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ECONOMICS

SA Local Government Grants Commission

Methodology Review

June 2013



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The findings in this report are based on a qualitative study and the reported results reflect a perception of South Australian Local Government Grants Commission but only to the extent of the sample surveyed, being South Australian Local Government Grants Commission approved representative sample of management and stakeholders (including South Australian Councils). Any projection to the wider management and stakeholders is subject to the level of bias in the method of sample selection.

No warranty of completeness, accuracy or reliability is given in relation to the statements and representations made by, and the information and documentation provided by, the South Australian Local Government Grant Commissions personnel / stakeholders consulted as part of the process.

KPMG have indicated within this report the sources of the information provided. We have not sought to independently verify those sources unless otherwise noted within the report.

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The findings in this report have been formed on the above basis.

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Executive summary

The South Australian Local Government Grants Commission (the Commission) is an independent statutory authority established under the South Australian Local Government Grants Commission Act 1992 and is the body responsible in South Australia (SA) for making recommendations on the distribution of Financial Assistance Grants (FAGs) to Councils within the state.

The Commission has developed a methodology which meets the set of National Principles which the distribution of FAGs must satisfy.

The Commission regularly reviews the methodology it uses to determine its recommendations for the distribution of FAGs to local governing authorities in SA. It has a well established process of continual refinement. This project is the first major review¹ of the entire South Australian methodology undertaken since 1996-97.

Consultation was a critical element of the review process and consequently the review involved extensive stakeholder consultation including a call for submissions from all councils, discussions with other jurisdictions and two stakeholder workshops.

The fundamental driver for the review was a decision by the Commission to undertake a holistic review. In undertaking such a review there are some fundamental issues that have emerged that have shaped the recommended direction outlined in this report. These issues are listed below.

- The Commission's desire for the methodology to be better understood by Councils.
- The Commission is broadly satisfied with the distribution of grants under the current methodology and views the maintenance of the equity objective as a foundation for any potential changes.
- Other jurisdictions (i.e. Victoria and Western Australia) have in recent years both gone down a "simplification" path on the expenditure side of the assessment process whilst maintaining or refining a distribution of grants that they felt were appropriate.
- The National Principles are set by the Commonwealth and the methodology of each state must comply with these for the annual proposed grant allocation to be approved by the Federal minister.

It is noted that the pattern of distribution in SA is such that:

- there is a concentration of metropolitan councils on the minimum grant; and
- the greatest level of distribution occurs to the relatively higher need rural areas.

It is also important to recognise that the Commission receives a pool of funds which is essentially fixed and that the role of the Commission is to distribute this fixed pool of funds in accordance with the distribution principles.

Councils receive income to varying degrees for rate revenue and other sources in addition to the grants distributed by the Commission. Individual councils have a range of factors which impact on their ability to raise revenue and/or to provide services (e.g. aged population, tourism). Many of these factors are outside the direct control of the respective council and in

¹ Reference to the word "Review" throughout this report has not been used in the context of a review in accordance with assurance standards issued by the Australian Auditing and Assurance Standards Board.

some instances, are the direct result of policy decisions taken by others including the state or federal governments. It is not for the Commission to address all of these issues and to attempt to do so in some areas would fall outside of their remit. In addition, it is important to recognise the Commission in applying its methodology, is comparing the relative needs of each Council. The relativity concept is often hard to grasp or conceptualise but a key implication is that the needs of individual Councils cannot necessarily be met and further, it is not the Commission's responsibility to ensure the sustainability of the local government sector, or an individual Council.

Conceptually, the ideal grant system would be one that meets the National Principles and the related objectives of the Commission (e.g. equity) and the desired goals of Councils (e.g. predictability and stability).

Ultimately it is up to the Commission itself to determine the approach to the distribution of the FAG funding and this will involve consideration of all of the above mentioned issues and those discussed throughout this report. The Commission has a current methodology and can continue to use this should it wish to do so.

It should be noted that although a number of changes to the current methodology are recommended for the Commission to consider, there are a number of elements of the Commission's current general approach where no change is proposed (e.g. the direct assessment approach). Where changes are being considered, they can be best assessed by breaking down the treatment into the following components:

- Revenue assessment.
- Road assessment.
- Other expenditure assessment.

This review found that no change to the revenue assessment process should be made with the exception of the Commission considering removal of the application of the SEIFA index (ABS Socio Economic Index for Areas) from the revenue assessment component of the methodology (noting that SA is the only state to include a SEIFA index in this way). It was found that all states use the same basic approach to the revenue assessment component of their methodology and the report concludes that there is not a viable alternative.

This review also concluded that no change should be made to the assessment process for road grants. The current approach is well understood, with the data that drives the allocation being independently sourced and/or verifiable. The alternative asset preservation approach is much more complex and requires extensive data much of which would be currently unavailable and relatively expensive to collect.

Consistent with the outcomes of the reviews recently undertaken in other states it is considered that the major opportunities for the Commission to consider are within the "other expenditure" assessment component of their methodology.

This report recommends that the Commission consider adopting a new function classification for expenditures and that this be supported by the development of a function-specific matrix of cost adjusters. The report outlines in Section 8 how the Commission may consider developing both the list of expenditure functions and the associated cost adjusters.

The proposed new approach is considered to be more intuitive and easier to understand and only utilises data which is from credible independent sources.

Should the Commission decide to adopt the recommendations, the development of the resultant model will likely require an iterative approach, through fine tuning the mix of adjustors, their relative weights (noting that the total weight of the cost adjustors for each function must add to 100%) or the relativity of the cost adjustors across councils. Such iterations can continue until such time as the Commission considers that the distributions generated by the model reflect the objectives of the National Principles and its assessment of relative need. In summary the report addresses the terms of reference for the review with the exception of item 6 for which the Commission has been provided with a separate report. While the main recommendations are summarised above there are a number of other issues covered within the report.

The report contains 18 recommendations as shown below and throughout sections 7-9 of the report. Each recommendation has been referenced to the relevant section of the report. A summary list is also provided in section 10.

The following provides a consolidated list of recommendations made within this report and a reference to the relevant section that the Commission might consider.

- No change to be made to the current approach to the general revenue assessment process. (Refer separate recommendation regarding the use of SEIFA on the revenue assessment process.) (Refer section 7.1)
- Discontinuing the use of a SEIFA based index on the revenue side of the assessment process as this would be duplication if it is included as a cost adjuster on the expenditure side. (Refer section 7.1)
- Other council revenue be netted off against the relevant expenditure function (as per current arrangements) unless it becomes sufficiently material to warrant it being included as a specific revenue function. (Refer section 7.1)
- No change to be made to the current approach to the road expenditure assessment process. (Refer section 7.2)
- Continuing the current approach of including depreciation and excluding capital from the assessment process. (Refer section 7.3)
- Undertaking substantive reform to the other expenditure assessment process. (Refer section 7.4)
- Reducing the number of expenditure function through a consolidation process based on an agreed set of criteria (e.g. minimum percentage of overall council expenditures) whilst seeking to include as close as possible to 100% of the expenditure of councils within the assessment process. (Refer section 8.3)
- Specific criteria as a basis for establishing a set of cost adjustors. (Refer section 8.4)
- An indicative list of expenditure functions and the basis upon which the list has been developed. (Refer section 8.5)
- An indicative list of cost adjustors and the basis upon which the list has been developed. (Refer section 8.6)
- The Index of Relative Socio-Economic Disadvantage (IRSD) as the cost adjuster for all expenditure functions where use of a SEIFA index is required. (Refer section 8.7)

- Removing Function 50 from the Commission's methodology as it is no longer required to achieve any desired redistribution. (Refer section 8.9)
- No change to the methodology is required to take account of the effects of water licensing. (Refer section 9.1)
- No change to the methodology is required to take account of the effects of fixed and variable property rates. (Refer section 9.2)
- The proposed methodological approach outlined in this report with the view that this might form the basis of assessing the waste management function moving forward.. (Refer section 9.3)
- Continuing with the current approach to scaling back from the raw grant to the pool of available funds. (Refer section 9.4)
- A number of the issues identified with the current structure of their model and the list of model enhancements that should be made. (Refer section 9.5)
- The development of a comprehensive manual (along the lines of the VIC manual) to assist Councils with the completion and associated accuracy of their annual returns to the Commission. (Refer section 9.6)

It is understood that in developing its methodology, the Commission intends to take into consideration, prior to making any decisions on the way forward:

- the findings of this review; and
- the results of any further consultation with the local government sector.

1 Project approach

This section of the report outlines the objectives, scope and methodology of the project.

1.1 Objective and purpose

The South Australian Local Government Grants Commission ('the Commission') regularly reviews the methodology it uses to determine its recommendations for the distribution of Commonwealth Financial Assistance Grants to local governing authorities in South Australia.

The 2011 annual report of the Commission provides a summary of the ongoing refinement to the Methodology². Recent reviews have focused on smaller individual parts of the methodology however, KPMG was engaged to undertake a review of the entire methodology and this review³ is the first major review of the entire South Australian methodology undertaken since 1996-97.

The fundamental objective and purpose of this engagement was to assess whether the methodology used by the Commission accurately captures the appropriate revenue and cost drivers and enables the Commission to achieve a distribution of grants in accordance with the principles contained in the *Local Government (Financial Assistance) Act 1995*.

It is noted that this review has been undertaken separately from the Commonwealth's Review on Improving the Impact of the Financial Assistance Grants on Local Government Financial Sustainability. This is further discussed in Section 1.4.

1.2 Scope

In November 2012, KPMG was engaged to conduct a comprehensive methodological review for the Commission. Specifically, the scope of the project included the requirement for KPMG to address each of the elements contained in the original Request for Proposal and as summarised in the Terms of Reference distributed by the Chair of the Commission.

A copy of the Terms of Reference is provided in Appendix A.

In the context of the Terms of reference KPMG was required to:

- Provide interim findings for consideration by the Commission which would include a priority list of areas to be further considered. It was also agreed to establish a stakeholder reference group which met on two occasions throughout the engagement. Membership of the stakeholder reference group is shown in Appendix B.
- Prepare a final report for the Commission. Note that a separate report addressing the requirements to review funding provided to Aboriginal Communities and the Outback Communities Authority has been prepared.

² Local Government Grants Commission Annual report 2010-11 page 4-6.

³ Reference to the word "Review" throughout this report has not been used in the context of a review in accordance with assurance standards issued by the Australian Auditing and Assurance Standards Board.

1.3 Approach

KPMG undertook the project by undertaking the following key steps:

- Document analysis and research;
- Inter-jurisdiction comparison;
- A survey/call from submissions from each local government body within South Australia;
- Consultation with local government and other key stakeholders; and
- Preparation of a final report and presentation of findings.

A list of stakeholders consulted including those who provided responses to the survey/call for submissions is shown in Appendix C.

A list of documents reviewed is shown in Appendix E.

1.4 Australian Government Review into Financial Assistance Grants (FAGs)

The Deputy Prime Minister wrote to the chair of the Commonwealth Grants Commission (CGC) on 9 November 2012 to convey to the chairman of the Commonwealth Grants Commission the terms of reference for a Review on Improving the Impact of the Financial Assistance Grants on Local Government Financial Sustainability. The Terms of reference for the review required the CGC to provide a report to the Australian Government by 31 December 2013.

While interrelated, the Commonwealth review and the review of the current methodology used in SA are different in nature. Furthermore the associated timelines are quite different. The requirements of the review of the Commission's methodology are to assess the methodology in the context of the current National Principles and other requirements.

To the extent that the issues are relevant they will be dealt with in this report. If in the future as a result of the CGC review there were to be changes to the National Principles and/or other requirements then the Commission would need to take these into account, as would the other state based Commissions.

The objective of the review to be undertaken by the CGC is to "identify tangible measures for improving the impact of the Local Government FAGs on the effectiveness of local governments and their ability to provide services to their residents within the current funding envelope."⁴

The Terms of Reference for the review to be undertaken by the CGC requires the CGC to "examine the impacts of FAGs on local government bodies and its appropriateness by focusing on:

- examining in the intrastate context whether the National Principles that guide the allocation of the general purpose grants remain valid and are conceptually consistent with one another;
- evaluating the economic and financial benefits of untied vs. tied funding for enhancing the effectiveness of local governments and their ability to ensure effective services for their residents;

⁴ Letter of Transmittal and Terms of Reference from the Deputy Prime Minister 9 November 2012.

- identifying the impact of the Minimum Grants principle on the intra-state distribution of FAGs; and
- assessing the relative need of local governments in each State and Territory with a particular focus on those that service regional and remote Communities.”⁵

⁵ Letter of Transmittal and Terms of Reference from the Deputy Prime Minister 9 November 2012.

2 Current Arrangements for Financial Assistance Grants (FAGs)

Financial Assistance Grants (FAGs) are provided by the Commonwealth government to all states and territories and are a key source of revenue for local government. This section provides some background and overview around how these grants are distributed to local government. Included in this section are key methodology principles and issues.

2.1 Financial Assistance Grants

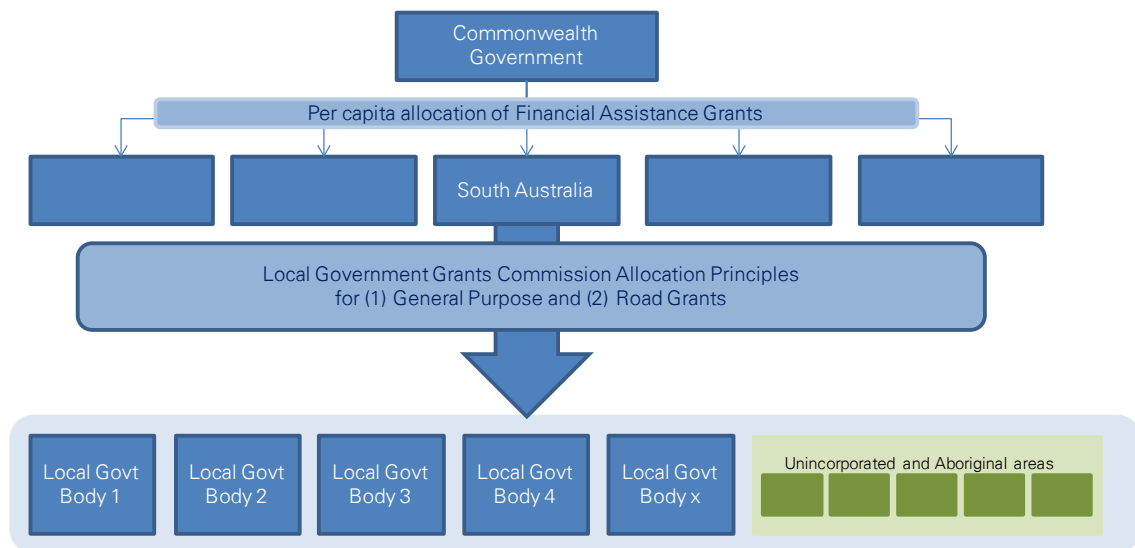
In accordance with the *Local Government (Financial Assistance) Act 1995*, the Federal Government provides all states and territories with FAGs. The Act provides for a per capita distribution (to the states) for the general Financial Assistance Funding.

For 2011-12, the Commonwealth Government distributed a total of \$2.15 billion of financial assistance grant funding to the States for local government funding. SA received \$145.8 million (6.8% of total Commonwealth financial assistance grant funding), which included both a general purpose grant and local roads grant.⁶

The Commonwealth grants received by each state are in turn distributed by the states/territories to local government in accordance with the methodology developed by each jurisdiction in a manner that best seeks to achieve the National Principles. It is noted that the state based local government grants commissions have each developed their own methodology for allocating grants within their respective jurisdictions. A number of alternative approaches are discussed in Section 5.

Figure 1 - Allocation process of Financial Assistance Grant funding (below) illustrates the broad allocation process.

Figure 1 - Allocation process of Financial Assistance Grant funding



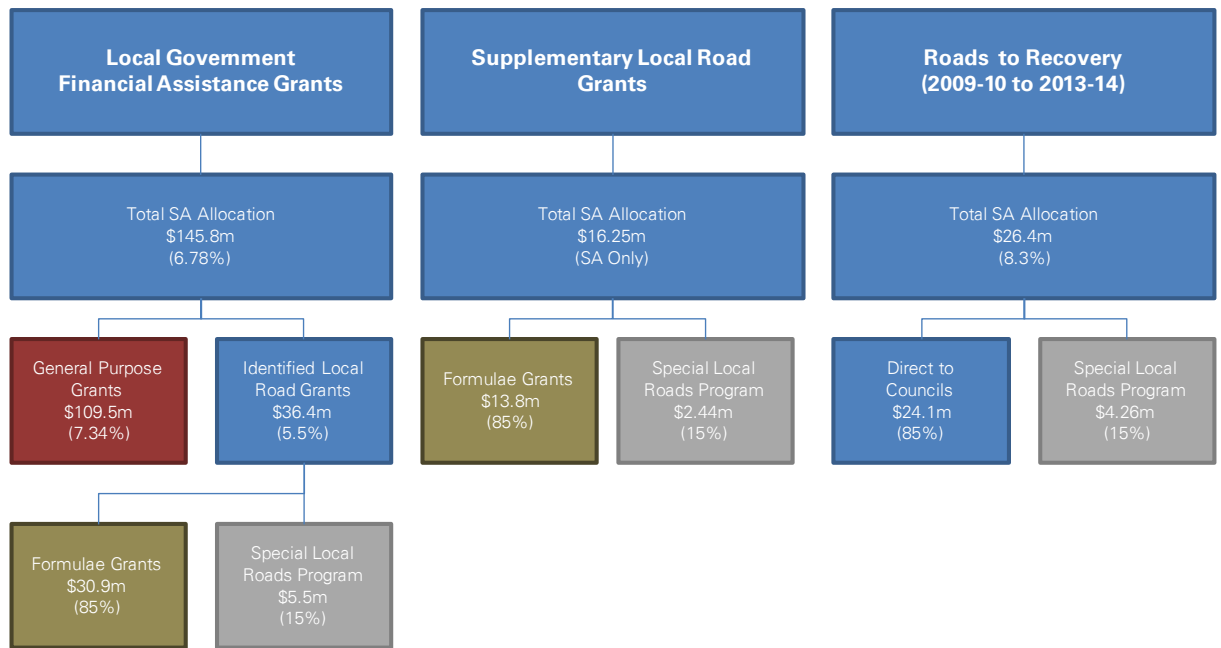
In 2011-12 the general purpose funding for SA was \$109.5 million. The local roads funding for SA was \$36.4 million, which includes special local road funding of \$5.5 million. Local road funding is distributed to States based on those roads existing prior to 1991-92. In addition SA

⁶ South Australian Local Government Grants Commission. 2012. 2011 2012 Information Paper.

received supplementary local road funding in 2011-12 of \$16.25 million which was distributed by the Commission in the same manner as the local roads funding. In addition, a proportion of the grants received under the Commonwealth's five year Roads to Recovery program is also allocated to the Special Local Roads Program, with the remainder direct to councils.

A summary of grants for 2011-12 is shown in the following figure.

Figure 2 - Summary of Grants for 2011-12⁷



In the case of SA, the grants are distributed quarterly by the Commission. The Commission in distributing grants to local government seeks to ensure that each local governing body in the State is able to function (by applying reasonable effort), at a standard not lower than the average standard of other local governing bodies in the State.⁸ This is referred to as horizontal equalization and is in line with the National Principles prescribed in the Commonwealth legislation. The Commission's methodology is discussed in Section 4.

In SA Local Government consists of 68 Councils comprising 19 metropolitan and 49 rural/regional. A significant land area of the State is not incorporated under the Local Government Act but for the purposes of the *Local Government (Financial Assistance) Act 1995* comprises five Aboriginal communities and the Outback Communities Authority.

⁷ South Australian Local Government Grants Commission. 2012. 2011 2012 Information Paper page 7.

