

TRANSCRIPTS

STANDING COMMITTEE ON THE ENVIRONMENT AND PLANNING

Inquiry into rate capping policy

Melbourne — 4 August 2015

Members

Mr David Davis — Chair	Ms Samantha Dunn
Ms Harriet Shing — Deputy Chair	Mr Shaun Leane
Ms Melina Bath	Ms Gayle Tierney
Mr Richard Dalla-Riva	Mr Daniel Young

Participating Members

Mr Jeff Bourman	Mr James Purcell
Ms Colleen Hartland	Mr Simon Ramsay

Staff

Secretary: Mr Keir Delaney

Research assistants: Ms Annemarie Burt and Ms Kim Martinow

Witnesses

Mr Steve Vlahos (sworn), assistant auditor-general, infrastructure, investments and environment,

Mr Tim Loughnan (sworn), financial audit sector director, local government, and

Mr Andrew Evans (affirmed), performance audit sector director, local government, Victorian Auditor-General's Office.

**Necessary corrections to be notified to
executive officer of committee**

The CHAIR — I thank the three witnesses, and ask them to make a brief opening statement, noting the importance of the Auditor-General's office and his auditing of local government, but noting also that I do not anticipate we would complete the discussion today.

Mr VLAHOS — Thank you, Chair, that is no problem at all. Also, thank you for inviting us to speak to the committee today on our submission. The Auditor-General sends his apologies as he has another engagement in Ballarat today as part of his commitment to working more closely with regional Victoria.

My name is Steven Vlahos, and I am one of the two recently appointed assistant auditors-general, responsible for managing the Auditor-General's performance audit program. My portfolio covers infrastructure, investments and the environment, which of course encompasses local government. As you know, the role of the Auditor-General is to provide assurance to Parliament on the performance and accountability of the Victorian public sector, and for this reason we value the opportunity to participate in inquiries of the committees of the Parliament to share the insights from our audits.

Today we are pleased to discuss three audit reports that we hope may offer some useful insights to the committee on its inquiry into rate capping. My colleague Andrew Evans will present on the performance audits regarding rating practices in local government, which we tabled in February 2013, and asset management and maintenance by councils, which we tabled in February 2014. Our financial audit colleague, Tim Loughnan, will also present relevant results from our annual report on financial audits in the local government sector.

Before I hand over to my colleagues, I want to mention a few key points. Firstly, we should remind the committee that section 16 of the Audit Act precludes the Auditor-General from questioning the merits of policy objectives, and for this reason our evidence today will not comment on the merits of any proposed policy on rate capping. Instead we will provide the committee with some insights from our reports that I have just mentioned, which we hope will inform your consideration of any rate capping policy.

Secondly — and I am sure committee members are aware of this — the Audit Act also precludes us from disclosing any confidential information that we have gathered during the course of an audit other than through a report to Parliament, so in practice what that means is that VAGO representatives here today will not be able to answer any questions that go beyond what has been tabled in a report to Parliament. On that note, I would like to hand over to our directors to give you a quick briefing and take any questions you might have.

Mr EVANS — As Steve mentioned, I am going to give a brief overview of two reports, *Rating Practices in Local Government* and *Asset Management and Maintenance by Councils*. I am really going to highlight some key points included in our submission which the Auditor-General thinks are relevant to the inquiry. I will start with the rating practices audit. Overall this audit found inconsistencies in the rating practices of local councils and with the quality and soundness of rating decisions. I will take you through a couple of issues and key points from that report which are of relevance.

We experienced difficulty in identifying directly comparable data for rates and charges across councils. This is due to the different ways in which councils reported average rates and charges. It initially makes it quite difficult to compare councils. Some of the issues include the fact that councils reported their average charges using either a mean or a median, which are quite different, and they averaged them over all ratepayers, or some would only average them over residential ratepayers. Rates and charges totals may or may not include supplementary rates, and I am sure, as the committee would realise, these can be quite significant for some councils. This is after the budget. Even the statutory disclosures on rates and charges required under the local government finance and reporting regulations were prepared inconsistently across councils. So we found, overall, that reporting on rates and charges data needs to be improved, and that standardisation across municipalities would make it easier to interpret and compare data.

