NORTHERN TERRITORY GRANTS COMMISSION

METHODOLOGY REVIEW
FINAL REPORT

May 2005

Electronic Version

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PREFACE

The Northern Territory Grants Commission is constituted under the *Local Government Grants Commission Act* for the purpose of recommending the allocation of the Commonwealth Financial Assistance Grants to local governing bodies within the Northern Territory.

There are currently 63 local governing bodies in the Territory. Of these 35 are gazetted under the *Local Government Act*, 25 under the *Associations Act* and 3 under the Commonwealth's *Aboriginal Councils and Associations Act 1976*.

This is the first and final draft report of the outcomes from the Commission's review of its methodology for the allocation of the general-purpose component of financial assistance grants. It is proposed that these outcomes will be used for the first time for the allocation of the 2005-06 grants and yearly thereafter with data being refreshed on an annual basis.

The review of the methodology first commenced in 1998 and has now been partially but substantially concluded. The review has highlighted the need for further work on the expansion of expenditure categories and the development of more suitable cost adjustors.

The current members of the Commission are as follows:

Chairman:	Mr Bob Beadman
Departmental Nominee:	Mr Nick Scarvelis
Member representing municipal councils:	Ms Fran Kilgariff (resigned 20 April 2005)
Member representing community government councils:	Mr Bob Bagnell
Deputy	Mr John Bailey
Deputy	Ms Margaret Vigants

ACKNOWLEDGEMENTS

In conducting this review, valuable assistance and advice was provided to the Commission by a number of people and the Commission now wishes to acknowledge their efforts and support. These people included:

Mr David Coles former CEO's nominee who was involved with the review from its inception and all other former members and staff who have contributed to the review at some time or other.

Mr Ted Clark, Ms Donna McLeod and Ms Annette Murtagh who, as officers of the department of Community Development, Sport and Cultural Affairs, provided executive and secretariat support to the Commission.

Mr Simon Pugh formerly of the Department of Community Development, Sport and Cultural Affairs.

Mr Dermot Doherty of the Commonwealth Grants Commission.

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EXECUTIVE SUMMARY

Since beginning the review of its methodology for the allocation of the financial assistance grants 1998, the Commission has issued a number of discussion papers.

There are two components of the financial assistance grants:

- General purpose grant (the cash component to the Northern Territory in 2004-05 was worth $10,647,147)
- Identified road grant (the cash component to the Northern Territory in 2004-05 was worth $11,088,564).

Although the Terms of Reference for the Commission's review required an examination of the methodology for the allocation of the Identified Road grant, the Commission resolved to defer that part of the review until the completion of the review of the general purpose component.

In June 2000, the Commonwealth Grants Commission (CGC) was required by the Commonwealth to examine and report on the effectiveness of the arrangements for achieving the purpose of the *Local Government (Financial Assistance) Act 1995.* The report was presented in June 2001. The report contained no findings or recommendations to change the basic underlying philosophies of the Act. It did, however, identify a number of inconsistencies in the methodologies used by the various Local Government Grant Commissions.

With the CGC findings in mind, the Commission issued its final discussion paper in October 2002. Regional workshops were held to explain the discussion paper with a view to assisting interested parties to make submissions on the issues raised. A progress report was then issued, followed by regional workshops and public hearings.

A SUMMARY OF KEY CHANGES TO THE METHODOLOGY

1. Population

Proposes to discontinue the use of tourism estimates in its methodology.

2. Loss Assist Factor

Proposes to discontinue with the use of loss assist factor.

3. Equalisation Methodology

Proposes to retain the balanced budget approach.

4. Scope of Equalisation

Proposes to use real financial data in the assessment of need.

5. Revenue Capacity Assessment

Proposes to discontinue the use of personal income and to consider nine revenue categories based on actual revenue figures.

6. Other Grant Support

No changes are proposed.

7. Expenditure Standards

Proposes no change in the short term other than the use of real expenditure data in the short term but proposes a further study of more appropriate expenditure categories.

8. Assessment of Capital Need

Proposes no changes

9. Disability Factors

Proposes to re-scale the factors around one and combine the factors where required by addition. Further proposes to concurrently review the disability factors with the study of more appropriate expenditure categories.

10. The Balanced Budget Approach

Proposes to introduce a Budget Result Term in accordance with the Commonwealth Grants Commission's recommendation.