⁸ SA Grants Commission, 2011. Annual Report 2010-11.

2.2 South Australian Local Government Grants Commission (the Commission)

The Commission is an independent statutory authority established under the *South Australian Local Government Grants Commission Act 1992*. The Commission makes recommendations to the Minister for State/Local Government Relations for the distribution of FAGs. The Minister then recommends a distribution to the Commonwealth Minister who must approve that the proposed distribution is in accordance with the National Principles set out in the *Local Government (Financial Assistance) Act 1995 (Cth)*.

Grants for local governing authorities in SA are distributed in accordance with National Principles set by the *Local Government (Financial Assistance) Act 1995*.

It is noted that while the allocation of funding is required to reflect these principles there is no activity undertaken to specifically audit the services delivered by a council to ensure that there is an average level of services available, and that where there is a greater concentration of a particular need within the population of a particular council, that there are services being provided to this segment of the population to meet their particular needs. That is, funding is provided on the basis of assessed need, not whether that need is being delivered. This allows the recipient organisation flexibility to deliver services and programs in accordance with long-term strategies. The National Principles are set out in section 2.3 below.

All funds allocated by the Commonwealth are distributed to councils in quarterly instalments; all of the Commission's costs are met by the State Government. In 2011-12, there were 68 councils, the Outback Communities Authority and five Aboriginal communities eligible for grants in South Australia.

2.3 National Principles

The National Principles relating to allocation of general purpose grants payable under Section 6 of the *Local Government (Financial Assistance) Act 1995* among local governing bodies are shown in the table below:

Table 1: National Principles

<p>Horizontal equalisation</p> <p>General-purpose grants will be allocated to local government bodies, as far as practicable, on a full horizontal equalisation basis as defined by the Act. This is a basis that ensures each local governing body in the State or Territory is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State or Territory. It takes account of differences in the expenditure required by those local governing bodies in the performance of their functions and in the capacity of those local governing bodies to raise revenue.</p>
<p>Effort neutrality</p> <p>An effort or policy neutral approach will be used in assessing the expenditure requirements and revenue-raising capacities of each local governing body. This means, as far as practicable, that policies of individual local governing bodies in terms of expenditure and revenue effort will not affect grant determination.</p>
<p>Minimum grant</p> <p>The minimum general purpose grant allocation for a local governing body in a year will be not less than the amount to which the local governing body would be entitled if 30 per cent of the total amount of general purpose grants to which the State or Territory is entitled under section 9 of the Act in respect of the year were allocated among local governing bodies in the State or Territory on a per capita basis.</p>
<p>Other grant support</p> <p>Other relevant grant support provided to local governing bodies to meet any of the expenditure needs assessed should be taken into account using an inclusion approach.</p>
<p>Aboriginal peoples and Torres Strait Islanders</p> <p>Financial assistance should be allocated to councils in a way which recognises the needs of Aboriginal peoples and Torres Strait Islanders within their boundaries.</p>
<p>Compliance Amalgamation</p> <p>Where two or more local governing bodies are amalgamated into a single body, the general purpose grant provided to the new body for each of the four years following amalgamation should be the total of the amounts that would have been provided to the former bodies in each of those years if they had remained separate entities.</p>

Source: *Local Government (Financial Assistance) Act 1995*

The identified road component of the grant is also as far as possible to be allocated on the basis of the relative needs of each local government body.

Some general observations on the National Principles are provided below.

2.4 National Principles – Horizontal Equalisation and minimum grant

The National Principles require that the minimum general purpose grant allocation for a local governing body in a year will be not less than the amount to which the local governing body would be entitled if 30 per cent of the total amount of general purpose grants were allocated on a per capita basis.

“Where a local governing body is on the minimum grant, its local government grants commission has determined that it requires less assistance to function, by reasonable effort, at a standard not lower than the average standard of all local governing bodies in the jurisdiction”.⁹

It is noted that there is general acceptance that the principles of Horizontal equalisation and the minimum grant are inconsistent with each other. Previous Commonwealth reports have either concluded that the minimum grant principle should be retained¹⁰ or abolished¹¹.

For the purpose of this review the potential inconsistency is noted and it is accepted that the minimum grant has the effect of reducing the amount that would otherwise be available for redistribution. It is also noted that even for those Councils that are on the minimum grant any reduction in the funding they receive would likely to be met with some resistance and would only partially solve the problem of inadequate equalisation associated with the current national funding pool.

2.5 National Principles – policy directions of governments

The current arrangements for the distribution of FAGs are such that they are untied. That is once calculated they are provided to Councils and there is no specific requirement for the funds to be spent on a specific purpose.

The untied nature of the FAG arrangements enables Councils to spend the funding received in the areas that they feel most benefit their communities. There is a low administrative burden on Councils as they do not have to acquit the funding. The alternative to the provision of untied grants is to provide the funding for a particular purpose and to require the recipient to account for the use of the funding against that purpose. Under a tied funding arrangement it is generally accepted that there is a higher level of administrative burden due to the requirement to acquit the funding.

The tied vs. untied issue is not a specific decision for the Commission but is subject to the Commonwealth Review as discussed in Section 1.4.

⁹ 2009-10 report on the operations of the Local Government (Financial Assistance) Act 1995 page 39.

¹⁰ Commonwealth Grants Commission, 2001, review of the Operations of the Local Government (Financial Assistance) Act 1995.

¹¹ The Parliament of the Commonwealth of Australia (October 2003), Rates and Taxes: A fair share for Responsible Local Government, House of Representatives Standing Committee on Economics, Finance and Public Administration (the Hawker Report)

2.6 National Principles – effort neutrality

The concept of effort neutrality requires that the general purpose grants are allocated on an effort or policy neutral basis, ignoring as far as possible the policies of individual councils. Put simply grants should not be effected by what councils do (e.g. levels of expenditure on specific functions).

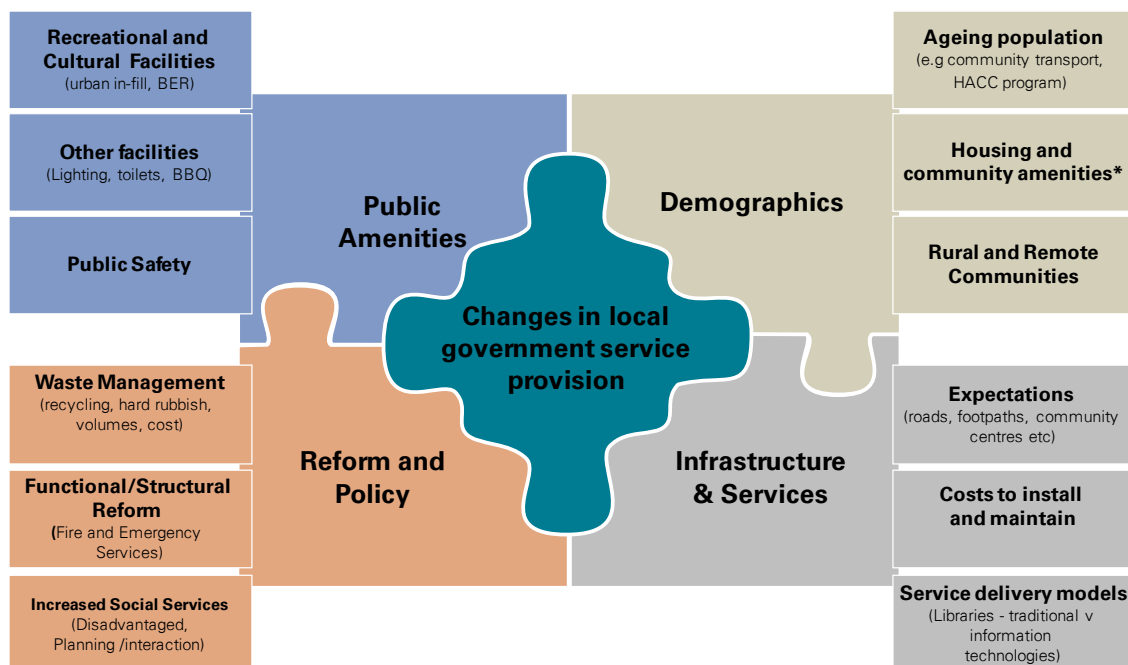
But as per the other grant support principle grants should take account of the grant support provided to councils by other levels of government as these are independent of the levels of effort of councils.

3 Socio Economic Analysis

The purpose of this review is to assess whether the methodology used by the Commission accurately captures the range of expenditures and revenue raising activities of local government and the factors which impact on the outcomes of these activities. Understanding the differences in the local government environment across regions is an important part of this exercise. Since the last review, which was undertaken in 1997-98, there has been a structural shift to the South Australian economy, and the rate of structural change has increased in the late 2000s. The higher Australian dollar has also restricted the competitiveness of the manufacturing sector, which has had a disproportionate effect in SA, given its relatively large manufacturing sector.

With the changes in the economy have come changes in actual or expected local government service provision. Figure 3 below highlights some of the changes that have occurred in local government service provision.

Figure 3 - Examples of changes in local government service provision



* Largely community amenities for Local Government in South Australia.

The broader social economic context is very important when considering the appropriateness of the distribution methodology. The methodology must ensure there is coverage of the typical range of activities of local government and that there is flexibility to account for different circumstances across local government and changes in these circumstances over time.

This section provides an overview of some of the socio-economic change that has occurred within SA over the last decade and also considers some of the key changes that have occurred at a local government level. The findings provide a useful backdrop for considerations, findings and recommendations of this review.

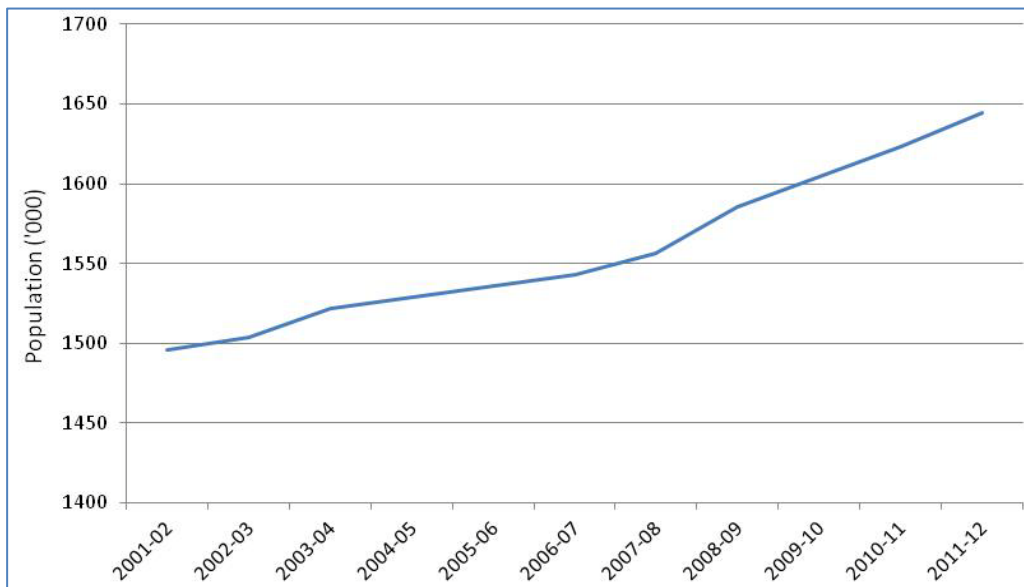
3.1 South Australian population

The vast majority of South Australia’s 1.6 million population lives within the Greater Adelaide metropolitan area. Other significant population centres (provincial cities) in SA include Mount Gambier, Whyalla, Murray Bridge, Port Lincoln, Port Pirie and Port Augusta.

Over the last decade (2001-02 to 2011-12) the state’s population has increased by roughly 10% (or at a compound annual growth rate of approximately 1%), see Figure 4 below.

Examination of South Australia’s population suggests that, given the fact that Financial Assistance Funding are distributed on a per capita basis to the states, South Australia’s grant share is unlikely to significantly increase into the future.

Figure 4 - South Australia’s population, 2001-02 – 2011-12



Source: ABS

The last decade (2001-02 to 2011-12) has seen the distribution of the state’s population by location change only marginally. An increase in the urban (urban, urban fringe, urban rural¹²) population has occurred whilst outside these urban areas population numbers decreased, see below.

Table 2 also shows how the distribution of grants has shifted from urban LGAs to rural LGAs (particularly the small and medium sized rural areas) and to Aboriginal and outback communities over the last decade.

¹² Areas defined by the Australian Bureau of Statistics as per Australian Standard Geographical Classification (ASGC)

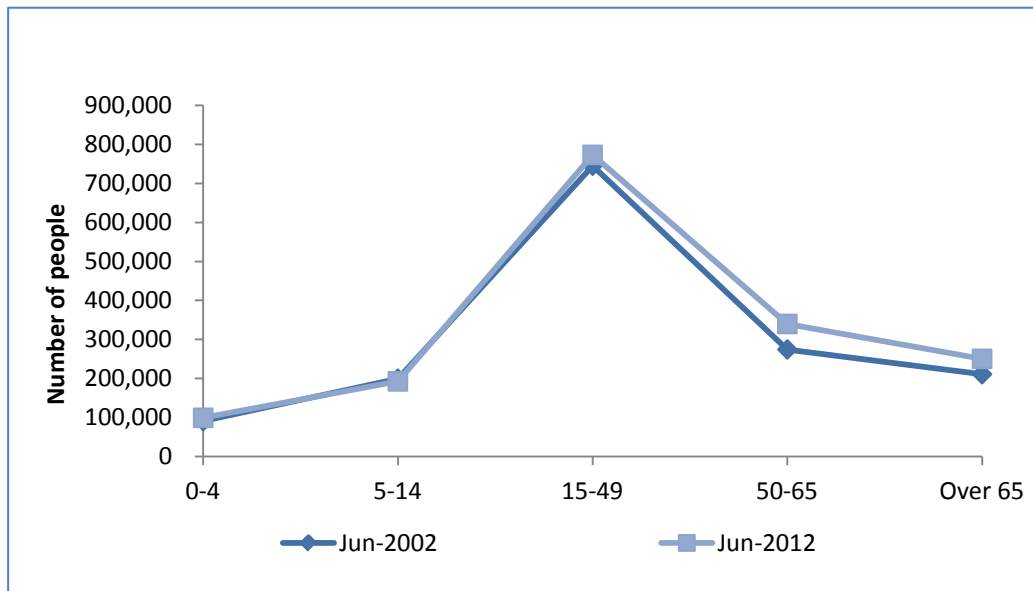
Table 2 - South Australian population by LGA location categories, 2001/02 - 2011/12

	2001-02				2011-12			
	Population	% of total population	Grant	% of total grant	Population	% of total population	Grant	% of total grant
Urban, urban fringe and urban rural	1,184,600	79.3%	35,848,042	48%	1,317,237	80.1%	40,564,055	38%
Provincial cities	108,454	7.3%	11,405,692	15%	116,684	7.1%	16,650,745	15%
Rural – large and very large	138,250	9.2%	14,797,718	20%	147,444	9.0%	25,214,405	23%
Rural – small and medium	55,078	3.7%	11,592,079	15%	56,725	3.4%	22,342,264	21%
Aboriginal / outback communities	8,252	0.6%	1,755,040	2%	6,492	0.4%	2,697,144	3%
Total	1,494,634		75,398,572		1,644,582		107,468,613	

Source: ABS; SA LGGC

South Australia’s population demographics have changed over the last decade. Like the rest of Australia, the state’s population is ageing as a result of fewer babies being born and more people living longer. The following figure reflects South Australia’s ageing population; it demonstrates the significant increases over the last decade in the number of people in the 50+ age categories.

Figure 5 - Age of population as at 2002 and 2012



Source: ABS

3.2 Local Government population

Population at an LGA level has important funding implications that need to be considered in the development of the distribution methodology.

As mentioned earlier, the urban, urban fringe and urban rural locations within SA have experienced the greatest number of people moving into them over the last decade. The additional 143,987 people that now populate the urban areas of SA represent a 12.15% increase, see below figures (Figure 6 and Figure 7). All other locations have experienced some population increases over the last decade, the only exception being the Aboriginal/outback communities', whose population has decreased by over 20%, over the last decade.

Figure 6 - Change in population (number of people) within given location types

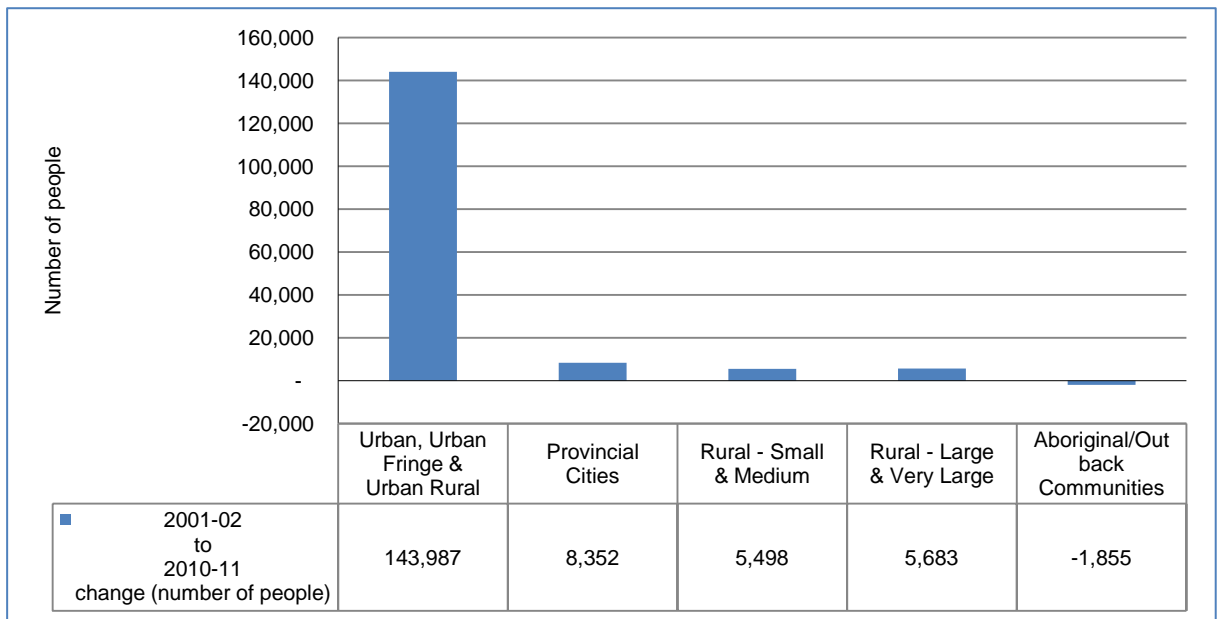
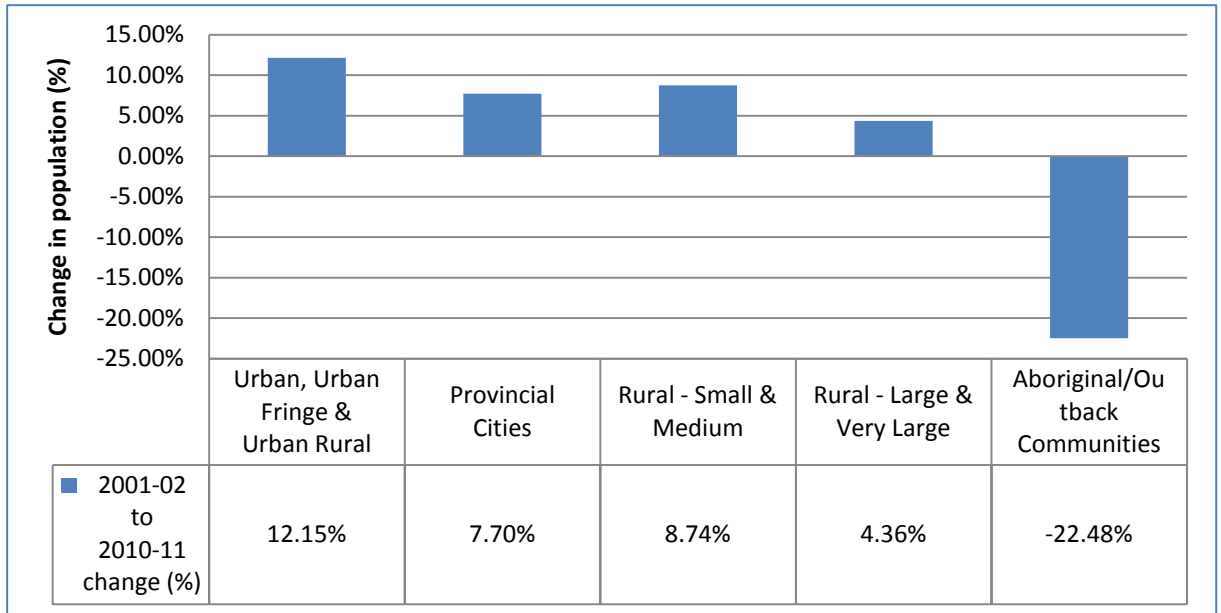
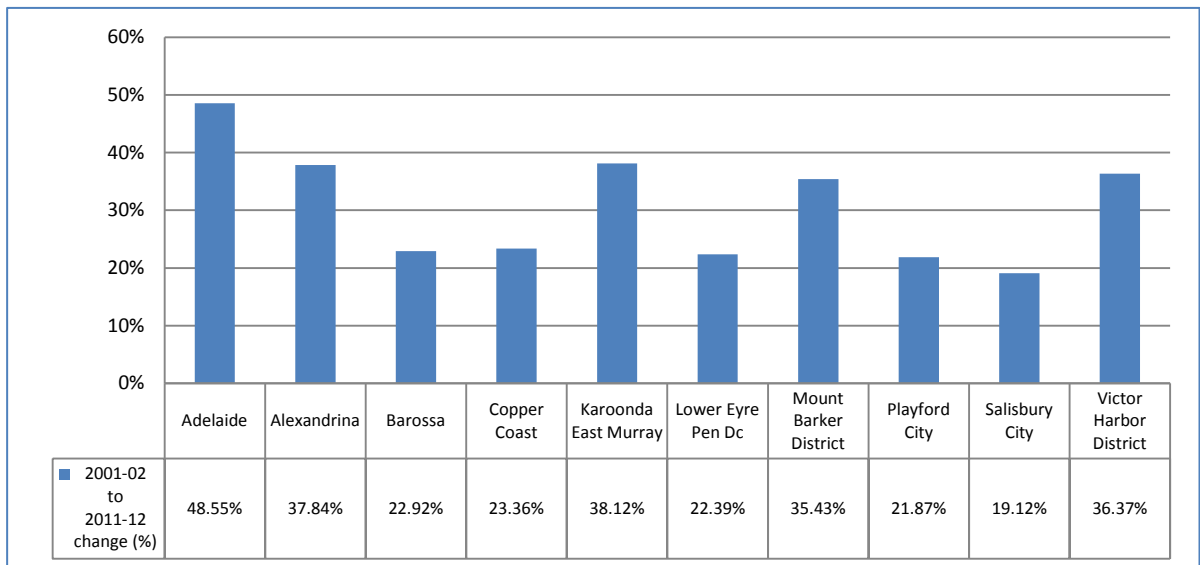


