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OFFICE OF THE MAYOR

Ref: 24/6413

13 March 2024

Carmel Donnelly PSM
Chair
IPART
PO Box K35
HAYMARKET POST SHOP
NSW 1240

Dear Ms Donnelly

RE: DRAFT TERMS OF REFERENCE FOR IPART NSW COUNCIL FINANCIAL MODEL REVIEW JANUARY 2024

I refer to the abovementioned Draft terms of reference released for consultation by IPART on 12 February 2024.

Council considered the matter at the Ordinary Meeting of 21 February 2024 and resolved to prepare a submission to address the draft Terms of Reference and issues around financial sustainability. We appreciate the opportunity to provide input into the issues raised.

Our submission structure provides a background to our Shire accompanied by relevant commentary regarding issues over financial sustainability in local government, but particularly affecting Dungog Shire Council. We also provide a comment on the draft Terms of Reference and we then separately address the questions raised by IPART in the draft Terms of Reference.

Background to Dungog Shire and our Financial Sustainability

Dungog Shire Local Government Area occupies an area of 2,251 square km in the Hunter Region of NSW. The Shire has a population of 9,722 (*ABS ERP 2022*) and small rate base of only 5,109 ratepayers. The shire is responsible for a large road network, with around 731km of roads under management.

The Dungog Shire is the only local government area in NSW without a state road, meaning the Council is responsible for funding the maintenance and construction of its extensive road network with a very small rate base. This is the critical issue relating to our ongoing financial sustainability.

Compounding the issue, is the location of large state owned assets, including National Parks, State Forests and water catchments which occupy over 23% of the land area and which are unrateable. Over 80% of the water supply for Greater Newcastle and the Lower Hunter is supplied directly from the Dungog Shire, with catchment restrictions impacting on development potential.

The Shire is a critical part of growth plans for the Hunter region as a result of this water dependence. With a population growth rate of 1.99% annually (2023 ABS) the Hunter Regional Plan 2041 forecasts the population of Dungog Shire to grow to 14,374 by 2041 with an additional 2400 homes projected to be constructed during the life of the Plan. This is second only to Maitland City Council area in NSW.

In terms of Dungog Shire Council's financial sustainability, we are heavily dependent of external grant funding to deliver the works and services our community need and expect. Council's own source operating revenue was 31.99% in 2022/23 which has declined from 35.34% in 2021/22 and 47.66% in 2020/21. The NSW Office of Local Government benchmark is >60%.

Whilst 73% of our total expenditure will be on roads and bridges (2023/24), 86% of the capital works program is grant funded. Council's road infrastructure backlog in 2022/23 was \$26Million (indexed) and our endorsed Capital Works Program for the current financial year is approximately \$42Million.

The variability of government grant funding makes it difficult to plan ahead to consistently manage and deliver capital works and clear infrastructure backlogs. There is greater risk of an inability to deliver our works and capital projects without greater funding certainty. The NSW Government should streamline as far as practicable grant programs across agencies with a view to long term and consistent streams of funding to address this variability.

This clearly shows the financial difficulties of maintaining a large infrastructure network with a small population and rate base.

The questions to be asked in the IPART Draft Terms of Reference need to address the underlying issue of funding for the local government sector and must seek to understand and interrogate inequity in funding models. Looking simply at the IPR Frameworks and asking questions about Councillors roles and responsibilities is missing the real underlying issue of the funding model.

Comments on the Draft Terms of Reference

Own Source Revenue and Grant Dependency

The terms of reference should address the issue of grant dependency because the financial performance of city, regional and rural councils is a transition towards it. It is also a transition away from easy access to government services and facilities towards only basic services. And this is accompanied by different community expectations.

Yet the NSW Government measures financial performance with equal terms as if Councillors and management of rural councils can overcome the realities of low population density and inadequate own source revenue to maintain infrastructure etc.

The terms of reference should consider introducing different parameters for assessing the financial performance of city, regional and rural councils, and at what point grant dependency is acceptable. For instance, an LGA having 23% of its area exempt from paying rates should not be compared on equal terms with less affected councils.

The proposed terms of reference seem to offer further means to scrutinize and evaluate financial performance and councillor responsibility/ accountability in budgetary aspects rather than addressing the root cause of the problems. It is considered the terms should be broader to provide more depth and meaning to the process. The terms should include greater investigation of the local government funding models which underpin all Councils across NSW, rather than simply focusing on the suitability of the corporate planning, elected leadership and operations of Councils themselves.

Increasing administrative costs through further scrutiny and extra committees will be counter-productive for grant dependant Councils, which lack the necessary staff capacity. For them, escalating bureaucracy is a major concern because it detracts from the delivery of basic services.

