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Dr. Ron Ben-David
Chairperson
Local Government Rates Capping and Variation Review.
By email to esc.vic.gov.au

Dear Dr. Ben David

I write to you on behalf of Ratepayers' Victoria Incorporated to submit our comments on the first draft report "A Blueprint for Change". The report seems to meet most of the challenges and we forward a number of further points for consideration of the Committee.

Chapter 2. The Rate Cap – Establishment.

The conclusion that the rates be capped per assessment, rather than total rate revenue is confusing. The Act, at s185B allows The Minister to cap the amount(s) which form General Income. Presumably, the intent in the report appears to be to drop service rates and service charges from the definition of General Income. Your fairly complex definition in Box 2.2 ends up as:

$$\text{Rates paid by average ratepayer} = \frac{\text{Total revenue from the rate}}{\text{Number of rateable properties}}$$

This is the current method of calculating the Municipal Charge (in some Councils). You appear to have introduced a common flat rate rating system to the General Rate. As the Municipal charge is for a different activity to the general rate (footnote on Box 2.1) it would be better to calculate the two items separately. It is not clear if calculation of the general rate in a manner different to the conventional, is intended. (Valuation of property is not considered in your scheme) If tradition were to prevail, the box at 2.2 would then be:

$$\textbf{Municipal Charge paid by each charge payer} = \frac{\textbf{Total Revenue collected from the Municipal Charge}}{\textbf{Total number of Properties paying the Charge}}$$

And

$$\textbf{General Rate Paid by each Rateable Property} = \frac{\textbf{Total Revenue to be Collected from General Rate}}{\textbf{Property Valuation Ratio}}$$

And

$$\text{Property Valuation Ratio} = \frac{\text{Value of all the Rateable property in the Municipality}}{\text{Value of the individual property being rated}}$$

Either group of calculations is able to form the Capping Base in a rate capping system. Whatever the capping system, the four sectors, General Rate, Municipal Charge, Special Rate and Service Rate, will need to be dealt with by separate accounting systems. There is a fifth sector which is relevant, that of Municipal Enterprises.

It would also appear that the intent is to use the same annual rate cap for both the Municipal Charge and the General Rate (s2.4). These are the two revenue streams to be capped. The other three sectors have inherent controls which render capping unnecessary.

We put the suggestion forward that, as the administration cost is largely a labour cost, and the general rates a contractor and materials cost, each of the rates would be better with separate rate caps. Such an arrangement would allow for different efficiency factors on each rate cap. (Box 2.3 could be modified).

Chapter 2. The Rate Cap – Implementation.

Having found a suitable capping base and a capping rate it is simple arithmetic to establish, for each Council payer, what the rate charged is to be**. HOWEVER**, we bring your attention to the errors and uncertainties in such a process.
Note that the element being capped is **REVENUE** (para 2.5, p15). Because of timing difficulties, Council cannot send out invoices based on the cost of the necessary program of work, at the time the work is completed and the cost is known. Revenue is collected as a **pre-payment based on the cost estimate contained in the budget.** The actual cost is either greater or less than estimated. The revenue is not accounted for until fifteen months after the rate demand is issued. It is not possible to wait until accounting date to determine the revenue needed.

The LGA has provision to deal with uncertainty. To allow for shortfalls to be met, there is a provision, at s128, for a Revised (increased) Budget to be prepared. However, in practice, revised budgets are avoided by a process of generous estimating and the collection of a surplus to cover contingencies. (VAGO standards require a surplus "greater than 0%"). This process invariably results in the amount of revenue collected, significantly exceeding the cost of the programme of work. There is provision at s165 and s141(b) and (c) for the unused money to be returned to the ratepayers. This provision is being (unlawfully) ignored.

Revenue is collected each year, in all Councils, which is unused. It is unaccounted for in the Balance Sheet, varies between Councils, and simply shows up as an unexplained event in the Cash Flow Statement. Even councils who have to borrow to balance the cash flow, borrow more than needed so accumulate a surplus.

It is suggested that if capping be applied to the revenue, the base must be adjusted to allow the surplus in the base year to transfer, as a reduction in allowable revenue, to the following year. (Run a prepayment account in the Balance Sheet)

Thus, Rate Capping Base in Yr 0 = Rate Revenue in Yr 0 - Revenue Surplus in Yr 0.

As a further complication it is observed that some, if not all, councils use rate revenue to purchase capital goods. They are also able to provide this supply from borrowing. Obviously, it is possible to switch sources of capital supply from income to borrowing, negating any constraint from the rate cap. There is no indication in the draft report that this issue needs to be addressed, let alone how it is to be resolved.

We suggest that the issue of control of capital supply be addressed, in the Final Report, to save the rate capping process from immediate irrelevance. The issue is, "should all capital be supplied from annual revenue or should no capital be supplied from the same source; the uncontrolled intermediate position is untenable".

Further to the need to remove the revenue surplus from the capping base, there is the need to deal with the hidden accumulated surpluses in Councils. There are hundreds of millions of dollars concealed in accounts which have been acquired from revenue collected for purposes which were oversupplied. This revenue has been retained by councils despite the provisions of s141(b) and s141(c) of the LGA. It is substantial and totals many hundreds of millions of dollars. In Bayside, with annual revenue about $110 million, there was just short of a spare $30 million traceable in their 2014 accounts. Should the rates in Bayside be capped, they could resume the 8-9% increase in spending (6% over the cap) for the next five years or more and take the money from hidden reserves.

We suggest that the issue of how to utilize the accumulated surplus funds held by Councils, without upsetting the rate capping process, needs to be addressed. The honest way is to return them to the ratepayers. Initially, such funds need to be frozen so that the rate capping process be allowed to work.