Figure 7 - Change in population (%) within given location types



Of the top 10 LGAs that have experienced the highest population increases over the last decade, 7 are urban, urban fringe & urban rural (Adelaide, Alexandrina, Barossa, Mount Barker District, Playford city, Salisbury city, Victor Harbor District). The below figure (Figure 8) represents the population changes that have occurred in these LGAs and provides further support for the idea that the South Australian population is moving into urban type locations to live.

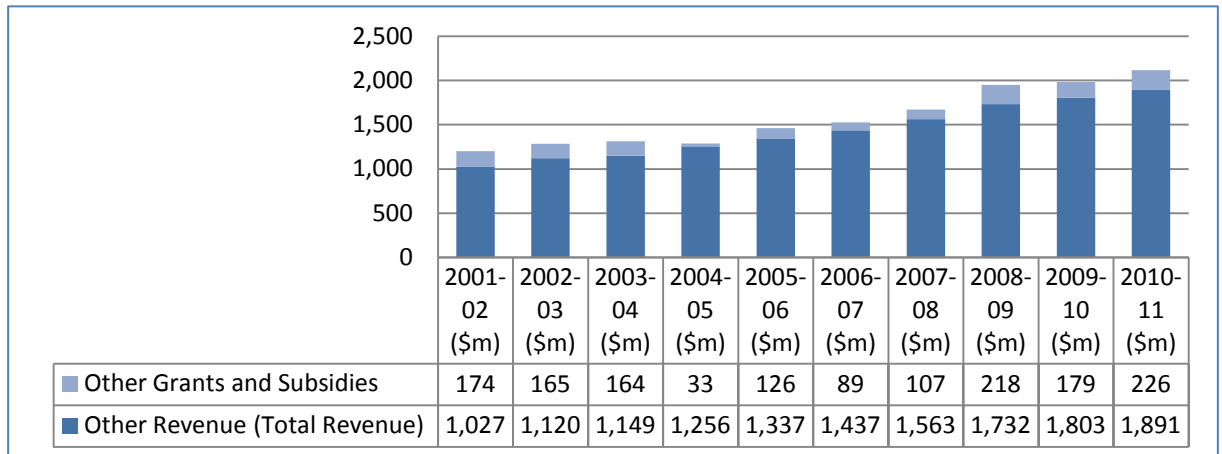
Figure 8 - Local governments that have experienced the highest increase in size of population between 2001 and 2011



3.3 Local Government revenue

In 2010-11, total South Australian Local Government revenue was approximately \$1.9 billion of which approximately \$0.2 billion or 12% was from 'Grants and Subsidies'. The following figure demonstrates total local Government revenue and the contribution of grants and subsidies to total revenue over the last decade. It also demonstrates that there has been a major reduction in local government revenue support from Grants and Subsidies over the last decade.

Figure 9 - SA Local Government Revenue, 2001-2 – 2010-11



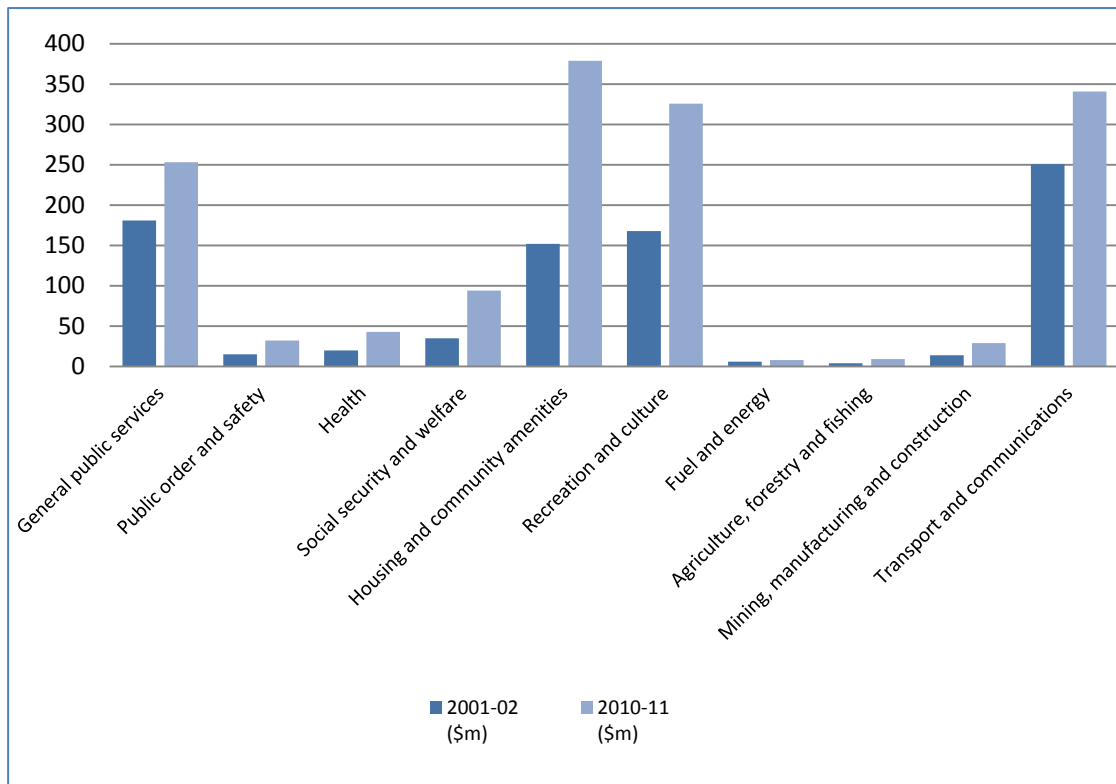
Source: ABS

3.4 Local Government expenditure

In 2010-11, South Australian Local Government expenditure totalled approximately \$1.5 billion, whilst in 2001/2 total expenditure was approximately \$0.8 billion. The areas of largest spend have not changed over time and include:

- 1 Housing and community amenities;
- 2 Transport and communications;
- 3 Recreation and culture; and
- 4 General public services.

Figure 10 - SA Local General Government Expenses by Purpose (\$ million)



Source: ABS. Expenditure in Housing and community amenities relates primarily to community amenities.

Whilst the broad areas of council expenditure have not changed over the last decade the distribution of expenditure within some of these areas has shifted. The largest proportional shifts in expenditure over the last decade have been:

- 1 An increase in housing and community amenities expenditure;
- 2 A decrease in transport and communications expenditure;
- 3 A decrease in general public services expenditure; and
- 4 An increase in social security and welfare expenditure.

Table 3 - Proportion of total local government expenditure, 2001-02 & 2010-11

Expenses by Purpose	2001-02	2010-11	Percentage point change
General public services	21%	17%	-5%
Public order and safety	2%	2%	0%
Health	2%	3%	0%
Social security and welfare	4%	6%	2%
Housing and community amenities	18%	25%	7%
Recreation and culture	20%	22%	2%
Fuel and energy	1%	1%	0%
Agriculture, forestry and fishing	0%	1%	0%
Mining, manufacturing and construction	2%	2%	0%
Transport and communications	30%	23%	-7%
Total	100%	100%	

Source: ABS. Expenditure in Housing and community amenities relates primarily to community amenities.

4 The Commission's methodology

The Commission is committed to regularly reviewing the methodology used to assess councils' capacity to provide an average level of service to their communities. The Commission considers specific areas of the methodology on an annual basis and has a continual refinement process. However, this project will be the most comprehensive review undertaken since the Commission's methodology review of 1997-98.

Previous Commission work on the methodology has included:

- reviewing all of expenditure assessments and making changes to reflect recurrent expenditure in local government;
- the replacement of expenditure on capital items in the calculations with annual depreciation;
- a review of the stormwater expenditure function;
- investigations into the impacts of growth within Local Government and whether the Commission adequately accounts for growth in its methodology; and
- investigations into the effects of decreasing/increasing valuations within Local Government.

Other recent examples of refinements to the existing methodology have included:

- A change to the cost driver for the sport and recreation expenditure function calculation – taking into account the proportion of councils' population aged between 5 and 64 years, instead of the previous 5 – 49 years.
- An Investigation into the reliability of libraries data which resulted in removal of the function for 2011-12, pending a review of the data used in the calculations.

This section provides an overview of the Commissions' current methodology as a basis upon which any recommended changes can be assessed.

4.1 Overview of the Commission's approach

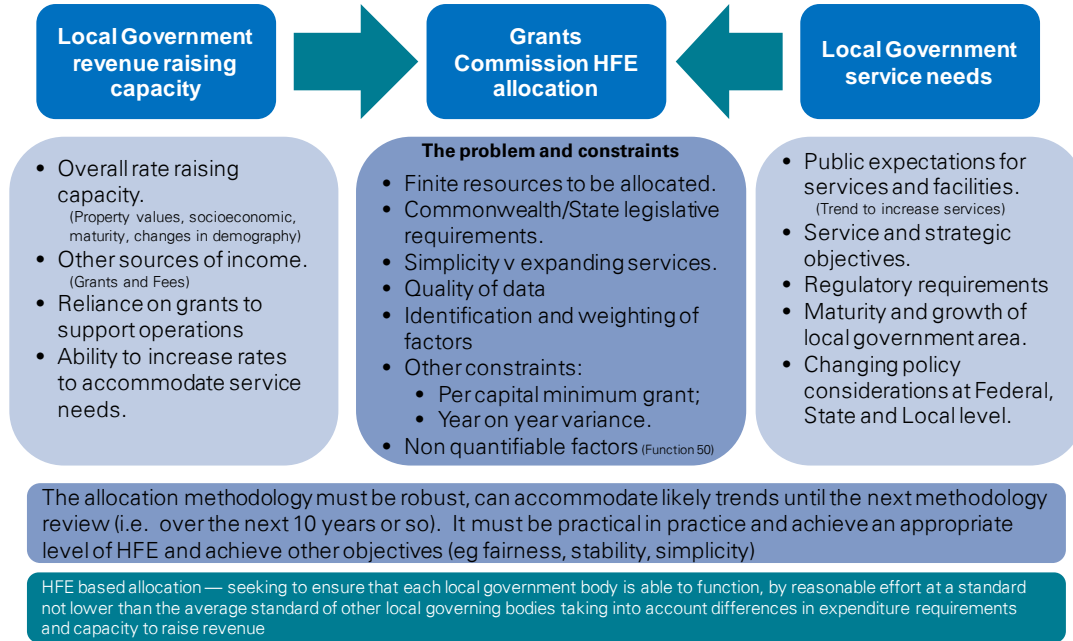
The methodology used by the Commission to assess the amount of general purpose funding provided to each council in SA is intended to recommend allocations consistent with National Principles. The overriding principle is that of horizontal fiscal equalisation and the methodology needs to take into account a range of factors including an assessment of both the expenditure needs and the revenue-raising capacity of each Council.

The Commission uses the direct assessment approach, that is, it separately estimates a component revenue grant and a component expenditure grant for each council. These are combined to determine each council's overall equalisation need. The available pool of funding is then distributed in accordance with the relativities established through this process, with adjustments made as required to ensure that the national per capita principle is achieved.

The Outback Communities Authority and the five Aboriginal Communities are treated differently to the remainder of Councils. The per-capita allocation determined for them is first deducted off the total pool of available funds to ascertain the total available for distribution to the remainder of Councils.

An overview of many of the practical issues that need to be taken into account in this process are highlighted below in Figure 11 -

Figure 11 - Practical considerations in the distribution of grants



In addition to the methodology used for the distribution of grants the Commission is responsible for the distribution of the funding received for roads. The Commission distributes 85% of the funding via a formula approach and 15% of the funding as a result of an application and recommendation process for which the Local Government Transport Advisory Panel is responsible.

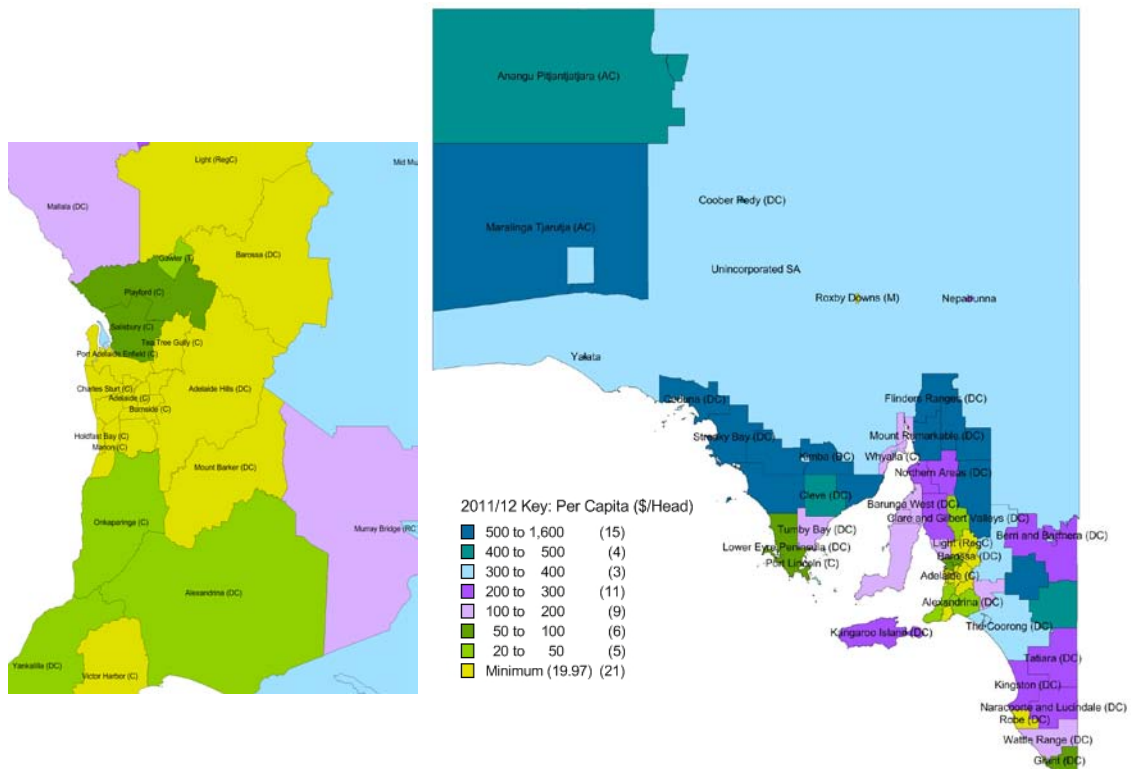
The Commission’s methodology is explained in more detail below.

4.2 The Commission’s methodology – current distribution of grants

The distribution of grants¹³ for 2011-12 across councils in SA is represented in the below maps (Figure 12). The maps highlight that the distribution of grants is higher to the outer metropolitan and regional areas of the state reflecting the relatively higher needs of these communities. This distribution pattern is not unique to SA with a general pattern across Australia being representative of metropolitan councils being on the minimum grant.

Discussions with the Commission indicated that they are essentially satisfied with the broad pattern reflected in the distribution of grants.

Figure 12 - General Purpose Grant 2011-12 (\$ per capita)



¹³ Grants reflected represent the general purpose grant component (ie they exclude the local road grant and supplementary local road grants).

4.3 The Commission's methodology – general purpose grant (revenue)

Component revenue grants aim to compensate or penalise councils according to whether their capacity to raise revenue is less than or greater than the state average. Councils with below average capacity to raise revenue receive positive component revenue grants and councils with above average capacity receive negative assessments.¹⁴

Each council's component revenue grant is estimated by applying the state average rate in the dollar to the difference between the improved capital values per capita and those of the state as a whole and applying this to the council's population. The calculation is undertaken across five categories (residential, commercial, industrial, rural and other). The SEIFA Index of Economic Resources is applied to the value of residential and rural properties as a weighting to and the data is also averaged over three years to minimise fluctuations.

The SEIFA Index of Economic Resources reflects data relating to the income and expenditure of families, such as income and rent and home ownership and aims to reflect the disposable income of families. The Commission considers that the capacity of communities to pay rates should be incorporated into the revenue assessments and that the above SEIFA index is the best way to do this. No other state is currently applying a SEIFA index in this way.

4.4 The Commission's methodology – general purpose grant (expenditure)

Component expenditure grants compensate or penalise councils according to whether the costs of providing a standard range of government services can be expected to be greater than or less than the average cost for the state as a whole due to factors outside the control of councils.¹⁵

The Commission assesses expenditure needs and a component expenditure grant for a range of functions and then compares each council's per capita grants against the state average.

