



Department of Local Government and Regions

Darwin – Consultancy - Review of Councils' Financial Sustainability

December 2013

Distribution:

Mr Alan McGill

Chief Executive Officer, DLGR

Copies:

Julie Crisp

Partner, Deloitte Touche Tohmatsu

Liability limited by a scheme approved under Professional Standards Legislation.

Member of Deloitte Touche Tohmatsu Limited.

Contents

1	<i>Executive Summary</i>	4
1.1	Introduction	4
1.2	Scope and Objectives	4
1.3	Disclaimer	5
1.4	Acknowledgements	5
2	<i>Analysis of Financial Sustainability</i>	6
2.1	Introduction	6
2.1.1	Financial 'sustainability' versus financial 'viability'	6
2.2	Approach to measuring financial trends	7
2.3	Summary of financial indicators of individual councils	9
2.4	Analysis of financial indicators of individual councils	11
2.5	Overall analysis on financial indicators	15
3	<i>Update on Key Issues Affecting Councils</i>	16
4	<i>Proposed separation of Victoria Daly Shire Council</i>	24

Inherent Limitations

The Services provided are advisory in nature and have not been conducted in accordance with the standards issued by the Australian Auditing and Assurance Standards Board, and consequently no opinions or conclusions intended to convey assurance under these standards are expressed.

Because of the inherent limitations of any internal control structure, it is possible that errors or irregularities may occur and not be detected. The matters raised in this report are only those which came to our attention during the course of performing our procedures and are not necessarily a comprehensive statement of all the weaknesses that exist or improvements that might be made.

Our work is performed on a sample basis; we cannot, in practice, examine every activity and procedure, nor can we be a substitute for management's responsibility to maintain adequate controls over all levels of operations and their responsibility to prevent and detect irregularities, including fraud.

Any projection of the evaluation of the control procedures to future periods is subject to the risk that the systems may become inadequate because of changes in conditions, or that the degree of compliance with them may deteriorate.

Recommendations and suggestions for improvement should be assessed by management for their full commercial impact before they are implemented.

We believe that the statements made in this report are accurate, but 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 Department of Local Government and Regions (DLGR) personnel. We have not attempted to verify these sources independently unless otherwise noted within the report.

Limitation of Use

This report is intended solely for the information and internal use of the DLGR in accordance with our terms of reference of 19 November 2013 and is not intended to be and should not be used by any other person or entity. No other person or entity is entitled to rely, in any manner, or for any purpose, on this report. We do not accept or assume responsibility to anyone other than the DLGR for our work, for this report, or for any reliance which may be placed on this report by any party other than the DLGR.

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee, and its network of member firms, each of which is a legally separate and independent entity. Please see www.deloitte.com/au/about for a detailed description of the legal structure of Deloitte Touché Tohmatsu Limited and its member firms.

Member of Deloitte Touche Tohmatsu Limited.

Confidential - this document and the information contained in it are confidential and should not be used or disclosed in any way without our prior consent.

© 2013 Deloitte Touche Tohmatsu. All rights reserved.

1 Executive Summary

1.1 Introduction

The Department of Local Government and Regions (DLGR) asked Deloitte to provide an update of the findings published within the report arising from the Review of the Council's Financial Sustainability released in May 2012 (the Deloitte Report).

The Councils (hereafter collectively referred to as the 'Councils') included as part of this consultancy were:

- East Arnhem Shire Council (EASC)
- West Arnhem Shire Council (WASC)
- Tiwi Islands Shire Council (TISC)
- Victoria Daly Shire Council (VDSC)
- Roper Gulf Shire Council (RGSC)
- Central Desert Shire Council (CDSC)
- MacDonnell Shire Council (MSC)
- Barkly Shire Council (BSC)
- Wagait Shire (WS)
- Coomalie Community Government Council (CCGC)
- Belyuen Shire Council (Belyuen).

1.2 Scope and Objectives

The purpose of the update was to determine whether there has been a significant change in the financial circumstances of the Councils that may result in a different conclusion to that formed in 2012 in relation to ongoing financial sustainability. In forming an updated conclusion, relevant to the Councils' financial position at 30 June 2013, we have taken into consideration the impacts on the Councils from critical issues identified in the Deloitte Report.

Deloitte has provided an update on the following critical issues identified in the previous report and determine if there has been significant change in the financial circumstances of the Councils. These critical issues were:

- The ability to develop long term plans is impaired
- Agreements are being entered into which are loss making for the Councils
- Core services are not being delivered to an acceptable standard
- Costs are not being appropriately recovered from either funding bodies or users
- Cross subsidisation cannot be identified
- Expectation gaps exist between communities and Councils on acceptable levels of service
- Funds are not available to maintain, repair or replace gifted assets
- There is insufficient funding available for repairs, maintenance upgrade and replacement leading to an increased backlog of infrastructure and capital assets
- There is a lack of transparency in financial reporting
- Rateable properties may not be identified and rates not collected
- Planned changes to leasing arrangements are likely to have a detrimental financial impact upon the Councils.

- The costs associated with policy initiatives introduced by other levels of government have been transferred to the Councils without an equal transfer of funding
- The budgeting and accounting policies, procedures, systems and reporting in place in many Councils are inadequate leading to a high risk of materially misstated financial reports and may result in Councillors and management making inappropriate decisions on the allocation of scarce resources
- Onerous reporting requirements imposed by funding providers has caused inefficiencies, additional costs and administrative requirements that reduce funding available for core service delivery
- The true cost of providing services cannot be determined as, for a number of Councils, there is no established and agreed process for allocating indirect costs or because funding providers are not funding an appropriate level of overhead.

1.3 Disclaimer

We have relied upon data supplied by Councils and/or gathered by DLGR. The information received has not been subjected to an audit on our part. While much of the data provided has been audited at the individual Council level, there is no check undertaken as to the consistency of reporting practices across Councils. While we have made our best efforts both to ensure that the information provided meets our requirements and to maintain the accuracy of this information after it is received, we accepted and used the information provided in good faith. We are unable to provide any warranties about the accuracy or completeness of the information provided to us by or in relation to individual Councils. It should be noted that two of the Councils have received qualified audit opinions on their 30 June 2013 financial statements, and four on their 30 June 2012 financial statements.

Where key data is missing or inadequate, we have to the extent possible, used the data that has been received for analysis.

Where we have exercised judgement (as is always necessary to complete an analysis of this kind), we have done so based on our experience.

We also acknowledge that, notwithstanding the obvious focus of our review, not all challenges to the sustainability of the Councils have a financial context, with capacity, skills, demographic and environmental dimensions also being important.

1.4 Acknowledgements

We would like to take this opportunity to thank DLGR officers and Council staff across the Northern Territory for providing the financial and related data necessary to undertake our analysis, and for assisting with the interpretation of the data.



Julie Crisp
Partner
Deloitte Touche Tohmatsu
20 December 2013

2 Analysis of Financial Sustainability

2.1 Introduction

This section of the report provides our analysis of the financial sustainability of local government in remote Northern Territory.

The Commonwealth Government defines fiscal sustainability (with 'fiscal' sustainability and 'financial' sustainability being inter-changeable in a public sector context) as:

'...a government's ability to manage its finances so it can meet its spending commitments, both now and in the future. It ensures future generations of taxpayers do not face an unmanageable bill for government services provided to the current generation.'

...One of the key requirements for sustainable government financial arrangements is a balanced budget over the medium to long term, given a reasonable degree of stability in the overall tax burden.'

(Commonwealth Government, Intergenerational Report, May 2002)

The NSW Government defines fiscal sustainability as:

'Fiscal sustainability requires that the Government be able to manage financial risks and financial shocks in future periods without having to introduce significant and economically or socially destabilising expenditure or revenue adjustments in those future periods. What is considered consistent with fiscal sustainability will vary depending on the strength and outlook for the economy, the structure of expenditure and revenue of the budget, the outlook for the State's credit rating, demographic and social trends that will affect the budget, and the nature of financial risks faced by the Government at any given time.' (NSW Government, Fiscal Responsibility Act 2005, section 3(1))

The financial sustainability assessment involves a comparison of a Council's long term financial capacity with its long term financial requirements.

