



An Australian Government Initiative

LONG-TERM FINANCIAL PLANNING

Practice Note 6
LTFP



IPWEA

INSTITUTE OF PUBLIC WORKS
ENGINEERING AUSTRALIA





An Australian Government Initiative

IPWEA Practice Note No.6 Long-term Financial Planning



This page intentionally blank

Minister's Message



Local government plays a vital role in the life of our nation – not only in the delivery of services, but in building communities, planning for future challenges and strengthening partnerships beyond council boundaries with business, community and all levels of government. Local government helps to underpin location-based solutions tailored to meet the specific needs and strengths of particular regions.

I am delighted to introduce a Practice Note for local government to help improve financial planning and management. The Practice Note is a product of the partnership between the Institute of Public Works Engineering Australia and the Australian Centre of Excellence for Local Government and will help guide local governments along a path to financial sustainability and strong financial management practices.

Strong financial planning and management are vital for the sustainable delivery of services by local government. Councils collectively own and operate billions of dollars worth of infrastructure assets that are an essential foundation for community service delivery and sustainability. With appropriate financial planning and strategies, councils are able to manage assets and deliver necessary services with much greater knowledge, understanding and commitment.

Strengthening the role and performance of local government is an important objective of the Australian Government which has provided over \$30 million dollars to establish the Australian Centre of Excellence for Local Government and create the Local Government Reform Fund. A wide range of reform projects – including the development of this Practice Note – have been undertaken, in all states and territories, and nationally.

I commend the Institute of Public Works Engineering Australia and the Australian Centre of Excellence for Local Government for their initiative and efforts in developing and promoting financial management processes that help to guide local government along the path to sustainability. Their partnership will continue to provide councils with the support needed to make informed decisions to balance community needs and priorities, levels of service delivery, potential risks, and available funding and human resources.

A handwritten signature in blue ink, appearing to read 'Simon Crean', with a long horizontal flourish extending to the right.

The Hon Simon Crean MP

Minister for Regional Australia, Regional Development and Local Government

LONG-TERM FINANCIAL PLANNING

Note to Readers

The Institute of Public Works Engineering Australia (IPWEA) has produced various Practice Notes to assist organisations and practitioners responsible for the management of public sector infrastructure and other assets to efficiently and effectively fulfil these roles.

While information contained in these Practice Notes is believed to be correct at the time of publication, the Australian Centre of Excellence for Local Government (ACELG), the IPWEA and its NAMS.AU Group, Working Parties and other contributors to these Practice Notes, do not accept any liability for its contents or for any consequence arising from its use.

Acknowledgements

The development of this document has been funded through the Australian Government Local Government Reform Fund.

The provision of documentation and information used during the compilation of Practice Notes is acknowledged with much appreciation by ACELG and IPWEA. Our aim is to tap into the most up-to-date practical experience being demonstrated by users around Australia. The willingness of others to make their data and systems readily available means all users of these Practice Notes will benefit from their collective wisdom. The sources of material reproduced in this Practice Note are disclosed throughout the document.

The principal author of the Practice Note is **John Comrie, JAC Comrie Pty Ltd.**

We are also indebted to those who have willingly given their time to review and provide comment as this Practice Note was being developed, to ensure we are always reflecting best practice in the field. Those who have been part of the Reference Group and have provided comment are acknowledged as follows:

- Mervyn Carter, Commonwealth Department of Regional Australia, Regional Development and Local Government
- Marianne Di Giallonardo, Maroondah City Council
- David Dobbs, Queensland Department of Local Government and Planning
- John Howard, Jeff Roorda and Associates
- Brian Jenkins, Wollongong City Council, representing New South Wales Local Government Finance Professionals
- Guy Jetson, Dorset Council, Tasmania
- Annette Martin, City of Charles Sturt, representing South Australian Local Government Financial Management Group
- Marilyn McAuliffe, New South Wales Division of Local Government
- Mike Stalley, Toowoomba Regional Council, representing Queensland Local Government Accountants Association
- Katrena Stephenson, Local Government Association of Tasmania
- John Wright, Local Government Association of South Australia

Institute of Public Works Engineering Australia

Level 12, 447 Kent St, SYDNEY NSW 2000

Phone (02) 8267 3001

Fax (02) 9283 5255

E-mail national@ipwea.org.au

PRACTICE NOTE 6

LONG-TERM FINANCIAL PLANNING

PREAMBLE

This Long-term Financial Planning Practice Note has been prepared to assist practitioners, particularly those in organisations with responsibility for service delivery that involves management of assets with long but finite lives, to prepare a long-term financial plan. Such a plan is likely to be needed to ensure equitable and cost-effective decisions regarding timing and delivery of desired and affordable services and financial and service level sustainability¹.

While intended to be of value to a broad range of organisations it has been developed with the particular needs and operating circumstances of local governments in mind. Local governments typically are asset rich but income poor. In Australia they have far more assets to manage relative to income than other spheres of government. Most of these assets are long-lived and require increasing maintenance as they age and eventually need replacement. If local governments are to sustain services their communities want and need, and remain financially viable themselves, they must be expert at financial and asset management planning.

The Long-term Financial Planning Practice Note is one of a series of Practice Notes developed by the National Asset Management Strategy Group (NAMS.AU) of the Institute of Public Works Engineering Australia (IPWEA). The aim is to assist practitioners in applying best practice and where appropriate foster a national approach and encourage consistency of data and outputs. Each Practice Note will be a living document, subject to review and update as further and better information comes to hand.

The following Practice Notes are available through the IPWEA web site www.ipwea.org.au/practicenotes :

- Preamble Document
- Practice Note 1 – Footpaths and Cycleways
- Practice Note 2 – Kerb and Channel/Gutter
- Practice Note 3 – Buildings
- Practice Note 4 – Asset Management for Small, Rural or Remote Communities
- Practice Note 5 – Stormwater Drainage

Practice Notes are also in development for:

- Water and Sewerage
- Levels of Service

Suggestions for development of further Practice Notes or revision to existing ones is welcome and may be made to national@ipwea.org.au

¹ Financial sustainability is about being able to manage likely developments and unexpected financial shocks in future periods without having at some time to introduce substantial and economically significant or socially destabilising revenue or expenditure adjustments.

This page intentionally blank

TABLE OF CONTENTS

1.	SCOPE OF THIS PRACTICE NOTE	1
2.	QUICK GUIDE	3
3.	INTRODUCTION	4
4.	LONG-TERM FINANCIAL PLANS – an overview.....	6
5.	DETERMINING A FINANCIAL STRATEGY	9
5.1	The need for a financial strategy	9
5.2	The operating result.....	10
5.3	Funding sources	13
5.4	Determining an appropriate financial strategy	14
6.	ACCOMMODATING ASSET MANAGEMENT EXPENDITURE NEEDS.....	18
6.1	Asset management planning	18
6.2	Relationship between the long-term financial plan and asset management plan.....	19
6.3	Minimising whole of asset life costs	20
6.4	Linking service from assets to affordability.....	21
7.	FINANCIAL MANAGEMENT INFORMATION NEEDS	24
7.1	Financial information needs to be meaningful.....	24
7.2	Use of accrual accounting information	25
7.3	Financial indicators	26
8.	USE AND TYPES OF BORROWINGS	32
8.1	Role of borrowings.....	32
8.2	When is it appropriate to borrow?	33
8.3	Treasury management	35
8.4	Forecasting interest rates for inclusion in a long-term financial plan	37
9.	CONTENT OF LONG-TERM FINANCIAL PLANS	38
9.1	Introduction	39
9.2	Extent and structure of included financial information.....	39
9.3	Specified assumptions and basis of a long-term financial plan.....	43
9.4	Specified project details	44
9.5	Price movements and the use of real or nominal values	45
9.6	Other specified assumptions	48
9.7	Narrative overview	48
10.	SENSITIVITY ANALYSIS	49
11.	REFERENCES	51
	APPENDIX I	53
	APPENDIX II	57
	APPENDIX III	59
	APPENDIX IV	61

This page intentionally blank

1. SCOPE OF THIS PRACTICE NOTE

This Practice Note is based on the content of *Section 5* and other supporting sections of the Australian Infrastructure Financial Management Guidelines (AIFMG) (IPWEA, 2009). It elaborates on and provides greater detail compared with the AIFMG, on the practical aspects of developing and using long-term financial plans. It has been prepared in particular to assist organisations responsible for ownership and management of infrastructure and other assets to fulfil service level responsibilities whilst achieving and maintaining a position of financial sustainability.

Both the AIFMG and this Practice Note provide a summary of key points at the start of each section to assist users in understanding and applying the content. They are designed to cover the needs of ‘core’ (those beginning the process) and ‘advanced’ users. Moving from a ‘core’ approach to an ‘advanced’ approach is one of continuous improvement in priority areas. The AIFMG specifies the following as criteria to be satisfied in order for a long-term financial plan to satisfy either the ‘core’ or ‘advanced’ approach.

Core Approach

A basic long-term financial plan:

- is for a period of at least 4 years
- takes into account the organisation’s strategic planning documents
- is based on a strategy that supports the organisation’s financial sustainability
- makes appropriate allowance for best estimate asset management needs, and
- is reviewed and updated annually.

Advanced Approach

The long-term financial plan:

- is recommended to be for a period of 10 years or more
- is based on achievement of and discloses projected performance against carefully developed financial sustainability targets
- fully accommodates, in quantum and timing, all activities identified as warranted in an asset management plan
- includes a sensitivity analysis highlighting key factors or assumptions most likely to impact on the achievement of the plan’s financial targets, and
- is reviewed and updated at least annually.

If an organisation is preparing its first comprehensive long-term financial plan, it might be appropriate to base it on satisfying the above core approach. Long-term financial plans need to be regularly reviewed and updated. As entities gain better knowledge and experience, they should aim to have their long-term financial plan meet the advanced approach criteria. (It would generate additional benefits and require little additional effort in preparation).

This Practice Note, consistent with other IPWEA Practice Notes, does not include a glossary of technical terms used in the document. Readers are instead encouraged to refer to the comprehensive glossary listed at the front of the AIFMG. Readers also should have regard to any specific legislative requirements regarding long-term financial planning applicable to their circumstances. For example in several states there are specific requirements applicable to local governments regarding the content of long-term financial plans, the frequency of updating and the process for this.

IPWEA Community of Practice in Asset Management

Visit www.ipwea.org.au/AM

You are invited to sign up to be part of the IPWEA Asset Management Community of Practice.