For 2011-12, there were 19 expenditure functions in the South Australian methodology. Each function is identified by a main driver or unit of measure. This is divided into the total expenditure on the function for the state to determine the average or standard cost for the function.

The methodology also allows for a cost relativity index (CRI) to be determined for each expenditure function for each council which potentially allows for an adjustment to be made for factors which impact in the unit cost of delivering services for each function (e.g. a CRI of 2 means the cost of delivering a service is double the average (set at 1.0), whereas a CRI of 0.5 means that it is half the average).

In practice, for the majority of functions (i.e. except for Waste management, Stormwater Draining and the six roads related functions) the CRI is actually set at 1.0 meaning that there is no adjustment to take account differences in unit costs. It is also noted that the data is averaged over three years to minimise fluctuations.

With respect to roads, the Commission applies a cost relativity index to the road length calculations to determine council's individual road need. Currently the Commission takes into account soil, terrain, rainfall and material haulage. Since 2003, the Commission has attempted to gather data from councils to reflect traffic volume; however councils have not been able to provide sufficient evidence to include this in the calculations.

¹⁴ 2009-10 Local Government national report, page 145.

¹⁵ 2009-10 Local Government national report, page 145.

The following table (Table 4) shows the expenditure functions and units of measure included in the current methodology. Note that the final function “Other Needs Assessments” also known as Function 50 is discussed in more detail in Section 4.7.

Table 4: Current Expenditure functions and unit of measure

Expenditure Function	Units of Measure	CRI 1.0
Waste Management	Number of residential properties	No
Aged Care Services	Population aged 65+ from the ABS Census and estimated resident population	Yes
Services to Families and Children	Population aged 0-14 from the ABS Census and estimated resident population	Yes
Health Inspection	Establishments to inspect	Yes
Libraries	Number of library visitors	Yes
Sport and Recreation	Population aged 5-64 from the ABS Census and estimated resident population	Yes
Sealed Roads – Built up	Kilometres of built-up sealed roads as reported in GIR	No
Sealed Roads – Non-built up	Kilometres of non-built-up sealed roads as reported in GIR	
Sealed Roads – Footpaths etc	Kilometres of built-up sealed roads as reported in GIR	
Unsealed Roads – Built up	Kilometres of built-up unsealed roads as reported in GIR	
Unsealed Roads – Non-built up	Kilometres of non-built-up unsealed roads as reported in GIR	
Unformed roads	Kilometres of unformed road as reported in GIR	
Stormwater drainage	Number of urban properties	No
Community Support	3yr average population *SEIFA Advantage/Disadvantage CRI	Yes
Jetties and Wharves	Number of jetties and wharves	Yes
Public Order and Safety	Total number of properties	Yes
Planning and Building Control	Number of new developments and additions	Yes
Bridges	Number of bridges as reported in GIR	Yes
Other Needs Assessment	Based on Commission determined relative expenditure needs in a number of areas	Yes

A raw grant is first calculated using the formulae. Where the calculation for any council results in a raw grant less than the required per-capita minimum the council will receive the per-capita minimum.

The available pool of funds is determined by deducting from the total pool of funds the per capita allocations for the minimum grant councils, Aboriginal Communities and the Outback Communities Authority. The available pool is then distributed amongst the remaining councils in accordance with their proportion of the raw grant. The Commission then undertakes an iterative adjustment process to ensure that the variation from the previous year’s grant for each council is within what they feel is an appropriate variance limit (‘+’ or ‘-’ percentage variation).

4.5 The Commission's methodology – identified road grants

As reflected previously in Figure 2 the identified local road grants pool is divided between formula grants (85%) and special local road grants (15%).

The formula component is divided between metropolitan and non-metropolitan councils on the basis of an equal weighting of road length and population. In the metropolitan area, allocations to councils are based on an equal weighting of population and road length. In the non-metropolitan area, allocations are made according to an equal weighting of population, road length and area of the council.

Allocations from the special local road grants program are made based on recommendations from the Local Government Transport Advisory Panel. This arrangement is unique to SA and requires regional associations to submit priority projects for their regions. The contribution from the Commission funds only a proportion of the total project with the remainder to be sourced from the relevant region. Regional Associations are provided with a tool to help them rank the projects within their region and then the Local Government Transport Advisory Panel makes an assessment of which projects will receive funding from the available pool.

4.6 The Commission's methodology – Aboriginal communities and the outback communities authority

The Commission's methodology treats the Outback Communities Authority and the five Aboriginal Communities differently to other councils for the purpose of calculating the distribution of the FAG pool due to an historical lack of available and/or comparable data to enable them to be treated in the same manner as other councils. Further details on this aspect of the methodology are contained in a separate report provided to the Commission.

4.7 The Commission's methodology – Function 50

As shown in Table 4 the Commission's methodology contains a final function "Other Needs Assessments" which is commonly known as Function 50. The Commission has included Function 50 within its methodology to recognise that there are many non-quantifiable factors, which may influence a council's expenditure, and that it is not always possible to determine objectively the extent to which a council's expenditure is affected by these factors. The Commission considers that Function 50 allows it to exercise some judgement within the overall methodology. SA is the only jurisdiction with a Function 50 concept within its methodology.

It should be noted that while a funding adjustment impacts the raw grant outcome it may or may not affect the final grant outcome because of the requirement to provide a minimum per capita grant to each council. The Capital City status adjustment within Function 50 is a case in point. While an adjustment of \$16 million is made to the raw grant calculation this does not alter the grant outcomes as the Adelaide City Council is on the minimum per capita allocation.

The following provides details of the specific adjustments that are made by the Commission within Function 50.

- Non resident use. The Commission classifies each council as having nil non-resident use, low, medium or high non-resident use. Nil non-resident use attracts no additional funding, low attracts \$100,000 medium \$175,000 and high \$250,000.

- Duplication of facilities. The Commission use ABS published statistics to determine the number of urban centres and localities for each council. Councils receive funding of \$20,000 for each urban centre and locality above 1.
- Distance/Isolation: The Commission provides each Council that is greater than 50 kms from the Adelaide GPO, their distance from the GPO be multiplied by 5.0 cents and further multiplied by the population in recognition of distance/isolation. Kangaroo Island receives the maximum distance.
- ATSIC population. The Commission provides additional funding to take account the number of indigenous residents as a percentage of the total population in that Council. The Councils ATSIC population is compared to the State percentage, and where it exceeds the State percentage funding will be provided on a sliding scale as shown in the following table (Table 5).

Table 5 - Function 50 provision for ATSIC population (% of population)

% of population (low – high)		Allocation to Council
From 1.62%	To 9.99%	\$35,000
From 10.00%	To 19.99%	\$70,000
Greater than 20%		\$140,000

- Unemployment. The Commission provides additional funding to take account the number of unemployed individuals as a percentage of the total population in that Council. The Councils Unemployed population is compared to the State percentage, and where it exceeds the State percentage funding will be provided on a sliding scale as shown in the following table (Table 6).

Table 6 - Function 50 provision for Unemployment

Council population		Allocation to Council
From 0	To 9,999	\$22,000
From 10,000	To 14,999	\$33,000
From 15,000	To 19,999	\$44,000
From 20,000		\$55,000

- Capital City Status. The Commission provides additional funding for Adelaide City Council in recognition of having an additional expenditure need.
- Environment Expenditure Assessment: The Commission provides additional funding for environmental expenditure based on the councils' level of expenditure in that area in relation to the overall expenditure levels. An allocation is provided on a sliding scale as shown in the following table (Table 7) provided that the level of expenditure first meets a minimum level.

Table 7 - Function 50 allocation for environmental expenditure

% of total expenditure	Classification	Allocation to Council
>= 2.5%	High	\$150,000
>= 1.5%	Medium	\$100,000
> = 0.5%	Low	\$50,000

- Coastal Protection Expenditure Assessment. The Commission provides additional funding for coastal protection based on the councils' level of expenditure in that area in relation to their overall expenditure levels. An allocation is provided on a sliding scale as shown in the following table (Table 8). All councils with a coastline receive an allocation.

Table 8 - Function 50 allocation for coastal protection

% of total expenditure	Classification	Allocation to Council
>= 1.5% then High	High	\$100,000
>= 0.75% Medium	Medium	\$50,000
> 0% Low	Low	\$10,000

- Cultural and Tourist Expenditure Assessment. The Commission provides additional funding for cultural and tourist expenditure based on the councils' level of expenditure in that area in relation to their overall expenditure levels. An allocation is provided on a sliding scale as shown in the following table (Table 9).

Table 9 - Cultural and Tourist expenditure

% of total expenditure	Classification	Allocation to Council
>= 5% then High	High	\$300,000
>= 3% Medium	Medium	\$150,000
> = 1% Low	Low	\$75,000

4.8 The Commission's methodology – calculation model

The Commission currently perform the grant calculation in an excel workbook. Section 9.5 provides high-level calculation model improvement suggestions.

5 Inter jurisdictional analysis

While all Local Government Grants Commissions must comply with the National Principles each has its own methodology for the allocation of Financial Assistance Grants (FAGs) to local government in its jurisdiction. This section provides some analysis of the methodologies used in a number of states. The analysis was undertaken through a combination of reviewing available documentation and a discussion with the Executive Officer in each of the chosen states.

5.1 Why across state comparisons is a useful starting point

There are a number of reasons why an analysis of the approach been used to distribute FAGs in other states is useful. These include:

- All states are operating under the same Commonwealth legislated National Principles and as such are trying to achieve the same objectives albeit using their own specific methodology. Given that the principles are the same there should be considerable scope for states to learn from each other in developing improvements in their individual methodologies.
- The identification of similarities and differences across states helps in focusing the efforts of the review. For instance if there are similarities (e.g. the use of depreciation) then the obvious question is why a state would choose to move away from what could be viewed as the generally accepted position. Conversely, if a state's approach was different to the other states in a particular area the obvious question is to ask why and to seek to explore the issue in more detail.
- A number of states have conducted reviews of their methodology in recent times. Lessons learned by these states and/or findings from their reviews may be useful in the context of the South Australian review.
- Issues that other states are currently aiming to address and/or are regularly raised as issues may highlight further issues that should be given detailed attention.

5.2 Why particular states were chosen for detailed comparison

Three states were chosen for detailed comparison. These were Western Australia (WA), Victoria (VIC) and New South Wales (NSW).

The selection of the three states was based on the preliminary desktop analysis of the states approaches and subsequent discussion with the Commission. Victoria and WA were chosen because they are the states where methodological reviews were most recently completed and NSW was included because it is the largest state and also has a large urban population and a sparse regional population like SA.

5.3 Basic features of the approach to HFE across other states

The approach to HFE across the states indicated that:

- While all commissions are required to make their recommendations in line with the National Principles there are considerable differences across states in the methodologies that they use for allocating FAGs in terms of both the expenditure and revenue categories and the disabilities applied.
- All states make significant use of across-year averaging to reduce the year on year changes in the allocation of FAGs.
- There are significant differences in the way user-charges revenue and other grant revenue is treated. User-charge revenue is either treated as a negative expenditure or as a revenue category in its own right. Other grant revenue is generally included as a separate revenue category but its level is diluted.
- The transparency of the methodology and the reliance on independent data varies considerably. The most common sources of independent data are the ABS, Centrelink, Government agencies or Research institutions/Universities.
- It is not always readily apparent (based on publicly available information) the quantitative impact of the various disabilities was established. Often this is based on commission judgements and refinements are made over a period of time.

5.4 General observations from across-state comparisons

The review of the approaches used in other states revealed the following general observations.

There are two broad approaches used for the distribution of the general purpose grant component of the FAGs (direct assessment or balanced budget). The direct assessment approach which is used in SA and NSW is based on the approach of assessing the level of disadvantage for a council in each area of expenditure and revenue.¹⁶ The balanced budget approach which is used by all of the other states is based on the approach of assessing the overall level of disadvantage of a council using a notional budget for the Council.¹⁷ Discussions with the Commonwealth Grants Commission confirmed that the two approaches should result in the similar outcomes provided all revenue and expenditures are included in the assessment process. The following table (Table 10) summarises the distribution models used by grants commissions.

¹⁶ 2009-10 Local Government National Report page 190.

¹⁷ 2009-10 Local Government National Report page 190.

Table 10 - Distribution models used by grants commissions for 2009-10¹⁸

State	Model Used
NSW	Direct assessment model
VIC	Balanced budget model after assistance for natural disaster relief is taken out of the pool.
Queensland	Balanced budget model
WA	Balanced budget model
SA	Direct assessment model after allocations for the Outback Areas Community Development Trust and five indigenous local governing bodies are determined separately and taken out of the pool
Tasmania	Balanced budget model
Northern Territory	Balanced budget model

- There are 2 broad approaches to the distribution of roads grants (direct assessment and asset preservation model). SA, NSW and Queensland use the simpler direct assessment model which takes into account road length, type and population. States such as VIC and WA use the more complex asset preservation model which takes into account type of roads, traffic volumes and construction/repair/maintenance costs.
- While the Commonwealth comparison table of expenditure and revenue categories suggests there are fairly similar numbers of categories across states, the use of generic categories hides significant differences. In fact there are significantly more expenditure categories in SA and NSW (19 and 20 categories respectively) than VIC and WA (8 and 6 categories respectively).
- As shown below in Table 11, based on some simple measures the extent of the redistribution appears to be significantly less in NSW and VIC than in WA and SA. It is noted this could simply reflect greater inequity.

Table 11 - Analysis of minimum allocation

Measure	SA	NSW	VIC	WA
% of Local Governments on minimum allocation	23%	13%	15%	23%
% of pop. on minimum the allocation	50%	27%	25%	75%
% of pool going to councils on the minimum allocation	15%	8%	8%	23%

¹⁸ 2009-10 Local Government National Report page 190.

5.5 Features of recent reviews in other states

Discussions with the executive officers in VIC and WA revealed the following key features associated with their respective recent reviews.

- Both of the reviews involved extensive consultation with the local government sector and the recommended methodological changes were heavily influenced by the outcomes of this consultation. It was noted that not all stakeholders will always be happy with the outcome particularly in a situation that there are perceived winners and losers.
- No changes were made to the overall approach used (i.e. balanced budget or direct assessment) with both states indicating that they felt there was general acceptance of the overall approach.
- There was consultation with the CGC on technical matters.
- The focus of the reviews was more on the general purpose grant component of the FAGs and expenditure categories rather than local roads and revenue assessments.

There have been two very clear trends emanating from the reviews. These were:

- To simplify (e.g. reduce the number of expenditure functions and disabilities); and
- To use independent data sources wherever possible (e.g. ABS, Centrelink, Government agencies or Research institutions/Universities) rather than rely on information from the local government sector (e.g. number of library visitors).

It was also noted that although there was a similar general direction in both the VIC and WA reviews in relation to their overall methodology there was still ample scope for the relevant Commissions to deliver on distribution objectives. In the case of VIC it was to simplify the approach whilst maintaining a distribution of grants that it considered to be appropriate and in the case of WA it was to simplify the approach but also to move towards what it considered a more appropriate distribution of grants.

Specific changes emanating from the reviews have included:

- A trend towards reducing the number of drivers for each expenditure function.
- Consolidating/removing disabilities where their effect could not be rigorously quantified or the relevant data was poor.
- Focusing on the effects of a small number of the most powerful disabilities which have broad effects across multiple functions e.g. location, socio-demographics, growth, pensioners/very young, dispersion, and language.
- Undertaking a detailed review of the best way to measure socio-demographic disability.
- Development of an options paper which was used to 'test' possible changes at a high level with councils prior to making final decisions.
- Undertaking modelling to ensure that the changes resulted in a distribution of grants that best satisfied the National Principles and underlying objectives of the State Grants Commission.

- Implementation of the agreed changes over several years to minimise the short term impact on the funding received by individual councils.

5.6 Possible lessons for the current SA review

The Inter jurisdictional analysis provided some useful insights that were used through the review. These included:

- To let the responses from Councils on the call for submissions drive the areas of focus wherever possible. The responses are discussed in more detail in the following section (Section 6).
- To look for opportunities to simplify the methodology and to use independent credible data wherever possible.
- Focus on the expenditure side of the assessment. The approaches to the revenue side of the assessment are relatively similar and while there are often criticisms of the revenue side of the assessment there is not an alternative approach that is clearly identifiable as superior.
- When changing/consolidating disabilities base it on clear and justifiable criteria.
- Focus on the effects of the most powerful disabilities.
- Implement any changes over time to ensure that the impact on individual councils is smoothed.
- Test options with Councils prior to finalisation. It is noted that the SA Grants Commission established a reference group for this purpose.

6 Themes/feedback from local government and other key stakeholders

As part of the terms of reference, we were asked to seek feedback from the Councils regarding the allocation of grants through a call for submissions. This section of the report provides a summary of the responses received for the specific questions contained in the call for submissions. Comments accompanying the responses have been provided to the Commission. For presentation purposes each respondent has been grouped according to their Australian Classification of Local Government (ACLG) category. References that identify individual respondents have been removed where applicable.

6.1 Overall response rate

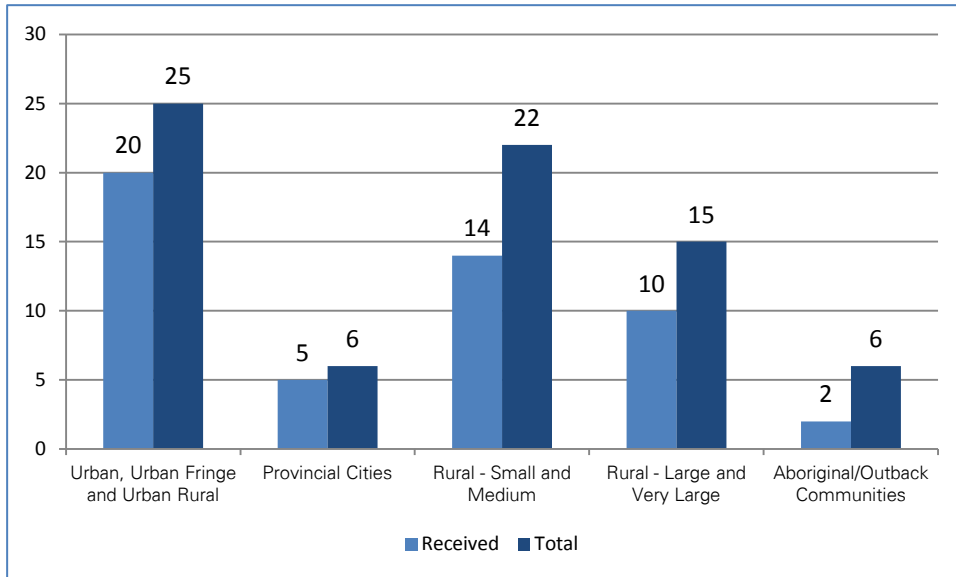
A total of 51 of a possible 74 responses from the call for submissions were received. The overall level of response (69 percent) is considered to be high from an overall survey perspective.

Four respondents did not answer the specific questions contained in the call for submissions but they did provide detailed submissions that were taken into consideration in the preparation of the report.

The spread of responses across the ACLG categories was broadly consistent with the overall response rate. A breakdown of the response rate in each category is shown below and depicted in Figure 13.

- Urban, Urban Fringe and Urban Rural — 80%.
- Provincial Cities — 83%.
- Rural - Small and Medium — 64%.
- Rural - Large and Very Large — 67%.
- Aboriginal/Outback Communities — 33%.