A Council's financial capacity is defined as the total financial resources (operating and capital) that a Council can mobilise through its existing and prospective revenue raising and financing policies.

A Council's financial requirements refer to the sum total of the spending (both operating and capital) that is required by a Council to meet both its present statutory obligations and any expected additional functions, spending pressures and financial shocks.

If a Council's long term finances are financially sustainable then disruptive rates increases or spending cuts can be avoided. The rating burden will be shared fairly between current and future rate payers.

A Council's financial requirements involve:

- The spending (both operational and capital) necessary to meet both its statutory obligations and any expected spending pressures (which in the case of local government is principally associated with addressing the asset maintenance and renewals backlogs)
- The margin of comfort necessary for the Council to be able to manage any future financial shocks.

2.1.1 Financial 'sustainability' versus financial 'viability'

It is important to note that a Council being classified as financially 'unsustainable' does not mean that the Council's financial viability is necessarily questioned.

The term 'financially unsustainable' in the long term refers only to the unsustainability of a Council's current policies, both revenue raising and spending. Council finances can almost always be corrected with substantial rate increases and/or expenditure cuts, albeit at a considerable cost to ratepayers and the community being served.

By contrast, the term 'financial viability' is used in the private sector in relation to whether an entity's financial performance and position does not jeopardise the interests of its creditors. In the context of the local government, there is no doubt that the local government sector is and also will be financially 'viable' in the sense that it will always be able ultimately to meet its debt service obligations. Ratepayers are bound to meet all outstanding obligations under the Local Government Act.

A Council's finances can be judged to be sustainable in the long term only if they are strong enough currently and in the foreseeable future given likely developments in the Council's revenue raising capacity and in the demand for and costs of services and infrastructure to allow the Council to manage financial risks and financial shocks over the long term financial planning period without having to introduce substantial or disruptive revenue (or expenditure) adjustments during that period.

2.2 Approach to measuring financial trends

The data set used to determine financial trends for local government in the Northern Territory was based on the eleven Councils listed in Section 1.1 of this report. The financial statements produced in accordance with the accounting standards and published in the annual reports for each of the Councils and other data sets as required were used to determine trend analysis and financial sustainability.

Financial sustainability relates to the long term financial performance and position of individual Councils rather than to the finances of local government in aggregate. We have examined the financial sustainability of each individual Council in Sections 2.4, 2.5 and 3 of this report and summarised the results for the Councils.

The sustainability of a Council's long-term financial performance and position is essential for ratepayers, as it:

- Ensures a reasonable degree of stability and predictability in the overall rate burden
- Promotes a fair sharing in the distribution of Council resources and the taxation required from current and future ratepayers ('intergenerational equity')
- Ensures continuation of delivery of essential community services and the efficient operation of infrastructure.

The following are the generally accepted indicators of financial sustainability. These indicators, and their related benchmarks, are consistent with those used in the PricewaterhouseCoopers 2006 National Financial Sustainability Study of Local Government.

Ratio	Explanation	Benchmark
Operating Surplus (Deficit) Ratio	Total operating revenue less total operating expenses divided by total revenue. The ratio is an indicator of a Council's ability to meet its operating expenses with its operating revenue stream. The analysis uses a benchmark operating deficit of 10% of total revenue as Councils with deficits larger than this are spending beyond their revenue base and are potentially at risk of sustainability problems.	>10%
Interest Coverage Ratio	Earnings before interest and taxation (EBIT) divided by borrowing costs. Interest coverage measures a Council's ability to pay interest on its outstanding debt. The analysis uses an interest coverage benchmark of 3 as Councils with interest coverage below 3 may have problems in repaying debt and associated interest.	>3
Sustainability Ratio	Capital expenditure divided by depreciation. The sustainability ratio is a measure of the net increase or decrease in a Council's asset base. The analysis uses a benchmark of one for the sustainability ratio. Where a Council records a value higher than 1, this indicates the overall asset base is increasing or being replenished at a rate equal to, or higher than, the Council's consumption of assets. Where the sustainability ratio is less than 1, the Council may have a declining asset base.	>1
Current Ratio	Current assets divided by current liabilities. The current ratio is an indication of a Council's ability to meet short-	>1

Ratio	Explanation	Benchmark
	term debt obligations. The analysis uses a benchmark value of 1 for the current ratio as a Council recording a current ratio of less than 1 may face difficulty in meeting short-term obligations.	
Rates Coverage Ratio	Total rates revenue as a proportion of total expenses. Rates coverage indicates a Council's ability to cover costs through its own revenue. The analysis uses a benchmark of 40%. Less than this may indicate rates cover an inadequate proportion of expenses.	>40%

A Council's net financial liabilities can be too low where they are:

- Associated with current ratepayers being asked to bear an inequitable proportion of the cost of future service potential
- Below levels that include more than enough room to absorb unexpected financial risks or financial outlays.

A Council's annual operating financial performance is sustainable if operating deficits will be avoided over the medium to long term, because such deficits inevitably involve services consumed by current ratepayers being paid for either by:

- Borrowing and so by future ratepayers
- Deferring funding responsibility for the renewal or replacement of existing assets onto future ratepayers.

A Council's operating surplus can be too high where it is:

- Associated with current ratepayers being asked to bear an inequitable proportion of the cost of the Council's future service potential
- Above a level that includes more than enough room to absorb unexpected financial risks or financial outlays.

A Council's annual capital financial performance is sustainable if capital expenditure on the renewal or replacement of existing assets on average approximates the level of the Council's annual depreciation expense, because any shortfall of such capital expenditure against annual depreciation expense would involve future ratepayers being left with an excessive burden when it comes to replacing or renewing the Council's non-financial assets.

A Council's net borrowing can be too low where it results in the Council's net financial liabilities as a ratio of non-financial assets falling below the targeted ratio.

The financial sustainability indicators have been determined based on the financial position and performance of the individual Councils as at 30 June 2012 and 30 June 2013 and for the years then ended. These financial sustainability indicators have been included together with the ratios for the years ended 30 June 2009, 2010 and 2011 as published in the Deloitte Report to enable performance comparison.

For each of the individual Councils we have used five key financial performance indicators (KPIs) as part of our analysis as discussed above; operating surplus/(deficit) ratio, interest coverage ratio, sustainability ratio, current ratio and rates coverage ratio. In Section 2.3 we collate the results of each individual Council and explain the financial sustainability of individual Councils and of local government in the Northern Territory.

2.3 Summary of financial indicators of individual Councils

The table below summarises the results of the individual Councils over the four years. Refer to above for a full explanation and definitions of these financial KPIs for the 2012 and 2013 financial years:

Summary of financial indicators for the 2010 – 2013 financial years:

Council	Operating Surplus/(Deficit) Ratio				Operating Surplus/(Deficit) - own source revenue				Interest Coverage Ratio			
	2013	2012	2011	2010	2013	2012	2011	2010	2013	2012	2011	2010
Tiwi Islands Shire Council	(13.8)%	(8.1)%	(10.3)%	(6.9)%	(40.9)%	(21.4)%	(29.1)%	(34.9)%	(524.6)	(605.3)	(257.8)	(27.7)
Victoria Daly Shire Council	(6.3)%	(1.4)%	(16.9)%	(6.1)%	(15.1)%	(3.1)%	(38.9)%	(15.9)%	(8,472.7)	25.7	0.0	0.0
Roper Gulf Shire Council	(21.6)%	(4.1)%	(3.1)%	(3.9)%	(65.6)%	(12.1)%	(9.0)%	(15.0)%	(155.2)	(37.7)	(5.4)	19.5
Barkly Shire Council	(19.9)%	(56.7)%	(15.8)%	(10.1)%	(58.3)%	(139.9)%	(242.9)%	(29.0)%	0.0	0.0	0.0	0.0
MacDonnell Shire Council	(0.1)%	(0.8)%	(5.9)%	(12.5)%	(0.4)%	(2.0)%	(17.5)%	(51.6)%	23.6	(66.6)	(27.2)	(41.2)
Central Desert Shire Council	1.0%	(4.5)%	(25.1)%	(1.7)%	3.6%	(17.7)%	(68.1)%	(11.2)%	80.1	29.5	15.6	53.2
West Arnhem Shire Council	(4.3)%	4.5%	(24.5)%	(24.7)%	(7.6)%	8.5%	(45.4)%	(63.7)%	(113.9)	258.7	0.0	0.0
East Arnhem Shire Council	(1.6)%	(10.7)%	(25.0)%	(10.9)%	(4.7)%	(27.1)%	(69.6)%	(52.5)%	16.1	(11.5)	0.0	0.0
Belyuen Shire Council	2.9%	(61.0)%	(36.9)%	(55.8)%	5.8%	(110.7)%	(85.3)%	(184.4)%	0.0	0.0	0.0	0.0
Wagait Shire	(6.6)%	(35.0)%	(62.0)%	(18.0)%	(8.5)%	(56.4)%	(122.0)%	(38.0)%	0.0	0.0	0.0	0.0
Coomalie Community Government Council	(9.9)%	(46.1)%	(19.2)%	(19.9)%	(22.0)%	(96.4)%	(47.9)%	(41.4)%	0.0	0.0	0.0	0.0
Average of all Councils	(7.3)%	(20.3)%	(22.2)%	(15.5)%	(19.4)%	(43.3)%	(70.5)%	(48.9)%	(831.5)	(37.0)	(25.0)	0.3

Continued: Summary of financial indicators for the 2010 – 2013 financial years:

Council	Sustainability Ratio					Current Ratio				Rates Coverage			
	2013	2012	2011	2010	Average	2013	2012	2011	2010	2013	2012	2011	2010
Tiwi Islands Shire Council	0.40	0.83	0.50	1.06	0.70	1.8	1.4	1.6	1.5	4.5%	4.4%	3.7%	3.5%
Victoria Daly Shire Council	1.63	3.22	0.81	2.08	1.94	1.4	1.5	1.7	2.7	3.1%	3.5%	2.4%	2.7%
Roper Gulf Shire Council	0.76	1.01	0.95	1.06	0.95	2.8	4.7	2.8	3.6	2.4%	1.8%	1.5%	1.7%
Barkly Shire Council	0.32	0.43	0.40	0.40	0.39	1.5	1.6	2.7	2.2	8.4%	7.8%	8.6%	7.0%
MacDonnell Shire Council	1.33	1.02	1.04	1.64	1.26	1.2	1.2	1.3	1.3	1.6%	1.2%	1.1%	1.0%
Central Desert Shire Council	1.71	1.81	1.25	1.64	1.60	1.7	1.4	1.5	1.8	3.7%	1.8%	1.6%	1.7%
West Arnhem Shire Council	0.21	0.13	0.31	0.35	0.25	2.3	1.6	1.3	2.2	11.2%	9.8%	6.6%	5.7%
East Arnhem Shire Council	0.55	0.73	1.12	4.32	1.68	2.2	1.6	2.0	2.8	5.4%	4.1%	4.1%	4.1%
Belyuen Shire Council	2.29	0.70	1.52	0.38	1.22	1.8	1.7	2.7	6.7	1.3%	0.7%	1.7%	0.0%
Wagait Shire	0.46	0.00	2.79	1.12	1.09	8.2	7.7	12.3	5.5	33.5%	26.5%	18.0%	20.2%
Coomalie Community Government Council	0.42	1.45	0.52	1.40	0.95	2.3	1.6	5.3	3.0	26.5%	20.1%	21.1%	14.6%
Average of all Councils	0.92	1.03	1.02	1.40	1.09	2.5	2.4	3.2	3.0	9.2%	7.4%	6.4%	5.7%

2.4 Analysis of financial indicators of individual councils

2.4.1 Tiwi Islands Shire Council

Overall, TISC's ratios have consecutively deteriorated over the period since the last financial sustainability review. All of the financial ratios are outside of the benchmarks identified in our approach to measure financial trends except for the current ratio which is stable at 1.8.

TISC's operating deficit has increased from the 2011 review to negative 13.8% in 2013. Using the benchmark of negative 10% indicates that TISC is spending beyond their revenue base and is at risk of sustainability problems.

The operating deficits ratio on TISC's own source revenue follows this trend as TISC's revenue from self-generated sources is not sufficient to cover its operational spending. This is primarily due to an increase in operating expenses with a corresponding decrease in grant funding.

TISC's interest coverage ratio has deteriorated consecutively over the four financial periods. It should be noted, that the significantly larger figure does not suggest a major problem for TISC's financial sustainability. The significant contributing factors to the fluctuation of the ratio are that TISC is operating at large deficits while only incurring small interest charges. For 2012 and 2013, TISC had earnings before interest and tax (EBIT) of negative \$2.21million and \$2.18million respectively and an interest expense of \$3,659 and \$4,154, respectively. The ratio figure is therefore a result of large operating deficits with smaller interest expenses.

TISC's sustainability ratio has fallen below the benchmark of 1 since 2010, repeatedly decreasing (except for 2012) to 0.4 for 2013. This ratio suggests that TISC may have a declining asset base in which its consumption of assets is greater than the injection of new capital. This is primarily due to the low level of capital funding provided of \$490,000 and \$370,000 in 2012 and 2013, respectively. This will ultimately impact TISC's level of purchases, maintenance and upgrades of its fixed assets.

The rates coverage ratio has remained below the benchmark of 40% at 4.5% for 2013. It has remained fairly steady over the four periods under review. The low ratio reflects an inadequate portion of rates revenue as a proportion of expenses.

2.4.2 Victoria Daly Shire Council

VDSC is performing well overall and within benchmark for four of the six ratio calculations. VDSC has seen an improvement in the operating surplus from our 2011 review, the operating surplus is currently negative 6.3% in 2013. The operating deficit on VDSC'S own source revenue is following this trend from the 2011 review and is currently negative 15.1% in 2013.

The sustainability ratio has experienced some volatility over the review period however has remained in a good position.

VDSC's interest coverage ratio has deteriorated consecutively over the four financial periods. It should be noted, that the significantly larger figure does not suggest a major problem for VDSC's financial sustainability. The significant contributing factor to the fluctuation of the ratio in 2013 is due to VDSC experiencing a large EBIT deficit of \$2.48million while only incurring \$293 in interest charges. The ratio figure is therefore a result of large operating deficits with smaller interest expenses.

The rates coverage ratio has remained below the benchmark of 40% at 3.1% for 2013. It has remained fairly steady over the four periods under review. The low ratio reflects an inadequate portion of rates revenue as a proportion of expenses.

2.4.3 Roper Gulf Shire Council

RGSC's overall performance has experienced a decline in all financial ratios specifically over the last twelve months, except for the rates coverage ratio; however this is still below the benchmark of 40%.

RGSC's operating deficit ratio has seen an increase from the previous financial years moving from negative 4.1% in 2012 to negative 21.6% in 2013. Using the benchmark of (10%) outlined in our

approach to measuring financial trends, a deficit greater than this benchmark indicates that RGSC is spending beyond their revenue base and is at risk of sustainability problems. The major cause of the increased deficit is a reduction in grant revenue (loss of CDEP revenue) from 2012 to 2013 of \$4.2million with operating expenditure remaining fairly constant. The operating deficit from RGSC's 'own source revenue' has followed this trend, increasing to negative 65.6% in 2013.