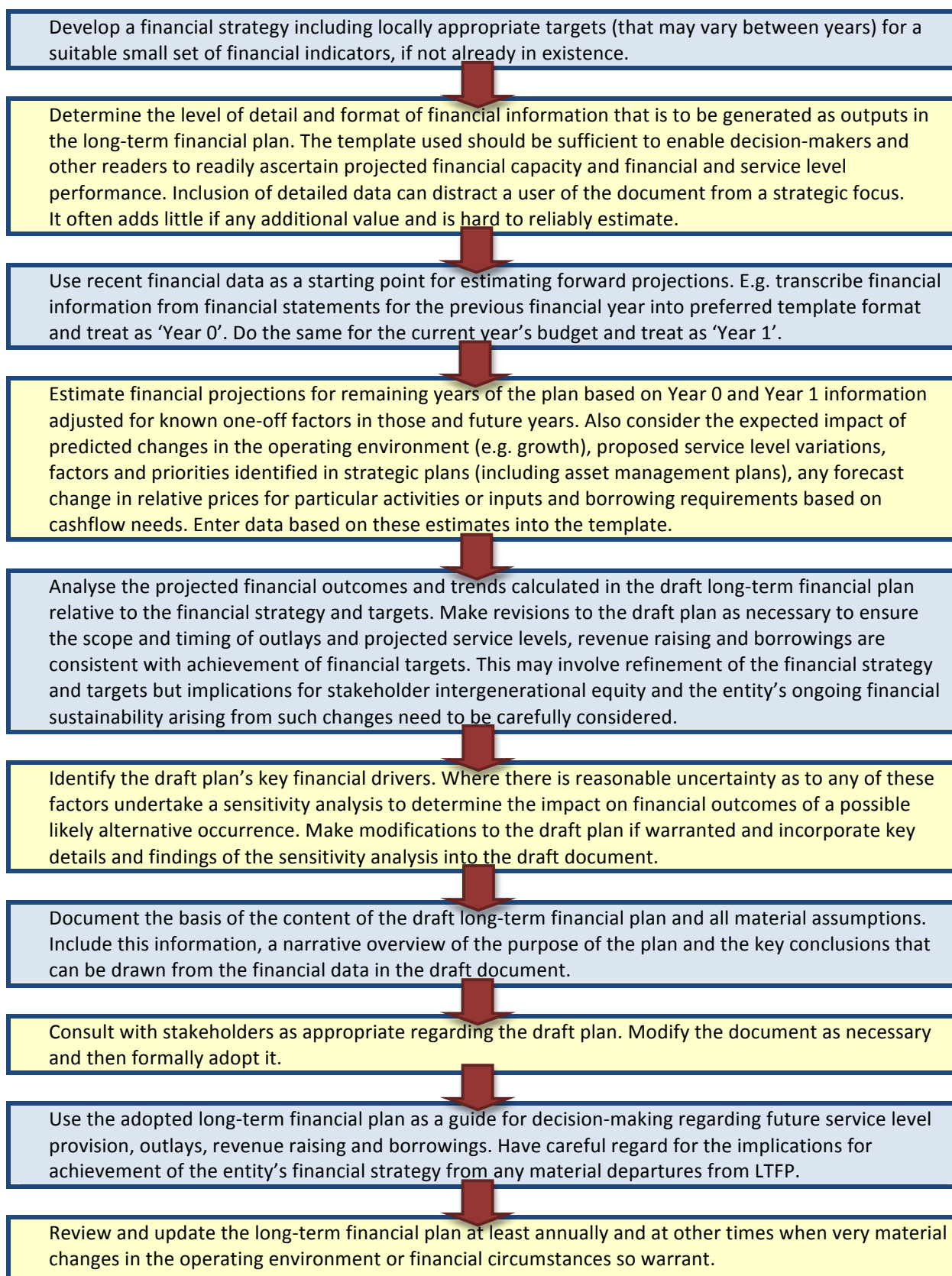
To create a free web account, go to www.ipwea.org.au/CreateWebAccount.

After logging in, update your Profile to
"Edit your Areas of Interest to join a Community of Practice".

The Community of Practice provides an active forum for discussing all issues in infrastructure asset management and financial planning.

2. QUICK GUIDE

Key steps in preparing, using and maintaining a long-term financial plan



3. INTRODUCTION

Key Points

- A long-term financial plan is needed by every organisation with significant long-lived infrastructure. Without one, it is impossible to effectively and equitably manage service level, asset management and revenue raising decisions and ensure ongoing financial sustainability
- A simple long-term financial plan is much better than no plan

Core Approach

A basic long-term financial plan:

- is under-pinned by a sound financial strategy that ensures that the organisation's financial sustainability is protected or improved as necessary
- accommodates asset maintenance and asset renewal and replacement activity at levels and at points in time that minimises whole-of-life economic costs relative to required service levels
- accommodates service levels proposed in the organisation's strategic plans.

Advanced Approach

The long-term financial plan:

- is based on achievement of and discloses projected performance against carefully developed financial sustainability targets
- fully accommodates, in quantum and timing, outlays consistent with activities identified as warranted in the organisation's asset management plan and other strategic planning documents.

Inquiries into the financial sustainability of local governments undertaken in all states of Australia in recent years consistently identified the short forward financial planning horizon of many local governments (often limited to an annual budget) as a key factor impinging on financially sustainable decision-making. The Inquiries emphasised the particular importance of long-term financial planning for organisations that are responsible for managing and generating service from a large stock of long-lived assets (relative to annual income) such as local governments.

Long-term financial planning together with the use of accrual accounting rather than cash accounting for reporting and decision-making and better asset management were identified as crucial for local government financial sustainability.

A long-term financial plan is more than just an estimate of forward revenue and expenditure projections. It needs to:

- be underpinned by a sound financial strategy that ensures that the organisation's financial sustainability is protected or improved as necessary. This includes ensuring that asset maintenance and asset renewal and replacement activity is carried out at levels and at points in time that minimises whole-of-life economic costs (relative to required service levels)
- accommodate service levels proposed in the organisation's strategic plans.

If an organisation does not maintain financial sustainability over the medium to longer-term or take steps to improve financial sustainability where this is warranted then it is not fulfilling one of its key responsibilities. The problem will not go away by itself and delaying action will simply make the challenge more painful to deal with (more expensive and more inequitable) when it inevitably must be addressed (e.g. when assets prematurely fail and the organisation can't afford to replace them).

If a long-term financial plan suggests that trying to achieve desired service levels will jeopardise ongoing financial sustainability, then the organisation needs to consider various alternative strategies to overcome this conundrum.

An organisation, therefore, should evaluate various options before ultimately settling on a long-term financial plan that is compatible with a financial strategy that supports its financial sustainability and a range and level of services that best meets service level needs and preferences. How to go about doing this is outlined in subsequent sections.

4. LONG-TERM FINANCIAL PLANS – an overview

Key Points

- Financial Planning is an essential component of optimally providing services from infrastructure.
- A long-term financial plan is a plan for generating, spending and investing future income and raising and repaying borrowings as appropriate. It will highlight the financial implications of an entity's proposed activities and anticipated events. It includes a projection of an organisation's financial performance and position over this period. It should be consistent with, and express financially, actions required to give effect to strategies proposed in the organisation's other strategic planning documents including its asset management plans.
- A long-term financial plan seeks to efficiently and equitably accommodate ongoing funding of:
 - existing services - operations, maintenance, asset renewal and upgrade, and
 - new services and assets as required.

Core Approach

A basic long-term financial plan:

- has at least a 4 year planning horizon
- has been developed in an iterative way with proposed activities and service levels adjusted to meet specified financial targets.

Advanced Approach

In addition to developing the long-term financial plan in an iterative way, the plan covers a period of at least 10 years.

The purpose of a long-term financial plan is to express, in financial terms, the activities that an entity proposes to undertake over the medium to longer term to achieve its stated objectives. It is similar to, but usually less detailed than, the annual budget. Just like the budget, it is a guide for future action although its preparation requires the entity to think about not just one year but the longer-term impact of revenue and expenditure proposals. The aggregation of future intended outlays and anticipated revenues enables the accumulating overall financial implications to be readily identified and, if warranted, proposed future activities to be revised.

Long-term financial plans are particularly important for entities with a high level of long-lived assets and significant asset management responsibilities relative to their income base. Such entities may have long periods with modest levels of asset renewal requirements and then other periods when very significant outlays are necessary. They need to be generating revenue in an equitable manner over time and ensure that they have capacity to finance peaks in asset management and other outlays when, and including by way of borrowings where, necessary.

The preparation of a long-term financial plan generates improved information to guide decisions about the mix and timing of outlays on operating activities and additional assets and the funding implications of these. Without a soundly based long-term financial plan, an organisation with significant asset management responsibilities, is unlikely to have sufficient data to determine sustainable service levels with affordable asset stockholding strategies, appropriate revenue targets or optimal treasury management.

A long-term financial plan, just like the annual budget, should be developed in an iterative way. If a draft version shows that the proposed activities will have a detrimental effect on service levels or financial targets over time, then proposed outlays need to be reviewed and/or financial strategies adjusted.

Example
**Increasing Revenue to Accommodate Financial Target
When Increasing Service Levels**

A council may have set itself the objective of basing its annual budgets on achieving an operating surplus in normal circumstances equivalent to 5% of its total operating revenue (in order to provide a buffer for risk and uncertainty).

Assume its budgeted operating revenue is \$20 million (M) and its operating expenses are \$19M (and therefore its operating surplus is \$1M or 5% of operating revenue). Assume also for simplicity that there is no development growth in the council's area and its long-term financial plan projects that operating revenue and operating expenses will remain unchanged in real terms over the planning period.

The council wishes to consider committing to providing and operating a swimming centre for its community. It has carefully costed the proposal and believes that the new centre will generate \$400,000 pa in revenue but add \$700,000 pa to its operating costs (inclusive of depreciation and financing charges).

Without an increase in other operating revenue or reduction in other operating expenses the council's operating revenue would then be \$20.4M and its operating expenses \$19.7M. Its operating surplus would be \$0.7M or 3.4% of total operating revenue. To maintain achievement of its financial target objective the council would therefore need to generate further additional revenue of \$335,000 pa. Total operating revenue would then be \$20.735M and its operating surplus \$1.035M (i.e. 5% of operating revenue).

If the council believed it would be counter-productive to raise charges for users of the proposed swimming centre and had no other capacity to generate additional revenue except through raising property rate revenue then it would need to consider this option. If rates represented 70% of existing operating revenue (i.e. \$14M) then rates would need to increase in real terms by 2.4% to enable this increase in the level of services provided by the council to be accommodated without adversely impinging on maintaining achievement of its financial target.

Alternatively the council could review its existing range and level of services with a view to reducing some of lower priority in order to reduce the level of rate increase needed.

A long-term financial plan showing a very sound ongoing financial position would allow an entity to consider raising service levels or introducing additional activities to further satisfy community wants and needs or reducing future proposed rates and charges.