Figure 13 - Summary of Responses



6.2 Understanding of National Principles and current methodology

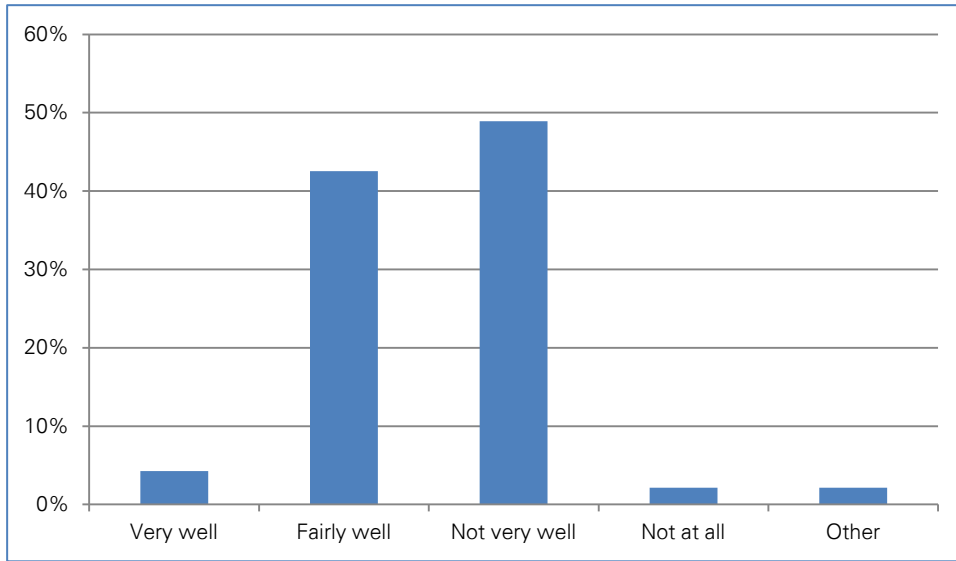
The following figure (Figure 14) shows the responses to the level of understanding of the National Principles and the current methodology.

Almost half (49%) of the responses indicated that they did not understand it very well.

The Commission is very keen for the methodology to be understood and accepted and seek to explain it when they visit each council on a rotational basis (current aim to visit one in every three years).

A lack of understanding in the current methodology is clearly an issue that requires attention. With an apparent increase in the turnover of Council staff there is a growing need to ensure that the methodology is easy to understand.

Figure 14 - Understanding of National Principles and current methodology



The following table (Table 12) provides a breakdown of the responses according to the ACLG classification.

It highlights that while the overall understanding of the methodology is low there is a lower level of understanding in the smaller councils than the larger ones. This is somewhat of a concern as the former are likely to have a higher level of relative need and therefore it is more important that they be assessed correctly.

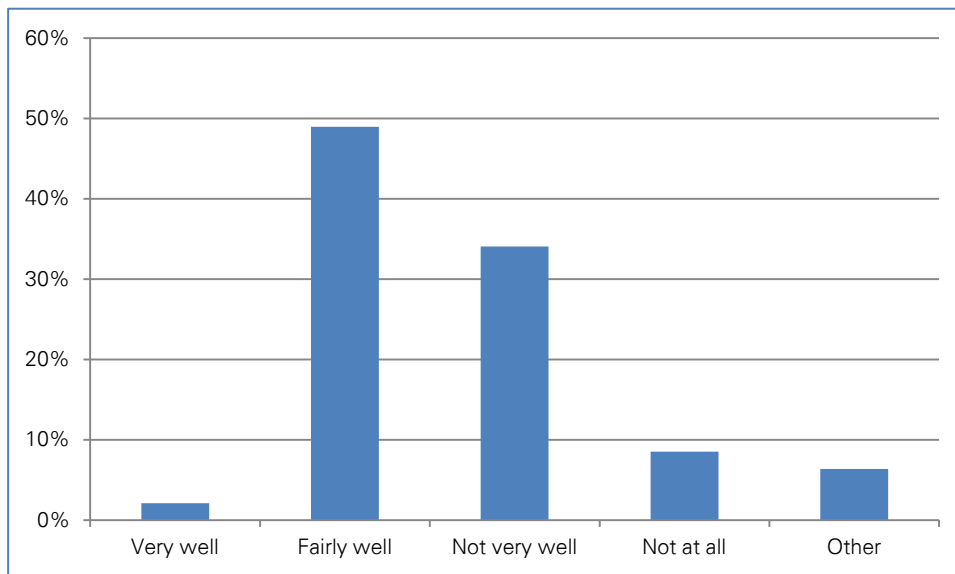
Table 12 - Understanding of National Principles and current methodology

	Very well	Fairly well	Not very well	Not at all	Other
Urban, Urban Fringe and Urban Rural	0%	42%	53%	0%	5%
Provincial Cities	0%	25%	75%	0%	0%
Rural - Small and Medium	14%	36%	43%	7%	0%
Rural - Large and Very Large	0%	67%	33%	0%	0%
Aboriginal/Outback Communities	0%	0%	100%	0%	0%
Total	4%	43%	49%	2%	2%

6.3 Level of satisfaction with current methodology

Councils were asked “overall, what is your level of satisfaction with the current methodology? (i.e. how well do you consider it meets the stated objectives for Financial Assistance Grants?)” As highlighted below in Figure 15 it is noteworthy that almost 50% of the respondents indicated that they were “not satisfied”, with the majority (34%) of these indicating that they were “not very satisfied” with the current methodology. Following discussion with the Commission it is recognised that the level of satisfaction may be reflective of the size of the overall grant pool and therefore the grant outcome for each council.

Figure 15 - Level of satisfaction with current methodology



The following table (Table 13) provides a breakdown of the responses according to the ACLG classification. It highlights that the level of satisfaction/dissatisfaction is broadly consistent across the various groups.

Table 13 - Level of satisfaction with current methodology

	Very well	Fairly well	Not very well	Not at all	Other
Urban, Urban Fringe and Urban Rural	0%	47%	42%	11%	0%
Provincial Cities	0%	75%	25%	0%	0%
Rural - Small and Medium	7%	43%	29%	14%	7%
Rural - Large and Very Large	0%	56%	22%	0%	22%
Aboriginal/Outback Communities	0%	0%	100%	0%	0%
Total	2%	49%	34%	9%	6%

6.4 Most desirable characteristics of the current methodology

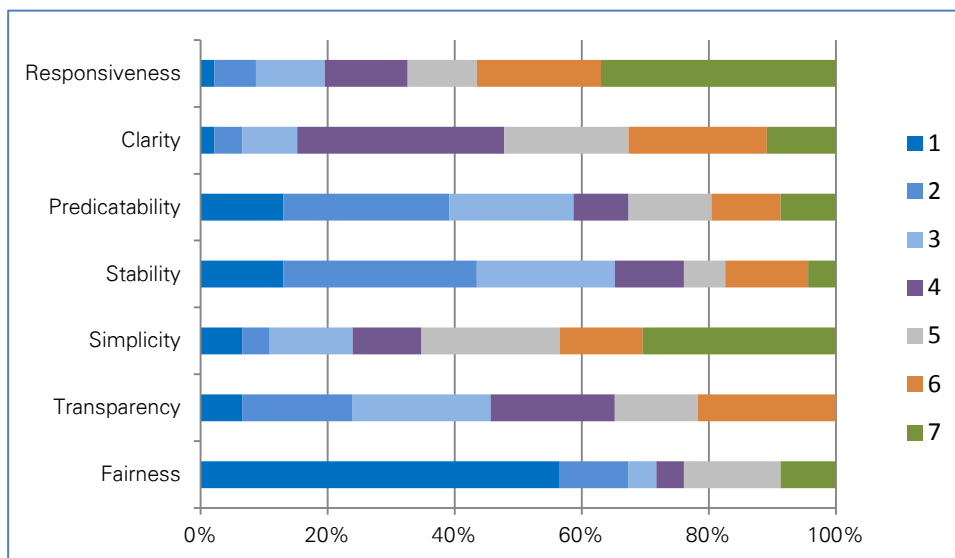
Councils were asked to rank in priority order the characteristics that they viewed as most desirable in the methodology. The characteristics are listed below. None of the respondents indicated that “other” was a desirable characteristic.

- Fairness; Transparency; Simplicity; Stability; Predictability; Clarity; Responsiveness; and other.

The following figure (Figure 16) shows how Councils responded to the ranking of the characteristics. Figure 16 shows that:

- Just over half of the respondents indicated that “fairness” was the most desirable characteristic and over two-thirds of the respondents indicated that it was in their top three characteristic. It is noted that the qualitative comments did question fairness in relative terms (e.g. fair to whom), furthermore fairness is considered a difficult goal to achieve given a very limited overall funding envelope.
- Stability and predictability were also seen as critical characteristics highlighting a dislike for large variations in grants from year to year and the importance of longer term financial planning for Councils.
- Transparency was also seen as relatively important, highlighting a desire to see and understand what drives the general allocation process. Many of the qualitative comments highlighted a keenness to understand how grant outcomes were comparable between Councils, particularly when there were perceived similarities in Council needs and differences in outcomes. Once again, given the general lack of understanding of the current methodology, transparency can be viewed as a critical characteristic.

Figure 16 - Ranking of most desirable characteristics (1 – most important to 7 least important)



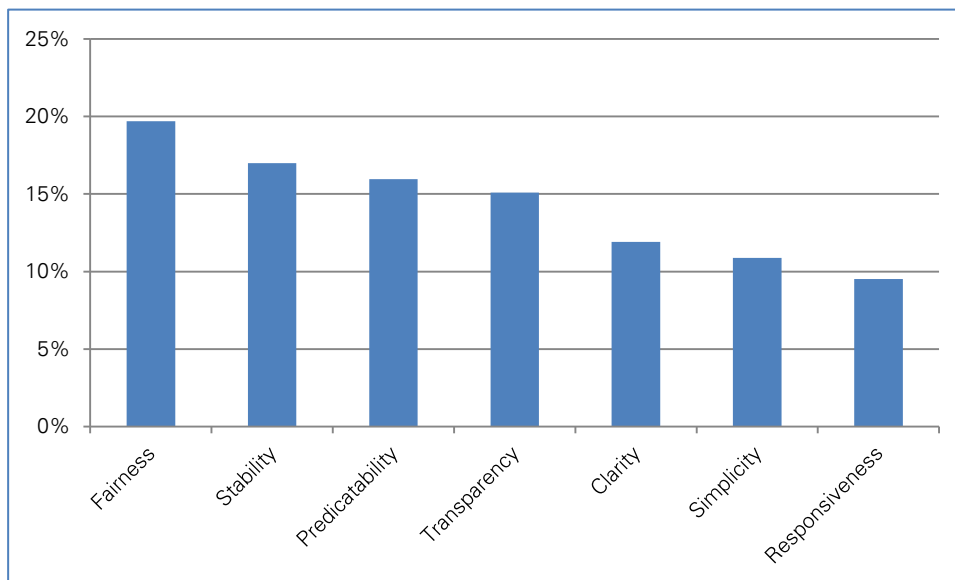
The following table (Table 14) shows for each characteristic how the respondents ranked the characteristic.

Table 14 - Ranking of most desirable characteristics (1 – most important to 7 least important)

	1	2	3	4	5	6	7
Fairness	26	5	2	2	7	—	4
Transparency	3	8	10	9	6	10	0
Simplicity	3	2	6	5	10	6	14
Stability	6	14	10	5	3	6	2
Predictability	6	12	9	4	6	5	4
Clarity	1	2	4	15	9	10	5
Responsiveness	1	3	5	6	5	9	17

The ranking of each characteristic can be used to present a weighted ranking which reflects the relative importance of the characteristics. The weighted ranking is shown below in Figure 17.

Figure 17 - Ranking of most desirable characteristics (weighted)

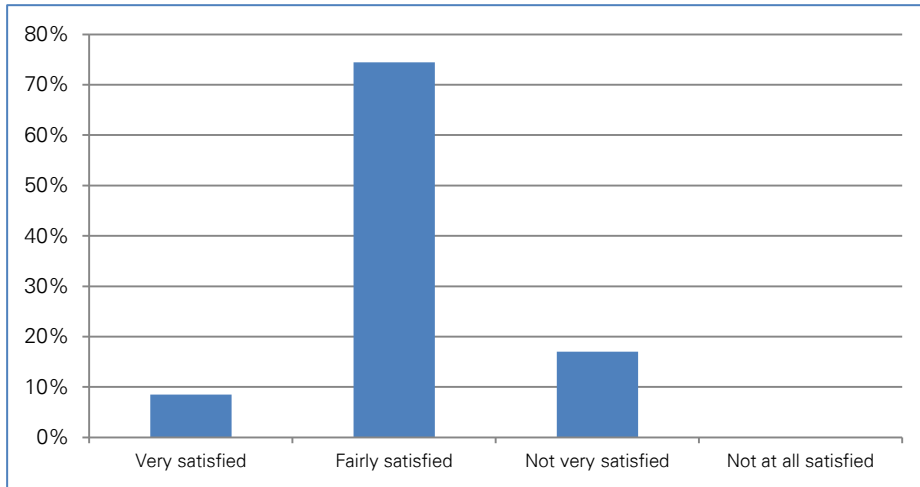


6.5 Level of satisfaction with current data requirements

Councils were asked to comment in their level of satisfaction with the current data requirements placed on them by the Commission.

The following figure (Figure 18) reflects that Councils are generally satisfied with the data requirements placed on them. However, comments received indicated that there are some concerns with the level of detail requested and the impact that this was having on the workload of Councils.

Figure 18 - Satisfaction with data requirements placed on Councils



The following table (Table 15) provides a breakdown of the responses according to the ACLG classification. It indicates that the level of satisfaction is relatively consistent across the groups.

Table 15 - Satisfaction with data requirements placed on Councils

	Very satisfied	Fairly satisfied	Not very satisfied	Not at all satisfied
Urban, Urban Fringe and Urban Rural	11%	68%	21%	0%
Provincial Cities	0%	100%	0%	0%
Rural - Small and Medium	14%	79%	7%	0%
Rural - Large and Very Large	0%	78%	22%	0%
Aboriginal/Outback Communities	0%	0%	100%	0%
Total	9%	74%	17%	0%

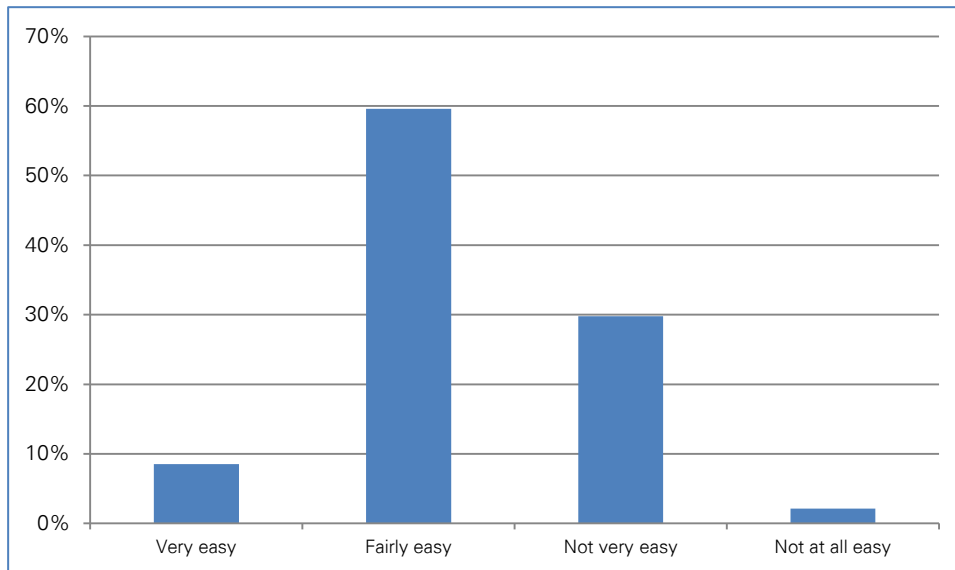
It should be noted that the Commission uses the annual return process to collect data for other users. Despite the best efforts to indicate for whom the data is being collected the survey responses indicated that there was some confusion in the area.

Overall it would appear that Councils recognise the need to provide data and they are prepared to accept responsibility for its provision. However, anything that lessens the burden would be appreciated, particularly by the smaller Councils.

6.6 Ease of meeting current data requirements

Councils were asked to comment on how easy they found it to meet the current data requirements. The following figure (Figure 19) shows that in total 69% of respondents indicated that in total it was "very easy" or "fairly easy" to meet the current data requirements. However, over 30% of the respondents indicated that it was "not very easy" or "not at all easy" to meet the data requirements. This represents a significant proportion of the respondents.

Figure 19 - Ease of meeting current data requirements



The following table (Table 16) provides a breakdown of the responses according to the ACLG classification. It indicates that the rural councils found it more difficult to meet the requirements than the larger Councils.

Table 16 - Ease of meeting current data requirements

	Very easy	Fairly easy	Not very easy	Not at all easy
Urban, Urban Fringe and Urban Rural	5%	68%	26%	0%
Provincial Cities	0%	50%	50%	0%
Rural - Small and Medium	21%	57%	21%	0%
Rural - Large and Very Large	0%	56%	44%	0%
Aboriginal/Outback Communities	0%	0%	0%	100%
Total	9%	60%	30%	2%

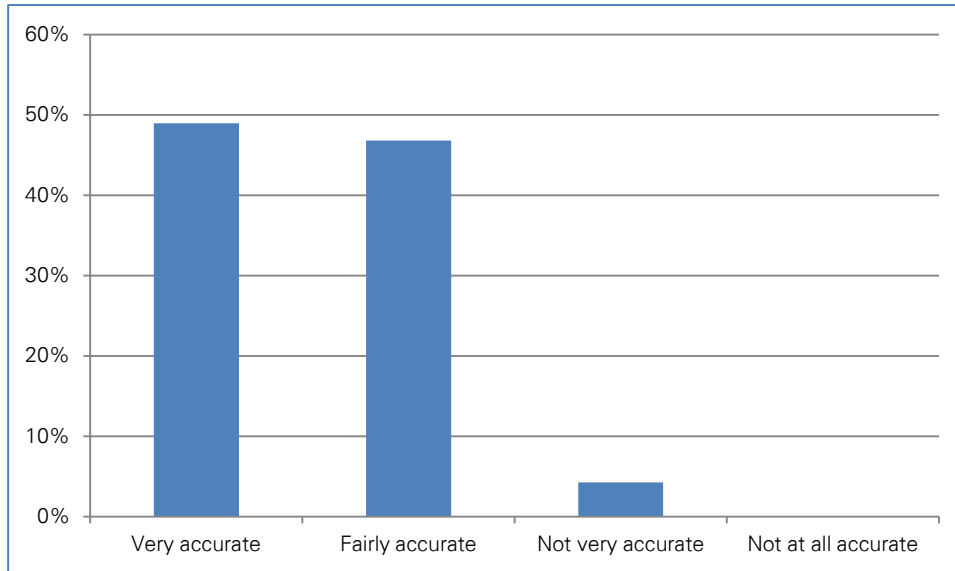
Comments received included "at present it takes a significant manual effort to complete the annual return", "it is felt to be time consuming, lack of understanding of ultimate use and little or no application or assistance to Council", "data requested contains information that would not otherwise be collected" and "the cost to provide is high compared to the benefit".

Overall it would appear that Councils recognise the need to provide data and they are prepared to accept responsibility for its provision. However, anything that lessens the burden would be appreciated, particularly by the smaller Councils.

6.7 Level of accuracy in data provided to the Commission

Councils were asked to comment on the level of accuracy in the data provided to the Commission. As shown in Figure 20 below the majority of respondents indicated that the information provided was either very or fairly accurate.

Figure 20 - Level of accuracy in data provided to the Commission



The following table (Table 17) provides a breakdown of the responses according to the ACLG classification. It indicates the level of accuracy is broadly consistent across the various groups.

Table 17 - Level of accuracy in data provided to the Commission

	Very accurate	Fairly accurate	Not very accurate	Not at all accurate
Urban, Urban Fringe and Urban Rural	53%	37%	11%	0%
Provincial Cities	50%	50%	0%	0%
Rural - Small and Medium	43%	57%	0%	0%
Rural - Large and Very Large	56%	44%	0%	0%
Aboriginal/Outback Communities	0%	100%	0%	0%
Total	49%	47%	4%	0%

While the respondents indicated that they considered the data provided to the Commission to be “very accurate” or “fairly accurate” an analysis of the percentage of expenditures allocated to expenditure functions did not appear to be consistently used by Councils (i.e. it was noteworthy that there are wide variations in the expenditure proportions between what appear to be similar councils). An example using a number of functions is shown below in Table 18.