RGSC's interest coverage ratio has deteriorated consecutively over the four financial periods. It should be noted, that the significantly larger figure does not suggest a major problem for RGSC's financial sustainability. The significant contributing factors to the fluctuation of the ratio are that RGSC is operating at large deficits while only incurring small interest charges. For 2012 and 2013, RGSC had an EBIT of negative \$1.0million and \$5.4million and an interest expense of \$27,000 and \$34,000, respectively. The ratio is therefore significantly influenced by large operating deficits with smaller interest expenses.

RGSC's sustainability ratio has fallen below the benchmark of 1 since June 2012 and is currently sitting at 0.76 for June 2013 with an average ratio of 0.95 over the four consecutive years to 2013. The decrease below the benchmark in 2012 is primarily attributable to a decrease in the capital funding in the 2012 financial year to \$300,000. In 2013, the capital grant revenue has increased to \$770,000 which should result in a ratio above the benchmark if the capital funding remains at a constant level.

The current ratio for RGSC remains above the benchmark of one however has seen a decline since 2010. This is due to a decline in current assets by \$2.8million between 2012 to 2013 and an increase in current liabilities of \$1.5million over the same period.

The rates coverage ratio has improved since the last review increasing by 0.9% to 2.4% at June 2013. Applying this against the benchmark of 40% still suggests that there is an inadequate portion of rates revenue as a proportion of expenses.

2.4.4 Barkly Shire Council

BSC's overall performance has seen improvements in its operating deficits, slight declines in its sustainability and current ratios while the rates coverage ratio has remained consistent over the four financial periods. Excluding the current ratio, all remain outside of the benchmarks adopted for this review.

BSC's operating deficit has increased by 4.1% from June 2011 however decreased by 36.8% from June 2012 to (19.9%) at June 2013. This is due to an increase in grant revenue of \$3million in 2012 and an overall increase in operating revenue of \$4million. This increase was slightly offset by an increase in operating expenses of \$2million. Whilst there has been a positive improvement, using the benchmark of (10%), it still indicates that BSC is spending beyond their revenue base and is at risk of sustainability problems. The operating deficit on BSC's 'own source revenue' has followed this trend as the operating deficit has decreased \$5.8million between 2012 to 2013 while BSC has increased its 'own source revenue' by \$1.4million for the same period.

BSC's sustainability ratio has remained below the benchmark of 1 since June 2010, currently sitting at 0.32 for June 2013 with an average ratio of 0.39 over the four consecutive years to 2013. The current ratio suggests that BSC may have a declining asset base, indicating that the overall asset base is decreasing at a lower rate than BSC's consumption of assets.

The rates coverage ratio has deteriorated since the last review decreasing by 0.2% to 8.4% at June 2013. Against the benchmark of 40%, this suggests that there may be an inadequate portion of rates revenue as a proportion of expenses.

2.4.5 MacDonnell Shire Council

MSC has seen improvements across the board in 2013 particularly in its operating deficit and interest coverage ratios. All ratios are performing above the benchmarks apart from the rates coverage ratio.

MSC has seen a decrease in operational grant funding of \$3.3million from 2012 to 2013 however was able to reduce its operating expenditure by \$8.5million in the same financial period. This has led to an

improvement in MSC's operating deficit to negative 0.1% in 2013. MSC's interest coverage ratio has improved due to an EBIT of \$414,000 with a reduction in interest expenses.

MSC's sustainability ratio has improved to 1.33 for the year ended 30 June 2013. The primary reason is an increase in capital expenditure over the 2013 period which is over and above the depreciation expense for existing fixed assets.

The current ratio and rates coverage ratio have remained fairly consistent over the four financial periods seeing slight improvements in 2013 since the last review performed in 2011. It should be noted that although the rates coverage ratio has improved it is still well below the benchmark of 40% at 1.6% and has the lowest rates revenue as a portion of its expenses of all the Councils under review.

2.4.6 Central Desert Shire Council

CDSC has seen improvements across the board in 2013 apart from the sustainability ratio and is performing above the benchmark in all areas excluding the rates coverage ratio. In 2013 CDSC operated at a surplus being able to decrease its operating expenditure in response to the decline in operating grant revenue.

CDSC's sustainability, current and rates coverage ratio have remained fairly consistent over the four financial periods under review although the rates coverage ratio is still well below the benchmark of 40% at 3.7%, indicating that there is an inadequate portion of rates revenues as a portion of expenses.

2.4.7 West Arnhem Shire Council

WASC has shown improvement since the 2011 review in its operating deficit ratios, current and rates coverage ratios. These ratios are all performing above the benchmark except for the rates coverage ratio. WASC has experienced a decline in its interest coverage and sustainability ratios.

WASC's interest coverage ratio has deteriorated in 2013. It should be noted that the significantly larger figures do not suggest a major problem for WASC's financial sustainability. The significant contributing factors to the fluctuation of the ratio are that WASC is operating at large deficits while only incurring small interest charges. For 2012 and 2013, WASC had EBIT of \$2.3million and negative \$750,000 and interest expense of \$8,791 and \$6,580, respectively. The ratio is therefore influenced by large operating deficits with smaller interest expenses.

WASC's sustainability ratio has remained below the benchmark of 1 since June 2010, currently 0.21 for June 2013 with an average ratio of 0.25 over the four consecutive years to 2013. This ratio suggests that WASC may have a declining asset base, indicating that the overall asset base is decreasing at a lower rate than WASC's consumption of assets. The primary reason for the low sustainability ratio is the level of capital funding per annum which is significantly less than the value of WASC's fixed assets. In 2013 WASC received \$465,000 in capital funding, while the value of fixed assets was \$56million.

The rates coverage ratio has improved since the last review increasing by 4.6% over the two years to 11.2% at June 2013. Using the benchmark of 40%, this suggests that there may be an inadequate portion of rates revenue as a proportion of expenses. The improvement in the ratio is primarily due to an increase in rates on certain residential properties.

2.4.8 East Arnhem Shire Council

EASC's overall performance has improved in 2013 as reflected in its operating deficits, current, interest and rates coverage ratios which are all performing above the benchmarks except for the rates coverage ratio. EASC has however experienced a decline in its sustainability ratio.

EASC's sustainability ratio has declined over the last two financial years and fallen below the benchmark in 2013. The decline in the ratio is primarily due to a decrease in the purchase of fixed assets by the EASC of \$730,000 and \$1.3million in 2013 and 2012 respectively. Capital grant revenue

for the same periods indicates funding of \$2.5million for both financial periods. If EASC continues to underspend on fixed assets, this may result in a declining asset base.

The rates coverage ratio has improved since the last review increasing by 1.3% to 5.4% at June 2013. Applying the ratio against the benchmark of 40% demonstrates that there may be an inadequate portion of rates revenue as a proportion of expenses.

2.4.9 Belyuen Shire Council

Belyuen finished with an operating surplus in 2013. All Belyuen's ratios are outperforming the benchmark excluding the rates coverage ratio.

The attributable factors in the significant turn around in Belyuen's operating surplus is an increase in operating grants of \$120,000 and a reduction to the Belyuen's loss on its disposal of assets of \$1.2million.

Belyuen's sustainability ratio has outperformed the benchmark of one. This is due to an increase in capital spending of \$189,000 to \$623,000 in 2012 and 2013, respectively, while having a consistent depreciation expense over the two financial years.

Belyuen's current ratio remains above the benchmark of 1 in 2013, however, has seen a steady decline over the four financial periods under review. The ratio reflects a decline in the financial position of Belyuen.

The rates coverage ratio has remained below the benchmark of 40% over the four financial periods. The ratio reflects an inadequate portion of rates revenue as a portion of expenses. The rates revenue has remained fairly consistent over 2012 and 2013 with rates increasing from \$25,000 to \$29,000 respectively, while total expenses were \$3.5million and \$2.2million, respectively.

2.4.10 Wagait Shire

WS has greatly improved its performance in most areas, particularly in its operating deficit ratios and its rates coverage ratio. WS has seen a slight decline in its current ratio since the review in 2011 however is still performing above the benchmark of 1.