We feel the focus of the Terms of Reference are too narrow in that regard and will do little to assist IPART, of the Government, to understand the true nature of the inadequacies of the current inequitable funding models.

Our submission outlines the basis for our concerns over the local government funding model to assist IPART broaden the draft Terms of Reference accordingly. Some more pertinent questions to ask may include:

Does the methodology utilised by the Grants Commission of NSW to distribute the Block Grants and Financial Assistance Grants on behalf of the Commonwealth, result in an equitable distribution of funds to the council in need of the funding? The Grattan Report (Potholes and Pitfalls: How to fix local roads, released in November 2023, clearly exposed the significant *underfunding* of the current Federal Financial Assistance Grants (FAG) provided to Council. Clearly there is also a difference in simply increasing funding in addition to how that funding is equitably distributed.

The terms of reference should examine how the reduction in real value of the FAGs has affected local government finances. In 1996 the quantum represented about 1% of Commonwealth taxation revenue and now it represents about 0.5% because the grants are adjusted for the CPI, which bears no relation to the delivery of services.

In 1995-96, the Total Pool of FAGs was \$1,159,600,000 and by 2023-24, it had increased to \$3,246,707,973.

If FAGs were to comprise 1% of Commonwealth taxation revenue in 2023-24, the total for distribution to the States would have been \$5,381,000,000 – a difference of \$2,134,292,027.

And NSW would have received 32.63% of that or \$1,755,820,300 instead of the \$996,598,246 provided.

In 1995-96 FAGs for Dungog Shire was \$906,840 GPC and \$484,684 LRC for a total of \$1,391,524

In 2023-24, Dungog Shire received \$2,239,141 GPC and \$1,158,154 LRC for a total of \$3,397,295.

However, if FAGs represented 1% of CTR, Dungog Shire would have received a total of \$5,985,400 and many millions would have been foregone between 1996 and 2024.

In Council's submission to the NSW Grants Commission in June 2023, we outlined our concerns over the inequitable block grant funding model, which results in lower levels of funding to Dungog Shire for the same roads which received significantly greater funding in the immediately adjoining local government areas administered by Port Stephens Council and Maitland City Council. Further, when requested to provide details on specifics of the funding distribution methodology (eg rainfall and topography) the Grants Commission was unable to provide the information and was unaware of where to find it.

Previous Reviews

This IPART Review will be the seventh review in 20 years, commencing with the LGSA Independent Inquiry of 2004 and then a further six reviews of the NSW Government culminating in the 2014 Independent Review Panel, which concluded that:

"too many councils face serious financial problems... far-reaching reform is essential ... current arrangements simply cannot maintain strong and effective local government for the majority of communities and regions across the State" ... "some amalgamations must be considered if we really want stronger and more effective local government" and "there is still considerable room to improve local government's efficiency and effectiveness, and to ensure that councils are properly accountable to their local community for their performance."

Reference: <https://www.parliament.nsw.gov.au/lcdocs/other/9002/OLG%20presentation%20to%20NSW%20LC%20Inquiry%20FINAL%20version.pdf>

The terms of reference for the 2024 IPART Review should include full consideration of the findings of the seven reviews preceding it and subsequent actions taken.

Amalgamations

In response to these reviews, the number of councils has been reduced from 172 to 128 through forced and or voluntary amalgamations. Fit for the Future benchmarks indicated weaker councils without addressing why they lacked the financial capacity.

The terms of reference should include an assessment of whether they provided better services, achieved improved financial performance and/or addressed infrastructure backlogs.

(In response to concerns about this, the NSW government recently introduced a process for de amalgamation.)

The IPART Review should be addressing these concerns in the Draft Terms of Reference.

Responses to Questions and Draft Terms of Reference

1. The visibility of Councillors and the community over the financial and operational performance of their councils

- Are the mechanisms for reporting on council performance clear and understood.

Our Response

The IP&R framework provides an effective tool that provides regular reports on council performance to the elected body and community including monthly cost reports and investment reports to council, quarterly performance and financial reporting and annual financial and performance reporting. Councillors understand the process and while the number of public submissions and community engagement opportunities will vary according to the stages of the IPR Process, it would appear that communities understand they can provide input into the process for consideration, and that this can influence outcomes in decision making.

- Does the accounting code for local government provide meaningful financial information to enable Councillors to understand and influence the financial and budget performance of their council. Is there a need to update the performance indicators to make them more useful for 'real time' monitoring.

Our Response

Real time would be useful however, this relies on the capacity of financial systems, small rural and regional councils are not able to resource such systems. Ratios require adjustment to ensure they are equitable to all councils. Many smaller rural Councils, such as Dungog Shire, are heavily reliant on grant funding and are unable to meet certain ratios and still deliver on community aspirations (road network). For example, approximately 70% of Council's revenue is derived directly from grants and contributions from the Commonwealth and State. Council is unable to deliver the required backlog of works in our Delivery Program without those grants and contributions. Our rate base is too small to fund the existing road network of over 731km.

