**AECGROUP COMPLETES SEMINAL RESEARCH PAPER ON LOCAL GOVERNMENT FINANCIAL SUSTAINABILITY FOR THE LOCAL GOVERNMENT ASSOCIATION OF QUEENSLAND (LGAQ)**

There has been much research on the topic of Local Government financial sustainability, although most of this research has been undertaken at a macro level without appropriate consideration given to the unique characteristics faced by different Local Governments. The broad brush recommendations arising from this research is therefore unlikely to be relevant to the majority of Queensland Councils given their unique characteristics.

Further, Local Government financial sustainability has generally been evaluated using credit ratings agency concepts of creditworthiness and the riskiness of repaying borrowings under a range of economic conditions such as external shocks, rather than continuity of services and infrastructure maintenance necessary in a Local Government context.

Some improvement in the application of appropriate financial sustainability measures to Queensland Local Governments has been made in recent times, with the release of the Financial Management (Sustainability) Guideline – June 2013 which focusses on three key measures:

- The Asset Sustainability Ratio, which reflects the extent of renewals relative to depreciation.
- Operating Surplus Ratio, which reflects the net operating result relative to operating revenues.
- Net Financial Liabilities Ratio, which reflects the extent of liabilities relative to operating revenues.

While the above measures of financial sustainability provide a means of assessment, it is important to understand the ***different factors influencing financial sustainability for different types of Local Government***s. LGAQ commissioned AEC*group* (with assistance from Orion Consulting Network) to fill this identified research gap, with a focus of the research being on the factors influencing financial sustainability on the Council 'segments' in the following table. (It is acknowledged that some Councils may feature characteristics akin to two or more of these segments, in which case outcomes and recommendations for multiple segments would be applicable.)

| Council Segment | Brief Description |
|---|---|
| Indigenous | Councils based in Indigenous communities (representing Indigenous Australians and Indigenous Torres Strait Islanders). |
| Rural/Remote | Councils located predominantly west of the Great Dividing Range which are geographically large, but contain populations of less than 10,000 residents. |
| Rural/Regional | Councils located inland which are geographically large and contain populations of greater than 10,000 residents. |
| Resources | Councils located in, or adjacent to, Queensland's key mining regions/basins, where their operations are impacted by current or proposed resource activity and whose economies are heavily influenced by the mining and mining-related sectors. |
| Coastal | Councils principally located along the Queensland coast line. |
| South-East QLD (SEQ) | High capacity and capability Councils located in SEQ, managing high population growth. |

The Queensland Audit Office (QAO) indicates that close to one quarter of Queensland Councils face a high risk of financial sustainability issues, despite Local Government reforms and amalgamations. This is consistent with the findings of a recent survey of Queensland Councils by AEC*group*, with 23% of Councils nominating that they are either challenged or severely challenged in terms of their financial sustainability outlook.

The biggest (common) issues identified in the survey included concerns surrounding the renewal of ageing infrastructure, given an inability to source appropriate levels of internal and external funding for such works, and concerns surrounding constrained and reduced funding assistance from the State and Commonwealth Governments in addition to uncertainties surrounding external funding moving forward.

The following dot points provide a snapshot of some of the key financial sustainability 'game-changers' identified in the research paper, which presents a comprehensive evaluation of all available Local Government datasets to draw conclusions surrounding the factors influencing financial sustainability by Council segment:

- Councils in all segments are financially vulnerable to a further devolution of responsibilities from other levels of Government.
- Councils in all segments require a greater commitment to long-term financial sustainability and asset management planning, including the evaluation of the financial implications of new asset and service additions on debt levels, future operating results and the ability to renew existing assets.
- Councils in all segments need to regularly monitor the appropriateness of rating levels and the efficiency of rating structures (in terms of the incidence placed on different ratepayer classes), with such actions of most importance for Councils within the Coastal and Rural/Regional segments due to an already high level of rating effort being in place and Councils within the Resources segment due to the need to ensure adequate revenue is generated from the resources sector to meet the demands placed on infrastructure and service delivery.
- Councils within the Indigenous, Rural/Remote, Rural/Regional and Resources are all heavily dependent on the provision of appropriate operational and grant funding (albeit to different extents), and are therefore extremely vulnerable to any reduction or uncertainties surrounding such assistance.
- Inherent funding issues are resulting in persistent and significant operating deficits for Councils within the Indigenous segment, with these Councils facing unique challenges that require specific funding and resourcing/skills development strategies by other levels of Government.
- Councils within the Rural/Remote segment are also very heavily reliant on contract works undertaken for other levels of Government (in particular the State Government), and are therefore extremely vulnerable to any reduction or uncertainties surrounding such works.
- Growth pressures, infrastructure charging constraints and a lack of (and reducing) capital funding from other levels of Government are threatening the future borrowing capacity of Councils within the SEQ and Coastal segments, with many of these Councils also experiencing operating deficits as a result of growing asset bases.
- Councils within the Resources segment need to ensure that appropriate direct funding of infrastructure required to service the resources sector is provided by external parties, given the often high risk of infrastructure becoming stranded in the event of the resources sector exiting from, or scaling down operations within, the Local Government area in question.
- A heavy compliance burden is being felt by Councils in the Indigenous, Rural/Remote and Resources segments.
- Councils within the Indigenous, Rural/Remote and Resources segments need to have in place workforce strategies to assist in the attraction and retention of professional and skilled technical employees, in addition to the ability to better manage and build capability of the local workforce in the instance of Councils within the Indigenous segment.
- Capacity issues and skills shortages (and identified infrastructure and operational risks) for the majority of Councils within the Indigenous, Rural/Remote and Resources segments suggest that some specialist management, technical and compliance functions may be better serviced at a regional level.

Other issues are also raised in the research paper, including the calculation and treatment of depreciation in assessing the financial sustainability of Local Governments. For example, the present accounting treatment of subsidised, contributed and donated assets requires these to be recognised as capital revenue in the year the financial asset is gifted to the Local Government, thus boosting performance and equity by the value of the donated asset in that year.

Meanwhile, depreciation charges in relation to the consumption of the asset are incurred on a progressive basis over time in the operating result without reference to the one-off boost in performance at the time the financial asset is received, thus resulting in an artificial deterioration in the operating result from a financial sustainability perspective. This outcome is of particular concern for those Council segments facing high growth outcomes (e.g. the Coastal and SEQ segments). Further work is required in relation to the depreciation method applied and/or the calculation of the operating result for financial sustainability assessment purposes to ensure that the adoption of generic reporting arrangements do not create perverse outcomes in ongoing financial sustainability assessments.

Further information on these and other identified issues, as well as policy actions across all levels of Government to help improve the financial sustainability of each Council segment, can be found in the research report (accessible via the following links on the AEC*group* and LGAQ websites).

http://www.aecgroupltd.com/publications/

http://www.lgaq.asn.au/documents/10136/13500/Factors%20Impacting%20Local%20Government%20Financial%20Sustainability%20A%20Council%20Segment%20Approach%20-%20Final%20Report%2020130926.pdf

Should you have any queries regarding the implications of this research paper for your Council, or any other financial sustainability issues you would like to discuss, please contact Gavin O'Donovan, Principal Consultant and Director of AEC*group* on (07) 3831 0577 or via gavin.odonovan@aecgroupltd.com.