WS's sustainability ratio has remained below the benchmark of 1 since June 2012, currently at 0.46 for June 2013 with no capital expenditure occurring during 2012. Capital expenditure in 2013 was \$70,000 however WS's depreciation expense for the year was \$150,000.

The decline in the current ratio demonstrates that WS may have a declining asset base, indicating that the overall asset base is decreasing at a lower rate than WS's consumption of assets. The primary reason for the low sustainability ratio is being the level of capital funding per annum declining, with no capital grants being received in 2012 and only \$11,000 in 2013. With WS's fixed assets currently at \$1.7million, the capital grants do not adequately support WS in maintaining a positive asset base.

WS has the highest performing rates coverage ratio of all eleven Councils under review and has seen improvement since the last review in 2011. The primary reason is the decrease in total operating expenses of \$120,000 and a slight increase in rates recovery.

2.4.11 Coomalie Community Government Council

CCGC's performance has improved in most areas since the last review in 2011 and is now performing above the benchmark for four of six ratios.

CCGC's operating deficit has decreased by 9.3% from June 2011 and decreased by 36.2% from June 2012 to negative 9.9% at 30 June 2013. CCGC is now performing above the benchmark, primarily due to an increase in operating grant revenue of \$280,000 in 2013 and a decrease in operating expenditure of \$400,000. The operating deficit from CCGC's 'own source revenue' has moved in line with the operating deficit ratio as expected.

CCGC's sustainability ratio has fallen below the benchmark of 1 at 0.42 in June 2013 with the four-year average at 0.95. The primary reason for the decline in the sustainability ratio is a decline in

capital expenditure in 2013. This financial period also saw a decrease in capital grant funding of \$80,000 which has impacted CCGC's ability to spend on capital items.

CCGC has a comparatively high performing rates coverage ratio of all eleven Councils under review and has seen improvement since the last review in 2011, however falls outside of the benchmark of 40% at 26.5% indicating there is still a dependence on grants from other levels of Government.

2.5 Overall analysis on financial indicators

2.5.1 Operating Surplus/ (Deficit) Ratio

The average operating surplus ratio (total revenue less capital expenditure / total operating expenses) in our 2013 review is negative 8.3% compared to negative 22.2% in the 2011 review which is an improvement of 13.9% over the period under review. Three of the eleven Councils have operating deficits above 10% of revenue with no Councils registering an operating surplus in 2013. Although operating at losses, this is still an improvement from 2011 when nine of the eleven Councils had operating deficits greater than 10% of revenue. Councils with continuing operating deficits have a tendency to defer renewals expenditure, which increases the risk of maintenance backlogs.

2.5.2 Operating Surplus/ (Deficit) Ratio – 'Own Source Revenue'

The average operating surplus from 'own source revenue' ('own source revenue' / total expenditure) is consistent with the movement in operating surplus/ (deficit) ratio. The average ratio improved from negative 70.5% in 2011 to negative 21.9% in 2013.

2.5.3 Interest Coverage Ratio

Eight Councils have borrowings in the 2013 financial period compared to four Councils in the 2011 financial period. For the year ended 30 June 2013, the interest coverage ratio (EBIT/interest expense) for four of the eight Councils was less than the benchmark of 3 which indicates that these Councils may have problems repaying debt and associated interest.

2.5.4 Sustainability Ratio

The average sustainability ratio across the four years is 1.07 with five of the eleven Councils having an overall sustainability ratio of less than 1. The average sustainability ratio over the four years has decreased from 1.4 in 2010 to 0.78 in 2013. A ratio of less than 1 indicates that the capital being consumed exceeds the Councils' investments in capital, maintenance and upgrades to its fixed assets.

2.5.5 Current Ratio

All Councils have current ratios (current assets/current liabilities) greater than the benchmark of one. The average across the Councils was 2.5 in 2012 compared to 3.3 in 2011, which shows a decline over the period. It is important to note that in some cases, current assets include amounts received from funding bodies which have been recognised as restricted cash however no liability has been recognised for unexpended grants at year-end or only a portion of the unexpended grants have been recognised as a liability with the remainder recognised as revenue for the year. Full recognition of unexpended grants balances as a liability would result in a reduced current ratio.

2.5.6 Rates Coverage Ratio

The average rates coverage ratio (rates and annual charges/ total operating expenses) across all Councils is well below the benchmark of 40% with the majority of Councils having a ratio less than 12% of total costs. There has, however, been a slight improvement from the 2011 financial period, where the average rates coverage ratio was 3.6%. Where rates are less than 40% of Council revenue, there is an indication that own-source revenue generating capacity is constrained and that the Council is likely to have a degree of dependence on grants from other levels of Government.

3 Update on Key Issues Affecting Councils

The following analysis examines whether there has been a significant change in the financial circumstances of the Councils that may result in a different conclusion to that formed in 2012. We considered the impacts on the Councils from those critical issues identified in the Deloitte Report.

3.1 The ability to develop long term plans is impaired

In the Deloitte Report, we noted that the ability of Councils to develop long term plans was impaired. A number of Councils have reported improvements in their approach to long term planning. Two of the Councils are in the process of increasing the forecast period of their long term plans, and are now setting plans for between 5 to 10 years where previously a three year outlook was common with a third Council now using a 10-year outlook for setting financial plans.

One of the Councils undertook a financial sustainability review recently which has proved useful in setting long term goals.

Most of the Councils are now following a similar approach for drafting long term plans, in that a draft is prepared by the Council staff, and the community is more actively involved in the consultation process before final long term plans are established. A number of Councils have reported that this process of community involvement has greatly assisted in aligning the plans of the Council with the expectations of the community, and has resulted in less complaints regarding rates as the community becomes increasingly aware of the constructive plans against which rates will be expended.

Although the process of setting plans has improved for some Councils, the majority of the Council representatives still reported that the process remains difficult due to the insecurity of long term funding and the inconsistency of the Government's funding schedule (i.e. many programs are funded for 1 to 3 years which makes it difficult to plan for 10-year periods). As there are a number of significant contracts up for tender across the Territory, this makes the Councils' future income unstable and often does not then allow Councils to sustain their long term plans.

3.2 Certain agreements entered into by Councils are loss making

We found when preparing the Deloitte Report that agreements are being entered into which are loss making for the Councils. The majority of the Councils reported that there are still programs which are continuously loss making, but as these services are essential services to the community, the Councils continue to provide these. Such services include operating the Post Office, Childcare Centres, Aged Care Centres, Parks and Gardens. The community has an expectation that these services will be provided so a number of Councils have continued to fund the deficit year on year using surplus funds generated from other programs. A number of Councils reported that providing minimum levels of service for certain programs is becoming increasingly difficult due to reductions in funding.

Most of the Councils reported improvements in responding to funded opportunities. One Council now has a dedicated grants officer responsible for reviewing opportunities, with another Council in the process of recruiting for a similar position.

A number of Councils advised that they are becoming more experienced in identifying hidden costs and cost management due to better utilisation of system functionalities and reporting. As noted in section 3.15, however there are still only a few Councils that have standardised their methodology for identifying and allocating indirect costs, therefore improvement in this regard will be key to ensuring loss making agreements are not entered into. Please see Section 3.15 for further details.

Overall, Councils have been endeavouring to manage costs more efficiently to address this issue and cross subsidise shortfalls where necessary. Even with the improvements noted above, as funding is continuously decreasing, there are still losses in a number of programs even with improved cost management, so this remains an issue across the Councils.

3.3 Core services are not being delivered to an acceptable standard

Core services were reported in the Deloitte Report as not being delivered to an acceptable standard, as there was inadequate funding to maintain core service delivery, and that minimum levels of core service delivery were not defined for the Councils.

Some core activities are still not being funded adequately by grants or 'own source revenue', and shortfalls have had to be cross-subsidised from other programs. A service funding change which affected many of the Councils was the cessation of CDEP, which was previously used to fund employees involved in many core services. To continue the service, some Councils have funded the shortfall in wage income for these employees with funds from other grants or own source income, leaving less funds for the service itself. Other Councils have terminated contracts with some employees as there was insufficient funding to cover their salaries, which impacted the delivery of the service.