Ideally a long-term financial plan should cover a period of at least 10 years but entities that haven't previously had a long-term financial plan may find it more feasible and practical to develop an initial financial plan with say a 5 year planning horizon. Even a plan over this period will generate substantially better information for financial decision-making compared with a traditional annual budget.

The form and content of a long-term financial plan is discussed in *Section 9* of this document. An entity should determine the structure and level of detail it includes in its long-term financial plan in the context of the issues discussed in *Sections 5 to 10*.

5. DETERMINING A FINANCIAL STRATEGY

Key Points

- A long-term financial plan needs to be under-pinned by a clear financial strategy with measurable financial targets.
- This strategy should in most circumstances be based on the entity maintaining or where warranted improving its long-term financial sustainability. The strategy also needs to have regard to the current and the projected future operating environment.
- Forecast projections of available and required forward cashflow are not sufficient to determine affordability of current or proposed service levels where an entity has significant levels of non-cash operating expenses.
- A long-term financial plan should include a description of the financial strategy on which the plan is based including its financial targets and their rationale.

Core Approach

The financial strategy under-pinning the long-term financial plan is consistent with basic and generally applicable recommended approaches for achievement of financial sustainability.

Advanced Approach

The financial strategy under-pinning the long-term financial plan has been tailored to take into account the particular current and projected long-term operating environment of the organisation.

5.1 The need for a financial strategy

A long-term financial plan needs to facilitate ready assessment of the affordability implications of current and projected service levels. This cannot be ascertained with confidence simply by examining past financial performance or current budget activity. It requires an evaluation of the future operating environment (e.g. will significant growth occur or is a change in service needs and preferences likely and if so what are the cash inflow and outflow implications?). Even if the operating environment is expected to remain relatively unchanged future annual net cashflow needs and projections may vary from current or historical levels because, for example, of peaks in forecast asset renewal requirements.

Forecast projections of available and required forward cashflow is not sufficient to determine affordability of current or proposed service levels where an entity has significant levels of non-cash operating expenses.

Local governments, for example, have very considerable stocks of assets with long but finite lives. The depreciation expense recognised by entities using accrual accounting is calculated to reflect the rate of consumption of the service potential of the physical assets under their control. For local governments depreciation can typically make up 25% to 35% of their total annual operating costs. Any judgement of the affordability of future proposed service levels therefore needs to have regard to the implications arising from expected future non-cash related financial events and changes in their level over time.

Balancing a long-term financial plan requires the fulfilment of an organisation's service level responsibilities and objectives within the constraints of its financial strategy – it is not sufficient to simply ensure cash inflows match cash outflows each year.

The use of financial indicators can facilitate assessment of the compatibility of service level proposals included in a long-term financial plan and achievement of an organisation's financial strategy. A long-term financial plan should highlight projected financial performance against appropriately determined targets for financial indicators that are suited to the organisation's circumstances. *Section 7* provides more information regarding financial indicators.

Financial Strategy Objectives

A long-term financial plan should be based on an organisation achieving its affordable service level objectives while also maintaining, or where necessary equitably improving its financial sustainability.

5.2 The operating result

The most critical indicator of financial sustainability is an organisation's operating result¹ shown in its Statement of Comprehensive Income, i.e. the difference between operating revenue and operating expenses expressed on an accrual accounting basis. It is critical that a long-term financial plan clearly highlight an organisation's projected operating result over the planning period.

Any organisation that incurs ongoing operating deficits should be quite clear about the strategic implications of this on its future capabilities to sustain current service levels. It means that:

- taxes and charges people are paying are less than the costs incurred in providing existing levels of service
- the entity is effectively running down its existing net assets (but not necessarily cash)

¹ There are slight but important differences in the mandated components included in the reported operating result of local governments in different jurisdictions. In particular, in some jurisdictions grants and contributions provided for new or upgraded assets (and the physical provision of such assets) are treated as operating income. Discussion in this Practice Note regarding interpretation of the Operating Result assumes that Operating Income does not include such items. In jurisdictions where local governments are required to include receipts from these components in Operating Income for financial reporting purposes an adjustment to remove these amounts would be required to enable valid application of interpretations of the Operating Result outcome made in this paper.

- in future it must inevitably reduce service levels, improve efficiency and/or increase operating revenue and the longer it delays remedial action the more severe the consequences are likely to be.

EXAMPLE

Impact of basing revenue target on cash vs accrual accounting expenses

Assume an organisation has operating expenses of \$10M pa including depreciation of \$2.5M and assets with a current value of \$100M (comprised of land worth \$25M and infrastructure and other depreciable assets worth \$75M). For simplicity assume it currently has no liabilities and no financial assets and always sets rates to ensure it raises sufficient operating revenue to offset all operating costs except depreciation.

Each year then its financial performance will be that it achieves an operating deficit of \$2.5M in real terms (ie net of inflationary impacts). All other things being equal the value of its net assets will decline by \$2.5M pa because of the consumption of part of the remaining service potential of its depreciable assets.

Year	1	2	3	4	5	6	7	8	9	10
All in \$Million										
Operating Revenue	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Operating Expenses other than depn	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Depreciation	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Total Operating Expenses	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0	10.0
Operating Surplus/(Deficit)	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5	-2.5
Value of infrastructure at year end	72.5	70.0	67.5	65.0	62.5	60.0	57.5	55.0	52.5	50.0
Value of land at year end	25	25	25	25	25	25	25	25	25	25
Total Value of Assets at year end	97.5	95	92.5	90	87.5	85	82.5	80	77.5	75

The council may continue to maintain this financial strategy and level of performance for many years without adverse consequences. Problems though will arise as assets age. They will require more maintenance and eventual replacement (and in fact the replacement timing need will arise earlier if maintenance has been inadequate).

The council is likely to find it difficult to raise rates in future to the degree necessary to fund additional asset maintenance and asset replacement at the time that it is needed. In any event it would be inequitable to over-charge ratepayers at that time relative to then current operating costs just because in previous years ratepayers had been under-charged. The council therefore would need to borrow cumulatively increasing and significant amounts to finance asset replacement (which also may be difficult) or accept lower levels of service from assets (e.g. putting load limits on bridges, converting sealed roads to unsealed condition or not re-sheeting unsealed roads or tennis/netball courts etc).

Imagine now instead that the council always sets rates at a level such that operating revenue exactly offsets operating expenses. It would mean that revenue raised from ratepayers and other service recipients matched the cost of service provision. Operating revenue would be \$10M pa. At the end of the first year depreciable assets would have declined in value by \$2.5M but the council would also have \$2.5M in cash. Net assets would remain unchanged. Over time as depreciable assets declined in value cash holdings would correspondingly increase until needed to be utilised to accommodate asset renewal. There is likely to be approximately enough cash on average over time to finance asset renewal (although modest levels of borrowings may be required for short periods if e.g. assets fail prematurely or the real cost of replacing assets rises over time).

Year	1	2	3	4	5	6	7	8	9	10
<i>All in \$Million</i>										
Operating Revenue	10	10	10	10	10	10	10	10	10	10
Operating Expenses other than depn	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5	7.5
Depreciation	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Total Operating Expenses	10	10	10	10	10	10	10	10	10	10
Operating Surplus/(Deficit)	0	0	0	0	0	0	0	0	0	0
Value of infrastructure at year end	72.5	70	67.5	65	62.5	60	57.5	55	52.5	50
Value of land at year end	25	25	25	25	25	25	25	25	25	25
Value of financial assets at year end	2.5	5	7.5	10	12.5	15	17.5	20	22.5	25
Total Value of Assets at year end	100	100	100	100	100	100	100	100	100	100

In practice, a council's total asset stocks will not remain constant over time. For example it may incur costs in acquiring additional assets to provide additional services. It may appropriately choose to use accumulated funds to finance their acquisition and this would mean that it would need to borrow in future to finance asset renewal. Note though, the need for the borrowing would arise not because of asset renewal but because of the decision to acquire additional assets.

Any decision to add to the stock of assets will add to operating costs in future years. In order to operate sustainably, an entity needs to be able and willing to generate higher income in future, or reduce other expenses, whenever it makes decisions to increase the quantity or standard of its asset stock and/or increase service levels.

If an organisation can maintain, on average, an operating breakeven result or better over the medium to longer term, looking backwards and forwards, it will be operating on a sustainable basis. It is important to recognise though that even in these circumstances, it may not always have sufficient internally generated cash to fund asset renewal and replacement, as and when it falls due, and all other proposed outlays.

In such circumstances, it is likely though to have the capacity to borrow to the extent necessary for such purposes, without significant impact on additional future income raising need or adversely affecting its future financial sustainability. (See *Section 8* for more information re effective use of borrowings.)

Where an organisation needs to take steps to improve its financial sustainability, its proposed responses should be incorporated into its long-term financial plan. Modelling of various options in the preparation of a long-term financial plan can show, for example, the impact of:

- generating more revenue in one or several years
- proposals that may improve the efficiency of service delivery
- reducing some service levels
- delaying the acquisition of additional assets that will enhance services
- delaying or reducing the scope of proposals that will increase service levels
- eliminating some services
- disposing of assets that are not required to achieve proposed service levels.

It is particularly important to recognise the long-term impact of proposals to increase service levels. Where they are introduced without adequate ongoing operating income being available, then there will inevitably be negative long-term impacts. Delaying the timing of provision of new additional assets and introduction of higher service levels will have a favourable financial impact. Modelling will demonstrate whether such initiatives can be accommodated later in the planning period, e.g. if and after projected annual operating revenues have grown.

5.3 Funding sources

Organisations need to determine an appropriate mix of revenue from all available sources (e.g. rates, user-pays fees and charges and grants). Revenue can be supplemented with borrowings if there is a cashflow need and this doesn't adversely impact on financial sustainability. It needs to be clearly understood though that borrowings are not a form of revenue. Technically it is better to think of borrowings as a financing source rather than a funding source². Funding sources come from revenue, either now or in future, e.g., borrowings need eventually to be repaid and this comes from future revenue.

² People often use the terms 'financing' and 'funding' interchangeably but in public finance literature and this Practice Note the two terms have different meanings. 'Funding' refers to the raising of revenue (e.g. through rates, user charges, or the receipt of grants, subsidies and contributions). 'Financing' describes how payment for an outlay is accommodated. This could for example be through an entity accessing its own funds (e.g. cash held in a bank account) or by an arrangement to use another entity's funds (e.g. by taking out a loan – also referred to as a borrowing). While 'financing' and 'funding' are different functions they are inter-related. For example, where total outlays in a particular year cannot be met from revenue in that year, some outlays may be financed by raising a borrowing but the servicing of the loan will need to be funded from revenue over a period of time. Thus, decisions regarding raising loans are not part of a funding strategy – they are a financing strategy.