Table 18 - Percentage of expenditure on selection expenditure functions

	Function 7 Waste Mgmt	Function 8 Aged Care Services	Function 15 Libraries	Function 18 Sport and Recreation	Function 34 Cultural and Tourist Facilities	Function 35 Community Support
Adelaide East						
Burnside	10%	13%	11%	18%	2%	2%
Campbell town & St Peters	14%	3%	8%	19%	1%	3%
Walkerville	21%	4%	11%	16%	5%	6%
Prospect	14%	0%	15%	13%	5%	6%
Unley	15%	4%	9%	17%	8%	9%
	13%	3%	9%	10%	3%	13%
Adelaide South						
Holdfast bay	9%	23%	7%	10%	7%	5%
Marion	15%	4%	11%	16%	10%	5%
Mitcham	14%	2%	9%	11%	1%	8%
Adelaide North						
Port Adelaide Enfield	13%	2%	9%	15%	6%	6%
Playford	9%	4%	7%	22%	5%	9%
Salisbury	14%	4%	7%	18%	4%	5%
Tea Tree Gully	17%	2%	7%	27%	2%	5%
Barossa, Light and Lower North						
Barossa	9%	3%	8%	17%	7%	8%
Light	9%	0%	7%	6%	3%	3%
Mallala	15%	1%	5%	7%	2%	4%
Limestone Coast						
Kingston	10%	1%	0%	23%	1%	4%
Tatiara	8%	0%	4%	17%	7%	6%
Naracoorte Lucindale	9%	1%	3%	9%	3%	4%
Robe	7%	1%	5%	13%	4%	3%
Wattle Range	15%	0%	5%	13%	3%	5%
Grant	9%	0%	3%	7%	4%	3%

Under the current methodology used by the Commission this allocation difference does not necessarily matter however if moving to an alternative approach this may become more important.

It is noted that the list is not exhaustive and there may be legitimate reasons for the variances. It is also noted that over the last two years, there has been a concerted effort by the

Commission and a group of local government finance officers, the Local Government Association, the Office of State/Local Government Relations and the Australian Bureau of Statistics to improve the reliability, consistency and comparability of data. Such efforts should continue and it is recommended that the Commission in consultation with this group look to develop a manual along the lines of that developed by the Victorian Grants Commission to assist Councils to complete the annual return.

7 Assessment of the Commission's Current Methodology

This section of the report provides an assessment of the Commission's current methodology. It highlights some general criticisms of the Commission's current methodology and also discuss some specific issues.

The Commission's current methodology for allocating General Purpose Grants can be best assessed by breaking down the treatment into a number of components:

- Revenue.
- Road expenditure.
- Other expenditure functions.

In addition a number of other local government activities and/or issues need to be considered.

7.1 The Commission's methodology – revenue assessments

Each council's capacity to raise revenue is assessed using property valuations, which represents its taxation base for setting rates. The Commission uses capital valuations regardless of whether the council uses site, annual assessed or capital valuations.

The Commission compares each council's valuation per capita against the State average valuation per capita in the category areas of residential, commercial, industrial, rural and other. The Commission then assumes councils make the average rating effort in each category and applies the average rate in the dollar. The rate that council sets is not considered, consistent with the effort neutrality principle that all calculations are independent of council policy and practices.

All states follow the same broad approach for undertaking the revenue assessment and it is not considered that there is a viable alternative approach.

The continued use of the averaging process and the breakdown of property values into the existing categories is the recommended approach.

Recommendation

No change to be made to the current approach to the general revenue assessment process. (Refer separate recommendation regarding the use of SEIFA on the revenue assessment process.)

It is noted that SA is the only state that is applying a SEIFA index to the revenue component of the grant calculation. Other states have indicated that they have looked into the use of SEIFA on the revenue side of their methodology and have chosen for a variety of reasons not to go down that path.

In South Australia's case the use of a SEIFA based index on the revenue side of the assessment aims to take into account resident's capacity to pay and is in part driven by the non-application of disability factors to the majority of expenditure functions.

Given the proposal to incorporate a SEIFA based index as part of the proposed cost adjustor matrix for functions on the expenditure side (refer discussion in Section 4.3), it is considered that its retention as an adjustor on the revenue side represents a duplication and should be discontinued.

Recommendation

That the Commission consider the discontinuation of the SEIFA based index on the revenue side of the assessment process as this would be duplication if it is included as a cost adjuster on the expenditure side.

Where councils provide significant concessions on fees and fines or rate revenues, these can be included in their own right as a separate expenditure function (with associated cost adjusters) In the interests of simplicity, however, this approach is probably only justified where the value of the concessions is comparable with other function expenditures.

Conceptually it is considered that the appropriate treatment for all revenues, including that from fees and fines, is for it to be included as part of revenue assessment (i.e. not netted off of associated expenditures). This is because if it is netted off of expenditures the cost adjuster is effectively being applied to the fee and fines revenue even though there is not necessarily any relationship between the cost adjusters and capacity to raise revenue from fees and fines.

Where revenue from each individual fee and fine is small, a practical approach' to avoid a large number of revenue functions, is to have a single aggregated revenue category for small user charges. Alternatively, even though it is conceptually flawed, if revenues from fees and fines are very small, it is probably acceptable to net them off of associated expenditures on the basis that it will have a negligible impact on the overall grant distributions.

Recommendation

That the Commission consider that other council revenue should be netted off against the relevant expenditure function (as per current arrangements) unless it becomes sufficiently material to warrant it being included as a specific revenue function.

7.2 The Commission's methodology – roads expenditure assessment

The current approach used by the Commission is simple, well understood and the data is independently sourced and/or verifiable. The alternative is an asset preservation approach which is much more complex and requires extensive extra data much of which is not currently available and would require a significant ongoing investment to obtain.

Based on the extra complexity and cost of moving to an alternative model and the fact that no significant issues were raised in the call for submissions it is not proposed to make any changes to the current arrangements.

Recommendation

No change to be made to the current approach to the road expenditure assessment process.

7.3 The Commission's methodology – other (capital expenditure and depreciation)

While consideration of capital expenditure is a high priority for Councils there are a number of reasons to continue to exclude capital from the methodology. These include:

- It is generally accepted that the state based approach to HFE is based on operating expenditures and revenues and thus capital is not included.
- All states use depreciation rather than capital in their approach and a move by SA to include capital would be a move away from the approach used by others. The perception by some Councils that the choice of depreciation method can affect the grants distribution process is misguided as it is only to the extremely limited extent that an individual Council can affect the average that it would have an impact on the outcome.
- A move from depreciation to capital would disadvantage those Councils that have already undertaken the capital spend and reward those that are yet to incur the capital.

While capital and new infrastructure is a high priority in some areas, many would argue that maintenance of existing infrastructure is of equal priority. While some growth areas may have a short term financing issue it is not considered that they have a funding issue, nor is it the role of the Commission to fund infrastructure.

Based on the above factors it is recommended that the Commission continue with the current approach of including depreciation and excluding capital from the process.

Recommendation

The current approach of including depreciation and excluding capital from the assessment process be continued.

7.4 The Commission's methodology – approach to other expenditure functions

Based on stakeholder consultation, feedback from Councils and an assessment of the methodology used in a number of other jurisdictions there are a number of general criticisms that could be labelled at the Commission's current approach to other expenditure functions. In particular:

- The current methodology is not well understood by many Councils, particularly the basis of Function 50 (refer section 7.6 for further detail), the major driver of redistributions.
- A large number of expenditure categories do not appear to be consistently used by Councils. It is noteworthy that there are no definitions provided to Councils by the Commission and as highlighted previously in Table 18 there are wide variations in the expenditure proportions between what appear to be similar councils.
- The cost drivers and disability factors often rely on data which is not from an independent source and therefore potentially open to manipulation and inconsistent interpretation.
- A number of the disability factors which other states consider have a major effect on the cost of service delivery are not used (e.g. Socio-economic disadvantage, growth).
- Several disability factors are at least in part effected by what individual councils do (e.g. the council's levels of expenditure) and hence are not completely policy neutral.

While none of the individual criticisms support a case for change in isolation when combined together they do indicate that there is room for substantive improvement in the Commission's methodology (albeit recognising that the distribution of grants may not significantly change).

Recommendation

The Commission consider undertaking substantive reform to the other expenditure assessment process.

7.5 The Commission's methodology – the current number and size of expenditure functions

The Commission's methodology currently contains nineteen (19) expenditure functions. As shown in the table below (Table 19) there is significant variance in the size of the expenditure functions ranging from as little as 0.2% to as high as 15%.

It is noteworthy that, with regard to the amount of total net operating expenditure captured, there was significant variability between councils with a minimum of 21% and a maximum of 93% of net operating expenditure captured by individual councils. This can be compared to the Victorian approach which according to the Victorian Grants Commission captures around 99% of expenditure (essentially all that is excluded is expenditure incurred on a fee for service basis).

Table 19: Three year average council expenditure by function, for 2009-10 to 2011-12

Expenditure Function	Average expenditure (\$)	% of expenditure
Waste Management	132,029,116	13
Aged Care Services	36,665,578	4
Services to Families and Children	15,028,339	1
Health Inspection	6,423,028	1
Libraries	76,308,003	7
Sport and Recreation	173,669,045	17
Sealed Roads – Built up and Non-built up	156,107,181	15
Sealed Roads – Footpaths etc	119,830,645	12
Unsealed Roads – Built up and Non-built up	71,245,901	7
Unformed roads	1,860,333	0.2
Stormwater drainage	42,683,312	4
Community Support	60,495,763	6
Jetties and Wharves	2,208,471	0.2
Public Order and Safety	25,759,527	2
Planning and Building Control	68,286,680	7
Bridges	4,872,324	0.5
Other Needs Assessment*	45,394,300	4
Total	1,038,867,545	100

Source: SA LGGC.

Based on the above, consideration should be given to:

- The relative size and importance of individual expenditure functions.
- Seeking to achieve a level of expenditure inclusion closer to 100% to ensure that the expenditure activities of Councils are being adequately captured).

7.6 The Commission's methodology – Function 50

The Commission's final expenditure function "Other Needs Assessments" which is commonly known as Function 50 is a major driver of redistributions. It is not well understood by Councils. Furthermore the outcomes from Function 50 are in part driven by the actual decisions taken by Council and hence are not completely policy neutral. This should ideally be avoided. It is also noted that SA is the only jurisdiction with a Function 50 concept within their methodology.

7.7 The Commission's methodology – how a consolidation of categories may help

A consolidation of categories may address some of the above criticisms for the following reasons:

- If the consolidation is based on simple aggregation of current expenditure categories it should improve the consistency of the expenditure allocations and mean no extra work for Councils. Note that the wide variation in the expenditure proportions between similar councils suggests an element of arbitrariness in current allocations.
- Fewer categories should allow councils to allocate a higher proportion of their overall expenditure as the process is simpler and requires less separation of expenditure.
- Expenditures for each category by a Council are likely to be more stable because of a dilution of the effect of 'one off or extraordinary' expenditures so redistributions should be more stable.
- Many of the current expenditure drivers will be retained although sometimes in a more generalised form (e.g. total population instead of a particular component of the population). The major change is increased use of population as a driver and reduced use of the number of properties.
- Use of a scale economy factor can be readily accommodated as part of an expenditure driver where appropriate.
- All the expenditure drivers would be based on data from independent credible sources.
- All of the new disability factors can be simple and readily understood – and collectively can incorporate what other states recognise as the most powerful.
- With the exception of the disability factors which are at least in part effected by what individual councils do, almost all of the current SA disability factors can be incorporated in full or at least in part (the exceptions are Duplication of facilities, Capital city).
- All the disability assessments can be based on data from independent credible sources.

Section 8 provides information on an alternative approach which develops these issues further.

8 An approach to reform of the general expenditure assessment approach

This section of the report provides an overview of the general approach to reform of the approach to the expenditure assessment given the conclusions reached in the previous sections.

8.1 General approach to reform

Based on stakeholder feedback and the results of recent reviews in Western Australian and VIC, the overall objectives for undertaking reform should be to achieve simplification and greater transparency. The clear constraint to the general approach to reform is that the simplification/transparency objectives should not over-ride an equitable redistribution outcome.

It should be noted from discussions with both VIC and WA that they have both gone down the simplification/transparency path without compromising the redistribution outcome. In fact they both embarked on the reform process with an end result in mind and were able to structure the revised approach such that this end result was achieved.

Both states indicated that given the functions and the matrix of cost adjustors, an iterative approach can then be used to achieve the desired redistribution outcome through incremental adjustment of:

- the relative weightings of the cost adjustors which are applied to each function; and
- the range (relativity between the more advantaged and the more disadvantaged) which applies to each cost adjustor.

What the above points are highlighting is that there are enough levers to be pulled such that they can be adjusted to achieve what the Commission considers is an equitable redistribution outcome.

Where there is a clear conceptual case and the necessary data is available from an independent source and it is of good quality the general approach is to move from a single Function assessment to a relative assessment for each Function (or expenditure category) individually using function-specific cost adjustors (or disabilities). Decisions on the Function breakdown and the mix of Function-specific cost adjustors and their relative importance can then be made based on a set of clear and conceptually sound criteria.

Further details on the approach are provided below.

8.2 Extent of the move away from existing expenditure methodology

The two main groups of expenditures within the general assessment are roads-related expenditures, which account for about one third of total councils expenditures, and other services to individuals, properties and businesses. The latter comprise functions such as health and welfare, community amenities and recreation and culture.

As discussed in Section 7.1, in the case of roads functions no changes are proposed to the current assessment approach.

For the non-roads functions, however, there are several reasons why major reform appears justified:

- The current approach of having almost all functions assessed as having no disabilities and having a single generic function carry virtually the full redistribution load is not intuitive or transparent.
- Councils have indicated that the current methodology is not well understood.
- Where other states and the Commonwealth Grants Commission have undertaken recent reviews they have, wherever possible moved away from approaches where there is a risk that they are at least in part effected by what individual councils do (e.g. the council' levels of expenditure) which is at odds with the objective of policy neutrality.
- The large number of functions, many of which cover only small levels of expenditure, increase the risk that expenditures will not be consistently allocated between them.
- There are apparent inconsistent in use of expenditure categories between Councils.
- For several of the disability assessments data is not from an independent source.
- A number of the disability factors which other states consider have a major effect on the cost of service delivery are not currently being used.

Based on the above analysis, it is considered that a new methodology based on a relative assessment for each function individually using function-specific cost adjustors be adopted for other functions.

Assuming that the Commission wish to proceed down this path then the next issue to be addresses is to develop a new function classification. This is discussed in the following section.

8.3 A proposed new function classification for expenditures

In developing a possible new function classification, there are several factors to consider:

- The extent to which each function is easily understood and represents a significant component of council activity but the overall breakdown achieves good coverage of what different councils actually do.
- Capacity to achieve consistent and relatively complete expenditure breakdowns across councils with minimum effort.
- Existence of a dominant and well understood driver for each function.
- Availability of good quality independently sourced/verified data.

Taking the above factors into account, the following criteria are proposed as a basis for the Commission establishing a new classification for non-transport functions:

- Each function should represent at least 4 percent¹⁹ of average council expenditure and overall there should be between 10 and 15 functions.
- Expenditure must be able to be allocated between the functions using the breakdowns provided in the current annual Grants Commission Returns.
- There should be a clear conceptual case based on the current SA methodology and/or interstate approaches for a dominant driver for each function.
- There should be quality independent source data for each driver.

Recommendation

The Commission consider reducing the number of expenditure functions through a consolidation process based on an agreed set of criteria (e.g. minimum percentage of overall council expenditures) whilst seeking to include as close as possible to 100% of the expenditure of councils within the assessment process.

¹⁹ Ideally this would theoretically be slightly higher but a number of functions are currently around this level and therefore at this point it is proposed to use 4 percent as a minimum. Of course this can be reviewed over time.

8.4 A function-specific matrix of cost adjustors

In developing a possible set of cost adjustors to apply to the new function classification there are again several factors to consider:

- The extent to which there is both a clear conceptual case and actual evidence that the feature (e.g. remoteness) impacts significantly on the cost of delivery of one or more functions.
- Evidence that the feature impacts on what jurisdictions do (i.e. councils with high levels of the feature actually have high per capita expenditures on the function the feature is expected to impact on).
- The availability of good quality independent data.
- The extent to which the cost adjustor assessment has a material effect on grant outcomes.

Taking the above into account, the following criteria are proposed as a basis for establishing a set of cost adjustors and then applying them to specific functions:

- There is a clear conceptual case that the feature will impact significantly on the cost of function delivery.
- The feature is already included as a cost adjustor for the same or similar services in several states.
- There is quality data for the proposed cost adjustor from an independent source.
- The cost adjustor assessment has a material effect on grant outcomes.

Recommendation

The Commission consider specific criteria as a basis for establishing a set of cost adjustors.

8.5 A proposed new set of functions

In developing a new set of functions using the proposed criteria, the key strategy was consolidation. This was generally undertaken for one or more of the following reasons:

- To eliminate existing functions which accounted for only very small expenditures.
- To improve the consistency and completeness of expenditure allocations to functions - existing functions typically had similar purposes and drivers and there appeared to be considerable variation between councils in the way expenditures were being allocated between them.
- The data for the existing function was considered to be of poor quality or not independent.

For reasons which have already been outlined, it is proposed that assessment of all transport-related functions remain unchanged.

The following table (Table 20) sets out the recommended set of non-transport functions and the justifications for the specific changes. The proposed new functions are colour coded.

Table 20 - Rationale for proposed treatment of existing SA functions

Current SA Function	Current % of exp	Justification for change	Proposed new function
Function 7: Waste management	12	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Public order and health and waste management
Function 8: Aged care services	3	<ul style="list-style-type: none"> No change justified (meets all criteria already) 	Aged care services
Function 10: Services to families and children	1	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Family and community services
Function 12: Health inspection	1	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Public order and health and waste management
Function 15: Libraries	7	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function Ensure quality independent driver data 	Family and Community services
Function 18: Sport and recreation	16	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function 	Recreation and culture
Function 33: Stormwater drainage maintenance	4	<ul style="list-style-type: none"> No change (meets all criteria already) 	Stormwater drainage maintenance
Function 34: Cultural and Tourist facilities	7	<ul style="list-style-type: none"> Consolidation of similar services 	Recreation and culture
Function 35: Community support	6	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function 	Family and community services
Function 38 Jetties and wharves	<1	<ul style="list-style-type: none"> Consolidation of a small expenditure 	Recreation and culture
Function 40: Public order and safety	2	<ul style="list-style-type: none"> Consolidation of a small expenditure 	Public order and health and waste management

Current SA Function	Current % of exp	Justification for change	Proposed new function
Function 41: Planning and building control	6	<ul style="list-style-type: none"> No change (meets all criteria already) 	Planning and Building control
Function 50: Other needs assessment	na	<ul style="list-style-type: none"> Not a component of council expenditure No longer needed to achieve desired redistribution 	Intent addressed through functions and cost adjustors

Recommendation

The Commission note an indicative list of expenditure functions and the basis upon which the list has been developed.

To keep the model relatively simple, a single driver is proposed for each Function based on drivers used for similar Functions in SA, VIC and WA. The proposed driver for each Function is as follows:

- Public order and health and waste management – number of dwellings.
- Aged care services –population aged over 65 years.
- Stormwater drainage maintenance – number of urban properties.
- Family and community services – population.
- Recreation and culture –population.
- Planning and Building control – number of new developments and additions.