11. Factoring Back Method

Proposes no change to the current method of factoring back.

12. Options to Provide Stability of Grant Outcomes

Proposes to introduce a three year average of the preliminary equalisation requirements of local governments. A three year average involves taking the equalised requirement for each of the last five years and dropping the highest and the lowest of the five figures out of the average to remove aberrations.

B THE FUTURE

1. Continuation of the Review

The Commission proposes to undertake a review of its expenditure categories and disability factors in the 2005-06 financial year with a view to their replacement for the allocation of the 2006-07 grants.

2. Viability of Small Councils

The Commission has, as a result of financial modelling, identified a number of small councils that are too small to benefit from the revision of the methodology in the long term, unless the proposed review of expenditure categories and disability factors provides a long term solution.

1. BACKGROUND

1.1 Overview

In 1998, a review of the Commission's methodology for the allocation of the general-purpose component of the financial assistance grants made under the Commonwealth's *Local Government (Financial Assistance) Act 1995* was commenced. While the review, for reasons beyond the control of the Commission, has seen delays and deferrals, substantial progress has been made to correct the inconsistencies subsequently identified by the Commonwealth Grants Commission.

The Commission proposes to introduce improvements to its methodology for the allocation of the 2005-06 grants.

1.2 What is the Financial Assistance Grant

The financial assistance grant referred to in this report is a special purpose payment or appropriation to the States/Territories from the Commonwealth of Australia under its *Local Government (Financial Assistance) Act 1995.*

There are two components of the financial assistance grant, a general-purpose component and an identified local government road component.

1.3 National Principles

The Commonwealth Act specifies two of the National Principles for the general-purpose grant. They are that:

- the allocation of funds must be on a full horizontal equalisation basis; and
- there must be a minimum grant for each local governing body equal to its per capita share of 30 percent of the State's allocation of general-purpose grants.

Horizontal equalisation is described in the Act as an allocation of funds that ensures that each local governing body in a State is able to function, by reasonable effort, at a standard not lower than the average standard of other local governing bodies in the State. It takes account of the differences in the expenditure required by the local governing bodies in the performance of their functions and in their capacity to raise revenue. **Put simply, horizontal equalisation is about ensuring that all councils in the Territory have the same financial capacity to deliver the "average level" of services to their communities, given that they make the "average effort" to raise revenue.**

There are three other National Principles. They are:

- Effort Neutrality
  This principle is to ensure that local governing bodies that choose to deliver higher level of services must find the funds for that themselves, and that local governing bodies, through policy decisions, that choose not to raise a reasonable level of revenue do not get extra money from the pool to fill the gap.

- Other Grant Support
  This principle requires that specific purpose grants provided to local governing bodies to meet any of the expenditure needs assessed should be taken into account using an inclusion approach.

- Aboriginal Peoples and Torres Strait Islanders
  This principle requires that financial assistance be allocated to local governing bodies in a way that recognises the needs of Aboriginal people and Torres Strait Islanders within their boundaries.

1.4 Role of the Commission

In order to be eligible for an appropriation under the *Local Government (Financial Assistance) Act 1995* each State and the Northern Territory is required to establish a Local Government Grants Commission to make yearly recommendations on the allocation of the financial assistance grants.

Each Local Government Grants Commission is required to develop and maintain a methodology that complies with the National Principles for that purpose. The Act also requires that there be some consistency between State/Territories in their respective methodologies. In the performance of its function, the Commission is required to hold public hearings and to permit local governing bodies, the local government association and other interested parties to make submissions relevant to the allocations.

Whilst the object of equalisation as discussed in 1.3, the reality is that with the funding available equalisation can not be achieved and is further exacerbated by the 30% factor.

2. THE REVIEW

2.1 Terms Of Reference

1. To examine the implications of the principle of horizontal equalisation as it applies to the methodology, with particular reference to:

   - The most appropriate method of assessment (standard budget versus direct assessment);
   - the definitions of relevant expenditure and (own source) revenue categories;
   - the definition and application of 'disabilities' or 'cost adjusters';
   - definition of relevant populations; and
   - the methods used for scaling back final grants and phase in of changes.

2. To examine the implications of the principle of effort neutrality as it applies to the methodology, with particular reference to:

   - methods for measuring expenditure; and
   - methods for measuring revenue.