The financial strategy needs to weigh up whether:

- today's service recipients should pay more or less than the cost of providing today's services to them and the consequential implications for future ratepayers, and
- the best balance between funding from direct users of specific services (fees and charges) and broader public beneficiaries (e.g. through general rates and taxes).

Illustrative Example of a Financial Strategy

A long-term financial plan should include a description of the financial strategy that the plan is based upon, including its financial targets and their rationale.

For example, a council may be satisfied with its existing service levels, and is expecting little in the way of population change or development growth over the next 10 years.

If it has been generating an operating deficit equivalent to say 10% of rate revenue in recent years, it may decide to adopt a financial strategy based on;

- Holding overall operating expenses constant in real terms (ie net of inflationary impacts) over the planning period
- Increasing real average rating levels by 1.5% each year.

Such a strategy, if achieved, would progressively reduce the annual operating deficit.

All other things being equal, it would result in achievement of an operating surplus equivalent to about 6% of rate revenue in the 10th year and a progressive improvement in its financial sustainability and capacity to fund any asset replacement needs.

5.4 Determining an appropriate financial strategy

A financial strategy that is based on maintaining or incrementally moving towards achievement of a small operating surplus, is likely to be appropriate for most but not all local governments. Each organisation's strategy needs to have appropriate regard to its own operating environment. There are situations in which a council might appropriately choose a different financial strategy, such as;

1. A council may experience a temporary significant increase, or decrease, in operating revenue or operating expenses. This could arise e.g. because of a short-term increase in untied operating grants (e.g. through the Commonwealth Government's Roads to Recovery Program). It would usually not be appropriate to reduce other operating income or allow ongoing operating expenses to rise when such windfalls occur. This is because it might be difficult to reverse such actions if and when the additional operating revenue ceases to be available (although a 'catch up' program to address outstanding asset maintenance backlogs may be warranted).

A better strategy may be to use the funds to address asset renewal needs. If this happened, a council that would have otherwise recorded an operating break-even result for the period(s), in which such grants were received and expended, would record operating surpluses each year equivalent to the annual windfall amount.

The above example illustrates the merit of basing a financial operating result target on achievement of an 'underlying' result i.e. one where the actual result is adjusted to net off one-off or abnormal events.

2. There may have been considerable change in a community since a council provided particular service-generating assets. For example, there may have been a population shift or changes in service preferences. In addition, the availability now of other non-council provided facilities often can mean that councils would not replace community halls in some localities where they currently exist. Community ageing could mean some sporting facilities similarly would not be replaced. Changes in freight route patterns could mean some roads designed for higher levels of traffic justifiably could be renewed in future with a road of lower specification.

It can still make sense for a council to keep and operate assets until the expiration of their useful life that now have much less service level demand. For example, if marginal additional costs associated with their availability and ongoing use are low and less than the service benefits they generate. Sunk costs of initial provision on which the annual depreciation charge is based should be ignored in any such assessment. Nevertheless, the opportunity cost of continuing to hold an asset that has reasonable market value does need to be taken into account in deciding whether to retain it.

A council might find that its recorded operating costs associated with such assets (calculated using accrual accounting and therefore including depreciation) make up say 10% of its operating costs and might reasonably set its operating result target having regard to this. That is, it might be willing to make operating revenue raising decisions based on recovery of less than full operating expenses if it doesn't propose to renew assets in future or provide alternative services from new additional assets with similar annual operating costs.

Note: the revaluation model option in Australian Accounting Standard 116, Property, Plant and Equipment, mandated for application by local governments in most Australian states, requires local government assets to be valued at fair value (net market value, aka net realisable value). Where market based evidence cannot be ascertained because of the specialised nature of the item, then the asset should be valued at written down replacement cost. Older community halls in remote localities are often likely to have a low market value. Hence the annual depreciation charge for any such assets, owned or controlled by a council, is unlikely to have a material impact on the entity's total operating costs, if the assets are correctly valued. That is, if they are valued based on market values rather than depreciated replacement cost.

-
3. Infrastructure and other assets provided by developers, will become the responsibility of a council when sub-division works, in estates they develop, are completed. Such assets need to be recognised in a council's balance sheet and their consumption will add to a council's annual depreciation expenses. This depreciation charge and other additional operating expenses associated with servicing a new sub-division may initially be considerably more than the additional revenue generated by a council (e.g. through rates on new allotments). This situation may persist for several years, even though over the long-term the council's total additional operating expenses are less than the associated operating revenue (and therefore the development is financially beneficial to the council and consequentially other ratepayers).

Some councils experience at times very rapid and significant levels of sub-division activity. It is possible that for them the value of additional developer provided assets, and the additional associated depreciation expenses, could be very material relative to their existing asset base and levels of depreciation. If rate revenue growth is initially likely to be materially less than the increase in operating expenses, a council should take this into account in setting its financial targets. In such circumstances it might be warranted for a council to set a financial target based on a temporary decline in its operating result. It may possibly even accept a negative operating result target in the short-term if it was confident this would be gradually reversed over the medium to longer-term.

In these circumstances, a council should consider structuring its long-term financial plan and financial reports separately to distinguish the impacts, on operating revenue and operating expenses, of:

- its decisions net of the any effects arising from the rapid growth, and
- the effects of growth.

That is, the long-term financial plan could show the following:

- Operating Revenue (excluding any impacts from major sub-divisions)
- Operating Expenses (excluding any impacts from major sub-divisions)
- Operating Result (excluding any impact from major sub-divisions).

As well as:

- Operating Revenue (total)
- Operating Expenses (total)
- Operating Result (overall).

This would help it avoid making decisions that adversely detract from long-term operating sustainability. It would be clear to what extent financial impacts on the operating result are arising from major new sub-divisions and to what extent they are arising from activity associated with serving existing residents and properties. Financial performance indicator information (e.g. the operating surplus ratio) could also be prepared exclusive and inclusive of such growth.

-
4. A council may currently have a small operating surplus but may have until recently, traditionally had significant annual operating deficits. It may also have very significant looming asset renewal needs and negligible net financial assets with which to finance these renewal works. It may be concerned about the level of additional borrowings it would need to raise to finance these asset renewals, or be concerned about its capacity to obtain a high level of additional borrowings.

In such circumstances, it may conclude that it would be prudent and not seriously compromise intergenerational ratepayer equity, if it incrementally increased rate revenue and therefore its operating surplus. This would enable it to build up financial assets to help finance future asset renewal needs.

The above scenarios are illustrative only. Each organisation needs to carefully consider its own current and future projected circumstances in determining the financial strategy that underpins and provides a framework for the content of its long-term financial plan.

In particular, it needs to determine whether achieving and maintaining a small ongoing operating surplus is an appropriate key component.

6. ACCOMMODATING ASSET MANAGEMENT EXPENDITURE NEEDS

Key Points

- The objective of asset management is to ensure that assets are managed, maintained, rehabilitated and replaced at points in time and in ways that enable achievement of affordable specified service levels from them, whilst also minimising whole of asset life costs.
- An asset management plan should highlight required cashflow needs to accommodate this objective.
- The long-term financial plan should accommodate the organisation's cashflow needs to enable it to carry out the asset maintenance activities and renewal and replacement of assets as set out in the asset management plan.

Core Approach

The long-term financial plan has been prepared in the absence of fully developed and reliable asset management plan covering all material asset classes under the entity's control, but accommodates best currently available estimates of future asset management needs.

Advanced Approach

The long-term financial plan is based on accommodating outlay projections specified in a well-developed and soundly based asset management plan that covers all material asset classes under the entity's control.

6.1 Asset management planning

Any organisation that is responsible for managing a significant stock of assets needs an asset management plan. It guides the scheduling of maintenance, refurbishment, renewal and replacement of assets, when it is optimal to do so, in order to minimise asset life-cycle costs, for any determined level of service.

An asset management plan is particularly critical for organisations with many long-lived, high value assets relative to their annual revenue (e.g. local governments).

Such organisations can experience significant change in the level of asset maintenance and asset renewal expenditure required over time. Their service level and revenue raising decisions need to allow for this.

An asset management plan should set out the optimal schedule of proposed asset maintenance, renewal and replacement necessary to achieve specified service levels while minimising asset life cycle costs.

An asset management plan also provides critical expenditure projections as input for the long-term financial plan.

6.2 Relationship between the long-term financial plan and asset management plan

The long-term financial plan should accommodate the organisation's cashflow needs to enable it to carry out the asset maintenance activities and renewal and replacement of assets, as set out in the asset management plan – providing the asset management plan is based on financially sustainable service levels.

It is not appropriate to vary the timing of proposed maintenance and capital renewal activities significantly in the asset management plan, to fit within the forecast net cashflow availability from funding (i.e. excluding borrowing) and other outlay decisions. Small variations are typically unlikely to have material impact and may be justified on operational and project management grounds. It needs to be recognised though, that large shifts in timing of actual expenditure, backwards or forwards from when identified as required, could increase asset life cycle costs and/or result in lower service levels than is affordable. (For example, if insufficient funds are available to reseal roads when it is optimal to do so, and the work is not carried out in a timely manner, then pavements may prematurely fail and annualised whole-of-life costs of road assets will rise as the pavement assets don't last as long as they should).

An organisation could have affordable service levels but not enough projected cash to accommodate forthcoming asset renewal. In this case it should simply borrow if necessary to accommodate this need. If it has reliably estimated long-run service level costs and generates sufficient revenue to meet such costs, then there will be periods where cashflow is in excess of asset renewal needs, enabling any borrowings previously raised to be repaid.

Table 6.1

EXAMPLE

Year	1	2	3	4	5	6	7	8	9	10
	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
Asset renewal (optimal)	3,000	3,500	2,800	2,000	2,000	2,000	2,000	1,000	1,000	1,000
Internally generated funds available	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Additional borrowings required	1,000	1,500	800	-	-	-	-	-	-	-
Capacity to repay borrowings	-	-	-	-	-	-	-	1,000	1,000	1,000

Alternatively, an organisation might have unaffordable service levels but plenty of retained cash or currently excess annual cashflow from operations. If decision-makers have a 'cash accounting mentality' or they don't explain to stakeholders the need to base revenue raising and service level decisions on medium/long-run accrual accounting information, they risk utilising this available/accumulated annual net cash in-flow to inappropriately increase service levels, or for reducing revenue raising efforts.

