



Draft Report

Inquiry into Local Government Costs and Efficiency

30 August 2019

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Preface

The release of this draft report gives interested parties the opportunity to comment on the Commission's analysis in relation to its inquiry into local government costs and efficiency.

The Commission will consider comments received prior to developing and presenting its final report to government.

In preparing this draft report, the Commission invited public submissions and consulted widely with a range of individuals, businesses, organisations and government agencies.

The Commission invites further written submissions on the draft report. These submissions may address any of the issues covered by the terms of reference. The Commission will hold further consultations as necessary, to gather further evidence and hear views on the draft report.

At the conclusion of consultation on the draft report, the Commission will prepare a final report to be presented to the Government of South Australia on 22 November 2019.

The Commission looks forward to receiving feedback on the draft report.

We would like to thank all those who have participated in this inquiry to date which includes state government departments, local government associations, councils, professional bodies, academics and the public.

In addition, we would like to acknowledge and thank the Office of the South Australian Productivity Commission staff for their work in researching and preparing this draft report.

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Date 30 August 2019

About the South Australian Productivity Commission

The Commission provides the South Australian Government with independent advice on facilitating productivity growth, unlocking new economic opportunities, supporting job creation and removing existing regulatory barriers.

The Premier and Cabinet Circular PC046 sets out the objectives and functions of the Commission; how inquiries are referred to the Commission, undertaken and reported on; and how the Commission and public sector agencies work together.

The Commission was established to assist the government to:

- i. improve the rate of economic growth and the productivity of the South Australian economy in order to achieve higher living standards for South Australians;
- ii. improve the accessibility, efficiency and quality of services delivered or funded by government;
- iii. improve South Australia's competitiveness for private sector investment;
- iv. reduce the cost of regulation;
- v. facilitate structural economic changes while minimising the social and economic hardship that may result from those changes;
- vi. take into account the interests of industries, employees, consumers and the community;
- vii. increase employment;
- viii. promote regional development; and
- ix. develop South Australia in a way that is ecologically sustainable.

The Commission is supported by the Office of the South Australian Productivity Commission (OSAPC). The Chair of the Commission also serves as the Chief Executive of the OSAPC.

For more information on the Commission, including Premier and Cabinet Circular PC046, visit the website at www.sapc.sa.gov.au.

Disclosure

The Commissioners have declared to the South Australian Government all personal interests that could have a bearing on current and future work. The Commissioners confirm their belief that they have no personal conflicts in regard to this inquiry.

Terms of Reference

SOUTH AUSTRALIAN PRODUCTIVITY COMMISSION INQUIRY INTO LOCAL GOVERNMENT COSTS AND EFFICIENCY

I, Steven Marshall, Premier, hereby request that the South Australian Productivity Commission (the Commission) undertake an inquiry into local government costs and efficiency.

Background

The South Australian Government is concerned that the rising cost of living has put undue pressure on South Australian households and businesses. Every level of government has a duty to ensure service delivery is as efficient and effective as possible to contain costs to taxpayers and ratepayers and ease cost of living pressures.

South Australian councils collectively manage a budget of \$2 billion and maintain infrastructure and other physical assets worth almost \$23 billion. Effective local government can be the mainstay of a strong community. It is responsible for aspects of everyday life from roads and infrastructure, to well-maintained libraries and community services.

Consequently, sustaining good financial and performance management practices and seeking to continually enhance productivity and efficiency are critical factors for councils as they aim to continue to improve the services they provide to their local community.

Improved performance monitoring by councils, combined with meaningful data analysis and reporting, will improve public accountability as well as provide evidence and opportunities for councils and the South Australian Government to drive and support continuous improvement. Further, effective performance reporting by councils is essential for ensuring accountability to residents and ratepayers as to how public money is being spent and the quality of services delivered.

An SAPC public inquiry process would enable full engagement with local councils and other stakeholders, as well as providing to both local and state governments some independent and objective analysis and advice on the issue of local government costs.

Terms of Reference

The Minister for Local Government has developed a 12-month plan for local government reform to improve council efficiency and effectiveness and restore confidence in council decision making. The reform elements address:

- Stronger council member capacity and better conduct
- Efficient and transparent local government representation
- Lowering costs and enhanced financial accountability in the local government sector
- Simpler regulation.

The South Australian Government is seeking independent advice on the third element regarding cost and financial accountability. This requires consideration of the key determinants of costs, or “cost drivers” of local council budgets; options to lower council costs; and how to ensure lower costs flow through to ratepayers.

Any interpretation of changes in local government costs, or comparisons between councils, would need to be able to take account of the impacts of factors likely to affect costs such as

council size/scale, quality standard and mix of services provided, size of population and geographical area served and urban versus outer metro versus rural and remote locations.

Scope

The Commission is asked to consider and report on the following matters regarding local government costs and efficiency:

1. Analysis of the information on local government costs and the key drivers of costs including:
 - Identify trends in local government activities and costs of local government operations
 - Identify the drivers of local government costs and assess their impacts.
2. Develop and analyse measures of local government efficiency and productivity.
3. Identify mechanisms and indicators that could be used by the local government sector to measure and improve performance over time.
4. Consider recent reforms in South Australia and other jurisdictions to policy, governance and management practices in the local government sector and their potential to improve council performance.
5. Provide advice on possible options to guide and assist councils to improve efficiency and create capacity to pass on cost reductions to rate payers.
6. Provide recommendations on actions by the South Australian Government to lower local government costs and enhance local government financial accountability.

In its consideration of the above matters, the Commission is expected to have regard to the changing service expectations of communities and the long-term financial sustainability of councils.

Inquiry Process

The Commission will consult local government and other key stakeholders on the methodology to be used for its analysis.

The Commission is to publish a draft report and seek submissions before presenting a final report to the Government.

The Commission will second and/or engage staff with required analytical expertise and knowledge of the local government sector for the period of the inquiry.

The inquiry will involve state-wide consultation with Councils, community groups and relevant professionals in the public, private and professional bodies as part of the public engagement process.

Key dates:

Draft report	30 August 2019
Submissions on draft report	25 October 2019
Final report	22 November 2019

Hon Steven Marshall MP
PREMIER OF SOUTH AUSTRALIA

13/05/2019

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Key Messages

The Commission's task is to: analyse local government's cost base and its drivers; analyse efficiency and productivity; provide advice to councils on improving efficiency and creating capacity to pass on cost reductions to rate payers; and provide recommendations on actions by the government to cut local government costs and enhance its financial accountability.

Local government is the level of government closest to neighbourhoods and regions and its performance is important in terms of the human and economic services it provides to their communities. There has been a long history of reforms in South Australia and in other jurisdictions that have broadened the discretionary power of councils to perform a range of functions. The Commission notes that the financial reforms initiated by the state's local government sector, some of which were incorporated into the *Local Government Act 1999*, have strengthened council financial performance.

Councils have varying degrees of control over factors that influence their costs. Some costs are the result of mandates by the state government. The price paid for labour and other inputs are influenced by industrial relations arrangements at the council level and procurement practices respectively. Councils have a good deal more control over the scale, scope and quality of non-mandated services and over productivity and efficiency levels through choice of technology and business processes.

Evidence has been gathered from consultations, submissions and the Commission's own analyses. The Commission has found a diverse range of service reviews and efficiency reform projects by various councils. Some projects have resulted in sizable and quantified improvements to council efficiency. Councils also participate in formal and informal resource sharing arrangements. That said, the evidence also indicates that few sector-wide management or work practice reforms have been undertaken.

The Commission's analysis of the detailed cost information from the South Australian Local Government Grants Commission and other sources shows:

- while total operating expenditure for the sector grew faster than inflation over the decade to 2017-18, the experience of councils varied widely. Growth in population and property numbers, while slow, is likely to have caused some increase in the volume of services demanded (except for small and medium rural councils);
- responsibilities (such as roads and waste collection) mandated by the State accounts for nearly half (46 per cent) of overall total operating expenditure, and nearly 60 per cent for rural councils;
- while total operating expenditure has grown, the shares between mandated and non-mandated expenditure have remained relatively fixed over the decade;
- the principal areas of total council operating costs in 2017-18 were employee costs (35 per cent), materials and other costs (41 per cent) and depreciation (23 per cent);
- total unit employee costs – a proxy for a council wage rate – grew faster than average earnings in South Australia over the decade to 2017-18. The Commission heard a wide range of views from the sector about industrial relations arrangements and will look further into this matter; and
- while the four largest service categories – transport, recreation, other environment and waste management – account for more than half of total council operating expenditure, the mix of services has not changed appreciably over the last seven years.

The Commission employed several methods to understand council efficiency and productivity, drawing on estimation techniques based on all inputs and outputs, partial productivity measures, case studies from councils and submissions. No single method is sufficient; together they suggest the following conclusions:

- South Australian councils, with a small number of exceptions, appear to achieve reasonably high levels of relative efficiency when compared with each other;
- there are outliers, but in those cases, there are local circumstances which contribute to the results;
- that said, the case studies show that councils with apparently high levels of measured relative efficiency can still achieve further significant improvement;
- estimates of productivity growth have been challenged by problems in measuring outputs: the Commission is inclined to attribute an apparent reduction in productivity to technical issues of capturing changes in the scope, quality and quantity of services provided by councils in output measures. Over this period there have also been changes in mandated services although the Commission has not yet been able to capture their impact; and
- detailed benchmarking has been used successfully by some groups of councils to target cost and efficiency opportunities within selected services.

Having considered all the evidence to date, the Commission concludes that understanding council efficiency and productivity is an important starting point in improving business processes and management decisions aimed at improving efficiency across the local government sector. Access to timely, reliable and comparable information on council performance can assist or provide the basis for continuous improvement programs at the council level. However, a measurable sector-wide increase in efficiency in the short to medium term is very unlikely if it relies on voluntary initiatives alone.

The Commission's draft recommendation to the South Australian Government contains two sets of proposed actions:

- to fill critical information gaps and promote the adoption of common approaches to performance measurement that provide the basis for comparisons to drive change, working in conjunction with the sector;
- to examine and ameliorate the impact its mandates have on council efficiency and to clarify the scope of the activities of local governments. There are short-, medium- and long-term actions.

The Commission also seeks advice on a third area of possible options for state government action to strengthen service review processes by councils. The Commission's suggested draft advice to councils addresses three elements:

- as a sector, facilitate in depth performance benchmarking through a community of practice, assisting benchmarking among groups of councils and regularly undertaking a sector-wide analysis of efficiency measures;
- prioritise, in any systems upgrade, a focus on improving information for planning, monitoring and managing performance; and
- enhance the transparency and accountability of their operations.

The final report is due to the Premier by Friday, 22 November 2019.

Executive Summary

1. The task

The Commission's task is to

- understand the cost base and cost drivers of councils in South Australia;
- develop and analyse measures of local government efficiency;
- identify mechanisms and indicators for use by local government over time to improve efficiency;
- provide advice on possible options to guide and assist councils to improve efficiency and create capacity to pass on cost reductions; and
- provide recommendations to the South Australian Government on actions to lower local government costs and enhance local government financial accountability.

In doing this task, the Commission is to have regard to:

- the changing service expectations of communities and the long-term financial sustainability of councils;
- recent reforms in South Australia and other jurisdictions to policy, governance and management practices in local government and their potential to improve council performance; and
- the government's direction that the Commission's advice will provide input to one of the four elements of the South Australian Government's plan for reforming local government in South Australia, comprising:
 - stronger council member capacity and better conduct
 - efficient and transparent local government representation
 - lowering costs and enhanced financial accountability in the local government sector (to which this inquiry is contributing independent advice regarding determinants of costs, options to lower council costs and how to ensure lower costs flow through to ratepayers)
 - simpler regulation.

2. Framing the Commission's approach

The Commission's work is directed towards identifying advice and recommendations that help to frame and inform decision making over time by councils in order to:

- respond to the preferences in their communities, with respect to both current and future generations, especially regarding the scope and quality of Council services,
- capture efficiency dividends from better use of council resources, including the services from council assets; and
- demonstrate accountability, by reporting on performance and expenditure, and financial sustainability.

The Commission's focus is on expenditure and on the opportunities to realise greater efficiency. Doing so provides a dividend that councils may at their discretion, and subject to financial sustainability, use to:

- reduce the rate of growth in local government rates; and/or
- increase the scope, volume and quality of services they provide.

Evidence from submissions is that efficiency dividends currently are mostly applied to extensions of service delivery, but it is important to consider the alternative of reducing rate increases.

The drivers of revenue, including the setting of rates, are outside the Commission's terms of reference, except to the extent that revenue sources are tied, that is, when they carry an obligation to be spent on specific programs, services or assets.

3. Costs: trends and drivers

Analysis of data provided to the Commission finds that the expenditure of councils has been increasing at a rate faster than indicators of the changes in prices which are relevant to councils. Total operating expenses by all councils rose, on average, by 4.2 percent per annum between 2008-09 and 2017-18. In comparison, the consumer price index (CPI) rose by 2.1 per cent and the local government price index (LGPI) by 2.6 per cent per annum.

In other words, real expenditure has been rising. The Commission has considered several drivers of this outcome, including the choices that councils make about their outputs, the procurement of their inputs, and the legislative framework in which they operate. This has also led to an examination of the efficiency with which they operate and the scope for improvements in efficiency over time.

Outputs

Scope, quantity and quality

The range of service councils provide, the volume of each and their quality levels are all drivers of expenditure.

Councils are expected to identify and reflect the interests of their citizens. According to section 6 of the *Local Government Act 1999* (LG Act), councils should 'act as a representative, informed and responsible decision-maker in the interests of its community'. Councils combine their capacity to do so with their knowledge of local conditions to solve problems of service provision. In the Commission's view, it is efficient for councils to deliver services for which they are best placed to make decisions, for the relevant community, about scope, volume and quality. This does not always require that councils be the service provider; they may choose to act as facilitator, regulator or coordinator. The Commission considers that it is inefficient for councils to be offering services which other levels of government, the not-for-profit or private sectors would provide, including services which generate benefits at state level or which extend across council areas.

Thereby councils, as the LG act expects, play a critical role in determining the quality of life of their local community.

Section 7 of the LG Act refers to several specific activities which councils can undertake. These include activities related to local area development, the environment of a region, local infrastructure and public areas. However the Act also permits a wide scope, referring to roles to 'provide for the welfare, well-being and interests of individuals and groups within its community', 'provide services and facilities that benefit its area, its ratepayers and residents, and visitors to its area', and 'establish or support organisations or programs that benefit people in its area or local government generally'. The act provides that a council should 'co-ordinate

various public services and facilities and develop its community and resources in a socially just and ecologically sustainable manner’.

Given this remit in the legislation, it is not surprising to see councils providing a wide range of services. According to submissions from councils the portfolio has widened, in part due to the requirement by the state government for additional functions to be performed, discussed further below. Such a widening in the scope of activities is not evident from an initial analysis of the SALGGC expenditure data divided into fourteen service categories. The Commission is continuing to work to find more data on the extent of this phenomenon and its significance.

With respect to volumes, some of these services are directly related to the characteristics of local government areas, such as the numbers of households and businesses, and the infrastructure, such as length of roads. However, these indicators have been relatively stable over the last decade. The Commission’s assessment is that these demographic or infrastructure factors have not been the most important drivers of rising real spending, although uneven population growth across the state may have contributed to observed differences in the growth and spending patterns among councils.

It is possible that the quality of services provided has increased significantly. The timeliness or frequency of the provision of services and the quality of the experience are linked to costs. Capacity for service provision is also linked to quality, since greater capacity leads to less congestion and easier access.¹ Indeed, there is anecdotal evidence of that in the submissions provided. However, the Commission has not been able to resolve the relative importance of quality changes, compared to other cost drivers, with the data available. It will be important to build the capability to resolve this matter.

Mandatory and non-mandatory functions

The act provides that councils ‘undertake other functions and activities conferred by or under an act’.² Councils have emphasised the impact on their expenditure of these instances, which the Commission refers to as mandated service delivery. Examples are the *Public Health Act 2011*, *Planning, Development and Infrastructure Act 2016* and the *Local Nuisance and Litter Control Act 2016*. The number of these examples has increased over time. These may be services which have wider benefits beyond the council’s own community (eg vermin control) but to which, given the capacity at its disposal, the council is an efficient contributor. In such cases, the council is the agent of the state government.

A key issue is the funding. In some cases, the mandate comes with its own funding, for example, development planning and assessment, where council fees and charges are also mandated, but argued to be set too low to enable councils to fully recover costs. Sometimes, funds are either not provided though the mandate changes, or the mandate has remained, but funding has been reduced or withdrawn. Submissions refer to these situations as ‘cost shifting’, since the higher-level government is observed to ‘shift’ costs to councils.

¹ It is useful for the sorts of services that councils provide to distinguish between the volume and the capacity. A library for example has a certain capacity to accommodate visitors, but the volume of library services depends on the level of its utilisation. Capacity is linked to quality, since greater capacity leads to less congestion and easier access. Costs will be related to both capacity and volume. There are also other elements of quality, related to the timeliness or frequency of the provision of services, and the quality of the experience, which are linked to costs.

² See section 7(k) of the *Local Government Act 1999*.

While noting there can be reasonable differences of opinion about what services a local government “should” provide, as distinct from what it may choose to provide, the Commission considers this to be a reasonable definition of “cost shifting”. That said, the Commission considers the usage of the term ‘cost shifting’ in practice can be unhelpfully imprecise, particularly where it includes a choice by councils to accept tied funding. In such circumstances the Commission considers ‘cost sharing’, rather than cost shifting, is a more accurate description. The Commission is also persuaded that the term ‘cost shifting’ is entirely appropriate as a description of the state government vacating or reducing a previously agreed cost sharing arrangement (such as for funding libraries) and it accepts the evidence that this has occurred.

A related issue is the quality levels at which these mandated services are provided. Generally, the Commission finds that when a service is or becomes mandated there is generally no description associated with this mandate of the quality to which the service is expected to be provided. Councils then determine their own quality levels, and they may over time also decide to raise these levels of quality. These changes may have contributed to the growth of expenditure. Coordination of service quality levels between councils is important where the mandated service is generating wider benefits that run beyond the area of each council.

The Commission therefore considers it is important to draw a sharp distinction between functions and services that are

- at the sole discretion of the council (with the test being no other level of government has the authority to make the specific decision) – non-mandatory;
- mandated externally (including the form of the mandate) where the council has no discretion to refuse to provide the service (but may have discretion as to the standard to which it is delivered) - mandatory.

The Commission’s assessment is that expenditure on these two broad categories in 2017-18 was divided roughly in half (54 per cent and 46 per cent respectively) and has been stable since 2011-12 (a period for which comparable data are available).

The Commission sees this distinction as central to the task of framing draft advice and draft recommendations to local government and the South Australian Government respectively with the purpose of enabling ‘sound decision making’, both in focusing on improving efficiency and on how the dividends are spent. It also notes that potential actions by the state government may assist councils to exercise their discretionary authority more effectively.

In saying this, the Commission accepts as a practical reality in some circumstances where councils are the decision maker, it may be very difficult to exercise the discretion to amend, reduce or remove services based upon historical decisions that some parts of the community value. Nonetheless, the fact remains this is a decision that only the council can make.

While councils have emphasised that this has been a major cost driver, the Commission has not been able to quantify the impact of cost shifting on expenditure to this point in the inquiry. Evidence from councils suggests that while it has some impact it is not the major driver of costs.

Several councils have argued that regulations set by other levels of government with which they must comply have added to their costs. Again, while it has not been possible to quantify

this impact the Commission has formed the view, based on submissions from councils to date, that compliance costs have not been a significant cost driver.

Inputs

Councils manage their workforce and capital assets in various forms to produce services. They also buy various goods and services from other providers. The prices paid for these inputs and the levels at which they are employed will be important drivers of costs. Expenditure on the major categories of input has grown at similar rates over the last decade.

Labour costs

Expenditure on employee costs account for almost half of council operating costs and has risen on average by 4.5 per cent a year from 2008-09-2017-18. This is despite employment in the local government sector rising on average by only 0.8 per cent a year over this period. Advice from councils indicates that a significant contributor to this cost rise appears to be wage growth through industrial arrangements particularly during the early part of this period. The Commission observes that the average increase in council wages has exceeded the rate of growth of wages elsewhere in the South Australian economy over the last decade.

Materials

Materials, contracts and other costs have similarly risen on average by 4 per cent a year over the last decade. This expenditure growth has been driven more by increases in the volume of inputs purchased than increases in the prices paid for them by councils. The growth may be explained in part by greater use of shared service arrangements, outsourcing or contracting out by councils. The Commission will examine this further.

Capital costs

Depreciation expense has grown on average by 4.5 per cent a year over the last decade – equalling the percentage rise in employee costs. This growth is largely explained by growth in the value of depreciable assets held by councils. The cost of financing capital expenditure has declined to a low level, reflecting councils low use of debt to finance capital expenditure.

4. Assessing efficiency

The way the various inputs are combined and coordinated determines the efficiency of service provision, and variations in efficiency will be an important driver of costs. For example, if it is possible to produce the same level of capacity and volume of a service but using few inputs, then efficiency improves, and costs fall.

Assessing efficiency is a difficult task. Estimates and conclusions depend on:

- data – quality, coverage and relevance;
- methodology, using approaches generally accepted;
- benchmarking;
- practical reality; and
- (ultimately) judgement.

The Commission aims for robustness through a balanced approach, taking care to assess the reliability and implications of evidence from every stream of analysis and evidence. Part of the

balance is to use the power of generalisation to draw out implications while using enough detail and context to confirm the validity of those conclusions.

While councils are diverse, they also form groups with common features, making cross-council comparisons useful both within and between those groups. The purpose of these comparisons is to:

- assist council staff and elected members to prioritise improvement, for which *highly detailed* benchmarking information is required;
- better inform the local community and assist councils to understand and balance the preferences of local communities with sustainability and other considerations, for which higher level information is more appropriate.³

Success in the application of a technique for assessing efficiency while making assessments across councils and across time depends on the available data. A method applied here is to use 'proxies' of council output levels (including the number of properties and the kilometres of roads) and to examine their relationship with expenditure. The experience of the top performers provides a level of relative potential against which others can be compared. This method does provide some conclusions, although with a low degree of confidence:

- a large number of councils have recorded a similar level of measured relative efficiency;
- comparisons can be made despite their diversity in geographical size, population density and other differences in possible cost drivers;
- the apparent outliers are explicable in terms of the unique circumstances of some council areas;
- an estimated fall in measured productivity in the local government sector over the last 10 years appears to be more likely the result of an expansion in the volume, scope and quality of services than a general decline in efficiency, although significant data and measurement issues make it difficult for the Commission to be definitive.

The method raises some important conundrums for further investigation. The available data do not capture important discretionary decisions by councils in the scope, volume and quality of services, either at its own discretion or for those that the state mandates (e.g. rubbish - 1 – 3 bins and frequency of collection). Given this data constraint, the risk in the method is that as councils raise their scope, volume or quality of services to meet rising community expectations, then these changes will not be captured in the simple output measures which have been applied. The efficiency measurement method will then flag a fall in productivity, since what it sees is rising inputs without a growth of output. This is apparent in the results to date, for all councils. The report therefore asks further questions of respondents to clarify the drivers of this outcome.

The Commission has reached the following preliminary conclusions regarding the drivers of growth in local government operating expenditure over the last decade:

Input costs:

- labour costs have been the main cost driver, followed closely by materials, contracts and other costs;

³ The distinction between the two types of information is exemplified by the detail required for benchmarking work between Marion, Charles Sturt and Port Adelaide Enfield Councils on the one hand (see appendix 8) and the Victorian Government, Know your Council website.

- Depreciation expense has grown as rapidly in percentage terms as labour expense but from a much lower base;
- cost shifting and compliance costs have contributed to expenditure growth, but to a lesser extent.

Output costs:

- the most significant cost driver is likely to be changes in the volume, scope and quality of services provided by councils;
- growth in demand arising from growth in the number of ratepayers and properties is expected to explain, in part, growth in the volume of services.

Efficiency:

- relative to the experience of all South Australian councils, most councils achieved high levels of measured relative efficiency, but case studies show that more efficiency gains can be made by top performers.

5. Improvement activity

Councils are very diverse. All of those responding considered efficiency improvement was firmly on their agenda. The Commission heard about a range of approaches and experience among councils regarding efficiency measurement and improvement, from individual councils benchmarking their performance over time to small groups of councils working together to compare their performance with other councils. However, the lack of a state-wide framework for performance reporting limits the comparability of data and limits the ability of councils, residents and ratepayers to make meaningful comparisons of performance.

Based on a review of local government performance monitoring nationally, the Commission regards best practice in performance monitoring as including: standardised comparator groups to enable meaningful comparisons across councils and consistency in the definition and recording of data as well as consistent reporting over time. Any estimate of council efficiency should also acknowledge the context influencing this efficiency estimate, including measures of quality and effectiveness as well as council targets or service standards. This can be further improved by allowing councils the opportunity to share their results and to comment publicly on their performance, prior to any estimates being publicly released. Any measurement and reporting framework should balance the costs against the benefits of collecting and reporting information, with every effort made to streamline reporting and reduce duplication. Council input into the design of the framework and choice of indicators is critical to its success.

The Commission has found limited evidence to date to demonstrate that the use of performance benchmarking by the local government sector in Australia has led to improvements in performance. A local example of successful benchmarking provided by a group of three councils in Adelaide, showed that reviews of 10 per cent of the cost base of these councils enabled a 11 - 22 per cent improvement in costs.

Councils are also examining options for economising on expenditure through various resource sharing arrangements in the provision of services. The Commission notes that one of the principles that councils should observe, according to section 8 of the *Local Government Act 1999* is to:

seek to collaborate and form partnerships with other councils and regional bodies for the purposes of delivering cost-effective services (while avoiding cost-shifting among councils), integrated planning, maintaining local representation of communities and facilitating community benefit.⁴

This occurs at various levels. At the simplest level, a staff member's time may be shared by a number of councils, for example, a planning officer. At the other extreme, councils may agree to form a separate subsidiary authority to deliver services across a number of council areas, for example waste management. The costs and benefits of these models are worth further attention, as are any impediments to their implementation.

Economies might also be found by contracting out the provision of a service. All these forms of sharing (with other councils and with the private sector) can be assessed against the alternative of provision in-house; a key consideration will be the costs of reaching agreement on what is to be provided, monitoring the outcome, and responding to issues or complaints as they arise. As noted above, councils may also withdraw completely from direct provision, instead working with other local bodies to provide services cooperatively.

6. Sound decision making

The materials examined by the Commission demonstrate the complexity of the environment in which councils operate and some of the challenges they face. As elected officials, council members are expected to make decisions around a portfolio of services in terms of what to provide, how much to provide and at what quality. A more fundamental decision for councils is whether they should be a direct service provider at all, or whether they perform their remit of functions by adopting alternative roles such as facilitator, coordinator, or regulator. They have an important mission with respect to the lives of their constituents. Success will depend on what the Commission refers to as 'sound decision making'.

In the Commission's view sound decision making is underpinned by at least six conditions:

1. capable decisionmakers particularly in terms of skills and experience;
2. fit-for-purpose information and evidence on which to base decisions and assess trade-offs in key elements;
3. practical tools for considering and assessing, from the point of view of the whole community, alternative roles to provider including informing, advocating, facilitating, funding or regulating;
4. having made the decision to provide a service, analysis of the alternatives of supplying in-house or through contracting out, or some shared service arrangement;
5. the clear authority and accountability to make decisions;
6. not only assessment of costs and benefits before decisions are made but also reporting on outcomes, including performance relative to expectations as well as financial results and sustainability.

The first point is outside the Commission's terms of reference. It is addressed elsewhere in the South Australian Government's reform plan.

The Commission considers the second and third points are clearly within its terms of reference, as evident in previous section. The fourth point relates to the matter of mandated and

⁴ See section 8(ea) of the *Local Government Act 1999*, p.2.

discretionary services. The fifth point is taken up in the draft advice to councils and the draft recommendations to the South Australian Government, which are now summarised, and which are designed to build the capacity in councils for sound decision making.

7. Draft recommendations and advice

The Commission notes that managing and containing expenditure growth requires improved data on council inputs and outputs and the development of analytical tools to deepen understanding of cost drivers and manage their impacts. Council decisions on whether to be a provider of a service and related decisions on volume, scope and standard of services, if based on quality data and robust analytical techniques, will help to clarify, to both elected members and ratepayers, the trade-offs between more or better services and higher expenditures and improve transparency and accountability. The Commission therefore encourages councils to work collectively to improve the quality of data and decision-making tools at their disposal.

The Commission has formed the view that the functions undertaken by councils should, in general, be guided by the principle of subsidiarity which holds that lead responsibility should be devolved to the lowest level of government practicable, allowing for the significant diversity of the state's 68 councils.

A clear and consistent division of responsibilities between state and local governments is fundamental to the efficient allocation of resources between them. This, and legislative clarity regarding mandatory service provision by councils, would assist council understanding of the boundaries around their autonomy and would provide a stronger foundation for council decision making and resource management. The Commission recommends legislative change to clarify the respective responsibilities of the two levels of government and reduce the burden of state government regulation on the local government sector.

This clarification of roles will also provide a basis for resolving any debates about cost-shifting. Councils should then have a solid basis on which to engage more effectively with their communities regarding their plans and performance with respect to the scope and quality of facilities and services and the use of any dividends from efficiency improvements.

All councils can benefit from benchmarking activity. Good data alone, however, will not drive better outcomes. Any measurable sector-wide improvement in efficiency in the short to medium term is highly unlikely to succeed if it relies on optional or voluntary initiatives alone. Individual councils are unlikely to consider the benefits for the sector as a whole that will arise from their individual efforts. The Commission believes that this strengthens the case for state government support for the development of a sector-wide benchmarking program and recommends that the South Australian Government assist councils to establish a sector-wide performance measurement system.

State government action would likely contribute to addressing critical information gaps and ensure the adoption of standardised approaches, which provide the basis for performance comparisons to drive change. Leadership, collaboration and a culture that supports innovation are also important. The Commission also recognises the importance of minimising increases in costs to councils associated with any increase in reporting requirements.

Lastly, the Commission is of the view that the local government sector cement the use of sound decision-making and performance monitoring practices through increased use of independent or external reviews and audits to demonstrate greater accountability to their communities.

Draft recommendations to the South Australian Government

To lower local government costs and enhance local government financial accountability, the Commission proposes that the South Australian Government:

1. Lift the capacity of *local councils to identify and address opportunities to reduce their cost base and improve their operations* by:

In conjunction with local government, defining and establishing a sector wide performance monitoring framework that would enable comparisons between councils and over time to assist decision making by council leaders and to inform communities, including by:

 - i. Establishing common key performance indicators (KPIs) for inputs, outputs, service standards and financial indicators;
 - ii. Optimising existing information held by the South Australian Government, especially that gathered by the South Australian Local Government Grants Commission;
 - iii. Filling the gaps in the current information;
 - iv. Publishing information in a contextualised form designed to assist individual councils.
2. Facilitating benchmarking by clusters of councils through an appropriate mix of incentives for councils to participate and expectations that they will report information publicly in a format consistent with the framework.
3. Further lower council costs by addressing aspects of the relationship between the South Australian Government and local government by:

In the short term

- i. Identifying and addressing inefficiency and red tape from the South Australian Government mandated services and other legislated requirements on:
 - a) councils
 - b) communities.
- ii. Adopting a strong South Australian Government review process for any measures affecting local government;
- iii. Clarifying local government responsibilities, including service standards, for mandated services.

In the medium term

- iv. Clarifying the respective responsibilities of the South Australian and local governments to remove unnecessary overlaps, or duplication and reduce uncertainty between governments.

In the long term

- v. Clarifying relevant aspects of s6, s7 and s8 of the *Local Government Act 1999* to reflect an appropriate division between the levels of government and to make clearer the range of options available to councils in the performance of legislated functions.

Draft advice to South Australian councils

To guide and assist councils to improve efficiency and to create capacity to pass on cost reductions to rate payers, the Commission suggests that local government:

1. As a body, facilitate in depth benchmarking between councils by:
 - i. Establishing a Community of Practice sponsored by the Local Government Association, to share among other elements:
 - a) Methods, tools and approaches;
 - b) Skilling of council staff;
 - c) Panel of competent providers; and
 - d) Lessons learned and examples of success.
 - ii. Assisting in “matchmaking” South Australian councils that seek deep benchmarking opportunities (noting value of groups of councils at different levels) with other councils, including interstate comparisons;
 - iii. Collectively undertaking a regular sector-wide analysis of efficiency measures.

2. Prioritise, in any systems upgrades, focus on improving collection, retrieval, analysis and presentation of information for planning, decision making, monitoring and managing performance.

3. Enhance the transparency and accountability of their operations by councils:
 - i. When considering new, or material changes to, council services, undertaking an independent review that includes consideration and analysis of alternatives to councils providing the service directly, community consultation; and publishing a report;
 - ii. Including in their external audits an examination of service reviews and program evaluations; and
 - iii. Incorporating in their published long-term asset and financial plans and draft annual budgets advice on whether changes to the scope or level of services are planned and their implications for council expenditure.

Information requests

Chapter 2

Information request 2.1: Funding

How does the untied nature of FAG funding affect council decisions to provide non-mandatory services?

How does other Australian Government program or project funding to councils, of a more ad hoc nature, affect council expenditure?

Information request 2.2: Competitive neutrality policy

How, if at all, do the requirements of competitive neutrality policy affect councils' decision making on whether, and how, to provide services to their communities?

This may include direct provision of services or contracting the services from private sector providers.

Information request 2.3: Financial management

How have the financial management program reforms affected councils' ability and incentives to manage costs?

What changes to the type or quality of financial management information would assist councils to improve their decision making and contribute to better performance?

Is there a need for a stronger external auditing process to increase councils' compliance with their legislated responsibility to produce long-term asset and financial management plans and lift the quality of these plans? If so, what form should it take?

Information request 2.4: Workforce planning

Have councils experienced any issues with attracting and retaining workers or securing workers with specific skills?

Are these issues unique to individual councils?

Is there value in a sector-wide or region-wide approach to workforce planning and the development of specific skills to support councils?

Information request 2.5: Resource sharing

What is the potential for additional use of resource sharing to deliver efficiencies and other benefits to participating councils?

In councils' experiences of resource sharing, what works and what does not? Why?

Councils are asked to provide further examples of resource sharing.

Are there any impediments to the greater uptake of various forms of collaboration or resource sharing?

What challenges, if any, do councils face in making use of the provisions contained in sections 42 and 43 and Schedule 2 of the *Local Government Act 1999* to deliver effective and efficient services to their communities?

Chapter 3

Information request 3.1: Materials, contracts and other costs

What are the main drivers of materials, contracts and other costs for rural small and medium councils?

In what ways do current council procurement practices affect expenditure on materials, contracts and other costs?

Information request 3.2: Population density

How does increasing population density and urban infill impact on council service costs?

Information request 3.3: Sector wide service standards

How do councils currently define and measure standards of service delivery?

What measures could be developed on a sector wide basis to measure quality standards for either mandated or non-mandated services?

Information request 3.4: Cost shifting

To what extent do councils receive external funding or an ability to charge fees for delivery of mandatory services?

To what extent are councils able to fully recover costs for the mandatory services listed in appendix 4?

How are service scope and standards determined for mandatory services?

Councils are asked to provide further information on instances of cost shifting and quantify how they have impacted on councils' costs.

Information request 3.5: Compliance costs

Councils are asked to provide further examples of compliance costs and quantify how they have impacted on councils' costs.

Information request 3.6: Cost pressures

What are the most significant cost pressures (and their impact on costs) which councils expect to face over the next 5 years?

Chapter 4

Information request 4.1: Performance reporting

How can these lessons from state-wide performance reporting frameworks in other jurisdictions be applied to South Australia?

Which indicators used in other jurisdictions would be appropriate for South Australian councils?

Information request 4.2: Partial productivity estimates

What do these partial productivity estimates tell us about local government efficiency?

What other partial productivity estimates can be used with currently available data?

What additional data would councils be able to report on for minimal additional cost which would improve our understanding of council efficiency?

Is there any other evidence of an expansion in the scope of council services, or improvement in quality over this time period?

Is the current reporting to the SALGGC an appropriate process for any additional reporting by councils? Is there value in making any changes to this reporting?

Information request 4.3: Service-specific efficiency

Acknowledging the gaps in data currently available, how can data quality be improved in order to measure service-specific efficiency across councils?

Information request 4.4: Efficiency changes through time

How can the change in volume, scope or quality of services be quantified or otherwise incorporated into an evaluation of local government efficiency?

Information request 4.5: Factors that influence estimated council efficiency

What other factors can explain the estimated efficiency differences between councils or over time?

What factors can explain the estimated productivity differences between councils over time?

What other possible data sources can improve this analysis?

What further information could be considered to analyse and interpret estimated partial and global efficiency scores?

Chapter 5

Information request 5.1: Employee costs

Are there any benefits from streamlining the current industrial relations arrangements by moving to sector-wide enterprise bargaining?

Information request 5.2: Quality and quantity of data

How can councils be assisted to work collectively to improve the quantity and quality of the available data on inputs, outputs and outcomes for services?

Information request 5.3: Strengthening councils' accountability and transparency

How can the South Australian Government strengthen the accountability and transparency of councils? Possible instruments include:

- funding;
- legislation and monitoring of implementation through audits of the processes of local government decision making; and
- an agreement with councils and regular dialogue to reinforce the expectation that councils will conduct audits of the processes of local government decision making.

Should councils be required to undertake an independent external audit of their expenditure and efficiency in the event of that they record relatively high operating expenditure growth in a given period?

Would growth in operating expenditure over any three-year period (normalised for population growth) which exceeds the rise in the Local Government Price Index for that period be an appropriate trigger for such an audit?

Acronyms

ABS	Australian Bureau of Statistics
ATSI	Aboriginal and Torres Strait Islander
ACLG	Australian Classification of Local Governments
ALGA	Australian Local Government Association
CEO	Chief Executive Officer
CNP	Competitive Neutrality Policy
CPA	Competition Principles Agreement
CPI	Consumer Price Index
CRS	Constant Returns to Scale
CWMS	Community wastewater management services
DEA	Data Envelopment Analysis
DRS	Decreasing Returns to Scale
EBA	Enterprise Bargaining Agreement
EHA	Eastern Health Authority
ESC	Essential Services Commission
FAGs	Financial Assistance Grants
FRSB	Financial Review Sustainability Board
FSP	Financial Sustainability Program
FTE	Full-time equivalent
GAROC	Greater Adelaide Regional Organisation of Councils
IRS	Increasing Returns to Scale
LG Act	Local Government Act
LGAP	Local Government Association Procurement
LGAMLS	Local Government Association Mutual Liability Scheme
LGASA	Local Government Association of South Australia
LGAQ	Local Government Association Queensland
LGAWCS	Local Government Workers Compensation Scheme
LGFA	Local Government Finance Authority
LGPI	Local Government Price Index
LGPRF	Local Government Performance Reporting Framework
LGWDG	Local Government Workforce Development Group
MFP	Multi-factor Productivity
NESB	Non-English-Speaking Background

OCA	Outback Communities Authority
RLGA	Regional Local Government Association
RoGS	Report on Government Services
SALGGC	South Australian Local Government Grants Commission
SALGFMG	South Australian Local Government Finance Managers Group
SAROC	South Australian Regional Organisation of Councils
SE	Scale Efficiency
SFA	Stochastic Frontier Analysis
TE	Technical Efficiency
TFP	Total Factor Productivity
VRS	Variable Returns to Scale
WPI	Wage Price Index

1. Introduction

1.1 Context

The South Australian Government has directed the South Australian Productivity Commission (the Commission) to consider and report on a number of matters regarding costs and efficiency of local government services.

Local government is the level of government closest to individual communities. Local government's performance is important in terms of the human and economic services it provides to meet those individual communities' needs.

South Australia's sixty-eight councils collectively manage an annual operating budget of \$2.2 billion and maintain infrastructure and other physical assets worth almost \$24 billion. Effective local government can be the mainstay of a strong community. Councils provide a range of services from roads and infrastructure, to well-maintained libraries and community services. Councils are not only direct providers of services but also act as advocates, planners, coordinators, facilitators and regulators. Councils perform specific functions mandated by the South Australian Government and deliver a range of non-mandatory services.

There are long standing and common challenges that councils have been reviewing and debating across the country for many years¹, several of which have focussed on the intersection of service expansion and long-term financial sustainability, including:

- the expansion in the scope, quantity and quality of services provided by councils in response to changing expectations of ratepayers;
- insufficient expenditure on infrastructure maintenance and renewal;
- capacity for effective asset and financial management arrangements; and
- the ability to achieve economies of scale for smaller councils, particularly in regional or remote areas.

Councils vary in geographical size and topography; population numbers and density; socio-economic characteristics of their residents; and the range of services provided to residents and businesses. The Commission's task includes identifying the systemic cost issues and understanding the unique features of councils and their rate payers, which affect their cost and efficiency levels.

The inquiry is examining trends in local government costs and the drivers of these costs as well as developing and analysing measures of efficiency. Mechanisms and indicators that might be used by local government to measure, analyse and improve performance will also be identified.

The Commission is also taking into consideration recent reforms in South Australia and other jurisdictions to policy, governance and management practices in the local government sector and their potential to afford cost savings and improve council efficiency.

¹ Commonwealth Grants Commission, *Review of the Operation of Local Government (Financial Assistance) Act 1995* (release in 2001)

House of Representatives Standing Committee on Economics, Finance and Public Administration ('Hawker Report'), *Rates and Taxes: A Fair Share for Responsible Local Government (2003)*.

Aulich, C, et al ACELG *Consolidation in Local Government : A Fresh Look*, Volume 1 Report (May 2011)
 Victorian Auditor-General's Office, *Reporting on Local Government Performance*, May 2019

1.2 Terms of Reference

The Minister for Local Government is developing a plan for local government reform to improve council efficiency and effectiveness and restore confidence in council decision making. The reform elements address:

- stronger council member capacity and better conduct;
- lower costs and enhanced financial accountability;
- efficient and transparent local government representation;
- simpler regulation.

The Minister released the *Reforming Local Government in South Australia* discussion paper on Monday, 5 August 2019, proposing reforms that aim to achieve these key reform elements and give each community certainty that their council is operating efficiently and sustainably.

The South Australian Government is seeking independent advice on the second element regarding cost and financial accountability from the Commission. This requires consideration of the key determinants of costs, or "cost drivers" of local council budgets; options to lower council costs; and how to ensure lower costs flow through to ratepayers. Any interpretation of changes in local government costs, or comparisons between councils, needs to be able to take account of the impacts of factors likely to affect costs such as council size/scale, quality standard and mix of services provided, population size and density and geographical area served and whether it is urban, semi-urban, rural or remote

The terms of reference for the inquiry (see p5-6) require the Commission to consult local government and other key stakeholders on the methodology to be used for its analysis and consult state-wide with councils, community groups and relevant professional bodies.

1.3 The Commission's approach

The Commission is required to take a broad perspective in developing advice for the South Australian Government. It must consider the broad interests of industry, business, consumers and the community, regional South Australia, social-economic implications and ecological sustainability.

Consultation and respectful engagement with stakeholders are an essential part of our work and, together with robust research and analysis, is the foundation for quality advice and recommendations to Government. Transparency, including publication of the submissions received by the Commission, is an important part of this process.

The Commission published a methodology paper² on Friday, 31 May 2019 after significant consultation with the Local Government Association of South Australia, the Office of Local Government, the South Australian Local Government Grants Commission, academics and other stakeholders. The paper sought input from stakeholders to assist the Commission to develop robust, evidenced based conclusions to direct reform initiatives.

The Commission invited submissions on the methodology paper that addressed any of the issues covered in the paper, and any other matters relevant to the terms of reference where

² <https://www.sapc.sa.gov.au/inquiries/inquiries/local-government-inquiry/methodology-paper>

the Commission's understanding was imperfect. Twenty-three submissions were received in response to the methodology paper which greatly assisted the Commission's understanding of all aspects of its task. The full list of submissions is in Appendix 1. In addition, the Commission undertook a wide consultation approach including eighteen meetings of Commissioners with various stakeholders and councils throughout the state.

Economic Insights Pty Ltd was engaged to calculate some estimates of relative efficiency and explore potential determinants of efficiency. The Commission also conducted its own data analysis, as part of a robust methodology strategy, to provide a basis for more substantiated conclusions.

As part of the inquiry and systematic approach to engagement, the Commission established a reference group of key stakeholders who are providing expert advice, insights and understanding about what are driving the productivity and efficiency trends across the South Australian local government sector. It was also asked to provide feedback on the veracity of the commission's analysis and merits of reform options. The terms of reference and members of the reference group are included in Appendix 2.

The Commission acknowledges with thanks the assistance from state government departments, local government associations, councils, professional bodies, academics and the public.

This draft report seeks a further round of consultation with stakeholders to identify opportunities and initiatives that could be implemented across councils to reduce costs and improve productivity.

1.4 Report structure

The report is structured as follows:

- Chapter 2 presents historical information on the development of the local government sector in South Australia. It provides context to understand the South Australian Government mandated aspects of local government functions. It also examines key reforms to the local government sector in South Australia and other jurisdictions, and their implications for costs and efficiency;
- Chapter 3 considers recent trends in local government costs and aims to identify some of the key drivers of costs;
- Chapter 4 presents partial and global measures of local government efficiency in South Australia and an analysis of possible determinants. It also discusses mechanisms and indicators that could be used to measure and improve local government performance over time;
- Chapter 5 draws elements of analysis together and suggests preliminary options and draft recommendations for cost and efficiency improvements to assist decision making by councils and the South Australian Government.

