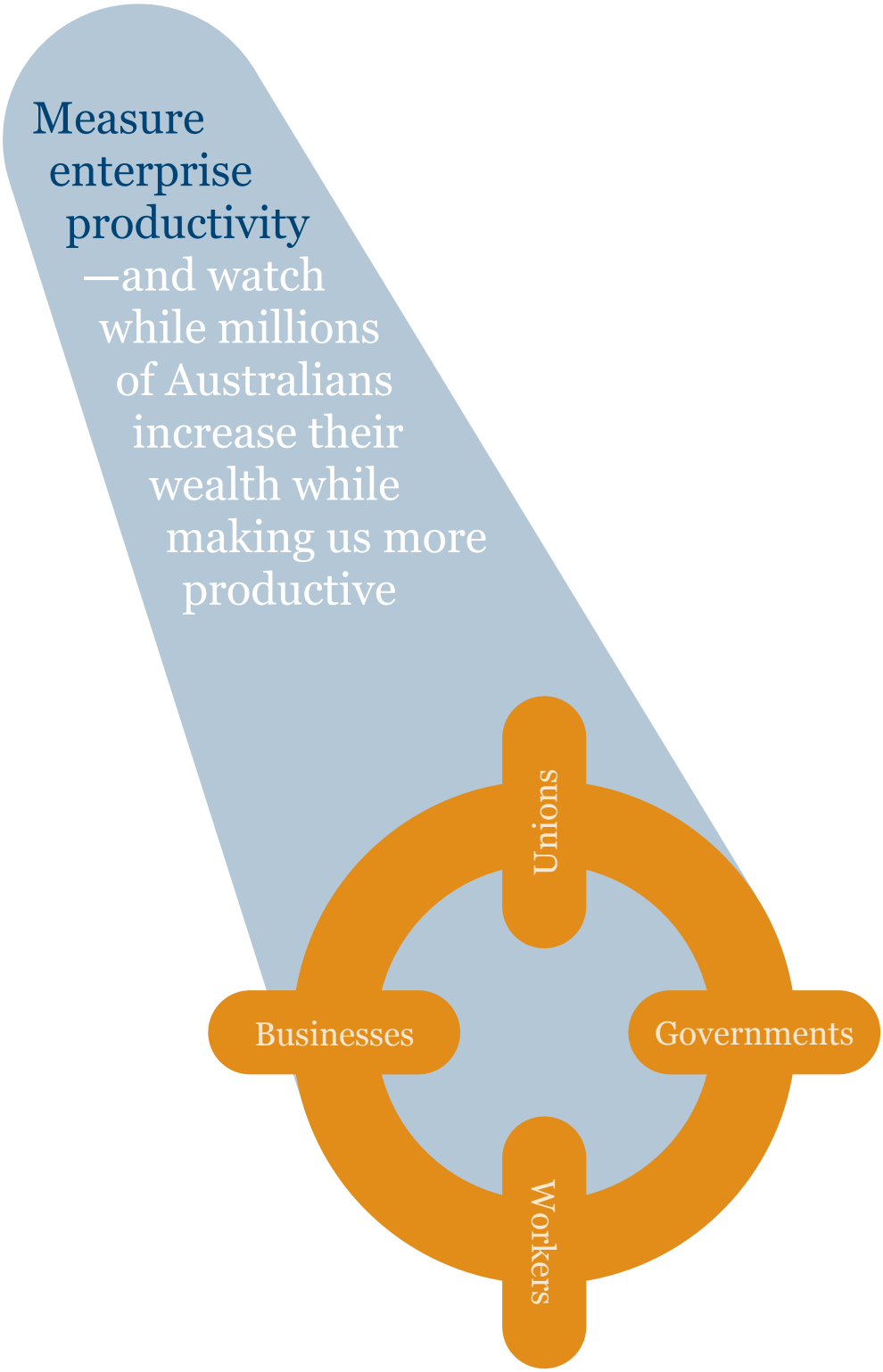

LSI Consulting presents

Where and How to Target Investment in Making Australia More Productive

A submission to the Productivity Commission, *Productivity Review* inquiry, December 2016

Preface

Where and How to Target Investment in Making Australia More Productive is a submission (the Submission) by LSI Consulting (LSI) to the Productivity Commission *Productivity Review* inquiry.

The Submission assumes the reader understands the fundamentals of productivity measurement—the ratio between quantity or value of realised products (outputs) and the quantity or value of used resources (inputs)—and does not seek to add to the wealth of available information that deals with explaining its technicalities.

LSI and Productivity

LSI is in the business of analysing performances of market and non-market sector enterprise environments and establishing systems that enable the value and/or volume of what is produced to be increased. This work is as tactical as it is technical; we are expert at not just measuring productivity, but providing management with the capability to put the measurement of productivity to productive business use.

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Linking Strategy to Implementation

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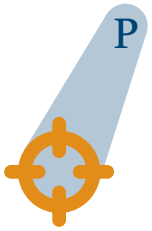


Overview

Here is how to make Australia more productive: promote accountability for productivity performance at the enterprise level of the economy, including in the non-market sector. And here is tactical plan for implementing that strategy:

1. Direct non-market enterprise organisations to measure productivity and make all federal funding subject to productivity measurement deliverables;
2. Develop standardised approaches, frameworks and tools for measuring enterprise productivity, including by the non-market sector, and,
3. Reward and recognise enterprise productivity improvement, but only when supported by transparent measurement.

Executive Summary

Macroeconomic and microeconomic productivity are one

The federal government measures the productivity of the Australian economy and employs policies for stimulating its improvement. But why only do this at macroeconomic level? The root cause of national productivity performance is microeconomic productivity performance. That is, national productivity performance is the aggregate of the productivity of every Australian private and government enterprise.

Leaders at all levels of the economy, not just the Australian Treasurer, can utilise productivity measurement to prioritise those activities that analysis shows will have the greatest impact on improving business performances.

The Submission argues that by,

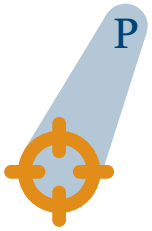
1. Promoting the use of productivity measurement as a key performance indicator at the enterprise level of the economy, and
2. Linking productivity measurement at the enterprise and industry level to the Australian National Accounts for purposes of analysis and informing the design of policy,

- Leaders in the federal sphere concerned with stimulating macroeconomic performance, and
- Enterprise leaders concerned with improving the microeconomic performance of their organisations,

will be more effective in improving productivity performance and, by extension, support the economy in a "top down, bottom up" concerted effort that makes Australia as productive as any comparable economy.

The Submission presents a plan for achieving these objectives. Not by way of indirect "drivers" of productivity. Rather, by enabling and promoting accountability and visibility measures at the source of national productivity, the market and non-market sector enterprise. This approach will harness the ingenuity of enterprise leaders, their managers and staff, to the challenge of improving productivity.

We outline our rationale for the Submission's recommended approach (Productivity Approach, on page 5), a way in which to execute it (Productivity Program, on page 8) and we present a case study example of how effective it can be when enterprise organisations have the measurement systems, tools and culture with which to optimise their productivity performance (Productivity At Work, on page 12).



1. Productivity Approach

The Submission presents the following principles as necessary elements of effective enterprise productivity measurement.

Keep it simple

Google will happily direct any one of us to endless papers, reports and discussions that demonstrate how complicated measuring productivity is. It need not be. For most enterprise leaders, an economist's approach to measuring productivity is a complex academic concept with little practical application. For those who approach the challenge academically, the challenge is where and how to draw the line between mathematical elegance and accuracy, on the one hand, and a useful computation methodology meaningful to stakeholders interested in the results, on the other. It is not so much the formula for measuring productivity that presents the challenge, but rather deciding what constitutes inputs, outputs and any quality or other adjustments.

Involve everyone

Rather than only seek to promote a definitive formula and methodology for measuring the productivity of an industry sector, class of enterprise, or workforce, the Submission also advocates a "productivity improvement" approach. A facilitator (being an expert productivity improvement organisation or individual) engages with stakeholders to determine "key result areas" to be measured, designs a situation-specific methodology for deriving what constitutes inputs and outputs and compiles the results as a weighted productivity index. This avoids arguments as to accuracy because the sector, organisation, managers or workforce being measured become party to any subjectivity in the formula; they contribute to the design of the measures they are to be accountable for. The net result is a measurable key performance indicator (KPI) that stakeholders focus on, aligned in the performance of productivity measurement and improvement.

Make it fashionable

Part of the solution must be to promote that productivity should be measured by convention. LSI's Managing Director is the co-author of the business book, *The Whole In One*, which provides a methodology for measuring the alignment of an enterprise, its stakeholders and resources. The book includes a chronology of fashionable business improvement approaches that became generic over time, including "balanced score card", "six sigma", and "business process re-engineering". Productivity measurement can become the basis the latest way in to measure and improve enterprise performances. The Submission argues that Australia can and should make it so.

1. Productivity Approach cont.

Measuring productivity in everyone's interests

There are many stakeholders to making Australia more productive and benefits are on offer for everyone.

1. Governments

   Governments should lead by example and show the market sector how it is done. However, a traditional approach to measuring non-market sector productivity has been to value outputs equal to the cost of inputs. This is done on the basis that government services are not priced in a way that allows the value or importance of output items to be weighted in a measurement index. Such an approach may well serve to measure efficiency but is not satisfactory when measuring productivity. LSI advocates using volume of service outputs where possible. For example, number of medical procedures, liters of drinking water distributed to a community, etc.

2. Businesses

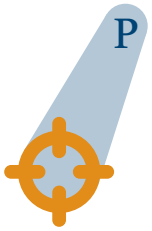
   Macroeconomic productivity measures do little to promote accountability for national productivity improvement at its source, the enterprise level of the economy. Similarly, the shareholder return metrics relied on by business to measure performance does nothing to promote workforce accountability for productivity improvement. When implemented well, productivity measurement can align the interests of all business performance stakeholders: boards are able to make executive management accountable for enterprise productivity and executive management are able to make staff accountable for workforce productivity.

3. Workers

   Wherever there is a work process, productivity can be effectively measured. Doing so focuses efforts to improve. It also dispels the myth that productivity improvement is about workers working harder. Workforce behaviour may well be a contributor to productivity under-performance. But it is just as likely to be an issue of inadequate processes, systems or tools that support the work effort. In other words, measuring productivity is just as likely to pressure management to improve support of the workforce, as it is likely to pressure workers to do more work.

4. Unions

   The political narrative around wage increases should include the use of productivity measurement as carrot, as much as a stick. It is both reasonable and desirable to not increase salaries on the basis that a request to do so is not supported by an increase in workforce productivity. But it is disingenuous to do so without providing workers with the means by which they can measure and improve their productivity. Productivity systems enable employment stakeholders to agree on reasonable expectations as to standards of performance and negotiate benefits that reward over-performance. A properly resourced commitment to productivity measurement and improvement can and should align the interests of management and workplace representatives.



1. Productivity Approach cont.

"...in the real world where Australians live, in the real world where people open businesses and risk their own money, you do not actually get a pay rise if you do not give a productivity gain. In voter land, when you are out having a coffee at a cafe, when you are having a beer at a pub, when you are having a sandwich at the local sandwich shop, the idea that you would get a pay rise and not have to offset that pay rise with a productivity gain, quite frankly, is unacceptable."
— Senator the Hon Michaelia Cash, Minister for Employment[1]

LSI agrees. Now lets work together to enable Australian workers, including non-market sector workers, to measure and improve their productivity, so they can earn a pay rise.

1 Parliamentary Debates, Senate Official Hansard, 15 October 2015, p. 7809.

2. Productivity Program

Productivity Financing Program

The Submission proposes that the government establish a program (that would have little if any impact on the federal budget) to finance productivity improvement of select applicant enterprises. The Submission is not concerned with so called drivers of productivity, such as innovation. Rather, we propose a program that provides loan finance for proposals over $1million that demonstrate a return on investment (ROI) based on measurable productivity improvements supported by analysis. Loans to be repaid with savings and/or performance improvements achieved.

The following outlines the rationale for such a program as well as how it could be structured, managed and funded.

Productivity Financing Program: Rationale

LSI has been performing ROI-based consulting for close to three decades. We, along with other productivity improvement consultancies, perform this work in two steps.

1. Productivity Analysis
   We identify and quantify the value of the opportunity for productivity improvement across an enterprise, achievable by enabling:
   a. extra capacity (increase of outputs without increasing inputs), and/or
   b. financial savings (reduction of inputs required to produce outputs).

2. Productivity Implementation
   We install productivity improvement systems to achieve projections contained in the Productivity Analysis.

The Productivity Analysis incorporates a business case that sets out the ROI for carrying out the Productivity Implementation. However, even when the Productivity Analysis includes:

- a high ROI projection as measurable against LSI fees,
- a low risk of failure, and,
- consultancy fees linked to the success of the Productivity Analysis projections being realised during or soon after the Productivity Implementation,

enterprise leaders still often find the upfront investment required to commence the proposed Productivity Implementation, an impediment to proceeding.

In other words, even when the Productivity Analysis supports a business case that makes the Productivity Implementation highly profitable for the enterprise, there can be resistance on the basis of the required initial investment.

The Submission proposes the Productivity Financing Program, to remove this impediment.

2. Productivity Program cont.

Productivity Financing Program: Structure

- Program Leadership Group

  Made up predominantly of productivity practitioners, experienced in analysis and implementation of enterprise change that enables measurable and financially quantifiable improvements—as opposed to academics or theorists.

  Responsible for approval of all financing proposals and overall governance.

- Program Promoter

  Commercial appointee.

  Responsible for development of frameworks, systems, tools and reporting to be used in performing enterprise services under the program.

  Responsible for the accreditation of each Productivity Consultant providing services under the program.
  Mentoring of each Productivity Consultant in developing enterprise ROI-based finance proposals.

  Remunerated when loan financing is repaid.

- Productivity Consultant

  Performs Productivity Analysis and Productivity Implementation services.
  Prepares proforma ROI-based finance proposals.
  Remunerated on the basis of achieved enterprise productivity performance gains.

Productivity Financing Program: Terms

Program to only offer loan finance over $1million with repayment due on realisation of projections contained in the Productivity Analysis.

1. Productivity Analysis
   Financed according to set program criteria (eg enterprise with more than 1,000 employees) at the discretion of the Program Leadership Group
2. Productivity Implementation
   Financed according to demonstrated ROI projections set-out in the Productivity Analysis.

Repayments to be apportion as follows.

- Principle repayment made to the program (government)
- Administration fee portion to contribute to program overheads
- Success fee portion to Program Promoter payable only when loan is repaid.

Productivity Improvement value (ROI) to be measured and catalogued by the Program Promoter but retained by the enterprise for reinvestment, for example in improved or expanded services or supporting innovation.

2. Productivity Program cont.

Productivity Level Agreements

The second way in which a government sponsored program could facilitate making Australia more productive is to facilitate deployment of Productivity Level Agreements (PLAs), to help promote productivity measurement as an enterprise KPI.