3. To examine the implications of the principle of the minimum grant with particular reference to:

   - methods for determining those councils to receive the minimum grant; and
   - implications of the application of minimum grants for equalisation.

4. To determine what grant support should be included as "relevant", with particular reference to:

   - NT Government Operational Subsidies; and
   - other grants, including Community Development Employment Program (CDEP).

5. To examine methods of capturing the additional costs of local government service delivery in a cross cultural environment.

6. To examine the methodology for distribution of the identified roads component with particular reference to:

   - examination of asset preservation models;
   - consideration of total roads funding needs; and
   - incorporation of roads usage / strategic roads factors.

7. To examine relevant issues relating to economic reform including[1]:

- methods of allowing for the additional costs of distributed service delivery;
- ensuring equitable distribution of funds within amalgamated councils;
- implications of the proposed Goods and Services Tax; and
- implications of other Commonwealth tax policies.

8. To examine the processes of the Northern Territory Grants Commission (NTGC) with particular reference to:

- methods for consulting with stakeholders;
- methods for collecting information; and
- methods for methodology review.

2.2 Our Approach

The review was effectively conducted in two parts as follows:

Part 1

Part one of the review was undertaken over an 18-month period and utilised the expertise in the Department of Local Government, Local Government Association of the Northern Territory (LGANT), individual councils and key stakeholders.

The review only examined issues relating to the distribution of the Commonwealth Financial Assistance Grants so accordingly this report does not address issues referred to in the Terms of Reference relating to the roads component.

The following consultations have been undertaken during the review period:

- Presentation of discussion paper to LGANT meeting February 1999;
- Regional workshops in Darwin, Alice Springs, Katherine and Nhulunbuy held from April to May 1999;
- Discussion paper circulated concerning cross cultural issues in March 1999;
- Draft discussion paper circulated analysing consultative process and draft recommendations in September 1999;
- Workshops held in Darwin and Alice Springs to discuss draft discussion paper in October/November;
- Discussions held with the NTGC re 2000 data collections to allow comprehensive modelling to be undertaken in May 2000;
- Discussions held with the Australian Bureau of Statistics in August/September to obtain additional data required for financial modelling; and
- Discussions with the respective State and Commonwealth Grants Commissions regarding current interstate practices, and options for grant distribution within the Northern Territory.

[1] This is not the role of the Commission and, in any case, has been superseded by subsequent events.

Part 2

The review was postponed when the Commonwealth of Australia required the Commonwealth Grants Commission to conduct a review of the *Local Government (Financial Assistance) Act 1995.* The CGC completed its review in June 2001. The

Commonwealth's response was to refer the matter to the House of Representatives Standing Committee on Economics, Finance and Public Administration on the assumption that there was large scale cost shifting onto local government by state governments.

On the basis that the Commonwealth's formal position on the outcomes of the CGC review was not known and that the findings of the "Cost Shifting Inquiry" would not impact on local governments in the short term, the Commission resolved to restart the stalled review of its methodology. In October 2002 the Commission distributed an Overview & Issues Paper to all local governing bodies in the Northern Territory announcing the recommencement of the review and highlighting issues for consideration and inviting submissions.

Workshops for interested local governing bodies to explain the implications of the issues raised in the discussion paper were held in Darwin, Nhulunbuy, Katherine and Tennant Creek during November 2002. A number of submissions were subsequently received and presented at LGANT meeting in Alice Springs February 2004

In January 2005, the Commission released a progress report and a summary of submissions received to local governing bodies and followed with workshops in Darwin, Katherine, Tennant Creek and Alice Springs. At these workshops a working paper, which formed the basis of this report, was presented to councils.

In March 2005, public hearings were held in Darwin and Alice Springs to enable interested parties to make final submissions to the Commission.

3. CHANGES TO THE METHODOLOGY

3.1 Population

The Current Arrangement

Population has been the major driver in the current methodology. The Commission attempts to estimate a council's 'service population', that is, the number of people to whom the council provides local government services on a regular basis. This includes residents of outstations who receive services, as well as tourists.

In the absence of reliable Australian Bureau of Statistics (ABS) data for remote communities, the Commission surveys each council annually to obtain up-to-date population data. To counter the mobility of Aboriginal people the Commission averages the population over a three-year period.

The three-year average is said to penalise the rapid growth councils as their population figure is always reduced in the averaging process. To offset this disadvantage, a growth factor was introduced in 1996.

