

Financial Sustainability Ratios and Targets Procedure

Procedure Author	General Manager Strategy and Corporate
Date of next review	May 2024

1. Purpose

This procedure supports the Financial Sustainability Ratios and Targets Policy and outlines the financial measures to ensure a consistent approach in accordance with the policy. The measures are designed to ensure that Council adheres to its plans and remains focused on achieving and maintaining financial sustainability.

2. Application

Chief Executive Officer	Ensure workers understand financial monitoring and reporting requirements.
Directors and Senior Managers	Compile financial monitoring and review information for their respective areas of responsibility.
Finance Manager	Responsible for the carrying out and oversight of Council's annual reporting and budget process. Assist the Directors with the monitoring and reviewing for their respective areas of responsibility.
Senior Manager – City & Corporate Planning	Ensures public consultation in accordance with section 123 of the <i>Local Government Act 1999</i> .

3. Procedure

3.1 Ratio 1 – Operating Surplus Ratio (Financial Performance)

Calculated as:

The Operating Surplus Ratio is the Operating Result expressed as a percentage of / Council's Total Operating Income, as prescribed by the Local Government Association (LGA).

Purpose:

This ratio is designed to highlight the financial performance for the year and is a key indicator for financial sustainability.

A positive result on this ratio indicates the services provided by Council are fully funded. It also suggests income may be available to fund capital or repay debt. A negative result indicates that Council is operating at a level beyond its means which, if chronic, 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 impact on 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 over time opposed to a single year.

Target
Between 0% and 10%

3.2 Ratio 2 - Cash Flow from Operations (Financial Performance)

Calculated as:

Cash Flow from Operations divided by 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. These are:

- 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.

Council has set its target range to reflect its desire to ensure it has sufficient funds from its operations to ensure that assets are being replaced regularly.

Target
Between 90% and 110%

3.3 Ratio 3 - Asset Sustainability Ratio (Asset Sustainability)

Calculated as:

This ratio is calculated by measuring Capital outlays on renewal, net of sale proceeds from replaced assets / amount planned to be spent in Asset Management Plans (AMPs).

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 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 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 AMPs to ensure consistent service delivery.

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

Council has accepted the target range recommended by the LGA, to reflect its desire to ensure assets are renewed and replaced in a responsible manner to maintain service levels for the community.

Target
Between 90% and 110%

3.4 Ratio 4 - Net Financial Liabilities Ratio (Debt Management)

Calculated as:

The net financial liabilities expressed as a percentage of total operating income as prescribed by the LGA.

Purpose:

This is a measure of the extent to which Council is managing its debt. It is 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.

A steady ratio means council is balancing the need to borrow against their affordability of debt. An excessive ratio means Council is borrowing beyond its 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.

The target range has been approved by Council acknowledging its position as a high growth council. It also reflects Council's long term financial strategy, which includes using debt as a mechanism for funding new services and assets, as a way of achieving intergenerational equity.

Target
Between 50% and 160%

3.5 Ratio 5 - Interest Expense Ratio (Debt Management)

Calculated as:

Interest expense (less interest income) / General Rate Income (less Natural Resource Management 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.

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.

The target range set by Council acknowledges its position as a high growth council and its ability to use debt as a mechanism to fund new assets and services. It reflects Council's assessment of the interest expense that can be afforded, without impacting its ability to maintain services to the community.

Target
Between 3% and 10%

4. Feedback

Your feedback on this policy is invited and can be directed to the Manager Governance via email to governance@playford.sa.gov.au or by calling the Customer Contact Team on 8256 0333

Administration use only

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1	25/05/2021	Council Resolution No. 4623	New Procedure document