2. Structure, development and reform

2.1 Introduction

The inquiry's terms of reference require the Commission to address the following matter regarding local government costs and efficiency:

- Consider recent reforms in South Australia and other jurisdictions to policy, governance and management practices in the local government sector and their potential to improve council performance.

The chapter examines the history, structure and evolution of the local government sector, particularly the legislative and governance environments which affect councils' decisions on the services delivered to their communities. It also considers the influence of the Australian Government on the capacity of councils to deliver services.

Finally, the chapter briefly examines some key local government reforms aimed at either efficiency improvement or cost reduction in other jurisdictions.

2.2 Structure of local government

2.2.1 Legislative framework in South Australia

In South Australia, councils operate within a legislative environment established by the state parliament. The current local government legal framework is constituted by the interaction of three acts: the *Local Government Act 1999* (LG Act); the *Local Government (Elections) Act 1999*; and the *Constitution Act 1934*. While other pieces of legislation, at both the state and national levels, influence local government, these three Acts together create the basic framework within which councils provide services for, and are held accountable to, their local communities.

South Australia's legislation defines the purpose of local government. According to section 6 of the LG Act, a council is established to act in the interests of its community, as well as to represent its interests. Councils provide services but they are also expected to promote initiatives within the community that improve quality of life.

The LG Act also provides the authority for local government to perform a range of functions. These are predominantly set out section 7, which says that the functions of a council include:

- plan at the local and regional level for the development and future requirements of its area;
- provide services and facilities that benefit its area, its ratepayers and residents, and visitors to its area (including general public services or facilities (including electricity, gas and water services, and waste collection, control or disposal services or facilities), health, welfare or community services or facilities, and cultural or recreational services or facilities);
- provide for the welfare, well-being and interests of individuals and groups within its community;
- take measures to protect its area from natural and other hazards and to mitigate the effects of such hazards;

- manage, develop, protect, restore, enhance and conserve the environment in an ecologically sustainable manner, and improve amenity;
- provide infrastructure for its community and for development within its area (including infrastructure that helps to protect any part of the local or broader community from any hazard or other event, or that assists in the management of any area);
- promote its area and provide an attractive climate and locations for the development of business, commerce, industry and tourism;
- establish or support organisations or programs that benefit people in its area or local government generally;
- manage and, if appropriate, develop, public areas vested in, or occupied by, the council;
- manage, improve and develop resources available to the council; and
- undertake other functions and activities conferred by or under an act.¹

Section 8 enumerates the principles that councils must uphold in carrying out their broadly defined functions. As the City of Salisbury observes in its submission, section 8 requires councils to observe a total of 12 principles in their decision making, including, for instance, ensuring that “council resources are used fairly, effectively and efficiently” and ensuring “the sustainability of the council’s long-term financial performance and position”.

This legislative approach, in which councils’ functions are broadly defined, is consistent with reforms in other jurisdictions throughout the 1990s.² These coalesced around a broadly common approach to statutory frameworks that gave local government a range of ‘general competence powers’.³ As Wensing observes:

In most cases the states have granted councils more autonomy and responsibility for planning and managing their local areas...In most states the changes to Local Government Acts have given councils general competence powers that enable them to do what is necessary to better meet local community needs and aspirations.⁴

In contrast to a statutory framework that limits local government to undertaking activities expressly included in legislation, general competence powers provide councils with the authority to carry out those activities necessary to fulfil the functions assigned to them.⁵ These functions, in turn, are defined in general terms in contemporary local government legislation, including in South Australia.⁶

¹ For the full list of councils’ functions under section 7 of the LG Act, as well as its relationship with sections 6 and 8, see <https://www.legislation.sa.gov.au/LZ/C/A/Local%20Government%20Act%201999.aspx>

² Aulich, C (1999), ‘From Convergence to Divergence: Reforming Australian Local Government’, in *Australian Journal of Public Administration*, 58(2), p.15.

³ Aulich, C (1999), ‘From Convergence to Divergence’, p.15.

⁴ Wensing, E (1997), ‘Systemic Reform or Administrative Update? Recent Legislative Changes in Local Government around Australia’, in Chapman, R, et al (eds), *Local Government Restructuring in Australia*, Centre for Public Management and Policy, University of Tasmania, Hobart, p. 42.

⁵ Aulich, C (1999), ‘From Convergence to Divergence’, p.14.

⁶ Aulich, C & Halligan, J (1998), ‘Reforming Australian Government: Impact and Implications for Local Public Administration’ in *Reforming Government: New Concepts and Practices in Local Public Administration*, Eastern Regional Organisation for Public Administration (EROPA), Local Government Centre, Tokyo, p. 25.

The legislative environment in which local government operates is marked by the absence of a strictly prescriptive approach to defining councils' functions. Queensland's local government legislation exemplifies the current approach to defining councils' sphere of legitimate activity:

A local government has the power to do anything that is necessary or convenient for the good rule and local government of its local government area.⁷

The Commission has found it useful to distinguish between mandatory and non-mandatory functions. Mandatory functions are those listed in both the LG Act and in other legislation. Some of the most significant acts include, but are not limited to, the *Dog and Cat Management Act 1995*, the *Public Health Act 2011*, the *Planning, Development and Infrastructure Act 2016*, the *Disability Inclusion Act 2018*, the *Emergency Management Act 2004* and the *Local Nuisance and Litter Control Act 2016*.⁸

Consequently, the legislative reforms of the 1990s had the effect of increasing the scope for councils to provide a range of non-mandatory services.⁹ Given the broad definition of councils' functions outlined in South Australia's LG Act, the total number of mandatory services and functions is comparatively low.¹⁰ The majority do not arise from the LG Act itself, but flow from other state legislation. Mandatory functions include responsibilities:

- in relation to the state's planning system;
- for some road construction and maintenance;
- for some environmental health services, including the monitoring of cooling towers for potential outbreaks of legionnaire's disease;
- for fire prevention, both in relation to building inspections and some bushfire prevention;
- for dog and cat management; and
- for a range of administrative requirements, including preparing strategic plans for the local area, which are contained in the LG Act.¹¹

Non-mandatory functions are those adopted, consistent with the role of a council in the LG Act, but at their own discretion. Based on advice from LGASA, Appendix 4 includes a full list of council activities, showing the division of mandatory and non-mandatory.'

The 1960s, in particular, witnessed a significant expansion of functions undertaken by the local government sector.¹² The Commission notes that the shift away from a focus on 'roads, rates and rubbish' and towards a broader range of services possesses a long history in South Australia, and predates the legislative reforms of the 1990s. In effect, therefore, the LG Act

⁷ See, in particular, section 9 of the *Local Government Act 2009 (Qld)*: <https://www.legislation.qld.gov.au/view/html/inforce/current/act-2009-017#>

⁸ The Commission has not been able to determine the total number of acts that impose some responsibilities on local government, but the South Australian Local Government Association has estimated the total to be approximately 200. However, not all of these acts are likely to be equally decisive for all councils.

⁹ Aulich, C (1999), 'From Convergence to Divergence', p.14.

¹⁰ For the purposes of this report, the Commission defines mandatory services as services or activities that are specifically required by statute and those that are at the full discretion of councils as non-mandatory.

¹¹ See Local Government Association of South Australia (2015), *Introduction to Local Government Handbook*, Adelaide, p. 12, available at <https://www.lga.sa.gov.au/webdata/resources/files/E&T%20-%20Introduction%20to%20Local%20Government%20Handbook.pdf>

¹² See, for example, House of Representatives Standing Committee on Economics, Finance and Public Administration (2003), *Rates and Taxes: A Fair Share for Responsible Local Government [the Hawker Review]*, Commonwealth of Australia, Canberra.

codified, but did not cause, the enlarged service mix that councils provide within their communities. The LG Act only enables, but does not require, councils to expand the number, scope and quality of services that they provide for their communities.

For the purpose of the report, the Commission found it useful, where possible, to define and distinguish between the terms functions, services and activities. Functions describe the broad areas where councils have the delegated authority (under the LG Act and other legislation) to make decisions and take actions in the best interests of their communities (both in relation to mandatory and non-mandatory functions). Services are councils' outputs that deliver mandatory and non-mandatory functions. Activities describe the actions taken by councils to deliver services, including regulatory services.

2.2.2 State and local government relations

In South Australia, local government has had a greater degree of autonomy from state government than in other jurisdictions, with the relationship described as a partnership model, rather than a 'top-down' and prescriptive relationship.¹³ The influence of the 'partnership model' in South Australia, especially the greater emphasis on councils' autonomy and accountability to their communities, is also reflected in the LG Act.¹⁴

This broadly cooperative model of state and local government interaction is underpinned by a 1990 memorandum of understanding between the two levels of government. As Aulich observes:

The early 1990s saw the introduction of two key changes that continue to influence local government in South Australia; the adoption of a partnership model to guide state-local government relations and the implementation of a voluntary approach to council amalgamations.¹⁵

This does not imply that the relationship between state and local government has been free from policy disagreement. Tensions over policy direction have arisen over time in response to a variety of issues, particularly on the demarcation between the respective responsibilities of the two levels of government. Nonetheless, as Procter observes, South Australia has differed from other jurisdictions by giving greater expression to the principle that local government is a separate sphere in its own right.¹⁶

This broad understanding was reaffirmed in 2015 when the two levels of government, signed the State-Local Government Relations Agreement. The agreement explicitly recognised that each level of government has its own separate mandate, and that closer strategic alignment is necessary to achieve positive public policy outcomes.¹⁷

¹³ See, for example, Aulich, C, Gibbs, M, Gooding, A, et al (2011), *Consolidation in Local Government: A Fresh Look – Volume 1: Report*, Centre of Excellence for Local Government, University of Technology, Sydney, p. 24

¹⁴ Aulich, C, Gibbs, M, Gooding, A, et al (2011), *Consolidation in Local Government*, p. 26.

¹⁵ Aulich, C, Gibbs, M, Gooding, A, et al (2011), *Ibid*, p. 24.

¹⁶ Procter, C (2002), *Local Government Reform in South Australia*, paper presented at 'The Cutting Edge of Change: Shaping Local Government for the 21st Century' conference, University of New England, Armidale.

¹⁷ For further details on the agreement, see

<http://www.lga.sa.gov.au/contentFile.aspx?filename=Premiers%20State%20Local%20Forum%20Executive%20Meeting%2028%20January%202015-2.pdf>

The partnership approach has also influenced the state government's oversight role in relation to councils' functions.¹⁸ This is reflected in the relevant legislation which is discussed in the previous section.

The general commitment to greater council autonomy also influenced major sector-wide reforms, including the last round of amalgamations, between 1997 and 1998.¹⁹ Rather than a policy of forced amalgamations, which had been adopted in 1994 by the Victorian Government, the South Australian government appointed a Local Boundary Reform Board in 1995, which was tasked with managing a strategy of encouraging voluntary amalgamations.

Councils and their communities had the final say over whether amalgamations would proceed.²⁰ The process, while not devoid of tensions, eventually led to the number of councils being reduced from 118 to 68.²¹ Amalgamations were seen at the time as a mechanism to reduce costs. In practice, the savings achieved appear to have been mostly directed towards equalising service standards within the merged councils. The Commission notes, however, that only limited evidence is available with which to quantify the impact of amalgamations on councils' costs and efficiency.

The *Local Government (Boundary Adjustment) Amendment Act 2017* commenced on 1 January 2019, and significantly reformed the processes within the LG Act that govern changes to council boundaries.²²

2.3 Features of local government

The number of councils in South Australia is 68, 21 councils that cover the metropolitan area, with a further 47 in regional areas (for a map of council areas, see appendix 3). In addition, five Aboriginal communities are also recognised as local government authorities. The Outback Communities Authority (OCA) was established on a statutory basis in 2009 to provide a range of services to outback communities in the state not incorporated into councils. The OCA functions, in effect, as a hybrid between a traditional council and a self-managed community.²³

The state's 68 councils encompass more than 880,000 rateable properties and are responsible for a total road network of approximately 74,000 kilometres. Councils are responsible for a comparatively small proportion of government revenue raising and expenditure. The sector manages approximately \$24 billion in community infrastructure and other assets, with operating expenditure across the sector amounting to around \$2.2 billion per annum.

Between 2008-09 and 2017-18 the total number of employees in the state's 68 councils, has increased by 7.4 per cent which represents an annual growth rate of 0.8 per cent, identical to the state-wide increase over the same period. As at 30th June 2018, the total number of FTE positions in the sector was 8,867.

¹⁸ Aulich, C, Gibbs, M, Gooding, A, et al (2011), *Consolidation in Local Government*, p. 24.

¹⁹ Ian Tilley & Brian Dollery (2010), *Historical Evolution of Local Government Amalgamation in Victoria, Tasmania and South Australia*, University of New England Working Paper, Centre for Local Government, Armidale, p.4.

²⁰ Aulich, C, Gibbs, M, Gooding, A, et al (2011), *Consolidation in Local Government*, p. 25.

²¹ Tilley, I & Dollery, B (2010), *Historical Evolution of Local Government Amalgamation*, p. 30.

²² For further details see https://www.dpti.sa.gov.au/local_govt

²³ For further information on the structure of, and services provided by, the Outback Communities Authority, see <https://www.oa.sa.gov.au/home>

South Australia's councils vary in geography, population size and demographic composition, ranging from larger metropolitan councils like Onkaparinga, with a resident population of around 171,000, to Orroroo Carrieton, with only around 850 residents. Regardless of their size or location, all councils have the same powers and statutory functions. In South Australia, as in other jurisdictions, councils have progressively taken a more active role in various areas of public policy, including economic development initiatives and the provision of some social services (such as aged care services).²⁴

The Local Government Association of South Australia (LGASA) which is constituted as a public authority under the LG Act with the specific purpose of promoting the interests of the sector, provides support, leadership and a range of services to the state's councils. In its legislated capacity as a peak body, the LGASA undertakes activities that range from policy formulation, including advice on councils' statutory responsibilities, to taking a leading role in the development and implementation of sector-wide initiatives.

In addition to the LGASA, non-metropolitan councils have formed regional local government associations (RLGAs). These predominantly seek to achieve better outcomes for their respective communities through collaboration. The six RLGAs, which are subsidiaries pursuant to section 43 of the LG Act, collectively form the South Australian Regional Organisation of Councils (SAROC). SAROC's Board comprises two members elected from each of the member RLGAs.²⁵ SAROC is mirrored on a metropolitan level by the Greater Adelaide Region Organisation of Councils (GAROC), which is made up of eight elected members from councils in the metropolitan region.²⁶

2.4 Role of the Australian Government

Councils' functions and decision making processes are also influenced by funding and policy decisions taken by the Australian Government (often as a result of agreements with the states and territories). Importantly, the drive for some key local government reforms has been national. This is particularly marked in the areas of financial assistance provided by the Australian Government and national competition policy.

2.4.1 Funding

In the mid-1970s, partially as a response to the expansion of local government functions throughout the preceding decade, the Australian Government began to provide direct untied funding to the local government sector. The current Financial Assistance Grants (FAGs) program is provided on the basis of grants to the states and territories. These, in turn, are distributed to councils by state and territory jurisdictions.

FAGs are distributed to councils within each state to support an average level of service, irrespective of their location. The South Australian Local Government Grants Commission (SALGGC) assesses councils' share of funding on the basis of the difference in the costs associated with providing services and councils' revenue-raising capacity (compared to the

²⁴ Productivity Commission (2017), *Local Government, Shifting the Dial: 5 year Productivity Review, Supporting Paper No. 16*, Canberra, p.4.

²⁵ The Commission notes that both SAROC and GAROC were established on the basis of clause 19 of the LGASA's constitution.

²⁶ Additional information on a variety of local government networks, including SAROC and GAROC, is provided the LGASA – <https://www.lga.sa.gov.au/page.aspx?u=6871#e9691>

average in South Australia).²⁷ Grants are only provided to councils that have been established under the LG Act or are defined as prescribed bodies for the purposes of the *South Australian Local Government Grants Commission Act 1992*. FAGs funding is untied once distributed to the local government sector. From time to time the Australian Government also provides specific purpose grants to councils of either a capital (e.g. GFC School grants scheme) or operating nature (e.g. Adelaide Hills Council case study, Chapter 3) to achieve its particular policy objectives. Councils are generally expected to contribute funds to these programs. Council participation in these programs has impacts on their operating expenditure.²⁸

Information request 2.1: Funding

How does the untied nature of FAG funding affect council decisions to provide non-mandatory services?

How does other Australian Government program or project funding to councils, of a more ad hoc nature, affect council expenditure?

2.4.2 Competitive neutrality

Competitive neutrality policy (CNP) is based on the principle that significant government businesses should not enjoy, as a result of their public sector ownership, any net competitive advantages over private businesses operating in the same market. Part of a wider reform process that resulted in the introduction of the *Competition Principles Agreement (CPA)*, the principles of competitive neutrality apply to local government.²⁹

The principle of competitive neutrality is given legislative expression in South Australia through the *Government Business Enterprises (Competition) Act 1996* and applies to the business activities of publicly-owned entities whose activities include “producing goods and/or services for sale in the market place with the intention of making a profit and providing financial returns to their owners”.³⁰ Local government business activities must also comply with the CPA. Examples of such activities could include, but are not necessarily limited to, subsidiaries established under sections 42 or 43 of the LG Act to provide community services.

Information request 2.2: Competitive neutrality policy

How, if at all, do the requirements of competitive neutrality policy affect councils’ decision making on whether, and how, to provide non-mandatory services to their communities?

This may include direct provision of services or contracting the services from private sector providers.

²⁷ For additional information on the principles and methodology that guide the distribution of FAGs funding in South Australia, see https://www.dpti.sa.gov.au/local_govt/LGGC.

²⁸ For additional information on infrastructure funding programs see <https://investment.infrastructure.gov.au>

²⁹ Government of South Australia (2010), A Guide to the Implementation of Competitive Neutrality Policy, Adelaide, p. 1.

³⁰ Ibid., p. 6.

2.5 Local government-initiated reforms

The Commission has reviewed key past and current efficiency and cost related reforms initiated by local government in South Australia. The Commission's literature review and consultation process revealed a diverse range of reviews, evidence and reform projects that have been undertaken by councils in the last 20 years.

Sector wide reforms which aim to deliver efficiency gains and reduce costs have included changes to:

- financial circumstances of local government, including changes to revenue and financial management practices;
- workplace and management processes of local government; and
- number or types of functions or services performed by local government, including the collaboration of functions between local government.³¹

The following section addresses these initiatives in more detail.

2.5.1 Financial management

As previously discussed, the local government reform process of the 1990s consisted of legislative changes and other structural reforms. Subsequently there was a new focus on financial management reforms.

In 2005 the LGASA established an independent Financial Review Sustainability Board (FRSB) to assess the financial capacity and sustainability of councils throughout the state. Many of the measures developed or adopted by the LGASA – and subsequently supported legislatively by the state government – flowed from the findings and recommendations of the *Independent inquiry into Financial Sustainability of Local Government 2005*.³² The Inquiry noted that at the time the balance sheets of councils appeared strong because of their low levels of debt, but the problem was the predominant pattern of deficits, and the likelihood that they would increase, as well as 'substantial infrastructure renewal/replacement backlogs'.³³

The FRSB put forward 62 recommendations, a substantial number of which have since been implemented through cooperation between the LGASA and the state government.³⁴

The LGASA's Financial Sustainability Program (FSP) produced resources to assist councils to achieve and maintain financial sustainability.

Under the Financial Sustainability Program, the LGASA and councils:

- prepared and updated a series of information papers;
- implemented projects to assist councils with financial and asset management reforms;

³¹ A. Goody, Davis (2013), *Review of current local government reform in Australia and New Zealand*, Australian Centre of Excellence for Local Government, University of Technology, Sydney; Local Government Association of South Australia, Adelaide p.3.

³² Financial Sustainability Review Board (2005), *Local Government in South Australia: Assessing Financial Sustainability*, Adelaide.

³³ https://www.lga.sa.gov.au/webdata/resources/files/Financially_Sustainable_LG_-_Rising_to_the_Challenge_-_Volume_1_-_Final_Report_2005.pdf, p.3

³⁴ Australian Centre of Excellence for Local Government (2011) 'Unfinished Business? A Decade of Inquiries into Australian Local Government', Working Paper no.4, University of Technology Sydney, p.42.

- undertook training and briefing programs to further assist councils;
- received Australian Government funding to further the financial sustainability reforms that were undertaken by South Australian councils; and
- worked with other governments on intergovernmental issues³⁵.

In submissions to the Commission's methodology paper, several councils³⁶ identified the FSP as an example of an efficiency monitoring program that resulted in improved financial performance. As noted by the Town of Gawler in its submission:

With myriad financial accountability measures already in place, Local Government is the most financially accountable tier of Government. Examples of financial accountability measures include the establishment of Audit Committees, legislative financial reporting requirements, consultations on draft Budget / Business Plans, Budget / Business Plan summary provided with annual Rate notices in July, financial performance indicators (and associated performance targets) (Town of Gawler Submission, p.13)

While the FSRB's recommendations were largely aimed at the local government sector, the state government, working with the LGASA, introduced amendments to the LG Act to give legislative expression to some of the FSRB's recommendations. Amendments to the LG Act, which commenced in 2007, sought to enhance the accountability of councils and strengthen their financial governance, asset management, auditing arrangements and rate setting methodologies.

These improvements included requirements for councils to:

- establish audit committees;
- prepare and adopt infrastructure and asset management plans;
- prepare and adopt a long-term financial plan;
- adopt several measures to strengthen the independence of external auditors; and
- adopt a consistent and improved reporting format for annual financial statements.³⁷

In addition, further legislative amendments, principally in the form of the *Local Government (Accountability Framework) Amendment Act 2009*, were introduced to strengthen the legislative framework for the internal and external review of councils' administration and financial management.

Since 2007 South Australia's councils must develop and adopt long-term financial, and asset management plans, each covering a period of at least 10 years. The approach adopted in South Australia became a model for similar reforms in several other states.³⁸

The LGASA submission reports the improvement in the financial performance of councils:

The aggregate level of local government's annual operating deficit reduced steadily from 2000-01 (when expenses exceeded income by \$75 million) until 2007-08 (when the operating deficit was eliminated). Subsequently, an

³⁵ For additional information on the FSP, see LGASA website. <http://www.lga.sa.gov.au/page.aspx?u=6582>

³⁶ See LGASA, Playford Council and City of Charles Sturt Submissions.

³⁷ Government of South Australia (2019) *Reforming Local Government in South Australia Discussion Paper August 2019*, Adelaide, p.34.

³⁸ Australian Centre of Excellence in Local Government (2011), *Unfinished Business: A Decade of Inquiries into Australian Local Government*, Working Paper 4, University of Technology, Sydney, p. 14.

approximate 'break-even' operating result was recorded for five years up until 2012-13. Since then, there has been a significant improvement in the financial performance of councils, culminating in an operating surplus of \$98 million in 2017-18. A total of 56 councils recorded an operating surplus in 2017-18 compared with only 16 councils in 2000-01. (LGASA Submission, p. 5)

The Commission notes that while some councils are recording deficits, the sector as a whole has moved from deficit to surplus. This has been achieved through increases in revenue rather than reductions in expenditure. The Commission seeks information on any other financial reforms undertaken by councils which have improved their efficiency.

Information request 2.3: Financial management

How have the financial management program reforms affected councils' ability and incentives to manage costs?

What changes to the type or quality of financial management information would assist councils to improve their decision making and contribute to better performance?

Is there a need for a stronger external auditing process to increase councils' compliance with their legislated responsibility to produce long-term asset and financial management plans and lift the quality of these plans? If so, what form should it take?

2.5.2 Workplace and management initiatives

The LGASA offers specific training programs to local government sector employees in South Australia.³⁹ Training and upskilling can lift labour productivity and the efficiency of local councils. The literature suggests there is considerable variation in the workforce capabilities of councils.⁴⁰

A 2018 national review, commissioned by the Local Government Workforce Development Group (LGWDG) for the Australian Local Government Association (ALGA), based on ABS data and a skills shortage survey completed by councils, identified that:

Local government professionals across Australia are facing a major skills shortage across key occupations and are not well positioned in new and emerging skills.⁴¹

Staff training was also found to be lacking, with almost one third of councils reporting having unmet training needs as a result of the high cost of training and lack of availability.⁴²

³⁹ For more details, see <http://training.lga.sa.gov.au/>

⁴⁰ Productivity Commission (2017) *Shifting the Dial*, p.13.

⁴¹ Local Government Workforce and Future Skills Report for further details see <https://www.governmentnews.com.au/councils-face-major-skills-shortages-national-review-finds/>

⁴² *Ibid.*

Councils that participated in the survey identified a lack of qualified individuals locally, the remoteness of some councils, inability of councils to compete with the private sector, and the lack of opportunity for career progression were among the forces driving the skills shortage.⁴³

Recruitment and retention of staff can be very difficult for regional councils. Some, where possible, have responded by sharing professional and technical staff between councils, providing a means for attracting locally based resources in regional areas.

However, other than joint provision and resource sharing among councils, especially smaller ones, the Commission's initial literature review has found little evidence of reform in increasing the capability for staff members.

Information request 2.4: Workforce planning

Have councils experienced any issues with attracting and retaining workers or securing workers with specific skills?

Are these issues unique to individual councils?

Is there value in a sector-wide or region-wide approach to workforce planning and the development of specific skills to support councils?

With respect to management matters, the LGASA released a discussion paper, 'Sensible Change', in 2017 on further reform ideas and options. As noted in its submission to the methodology paper, the LGASA's proposed reforms concentrate on several areas of local government operations that can be strengthened without the need for legislative intervention. Reforms listed in the LGASA paper that offer potential for efficiency improvement or potential cost savings include:

- industry-wide industrial relations framework
- sector wide benchmarking program;
- best practice audit committees;
- standardising external audits;
- best practice service reviews⁴⁴.

The Commission seeks additional evidence and views from councils on these and other possible sector-wide reform initiatives that could deliver efficiency gains in South Australia.

2.5.3 Resource sharing

Within the local government sector, resource sharing currently occurs in a variety of forms and at different levels of legal and administrative formality, ranging from the highly informal, such as information sharing arrangements between councils, to formal legal structures, including subsidiaries established under sections 42 or 43 of the LG Act.

⁴³ For further details, see Australian Local Government Association (2018) *Local Government Workforce and Future Skills Report Australia*, September, p.72.

⁴⁴ LGASA, Part 2 Submission on methodology paper, p 16.

The Independent Inquiry into the Financial Sustainability of Local Government in 2005 recommended “that in canvassing alternative methods of delivery, councils consider further resource-sharing initiatives, especially involving the smaller councils, ranging from working together more effectively to more formalised regional groups, area integration and whole-of-sector initiatives”⁴⁵.

Various forms of collaboration, which broadly fit under the definition of resource sharing, have been identified as an important example of local government-initiated reform aimed at reducing service cost and improving efficiency.

The LGASA has established several entities and activities to provide services to member councils across South Australia. Examples of sector wide services that the LGASA advised have led to significant cost savings include:

- LGA Mutual Liability Scheme (LGAMLS): the LGAMLS will deliver \$4.05 million in bonuses back to the sector in 2018-19, with a contribution rate lower than 10 years ago.⁴⁶
- LGA Workers Compensation Scheme (LGAWCS): LGAWCS will deliver \$11.8 million in performance rebates back to the sector in 2018-19. Self-insurance has delivered over \$250m in savings to the sector since 1986. The number of new LGAWCS claims received in 2018-19 (509), was 3.4 per cent lower than the previous financial year⁴⁷.
- LGA Procurement (LGAP), a company wholly-owned by the LGASA, undertakes procurement for member councils. This has enabled electricity cost savings via LGA’s ability to aggregate the load profile and approach the market. Savings have been realised by participating councils of over \$8.2 million over three years.⁴⁸

Councils also may, pursuant to section 43 of the LG Act, establish a variety of regional subsidiaries to enable more effective service delivery. The Eastern Health Authority (EHA), jointly established by five eastern and north-eastern metropolitan councils, is generally seen as a significant example of service delivery through a regional subsidiary. EHA provides a range of health services to the community, by means of a shared services model in which one entity provides services on behalf of the constituent councils. While subsidiaries have been established for various purposes, the Commission understands waste management remains a common area in which councils have used such arrangements.

The Commission’s Local Government Inquiry Reference Group, noted that there has been an increase in the use of resource sharing, and it has become more necessary in a contemporary context. They also noted, that there is comparatively little data on resource sharing initiatives, making it difficult to assess their impact on council performance. In addition, resource sharing schemes, such as shared services arrangements, can be complicated to arrange and manage effectively, cost savings are not always realised, and the resulting services can become more expensive.⁴⁹

⁴⁵ Quoted in LGASA (2012), *Shared Services in SA Local Government*, South Australia, Adelaide, p.2.

⁴⁶ LGASA, Part 2 Submission on methodology paper, p 40.

⁴⁷ *Ibid.*, pp. 40.

⁴⁸ *Ibid.*, pp. 38.

⁴⁹ Minutes of Local Government Reference Group, 31 July 2019.

Despite these qualifications, the Commission has also received information on resource sharing initiatives that have produced savings:

City of Salisbury is a major constituent council of the Northern Adelaide Waste Management Authority who are widely recognised for the great work they do in managing waste and reducing costs for the member councils.⁵⁰

Many councils also participate in other localised arrangements based on a common interest such as:

- sharing information about activities or services between councils;
- common specifications used by multiple councils for procurement of a service; and
- sharing of resources such as specialist staff and equipment.

The common cost and efficiency gain drivers for considering collaboration between councils identified by the Commission can be summarised as:

- cost savings, efficiencies in service delivery, affordability, economies of scale, helping to improve financial sustainability and reduced duplication of effort and resources;
- increased capacity and value for money, capacity to provide additional services, and capacity to address gaps not otherwise provided for by the market; and
- better risk management due to sharing of risks and improved ability to comply with legislation due to increased capacity and resources.

The Commission's literature review has also identified common difficulties and challenges faced by councils in instigating and undertaking resource sharing arrangements.

For example, in its 2017–18 performance audit of shared services, the Audit Office of NSW found that most NSW councils surveyed were not efficiently and effectively sharing services:

councils don't always assess current service performance before deciding on the best delivery model and build a business case to outline the costs, benefits and risks of a proposed shared service arrangement before entering it.⁵¹

The LGASA case studies of local government shared services in South Australia found:

one of the key lessons from its analysis is that quantifying the cost efficiencies and the measurement of outcomes provided by certain shared services remains a challenging task.⁵²

The Commission's literature review also identified commitment, equity across councils, quality of business cases and governance models as further challenges to collaboration that councils face. Consultations suggest that many councils are of the view that there is more scope for use of shared services. The Commission seeks additional information regarding council experiences with resource sharing.

⁵⁰ City of Salisbury, Submission, p.2

⁵¹ See Audit Office of New South Wales *Performance Audit of shared services* <https://www.audit.nsw.gov.au/our-work/reports/shared-services-in-local-government>

⁵² The South Australian Centre for Economic Studies (2017), *Case Studies in Local Government Shared Services in South Australia*, Adelaide, p.1.

Information request 2.5: Resource sharing

What is the potential for additional use of resource sharing to deliver efficiencies and other benefits to participating councils?

In councils' experiences of resource sharing, what works and what does not? Why?

Councils are asked to provide further examples of resource sharing.

Are there any impediments to the greater uptake of various forms of collaboration or resource sharing?

What challenges, if any, do councils face in making use of the provisions contained in sections 42 and 43 and Schedule 2 of the *Local Government Act 1999* to deliver effective and efficient services to their communities?

2.6 Reforms in other jurisdictions

The Commission's review of the reforms in other jurisdictions suggests that, at least to date, comprehensive evaluations of initiatives aimed at enhancing council efficiency and lowering costs have been limited. This makes it difficult to judge the overall effectiveness of different jurisdictions' responses to significant issues in the sector on an interjurisdictional level.

It is also a notable feature of recent local government reforms that, with the exception of South Australia, the majority of initiatives have originated with state governments, not as result of collective action from within the local government sector itself.⁵³

Reforms aimed at improving councils' capacity for long term strategic planning, particularly in relation to financial and asset management plans, have become a predominant focus of reform efforts in most jurisdictions. In NSW, all councils are now required to use an integrated planning and reporting framework that is designed to improve council capacity for strategic community planning, especially for financial and asset management planning.⁵⁴

The Commission also notes that, as part of a wider strategy to improve councils' capacity to monitor and enhance their own performance, the NSW Office of Local Government is developing a Performance Management Framework to provide councils and the community with a consistent set of performance indicators, including costs and asset management.

In Victoria, the need to build councils' capacity for long term planning was recently addressed through the Local Government (Planning and Reporting) Regulations 2014. These reforms aimed to standardise the way councils report on their long term financial and asset management plans, with a range of documents, including statutory financial statements, now required to conform to the Local Government Model Financial Report.⁵⁵ In support of this regulatory requirement, Local Government Victoria issued its revised *Best practice guidance in asset management* guidelines in 2015.

⁵³ Australian Centre of Excellence in Local Government (2011), *Unfinished Business*, p. 5.

⁵⁴ Australian Government, (2017) *Local Government National Report 2014-15*, Canberra, p. 35.

⁵⁵ *Ibid*, p. 35.

In addition to reforms to the way in which councils undertake strategic planning, the Victorian Local Government Reporting Framework, introduced by the Victorian Government as a mandatory performance reporting system, is designed to address the need for a consistent framework for performance management and reporting. The resultant performance data is presented to the community through the 'Know Your Council' website and represents one of the most developed sector-wide approaches to benchmarking and efficiency comparison.⁵⁶

The Tasmanian government mandated similar strategic planning requirements in 2013. The Commission notes that the Tasmanian legislation assigns responsibility for monitoring compliance to the Auditor-General. Recent audits of compliance with the new reporting regime suggest that councils' financial and asset management performance has undergone a noticeable improvement.⁵⁷

The Commission notes that the Tasmanian Government, is also currently developing the Local Government Data, Analysis, Transparency and Accountability (LG DATA) project. The initiative aims to enhance transparency in the way that local government performance is reported and provide councils with a tool to identify opportunities for performance enhancement.⁵⁸

2.7 Conclusion

The Commission has been asked to consider recent reforms in South Australia and other jurisdictions to policy and management practices in the local government sector and their potential to improve council performance.

The move away from prescribing specific functions to broadening the discretionary power of councils to perform a range of functions in SA also occurred in other jurisdictions. The LG Act, in common with local government legislation in other jurisdictions, defines councils' functions and powers broadly, which has enabled councils to undertake a significant number of non-mandatory functions. However, the South Australian local government sector has arguably a greater level of autonomy than other jurisdictions, with the South Australian Government taking a less prescriptive approach.

Initial research and consultation with councils and other stakeholders has revealed a diverse range of reviews and reform projects that have been undertaken by councils. The Commission has noted some evidence linking these changes or reforms to council performance. Some observations can be made.

The literature suggests that sector-wide improvement or reform is more likely to be fully implemented if it is mandated by state governments.⁵⁹

⁵⁶ For the 2018 review of the effectiveness and efficiency with which Victorian councils deliver services to their communities, conducted by the Victorian Auditor-General, see <https://www.audit.vic.gov.au/report/delivering-local-government-services?section=>

The Commission is aware of the work also being undertaken by the Queensland Auditor-Generals Department in relation to efficiency in the local government sector. <https://www.qao.qld.gov.au/audit-program>

⁵⁷ *Ibid*, p. 36. In addition, see Tasmanian Audit Office, *Auditor-General's Report on the Financial Statements of State Entities: Local Government Authorities 2017-18*, available at <https://www.audit.tas.gov.au/publication/local-government-authorities-2017-18/>

⁵⁸ For additional information, see Tasmanian Local Government Division, Department of the Premier and Cabinet: http://www.dpac.tas.gov.au/divisions/local_government/measuring_tasmanian_local_government_performance

⁵⁹ Australian Centre of Excellence for Local Government (September 2011) 'Unfinished Business? A Decade of Inquiries into Australian Local Government', Working Paper no.4, University of Technology Sydney, p.39.

Regarding sector wide improvement, financial management reforms initiated by the local government sector, some of which were subsequently incorporated into the LG Act, have strengthened council financial performance. However, the Commission's initial assessment of the evidence suggests that few management or work practice reforms have been undertaken in recent years by the sector.

Councils also participate in a large number of collaborative resource sharing arrangements, ranging from relatively informal arrangements to formal legal structures, with varying degrees of success. Again, however, it is difficult to locate information that enables a quantification of the cost, efficiency or other outcomes of these initiatives.

3. Local government costs

3.1 Introduction

The Inquiry's terms of reference require the Commission to address the following matters regarding local government costs and efficiency:

Analysis of the information on local government costs and the key drivers of costs including:

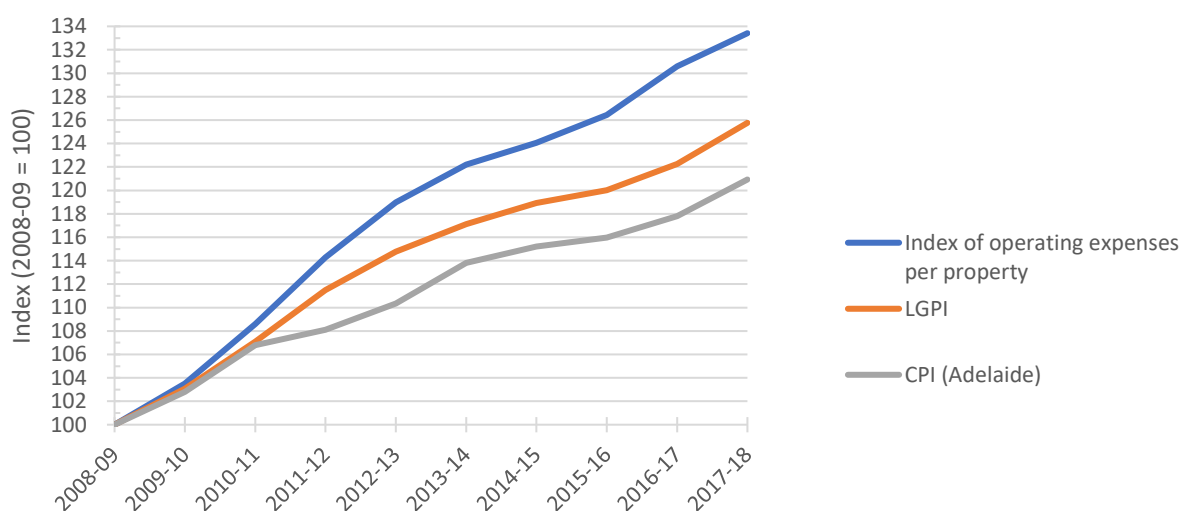
- identify trends in local government activities and costs of local government operations; and
- identify the drivers of local government costs and assess their impacts.¹

Between 2008-09 and 2017-18, total operating expenditure of all South Australian councils increased from \$1.6 billion to \$2.2 billion at an average annual rate of 4.2 per cent. Adjusting for the change in the number of properties over time, the average annual increase in operating expenditure was 3.3 per cent per annum per property.

In comparison, the two popular measures of price inflation generally used by councils — movements in the consumer price index (CPI) and the local government price index (LGPI) — reflected increases of 2.1 per cent and 2.6 per cent per annum, respectively (refer to Figure 3.1).²

This chapter examines trends and changes in council operating expenditure and likely explanations for these changes. To understand the cost drivers, the Commission examined councils' costs for the period from 2008-09 to 2017-18 on both a resource (or input) basis and a function or service (output) basis.

Figure 3.1: Index of the change in operating expenditure per property across all councils and price indices



Source: SALGGC (2017b), ABS (2019), SACES (2019).

¹ For a complete text of the Terms of Reference refer to Appendix 2.

² Inflation as measured by the Australian Bureau of Statistics' Consumer Price Index for Adelaide and the South Australian Centre for Economic Studies' (SACES) Local Government Price Index (LGPI). Information on the construction of the LGPI may be accessed at: <https://www.adelaide.edu.au/saces/economy/lgpi/>.

3.2 Data sources and council groupings

3.2.1 Data sources

In undertaking this inquiry, the Commission has drawn upon a range of data sources. It acknowledges the support of the South Australian Local Government Grants Commission (SALGGC) in providing information from councils' annual returns, supplementary surveys and general information returns.³ In addition, the Local Government Association of South Australia (LGASA) provided information and data collated from its member councils. Several councils provided additional information in their submissions that has assisted in understanding underlying trends.

The SALGGC provided a database of information and cost data covering the 10-year period from 2008-09 to 2017-18 for all 68 councils. This database included, but was not limited to, the following indicators:

- general and statistical information;
- operating income;
- operating expenditure;
- physical asset and associated capital expenditure;
- statutory accounting statement of financial position and net financial liabilities; and
- financial ratios.

All councils in South Australia must prepare annual financial statements in accordance with the "Model Financial Statements" as published by the LGA.⁴ These statements include guidance on the allocation of costs to activities.

The financial information submitted by councils and collected by the SALGGC is based on these model financial statements. The SALGGC reports the consolidated information collected from councils on their website.⁵ The SALGGC notes:

...these reports may include differences from council financial statements and amounts shown in supplementary returns as to enhance data consistency and comparability.⁶

The inquiry has relied on the information contained in these database reports.

3.2.2 Council groupings

The Commission grouped councils, using the Australian Classification of Local Governments (ACLG) Scheme, as detailed in Appendix 6, to enable meaningful comparisons and conclusions to be drawn.⁷ This is consistent with the SALGGC's interpretation.

³ Refer to Appendix 5 for an outline of the extent of the information provided by SALGGC.

⁴ Refer to the Local Government Act 1999 (Section 127) and Regulation 4(3) and Regulation 13 of the Local Government (Financial Management) Regulations 2011.

⁵ The Database Reports are available from https://www.dpti.sa.gov.au/local_govt/LGGC.

⁶ SALGGC, *SA Local Government Grants Commission Database Reports 2017-18*, p1. This report can be accessed at: https://www.dpti.sa.gov.au/_data/assets/pdf_file/0003/564177/Database_Reports_2017-18.pdf.

⁷ As outlined in Appendix 6, the ACLG scheme is based on a three-step hierarchy system. Each step allocates a prefix made up of three letters to produce a unique identifier for each type of local government area. The system's full classification structure contains 22 separate categories. By way of example, a medium-sized (populated) council in a rural agricultural area would be classified as RAM – Rural, Agricultural, Medium.

The Commission allocated the 68 councils, using this scheme, into one of four groups depending on location and population, broadly as follows:

- Urban:
 - Urban – metropolitan and fringe — which includes the capital city, developed (suburban) and fringe (suburban) metropolitan councils;
 - Urban – regional — non-metropolitan councils with urban centres in regional areas;
- Rural:
 - Rural agricultural – large and very large populated councils in rural or agricultural areas; and
 - Rural agricultural – small and medium populated councils.

Table 3.1 shows the differences between urban, rural and the four council groupings.

Table 3.1: Selected statistics by urban and rural type 2017-18

Indicator	Council group	All urban councils	All rural councils	State-wide total	Urban-Metro & Fringe	Urban-Regional	Rural-Small and medium	Rural-Large and very large
Number of councils		30	38	68	21	9	20	18
Area	Total (square kilometres)	10,600	146,230	156,830	5,139	5,461	82,780	63,450
	Average per council	353	3,848	2,306	245	607	4,139	3,525
Population	Total	1,506,515	223,765	1,730,280	1,350,028	156,487	45,342	178,423
	Average per council	50,217	5,889	25,445	64,287	17,387	2,267	9,912
Employees	Total (FTE)	7,029	1,838	8,867	6,036	993	546	1,292
	Average per council	234	48	130	287	110	27	72
Sealed roads	Total (km)	10,768	8,031	18,799	8,813	1,955	2,030	6,001
	Average per council	359	211	276	420	217	101	333
Unsealed roads	Total (km)	3,945	52,249	56,194	2,192	1,753	27,152	25,097
	Average per council	132	1,375	826	104	195	1,358	1,394
Roads (including laneways)	Total (km)	14,873	60,307	75,180	11,091	3,782	29,184	31,123
	Average per council	496	1,587	1,106	528	420	1,459	1,729
Number of properties	Total	716,175	190,258	906,433	630,838	85,337	51,744	138,514
	Average per council	23,873	5,007	13,330	30,040	9,482	2,587	7,695
Capital value of properties	Total (\$billion) at 1 Jan-19	\$337.9	\$58.6	\$396.5	\$313.3	\$24.5	\$14.5	\$44.1
	Average per property (\$'000)	\$471.8	\$308.0	\$437.4	\$496.7	\$287.5	\$280.0	\$318.5

Source: SALGGC (2019), Valuer-General (2019)

Expenditure by council will vary according to a range of factors including population, area, properties and road length amongst other things.⁸ Accordingly, where appropriate, the Commission has also undertaken analyses using the following classifications:

- Urban metropolitan and fringe councils were classified to reflect their level of development — suburban (otherwise referred to as developed) or fringe (or developing), and
- rural councils were classified to reflect similar regional areas or geographies,⁹ such as:
 - Eyre Peninsula;
 - Legatus Group¹⁰ of councils (includes various Yorke Peninsula, mid-north and other similar regional councils);
 - Limestone Coast;
 - Murraylands and Riverlands; and
 - Southern and Hills.