Improving the Arrangement

While there was not strong support in the submissions received for the retention of the three-year average, the reasons for its introduction in the first place are still relevant. Additionally, the Commission remains of the opinion that the 2001 Census under-counted the population of the Northern Territory and, therefore, the use of ABS population figures remains impractical. The ABS needs to be able to demonstrate that it collects population universally in the Territory by local government statistical area and has instituted a means of estimating remote community population on an annual basis.

Due to the difficulty in collecting accurate data on tourism impacts and because of the debate about whether they are a negative or a positive for councils there is a school of thought that the tourist element should be removed.

In acknowledgment of that school of thought, the Commission intends to discontinue the use of tourism estimates in its methodology. This, however, will not preclude a council from making a submission that it is disadvantaged by having to provide services to tourists. The submission must be based on the "Tourist Impact Model for Australian Local Government" (Commonwealth Department of Industry and Resources - Tourism Division) that clearly shows that tourism has a negative impact on that council.

3. 2 Loss Assist Factor

The Current Arrangement

Once the annual allocations are determined by the NTGC for a particular year, they are checked against the previous year's allocation. If the amount to be allocated is less than 95% of the previous year's allocation, then it is adjusted upwards to ensure that no council loses more than 5% in a year. Other council allocations are adjusted slightly downwards to make up the difference.

Improving the Arrangement

Although most submissions favoured the retention of a loss assist factor, the Commission has formed an opinion that continuing with a 5% factor can no longer be justified. It has resolved therefore that there will no longer be a loss assist factor included in the methodology.

The resolution should be read in conjunction with section 3.12 of this report. In the opinion of the Commission the approach proposed in that section will provide an adequate cushion over time.

3.3 Equalisation Methodology

The Current Arrangement

The Commission uses the Balanced Budget approach. This approach measures a local government's financial capacity as the difference between its total assessed costs of providing services and its assessed revenue. The outcome, the local government's financial capacity, is then compared with the financial capacity of the average local government to determine whether it has an overall advantage or disadvantage.

Improving the Arrangement

The only alternative to this approach is the Direct Assessment approach, which measures a local government's financial advantage or disadvantage in each area of expenditure and revenue. It does this by comparing its assessed costs of providing services (and its assessed revenue) to the average local government's assessed cost of providing services (and revenue raising capacity). The overall advantage or disadvantage is calculated by summing across all areas of expenditure and revenue.

Given the disparity in the size of councils in the Northern Territory, the average is likely to be set at a relatively artificial level. However, as a result of the inadequacies and inconsistencies in local government financial data in the past, there is no historical basis on which to make a comparison of the two models at this point in time. The Commission believes that the artificial average could severely disadvantage the municipal and larger community government councils and therefore proposes to retain the Balanced Budget Approach for the time being.

3.4 Scope of Equalisation

The Current Arrangement

As land based taxes (rates) are generally not applicable in remote communities, the Commission estimates revenue raising capacity by using the average income of residents in the council.

In the absence of meaningful expenditure data, the standard expenditure has been calculated by allocating to each council a share of the total Territory expenditure in a number of categories. This, then, was a theoretical number that had been determined as representing the cost that a council would incur in providing the Territory average level of services at their location.

Improving the Arrangement

The introduction of new financial reporting requirements in 2003 has given the Commission the ability to view the annual income and expenditure of individual councils and to determine the total income and expenditure of local governments in the Northern Territory. This now provides the Commission with the opportunity, for the first time, to move away from a theoretical assessment to a more practical assessment based on real financial data.

3.5 Revenue Capacity Assessment

The Current Arrangement

For reasons set out in the scope of equalisation above, the Commission uses the average income of residents in the council area as the basis for the assessment.

Rating capacity is, therefore, basically assessed as the average income of all residents over 15 years of age, adjusted for a "basic necessities allowance", multiplied by the number of residents over 15.

For the 2004-05 allocation total local government income was deemed to be $110,340,000.

Improving the Arrangement

With the advent of actual, accurate financial data the Commission is in a position to move away from average incomes. The total revenue raised by councils in the 2002-03 amounted to $137M. Included in this amount were revenues raised that are not considered to strictly relate to local governments. The Commission has determined that there are nine categories of revenue functions specific to local governments and proposes to use the nine in the assessment of a council's rating capacity. The nine categories and associated revenue for 2002-03 financial year are outlined in Table 3.5.

