

The Proposal to Cap Council Rate Demands.

Submission from Ratepayers Victoria Inc.

Introduction.

Ratepayers Victoria has been researching the morality and legality of Municipal Council conduct in the collection and spending of the funds it obtains by compulsion. This work is essentially complete and is ready to be handed to lawyers for possible action. In the process, our view on the matter has been put to a previous Minister for Local Government; the matter has also been put to the exemplar council, the City of Bayside; the basis of a claim of false accounting is also being brought to the attention of the Victorian Auditor-General. The general response is one of avoidance.

The +3 years of research into the matter forms the basis of this submission.

General Proposition.

Rate Capping to CPI will have little effect on the improper conduct of Councils. One has only to look at page 19 of the VAGO report, ***Local Government: Results of the 2013-14 Audits***, to see that the cost of the real tasks has grown by only 2%pa in the past five years – an acceptable trend. For the annual average increase in costs to be 5%pa, the wasteful part, the administrative costs, must be growing by 8 or 9%pa. In our exemplar council, staff numbers have doubled in the past fifteen years (5%pa) yet the council has not had any expanded production tasks since it was formed. Indeed, the computerisation of its affairs during this period ought to have brought significant administrative savings. The cause of this growing imbalance between production costs and administrative costs is that Councillors have no control on the level of employment – the control is exclusive to the CEO, who has an obvious self-interest.

Should the rates be capped to CPI or lower, we anticipate that the productive work would be curtailed and the administrative work expanded to cater for the staff self-interest. (Note that the MAV has already stated that services will be reduced). Capping of the rates will not cap the expansion of employment! Neither the Council nor the Minister has any control mechanism. While a rate cap is supported, the improper conduct of Councils (promoted by the MAV) must be corrected, to enable a capping system to work.

The Cause of Excessive Rate Charges.

Councils assert that they are a third tier of Government; they openly claim that the municipal rates and charges are simply the taxes applied by their tier of government. A reference document, *Local Government, Funding and Constitutional Recognition. A Twomey. CRU Report No3.* pp 64-68; p84, shows that Victorian councils have only the authorities given to them by the Parliament. They have no constitutional independence to raise taxes.

Council staff blatantly ignore the controls implemented by Parliament, as applied by the Local Government Act 1989 and the Constitution Act 1975. There is widespread practice of the tort of conversion; this is concealed by false and misleading accounting, supported by inept (possibly corrupt) auditing.

Examples of misapplication of funds in our exemplar Council, are:

- Depreciation and amortisation is deducted as an expense in the income and expenditure account. It is based on the value of assets not the cost; as capital is not obtained from the

balance sheet, there is no place to transfer this deduction. The deducted amount is hypothetical in magnitude and mystical in purpose. (It represents about 20% of the General Rate).

- The surplus collected each year is retained and “disappears” into the accumulated assets. It is collected as a pre-payment yet the balance sheet has no such account. (This represents upwards of 8% of the General Rate). Bayside which has a General Rate revenue of around \$65million has about \$40million of unallocated funds accumulated in this manner.
- The Municipal Charge is intended, in the LGA, to provide for the costs of governance. It is limited to (effectively) 25% of the costs of the productive work, materials and contracts. In Bayside, the administrative cost is estimated to be 58% of the cost of production. (It is estimated that 30% of the General Rate is composed of charges that ought to be provided as a Municipal Charge but would thus bring it seriously over its limit).
- Our exemplar Council provides funds from the rates to provide benefits to parties (such as sporting clubs) who pay for their exclusive occupancy of the assets as a “licence fee”. (This is the same mechanism as fees from parking meters). If the rates are raised as a “fee for service” and used to subsidise a necessary licence fee, this is the tort of conversion. (Because of accounting difficulties, it is not clear what influence this has on the rates)

Capital Provision.

In our exemplar Council, capital is provided, in the year of purchase, from the rates. There is a minor contribution from the State and from some of the users of the capital. In the 2014 year, 93% of the capital budget was provided from rate payments. This raises the issue of intergenerational transfers. Because there is no functional depreciation provision, there is no spreading of the cost of the asset over its useful life. In terms of Council raising money as a fee for service, the present generation is paying for a service that is being provided to future generations.