Submissions provided broad support for the use of the ACLG classification scheme; for example, the Town of Gawler:

As acknowledged in the Paper, it is inherently difficult to compare Councils, given each Council has distinct and diverse characteristics. Utilisation of the ACLG is deemed appropriate. (Town of Gawler Submission, p.1)

In contrast, the City of Playford's submission raised the following concern:

The issue with the ACLG grouping is some Councils can be considered in multiple groupings given their diversity. Therefore, groupings are not relevant for all services. (City of Playford Submission, p.1)

The Commission notes the concerns raised in submissions. Its analysis focuses on the underlying drivers of costs and not in making comparisons between individual councils.

3.3 Analysis of operating expenditure by resource type

This section discusses the issues that the Commission and various submissions have put forward as drivers of council costs. It examines expenditure by the type of resources, or inputs, employed — these comprises employee costs, materials and contracts costs, depreciation charges and finance costs.

3.3.1 Total operating expenditure

As noted, total operating expenditure by councils has grown more rapidly than inflation between 2008-09 and 2017-18.

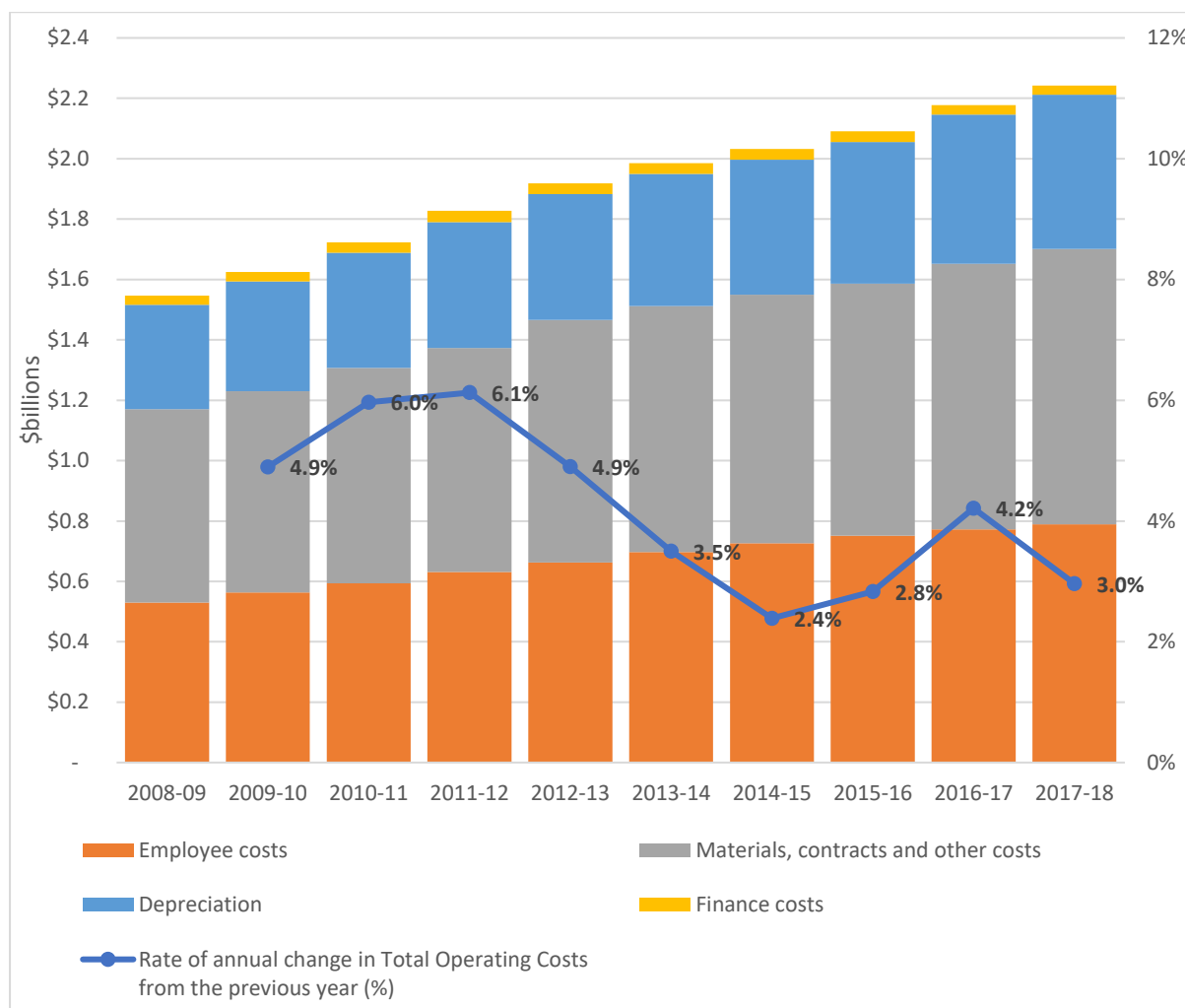
Figure 3.2 shows the individual cost components of total operating expenditure as well as the rate of change in total annual costs from the previous year.

⁸ The properties data used in the analysis throughout the report is sourced from the SA Valuer-General and includes both rated and unrated properties to ensure a consistent and reliable time series. The time series data provided by the SALGGC was found to be inconsistent and unreliable primarily due to a change in the data collection and classification systems that were implemented in 2015. A detailed discussion on this matter is provided by Coelli (2019), p.9.

⁹ The regional classifications used largely reflect the regional local government associations to which the councils themselves belong.

¹⁰ The Legatus Group is the trading name of the Central Local Government Region established under the LG Act. It is a collection of councils from the Yorke Peninsula, mid-north and other nearby areas (refer to Appendix 6).

Figure 3.2: Total operating expenditure by input (\$billion) and total annual change (per cent)



Source: SALGGC (2019)

Figure 3.2 shows that the annual growth in operating costs between 2008-09 and 2012-13 ranged between 4.9 per cent and 6.1 per cent, falling to 2.4 per cent in 2014-15. The rate of change has trended upwards in recent years and it slowed to 3 per cent in 2017-18.

Table 3.2 compares the average annual increases in total operating expenditure for all council groups over three different time periods. The table shows that growth in operating costs for the urban metropolitan and fringe group of councils has been highest, and remains high, whereas for the urban regional group expenditure slowed (and fell in 2017-18). In addition, the rate of growth in operating expenditure of the rural small and medium group was the smallest among the council groups over the decade and the past seven years.

Table 3.2: Average annual increase in total operating expenditure by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	4.3	3.7	4.0
Urban - Regional	4.0	3.0	-0.1
Rural - Small & Medium	3.3	2.2	0.5
Rural - Large & Very Large	4.3	3.3	2.0
All Groups	3.9	3.5	3.0

Source: SALGGC (2019)

The two urban and rural council groups experienced similar annual average increases over the 10 years (4.2 per cent and 4.0 per cent per annum, respectively).¹¹ The capital city and urban fringe councils experienced average annual growth increases of 5.8 per cent and 5.1 per cent, respectively.

The greatest average annual growth in total operating expenditure among the rural councils was experienced by the rural councils of the Murraylands and Riverlands (4.9 per cent).

Figure 3.2 shows that overall spending increased by approximately 45 per cent (or \$693 million) over the ten years to 2017-18 and that the relative proportions of the individual components have changed little in that time. In 2017-18, the major components of councils' expenditure were:

- materials, contracts and other costs (\$912 million or 41 per cent of total operating expenditure);
- employee costs (\$789 million or 35 per cent); and
- depreciation charges (\$511 million or 23 per cent).

Finance costs represented only 1.4 per cent (or \$31 million) of total operating expenditure in 2017-18. The only other operating charge reported by councils is the loss incurred on their ownership in joint ventures and other businesses.¹²

Each of these cost components is discussed in the following sections.

¹¹ Similarly, over the last seven years since 2011-12, the average annual rate of increase in total costs has been higher for urban councils, at 3.6 per cent, compared to 3.0 per cent for rural councils.

¹² In 2017-18, this item represented approximately 0.1 per cent of total operating expenditure (or less than \$1.5 million) and is not separately examined. The corresponding profit on these ventures is reported as income in the revenue section of the Income Statement.

3.3.2 Materials, contracts and other costs

Materials, contracts and other costs is the most substantial category of expenditure for councils making up approximately 41 per cent of total operating expenditure and, in 2017-18, expenditure in this area reached \$912 million.¹³ The average rate of increase for materials and contract expenditure, over the last 10 years, was 4.0 per cent annually and this was similar across both urban and rural councils. The LGPI increased by 2.6 per cent annually and, assuming this represents the changes in materials prices, the real increase or the volume growth of materials (and other costs) spending is approximately 1.4 per cent annually.

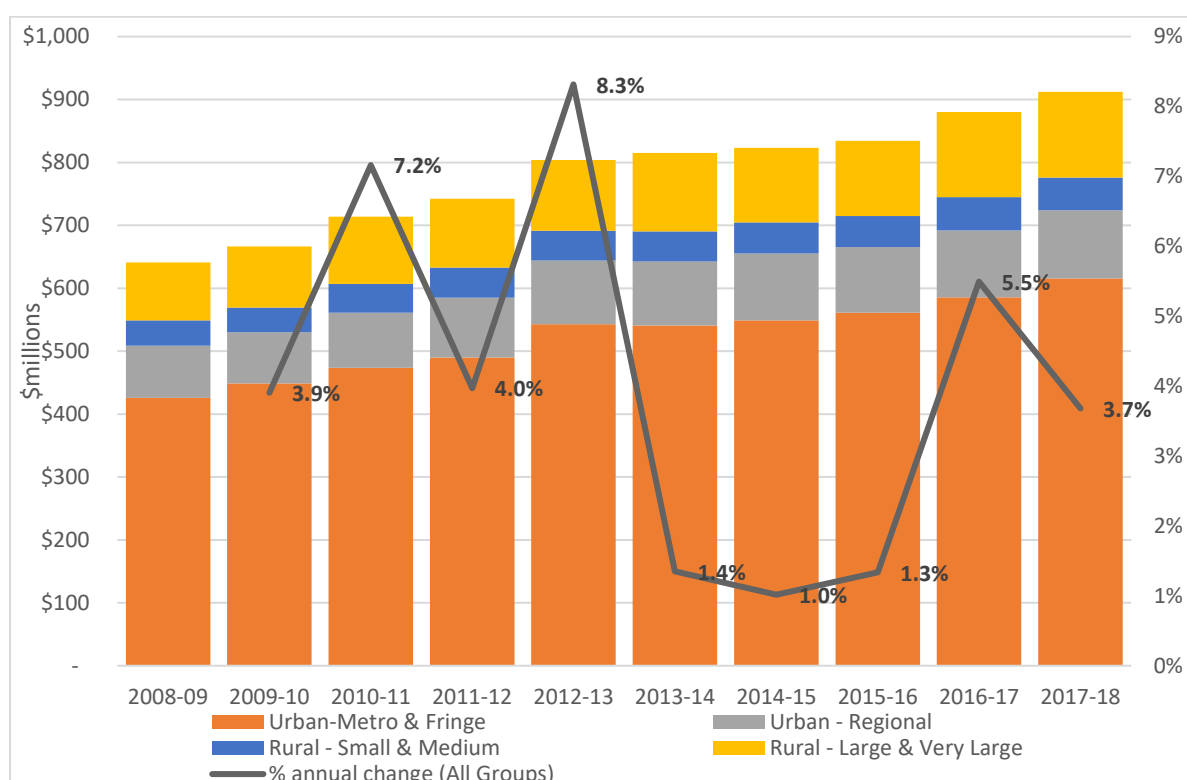
Figure 3 shows the total operating expenditure by group as well as the annual rate of change in the overall materials and contracts cost.

Urban metropolitan and fringe councils represent 67 per cent of materials and contract costs in 2017-18 and, in comparison:

- large and very large rural councils represent 13 per cent;
- small and medium councils' rural councils represent 12 per cent; and
- urban regionals represent less than 6 per cent.

These relative proportions have changed negligibly over time as shown in Figure 3.3.

Figure 3.3: Materials, contracts and other expenditure in total and by group (\$million) and total annual change (per cent)



Source: SALGGC (2019)

¹³ The materials, contracts and other category includes expenditure on a range of items including consultants, contractors, energy, water, waste services, maintenance, legal, levies to state government, advertising, catering, cleaning, communications, entertainment, various project related costs, sponsorships, subscriptions, insurance, security, information technology and other items.

Despite the similar increase in expenditure across both urban and rural councils over the last 10 years, Table 3.3 shows that there are significant compositional differences in the rate of increase in materials costs amongst the various council groupings:

- the urban metropolitan and fringe council group costs increased by 4.2 per cent per annum on average over the past 10 years. There has been a slight downward trend in the rate of increase (3.9 per cent) over the last seven years but 2017-18 recorded an increase of 5.1 per cent.
- the urban regional group costs increased by 3.0 per cent per annum on average over the 10 years and are moderating — in 2017-18 the increase was 1.8 per cent;
- rural small and medium council group costs increased by 3.1 per cent per annum on average and in 2017-18 costs fell by 1.2 per cent (it is noted that in 2016-17 there was an increase in costs of 7.8 per cent); and
- rural large and very large group costs grew by 4.4 per cent per annum and appear to be falling below the long-term average. In 2016-17, there was an increase of over 13 per cent.

Table 3.3: Average annual increase in materials, contracts and other costs by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	4.2	3.9	5.1
Urban - Regional	3.0	2.2	1.8
Rural - Small & Medium	3.1	1.5	-1.2
Rural - Large & Very Large	4.4	3.7	0.8
All Groups	4.0	3.5	3.7

Source: SALGGC (2019)

The City of Adelaide experienced a 6.4 per cent average annual increase over the 10 year period. In contrast, the metropolitan and fringe councils, experienced average increases of 3.5 per cent and 4.5 per cent per annum, respectively.

In respect of the other regions, the largest average annual increases over the 10 years to 2017-18 related to:

- the rural councils of the Murraylands and Riverlands regions which experienced an average increase of 6.7 per cent;
- the rural councils of the Southern and Hills regions: 5.4 per cent; and
- the metropolitan fringe councils: 4.5 per cent.

The increases for the metropolitan fringe and southern and hills councils may be in part attributed to the growth in population and the demand for greater services in these areas. In contrast, the rural councils of the Murraylands and Riverlands experienced an overall decline in numbers over the last 10 years — although there has been an increase in population in the last two years.

Information request 3.1: Materials, contracts and other costs

What are the main drivers of materials, contracts and other costs for rural small and medium councils?

In what ways do current council procurement practices affect expenditure on materials, contracts and other costs?

3.3.3 Employee costs

Employee costs is the next most substantial expenditure for councils representing approximately 35 per cent (or \$789 million) of total operating expenditure in 2017-18. Employee costs incorporate:

- total number of employees; and
- costs per employee, including wages, salaries and supplements.

The average annual increase in total employee costs across the local government sector was 4.5 per cent over the last 10 years, with no major difference between urban and rural councils.

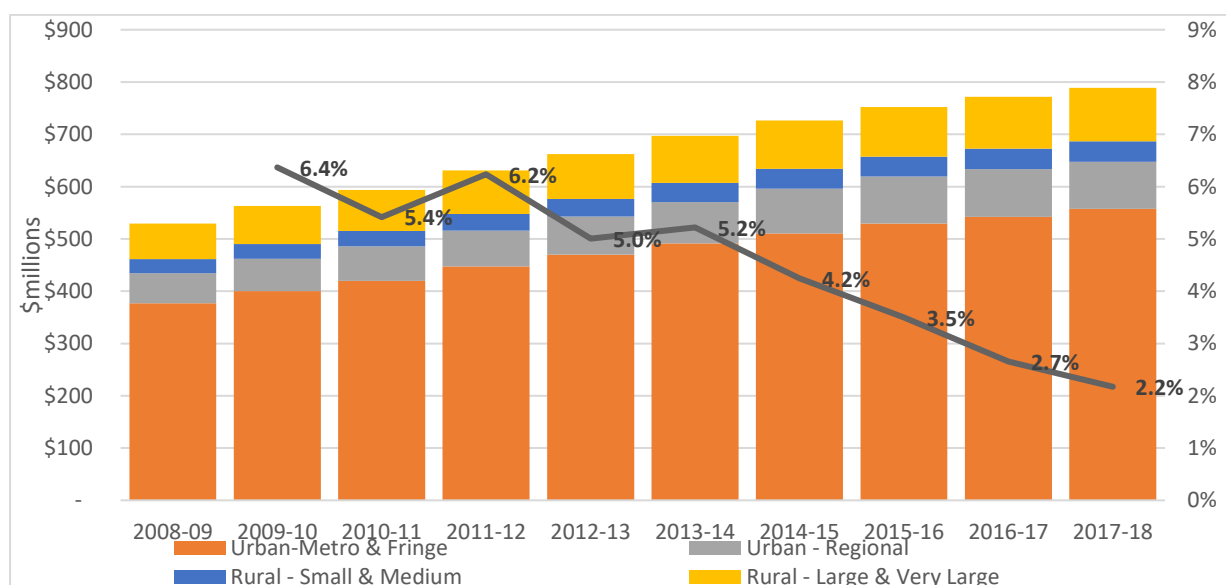
Total employee costs across the four council groups since 2008-09 are shown in Figure 3.4. It is noted that there may be some variation in employee costs from year to year due to the rate of capitalisation of labour that occurs — the Commission does not have access to the labour capitalisation rate for each council.

Urban metropolitan and fringe councils represent 71 per cent of total employee costs in 2017-18 and, in comparison:

- large and very large rural councils represent 13 per cent;
- small and medium rural councils represent 11 per cent; and
- urban regional councils represent 5 per cent.

These relative proportions have changed negligibly over time as may be inferred from Figure 3.4.

Figure 3.4: Employee costs in total and by council group (\$million) and annual change (per cent)



Source: SALGGC (2019)

Table 3.4 shows the slowing growth in total employee costs over the last 10 years was experienced across both urban and rural councils. The table also shows that the changes in employee costs tended to diverge more between the various council groupings over time:

- urban metropolitan and fringe councils' employee costs grew by 4.4 per cent per annum on average over the past 10 years, although there has been a downward trend in the rate of increase (to 3.7 per cent) over the last seven years and the rate of increase slowed to 2.8 per cent during 2017-18;
- urban regional councils' employee costs grew by 5.1 per cent per annum over the past 10 years and 4.6 per cent over the last seven years. However, 2017-18 experienced a decrease of 1.5 per cent;
- rural - small and medium councils' costs grew by 4.4 per cent per annum over the 10 years and appear to be slowing, experiencing a 1.2 per cent increase during 2017-18; and
- rural - large and very large councils' costs grew by 4.6 per cent per annum over the 10 years but over the past seven years experienced the smallest rise of all groups (3.5 per cent) and in 2017-18 the rise was 2.6 per cent.

Overall annual growth in employee costs for the entire sector (across all groups) has declined to 2.2 per cent in 2017-18 as shown in Table 3.4.

Table 3.4: Average annual increase in employee costs by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	4.4	3.7	2.8
Urban - Regional	5.1	4.6	-1.5
Rural - Small & Medium	4.4	3.8	1.2
Rural - Large & Very Large	4.6	3.5	2.6
All Groups	4.5	3.8	2.2

Source: SALGGC (2019)

As shown in Table 3.5, over 10 years, the urban fringe councils (of all the groups) experienced the greatest increase in employee costs at 5.8 per cent per annum and 5.4 per cent per annum over the last seven years. Growth during 2017-18 also remained high at 4.6 per cent.

Similarly, the rural regional groups of Eyre Peninsula and the Legatus Group, and the urban regional council group all experienced increases of 5.1 per cent per annum over the 10 years and increases of between 4.1 per cent and 4.6 per cent per annum over the last seven years.

In contrast, the total employee cost increases of the group of rural councils of the Murraylands and Riverlands averaged approximately 3.5 per cent per annum over the 10 years and 2.3 per cent over the last seven years. In 2017-18, these councils' employee costs grew by 1.0 per cent and the southern and hills councils experienced a growth of 0.7 per cent.

Table 3.5: Average annual change in employee costs by regional council grouping (per cent)

Council type and region	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban capital city	3.9	4.0	2.0
Urban metropolitan	4.0	2.9	2.1
Urban fringe	5.8	5.4	4.6
Urban regional	5.1	4.6	-1.5
Rural Eyre Peninsula	5.1	4.1	1.8
Rural Legatus Group	5.1	4.1	3.4
Rural Limestone Coast	4.3	3.2	1.7
Rural Murraylands & Riverlands	3.5	2.3	1.0
Rural Southern & Hills	4.4	4.7	0.7

Source: SALGGC (2019)

From information collected by the ABS for its Wage Price Index for South Australia, the annual growth in total hourly rates of pay (excluding bonuses) for both private and public sectors across all industries was 2.8 per cent over the same 10-year period of this review, 2.6 per cent over the past seven years and 2.1 per cent during 2017-18.

The Commission notes that the average annual growth in the number of council employees (on an FTE basis) has followed the general growth rate of the population at around 0.8 per cent. On an FTE basis, total unit employee costs for the local government sector have increased from \$64,100 in 2008-09 to \$88,900 in 2017-18 — an average annual increase of 3.7 per cent over the decade.¹⁴

The increase in total employee cost is driven by the increase in salary and wages rather than by the increase in employee numbers. Furthermore, the increase in salaries and wages may also be due to changes in labour composition to a more skilled workforce. The Commission's analysis shows that the rate of increase in council unit employee costs rose more rapidly than average wages in the South Australian economy for the full decade, for the period 2011-12 – 2017-18 and for 2017-18.

On an urban/rural basis, unit employee costs have increased at a faster rate for the rural council group compared with the urban council group as shown in Table 3.6. The table also shows the average annual change in unit employee cost by the four major council groups and regional area.

¹⁴ It is noted that the full time equivalent employee numbers provided by the SALGGC represents the total workforce and, as such, no adjustment is made for the capitalisation rate associated with the split between operating and capital costs.

Table 3.6: Average annual change in unit employee cost (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban	3.6	3.3	2.7
Rural	4.0	3.4	2.1
Urban - Metro & Fringe	3.5	3.2	2.4
Urban - Regional	4.4	3.9	4.5
Rural - Small & Medium	4.4	4.3	-0.8
Rural - Large & Very Large	3.8	3.0	3.3
Urban capital city	3.1	2.9	3.2
Urban metropolitan	3.4	3.0	1.8
Urban fringe	4.0	3.6	3.5
Rural Eyre Peninsula	4.7	4.3	-1.3
Rural Legatus Group	4.3	3.4	3.8
Rural Limestone Coast	3.7	3.6	0.5
Rural Murraylands & Riverlands	3.4	3.1	3.1
Rural Southern & Hills	3.5	2.7	-0.6
All Groups	3.7	3.3	2.6
SA Wage Price Index	2.8	2.6	2.1

Source: SALGGC (2019)

The average cost per FTE is generally higher among urban councils compared to rural councils. In particular, the average unit employee cost in 2017-18 for each council group was:

- urban metropolitan and fringe group: \$92,300;
- urban regional group: \$90,500;
- rural small and medium group: \$72,500; and
- rural large and very large group: \$78,800.

Some stakeholders raised the issue of employee costs and the central role that enterprise agreements play in the wage setting process. In its submission, the City of Charles Sturt stated that:

Employee expenses comprise approximately 35% of operating costs and governed by Enterprise Bargaining Agreements. In 2008/09 the EBA wages increase at Charles Sturt was 5.5%. It then decreased to 4% until 2013/14 where it was 3% until 2017/18.
(City of Charles Sturt Submission, p.6)

In addition, the South Australian Financial Management Group (SALGFMG) noted that:

From 2008/09 many Councils had wages increase in the order of 4% to 6%, falling to around 3% in 2014/15 and more recently in the order of 2%, and more reflective of wages growth in the broader economy.
(SALGFMG Submission, p.10)

The SALGFMG submission offered a possible explanation and noted that enterprise agreements may have an indirect role by making costs fixed rather than variable:

Employee costs represent 35% of councils total operating cost [...]. This cost is driven by Enterprise Bargaining Agreements and often include no forced redundancy clauses resulting in labour being largely a fixed cost.
(SALGFMG Submission, p.10)

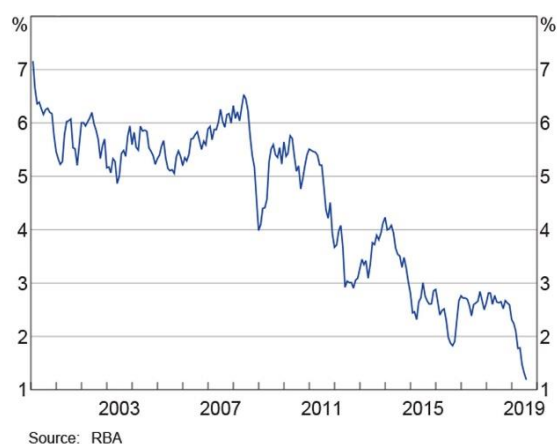
Several submissions, including from the City of Charles Sturt, identified employee costs as a driver of increases in operating costs. In particular, the industrial relations framework within which councils operate has been identified by some stakeholders, including the SALGFMG, as a significant driver of operating costs. The Commission understands that, at present, councils negotiate Enterprise Bargaining Agreements (EBAs) individually, with different conditions in place for staff classified as either 'indoor' or 'outdoor' employees.

3.3.4 Finance costs

In general, the cost of finance is small across councils — making up less than 1.4 per cent (or \$31 million) of total operating expenditure in 2017-18. Councils generally have very low debt levels.

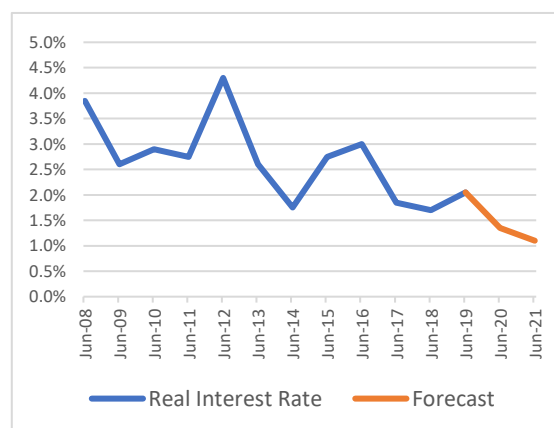
Over the last 10 years, total finance costs have fallen by an average of less than 0.2 per cent per annum but since 2011-12, finance costs have fallen by 3.0 per cent per annum on average. This reflects falling long term borrowing interest rates — as represented by the 10 year Commonwealth bond yields in Figure 3.5 and the subsequent decrease in deposit rates.

Figure 3.5: 10 year Australian government bond yield



Source: LGFA (2019)

Figure 3.6: Local government real interest rates from 2008 to 2021

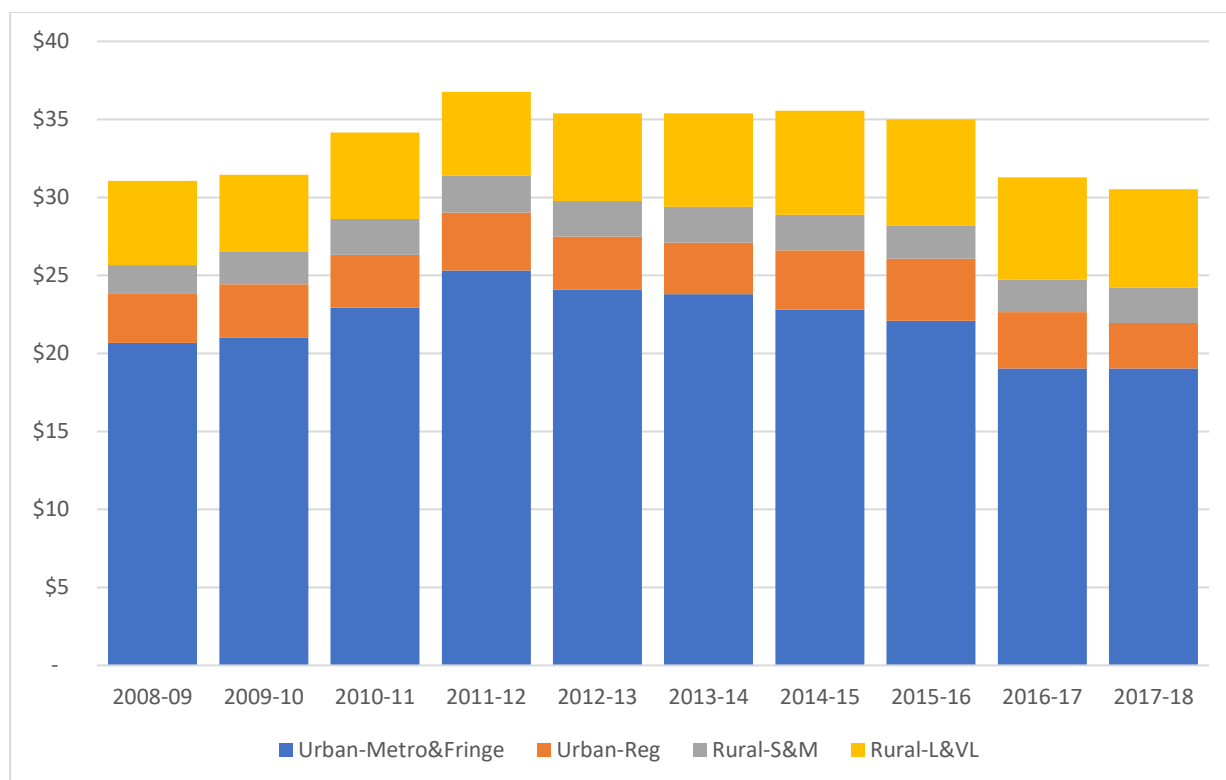


Similarly, Figure 3.6 shows the general decline in actual real interest rates that councils were able to access since 2008 from the Local Government Finance Authority (LGFA).¹⁵

These declines in interest rates (as well as declining levels of net debt) are reflected in the total finance costs incurred by councils as shown in Figure 3.7.

¹⁵ The Local Government Finance Authority of South Australia, is a body corporate, which provides financial services exclusively to South Australian councils and local government bodies. It was established in January 1984 under the Local Government Finance Authority Act, 1983.

Figure 3.7: Total finance costs by council group (\$million)



Source: SALGGC (2019)

As noted, although there was a slight fall of 0.2 per cent per annum in total finance costs across all councils in the past 10 years, the decline in interest rates has resulted in a decline in finance costs of 3 per cent per annum over the last seven years.

Rural councils, as a group, experienced an increase in finance costs of almost 2 per cent per annum over the last 10 years compared with urban councils which experienced a fall of almost 1 per cent. Over the last seven years, rural councils' finance costs fell by 1.8 per cent per annum while urban councils experienced a fall of 4.6 per cent per annum over the same period.

Table 3.7 shows these differences and also shows that the large rural councils faced an increase in finance costs of 2.7 per cent per annum since 2011-12, while other council groups experienced a fall.

Table 3.7: Average annual changes in finance costs by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	-0.92	-4.6	-0.01
Urban - Regional	-0.98	-3.9	-19.4
Rural - Small & Medium	2.6	-0.55	9.3
Rural - Large & Very Large	1.7	2.7	-3.9
All Groups	-0.2	-3.0	-2.4

Source: SALGGC (2019)

Of the increases in total finance costs in the rural council groups, the largest increase was experienced by the Eyre Peninsula rural councils which saw an increase of an average of 6.7 per cent per annum over 10 years and 5.5 per cent over the last seven years.

The biggest decline was by the City of Adelaide which saw its total finance costs fall by an average of over 24 per cent per annum over the last 10 years from \$2.4 million down to \$0.2 million; however, in 2017-18, its finance costs increased by over 500 per cent from \$0.03 million to \$0.2 million.

Councils raise funds to finance their operations from a range of sources including:

- grants from governments and gifts in cash or kind from the private sector;
- borrowings from lenders or lending institutions such as banks or non-bank institutions;
- excess funds resulting from operating efficiencies or the deferral (or cancellation) of projects or other programs;
- proceeds from asset sales, and the biggest of all; and
- funds raised from ratepayers.

In terms of borrowings, the local government sector held \$668 million at 30 June 2018. This level of borrowings represents approximately 2.7 per cent of the total value of fixed assets. If councils increased their use of debt, finance costs would increase resulting in higher total operating expenditure.

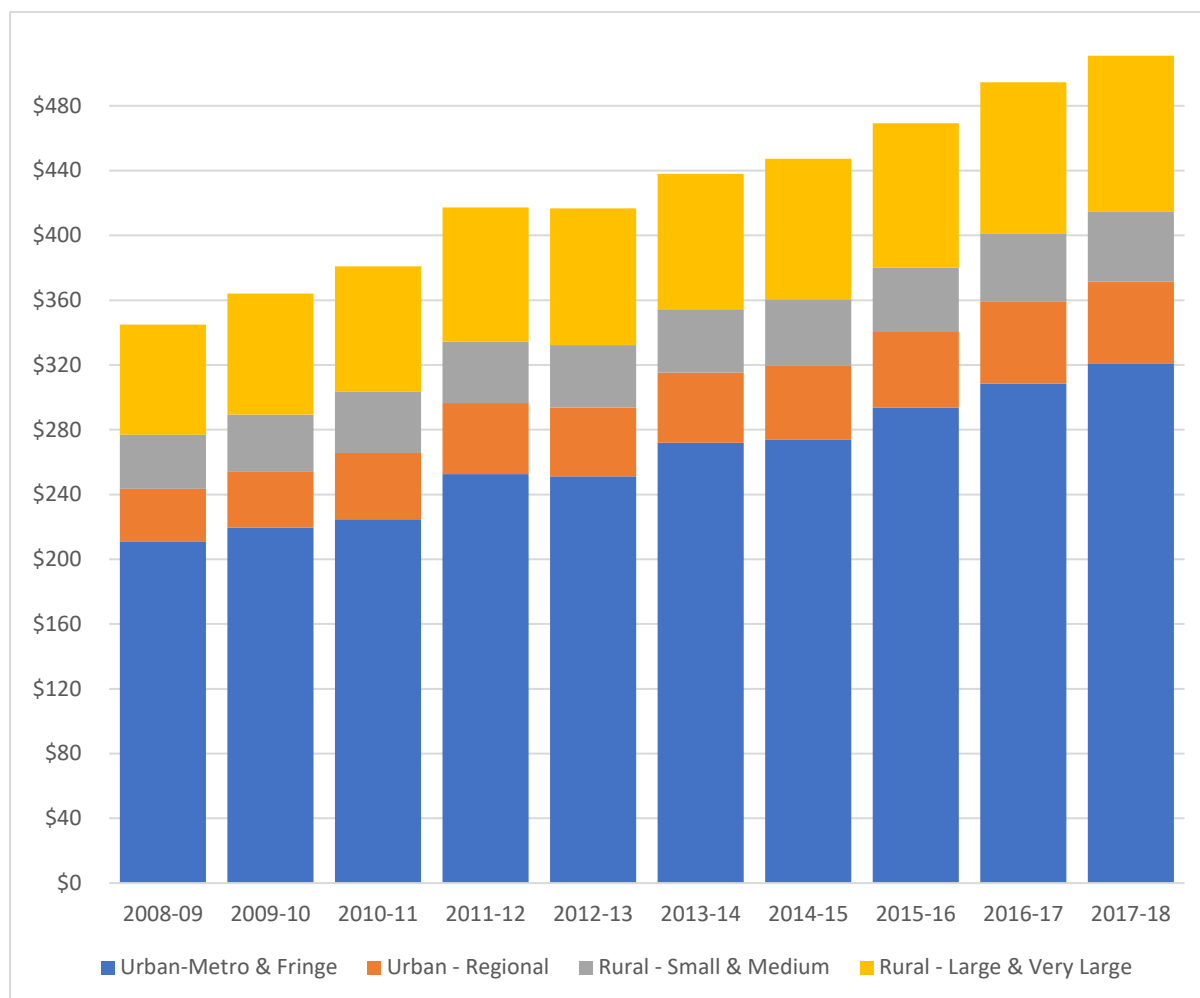
3.3.5 Depreciation, amortisation and impairment of assets

Of all the major resource expenditure categories, depreciation is not an actual cash expense but, in simple terms, an accounting charge that attempts to reflect the loss in the value of an asset as it is consumed over each year of its life.

Although a non-cash item, depreciation is substantial representing approximately 23 per cent (or \$511 million) of total operating expenditure in 2017-18 and reflects the level of the fixed asset base (excluding land).

Figure 3.8 below shows that depreciation has increased over the last 10 years from approximately \$345 million in 2008-09 to \$511 million in 2017-18.

Figure 3.8: Depreciation, amortisation and impairment charges (\$million)



Source: SALGGC (2019)

Table 3.8: Average annual changes in depreciation, amortisation and impairment charges by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	4.8	4.1	4.0
Urban - Regional	5.0	2.3	0.2
Rural - Small & Medium	2.9	2.0	1.7
Rural - Large & Very Large	4.0	2.6	3.5
All Groups	4.1	3.4	3.3

Source: SALGGC (2019)

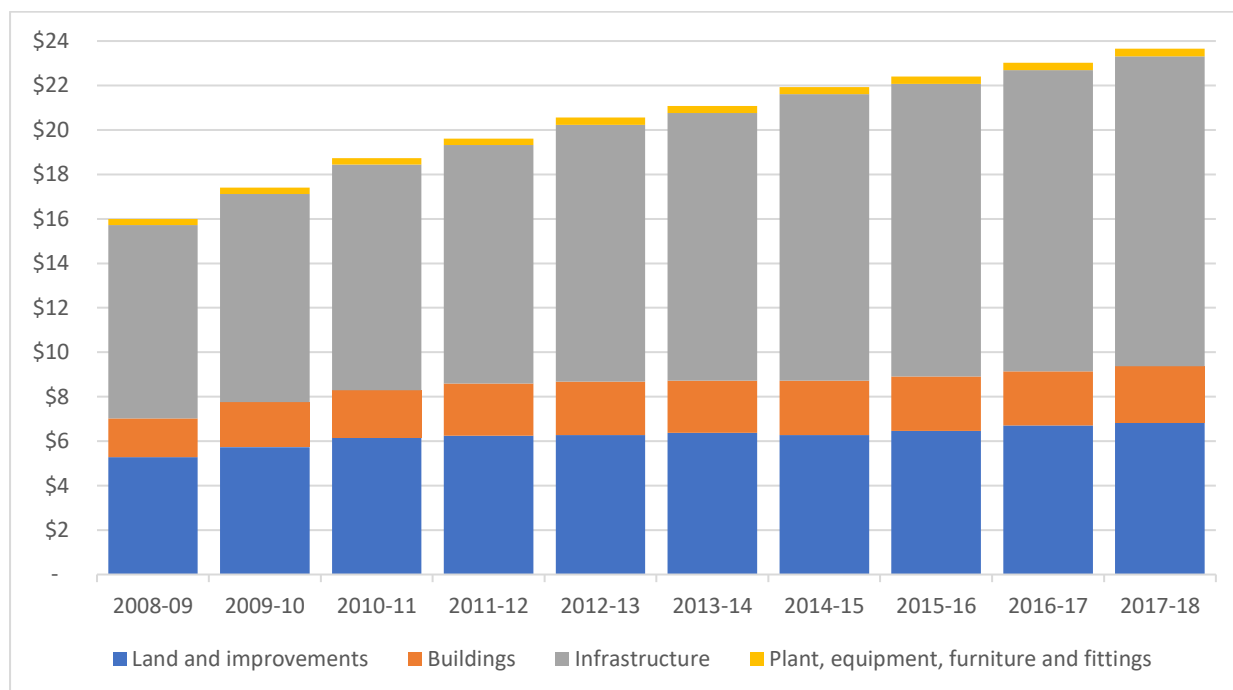
Table 3.8 shows that average annual growth in depreciation charges has been slowing over the decade and is variable across council groups.

Figure 3.9 shows the current value of depreciating assets is approximately \$16.8 billion of the \$23.7 billion of total fixed assets held by the local government sector at 30 June 2018. Over the 10 years since 2008-09, total assets have increased by \$8.2 billion of which the value of net depreciable assets have increased by \$6.1 billion — from a combination of revaluations, write-

downs, asset disposals and new additions which is reflected by the levels of capital expenditure.¹⁶

As a consequence of the levels of capital expenditure in recent years, a total of \$6.3 billion of new and upgraded capital works will have been added to councils' asset bases over the course of the past 10 years.

Figure 3.9: Infrastructure, building, plant and equipment assets 2008-09 to 2017-18 (\$billion)



Source: SALGGC (2019)

Depreciation is affected by the level of capital expenditure over time as new assets are commissioned and added to the asset base.

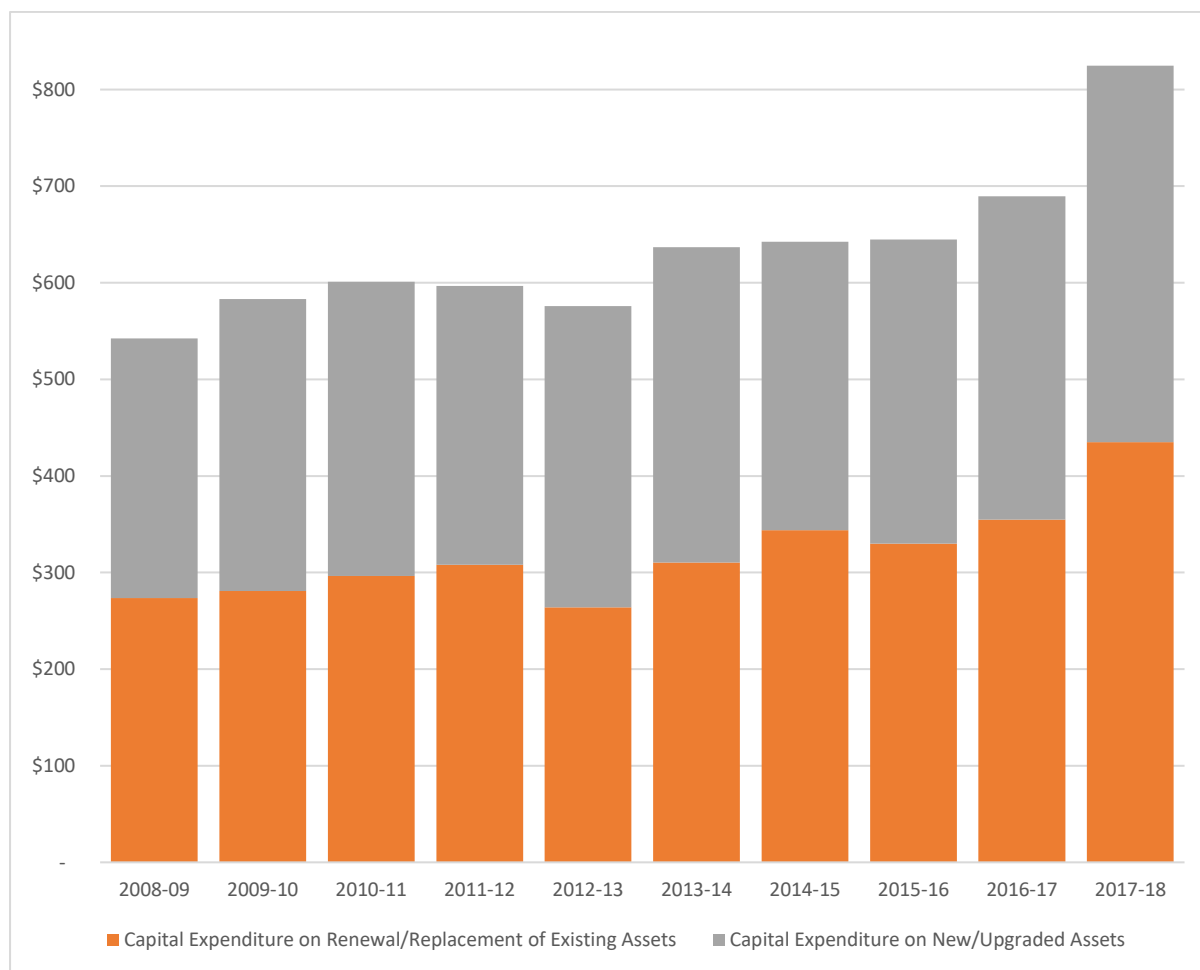
Capital expenditure peaked in 2017-18 at \$825 million compared to \$542 million in 2008-09 as shown in Figure 3.10 — an increase of over 52 per cent or an annual average increase of 4.8%. The increase in capital expenditure fluctuates from year to year, as shown in Figure 3.10. The increase from 2016-17 to 2017-18 was approximately 20 per cent or over \$135 million as follows:

- the urban metropolitan and fringe council group's capital expenditure increased by \$99 million (an increase of approximately 23 per cent) — of which \$58 million was incurred by the City of Adelaide;
- the urban regional group decreased capital expenditure by \$700,000 (a decrease of approximately one per cent);
- the rural small and medium council group increased capital expenditure by \$22 million (an increase of approximately 34 per cent); and
- the rural large and very large council group increased capital expenditure by \$15 million (an increase of approximately 12 per cent).

¹⁶ New capital works additions include assets gifted to councils by developers and governments.