Our elected Councillors are acutely aware of the financial challenges and decision making reflects these considerations in our annual budget and operational planning.

- Are Councillors receiving timely and appropriate information to enable decisions on allocation of public funds in an efficient and cost effective way.

Our Response

Dungog Shire Councillors receive monthly budget reports, monthly works expenditure reports, monthly works progress reports and quarterly budget review reports to outline any variances to revenue and expenditure. Additionally, following several years of quarterly reports on the delivery program (aligned with the quarterly budget reports), Council reintroduced 6 monthly reporting in accordance with the IPR Framework. It is considered more than adequate information and timeframes exist to enable efficient and cost effective decisions by the Council.

- Are there benefits to moving to dedicated budget or expenditure review committee models to ensure budget decisions are understood by Councillors and the communities they serve?

Our Response

There is no perceived benefit for small rural and regional councils to implement more committees mainly due to the impost of additional compliance requirements and allocation of resources with no revenue generating capacity. To move in this direction would be considered unnecessary and overkill on top of other recent reforms and cost shifting from the NSW

Government such as new Audit Risk and Improvement Committee requirements and comprehensive Modern Slavery requirements.

Moving to these models will likely have timing implications with flow on effects of possibly causing or adding to delays in implementation of projects, supply chain issues and associated cost implications. Any decision by the NSW Government to introduce more requirements to this effect will further adversely impact our resourcing ability and financial sustainability.

2. Whether the current budget and financial processes used by councils are delivering value-for-money for ratepayers and residents

- Is the Integrated Planning and Reporting process, currently used by councils to make budget decisions, effective in allowing Councillors to engage with the community on the challenges in setting a budget and meeting service level expectations.

Our Response

*This will be dependent on the robustness of and individual Council's community engagement strategy. Strategies based on accepted and industry leading methodologies *(such as IAP2) will provide multiple opportunities for engagement in decision making. The main challenge is to ensure the community is aware that sticking to the delivery plan is the best way to deliver on the community vision and that the delivery program is prepared with engagement from across the community not simply the loudest voices on a particular issue during the delivery cycle.*

- How well Councils are setting service delivery standards that match revenue, managing their expenses within allocated budgets, and what opportunities exist for improvement in efficiency, service quality and sustainability.

Our Response

Community Strategic Plan (CSP) objectives are often beyond council capacity which is reflected in the heavy reliance on grant funding to deliver infrastructure expected by the community. The CSP is an aspirational document that encourages the governing body to try and meet community expectations, but also manage those expectation of "what we want" versus "what we can afford". The theory of asset management planning to assist in setting service level objectives is paramount however not always effectively implemented due to resourcing constraints and staff capacity.

Uncertainty with annual Rate pegging does not allow council to effectively undertake long term planning, nor does cost shifting from other levels of government. Heavy reliance on grants is also not an effective way to plan long terms. Variability in those external sources of funding mean planning for the workforce needed to deliver on the community vision is difficult. Both imposes impact/influence service delivery standards and budget decisions and impact delivery of works and services. This in turn can adversely impact on confidence in the Council.

- How to visibly boost elected Councillor accountability for council budgets and expenditure to the community

Our Response

This should be considered through NSW Government funded education, training and communication. In referring to our earlier comments about the terms of reference, we question the value of the question when the issues affecting financial models for local government are sector wide, not dependent elected councillors.

3. Whether the current funding model will sustainably support the needs of communities

- How do councils balance cash flow to manage the different {and sometimes uncertain}, time frames for revenue and grants money {including Financial Assistance Grants}. coming into council

Our Response

Currently the only ability small rural Council's such as Dungog Shire have in this regard, is by committing amounts to internal reserves and creation of reserves by "squirrelling" away small amounts as and when they become available. During annual external audits, matters of cash flow as a result of the myriad of grant funds received and expended are consistently raised as high risk. This will be an ongoing issue for Dungog Shire Council given our heavy reliance on grant funds. Consistent approaches from the NSW Government Agencies in the distribution of grants could assist in how this issue is managed to alleviate the pressure on Council reserves.

- How effective are councils in identifying and using other revenue sources beyond grants and rates to support the needs of communities and sustainably provide services required to be delivered by councils.

Our Response

Other revenue sources beyond grants and rates are very few and inconsequential in rural and regional areas to assist in sustainable service delivery. Fees and charges rarely cover the cost of services provided. Case in point, development application fees are set by the NSW Government and not Councils. They do not cover the cost of development assessment and place further burden onto the ratepayer to fund the service. This further erodes the financial position of the Council.