Table 3.1 Revenue Categories

Category	Territory Revenue
Domestic Waste	$7,152,892
Garbage - Other	960,241
General Rates	47,738,618
General Rates - Poll Tax Figure	3,150,739
General Rates Other	2,099,605
Special Rates Parking	789,326
Special Rates Other	1,362,526
Fines	1,056,961
Interest	3,958,851
Total	$68,269,759

3.5.1 Method of assessing revenue

The Commission intends to divide local governing bodies into three groups, viz

- community government councils (cgc)/associations councils with populations less than 1,000
- cgc/associations councils with populations greater than 1,000
- municipal councils (because of rate base).

and to establish NT average for each revenue category were relevant. This section describes the proposed method for determining the NT average and for applying that average to each council.

A. Domestic Waste

FORMULA

Total Territory Domestic Waste per group X Council population
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Total Territory Population per group

B. Garbage Other

FORMULA

Total Territory Garbage per group (excludes muns*) X Council population
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Total Territory Population per group

*Municipals - actual income

C. General Rates

FORMULA

1. Municipals (equalised rate)

Total Land Valuation for Council (LV) X Territory Average Land cent in dollar rate (LC)

2. Other (per capita)

Total Territory Rates per group X Council population

Total Territory Population per group

D. Poll Tax

FORMULA
community government councils(cgc)/association councils only - per capita by group

E. General Rates Other

FORMULA
all councils - per capita

F. Special Rates Parking

FORMULA
Actual Income raised

G. Special Rates Other

FORMULA
cgc/associations - per capita municipals = actuals

H. Fines

FORMULA
Actual Income raised

I. Interest

FORMULA
cgc/associations per capita (2002-03) = $26.65
municipals = actuals

3.6 Other Grant Support

The Current Arrangement

The Commission recognises the local road grants received by each council in its assessment of transport needs. In addition, it recognises library operational grants and fifty percent of the Northern Territory Operational Subsidy paid to the community government councils. More recently, fifty percent of the Roads to Recovery grant was also included. The Commission treats CDEP grants by exclusion.

Improving the Arrangement

The current arrangement complies with the National Principle. The Commission, therefore, proposes to make no changes to the grants currently recognised. Fifty percent of the Northern Territory Operational Subsidy and Roads to Recovery grants will continue to be the norm. It is also proposed to continue to treat CDEP grants (and expenditure) by exclusion.

In the revised methodology, the grants will be shown as revenue rather than deducted from expenditure.

3.7 Expenditure Standards

The Current Arrangement

The Commission uses State averages by allocating to each local government a share of the total Territory expenditure in six categories to calculate standard expenditure.

The Commission, has in the past, been restricted to using old data for State expenditure amounts because of the periodic nature of inclusive government financial statements (GFS) for the whole of the Northern Territory. Total Territory expenditure is apportioned to each of the six expenditure categories based on hypothetical percentages. The relativity between the expenditure categories is, therefore, theoretical and, due to the large size of municipalities compared to remote councils, the relativity may, in fact, tend to represent the relativity of the municipal councils. This would not be a problem if the percentages spent in each category was much the same for the municipal as well as remote councils but that is unlikely. The expenditure categories and the hypothetical percentage is outlined in Table 3.2

Table 3.2 Expenditure Categories & Hypothetical Apportionment.

Category	**%**
Amenities	20
General Services	24
Human Services	11
Libraries	4
Recreation	21
Road Works	20
	100%

Improving the Arrangement
The new financial reporting requirements introduced in 2003 collects financial data in accordance with the ABS's "Local Government Purpose Classifications" (LGPC). It is obvious, however, that the ABS categories can not be used without a major revision of disability factors. For the 2005-06 allocations it is proposed that the Commission's current functions be retained while a study is completed on more appropriate disability factors. The actual expenditure in the ABS classifications in the 2002-03 reporting year when extrapolated to the Commission's six functions is shown in Table 3.3.

Table 3.3 Actual expenditure & percentage apportionment.

Expenditure Category	**Expenditure**	
Amenities	$42,018,462	26
General Services	56,226,284	35
Human Services	15,444,910	10
Libraries	2,606,977	2
Recreation	20,212,859	13
Road Works	23,667,543	14
	$160,177,035	**100%**

3.8 Assessment of Capital Needs

The Current Arrangement
The Commission currently has no means of recognising capital expenditure and therefore excludes it from its methodology.

