Department of
Local Government, Sport
and Cultural Industries

GOVERNMENT OF
WESTERN AUSTRALIA

Local Government
Act 1995 Review
agile • smart • inclusive

LOCAL GOVERNMENT ACT REVIEW ▶▶▶ DELIVERING FOR THE COMMUNITY

SUMMARY DISCUSSION PAPER | AGILE

Financial management

Introduction

To deliver services efficiently and effectively, local governments must be prudent users of public funds. Local governments must be transparent and accountable while striking a balance between community expectations and the practical limitations of revenue and expenditure.

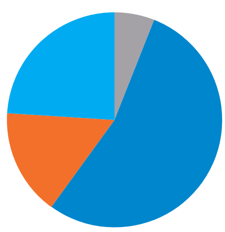
There are a number of accountability measures in place to provide financial oversight of local governments, including:

- The Office of the Auditor General, which is taking responsibility for local government audits following the introduction of the legislation in 2017.
- The requirement to give public notice for rates and other financial matters.
- Publication of annual reports (it is proposed to make these available online).
- MyCouncil website which provides a geographic, demographic and financial snapshot of each local government.

Local government revenue is principally drawn from rates, fees and charges, and grants from the State and Commonwealth Government. Financial Assistance Grants from the Commonwealth comprise approximately 40% of the grants received by the local government sector, with the remaining 60% allocated from State Government grant programs. In the last two years, rates have made up approximately 55% of local government operating revenue, with grants from the State and Commonwealth Government making up around 15% of local government operating revenue.

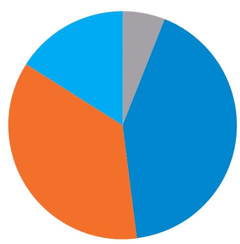
In 2016-17, grants from the State and Commonwealth were the primary source of funding for 27% of the State's local governments. In over half of the State's local governments, revenue from State and Commonwealth grants made up more than one-third of their total operating income.

Revenue sources all Western Australian local governments in 2016-17



Rate revenue | Grants
Fees charges | Other revenue

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



Rate revenue | Grants
Fees charges | Other revenue

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

The local government sector's operating expenditure exceeds $4 billion annually and local governments manage an asset base worth more than $40 billion. To manage their finances, local governments are required to prepare a budget annually. The Local Government Act 1995 (the Act) requires that a local government is to, having regard for its Integrated Planning and Reporting documents, prepare an estimate of its upcoming expenditure, the revenue and income it will receive independent of rates, and the amount in rates required to make up any deficiency. This means that local governments are required to establish their budget by first determining the amount they wish to spend and then estimate the revenue sources required to fund this outlay.

Investments

The Act allows local governments to invest surplus funds but places restrictions on local governments from making some investments for example, investing in bonds that are not guaranteed by a Commonwealth, State or Territory government. Many local governments hold significant amounts in cash reserves, including those obtained through development contributions. To ensure the public receives the benefits of these reserves, local governments need to invest these funds wisely.

What are the opportunities for reform?

The current approach to regulating investments was introduced after the Global Financial Crisis (GFC) when multi-million-dollar losses were suffered by a number of local governments who had invested in Collateralised Debt Obligations (CDOs) with Lehman Brothers. The approach has been criticised by the sector as being overly restrictive. In 2016, the Department of Local Government, Sport and Cultural Industries (the department) conducted a review of the investment restrictions. This review found that the provisions did not have their intended effect with the types of investments prohibited not necessarily correlating to risk.

One way to resolve this situation could be for the introduction of a requirement for local governments to have an investment policy which addresses risk and would need to be regularly reviewed.

A tiered approach to investments could also be introduced. Tier one investments would incorporate low risk and be subject to minimal regulatory oversight. Tier two investments would require additional due diligence such as the development and approval of investment plans by the department or another regulator.