In addition to this not all of the Councils were successful in their tender for the replacement program the Remote Jobs and Communities Program (RJCP) which has had a big effect on the forecasts for these Councils for the next financial year as this funding represented a significant portion of overall income. This may cause a shortfall in funding for a number of Councils over the coming period. One Council reported that they did not receive notice that they were unsuccessful in their tender for the RJCP program until two weeks before financial year end, which caused significant issues affecting staff employment and budgeting.

The Shire plans for three Councils now clearly outline minimum standards of core service delivery. Another Council had minimum service levels set out in the Big Rivers Regional Management Plan, although they understand that this plan has now been repealed and they are unsure who is now responsible for setting minimum service level. It was suggested by one Council that benchmarks for core service delivery be established to use as a guideline for setting their service delivery standards. Another Council is still developing guidelines regarding service levels and striving to be more efficient in service delivery however decreased funding year on year makes it increasingly difficult for Councils to meet these standards. Overall, most Councils still need to finalise minimum standards of core services to ensure that expectation gaps will not form between the community and the Council. If these are clearly set out it will also assist Councils in assessing costs of core services.

A number of Councils reported increased sharing of services which has helped to relieve this issue slightly, including joint waste management systems, asset management systems and information technology systems.

It should be noted that the current de-amalgamation of a Council into two Councils will put further pressure on their ability to deliver core services effectively unless emphasis is placed on shared arrangements.

Overall, there are still some instances of insufficient funding being received by the Councils to deliver core services to an acceptable standard, therefore Councils have to cross subsidise to adequately fund core services.

3.4 Costs are not being appropriately recovered from either funding bodies or users

It was noted in the Deloitte Report that costs are not being appropriately recovered from either funding bodies or users.

The majority of Councils noted this year that funds are still not being received in a timely manner and that the situation has deteriorated since the previous report. A number of Councils have reported delays up to a few months in receiving funds from funding bodies. In these instances the Councils have funded the program in the interim which caused budgeting and cash flow issues, and thus affected quality of service delivery. Two Councils did however report improvement in the regularity with which funds are received.

There were also incidents in a number of Councils whereby previously granted funds for programs were later announced as being no longer available, often where the Council had already commenced work. In some instances, the Council then had insufficient funds to complete these projects or were not refunded funds already spent. These affected the following programs:

- Road Works and Footpath Program
- Housing Tenancy Management Program
- National Disaster Relief and Recovery Program
- Dog Health Program
- Youth Voice Messaging Program
- Community Energy Efficiency Programs
- Job Matching Funds Program
- National Crime Prevention Program

As discussed in Section 3.2, some services still remain underfunded, and cross-subsidisation between programs is necessary in some instances. In addition, as some Councils have not developed a standardised methodology for allocating indirect costs (see Section 3.15), it is difficult for these Councils to have accurate indications of total expected costs when applying for opportunities.

Overall, under-recovery of costs remains an issue across a number of programs, and the Councils have to cross-subsidise between programs to fund these shortfalls as funding is inadequate. Refer to Section 3.5 for further information.

3.5 Cross subsidisation cannot be identified

Identification of cross subsidisation remains an issue in the current year, as observed in our previous report. Any programs running at a loss are being delivered using funding from other programs, including tied income that is meant to be used for specific purposes.

The majority of Councils reported that this is still ongoing across most programs. Often services are linked which makes it difficult to split costs between specific programs, but Councils deal with this on a case by case basis. There are funding shortfalls in a number of loss making programs and it remains the responsibility of the Councils to cross subsidise if they want the program to continue in operation. In addition to loss making programs, these funding shortfalls can be due to inheriting assets in poor condition and being unable to fund increasing maintenance rates, or due to increasing requirements in services. Councils are still pressured to fund these programs from rates and core income, which is already limited in a number of Councils.

As cross subsidisation is prevalent across most programs, it is difficult for Councils to identify and quantify specific occurrences. Again, as discussed in Section 3.15 some Councils do not have standardised methodologies in place for allocating indirect costs, and thus it is difficult to have accurate indications of overall costs when applying for grants, and if the program is loss making cross-subsidisation occurs. Councils advised that they do not have sufficient resources to have a full time staff member to quantify / allocate cross-subsidisation on a regular basis.

Overall, this remains an issue across the majority of the Councils.

3.6 Expectation gaps exists between communities and Councils on acceptable levels of service

We observed in our Deloitte Report that expectation gaps existed between communities and Councils on acceptable levels of service. These gaps occurred as a result of past policies establishing expectations which could not be sustainably funded by the Councils, yet due to the remoteness of these communities it falls to the Councils to provide services which other organisations or private entities would usually perform.

A number of Councils noted that communities' expectations will remain the same although funding is continuously decreasing, therefore Councils find themselves trying to 'do more with less'. As previously discussed (in Section 3.2), Councils will continuously provide these services as they are often considered an essential service to the community, and there is an expectation that these will be provided. The Councils are continuing to provide these through cross-subsidisation.

Councils are becoming more efficient in evaluating what new programs can be successfully delivered within a community, through improvements in costing techniques, before accepting an opportunity. Certain Councils have recruited grants officers to specifically focus on finding funds to assist in managing what services can realistically be delivered to the community with the resources and level of funding available. One Council has developed concise service level standards which have been very well received.

The majority of Councils received fewer complaints from the community in relation to service delivery. Some Councils are in the process of implementing policies and procedures for dealing with complaints as they arise.

A number of Councils are actively involving the community in setting the long term plans of the Shire, which has helped to align expectations with what the Council can realistically achieve, including more interaction between the Chief Executive Officers and Councillors themselves when dealing with community issues.

Overall, this does not appear to be a significant issue for the majority of Councils.

3.7 Funds are not available to maintain, repair or replace gifted assets

Funds were previously not available to maintain, repair or replace gifted assets. As noted in the Deloitte Report many Councils were gifted assets by organisations, but the donating party often did not plan to provide additional financial support for the ongoing operation and maintenance of the capital assets.

This appears to be less of an issue for the majority of Councils, as they did not accept any gifted assets over the past two years, with the exception of two Councils who accepted gifted assets since the last report.

One Council is in the process of being gifted a Police Museum, and it expects that enterprise revenue will be sufficient to cover costs. Another Council has received a new water project from an organisation and have secured an additional grant to cover maintenance costs. Neither Council foresaw any issues with maintaining these new gifted assets in the future.

There are previously gifted assets which are proving difficult to maintain because as mentioned above, only the purchase price of the asset was gifted and maintenance of the asset is now the responsibility of the Council. One Council was previously gifted a swimming pool which it cannot open to the public at full capacity of hours due to insufficient funds to cover lifeguards and maintenance. Another Council reported a decrease in funding from the Department of the Attorney General and Justice to support costs associated with night patrol vehicles and the office which was previously gifted to them, and this is causing ongoing resource issues. Another Council advised of a swimming pool which is being funded through a combination of grants and donations from local businesses.

A number of Councils reported improvements in their ability to assess whole-of-life costs before accepting gifted assets and programs, as mentioned in Section 3.2 above, and it appears that this year Councils are not becoming burdened with unsustainable gifted assets as in prior years.

3.8 Insufficient funding available for infrastructure and capital assets

There still appears to be insufficient funding available for repairs, maintenance upgrade and replacement leading to an increased backlog of infrastructure and capital assets. It was noted in the Deloitte Report that capital asset replacement plans were not in place in most Councils.

The majority of Councils have this year again expressed their concern about the level of funding available to repair and maintain capital assets, in particular roads, Council buildings and drainage systems. The issue is not just an inability to purchase necessary new assets due to lack of funding, but also an inability to maintain and repair assets they already have. It was also noted that much of the infrastructure within the communities were not built originally to comply with industry standards, which puts increasing financial pressures each year on the Councils.