PLAs are similar to Service Level Agreements in that the process of forming the agreement is often more powerful and valuable than performance standards set by the final agreement.

A facilitator works with everyone within an organisation that is to be impacted by the use of productivity measurement as a KPI. The process involves working with managers to:

a. Design and facilitate agreement on a measurement formula or approach (eg inputs/outputs+quality=productivity)
b. Determine key results areas (KRAs) and associated methodologies for deciding what constitutes inputs (volume or value) and outputs (volume or value)
c. Establish baseline productivity, and
d. Set productivity performance goals, to improve upon baseline.

In some instances the PLA process leads to the establishment of an enterprise productivity index. Rather than focusing on KRAs, "key productivity ratios" are selected that, collectively, express an organisation's mission. Managers then weight each ratio to total 100, thereby establishing an enterprise or departmental productivity index that produces a numerical productivity score that can be charted over time.

Productivity Level Agreements: Tool Kit

To make the above approach effective on a wide scale, particularly across the non-market sector, the government could work with a productivity expert organisation to develop a PLA Toolkit to be used by facilitators. The PLA Toolkit could provide a framework incorporating approaches, methodologies and tools with which facilitators could adopt a flexible albeit common approach, across designated sectors.

Productivity Level Agreements: Promotional Campaign

Launch of the PLA Toolkit could form part of a government orchestrated campaign to promote enterprise productivity measurement. As part of a coordinated effort: agencies could be directed to measure productivity; a marketing campaign could promote the virtues of enterprise productivity measurement; a period of government sponsored facilitation support could be made available to select sectors and enterprises; and, the *Australian Productivity Measurement and Improvement Awards* could attract entrants that demonstrate productivity improvement supported by measurement systems.

2. Productivity Program cont.

Align Enterprise Productivity to the National Accounts

The third initiative the Submission advocates for making Australia more productive is the design of a new approach for aligning microeconomic productivity performance directly to the national accounts. This would provide policy makers with greater visibility when seeking to understand the root causes and location of any productivity under-performance at the enterprise level of the economy.

Here is how we might approach such effort, if tasked with doing so.

1. Determine the sectors and enterprise organisations, the productivity performance of which is material to Australia's productivity performance. (An example of an LSI sector-wide analysis is a report at the Appendix: *Where and How to Target Investment in Merging Sydney Councils)*

2. Using the KLEMS productivity measurement model as a guide, establish a standardised way to objectively measure the productivity of an enterprise (as opposed to the "subjective measure" used by PLAs).

3. Assemble task-forces of experts aligned with the market and non-market sectors chosen in 1 above.

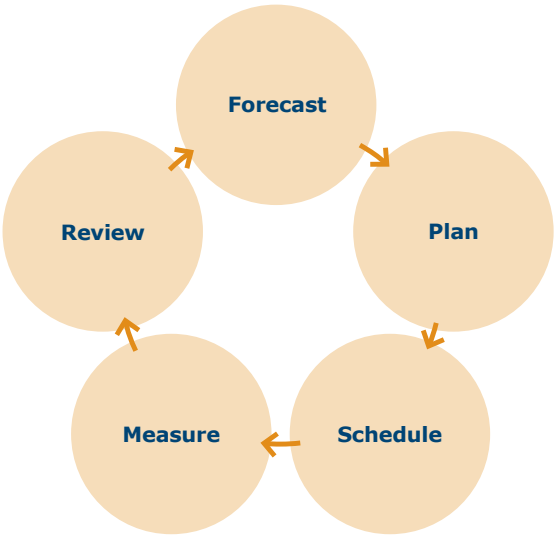
4. Develop sector frameworks, including methodologies and tools, to facilitate engagement with and solicit feedback from, each sector, in determining where and how they recommended productivity should be measured. The output of this work would inform decisions as to quality or other adjustments to productivity measurement formulas used for that sector.

5. Develop a formula for linking enterprise measures with the national accounts.

3. Productivity at Work

Productivity systems

LSI establishes enterprise productivity systems that make it possible for standards of productivity performance to be maintained and improved. Productivity systems provide frameworks and tools with which to forecast, plan, schedule, implement, measure and review work and corresponding performances—supported by a feedback loop that enables a continuous improvement process.



Enterprise productivity system instalation requires, as a first step, identifying the source and scope of improvement opportunities: firstly, by analysing alignment and gaps between operational delivery and strategic plans; and, then, by measuring performances (current and past, best and worst) and variances in each area operational area and working collaboratively with management and staff to quantify opportunities for improvement.

Case Study

Between 2012 and 2014, LSI carried out an enterprise-wide productivity systems installation for a local government serving a population of 172,200. The project was to enable a strategy supporting forecasted limited growth and a requirement was that there be no redundancies. All eight of council's divisions were diagnosed and improvement opportunities catalogued and prioritised. Productivity systems were subsequently installed over three years in operational areas with all functional inputs and outputs reviewed. A training and development program for managers and supervisors engaged them in the design and implementation of the productivity systems. Financial performance of the council (as reported in audited accounts) moved from an operating deficit of $14.8m in 2012 to a surplus of $12.3m in 2015.

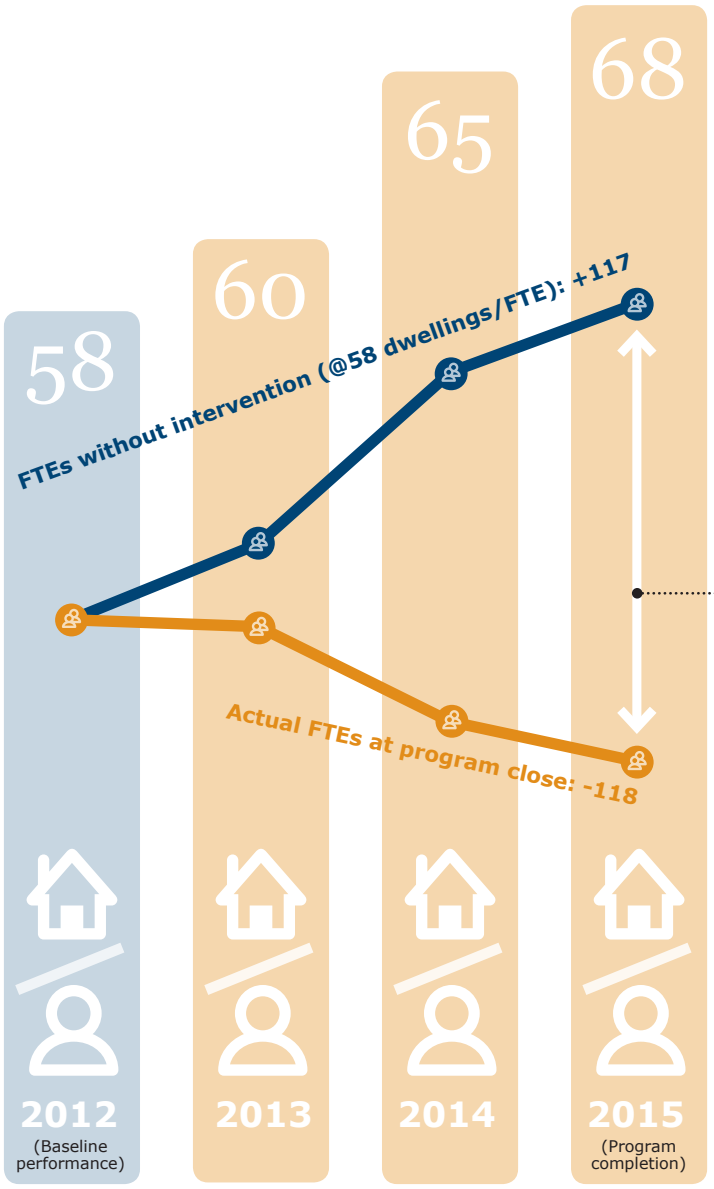
"The city is in the strongest financial position in living memory"—Mayor[2]

2 Of the council that is the subject of the above case study, October 2016

3. Productivity at Work cont.

Case Study cont.

The chart below shows one productivity metric of the program, being dwellings serviced, per FTE. New dwellings (volume) increased by 6,025 (+10.4%) over the period, while the FTE resources required to service them (inputs), not only did not increase, they reduced (-10.5%). On this basis, the council's monetary return on investment in the program after three years exceeded 12:1.



At the program start, productivity was measured at 58 dwellings serviced, per FTE (baseline); at program's end, 68 dwellings per FTE were being serviced.

$17.9m
improvement per annum

Based on 235 FTEs @2015 cost of $75,985

LGA profile (2012)

- Population: 172,200
- Density: 1072 persons/km2
- Dwellings: 57,878

3 FTE: Full time equivalent employee

4 Direct Income: Total income less federal and state grants and contributions

Productivity improvements a further year after program continue to yield dividends. Based on audited financial accounts in the period June 2012 (baseline) and June 2016, improvements include the following.

- Physical Assets managed per FTE[3]: up 28.9%
- Total FTE[3] count: down 8% (achieved through attrition, ie no redundancy)
- Employee & On-costs as a % of Direct Income[4]: down 25.3%
- Contractors & Materials costs as a % of Direct Income[4]: down 8.8%.

LSI Profile

LSI is an organisational performance and productivity improvement consultancy. Our work is underpinned by two philosophical beliefs: in order to improve something it must first be measured; and, given the right circumstances, everyone will want to do a good job when they come to work.

Organisation

- 27 years of operation
- Over 800 client projects completed; majority measured against return-on-investment goals
- Client benefits in excess of $3 Billion (annualised) delivered
- National team of management, competency experts and consulting practitioners
- Completed assignments across Asia Pacific including Australia, New Zealand, Singapore, Malaysia, Taiwan, Philippines, Thailand and Fiji
- Offices in Sydney, Melbourne, Canberra and Auckland
- QMS certified to ISO9001:2008
- Client testimonial satisfaction level (feedback) measured at over 91%

Government Panels

LSI is a member of Commonwealth and State government procurement panels, including:

- NSW Whole of Government panel – Department of Finance, Services & Innovation, Performance and Management Services scheme, fully pre-qualified service provider (9 of 28 capabilities; all those relevant to business improvement)
- Local Government Amalgamation – Supplier Panel
- Department of Education - Learning and Development Panel
- Department of Employment - Learning and Development
- Defence Materiel Organisation Support Services (DMOSS) Panel
- Department of Innovation, Industry, Science and Research Panel
- Department of Education, Employment and Workplace Relations
- WA Department of Finance, provision of Audit Services & Financial Advice
- Queensland Whole of Government panel - Queensland Government Professional Services Panel
- Queensland Whole of Government panel - Queensland Government ICT Pre-qualified Panel.

Appendix

Where and How to Target Investment in Merging Sydney Councils

An obstacle to productivity improvement for governments is fragmented levels of authority to direct change. This could be overcome with funding arrangements. For example, the federal government does not have power over local governments. However, it will, in 2016–17 via the Financial Assistance Grant programme, distribute over $2.2billion to local governments nationally. This money is provided to councils on an effort neutral basis; they can spend it how they like.

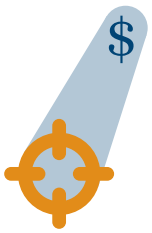
LSI considers this to be a lost opportunity. The Submission advocates an approach where more federal funding is "tied", particularly in ways that enable productivity to be measured.

The attached independent report produced by LSI Consulting, *Where and How to Target Investment in Merging Sydney Councils*, presents such a proposal. The report argues the case for the NSW Government to tie council "merger program" funding (up to $25 million per merged council) to productivity improvement outcomes.

LSI Consulting presents

Where and How to Target Investment in Merging Sydney Councils

May 2016



Preface

Strategic intent

Where and How to Target Investment in Merging Sydney Councils is an independent analysis (the Analysis) by LSI Consulting Pty Ltd (LSI) of financial and non-financial performance of Sydney metropolitan councils (the 43 Councils). The Analysis responds to and supports *Fit For the Future* and Local Government Authority reforms including council amalgamations (the LGA Program).

There are two obstacles to realising the $341m per annum ($3.01b NPV)[2] benefit projected by the Analysis:

- funding for programs that support workforce productivity, asset management and other performance improvement; and,
- resistance-to-change inertia within councils.

The LGA Program *may* provide funding to councils that agree to merge. The Analysis recommends that it be tied to performance improvement deliverables. The LGA Program *will* disrupt resistance-to-change inertia. The Analysis points to where and how to make use of this opportunity. For example, by installing productivity systems that enable the financial and non-financial performance improvements detailed in the following pages to be realised.

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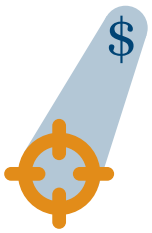


Overview

Introduction

The Analysis is of published Financial Statements[1] of the 43 Councils for the years 2014 and 2015 (the Period). Opportunities are identified for generating community benefits in the form of financial savings, additional income and increased workforce capacity—all resources for generating greater services to the community (STC).

The Analysis may be useful to the NSW Government when designing policies in support of LGA Program merger funding. For example, when considering what benchmark settings are reasonable to require newly formed councils to perform against, in exchange for LGA Program funds provided.

As a catalyst for change, merger funding can be the most strategic element of the LGA Program. Funding tied to performance deliverables can extend the LGA Program beyond structural change of council mergers to enabling transformational improvement of operating performances. Councils with weak financial positions could be prioritised, or funds provided as a sector-wide performance improvement approach.

Recommendations (page 30) include investigation with some councils to validate benchmark data before 2015/16 Financial Statements are finalised and new councils formed. In future, this will enable workforce productivity and asset management performance data to be used to communicate LGA Program benefits more authoritatively by councils, the Office of Local Government (OLG) and NSW Government ministers.

Stakeholders of the LGA Program are encouraged to consider a point of difference in the Analysis. The Report Card, *IPART assessment of NSW council Fit for the Future proposals,* states that 'Sydney metro mergers could save close to $2billion' (NPV) in savings. To an extent this estimate is based on economies of scale impacting above-the-line costs. The Analysis, on the other hand, is concerned with the identification of below-the-line productivity improvements valued at an additional $3.01billion (NPV[2 (page 5)]). In some areas, such as Asset Management, the Analysis' projections are understated.

Investing in councils as recommended by the Analysis will enable workforce productivity, asset management and other performance improvements to generate the projected benefits. (Page 13 illustrates how such benefits were achieved at one council.) Merger economies *and* operational performance improvements will, together, ensure that new Sydney metropolitan council organisations add up to more than the sum of their 43 parts.

1. Accounting anomalies have been identified that warrant further investigation. Some of them are particularised in boxes below charts on pages 4, 11, 17, 21, 23, 24, 25 and 26, and in text on page 27.

