

LOCAL GOVERNMENT FINANCIAL SUSTAINABILITY INQUIRY

GOVERNANCE ARRANGEMENTS

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Governance Arrangements

- Do local governments adhere to good governance standards?
- How well do they manage conflicts of interest?
- Should voters or the State deal with crises?

'Governance'

Governance is the administrative and process-oriented elements of governing.

It is not politics or 'the government'.

Corporate governance generally refers to the processes by which organizations are directed, controlled and held to account. It encompasses authority, accountability, stewardship, leadership, direction and control exercised in the organization. (AS 8000)

There is no one model for good corporate governance. While AS 8000 applies corporate governance principles for shareholder companies to statutory corporations and not-for-profit organizations, how appropriate are they for local government?

Corporate governance principles are likely to more appropriate for a minimalist council that is similar to a strata title corporation. The principles are likely to be less appropriate for a government of the area, although clearly they could be applied to any business units or subsidiary corporations of such a government.

Issues

Applicability of Corporate Governance Principles to Councils

The follow is a summary of the main AS 8000 corporate governance principles:

AS 8000 on the Role of the Board

A Board should be responsible for

Strategic guidance of the entity, effective monitoring of management, and accountability to the entity and the members.

All directors are expected to exercise independence of judgment on all matters.

Directors have no individual authority to participate in the day-to-day management of the entity

The Board should be responsible for strategic direction with a 3 year strategic plan and annual business plan.

It should approve the budget, review performance, ensure compliance with laws, have

documented policies, manage risks, adopt a board structure, appoint and monitor the performance of the CEO and “approve and foster an appropriate corporate culture matched to the entity’s values and strategies”.

The Board of a statutory authority should only be directed by the Minister in writing.

Does a council have a ‘Board’?

A council is a corporate body with a legal entity apart from the members of its ‘governing body’ – which are the Councillors.

There are similarities between a meeting of councillors and the meeting of a board of a statutory corporation, but there are some important differences:

- Members of the public qualified to vote at council elections elect councillors.

Voters who are property owners or tenants have a financial interest in the performance of the council but they are not shareholders. To some extent they are customers, although there is little market choice and prices are charged for only a few services, such as garbage, a service without consumer choice. The electorate is somewhat like members of a non-profit corporation. Voting is compulsory although sometimes not very well informed about the candidates.

- Most councils are divided into wards for electoral purposes.

The electors of each councillor are only a part of the whole electorate. At meetings of the ‘board’ councillors are presumably ‘representing’ the interests of their ward, while also being required to vote in the interests of the corporation. Should they also exercise independent judgment, which may be contrary to the interests of their particular electorate?

- Councils are likely to be split into factions.

Membership of a party is not discouraged. Accordingly there is likely to be a majority and a minority grouping on the ‘board’. The minority may be at times be working to ensure that the performance of the council is less than optimal in order that the poor performance of the council will enhance the opportunity for their grouping becoming the majority at the next elections. A factionalised ‘board’ may find it difficult to act corporately to encourage a coherent culture based on agreed strategies and values.

The annual election of a mayor, which is the default situation (the option of a popularly elected mayor requires a referendum), is an added source of instability and factionalism.

- Parliamentary meeting format and rules of debate

Reflecting the essentially political/representative nature of the ‘board’, the meeting rules are based on the parliamentary rules of debate, meetings generally have to be held in public, sometimes in the presence of disputing interest groups, with documentation that has to be made available to the public, except for a limited range of confidential items, and in a setting that often reflects a parliament.

In short, meetings of a council can be more like those of a parliament, than a board meeting, especially where the number of councillors is more than, say, 8 or 9.

Council as a Cabinet?

If councils are not properly a board, do meetings of a council resemble a cabinet meeting?

Cabinets are drawn from the members of the majority faction/s in the parliament, or, in a Presidential government, are formed from supporters of the President.

The papers and discussions in meetings of executive cabinets are generally confidential. Cabinet solidarity assumes that members of cabinet support decisions of cabinet; notwithstanding they may have opposed the decision in the meeting.

Clearly councils, although they have an executive role, do not resemble a cabinet in any respect. Yet, in both State and Federal Governments, the executive is a cabinet.

(Interestingly, where there are strong Party caucuses consisting of a majority of the councillors, the caucus can operate as an informal cabinet. Decisions are made in confidence, caucus decisions can be assured of endorsement by council because the political party has a disciplined majority and there is usually caucus solidarity. The ICAC has ruled that caucus should not make binding decisions on Development Applications, given their nature – see below.)