As discussed in Section 2.5.4, five of the eleven Councils have an overall average sustainability ratio of less than one over the past four years which indicates that the capital being consumed exceeds the Councils' investments in capital as there is insufficient funding to cover this year on year.

A number of Councils have now put in place a capital expenditure program to assist in planning for maintenance costs and, where relevant, new purchases, however the lack of funding remains the key issue. Some Councils highlighted the fact that there is no regional infrastructure program in place in the Northern Territory, and would welcome this.

This situation has not improved since the prior year, especially due to the additional level of roads now being the responsibility of the Councils, without a transfer of funding to fully cover this.

3.9 There is a lack of transparency in financial reporting

The Deloitte Report stated that there was a lack of transparency in financial reporting across the Councils, and often information was not available or comparable with other Councils.

This year the Councils feel that they have improved the transparency of their reporting by utilising more functions on their systems and having better visibility as a Council over their own financial information. Finance Committees have been established in some Shires to manage this. Councils reported increased use of their websites to make this improved information available to the community, as well as annual reports. Certain Councils use their websites to disclose the accounting policies they use as a Council.

For the year ended 30 June 2012, six Councils had unqualified opinions on their financial statements. For the year ended 30 June 2013, eight Councils had unqualified opinions showing increased compliance with financial reporting, among other improvements.

Local Government are in the process of drafting a suggested income and expenditure template for the Councils which will assist in having more comparable information, but this has not yet been finalised.

3.10 Rateable properties may not be identified and rates not collected

An issue raised in the Deloitte Report concerned rateable properties not being identified, associated rates not being collected and conditional ratings preventing the Councils from generating sufficient income.

Collectability of rates appears to be less of an issue for the Councils this year. A number of Councils reported improvements in the collectability of rates mainly due to the efficiencies in the procedures surrounding rates collection and more accurate information being stored on the system regarding names and addresses. Providing more information to the Community about what rates revenue is used for has also contributed to improved collections.

Four Councils have undertaken their own reviews of the rates which has increased rates and income received by the Councils. A number of Councils mentioned that the collection of rates is hampered by

the fact that there are so many exemptions and 'loopholes' in legislation, which allows quite a few rates to 'fall through the gaps'.

There have been changes in some of the Councils regarding how some properties are assessed for rateability, i.e. certain properties are now split into a number of units which has increased rate applicability. Further to this, there has been an increase in sale by Councils of properties where there were large rental arrears. These properties have been sold by the Councils as permitted under the Local Government Act in order to recover the backlog thus reducing rates arrears.

The key issue relating to conditional rating on certain types of properties (including mines and pastoral lands) remains an issue this year. Councils have expressed the desire to review these conditional rating systems, but no significant changes have been noted in this area since the Deloitte Report.

3.11 Planned changes to leasing arrangements are likely to have a detrimental financial impact on Councils

Planned changes to leasing arrangement were likely to have a detrimental financial impact upon the Councils as reported in the Deloitte Report. These changes involved the expiration of all five year leases of land held by Councils in August 2012, regardless of whether the land had buildings or other infrastructure on them.

This situation has not affected some of the smaller Councils, but for other larger Councils it is an ongoing issue. Some Councils are still in negotiations regarding these leases and the situation is still being monitored. Another Council had to transfer an aged care centre to another organisation and it is still being negotiated how this should be managed in the future. Nearing completion of the process one Councils are anticipating costs which range from \$95,000 per annum to \$380,000 per annum, which is a cost borne by the Councils.

Councils are facing constraints establishing 40-year leases on Aboriginal land for facilities used to deliver services that are actually funded annually. Loss of contracts may result in some of the premises used to deliver the programs being unused but the Council is still required to pay for lease costs. Similarly, if there are any delays in signing of agreements or receiving funds these costs will have to be funded from other sources.

This situation remains an issue as negotiations appear to be ongoing and not finalised for a number of Councils.

3.12 Funding to cover costs of policy initiatives introduced by other levels of government have not been transferred to Councils

It was noted in the Deloitte Report that the costs associated with policy initiatives introduced by other levels of Government were being transferred to the Councils without an equal transfer of funding such as road maintenance being transferred to the Councils as their responsibility.

The following policy initiatives have affected Councils:

- Overall road maintenance costs continued to be a significant issue across the Councils, as discussed in Section 3.8
- As noted in Section 3.11 the Northern Territory Government leasing policies continue to be an issue for a number of Councils
- As noted in section 3.3 the replacement of CDEP with RJCP has affected a number of Councils.
- Power and Water Corporation tariffs have been passed onto Councils

Previous increases in operational funding grants now need to be used to fund the above.

In addition to this a Council advised there are ongoing negotiations surrounding the passing on of a charge from the Power and Water Corporation for maintenance of street lamps in one of their communities where the cost of maintenance had previously not been the Council's responsibility.

3.13 Budgeting and accounting policies, procedures, systems and reporting in place in many Councils are inadequate

It was highlighted in the Deloitte Report that the budgeting and accounting policies, procedures, systems and reporting in place in many of the Councils were inadequate leading to a high risk of materially misstated financial reports and possibly resulting in Councillors and management making inappropriate decisions on the allocation of scarce resources.

The majority of the Councils reported improvements in this area. Budgeting improvements are due in some cases to better utilisation of systems by staff members and the use of additional functionalities/reporting capabilities within the systems to assist with the budgeting process. The improvements are also due to clearer procedures in place with regard to the budgeting process, and more involvement from management and boards in setting budgets. Additional and more experienced staff members have been employed in some of the finance teams and we were advised this has greatly assisted in improving efficiencies.

Two Councils feel they have better utilised their subsidiary, Latitude12, to manage the budgeting function on behalf of these Councils and feel efficiencies have been notable in the processes.

Another Council has implemented additional procedures and engaged two external forensic auditors to advise on the financial systems, along with establishing an internal audit committee. One Council also undertook its own financial sustainability review which greatly assisted in developing long term planning.

Overall, there have been improvements made in this area since the prior report.

3.14 Costs associated with onerous reporting requirements reducing funding available for core service delivery

We previously reported that onerous reporting requirements imposed by funding providers had caused inefficiencies, additional costs and administrative requirements that reduced funding available for core service delivery.

Most Councils reported no reduction in the reporting requirements to the Northern Territory and Federal funding providers.

Councils advised there are few similarities between the reporting requirements of the Northern Territory versus the Federal requirements, and efficiencies in reporting could be established if reporting was more standardised between these bodies. It was also noted that smaller grants still required the same level of reporting as larger ones, and it would be more efficient if the requirements were reduced for certain smaller grants.

This remains an issue for the majority of Councils, although slight reductions in reporting requirements were noted by two of the Councils, for example Federal funding previously required reporting on a quarterly basis which has now been changed to a semi-annual basis.

3.15 The true cost of providing services cannot be identified or funding providers are not funding an appropriate level of overhead

The Deloitte Report identified that the true cost of providing services could not be determined for a number of Councils because there was no established and agreed process for identifying and allocating indirect costs and funding providers are not providing an appropriate level of overhead.

Three of the Councils now have a standardised methodology for allocating these costs and accordingly they have been more successful in allocating these costs more efficiently. Another Council is currently developing a methodology but improvements in the process have already been noted due to additional and more experienced finance staff.

For Councils which did not have a formal methodology in place, most of these Councils base their allocation on the percentages outlined in the grant agreement and the percentage allowed by funding

bodies, which is generally between 5% and 15%. Councils may not be able to accurately identify what the true costs of a program are and this increases the risk that programs will be underfunded.

Overall, it would be beneficial for all Councils to implement formal methodologies, as this has not been done for the majority of Councils and completion of these methodologies remains a priority for the Councils. This is a potential area for local government assistance.