Overview

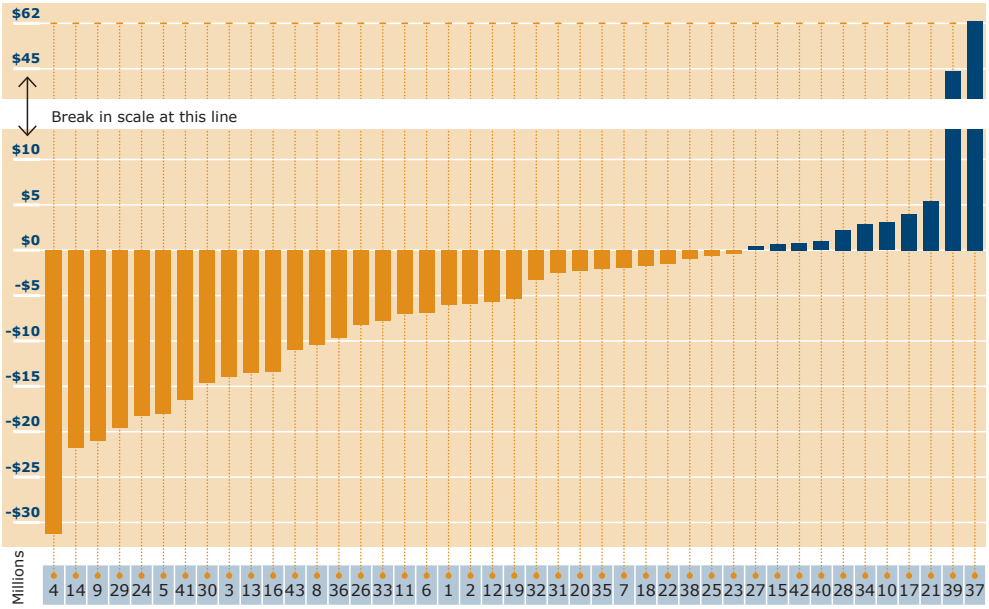
The problem the LGA Program is addressing

More than two thirds of NSW Councils have expenditure greater than revenue.

Figure 1 illustrates the Net Operating Result of the 43 Councils at June 2015, excluding Grants and Contributions (provided by the Commonwealth and the NSW Government). More specifically, for each of the 43 Councils, in order of poorest to best operating result, Figure 1 presents:

- Income from Continuing Operations, less
- Expenses from Continuing Operations.

Net Operating Result of the 43 Councils - June 2015



The Analysis assigns a number to each of the 43 councils and charts them in numerical order in all charts but those where they are sorted in a particular order, in this case, by Net Operating Result (worst to best result).

Extraordinary items of some councils make the financial position of councils worse than that illustrated above. For example, in the 2014/15 year, in relation to:

- income,

  $108.3m of asset sales by 31 of the councils were recorded, including,

  a. Council No. 39 (second from right) recorded as income, an extraordinary item in the amount of $48.73m, being 'Net gain from the disposal of assets'. If not for this item, the result would show a loss of $3.81m.

  b. Council No. 37 (rightmost) recorded as income, an extraordinary item in the amount of $120m, being 'Fair Value Adjustments - Investment Properties'. If not for this item, the result would be a loss of $245K.

- and expenses,

  $5.48m 'Net Losses from Disposal of Assets' were reported by 11 councils and a further $20.53m losses from 'Net Share of Interest' was recorded.

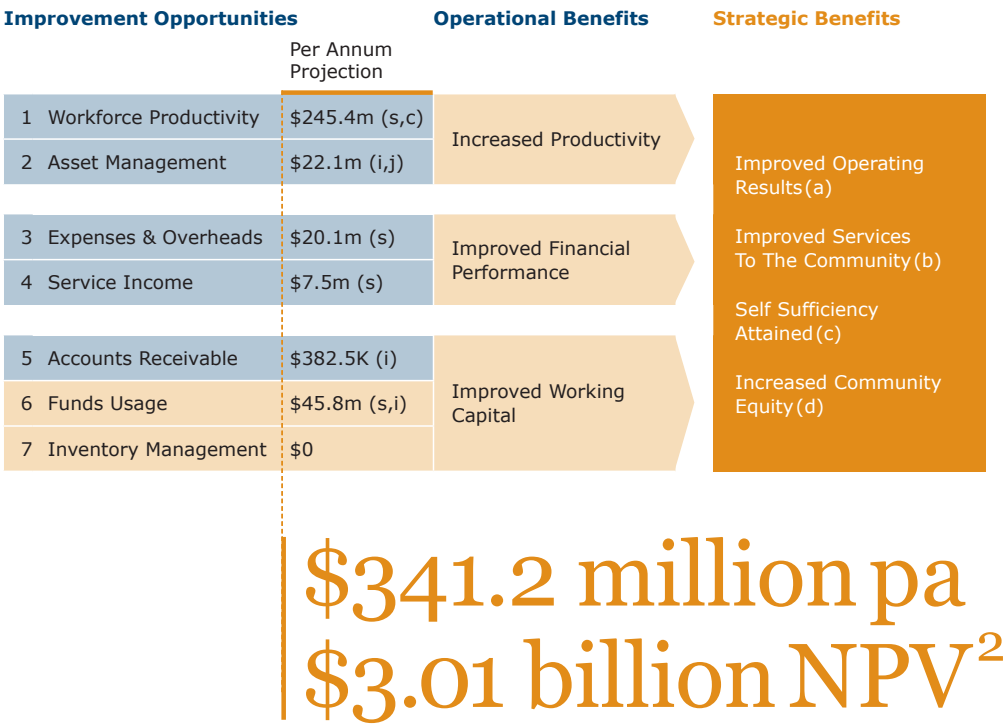
Figure 1

Those councils that have a breakeven financial trading position (dark blue bars) are able to use Grants and Contributions—whether provided by the Commonwealth or NSW Government, for operational, capital or financial assistance purposes—to build community equity, for example by building and maintaining community assets and providing new and improved STC.

Overview cont.

Benefits

Figure 2 below presents a valuation of improvements identified by the Analysis. While LSI's intent in publishing the Analysis is, primarily, to encourage improvement in workforce productivity (the areas shaded in blue are those we will seek to impact around the time of the LGA Program), we present categories of opportunities numbered one to seven that include areas of financial management (Target Areas). The Analysis presents the value of benefits in Target Areas based on a level of performance improvement in each area. The projections total per annum, $341.2m ($3.01b NPV)[2].



$341.2 million pa
$3.01 billion NPV[2]

Areas impacted by productivity systems (page 9)
(s) Savings
(c) Capacity increase (based on FTE value)
(i) Income/cash generation
(j) Reduce infrastructure maintenance backlog

(a) Reflected in annual accounts
(b) Range, volume, standards
(c) Operating at break-even, independent of Comm. and State Govt grants and contributions
(d) More community value generated, from Comm. and State Govt grants and contributions

Figure 2

2. The Analysis projects a per annum financial benefit based on an improvement in each Target Area. The projection is accompanied by its Net Present Value (NPV), based on: 20 years; and, a 9.5% nominal (7% real) discount rate. Source of NPV discount rate and period: IPART *Assessment of Council Fit for the Future Proposals.*

Overview cont.

Getting the most from the Analysis

The Analysis covers financial and non-financial performances of the 43 Councils as published in their audited financial statements. The following four criteria provide context for its findings, conclusions and recommendations.

1. Landscape: the 43 Councils

June 2015	Total	Largest	Smallest	Average
Population served	4,839,638	332,424	14,689	112,550
Dwellings served	1,706,638	101,950	4,900	39,689
Staff employed	22,323	1,807	59	519
Total Assets	$80,096,885,000	$7,795,037,000	$302,234,000	$1,862,718,000
Total Liabilities	$2,565,221,000	$307,114,000	$6,080,000	$59,656,000
Net Equity	$77,531,664,000	$7,618,770,000	$284,108,000	$1,803,061,000

Figure 3

2. What is meant by: STC Income[3], STC Labour[4] and Expenses[4]

   Figure 4 is a combined Income Statement of the 43 Councils for the year 2014/15. It shows how STC Income[3], STC Labour[4] and Expenses[4] are defined throughout. The definitions include only those categories—from the column on the left in Figure 4—that represent areas council management and staff are able impact the performance of in how they work together, ie controllable income and controllable expenses.

Income Statement (2014/15) of 43 councils & definitions (000s)

		3 STC Income	4 STC Labour	5 Expenses
Income from Continuing Operations (000s)				
Rates & Annual Charges	3,225,913	3,225,913		
User Charges & Fees	831,432	831,432		
Other Revenues	596,508	596,508		
Interest and Investment Revenue	163,181			
Grants & Contributions-Operational	489,173			
Grants & Contributions-Capital	1,218,361			
Net Gains from Disposal of Assets	108,322			
Associates using equity method	5,343			
Total	$6,638,233			
Expenses from Continuing Operations (000s)				
Employee and On-costs	2,055,927		2,055,927	
Materials and Contracts	1,217,773		1,217,773	
Borrowing Costs	67,071			
Depreciation & Amortisation	888,975			
Other Expenses	803,311			803,311
Net Loss from Disposal of Assets	5,478			
Loss from Interest in Joint Ventures	20,527			
Total	$5,059,062	$4,653,853	$3,273,700	$803,311

Figure 4

Overview cont.

3. Performance Benchmarks

Charts in the Analysis are based on many and varied financial measures, such as those representing expenses and income. The Analysis also presents ratios and findings based on non-financial inputs and outputs, including:

- Number of dwellings
- Population
- Population density
- Full Time Equivalent (FTE) staff
- Equivalent Persons (STC Labour[4] to FTEs)
- Receivables days outstanding
- Inventory days coverage

In taking this approach, the Analysis focuses on workforce productivity and asset management, not only as root causes of inefficiency and poor financial performance, but also as sources of improvement opportunity and that which can best enable the breadth and quality of STC.

Assets and STC Labour[4] productivity measured and reported

New South Wales Treasury Corporation (TCorp) published, in 2013, *Financial Sustainability of the New South Wales Local Government Sector* (the TCorp Report), a precursor to the LG Program. The TCorp Report presents analysis based on an index made up of the following 10 ratios.

1 Operating ratio	6 Interest cover ratio
2 Cash expense ratio	7 Building and infrastructure backlog ratio
3 Unrestricted current ratio	8 Asset maintenance ratio
4 Own source operating revenue ratio	5 Building & infrastructure asset renewal ratio
5 Debt service cover ratio (DSCR)	10 Capital expenditure ratio

The Councils report performances in their Financial Statements in line with ratios 1-5. However, ratios 6-10, that mostly relate to asset management, are not reported against. The Analysis recommends the inclusion of asset management ratios in performance reporting along with ratios that measure workforce productivity, as part of the OLG Integrated Planning and Reporting framework (IP&R). Such a need is supported by the 2012 Audit Office of NSW Performance Audit, *Monitoring Local Government*:

‘The financial information meets requirements. However, the non-financial information is not standardised to allow comparisons’ – Audit Office of NSW

Figure 5

Overview cont.

4. Productivity Measurement

To enable comparison of differing council business models, where STC work is performed by either council staff or by contractors, an equivalent person (EP[6]) derivation has been used. Productivity is then measured by dividing the number of EPs[6] employed by a council (inputs), into the number of dwellings it services (outputs).

Figure 6

Figure 7 below shows the number of council dwellings serviced per EP[6], for each of the 43 Councils. There is wide variation (60.2%) in productivity performance. The council with the most productive workforce services 63 dwellings per EP[6] and the least productive services 26. The orange line represents the 43 Councils in order of population density. The blue line (STC Labour[4] productivity) shows little if any correlation with the population density of the areas served by councils.

No of council dwellings per equivalent person

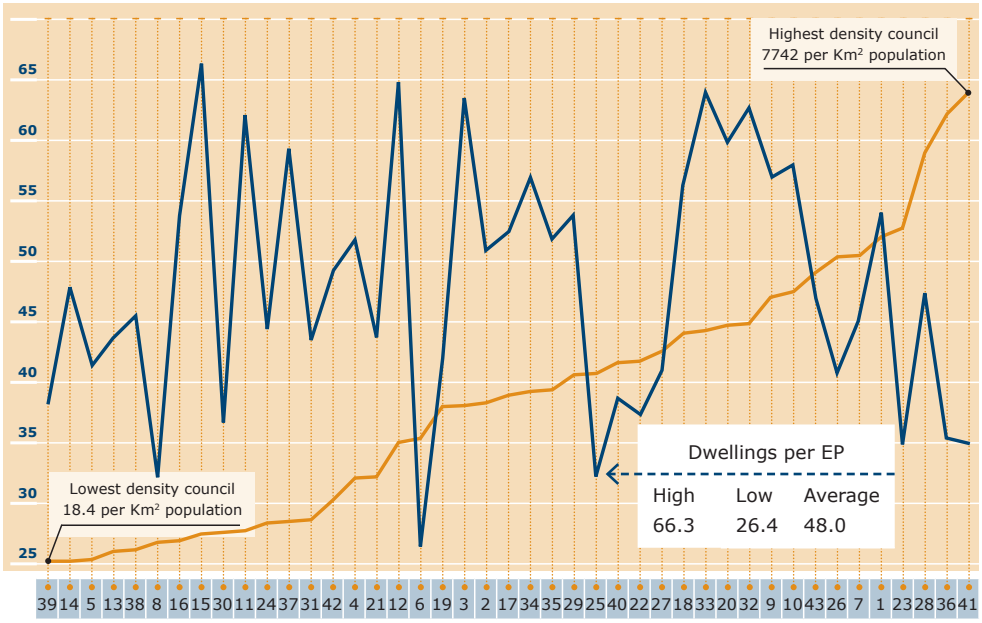


Figure 7

6. An EP is a) the number of full time equivalent (FTE) council staff employed, plus b) the sum of, a council's 2015 Materials and Contracts value, divided by its 2015 FTE value.
7. Dwellings number source: Australian Bureau of Statistics supported by data provided by some of the 43 Councils.

1. Workforce Productivity

The significance of STC Labour[4]

Workforce productivity is the Target Area offering the greatest opportunity for improvement. As Figure 4 shows on page 6, STC Labour[4] represents the largest portion of the 43 Councils' business.

- STC Labour[4] as a percentage of STC Income[3], is 70.3%.
- STC Labour[4] as a percentage of all expenses (Expenses from Continuing Operations), is 65.9%.

The economies of scale generated by amalgamations and the LGA Program, however great and valuable, will be no substitute for the resource management dividend (STC standards improvement, financial savings and labour capacity increase) that can be generated by productivity systems that up-skill the 43 Councils' management and staff, to:

- plan, measure and review work performance;
- on a daily, weekly and monthly basis;
- to agreed performance and quality standards;
- as part of a continuous improvement, productivity management loop; and,
- as an effective, accountable and multi-skilled workforce.

Productivity systems, installed by skilled personnel that engage with people who perform the work at issue, achieve that.

