KINGSTON DISTRICT COUNCIL

Financial Sustainability Ratios and Targets Policy

Classification:	Council Policy
Version Number:	3
Review Frequency:	Annually
Last Reviewed:	May 2023
Review Due:	May 2024
Responsible Officer:	Chief Executive Officer
Applicable Legislation:	SA Local Government Act 1999 SA Local Government (Financial Management) Regulations 2011 LGA Financial Sustainability information papers 1,8,9 & 13
Related Policies/Procedures:	Budget Framework policy

1. PURPOSE:

The purpose of this report is to set 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. LEGISLATIVE CONTEXT:

Local Government (Financial Management) Regulations 2011 require a Council to use three specific indicators.

- Operating surplus ratio
- A net financial liabilities ratio; and
- An asset renewal funding ratio.

In the Council's:

- Long Term Financial Plan
- Annual Budget
- Mid-year review of the annual budget, and
- Report on annual financial results.

The Regulations also require a Council's Long Term Financial Plan to include target ranges adopted by the Council for each indicator.

In these documents, Councils effectively are required to evaluate past performance and project the future impact of strategies under consideration against financial indicators.

Section 122 (1)(d) of the Local Government Act 199 (the Act) requires a Council when preparing and adopting its strategic management plans to '*state the measures (financial and non-financial) that are to be used to monitor and assess the performance of the Council over the relevant period".*

3. SCOPE:

This policy is to be used by Council in the development of the Annual Budget, Long Term Financial Plan, Infrastructure and Asset Management Plans, budget reviews and other financial decisions.

4. DEFINITIONS:

Operating Surplus Ratio	By what percentage does the operating income vary from operating expenses.
Net Financial Liabilities Ratio	How significant is the net amount owed to others, compared with operating income?
Asset Renewal Funding Ratio	Are assets being renewed and replaced in an optimal way.

5. CONTENT:

The policy establishes three (3) measures to help Council assess the financial sustainability of its operations with a particular focus on intergenerational equity.

5.1 **Ratio 1 Operating Surplus Ratio:**

Calculated as:
The operating surplus ratio is the operating surplus (deficit) expressed ratio as a percentage of operating income.

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

A positive ratio indicates the percentage increase in operating income or the approximate decrease in operating expenses required to achieve a break-even operating result.

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 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. The calculation should be done on a yearly basis and it is also beneficial to review the target in terms of a trend overtime opposed to single year.

Target 5-year average of 0%.
-2% and 2% in any one year

5.2 Ratio 2 – Asset Renewal Funding Ratio

Calculated as:
It is calculated by measuring capital expenditure on renewal or replacement of assets for a period, divided by the optimal level of such expenditure proposed in the Council's Infrastructure and Asset Management Plan (IAMP).

Purpose:
This ratio indicates the extent to which existing assets are being renewed and replaced, compared with the asset renewal and replacement expenditure identified in Council's IAMP.

Council AIMP 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 IAMP to ensure consistent service delivery.

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

Target 5-year average of 100%
between 90% and 110% in any one year

5.3 Ratio 3- Net Financial Liabilities Ratio

Calculated as:
The Net Financial Liabilities ratio is calculated by expressing net financial liabilities at the end of a financial year a percentage of operating income for the year.

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.

A steady ratio means Council is balancing the need to borrow against their ability to afford debt. An excessive ratio may mean Council is borrowing beyond their means and cannot generate the income required to service assets and operations.

Target
Target percentage over time should be above zero, this means that Council is using debt as a tool in distributing the burden of debt over more than one generation of ratepayers (intergenerational equity). This is an appropriate strategy in government debt.

Where the result is negative Council has more cash available than what is owed in Council borrowings. This may indicate that Council is either raising more rates than it needs or is not providing appropriate services and assets to the community.

A falling result means Councils debt position is improving.

In order to ensure this target is meaningful it needs to be set and aligned with the planning strategy of 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.

Maximum of 100% in any single year
Considered each year against Councils Operating Surplus Ratio.

6. AVAILABILITY OF THE POLICY:

This policy will be available for inspection at the Council's principal office, 29 Holland Street Kingston SE, during ordinary business hours and on Council's website: www.kingstondc.sa.gov.au. Copies will also be provided to interested members of the community upon request, and upon such payment of the fee set by Council.