The increase in 2017-18 compares with the 10 year and seven year average annual increases in capital expenditure of 4.8 per cent and 5.5 per cent, respectively — and reflects the increasing level of capital projects being undertaken in recent years.

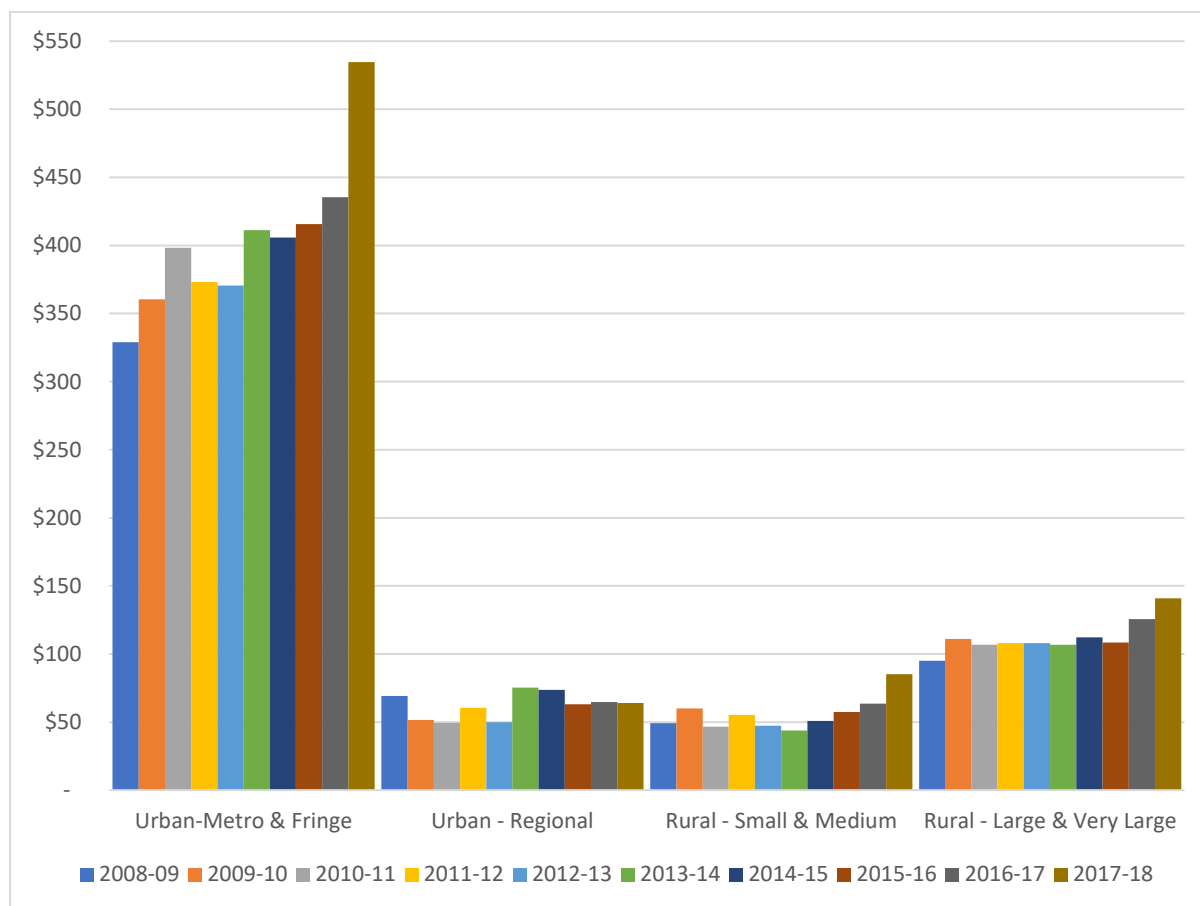
Figure 3.10: Total capital expenditure by project type across all councils (\$million)



Source: SALGGC (2019)

Figure 3.11 shows capital expenditure for each of the four council groups. This figure and Table 3.9 shows that other than for the urban regional group, capital expenditure had increased across all groups in 2017-18.

Figure 3.11: Total capital expenditure by council group (\$million)



Source: SALGGC (2019)

Table 3.9: Average annual change in capital expenditure by council group (\$million) (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	5.5	6.2	22.8
Urban - Regional	-0.8	1.0	-1.1
Rural - Small & Medium	6.3	7.5	33.9
Rural - Large & Very Large	4.5	4.6	12.1
All Groups	4.8	5.5	19.6

Source: SALGGC (2019)

Depreciation expenses were approximately 23 per cent of total operating expenditure in 2017-18 and this share has not changed significantly since 2008-09. It increased by 48 per cent for the period (an annual average of 4.5 per cent) while the value of depreciable assets increased by 57 per cent. Increased capital expenditure by councils, revaluations of assets and the 'gifting' of new infrastructure from land developments will impact on future changes in the depreciation expense. As an important driver of financial sustainability, depreciation requires more consideration.

3.3.6 Findings

Councils' operating costs are comprised mostly of labour (35 per cent), materials (including other costs, 41 per cent) and depreciation (23 per cent) with these proportions not changing significantly over the past decade.

Councils' overall operating expenditure has risen at an average annual rate of 4.2 per cent over the last decade and this has been well above the rate of inflation. There have been minor differences between each of the council groupings but, on an overall basis, average annual increases were well in excess of inflation — ranging from 3.3 per cent (for the small rural group) up to 4.3 per cent (for the urban and the large rural groups).

In particular, materials, contracts and other costs have increased at an annual average rate of 4 per cent over the last 10 years, driven by urban metropolitan and fringe councils and the rural councils of the Murraylands and Riverlands region.

Growth in this expenditure category has resulted more from volume growth than increases in prices paid for materials, contracts and other costs. This may reflect increased use of shared service arrangements and other forms of contracting out.

Total employee costs have increased at an annual average of 4.5 per cent over the last 10 years, well above other parts of the economy. It is noted that the rate of increase has slowed to 2.2 per cent in 2017-18 and is only slightly above the state-wide increase of 2.1 per cent for all employee types as measured by the ABS Wage Price Index for South Australia. These increases contrast sharply with the relatively low average annual growth in employee numbers of 0.8 per cent in the local government sector. These increases are the average outcomes of enterprise bargaining arrangements.

Depreciation (and related) charges have increased by over 48 per cent, or \$166 million, from \$345 million in 2008-09 to \$511 million in 2017-18 — equivalent to an average annual increase of 4.5 per cent.

The increase in recent years in capital expenditure can be expected to flow through to higher depreciation charges in coming years. Depreciation is a substantial figure and an important driver of financial sustainability and deserves more attention.

On the other hand, total finance costs fell from a peak of \$37 million (in 2011-12) to a low of \$31 million (in 2017-18).

3.4 Analysis of costs by service

This section considers how the mix of functions provided by councils has changed over time for the sector as a whole and by each of the four council groups.

3.4.1 Mandatory and non-mandatory services

The Commission noted in Chapter 2 that, under section 7 of the LG Act, there is wide scope for a council to determine the exact nature and specific level of the function or service to be delivered; that is, the number, volume, depth and quality of services to be provided to its community and the terms on which it is provided in most cases.

Several submissions to the inquiry noted that, over time, councils have grown from a small number of services (such as roads, rates and rubbish) to delivering an extensive and diverse range of services and functions as noted by the following extracts from three submissions:

... the Campbelltown community have increased their expectations, in regard to the level of services provided, including the provision of new services ...
(City of Campbelltown, p.2)

and

Elected Councils ... influence the range and extent of services provided by their council. Each change over time due to aspirations, demographics and interest of a community. For example, a community may place, indeed warrant, more extensive library services - providing increased geographic accessibility to a lower socio demographic community, or conversely, a higher service level consciously chosen by a higher socio demographic community.
(City of Charles Sturt Submission, p.3)

and

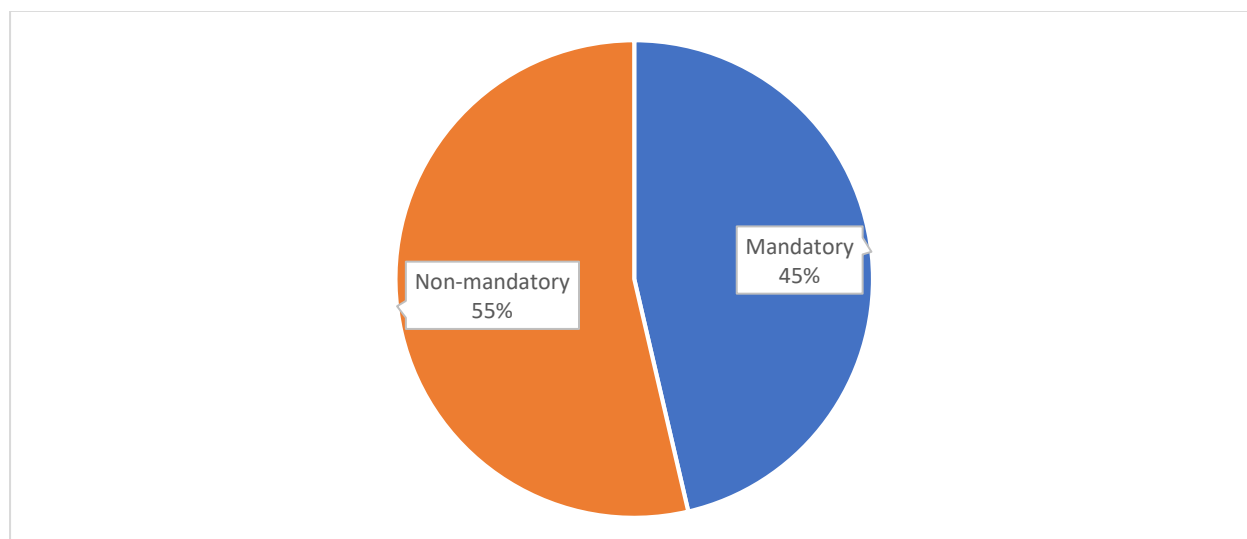
Changes in service provision and community expectations has increased over the period. Councils are providing additional services in Community Services, Library Services, Economic Development and Recreation and Open Space.
(City of Prospect Submission, p.2)

Appendix 4 provides a detailed list of mandatory and non-mandatory council activities, based on advice from LGASA.

The Commission notes that the delivery of mandatory services (as defined in Chapter 2) by councils to their communities accounts for less than half (or around 46 per cent) of annual operating expenditure.¹⁷ This proportion has not changed significantly since 2008-09, reflecting similar rates of growth for mandatory and non-mandatory services.

A small number of mandatory services accounts for nearly half of council expenditure. While councils have no choice but to deliver mandated services they largely decide how they deliver these mandated services — which affects their costs.

Figure 3.12: Split of operating expenditure by mandatory / non-mandatory service type for all councils, 2017-18

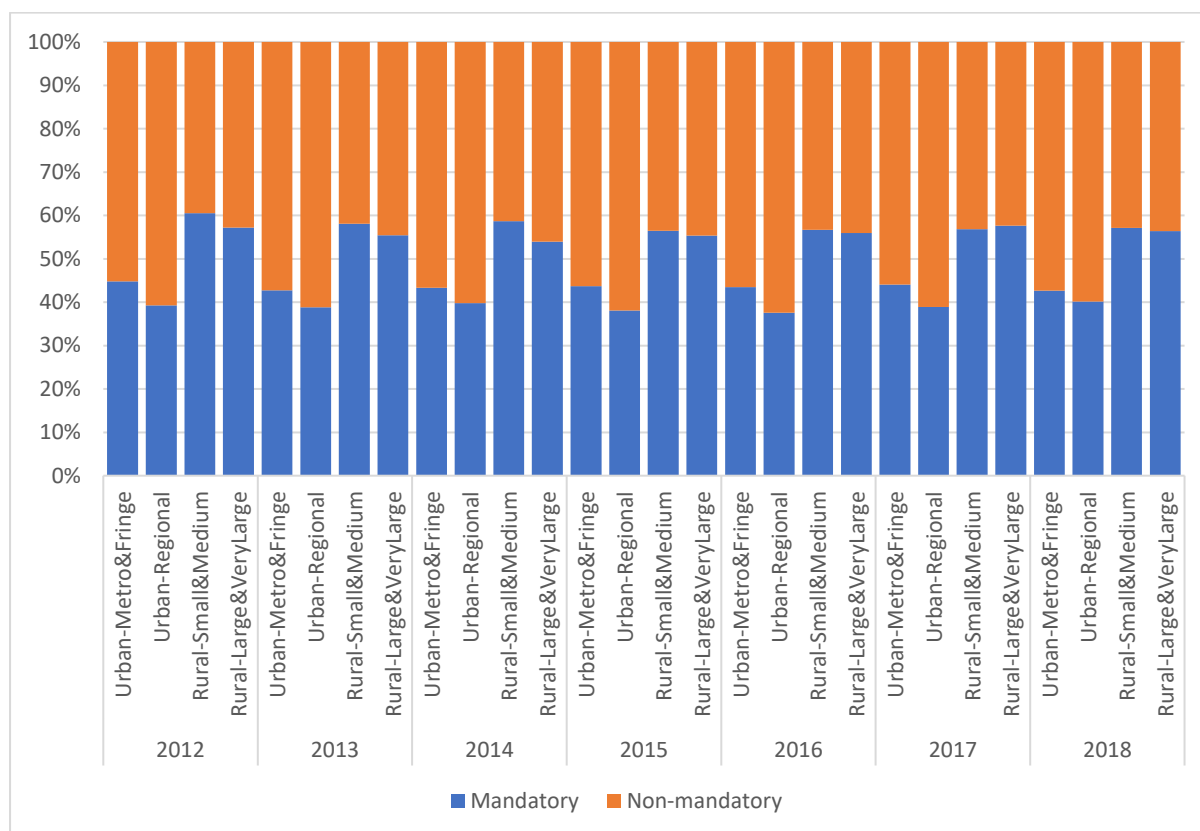


Source: LGASA and SALGGC (2019)

¹⁷ The operating costs used in arriving at this split excludes governance costs (\$60m), finance charges (\$31m) and the balance of amounts (\$12m) not allocated to other functions or services.

Figure 3.13 and Table 3.10 shows the differences between rural and urban council groups in the split of expenditure between mandatory and non-mandatory services.

Figure 3.13 Proportion of operating expenditure by mandatory / non-mandatory service types by council group from 2011-12 to 2017-18 (per cent)



Source: LGA and SALGGC (2019)

Table 3.10: Function mix expenditure proportions for 2017-18 (per cent)

Council group	Mandatory	Non-mandatory
Urban - Metro & Fringe	42.7	57.3
Urban - Regional	40.2	59.8
Rural - Small & Medium	57.1	42.9
Rural - Large & Very Large	56.4	43.6
All Groups	45.2	54.8

Source: LGA and SALGGC (2019)

Figure 3.13 and Table 3.10 shows that rural councils spend relatively more on mandatory services than their urban counterparts. In 2017-18, the rural council groups spent around 57 per cent compared to urban council groups, which are spending around 40 to 43 per cent on mandatory expenses. This is consistent with the views of rural councils that they have less flexibility in responding to the preferences of their communities. While total expenditure has grown, these shares have remained stable over time, since the expenditure on mandatory and non-mandatory functions have grown at similar rates. The highest proportion of expenditure on non-mandatory services, about 60%, is by urban regional councils.

3.4.2 Expenditure by service

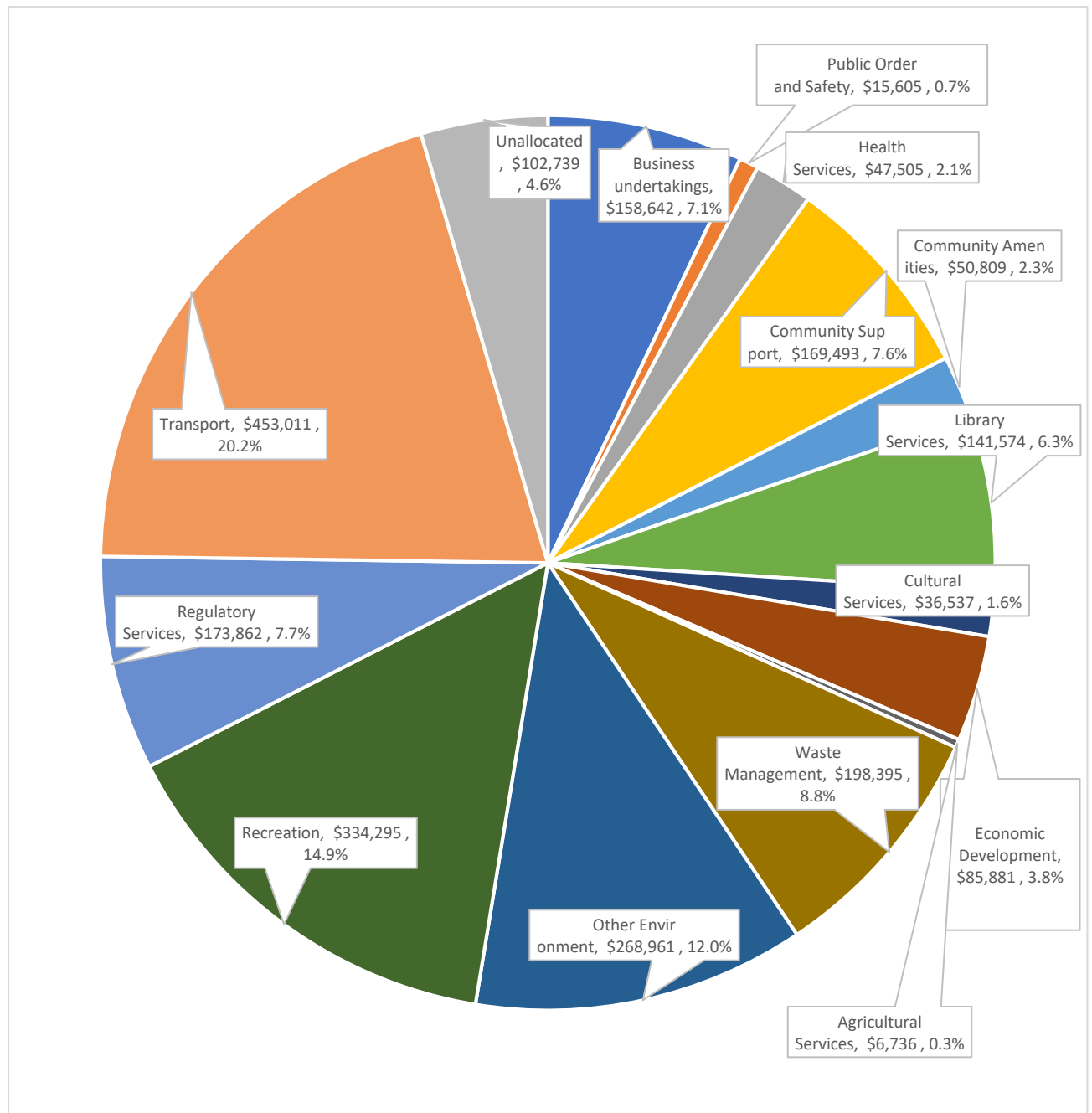
To meet their broad and diverse community demands, councils design and operate their services to be as efficient as possible by minimising input costs while maximising service outputs.

Councils are required to allocate and report their annual operating expenditure against a set of 14 service functions as follows (Appendix 4 provides more detail):

- business undertakings;
- transport;
- community services which includes:
 - public order and safety;
 - health services;
 - community support; and
 - community amenities.
- culture which includes:
 - library services; and
 - cultural services.
- regulatory services;
- economic development;
- environment which includes:
 - agricultural services;
 - waste management; and
 - other environment.
- recreation;

Of the total operating expenditure of \$2.2 billion incurred in 2017-18, approximately \$2.1 billion (or 95.4 per cent) was allocated to the above service functions. The remaining \$100 million of unallocated expenditure, in the main, relates to council administration, governance and finance costs.

Figure 3.14: Expenditure by function 2017-18 (\$'000)



Source: SALGGC (2019)

Figure 3.14 reveals that of the \$2.1 billion in expenditure allocated to the above 14 functions (excluding unallocated expenses) in 2017-18, a total of \$1.9 billion (or 89 per cent) was incurred on the following eight services functions:

1. transport (\$453m, 20 per cent);
2. recreation (\$334m, 15 per cent);
3. other environment¹⁸ (\$269m, 12 per cent);
4. waste management (\$198m, 8.8 per cent);
5. regulatory services (\$174m, 7.7 per cent);
6. community support (\$169m, 7.6 per cent);
7. business undertakings (\$159m, 7.1 per cent); and
8. library services (\$142m, 6.3 per cent).

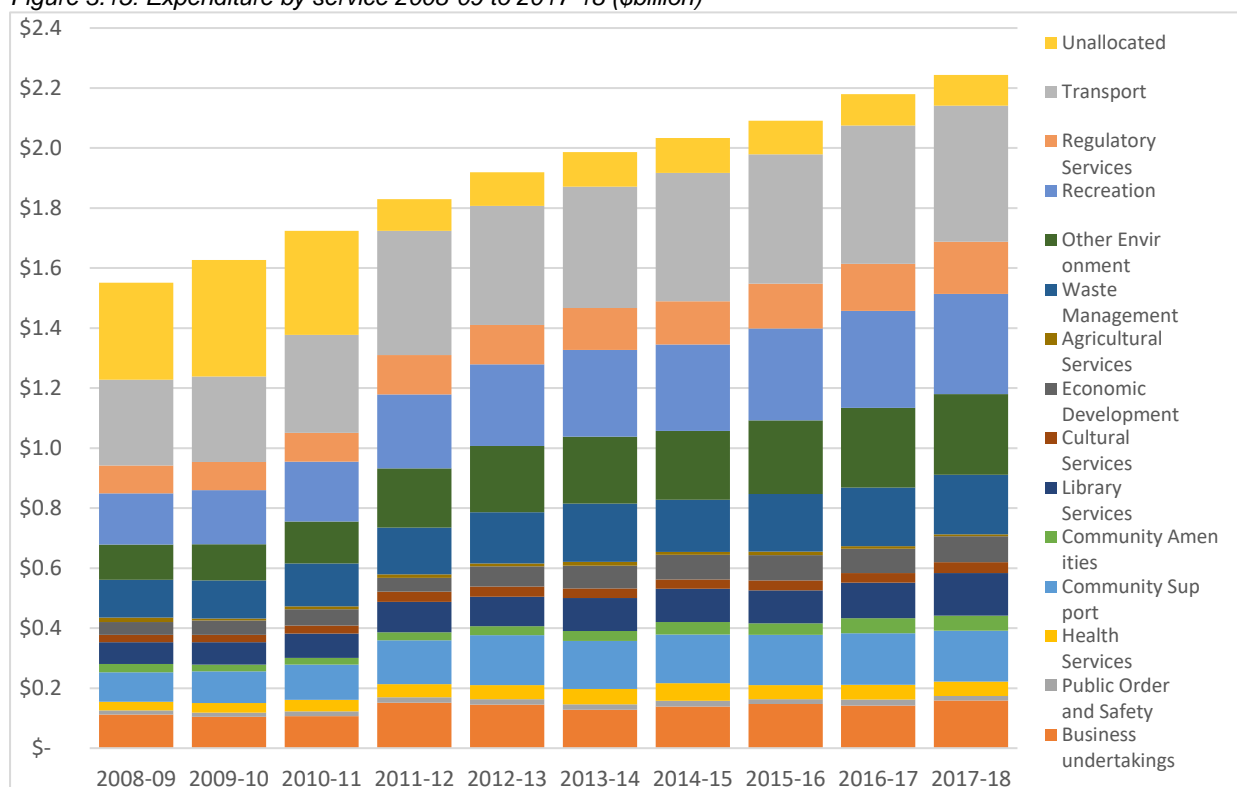
Expenditure on the remaining six categories contributed less than 11 per cent of total services expenditure (or \$243 million) with the largest of those being Economic Development at \$86 million or 3.8 per cent of the total allocated expenditure on services.

While economic development costs represent 3.8 per cent of the overall total expenditure, the City of Adelaide disproportionately contributes almost 18 per cent to the overall cost in this category reflecting the State's capital role in major events and as a key location for economic activity. If the City of Adelaide is excluded, the overall growth over the 10 years was 0.3 per cent.¹⁹

¹⁸ Other environment includes expenditure on coastal protection, stormwater management, street cleaning, street lighting, street-scaping and a range of other environmental protection services.

¹⁹ It is noted that, due to its nature and its status as the state's capital, the proportion of costs borne by the City of Adelaide tends to distort the analysis. For example, the contribution by the City of Adelaide to total operating expenditure (by all councils) can be as high as 38 per cent for business undertakings and 23 per cent for recreation (parks and gardens).

Figure 3.15: Expenditure by service 2008-09 to 2017-18 (\$billion)



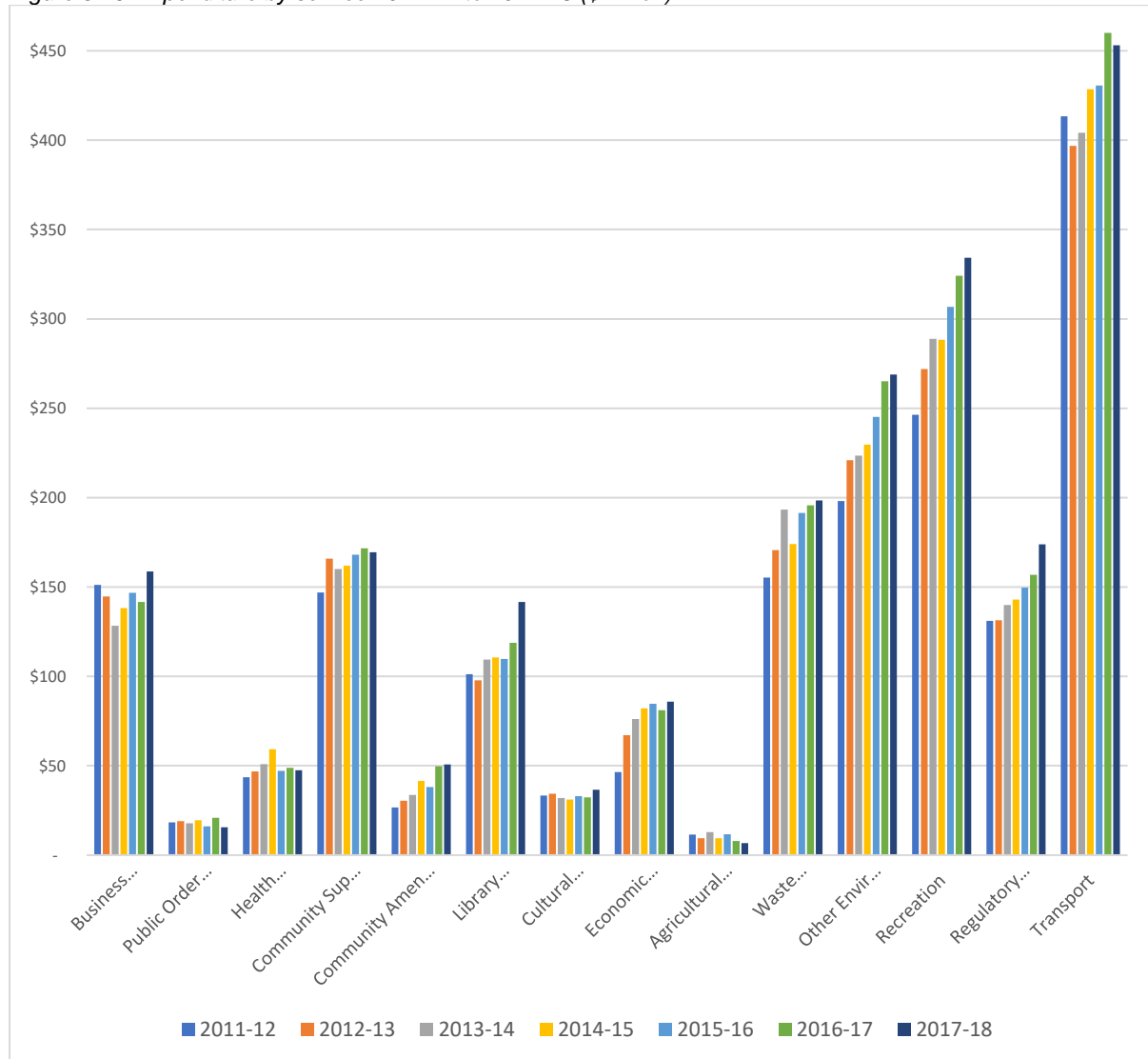
Source: SALGGC (2019)

Figure 3.15 shows that in the first three years, the level of unallocated expenditure was considerable and varied substantially from the levels in subsequent years.²⁰ Accordingly, the analysis that follows focuses on the years from 2011-12 to 2017-18.

Figure 3.16 provides an overview of the relative expenditure across each of the service functions from 2011-12 to 2017-18 and provides a context for the discussion that follows.

²⁰ The SALGGC advised that there was a change to the data collection methodology in 2011-12 to address the level of unallocated expenditure.

Figure 3.16: Expenditure by service 2011-12 to 2017-18 (\$million)



Source: SALGGC (2019)

The following table provides a breakdown of expenditure by function mix and by council group for 2017-18.

Table 3.11: Relative expenditure by service and by council group 2017-18 (per cent)

Service	Urban-Metro & Fringe		Urban-Regional		Rural – Small & Medium		Rural-Large & Very Large		State-wide Total	
	\$millions	%	\$millions	%	\$millions	%	\$millions	%	\$millions	%
Agricultural services	3.1	0.2	1.8	0.7	0.4	0.3	1.4	0.4	6.7	0.3
Business undertakings	87.0	5.7	23.8	9.5	14.2	10.4	33.6	9.9	158.6	7.1
Community amenities	25.9	1.7	10.0	4.0	4.5	3.3	10.3	3.0	50.8	2.3
Community support	122.8	8.1	19.5	7.7	6.9	5.0	20.3	6.0	169.5	7.6
Cultural services	28.4	1.9	5.3	2.1	0.8	0.6	2.0	0.6	36.5	1.6
Economic development	57.1	3.8	12.9	5.1	5.1	3.7	10.8	3.2	85.9	3.8
Health services	31.6	2.1	13.7	5.4	1.3	1.0	0.9	0.3	47.5	2.1
Library services	119.0	7.9	11.1	4.4	1.3	0.9	10.2	3.0	141.6	6.3
Other environment	215.9	14.3	22.9	9.1	7.3	5.3	22.9	6.7	269.0	12.0
Public order and safety	10.0	0.7	2.2	0.9	1.0	0.7	2.4	0.7	15.6	0.7
Recreation	253.9	16.8	34.5	13.7	13.1	9.5	32.8	9.6	334.3	14.9
Regulatory services	124.5	8.2	18.2	7.2	5.8	4.2	25.4	7.4	173.9	7.7
Transport	244.1	16.1	43.8	17.4	51.2	37.3	114.0	33.4	453.0	20.2
Waste management	135.0	8.9	23.1	9.2	9.8	7.2	30.5	8.9	198.4	8.8
Unallocated charges	55.8	3.7	8.9	3.5	14.4	10.5	23.6	6.9	102.7	4.6
Total	1,514.2	100	251.7	100	137.0	100	341.1	100	2,244.0	100

Source: SALGGC (2019)

Between 2011-12 and 2017-18, services that recorded the largest relative increases were:

- economic development — increasing at an annual average of 11 per cent (a total increase of \$40 million over the seven years which largely reflects increased activity by the City of Adelaide);
- community amenities — increasing at an annual average of 11 per cent (a total increase of \$24 million over the seven years); and
- library services — increasing at an annual average of 6 per cent (a total increase of \$40 million over the seven years).

The largest increases by value were:

- recreation — increasing by a total of \$88 million or an annual average 5.2 per cent;
- other environment — increasing by a total of \$71 million or annual average 5.2 per cent;
- waste management — increasing by a total of \$43 million or annual average 4.2 per cent; and
- regulatory services — increasing by a total of \$43 million or annual average 4.8 per cent

The services that recorded the smallest relative increases were:

- agricultural — decreasing at an annual average of 9 per cent (a total decrease of \$5 million over the seven years); and
- public order and safety — decreasing at an annual average of 3 per cent (a total decrease of \$3 million over the seven years).

3.4.3 Findings

Based on an analysis of 14 service categories, the mix of services provided by the local government sector has not changed significantly over the last decade. The split between mandatory and non-mandatory activities for the sector as a whole has remained steady at 46 per cent and 54 per cent, respectively.

Urban councils are spending relatively more on non-mandatory activities than rural councils — in particular, rural councils spend approximately 60 per cent of expenditure on mandatory activities compared to urban councils which are spending around 40 per cent on their mandatory activities.

While there may have been some increase in the number of mandated activities, the Commission understands that councils generally make decisions regarding the extent and quality of the service levels for those activities.

Of the services provided by councils, expenditure on transport is the biggest expenditure at \$453 million in 2017-18, followed by recreation, other environment and waste management. Rapidly growing areas were recreational and environmental services, as well as regulatory services. Slower growing areas of expenditure were agriculture and public safety.

The analysis suggests to the Commission that, at the sector level there is no particular function, or change in service mix which has driven growth in council expenditure.

3.5 Other cost drivers

The Commission has studied the existing data and sought council views through consultation and submissions to identify and understand what council cost drivers are.

In doing so, the Commission has reviewed costs, both at the input level and at the output level. Input costs have been addressed earlier in the chapter and the following section provides detail on the costs of outputs, including those related to demographic change, scope and standards of services.

3.5.1 Demographics

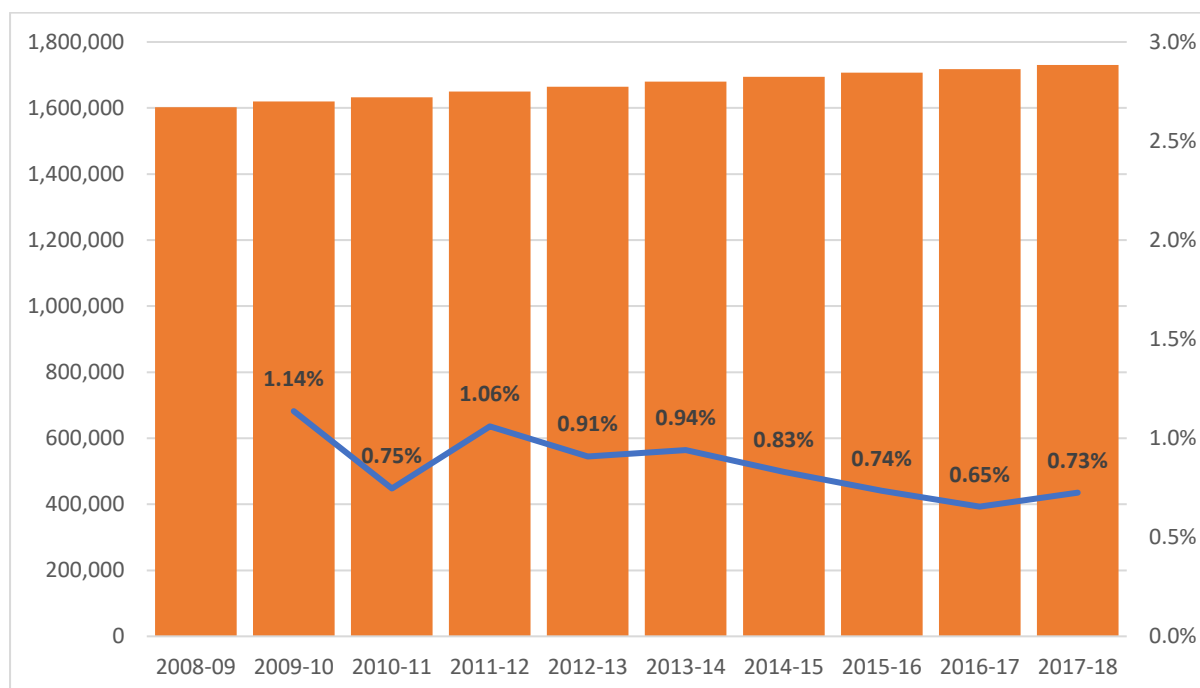
Funding and service delivery requirements are very different for fast-growing population councils compared to councils facing slow growth or declining growth. Fast population growth

places pressure on existing infrastructure (e.g. road networks) and demands investments in new or augmented infrastructure.²¹

Growth areas – may require councils to increase service levels and/or introduce additional services, may also speed up consumption of assets.
(LGASA Submission, p.8)

Total population across all councils has increased from 1.6 million to 1.7 million over the 10 years as shown in Figure 3.17 — this reflects an average annual increase of 0.9 per cent over the period. As the figure shows, population growth is also slowing.

Figure 3.17: Estimated resident population of all councils (by number) and annual change (per cent)



Source: ABS (2019)

Over the 10 years, urban areas recorded average population growth of 0.9 per cent per annum compared with a 0.5 per cent per annum growth for rural councils — almost double the rate of growth.

The growth in population across the various council groupings is shown in Table 3.12.

²¹ The New Zealand Productivity Commission (2018), Local Government Funding and Financing Issues Paper, New Zealand, p.30.

Table 3.12: Annual increases in population by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	0.93	0.85	0.82
Urban - Regional	0.82	0.70	0.69
Rural - Small & Medium	-0.03	0.11	-0.36
Rural - Large & Very Large	0.60	0.66	0.32
All Groups	0.8	0.8	0.7

Source: SALGGC (2019)

Table 3.12 shows a general decline in the rate of growth in population generally among the groups over the 10 years. Rural small and medium councils have experienced declines in their resident populations.

The City of Adelaide has experienced an increase in its population of approximately 2.5 per cent per annum over the 10 years compared with 1.2 per cent for the fringe councils and 0.8 per cent for the general metropolitan councils.

Urban regional councils have experienced an average increase of 0.8 per cent per annum over the 10 years (close to the state average) while rural regional councils have experienced very low population growth in the range of 0.2 per cent to 0.6 per cent per annum. The only big mover was the southern and hills regional councils which experienced an average increase of 1.7 per cent per annum largely driven by the growth of Yankalilla with 2.4 per cent per annum (off a very low base).

Demographic changes also affect the level and mix of council services demanded by ratepayers:

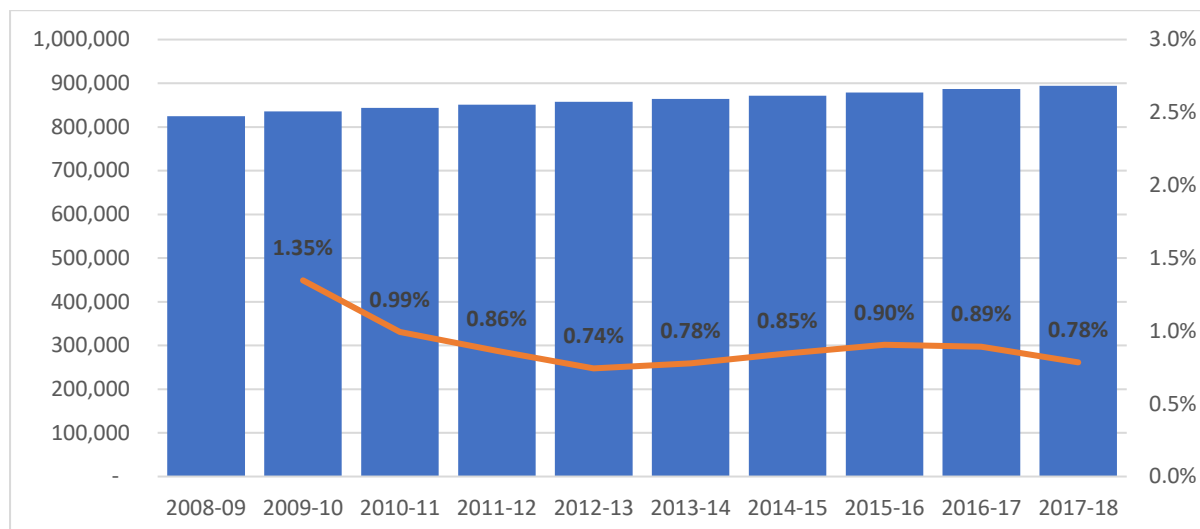
Aged care is not a 'core' service of councils however demand is growing in a context of reducing external funding and a focus of Commonwealth aged care funding reforms towards 'functional' improvement at the expense of 'social connectivity' (LGASA Submission, p.8).

The changing demographics of the local area will also play a significant part in the demand for services, along with the efficiency relating to the introduction of new services. Campbelltown has noted that its population is aging, so demands for services for this age profile are likely to increase in future years. (The City of Campbelltown Submission, p.7).

Property numbers across all councils have increased at a rate similar to that of population — increasing from around 824,300 to 893,900 over the 10 years, as shown in Figure 3.18, at an average annual rate of increase of 0.9 per cent over the period although, as can be observed, the growth in property numbers appears to be slowing.²²

²² As previously discussed, the properties data used in this analysis includes both rated and unrated properties to ensure a consistent time series of data. This was necessary due to a change in data collection and classification systems implemented in 2015 that resulted in unexplained data inconsistencies.

Figure 3.18: Estimated number of properties (including annual change in number) of all councils under review



Source: Valuer-General (2019)

The increase in urban properties was double that of rural properties — 1.0 per cent per annum for urban areas compared to 0.5 per cent per annum for rural areas.

The growth in number of properties across the various council groupings is shown Table 3.13 below.

Table 3.13: Estimated annual growth in property numbers by council group (per cent)

Council Group	2008-09 to 2017-18	2011-12 to 2017-18	2016-17 to 2017-18
Urban - Metro & Fringe	1.01	0.94	0.95
Urban - Regional	1.05	0.95	0.83
Rural - Small & Medium	0.47	0.38	0.36
Rural - Large & Very Large	0.53	0.41	0.16
All Groups	0.9	0.8	0.8

Source: SALGGC (2019)

Note the general decline in the rate of growth in properties all council groups over the 10 years and, in particular, that rural small and medium councils are experiencing very slow growth in property numbers.

Urban regional councils have experienced an average increase of 1 per cent per annum over the 10 years while rural regional councils have experienced very low growth in property numbers – except for Eyre Peninsula which also experienced growth of 1 per cent. In contrast to the increase in population, property numbers in the southern and hills regional councils experienced an average increase of 0.4 per cent per annum. This outcome may be explained by the take up of the existing stock of unoccupied or vacant properties rather than the development of new properties.

Other dynamic factors also change the level of services provided over time, even for a given population. For example, development of an area is a driver extending service delivery, perhaps faster than the increment in population.

...minor capital improvements on residential properties ... may not have a significant impact on council services in isolation, although this type of development when taken together reduces green space on private property and impacts on drainage systems. Other forms of development include development on vacant allotments, infill development in existing suburbs, and construction of new industrial and commercial facilities. This results in greater consumption of Council's services and assets, such as additional drainage capacity and increased wear and tear on roads, additional kerbing and footpaths in areas surrounding the development, due to increased traffic volumes. This also increases demand for Council services consumed by additional residents and visitors to the area. (SALGFMG, Submission, p. 8)

3.5.2 Findings

The population of South Australia continues to grow and its composition is changing. This growth is creating external cost pressure in many councils. The annual increase in population growth in the urban metropolitan and fringe council group will potentially exacerbate cost pressures. Changes in the demographic composition will also drive changes in expenditures as an ageing population brings increased demand for access to its services.

In addition, the increase in population density in the urban and fringe that includes development activity such as urban infills has additional externalities on other residents such as infrastructure pressures.

Information request 3.2: Population density

How does increasing population density and urban infill impact on council service costs?

3.5.3 Service quality and standards

Councils provide a range of services which aim to meet the needs and expectations of their communities. Changes in service quality and standards will often affect operating costs and councils largely determine the level of the service to be delivered for non-mandatory services.

In submissions to the Commission's methodology paper, councils have noted that changes in community demands for facilities and services have contributed to increases in council operating expenditure. For example, the City of Charles Sturt observed:

Another community may require its Council to provide higher quality of footpaths to accommodate either or both ageing residents or young families who may have children in strollers. Later that community may have a higher demand for playgrounds and later still for structured sports facilities. Over time community expectation changes for example the current unmet demand for women's change rooms and the increase in women's participation in field sports as they transfer from traditional court sports. (City of Charles Sturt Submission p.3)

The City of Salisbury noted:

The City of Salisbury provides a wide range of services to its community; however, we also undertake additional activities that generate social, environmental and economic benefits to our community ... The fundamental

driver of changes to council costs over time is community need. (City of Salisbury Submission, p.2).

The LGA identifies some rapidly growing service areas:

Analysis of Local Government Grants Commission (LGGC) expenditure figures for the 10 years to 2015/16, shows that councils have increased their spending on the things which make local communities safe, comfortable and functional such as drinking fountains, street furniture, bike racks and bus shelters, on emergency service and fire prevention programs, on Elderly Citizens Facilities, the Home Assistance Scheme, Services for the Aged & Disabled and on providing parks and gardens. (LGASA Submission part 2, p.10)

Delivering effective services may be achieved by gathering better information on service delivery costs.²³

Some councils undertake formal service reviews to ensure the services they provide are relevant to their communities and are financially sustainable in the long term (as raised in submissions from councils including the Town of Walkerville, City of Playford and the City of Charles Sturt). As noted by the City of Salisbury:

... in the past six years we have undertaken a comprehensive review of service levels across the organisation ... overall the program of review has delivered approximately \$3.0 million in ongoing savings. (City of Salisbury Submission, p.3)

While acknowledging the use of surveys by a significant number of councils, the Commission has not been able to obtain any standardised sector-wide quality or service standard data to analyse the effects of changes in service standards on council operating costs.