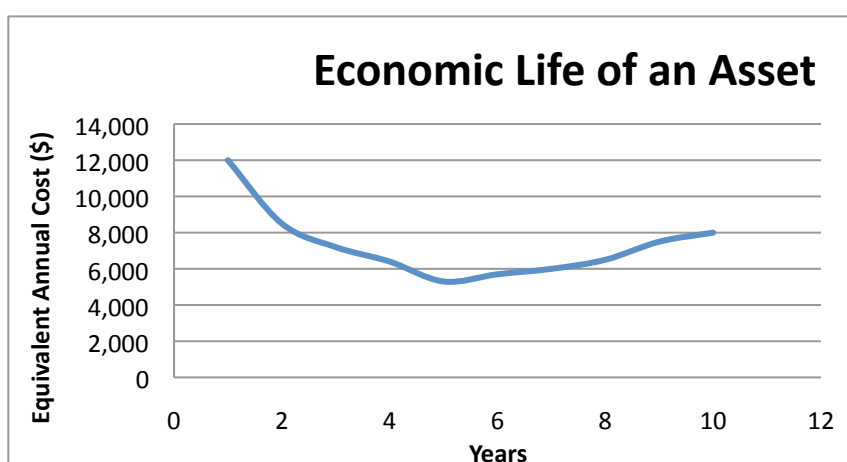
An organisation cannot determine affordable service levels by considering historic asset management outlays or projected available budget cashflow capacity for asset management. The only simple, practical way to determine affordable service levels is by looking at an under-lying trend accrual accounting projected operating result, and other financial indicator results, over at least a 5 year or preferably a 10 year period.

6.3 Minimising whole of asset life costs

The economic life of an asset is the period (measured in time or units of output) that it is optimal to hold the asset to achieve desired service levels prior to replacement. It is estimated by determining from current available knowledge (including but not limited to past experience), the likely economic costs (acquisition, opportunity cost of capital, maintenance, repairs, risks and costs of downtime, resale value) that would arise from holding the asset for different periods and calculating the equivalent annual cost for each of these periods.

For example, take the case of a piece of plant. Holding it for longer periods allows net capital costs (acquisition costs less disposal value) to be apportioned over a longer period and also therefore reduces annualised financing costs but maintenance and downtime costs will rise over time and eventually more than offset the capital related savings from holding the item longer.

Figure 6.1



In the illustration above the predicted economic life of the asset is 5 years.

(Note: The actual useful life of an asset may turn out to be greater or less than its predicted economic life for various reasons. For example, performance may not match expectations, needs may change or technological advances may make earlier replacement warranted. Entities need to review assumed useful lives of assets whenever they update their asset management plans and at other times when evidence suggests this is warranted.)

6.4 Linking service from assets to affordability

It may become apparent in the preparation of the long-term financial plan that the demands of the asset management plan are beyond the long-run financially sustainable capacity of the organisation (including after consideration of feasibility/merit of generating more revenue and capacity to improve efficiency). In these circumstances, the organisation has no option but to review service levels and reduce some, as most appropriate, in order to generate and be able to maintain levels that can be afforded, on an ongoing basis.

In such circumstances, it would have no capacity to accommodate the long-run financial implications of building or acquiring additional new assets or enhancing existing assets to produce higher service levels unless it was prepared to reduce or forego service from other assets that more than offset this.

In the economic life example shown above, the lowest equivalent annual cost of holding an asset before replacement is \$5,300 p.a. (achieved with a 5 year period of ownership). If the organisation cannot raise annual revenue to offset this level of annual costs, it cannot afford this asset and the service level it offers. Another brand or model of plant might have a lower equivalent annual cost of ownership over its optimal economic life, but may also have a lower service level capability (if it had a lower annualised cost and provided an equal or higher level of service capability it possibly would have been chosen in the first place).

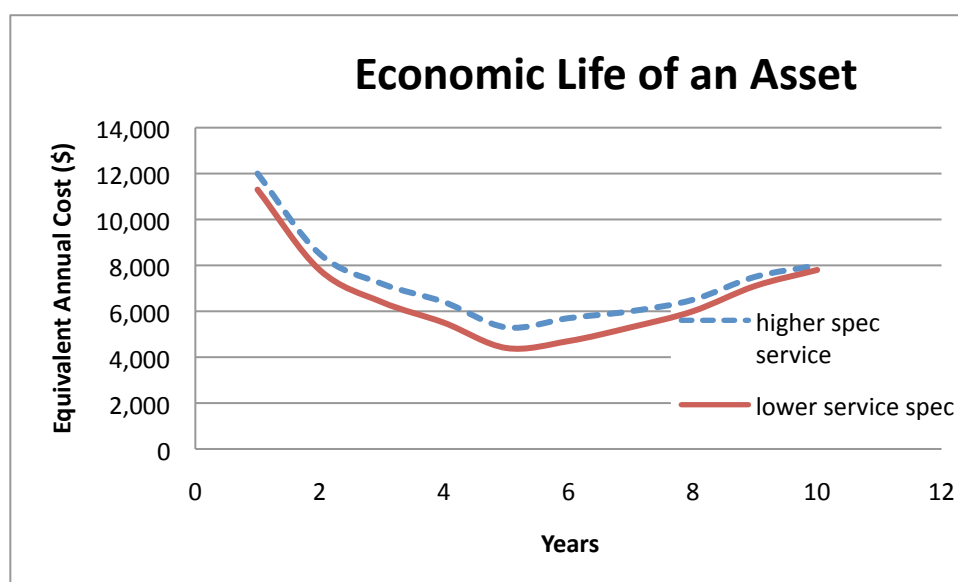
In some cases, it is not practical to choose an asset providing lower service levels. In many instances though, this is feasible and should be considered where it is also expected to result in lower equivalent annual costs. For example, an organisation may elect to replace block-paved footpaths with bitumen ones or provide roads with lower carriageway widths. Roads should be repaired as required, in order to avoid premature asset failure, but levels of maintenance should be based on a hierarchical classification of roads based on needs and affordability. High use unsealed roads should receive more frequent patrol grading than those that are only lightly used. It may also be appropriate for building sizes, equipment and levels of fit-out to be designed to adequately accommodate most (but not necessarily peak) demand requirements.

The specifications of an asset should be based on achieving affordable service-level preferences, most cost-effectively.

An entity needs to adopt service levels that are affordable on an ongoing basis, and then to ensure that maintenance and renewal activity is undertaken on a basis that minimises equivalent annual costs. Choosing a lower service specification asset and then not carrying out maintenance activity at the level, and renewal at the intervals that minimises equivalent annualised costs, could actually mean that annualised service level costs are higher than from an optimised maintenance and renewal program for an asset with a higher specified service level. This means that it could be more costly to have a poorer service provided by the asset.

For example in the graph below, holding the lower service specified asset for eight years or more would result in higher equivalent annual costs compared with having the higher service specified asset and replacing it at 5 yearly intervals. Costs would be higher and service levels lower than they could have been if the organisation had undertaken good asset management and financial planning.

Figure 6.2



Where an entity is unable to financially sustain higher standards of service from assets, it should plan to reduce the range and level of service from assets, to achieve long-run service level affordability in a way that optimally balances long-run costs and service levels. The reality is that even if an organisation doesn't objectively determine to reduce service levels, it will happen anyway because insufficient funds will be available to maintain and renew assets when necessary. The results will simply be haphazard and more costly for the organisation and the service risks and financial shocks are likely to be greater (e.g., a bridge may fail rather than be repaired at an earlier stage or a road pavement may need premature reconstruction because a seal wasn't relayed when warranted).

An organisation’s long-term financial plan should accommodate the cashflow outlays necessary to enable it to carry out the asset maintenance activities as well as renewal and replacement of assets, as set out in its asset management plan. The asset management plan needs to be based on the achievement of proposed service levels from assets (which need to have regard to financial sustainability considerations) and minimising related whole of economic life costs.

The asset management plan and long-term financial plan each should be iteratively refined having regard to the content of each other. For example, asset management scenarios with different levels of service might need to be developed, to satisfy financial sustainability criteria for given operating revenue projections. Likewise various revenue raising strategies could be modelled in the long-term financial plan, for a given level of service, from assets to assess the implications for financial sustainability objectives.

Table 6.2

ILLUSTRATION OF KEY CONTENT OF AN ASSET MANAGEMENT PLAN										
Year	1	2	3	4	5	6	7	8	9	10
Outlays - all in \$Million										
Operations - existing assets	x	x	x	x	x	x	x	x	x	x
Maintenance - existing assets*	x	x	x	x	x	x	x	x	x	x
Cap Ex – Renewal/Replacement of existing assets*	x	x	x	x	x	x	x	x	x	x
Cap Ex on acquisition of new additional / upgraded assets	x	x	x	x	x	x	x	x	x	x
Acquisition of new/upgraded assets & additional assets received free of charge	x	x	x	x	x	x	x	x	x	x
Operations - additional assets										
Maintenance - additional assets*	x	x	x	x	x	x	x	x	x	x
<p>* Proposed maintenance based on achieving specified service levels and minimising whole of life economic costs.</p> <p>The above projected asset management plan outlays and acquisitions would be inputted to the draft long-term financial plan, and the financial sustainability implications assessed, in order to determine whether specified service levels from assets should be varied.</p>										

7. FINANCIAL MANAGEMENT INFORMATION NEEDS

Key Points

- A long-term financial plan needs to do more than simply record proposed and projected cash outlays and receipts. It needs to be able to provide a robust guide regarding the affordability of service level proposals and revenue raising needs. For most organisations, this means the long-term financial plan should include summary level information based on accrual accounting financial statements. Accrual accounting provides far better information to guide forward planning than cash accounting does— particularly for organisations with a significant stock of long-lived assets relative to their income.
- A long-term financial plan and its under-pinning financial strategy need to be based on achieving financial indicator target level performance.
- In order to achieve short, medium and long-term targets, an organisation may need to vary its existing service level and revenue raising policy settings.

Core Approach

A basic long-term financial plan includes:

- summary level information based on accrual accounting financial statements
- financial indicator outcomes for indicators that gauge financial sustainability performance.

Advanced Approach

The long-term financial plan is based on maintaining achievement of sound long-run financial performance targets or making satisfactory progress towards same. Where satisfactory long-run financial performance is not currently being achieved, the plan shows short-term and medium-term 'milestone' targets to guide the organisation towards progressive incremental achievement of long-term targets, and financial content of the plan is based on achievement of such targets.

7.1 Financial information needs to be meaningful

In order for a long-term financial plan to provide reliable information to guide and help demonstrate justification for service level and revenue generation decisions, it needs to be based on clear and sound financial information.

It is impossible to be precise about the future, but projected financial information needs to be sufficiently accurate and reliable, relative to the needs for which it is used. The value of depreciable assets (upon which depreciation expenses are based) in any financial document used for decision-making or reviewing an organisation's performance need to be reasonably up to date. Unless significant and volatile changes in fair value of assets are occurring, Australian Accounting Standard AASB 116 suggests that asset revaluations are necessary only every three to five years. See also *Section 12.7* of the AIFMG.