Expenses from Continuing Operations of the 43 councils 2014/15

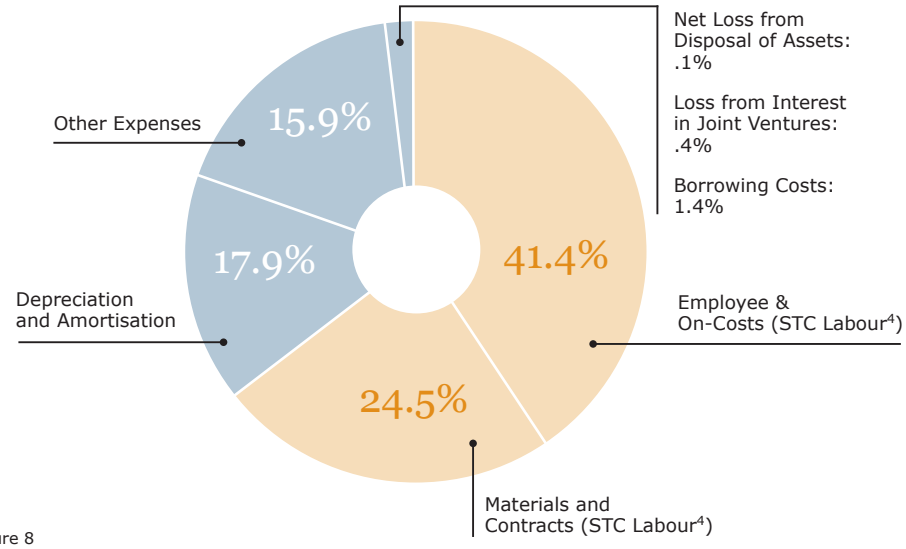


Figure 8

STC Labour[4] represents 70% of STC Income[3] and 66% of all expenses

1. Workforce Productivity cont.

Figure 9 is a 2015 productivity comparison and Period trend for the 43 Councils.

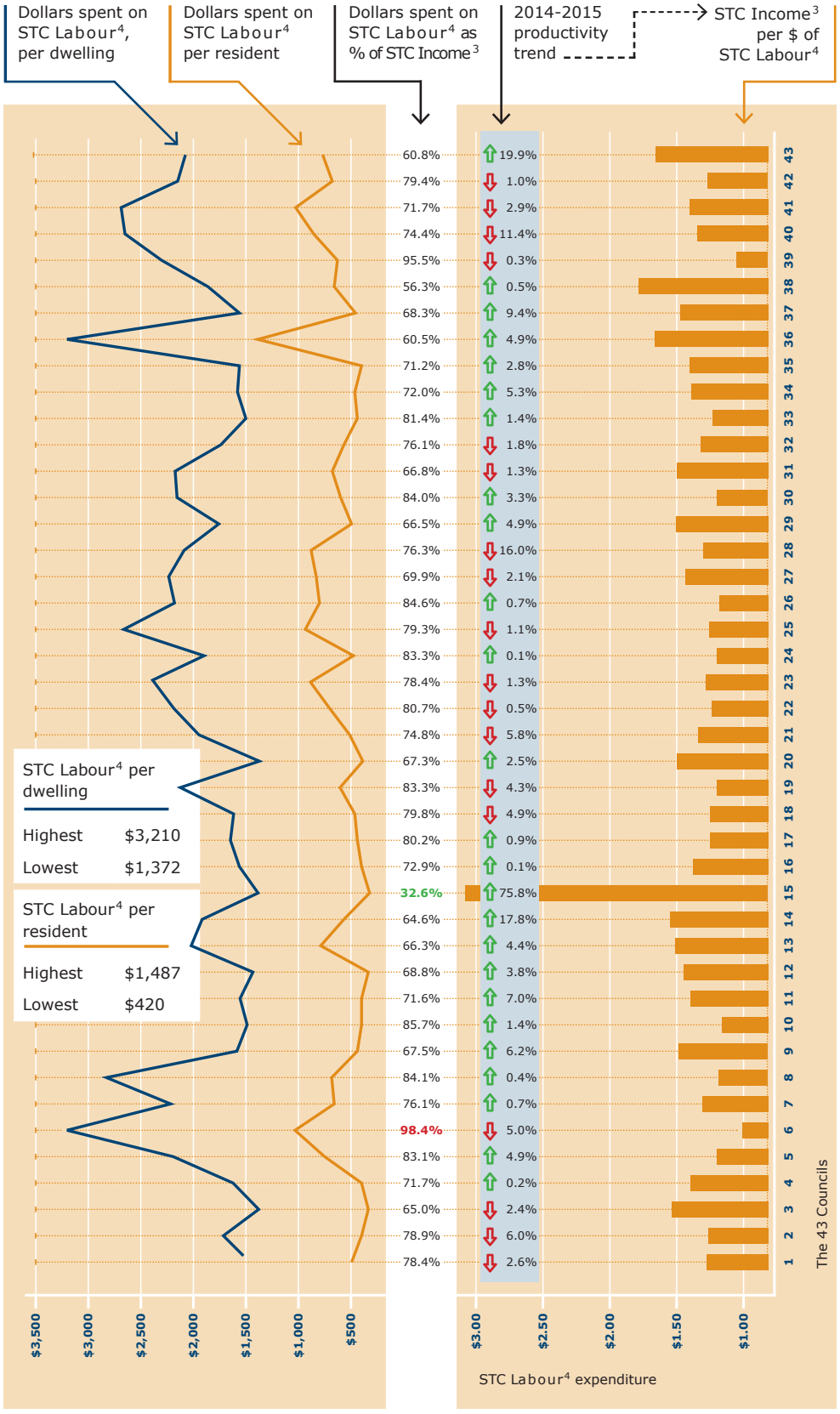


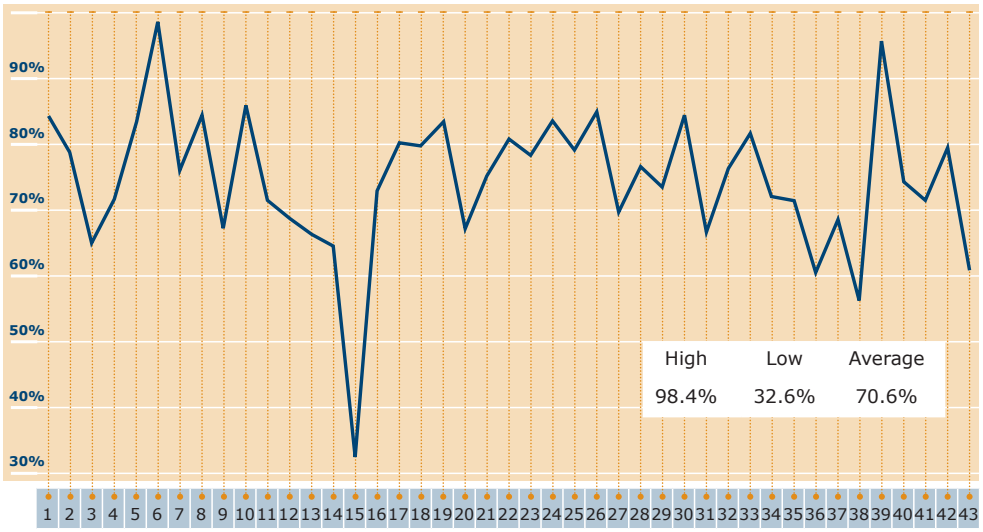
Figure 9

1. Workforce Productivity cont.

STC Labour[4] by council

Figure 10 below plots STC Labour[4] costs as a percentage of STC Income[3], across the 43 Councils.

STC Labour[4] as a percentage of STC Income[3] 2014/15



Council No. 15 recorded $6m project costs and $125.9m Fair Value Adjustments for Investment Properties as Income which is not income derived from STC.

Figure 10

Understanding productivity improvement

Workforce productivity improvement is not about making people work harder, longer or for less. Nor should it be thought of as associated with redundancy. Productivity systems provide council management and staff with business improvement capability and skills that, in turn, enable continuous improvement in managing community assets and delivering STC.

This systematic approach ensures waste and rework is at a minimum and that work is carried out as productively as possible.

A council will typically require around 15 productivity systems to adequately capture its critical functions. Areas with the largest number of personnel, usually operational and customer services areas, require the most time and effort and also provide the greatest STC improvement opportunity. Installation involves the implementer engaging with management and staff to instill ownership and ensure sustainability.

1. Workforce Productivity cont.

Productivity analysis (Establishing Opportunity)

Improving productivity requires, as a first step, identifying the source and scope of improvement opportunities: firstly, by analysing alignment and gaps between operational delivery and strategic plans; and, then, by measuring performances (current and past, best and worst) and variances in each area operational area and working collaboratively with a council to quantify opportunities for improvement. Below is an actual output of such an analysis process showing: a result for the council organisation (top, shaded table); and, for just one division (bottom, white table).

Council organisation

Business Area	Scope of Gain	Improvement Opportunity
Corporate Services	$1.6m to $2.1m	Service Level Agreement (SLA)
Planning & Development	$500K to $650K	Standards, delivery and monitoring
Community Services	$260K to $360K	Delivery, engagement and feedback
Technical Services	$200K to $230K	SLAs, engagement, contested delivery
Infrastructure Services	$200K to $300K	Standards, delivery and monitoring
Works, Parks & Recreation	$2m to $2.8m	Standards, delivery and monitoring
	$4.8m to $6.4m	

Works, Parks & Recreation division - on-site analysis

Function	FTEs Current	FTE Loaded Costs (Millions)	FTE Gain	Value of Gain @$70K (Thousands)	Evidence (Studies and analysis of Processes, Systems, Tools and Behaviours)
Parks	120	$8.40	9.0	$630.0	▪ Manager Interviews ▪ Work sequence maps, process flows and observations ▪ "Day in the Life" studies and analysis ▪ Maps of business processes, inputs and outputs, gap analysis ▪ Skills & capability assessment, gap analysis ▪ Cause and effect for variances ▪ Review of management systems ▪ Management critiques ▪ Review of HR performance management ▪ Receptivity to change level ▪ Waste estimate, lost time, duplication and rework
Civil Works	142	$9.94	10.7	$745.5	
Cleansing	53	$3.71	4.0	$278.3	
Maintenance	43	$3.01	3.2	$225.8	
Waste Mgmt	12	$0.84	0.9	$63.0	
Fleet Mgmt	4	$0.28	0.3	$21.0	
Small Plant	2	$0.14	0.2	$10.5	
Fleet Servicing	24	$1.68	1.8	$126.0	
Line Marking	12	$0.84	0.9	$63.0	
Street Signs	3	$0.21	0.2	$15.8	
Soil Testing	4	$0.28	0.3	$21.0	
Streetscape	16	$1.12	1.2	$84.0	
Road Defects	32	$2.24	2.4	$168.0	
Contributed assets	2	$0.14	0.2	$10.5	
Support services	28	$1.96	2.1	$147.0	
	497	$34.8m	37.3	**$2.6m**	

The example shows that, based on analysis, the council's Works, Parks & Recreation improvement opportunity is in the range of $2.6m.

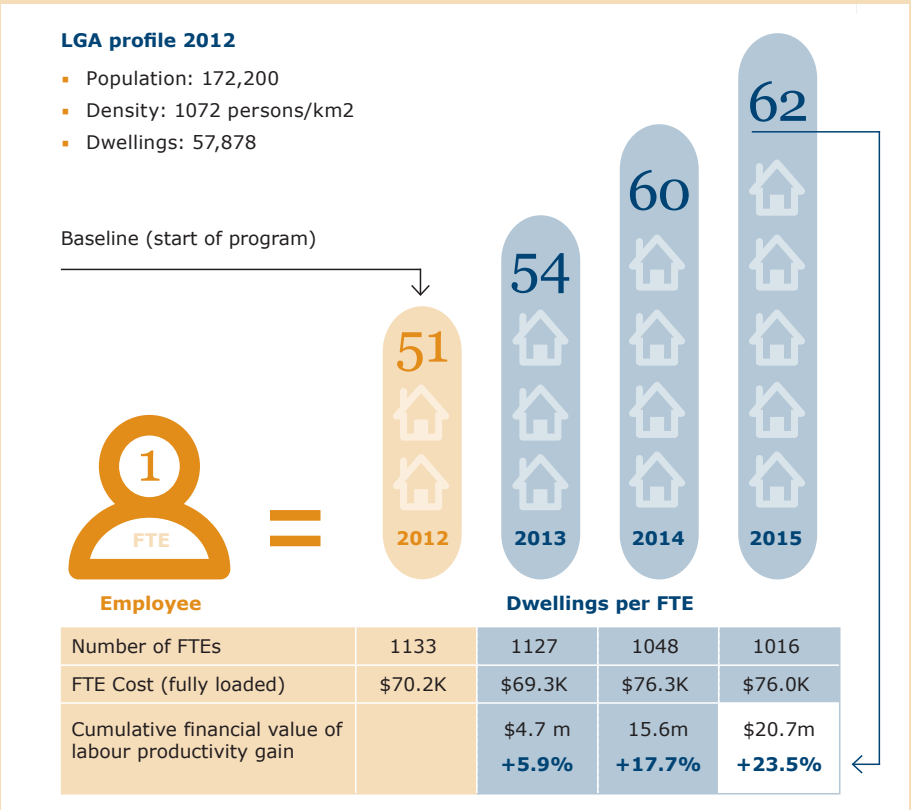
Figure 11

1. Workforce Productivity cont.

Productivity systems installation (Realising Opportunity)

Between 2012 and 2014, LSI carried out a council-wide productivity systems installation for an LGA serving a population of 172,200. The project was to enable a strategy supporting forecasted limited growth and a requirement was that there be no redundancies. All eight of council's divisions were diagnosed and improvement opportunities catalogued and prioritised. Productivity systems were subsequently installed over three years in operational areas with all functional inputs and outputs reviewed. A training and development program for managers and supervisors engaged them in the design and implementation of the productivity systems. Financial performance of the council (as reported in audited accounts) moved from an operating deficit of $14.8m in 2012 to a surplus of $12.3m in 2015. Moreover, State Financial Assistance grants for operational purposes reduced from $16.2m in 2012 to $14.8 in 2015.

Realised productivity improvements of program - Dwellings per FTE



Number of FTEs	1133	1127	1048	1016
FTE Cost (fully loaded)	$70.2K	$69.3K	$76.3K	$76.0K
Cumulative financial value of labour productivity gain		$4.7 m **+5.9%**	15.6m **+17.7%**	$20.7m **+23.5%**

This chart shows productivity improvement in dwellings serviced, per FTE. New dwellings (volume) increased by 6,025 (+10.4%), while the FTE resources required to service them (inputs), not only did not increase, they reduced (-10.5%), without redundancies. The council's monetary return on investment after three years exceeded 12:1. Projected savings from completion, are $29.7m per annum ($261m NPV[2]).