Improving the Arrangement
The Commission has deferred consideration of this issue pending the outcome of the depreciation of infrastructure project initiated by the National Local Government Financial Management Forum.

3.9 Disability Factors

The Current Arrangements
The Commission uses disability factors to reflect the higher costs of service provision in some areas and adjust the calculated expenditure for each category. The factors currently recognised by the Commission are:

- isolation - administration
- isolation - works
- dispersion
- growth factor
- Aboriginality

The first three of the above are difficult to estimate and tend to stay the same over time. A growth factor greater than 1 is assigned to a local government when its population growth is greater than the Territory average. The proportion of the resident population that is Aboriginal determines the Aboriginality factor.

Disability Factors for each expenditure category are multiplied to get the overall disability factor for the category.

Table 3.4 shows that the current method of applying the disability factors has the effect of increasing expenditure.

Table 3.4 Expenditure after the application of disability factors.

Expenditure Category	Adjusted Expenditure
Amenities	$47,638,912
General Services	85,228,516
Human Services	23,641,868
Libraries	848,912
Recreation	22,203,682
Road Works	17,062,808
	$196,624,698

Improving the Arrangement

For the sake of consistency with other Local Government Grants Commissions (LGGC), the Commission proposes to adopt the CGC recommendation. In the opinion of the CGC it is fair that the expenditure assessments have as an outcome total standardised expenditure equal to total actual expenditure. To do otherwise skews the grant outcomes in favour of expenditure assessments.

The term "natural weighting" captures the idea that total standardised expenditure equals total actual figures. A benefit of natural weighting is that the weight given to a function in the standardised budget is exactly the same as the weight it has in an actual budget.

The objective then is to ensure that the total standardised expenditure per category equals the actual expenditure per category. This is achieved by re-scaling the factor around one.

Re-scaling, firstly, requires the calculation of an "average NT wide factor" for each disability factor. This factor is calculated by multiplying the population for each council by the relevant disability factor and dividing the sum of the results by the total population.

The “average NT wide factor” per current disability factors is outlined in Table 3.5.

Table 3.5 Average NT wide factor per disability factor.

Disability factor	**%**
Isolation – Admin	1.074524445
Isolation – Works	1.083166079
Dispersion	1.038403445
Growth	1.007457000
ATSI	1.202071178

After determining the "average NT wide factor" a council's disability factor is then divided by it to achieve the re-scaled cost adjustor.

The CGC advises that to continue to multiply the factors would not only be inconsistent with the other States but creates further problems arising from interactions between terms that are multiplied/compounded. The Commission therefore proposes to combine the factors where required by addition. The formula to combine additive factors is:

Combined Factor = One + (Factor- One)+(Factor-One)+(Factor-One).....

One is subtracted in each case to prevent the factors from becoming excessively large.

The effect of re-scaling is illustrated in the table below. It can readily be seen that the application of the re-scaled factors in the calculation of the standardised expenditure ensures that the standardised expenditure per category equals the amount of the actual expenditure in each category.

Table 3.6 Expenditure after application of adjusted disability factors.

Expenditure Category	**Adjusted Expenditure**
Amenities	$42,018,462
General Services	56,226,284
Human Services	15,444,910
Libraries	2,606,977
Recreation	20,212,859
Road Works	23,667,543
	$160,177,035

The need to introduce additional expenditure categories (see section 3.7) dictates the need to concurrently review the disability factors to ensure that the integrity of the National Principles is maintained. In the revised methodology, disability factors will be referred to as "cost adjustors."

3.10 The Balanced Budget

The Current Arrangement
In common with several other LGGCs, the Commission does not apply a Budget Result Term to its methodology.

Improving the Arrangement
The Commission has resolved to incorporate the Budget Result Term in assessments. The budget result represents the total shortfall or surplus of all local governments in the Territory as assessed by the balanced budget model. It is the view of the CGC that the inclusion of a budget result term is a safeguard against the omission of an aspect of local government operations such as revenue or expenditure category.

The CGC asserts that over time, councils have a net bottom line of zero rather than a loss or profit.

