Managing local government rates and charges

Report 17: 2017–18

Queensland Audit Office

Better public services

Contents

Audit objective and scope

This report is the second in a series of performance audits on the financial sustainability of the local government sector. It follows our 2016–17 audit on forecasting the sustainability of local government (*Forecasting long-term sustainability of local government* (Report 2: 2016–17)).

In Report 2: 2016–17 we noted councils need to generate sufficient finances to continue to operate without eroding their physical asset base. The major recurrent sources of finance available to councils are rates, fees and charges, and grants.

This audit examines rates and charges. Future audits will examine other elements of financial management such as the cost of local government services and strategic asset management.

The objective of the audit was to examine whether councils set and administer rates and charges appropriately to support long-term financial sustainability.

We assessed whether a selection of councils:

- have robust and transparent processes for setting rates and charges
- have revenue policies and statements that meet legislative requirements
- effectively administer rates and charges according to legislation and better practice.

Our scope included a high-level review and analysis of published budget documents of all non-Indigenous councils. We excluded Indigenous councils because most of them do not charge general rates.

We also audited one council from each of five of the Local Government Association of Queensland's segments:

- coastal
- resources
- rural/regional
- rural/remote
- South East Queensland.

We gave each audited council a detailed brief specific to it and we used the findings for this report.

More information about the audit objectives and methods is in Appendix B.

Key facts

The five audited councils use between 16 and 72 different general rates categories

In 2016–17, 44 councils were at high or moderate risk of becoming unsustainable

77 Queensland councils provide services to nearly five million people

Councils collect rates, levies, fees and charges of more than $6 billion per year—which is about half of their total revenue

In 2016–17, total council revenue from rates and levies increased by $236 million

Introduction

In 2016–17, Queensland's 77 councils generated more than $6.2 billion revenue in rates and levies. This was approximately 50 per cent of their total revenue. For many of them, rates, levies, fees, and charges are the main source of revenue other than Queensland and Australian Government grant funding.

Rates and charges

There are four types of rates and charges:

- general rates—these contribute to services and facilities that everyone uses, such as roads, parks, sporting and cultural facilities, and general council administration
- special rates and charges—for services and facilities that only benefit particular properties, such as rural fire equipment for certain rural areas
- utility charges—for waste management, sewerage, and water services
- separate rates and charges—for any other service or facility not already covered.

Appendix C provides full definitions of the main terms used in this report.

General rates are, in effect, a general tax providing a revenue base to fund council activities that are not funded by the other three types of rates and charges, or other sources of revenue. They are a tax based on the value of land, not a fee for a particular service or facility.

The *Local Government Act 2009* (the Act) and the Local Government Regulation 2012 (the Regulation) allow councils to develop their own approaches to meet their communities' needs through rates and charges. A council's approach is referred to as a rates strategy.

A rates strategy may include, for example:

- how a council decides to charge different amounts of general rates for different categories of rateable land
- how it sets minimum levels of rates for different categories
- whether it caps rate increases
- whether it uses averages of two or three years of valuations to calculate general rates.

Setting rates and budgets

The Act and Regulation prescribe how councils must develop their annual budgets and set rates and charges each year. Under the Act, mayors present their budgets to councillors, who consider and adopt them by resolution, with or without amendment. In practice, council staff and chief executive officers assist and support mayors in developing budgets over many months. Councillors are often involved in this process.

The Act and Regulation also require that councils:

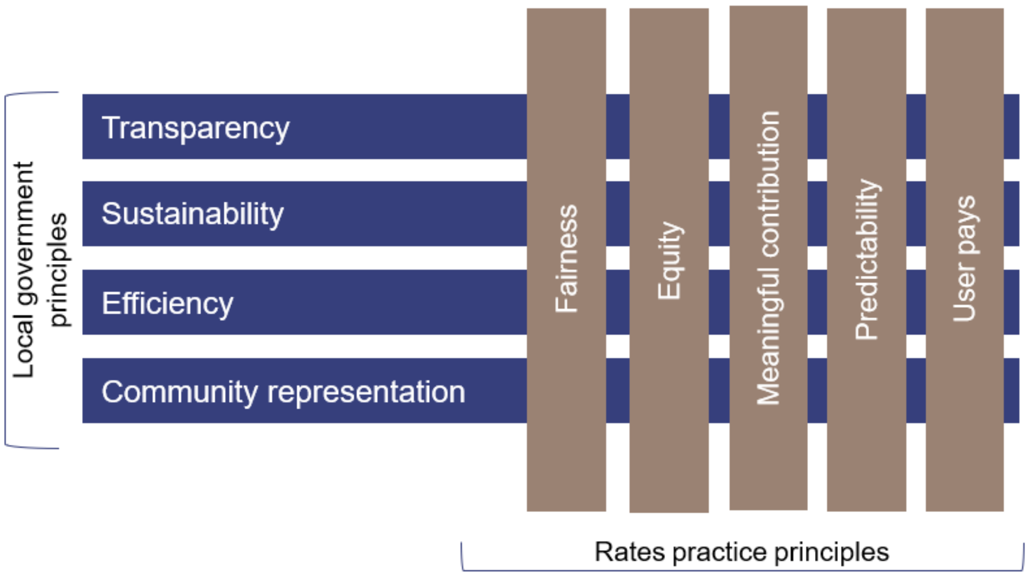
- adopt their budgets before 1 August each year
- include in their budgets a range of documents (such as a revenue statement and a revenue policy)
- pass a resolution each year at their annual budget meeting setting out the differential rates categories they intend to use in the financial year
- pass a resolution each year at their annual budget meeting setting the rates and charges for the financial year.

The Act also includes local government principles with which councils must comply in everything they do. These include transparency, sustainability, efficiency, and community representation. As well as these principles, some court cases and other research identify a range of principles specifically about rates and charges (these are known as rates practice principles).

Figure A shows the complexity councils face in balancing all these principles when setting rates, developing financial forecasts and budgets.

Figure A

Key principles for forecasting and managing rates effectively



Source: Queensland Audit Office adapted from the Local Government Act ss. 3 and 4, the Australian Productivity Commission's April 2008 report: Assessing Local Government Revenue Raising Capacity, and the Department of Local Government, Racing and Multicultural Affairs' June 2017 Guideline on equity and fairness in rating for Queensland local governments.

Financial sustainability

A council is financially sustainable if it can maintain its financial capital and infrastructure capital over the long term (at least 10 years). Infrastructure capital refers to a council's physical assets, many of which do not have any return on investment and yet require considerable maintenance over their long lives. They include things like roads, water pipes, storage and treatment facilities, sporting fields, playgrounds, parks and gardens.

Most councils raise revenue through rates and charges. Ideally, councils set rates and charges at a level that allows them to maintain their assets in the short- and long-term and deliver services in line with community expectations now and in the future.

For some councils, the rates they can collect from their limited ratepayer base is very small compared to their reliance on other sources of revenue such as state and federal government grants and subsidies. But even these councils must manage this revenue source well to contribute to their long-term sustainability.

Under the Regulation, councils must calculate and disclose key financial sustainability measures in budget documents, long-term financial forecasts, and annual reports. In our report on *Forecasting long term sustainability of local government* (Report 2: 2016–17) we recommended, among other things, that the now Department of Local Government, Racing and Multicultural Affairs allow councils to set their own financial sustainability targets where they can justify that a different target is more appropriate for their long-term sustainability.

The Department is currently considering this recommendation but has not yet implemented it. In the meantime, the measures currently specified in the Regulation are the:

- operating surplus ratio—the extent to which a council's operating revenue covers operating expenses (a positive ratio means the surplus can be used to build or replace assets or repay debt)
- asset sustainability ratio—approximates the extent to which a council is replacing its assets as they reach the end of their useful lives
- net financial liabilities ratio—the extent to which a council's operating revenue can cover its liabilities (such as loans and leases).

Overdue rates and charges

The Regulation includes a range of options for councils to use when rates are unpaid or overdue. These include charging interest, taking court action, selling land, and acquiring land.

These and other legislative requirements and guidelines governing recovery of overdue rates and charges are complex, but the significance of the outcomes (for example, sale of land without the owner's approval) makes it critical that councils comply with them.

Summary of audit findings

How transparent are councils' rates strategies?

The five councils we audited use between 16 and 72 differential rates categories. They also use minimum charges, where the rates are set at a minimum level regardless of the value of the land. Within the residential property categories, across the five councils, between 23 to 87 per cent of properties are charged at the minimum level.

One of the councils we audited publishes a comprehensive description of its rates categories, why it uses the different categories, and the rationale for the different levels of rates for each category. This council includes this description in its annual revenue statement. The other four councils we audited do not provide this level of detail in their revenue statements or policies.