Councils as Arbitral Bodies

Much of the time of councils is actually taken up with the formulation of development controls and making decisions on the discretions that are available within those controls. These regulatory decisions can have significant financial and emotional consequences for individual landowners and their immediate neighbours. So far as many voters are concerned, this is perhaps the most important and, certainly the most exposed area of the responsibilities of councils. Most councils are sacked because of decisions in this area.

Decisions on the making of development controls (decisions about land use zoning and other controls) are essentially *legislative* in nature (although with a detailed statutory process to be followed), while decisions on discretions available within those controls (Development Applications) are *arbitral* or *administrative* in nature (decisions should be taken within the limits of the discretions in statutory documents). Appeals on the merits to the Land & Environment Court are available to applicants for DAs.

In addition, both types of decision can be the subjects of challenges to their legality. The general inability of Third Parties to be able to have decisions reviewed on their merits increase the use of legal challenges and therefore makes councils particularly concerned about using the correct processes.

AS 8000 deals with transparency in the context of disclosure of information and ensuring no conflicts of interest. It does not establish principles where a Board conducts a regulatory role, because few public boards combine service and regulatory roles.

The systems within which councils make these regulatory decisions are flawed:

Rezoning decisions

In rezoning decisions:

- The process on a rezoning cannot be started without council's support. A landowner cannot require a council to consider a change in zoning – there is no appeal body to approach if a council refuses to consider the proposed rezoning.
- Where there are third party objections, there is no automatic review by an independent body of a proposal to rezone land.

The extent of discretion and the lack of transparent processes ensures that rezonings, especially of individual parcels, is an area where probity risks are high.

Development Applications

There can be significant discretions available in development controls. There are different interests a council should consider – the administrative need for consistency of decision-making, the needs of the applicant and those of any neighbours potentially affected by a proposed decision.

The decision on a development application is an 'arbitral' decision. Council has to make the decision within the discretions set out in the statutorily recognised controls.

The following statements (from Transparency International) set out what can be expected from the performance of public officials in these circumstances:

- *Impartiality and objectivity of public officials in the performance of their functions and their relations with the public are essential to ensure the correct discharge of public duties and the positive perception of the public service by the general public. Impartiality requires decisions to be taken on the basis of facts, taking into account only relevant matters and disregarding considerations that could interfere with neutral decision-making.*
- *Public officials, to the extent required by their position, shall, in accordance with laws or administrative policies, declare business, commercial and financial interests or activities undertaken for financial gain that may raise a possible conflict of interest. In situations of possible or perceived conflict of interest between the duties and private interests of public officials, they shall comply with the measures established to reduce or eliminate such conflict of interest.*

In the interests of good administration and probity, councils should strive to make consistent decisions.

While the applicants have a right to a review of a council decision by the Court, the neighbours do not. The Court 'stands in the shoes' of council in arriving at a decision – it is made again on the facts before the Court. A proper hearing is conducted before the Court but this is not the case in the parliamentary process under which a council operates when making the decision in the first instance.

Although the practice is that councils conduct 'hearings' – the opportunity to address council in committee – because council has to use a parliamentary process, it does not generally comply with what lawyers would call a 'fair hearing'.

A fair hearing requires:

- no canvassing of members of the hearing body outside of the hearing,
- no conflicts of interest,
- the right to question those making a submission,
- the right to written reasons for a decision.

Council meetings are structured to be parliamentary not arbitral. Councillors are representatives, not members of an independent hearing body. Hearings before councillors seldom comply with the principles of fairness.

The parliamentary process is bound to lead to concern from a probity point of view. While not suggesting that councils cease conducting hearings and making decisions, the ICAC does draw attention to the difficulties of councillors making a distinction between their role as representatives and arbitrators.

This distinction is the harder to make when, so far as the neighbours are concerned, the council decision is the end of the line (apart from a legal challenge, in which it is difficult to be successful). There is often considerable pressure on the representatives to decide in favour of the neighbours, despite what the controls say. In other States, where there is a third party right to a merit appeal to the Court, there is less pressure on councillors to support the point of view of the residents.

Conflicts of Interest

The problem of conflicts of roles between the representative and arbitral roles for councillors will not go away despite the publication of longer codes of conduct and exhortation by bodies such as the ICAC that councillors should stop being representatives when they are exercising judgement on DAs.