The standard budget result term is a balancing item to make the total Territory revenues, including grants, in the assessment methodology equal to the Territory expenditures included. It can be either a revenue or expenditure category depending on the scope of revenues and expenditures included. For example, the Commission has determined that the standardised revenue and expenditure for financial modelling purposes extrapolated from the 2002-03 actual financial data shall be based on revenue (including recognised grants) of $90,834,614 and expenditure of $160,177,035. The difference is $69,342,422 or $349.40 per capita. This is the budget term and in this case (and for the foreseeable future) it is a revenue item.

To arrive at the standard budget term the per capita amount is allocated to each council according to its population, which ensures that the budget term is not affected by changes in other, assessed revenues or expenditures.

3.11 Factoring Back Method

The current Arrangement
The Commission's current methodology allocates grants to local governments based on receiving the same percentage share of their equalisation requirement.

Improving the Arrangement
The Commission proposes to retain its current method of factoring back.

3.12 Options to Provide Stability of Grant Outcomes

The Current Arrangement
As stability of outcomes is the anthesis of horizontal equalisation, the Commission has deliberately refrained from having a policy that requires attention be paid to the stability of grant allocations, in addition to Loss Assist, out of a belief that this is inconsistent with the Horizontal Equalisation principle.

Improving the Arrangement

Most of the respondents to the issues paper stated that stability of grant allocations was important to them. With this in mind and also mindful of the resolution to remove the loss assist factor, the Commission had to consider the introduction of a mechanism that would provide some stability over time.

From the Commission's perspective, there are two such mechanisms. The first is to adopt the CGC recommendation of a transitional period of five years to allow councils time to adjust to changes in their grant outcomes. This approach, however, would provide some cushioning but no consistency in allocations. The second is to consider an approach where assessments of need are averaged over a number of years.

After considering how the other local government grant commissions deal with this issue, the Commission has resolved to adopt an averaging approach similar to that used by the WA Local Government Grants Commission. This approach involves a three year average. To arrive at the average, the assessments of need for the year under consideration plus the assessments for each of the preceding four years are used. The highest and the lowest of the five assessments are then dropped out of the average.

In resolving to adopt a three year average, the Commission was influenced by the need to review expenditure categories and disability factors and the possibility that the outcomes of that review could cause aberrations in a five year transitional period approach.

The Commission believes that the averaging approach will help to provide more long term stability in grant outcomes.

It must be realised, however, that the desired level of stability can not and will not be achieved until at least the 2009-10 financial year. The main reason for this is the disparate base amounts of income and expenditure used in the assessments caused by the switch to actual financial data sourced from councils, viz

Table 3.7 Base income and expenditure

YEAR	INCOME	EXPENDITURE
2001-02	$110,340,000	$192,171,000
2002-03	110,340,000	192,171,000
2003-04	110,340,000	192,171,000
2004-05	110,340,000	192,171,000
2005-06*	68,269,759	160,177,035

*the base amounts to be used in the allocations for this year are not yet available. The amounts shown here are for indicative purposes only.

The Commission concedes that the disparity may cause some aberrations in the 2005-06 assessments. Should that happen, allocations to councils unfairly advantaged as a result, will be capped at the 2004-05 level plus an adjustment for CPI.

4. THE FUTURE

4.1 Continuation of the Review

The Commission now has access to up to date financial data for most local governments in the Northern Territory with expenditure classified at the ABS category level. In section 3.7 above, it was highlighted that it was not practicable to adopt the ABS categories until we concurrently address the applicability of the current disability factors.

In the current methodology, the Commission assesses six expenditure categories by the application of six disability categories whereas there are nine ABS categories.

The Commission is mindful that an outcome of the methodology review prior to its postponement pending the results of the CGC review of the Act was a proposal to use only three expenditure categories namely, administration, services and roads. This, apparently, was based on the interests of simplicity and transparency to reflect in broad terms an amalgam of the ‘traditional’ local government services in the mistaken belief that it reflected the ABS Government Financial Statistics.

However, after further consideration and, in view of the opinion of the CGC that all categories in which a local government spends money should be accessed, that proposal has been discarded.

In addition, a comparison with other LGGCs showed that the number of expenditure categories and disability factors assessed ranged from 8 to 21 and 7 to 45 respectively. This would clearly indicate that the Commission should consider more expenditure categories with a concomitant increase in disability factors.