Three of the five councils' revenue policies include all information required by the Regulation (section 193). One includes most of the information but not all of it. The fifth council does not have a current revenue policy at all. Section 193 of the Regulation requires councils to include in their revenue policies, among other things, the principles they intend to apply when levying rates and charges and granting concessions.

Although the Regulation does not require councils to document their rates strategies, this absence of detail limits the ability of ratepayers to understand the drivers of general rates. It also makes it hard to compare and predict the level of general rates that different councils charge for similar properties.

Do councils consider sustainability when setting rates?

Setting rates and charges

The budgeting and forecasting processes of the five councils' we audited identify their short- and long-term revenue needs. Revenue needs should reflect the full cost of maintaining and replacing council's assets. We expected to see councils increasing rates to cover the gap between their forecast revenue from other sources and their forecast revenue needs. However, we found that their decisions to increase rates and charges at certain levels are not directly linked to their forecast revenue needs. Rather, they increase rates at levels that councils consider to be fair and reasonable for their ratepayers, rather than with a focus on operating sustainably over the long term without eroding their physical asset base.

Their rate modelling processes put their rates strategies into practice and focus on rates practice principles such as fairness, equity, and meaningful contribution. This rate modelling aims to minimise the impact on properties with higher valuation changes and achieve an overall level of rate increase with which the councils are comfortable.

One council has data available to enable it to fully understand the cost of its utilities (for example water, rubbish and sewerage). The other four councils could not confirm that their individual utilities are operating in a way that is financially sustainable in the long term. They do not fully understand the cost of providing their utilities and the extent of any cross-subsidisation of them from general rates or other charges.

Increasing rates and charges transparently

We found that the rationale for increasing rates and charges at certain levels is not as transparent as it could be. The councils we audited do not fully explain to ratepayers why their rates and charges have increased by the amount they have, and whether those increases are enough to keep the council sustainable. The Act and Regulation do not currently require councils to provide this level of information.

Demonstrating long-term financial sustainability

All of the five councils we audited could verbally explain the actions that they are taking to work towards achieving the target ranges for the three statutory financial ratios. Two of the three councils have corporate and operational plans that go some way to broadly demonstrating how they are addressing gaps between their forecasts and the targets. But none have specifically documented an action plan for that purpose that allows them to closely monitor their progress towards, or to maintain, financial sustainability.

Over the five years to 2016–17, the local government sector (all 77 councils) had an operating surplus ratio of -4.13 per cent, well below the target range of 0 to 10 per cent. Meaning the sector as a whole spends four per cent more than it earns each year. Of the five councils we audited, only one had an average operating surplus ratio within the target range.

Community engagement

We found that none of the five councils could demonstrate that their communities had input to their budgets and rate setting decisions. Similarly, they could not demonstrate that their communities were involved in determining the level and quality of services and facilities the councils provide and the rates and charges the community is prepared to pay for them. Two of the councils we audited have started to do this by conducting community surveys to measure satisfaction with council services and facilities.

A Queensland council (one we did not audit) is using a different approach to community engagement. This council publishes draft budgets and proposed rate increases and allows the community 28 days to make submissions before finalising them. The council also uses other tools to communicate with the community and hear their views about what rates and charges pay for, and about council's budget and long-term sustainability.

Are councils meeting their legislative obligations?

Budget documents

Our desktop review of all 60 non-Indigenous councils’ 2017–18 budget documents including their revenue statements and revenue policies, showed that only a few of them clearly include all relevant information using the same terminology and format as specified in the Regulation.

These results highlight the need for councils to improve their understanding of the disclosure and process requirements in the Act and Regulation to ensure that these crucial documents include all relevant information in a way that can be easily identifiable and comparable across councils. This will allow the community and other stakeholders to make more informed decisions about how well their councils are managing their finances.

Rates and charges resolutions

A number of councils' resolutions to adopt their rates and charges for 2017–18 were very similar to those of the Fraser Coast Regional Council. In November 2017, the Supreme Court found the Fraser Coast Regional Council's resolutions were invalid.

To address this issue, the Queensland Parliament has recently passed legislation to validate all councils' prior rates and charges resolutions. However, the validating legislation does not assist any councils' future budget resolutions that do not strictly comply with the Act and Regulations. Without building their capability to correctly apply the Act and Regulations, councils risk setting rates and charges that they cannot legally collect.

Overdue rates and charges

One of the councils we audited had sold vacant land to recover overdue rates and charges before it was legally entitled to.