Suitable annual price escalators may also be applied to adjust asset values between formal revaluations. Reviews of the remaining useful lives of assets and residual values of assets should be undertaken annually, based on best information available.

Financial information may be accurate though not necessarily meaningful. If for example, financial projection information is prepared on a cash accounting basis it may be accurate but almost certainly not useful for determining affordability of service levels by organisations with a large stock of long-lived assets. Financial information also needs to be presented in a succinct way that assists ready comprehension of the situation and its implications. These issues are discussed more fully below.

7.2 Use of accrual accounting information

While all councils are required to prepare their end of year financial statements using accrual accounting, many still base their revenue raising and service level decisions on cash accounting information.³

Cash Accounting:

- records a financial transaction when cash is outlaid or received
- doesn't distinguish between payments for expenses or to acquire assets
- doesn't recognise liabilities or other events that don't involve a cash receipt or payment (e.g. depreciation).

Cash accounting can be appropriate for use by small organisations with stable/predictable receipts and outlays and minimal non-cash expenses (e.g. minimal depreciable assets and few employees accruing future entitlements). For other organisations cash accounting:

- is a poor guide for
 - decision-making re service affordability and equitable revenue raising
 - measuring performance
- can often lead to the perception of the organisation being in a better position than it really is.

Cash accounting is particularly inappropriate for use by organisations that have a large stock of high value, long-lived assets relative to their income. Recorded costs of such organisations will, under cash accounting, vary widely between years and over-time depending on the timing of outlays on asset acquisition and renewal. This makes it virtually impossible to determine equitable revenue raising and affordable service level decisions or objectively measure performance.

Accrual Accounting:

- Recognises events when they occur irrespective of whether cash is outlaid or received at the time

³ Some accrual accounting information may be had regard to (for example employee entitlements that accrue) but depreciation is often ignored. Decisions are often made on how much cash is needed to meet proposed outlays / what outlays can be accommodated from projected available cash that will be generated.

- Distinguishes between payments
 - for day to day expenses (these are recorded in the income statement⁴)
 - to acquire assets (these are recorded in the balance sheet)
- Recognises depreciation to reflect the gradual consumption of assets and as a result
 - shows the decrease in an asset's value for the accounting period (the reduced value of the asset is shown in the balance sheet⁵)
 - a corresponding depreciation expense is shown in the income statement.

Good use of accrual accounting can tell an accurate picture about infrastructure condition and performance. Soundly based assumptions regarding an asset's useful life and rate of depreciation, and regularly reviewing asset service performance and written down recorded value, will mean that financial statements reliably reflect asset values and rates of consumption. This is essential in order to determine affordability of current and proposed service levels and to equitably generate revenue from service recipients over time.

Annual outlays associated with acquiring and operating an asset will vary. In determining affordability of service level proposals and how much revenue to equitably raise, it is best to focus not on the outlays but on the expected average increase in operating costs (including from depreciation expenses), arising from the service level proposal.

Example

If an organisation had outlays of \$10 million pa for recurrent operating activities and \$5 million every 5th year for capital outlays that have a useful life of 5 years and no residual value how much revenue should it raise each year (ignoring any financing costs)?

Cash accounting would suggest that costs are \$10M pa for four years out of 5 and \$15m in the other year. Generating \$10M in revenue from service recipients in 4 years out of 5 and \$15M in the other one would be inequitable. If instead \$11m was raised each year then cash accounting would suggest a profit of \$1m pa has been made in 4 of the years and a loss of \$4M in the other. This may also generate concern. Accrual accounting instead would simply record operating expenses of \$11M each year (\$10M of recurrent outlays and \$1m of depreciation, capital outlays are not an operating expense). Pricing based on recovering accrual accounting operating expenses would suggest \$11M should be raised each year.

7.3 Financial indicators

In preparing and adopting long-term financial plans, organisations need to specify the financial measures that are to be used to monitor and assess financial performance over the planning period.

⁴ The term *income statement* has been used throughout this paper to mean *Statement of Comprehensive Income* as defined by Australian Accounting Standards. The term *income statement* is more widely used and recognised.

⁵ The term *balance sheet* has been used throughout this paper to mean *Statement of Financial Position* as defined by Australian Accounting Standards. The term *balance sheet* is more widely used and recognised.

To be effective, it is essential that indicators:

- measure those factors which define financial sustainability
- be relatively few in number, and
- be based on information that is readily available and reliable.

Organisations need to determine which financial indicators to use to monitor performance, and appropriate target levels or ranges, based on maintaining operating capability, considering their own specific circumstances.

The AIFMG (*see Section 2.6*) includes a set of eight financial indicators that were developed with particular regard to the needs and circumstances of local governments and similar organisations with significant asset management responsibilities. It also includes guidance on the setting of performance targets for these financial indicators.

The financial indicators are:

1. Operating Surplus

The operating surplus (deficit) before amounts received specifically for new or upgraded assets and physical resources received free of charge.

2. Operating Surplus Ratio

A. The percentage by which the operating surplus or deficit as defined above varies from the major controllable income source (e.g. rate income).

B. The percentage by which the operating surplus or deficit as defined above varies from the major controllable income source plus predictable operating grants.

3. Net Financial Liabilities

What is owed to others less money held, invested or owed to the entity.

4. Net Financial Liabilities Ratio

The significance of net amount owed compared with the period's income.

5. Interest Cover Ratio

The proportion of day-to-day income (i.e. operating income) used to pay interest on loans net of interest income.

6. Asset Sustainability Ratio

The ratio of asset replacement expenditure relative to depreciation for a period. It measures whether assets are being replaced at the rate they are wearing out.

7. Asset Consumption Ratio

The average proportion of 'as new condition' left in assets.

8. Asset Renewal Funding Ratio

The ratio of the net present value of asset replacement funding accommodated over a 10 year period in a long-term financial plan relative to the net present value of projected capital renewal expenditures identified in an asset management plan for the same period. It assesses the entity's financial capacity to fund asset renewal.

A key focus of a reader of a long-term financial plan should be overall projected financial performance. This is most readily assessed by studying projected financial performance indicator outcomes, relative to appropriately specified target ranges. Graphical representation of projected performance trends for financial performance indicators and colour-coding of result outcomes, can enhance reader comprehension.

For example, assume a council with an operating deficit has set itself a target to achieve at least an operating break-even position in the first year of its long-term financial plan, improving at 1% p.a. for 5 years and then to maintain this level of performance thereafter. The council highlights in its long-term financial plan, projected actual performance, showing in green for the years it is forecasting its targets will be achieved, amber for the years where projected performance is within 3 percentage points of its target and red for the years where projected performance is more than 3 percentage points outside of its target, as shown in Table 7.1.

Table 7.1

Year	1	2	3	4	5	6	7	8	9	10
Op Surplus as % Op Revenue Forecast	-5.0%	-3.5%	-2.0%	-0.5%	1.0%	2.5%	4.0%	5.5%	7.0%	8.5%
Op Surplus as % Op Revenue Target	>0%	>1%	>2%	>3%	>4%	>5%	>5%	>5%	>5%	>5%
Result										

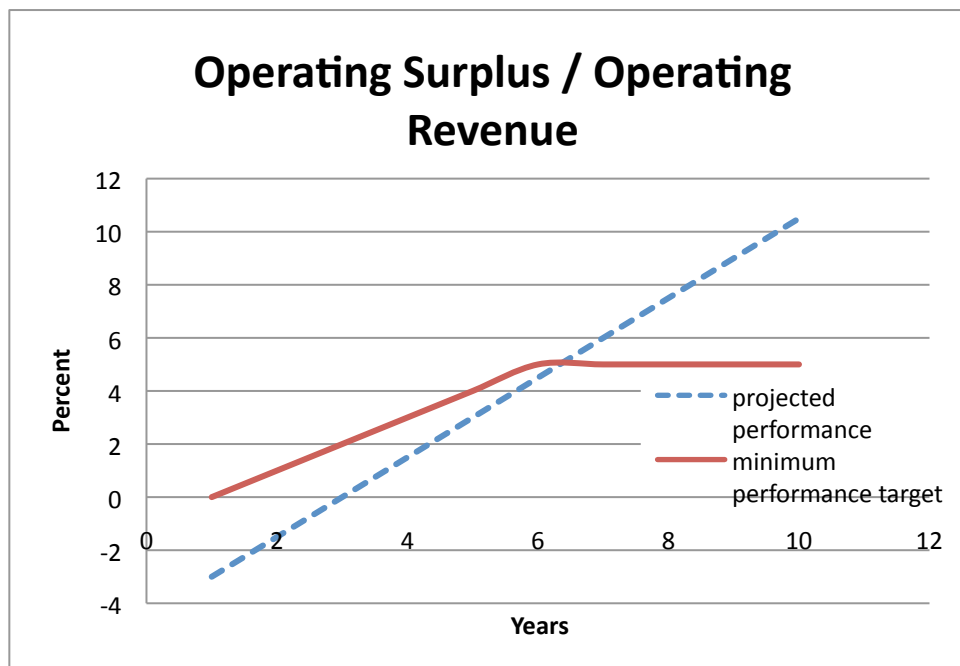
If it then decided to base its long-term plan on increasing operating revenue and/or decreasing operating expenses, such that its operating surplus as a percentage improved in the first year by 2% then, all other things being equal, its projected performance would be as follows in Table 7.2.