Examples of failure to properly account are:

- The income and expenditure account fails to show expenditure on loan repayments and interest.
- The income and expenditure account fails to show capital expenditure. (There is a strange element where the capital income is shown but the capital expenditure is not listed).

The Ratepayers View.

Ratepayers Victoria believe that simply capping rate increases will have little effect on the extravagance and unlawful conduct of Local Government. Much more comprehensive action is necessary. There is an urgent need to limit the authority of the CEO and make him or her subject to the total direction of the Council. In turn, Councillors should be subject to the same rules and limitations as company directors. Maybe Councils should return to the status they had in 1996 when operating for a few years being managed by Commissioners.

Should this not be an option, a basic requirement is to ensure that all accounts are correctly prepared - particularly the income and expenditure account. Accounts should be prepared separately for different activity groups that are serviced differently and financed from different sources. The cost of administration should be accounted for separately and then the limitations set out in s159 of the LGA, applied. A target to keep the increase in expenditure on goods and service within its historical range of lower than CPI, is suggested. Ensuring that all the administration expenditure forms the municipal charge, it will then reduce to the CPI limits.

It would also be a good idea to abolish the MAV – the MAV Act of 1907 is seriously outdated. The MAV is complicit in encouraging Council to act improperly. It has no function that cannot be better conducted by a commercial organisation. Also, Councils and the MAV ought to be banned from spending ratepayer funds for political purposes – such as supporting the VLGA. Note the levy of funds raised by the MAV to be spent by the ALGA to promote the YES case in the proposed referendum of 2014.

Addressing some of the Matters Raised in the Briefing Paper.

1. Autonomy of Councils.

This matter has been addressed by Professor Twomey in her report “Local Government Funding and Constitutional Recognition”. Essentially part IIA of the Constitution Act of 1975 purports to give Local Government the status of a separate tier of Government. However, this freedom is immediately removed by the clause “having the function and powers that the Parliament considers necessary..”. When the powers given by the Parliament are examined, Local Government is found to be a tier of the administration function of Government. The “function and powers” are contained in various Acts of the Parliament, particularly the Constitution Act 1975 and the Local Government Act 1989. It is also given delegated authority in many other Acts, e.g. the Road Safety Act and the Road Management Act. A determination by the High Court of Australia in the 1904 Sydney Municipal Council case found, “Municipal Government is the State”. This status has not changed!

These enabling Acts restrict the autonomy of Local Government; it, like the rest of us, must follow the requirements of the law.

2. CPI is not an Appropriate Index to use in Rate Capping.

This may be true when dealing with Council costs. However, it is an appropriate index to use when dealing with the capacity of a community to pay. Pensions, both State and private, when indexed, follow the CPI. The minimum wage and Average Weekly Earnings follow the CPI closely.

Many of us, in managing the budget process of large corporations, know that unaffordable calls are regularly made for funds; the budget has then to select those that the company can afford. It is desirable that a similar constraint be applied in Local Government. Community affordability ought to be the criteria for selection of the capping index.

3. Level of Service Will Deteriorate if Rates are Capped.

Experience shows that Councils over-service and play favourites. Councils give grants to “needy” causes because the favourite (vote gathering) cause cannot pay its way. This requires a subsidy from one group to another – particularly in intergenerational transfers. Capping of the rates will minimise this practice. Greater use of Council guaranteed loans will spread capital costs to an affordable level across a number of generations. A schedule of interest and capital repayments needs to be committed when loans are drawn down. Capping of total loan obligations is a necessity

4. Rate Capping may Create Perverse Incentives.

This may be true but rates may be monitored to ensure that sectoral interests do not overpower the public good. Isn't this what organisations like the ESC are for?

The LGA contains provisions for Special Rates and Special Charges. Sectoral interests have this mechanism available to them. Most importantly it contains methods of estimating sectoral benefit

and allowing a ratepayer vote on implementation. (Not used much as it limits the opportunity for Councils to display omnipotence).