The Commission proposes therefore to undertake a review of its expenditure categories and disability factors beginning in early 2005-06 with a view to replacing the existing categories and factors in the methodology for the allocation of the 2006-07 grants.

4.2 Viability of Small Councils

There are a number of councils, because of relatively small population bases and the small area over which they are required to provide local government services, that have in the past, enjoyed a reasonable level of grant support partly by a contrived "economy of scale" adjustment and the use of personal income as the capacity to measure a council's ability to raise revenue.

The current methodology contains an "economy of scale" adjustment of a minimum of $70,000 built in to the general administration expenditure category. The import of this factor means that where a council's calculated expenditure for the category is less than $70,000, the expenditure is adjusted up to the minimum.

The Commonwealth Grants Commission identified "economy of scale" as one of two reasons why ‘natural weighting’ could not be achieved in the methodology in the current form. (The other reason was that disability factors were not centred around 1.0).

The term ‘natural weighting’ captures the idea that total standardised figures (expenditure, revenue or SPPs) should equal total actual figures (expenditure, revenue and SPPs). A benefit of natural weighting is that the weight given to a function in the standardised budget is exactly the same as the weight it has in the actual budget and thus has the appeal of fairness.

As far as the use of personal income as the measure of revenue raising capacity is concerned, the CGC states (see Chapter 13 - section 48 Working Papers for Review of the Operation of the *Local Government (Financial Assistance) Act 1995)* this produces:

- a lower assessed revenue capacity for the municipal LGBs than would be produced by a valuation approach; and
- a higher assessed revenue capacity for other LGBs

As outlined in section 3.5 of this report, the Commission intends to discontinue the use of personal income as the basis of assessing revenue-raising capacity. Theoretically, this should benefit the other LGBs but the statement is axiomatic. It may be true if the assessed revenue capacity was based on a straight per capita basis. The Commission, however, assesses revenue capacity as the average income of all residents over 15 years of age, adjusted for a "basic necessities allowance", multiplied by the number of residents over 15.

As far as the "economy of scale" adjustment is concerned, again according to the CGC, a possible way of implementing the minimum diseconomy allowance would be to divide the expenditure category into two parts. The first part of the category would deal only with an “economy of scale adjustment”, $70,000 for each council, and the balance of the expenditure in the general administration category would go to the second part. By definition, total standardised expenditure would equal total actual expenditure for the first part of the category. A different method would have to be used to ensure that total standardised expenditure equals total actual expenditure for the second part of the category. The category assessment would then be the sum of the two parts.

Financial modelling undertaken by the Commission has indicated that should the Commission adopt such an approach, it would have the affect of taking money away from other councils. Making provision for a $70,000 “economy of scale” is the antithesis of equalisation. The Commission is anxious to preserve the "purity" of its methodology in the most transparent way possible and has resolved to discontinue the "economy of scale" adjustment forthwith.

The Commission's resolution to average the assessment of need over five (see section 3.12) years will afford some protection for these councils in the short term with the full impact of the revised methodology being felt in the 2008-09 financial year.

With the removal of the two buffers that have propped up the small councils, their continued existence as local governments in their own right is clouded if the proposed review of expenditure categories and disability factors does not provide a solution to this dilemma.

The following table shows a list of those councils that have been identified as being most likely to be impacted by these changes. There are other small councils while not readily identifiable that may fall in too this category in ensuing years.

Table 4.1 Identified councils impacted by economy of scale

Council	Pop	Sq Klms	From Reg Centre	Road Length
Amoonguna	297		15	6.70
Aputula	228		420	66.50
Areyonga	234		240	37.40
Arltarlpilta	271	12.31	75	52.50
Belyuen	259	40.91	130	84.05
Binjari	263	2.82	18	5.01
Cox Peninsula	315	5.62	156	13.17
Ikuntji	146		240	124.90
Imanpa	189		285	19.80
Jilkminggan	273	6.1	140	16.00
Marngarr	309	2.7	15	12.40
Milyakburra	217		*	52.00
Minjilang	255		*	73.40
Peppimenarti	235		330	119.50
Tapatjatjaka	297	12.14	120	55.54
Timber Creek	306	16.12	284	173.11
Wallace Rockhole	163	5.15	170	22.70
Watiyawanu	249	78	328	73.20
Yuelamu	295		280	213.60

* island communities

APPENDIX