Debt

Debt is a contentious issue. Some people believe that debt should be avoided wherever possible. Another perspective is that the prudent use of debt serves a user pays philosophy by enabling multiple generations to contribute to infrastructure projects they will use into the future.

Local governments have the power to borrow money or obtain credit. They do not need to seek external approval to borrow, although financial indicators, including a debt service ratio, must be reported in their annual report allowing monitoring of their indebtedness. Local governments are restricted in that their borrowings may be secured only by giving security over their income from general rates or untied government grants.

The Municipal Association of Victoria recommends that local government debt should not exceed 60% of their annual rate revenue. In Western Australian, just three local governments exceeded 60%, with the state-wide average being 16%.

To fund infrastructure, local governments in Western Australia will often access several grants from both the State and Commonwealth governments so even if a local government was to borrow in order to make a contribution themselves, it may constitute only a small part of the whole cost.

What are the opportunities for reform?

Security over borrowing

Local governments are currently restricted from using anything other than income from general rates or untied government grants as security. Removing these restrictions may increase the legitimacy of borrowing as a financial management tool and serve to reduce the stigma associated with local government debt.

Some local governments have contended that they should be permitted to secure funds using their assets. Local governments have suggested that 'commercial' assets such as property and infrastructure like airfields could be used to secure loans at competitive rates.

Public notice of borrowing

In some circumstances a local government is required to give one month's public notice in relation to the use of or borrowing money for example, to spend funds that have been left over from previous borrowing.

Ceasing the requirement to give public notice would relieve an administrative burden (which local governments argue rarely generates community interest) but reduces transparency.

Procurement

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

Currently, local governments are required to have a purchasing policy addressing contracts to supply goods and services where the value is expected to be under $150,000. Contracts over this amount are required to be via public tenders, unless an exemption applies, for example, using the WALGA preferred supplier scheme or an Australian Disability Enterprise. Local governments can also establish a panel of pre-qualified suppliers, after issuing a public invitation to join the panel.

Under WALGA's preferred supplier scheme, local governments can contract for goods or services from a panel of suppliers that have been pre-approved by WALGA. As part of the scheme, WALGA receives a portion of the contract's value.

The local government sector has long advocated for raising the threshold where public tenders must be advertised due to the time and effort required to go through the tendering process. This must be balanced with the need to provide confidence for suppliers and the community that value for money is being obtained. High profile breaches of tendering rules have reduced this confidence. Concern regarding procurement practices is one of the major sources of community complaints to the department.

It is widely acknowledged, including by the Commissioner of the Corruption and Crime Commission, that procurement is an area vulnerable to corruption. It is important that any reforms to procurement take into account the risks associated with using public money and opportunities for unethical behaviour.

What are the opportunities for reform?

Align local government procurement rules with the State Government

State government procurement rules are set by the State Supply Commission under its own legislation. State government agencies must receive written quotations for expenditure up to $250,000 (for goods or services not on the Common Use Arrangement (CUA) and open tender for contracts exceeding that amount. While the monetary threshold before public advertising is higher, the State Supply Commission's regime of procurement policies means that there is tighter control of State government procurement.

The CUA, established through tendering, requires State government agencies to use specific suppliers for specified items. There is currently no requirement for local governments to use the CUA although they can use it if they wish to take advantage of the greater buying power of State Government.

Tender threshold based on local government expenditure

One option is to set tender threshold rules based on a local government's annual average expenditure. Under this approach, local governments would be required to advertise for tenders for goods, services and capital works with an anticipated value that is greater than a set percentage of that local government's average annual operating expenditure over a set number of years.

Example – tender thresholds scaled to expenditure

Over the last three financial years a given local government has had an annual operating expenditure of $63m, $60m and $59m. The three-year average annual operating expenditure of the local government is $60.6m

In this scenario, if the prescribed percentage was 0.25%, for example, the tender threshold for the local government would be $151,500.

