Value* (2006)—designed to assist in developing or enhancing formal or informal improvement and planning frameworks to effectively incorporate the Best Value Principles — developed in partnership with Local Government Professionals (LGPro) Corporate Planner's Network and the Best Value Commission.

The *Asset Management Policy, Strategy and Plan* and *A Guide to Achieving a Whole of Organisation Approach to Best Value* guides were developed several years ago and need to be reviewed. The 2006 Best Value guide is currently under review, and LGV advised that the 2004 asset management guidelines will be reviewed and updated in 2014.

LGV has initiated a number of strategies and programs aimed at sustainability that involve or apply to small councils. These include:

- **Building Best Value Capacity**—working with 10 regional and metropolitan councils to conduct Best Value service reviews of records management and customer service. Three small councils (Alpine, Indigo and Towong) were involved in the program. Project outcomes included the delivery of Best Value reviews, enhanced knowledge and skills in conducting Best Value reviews, and review and update of guidance. Legislative reform is also being considered in response to participating councils identifying a lack of clarity and definition in Best Value legislation as a barrier to conducting Best Value reviews.
- **Procurement in Practice**—working with five councils (including the small councils of Ararat, Golden Plains, Hepburn and Pyrenees) to undertake a collaborative procurement of their bituminous resealing programs. This is anticipated to result in potential cost savings of $3.1 million over five years if all participating councils elect to take up the contract options. Other program outcomes include procurement tools and templates being made available to the sector and project learnings informing the update of the 2012 guidelines.
- **Asset Management, Financial Planning and Performance Measurement project**—a research-based project that commenced in 2012, which will assess the quality of data and decisions that have been driven by asset management and financial planning programs across Victorian councils.
- **Local Government Performance Reporting Framework**—discussed in Part 4.4.

- **A review of the status of asset management practices in Victorian local governments**—the review was commissioned in October 2012. A discussion paper developed from this review will be the subject of five regional forums to inform the development of a strategic plan to guide a refocusing of asset management efforts across Victorian councils.

While LGV conducts evaluations of its programs, these could be improved. For example, LGV could collect information from participating councils to assist in determining the effectiveness and suitability of its program for individual councils and to inform the development of future programs.

LGV also works in partnership with peak and industry bodies on strategies and programs. Examples are described in Figure 4A.

Figure 4A
Strategies and programs delivered by Local Government Victoria in partnership with peak and industry groups

Strategy/Program title	Description	Delivered in partnership with
Local Government Reform Fund program	Aims to assist councils to improve their financial and resource management capabilities and business practices. A number of initiatives have been developed through this initiative, including the previously discussed Building Best Value Capacity and Procurement in Practice programs	Overseen by a steering committee including council Chief Executive Officers, the Municipal Association of Victoria, LGPro, VAGO and the Local Government Investigations and Compliance Inspectorate
Councils Reforming Business Program	Aims to support councils to improve services, decrease costs and reduce red tape for businesses working with them, including in the areas of procurement, local laws, shared services and affordable housing. Project outcomes included 53 councils—including 14 small councils—working together on various procurement projects funded by grants, establishing the Local Government Procurement Training Program, and developing six projects to encourage shared services by councils in various areas, such as ICT services	MAV
Local Government Procurement Special Interest Group	Aims to facilitate sector-wide reform and networking for procurement improvement.	LGPro

Source: Victorian Auditor-General's Office.

While LGV are involved in a number of programs relevant to supporting council sustainability, this audit identified a number of common issues across councils that may require more targeted support and guidance and/or coordination by LGV. These include the recruitment and retention of suitable staff, development of long-term financial plans, and dealing with population change. There is a range of guidance available outside of government, but LGV could play a more proactive facilitation role.

4.4 Monitoring and reporting on the sector

LGV conducts various monitoring and reporting activities that assist it to identify councils at high risk of sustainability issues and to inform its work program. These activities include monitoring VAGO and council reports, local media and sector trends, such as through the analysis of community satisfaction survey results.

LGV's monitoring activities have identified councils at high risk of sustainability issues and it has implemented actions to address issues when they have arisen. LGV has prepared a number of submissions and briefings for government who have acted on their recommendations. This has resulted in, for example:

- The appointment of an Inspector of Municipal Administration in March 2012 to conduct an independent assessment of Buloke’s financial health in response to its audit qualification in the 2011 VAGO audit report *Local Government: Results of the 2010–11 Audits*. The review identified critical concerns about the council's future financial health that were primarily driven by inadequate analysis and reporting of current and forecast cash flows by management, which led to inadequate strategies and actions taken by council. An Inspector has been appointed for a further term of up to two years to provide continued oversight of the council’s financial operations.
- Assistance to councils, such as Murrindindi, which was the most heavily impacted municipality during the Black Saturday bushfires, including conducting a review of the council’s financial position, asset management and sustainability.