Table 7.2

Year	1	2	3	4	5	6	7	8	9	10
Op Surplus as % Op Revenue Forecast	-3.0%	-1.5%	0%	1.5%	3.0%	4.5%	6.0%	7.5%	9.0%	10.5%
Op Surplus as % Op Revenue Target	>0%	>1%	>2%	>3%	>4%	>5%	>5%	>5%	>5%	>5%
Result										

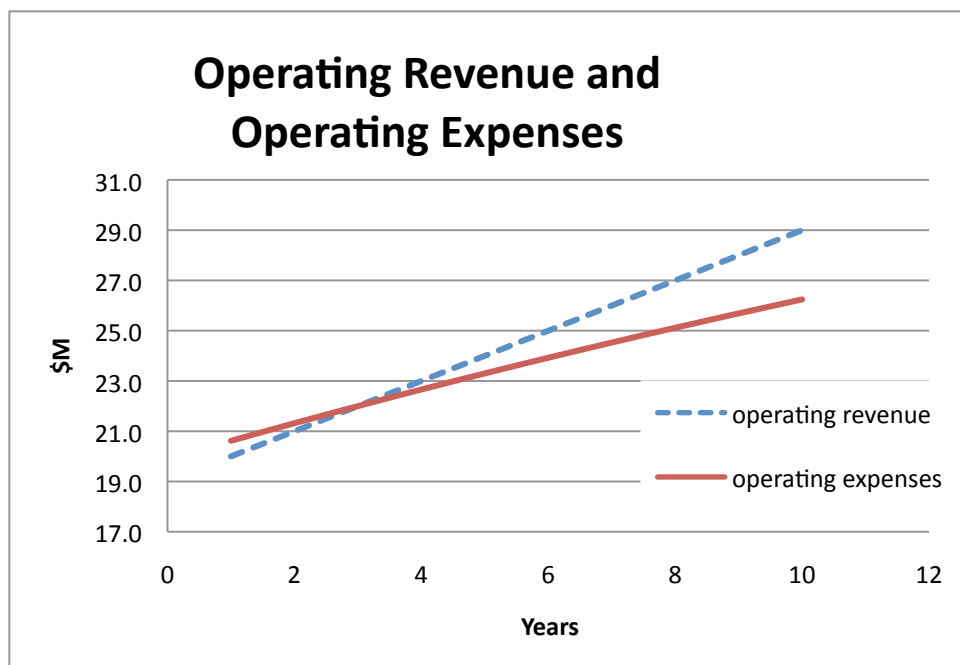
Graphically this outcome could be shown as follows:

Figure 7.1



A graph of projected operating revenue and operating expenses could also be included as shown below.

Figure 7.2



Although the AIFMG includes eight indicators for consideration for adoption by entities with substantial asset management responsibilities, it is considered that three of these are likely to be of most value for assessing and guiding performance.

These indicators are the:

- Operating Surplus Ratio (calculated based on either of the denominators recommended in the AIFMG as most appropriate or alternatively total operating revenue)
- Net Financial Liabilities Ratio
- Asset Renewal Funding Ratio (preferably determined using a net present value calculation as recommended in the AIFMG. Where decision-makers are unfamiliar with net present value concepts the ratio calculated without converting data to net present values is likely to still provide a worthwhile guide).

It is recognised that the Asset Renewal Funding Ratio relies on the organisation having an asset management plan. To be reliable for planning purposes an asset management plan requires reasonable quality asset data. In the absence of an asset management plan based on reasonably reliable data, the Asset Sustainability Ratio is recommended. As the organisation's asset management matures, then the Asset Renewal Funding Ratio will be more appropriate.

In some jurisdictions there may be a legislated requirement for councils to publish other financial indicator data but consideration should still be given to also including outcomes for the above described three indicators where they are not mandated for reporting against.

Reporting on a smaller rather than larger number of indicators, helps decision-makers and stakeholders more readily focus on, and comprehend, key outcomes and implications. Reporting on a smaller number of financial indicators is also consistent with the national frameworks for assessing financial sustainability, endorsed by the Local Government and Planning Ministers' Council.

In addition, encouraged by the Australian Centre of Excellence for Local Government (ACELG), the most recent (2010) meeting of the National Local Government Financial Management Forum agreed in principle to IPWEA promoting three high level financial indicators which might be endorsed for use in all jurisdictions in the future. The Forum suggested the possibility of one indicator covering a council's financial performance, one covering a council's financial position and one covering a council's asset management performance.

ACELG's separate but related projects currently underway covering 'National Minimum Data Sets' and a 'National Framework for Local Government Asset Management and Financial Planning' would appear to provide an ideal opportunity for all stakeholders to reach a consensus on the most appropriate indicators for local governments to use on a nationally consistent basis. It is hoped that this process will result in the commitment of all jurisdictions to encourage their local governments to report and manage their performance using the agreed indicators including by establishing locally appropriate targets for these indicators.

At this point in time there is no reason to think that the three indicators described above would not be widely agreed to be the most suitable for national applicability to local governments. The AIFMG are reviewed and updated (electronically) every six months. It is anticipated that *Section 2.6* (Performance Measures) and related components of the AIFMG will be revised and include more detailed explanatory material regarding the calculation of each recommended indicator following completion of the above described ACELG projects.

Long-term financial plans should be constructed at relatively high 'aggregate' levels.

It is impossible to be precise about forward projections for many individual accounting line items, and such information not really necessary for the preparation of a reliable useful long-term financial plan. However, the plan should show data at the level necessary for the calculation of outcomes for financial indicators published in the document, in order to enable a reader to identify the drivers of variations in performance outcomes between years. (**Note:** *Section 9* includes more information to guide the design and level of content of a long-term financial plan.)

The suggested template included at *Appendix I* for the data content of a 'high level' long-term financial plan includes sufficient detail to demonstrate the basis of calculation of the outcomes for the above three financial indicators. If additional financial indicators were included, this may require inclusion of additional reported data.

For example, in order to be able to demonstrate the basis of calculation of projected outcomes for all eight of the financial indicators listed for consideration in *Section 2.6* of the AIFMG, it would also be necessary to disclose the following:

- predictable operating grants (e.g. Commonwealth Financial Assistance Grants) (if the selected denominator for the Operating Surplus Ratio included predictable operating grants)
- interest income
- interest expenses
- written down value of total assets
- replacement value of total assets.

8. USE AND TYPES OF BORROWINGS

Key Points

The long-term financial plan:

- can highlight the affordability and impact of additional borrowings (e.g. to address asset renewal)
- is a key financial management tool to assist in optimising an organisation's treasury management activity.

Even where an organisation is operating sustainably by raising sufficient operating revenue to cover operating expenses, it may not have generated enough cash to fund peaks in asset replacement activity. In such circumstances it should borrow to accommodate these peaks, in order to maintain existing service levels most cost effectively.

Core Approach

A basic long-term financial plan clearly highlights anticipated movements in annual cash flows linking movements in an organisation's level of borrowings and financial assets over the planning period.

Advanced Approach

The long-term financial plan provides for borrowings to be raised and repaid in a way that minimises forecast net interest costs. That is, any net cash inflow is applied to reduce, defer or avoid borrowings, to the extent any applicable legal constraints allow.

8.1 Role of borrowings

Borrowings are not a substitute for income. In order to be able to sustain service levels organisations need on average, over the medium to longer-term, to generate operating revenue sufficient to at least offset their operating expenses. Borrowings are an appropriate means of financing some (but not all) capital costs and equitably balancing cashflow requirements between periods.

Managing decisions about service levels and the level of operating revenue to raise, in accord with a well developed long-term financial plan, can help ensure debt levels are managed responsibly and kept within an appropriate range.

When it is necessary to borrow, the existence of a long-term financial plan helps an organisation determine, not only the quantum of any borrowings that are needed to provide the desired, affordable level of services, but also the point in time when a borrowing should be raised, the period over which it can be repaid and the optimal pattern of repayment.

There is generally no point in an organisation borrowing at a point in time when it has substantial financial assets, which could be applied, to accommodate proposed outlays.

Similarly, there is no point in borrowing long-term as a result of the need to finance acquisition of a long lived asset, if an organisation's financial plan indicates it is likely to have surplus cash available to invest in future. It would be better off taking out a loan that can be repaid as quickly as its future cash flow projections suggest is possible.

Note: *Section 5.6* of the AIFMG provides a more detailed discussion on the role of borrowings.

8.2 When is it appropriate to borrow?

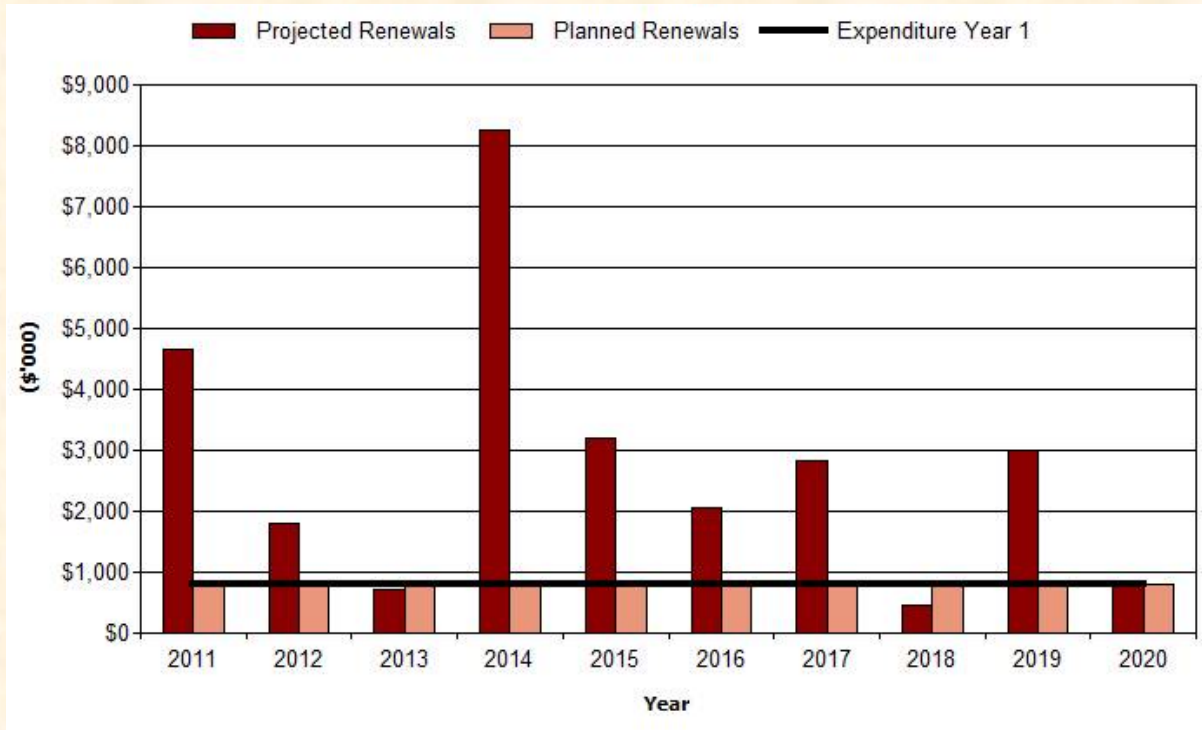
Providing an organisation operates sustainably⁶, it can expect to generate approximately enough cash for asset replacement needs and be reasonably able to maintain service levels from assets. However, the pattern of required asset renewals will be uneven, even over different 10 year periods. It is possible therefore, that even where an organisation has achieved an operating breakeven result for a 10 year period, actual funds required for asset renewal for the same period may be significantly greater or less than those generated from operating revenue, after meeting all operating outlays.