Further detail on the current and proposed drivers and the data source for each proposed driver is given in Appendix D. Data for all proposed drivers is available from independent sources.

8.6 A proposed set of cost adjustors

In developing a new set of cost adjustors to apply to the above set of proposed functions a logical starting point is a review of the general range of the cost adjustors currently in use across the states. The case for inclusion of a cost adjustor is clearly stronger the more functions it is being applied to and the more states it is being used in.

To keep the analysis manageable, the analysis was confined to SA and the two states which have undertaken the most recent methodological reviews, VIC and WA. Cost adjustors for which data was considered of poor quality or not from an independent source were excluded and generic cost adjustor descriptions were used to accommodate slight differences in the terminologies and definitions across states.

The results of the analysis are summarised in the following table (Table 21). It was concluded that there is a good case for confining the methodology to a maximum of only 8 cost adjustors, all of which it is considered have wide applicability and can be assessed using high quality independently-sourced data.

Table 21 - Evaluation of potential cost adjustors for non-transport Functions

Generic cost adjuster description	Vic	WA	SA	Proposed outcome and justification
Aged pensioners	✓			Exclude - Very limited use - 1 Function in 1 state
Environment	✓		✓	Probably include - Used for 1 Function in another State and in SA
Indigenous	✓	✓	✓	Include - General use in all states
Language	✓			Exclude - Limited use - 2 Functions in 1 state
Pop Density	✓			Exclude - Very limited use - 1 Function in 1 state
Pop. Dispersion	✓	✓		Include - General use in 2 states
Growth	✓	✓		Include - General use in 2 states
Pre-school children	✓			Exclude -Very limited use - 1 Function in 1 state
Regional centre	✓	✓	✓	Include - General use in all states
Remote	✓	✓	✓	Include - General use in all states
Scale	✓			Probably exclude- Limited use - 3 Functions in 1 state
Socio-economic	✓	✓	✓	Include - General use in all states
Tourism	✓		✓	Include - General use in 2 states

A tick in above table indicates currently used in states methodology. Cost adjuster adopted in two or more states shaded blue in the above table.

Whilst it is considered that the case for using a methodology which is fully integrated is strong, it is recognised that this may not fully take into account a number of unique characteristics /

factors that will impact on a number of individual councils. An example of a council with unique characteristics is Kangaroo Island which, as the only Island based council in South Australia, suffers from its isolation and its increased costs of doing business and providing services (e.g. waste collection and disposal) for the Island's population and national and international tourists. The high costs of providing services in this area (due to transport and isolation related issues) is recognised in a number of reports including "Paradise Girt by Sea" and the Merrick "Kangaroo Island Watergap Recognition Project"²⁰. The extent to which there needs to be a stand-alone adjustment to accommodate unique situations and the best approach for achieving this is best considered as a matter for Commission judgement.

The proposed measure for each potential cost adjustor and the independent data source are as follows:

- Environment: – Relative risk ratings for Local Government areas on bushfires, floods and landslides compiled by the Natural Research Centre, Macquarie University.
- Indigenous: – Number of indigenous residents as measured by the ABS.
- Population Dispersion: – A dispersion score is calculated based on the population of each town or locality within the local government area with a population above 200 as measured by the ABS and its road distance from the centre in which the council is based (based on RAA data).
- Growth: – Population growth from the previous to the current year as measured by the ABS.
- Regional Centre: – A significance score is calculated based on the number of people within the council area working in the nine industry classifications which relate to service industries as measured by the ABS as a proportion of total residents.
- Remote: – Based on the Accessibility and Remoteness Index of Australia (ARIA) as compiled by the National Key Centre for Social Applications of Geographic information Systems at the University of Adelaide.
- Socio-economic: – Based on the Index of Relative Disadvantage for each Local Government area as compiled by the ABS as part of its Socio-Economic Indexes for Areas. Further detail on the SEIFA alternatives are provided below in Section 8.7.
- Tourism: - Based on the number of visitors derived from the National Visitor Survey and International Visitor Survey compiled by Tourism Research Australia.

Recommendation

The Commission note an indicative list of cost adjustors and the basis upon which the list has been developed.

²⁰ "Paradise Girt by Sea, available at http://www.competitivesa.biz/documents/1816DPC-EconomicDevelopmentDockI_FAW.pdf
Kangaroo Island Watergap Report http://satic.com.au/images/uploads/documents/ki_watergap.pdf

8.7 Consideration of the SEIFA cost adjustor

The Socio-Economic Indexes for Areas (SEIFA) has been developed by the ABS to rank areas in Australia according to relative socio-economic advantage and disadvantage based on information from the five-yearly census.

The current version of the SEIFA consists of 4 indexes:

- The Index of Relative Socio-Economic Disadvantage (IRSD).
- The Index of Relative Socio-Economic Advantage and Disadvantage (IRSAD).
- The Index of Education and Occupation (IEO).
- The Index of Economic Resources (IER).

While each index is a summary of a different subset of Census variables and focuses on a different aspect of socio-economic advantage and disadvantage there is a high level of correlation between them.

The following Indexes are currently used in different states as part of their methodology for distribution of Financial Assistance to LG:

- SA – Uses the IER as part of the Revenue assessment as a way of recognising capacity of residents to pay rates.
- Victoria – Uses the IER as part of the Expenditure assessment as a way of recognising that residents of areas of low socio-economic disadvantage will make a greater call on certain council services.
- WA - Uses the IRSD as part of the Expenditure assessment as a way of recognising that local governments with higher proportions of disadvantaged people incur higher operating expenditures in the delivery of services.

The Commonwealth Grants Commission advises that, as an indicator of the need for services the choice is between the IRSAD and the IRSD depending on the service being considered. They consider that the key question is whether differences in the level of use are driven by:

- whether or not the person is poor i.e. the key indicator is the absence of poverty; or
- a person's level of wealth. i.e. the key indicator is not simply absence of poverty, rather differences in wealth levels cause differences in levels of use.

For example, the IRSAD might be better for health-type services because people on high incomes have a different use of services whereas the IRSD might be better for welfare-type services where need is driven by the existence of poverty.

It is recommended that the Index of Relative Socio-Economic Disadvantage (IRSD) be adopted as the cost adjustor for all expenditure functions where use of a SEIFA index is required for several reasons:

- The key services where it is proposed that SEIFA be used as a cost adjustor are of a general welfare nature (e.g. aged care services and family and community services).
- The Commonwealth Grants Commission uses the Index of disadvantage because they consider it is a better indicator of levels of disadvantage for their work.

It is considered that it would be excessively complicated to use different SEIFA indexes for different services.

Recommendation

That the Commission consider the adoption of the Index of Relative Socio-Economic Disadvantage (IRSD) as the cost adjuster for all expenditure functions where use of a SEIFA index is required.

8.8 Matching Cost Adjustors to Functions

The second stage in the development of a matrix of cost adjustors is to match specific adjustors with individual functions. An intuitive assessment, combined with a review of which adjustors are currently being applied to the various functions in other states, is a logical basis for development of a preliminary matrix focusing on the key cost adjustors.

A matrix showing the cost adjustors currently applied to the proposed functions in VIC and WA and their use as part of Function 50 in SA is shown in the following table (Table 22). Based on the relative importance given to the various adjustors for each Function in these states and their use as part of Function 50 in SA a preliminary assessment can be made of their relative importance for each proposed function. These are also shown in the following table (Table 22).

Table 22 - Development of a matrix of key cost adjustors based on VIC, WA and SA⁽¹⁾

Function	Environment	Indigenous	Dispersion	Growth	Regional centre	Remote	Socio-Economic	Tourism
Public order and health and waste management			Vic WA	WA	WA	WA	WA	
Aged care services			Vic WA			WA	Vic WA	
Family and Community services		WA	Vic WA	Vic		WA	Vic WA	
Stormwater drainage maintenance	Vic		Vic WA	VicWA	WA	Vic WA	WA	
Recreation and culture			WA	Vic WA	Vic WA	WA	WA	Vic
Planning and building control			WA	WA	Vic WA	Vic WA	WA	Vic
Data source	Natural Research Centre, Macquarie Uni	ABS	ABS	ABS	ABS	ARIA Uni. Of Adelaide	ABS (Socio-economic Indexes for Areas)	Tourism Australia Visitor Survey
Significance of adjuster for each Function	High	Moderate	Low					

(1) SA taken into account based on inclusion in current Function 50.

8.9 The need for Function 50

It is considered that the intent of the Function 50 based adjustment – a major redistribution towards councils having major disadvantages in delivery of a many services – is very similar to that which the proposed matrix of functions and cost adjusters aims to achieve. Further, as the function is not a direct component of council expenditure it does not fit within the general framework of the proposed methodological approach.

In summary given that the capacity of the Commission to exercise appropriate judgement and flexibility as required to achieve its distributional objectives continues to be available, it is considered that Function 50 is effectively redundant. On this basis it can be removed.

Recommendation

That the Commission consider removing Function 50 from the Commission's methodology as it is no longer required to achieve any desired redistribution.

8.10 Fine tuning the assessments

Within the proposed methodology there is considered to be very considerable flexibility to fine-tune both the Function drivers and the cost adjusters that are applied to them to allow the Commission to achieve any redistribution objective.

While a single driver has been proposed for each function, there are several ways that a driver can be refined if required:

- Only a sub-section of the driver can be used – this can be appropriate where the service is linked most closely to only a segment of the overall driver e.g. use of recreation and culture services may be most closely linked to the population aged within a particular range rather than the total population.
- A minimum level of the driver can be used where the actual level is below this level – this can be appropriate where there is considered to be a minimum level of cost for delivering a service regardless of the service level e.g. Public order and health and waste management may have a minimum level of service based on that required for 1000 people.

A composite driver can be constructed i.e. including values for more than one measure of need – this can be appropriate where the demand for a service is significantly influenced by more than one factor e.g. Aged care services may require a higher level of service for the disabled aged and in recognition of this they could be given double weight i.e. the driver would be the number of aged plus the number of disabled aged.

Specific examples of functions where the above fine tuning could be justified, based on judgment and approaches in SA or other states, include:

- Public order and health and waste management – adjusted number of properties (minimum number of properties).
- Aged care services – adjusted population (aged over 65 years plus disabled pensioners).
- Family and community services – adjusted population (aged 0-14).
- Recreation and culture – adjusted population (aged 5-49 years).

As previously outlined, the distribution outcome can be further fine-tuned by changing the mix of cost adjustors for individual functions either by adding/removing adjustors or altering their relative weights (noting that the total weight must obviously always add up to 100%). Further adjustment can be made by changing the range of relativity between the most advantaged and most disadvantaged which applies to each cost adjustor (e.g. a range from 1 to 2 equates to the most disadvantaged having unit costs which are double those of the most advantaged).

The range for each cost adjustor should ideally be based on actual council experiences (i.e. the typical range of the impact of the adjustor on unit costs across councils). This issue was examined in detail as part of the last VIC review. This review concluded that, while it involves a significant simplification, there is a strong case for the adjustor range to be the same **within** the mix for a function and **between** functions to ensure that there is no distortion of either the relative weighting between adjustors or the relative importance of the functions themselves. VIC is currently using a range of 1 to 2 and it is suggested that a similar range be the starting point for iterations in SA.

9 Other Issues

9.1 The effects of water licensing

It is noted that the separation of water licences from property valuations would have had an impact on the revenue assessment process as the Valuer-General does not value water licences when considering property values; water licences are considered personal property. Discussions with the Victorian and NSW Grants Commissions indicated that this was a relatively small issue a number of years ago. It was not an issue for WA. Discussions indicated that as valuations fell it had the effect of a higher grant outcome. However, the three year rolling average of property values within the revenue assessment process had the effect of smoothing out the impact. Neither VIC nor NSW include any specific disability adjustment for the issue. No comments were received from the call for submissions on this issue. The effect of water licensing is an example of a specific issue that will arise from time to time.

The Commission should be aware of such issues as they arise and mindful of the materiality of the issue on both the effected council areas and the overall methodology. Only where material on both should the Commission seek to adjust its methodology.

Recommendation

No specific change to the methodology is required to take account of the effects of water licensing.

9.2 The effects of fixed and variable property rates

The responsibility for decisions about the amount and distribution of the property rates rests with Councils. Councils can change the composition of rates revenue by altering the:

- rate in the dollar applied to the value of rateable land;
- categorisation of land for the purpose of applying differential rates (residential, commercial, industrial, rural and other); and
- structure of the rate (e.g. fixed and variable components).

Rate revenue may also change through adjustments for specified values or a council exercising its powers to rebate, remit or defer rates in ways that may affect groups of properties or individual properties.

Value of rateable land

Councils have the choice of three types of values as their valuation base for the purposes of rating under the Local Government Act 1999 (s151): 1) Capital value; 2) Site value; 3) Annual value. Most councils use the capital value basis of valuation.

Under section 167, a Council may also choose to use property valuations supplied by the Valuer-General; made by a qualified valuer (or firm or consortium of valuers) employed or engaged by the council; or a combination of both. We understand that almost all councils use valuations supplied by the Valuer-General.

Rate in the dollar

The council will set a "rate in the dollar" (or several differential rates in the dollar, one of) which is then applied to a property (and added to a fixed charge, if any) to calculate the amount of general rates for the year.

A council could apply no fixed charge and would apply the same rate in the dollar to all land. However, all councils choose to make some variation to this basic strategy. The options for variation may include one or more of the following:

- Differentials between categories of land (differential general rates);
- A fixed charge; or a
- Minimum rate; and
- Adjustments for specified values.

Differential Rates

Councils may choose to apply different rates in the dollar for different land uses within their area (e.g. residential, commercial, industrial, rural and other).

Fixed charges

The fixed charge is a set amount levied against all properties irrespective of their value. The fixed charge component is paid in addition to the property valuation component (which is determined by the rate in the dollar and property value).

Using a fixed charge reduces the effect of the property valuation component of the general rate. In other words, it changes the distribution of the total rate burden to reduce some of the difference between what would be paid by the owners of low-value land and the owners of high-value land. The higher a council's fixed charge component, the less difference there is between property owners. Fixed charges cannot raise more than 50% of a council's general rate revenue, as this would be contrary to the taxation principles of equity and capacity to pay.

Minimum rates

Councils not using a fixed charge may set a minimum amount payable, as an alternative. This has a similar effect to a fixed charge, in that lower valued properties subject to a minimum rate, must pay more than the rate in the dollar that applies to their land. For example, if a council declared a minimum rate of \$600, but the rate in the dollar for a low-value property is calculated to produce a rate of \$560, the landowner must pay the higher, minimum amount. This means that up to a certain property value (as determined by the council) property values are in effect irrelevant.

A minimum amount must not apply to more than 35% of the properties in a council area (section 158).

General rates may be based on property value alone, however in SA they all councils base their rates on a combination of property value, and a fixed charge (flat rate).

Adjustments for specified values

We note that councils may also alter the amount payable for properties that fall within a defined range of valuations. Adjusted rates are often used in combination with minimum rates, so that a council has, in effect, both a maximum and a minimum rate. However section 158 of the

Local Government Act prohibits either or both of these mechanisms being used to affect any more than 35% of properties in a council area.

A Council can also exercise its powers to rebate, remit or defer rates in ways that may affect groups of properties or individual properties.

Conclusion

The current methodology considers a council's capacity to raise revenue. In considering a council's ability to raise revenue from property it uses the Office of the Valuer-Generals determined values for each property of the various property types: residential, commercial, industrial, rural and other and also the actual total property rates for each Council. The model therefore currently considers that each council is applying a variable rate approach to property rating.

We note that approximately 30 councils apply a fixed charge on top of the property valuation component (which is determined by the rate in the dollar and property value) and that approximately 38 councils set a minimum amount payable. This means that all councils are applying some sort of fixed charge or minimum rate.

It is argued by some that the current methodology does not sufficiently take account of the existence of fixed rates or minimum rates and that this could have a distorting effect on the grants calculation.

We note that the current methodology is also not accounting for the other adjustments, rebates, remits or deferrals that councils are providing. These are all council policy decisions in addition to the fixed and minimum rate. Given the model is currently accounting for the total rate revenue (including fixed charges and minimum rates) and the fixed and minimum rate issues is a policy decision that is in some way being adopted by each council, the above mentioned argument is not likely to have a significant effect on the grant outcomes. We suggest to maintain simplicity of the model the Commission not change the current approach.

Recommendation

No specific change to the methodology is required to take account of the effects of fixed and variable property rates.

9.3 The waste management expenditure function

It is noted that waste management is a critical component of the functions performed by Councils. The function can be performed in a number of ways and there are reported to be wide differences in reporting costs and waste levels across councils. No specific comments were received in relation to waste management in the call for submissions. It is noted that the Commission is currently taking into account both the distance of collection route and the distance of disposal.

A report prepared by Hyder Consulting²¹ highlighted some of the issues associated with waste management across Councils including the significant variability in waste management costs and annual reported tonnes of waste to landfill.

Discussions with other local government grants commissions indicated that they too are generally concerned with the issue of waste management and how to accommodate the differences in cost and disability factors within their methodologies. Population dispersion and remoteness appear to be the critical cost adjustors in relation to waste management functions. In summary it is important that the Commission take into account the distance required to be travelled to both collect and dispose of waste. These types of effects are already incorporated in the proposed methodology so no additional modifications are required.

Recommendation

That the Commission considers the proposed methodological approach outlined in this report with the view that this might form the basis of assessing the waste management function moving forward.

9.4 The level of scaling back required

It is noted that the Commission is required to undertake a scaling back process. This process takes the raw grants calculated through the methodology and scales them back to enable the final calculated grants to fit within the pool of available funds. Discussion with the Commonwealth Grants Commission indicates that this may be as a result of an 'all state' averaging approach. An 'all state' averaging approach means that larger councils will influence any 'all state' average calculations more so than small councils and therefore over time as the expenditure of larger councils grows smaller councils will become more disadvantaged.

It is noted that there are two approaches currently used by commissions throughout Australia to undertake the scale back process. These are:

- The proportional method where each council's raw grant is reduced by the same proportion so that the total of the grants equals the available grant.
- The equalisation ratio method where each council's raw grant is reduced such that all councils can afford to fund the same proportion of their expenditure needs with their total income.

The Commission uses the proportional method approach.

²¹ Role and Performance of Local Government, Waste and recycling related data and information. A report by Hyder Consulting Pty Ltd for the Department of Sustainability, Environment, Water, Population and Communities, October 2011. Accessed at www.environment.gov.au/wastepolicy.

Given the pool of funds is not large enough to achieve true equalisation across councils, scaling back the raw grant calculation will need to continue. Moreover, the Commission's current method would appear to have the greatest alignment to the principle of HFE and it is not recommended that any change be made to the current scale back approach.

Recommendation

The Commission continue with their current approach to scaling back from the raw grant to the pool of available funds.

9.5 The Commission's grant calculation model

In reviewing the methodology it was noticed that the current excel model which calculates the grants distribution could be further enhanced to:

- allow for an increased understanding of the methodology and approach by users;
- increase usability, readability and transparency;
- better capture changes in the model over time; and
- reduce the risk of error.

The following information provides high-level model improvement suggestions; a detailed model review was not undertaken and was out of the scope of this engagement.

Improvements can be incorporated into the Commission's existing model or into a new model that may be developed to accommodate the suggested changes to the methodology.

The suggestions are grouped under three headings.

- Improvements at the "workbook level".
- Improvements at the "worksheet" level.
- Improvements at the "cell" level.

Model enhancement considerations at a workbook level include:

- Improving the presentation of the workbook and the results. The addition of a table of contents to the model will increase the useability of the model. The table of contents should be broken down into functional areas i.e. input, calculation and outputs. It would include an overview of the workbook structure and possibly an information flow diagram. The addition of a summary results worksheet, which has no calculations on it, may also be considered to improve the readability of the model.
- Improving the presentation of the printed model. This could include adding ensuring headings, worksheet descriptions, date and page numbers are on every printed page.
- Change tracking. This could include the addition of a time stamp or version number to indicate the source or any revision of the data from external sources.
- Improving model controls. This may include the addition of model integrity checks; the addition of a master check of all individual checks to add to zero to indicate no problems. Another control could be achieved through cell formatting which could restrict the possible

values that are able to be entered into a particular cell. These controls will reduce the risk of error.