Information request 3.3: Sector-wide service standards

How do councils currently define and measure standards of service delivery?

What measures could be developed on a sector wide basis to measure quality standards for either mandated or non-mandated services?

3.5.4 Cost shifting

Evidence from councils indicates that both federal and state governments have engaged in cost shifting.

The growing burden of state government costs shifted to local government continues to put upward pressure on council rates. Cost shifting creates uncertainty for local government and makes planning and budgeting for delivery of facilities and services more difficult. (LGASA Part 1 Submission, p.6)

²³ Victorian Auditor-General office (2018) Delivering Local Government Services, Victoria, p.8.

Forms of cost shifting include:²⁴

- transferring responsibility for a function to councils without transferring an adequate funding source;
- requiring (usually by law) councils to deliver services or collect taxes for another sphere of government without being provided with enough funds to cover the costs for example, mandated user fees and charges for council services under the PDI Act;²⁵ and
- requiring councils to forego revenue by providing mandatory rebates for activities to implement a policy of the state government.

Examples of cost shifting identified by the LGASA submission to the methodology paper (Part 1) are the state government solid waste levy and community housing mandatory rate rebates.

The Commission has formed the view that there have been some instances of cost shifting which have raised council costs. However there also appear to be a number of cases where councils have control over expenditure decisions and the term cost-shifting should not be applied. The term cost shifting in practice is unhelpful particularly where it includes a choice by councils to accept tied funding. In such circumstances the commission considers cost sharing rather than cost shifting, is a more accurate description. The Commission is seeking clarification on this from councils.

Information request 3.4: Cost shifting

To what extent do councils receive external funding or an ability to charge fees for delivery of mandatory services?

To what extent are councils able to fully recover costs for the mandatory services listed in appendix 4?

How are service scope and standards determined for mandatory services?

Councils are asked to provide further information on instances of cost shifting and quantify how they have impacted on councils' costs.

Box. 3.1 Cost Sharing: Adelaide Hills Council continuing government digital hub program Case Study

Cost sharing in most cases is the stopping or reducing funding for a service or program when communities expect that councils will continue to provide it.

Adelaide Hills council entered into a 3-year agreement with the Commonwealth to provide a 'digital hub' to showcase the potential of the NBN and provide direct assistance to community members seeking help connecting to and using online technology.

²⁴ LGASA, Delivering the LGA 2018 State Election Agenda; Local Government Stopping Cost Shifting, Adelaide, p.1.

²⁵ See LGASA submission (Part 2), p.35 for more details.

The Commonwealth was the prominent funding partner, with the council providing in-kind contributions through the provision of space, management and employment of the hub staff, IT support, etc. The Hub was essentially a 2 FTE function.

At the end of the 3-year agreement, Commonwealth funding ended in accordance with the arrangement. There was a community expectation that people could still seek support from the council for connecting to and using online technology.

The council subsequently reallocated approximately 0.5 FTE from other areas to enable ongoing provision of digital literacy and support services to the community, albeit limited in comparison to the former Hub. In response to continued community demand, the council allocated an additional 0.5 FTE resource in 2018-19 to expand digital literacy and support services to the community.

When the digital hub funding ended in 2015, council experienced continued community demand for digital literacy and support. Council's administration reprioritised resource allocation to enable continuation of some level of community support in this space. In 2018, the council adopted a budget containing additional allocation of funding for further resources to meet community demand.

The total attached cost to continue the showcase for the council is \$90,000 per annum, technology costs nominally \$8,000 per year and additional space, employment support.

Source: Adelaide Hills Council case study

3.5.5 Compliance costs

A number of submissions from councils, including the Copper Coast Council, City of Salisbury, and the Town of Gawler, argued that the costs of complying with legislation and regulation have increased council operating costs.

In analysing corporate costs, the Commission should give consideration to the compliance requirements of councils to meet legislation. It is appropriate that a high level of accountability is placed on councils given the management of public funds, but it also imposes additional costs that other industries are not required to have. The compliance requirements also don't discriminate between council sizes and therefore smaller councils are likely to have a greater cost ratio of compliance costs than a larger council. (City of Salisbury, p.2).

The statutory compliance costs can include permits and planning, health and safety and regulatory compliance. An estimation of council compliance costs has been provided by the Copper Coast Council.²⁶

Information request 3.5: Compliance costs

Councils are asked to provide further examples of compliance costs and quantify how they have impacted on councils' costs.

²⁶ See Copper Coast Council Submission Appendix 1 for details of compliance costs.

Consultation to date has also identified a number of other potential drivers of council costs. They include:

- technological change;
- thin markets;
- loss of overseas markets for materials collected for recycling;
- statutory fees and charges are insufficient to fully cover costs incurred;
- rising prices for inputs (suppliers' costs); and
- climate change.

The Commission is seeking additional information and evidence from councils to identify and understand drivers of councils' costs, the extent to which they are internal or external to councils, the extent to which cost pressures are systematic or unique to particular councils, and their impacts on council costs.

Information request 3.6: Cost pressures

What are the most significant cost pressures (and their impact on costs) which councils expect to face over the next 5 years?

3.5.6 Findings

The growth in councils' operating expenditure is explained in part by growth in the output costs such as the volume and range of services supplied, as well as increases in the quality of these services. A significant number of individual councils conduct formal service reviews to ensure the services they provide are financially sustainable in the long term. Despite this, the Commission has not been able to obtain sector-wide data on service quality to enable conclusions to be drawn on the extent to which quality standards have changed and what impact this has had on council operating costs.

Anecdotal evidence from councils suggests that both federal and state governments have contributed to pressures on council resources by cost shifting. While this would put upward pressure on council costs, the full impact on councils' costs is difficult to quantify.

3.6 Conclusions

Total operating expenditure by the local government sector has grown more rapidly than inflation between 2008-09 and 2017-18.

Urban metropolitan and fringe councils consistently recorded higher growth in operating expenditure than other councils over this period.

Council operating costs are comprised mainly of employee costs and materials, contracts and other costs, which accounted for 35 per cent and 41 per cent of total sector operating expenditure in 2017-18. These proportions have not changed significantly since 2008-09.

The average annual growth in materials (and other costs) of 4.0 per cent exceeds growth in the LGPI over the last decade suggesting that increases in the volume of materials and other costs

has been the main cause of growing expenditure. This growth may reflect a trend towards greater use of contracting out or shared services arrangements.

Sector expenditure on employee costs increased more rapidly over the decade than materials, contracts and other costs at an annual average increase of 4.5 per cent, although it has moderated over the decade in both urban and rural councils.

The number of council employees across the state has increased by an annual average of 0.8 per cent over the decade, resulting in higher employee costs expenditure per FTE. The rate of increase in employee costs expenditure per FTE, particularly in the early part of the decade, has been consistently higher than the growth in average earnings in South Australia over the decade to 2017-18. This differential may – based on submissions – be partly related to the industrial relations arrangements that apply in the sector.

The extent to which growth in employee costs expenditure per FTE has been offset by productivity growth is difficult to determine in the absence of data on council outputs.

Depreciation expenses were approximately 23 per cent of total operating expenditure in 2017-18 and this share has not changed significantly since 2008-09. It increased by 48 per cent for the period (an annual average of 4.5 per cent) while the value of depreciable assets increased by 57 per cent. Increased capital expenditure by councils, revaluations of assets and the 'gifting' of new infrastructure from land developments will impact on future levels of depreciation expense.

Finance costs have been negligible and falling over the decade as councils have tended to finance their operations using internal funds, or equity, rather than debt. This results in their operating costs being lower than they would be if debt levels approaching economy wide norms were used by councils.

More than half of councils operating expenditure is accounted for by the four largest service categories – transport, recreation, other environment and waste management. Analysis of council operating expenditure by 14 service categories indicates that the mix of services delivered has not changed significantly over the last seven years.

While mandated services are relatively small in number, they accounted for 46 per cent of sector operating expenditure in 2017-18.

Mandatory services consistently accounted for a higher proportion of operating expenditure for rural councils (close to 60 per cent) compared to urban councils (around 40 to 43 per cent) throughout the decade. Urban regional councils had the highest proportion of expenditure on non-mandated services at 60 per cent. The Commission notes that while councils have no choice but to deliver mandated services, they generally have discretion to determine how these services are delivered, thereby affecting their costs. Expenditure on mandatory and non-mandatory services has grown at similar rates, both for the sector as a whole and across all council groupings.

In respect of the service mix, the most significant difference between the council groupings is that expenditure on the transport function is substantially greater in proportion for the rural council groups than urban councils.

Growth in population and property numbers (except for small and medium rural councils), while low, would have caused some increase in the volume of council services demanded which would explain part of the growth in council operating expenditure. Slowing population growth

in the later part of the decade would likely have contributed to the observed moderation in operating expenditure growth.

Population ageing can also be expected to have altered the mix of services demanded, although this impact is not evident in the 14 service categories examined by the Commission.

A number of councils have submitted that rising service standards have been a significant contributor to growth in expenditure. However, the Commission has not been able to obtain any sector-wide service level data to enable an assessment of the extent to which increases in the quality of services or facilities have caused increases in councils' costs.

Instances of cost-shifting from federal and state governments to local government have been argued by councils to have increased their costs. The Commission is not in a position to quantify the cost impact of cost shifting at this stage. Councils have sometimes decided to continue to deliver a service or program after federal or state funding commitments have expired, presumably in response to community expectations. Such instances, in the Commission's view, do not constitute cost shifting.

Some councils argued that the burden of complying with state and federal legislation has grown thereby adding to their costs, but data limitations have prevented quantification. Consultation with councils suggests the cost impact may be small and that it requires further investigation.

Councils have varying degrees of control over factors which influence their cost. Some, like the regulatory or taxation environment, or growth in ratepayer or property numbers that drive up demand for services, are externally determined. Others - like the prices they pay for labour and other inputs - can be influenced through industrial relations arrangements and council procurement practices. Councils are also able to influence community expectations through consultation and informing ratepayers regarding changes in service mix and quality.

A third group of costs drivers is more strongly controlled by councils and includes scale, scope and quality standards particularly for non-mandated services, and productivity and efficiency through choice of technology and business processes.

The Commission has reached the following preliminary conclusions regarding growth in local government operating expenditure over the last decade.

In terms of inputs:

- labour costs (in percentage terms) have been the main cost driver, followed closely by materials, contracts and other costs;
- depreciation charges have also been a significant driver of costs but off a smaller base; and
- cost shifting and compliance costs have contributed to expenditure growth, but to a lesser extent.

In terms of outputs:

- the most significant cost driver is likely to be changes in the volume, scope and quality of services provided by councils;
- growth in demand arising from growth in the number of ratepayers and properties is expected to explain, in part, growth in the volume of services.

4. Local government efficiency and productivity

4.1 Introduction

The terms of reference for the inquiry require the Commission to:

- develop and analyse measures of local government efficiency and productivity; and
- identify mechanisms and indicators that could be used by the local government sector to measure and improve performance over time.

The Commission released a methodology paper in May 2019, outlining the technical and analytical issues in estimating local government efficiency and productivity. The Commission's proposed approach is a robust methodology portfolio, consisting of a suite of complementary tools including partial productivity measures, global efficiency measures using Data Envelopment Analysis (DEA), case studies and submissions.

The Commission acknowledges that both partial productivity and DEA measures have their limitations. Taken together, they add significant value and insights to assist councils with understanding their performance relative to other councils or their performance through time.

The terms productivity, efficiency and effectiveness are related but different concepts. They are all elements of the performance of an organisation.

Productivity is defined as the ratio of the output(s) that an organisation produces to the input(s) used.¹ Productivity can refer to measures of partial productivity, which is a single-input, single-output measure such as output per worker. When all inputs and outputs are considered, it is referred to as total factor productivity (or multifactor productivity).

The term efficiency in this chapter refers to technical efficiency. An organisation is technically efficient if it produces the largest possible output from a given set of inputs, or if it uses the least possible quantity of inputs to produce a given level of output. However, as also discussed below, there are practical challenges in the context of the application of this concept to local government operations, because of the problem of measuring correctly the outputs produced, particularly their quality and scope.

There is also a distinction between outputs and outcomes. Outputs are measured as a level of activity while outcomes are defined as the impact of a program or service. As efficiency relates to the relationship between inputs and outputs rather than outcomes, it does not include an assessment of how well it achieves its objectives or the value of these outputs.

In addition to efficiency, a measure of effectiveness is sometimes used to analyse the overall performance of a program or service.² Effectiveness commonly refers to the extent to which stated objectives are met. This includes both cost effectiveness (achieving an outcome for the

¹ For a more detailed discussion of the concepts of productivity and efficiency see Coelli, T., Rao, P.O'Donnell, C and Battese, G. (2005), "Introduction to Efficiency and Productivity Analysis", Second Edition, Springer.

² Estimating measures of local government effectiveness is outside the scope of this inquiry. However, the Commission has examined how indicators of effectiveness are adopted in other jurisdictions.

lowest cost) and program effectiveness (how well the outputs of a program achieve the desired and valued outcome).³

This chapter presents the principal methodological approaches used in the Commission's analysis. The first section introduces the concepts of productivity and efficiency and the experience and lessons of local government efficiency monitoring in South Australia and other jurisdictions. Section 4.2 discusses the experience of local government performance monitoring, section 4.3 presents the partial productivity analysis and section 4.4 presents the global measures of efficiency using DEA. Section 4.5 discusses factors that influence efficiency of councils. The final section presents the Commission's initial conclusions.

4.2 Experience of local government performance monitoring

Performance and efficiency measurement play a role in helping councils to understand of their business and to improve outcomes through reduced costs or better services. This section describes performance monitoring activities across Australia to assist the identification of mechanisms and indicators that might usefully be employed by local government in South Australia.

Performance measurement is most meaningful when comparisons can be made both over time and across organisations.

Comparisons across councils can be difficult if they provide different types and levels of service or face different underlying cost structures. However, such comparisons can help councils identify attainable levels of performance and to learn from peers that are delivering higher quality and/or more cost-effective services. Comparisons of council performance and efficiency, both across councils and through time, can assist in identifying opportunities to improve their performance.

4.2.1 Current performance monitoring programs

South Australia

Throughout the Commission's consultation process, a consistent theme raised was that while most councils monitor their own performance, there has been little performance monitoring conducted across the local government sector as a whole. Nevertheless, there have been attempts made across the sector by the LGASA, groups of councils and individual councils to estimate their performance relative to other councils or the sector.

Submissions from councils including the City of Salisbury, Town of Walkerville, City of Playford, Campbell Town City Council, Copper Coast Council, City of Prospect, City of Tea Tree Gully, Town of Gawler and the City of Charles Sturt provided examples of council level programs to evaluate and compare their performance over time or against similar councils.

The Commission notes that councils have their own service review processes to ensure the services they are delivering are effective in meeting the demands of the community.

Councils already undertake regular reviews of key services to ensure they are meeting community needs, being delivered in an efficient manner and not impacting on the long-term financial sustainability of the council. Sometimes

³ Productivity Commission (2013), "On efficiency and effectiveness: some definitions", Productivity Commission staff research note, Canberra.

difficult and unpopular decisions need to be made about reducing or consolidating services for the sake of greater efficiency and sustainability. It is important that these decisions about the range and level of local services provided remain in the hands of councils and their communities. (LGASA Submission, p.19)

In the past six years we have undertaken a comprehensive review of service levels across the organisation, followed by a review on how we deliver the agreed service levels. This has required some benchmarking as part of the process, but more importantly identified areas within our operations that can be improved to deliver the best outcome for our community. (City of Salisbury Submission, p3)

The Commission also identified several councils that have sought to make comparisons of their performance against other councils.

In February 2015, Council resolved to undertake a benchmark exercise, fashioned on the Victorian Government Performance Reporting Framework introduced in 2014. The first benchmark report prepared for Council was in September 2016, followed by a revised report in June 2018 and again in February 2019. Council is expecting the latest iteration of its benchmark report at or about November 2019. Council supports mandatory benchmarking within an agreed framework. (Town of Walkerville Submission, p.2)

City of Prospect has previously conducted various efficiency and economy audits and various Service Reviews. Most of these reviews included comparisons with our Councils of similar size. (City of Prospect Submission, p.8)

Council has recently participated in the Local Government Performance Excellence Program (LGPEP), which compares performance against approximately 150 other Councils. (Town of Gawler Submission, p.5)

Establishing service standards is another mechanism for councils to identify areas of improvement and monitor performance as illustrated by the example from the City of Playford described in Box 4.1.

Box 4.1 City of Playford Community Service Standards System

The City of Playford introduced a Community Service Standards System in 2014-15 to help define, measure and analyse the outcomes of services provided by the council. Prior to this, there was no standard process, with ad-hoc reports being manually created when required. The system is a consultative process providing clarity around council activities which can inform and contextualise communication with elected members and the community.

The establishment of service standards is an iterative process which includes defining service outcomes and how they will be measured. Service Standards go through a review process every three years as a regular internal process, or as required by organisational alignment. Currently there are 25 service standards with community outcomes, including one to five related measures per service standard.

Creating quality service standards involve the following:

- consultation with the community and staff to better understand service standards;
- align with the council's community vision and strategic priorities, policies and procedures;
- research into industry best practices and benchmarking;
- monitoring and evaluation, including pre and post-testing implementation of new standards; and
- staff engagement and ownership.

The system was primarily designed to improve service delivery and their alignment to community expectations and outcomes. Any financial savings are an additional benefit. The creation of the standards themselves were the foundational piece to a variety of improvements. These include:

- cost avoidance of approximately \$2 million over seven years, where the council was able to improve the effectiveness of the service and reduce exposure to cost pressures of service delivery; and
- efficiency savings of \$1.2m from the "City Operations" area alone (Streetscapes, illegal dumping, city maintenance programs). Savings re-invested to expand the area of delivery or increase the standard of service to meet community need without increasing the cost of service.

In addition, there were improvements in consistency and streamlining of processes and procedures, evidence-based decision making and improvements in data accuracy and integrity.

The standards created a measure of performance that is reported on a quarterly basis to the community.

City of Playford state that the system is a journey, not a set and forget implementation exercise. The system is a basis for continuous improvement and the system itself continues to be reviewed and improved. While initial implementation can occur with external assistance, it was quickly learnt that further development and effectiveness of the system needed ownership of each service owner internally.

As an example, the council previously picked up illegally dumped rubbish in a reactive manner. Analysis by the council indicated that picking up illegal dumping within ten days would maintain community satisfaction while minimising complaints. This helped establish the service standard and associated measures that the council could hold the service accountable in terms of its effectiveness. Subsequent review of this service generated improvement to create planned and timed collection to align with those set by the standard. This has led to a decrease in costs by 20% over the last five years (after adjustment for the waste levy increases).

Most councils have not developed formal service standards.

Campbelltown has not undertaken formal service reviews that articulate the levels of services provided to the community due to the resources required to do this. Internally, efficiency has been focussed on and has been achieved over the years, however a formal register has not been maintained to identify improvements or savings have come from. (Campbelltown City Council Submission, p.4)

Some councils are collaborating to identify possible opportunities to reduce costs and to improve operations and efficiency, as illustrated by the submission from the City of Charles Sturt:

City of Charles Sturt, Marion and Port Adelaide Enfield have been working on benchmarking between the councils. All council costs are allocated to the activities of councils (around 350 possible activities) and these each have drivers (some of which aren't able to be collected as yet). These activities are rolled up into sub-functions (35) and these are rolled up into 11 functions. The sub functions and functions also have primary drivers. Comparisons occur at the function and sub function level and the activity level data is used to inform improvement areas. (City of Charles Sturt Submission, p.13)

The strength of this approach relative to models like the Performance Excellence Program and the Victorian Performance Reporting Framework is that the benchmarks are comparable and at a level where the basis for differences in performance can be explained and therefore ways to improve performance are identifiable. Internal charge and allocation impacts are removed, there is transparency around corporate service related costs (and performance). (City of Charles Sturt Submission, p.14)

Further detail on the collaboration between Cities of Marion, Charles Sturt and Port Adelaide Enfield is available in appendix 8.

The only example of a sector wide attempt to conduct comparisons across councils that the Commission has been able to identify is a series of reports prepared for the LGASA by UHY Haines Norton.⁴ The reports attempt to replicate the Victorian Local Government Performance Reporting Framework using SALGGC data. Due to data limitations, including a lack of data on activities and outputs, this is limited to estimates of expenditure per ratepayer for each of the service areas examined.

In addition, the LGASA has created a web-based tool that consolidates data available from the SALGGC. The tool is available to members and provides a range of financial, socio-economic and other information by council for the period from 2011 to 2017.⁵ It allows councils to compare themselves to other councils across a range of measures constructed using SALGGC data.

Other Jurisdictions

The Local Government Professionals 'Australasian LG Performance Excellence Program'⁶ provides comparative information, including a range of partial productivity measures, on participating councils. It is a voluntary benchmarking and performance initiative aimed at improving management and operational decision-making and planning.

It comprises an annual survey that collects, compares and benchmarks information from the 163 participating councils across New South Wales, Western Australia, South Australia, Queensland, ACT and New Zealand. The program is managed through Local Government

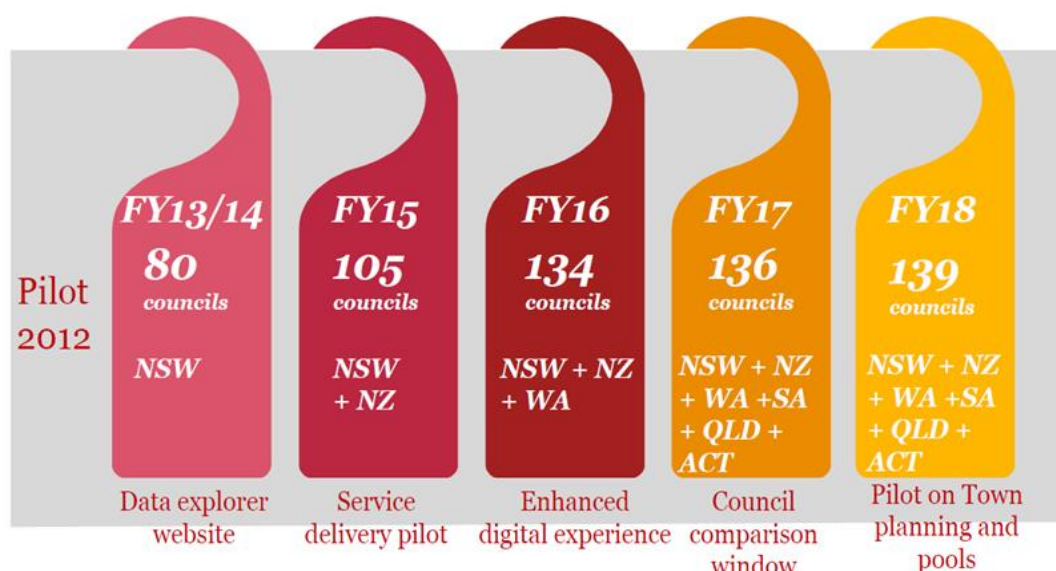
⁴ UHY Haines Norton (2019), "Analysis of Council Data – South Australia- Part 1 and part 2", Prepared for the Local Government Association of South Australia, Adelaide.

⁵ The web tool is based on a series of reports commissioned by the LGASA that consolidates the data. See UHY Haines Norton (2019), "Analysis of Council Data – South Australia- Part 1 and part 2", Prepared for the Local Government Association of South Australia, Adelaide.

⁶ Local Government Professionals (2019) Australasian LG Performance Excellence Program 2019 Prospectus, Available from: https://www.lgprofessionalssa.org.au/resources/LG%20Professionals/PEP/2019/e_PwC_Prospectus_2019.pdf

Professionals Australia, NSW. The program started with a pilot in NSW in 2012 and has added additional features and councils each year, as shown in Figure 4.1. The first South Australian councils joined in 2016-17.

Figure 4.1: Local Government Professionals Performance Excellence Program progression



Source: Local Government Professionals (2019)⁷

The Australasian LG Performance Excellence Program includes:⁸

- a semi-customised individual Performance Excellence Report (which includes information on corporate leadership, workforce, finance, operations, risk and asset management, and service delivery);
- a Comparative Analysis Tool that enables each council to analyse their own data; and
- networking.

This information is confidential to each council, with aggregated information being provided to member councils. While this is a useful tool for member councils to track and measure their own performance, it is not a sector-wide performance monitoring mechanism.

The City of Charles Sturt noted in their submission that the Performance Excellence Program currently only presents differences across councils on each metric. It does not attempt to explain differences.

It should be noted the Performance Excellence Program is undertaken at two of the three councils [that are part of the above-mentioned collaboration]. The PEP has highlighted similar performance differences however does not yet inform the councils on why those differences exist or how they can be addressed, and the data remains focussed on a number of key areas of councils operations rather than covering all activity areas. (City of Charles Sturt Submission, p.14)

⁷ LG Professionals (2019) Presentation to the South Australian Productivity Commission, 28 June 2019.

⁸ Local Government Professionals (2019)

Victoria

Victoria's Local Government Performance Reporting Framework (LGPRF) was the first state-wide performance reporting framework for local government in Australia.

The Victorian Government established the LGPRF in 2014 in response to a Victorian Auditor-General's observation that performance reporting in local government had limited relevance to ratepayers because it lacked information about the quality of council services, the outcomes being achieved and how these related to councils' strategic objectives.⁹

The 'Know Your Council' Compare Councils tool¹⁰ produces graphs of council performance over the previous four financial years across 12 service areas¹¹ and allows for direct comparison of up to four 'similar' councils.

The framework provides comprehensive performance information in a consistent manner that provides:

- councils with information to support strategic decision-making and continuous improvement;
- communities and ratepayers with information about council performance and productivity;
- regulators with information to monitor compliance with relevant reporting requirements; and
- state and federal governments with information to allow better informed decisions that insure an effective, efficient and sustainable system of local government.

To provide a comprehensive picture of council performance, four indicator sets: service performance, financial performance, sustainable capacity, and governance and management, were developed across three thematic areas: service performance, financial performance and sustainability. Figure 4.2 provides further detail. An objective for assessing performance against each thematic area has been established to inform the development of performance indicators.

The specific measures of efficiency included in the LGPRF all relate to the average cost per unit of output.¹²

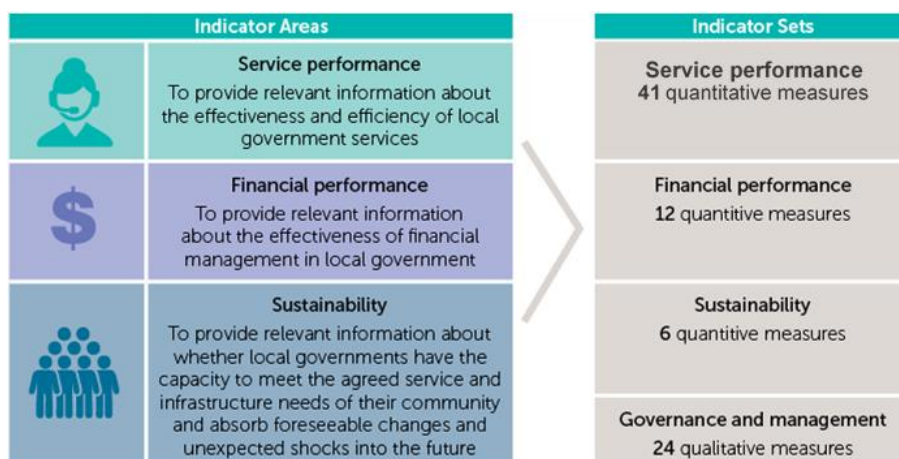
⁹ Local Government Victoria, the Department of Environment, Land, Water and Planning (2019), Local Government Best Practice Guide: Performance Reporting Framework Indicator Workbook, Victoria.

¹⁰ Local Government Victoria (2019), Know Your Council Website, Available from: <https://knowyourcouncil.vic.gov.au/>

¹¹ The 12 service areas are: animal management, aquatic facilities, food safety, governance, home and community care, libraries, maternal and child health, roads, statutory planning, waste collection, financial performance and sustainable capacity.

¹² They include: direct cost of indoor aquatic facilities less income received per visit; direct cost of the animal management service per number of registered animals; direct cost of the food safety service per number of food premises; direct cost of the governance service per number of councillors elected at the last council general election; direct cost of the library service per visit; cost of the maternal and child health (MCH) service per hour work by MCH nurses; direct cost of sealed local road. reconstructed per square meter of sealed local roads reconstructed; direct cost of the statutory planning service per planning application received; and direct cost of the kerbside garbage bin collection service per kerbside garbage collection bin.

Figure 4.2: Scope of the LGPRF



Source: Local Government Victoria, the Department of Environment, Land, Water and Planning (2019)

New South Wales

The Office of Local Government in New South Wales publishes a range of time series data annually for each council.¹³ The data are collected from a range of sources including the ABS, the Grants Commission process and councils financial reporting to the Office of Local Government.

The focus of the time series data is not specifically on efficiency monitoring, but rather to assist the community to have a greater understanding of their council.

Queensland

The Department of Local Government, Racing and Multicultural Affairs collects information from local governments about the key services they provide and publishes it in the annual 'Queensland local government comparative information report'.¹⁴ The report includes a suite of efficiency, effectiveness and quality-of-service indicators across the areas of finance, personnel, road lengths, water services, waste management, library services and parks and gardens.

Most of the information is collected in local government's annual consolidated data collection, similar to the SALGGC process.¹⁵ This data is then published in excel format to allow comparisons in performance across councils.

Another resource in development is 'LG Sherlock', a data storage and analysis tool that is facilitated and funded by the Local Government Association of Queensland (LGAQ). The primary objective of the system is to help Queensland councils use their data to "support better decision making that will improve financial sustainability, enhance sector reputation and reduce exposure to risk".¹⁶ The details of the program are not yet publicly available.

¹³ NSW Government (2019) *Your Council Report*, Available from: <https://www.olg.nsw.gov.au/public/my-local-council/yourcouncil-website>

¹⁴ Department of Local Government, Racing and Multicultural Affairs (2019), *Local Government Comparative Reports*, Available from: <https://www.dlgrma.qld.gov.au/resources-ilgp/plans-strategies-reports/local-government-comparative-reports.html>

¹⁵ South Australian Local Government Grants Commission (SALGGC) (2017), 2016-17 Annual Report.

¹⁶ LGAQ (2019) *What is Sherlock*. Available from: <https://sherlock.lgaq.asn.au/what-is-sherlock>

Western Australia

The Western Australian Government has established the 'MyCouncil' website as a central place to access and compare information on councils.¹⁷ The website provides a geographic, demographic and financial snapshot of each council. It allows data such as council expenditure by program, rates and other revenue and services delivered to be viewed for each council and compared to others. The MyCouncil website relies on data from existing local government reporting requirements and selected ABS data.

Tasmania

The Tasmanian Government's Local Government Data, Analysis, Transparency, Accountability (LG DATA) project has published local government performance information since 2016-17.¹⁸

The project aims to enhance transparency and accountability of local government performance and help councils to identify opportunities to improve performance. This includes publishing 'snapshot reports' including comparative information for all Tasmanian councils over a financial year, along with a range of performance indicators related to the snapshot theme.

LG DATA also publishes raw, open datasets from the *Tasmanian Local Government Consolidated Data Collection* for public use through the Tasmanian Government's *Open Data* website.¹⁹ In addition to the LG DATA program, the Auditor-General produces annual reports on local government financial sustainability.

Report on Government Services

While not specific to local government, the Productivity Commission's *Report on Government Services* (RoGS) provides another example of monitoring the efficiency of government delivered services. RoGS publishes annual data on the equity, efficiency and effectiveness of government services in Australia. The Report is used by governments to inform planning and evaluation of policies, for budgeting (including to assess the resource needs and performance of government agencies) and to demonstrate government accountability.²⁰

4.2.2 Lessons from performance monitoring programs

The Commission has examined the existing performance monitoring programs in other jurisdictions to understand what does and does not work, and what are some common barriers to success. These lessons have been identified from initial program documentation, program reviews, audits, consultation, submissions and other literature on efficiency and productivity measurement.

This section is not a formal evaluation of existing monitoring, rather it draws lessons that could be applied to any state-wide performance monitoring program adopted in South Australia.

¹⁷ Department of Local Government, Sport and Cultural Industries (2019) *My Council: Frequently Asked Questions*, Available from: <https://mycouncil.wa.gov.au/Home/fags>

¹⁸ Tasmanian Government (2019) *Measuring Tasmanian Local Government Performance*, Available from: http://www.dpac.tas.gov.au/divisions/local_government/measuring_tasmanian_local_government_performance

¹⁹ Tasmanian Government (2019) *Open Data*, Available from: <http://listdata.thelist.tas.gov.au/opendata/>

²⁰ Productivity Commission (2019) *Report on Government Services*, Canberra

Standardised reporting of performance indicators

The Victorian Auditor-General's Office reviewed the LGPRF using three selected indicators across five councils.²¹ The review highlighted inconsistent performance reporting by councils as a sector-wide issue and found that councils need to "identify a consistent set of performance indicators that they report to their leadership team" p.13.

The case for standardised performance reporting was also supported by the LGASA and several councils. The submission from LGASA states that:

While there is a considerable amount of information already available to communities about what their council is doing; this information is often spread across multiple documents and platforms, can be difficult to find and is not easy to compare with other councils.

Sector wide benchmarking would create a suite of meaningful performance measures that build a more complete picture of the financial and governance health of the sector and the public value of the services and programs delivered by councils. This would support council planning and increase meaningful community consultation to enable local government to continually improve. (LGASA submission, p.16)

The submission from the City of Prospect:

There is merit in developing a sophisticated online platform for councils to share and compare meaningful data about their performance and enhance the transparency and accessibility of council data for the community. (City of Prospect submission, p.6)

The Town of Walkerville:

We believe that a sector wide benchmark, possibly mandated, will go a long way to:

- ensure consistent reporting;
- ensure that Councils will have evidence based information to support strategic decision making;
- ensure that communities will have accurate information about their respective Council performance;
- Councils and other tiers of Government will be better informed to make decisions that support an effective, efficient and sustainable system of local government;
- identify areas for improvement; and
- promote accountability and transparency across the sector

(Town of Walkerville Submission, Additional Information Request)

However, this view was not universally shared:

Benchmarking across Councils will not improve efficiency, it takes resources away from service delivery, increases red tape and administrative overheads

²¹ Victorian Auditor-General's Office (VAGO) (2019), Reporting on Local Government Performance, May.

and is a distraction from improvement initiatives. The rationale for this is that each Council calibrates its services to meet their community's needs. When we compare across Councils it takes time to understand whether we are comparing on a like for like basis and further time to understand the remaining level of difference. It is found that services are intentionally different because each Council is serving the needs of its distinct community. (SALGFMG Submission, p.11)

Submissions stress the importance of allowing for local conditions and choices about quality.

Costs alone also provide no insight into the quality of work undertaken or different construction methods, which may be reflected in the total expenditure. (Tatiara District Council, p.1-2)

These issues, and other comments in submissions, point to a number of other lessons for the design of performance monitoring programs.

Standardised comparator

A consistent theme in performance monitoring programs across jurisdictions is the value of standardised comparator groups. Due to the partial nature of many of the measures, it is important that only 'like-for-like' councils are compared. This limits to some extent, comparisons between councils which face structurally different costs or different demands for services.

For example, the Victorian LGPRF specifies five 'comparator groups' based on geographic and population criteria.²² The comparator groups are:

- metropolitan;
- interface;
- regional city;
- large shire (>15,000 population); and
- small shire (<15,000 population).

As council characteristics can change over time, Local Government Victoria has committed to review the groupings every five years in line with the national census.

Consistent reporting over time

Because of underlying differences between councils in the range, quality and cost of service delivery, sometimes the most suitable comparator for a council to benchmark against is themselves over time. The use of trend data can demonstrate whether a council is improving its performance.

According to the submission of the Campbelltown City Council (p. 5)

Greater benefit to individual Councils would be to compare each Council's own performance over time.

²² Local Government Victoria (2015), "Victorian Local Government Comparator Groups", LGPRF Practice Note, no. 5, VIC.

The availability of trend data is likely to increase the possibility of councils viewing a performance monitoring framework as a useful exercise, rather than simply a compliance activity. A review of Victoria's LGPRF in 2017²³ found that 24 per cent of councils did not access the 'Know Your Council' website until it was updated to include year-on-year trend data.

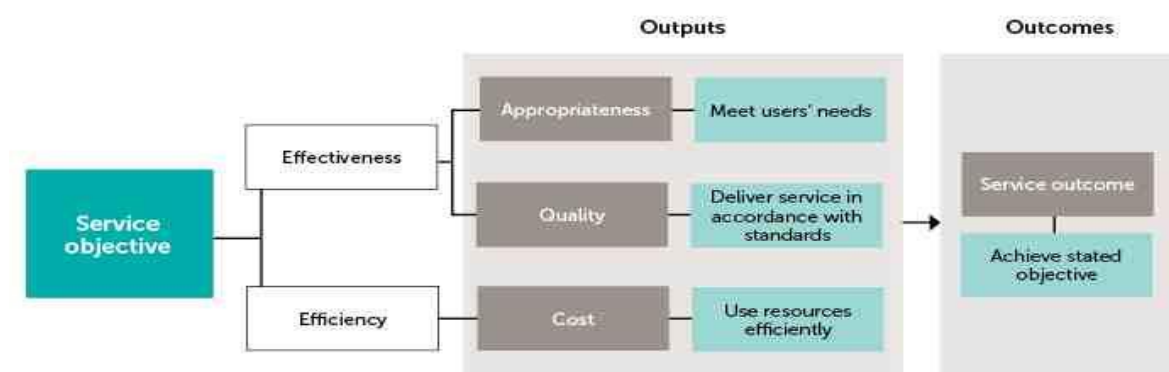
Measures of quality and timing

To be relevant to users, performance information should provide a full picture of service performance, including cost and quality, a range of additional performance measures is needed to provide a context around which the productivity estimates can be interpreted.

The Review should take into account the varying degree of service standards and expectations of the community. The review should delve down into unit rates and introduce the benchmarking results in order to properly compare one council with another. (City of Tea Tree Gully Submission, p.3)

Victoria's LGPRF addresses this by incorporating measures of effectiveness, including the appropriateness of services and their quality for each of the service objectives being evaluated (Figure 4.3).

Figure 4.3: LGPRF services performance framework



Source: Local Government Victoria (2019)

The LGPRF was developed based on the Productivity Commission's *Report on Government Services* (RoGS).²⁴ The RoGS framework goes further and includes measures of accessibility and equity.

Council comment on publicly reported measures

For many measures, there can be plausible explanations why one council's estimated productivity differs from others or over time. Incorporating explanations from the council when publicly reporting on performance measures can assist the public in understanding what the measure indicates as well as other councils understand why their performance differs.

Should comparisons be made, the ability to provide commentary for context purposes would be important, as some Councils may have distinct differences with other Councils such as different levels of service provided to their

²³ Local Government Victoria (2017), "Local Government Performance Reporting Framework, 2015/16 Reporting Period Review", VIC.

²⁴ Productivity Commission (2019) <https://www.pc.gov.au/research/ongoing/report-on-government-services>

communities and additional costs to deliver services due to distance.
(Campbelltown City Council Submission, p.5)

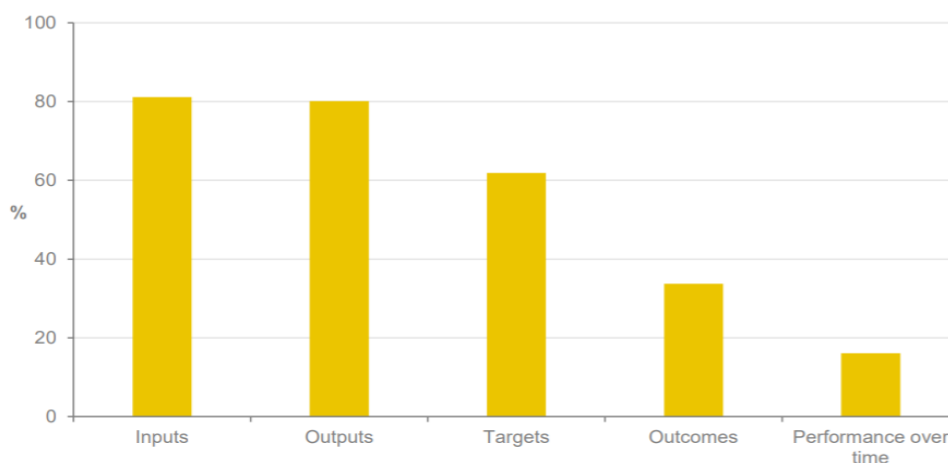
The Victorian Government's 'compare councils' tool achieves this by allowing councils the opportunity to comment on a particular metric prior to publication. This is then linked to the 'compare councils' tool on the website, where data are presented for the current year.²⁵

Outcomes in addition to outputs

Data on council outputs are more easily recorded and collected than data on outcomes. As a result, it is easier to construct a measure of performance comparing inputs to outputs.

The NSW Auditor General²⁶ found that "while councils report on outputs, reporting on outcomes and performance over time can be improved". An analysis of NSW councils' annual reports, presented in Figure 4.4, found that 80 per cent of reporting measures included measures of outputs, but less than 40 per cent included measures of outcomes.

Figure 4.4: Frequency of reporting measures by type, NSW



Source: Audit Office analysis of 105 published 2015–16 annual reports, 2017.

Source: Audit Office of New South Wales (2018)

Reporting on inputs and outputs provides communities with a general understanding of council's day-to-day activities. However, this type of reporting cannot demonstrate to communities whether councils are delivering services effectively or making improvements over time. The Victorian Auditor-General's Office²⁷ also concluded that the LGPRF is "not yet realising its full potential because it lacks good outcomes measures..."

A complicating factor in measuring outcomes is identifying the drivers of outcomes. This is especially the case when activities or services provided by councils are part of a complex web of services by multiple government agencies. In addition, there are external factors: for example, variations in business conditions are likely to have more impact than council effort under an economic development banner.

²⁵ <https://knowyourcouncil.vic.gov.au/compare-councils>

²⁶ Audit Office of New South Wales (2018), "Council reporting on service delivery", February.

²⁷ Victorian Auditor-General's Office (2019), "Reporting on Local Government Performance", May.

Targets and service standards

Targets provide a context around what a council is attempting to achieve and therefore can help to make performance information easier to understand.

The effectiveness of a program should be measured by the change in the outcome relative to this counterfactual. Operationalising this usually requires setting targets that imply an improvement on what would otherwise have happened. Where the counterfactual is an expected deterioration in the outcome, the appropriate target may be no change, or a smaller decline, which can be conceptually hard to explain. As targets should be achievable, this can create a quandary for measuring effectiveness.²⁸

The LGPRF currently does not require councils to adopt targets, however the Victorian Auditor-General's Office found that three of the five councils they audited had adopted targets for some of the LGPRF indicators.²⁹ Based on a previous audit, Local Government Victoria has committed to introducing targets for a subset of indicators, the 28 indicators that councils include in their annual performance statement, into the LGPRF from 2020-21.

An audit of council reporting on service delivery by the Audit Office of New South Wales found that one third of council reports did not have related target making it difficult for the community to assess a council's achievements in implementing its service delivery program.³⁰

Costs of reporting

Councils have expressed concerns about the additional burdens including costs of increased reporting requirements on councils. For example, the submission from the City of Charles Sturt refers to the "number of external data collection requirements for council in place" and suggests making use of and building on what is already in existence such as the SALGGC data.³¹

For some years, the Victorian Government has collected large amounts of data and cost comparisons from local government and shared them on the "Know Your Council" website. Unfortunately, the reporting regime created significant administrative costs for councils. While these costs can be easily quantified by councils, I am not aware that the Victorian Government has been able to quantify any efficiencies that the system has achieved for the sector. Should regular reporting of additional council data be a part of the Commission's proposed approach to improving efficiency and financial accountability of local government, it is essential to undertake this cost-benefit comparison from the outset. (Tatiara District Council Submission, p.2)

Achieving consistent data reporting across 68 councils will be a resource intensive exercise and consideration will need to be given to the items that are reported to ensure that they deliver some strategic, operational and policy benefit. Consideration should be given to the cost to implement any proposed model and that this doesn't become an additional cost driver that works against

²⁸ Productivity Commission (2013) p.7.

²⁹ *Ibid.*

³⁰ Audit Office of New South Wales (2018)

³¹ City of Charles Sturt submission, p 2.

local government's efforts to put downward pressure on council rates. (LGASA submission, p.16)

A review of the first two years of operation of the Victorian LGPRF conducted by Local Government Victoria in 2017 found that on average each council had more than 10 interactions per year with the Performance Reporting Analysis and Support Team.³² While the Commission understands that the number of interactions per year has reduced in more recent years as councils become familiar with the LGPRF and improve their internal reporting processes, councils have been required to allocate resources to the reporting.

Streamlining reporting to the state government

In all states, councils are required to report to state government departments on a range of statutory functions such as waste collection, health inspections and expenditure of government infrastructure grants. To minimise any additional costs to councils of a state-wide performance reporting approach, a streamlined reporting framework which minimises duplication in reporting is desirable.

