

Financial Sustainability Ratios and Targets Policy

1. Policy Statement

This policy sets the principles and criteria with regard to financial sustainability. It outlines the measures by which Council will assess the implications of financial decisions on its financial position and financial sustainability.

2. Scope

This policy is to be used by Council in the development of the annual budget, long term financial plan, asset management plans, budget reviews and other financial decisions.

3. Definitions

Asset Management Plan (AMP) – Forecast expenditure

This is the annual amount required for the renewal/replacement of all of Council’s existing assets that are due over the next 10 years adjusted for indexation and reflected in the Long Term Financial Plan (LTFP)

Asset Management Plan (AMP) – Annuity


This is the average amount required for the replacement of all of the Council’s existing assets that are due over the next 10 years in the AMP and adjusted for indexation.

Councillor is a person appointed or elected by the electors of a particular ward, as a representative of the ward in the City of Playford.

Independent Members are members on a committee or panel who are not elected but have been appointment by the Council to undertake a role on Council’s Section 41 Committees or the Council Development Assessment Panel. They are external appointees.

Mayor is the person appointed or elected as the principal member of the City of Playford to represent the local government area as a whole.

Staff includes Council staff, contractors, volunteers and all others who perform work on behalf of Council.

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	Authorised by:	Council (Resolution 2572)	Date of Current Version:	24/05/2016
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4. Legislation and References

- SA Local Government Act 1999 (as amended)
- SA Local Government (Financial Management) Regulations 2011
- Local Government Association, Financial Sustainability Information Paper 1
- Local Government Association, Financial Sustainability Information Paper 8
- Local Government Association, Financial Sustainability Information Paper 9
- Local Government Association, Financial Sustainability Information Paper 13

5. Policy

The policy establishes five measures to help Council assess the financial sustainability of its operations with a particular focus on intergenerational equity. In particular the ability to make financial decisions based around:

- Financial performance
- Asset Sustainability
- Debt management

The five measures are:

- Operating Surplus Ratio (LGA Core Ratio)
- Cash Flow from Operations (Existing Playford Ratio)
- Asset Sustainability Ratio (LGA Core Ratio)
- Net Financial Liabilities Ratio (LGA Core Ratio)
- Interest Expense Ratio (Used by Local Government Finance Authority)

Ratio 1- Operating Surplus Ratio (Financial Performance)

Calculated as:

Operating Result / Total Operating Income

Purpose:

This ratio is designed to highlight the financial performance for the year and is a key indicator for financial sustainability. The ratio expresses the operating result as a percentage of Council's total income, as prescribed by the LGA.

A positive result on this ratio indicates the means current residents are able to fully fund the cost of services provided to them by Council. It also suggests the income available to fund capital or repay debt. A negative result indicates that Council is operating at a level beyond their means which will present long term financial issues.

Target:

In general Council should not be targeting operating deficits, nor should it be targeting large operating surpluses. Both of these results negatively affect intergenerational equity.

The range was selected to target the generation of revenue sufficient to cover Council's operation without over rating the community. While the calculation should be done on a yearly basis, it is also beneficial to review the target in terms of a trend overtime opposed to single year.

Target
Between 0% and 10%

Ratio 2 - Cash Flow from Operations (Financial Performance)

Calculated as:

Cash Flow from Operations / Asset Management Plan Replacement Annuity

Purpose:

This ratio measures whether Council is generating enough cash from its operations to cover the replacement of assets over-time. This ensures that Council is delivering intergenerational equity and also provides the capacity to repay the borrowings used to fund the large capital cost over time from a sustainable income source, thus putting Council in a position to be able to re-borrow funds for asset replacement in the future.

Target:

The target range is designed to accommodate annual variation, but in general Council should be targeting around 100%, to ensure enough cash from operations is available to cover the replacement of assets over time. This enables the delivery of intergenerational equity and a sustainable use of borrowings that can be repaid over the life of the asset and re-borrowed when the replacement is due.

A lower ratio indicates that Council is not generating enough cash from operations to cover asset replacement (less than 100%) and one of two things is potentially happening, neither of which is desirable. Namely:

- Council is running down the condition of its assets by not replacing them at the rate they need to be replaced (declining service levels); or
- Council is funding the replacement of assets from unsustainable sources of income that will lead to an increasing level of borrowings over time.

Target
Between 90% and 110%

Ratio 3 - Asset Sustainability Ratio (Asset Sustainability)

Calculated as:

Capital outlays on renewal, net of sale proceeds from replaced assets / amount planned to be spent in AMP.

Purpose:

This is a measure of the extent to which Council is replacing assets at the rate that ensures consistent service delivery and levels determined by the Asset Management Plans (AMPs).

Council's AMPs determine, for the given level of service, when assets need to be replaced to ensure that level of service is maintained. If Council is achieving close to 100% for this measure then it is maintaining the current service levels delivered by assets. This ratio simply measures if Council is performing the required work to replace assets and maintain the level of service.

Target:

In general, Council should be targeting around 100% of the replacement works determined by the Asset Management Plans to ensure consistent service delivery.

A lower ratio suggests that Council is not maintaining assets and infrastructure in order to optimize asset lives. A higher ratio suggests that Council is replacing assets earlier than needed.

Target
Between 90% and 110%

Ratio 4 - Net Financial Liabilities Ratio (Debt Management)

Calculated as:

Net Financial Liabilities / Total Operating Income.

Purpose:

This is a measure of the extent to which Council is managing its debt. It's a broader measure of debt than simply looking at borrowing levels. It highlights that borrowings are often an effective means of financial sustainability, rather than trying to fund all assets and services from operating income. The ratio expresses the amount as a percentage of Council's total income as prescribed by the LGA.

A steady ratio means council is balancing the need to borrow against their affordability of debt. An excessive ratio means Council is borrowing beyond their means and can't generate the income required to service assets and operations.

Target:

In order to ensure this target is meaningful it needs to be set and aligned with the planning strategy of the Council. If Council is in a significant development stage then a higher range may be acceptable. The target needs to be flexible based on community needs and long term financial sustainability.

Target
Between 50% and 160%

Ratio 5 - Interest Expense Ratio (Debt Management)

Calculated as:

Interest expense (less interest income) / General Rate Income (less NRM levy).

Purpose:

This ratio measures the affordability of Council's debt and articulates the proportion of Council's general rate income that is being used to service debt. The ratio is consistent with the Local Government Financing Authority (LGFA) calculation.

Target:

Interest expense greater than 10% of general rate revenue is considered to be an unacceptable level of servicing costs for borrowings. The target indicates Council's ability to afford the level of debt, as well as continue operations as usual.

A higher percentage means that more of Council's revenue is required to pay for debt rather than paying for community services and other benefits, which may require higher rate rises to maintain service standards.

If Council is in a significant development stage then a higher range may be acceptable and aligned with the planning strategy of the Council.

Target
Between 3% and 10%

6. Responsibilities

Deputy Chief Executive Officer - Strategy and Corporate will be responsible for:

- Developing and changes to the policy
- Implementing the policy

7. Relevance to Strategic Plan

All ratios are to be included in the Annual Business Plan, Long Term Financial Plan and all Model Financial Statements produced for internal and external reporting in accordance with relevant regulations and legislation.

Strategy 5. Building our capabilities

Outcome 5.1 Highly performing organisation

8. Supporting Documentation

Nil

9. Approval and Change History

Version	Approval Date	Approval by	Change
1	22/03/2011	Council	New Policy
2	24/05/2016	Council (Resolution: 2572)	Policy updated to reflect current practice