6. An Additional Layer to the Budgetary Cycle.

If special provision is needed to deal with unusual aspects of plans, plenty of time exists in the present system. Councils run to a 10 year planning cycle. If as in 4 above special issues were dealt with by special rates, the matter would be well resolved. Emergency issues like bushfires are an issue involving the supply of Public Goods and must be dealt with in conjunction with the State. Note the function and importance of the Fire Services Levy.

7. Ratepayers Concerned with High Rates.

This is the substance of substantial work by Ratepayers Victoria Inc. (RVI) over the past three years. The document, Council Rates – a Tax or a Fee for Service, sets out our conclusions on the issue.

We also have a set of three PowerPoint diagrams (CASHFLOW -COMPANY) which trace the cash flow from rates and charges and try to relate it to the delegation which Councils have to collect revenue. Slide 2 shows the value the current generation of ratepayers get from their rate payments and links it to the payments made. In our exemplar Council, about \$43M of the (\$65M) general rate charged in 2014 is delivered as current value. The \$27M difference is either stolen or the benefit is transferred to later generations. In addition, significant amounts are charged for administration costs which are above and beyond the allowance set by the LGA.

It is not surprising that ratepayers have an intuitive understanding that they are not receiving proper value for their contribution. Slide 3 in the document shows a more equitable arrangement using secured borrowing to provide most of the capital needs.

8. VAGO's Critical Assessment.

In RVI, we have a serious problems with the work of VAGO. In our exemplar Council, we claim that the accounts are false and misleading. VAGO, of course, has certified these accounts as "true and fair". The false accounting begins with the incorrect treatment of depreciation. As far as we are able to ascertain from a casual look at the accounts of other Councils, this improper treatment is common to many of the other 78 Councils in Victoria. As we have stated earlier, depreciation in Council accounts has a hypothetical magnitude and a mystical purpose. We suggest that the accounting problem is the most important issue facing Local Government. It needs to be fixed ahead of any action to cap rates.

General Conclusion

Simply making Councils follow the provisions of the LGA and the Constitution Act will solve many of the problems current in Local Government. It may not be necessary for the ESC to promote changes to any Act to ensure that Councils conduct their affairs fairly. The LGA and the Constitution Act provide adequate controls on the conduct of Local Government to ensure a fair and legitimate outcome. However, tightening up of the wording of some provisions may be needed. Councils need to be given a much clearer view of its true function – governance of a tier of state administration. Making the Finance and Reporting Regulations 2014 operate as intended will bring great benefit to ratepayers.

Necessary tasks are:

Proper cost allocation. Recast Income and expenditure accounts by different classes of economic goods or economic benefit produced.

Supply capital goods by borrowing – hopefully at State rates – with a fixed repayment schedule.

Treat any surplus collected as a pre-payment to be used in the following year.

Limit administrative costs to 25% of the cost of Capital and Operating Cost as per s159 of the LGA.

Limit the total borrowed capital by some criteria such as rateable value or number of ratepayers.

Ensure those with a Licence to Occupy pay for the full cost of occupation.

Deal with Special Needs. Encourage wider use of Special Rates and Special Charges

Deal with Municipal Enterprises.

Encourage the use of Municipal Enterprises but ensure they are self-financing.

Use Risk Analysis to justify capital raised but allow it to be outside the ordinary capital limits.

While these tasks may be judged as difficult and time consuming, this is not so. The various Acts and the Financial and Reporting Regulations 2014 have been set up to permit the implementation of systems such as those suggested. It is simply a matter for the Minister to publish appropriate guidelines and limits which require Council compliance. The only change to the LGA which is required, is to remove Clause 94A(2).

End of Document. Escratecap140415. Author G. Reynolds. Rev 2. 070515.

Reference documents. Local Government Funding and Constitutional Recognition. A Twomey. CRU Report No.3.

Council Rates – a Tax or a Fee for Service? G Reynolds. Yet to be published.

PowerPoint Presentation CASHFLOW – COMPANY. Attached.