None of the councils we audited had sufficiently detailed policies and procedures for recovery of overdue rates and charges. Councils must comply with specific and technical requirements in the Act and Regulation, which overlap with other legislation and debt recovery guidelines. Staff need clear guidance and procedures to follow to make sure they, and their legal or collection agents, comply.

We found that the councils are not using all the legislative tools available to recover overdue rates and charges as efficiently and fairly as possible. None of the five councils has ongoing formal training or quality assurance processes to improve their debt collection activities.

All audited councils also lacked a policy or application process for ratepayers to use in situations of genuine hardship. Requests are assessed on a case-by-case basis by councils, but it is unclear what information is required when applying for a concession under the Regulation.

Audit conclusions

Queensland councils walk a fine line when balancing competing principles like financial sustainability against fairness and equity.

They have significantly more autonomy than councils in other states. The benefit of this autonomy is that they can tailor their rates and charges to meet the needs of their communities. However, with this autonomy comes the responsibility to be very clear about how and why rates decisions are made.

One of the five councils we audited provides good information to its ratepayers about its rates strategy. The other four councils need to provide clearer rates strategies to their communities. Currently, those councils' ratepayers do not have enough information to understand:

- why councils have established the suite of different categories they use
- how general rates are determined and why some categories are charged more than others
- the economic and other factors that influence councils' rates decisions (including that they have a range of assets to maintain over the long term).

None of the five councils provides enough information to help ratepayers predict how rates may change in the longer term (over the next 10 years). This lack of transparency can lead to a distrust in local government rates practices.

Councils still have work to do to improve their financial planning and forecasting. The five councils we audited are working toward improving their management of their infrastructure assets—it is critical they complete this work and factor asset maintenance and replacement into their rate setting decisions.

The rate increase decisions we audited were generally made behind closed doors with limited community input. While councils' final rates decisions are recorded, the decision-making process and the reasons for those decisions are not usually documented. Therefore, it is not clear how rate increase decisions ultimately support long-term sustainability.

On the whole, councils need more support and guidance to help them in understanding their obligations under the Act and Regulation and in making sure they comply with all requirements.

Recommendations

Department of Local Government, Racing and Multicultural Affairs

We recommend that the Department of Local Government, Racing and Multicultural Affairs:

1. amends the Local Government Regulation 2012* to:
   - require councils to include in their revenue policies a long-term rates strategy (Chapter 2)
   - require councils to include in their revenue statements how annual decisions on rates and charges support financial sustainability (Chapter 3)
   - require a council's chief executive officer to certify to the mayor (in a prescribed form) that the council's final adopted budget complies with all legislative requirements (Chapter 4)
2. continues to develop best practice tools and templates for councils on the budget and rates provisions of the *Local Government Act 2009** and the Local Government Regulation 2012* (Chapter 4)
3. develops resources and tools for councils on:
   - best practice community engagement approaches to strengthen community understanding of, and input into, the rates decisions required to ensure continuation of services (Chapter 3)
   - the budget documents and overdue rates and charges provisions of the *Local Government Act 2009** and the Local Government Regulation 2012* (Chapter 4)
   - chapter 4 part 12 of the Local Government Regulation 2012* (Chapter 4).

All Queensland councils

We recommend that all Queensland councils:

4. document the actions they are taking to support their financial forecast that are required to achieve or maintain sustainability:
   - the actions should be specific, measurable, achievable, realistic, and time-bound, and be allocated to responsible officers (Chapter 3)
   - the document should have a long-term focus (10 years) and include the assumptions on which the forecast is based, the risks that may impact on achieving the forecast, and the factors driving the forecast (including links to strategic asset management plans) (Chapter 3)
5. implement an appropriate costing model to gain a clear understanding of the full cost of delivering utilities and use this information to annually review pricing (Chapter 3)
6. implement appropriate community engagement approaches to strengthen community understanding of, and input into, the rates decisions required to ensure continuation of services (Chapter 3)
7. publish a hardship policy to assist ratepayers to seek a concession for hardship as allowed by section 120(1)(c) of the Local Government Regulation 2012* (Chapter 4)
8. ensure that all future budget documents and resolutions and rates and charges resolutions comply with all requirements in the *Local Government Act 2009** and the Local Government Regulation 2012*
9. train staff on all relevant requirements in the Local Government Regulation 2012*, and on better practice debt collection techniques (Chapter 4).

* All recommendations about the *Local Government Act 2009* and the Local Government Regulation 2012 apply to the equivalent provisions in the *City of Brisbane Act 2010* and the City of Brisbane Regulation 2012 as relevant.

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