Until 2010, LGV conducted sector-wide reporting, which was published in the annual *Local Government in Victoria Report*. This report included analysis of the financial sustainability of councils as a whole and by five council groupings using information from councils’ annual reports. It outlined average performance for all councils across LGV’s 11 key performance indicators and incorporated analysis from VAGO’s financial indicators. This report has not been published since 2010. However, LGV advised that it plans to release a broader *Local Government in Victoria Report* in December 2013, which will include reporting against a new set of performance indicators, as discussed below.

An appropriate performance monitoring framework is important for monitoring the performance and sustainability of councils. LGV is currently developing a local government performance reporting framework with the sector, which is scheduled for a trial by July 2013 and mandatory use in July 2014. A directions paper has been developed by LGV, and technical working groups have recently been established to develop performance indicators across three areas—service performance, financial performance and sustainability. The sustainability indicators are intended to assist councils to monitor, evaluate and report on sustainability and measure their capacity to meet current and future service, infrastructure and other obligations as they fall due. A sector performance report will be issued by DPCD. LGV aims to align this project with the recommendations from VAGO's 2012 *Performance Reporting by Local Government* audit.

The development of this framework provides an opportunity for LGV to more closely monitor council sustainability and respond appropriately to support councils on a timely basis.

Recommendations

The Department of Planning and Community Development should:

4. review and update its asset management guidance
5. consider making the development of a long-term financial plan mandatory and provide support and guidance in the development of these
6. routinely review the guidance and support it provides so that it is aligned with areas of highest need and addresses gaps in councils' capability and capacity
7. expedite implementation of the planned local government performance reporting framework and make sure it includes appropriate sustainability indicators.

Appendix A.
Financial sustainability indicators for councils

Figure A1
Financial sustainability indicators for councils

Indicator	Formula	Description
Underlying result (per cent)	Adjusted net surplus/ total underlying revenue	A positive result indicates a surplus. The larger the percentage, the stronger the result. A negative result indicates a deficit. Operating deficits cannot be sustained in the long term. Underlying revenue does not take into account non-cash developer contributions and other one-off (non-recurring) adjustments.
Liquidity	Current assets/ current liabilities	Measures the ability to pay existing liabilities in the next 12 months. A ratio higher than 1:1 means there is more cash and liquid assets than short-term liabilities.
Self-financing (per cent)	Net operating cash flows/ underlying revenue	Measures the ability to replace assets using cash generated by the entity's operations. The higher the percentage, the more effectively this can be done.
Indebtedness (per cent)	Non-current liabilities/ own-sourced revenue	Comparison of non-current liabilities (mainly comprised of borrowings) to own-sourced revenue. The higher the percentage, the less able to cover non-current liabilities from the revenues the entity generates itself. Own-sourced revenue is used (rather than total revenue) because it does not include capital grants, which are usually tied to specific projects.

Figure A1
Financial sustainability indicators for councils – *continued*

Indicator	Formula	Description
Capital replacement	Capital expenditure/ depreciation	Comparison of the rate of spending on infrastructure with its depreciation. Ratios higher than 1:1 indicate that spending is faster than the depreciation rate. This is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option.
Renewal gap	Renewal and upgrade expenditure/depreciation	Comparison of the rate of spending on existing assets through renewing, restoring, and replacing existing assets with depreciation. Ratios higher than 1:1 indicate that spending on existing assets is greater than the depreciation rate. Similar to the investment gap, this is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option.

Source: Victorian Auditor-General's Office.

Figure A2
Risk assessment criteria for financial sustainability indicators

Risk	Underlying result	Liquidity	Indebtedness	Self-financing	Capital replacement	Renewal gap
High	**Negative 10% or less** Insufficient revenue is being generated to fund operations and asset renewal.	**Equal to or less than 1.0** Insufficient current assets to cover liabilities.	**More than 60%** Potentially long-term concern over ability to repay debt levels from own-source revenue.	**Less than 10%** Insufficient cash from operations to fund new assets and asset renewal.	**Equal to or less than 1.0** Spending on capital works has not kept pace with consumption of assets.	**Equal to or less than 0.5** Spending on existing assets has not kept pace with consumption of these assets.
Medium	**Negative 10% to zero** A risk of long-term run-down to cash reserves and inability to fund asset renewals.	**1.0–1.5** Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	**40–60%** Some concern over the ability to repay debt from own-source revenue.	**10–20%** May not be generating sufficient cash from operations to fund new assets.	**1.0–1.5** May indicate spending on asset renewal is insufficient.	**0.5–1.0** May indicate insufficient spending on renewal of existing assets.
Low	**More than zero** Generating surpluses consistently.	**More than 1.5** No immediate issues with repaying short-term liabilities as they fall due.	**40% or less** No concern over the ability to repay debt from own-source revenue.	**20% or more** Generating enough cash from operations to fund assets.	**More than 1.5** Low risk of insufficient spending on asset renewal.	**More than 1.0** Low risk of insufficient spending on asset base.