3.16 Lack of shared services between Councils

The Deloitte report identified that there was duplication of costs between the Councils which could be alleviated through sharing of certain services between the Councils. The hub and spoke structure in place at many Councils is an appropriate structure to deliver services in such widely dispersed geographical situations. However, this remains an issue irrespective of the structure due to the availability of appropriately skilled employees within communities and the distance between them. Part funding of a position is not appropriate where that individual must spend regular amounts of time in a number of areas. Deloitte observed that there has been some improvement in sharing of service efficiencies noted between the Councils, most notably joint projects in both waste management and asset management. However the remoteness of the Councils remains the key issue which prohibits general sharing of core or agency services. Deloitte recommends that corporate services could be shared between the Councils. Council Biz and Latitude 12 have achieved savings in administration costs, but more sharing of corporate services is recommended including the use of joint consultants and engineers etc.

3.17 Summary

Overall, a number of the above points remain an issue for the Councils. In particular the backlog of infrastructure remains a concern for the Councils, and assistance from an asset replacement fund would be very beneficial for the majority of the Councils. Conditional ratings continue to cause revenue issues for Councils, and a review of these conditional ratings by Government could be an avenue for significant revenue generation for Councils. More formal methodologies for budgeting and allocating costs would be very beneficial for Councils. Also, more focus on shared services could prove a successful cost saving initiative for the Councils.

Due to escalating costs which the Councils now bear due to policy initiatives being passed on by other levels of government, an increase in the NT Operational Grant will be necessary to ensure service delivery is not affected. Councils have already increased rates and improved costing to cover service delivery and, without an increase in funding from Government, service levels in some communities will have to be reduced. The emerging and ongoing costs include:

- Land leasing costs to secure tenure over Aboriginal land to continue delivering services (based on average cost estimates received from Councils this cost is estimated to be between \$2m to \$2.5m per annum across the Territory);
- New costs associated with councils being charged for street lighting and maintenance (based on average cost estimates received from Councils this cost is estimated to be between \$800k to \$1m per annum across the Territory);
- Continued backlog of infrastructure assets;
- Increase in power and water tariffs;
- New costs associated with the establishment of Local Authorities (see Section 4).

Based upon the best information, we categorise the current finances and financial policies of the Councils subject to our analysis as financially unsustainable based on current practices, although we note that there have been significant improvements in a number of areas since the last report. This does not mean these Councils are in imminent danger of defaulting on their debt service obligations or that their immediate financial viability is being questioned, however the long term financial sustainability of these Councils will only be achieved through substantial or disruptive adjustments to revenue and/or expenditure.

4 Analysis of proposed separation of Victoria Daly Shire Council into two separate Councils

Deloitte performed an analysis of the potential costs associated with the proposed separation of the VDSC into the Victoria Regional Council and the Daly River Council. Deloitte has estimated both the one off costs as a result of establishing the new Councils, as well as the estimated revenue shortfalls (deficits) for the first year of operation for each of the Councils. These indicative cost estimates are based on a range of assumptions, which would need to be verified depending upon the individual region's circumstances. There has been no final decision as to whether to create two new Councils, or to create one new Council and redefine the border of the existing Council.

Deloitte assessed both elements of the separation process; the one off establishment costs and the ongoing costs. For the one-off establishment costs Deloitte estimated rates per hour for both inhouse staff and outsourced consultants and timescales necessary to carry out the initial start up tasks, as well as any purchases of assets needed, to estimate an overall cost. To estimate the ongoing costs, Deloitte used VDSC's 2014 budgeted data as a basis for estimating what costs will be involved in running both Councils.

Please note that these estimates are based upon a high level understanding of the costs involved in the process rather than through development of a detailed model. Should further clarity be required on the costs involved, we recommend that the development of a detailed model using actual past costs and future estimates as the basis for the analysis.

One-off implementation costs

Deloitte conservatively estimate that establishment costs will be between \$2.5 million to \$4 million, however the final costs are largely dependent on a number of decisions yet to be made. These one-off costs relate to a number of areas, and broadly cover the following:

1. Finance costs – estimated cost \$200,000 to \$300,000

These costs would be incurred in undertaking a review of the general ledger as a result of the transfer of assets, transferring information from the current accounting system to a new system, implementing accounting standards for the new Council, preparing opening annual budgets for new Councils and conducting a preliminary audit report, among other costs.

2. Human resources (HR) costs - \$500,000 to \$700,000

These costs would be incurred in order to implement HR processes, procedures and legal requirements in the new Council (including developing salary packages, recruitment, setting code of conduct etc) and to review the HR practices in the existing smaller Council.

3. Information technology (IT) requirements - \$600,000 to \$700,000

These costs would be incurred in order to implement new IT systems across a range of functions, and the costs of purchasing additional hardware.

4. Legal costs - \$150,000 to \$250,000

These costs may be incurred if there is a need to seek legal advice on a range of areas including employment contracts, leases and establishing local by laws among other costs.

5. Planning / strategic costs - \$150,000 to \$200,000

These costs would be incurred to assist in setting annual and long term plans for the Council, setting governance plans/structures, and also implementing due diligence procedures related to the transfer of accounting balances and physical assets.

6. Operational costs - \$500,000 to \$700,000

These costs would be for developing Council policies and service plans, as well as covering the cost of acquiring additional offices or buildings.

7. Electoral costs - \$400,000 to \$600,000

These costs are estimated for holding elections for new Council members in both of the new Council areas as necessary.

8. Transition committee costs - \$80,000 to \$100,000

These costs are intended to cover airfares, travel accommodation and associated costs for the committee members during the initial establishment of the Councils.

Please note that these estimated costs represent likely costs associated with separation and are not based on a detailed model and analysis taking into account past trends.

It is currently proposed that the new headquarters for the Daly Rivers Council be established in Peppimenarti, however the current lack of available accommodation or office buildings is a key consideration. Peppimenarti is difficult to access during certain periods of the year when flooding becomes prevalent which will increase transportation costs. There has been no decision whether new Council elections will need to take place in either or both of the new Council areas, as these are costly and time consuming processes for a Council.

We have made the following key assumptions when estimating one-off costs:

- The separation process takes place at the start of the financial year
- One new Council is established and the existing Council's boundaries are redefined
- Office buildings will need to be purchased / built (note that it is still being considered whether demountable offices will be used)
- Additional short-term assistance to carry out finance, IT, legal and HR tasks are carried out by external consultants
- Two elections (one for each Council) will need to take place to elect Councillors
- A transition committee will need to be established
- The new Council will require the following staff: CEO, Director of Corporate Activities, Accounts Officer, Executive Officer, Procurement Officer, Receptionist, Governance Manager and six additional Administration Staff

Ongoing costs:

Using VDSC's budget data (as entered in the Tech1 system) as a basis, Deloitte estimated a revenue shortfall of approximately \$3 million to \$4 million per annum for each Council will occur per annum in the absence of alternate or changed revenue sources and/or reduced operating costs. This costing analysis assumed no agency services income or service level agreements between the two Councils, and assumed the same level of service delivery will continue.

Duplication of costs remains the key issue particularly in relation to head office expenses, salaries and licence fees.

Certain grants (including financial assistance grants, road grants and NT operational grants) are allocated to the existing Council based on a set formula which takes into consideration population and remoteness, therefore when a Council's border is redefined this affects the entire NT distribution, rather than resulting in a straight forward division between the two Councils being separated.

This shortfall in each Council will need to be funded to ensure that the Councils can effectively deliver their core services.

We have made the following key assumptions when estimating ongoing costs:

- One new Council is established and the existing Council's boundaries are redefined
- No agency, administration fee income or grants income is received
- No service level agreement between the Councils is in place
- A split of rates and certain associated costs of 45% to 55% between Victoria Regional Council and Daly Regional Council respectively (based on population split)
- Certain activities will continue to be carried out by both Councils
- VRC will lose four administration staff
- Each Council will consist of six Councillors
- New headquarters will be located in Peppimenarti
- The new Council will incur same Council Biz costs as there is a fixed rate charged per Council.