Secondly, we found variation in how councils interpreted and applied some of the key rating principles in the legislation, as well as in the content and quality of their rating strategies. Key principles such as equity and stability, which are in the Local Government Act, are not defined, so this means councils must really determine their meaning and how they are applied in practice. Overall, however, about half of the audited councils defined their rating principles well, particularly equity, with only a third defining their overall objectives for their rates and charges well.

Half of the audited councils poorly defined the objectives of specific rating categories, with many using only broad generic objectives, particularly for their differential rates. We found wide variability in the content and quality of rating strategies as well as in annual budgets where the content, depth and transparency of rating sections varied considerably. Overall, key considerations and drivers behind rating decisions were often not clearly identified in either rating strategies or council budgets. Only a third of the audited councils performed well in terms of demonstrating an understanding of how rates contribute to their council plans and their strategic resource plans, in identifying key drivers that would impact on their rate revenue requirements and in regularly reviewing their rating structures and decisions.

Thirdly, on this audit there was also considerable variation in the depth and quality of community engagement. Councils primarily rely on the annual budget development process to engage ratepayers about rating proposals. While audited councils did respond to rate-related submissions from ratepayers, they generally did not explain the basis for their rating decisions on the matters that were queried. We think engagement and communication could be improved by providing better information on how and why rating decisions are made, reporting on the outcomes affecting ratepayers, and by better considering and acquitting ratepayer concerns and objections. We also think councils should explore more effective methods of engaging with communities beyond the traditional budget information sessions, use their rating strategies as a communication tool, and consider making greater use of some newer tools such as social media.

We note that councils have reported, through our follow-up audit process, that they were responding to and monitoring progress against the majority of the recommendations we made in this audit, with the exception of the recommendation relating to developing and implementing comprehensive ratepayer communication and engagement strategies, which has been slow.

Our submission also points to some key findings from our report *Asset Management and Maintenance by Councils*, and I will just touch on a few points from that one. The report found that spending on existing assets is not keeping pace with their consumption. Audited councils were not budgeting to meet existing asset renewal requirements, that is to maintain, renew and replace existing assets, resulting in cumulative renewal gaps growing each year. This may adversely impact the condition of assets, service levels and councils' long-term financial sustainability. For 2011–12 the five audited councils budgeted around 14 per cent less than was required to meet their renewal gap, and there was a similar shortfall of 16 per cent for the five-year period to 2015–16.

In this audit we also came across many examples of assets that audited councils considered surplus to their needs, including council buildings and swimming pools. Disposing of these assets could reduce councils' asset management liabilities.

The audit also found there are significant differences in expenditure against capital works budgets, and particularly underspending. While there were generally explanations for underspending, such as work delays, reprioritisation or reallocation of works or unplanned works, the large and consistent deviations from budgets for some councils point to a need to better integrate their capital works budgets and programs with asset management plans and long-term financial plans.

I will now pass over to my colleague Tim Loughnan to briefly talk about financial audit results.

The CHAIR — For 5 minutes, because I am ready to call a halt.

Mr LOUGHNAN — Thank you. In the Auditor-General's report to Parliament, *Local Government — Results of the 2013–14 Audits*, the report identified that to be financially sustainable councils need to be able to meet current and future expenditure as it falls due. Councils must also be able to absorb foreseeable changes and the effect of financial risk materialising.

When considering the financial sustainability risks, we consider there are six indicators. Those indicators are: the underlying result or profitability of the council; liquidity, or a council's current assets compared to their current liabilities; the level of indebtedness of the council; self-financing, or the ability to replace assets using cash generated by the entity's operations; capital replacement, comparing capital expenditure with depreciation; and the renewal gap, or comparing renewal and upgrade expenditure with depreciation.

In the report we concluded that local councils as a whole had a low financial sustainability risk. We identified five councils that were assessed as a high financial sustainability risk, compared to two that were identified in the prior year. Twenty-one of the councils reported an underlying deficit compared to eight in 2012–13, and 33 councils were rated as high or medium self-financing risk compared to 27 in the prior year.

The observation that I make in regard to rate capping is that the introduction of a cap will obviously impact upon a council's ability to raise revenue from rates, although I note that it is proposed that councils may be able to seek a variation to that cap.

Those are the specific comments that I would like to make.

The CHAIR — In the circumstances, we might conclude now. Again, I apologise that we have not had the full time with this important Auditor-General's office and would look to see an opportunity for that to continue at a mutually convenient point. I thank you for your attendance.

Committee adjourned.