- Further protecting the security of the data by applying a password to the workbook. This would act to reduce the risk of accidental changes whilst viewing the model.

Any update to the model would involve updating the Local Government Grants Model Handbook in conjunction with the Database Handbook. These documents include instructions of critical tasks associated with the use of model.

At a worksheet level, the model could be enhanced by:

- Adjusting the flow of the model (position of the worksheets) to make it more user friendly. Worksheets should be ordered so that information flows from left to right although it is acceptable to have results near the beginning of the model. This could assist the user better understand the methodology.
- Indicating which worksheets are inputs, calculations or outputs through the use of coloured worksheet tabs. This would facilitate useability.

At a cell level, the model could be enhanced through:

- Defining all the various shades applied to cells. Currently there is some coloured shading applied to various cells without reference to the reason for the shading. There is value in defining the reason for the current cell shading but also further considering the benefit of applying cell formatting/shading to help define the type of information in the cell (i.e. input, calculation, output). The use of consistent, distinguishable and well thought-out formatting, enhances the structure, layout and readability of a spreadsheet.
- Avoiding hard coding a number into formulae. Imbedding hard-coded numbers into formulae means the model becomes less transparent and less flexible to changes to any future changes.
- Ensuring formula simplicity. Breaking down some complicated calculations into simple 'bite size' formula i.e. avoiding nested IF functions will enhance readability, understanding and transparency of the model.

It is also noted that mapping the grant amount per head by council area can be better performed by using Geographic Information System rather than what has been attempted in the current model, see Section 4.2, Figure 12 for an example resultant image.

Recommendation

The Commission note a number of the issues identified with the current structure of their model and the list of model enhancements that might be made.

9.6 Guidance material

As outlined previously in this report the level of understanding of the currently methodology is low and it was also noted that there appeared to be considerable variability in the classification of expenditure into functions by councils as well as a relatively low overall level of allocation.. While the variability in all allocation has little or no impact under the Commissions current approach there is the potential for a greater impact under the proposed new approach.

It is also noted that over the last two years, there has been a concerted effort by the Commission, a group of local government finance officers, the Local Government Association, the Office of State/Local Government Relations and the Australian Bureau of Statistics to improve the reliability, consistency and comparability of data. Such efforts should continue and it is recommended that the Commission in consultation with this group, look to develop a manual along the lines of that developed by the Victorian Grants Commission to assist Councils to complete the annual return. The Victorian manual is quite prescriptive as to what should and or should not be included within specific functions. Given the quality of the Victorian manual and the many similarities with SA it should be relatively easy for such a document to be established (noting that it can and should be subject to an ongoing refinement process).

Recommendation

The Commission considers the development of a comprehensive manual (along the lines of the Victorian manual) to assist Councils with the completion and associated accuracy of their annual returns to the Commission.

10 Summary of recommendations

The following provides a consolidated list of recommendations made within this report and a reference to the relevant section that the Commission might consider.

- 1 No change to be made to the current approach to the general revenue assessment process. (Refer separate recommendation regarding the use of SEIFA on the revenue assessment process.) (Refer section 7.1)
- 2 Discontinuing the use of a SEIFA based index on the revenue side of the assessment process as this would be duplication if it is included as a cost adjuster on the expenditure side. (Refer section 7.1)
- 3 Other council revenue be netted off against the relevant expenditure function (as per current arrangements) unless it becomes sufficiently material to warrant it being included as a specific revenue function. (Refer section 7.1)
- 4 No change to be made to the current approach to the road expenditure assessment process. (Refer section 7.2)
- 5 Continuing the current approach of including depreciation and excluding capital from the assessment process. (Refer section 7.3)
- 6 Undertaking substantive reform to the other expenditure assessment process. (Refer section 7.4)
- 7 Reducing the number of expenditure function through a consolidation process based on an agreed set of criteria (e.g. minimum percentage of overall council expenditures) whilst seeking to include as close as possible to 100% of the expenditure of councils within the assessment process. (Refer section 8.3)
- 8 Specific criteria as a basis for establishing a set of cost adjusters. (Refer section 8.4)
- 9 An indicative list of expenditure functions and the basis upon which the list has been developed. (Refer section 8.5)
- 10 An indicative list of cost adjusters and the basis upon which the list has been developed. (Refer section 8.6)
- 11 The Index of Relative Socio-Economic Disadvantage (IRSD) as the cost adjuster for all expenditure functions where use of a SEIFA index is required. (Refer section 8.7)
- 12 Removing Function 50 from the Commission's methodology as it is no longer required to achieve any desired redistribution. (Refer section 8.9)
- 13 No change to the methodology is required to take account of the effects of water licensing. (Refer section 9.1)
- 14 No change to the methodology is required to take account of the effects of fixed and variable property rates. (Refer section 9.2)
- 15 The proposed methodological approach outlined in this report with the view that this might form the basis of assessing the waste management function moving forward.. (Refer section 9.3)

- 16 Continuing with the current approach to scaling back from the raw grant to the pool of available funds. (Refer section 9.4)
- 17 A number of the issues identified with the current structure of their model and the list of model enhancements that should be made. (Refer section 9.5)
- 18 The development of a comprehensive manual (along the lines of the VIC manual) to assist Councils with the completion and associated accuracy of their annual returns to the Commission. (Refer section 9.6)

Appendix A Terms of Reference

1. Develop an understanding of the National Principles contained in the Commonwealth legislation – the Commonwealth *Local Government (Financial Assistance) Act 1995*;
2. Develop an understanding of the methodology including a clear understanding of the assessment of general purpose and identified road grants;
3. Review the application of the National Principles contained in the Commonwealth Legislation, including:
 - 3.1. The effects of distribution of Commonwealth Financial Assistance Grants amongst the States based on population share versus distribution within each State based on need (Horizontal Fiscal Equalisation);
 - 3.2. To what extent to the National Principles allow for the distribution of grants in a manner that is consistent with specific policy directions of the Commonwealth and State Governments of the day; and
 - 3.3. The application of the Effort Neutrality Principle in an environment where Commonwealth and State Governments are placing a greater emphasis on accountability and sustainability within local government.
4. Review the current methodology for the assessment of general purpose grants introduced in 1998-99 and subsequent modifications, which includes an assessment of:
 - 4.1. The relevance of the current revenue assessments and the use of property values as a measure of capacity to pay;
 - 4.2. The effects of changes to land valuations which are impacted by water licensing and the impacts of these effects on revenue assessments;
 - 4.3. The effects of fixed rates and variable charges on the assessment of councils capacity to raise revenue;
 - 4.4. The material impact of the use of the SEIFA index adjustments on revenue assessments (for residential and rural assessments) and the effects of further weighting of this index to take account of socio-economic advantage or disadvantage experienced by ratepayers within councils;
 - 4.5. The current number of expenditure functions and the relevance of their units of measure as a determinant of the provision of services by each council;
 - 4.6. The waste management expenditure function to quantify the relative advantage or disadvantage of transferring waste to transfer stations or landfill sites outside of council areas (this may result in an additional or updated cost relativity indices for waste management);
 - 4.7. The expenditure functions and identify possible alternatives to the natural weighting provided by the level of council expenditure reported;
 - 4.8. Any costs of services provided by councils that are not being assessed (or should no longer be assessed) as part of the methodology (e.g., growth, airstrips, traffic volumes); and
 - 4.9. The impacts of including capital expenditure in the assessment process and whether the assessment process should consider capital items in addition to the inclusion of depreciation.
5. Analyse the level of scaling back required under the current methodology and its impact on grant outcomes;

6. Review funding provided to the Aboriginal Communities and the Outback Communities Authority; and
7. Review the distribution of the identified road grants, including an assessment of the feasibility of incorporating the use of Asset Management Plans into the assessment process.

Appendix B Membership of the Stakeholder Reference Group

The following is a list of the members of the stakeholder reference group. A number were invited to the second meeting only

Name, title	Organisation	Date
Rob Schwarz, Assistant Under Treasurer	Department of Treasury and Finance	8/3/13 & 30/4/13
Andrew Wroniak, Chief Finance Officer	City of Playford	8/3/13 & 30/4/13
Steve Wilkinson	Mid Murray Council	8/3/13 & 30/4/13
Debra Larwood, Manager, Corporate Services	Kimba Council	8/3/13 & 30/4/13
Kingsley Green, Manager Corporate & Community Services	Tatiara Council	8/3/13
David Hitchcock, Director, Infrastructure	Local Government Association	8/3/13 & 30/4/13
Peter Fairlie - Jones, Director Finance	City of Salisbury	8/3/13 & 30/4/13
Professor Clem MacIntyre, Head of School of History and Politics	University of Adelaide	8/3/13 & 30/4/13
Steve Mathewson, Director of Finance, Assets and Commercial Viability	City of Onkaparinga	30/4/13
Andrew Stuart, CEO	Mt Barker Council	30/4/13
Cr Jerry Moller and Mark Heinrich	Yankalilla Council	30/4/13
Andrew Cole, General Manager Finance	Kangaroo Island Council	30/4/13
Ron Malcolm and Paul Francis	Adelaide Hills Council	30/4/13
Norm Biggs and Karen Trowbridge	City of West Torrens	30/4/13
John Wright	Department of Treasury and Finance	30/4/13
Henry Inat, CEO	Town of Gawler	30/4/13

Appendix C Stakeholders consulted

The following is a list of all councils KPMG sought submissions from and whether submissions were received or not:

Council	Response received	Council	Response received
Adelaide City Council	✓	Northern Areas Council	✓
Adelaide Hills Council	✓	Norwood, Payneham, & St Peters	✓
Alexandrina Council	✓	City of Onkaparinga	✓
Barossa Council	✓	Orroroo Carrieton Council	x
Barunga West Council	✓	Peterborough Council	x
Berri Barmera Council	✓	City of Playford	✓
City of Burnside	x	City of Port Adelaide Enfield	x
Campbelltown City Council	✓	City of Port Augusta	x
Ceduna Council	✓	City of Port Lincoln	✓
City of Charles Sturt	x	Port Pirie Regional Council	✓
Clare & Gilbert Valleys Council	✓	City of Prospect	✓
Cleve Council	✓	Renmark Paringa Council	x
Cooper Pedy Council	✓	Robe Council	✓
Coorong Council	x	Roxby Downs Council	x
Copper Coast Council	✓	City of Salisbury	✓
Elliston Council	x	Southern Mallee Council	✓
Flinders Ranges Council	✓	Streaky Bay Council	x
Franklin Harbour Council	x	Tatiara Council	✓
Town of Gawler	✓	City of Tea Tree Gully	✓
Goyder Council	x	Tumby Bay Council	✓
Grant Council	✓	City of Unley	✓
City of Holdfast Bay	✓	City of Victor Harbor	✓
Kangaroo Island Council	✓	Wakefield Council	✓
Karoonda East Murray Council	✓	City of Walkerville	x
Kimba Council	x	Wattle Range Council	✓
Kingston Council	✓	City of West Torrens	✓
Light Council	x	City of Whyalla	✓
Lower Eyre Peninsula Council	✓	Wudinna Council	✓
Loxton Waikerie Council	✓	Yankalilla Council	✓
Mallala Council	x	Yorke Peninsula Council	✓
City of Marion	✓		
Mid Murray Council	✓	Anangu Pitjantjatjara Inc	x
City of Mitcham	✓	Gerard Community Council Inc	x
Mount Barker Council	✓	Maralinga Tjarutja Inc	x
City of Mount Gambier	✓	Nipapanha Community Inc	✓
Mount Remarkable Council	x	Yalata	x
City of Murray Bridge	✓	Outback Communities Authority	✓
Naracoorte Lucindale Council	x		

The following is a list of stakeholders that were consulted throughout the project.

Name, title	Organisation	Date
Mary Patetsos, Chair	SA LGGC	Various
Jane Gascoigne, Commissioner	SA LGGC	Various
John Ross, Commissioner	SA LGGC	Various
Peter Ilee, Executive Officer	SA LGGC	Various
Colin Morrison, Director, Governance and Funding Programs	Local Government VIC	6/3/13 & 28/3/13
Ross Earnshaw, Manager, Structural Reform	Department of Local Government, Western Australia	6/3/13
Bruce Wright, Executive Officer	Grants Commission, Department of Premier and Cabinet, NSW	8/3/13
Wendy Campana, CEO	Local Government Association	6/3/13
Chris Russell, Director, Communications	Local Government Association	6/3/13
Mick Petrovski, Director	Office for state / local government relations	4/3/13
John Wright	Department of Treasury and Finance	27/2/13
Rob Schwarz, Assistant Under Treasurer	Department of Treasury and Finance	13/2/13
Mark Elford, Executive Director	Department of Planning, Transport and Infrastructure	28/2/13
Don Hogben, Director, Road Policy and Planning	Department of Planning, Transport and Infrastructure	28/2/13
Dr Matasha McConchie, Assistant Secretary, Territories, Local Government and Disaster Policy Branch	Commonwealth Department of Regional Australia	4/3/13
Dermot Doherty, Assistant Secretary	Commonwealth Grants Commission	21/2/13, 2/4/13, 3/5/2013
Mark Gwynne, Manager, Local Government Statistics Unit	ABS	21/2/13
Karan Coombe-Smith, Acting Manager, Aboriginal Policy and Statewide Team, Aboriginal Affairs and Reconciliation Division	Department of Premier and Cabinet	6/3/13
Jacqueline Allan, Assistant Director, Local Government Engagement Team	Department of Regional Australia, Local Government, Arts and Sport	4/3/13
Richard Preece, General Manager	Anangu Pitjantjatjara Inc.	7/3/13
Greg Moore, CEO	Nipapanha Community Inc.	18/2/13
Greg Franks, CEO	Yalata Community Inc.	28/2/13
Mark Sutton, General Manager	Outback Communities Authority	8/3/13
David Hitchcock, Director, Infrastructure	Local Government Association	6/3/13

Appendix D Rationale for proposed treatment of existing SA functions

Current SA Function	Current % of expenditure	Current driver	Justification for change	Proposed new function	Proposed driver	Data source for proposed driver
Function 7: Waste management	12	Number of residential properties	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Public order and health and waste management	Number of dwellings	Local Gov.
Function 8: Aged care services	3	Population 65+	<ul style="list-style-type: none"> No change justified (meets all criteria already) 	Aged care services	Population 65+	ABS
Function 10: Services to families and children	1	Population 0-14	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Family and community services	Population	ABS
Function 12: Health inspection	1	No. of establishments to inspect	<ul style="list-style-type: none"> Consolidation of a small expenditure; Similar driver for each consolidated function; Driver used in other states 	Public order and health and waste management	Number of dwellings	Local Gov.

Current SA Function	Current % of expenditure	Current driver	Justification for change	Proposed new function	Proposed driver	Data source for proposed driver
Function 15: Libraries	7	No. of visitors	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function Ensure quality independent driver data 	Family and Community services	Population	ABS
Function 18: Sport and recreation	16	Population 5-49	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function 	Recreation and culture	Population	ABS
Function 33: Stormwater drainage maintenance	4	No. of urban properties	<ul style="list-style-type: none"> No change (meets all criteria already) 	Stormwater drainage maintenance	No. of urban properties	ABS
Function 34: Cultural and Tourist facilities	7	No. of Service Industry employees	<ul style="list-style-type: none"> Consolidation of similar services 	Recreation and culture	Population	ABS
Function 35: Community support	6	Pop. SEIFA advantage/disadvantage	<ul style="list-style-type: none"> Consolidation of similar services Similar driver for each consolidated function 	Family and community services	Population	ABS
Function 38 Jetties and wharves	0	No. of jetties	<ul style="list-style-type: none"> Consolidation of a small expenditure 	Recreation and culture	Population	ABS

Current SA Function	Current % of expenditure	Current driver	Justification for change	Proposed new function	Proposed driver	Data source for proposed driver
Function 40: Public order and safety	2	No. of properties	<ul style="list-style-type: none"> Consolidation of a small expenditure 	Public order and health and waste management	Population	ABS
Function 41: Planning and building control	6	No. of new developments and additions	<ul style="list-style-type: none"> No change (meets all criteria already) 	Planning and Building control	No. of new developments and additions	Local Government/State Government
Function 50: Other needs assessment	na	Set at 1	<ul style="list-style-type: none"> Not a component of council expenditure No longer needed to achieve desired redistribution 	Intent addressed through functions and cost adjustors		

Appendix E Document analysis

The following is a list of documents referenced in the project.

Document
Walsh, C. 2011. The impacts on councils' relative fiscal capacities of differential rates of growth: possible implications for SALGGC's methodology
Tonkin Consulting. 2012. Audit of road length data: update log & road lengths as at 30 June 2011
SALGGC. 2006. Review of use of depreciation and examination of the expenditure assessments used in the calculation of the general purpose component of the financial assistance grants: Final report to Commission
SALGGC. 2004. Summary of outcomes for the 2002-03-04 review of methodology: "Review of the use of property values as the sole indicator of capacity to raise revenue"
Tonkin Engineering. 2008. Cost Relativity Indices: Stormwater maintenance
Tonkin Engineering. 2004. Traffic Volume CRI study: Summary report.
Ilee, P. 2011. Final discussion paper – Traffic volume
Burgon, B & Spoehr, J. 2011. Federal assistance grants to local government review: Final report
Moller, J. 2012. Issues related to the SA Grants Commission funding allocation system for the Yankalilla District Council
South Australian Government. 1995. Submission by SA to the Commonwealth Grants Commission: Review of the Commonwealth (Local Government) Financial Assistance Act 1995
South Australian Local Government Grants Commission. 2011. Annual Report 2010-11.
SA LGGC. 2007. The Local Government Grants Model handbook
SA LGGC. 2008. Methodology and functional calculations
SA LGGC. 2012. Local Government financial statements & supplementary return
SA LGGC. 2012. General information return
SA LGGC. 2012. General information return: Part 3.1 Road lengths and construction
Commonwealth Grants Commission. 2001. Review of the operation of the local government (financial assistance) act 1995
South Australian Local Governments Grants Commission Act 1992
Local Government (Financial Assistance) Act 1995
SALGGC. 1998. Summary of outcomes for the 1997-98 review of methodology
Commonwealth Government. 2009-10. Local Government national report – 2009-10 report on the operation of the <i>Local Government (Financial Assistance) Act 1995</i>
Local Government Association of South Australia. 2013. Financial Assistance Grants review – Local Government Association of SA submission to the Commonwealth Grants Commission
Local Government Association of South Australia, 2013. Taxation Review – Submission to the South Australian Parliaments Economic and Finance Committee.
Commonwealth Grants Commission, 2012. Review into improving the impact of Financial Assistance Grants on Local Government Financial Sustainability – Issues paper
Milbur & Spiller Gibbins Swan Pty Ltd for the VIC Grants Commission. 2001. Review of the allocation of general purpose grants to VIC n councils: Final report – May 2001

Document
Milbur Consulting for the VIC Grants Commission. 2003. Allocation of General Purpose Grants: Review of Standardised Revenue Assessment – Discussion Paper.
VIC Grants Commission. 2013. VIC Grants Commission Allocation Information 2012-13
VIC Grants Commission. 2012. VGC Questionnaire Manual
VIC Grants Commission. 2012. General Purpose Grants Model (cost adjustors)
VIC Grants Commission. 2010-11. VIC Grants Commission Annual Report
WA Local Government Grants Commission. 2012. Overview of the new general purpose grants methodology.
ABS Cat. No. 1351.0.55.015, Research Paper: Socio-Economic Indexes for Areas: Introduction, Use and Future Directions, September 2006