Source: Victorian Auditor-General's Office.

The overall financial sustainability risk assessment is calculated using the ratings determined for each indicator as shown in Figure A3.

Figure A3
Overall financial sustainability risk assessment

High risk of short-term and immediate sustainability concerns indicated by either:

- **red** underlying result indicator or
- **red** liquidity indicator.

Medium risk of longer-term sustainability concerns indicated by either:

- **red** self-financing indicator or
- **red** indebtedness indicator or
- **red** capital replacement indicator or
- **red** renewal gap indicator.

Low risk of financial sustainability concerns—there are no high-risk indicators.

Source: Victorian Auditor-General's Office.

Appendix B.

Audit Act 1994 section 16—submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994* a copy of this report was provided to the Department of Planning and Community Development and to the following five councils, with a request for submissions or comments:

- Buloke Shire Council
- Golden Plains Shire Council
- Strathbogie Shire Council
- Towong Shire Council
- Yarriambiack Shire Council.

The submission and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

Further audit comment:

RESPONSE provided by the Acting Secretary, Department of Planning and Community Development

Department of Planning and Community Development

1 Spring Street
Melbourne
Victoria 3001
GPO Box 2392
Telephone: (03) 9208 3333
Facsimile: (03) 9208 3680

RECEIVED
31 MAY 2013
VICTORIAN AUDITOR-GENERAL'S OFFICE

Ref CSEC003816
File 13/001953

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Dr Frost

AUDIT ACT 1994, S16(3): PROPOSED AUDIT REPORT – ORGANISATIONAL SUSTAINABILITY OF SMALL COUNCILS

Thank you for the opportunity to provide comment on the proposed audit report *Organisational Sustainability of Small Councils*.

I accept the report as a fair representation of the sustainability challenges facing small councils and accept your recommendations numbered 4 to 7 in respect to the Department of Planning and Community Development.

It is not my intention to comment on the specific findings in respect of individual councils but I expect those councils will also accept the opportunity for comment afforded them by Section 16(3)(b) of the *Audit Act 1994*.

I am pleased with the degree of symmetry between your recommended actions for the Department and the current and proposed priorities identified for delivery by Local Government Victoria and offer the following additional comments:

***VAGO Recommendation 4**: review and update its asset management guidance*

The need to update this guidance is accepted, as is the impact of asset management practices on the sustainability of an organisation.

There have been a number of support mechanisms made available to small (and large) councils in the pursuit of improved asset management practices and ultimately organisational sustainability and this guideline, issued in 2004, is one such tool.

The review and update of these guidelines must also consider broader information now available:

- Results of the Annual Local Government Victoria 'Asset Management Performance Measurement Survey' which was commenced in 2003;
- Progression of the Municipal Association of Victoria STEP Asset Management Program;

State Government Victoria

RESPONSE provided by the Acting Secretary, Department of Planning and Community Development – continued

- Results of the Regional Asset Management Project and the Victorian Local Government Sustainability Project; and
- The National Assessment Framework for Asset Management and Financial Planning developed by the Australian Centre for Excellence in Local Government (ACELG).

VAGO Recommendation 5: *consider making the development of a long term financial plan mandatory and provide support and guidance in the development of these*

The importance of a long term financial plan that is aligned with shorter term plans is acknowledged. The *Local Government Act 1989* requires the completion of a four year Strategic Resource Plan by a council however there is evidence of the benefits and use of longer term planning, provided it is both realistic and subject to periodic review.

Decisions on whether a ten year plan or similar long term planning should be mandatory (legislated) or voluntary will be given thorough consideration.

VAGO Recommendation 6: *routinely review the guidance and support it provides so that it is aligned with areas of highest need and addresses gaps in councils' capability and capacity*

Two planning forums conducted by Local Government Victoria each year are informed by the annual Auditor-General's report on local government audits, specific performance audits completed by VAGO and the Asset Management Performance Measures Survey. From 2013/14 the National Assessment Framework for Asset Management and Financial Planning will also provide valuable input.

In 2011/12 Local Government Victoria delivered the Local Government Reform Fund Program 'Aligning Strategy, Capacity and Sustainable Outcomes' which is detailed in your report at page 35. The lessons learned from these programs have been useful in further program development as well as the consideration of any future legislative change.