Figure 12

1. Workforce Productivity cont.

Leave Entitlements

Provisions for future contingencies for the 43 Councils at June 2015 totalled $827.4m. The majority of these provisions (80.5%, or $667m) relate to accrued employee Annual Leave, Long Service Leave, Sick Leave and Other Leave. Analysis shows that not all the 43 Councils accrue Sick Leave and Other Leave. The overall provisioning for the 43 Councils' leave at June 2015 is presented in Figure 13 below.

Leave Provisioning

Provision Type	Total Provisions-$Millions	Total Provision-Days	Council with Highest No. of days	Council with Lowest No. of days	Average No. of Days per council
Annual Leave	176	502,412	33.4	16.2	22.5
Long Service Leave	402	1,143,261	68.6	33.0	51.2
Sick Leave[8]	73	211,549	61.9	.2	9.5
Other Leave[8]	12	31,635	6.0	.2	
ELE On-Costs	4				
Total	**$667m**	**1,888,857**	**169.9**	**49.6**	**83.2 days**

Figure 13

The above indicates inconsistency in human resources practices and policies. On average, the 43 Councils' 22,323 employees have accrued 22 days annual leave each (more than one year's entitlement). Also, each of the 43 Councils have on average 51 days of long service leave accrued per employee. These findings demonstrate opportunity for improvement in resource management.

Long Service and Annual Leave Provisions (2014/15) - Days Per FTE

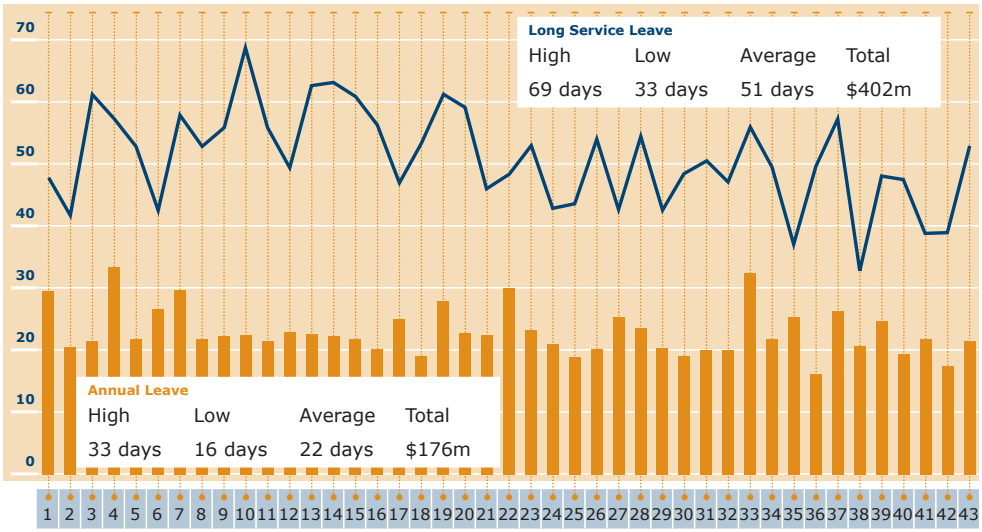


Figure 14

8. At June 2015, the 43 Councils all have Annual Leave and Long Service Leave provided, but seven councils have no Sick Leave provided for and 19 have no Other Leave provided for.

1. Workforce Productivity cont.

Staff Costs

Analysis reveals high variation in annual salaries and benefits across the 43 Councils. Following is a summary of Employee and On-costs amounts for the 43 Councils, per FTE, for the year 2014/15. This shows wide variation, with the highest FTE cost being 42.7% greater than the lowest.

Average cost per FTE 2014/15

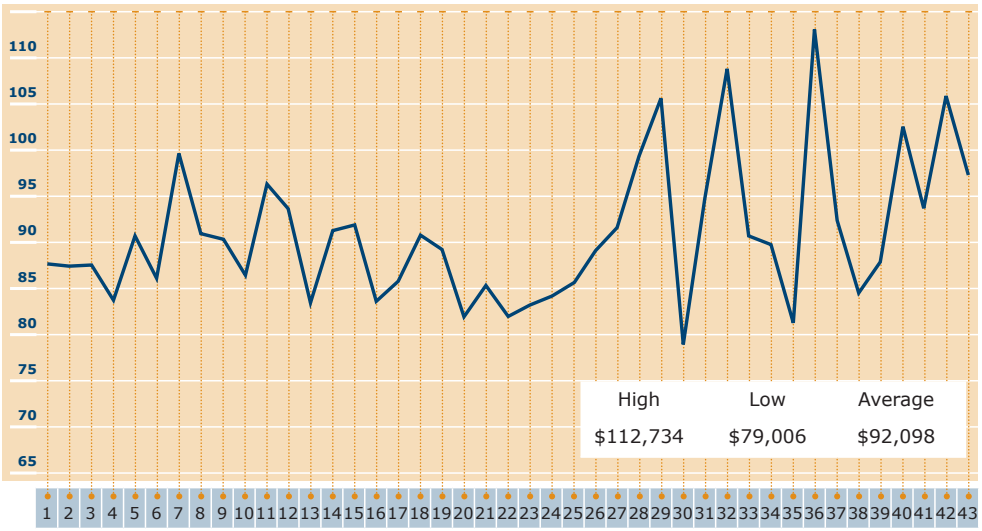


Figure 15

Further in-depth analysis based on roles (eg Arborist, Ranger, Property Development Planner, etc) would provide useful insight. For example, if this issue is not addressed when councils merge, rates of pay may be pressured to "rise to the highest level" in each category. This is a notable risk as a small increase in STC Labour[4] costs would require substantial growth in productivity to offset it.

Figure 16

9. Based on 2014/15, where: Employee and On-costs amounted to, $2,055,927K; Rates & Annual Charges amounted to, $3,225,913K; and, Dwellings numbered, 1,706,639.

1. Workforce Productivity cont.

Labour and asset productivity systems opportunity

Based on experience implementing productivity systems with council workforces, as demonstrated on pages 12 and 13, LSI projects a productivity benefit across the 43 Council's, of 7.5% increased STC Labour[4] capacity (comprising Employee and On-costs improvement of 9% and Materials and Contracts improvement of 5%). The 43 Councils' STC Labour[4] expenditure in 2014/15 was $3.3b, 7.5% of which represents a potential per annum benefit of $245.5m. Taking LGA Program job protections into account, realising the value of improvements can occur by way of productivity systems—that reduce rework and duplication, therefore requiring less resources—or financial savings. More specifically, gains can be realised by way of:

1. Capacity Increases
   - Additional type, range and volume of STC, eg serving population growth
   - Commercialisation of services, eg supplying STC to neighboring councils
2. Financial savings
   - Workforce attrition (see Figure 17 below), supported by up-skilling and redeployment of staff
   - Reduction in Materials and Contracts costs
   - Reduction of Materials and Contracts services (less supplier services)
   - Reduction in overtime

The projected $245.4m per annum benefit is to be achieved progressively through a three-year productivity systems implementation program.

+$245.4m/$2.2b NPV

Workforce Attrition

In 2015 LSI worked with one of the 43 Councils that has current attrition rate of 4.8%. Using a lower 4.2% rate as a base, the following outlines the potential value of attrition—as just one form of realising productivity gains generated by productivity systems—over three years (a typical period during which a comprehensive improvement program takes place). Notwithstanding the need to fill vacancies in key roles, the chart illustrates that realising savings by way of removing capacity is achievable without redundancies.

End of Year:	No of FTEs at 1 council (43 council FTEs 22,323)	No. of FTEs that are 4.2%	No. of FTEs net of 4.2%	Value of reduction (@ FTE fully loaded cost: $92,098)
1	519.0	21.5	497.5	1,983,653
2	497.5	20.6	476.8	1,901,331
3	476.8	19.8	457.0	1,822,426
Employee, per annum $ benefit at single council, after 3 years				$ 5,707,410
Employee, per annum $ benefit at 43 councils, after 3 years				**$245,418,625**

Figure 17

2. Asset Management

Community assets definition

This section of the Analysis deals with community assets managed and maintained by the 43 Councils and used for providing STC: that which is referred to in council accounts as Infrastructure, Property, Plant and Equipment (IPP&E Assets). Figure 19 on page 18 lists the 43 Councils' IPP&E Assets, the value of which is $73.6 billion.

Infrastructure maintenance

The TCorp Report (referenced on page 7) defines an infrastructure backlog (IB) as: 'the estimated cost to bring infrastructure, building, other structures and depreciable land improvements to a satisfactory standard, measured at a particular point in time'.

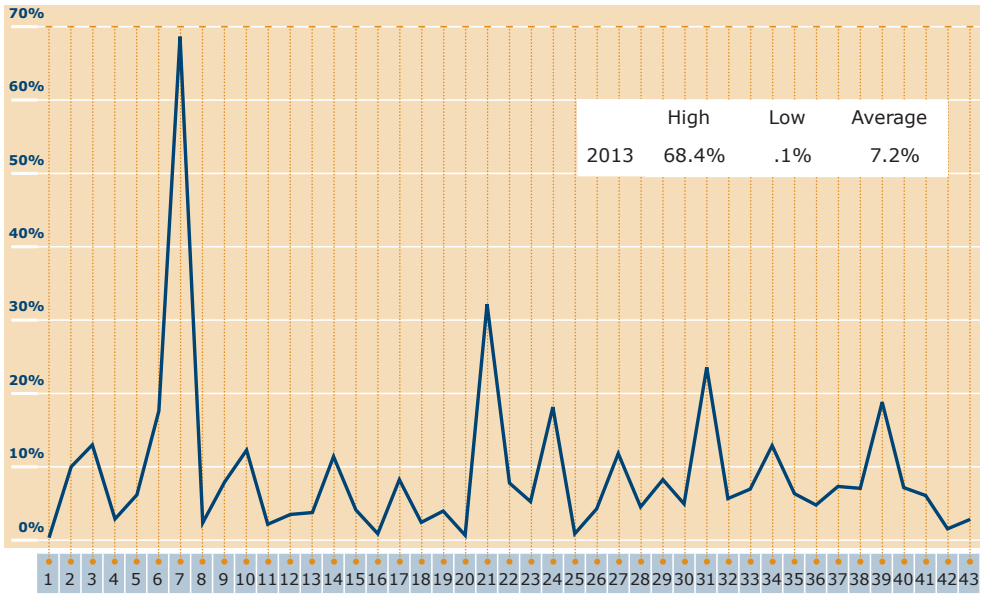
IB and councils' capacity to maintain assets has been reported in both the TCorp Report and the June 2013 Premier & Cabinet, *Local Government Infrastructure Audit* (the LG Audit). The Analysis deals with IB, as follows.

The most recent set of publicly available IB figures are published in the LG Audit. It records total IB of the 43 Councils in 2013, as $2,424,981,759 (the LG Audit lists IB for all 152 NSW councils, as $7.4b). By comparing this figure with the value of those IPP&E Assets that are subject to IB (highlighted column, Figure 19, page 18), the following ratios can be presented:

- IB 2013 as a percentage of IPP&E Assets subject to Backlog: 7.16%
- IB 2013 as a percentage of total IPP&E Assets: 3.29%.

Figure 18 presents the first of the above ratios, for each of the 43 Councils.

Infrastructure Backlog (IB) $ as % of IPP&E Asset value subject to IB



Council No. 7 requires further investigation. If accurate, its IB position is extreme. It reports IB of $167.2m and has IPP&E assets (that are subject to IB) of only $224.5m; an amount equivalent to 68.4% of the value of its IPP&E assets (that are subject to IB) would be required to complete all its IB work.

Figure 18

2. Asset Management cont.

Figure 19 shows IPP&E asset classes in order of value, the number of councils recording each class, and value of the classes that are, and are not, subject to IB. The top five 'Subject to Backlog' items (orange shade) make up 83% of IB.

IPP&E Assets at June 2015

IPP&E Asset Class	IPP&E Asset Value June 215 (000s)		Asset class as % of Total	No of LGAs Record Asset Class
	Not Subject to Backlog	Subject to Backlog		
Land Community	20,460,678		27.79%	43
Roads		15,546,611	21.12%	43
Land under Roads	7,199,491		9.78%	22
Storm-water Drainage		7,103,211	9.65%	43
Land Operational	5,973,303		8.11%	43
Buildings Non Specialised		2,995,905	4.07%	42
Bulk earthworks	2,489,013		3.38%	32
Sewerage network		2,218,318	3.01%	19
Buildings Specialised		2,126,615	2.89%	39
Footpaths		1 ,385,605	1.88%	36
Water Supply Networks		1,062,438	1.44%	19
Land Improvements Depr		820,251	1.11%	35
Other Open Space		785,101	1.07%	32
Other Structures		633,858	0.86%	36
Capital Work in progress	621,887		0.84%	40
Bridges		447,313	0.61%	37
Kerb and Gutter		369,904	0.50%	17
Plant & Equipment	353,156		0.48%	43
Swimming Pools		205,840	0.28%	26
Other		150,671	0.20%	29
Land Improvements Non Depr	126,088		0.17%	13
Open car Parks		95,462	0.13%	9
Quarry Assets		76,521	0.10%	2
Furniture & fittings	73,484		0.10%	38
Office Equipment	72,773		0.10%	42
Heritage Collections	54,575		0.07%	16
Library Books	48,272		0.07%	40
Sea Walls		37,716	0.05%	3
Tip		26,112	0.04%	6
Stormwater Drainage Non Depr		24,825	0.03%	2
Parks Equipment		15,009	0.02%	2
Council Controlled Land	9,096		0.01%	1
Traffic Facilities		3,722	0.01%	1
Wharves		3,680	0.00%	1
Domestic Waste		3,529	0.00%	1
Assets Not Subject to IB	**$37,481,816**			
Assets Subject to IB		**$36,138,217**		
Total IPP&E Asset Value	**$73,620,033 ($73.6b)**			

Figure 19

2. Asset Management cont.

Infrastructure Backlog

Analysis shows that the infrastructure backlog of the 43 Councils has little if any correlation to financial adequacy, debt position, size of asset portfolio or population density. A conclusion can be drawn from findings of the Analysis that the 43 Councils' high IB is a product of management decision-making, for example not making IB a strategic priority. Figure 20 and 21 below present the 43 Councils in order of the value of their IB (orange line), against which: Figure 20 plots the value of IPP&E assets per resident (blue line); and, Figure 21 plots total council borrowings (blue line).