There is a problem of roles because the basic principles of the *separation of powers* have not been applied to the governance structures of councils.

The problems flowing from this conflict of roles is exacerbated by the parliamentary nature of council meetings.

Conflicts of interest can also occur in the service role of councils. The determination of budgets may not be on the basis of need or effective management of assets but on party or faction grounds for electoral advantage – i.e. ignoring wards with a majority of councillors from the minority party.

While these budget distortions are to be expected with members of the governing body being elected using wards, the consequences of conflicts of interest and inappropriate meeting process in regulatory decisions are both damaging for individuals and the reputation for good corporate governance.

In recognition of these conflicts, some councils have inserted an independent process (Independent Hearing and Assessment Panel - IHAP) to conduct hearings on difficult DAs. An IHAP makes to councillors a recommendation supported by written reasons. Councillors then make the final decision.

This process does not take the decisions away from councillors but does ensure a transparent and 'fair' hearing process before the decision is made. As would be expected when a proper process for the nature of the decision is put in place, in

councils where there is an IHAP there has been a significant improvement in public, staff and councillor satisfaction with the DA process.

Strategic Planning and Reporting

AS8000 suggests that the system of governance should ensure that timely and accurate disclosure is made on all material matters regarding the entity, including the ownership, governance, financial situation and performance of the entity.

What are councils reporting on – outcomes and outputs, or merely outputs?

There is not a comprehensive and simple planning framework for councils in NSW.

The main planning document is the *Management Plan*, which is required by the Act. It reports on proposed *activities* and is the basis for the council's budget.

The *outputs* identified in the Management Plan may have reference to some specialist strategic plans, including the legislatively required *State of the Environment Report* and a *Social Plan*, which do sometimes set some outcome objectives and targets, although they tend to be more of a wish list.

The Planning legislation requires a *Local Environment Plan* but this consists of detailed land use controls. As one of the means of achieving strategic objectives, it too is an output document. Within the LEP, the objectives, or outcomes, sought by the controls are usually vague and seldom measurable.

The Act requires quarterly reporting on the achievement of activities in the Management Plan. These reports are useful to see how budgets are being met but do not really assist in measuring the effectiveness of activities in achieving outcomes, which, because of the absence of meaningful strategic plans with measurable outcomes, are not available.

Only a few councils have prepared Strategic Plans that provide the framework for the detailed annual Management Plan (eg Fairfield).

A council that sees itself as a property services corporation can appropriately report on outputs.

A council that aims to be the government of the area should have a long term Strategic Plan with measurable outcomes, a Management Plan and Budget that identifies the outputs to be achieved in pursuit of the outcomes in the Strategic Plan and regular reporting on both outputs and outcomes. All other planning requirements, except the regulatory controls, should be able to be accommodated within this planning framework. The regulatory controls should not pretend to be a strategic plan and should be limited to provisions that affect development rights only.

Sanctions

Unlike the board of a statutory corporation, a council is not responsible to the Minister for Local Government, although in NSW the Department and Minister play an active role in monitoring local government and responding to complaints about its performance. The Minister has a tight control over the resources available to councils through the Rate Pegging arrangements.

In some other States, notably South Australia, the State minister has a more hands off approach.

Apart from facing elections every four years, the main sanction against unacceptable performance by a council is the holding of a Ministerial inquiry, and, subject to the outcome, the subsequent dismissal of the council and the appointment of Administrators as the governing body.

Councils are also subject to provisions of the legislation for the ICAC and the Ombudsman.

Following recent ICAC reports, the Act has been amended to enable the suspension of individual councillors following an adverse report of the ICAC or an Inquiry.

Improved processes for the conduct of hearings on DA's and a more transparent process for rezonings should reduce considerably the number of complaints about the performance of councils, councillors and staff and therefore lead to less need for sanctions.

Other Jurisdictions

Compared to Australia, the *separation of powers principles* have been applied more thoroughly to the governance structures of local government in the USA and, more recently, in England.

The checks and balances of the US arrangements commonly see a separation between the 'legislature', the executive and the arbitral decision-making. There are both strong mayor and weak mayor arrangements.

Most big cities have the strong mayor structure. The CEO and staff (in the US tradition, the CEO and senior positions are often 'political', non-merit appointments) report directly to the popularly elected mayor. The Council is a legislative body with power to approve the mayor's Budget, make the rules and generally supervise the performance of the Executive. Development Application decisions and recommendations on the making of development controls will be made by a separate Planning Commission which may be appointed by Council or directly elected.