The findings from these projects have been presented to the Local Government Reform Strategy Reference Group to assist in planning alternate models of capacity building.

VAGO Recommendation 7: *expedite implementation of the planned local government performance reporting framework and make sure it includes appropriate sustainability indicators.*

The development of a Performance Reporting Framework has been a key priority during 2012/13 with a pilot to be launched for the 2013/14 financial year. This has been the subject of extensive consultation with the sector, professional bodies and academics and is the guiding framework for the development of sustainability, service and financial indicators.

The recently released 'Draft Local Government Performance Reporting Framework & Indicators – working paper' proposes three key reporting streams: service performance, financial performance and sustainability.

Local Government Victoria has invited councils to nominate for participation in the 2013/14 pilot of this framework.

I would also take this opportunity to provide general comments on the report:

RESPONSE provided by the Acting Secretary, Department of Planning and Community Development – continued

Financial sustainability

The audit has reported that on average, government grants have increased significantly as a percentage of total revenue. It is worthwhile noting that decisions of the Victoria Grants Commission have increased allocations to small councils with increased weighting assigned to factors such as population dispersion and remoteness which have generally favoured regional and rural councils.

Sustainability issues, challenges and strategies

The report identifies the importance of integrating asset management planning with long term financial planning.

The development of these documents is dependent on the level and quality of service planning and delivery, which in turn is a function of the quality of community consultation around levels of service. Local Government Victoria is contributing to the ACELG and Institute of Public Works Engineering Australia draft practice note 'Levels of service and community consultation'. This information will be made available to all councils.

I am confident of the contribution that the Performance Reporting Framework will make to the identification of emerging sustainability problems. In addition, the community will have access to concise and comparable data sets to better understand and assess the performance of their local council.

I look forward to the successful implementation of these important initiatives over the coming 12-18 months.

Yours sincerely

DG Yates.

Dean Yates
ACTING SECRETARY
31/5/13

RESPONSE provided by the Chief Executive Officer, Towong Shire Council

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towongshire

Reference: 07/05/0007

31 May 2013

RECEIVED
31 MAY 2013
VICTORIAN AUDITOR-GENERAL'S OFFICE

Mr Peter Frost
Acting Auditor-General
VAGO
Level 24, 35 Collins Street
Melbourne VIC 3000

Dear Mr Frost,

Performance Audit – Organisational sustainability of small councils

Thank you for the opportunity to provide comments in relation to the Proposed Audit Report – Organisational sustainability of small councils. Thank you also for the correspondence of 28 May 2013, which responded to our meeting of 16 May 2013 and our correspondence of 17 May 2012 (Appendix A).

Our correspondence of 17 May 2013 (Appendix A) raises a number of issues in relation to the provisional Audit Report. As our correspondence is appended to this document we do not intend to reproduce those issues within the body of this document. We do however believe that the issues raised are still relevant to the Proposed Audit Report.

Towong Shire Council has relied on previous VAGO reports to drive significant reform within our organisation and we are disappointed by the quality and content of this Proposed Audit Report. Having reviewed the report we believe it remains well below the standard we have come to expect from your office.

We are also disheartened by the response of senior VAGO staff to our input. We have found their approach to be very defensive and the correspondence of 28 May 2013 is a good example of this. It is of concern to us that at our 16 May 2013 meeting we were told that VAGO had the last right of reply to whatever the participant organisations said. Given the manner in which this was articulated we were left feeling that that any criticism of VAGO was a pointless exercise as it would result in that criticism coming back at us.

I have had the opportunity to discuss these matters with other CEOs involved in the audit and unfortunately there seems to be a shared common view. It appears that there has been a tendency for VAGO to rely on disengaged or non-existent feedback as tacit endorsement. When in fact other organisations simply feel it is a futile exercise to raise any concerns. I would like to suggest that you contact the CEOs of the participating Councils to understand more about their audit experience. While it may seem reasonable to rest responsibility for not raising concerns with the respective CEOs we believe that once you discuss the extent of the issue with them you will gain greater clarity.

Regardless of these matters, we would like to provide input that may assist with improving the quality of the report so that it can be of genuine benefit to the sector. We are unable to commit the resources to complete the laborious review that we believe the report requires and based on the response to previous feedback we are also not certain of the merits of doing so. That said, we hope the following general feedback will be of assistance.

innovation : technology : sustainability

1

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

The report, we believe, shows Towong Shire Council in a positive light. As a result we feel it is necessary to state that our criticism of the report stems from a genuine desire to see the report and its recommendations have meaningful impact across the sector and is not from a defensive position.