In Victoria, one key barrier to minimising duplication in reporting has been timelines and frequency of reporting where regulatory periods differ across services and do not fully align with the performance reporting period.³³

There is no central reporting system in place in NSW, and a recent report by the Auditor-General concludes that consolidating and coordinating the reporting requirements will help lower council reporting burden and duplication, and lead to better reporting over time.³⁴

Another barrier is the different IT systems used by different councils and state government departments which have been developed to meet their individual circumstances. These different systems make data sharing difficult, resulting in increased reporting burden for councils.

Council input in the design of a framework

Performance monitoring improves transparency and provides the potential for decision-making that can lead to better outcomes for the community. In order to achieve this, the Victorian Auditor General considers that performance indicators should provide information which help leadership teams to make decisions. These indicators would "support leadership teams to manage strategic risks to the council and assess if the council is delivering services and meeting its strategic objectives".³⁵ Therefore, it is important to give councils the opportunity to shape information that would help them compare themselves to other councils and identify opportunities to improve service delivery and reduce costs.

The Victorian Auditor General's Report on Local Government Performance highlights the value of shifting councils' perception of performance reporting and monitoring from compliance to an opportunity for improvement.³⁶

³² Local Government Victoria (2017)

³³ Victorian Auditor-General's Office (2019)

³⁴ Audit Office of New South Wales (2018)

³⁵ Ibid.

³⁶ Ibid.

Involvement of councils in the development of a performance monitoring framework can also help to minimise the reporting burden on councils by designing indicators which are closely aligned with existing council recording systems and relatively easy for councils to collect.

Local Government Victoria established a steering committee, consisting of council CEOs, for the LGPRF. This steering committee oversees an annual program of review and continuous improvement of the framework and has responsibilities including providing recommendations on the overarching framework, the set of indicators and content of reporting by councils and state.

Information request 4.1: Performance reporting

How can these lessons from state-wide performance reporting frameworks in other jurisdictions be applied to South Australia?

Which indicators used in other jurisdictions would be appropriate for South Australian councils?

4.2.3 Findings

Possible mechanisms that could be used by the local government sector to measure and improve performance over time include:

- a sector-wide public reporting framework;
- collaborations among councils to identify opportunities to improve processes and efficiency; and
- documenting service standards and reporting performance against those service standards.

These mechanisms are not, in the Commission's view, mutually exclusive.

There are several examples of sector-wide local government performance monitoring frameworks in other jurisdictions. There is currently no sector wide approach in South Australia. The Commission notes that 25 South Australian councils have joined the Local Government Professional's 'Australasian LG Performance Excellence Program' to benchmark their performance against other councils. In addition, the Commission identified many examples of councils attempting to compare their performance with other councils. However, the lack of a state-wide framework for performance reporting limits the comparability of data and limits the ability of councils, residents and ratepayers to make meaningful comparisons of performance.

After examining the performance monitoring frameworks in other jurisdictions, the Commission considers:

- standardised reporting on performance across the sector would assist decision making by councils, better inform residents and ratepayers and assist discussions between councils about their results;
- not all councils can be directly compared, therefore the definition of standardised comparator groups is valuable;

- performance reporting should be consistent over time whether being used to track performance of a council over time or compare councils at a point in time;
- efficiency should be considered along with measures of quality and effectiveness;
- context and circumstances are important, and councils should be able to comment on their performance before the results are reported publicly;
- targets and service standards are useful for councils to explain their priorities;
- additional reporting imposes a cost to councils and consideration should be given to streamlining any public reporting;
- high data integrity is central to valid comparisons, hence attention to consistency in definition and recording is important; and
- council input into the design of the framework and choice of indicators is important.

4.3 Partial productivity measures

The most widely used measures of local government productivity are partial productivity measures, which relate a single output to a single input. Labour productivity (output per hour worked) and capital productivity (output per unit of capital) are common examples of partial productivity measures.

Such measures are commonly used for benchmarking and provide a useful way of comparing a council's performance against similar councils. These measures have the advantage of being computationally simple and easy to understand. They also provide valuable insight into where a council's costs are higher or lower than comparable councils in certain areas. However, owing to their simplicity, partial productivity measures do not account for differences in council size, scale, service standards and underlying cost structures. Therefore, the interpretation of direct comparisons between councils using partial productivity measures should be undertaken with care.

While productivity is defined as output per unit of input, in this section the Commission has chosen to present the inverse, or inputs per unit of output. The indicator used here is total expenditure divided by an indicator of the level of activity in a service area. These can be interpreted as unit costs. An increase in unit costs represents a decrease in productivity, and vice versa.

As with all partial productivity measures, these estimates do not capture the effects of the scope and quality of service provided.

4.3.1 Estimates for South Australian councils

While South Australian councils use a range of different productivity measures, the Commission has not identified any sector-wide measurement and reporting of recognisable measures of productivity and efficiency. As part of the analytical approach to understanding patterns in local government productivity and efficiency, the Commission has created a set of partial productivity estimates for South Australian councils. These partial productivity measures could be used by the local government sector to measure and improve performance over time.

These partial productivity estimates are based on data available from the SALGGC, with estimates calculated for selected service areas where consistent data are available for both the quantity and expenditure categories reported.

Data availability has limited the number and quality of partial productivity indicators that the Commission has been able to estimate. There are also some concerns with the consistency of the financial data at the individual service level and their comparability across councils. For instance, there may be differences in how councils apportion indirect costs across services and allocate costs to each of the SALGGC expenditure subcategories. Moreover, output quantity data that are reported to the SALGGC but not used by them are subject to less thorough checking than the financial data.

Several councils, including City of Charles Sturt, City of Playford and the Limestone Coast Local Government Association, have raised concerns about the accuracy of the SALGGC data during consultation. However, most agree that it is the most accurate data available and that it is an appropriate starting point for analysis.

Data collection comes with an impost for councils thus Grants Commission data is a good starting point and is generally comprehensive for financial data. However, the sector has a not unreasonable degree of scepticism as to accuracy of some contained data sets due to the self-reporting nature of data collection and the inconsistency that arises from this and little structure around collection methodology. It would be preferable for consideration to be given as to how the data collection and compilation effort for councils can be minimised as the commission progresses its investigations. (City of Charles Sturt Submission, p.7)

The reliance on data from existing data bases (grants data bases for example), the existing data sets available, such as the grants data base, were developed for a range of purposes, evaluating performance and efficiency to inform economic models was not one of them. Therefore, these data bases are unlikely to provide valid information for the model and indeed a recent analysis using the SA Grants data base shows that this data has some significant difficulties. (Limestone Coast LGA Submission, p.2)

The Commission has made efforts to 'clean' the data, including adjusting some council expenditure data where expenditure appears to have been reported in thousands of dollars in the earlier years but dollars in the later years. In addition, councils that did not report expenditure in at least one year, while still providing that service, were excluded from the estimation of time series trends. However, there are likely to be some remaining issues with the data, largely relating to the consistency across councils of what expenditure is reported.

All expenditure figures used by the Commission have been converted to 'real' 2018 dollars using the LGPI discussed in Chapter 3.

The methodology paper proposed to investigate a ten-year period from 2008-09 to 2017-18. The Commission has excluded the first three years of this period from service level analysis due to changes in reporting of service level expenditure. In the years 2008-09 to 2010-11, a significantly higher proportion of council expenditure was allocated to the category of 'rates and balance of amounts not allocated to other functions'. Therefore, councils reported service level expenditure is likely to be much more accurate from 2011-12 onwards.

A summary of the types of services provided by councils across the 14 SALGGC service categories (excluding rates and balance of amounts not allocated to other functions) is available in Appendix 5.

The service areas that are responsible for the largest proportions of expenditure are likely to explain the greatest proportion of overall council productivity. Therefore, priority is given to these larger expense categories discussed in Chapter 3 such as transport, recreation, other environment and waste management although current data availability has made it difficult to assess recreation and other environment expenditure.

All councils are also required to report on activities undertaken in relation to a range of regulatory functions and other services such as libraries which has made estimating partial productivity measures for these services more meaningful.

Transport

Transport is the largest expense category for councils, accounting for 20 per cent of local government expenditure in 2017-18.

Councils currently report expenditure on sealed roads, unsealed roads and bridges and major culverts to the SALGGC. This expenditure includes depreciation, capital renewal, maintenance, upgrades and capital expansion. They are also required to report on the total length of sealed and unsealed roads and laneways and the estimated replacement cost for each.

Estimating a partial productivity ratio for the entire category of transport is likely to be misleading and difficult to interpret as councils have different types of roads and related expenditure. Therefore, separate ratios for sealed and unsealed roads have been estimated. No indicators for bridges and major culverts have been estimated as many councils did not have any and the underlying costs vary significantly depending on their size and topography.

Reported expenditure on roads compared to total kilometres of roads provides no insight into efficiency. Expenditure would have to be compared against kilometres of work completed, and possibly councils' sustainability ratios. Even then, low costs will not necessarily equate greater efficiencies but can simply be a reflection of construction materials like limestone having to be transported significant distances compared to a limestone quarry close by. Costs alone also provide no insight into the quality of the work undertaken or different construction methods, which may be reflected in the total expenditure. (Tatiara District Council Submission, p. 1)

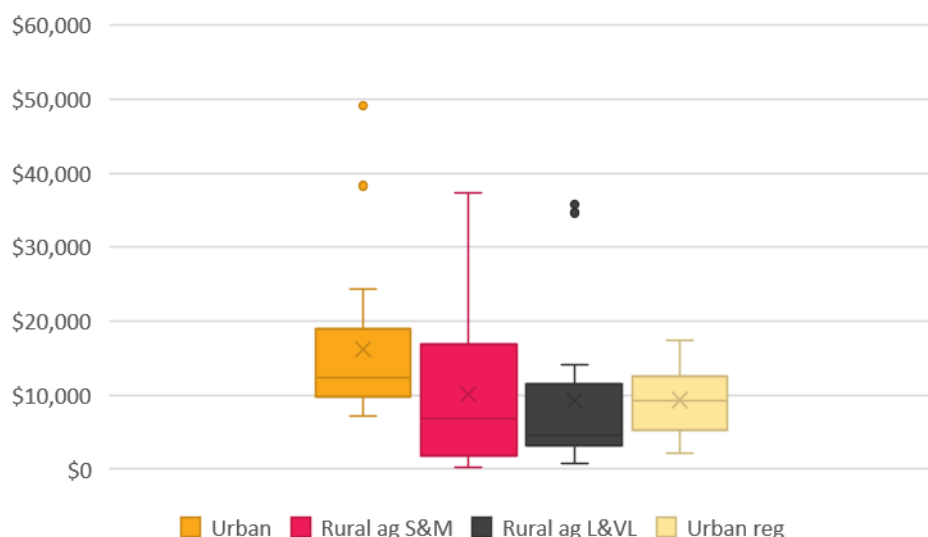
Sealed roads

There are significant differences between councils in total expenditure per kilometre of sealed roads (excluding depreciation). As a result, this measure may be difficult for benchmarking across the sector as some investigation would be required to identify reasonable 'peers' for councils to compare themselves. This distribution appears to be similar to that of earlier years in the sample, although there was one significant 'outlier' in 2013-14 and 2014-15.

Analysis of the expenditure/kilometre of sealed roads for the four groupings of councils, discussed in Chapter 3, shows that there is considerable variation within each group, as

demonstrated in Figure 4.5.³⁷ It also shows that overall expenditure per kilometre of sealed roads is higher for urban councils than for regional councils, and that the variation is highest among rural agricultural (small and medium) councils.

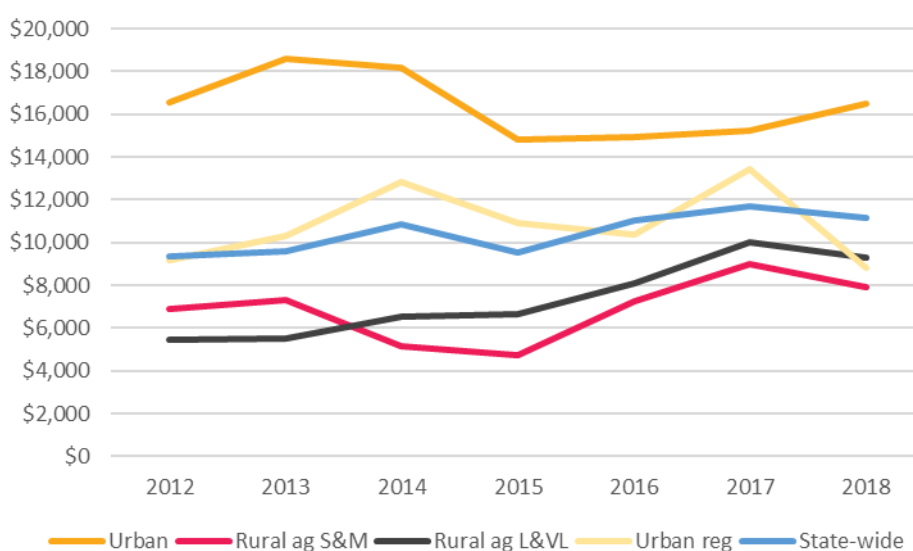
Figure 4.5: Distribution of expenditure per kilometre of sealed roads, by council group, 2017-2018



Source: SALGGC, SAPC estimates

Figure 4.6 below presents the simple average of expenditure per kilometre of sealed roads for each group of councils. There were five councils which reported zero expenditure in any one year³⁸ which are excluded from this calculation.

Figure 4.6: Average real expenditure per kilometre of sealed roads, by council group, 2011-12 to 2017-18



³⁷ The lines in a box and whisker plot correspond to the quartiles of the data, ranked in decreasing order, with the top line representing the maximum, then 75th percentile, the median, 25th percentile and the minimum. The cross represents the mean and the dots outside this range represent outliers, defined as data that is more than 1.5 times the interquartile range (the 75th percentile minus the 25th percentile)

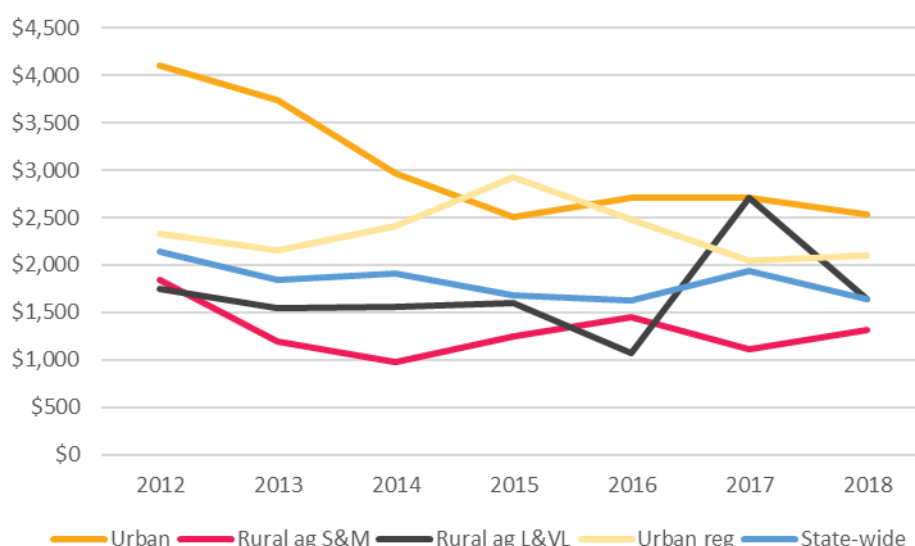
³⁸ One urban, three rural small and medium and one urban regional council.

Source: SALGGC, SAPC estimates

Over the seven-year period analysed, there has been an average annual increase of three per cent in the total expenditure per kilometre of sealed roads. This is mainly observed in rural areas, with rural agricultural large and very-large (9 per cent) and rural agricultural small and medium councils (2 per cent) having the most increase.

As this measure is based on total expenditure on sealed roads, the observed changes in expenditure per kilometre could be a result of greater capital expenditure rather than maintaining current roads or improving the quality of sealed roads. To test this, the Commission also estimated reported expenditure on maintenance of sealed roads per kilometre, presented in Figure 4.7.³⁹

Figure 4.7: Average real expenditure on maintenance of sealed roads per kilometre, by council group, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

Overall average expenditure per kilometre on the maintenance of sealed roads has fallen by four per cent a year across the state over the period. The reduction in expenditure is observed across all council groups, but greatest among urban councils (8 per cent) and rural agricultural small and medium councils (6 per cent).

This may indicate that the increase in expenditure per kilometre of sealed roads is a result of upgrades to existing roads rather than increased maintenance costs, however there is insufficient data available to test this further.

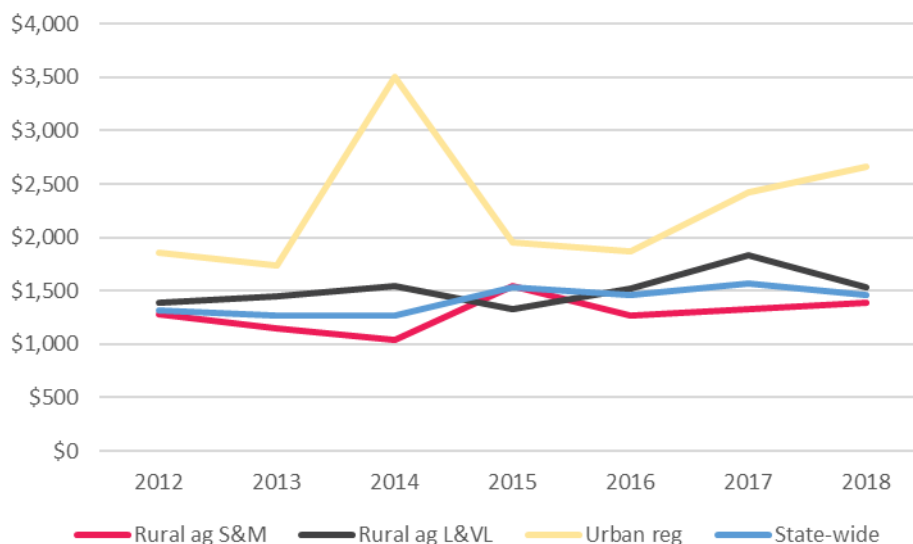
There has also been an increase in total kilometres of sealed roads of approximately 0.8 per cent per year, while the length of unsealed roads has declined by 0.15 per cent per year, suggesting some upgrading of unsealed roads to sealed roads.

³⁹ Reported expenditure on sealed roads is classified as either maintenance, capital renewal, capital expansion (expenditure on new roads) or upgrade. Comparing these other categories to total kilometres of roads is not meaningful and no data is available on the amount of activity for these other activities (such as the distance of road upgraded).

Unsealed roads

Across the state, there has been a two percent average annual increase in total expenditure per kilometre on unsealed roads (Figure 4.8). Urban councils were excluded from this analysis as they have very few unsealed roads.

Figure 4.8: Average total real expenditure per kilometre of unsealed roads, by council group, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

Waste Management

As discussed in Chapter 3, waste management (including recycling) accounted for 9 per cent of total council expenditure in 2017-18. Councils report the type and tonnage of waste collected annually to the SALGGC. This section presents partial productivity measures relating to recycling, general and green waste collection based on the data available.

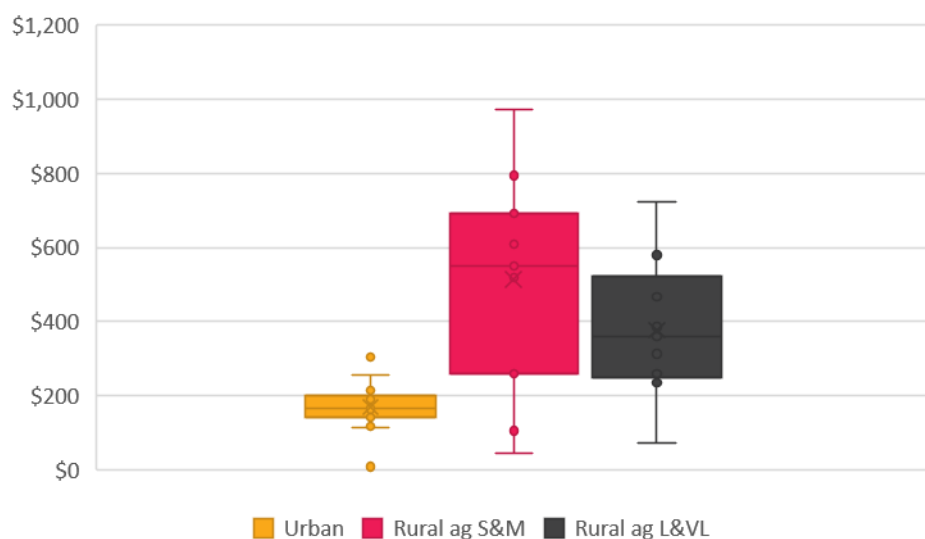
Recycling

During 2011-12 – 2017-18, approximately 88 to 98 per cent of councils reported tonnes of recycling collected annually. However, during the same period, only 60 to 74 per cent of councils recorded expenditure on recycling.

The distribution of expenditure per tonne of recycling for 2017-2018 is presented in Figure 4.9, which illustrates its variation across councils. Urban regional councils have been excluded from Figure 4.9 as only four out of the nine councils reported expenditure in 2017-18.

A council not reporting expenditure in any one year may reflect differences in reporting and accounting practices, including where recycling is managed by regional subsidiaries. As a result, this expenditure is likely included elsewhere in the SALGGC data but not separated out. The Commission has not investigated this at depth.

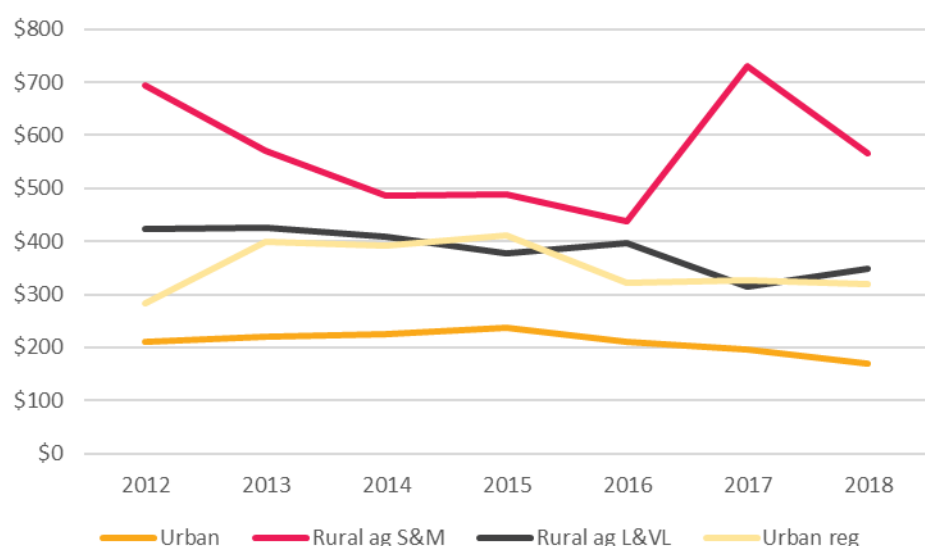
Figure 4.9: Distribution of expenditure per tonne of recycling collected, by council group, 2017-18



Source: SALGGC, SAPC estimates

Figure 4.10 shows the average expenditure per tonne on recycling between 2011-12 and 2017-18. Urban councils had the lowest cost per tonne of recycling and rural councils have the highest. As properties tend to be more spread out in rural and regional areas, the cost of waste collection can be higher compared with urban councils. The data also indicate that during the same period, the average annual real cost per tonne of recycling fell for urban councils (4 per cent), rural agricultural small and medium (3 per cent) and rural agricultural large and extra- large (3 per cent).

Figure 4.10: Average real recycling expenditure per tonne, by council group, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

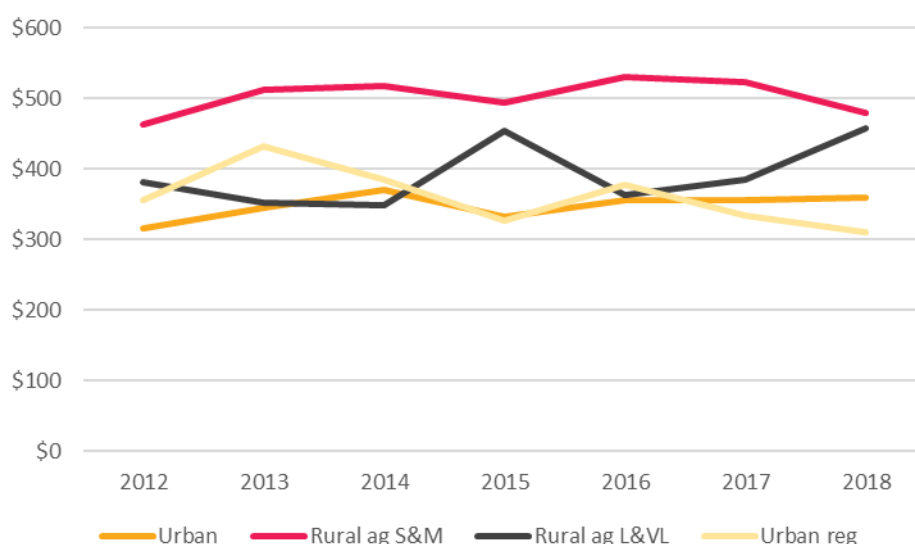
Urban regional councils recorded an increase in costs per tonne of two per cent per year. However, this was a very small group as only three councils reported costs for the entire period.

Overall, there has been a reduction in the cost of recycling per tonne across all councils. This seems to relate to a reduction in total expenditure, which fell by an average of four per cent per year, whereas the total tonnes of recycling collected remained relatively constant over the seven-year period analysed.

General waste collection

The average real expenditure per tonne of general waste collected between 2011-12 and 2017-18 is presented in Figure 4.11 below. Overall, average annual real costs per tonne increased by approximately two per cent. However, this increase has not been evenly shared by all councils. Large and extra-large rural agricultural councils had the greatest cost increase of three per cent per year, while urban regional councils achieved cost reductions of two per cent per year.

Figure 4.11: Average real expenditure per tonne of general waste collected, by council group, 2011-12 to 2017-18



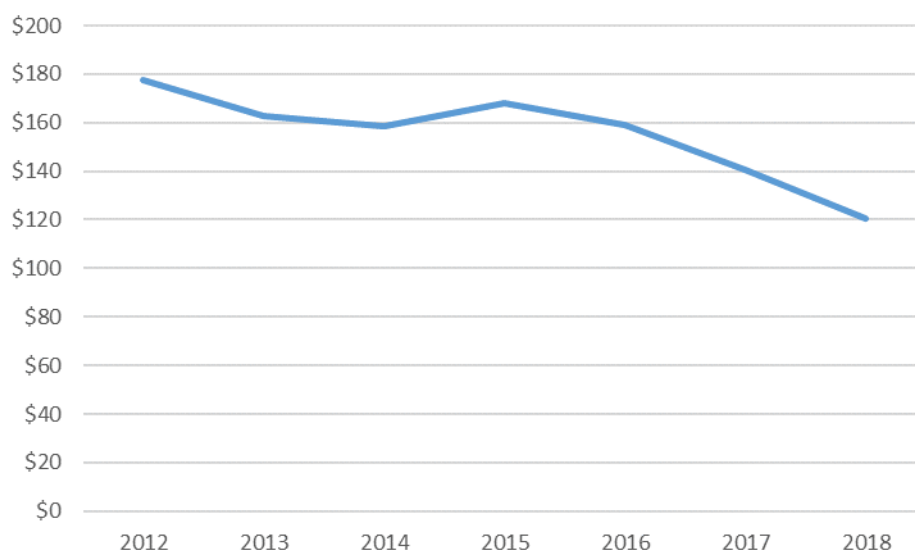
Source: SALGGC, SAPC estimates

During this period, the total tonnes of general waste collected have remained relatively constant for both urban and small and medium rural agricultural councils. However, rural agricultural large and very-large councils reported a decline in the tonnes of waste collected by an average of over five per cent per year, while urban regional councils had general waste collection cost increase by three per cent per year.

Green waste collection

Only fifteen of the 68 councils reported expenditure on green waste in all seven years analysed, therefore examination by council grouping is not meaningful in this instance. Among the fifteen councils whose data was available for all years, average expenditure per tonne of green waste collected declined by six per cent per year (Figure 4.12).

Figure 4.12: Average real expenditure per tonne of green waste, all councils, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

There is some evidence of an expansion of green waste collection by councils over this period. Approximately 70 per cent of councils reported having collected green waste in 2011-12. This figure rose to 79 per cent by 2017-18. There has also been an increase in total tonnes of green waste collected by an average of four per cent per year.

Planning

Town planning is the largest regulatory function councils perform, accounting for over 47 per cent of regulatory services expenditure in 2017-18.

Councils report to the SALGGC their total planning costs, as well as quantity data relating to the number of new development applications and additions and alterations by type. The costs of assessing a planning application vary significantly depending on its complexity.

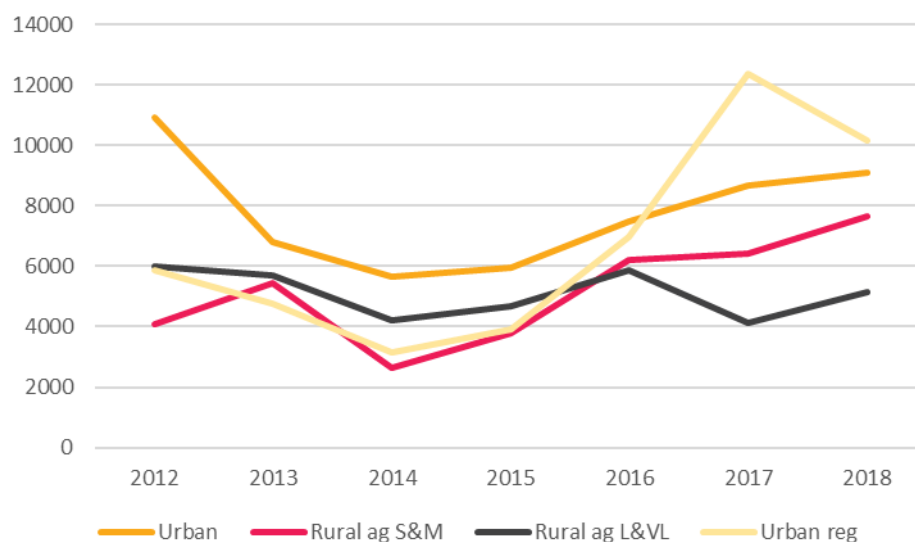
Factors other than the type of development also affect the costs of planning. Proximity to areas such as the Hills Face Zone and other environmental areas affect the level of analysis by a council as well as state authorities where concurrent advice is required. Impacts on existing infrastructure also need to be considered which can affect timeframes and costs of development assessment. In addition, if a council approves groups of the same type of house in bulk in a new development, compared to different houses each with a separate assessment process, their 'productivity' would be higher.

Therefore, comparisons across councils and over time should be interpreted with caution as they may reflect differences in the type and location of development activity rather than differences in efficiency. Nonetheless an estimate of the costs to councils per application can be useful in examining trends in council expenditure and activity.

The Commission has not received any data that separates planning costs by type. Therefore, the analysis is based on constructing partial productivity ratios of the total planning expenditure per number of applications for each new development and additions and alterations as shown in Figure 4.13 and Figure 4.14.

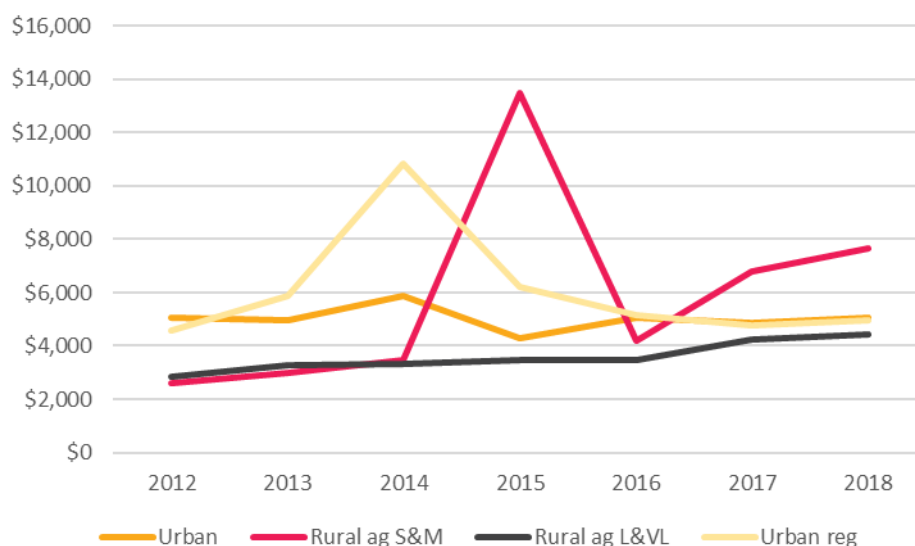
A council that has a higher proportion of additions and alteration applications can be expected to have a significantly higher total planning expenditure per number of new planning applications. Similarly, a shift in the type and level of development occurring in any year will have significant impact on the estimated ratios.

Figure 4.13: Average real total planning expenditure per number of new planning applications, by council group, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

Figure 4.14: Average real total planning expenditure per number of additions and alteration applications, by council group, 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

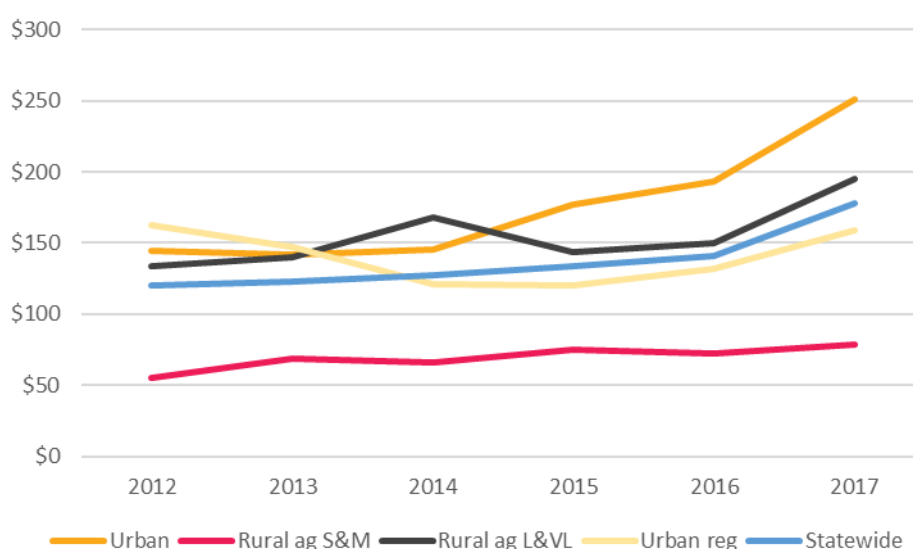
Overall, real costs per planning application have fallen for urban councils, with costs per new application falling by an average of three per cent per year and costs per addition and alteration application remaining constant. However, costs for rural agricultural small and medium and urban regional councils have increased across both measures.

Provision of library services

Library services accounted for six per cent of total expenditure across all councils in 2017-18. The LGASA estimates that library services cost \$89 per ratepayer per year on average for the period 2012-2018.⁴⁰

Councils report to the SALGGC the number of 'active borrowers' and the number of 'active borrowers' who reside outside the council area. The data indicate that the proportion of borrowers who reside outside the council area varied across councils from zero to 98 per cent in 2017. Therefore, expenditure per ratepayer may not be the best measure to estimate productivity of libraries. Instead the Commission has estimated real expenditure per 'active borrower', demonstrated in Figure 4.15.

Figure 4.15: Average real expenditure on libraries per active borrower, by council group 2011-12 to 2017-18



Source: SALGGC, SAPC estimates

Across the state, average annual real expenditure on libraries per 'active borrower' has increased by over eight per cent. This increase is across all councils, except urban regional councils where real expenditure per active borrower fell by an annual average of 0.4 per cent.

This apparent decline in productivity reflects falling numbers of active borrowers, as real expenditure has increased by only 1.5 per cent per year. On the other hand, the number of active borrowers across the state has declined by an annual average of 8.3 per cent. This decline in borrowers is higher for urban councils (9.2 per cent) and lower for urban regional councils (4.7 per cent).

One possible weakness of this measure is that the number of 'active borrowers' may not accurately reflect the number of people who use library services. Submissions from stakeholders also highlight that the type and number of services offered by libraries has expanded beyond the traditional provision of no-cost access to books.

⁴⁰ UHY Haines Norton (2019), "Analysis of Council Data – South Australia- Part 2 - services", Prepared for the Local Government Association of South Australia, Adelaide.

A library service can be a simple online service, it could be just books, or it could provide a community hub for knowledge, learning and to connect community. In each case the costs are for a library, but the inputs and outputs are different, and their cost allocations will vary across each Council. It will also vary over time as the nature and scope of services change, for example the outputs for a library 10 years ago will be different to the outputs provided today. (Limestone Coast LGA, p3)

The Commission notes that in light of these limitations, the Victorian LGPRF used an estimated number of visits to the library as the denominator of their productivity measure. A review of the LGPRF in 2017⁴¹ recommended that this be expanded as the door counts did not include online visits, whereas the expenditure amount included the costs of e-books.

4.3.2 Findings

Current data availability and quality issues severely limit the ability to conduct meaningful analysis of council performance at the service level. While there is data on expenditures on higher level service types, there are issues with the consistency of reporting across councils and missing values for some councils in single years limits the ability to analyse sector-wide trends over time.

Accounting changes in 2011-12 further limit the ability to compare service level expenditure prior to this period as changes to the amount of expenditure not allocated to a function decreased substantially.

These issues need to be addressed as part of a strategy to develop a common performance framework across all councils.

Nevertheless, the data demonstrates that urban councils face different unit costs than rural councils, and that metropolitan urban councils differ from urban regional councils. For example, urban councils have significantly higher expenditure per kilometre of sealed roads than other councils, but lower expenditure per tonne on waste collection. Furthermore, there is significant variation within each council group.

Despite the issues with the data, the Commission found some evidence of an expansion in the scope of services as the number of councils reporting expenditure on green waste collection increased from 70 to 79 per cent over the time period analysed. As discussed in Chapter 3, several councils argued that the scope of their services had expanded, and this had driven up expenditure.

There is also some possible evidence that the increased expenditure on roads is a result of an uplift in quality of roads. This is a result of real total expenditure per kilometre of sealed roads increasing over this period, while real expenditure on maintenance of sealed roads per kilometre has not.

However, there are issues with measuring expenditure per kilometre of total roads. Without data on the amount of activity conducted, these estimates must be interpreted with caution.

⁴¹ Local Government Victoria (2017) Local Government Performance Reporting Framework 2015/16 Reporting Period Review.

Information request 4.2: Partial productivity estimates

What do these partial productivity estimates tell us about local government efficiency?

What other partial productivity estimates can be used with currently available data?

What additional data would councils be able to report on for minimal additional cost which would improve our understanding of council efficiency?

Is there any other evidence of an expansion in the scope of council services, or improvement in quality over this time period?

Is the current reporting to the SALGGC an appropriate process for any additional reporting by councils? Is there value in making any changes to this reporting?

4.4 Global efficiency measures

In addition to the partial productivity measures described above, the Commission has undertaken a global analysis that enables the estimation of multiple-input, multiple-output estimates of local government efficiency. This also enables some allowance for local conditions that affect performance.

As noted in section 4.1, our focus in this chapter is on the measurement of efficiency in terms of multiple inputs and outputs, which is referred to as technical efficiency. Different methods are available for this purpose, which are discussed in appendix 7. The Commission in this instance has chosen Data Envelopment Analysis (DEA) as the best method to apply to the data available. Box 4.3 contains some notes on constraints on the application of DEA in this situation and their implications.

Box 4.3 Data Envelopment Analysis

The application of the DEA method requires data on outputs and inputs. It produces a measure of the ratio of actual inputs used to an estimated minimum achievable amount of inputs, which is defined by the observed inputs used by the best performing councils in the sample if they were to operate in similar circumstances. For example, a score of 0.9 indicates that the council of interest could produce its current output using 10 per cent fewer inputs, according to the experience of others, while a score of 1 indicates the council is producing its current output using less inputs than other similar councils. The measures of technical efficiency are relative to the performance of others in the sample: they are not indicators of what can be achieved in absolute terms.

The technique can be used to assess changes over time, not only in the performance of an individual council, but also of the best performers in the sample, which is regarded as measure of technical change. A set of measures like this is potentially a powerful tool to provide advice and insight to council leaders.

The challenge, because of gaps in the availability of data, is that the method can produce measures of performance which may be the consequence of factors other than technical efficiency.

The most serious of these gaps is that related to measuring output. This issue is examined in more detail in appendix 7. Care must therefore be taken when interpreting the results in terms of either levels of technical efficiency or the patterns of technical change. Even so, the results can be used to identify interesting questions for further analysis. Examples of these situations and their consequences for the analysis are provided in the discussion of the results below.

4.4.1 Previous research on local government efficiency using DEA

The Commission has reviewed previous research on estimating local government efficiency to identify appropriate methodologies and lessons that could be applied to South Australia. It is important to note that the results of separate DEA studies cannot be compared as they relate to different frontiers and there is an established relationship between DEA efficiency scores and sample size⁴² (in this case the number of councils). Furthermore, as DEA efficiency scores are relative to those included in the study, it cannot be said that South Australian councils are on average more or less efficient than those in other states.

The existing body of literature on measuring global efficiency using DEA in local government in Australia predominantly relates to Victoria and New South Wales. The choice of inputs and outputs used in the DEA models is based on several factors including the research or policy questions analysed, data availability and quality, and applicability within local government. An overview of existing studies is summarised in table 4.1 below.

The Commission is aware of only one available study that estimates relative efficiency in local government in South Australia.⁴³ The analysis uses an input-oriented DEA with operational and staff expenditure as inputs and a series of output measures that capture the number of planning assessments and length of roads. It concluded that the relative efficiency of a typical council in South Australia had slightly decreased during the study period. The average relative efficiency fell from 0.863 in 2013 to 0.835 in 2014 and further decreased to 0.823 in 2016. The study also concludes that rural councils, on average, have a higher relative technical efficiency than their urban counterparts.

Other studies have used several different combinations of inputs and outputs in the DEA model which allows comparison of relative efficiency estimates under different specifications.

For example, the models estimated by the Essential Services Commission (ESC) of Victoria found that total factor productivity across Victoria's local government sector decreased between the period 2010-11 to 2015-16, which was attributed to reductions in technological change. DEA models estimated across 152 councils in New South Wales for the year 2011 found average efficiency scores ranging from 0.66 to 0.72. Based on a series of robustness analysis, the study presented a preferred model which consists of staff and capital expenditure as inputs and the number of businesses, households and length of roads as outputs.⁴⁴

⁴² Zhang, Y. & Bartels, R (1998), The Effect of Sample Size on the Mean Efficiency in DEA with an Application to Electricity Distribution in Australia, Sweden and New Zealand. *Journal of Productivity Analysis* 9: 187.

⁴³ Drew, J. (2018), "Measuring Relative Technical Efficiency of South Australian Local Governments", University of Technology Sydney Centre for Local Government, Sydney, NSW.

⁴⁴ Drew, J., Kortt, M. and Dollery, B. (2015), "What Determines Efficiency in Local Government: A DEA Analysis of NSW Local Government", *Economic Papers*, 34(4), 243-56.

Table 4.1: Summary of Methodologies for Australian Local Government Efficiency Measurement

Author	Inputs	Outputs	Data
Victorian Essential Services Commission (2017) ⁴⁵	Council Staff (\$), Capital (\$)	Households, businesses, length of roads	79 Victorian councils
Victorian Essential Services Commission (2017) ⁴⁶	Council Staff (FTE), capital (\$)	Households, businesses, length of roads	79 Victorian councils
Victorian Essential Services Commission (2017) ⁴⁷	Council Staff (\$) Capital (\$)	Households, businesses, length of roads, waste collected	79 Victorian councils
Victorian Essential Services Commission (2017) ⁴⁸	capital (\$) operating expenses (excl. depreciation) (\$)	Households, businesses, length of roads	79 Victorian councils
Victorian Essential Services Commission (2017) ⁴⁹	operating expenses (excl. depreciation) (\$) + depreciation (\$)	Households, businesses, length of roads	79 Victorian councils
Fogarty and Mugera (2013) ⁵⁰	employee costs, physical expenses and financial expenses	Population, number of properties, length of sealed and unsealed roads	98 Western Australian councils (2009,2010)
Worthington (2000) ⁵¹	Number of workers, financial expenditures (except depreciation), other expenditures	Total population, number of properties acquired to provide the following services: potable water, domestic waste collection, surface of rural and urban roads (km).	177 New South Wales councils (1993)
Drew, Kortt and Dollery (2015) ⁵²	Staff (\$), Capital (\$)	Businesses, Households, Roads	152 New South Wales councils
Drew (2018) ⁵³	Operational expenditure (\$), staff expenditure (\$)	Number of assessments (residential, business, other), length of roads (sealed, unsealed)	68 South Australian councils (2012-2016)

⁴⁵ Essential Services Commission (ESC) (2017), "Measuring Productivity in the Local Government Sector: Consultation Paper", September.