Turning our attention to rate capping in the Municipal Charge, we find that this is like trying to trap a jelly in a string bag. The LGA, at s150, indicates the charge is to cover some of the administrative costs of Council. The report notes that the nature of the costs met by this charge are not defined. In practice, different Councils calculate the charge in different ways. Some charge in the manner set out in Box 2.2, others use a fixed annual sum per property and some do not apply the charge.

The setting of caps in such a diverse set of circumstances would tend toward a nonsense. It would prevent a council from moving costs from the general rate to the municipal rate if it found the status untenable. Before setting the Yr 0 cap it is necessary to define what the administrative cost consists of.

Definition of a common series of cost sectors which all Councils must adopt is essential, with the accounts recalculated as appropriate. Because of the 80/20 ratio limit, of operating cost to administration costs, the municipal charge, has an overriding cap. This is a necessary constraint to prevent a "top heavy" organization. However it

requires a new and restructured set of accounts for Yr 0 and the obligation imposed on all councils to follow a standard cost allocation system.

Chapter 2. The Rate Cap – Reporting

The information indicated to be monitored shown in Table 2.4 deals with rating outcomes rather than rating requirements. All the rating activity takes place at budget time. The information is needed in March of Yr. 0 but can only be developed as an estimate; firm data forYr.0 does not become available until September of Yr. 1- after the budget for Yr 1 has been converted into a rate notice. Maybe the rate capping to be used for year 1 needs to be collected from data available at Yr -1 and given a double rate increment i.e. $(1 + r)^{2}$. (The introduction of back adjustment to accounts for 2014 assists here)

Some process must be agreed to deal with the timing constraints where rates are based on estimated costs.

The list in Table 2.4 would seem largely superfluous if the only items being capped are General Rates and Municipal Charges. The real task is to ensure no cross subsidy between sectors. Note that Municipal enterprises do not appear to have been considered, yet form a major source of improper subsidy from the general rate.

The evaluation task is essentially one to control the budget. Maybe there should be a step in the budget process (as part of the public review under s223 of the LGA) where the test is:

- **is the expenditure properly assigned to the general rate, and**
- **is the administration cost properly assigned to the municipal charge, and**
- **are both estimates within the rating cap?**

Chapter 3. The Variation Process.

This readily fits into the existing review process under s223. All that is necessary is for a supplementary expenditure budget to be prepared. Identification of the basic needs and the preparation of a schedule of estimated costs would be published for consideration. A simple set of requirements, (per para 3.3) giving a few items of information, promoting the cost and relative importance of the proposal, is all that is needed. If incorporated into the s223 process, public comment would be also be allowed. The ESC being nominated as the arbiter of the outcome from such process, will make a welcome addition. The outcomes need to be limited to something like:

- approval
- not suitable ever
- not suitable at this time
- could be covered by a special rate
- could be covered by a municipal enterprise.

Note that special rates and municipal enterprises have their own rules of acceptance.

In the present format of budget review, Council is both the proposer and the judge. A change to a new and independent judge, in the case of supplementary expenditure proposals, will be welcome.

Chapter 4. Monitoring and Reporting.

The ideas listed in this sector are valid but take responsibility away from those with have the traditional task of reporting compliance with the rules. The auditors should be accorded the task of reporting compliance, overseen by the Auditor-General. A set of auditing tasks, carried out by the auditors appointed to the Audit Committee, should be established. The auditors will then monitor and report nominated outcomes.

The monitoring and reporting task needs to be a key part of the annual audit. Importantly, there is a need to ensure that the non-capped sectors remain within their defined (lateral) limits. This can only be verified by monitoring and reporting all of the activities of a council.

SUMMARY.

Ratepayers Victoria Inc. supports the following:

That a Municipal Rate cap be established, and

That the rate cap be established from a base year calculated on the actual performance data from the 2014-15 financial year, and

That rate controls be applied to individual activity centres consisting of:

- General Rates
- Municipal Charges
- Special Rates
- Service Rates and
- Service Charges and Municipal Enterprises, and

That rate caps be applied to General Rates and Municipal Charges only. (The others have inbuilt controls).

That the capping base be the rates paid by the average ratepayer, in the base year, adjusted to correct for the return due for rates levied yet not spent during the rating year, and

The capping rate be calculated either as a combined rate (0.6 CPI + 0.4 WPI) over both caps or as separate caps with CPI for the General Rate and WPI for the Municipal Charge.

The system will have to identify and define the nature of the costs which are assigned to each of the five cost centres. This is generally clear but is suggested as:

Municipal charge	Costs of governance (or administration)
General rate	Supply of goods and services (incl management of supply) Limited to g&s of benefit to all occupants and owners of land.
Special Rates	Supply of goods services and management to groups Generally limited to geographic locations and set tasks.
Service Rates	Supply of goods services and management to selected customers Typically opt-in services such as garbage etc.,
Service Charges	Supply of goods services and management to groups/individuals Typically sporting clubs, kindergartens, plant nursery etc.

Following the establishment of the five operating sectors, the accounting system needs to be standardized. While it will need to be very different in outcome to that currently on offer, very few changes are needed – simply stop trying to account for profit and include ALL expenditure in the income and expenditure account. The 2014 accounting regulations are set up to provide a suitable financial reporting system.

We support the proposed reporting and monitoring proposal. However we see it best incorporated with the current rate setting system set out in s127-s129 of the LGA. Likewise, reporting compliance will be a task properly assigned to the auditors.

Obviously, following the adoption of the capping procedure, there are many tasks to support the evaluation and rate setting procedure. We are willing to participate in any working groups need to identify the finer detail of the proposal.

Yours faithfully

George Reynolds,
Vice President.