It is important to note that we have responded to the Audit Specification, Post Planning Briefing and Provisional Report and more importantly believe we have had ample opportunity to provide evidence to VAGO during the course of the audit and that this has successfully occurred.

In terms of the recommendations, four of the seven recommendations relate specifically to the Department of Planning and Community Development (Local Government Victoria). We believe that Department has very strong insight into the sector and will chose to implement recommendations if they are considered to be appropriate and effective. A further recommendation specifically relates to Yarriambiack Shire Council. This has no bearing on Towong Shire Council and as a result we have no comment on that recommendation.

The remaining two recommendations relate more broadly to the five participant Councils. We believe that both of these recommendations lack the maturity that we would expect from an experienced auditor and are not supported by evidence. *Recommendation 1* is highly non-specific and this was self-evident when we discussed it at our meeting with VAGO staff on 16 May 2013. *Recommendation 3* whilst based on a policy position is not supported by evidence. Our recent experience with a 'Best Value' review (which included a number of Councils) demonstrated that this is not an effective way of moving an organisation towards organisational sustainability. This information was provided to the audit team.

We believe that the report should be revised so that the following issues are addressed, in accordance with the audit initiation briefing and audit specification:

- The report does not identify:
  - best practice that can assist in driving improvements across the sector.
  - documentation, systems nor processes that are likely to yield improved outcomes.
  - mechanisms that could be used to communicate best practice, that improves sustainability, between Councils.
  - pilot projects that could be supported to advance the sector.
- The potential effectiveness of the recommendations is not supported by an accurate evidence-based approach, even where evidence is readily available.
- There are large sections of the report that raise concerns that do not result in any recommendations e.g. recruitment and retention of qualified staff.
- Where evidence is provided it appears to be used to support recommendations rather than inform them and the primary financial data included has been relied on without interpretation.
- The report shows a fundamental lack of understanding of the significant structural and operational circumstances that prevail within any small Council.

While we appreciate that VAGO have in excess of 25 audits to deliver each year we are left wondering if quality is being sacrificed for expedience, if there is a lack of experience within the audit team or if there is a lack of commitment to delivering value from the report.

We believe that VAGO has not succeeded in translating evidence into mature evidence-based recommendations and should seek to understand why that has occurred and try to improve on the outcomes of future similar audits.

Regardless of the reason, it is disappointing that a significant opportunity to advance the sector has not been realised. While the cost of the report has not yet been provided it is important to note that a one

2

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

percent rate increase for Towong Shire Council generates approximately $50,000 revenue and this would be typical of any of the five Councils involved. It is imperative within our organisation that any expenditure yields a quality outcome. We would hope that this is also the position of VAGO when conducting performance audits.

Thank you for the opportunity to provide comments in relation to the Proposed Audit Report.

Should any further information or clarification be required please do not hesitate to contact me on 02 6071 5100.

Yours sincerely,

Juliana Phelps
Chief Executive Officer

Enc.

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

Appendix A.

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towongshire

Reference: 07/05/0007

17 May 2013

Mr Andrew Evans
Senior Manager, Performance Audit
Level 24, 35 Collins Street
Melbourne VIC 3000

Dear Andrew,

Performance Audit – Organisational sustainability of small councils

Thank you for meeting with myself and Dave Barry, Director Community and Corporate Services at your offices on Thursday 16 May 2013. Please extend our thanks also to Natalia Southern and Janet Wheeler for meeting with us.

Our understanding is that a performance audit is 'an audit which evaluates whether an organisation or government program is achieving its objectives effectively, and doing so economically and efficiently, and in compliance with all relevant legislation' (VAGO website). We do not believe that this performance audit has achieved this.

As discussed, we are disappointed that the audit and subsequent report do not adopt a robust evidence based approach and as a result:

- no recommendations are made in relation to:
    - best practice that could have assisted in driving improvements across the sector
    - documentation, systems, processes that are likely to yield improved outcomes
    - mechanisms that could be used to communicate best practice, that improve sustainability, between Councils
    - pilot projects that could be supported to advance the sector
    - mechanisms to address the recruitment and retention of qualified staff, despite it being raised as a matter of concern in the report.
- there are only two recommendations that generally relate to the small Councils involved, which does not appear to be a sufficiently mature approach to addressing very real challenges
- the relationship between documentation and outcomes is not supported by evidence
- the capability of the sector to address sustainability challenges is not clear
- the primary financial data included has been relied on without interpretation

Provided below, as requested at our meeting, are our comments in relation to provisional draft report.

Comments in relation to the Audit Summary Section

Conclusions section

In this section of the Audit Summary it is stated 'Over the past five years, the reliance of audited councils on government grants has increased substantially'. We believe this interpretation is incorrect.