⁴⁶ *Ibid.*

⁴⁷ *Ibid.*

⁴⁸ *Ibid.*

⁴⁹ *Ibid.*

⁵⁰ Forgarty, J. and Mugera, A. (2003), "Local Government efficiency: Evidence from Western Australia", Australian Economic Review, 46(3), 300-11.

⁵¹ Worthington, A (2000), "Cost Efficiency in Australian Local Government: A Comparative Analysis of Mathematical Programming and Econometric Approaches", Financial Accountability and Management, 16(3), 0267-4424.

⁵² Drew, Kortt, and Dollery (2015).

⁵³ Drew, J. (2018) "Measuring Relative Technical Efficiency of South Australian Local Governments", University of Technology Sydney Centre for Local Government, Sydney, NSW.

4.4.2 Global efficiency measures for South Australian councils

The methodology paper released by the Commission in May 2019 proposed a model for estimating the technical efficiency of South Australian local governments.⁵⁴ The Commission has since consulted extensively on the proposed model and analysed the suitability of data available.

The Commission also engaged Economic Insights Pty. Ltd. to provide advice on issues relating to productivity and technical efficiency measurement and to estimate local government efficiency using DEA.⁵⁵

In order to produce meaningful estimates for each of the 68 councils in South Australia, Economic Insights advised that a single model for all councils, with a maximum of five or six variables, was needed. As a result, it was not possible to include data on all council outputs (even if available). Therefore, several proxies that are likely to represent the outputs a council produces were chosen instead. Clearly, these proxies do not capture all the outputs produced by any council, therefore the estimated efficiency scores must be interpreted with caution.

After consideration, the preferred DEA model proposed by Economic Insights and agreed by the Commission was⁵⁶:

Inputs:

Opex = labour expenses + materials, contracts and other expenses

Capital = depreciation expenses

Outputs:

Residential properties

Other properties

Total road length

A detailed discussion of the variables included in the model is in the Economic Insights report.

Having analysed the peers selected by the model, the Commission has chosen to exclude one council, the City of Adelaide, from the results. As described in their submission, the City of Adelaide faces significantly different expenditures than other metropolitan councils, and as a result, the peers selected by the model for City of Adelaide were not informative.

A direct comparison with other metro Councils to determine efficiency may be misleading as being a Capital City Council, our service provision often extends to those outside its ratepayers' catchment area. This is particularly evident in Council's support for key city events and activation activities such as the Adelaide Fringe, Supaloop500 and the various Christmas and New Year's Eve events extending beyond the event itself to the cost impact associated with the management of key infrastructure components that enable these activities. (City of Adelaide Submission, p.1)

⁵⁴ A similar methodology to that discussed in Drew, Kortt and Dollery (2015).

⁵⁵ Detailed analysis available in Economic Insights (2019), "Efficiency and Productivity Analysis of Local Government in South Australia", Report prepared for the South Australian Productivity Commission, July.

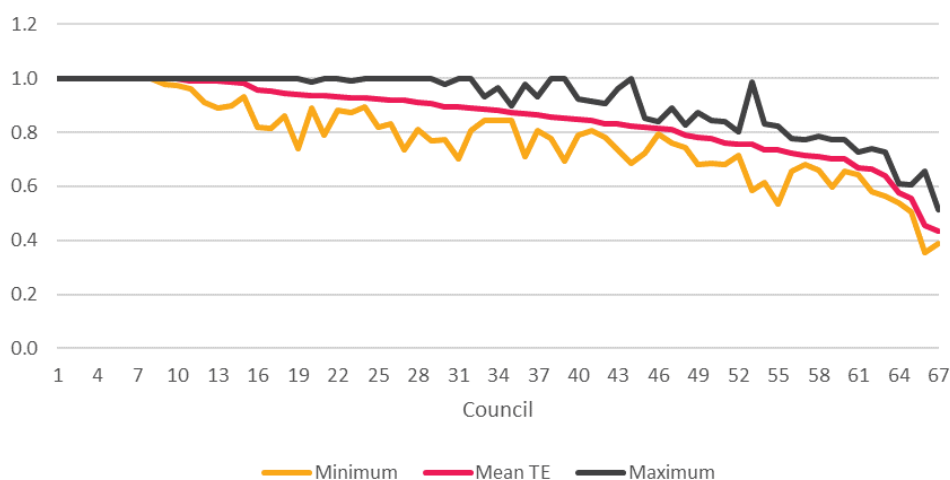
⁵⁶ Ibid.

While the City of Adelaide has been excluded from the presentation of the results, it was included in the model, however this does not affect the results for any other council. Figure 4.17 presents technical efficiency scores of each council in the four council groups, estimated using the single 68 council model.

Sector-wide estimates

The analysis by Economic Insights indicates that with a few notable exceptions, South Australian councils overall estimated technical efficiency scores were relatively close to the maximum score of one. For example, 43 per cent of South Australia's councils had an estimated mean technical efficiency over the 10-year period greater than 90 per cent. A further 35 per cent of councils had a mean technical efficiency of over 75 per cent. This is demonstrated in Figure 4.16, which presents the mean technical efficiency for each of the 67 councils over the ten-year period (in descending order) as well as the maximum and minimum technical efficiency score by each council in any year.

Figure 4.16: Minimum, Maximum and Mean Technical Efficiency Scores, by council ranked in descending order 2008-09 to 2017-18



Source: Economic Insights (2019), SAPC estimates

The efficiency scores in Figure 4.16 are an estimate of efficiency relative to all other councils in the sample, not an estimate of absolute efficiency. The Commission is unable to estimate the levels of council efficiency and a value of one does not mean a council cannot become more efficient.

Analysis by council group

The methodology paper proposed to conduct separate DEA studies for each of the groupings of councils used in Chapter 3 and partial productivity analysis. However, advice from Economic Insights was that this may result in too few observations in each model to have reliable estimates and that a single model for all councils is preferred. This single model would then self-select appropriate 'peers' for each council and rural councils would be compared against other rural councils (based on their high ratio of roads to properties) and urban councils would be compared against other urban councils.

Compared to urban councils, rural and urban regional councils had a higher variation in mean technical efficiency. Urban regional councils had the widest range of estimated technical

efficiency, which could be because it is a small group with a few members that are quite unique. As discussed in Chapter 3, urban regional councils also had the highest proportion of expenditure on non-mandated services.

Figure 4.17: Minimum, Maximum and Mean Technical Efficiency Scores, by council type ranked in descending order 2008-09 to 2017-18



Source: Economic Insights (2019), SAPC estimates

4.4.3 Service-specific DEA estimates

As discussed in the methodology paper, estimating service-specific global efficiency of councils can potentially avoid some of the limitations of whole of council estimations, particularly in defining a comparable and comprehensive set of inputs and outputs. Estimating service-specific efficiency also largely addresses the criticism that councils providing additional services may be deemed inefficient as variability of costs between councils is likely to be more contained when looking at specific services and analysis of differences is simpler than for whole-of-council comparisons.

Several submissions from councils also supported estimating service-specific efficiency (for example, City of Tea Tree Gully, City of Charles Sturt, Copper Coast Council, and Playford City Council). Councils noted that as “non-specific” measures do not account for the variability across councils, they are not comparable.

Other submissions, including those from Campbelltown City Council and the LGASA raised concerns about such measures:

Due to the differences in service levels between councils (and also potentially in the way a council financially accounts for that service) it may be difficult to get to a point where service-specific metrics are directly comparable. There is also a risk that councils operating in thin markets (more likely in regional areas) which need to pay more to procure certain services could be viewed as ‘inefficient’ when compared to others. (LGASA Submission, p.29)

The risk with these types of comparisons is that the areas being compared may not be a focus of all Councils. Establishing comparisons of this nature may place an expectation on perceived low performing Councils to improve in this area,

meaning that other services may need to be reduced or further rate increases required to fund the extra services. (Campbelltown City Council, p.5)

The Commission investigated possible options for measuring service-specific global efficiency estimates, including obtaining expert advice from Economic Insights, and has concluded that currently available data do not support this exercise at this point. Nevertheless, the Commission sees value in further work in this area. The submission from Copper Coast Council suggests that:

a working party be established through the Local Government Association of South Australia to develop service-specific efficiency models for councils.
(Copper Coast Council Submission, p.5)

Information request 4.3: Service-specific efficiency

Acknowledging the gaps in data currently available, how can data quality be improved in order to measure service-specific efficiency across councils?

4.4.4 Efficiency changes through time

As previously discussed, DEA efficiency scores are defined relative to the efficiency frontier of the sample under consideration. It is therefore not meaningful to compare efficiency scores calculated against different efficiency frontiers. This means that it is not possible to directly compare estimated efficiency scores over different time periods, even for the same underlying sample.

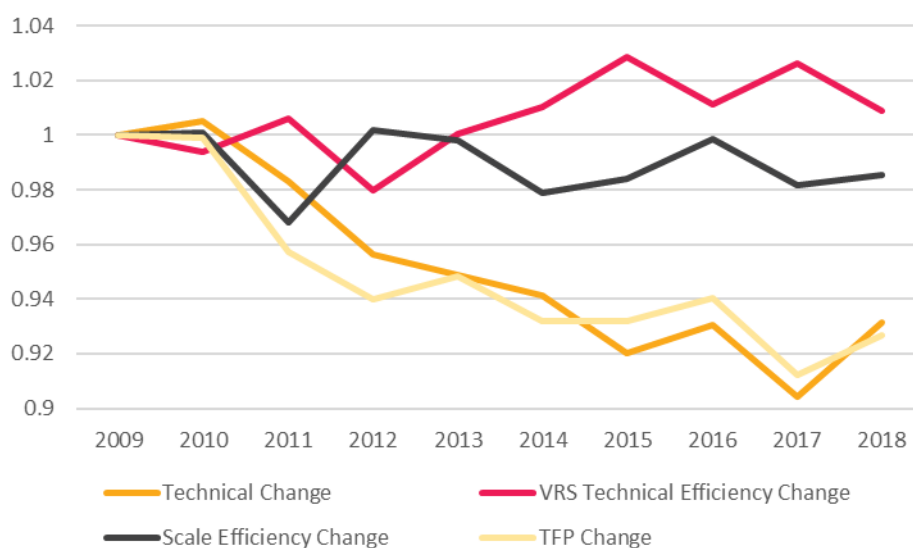
The technical efficiency scores, discussed in section 4.3.2, relate to the distance from the frontier. However, over time the frontier can also move. This is known as technical change.

Economic Insights estimated changes in efficiency and Total Factor Productivity (TFP) for each council over each pair of adjacent years. These estimates can be decomposed into measures of changes in technical efficiency, technical change and changes in scale efficiency.⁵⁷ This technique enables comparisons of productivity and efficiency over time without directly comparing the estimated efficiency scores.

The analysis by Economic Insights includes estimating TFP growth for the 10-year period from 2008-09 to 2017-18. This provides measures of TFP growth for each council between each pair of adjacent years. The results are presented in Figure 4.18.

⁵⁷ Further details are available in Economic Insights (2019).

Figure 4.18: Malmquist DEA TFP change aggregate indices 2008-09 to 2017-18



Source: Economic Insights (2019)

The results indicate that TFP has fallen by an average of 0.8 per cent per year over the ten-year period. This decline is primarily due to the technical change component declining by an average of 0.8 per cent per year over this period. There are also minor contributions from technical efficiency and scale efficiency (of approx. 0.1 per cent) but these tend to be minor compared to the larger effect of technical change.

In most sectors one would expect technical change to be positive. There are several explanations for the estimated negative technical change. They include:

- declining performance across our sample;
- an increase in the volume, scope or quality of services that are not measured by the output proxies used in the model; or,
- measurement issues.

Based on the feedback from the Local Government Reference Group and consultation with stakeholders, the Commission understands that increases in scope, quality and quantity of services are likely to be a factor in the explanation of these results. This is consistent with the Commission's findings in Chapter 2 that the legislative framework has enabled an expansion in functions and in Chapter 3 that growth in the volume and quality of outputs are a significant driver of increased operating expenditure.

However, quantifying changes in the volume and scope of council services is problematic. The Commission has not been able to identify any standardised measures of service quality across councils, which limits incorporating service quality into the model.

Some Councils have embarked on community surveys to ascertain Council service quality. In my view, it is considered that a sector wide community survey could be explored, but subject to a review of the cost benefit of such survey. Previously, some years ago, the Local Government Association of South Australia coordinated a community survey for councils that chose to participate on a cost basis. (Copper Coast Council Submission, p.4)

Data issues have also prevented the Commission from quantifying any expansion in the scope of services provided by councils. Therefore, estimates of declining productivity should be interpreted with caution. However, the Commission has found some evidence of an expansion in the scope of services (as discussed in section 4.3), with the number of councils reporting expenditure in green waste collection increasing from 70 per cent to 79 per cent in seven years. Further evidence provided by councils in their submissions, discussed in Chapter 3, also supports the view that the scope of services provided has grown.

Information request 4.4: Efficiency changes through time

How can the change in volume, scope or quality of services be quantified or otherwise incorporated into an evaluation of local government efficiency?

4.5 Understanding factors that influence efficiency of councils

Council performance may be influenced by factors outside their control, including socio-economic and demographic characteristics of council areas, their geographic location, and operating and policy environments, as discussed in Chapter 3. Submissions from stakeholders also noted factors such as growth areas, ageing populations, labour market shocks (for example, large scale redundancies such as the closure of automotive manufacturers) and thin markets (LGASA submission, p.32).

Some of the limitations of the DEA efficiency estimation described in earlier sections can be addressed by analysing the effect of external factors on council efficiency scores. This will also assist in establishing a context with which the estimated efficiency scores from the DEA analysis can be more meaningfully interpreted.

The most commonly used methodology is Two-Stage DEA. It involves using the DEA efficiency scores in a regression model to explain differences in estimated efficiency scores of councils.

The Commission acknowledges that such an analysis will be limited by the data available and may not capture the context in which councils operate in its entirety.

4.5.1 Previous studies of two-stage DEA in local government

The type of factors analysed depends on the specific research or policy questions addressed. Existing studies have used a range of variables summarised in Table 4.2. While it is not possible to directly compare possible factors that are associated with council efficiency across different jurisdictions, they provide useful insight into the nature and extent of differences and similarities of councils.

Table 4.2: Factors associated with council efficiency

Study	Factors used in the study
Comparing cost efficiency of NSW councils. Worthington (2000) ⁵⁸	Grant dependence; debt service; current assets; number of staff; average residential property rate
Local government efficiency in WA. Fogarty and Muger (2013) ⁵⁹	Population density; rate share of total expenses; ABS disadvantage index; employee cost per resident
Local government efficiency in NSW. Drew et al (2015) ⁶⁰	Population; population density; percentage of population over/under 65; percentage of ATSI ⁶¹ population; percentage of NESB ⁶² population; annual unemployment rate; average annual wage; total liabilities; total infrastructure value; grant funding; depreciation; sealed and unsealed roads (km)
Planning and regulatory efficiency in NSW. Worthington and Dollery (2000) ⁶³ Waste management in NSW. Worthington and Dollery (2001) ⁶⁴	Geographic and demographic conditions classified into five categories (urban developed; urban fringe; urban regional; rural significant growth' rural agricultural)
Efficiency measurement in municipal water services in NSW. Woodbury and Dollery (2004) ⁶⁵	Population, properties per km of main location; rainfall; proportion of residential properties; unfiltered water; groundwater.
Measuring productivity in the local government sector in VIC. Applied Econometrics (2017) ⁶⁶	Population, population density, proportion of population under 15; proportion of population over 65, percentage of ATSI population, percentage of NESB population; unemployment rate; median annual wage rate; total liabilities; total infrastructure value; total grants, annual depreciation; length of roads
Local government efficiency in SA. Drew (2018) ⁶⁷	Population, population density, proportion of population under 15, on Newstart allowance, NESB, ATSI; median wage; financial assistance grants; urban; shared services

⁵⁸ Worthington (2000)

⁵⁹ Fogarty and Muger (2013)

⁶⁰ Drew *et al* (2015)

⁶¹ Aboriginal and Torres Strait Islander

⁶² Non-English-speaking background

⁶³ Worthington, A. and Dollery, B (2000), "Measuring Efficiency in Local Governments' Planning and Regulatory Functions", Public Productivity and Performance Review, 23(4), 469-485.

⁶⁴ Worthington, A. and Dollery, B. (2001), "Measuring Efficiency in Local Government: An analysis of New South Wales Municipalities' Domestic Waste Management Function", Policy Studies Journal, 29(2), 232-249.

⁶⁵ Woodbury, K. and Dollery, B. (2004), "Efficiency Measurement in Australian Local Government: The Case of New South Wales Municipal Water Services", Review of Policy Research, 27(2), 77-91.

⁶⁶ Applied Econometrics (2017), "Measuring Productivity in the Local Government Sector, A Reply to Stakeholder Comments concerning DEA", Response to the Essential Services Commission, VIC.

⁶⁷ Drew, J (2018).

4.5.2 Estimates for South Australian councils

The Commission engaged Economic Insights to conduct second-stage DEA analysis of a range of social and economic factors that might influence council efficiency. A detailed discussion of the analysis is available in the Economic Insights report.⁶⁸

The Commission notes that several other factors are not accounted for in the analysis due to data and/or analytical constraints that may contribute to differences between councils in measured efficiency scores. Some of these noted in the consultation process, including submissions are outlined below:

- multiple towns/service delivery centres – might reduce efficiency because a duplication of services such as libraries may be required;
- climatic factors – such as higher rainfall might influence efficiency through increasing maintenance requirements on roads and bridges due to water damage;
- soil types – such as reactive clays versus more stable gravels and loams might affect road maintenance costs;
- topographic differences – such as hilly versus flat terrain might also influence maintenance costs of roads and parks to some degree;
- coastal versus inland setting – humid salty air might imply extra maintenance is valuable for buildings plus there might be more parks, jetties and wharves to maintain in coastal areas;
- tourism – extra seasonal populations might put additional pressure on parks and waste facilities; and
- quality of services – some councils might deliver higher quality services because they are demanded by their residents.

The issue of quality of services provided by councils was regularly raised in the consultation process. However, the absence of appropriate data that captures service quality in a consistent manner across the sector has precluded further analysis.

Given that there are considerable data limitations, further analysis would be required to investigate what factors and how they are related to estimated council efficiency and productivity.

Information request 4.5: Factors that influence estimated council efficiency

What other factors can explain the estimated efficiency differences between councils or over time?

What factors can explain the estimated productivity differences between councils over time?

What other possible data sources can improve this analysis?

What further information could be considered to analyse and interpret estimated partial and global efficiency scores?

⁶⁸ Economic Insights (2019)

4.6 Conclusions

This chapter brings together the Commission's analysis of local government efficiency, which includes a portfolio of partial and global efficiency measures supplemented by contextual analysis based on qualitative information available from submissions and consultations. It is expected that this analysis will help initiate constructive conversations across the local government sector.

The Commission notes that many councils are attempting to compare their performance against other councils. However, it is evident that issues around the comparability and quality of currently available data limit the usefulness of such comparisons and impose analytical constraints with respect to efficiency analysis across the sector as a whole. The Commission's analysis also highlights the benefits of a standardised sector-wide performance measurement reporting framework.

Based on a review of local government performance monitoring nationally, the Commission regards best practice in performance monitoring as including: standardised comparator groups to enable meaningful comparisons across councils and over time. Any estimate of council efficiency should also acknowledge the context influencing this efficiency estimate, including measures of quality and effectiveness as well as council targets or service standards. The value of performance monitoring can be further improved by allowing councils the opportunity to comment publicly on their performance, prior to any estimates being publicly released. Furthermore, any reporting framework should balance the costs of reporting against the benefits of the additional information and every effort made to streamline existing reporting and remove duplication. Council input into the design of the framework and choice of indicators is critical to its success.

While mean technical efficiency has remained relatively constant over the ten-year period, the DEA model indicates that TFP has fallen by an average of 0.8 per cent per year.

This observation may be at least partially explained by a combination of declining performance, an increase in the volume, scope or quality of services that are not measured by the outputs chosen in the model, or inherent measurement issues. Based on stakeholder consultations, the Commission is of the view that this fall could largely be attributed to the unmeasured changes in volume, scope or quality of services provided.

In terms of the relative efficiency scores by council grouping, compared to urban councils, rural and urban regional councils had a higher variation in mean technical efficiency. Urban regional councils had the lowest estimated technical efficiency, which could be due to the fact that it is a small group with a few members that are quite unique.

The Commission has sought to analyse the councils that were identified as either the most efficient, or relatively inefficient to identify possible reasons and problems with the DEA model. However, further comment is constrained by the Commission's commitment to not publicly identify individual councils.

Many of the less 'efficient' councils according to the DEA study were quite unique compared to other councils in terms of their size, location or service mix. As a result, their levels of operational expenditure per property or kilometre of roads is higher than their 'peers' in the model.

The Commission's estimates of partial productivity highlighted the limitations of available data for this purpose, particularly relating to the quality and consistency of reported data, across councils and over time.

The Commission has identified some limited evidence, presented in section 4.3, to demonstrate an expansion of the scope or quality of services. However, quantifying changes in scope of services requires additional information and data, highlighting the value of further work to understand the underlying influences on efficiency.

While DEA provides an important starting point for an analysis of council efficiency and is the best methodology available to provide an overall estimate of council efficiency, it is imperfect. The inability to capture all council outputs requires the use of proxies that are unable to capture all aspects of every councils' activities. Therefore, DEA is an important first step in efficiency analysis and can be more meaningful when complemented by analysis of partial productivity and service quality measures.

5. Costs and efficiency improvements

5.1 Introduction

The inquiry's terms of reference require the Commission to analyse, and report on, the following terms of reference in relation to costs and efficiency in the local government sector:

- provide advice on possible options to guide and assist councils to improve efficiency and create capacity to pass on cost reductions to ratepayers;
- provide recommendations on actions by the South Australian Government to lower local government costs and enhance local government financial accountability.

The Commission is expected to have regard to the changing service expectations of communities and the long-term financial sustainability of councils.

The Commission's analysis of the observable trends in, and potential drivers of, costs and efficiency in the sector, together with consideration of input received from councils and other stakeholders, provides the basis for the recommendations to the South Australian Government and advice to councils presented in this chapter.

The Commission's focus has been on identifying measures that can be implemented by state and local governments in the short to medium term to effectively frame and inform councils' decision-making. These measures can be broken down into three broad elements.

First, the Commission seeks to identify ways in which councils can obtain a deeper understanding of their costs and related aspects of their performance. This is intended to provide councils with better information to inform their decisions on what services to provide and how to provide them. Better decision making, in turn, will help councils to improve their efficiency and create a capacity to pass on cost reductions to ratepayers. The Commission's draft recommendations and advice in this area are focused on enabling councils to respond more effectively to their communities' preferences, both now and into the future.

Second, the Commission seeks to identify ways in which councils can improve their performance over time, potentially contain expenditure growth and utilise efficiency dividends from the more effective use of their resources. The Commission's draft recommendations and advice in this area relate to improving the ways in which councils make use of data and analytical tools to monitor and improve performance.

Third, the Commission's focus is directed towards identifying ways in which councils can use performance and expenditure reporting to demonstrate and achieve greater accountability and financial sustainability. This involves giving consideration to the way in which councils interact with other levels of government and their ratepayers.

In sum, the recommendations and advice aim to achieve the following interrelated key outcomes sought by the terms of reference:

- reduce growth in councils' costs;
- improve efficiency in the sector;
- create greater capacity within local government to pass on any reductions in costs to ratepayers; and
- enhance councils' financial accountability.

The Commission's findings, views and councils' views on costs, efficiency and accountability are discussed below. This is followed by draft recommendations to the South Australian Government and draft advice to councils.

5.2 Cost drivers and improved decision-making

5.2.1 Commission's findings

The analysis in Chapter 3 of trends in, and possible drivers of, expenditure in the local government sector shows that the growth in local government operating expenditure over the last decade has been relatively high. Urban metropolitan and fringe councils consistently recorded higher growth in operating expenditure than other councils during this period. This growth has been greater than underlying measures of inflation and has been funded, in the main, by increases in rate revenue, thereby putting upward pressure on the cost of living for ratepayers.

The Commission has found that councils' operating expenditure is mainly made up of employee costs and materials, contracts and other costs, which accounted for 35 per cent and 41 per cent of total sector operating expenditure in 2017-18. These proportions have not changed significantly since 2008-09.¹

Sector expenditure on employee costs increased more, in percentage terms, over the decade than any other expenditure category at an annual average increase of 4.5 per cent, although growth has moderated over the decade in both urban and rural councils.

The number of council employees across the state has increased by an annual average of 0.8 per cent over the decade, resulting in higher employee expenditure per FTE employee. The extent to which this has been offset by productivity growth is difficult to determine in the absence of data on council outputs.

Finance costs have been negligible and falling over the decade as councils have tended to finance their operations using internal funds, or equity, rather than debt. This results in their operating costs being lower than they would be if debt levels approaching economy wide norms were used by councils.

More than half of councils' operating expenditure is accounted for by the four largest service categories – transport, recreation, other environment and waste management. Analysis of operating expenditure by the fourteen service categories indicates that the mix of services delivered has not changed significantly over the last seven years.

While mandated services are relatively small in number, they accounted for 46 per cent of sector operating expenditure in 2017-18.

Mandatory services consistently accounted for a higher proportion of operating expenditure for rural councils, at close to 60 per cent, compared to 40 per cent for urban councils. The most significant service mix difference between council groupings is that expenditure on the transport function is proportionally greater for regional councils than urban councils.

¹ As noted in Chapter 3, data limitations have prevented the Commission from analysing the extent to which the average annual growth in materials (and other costs) reflect increases in prices paid, volumes purchased or changes in efficiency.

Growth in population and property numbers, while low, is likely to have caused some increase in the volume of services demanded, with the exception of small and medium rural councils. This could explain part of the growth in council operating expenditure. Slowing population growth in the later part of the decade would likely have contributed to the observed moderation in operating expenditure growth. In addition, the effect of an ageing population is likely to have altered the mix of services demanded, although this impact is not evident in the fourteen categories of operating expenditure examined by the Commission.

Instances of cost-shifting from federal and state governments to local government have been argued by councils to have increased their costs. The Commission is not in a position to quantify the cost impact of cost shifting. Councils have sometimes decided to continue to deliver a service or program after federal or state funding commitments have expired, possibly in response to community expectations. In the Commission's view, a decision to continue to provide a service after funding has been withdrawn by a higher level of government does not constitute cost shifting. Cost shifting is discussed further in section 5.4.

In addition to the expansion of responsibilities under various pieces of state legislation, some of which are unfunded, councils have raised the issue of a cost pressure resulting from an increased regulatory compliance burden imposed by state government.

Councils have varying degrees of control over factors which influence their cost. Some are externally determined, including, for example, the broader regulatory or taxation environment or growth in ratepayer or property numbers, which drive up demand for services. Other factors, such as the prices councils pay for labour and other inputs, are influenced by industrial relations arrangements and procurement practices. Councils are also able to influence community expectations through consultation and informing ratepayers regarding changes in service mix and quality.

A third group of cost drivers is more strongly controlled by councils and includes scale, scope and quality standards particularly for non-mandated services, and productivity and efficiency levels through choice of technology and business processes.

5.2.2 Councils' views

The Commission notes that councils have highlighted a range of factors that could, either separately or collectively, account for the observed increase in expenditure over the last decade.

A large number of councils, both in metropolitan and regional areas, have noted in their submissions that state government legislation has expanded the scope of councils' responsibilities. Councils have contended, in particular, that the increased scope of their responsibilities under new or amended legislation has not been matched by an increase in state government funding sufficient to cover the costs of providing additional services or regulatory functions.

The City of Prospect, for instance, cites a number of examples of legislative requirements imposing greater costs on the local government sector, including functions under the *Dog and Cat Management Act 1995* and the *Local Nuisance and Litter Control Act 2016*. Under the latter piece of legislation, for example, councils are defined as the principal authority for dealing with local nuisance and littering in their areas.

Several councils, including the City of Charles Sturt, have argued that some legislated requirements, such as the mandatory 75 per cent rate rebate for community housing properties, have become a substantial cost burden.²

Other councils argued that the burden of complying with state and federal legislation has grown significantly over the last decade, thereby increasing their overall cost burden. While data limitations have prevented quantification, consultations with councils have suggested that the cost impact is likely to be comparatively small. This remains an issue that is likely to require further analysis.

A number of councils have submitted that rising service standards have been a significant contributor to growth in expenditure. However, the Commission has not been able to obtain any sector-wide service level data to enable an assessment of the extent to which increases in the scope or quality of services or facilities have caused increases in councils' costs.

In addition to an increase in costs as a result of new or enlarged functions mandated by legislation, councils have highlighted other fees imposed by the state government as significant cost drivers, including the solid waste levy. Councils have been clear in their submissions to the Commission that the levy – which is seen by the local government sector as a prominent example of cost shifting – contributes significantly to overall costs:

The waste levy increase equates to 0.58% increase in rates and Council has no choice but to pass the cost of the State Government Tax on to our ratepayers.³

The Commission notes that a concern about the costs mandated by state legislation are pervasive within the sector, taking in a range of areas beyond community housing and the waste levy.

Councils have also expressed concerns about the overall effects, which are borne out by the Commission's analysis in Chapter 3, that employee costs have had, and are likely to continue to have, on councils' costs.

A number of councils have contended that Enterprise Bargaining Agreements, which are not sector-wide and include 'no forced redundancy' clauses, have been a major cost pressure point. The South Australian Local Government Financial Management Group (SALGFMG) points out that, beginning in 2008-09, annual wage increases for many councils were in the order of 4 to 6 per cent. This had fallen to approximately 3 per cent by 2014-15, with more recent increases averaging around 2 per cent, which is broadly reflective of growth in wages throughout the wider economy.⁴

At present, councils negotiate Enterprise Bargaining Agreements (EBAs) individually, with different conditions in place for staff classified as either 'indoor' or 'outdoor' employees. A number of councils have expressed the view that the current industrial relations environment requires reform, and that moving towards a sector-wide system of bargaining could have significant benefits. The Commission understands that the LGASA has convened a working group to consider potential opportunities for moving towards sector-wide enterprise bargaining.

² City of Charles Sturt, Submission, p.4

³ *Ibid.*, p.2

⁴ SALGFMG, Submission, p.10.

Information request 5.1: Employee costs

Are there any benefits from streamlining the current industrial relations arrangements by moving to sector-wide enterprise bargaining?

5.2.3 Commission's view

As noted above, the Commission's analysis of councils' costs showed that, over the last decade, there has been real growth in operating costs, but little significant change in the composition of input costs and output mix.

Moreover, the Commission's analysis of the sector's major cost drivers, both in relation to inputs and outputs, suggest that the most plausible explanation, at least in part, for the real increase in the sector's expenditure over the last decade is a growth in output costs, including the volume, scope and quality of services supplied. Some of these services are mandated by legislation, while others are provided on a non-mandatory basis.

The Commission is of the provisional view that enhancing councils' capacity for sound decision making is likely to have a positive effect on improving their performance over time, reducing costs and enhancing efficiency and financial sustainability.

As local decision-makers, councils have a broad remit. The LG Act, for instance, makes clear that councils are expected to take a leading role in ensuring, either by direct provision or through coordination, equitable access to "public services and facilities", and to ensure that their communities and resources are developed in a "socially just and ecologically sustainable manner".⁵

In the Commission's thinking, sound decision making by councils requires a clear conception of which services are most effectively and efficiently delivered at the level of local communities.⁶ Various organisations, individuals or business provide services. Sometimes it may be appropriate for the council itself to manage the provision of the service, but councils always look for roles of others.

The services provided tend to be used by groups of people and often the benefits are greater because the facility or activity is shared. The services might be social, cultural recreational or political. The bundle of services provided at local level will be responsive to local preferences, innovative and effective. The service bundle is not based on a list fixed by a higher level of government but is an outcome of local decision making. Local governments fund their own activities by raising revenues, notably rates. They operate in a financially sustainable manner; weigh the interest of current and future generations; look to minimise costs; and seek cooperation with their neighbours, or buy from an at scale provider, when scale matters.

⁵ See section 6(b) of the Local Government Act 1999, p. 2.

⁶ The Commission has been guided by its reading of the assessment of the principle of subsidiarity presented in Drew, J and Grant, B., (2017), 'Subsidiarity: more than a principle of decentralization – a view from local government', *Publius: The Journal of Federalism*, 47(4), pp. 522-545.

Some implications of this framework are that local governments would observe the following principles:

- regularly review current service functions, and divest if the case is made for some form of cooperation or the private sector, if possible, to provide the service;
- look for options to reduce the dependency on funding from other governments, including through joint arrangements with users and/or councils (among other service providers), or methods of managing demand through pricing or other forms of rationing;
- regularly consider the options for provision including comparisons of in-house provision to contracting out in order to lower costs;
- foster the development of a variety of forms of cooperation within their areas which might have the capacity to undertake existing services or meet new demands that emerge;
- make transparent the relationships between taxpayers and recipients of funds and make users accountable for funds;
- apply mechanisms that demonstrate in a credible manner the accountability of local government elected officials and staff for their decisions and use of the funds.

Local government can be supported in these processes by operating in a legal and policy framework that is defined by a higher level of government, in which these principles are embodied, and which creates the expectation of reporting against them. Local governments themselves may regulate to establish an environment at the local level which supports the operations of the cooperative bodies in their jurisdictions.

Given councils' broad legislated remit, especially in relation to non-mandatory services, it is possible for councils to provide a wide range of services reflecting community preferences and values. As already noted, councils' expenditure has been increasing at a higher rate than underlying measures of inflation. This is true of both mandatory and non-mandatory services and is likely to be strongly influenced by decision-making at the local level.

In the case of services required by legislation, the Commission accepts that councils have no control over the ultimate decision about *what* services are mandated by legislation. However, they retain a considerable degree of local autonomy over decisions on *how* they deliver mandatory services.

Mandatory services are comparatively small in number but accounted for 46 per cent of the sector's operating expenditure in 2017-18. The Commission has formed the view that councils could achieve greater efficiency and lower costs by improving information and analysis as a basis for decisions on what services they provide and how they deliver them. Adjusting the scope, volume and quality of services, both mandatory and non-mandatory, can help councils to manage the further expansion of their operating expenditure.

The Commission's identification of cost drivers has been constrained by a lack of data, particularly with respect to outputs and quality. It has formed the provisional view, through consultation with councils, that increases in the scope, volume and quality of outputs have been a significant driver of growth in councils' operating expenditure.

The Commission notes that managing and containing this growth requires improved data on council inputs and outputs. It also requires the development of analytical tools to deepen understanding of cost drivers and manage their impacts. Council decisions on volume, scope

and standard of services, if based on quality data and robust analytical techniques, will help to clarify the trade-offs between more or better services and higher expenditures and improve transparency and accountability.

Information request 5.2: Quality and quantity of data

How can councils be assisted to work collectively to improve the quantity and quality of the available data on inputs, outputs and outcomes for services?

5.3 Efficiency and continuous improvement

5.3.1 Commission's findings

The analysis in Chapter 4 of the local government sector's efficiency and productivity, over the period 2008-09 to 2017-18, shows that technical efficiency has remained relatively constant and indicates that measured total factor productivity (TFP) fell by an average of 0.8 per cent a year.

While the Commission has been unable to determine the causal relationships that might fully explain this observation, it could be partly explained by an increase in the volume, scope or quality of services that are not measured by the outputs chosen in the model. Based on stakeholder consultations, the Commission has formed the view that the declining trend in measured efficiency could be largely attributable to the unmeasured changes in scope, quality or volume of council services provided. This conclusion is also supported by the analysis of cost drivers undertaken in Chapter 3.

In terms of the relative efficiency scores by council groups, rural and urban regional councils, when compared with their urban counterparts, had a higher variation in mean technical efficiency. Urban regional councils had the lowest estimated technical efficiency. This could reflect the fact that the group is comparatively small, with a few members that are unique in their defining characteristics.

Significantly, the Commission's estimates of partial productivity measures have highlighted the significant limitations in available data for this purpose. The Commission notes that this is particularly marked in relation to the quality and consistency of reported input and output data, both across councils and over time.

The Commission has identified some limited evidence that demonstrates an expansion of the scope or quality of services. However, quantifying these changes in service scope requires additional data, which highlights the potential value of additional work aimed at understanding the relationships between cost and service mix.

While DEA provides a useful starting point for an analysis of council efficiency, it is clearly imperfect, and the results should be interpreted with a degree of caution. DEA is therefore only a first step, albeit an important one, in analysing councils' efficiency, and further analysis is required.

This analysis also highlights the need for a standardised sector-wide performance measurement and reporting framework.

5.3.2 Councils' views

Several councils have begun, or are in the process of beginning, to compare their performance against other councils. It is also evident from councils' engagement with the inquiry, both through submissions and on the basis of consultation, that there is qualified support for the development of a performance measurement framework. In its submission, the City of Charles Sturt offers some support for a form of benchmarking, provided that the framework uses and builds on current data sources:

Data collection comes with an impost on councils. There are already a number of external data collection requirements for council in place. It would be good to build on and refine those rather than replicate.¹

The Commission notes the LGASA's view, which is supported by a number of councils, such as the City of Prospect, that much of the data on councils' performance is currently dispersed and difficult for stakeholders to access in a meaningful form. This contributes to the overall difficulty of developing performance measurement standards for councils' activities. As submissions make clear, this caveat lends some additional weight to the need to devise a form of performance monitoring that is appropriate to the sector's diversity.

A number of councils, such as the City of Salisbury and the City of Prospect, noted that any benchmarking framework would require, as a minimum, a source of consistent and reliable data. It must also have sufficient analytical flexibility to account for the differences in councils' pertinent characteristics that affect costs, efficiency and effectiveness. Councils have suggested that these differences are particularly important in relation to explaining differences in service mix, which may often arise from the diversity between council areas.

The Commission notes that this analytical concern is closely related to, but is also separable from, concerns around the comparability and quality of currently available data. These limitations, when linked with the diversity of councils' services, impose significant analytical constraints on any form of efficiency analysis across the sector as a whole.

Councils' submissions have cautioned that any form of performance measurement and analysis involves potentially significant administrative costs and could lead to the redirection of considerable resources from other activities. The submission from the SALGFMG addresses this concern in relation to the difficulty of comparing the service provision of inherently disparate councils:

Benchmarking across Councils will not improve efficiency, it takes resources away from service delivery, increases red tape and administrative overheads and is a distraction from improvement initiatives.²

In addition to the mandatory reporting requirements contained in the LG Act, individual councils have provided the Commission with examples of the benchmarking and continuous improvement activities that have been, or are currently being, undertaken.

The City of Charles Sturt, for instance, provided the Commission with a detailed overview of the benchmarking project that it is undertaking along with the City of Marion and the City of Port Adelaide Enfield.³ The Commission notes that, given the methodological and data limitations

¹ City of Charles Sturt, Submission, p.2.

² SALGFMG, Submission, p.11.

³ City of Charles Sturt, Submission, p. 13.

that affect comparisons of diverse council activities, a salient feature of the group's program is that comparisons are based on activity-level data at the function and sub-function levels:

The fact the allocations and drivers are undertaken by a common resource across the 3 entities and are performed at close to a transactional level has meant the benchmark comparisons are factual, fair and impartial. This has contributed significantly to the effectiveness of the change management program that follows to enable improvements to be made and reduces the ability for stakeholders to discredit the comparability of functions.⁴

The experience reported to the Commission suggests that these efforts can yield high returns. In particular, this group of three councils reported that, to date, they have subjected less than 10 per cent of their total spending to deep analysis, yet this has yielded resource savings of 11 to 22 per cent. Were this ratio to apply to all spending across the sector, then the estimated benefit could be substantial (for further details on the joint performance improvement project, see appendix 8).

5.3.3 Commission's view

The Commission notes that recent reforms in the local government sector have focussed on shaping the relationship between state and local government and lifting the financial sustainability of the sector.

Moreover, there is considerable evidence to suggest that the financial management reforms initiated by the sector have contributed significantly to strengthening the financial performance of councils.

Conversely, the Commission has found little evidence to date on significant reforms in other areas, especially in relation to management and workplace practices, at least in recent years. It is possible that individual councils might have undertaken reforms in these areas, but the Commission has been unable to find significant information on reform projects initiated within the sector.

The Commission is aware that a number of councils have sought to utilise, with varying levels of measurable success, a variety of collaborative initiatives aimed at, amongst other things, lowering costs or improving efficiency often in the area of resource sharing. However, the available evidence is insufficient to enable the Commission to quantify the outcomes, cost and efficiency impacts of these initiatives.

The Commission is seeking further information on the opportunities and challenges associated with resource sharing.

The findings of the efficiency analysis now point to the need for concerted and consistent sector-wide efforts to measure and improve performance. While most councils engage in some form of performance monitoring at the council level, there is no sector-wide framework to support rigorous and consistent comparisons or monitoring of productivity or efficiency over time.

The Commission notes that performance monitoring initiatives, such as the joint project being undertaken by the cities of Marion, Charles Sturt and Port Adelaide Enfield, will necessarily place greater demands on councils' resources, including existing databases, reporting systems

⁴ Ibid., p. 13.

and workforce skill sets. Any expansion of performance monitoring, especially on a sector-wide basis, will therefore require councils to develop their workforces' abilities to manage data collection and analysis. The investment in staff skills will also require a matching upgrade of the systems needed to support larger-scale data analytics.

The Commission's analysis of partial productivity and global efficiency measures highlighted the importance of an appropriate framework and consistent data to facilitate sector-wide benchmarking. It also highlighted the value of collaborative efforts to identify continuous improvement opportunities, as well as the importance of council input into the design of a suitable framework and choice of indicators.

The Commission is of the view that an analysis of council efficiency and productivity is an important starting point in improving business processes and management decisions aimed at lifting efficiency across the local government sector. Access to timely, reliable and comparable information on council performance can provide the basis for the development of continuous improvement programs at the council level.

Current SALGGC data is not adequate for performance measurement or benchmarking, but a significant investment has been made by state and local governments in its development. It could provide the basis for an improved local government sector data-set for performance measurement and monitoring. The quality and consistency of council reporting to the SALGGC would need to be improved. State government leadership is required to improve the value of the data that it requires councils to provide to the SALGGC. Action to define, measure and collect data on service levels is critical to understanding unit costs and efficiency. Improved output data is also needed.

The Commission has formed the view that all councils can benefit from benchmarking activity. Good data alone, however, will not drive better outcomes. An improvement in data is a necessary, but not a sufficient, condition for the successful implementation of change. Individual councils are unlikely to consider the benefits for the sector as a whole that will arise from their individual efforts, and the Commission believes that this strengthens the case for state government support for the development of a benchmarking program.

Any measurable sector-wide improvement in efficiency in the short to medium term is highly unlikely to succeed if it relies on optional or voluntary initiatives alone. State government action could contribute to addressing critical information gaps and ensuring the adoption of standardised approaches, that provide the basis for performance comparisons to drive change. Leadership, collaboration and a culture that supports innovation are also required. The Commission also recognises the importance of minimising increases in costs to councils associated with any increase in reporting requirements.

5.4 Governance, accountability and transparency

5.4.1 Commission's findings

The Commission's examination of the legislative and governance framework within which councils currently operate, largely undertaken in Chapter 2, indicates that South Australian councils, when compared to some of their interstate counterparts, exercise a comparatively high degree of autonomy in relation to decisions about the appropriate service mix for their communities and its form of delivery. The state government's legislative reforms had the effect of increasing autonomy, combined with strengthening governance and transparency, with an

expectation, articulated in section 8 of the LG Act, that councils would take responsibility for managing their activities in an efficient manner.

The relative autonomy of councils in relation to oversight by the state government, along with the broad powers and functions assigned to the local government sector, is a fundamental feature of the LG Act, especially in the provisions, contained in sections 7 and 8, that define councils' functions and the principles that must inform their decision-making.

The Commission notes that the very general nature in which councils' functions are defined in the act has helped to enable an expansion in the non-mandatory services provided by councils. While the LG Act did not cause the current mix of non-mandatory services – with councils' current service mix a consequence of a number of complex causes, including community preferences – the legislative and governance environment has a potentially significantly effect on costs and efficiency in the sector by increasing the scope of non-mandatory services.

The Commission has also found evidence that councils' decision-making processes, especially in relation to changes in the mix, scope and standards of their services, are not always articulated clearly by councils or communicated to ratepayers. This could adversely affect councils' capacity to justify a decision to withdraw from, or contain the expansion of, non-mandatory services.

On the basis of the available evidence, that reforms initiated by the local government sector have focussed predominantly on efforts to ensure councils' financial sustainability.

5.4.2 Councils' views

In their submissions to the Commission, a number of councils have highlighted the fact that the state's legislative and governance environment, while granting local government considerable autonomy, has also facilitated a generally unfunded transfer of regulatory and service responsibilities by both the State and Australian governments.

Some councils, such as Campbelltown City Council, have argued that councils' costs and responsibilities have increased substantially as a direct result of legislation assigning responsibilities to the sector, including statutory fees and charges that are set by the state government, but which do not always cover councils' costs.⁵ Councils have consistently argued that many of the responsibilities transferred or assigned under legislation involve a form of cost shifting.

Several councils have contended that the LG Act, particularly the principles enumerated in section 8, place an obligation on councils to be responsive to community needs and expectations beyond considerations of efficiency and subsidiarity. The City of Salisbury, for instance, argues that section 8 demands a focus on ensuring that councils are meeting the expectations of their communities, both in terms of the scope and quality of service delivery:

Proper consideration of these principles requires broader thinking as well as innovative approaches that add greater value when delivering council services to a standard that at least meets community expectations, rather than focussing solely on efficiency and effectiveness.⁶

⁵ Campbelltown City Council, Submission, p.2.