This would still require a ceiling where a public call for tenders is required due to the large annual expenditure of approximately a dozen metropolitan local governments, and a floor to account for the majority of small regional local governments with an operating budget closer to $10m.

Tender threshold based on an assigned band salaries and allowances band

Another approach could be to set the tender threshold based on an assigned band. For more information on this and other models please read the full discussion paper available here.

Timely payment of suppliers

The Regional Chamber of Commerce and Industry and the Small Business Development Corporation have called for reforms that ensure the timely payment of suppliers.

In 2018, the Auditor General published a report which found that while the majority of local governments audited made payments to suppliers on a timely basis, few had policies to ensure timely payments. Among the Auditor General's recommendations was that local governments should have policies or procedures that clearly require payment of invoices within specific time frames.

Another option is to align the rules for timely payment of suppliers with State Government requirements. Treasurer's Instruction 323 requires State Government agencies to make payments within 30 days of the receipt of the invoice, or within 30 days of the provision of the goods or services (whichever is later).

Regional price preference

The regional price preference encourages governments to use locally sourced suppliers allowing local governments to assess a tender from a regional supplier as if the price bids were reduced.

The maximum permitted regional price preference to a regional tenderer is up to 10% for goods and services or 5% for building services up to a maximum price reduction of $50,000. Under State government tendering rules, the maximum permitted regional price reduction is $250,000.

Both local government and the Regional Chamber of Commerce and Industry have called for the cap to be increased in line with the State government limits and Local Government Professionals Australia WA have suggested that it should apply to all services.

Local government operating budgets vary considerably. For many regional local governments, the $50,000 cap represents a comparatively large proportion of their annual budget.The current cap restricts the value of the regional price preference of tenders with a value greater than $500,000. More than half of the State's local governments have an annual operating budget of less than $10,000,000, meaning that this discount represents 5% or more of their budget. Raising the cap may further promote opportunities for local governments to buy local but may also increase costs for regional local governments.

What are the opportunities for reform?

Amend the financial ratios

Altering the financial ratios that local governments are required to calculate and report may improve awareness and understanding of local government financial performance.

Annual reporting

Currently, local governments are required to prepare an audited financial statement annually in accordance with the Australian Accounting Standards as modified by the Act and regulations.

Financial reporting is not a unique requirement to local government. All State Government and Commonwealth department financial reports are audited by their respective Offices of the Auditor General and are tabled in Parliament. In the private sector, audited financial reports for many types of companies are submitted to the Australian Securities and Investment Commission and some charities must submit a general-purpose financial statement that complies with the Australian Accounting Standards to the Australian Charities and Not-for-profits Commission.

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

Across Australia, local governments are required to calculate and publish different ratios. The lack of consistency makes the comparison of financial performance across local governments around the country more complex. Likewise, methods of valuation used to calculate ratios under the International Valuation Standard can vary, which means that ratios are a guide or indicator rather than a definitive account of financial health.

In Western Australia, benchmarks for the seven ratios that local governments must report on were set in departmental guidelines published in 2013. While these benchmarks are not legislated, these benchmarks are used to inform the department's risk management approach means that they are of considerable interest to local governments.

Building Upgrade Finance

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

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

BUF involves three parts: the building owner agrees to undertake works; a financier agrees to finance the works; and the local government agrees to recoup the loan (known as a building upgrade charge).

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

In other states that use this mechanism, the local government is by law not financially liable for any non-payment by the building owner.

What are the opportunities for reform?

The City of Perth and the Property Council of Australia have advocated for reforms that would enable local governments to guarantee finance for building upgrades for non-residential property owners.

Their proposal is not to limit the scheme to environmental projects, instead they believe this could be used to finance general upgrades to increase the commercial appeal of buildings for potential tenants. In this way, BUF is viewed as means to encourage economic growth.

Have your say

Have your say on these important issues by completing the survey or emailing actreview@dlgsc.wa.gov.au. A more detailed paper is also available.