The weak mayor/strong CEO structure is more like that set out in the NSW legislation and is more common in the smaller municipalities. Council makes both executive and policy decisions and the mayor is more of a ceremonial/chairperson position. An 'apolitical' CEO is appointed by the council and is responsible to it for the administration.

Large metropolitan councils in England have a relatively large number of elected members, clearly operating as a local parliament, although the council is still formally the executive. Generally the chairs of the committees of council form a *de facto* executive, especially when they are drawn from the majority party.

This is also the case in the large Brisbane City Council, although, the popularly elected Lord Mayor can come from a different party than the majority on the council. This can be a problem in US Mayoral systems and is one of the difficulties, or advantages, of the US as against the Westminster system.

A recent model in England (introduced for London and as an option for other large council areas) is a variant of the US strong mayoral structure. There is a popularly

elected mayor with a cabinet and executive responsibility for staff. Council is more a legislative body with budget approval powers and a supervisory role.

Planning Commissions are not used in England. The Planning controls rest ultimately with the Minister who uses Planning Inquiries by independent inspectors for controversial decisions. Most decisions are delegated by the Minister to the Council, which deals with them in much the same manner as in Australia.

Conclusions

The NSW local government situation suffers because:

- The Act is confused as to whether the governing body of a council is a parliament or a board.
- Notwithstanding that a council meets like a parliament, there are many provisions in the Act that assume it is board of a service corporation.
- A council's most prominent and arguably most important role is likely to be as an administrator of a complex regulatory system that contains extensive discretions that are subject to merit appeal and/or legal challenge. These are not decisions that should be taken by a parliamentary style meeting.

It is difficult to hold a council accountable for outcomes as there is no requirement to have a strategic, as against a management, plan that contains measurable outcomes. The planning system is nonetheless fragmented, complex and wasteful of planning effort.

The lack of application of the separation of powers doctrines and the inadequate and confused planning and accountability mechanisms mean that councils find it difficult to comply with governance principles, even those that might be adjusted to the local government situation.

Recommendations

The Act should provide for a choice of governance structures

Corporate Structure

The default structure should be similar to the current structures except that

- The number of councillors should be limited to up to seven (7)
- The default position should be for an electorate of the whole with a referendum being required for a ward division
- The election for mayor should be bi-annual and not annual, with the option of a direct election of mayor, subject to a referendum

Corporate governance principles, with appropriate modifications, should apply to the performance of council.

Parliamentary/Executive Structure

Councils that are over a certain population (over 50,000?) should have the option of a structure that applies the separation of powers doctrine as between the legislature and the executive:

- Up to 15 councillors can be elected on a ward basis
- Popular election of the mayor
- The mayor may appoint an executive committee of 3 selected from the councillors with the option of secondments from outside the council
- The general manager, selected by the mayor and endorsed by council, reports to the mayor

The role of council would be to:

- Approve the strategic plan, the management plan and the budget
- Approve the policies and development controls of council
- Question the executive and hold inquiries into policy and performance issues

Arbitral Functions

In all councils there should be a separate independent hearing panel to be instituted to report with recommendations and written reasons to Council for final decision, with the option of having delegated powers to decide on DAs.

The panel also to conduct hearings on spot rezonings.

The State Government should provide regional panels where there are small councils or few applications and should provide assistance to the establishment and oversight of the panel system.

There should be legal costs implications where a party takes a merit appeal and the Court upholds the panel's recommendation.

There should be a right of Third Party merit appeal for most DAs.

Planning System

All councils to have a long term Strategic Plan with measurable outcomes and a Management Plan that demonstrates how the Strategies (outputs) in the Strategic Plan are being implemented in the Budget.

All other planning documents to be integrated into either the Strategic or Management Plans.

Subsidiary Corporations

Where the production of outputs have been contracted to business units or corporations 'owned' by council, in addition to the current requirements for competitive behaviour, corporate governance principles should be applied to those business units or corporations.

Separate board, which can include suitably qualified persons who are not councillors, can be appointed to supervise business units and corporations 'owned' by council.

Sanctions

The current supervisory process – ICAC, Ombudsman and Departmental Inquiries – should continue to apply.

The Department of Local Government and its Minister should retreat from active management of local government, relying more on proper reporting to a better-informed electorate.

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