⁶ City of Salisbury, Submission, p. 4.

Apart from the potentially rivalrous nature of community expectations and technical efficiency, the Commission notes councils' concerns that the current legislative and governance arrangements are frequently affected by an imprecise division of responsibilities between the state and local levels of government.

The current legislative framework does not always provide clear or sufficient guidance on the respective responsibilities of the two spheres of government, especially where functions or responsibilities might overlap. As the City of Charles Sturt observes in its submission, "Unfortunately without clear roles defined in the *Local Government Act 1999* for local government, much cost shifting occurs with associated impact on costs to Council".⁷

5.4.3 Commission's view

South Australia's legislative framework, particularly the LG Act itself, not only recognises local government as a separate and legitimate sphere of government in its own right, but also provides councils with a high degree of autonomy to act as decision makers in their communities. The quality of councils' decision-making will therefore have a significant effect on the service mix that councils provide in their communities. This is especially important in relation to non-mandatory services, where councils' discretionary authority is greatest, but is also important when councils consider the scope and quality of service provision for mandatory services.

The Commission acknowledges the important role that councils play as decision makers in relation to services that can be provided at a local scale and at least cost. Similarly, communities have legitimate preferences in relation to the most locally appropriate service mix, including in relation to scale and quality. These preferences are more easily determined and addressed at the local level, as envisaged by the LG Act.

Councils' capacity to exercise autonomy in making decisions in the best interests of their communities, however, can be affected by a variety of forms of 'cost shifting' by other levels of government. The Commission notes that the LG Act can facilitate 'cost shifting' by requiring that councils "...undertake other functions and activities conferred by or under an Act". The Commission is aware that councils have repeatedly emphasised the adverse effects on their overall costs of functions and services required under other state legislation. Submissions received by the Commission generally argue that this amounts to a form of cost shifting, where the higher level of government 'shifts' responsibility for service delivery without commensurate funding to councils.

The Commission has concluded that 'cost shifting' is an accurate description of situations where the higher level of government removes or reduces a previously agreed cost sharing arrangement. This can leave councils with service delivery or regulatory responsibilities without sufficient funding to cover the ongoing costs of delivering the function. However, the Commission has also formed the view that, in some situations, especially when local government has accepted tied and time-limited funding, 'cost sharing' is a more appropriate description of the division of delivery and funding responsibilities.

While mindful of the complex nature of service delivery responsibility, the Commission believes that councils' decision making could become more effective. As already noted, councils' legitimate authority as decision makers, as outlined in the LG Act, imposes a corresponding

⁷ City of Charles Sturt, Submission, p. 8.

responsibility to make decisions that take seriously the distinction between mandatory services and non-mandatory services.

The Commission has formed the view that the functions undertaken by councils should, in general, be guided by the principle of subsidiarity which holds that lead responsibility should be devolved to the lowest level of government practicable, allowing for the significant diversity of the state's 68 councils.

A clear and consistent division of responsibilities between state and local governments is fundamental to the efficient allocation of resources between them. This, and legislative clarity regarding mandatory service provision by councils, would assist council understanding of the boundaries around their autonomy and would provide a stronger foundation for council decision making and resource management.

This also provides a basis for resolving any debates about cost-shifting. Councils should then have a solid basis on which to engage more effectively with their communities regarding their plans and performance with respect to the scope and quality of facilities and services and the use of any dividends from efficiency improvements.

The Commission's consideration of options for containing cost growth and improving efficiency have led it to consider the alternatives of the state government imposing mandated requirements on the sector as against promoting voluntary action by councils. The Commission seeks views from stakeholders on these alternative approaches to the use of external audits.

Information request 5.3: Strengthening councils' accountability and transparency

How can the South Australian Government strengthen the accountability and transparency of councils? Possible instruments include:

- funding;
- legislation and monitoring of implementation through audits of the processes of local government decision making; and
- an agreement with councils and regular dialogue to reinforce the expectation that councils will conduct audits of the processes of local government decision making.

Should councils be required to undertake an independent external audit of their expenditure and efficiency in the event of that they record relatively high operating expenditure growth in a given period?

Would growth in operating expenditure over any three year period (normalised for population growth) which exceeds the rise in the Local Government Price Index for that period be an appropriate trigger for such an audit?

Draft recommendations to South Australian Government

To lower local government costs and enhance local government financial accountability, the Commission proposes that the South Australian Government:

1. Lift the capacity of *local councils to identify and address opportunities to reduce their cost base and improve their operations* by:

In conjunction with local government, defining and establishing a sector wide performance monitoring framework that would enable comparisons between councils and over time to assist decision making by council leaders and to inform communities, including by:

 - i. Establishing common key performance indicators (KPIs) for inputs, outputs, service standard and financial indicators;
 - ii. Optimising existing information held by the South Australian Government, especially that gathered by the South Australian Local Government Grants Commission;
 - iii. Filling the gaps in the current information;
 - iv. Publishing this information in a contextualised form designed to assist individual councils.
2. Facilitating benchmarking by clusters of councils through an appropriate mix of incentives for councils to participate and expectations that they will report information publicly in a format consistent with the framework.
3. Further lower council costs by addressing aspects of the relationship between the South Australian Government and local government by:

In the short term

- i. Identifying and addressing inefficiency and red tape from the South Australian Government mandated services and other legislated requirements on:
 - a. Councils
 - b. communities
- ii. Adopting a strong South Australian Government review process for any measures affecting local government;
- iii. Clarifying local government responsibilities, including service standards, for mandated services.

In the medium term

- iv. Clarifying the respective responsibilities of the South Australian and local governments to remove unnecessary overlaps, or duplication and reduce uncertainty between governments.

In the long term

- v. Clarifying relevant aspects of s6, s7 and s8 of the *Local Government Act 1999* to reflect an appropriate division between the levels of government and to make clearer the range of options available to councils in the performance of legislated functions.

Draft advice to councils

To guide and assist councils to improve efficiency and to create capacity to pass on cost reductions to rate payers, the Commission suggests that local government:

- 1 As a body, facilitate in depth benchmarking between councils by:
 - a) Establishing a Community of Practice, sponsored by the Local Government Association, to share among other elements:
 - i. methods, tools and approaches;
 - ii. a panel of competent providers; and
 - iii. lessons learned and examples of success.
 - b) Assisting in “matchmaking” South Australian councils that seek deeper benchmarking opportunities (noting value of groups of councils at different levels) with other councils, including interstate comparisons;
 - c) Collectively undertaking a regular sector-wide analysis of efficiency measures.
- 2 Prioritise, in any systems upgrades, a focus on improving collection and retrieval of information for planning, monitoring and managing performance.
- 3 Enhance the transparency and accountability of their operations by councils:
 - a) When considering new, or material changes to, council services, undertaking an independent analysis that includes consideration of alternatives to councils providing the service directly, community consultation; and publishing a report;
 - b) Including in their external audits an examination of service reviews and program evaluations; and
 - c) Incorporating in their published long-term asset and financial plans and draft annual budgets whether changes to the scope or level of services are planned and their implications for council expenditure.

Appendices

Appendix 1. Submissions to the Methodology Paper

Organisation	
1	Campbelltown City Council
2	City of Adelaide
3	City of Charles Sturt
4	City of Mitcham
5	City of Prospect
6	City of Salisbury
7	City of Tea Tree Gully
8	City of West Torrens
9	Copper Coast Council - includes Appendices 1 to 2 Copper Coast Council - includes Appendices 3 to 4
10	Councillor Martin Bray
11	Councillor Ruth Trigg
12	Councillor Ruth Trigg - Supplementary
13	HomeStart Finance
14	Limestone Coast LGA
15	Local Government Association
16	Local Government Association - Supplementary
17	Martin Morris
18	Playford Council
19	SALGFMG
20	Tatiara District Council
21	Town of Gawler
22	Town of Walkerville
23	Town of Walkerville - Supplementary
24	Winni Pelz

Appendix 2: Local Government Reference Group Terms of Reference

As part of the inquiry and the systematic approach to engagement the commission has established a reference group which will assist the SAPC by providing:

- relevant data and information;
- expert advice, insights and understanding about the drivers of productivity and efficiency in the South Australian local government sector;
- feedback on the commission's analysis and possible improvement options: and
- advice on communicating with stakeholders.

The group will last for the duration of the inquiry and have an advisory status only. Meetings will be chaired by the Commission. The meeting agenda will be distributed to members and meeting notes will be circulated to members of the group following each meeting.

The Local Government reference group comprises:

Dr Helen MacDonald, Chief Executive Officer, Clare and Gilbert Valley Council

Ms Annette Martin, Manager Financial Services, City of Charles Sturt

Mr John Comrie, Consultant

Ms Natasha Cheshire, Director, ESCOSA

Mr Matt Pinnegar, Chief Executive Officer, Local Government Association

Mr Peter Ilee, Executive Officer, Local Government Grants Commission

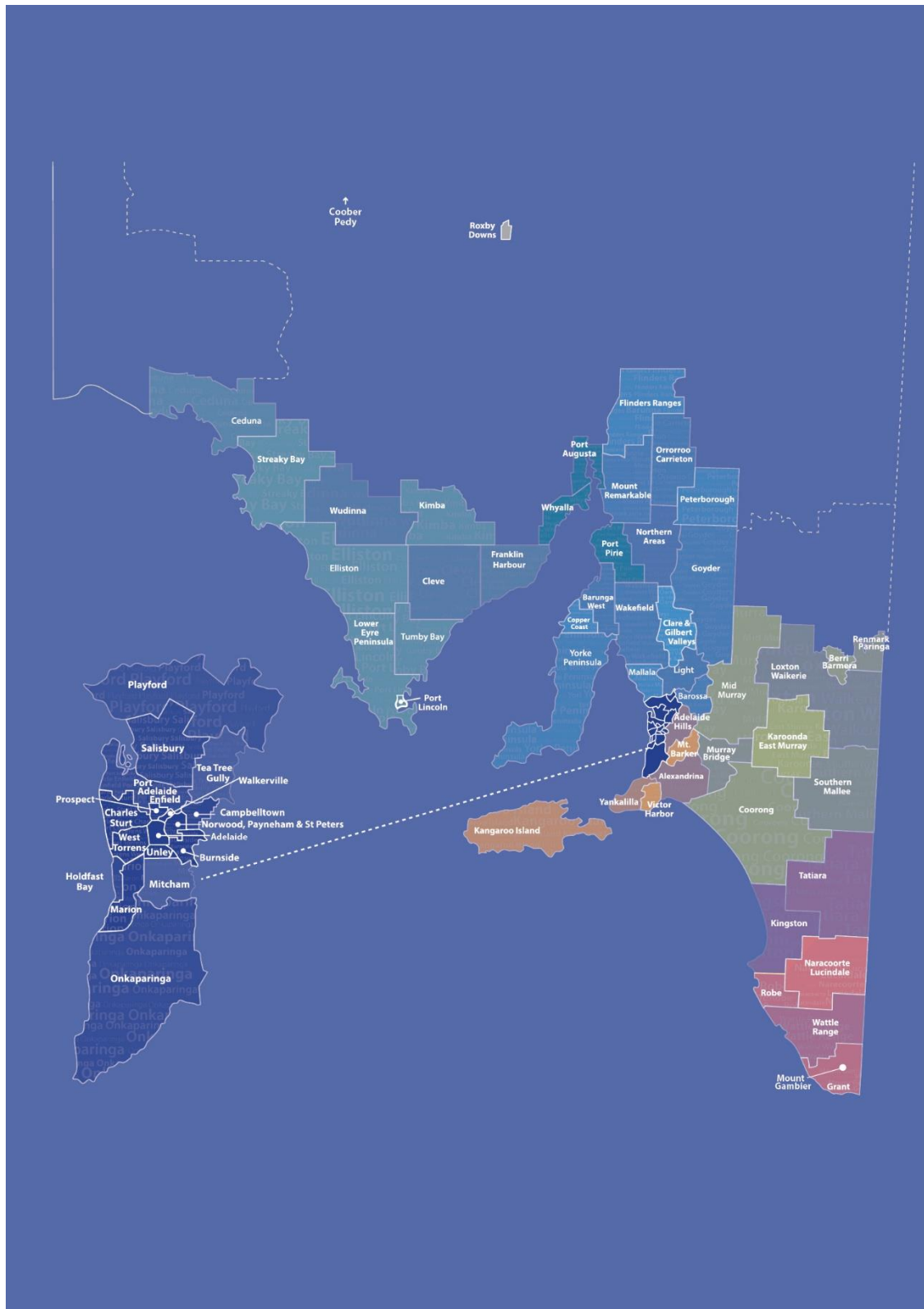
Mr Adrian Skull, Chief Executive Officer, City of Marion

Dr Matthew Butlin, Chair SAPC

Mr Jeff Tate, Commissioner SAPC

Professor Christopher Findlay, Commissioner SAPC

Appendix 3: Map of councils and SA Government regions



Source: Local Government Association of South Australia

Appendix 4: List of mandatory and non-mandatory activities

Community Services Community Centres and Halls * Libraries ✖ * Home Library Services * Literacy Programs * Community transport (passenger networks)* Town Bus Service ✖* Aged care home support and facilities * Services for the Aged and Disabled ✖* Food Business Health Inspections ^ Cooling Tower Inspections □ Management of Hoarding and Squalor * Environmental Protection Control □ Shaded recreational areas * Public Health and Community Wellbeing * Heritage Advisory Service * Heritage Assessment □ Museums and art galleries * Other arts and culture programs * Heat refuges * Migrant resource centres * Busking permits* Community IT Programs * Youth outreach services * Volunteers programs * Immunisation – Infants and Youth ✖* Disability services*	Art gallery services and programs *	Control of soil erosion * Land reclamation and conservation *	Telecommunications networks *	Visitor centres ✖ *
	Cultural development *	Landcare programs ✖*	Bus shelters *	Markets /Saleyards *
	Child care centres ✖* Worksite Immunisations *	Agriculture pest control *	Jetties ^ *	Emergency Management Fire Prevention Enforcement □ Emergency Management □
	Children and youth services * Holiday programs for youth * Family and neighbourhood support *	Street cleaning *	Marine facilities ✖ * Sports facilities – indoor ✖*	
	Infrastructure Road construction and maintenance □ ✖	Car parking - off street *	Sports facilities – outdoor ✖*	
			Swimming centres ✖*	Public order and safety *
	Community networks *	Street scaping *	Building control □ Town planning □	Climate Adaptation Planning ✖* Coastal Risk Management Planning ✖*
	Victims of domestic violence support* Cemeteries/Crematoria □*	Street lighting *	Public toilets *	Community Events Citizenship ceremonies *
	Drug action teams * Health Risk from hoarding and squalor □	Heritage protection □ Footpath Construction and maintenance *	Parks and Gardens Caravan Parks / Tourist accommodation *	
	Environmental Services Rubbish collection □ Recycling Metro □	Playground Construction & Maintenance *		Irrigation * Landscaping and Management *
Recycling Regional * Green waste – Metro councils □ Green waste – Regional councils * Hard Rubbish Collection *		Community wastewater management □ ^ Water supply – domestic * Electricity supply undertakings *	Street Tree Program * Public Reserves – Maintenance *	Australia Day events *
Waste disposal facilities □ *	Pedestrian malls *	Street Beautification *	Christmas Decorations *	
Coastal protection □ Stormwater and drainage □	Drinking fountains *	Economic Development Regional development ✖* Support to local businesses ✖* Employment creation programs *	Christmas Parades *	
Flood mitigation □ Noise and nuisance controls □ Dog management and control □	Public clocks *		Carols by Candlelight *	
Cat management and control *	Street furniture *	Finance Rate Postponement for seniors □ Rate postponement for others *	Event Support * Sponsorship and grants *	
	Bicycle racks * Development assessment □ Bicycle path construction and maintenance*		Legend □ – Required by legislation/regulation ^ – MOU or agreement ✖ – Receives Funding * – non-mandatory activities	
	Graffiti removal *	Youth work experience *		
	Drainage Maintenance □ Private works *	Youth traineeships ^ ✖ Tourism and regional promotion ✖*		

Legend

□ – Required by legislation/regulation
^ – MOU or agreement
✖ – Receives Funding
* – non-mandatory activities

Source: LGA of SA ECM 65110 2017 – Council Service List

Appendix 5: Summary of SALGGC data sets used

Statistical and general information (Database Report 1); for example:

- *size of council area*
- *population (resident)*
- *employees*
- *road lengths (various categories)*
- *rateable properties (total number)*
- *capital value of properties*

Operating income **information** (Database Report 2 and Report 10); for example:

- *general rates and other rates collected*
- *late payment charges etc*
- *rebates, remissions and write-offs*
- *statutory charges*
- *user charges*
- *grants, subsidies and contributions*
- *investment income*
- *Joint venture profits*

Operating income information is further broken down (in Report 10) on a functional basis.

Operating expenditure information (Database Report 3); for example:

- *employee costs*
- *material, contracts, and other expenses*
- *finance costs*
- *depreciation and other charges*
- *Joint venture losses*

Operating expenditure information is further broken down (in Report 9) on a functional basis.

Physical asset and associated capital expenditure information (Database Report 4); for example:

- *expenditure on renewal/replacement of existing assets*
- *expenditure on new/upgraded assets*
- *amounts received for new/upgraded assets*
- *proceeds from sale of replaced assets*
- *proceeds from sale of surplus assets*

Summary statement of financial position statutory accounting information (Database Report 5) and **net financial liabilities** information (Database Report 7)

Council rates and rating information (Database Report 6); for example

- *total rates*
- *rateable residential properties (number)*
- *minimum rate*
- *rates as a proportion of total operating income*
- *total residential rates (including on a per property basis)*
- *rating basis*
- *fixed charge declared*
- *percentage of general rates raised by fixed charge*
- *total rate income change from previous year*

Financial ratio information (Database Report 8); for example

- *operating surplus ratio*
- *net financial liabilities ratios*
- *adjusted operating surplus ratio*
- *adjusted net financial liabilities ratio*

Table 14 Summary of activities provided by councils by SALGGC service area

Service area	Types of activities	
Business Undertakings	Caravan/tourist accommodation Real estate development Car parking – on street controlled Car parking – fee paying Community Waste Water Management Domestic Water Supply	Town Bus Service Gravel Pits/Quarries Markets/Saleyards Private works Investment Property Electricity
Public Order & Safety	Emergency Services & fire prevention Beach inspections and patrols; Surf life saving	Crime prevention Road safety/driving schools General Inspectors
Health Services	Immunisations Nursing Homes Support for home nursing Community health and dental clinics	Family planning CAFHS/CAMHS Housing for health workers
Community Support	Community Centres & Halls Child Care Centres Community Transport Services for Aged and Disabled; Children and Youth Services; Family & Neighbourhood support Grants, donations or 'in-kind' assistance to persons and community welfare groups	Assistance for homeless people Aboriginal welfare programmes Immigrants/refugees Disaster relief Suicide prevention programs Community Halls/centres used by welfare groups
Community Amenities	Cemeteries/Crematoria Telecommunications Networks; Public Conveniences Street furniture Bicycle racks	Pedestrian Malls Drinking fountains Public clocks Bus shelters Municipal directories Free off-street parking
Library Services	Static Libraries Mobile Libraries	Housebound services
Cultural Services	Performing Arts Museums & Art Galleries Heritage	festivals/concerts/artist/writers; Flora and Fauna parks Zoos; Botanical Gardens
Economic Activity	Employment Creation Programs Support for Local Businesses	Regional Development Tourism and regional promotion
Agricultural Services	Agriculture water Agriculture pest control	Agriculture Land
Waste Management	Ordinary solid waste collection & disposal Recycling collection and disposal; Green waste	Street bins; Public area bins Hard rubbish collection Drum Muster; Chemicals and paint collection

Service area	Types of activities	
	collection and disposal Waste disposal facilities	Purchase and sale of wheelie bins
Other Environment	Coastal Protection Street Cleaning Streetscaping Stormwater & Drainage Street Lighting	Flood mitigation works Riverbank environment protection; Non-agricultural land programmes; Water conservation programmes
Recreation	Jetties; Parks & Gardens Sports Facilities	Marine Facilities Swimming Centres
Regulatory Services	Dog & Cat Control; Town planning; Environmental Protection Control	Building Control Health Inspection
Transport	Aerodromes Footpaths & Kerbing Roads	Bridges & Culverts Traffic Management Wager Transport

Source: LGASA (2019) Analysis of Council Data -South Australia – Part 2 – Services.

Appendix 6: Local government groupings

Step 1	Step 2	Step 3	Identifiers	Category
URBAN (U)				
Population more than 20 000	CAPITAL CITY (CC)	Not applicable		UCC
OR	METROPOLITAN DEVELOPED (D)	SMALL	up to 30 000	UDS
If population less than 20 000,	Part of an urban centre of more than 1 000 000 or population density more than 600 per square kilometre	MEDIUM	30 001–70 000	UDM
EITHER		LARGE (L)	70 001–120 000	UDL
Population density more than 30 persons per square kilometre		VERY LARGE (V)	more than 120 000	UDV
OR	REGIONAL TOWNS/CITY (R)	SMALL	up to 30 000	URS
90 per cent or more of the local governing body population is urban	Part of an urban centre with population less than 1 000 000 and predominantly urban in nature	MEDIUM	30 001–70 000	URM
		LARGE (L)	70 001–120 000	URL
		VERY LARGE (V)	more than 120 000	URV
	FRINGE (F)	SMALL	up to 30 000	UFS
	A developing LGA on the margin of a developed or regional urban centre	MEDIUM	30 001–70 000	UFM
		LARGE (L)	70 001–120 000	UFL
		VERY LARGE (V)	more than 120 000	UFV
RURAL (R)				
A local governing body with population less than 20,000	SIGNIFICANT GROWTH (SG)	Not applicable		RSG
AND	Average annual population growth more than three per cent, population more than 5000 and not remote			
Population density less than 30 persons per square kilometre	AGRICULTURAL (A)	SMALL	up to 2000	RAS
AND		MEDIUM	2001–5000	RAM
Less than 90 per cent of local governing body population is urban		LARGE (L)	5001–10 000	RAL
		VERY LARGE (V)	10 001–20 000	RAV
	REMOTE	EXTRA SMALL (X)	up to 400	RTX
		SMALL	401–1000	RTS
		MEDIUM	1001–3000	RTM
		LARGE (L)	3001–20 000	RTL

Source: Department of Infrastructure and Regional Development (2015), *Local Government National Report, 2012-13*, Canberra

Rural – Small and medium: 20 councils

Council Name	Group	ACLG	Other Association	Regional grouping
Barunga West	Rural-Small & Medium	RAM	Legatus Group	Yorke Peninsula
Ceduna	Rural-Small & Medium	RAM	Eyre Peninsula LGA	Eyre
Cleve	Rural-Small & Medium	RAS	Eyre Peninsula LGA	Eyre
Elliston	Rural-Small & Medium	RAS	Eyre Peninsula LGA	Eyre
Flinders Ranges	Rural-Small & Medium	RAS	Legatus Group	Far North
Franklin Harbour	Rural-Small & Medium	RAS	Eyre Peninsula LGA	Eyre
Goyder	Rural-Small & Medium	RAM	Legatus Group	Mid-North
Kangaroo Island	Rural-Small & Medium	RAM	Southern & Hills LGA	Fleurieu
Karoonda East Murray	Rural-Small & Medium	RAS	Murraylands & Riverlands LGA	Murraylands
Kimba	Rural-Small & Medium	RAS	Eyre Peninsula LGA	Eyre
Kingston	Rural-Small & Medium	RAM	Limestone Coast LGA	South East
Mount Remarkable	Rural-Small & Medium	RAM	Legatus Group	Mid-North
Northern Areas	Rural-Small & Medium	RAM	Legatus Group	Mid-North
Orroroo Carrieton	Rural-Small & Medium	RAS	Legatus Group	Mid-North
Peterborough	Rural-Small & Medium	RAS	Legatus Group	Mid-North
Robe	Rural-Small & Medium	RAS	Limestone Coast LGA	South East
Southern Mallee	Rural-Small & Medium	RAM	Murraylands & Riverlands LGA	Murraylands
Streaky Bay	Rural-Small & Medium	RAM	Eyre Peninsula LGA	Eyre
Tumby Bay	Rural-Small & Medium	RAM	Eyre Peninsula LGA	Eyre
Wudinna	Rural-Small & Medium	RAS	Eyre Peninsula LGA	Eyre

Rural – Large and very large: 18 councils

Council Name	Group	ACLG	Other Association	Regional grouping
Adelaide Plains	Rural-Large & Very Large	RAL	Legatus Group	Barossa Light and Lower North
Berri Barmera	Rural-Large & Very Large	RAV	Murraylands & Riverlands LGA	Riverlands
Clare & Gilbert Valleys	Rural-Large & Very Large	RAL	Legatus Group	Mid-North
Coorong	Rural-Large & Very Large	RAL	Murraylands & Riverlands LGA	Murraylands
Copper Coast	Rural-Large & Very Large	RAV	Legatus Group	Yorke Peninsula
Grant	Rural-Large & Very Large	RAL	Limestone Coast LGA	South East
Light	Rural-Large & Very Large	RAV	Legatus Group	Barossa Light and Lower North
Lower Eyre Peninsula	Rural-Large & Very Large	RAL	Eyre Peninsula LGA	Eyre
Loxton Waikerie	Rural-Large & Very Large	RAV	Murraylands & Riverlands LGA	Riverlands
Mid Murray	Rural-Large & Very Large	RAL	Murraylands & Riverlands LGA	Murraylands
Naracoorte Lucindale	Rural-Large & Very Large	RAL	Limestone Coast LGA	South East
Port Pirie	Rural-Large & Very Large	RAV	Legatus Group	Mid-North
Renmark Paringa	Rural-Large & Very Large	RAL	Murraylands & Riverlands LGA	Riverlands
Tatiara	Rural-Large & Very Large	RAL	Limestone Coast LGA	South East
Wakefield	Rural-Large & Very Large	RAL	Legatus Group	Mid-North
Wattle Range	Rural-Large & Very Large	RAV	Limestone Coast LGA	South East
Yankalilla	Rural-Large & Very Large	RSG	Southern & Hills LGA	Fleurieu
Yorke Peninsula	Rural-Large & Very Large	RAV	Legatus Group	Yorke Peninsula

Urban – Metropolitan & fringe: 21 councils

Council Name	Group	ACLG	Other Association	Regional grouping
Adelaide	Urban-Metro	UCC	n/a	Capital City
Adelaide Hills	Urban-Metro	UFM	Southern & Hills LGA	Adelaide Hills
Alexandrina	Urban-Metro	UFS	Southern & Hills LGA	Fleurieu
Barossa	Urban-Metro	UFS	Legatus Group	Barossa Light and Lower North
Burnside	Urban-Metro	UDM	Eastern Region Alliance	Eastern Adelaide
Campbelltown	Urban-Metro	UDM	Eastern Region Alliance	Eastern Adelaide
Charles Sturt	Urban-Metro	UDL	n/a	Western Adelaide
Gawler	Urban-Metro	UFS	n/a	Barossa Light and Lower North
Holdfast Bay	Urban-Metro	UDM	n/a	Southern Adelaide
Marion	Urban-Metro	UDL	n/a	Southern Adelaide
Mitcham	Urban-Metro	UDM	n/a	Southern Adelaide
Norwood, Payneham & St Peters	Urban-Metro	UDM	Eastern Region Alliance	Eastern Adelaide
Onkaparinga	Urban-Metro	UFV	n/a	Southern Adelaide
Playford	Urban-Metro	UFL	n/a	Northern Adelaide
Port Adelaide Enfield	Urban-Metro	UDV	n/a	Western Adelaide
Prospect	Urban-Metro	UDS	Eastern Region Alliance	Eastern Adelaide
Salisbury	Urban-Metro	UDV	n/a	Northern Adelaide
Tea Tree Gully	Urban-Metro	UDL	Eastern Region Alliance	Northern Adelaide
Unley	Urban-Metro	UDM	Eastern Region Alliance	Eastern Adelaide
Walkerville	Urban-Metro	UDS	Eastern Region Alliance	Eastern Adelaide
West Torrens	Urban-Metro	UDM	n/a	Western Adelaide

Urban – Regional towns/cities: 9 councils

Council Name	Group	ACLG	Other Association	Regional grouping
Coober Pedy	Urban – Regional	URS	n/a	Far North
Mount Barker	Urban – Regional	URM	Southern & Hills LGA	Adelaide Hills
Mount Gambier	Urban – Regional	URS	Limestone Coast LGA	South East
Murray Bridge	Urban – Regional	URS	Murraylands & Riverlands LGA	Murraylands
Port Augusta	Urban – Regional	URS	Upper Spencer Gulf Common Purpose Group	Far North
Port Lincoln	Urban – Regional	URS	Eyre Peninsula LGA	Eyre
Roxby Downs	Urban – Regional	URS	n/a	Far North
Victor Harbor	Urban – Regional	URS	Southern & Hills LGA	Fleurieu
Whyalla	Urban – Regional	URS	Eyre Peninsula LGA Upper Spencer Gulf Common Purpose Group	Eyre

Numbers of councils by geographic category

Type	Geographic category	Number
Urban – Metro & Fringe	Capital City	1
Urban – Metro & Fringe	Metropolitan Developed (suburban)	14
Urban – Metro & Fringe	Metropolitan Fringe (developing)	6
Urban – Regional	Non-metropolitan regional urban centre	9
Rural	Eyre Peninsula	9
Rural	Legatus Group	14
Rural	Limestone Coast	6
Rural	Murraylands and Riverlands	7
Rural	Southern and Hills	2
Total		68

Appendix 7: Estimation of global efficiency measures

Data Envelopment Analysis (DEA)

DEA is the most commonly used methodology in measuring the relative efficiency of local councils in Australia. This approach does not require assumptions regarding the relationship between inputs and outputs. It uses a technique known as linear programming to construct an 'efficiency frontier' (comprising of councils that convert inputs into outputs most efficiently), and then estimates the relative efficiency of councils based on the distance from the frontier.

The results from the DEA estimation can be further analysed to examine the effect of external factors and council characteristics on estimated council efficiency.

Questions that can be answered using DEA¹:

- How to select an appropriate role model to serve as a benchmark for performance improvement?
- What are the most efficient councils within a local government area?
- What are the characteristics of efficient councils?

Advantages of using DEA in analysing local government performance are that it:

- provides the observed efficiencies of individual councils, which helps in benchmarking against performance targets;
- identifies possible peers or role models, which also helps in benchmarking;
- readily incorporates multiple inputs and outputs using information on output and input quantities.
- does not require price data – this makes it particularly useful in analysing efficiency in government service providers (such as councils), where it may be difficult to assign prices to inputs and outputs;
- provides a way of identifying possible sources of inefficiency as well as levels of efficiency;
- provides simple efficiency scores that are easy to interpret and understand;
- does not require an assumption regarding the relationship between inputs and outputs (as is required in the use of the SFA approach); and
- allows for different assumptions regarding economies of scale (see Box 1).

The literature discusses several limitations of DEA including the following:

- DEA measures efficiency relative to best practice with the given sample – therefore, it is not meaningful to compare across groups outside the sample;
- efficiency scores are sensitive to input and output specification and the size of the sample.

The Commission acknowledges the limitations of DEA, particularly within the context of a policy framework. However, it is useful in providing a broad understanding of the relative efficiency of councils and is the most widely used methodology in local government efficiency analysis, including by the Essential Services Commission of Victoria (ESC 2017).

¹ Steering Committee for the Review of Commonwealth/State Service Provision (1997)

Stochastic Frontier Analysis (SFA)

An alternative to DEA efficiency estimation is Stochastic Frontier Analysis (SFA). The concepts are similar, however SFA is a parametric method for estimating the production frontier, first proposed by Aigner, Lovel and Schmidt (1977) and Meeusen and Ben den Broeck (1977).

Under SFA, rather than the production frontier being a series of straight lines between the most efficient firms, the production frontier can be represented mathematically as a function of the inputs used by councils.

The main advantage of SFA is its parametric nature, which means that it is less sensitive to outliers or measurement issues with the data. It is also simple to obtain measures of reliability for estimates such as standard errors, making it relatively easy to conduct statistical inference using confidence intervals and hypothesis testing.

However, SFA has several disadvantages including the need to assume the form of the production function (typically Cobb-Douglas, however there are several alternatives), and the results can be sensitive to the choice of function. In addition, results can be unreliable in small samples and estimation of models with multiple-inputs and multiple-outputs can be problematic.

Because of these factors, SFA is usually preferred to DEA when a single measure of output is available (such as GDP when measuring total factor productivity of economies), and DEA is usually preferred for multi-input, multi-output models. Most economic studies of local government efficiency have applied DEA for these reasons.

Further considerations

Regardless of the choice of DEA or SFA methodology, a few additional considerations need to be made about the nature of local government production, and as a result, their efficiency. This includes whether local governments face constant or variable returns to scale, and whether they seek to maximise their output or to produce a certain level of output for the minimum amount of inputs.

Returns to scale

The shape of the production frontier depends on the scale assumptions that underpin the model. There are two scale assumptions generally used: constant returns to scale (CRS), and variable returns to scale (VRS).

Given that councils have little control over the scale of their operations, it is preferred to estimate a VRS frontier. This will ensure that councils that are 'scale inefficient', either smaller or larger than the point of optimum scale, are not unfairly labelled as inefficient due to their size.

However, the Commission's analysis also includes estimating the CRS frontier to allow for investigation of the extent to which council size might affect their efficiency.

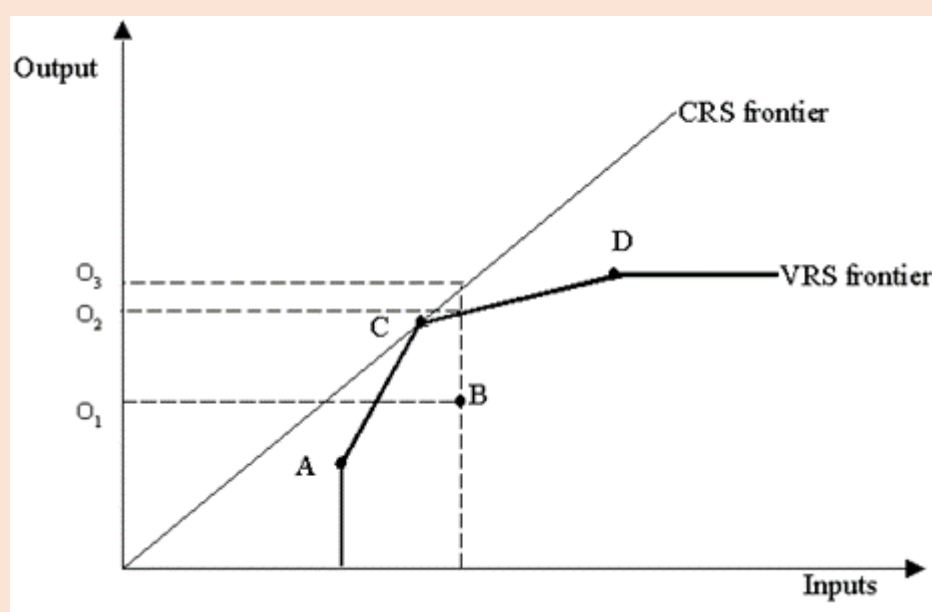
Box 1 Returns to scale

Constant Returns to Scale (CRS) and Variable Returns to Scale (VRS) frontiers

CRS assumes that output will change in the same proportion as the proportionate change in inputs (e.g. a doubling of all inputs will double output). It evaluates inefficient councils against any peer on the frontier (regardless of size).

VRS takes into account the fact that production technology may exhibit increasing, constant and decreasing returns to scale. The effect of the scale assumption on the efficiency measure is illustrated in Figure 19.

Figure 19 Simplified single-input -output production frontiers



Source: Pascoe et al (2003)

Points A, B, C, and D (which refer to input and output pairs for different councils) in Figure 19 are used to estimate the efficient frontier under both scale assumptions. Points along the frontier are defined as efficient. With constant returns to scale, the frontier is defined by point C, with all other points falling below the frontier (hence indicating relative inefficiency).

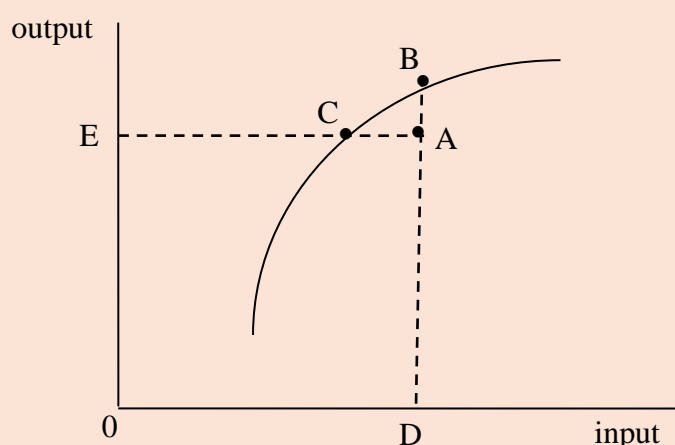
Under variable returns to scale, the frontier is defined by points A, C and D. In this scenario, only point B lies below the frontier indicating relative inefficiency. Under both estimates, efficient councils are given a score of 1 and (relatively) inefficient councils are assigned a score between 0 and 1, with a lower score indicating lower relative efficiency.

Input/output orientation

DEA models can be constructed as either input-oriented or output-oriented depending on the assumptions made about the behaviour of firms, or in this case councils, in the model. An input-oriented DEA assumes that a firm attempts to minimise the level of inputs to produce a given level of output, whereas an output-oriented model assumes that a firm attempts to maximise its outputs for a given level of inputs.

Box 2 Output and input orientation

Figure 20 Output and input orientation



Source: Coelli (2019)

Figure 20 above demonstrates the difference between an output and input orientation. In an output-oriented model, for firm A, the maximum amount possible to produce for a given level of inputs, therefore firm A's output-oriented technical efficiency is defined as the ratio of the distance AD to BD. Similarly, in an input-oriented model, firm A's input-oriented technical efficiency is defined as the ratio of the distance EC to EA.

Given that local councils are obliged to service the residents, ratepayers and roads that are within their jurisdiction, an input-oriented model is likely to be more appropriate for an analysis of local government efficiency as council management have more control over input levels than output levels.

Estimating productivity and efficiency change over time

DEA efficiency measures are defined relative to the efficiency frontier of the sample under consideration. It is therefore not meaningful to compare efficiency scores across different samples as all calculations are based on different efficiency frontiers. This also means that it is not possible to directly compare estimated efficiency scores over different time periods, even for the same underlying sample.

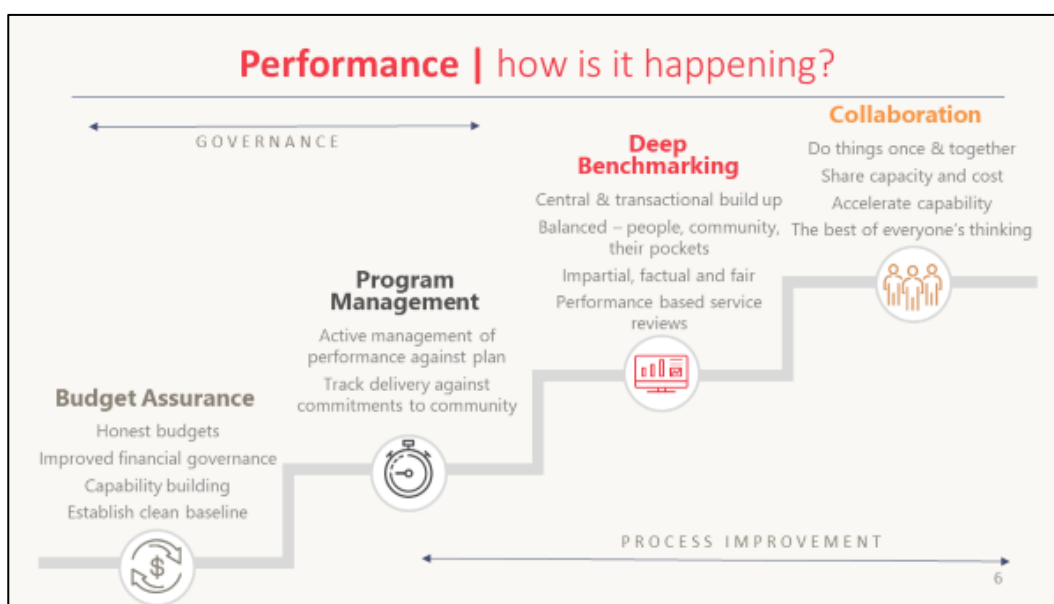
One way of comparing efficiency through time is to construct a Malmquist TFP index, which can be decomposed into measures of changes in technical efficiency (catch up to the frontier), changes in scale efficiency and technical change (shifts in the frontier). A full discussion of how Malmquist indexes are calculated can be found in the Economic Insights report.

Appendix 8: Performance improvement

BACKGROUND

Since 2017, the Cities of Marion, Charles Sturt and Port Adelaide Enfield have been working collaboratively on performance improvement. The three councils partnered based on the shared values of the Chief Executive Officers (CEO's) and their collective aspiration to contain rate increases and do more for their communities.

The councils jointly funded a performance improvement resource to lead a program across the councils to identify, justify and deliver performance improvement into the three organisations.



GOVERNANCE | ACHIEVEMENTS

Initial stages of the program focussed on financial governance, supporting the finance teams to drive increased ownership of financial outcomes, trimming funds from budgets that were no longer required and increasing rigour around project delivery to ensure commitments to the community were both met and achieved as cost effectively as possible.

This activity has driven greater engagement in how community funds are used at all levels of the organisations. Budgets have been reduced by more than three per cent to date (with more possible as the change process continues) and two of the councils achieved record low rate rises in 2018 and 2019. Two of the three councils were in the lowest four rate increases in South Australia in 2019, with Charles Sturt achieving its lowest ever rate rise since amalgamation 22 years ago. Project delivery has increased by more than 80% at one of the councils with all having greater data-driven focus on delivery than two years prior.

PROCESS IMPROVEMENT | ACHIEVEMENTS

The second phase of the program has focussed on sustainable performance improvement through process change. This has been informed by detailed activity and driver analysis which has enabled benchmarking and identification of an opportunity pipeline.

This critical phase was undertaken centrally for the three councils to ensure comparability and meaningfulness of the data from the ground up. The benchmarking is sufficiently detailed to not only point to areas where difference in performance or costs exists, but to inform each council on what to focus on to improve. Improvements are generated by taking the best of each council's performance, and then testing the functions under review against criteria designed to find further improvement opportunities.

Initiatives implemented to date include open space transformation at Marion, shared procurement between Charles Sturt and Marion and a cross-council irrigation construction crew operating across all three council boundaries. A further three initiatives are underway and will be implemented by the end of the 19/20 financial year.

To date less than 10% of the costs of the organisations have been subject to detailed optimisation reviews. Outcomes range from 11-22% improvement in costs and capacity (17% overall) with reviews typically identifying around 20% improvement. These improvements have been achieved with minimal disruption to staff and an increase in service levels delivered. The additional optimisation analysis has seen even the "better" performing areas of the three councils improve by up to 20% again, demonstrating good sector performance can be improved upon. Collaboration has also allowed the councils to deliver benefits beyond what the any of the councils could achieve alone.

CHALLENGES

Key challenges have been:

- Reliance on key individuals, in particular the CEO's to drive the program. Driving performance is more challenging in the public sector than the private sector due to the absence of dynamic price signals to provide rapid performance feedback. With a focus on rate stability and avoiding price shocks, an unintended consequence can be an organisational reluctance to vigorously pursue performance improvement.
- The magnitude of change the program has driven has at times been underestimated and required effort and consistency of vision to remain on track.
- Being equipped with change and collaboration capabilities throughout the organisations at a level that actively supports the program, combined with a willingness to be humble and open to new ways of doing things cannot be underestimated.

The ability to attract, develop and retain highly developed analytical and commercial skills to the public sector on scale is also expected to be a challenge.

SUPPORT FOR THE SECTOR

The experience of the councils and the sector to date has highlighted that league table benchmarks alone will not drive sector performance. They can typically lead to defensiveness rather than encouraging people to be open to improvement and actively seeking the best solution.

Detailed, comparable, data-based benchmarking is considered an important foundation to performance improvement. This needs to be supported in turn by the skills and capability to convert observations to realised performance outcomes, and these skills need to be accessible and affordable to all councils.

Additionally, measurement needs to be supported by motivators for good performance (and consequences for poor performance) and active change management in order to drive deep and sustainable sector wide improvement.

Benchmarking sector experience								
Different models appear to drive performance to different degrees								
Method Comparison	Budget assurance / rate capping	PEP	Know your council	AG	Grants Commission	Cross Council	Published Value Driver Analysis	Supported performance improvement
Irrefutable comparisons						✓	✓	✓
Drives performance	✓					✓	✓	✓
Sustainable performance improvement		✓	✓			✓	✓	✓
Better than sector performance						✓		✓
External drivers	✓						✓	✓
Community needs considered			✓			✓		✓
Transparent performance			✓				✓	✓
Able to be supported/afforded by individual councils	✓		✓	✓	✓			✓