IPP&E asset value per person (blue line) - sorted in order of IB backlog $ (orange line)

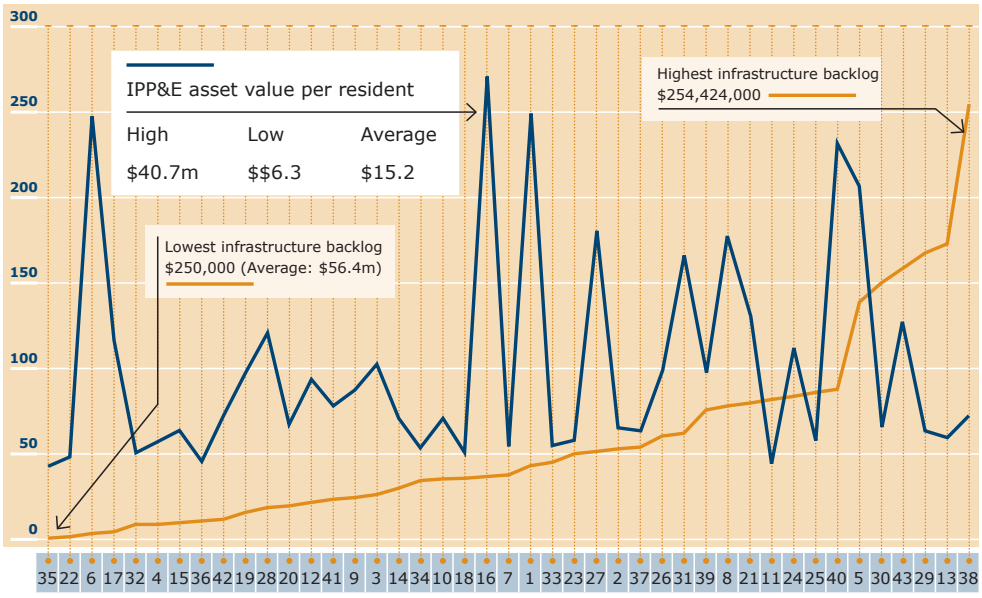


Figure 20

Total council borrowings (blue line) - sorted in order of IB backlog $ (orange line)

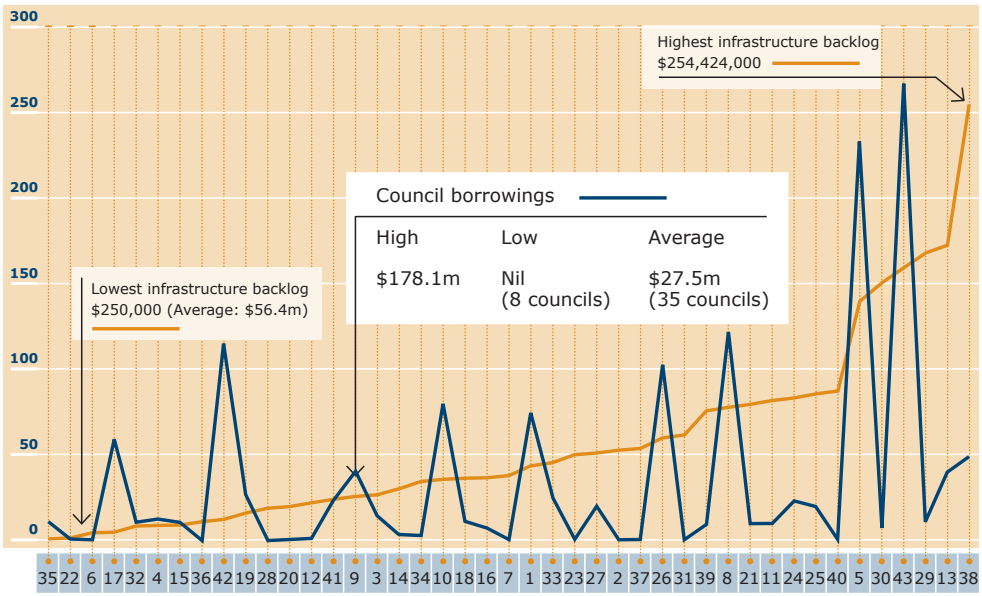


Figure 21

2. Asset Management cont.

Asset Management opportunities

1. Intergenerational Funding

   Many IPP&E Assets are of high value, with a long or unlimited economic life span (Inter-generational Assets). There is an equity argument to support the borrowing of capital sums (for example, by way of a government bond established for the sector) for the building of Inter-generational Assets and carrying out some IB. This approach transfers burden from the current generation to those enjoying future use of the Intergenerational Assets. Low debt associated with the 43 Councils' $73.6b of IPP&E Assets supports this proposition. The TCorp Report recommended that councils 'with the borrowing capacity, consider using debt funding to reduce infrastructure backlog and improve intergenerational equity'.

2. Asset Reporting

   OLG has, through IP&R, made progress in standardising how councils plan and report. Further standardisation with respect to the recording and accounting of assets would be beneficial. For example, accounting standards cause some councils to account for Land Under Roads (LUR) for roads built after 2008. As shown in Figure 19 on page 18, 22 of the 43 Councils have LUR assets of $7.2b, or 9.8% of the total IPP&E Asset value of the 43 Councils, whereas the remaining 21 have no LUR asset recorded. Moreover, it is possible that the 22 councils recording LUR may have LUR not recorded for roads built prior to 2008. A consistent approach for each asset class would enable and facilitate analysis and benchmarking.

3. Asset Productivity

   Scope exists to rationalise IPP&E Assets as part of more consistent reporting and improved categorisation of IPP&E Assets. This would facilitate and enable a sector wide approach and/or encourage behaviour with respect to improved management of IPP&E assets; for example, as relates to the sale of assets that are shown to be surplus, non-productive or non-essential. As part of mergers resulting from the LGA program, the sale of such assets could provide funds for IB and other investments. Additional funds may also lead to a reduction in Grants and Contributions for Operational Purposes provided by the NSW Government.

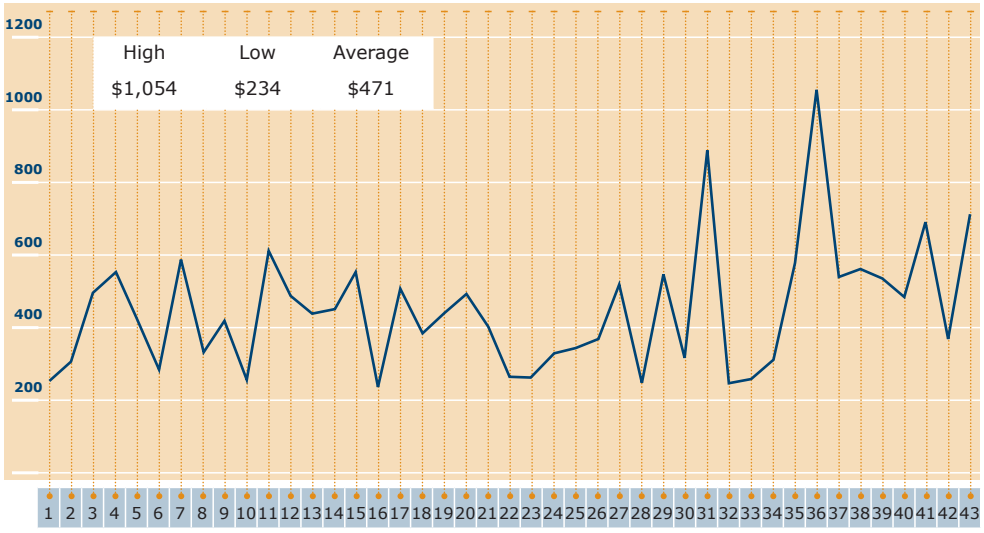
   Based on the value of IPP&E assets of $73.62b at June 2015, a sale of 1% of IPP&E Assets would generate $736.2m. At 3% yield, this would generate an investment return of per annum $22.09m.

+$22.1m/$194.6m NPV

3. Expenses & Overheads

Figure 8 on page 9 shows that STC Labour[4] is the greatest cost of delivering STC. All other costs of council operations (overheads) are accounted for as Other Expenses. The complexity and scale of the 43 Councils result in Other Expenses also representing a large proportion of their expenditure. In analysing Other Expenses, some expenditure items were identified which may be accounted for inappropriately, requiring further investigation. For example, 'waste levies' were accounted as overheads by some councils and 'tipping fees' as Materials and Contracts expenses by others.

Other Expenses per dwelling 2014/15



The Income Statement category Other Expenses (Figure 4, page 6) incorporates overhead expenses. Analysis identified inconsistency in expense allocation in this category. 13 councils had a total of $98.8m of waste levies recorded as Other Expenses. Further entries in Other Expenses that were identified (2014/15) include the following: Council No. 9, $1.044m agency costs; Council No. 39, $64K contractors; Council No. 12, $3.5m contractors; Council No. 15, $6m project costs and $125.9m Fair Value Adjustments for Investment Properties; Council No. 39, $4.2m revaluation IPP&E assets; Council No. 41, $2.8m Temporary Staff.

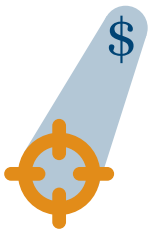
Figure 22

Expenses & Overheads opportunity

Accounting anomalies notwithstanding, LSI experience of productivity system installations in councils, where input costs are analysed, challenged and contested, is that they generate improvement in the form of reduced overheads. Relying on this experience together with analysis across the 43 Councils, an estimate of 2.5% reduction in Expenses & Overheads is projected, as follows.

- Total expenses & overheads (2014/15): $803m per annum
- Reduced Expenses & Overheads @ 2.5%: $20.1m per annum

+$20.1m/$176.9m NPV



4. Service Income

Service Income opportunity

The consolidated Income Statement, Figure 4 on page 6, defines council STC Income[3] as including three categories:

1. Rates & Annual Charges

   Rates are based on land values as administered by the NSW Government Valuer General and increases beyond the annual rate peg are subject to a 'special rate variation' approved by IPART. Rates are in large part beyond the capability of councils to control.

   - Other than with respect to collections (receivables), productivity systems do not impact Rates & Annual Charges

2. User Charges & Fees

   These are fees and charges levied for the delivery of statutory and regulatory services, for example inspection and compliance services such as park rental fees, pool admissions and road restoration charges.

   - Productivity systems impact some User Charges & Fees

3. Other Income

   Councils account for all other revenue in Other Income, eg income from property rental, fines, events, library fees and other miscellaneous sources.

   - Productivity systems impact Other Income.

Productivity systems prevent leakage (waste) with respect to User Charges & Fees, for example they ensure fees due, are collected. The Analysis relies on Other Income only (3 above) in projecting the value of improvements in Service Income (page 23), due to there being opportunity to expand revenue within this category.

Nature of performance improvement

Productivity systems establish planning mechanisms and positively impact culture in ways that promote continuous improvement.

1. Planning and transparency

   Historical and current records of performance, formally establish standards of performance, and a system-led focus on key results areas establish benchmarks against which poor performance is exposed and good performance is positively recognised.

2. Culture

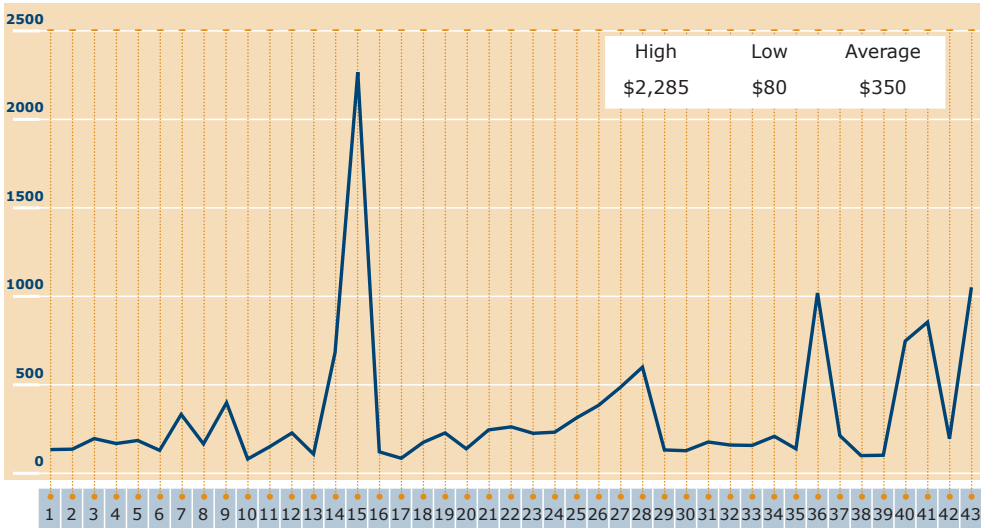
   Increased engagement and accountability cause people to move from a reactive to a proactive culture. In such environments, staff actively participate in pursuing opportunities for improvement, including as relates to income generation and collection.

4. Service Income cont.

Other Income analysis

Figure 23 below plots Other Income against the number of dwellings in each council area. The anomaly that is council number 15 notwithstanding, there is significant variance in the 43 Councils' Other Income performance.

Other Income per Dwelling 2014/15



Council No. 15 recorded in Other Income, an entry of $125.9m as Fair Value Adjustments for Investment Properties. This may be incorrectly or inappropriately accounted for and requires further investigation. Notably, Council No's 28, 36, 41 and 43 receive significant Other Income generated from larger commercial areas and parking fees, when compared with the 43 Councils overall.

Figure 23

Other Income opportunity

LSI's experience of productivity system installations in councils—where income generation and margins are analysed and contested, and focus on improving STC income is enabled—is that improvement in Other Income categories can be achieved. Relying on this experience, together with analysis across the 43 Councils, an estimate of 2.5% increase in Other Income is projected, as follows.

- Total Other Revenue (2014/15): $596.5m (12.8% STC Income[3]) per annum
- Additional income @ 2.5%: $14.9m per annum
- Cost of service delivery @ 50%: $7.45m per annum
- Net benefit (margin): $7.45m/$65.7 NPV per annum

+$14.9m/$65.7m NPV

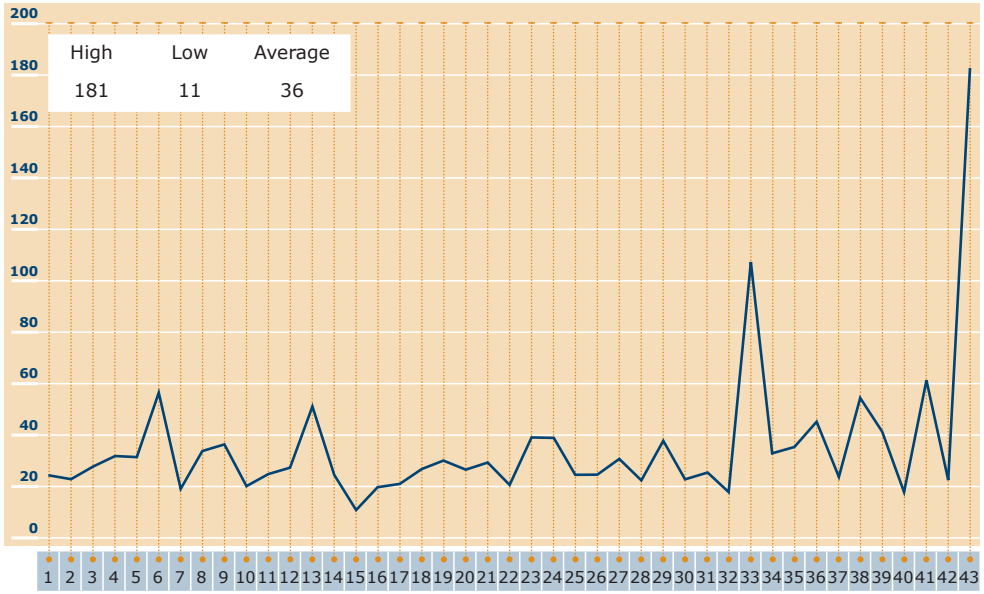
5. Accounts Receivable

A council's working capital is impacted by its ability to collect receivables, from which operations are funded. For example, poor collections performance may necessitate borrowing to pay overheads and expenses. Analysis of consolidated receivables for the 43 Councils at June 2015, shows the following position.