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

Over the past five years the level of government grants to councils has increased and as a result the ratio of own source income to grant income has shifted however this does not mean that the audited councils' reliance has increased. The services and infrastructure delivered by council are determined by the funding available (and generally the State or Federal Government funding is tied to pre-determined outcomes). If the increased funding was not available the Councils would not provide increased levels of services and infrastructure. We would 'cut the cloth to fit' the funding available.

We do not believe it is accurate to say that the reliance of audited councils on government grants has increased substantially. A better way of presenting this would be to say 'the level of government grants has increased significantly and the ratio of own source income to grant income has shifted accordingly.'

Within this section of the Audit Summary it also states 'However, the councils generally cannot demonstrate the effectiveness of strategies and actions and whether these are having a material impact on improving their sustainability'. The report should recognise that improving sustainability is not an overnight proposition and the effectiveness of strategies and actions (such as those to increase population and rate base) are medium to long-term propositions and accordingly the effectiveness of the strategies may not be apparent for some time.

We also believe there are extremely good examples of actions taken to improve Towong Shire Council's sustainability including a demand reduction program to reduce wasted expenditure by $250,000 on an annual recurring basis and development of a solution to GPS track our heavy plant. It is worth noting this in the context of a 1% rate rise generating an $50,000 additional revenue for Council. These examples could have been highlighted in the report to demonstrate efforts taken to improve efficiency and economy and thereby work towards the attainment of organisational sustainability).

Findings section

Within this section there is a comment on the increase in funding from $33.766m to $72.434m without providing any context as to why/how this has come about e.g. change to State Funding programs (introduction of the Regional Growth Fund) etc.

In effect the increase in funding was due to a number of factors including:

- The receipt of 50% of the annual VGC grants in advance
- The first year of the Local Government Infrastructure Program
- The first year of Country Roads and Bridges funding program
- The receipt of National Disaster Funding (in relation to Floods within our municipality)

The absence of this context reduces the quality of the report and does not provide sufficient information for readers of the report. In addition, this data in not presented in Net Present Value terms, which is standard practice.

This section also states "While councils have increased the amount of own-source revenue they generated through rates and user charges, it has not been enough to keep pace with their increase in costs". This comment is not substantiated by any evidence.

In this section it also states "Several longer-term financial sustainability indicators are projected to deteriorate for Golden Plains and for Towong, although Towong is projected to improve against all other indicators. In Towong's case this is incorrect. We refer you to Figure 2B (page 10) and the commentary on page 11. The only indicator that is projected to deteriorate is the indebtedness indicator and not 'several' indicators as stated in the Audit Summary.

Recommendations

The first of the recommendations is:

'Councils should clearly identify and publically report their sustainability challenges and associated strategies and actions, including how they will monitor, report and evaluate their effectiveness, including relevant and appropriate performance indicators'

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

We believe this has already been achieved through the Council Plan and Annual Report as recognised in Section 3.3 of your report.

Section 125(2) of the Local Government Act sets out the requirements for the Council Plan. The Council Plan sets out the Council's Strategic Objectives and the Strategies to achieve the objectives. Also included in the Council Plan are the strategic/performance indicators used to measure success. The Annual Report reports against the objectives and strategies included in the Council Plan.

We suggest that the recommendation be modified along the followings lines:

'Councils strengthen the material in their Council Plan and Annual Report which identifies their sustainability strategies and outline how the strategies and actions address this.'

Financial Sustainability section

The first concern we have in relation to this section is that there is no contextual information. Whilst the details for the audited councils are included there is no comparison information in relation to the sector. The reader is unable to ascertain how the audited councils are performing in relation to the rest of the sector. For example, what is the state average or median for the six key financial sustainability indicators and how do the audited councils compare against these?

Towong is shown as having an upward 'trend' in relation to the indebtedness indicator. The Indebtedness ratio is *total liabilities/realisable assets* and in Towong's case our level of mean indebtedness (2007-2011) is 5.66% compared to the average of the Small shire council group of 22.3%.

As a result of having low total liabilities the percentage indicator is highly sensitive and due to a $1.1m Defined Benefits call being recognised in 2011/12 this indicator increased to 16.8%. This does not constitute a trend and remains far below the average of the Small shire council group.

If VAGO wish to include this representation we request that where it is stated 'Towong's indebtedness indicator is also predicted to deteriorate.' that contextual information is included to explain how this has come about.

There is also no mention of the significant work (commissioned by small councils) by Mr Merv and Mr Rohan Whelan in relation to financial sustainability of rural councils. This work has been key in terms of informing councils and the State and Federal Governments of the factors influencing sustainability and how each of the participating councils are placed regarding sustainability. We believe the commissioning of the work demonstrates that councils are taking it upon themselves to understand and address sustainability issues.