Dungog Shire has endorsed a strategic property management program to seek alternate sources of own source revenue by optimising the use, disposal or acquisition of property assets. The program is in its infancy and staff capacity is proving to be an issue in progressing the program.

- Identify measures to put downward pressure on rates through other own source revenue or closer scrutiny of expenditure.

Our Response

See comment above.

- Consider the needs of diverse communities and councils and protect the interests of current and future ratepayers from unnecessary impact on their cost of living.

Our Response

The uncertainty and inequity of grant funding impacts councils ability to plan and deliver efficient and effective service delivery to the community. Cost shifting from state government contributes to the impact on ratepayers cost of living. The increasing compliance burden has also been challenging to fund and resource as these costs are passed onto council without any way of increasing revenue.

4. Whether councils (both Councillors and staff) have the financial capacity and capability to meet current and future needs of communities.

- Are councils equipped with the right internal capabilities to deliver on the services which their community requires?
- Has the Audit Mandate been successful in providing a consistent view on the accounting and risk management practices of councils?

Our Response

We have addressed the diminished financial capacity of Council earlier in the submission. Further to this, smaller Councils consistently struggle to attract and retain the best and brightest staff needed to deliver the services and works expected by communities. Being under resourced and with lower levels of staff, often with one or less than one person employed to carry out a specific function, staff turnover results in extended vacancies and services which simply cannot be delivered until recruitment processes are completed. Larger council do not experience this same issue given functions are often delivered by larger teams of staff who can

help to cover during vacancies. Attraction and retention of staff is an enormous challenge for the smaller rural councils with reduced financial capacity to match larger salaries and wages in metropolitan and larger regional centres. Further to earlier comments, the terms of reference really need to address the underlying financial funding models to help address and improve this capacity across the sector.

The Audit mandate across all councils, regardless of size, has been unreasonable and contributed to an unreasonable increase in compliance costs. For example, the Audit Office of NSW increased the cost of the annual audit from \$40,000 to \$110,000 in one year. Council has no option but to pay. This is unacceptable and has not been subject to a competitive procurement process. In our view, the consistency across councils by the NSW Audit Office has certainly been evident through an excessive level of scrutiny which had contributed to psychosocial risk to our finance personnel and excessive delays in the delivery of Annual Financial Statements.

- Are there opportunities to look at long term expenditure and service delivery improvements by insourcing services? Where outsourcing models have been used, do they provide an efficient and effective means of meeting community needs?

Our Response

Yes, however opportunities are not always readily available or cost effective in rural and regional areas to assist in effective and sustainable service delivery.

- What examples of best practice capability building and innovation could be implemented more widely?

Our Response

See comment above, rural and regional areas have limited resourcing and capacity to be innovative.

5. How can better planning and reporting systems improve long term budget performance, transparency and accountability to the community?

- How effective councils are in managing their assets and planning for future growth and renewal of assets.
- Whether current community engagement allows for effective long-range planning and sustainable funding.

Our Response

The question is only looking at the surface of the issue. The IPR Framework includes resourcing strategies which cover Asset Management Strategy and Plans. The real issue facing Council is the inability to fund the basic level of staffing and expertise required to deliver on the Asset Management Strategies and Plans. Again, the terms of reference need to address the financial models underpinning the funding of the sector in order to address the broader issue.

We have addressed community engagement earlier in the submission and while we believe the current framework allows for effective long range planning, it cannot possibly address sustainable funding without an overhaul of the funding models which underpin the sector.

- Whether the current framework of reporting and compliance is appropriate and effective.

Our Response

In simple terms, the current compliance requirements impose additional resourcing requirements on rural and regional councils which then impacts on their capacity to plan and implement improvement.

6. Any other matters IPART considers relevant.

Our Response

We have outlined earlier in the submission our views on the Draft Terms of Reference, in the context of Council's financial sustainability challenges.

The terms of reference cover matters identified by IPART in the review of the rate methodology last year in terms of accountability, transparent governance, streamlined frameworks and better engagement with the community.

These terms of reference do not cover the inequity in the distribution of the Financial Assistance Grant nor the RTA Block grant. The investigation of council financial models in NSW would be better served looking to identify measures to improve the capacity of small and diverse councils to increase own source revenue to support the needs of their communities and sustainably provide services required to be delivered by councils.

Other measure to consider include ensuring statutory fees and charges reflect the actual costs of providing these services.

It is also suggested that IPART review rates exemption criteria for government agencies and land assets – almost 23% of councils area is non rateable due to National Parks and State Forests.

We appreciate the opportunity to provide our feedback into the Draft Terms of Reference and look forward to further opportunities during the review itself.

If you would like to discuss our submission, please telephone the Office of the General Manager on [REDACTED] during business hours.

Yours faithfully

[REDACTED]

[REDACTED]