- Current $462m
- Non-current $103m
- Total $565m

Average days receivables outstanding for each of the 43 Councils, as is follows.

Receivables Days outstanding June 2015



Some councils recorded amounts that produced anomalies in the chart above. For example, Council No. 43's entry of a $7.8m "legal settlement" and Council No. 33's recording of a $43.2m "sale of land", are not trade receivables generated from Income from Continuing Operations.

Figure 24

Accounts Receivables opportunity

Improvement in receivables is impacted by productivity systems. For example, LSI-installed productivity systems at a NSW water utility caused the aged debt position to be improved by 24%.

For the year 2014/15, the 43 Councils generated STC Income[3] in the amount of $4.654b. Dividing this figure by 365 produces a consolidated average Days Receivables Outstanding amount of $12.756m. An improvement of one day would, therefore, provide $12.756m that could be invested. At 3.0% yield, a benefit would be produced of, per annum $382.5K ($3.37m NPV).

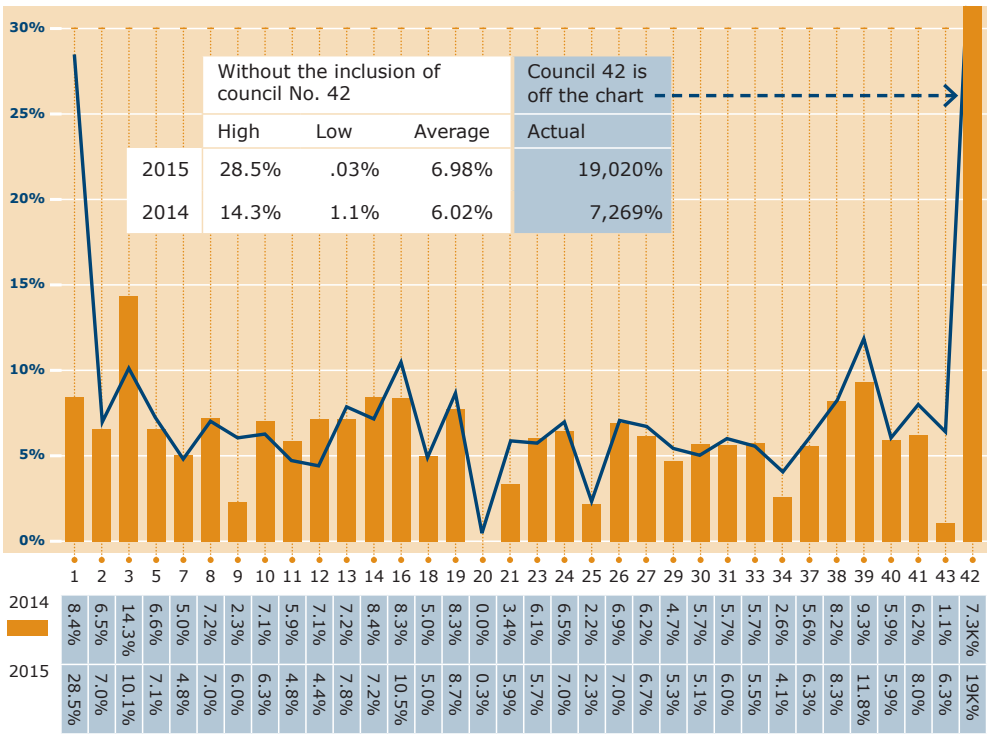
+$383K/$3.4m NPV

6. Funds Usage

Borrowing Costs

Councils report interest paid to lenders in the Income Statement (Figure 4, page 6) of council accounts as Borrowing Costs. The amounts borrowed are shown as a Balance Sheet item under Current and/or Non-current Liabilities. Over the Period, eight of the 43 Councils had no Current or Non-current Borrowings (no borrowings) and two had no Non-current Borrowings. Analysis of the Borrowing Costs of the remaining sample (34) that had both during the Period, shows a wide variation.

Borrowing Costs as a percentage of borrowings



The borrowings of council No. 42 warrant further investigation. It reported Borrowing Costs in 2014 of $945K against borrowings of only $13K and, in 2015, Borrowing Costs of $945K against Borrowings of only $5K.

Figure 25

Borrowing Costs opportunity

Opportunity exists to improve the cost of borrowings. A sector-wide approach, for example led by TCorp, could enable this. Based on total borrowings at June 2015 of $961m ($105m Current and $856m Non-current), a 1% improvement in the cost of funds would save $9.614m per annum (NPV $84.772m).

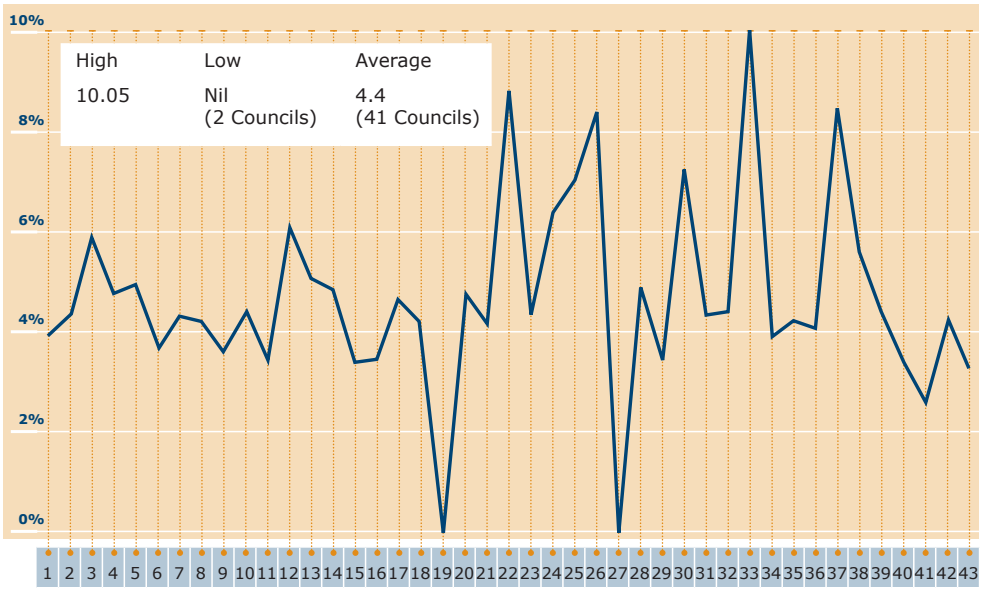
+$9.6m/$84.8m NPV

6. Funds Usage cont.

Investment Income

Councils that have surplus funds invest the funds, subject to obligations with respect to Restricted Funds. Interest earned on cash deposits and investments is recorded in the Income Statement of council accounts (Figure 4, page 6) as Interest and Investment Revenue. Amounts invested by the 43 Councils are shown as a Balance Sheet item under Current and Non-current Investments. Figure 26 below shows the percentage return councils received for the above mentioned investments in the year 2014/15.

Percentage return on investments (2015)



Council No. 19 and No. 27 warrant investigation. They show a 0% return in the chart above, as there is no denominator, ie they record a return without investments. Council No. 19 recorded income from investments of $327K in 2015 and $363K in 2014, with no investments recorded in their 2015 or 2014 balance sheets. And it recorded equity method investments of $433K in its Balance Sheet with income of $16K from equity method investments in its Income Statement. No. 27 has $503K recorded as Investment Income in 2015 and $438K in 2014, with no Current or Non-current Investments recorded in its 2014 or 2015 Balance Sheets.

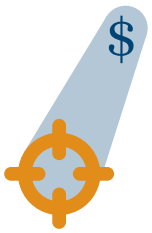
Income from investments under the equity accounting method is excluded in the chart above because this income is recorded separately as Other Income in the Income Statement. Equity assets are recorded separately under Non-Current Assets in the Balance Sheet.

Figure 26

Investment Income opportunity

Opportunity exists to improve the rate of return on investments. A sector-wide approach, for example led by TCorp, could enable this. Based on total Investments at June 2015 of $3.684b (Current Investments of $2.867b and Non-current Investments $817m), a 1% improvement in the rate of return would generate additional earnings of $36.2m per annum (NPV $224m).

+$36.2m/$319m NPV



7. Inventory Management

The Analysis sought to identify inventories used in delivering STC and maintaining assets.

Non trading inventories were identified, including practices that appear inconsistent with the guidelines, *Local Government Code of Accounting Practice and Financial Reporting*. For example, the 43 Councils reported $69.613m of Inventories at June 2015. Council No. 15, Council No. 4 and Council No. 37 had classified Land Held for Resale as inventory in the amounts of $5.604m, $37.339m and $7.241 respectively. These three amounts total $50.184m, representing 72% of the total inventories reported by the 43 Councils. Other councils recorded Land Held for Resale as Current Assets in their Balance Sheets. Moreover, it is possible that some councils account for this item elsewhere, for example they may record such an item in 'Investments Properties'.

Inventory Management opportunity

Council No. 15, Council No. 4 and Council No. 37 inventories, which total $50.2m, are not inventories utilised in the performance of generating STC Income[3]. The remainder, being $19.4m, while significant, does not make Inventory Management an area that warrants business improvement focus and investment. That is to say, other Target Areas will generate greater return on investment.

+$0m

Target Areas Breakdown

Figure 27 illustrates sources of the Analysis' $341m per annum projection.

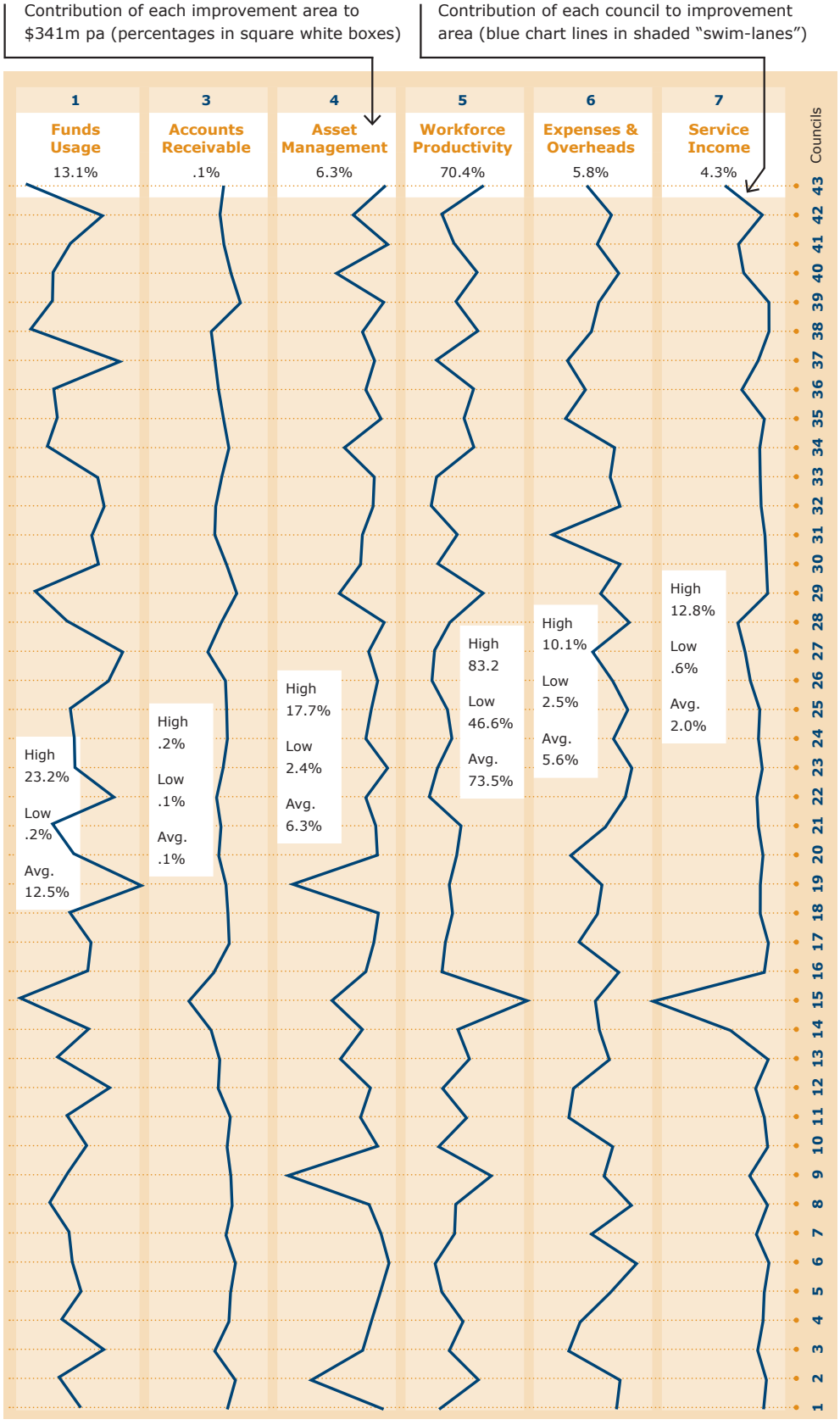
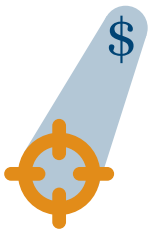


Figure 27



Target Areas Breakdown cont.

Following are drivers for each Target Area where the Analysis projects an improvement benefit. Councils with the greatest opportunity are those where:

1. Funds Management
   - funds borrowed or invested are higher (volume), and/or
   - borrowing cost is high and/or investment return is low (rate).

   Improvement driver examples: funds management competence; negotiating skills; review of strategy or lender/investment; and, renegotiation of terms.

3. Accounts Receivable
   - receivables income is high (volume), and/or
   - collections days outstanding is high (rate).

   Improvement driver examples: debtor management competence; effective policy and compliance; and, management of payment plans.

4. Asset Management
   - high 'Infrastructure, Property, Plant and Equipment' asset value exists (volume), and /or
   - analysis shows that asset classification (mix) and/or utilisation (use) can be improved and non-essential assets disposed of (providing funds for other uses, for example uses that add value to STC).

   Improvement driver examples: asset management practices; management of asset maintenance; infrastructure backlog policy; asset utilisation policy; OPEX plan; and, effective program management for CAPEX.