Sustainability issues, challenges and strategies section

Section 3.3.1
Towong Shire has adopted an approach where our Long Term Financial Plan is a dynamic document that is continuously updated and communicated to all stakeholders. There is no acknowledgement of this approach and the associated benefits. A different approach, such as the one taken at Towong, is not necessarily not 'better practice' particularly when the relevant information is contained within the Plan and the method of presentation and fluid nature of the Plan is fit for purpose for a small council.

Section 3.3.3
On page 25 following Figure 3B it states "The necessary rationale for councils adopting shared services is generally not clear". We are surprised by this comment.

The rationale for adopting shared services was clearly articulated during the audit. Perhaps the wording here should be changed to "The rationale for councils adopting shared services has not been provided in the form of a document".

The reality for Towong is that the community expects certain services (e.g. environmental and public health functions) and because we cannot afford a full-time qualified officer (and often can't attract

RESPONSE provided by the Chief Executive Officer, Towong Shire Council – continued

professional/qualified people to our municipality due to our remoteness) we have two choices: partner with a neighbouring council or not provide the service. Sharing services in this situation is not necessarily about improving the sustainability of council. We believe the report should note that sharing services may be required to provide communities with services (and doing so may not be with a view to achieving sustainability).

Section 3.3.4
The material included is directly related to the argument for shared services and the report should make this connection.

Section 3.3.4
This section discusses workforce planning in depth and does not form any recommendation nor provide any evidence that that approach currently taken at Towong or the other audited councils is deficient.

Section 3.3.7
This section discusses performance indicators and states that "Councils do not have relevant and appropriate performance indicators for specific actions or to measure sustainability beyond financial parameters." We do not understand this comment and would appreciate the inclusion in the report of examples of performance indicators to measure sustainability beyond financial parameters.

Presentation of report

Referencing of data sources
To enhance the value of the report to readers we suggest that references to documents without footnotes to direct the reader be avoided e.g. 'In January 2012 the Australian Government released a better practice guide'. The better approach would be to reference this document or alternatively provide the correct name of the document/guide in the body of the report to assist the reader.

Process
It would be remiss not to comment on the timing of the audit and the unreasonable time frames. Small councils have incredibly limited resources and the conduct of the audit in the first six months of a new Council (the Local Government Elections were in October 2012) when the new Council and staff are formulating the four year Council Plan and Budget was completely unreasonable, putting additional strain on organisations that are already under enormous pressure.

To compound this a key member of staff had five weeks leave during the audit (and there was no real flexibility on the part of VAGO to accommodate this). We completely understand the timeframes to which you are required to adhere but we do not believe there was any understanding of how small councils function nor any appreciation of the impact an audit like this has on a small council particularly if meaningful engagement is desired.

Housekeeping matters
We noted there is no page 16 in the report.
We also noted an issue with the numbering of recommendations. On page 30 under 'Recommendations' the final point should be a bullet not number 4 (this will then align the recommendation numbering with the recommendations on page xi – provide the numbering of recommendations on page 36 start with 4 and not 5).

Thank you for the opportunity to provide comments in relation to provisional draft report.

Should any further information or clarification be required please do not hesitate to contact me on (02) 60 715 100.

Juliana Phelps
Chief Executive Officer

Acting Auditor-General's response to Towong Shire Council

Towong Shire Council has raised three issues in its letter which we emphatically refute: the quality and evidence base of the report, the opportunities that have been provided for engagement and the overall value of performance audits.

Quality and evidence base

We strongly refute any suggestion we did not follow an evidence-based approach. In developing the audit findings, conclusions and recommendations the Auditor-General considered all of the relevant and appropriate evidence provided by the audited councils, including Towong, which related to the audit scope.

Towong's letter attaches its correspondence from 17 May 2013 at Appendix A. We note that we have already provided Towong a detailed acquittal of the issues raised, and advised of a number of changes to the final report acknowledging the further information and context provided. We do not intend to re-state the advice already provided. We reiterate that we believe Towong's comments are largely contextual or opinion rather than evidence based and do not change our findings, conclusions or recommendations.

We further note Towong's comment that the Department of Planning and Community Development (DPCD) has strong insight into the sector and refer to the department's response which states the report is a 'fair representation of the sustainability challenges facing small councils' and it clearly accepts the four relevant recommendations.

Engagement

We believe Towong has been poorly served by the unprofessional prosecution of this audit by Council Officers, which has been conducted in less than good faith.

Towong was provided with the same opportunities to provide evidence, comment and engage with this audit as were all the other small councils subject to this audit. All other councils provided timely submissions on our emerging findings, except Towong, despite it being provided with multiple extensions to provide comment and supporting evidence.