5. Workforce Productivity
   - employee numbers are high (volume),
   - remuneration is high (rates), and /or
   - analysis shows that productivity (utilisation) can be improved.

   Improvement driver examples: workforce management practices; management of leave; remuneration rates; provisioning policy; management of workforce and contractors delivering STC.

6. Expenses and Overheads
   - expenses and overhead costs are high (volume), and
   - analysis indicates that procurement methods and costs (rates) can be improved.

   Improvement driver examples: expenditure policy and practices; delegations; management of procurement; negotiating skills; and, contesting expenditure as circumstances change.

7. Service Income
   - analysis shows potential to increase STC income (volume) through type of STC (mix) and improved and new STC (use).

   Improvement driver examples: proactive approach to income generation and management of council policy as relates to delivery of current and new STC.

Recommendations

1 Establish pre-merger productivity benchmarks

Performance ratios reported by the 43 Councils, as published in their Financial Statements and relied on by OLG, relate predominantly to financial performance. They do not include measures that reflect the two main responsibilities of a council, eg:

1. ratios that measure asset management performance
2. ratios that measure workforce productivity performance.

LSI recommends that ratios for the above key result areas, as identified in the Analysis, be set and incorporated into OLG and IR&R reporting guidelines. This will establish robust benchmarks and a performance datum point upon which, post mergers, new council performance can be authoritatively measured.

Recommendation

Incorporate asset management and labour productivity benchmarks into councils' Financial Statements and IP&R reporting.

Workforce productivity and asset management benchmarks of the 43 Councils, for example as presented in the Analysis, form a base upon which the performance of newly formed council entities are assessed, and improvement measured.

2 Address financial reporting anomalies and planning

Reporting anomalies have been identified, some of which are reported throughout the Analysis. Also of significance is the high value of Provisions[10] for future expenses. As presented in Figure 28 on page 31, at June 2015 Provisions[10] totaled $827.4m. Employee related Provisions[10] represent:

- 81% of all provisioning, and
- 32.5% of the total annual Employee and On-costs expenditure for 2014/15,

LSI recommends that Provisions[10] of the 43 Councils be validated.

Notably, the TCorp Report stated: 'There is little evidence to suggest that Councils' recent experiences with employee numbers and cost increase drivers are included in the LTFP [long term financial planning]. For example, LTFPs with reduced employee expenses should reflect cost reduction strategies and/or reduced services.'

10. Provisions are a Balance Sheet item and, therefore, not part of the Income Statement, as per Figure 4 on page 6.

Recommendations cont.

Total Provisions at June 2015

Below are Provisions recorded for the 43 Councils at June 2015. Only eight have Provisions for Asset Remedial work in the amount of $99.9m. This falls short of the LG Audit reckoning of IB for the 43 Councils at June 2013, of $2.4b (4.1% of IB provisioned for at June 2015).

Provision Type	Provision Value	No. of 43 councils reporting Provision
Employee related	$667.7m	43
Asset remedial work (infrastructure backlog)	$99.9m	8
Insurance	$44.5m	12
Gratuities	$9.9m	21
Workers Comp	$4.3m	4
Carbon Tax	$1.4m	1
Total Provisions	$827.4m	

Figure 28

Having regard for the above as to Provisions[7], LSI advocates two additional undertakings as part of 2016 financial reporting that will strengthen existing IP&R reporting and address 'LTFP' objectives.

a. Investigate with relevant Councils, the full set of accounting anomalies identified by LSI, some of which are included in the Analysis.

b. Review Provisions[10] in the 43 Councils' accounts, prior to amalgamations. This offers two benefits:

   - Provisions[10] are an area where anomalies are not always visible. Reviewing the appropriateness of recorded Provisions[10] will mitigate anomalies being obfuscated when amalgamations take place.
   - Provisions[10] will accurately record future liabilities of merged councils.

Recommendation

Investigate accounting anomalies over the Period directly with councils and cause adjustments to be made where appropriate.

Provisions evaluated and confirmed prior to the amalgamation of Councils.

Recommendations cont.

3 Improve organisational structures

The 43 Councils have an array of organisational structures, many of which do not align strategically with their principle functions: managing community assets and delivering STC. As shown in Figure 29: in relation to people, many councils perform their human resource function as a second level role (this may be a contributor to the resource management variances reported in the Analysis); and, in relation to assets, many councils have asset management and planning functions not segregated from operational delivery and perform the functions as a second level role (this may be a contributor to variances in asset management performance as reported by the Analysis).

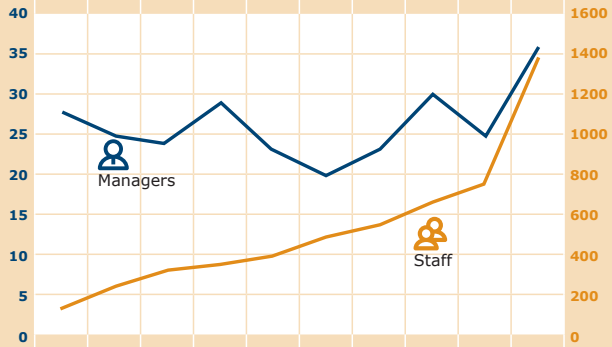
Organisational structure and reporting analysis

Below is a sample of 10 of the 43 Councils, showing the following.

a. Staff to managers ratio: where variance ranges from a low of 5.4 staff per manager to a high of 38.6 (86% variance). The chart is plotted in order of council staff numbers, lowest (under 200) to highest (close to 1400). Notably, councils that employ more Staff have a similar number of Managers to those with less Staff.

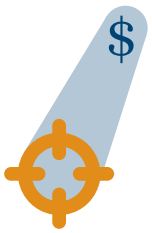
b. Reporting levels of key roles: where the HR function is Level 1 at only one council and the Asset Management function is Level 1 at only 4.

Council No.	1	14	28	43	34	24	42	10	29	4
Staff to Managers Ratio										
0 General Manager	1	1	1	1	1	1	1	1	1	1
1 First Line Manager (reports to 0)	6	9	6	5	4	8	6	5	7	6
2 Second Level Manager (reports to 1)	21	15	22	18	18	21	16	14	17	29
3 All Managers (0,1,2)	28	25	29	24	23	30	23	20	25	36
4 All staff (no managers)	150	252	362	343	418	674	566	494	766	1391
Ratio of Staff to Managers	5.4	10.1	12.5	14.3	18.2	22.5	24.6	24.7	30.6	38.6



Reporting Level of Key Roles										
Financial Controller	2	2	2	2	2	1	1	2	1	2
Human Resources	2	1	2	2	2	2	2	2	2	2
Asset Strategy	2	2	2	2	2	2	2	2	2	2
Asset Management	1	2	2	2	2	1	1	2	2	1
Community Services	1	2	1	1	1	1	1	1	1	1

Figure 29



Recommendations cont.

The Local Government Acts Taskforce recommends in its Discussion Paper, *A New Local Government Act for NSW* (April 2013), that 'the strategic responsibilities of the council be clearly separated from the operational responsibilities of the general manager in determining the council's structure and be aligned with IPR' [IP&R]. The LGA Program, in causing new organisations to be formed, offers an opportunity to establish appropriately aligned structures, consistent with the taskforce recommendation.

Recommendation

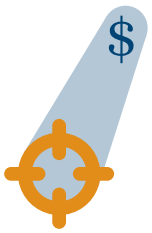
Reconfigure organisational structures to be aligned to the strategic goals of individual councils in managing community assets and delivering STC; roles, accountabilities and responsibilities to be aligned to IP&R.

4 Undertake workforce profiles

As part of each merger program, LSI recommends that the workforce capacity of each newly formed council be established through engagement with all stakeholders, including councillors, staff, unions and communities. A Workforce Profile includes reviewing roles, job classifications, accountabilities and performance criteria. The Analysis identifies wide variances in remuneration, leave provisions and entitlements across the 43 Councils. A valuable output of workforce profiling would be that it provide a planning resource to mitigate pressure for remuneration rates of merged councils to "rise to the highest" current level for each category and/or role.

Recommendation

Workforce profiles are carried out with wide stakeholder consultation to ensure reconfigured council resources and structures are aligned to the community strategic goals.



Recommendations cont.

5 Facilitate installation of productivity systems

An LSI council productivity systems installation, as presented on page 12 and 13, achieved a per annum productivity gain valued at $20.7m (without redundancies). This program included improving and up-skilling management and staff capability by establishing an environment where staff were systematically "responsible, accountable, consulted and informed", leading to defined standards of performance being achieved and exceeded. The LGA Program can enable the 43 Councils, or as 25 merged councils, to achieve benefits of similar proportion through productivity system installation—that generate workforce capacity increase and additional STC, asset management improvement and financial savings—without redundancies.

Recommendation

Cause productivity systems to be installed across the 43 Councils.

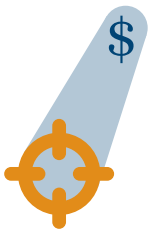
Tie any LGA Program merger funding provided to councils, to performance outcomes based on improvement asset management and delivery of STC.

6 Explore Service NSW representing councils

The NSW Government has successfully implemented the Service NSW model. This achievement is significant in no small part because of the way in which it has worked with agencies to transition service functions, sometimes involving large teams, to Service NSW delivery. This competency, and the Service NSW infrastructure, could also benefit the 43 Councils in providing efficient agency services. For example, Liverpool City Council recently outsourced its customer service function to a private sector company. LSI recommends that Service NSW and councils evaluate working together.

Recommendation

The LGA Program include exploring economies of scale by way of councils working with Service NSW.



Recommendations cont.

7 Develop TCorp financing products for councils

Analysis of investment returns and borrowing costs across the 43 Councils indicates a wide range of funds management performance. Even though the 43 Councils have the capacity to borrow at favourable rates, they continue to report, by way of high IB, that community IPP&E assets are not being maintained to satisfactory standards. Centralising investment and borrowing functions through TCorp would generate a more productive and strategic approach to the 43 Councils' funds usage and requirements. TCorp has the capability to bring a centralised banking facility and approach to council funds management.

Recommendation

The NSW Government direct councils to use centralise funding established by TCorp and incorporate related functions and reporting into IP&R.

8 Require Infrastructure Backlog to be carried out and reported

The role of a council is, primarily, to deliver STC and manage community assets. The Analysis finds that no substantive change has been reported in the management of IB since the introduction of the Local Infrastructure Renewals Scheme (LIRS) in 2011. LIRS provides a subsidy in interest costs to make funds more affordable for IB projects. Reasons why IB has not reduced, include: lack of funding; low accountability (caused, in part, by non-segregation of asset *planning* and *execution* management functions); inadequate provisioning for IB; and, an absence of IB reporting in council Financial Statements[11].

Recommendation

Require IB performance to be reported in published Financial Statements.

Direct asset planning and execution functions to be segregated within council organisation structures, as a governance requirement.

Direct IB maintenance to be prioritised and carried out.

Provide funding where required via a TCorp facility for IB, and explore creating a government bond for the sector that Council communities can participate in as retail investors.

Set performance ratios for asset management and IB performance and include them in IP&R.

11. IB is reported in Special Schedule 7 that accompanies council annual Financial Statements, which is not published or publicly available.

Recommendations cont.

9 Tie LGA Program merger funding to productivity outcomes

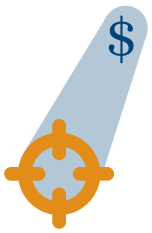
The LGA Program provides an opportunity to break the historic inertia that is resistance-to-change within local government environments. Moreover, merger funding can be used to generate performance improvements.

Recommendation

Tie NSW Government funding provided as part of the LGA Program (whether for meeting merger costs, or investment in community infrastructure projects or better services, as offered in 2015) to priorities specific to each council and, also, improved performance, eg as reported in their current IP&R ratios and benchmarks. For example, at a minimum:

- achieve a breakeven financial position (STC Income[3] less STC Labour[4] and Expenses[5])
- improved asset management performance, to IP&R benchmarks/ratios
- improved workforce productivity, to agreed standards and ratios.

Figure 30



LSI Profile

LSI is an organisational performance improvement consultancy. It operates with two philosophical beliefs: in order to improve something it must first be measured; and, given the right circumstances, everyone wants to do a good job when they come to work.

Organisation

- 27 years of operation
- Over 800 client projects completed; majority measured against return-on-investment goals
- Client benefits in excess of $3 Billion (annualised) delivered
- National team of management, competency experts and consulting practitioners
- Completed assignments across Asia Pacific including Australia, New Zealand, Singapore, Malaysia, Taiwan, Philippines, Thailand and Fiji
- Offices in Sydney, Melbourne, Canberra and Auckland
- QMS certified to ISO9001:2008
- Client testimonial satisfaction level (feedback) measured at over 91%

Government Panels

LSI is a member of Commonwealth and State government procurement panels, including:

- Local Government Amalgamation – Supplier Panel
- NSW Whole of Government panel – Department of Finance, Services & Innovation, Performance and Management Services scheme, fully prequalified service provider (9 of 28 capabilities; all those relevant to business improvement)
- Department of Education - Learning and Development Panel
- Department of Employment - Learning and Development
- Defence Materiel Organisation Support Services (DMOSS) Panel
- Department of Innovation, Industry, Science and Research Panel
- Department of Education, Employment and Workplace Relations
- WA Department of Finance, provision of Audit Services & Financial Advice
- Queensland Whole of Government panel - Queensland Government Professional Services Panel
- Queensland Whole of Government panel - Queensland Government ICT Prequalified Panel.

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Fit For The Future

- New South Wales Treasury Corporation, *Financial Sustainability of the New South Wales Local Government Sector*, April 2013
- Final Report of the NSW Local Government Independent Review Panel, *Revitalising Local Government,* October 2013
- Independent Pricing and Regulatory Tribunal, Local Government Final Report, *Assessment of Council Fit for the Future Proposals*, October 2015

The 43 Councils

2014 and 2015 published Financial Statements, organisational structures and plans of 43 NSW metropolitan councils.

Ashfield Council
Auburn City Council
Bankstown City Council
Blacktown City Council
Blue Mountains City Council
Botany Bay City Council
Burwood Council
Camden Council
Campbelltown City Council
City of Canada Bay Council
City of Canterbury Council
City of Ryde Council
City of Sydney Council
Fairfield City Council
Gosford City Council
Hawkesbury City Council
Holroyd City Council
Hornsby Shire Council
Hunter's Hill Council
Hurstville City Council
Kogarah City Council
Ku-ring-gai Council
Lane Cove Council
Leichhardt Municipal Council
Liverpool City Council
Manly Council
Marrickville Council
Mosman Municipal Council
North Sydney Council
Parramatta City Council
Penrith City Council
Pittwater Council
Randwick City Council
Rockdale City Council
Strathfield Council
Sutherland Shire Council
The Hills Shire Council
Warringah Council
Waverley Council
Willoughby City Council
Wollondilly Shire Council
Woollahra Municipal Council
Wyong Shire Council