Towong provided no written response to our emerging findings for nearly three months. On 16 May 2013, the senior Council Officer responsible for day-to-day engagement with VAGO advised he had 'stopped engaging with the audit'. The council made no attempt to advise VAGO of this decision to 'disengage' or to escalate this significant issue prior to 16 May 2013.

The Towong May 31 response to this audit asserts that the other CEOs involved in the audit share similar views, and suggests that we contact the CEOs of those councils to understand more about their experience. We did. We have spoken directly to each of the four CEOs at the other audited councils who do not share Towong's view, notwithstanding that Towong had circulated its response to these councils.

Value

Towong's letter appears to question whether the expenditure on this audit has yielded a quality outcome. We note that VAGO conducts audits of some 550 entities in the Victorian Public Sector, as well as the local government sector, which have a combined income of around $71.1 billion. The total cost of VAGO operations represents 0.05 per cent of the income of the entities we audit. More importantly, the Auditor-General's audits provide assurance to Parliament on the accountability and performance of the Victorian Public Sector and make recommendations for further improvement.

This audit includes three recommendations directed at councils relating to sustainability strategies, long-term financial planning and service planning and delivery. We note Towong's comments about 'best value', but remind it that it is a mandatory requirement of the *Local Government Act 1989* for councils to provide services in accordance with Best Value Principles.

This audit identifies better practices which could assist in driving improvements across the sector such as improved long-term financial planning. Towong has not indicated clearly in its response to the audit whether it intends to adopt these recommendations going forward. We suggest that if Towong were to not act on the recommendations this would represent a seriously missed opportunity to improve its sustainability, performance and value to its community.

In our response to Towong's correspondence of 17 May 2013—Appendix A of Towong's letter of 31 May—we indicated that we would like to meet with the council as we have significant concerns with the prosecution of this audit. Towong's Mayor confirmed with us on 5 June 2013 council's invitation to meet with it. We take this proposal to meet seriously and suggest that in any future VAGO audits Towong fully apprises itself of audit methodology and standards, the nature of audits and Towong's responsibilities and obligations under both the *Audit Act 1994* and the *Local Government Act 1989*.

Auditor-General's reports

Reports tabled during 2012–13

Report title	Date tabled
Carer Support Programs (2012–13:1)	August 2012
Investment Attraction (2012–13:2)	August 2012
Fare Evasion on Public Transport (2012–13:3)	August 2012
Programs for Students with Special Learning Needs (2012–13:4)	August 2012
Energy Efficiency in the Health Sector (2012–13:5)	September 2012
Consumer Participation in the Health System (2012–13:6)	October 2012
Managing Major Projects (2012–13:7)	October 2012
Collections Management in Cultural Agencies (2012–13:8)	October 2012
Effectiveness of Compliance Activities: Departments of Primary Industries and Sustainability and Environment (2012–13:9)	October 2012
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2011–12 (2012–13:10)	November 2012
Public Hospitals: Results of the 2011–12 Audits (2012–13:11)	November 2012
Water Entities: Results of the 2011–12 Audits (2012–13:12)	November 2012
Port of Melbourne Channel Deepening Project: Achievement of Objectives (2012–13:13)	November 2012
Portfolio Departments and Associated Entities: Results of the 2011–12 Audits (2012–13:14)	November 2012
Local Government: Results of the 2011–12 Audits (2012–13:15)	November 2012
Prison Capacity Planning (2012–13:16)	November 2012
Student Completion Rates (2012–13:17)	November 2012
Management of the Provincial Victoria Growth Fund (2012–13:18)	December 2012
Learning Technologies in Government Schools (2012–13:19)	December 2012
Addressing Homelessness: Partnerships and Plans (2012–13:20)	February 2013
Implementation of School Infrastructure Programs (2012–13:21)	February 2013
Rating Practices in Local Government (2012–13:22)	February 2013
Management of Unplanned Leave in Emergency Services (2012–13:23)	March 2013
Management of Freshwater Fisheries (2012–13:24)	March 2013

Report title	Date tabled
Managing Traffic Congestion (2012–13:25)	April 2013
Consumer Protection (2012–13:26)	April 2013
Public Asset Valuation (2012–13:27)	April 2013
Planning, Delivery and Benefits Realisation of Major Asset Investment: The Gateway Review Process (2012–13:28)	May 2013
Tertiary Education and Other Entities: Results of the 2012 Audits (2012–13:29)	May 2013
The State of Victoria's Children: Performance Reporting (2012–13:30)	May 2013
Management of Staff Occupational Health and Safety in Schools (2012–13:31)	May 2013
Infection Prevention and Control in Public Hospitals (2012–13:32)	June 2013

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