In years of peak asset replacement need, such outlays will exceed funds raised from depreciation and as a result, the organisation will need to draw down on its stock of previously accumulated cash assets and possibly borrow money. In other years, cash generated from raising revenue to offset all total expenses including non-cash expenses such as depreciation will exceed asset replacement needs, and borrowings may be repaid and/or cash used for other purposes, or retained for future use.

An organisation that has more significant renewal expenditure needs during some periods, than can be accommodated from operating revenue, may cost-effectively elect to borrow funds (subject to the implications for its ongoing financial sustainability). It can repay such borrowings in future from funds generated from available operating revenue (that is by ensuring that aggregate operating revenue matches or exceeds aggregate operating expenses, including depreciation).

⁶ i.e. on average over time generates operating revenue to at least cover operating expenses.

Figure 8.1



Councils often show in their asset management plans both projected asset renewal needs and planned renewal expenditure as recommended in IPWEA's asset management plan templates. Often planned expenditure is based on available cashflow and, as shown above, doesn't accommodate identified asset renewal needed to maintain service standards. Providing service levels are as preferred and financially sustainable, then long-run costs will be minimised by borrowing, if necessary, to enable renewals to occur when required.

An organisation that operates in a financially sustainable manner and has little in the way of renewal expenditure needs, during some periods, may elect to utilise any available surplus cash generated in excess of renewal needs, to repay debt or finance new capital works. In so financing new capital works, it should recognise that it is likely that to need to raise similar amounts in loans in future to finance asset replacement requirements. It should therefore ensure that its projected revenue can fully accommodate the additional operating costs (including depreciation) arising from the expansion in physical assets and resulting higher service levels.

Additions (quality or quantity) to an organisation's stock of physical assets can only be financed in two ways:

- they can be given to an organisation (e.g. by a developer providing infrastructure or open-space in a new sub-division or another government providing grants for asset creation), or
- the organisation has to pay from its own sources for the assets. There are two distinct ways it can do so. It could borrow or it could save up.

Saving up and paying cash for an additional asset can only occur if an organisation generates more operating revenue than operating expenses. This must mean that some persons who were not benefiting from the new asset (it didn't then exist) were paying more than the cost of services they received, so that the organisation could generate an operating surplus to fund the provision of the new asset needed to provide future services.

To avoid people paying more than the cost of the services they require, organisations should be prepared to borrow money as a result of a decision to acquire new assets (but only raise the borrowing at the point in time when cashflow needs so warrant). It could then repay the loan over time. (If an entity ensures that operating revenue at least matches operating expenses on average over time it will always have the capacity to repay borrowings raised to finance additional asset acquisition.)

Note: *Section 5.7* of the AIFMG provides a more detailed discussion on when it is appropriate to borrow.

8.3 Treasury management

The preparation of a long-term financial plan is likely to help organisations determine whether their existing treasury management policies and practices could be improved.

Considerable savings can often be made through a holistic focus on funds management compared with undertaking separate or specific borrowings to finance particular projects or assets and quarantining existing financial assets in separate special purpose accounts.

There are two distinct aspects to the treasury management function:

- a strategy covering the level of an organisation's debt over the planning cycle; and
- a strategy to minimise the organisation's net interest costs over time in a risk averse manner. This necessitates a balanced mix of fixed and variable interest rate borrowings with differing maturity dates, since future movement in interest rates, over at least the medium and longer term, is always uncertain.

Many entities have periods of years (and periods within years) when net cash inflows exceed net cash outflows. Entities that have ready access to borrowings (like local governments in most circumstances) don't need to retain significant working capital or quarantine funds for particular proposed future purposes. In fact their net costs and exposure to interest rate risks would be reduced by applying funds that are surplus to immediate requirements to reduce existing borrowings.

A significant proportion of total borrowings therefore generally should be structured to enable repayment of outstanding balances. The quantum so structured should have regard to the extent that forecast net available cashflow suggests that this is possible, including even for short periods. This will generate net savings since interest rates payable on borrowings are invariably higher than that which an organisation can earn on lendings (investment of the funds with financial institutions).

The long-term financial plan is a key financial management tool to optimise an organisation's treasury management strategy. It needs to clearly highlight anticipated movements in annual cash flows linking movements in the organisation's level of borrowings and financial assets, over the planning period.

Example

Consider the information below generated from an entity's long-term financial plan. It indicates that the organisation will have a need to borrow \$5M by the end of year 2 and a further \$4M by the end of year 3. However, it also suggests that it shouldn't borrow this money for a long-term period as it will have surplus cash from year 5 onwards, that could be used to reduce debt (and fully extinguish it before the end of year 8). It is immaterial whether the borrowings were required as a result of acquisition of long-lived assets. Asset acquisition and service level decisions should be based on satisfying service level preferences whilst maintaining financial sustainability. Financing and treasury management decisions should be based on minimising net interest costs and managing interest rate risks. These decisions are independent of each other.

Year	1	2	3	4	5	6	7	8	9	10
All in (\$'M)										
Cash Outlays (Operating and Capital)	20	25	26	23	22	23	23	24	24	25
Cash Inflows (Operating and amounts received to acquire or upgrade assets)	20	20	22	23	24	25	26	27	28	29
Net Cash Inflow / (Outflow)	0	-5	-4	0	2	2	3	3	4	4
Cash on hand at start of period	0	0	0	0	0	2	4	7	10	14
Additional Borrowings required during year	0	5	4	0	0	0	0	0	0	0
Cash on hand at end of period / available to repay borrowings	0	0	0	0	2	4	7	10	14	18

Many councils have very low levels of net financial liabilities (debt and other liabilities less financial assets) relative to their revenue levels and the level of infrastructure assets they manage. A soundly based long-term financial plan can highlight the affordability and impact of additional borrowings (e.g. to address warranted but otherwise unachievable asset renewal). A modest increase in borrowings to fund priority needs would typically add materially very little to most councils' total operating costs. While organisations should not borrow unless necessary to satisfy their objectives, they should also not be averse to borrowing where this is warranted, to provide cost effective and affordable, desired levels of service.

An entity's treasury management policy and practices will also need to have regard to any mandated limitations and constraints (e.g. legislation or regulation) that apply. For example in some jurisdictions there are limits in relation to the quantum, source or structure of council borrowings and/or external approval is required from relevant state authorities for any borrowings or for borrowings above specified thresholds.

8.4 Forecasting interest rates for inclusion in a long-term financial plan

Future interest rates are always uncertain. They will move up and down over time depending on current and future expected economic conditions, and in particular inflationary expectations. Fixed interest rates at any point in time reflect expectations regarding variable interest rates over the related period.

Interest income from lendings and interest costs from borrowings typically make up only a very small proportion of total operating revenue and operating expenses respectively for most organisations. For example, for most councils interest costs represent no more than two or three percent of total operating expenses. Any variation therefore, between actual interest rates in future and those assumed in preparing a long-term financial plan, are likely to have only a very minor overall impact on financial performance. Any major medium-term variation in nominal interest rates is also likely to be accompanied by a significant variation in inflation rates. This will result in nominal increases in the price of other expenses and probable acceptability of higher nominal increases in taxes and charges levied by an entity. These nominal increases in revenue and other expenses are likely to mean that the overall relative impact of a significant increase in nominal interest rates is modest.

In most circumstances, an organisation could reasonably base variable interest rate estimates in a long-term financial plan on current or recent historic average interest rates, that have applied, and fixed interest rate estimates on those that currently apply. Where variable and fixed nominal market interest rates are currently at historically high or low levels, it is likely to be best to assume these will gradually revert to historic trend rates over a 3 to 5 year period.

9. CONTENT OF LONG-TERM FINANCIAL PLANS

Key Points

- A long-term financial plan should incorporate summary level financial information sufficient to enable projected financial performance to be measured and assessed, and to allow judgments to be made regarding the organisation's financial sustainability, and the impacts on it, arising from the long-term financial plan's proposals.
- Any break-down of this summary level financial data into more detail, needs to have regard to the possibility of it diverting attention from big picture projections, and the difficulty of confidently forecasting detailed financial information projections – summary level information can usually be predicted more reliably.
- Where some material classes of financial data are likely to vary over time relative to other classes, it may be worthwhile to show these components separately, if it helps to highlight reasons for significant changes in financial performance over the planning period.
- The financial performance information included in the long-term financial plan needs to be considered in the context of the assumptions and basis upon which it has been built. The long-term financial plan needs to specify the basis of its preparation and all material assumptions made.
- A listing of major capital works and other material project proposals accommodated in the financial data and a narrative overview, to help a reader understand the purpose of the long-term financial plan, service level proposals and the key conclusions, that can be drawn from the financial data, all should be included in the plan.
- IPWEA has prepared a simple Excel-based model that can be used (and modified as preferred) for preparation of a long-term financial plan. It and guidelines on its use are available without charge at www.ipwea.org.au/LTFPmodel

Core Approach

A basic long-term financial plan:

- includes financial data presented at a summary level to assist readers to focus on the strategic and material implications from the financial projections, but with sufficient detail to ascertain the basis of calculation of published financial indicator outputs
- specifies the basis of its preparation and all material assumptions made
- incorporates a narrative overview.

Advanced Approach

In addition to criteria included in the core approach the long-term financial plan incorporates:

- information highlighting details of material classes of financial data that varies over time relative to other relevant data
- a listing of major capital works and other material project proposals accommodated in the financial aggregates.

9.1 Introduction

There is no single specific best form that a long-term financial plan should take. That will depend, to some degree, on the organisation's operating environment, business needs and capacity.

A long-term financial plan should incorporate summary level financial information consistent with key data in an organisation's annual financial statements, and also its summary level annual budget, if this is in a different form from its financial statements.

Various proprietary software models exist, and are available for purchase in the marketplace, to assist and enable an entity to develop a long-term financial plan.

These models typically calculate double-entry accounting transactions for all inputs made and therefore automatically update financial statements for the period of the plan.

However there is nothing to prevent a council developing a long-term financial plan without such modelling software. It just requires consideration of the consequences of receipts, outlays and other financial events for key reported financial aggregates. For example, the implications for the annual depreciation charge from acquisition of additional, or disposal and non-equivalent replacement of existing, depreciable assets needs to be considered.

Each organisation needs to determine the form and content of its long-term financial plan that best suits its needs and circumstances. IPWEA has developed a very straight-forward Excel-based long-term financial plan data input and reporting model that is worth consideration by organisations looking to prepare a simple long-term financial plan at a strategic level. It can be used as is or its structure and outputs modified for the circumstances and needs of individual users. It is available for downloading without charge from the IPWEA website (see www.ipwea.org.au/LTFPmodel). Instructions on the model's use are also available at that same location.

9.2 Extent and structure of included financial information

Having regard to the issues canvassed in this paper and explanations provided, regarding information necessary to determine affordable service levels and ensure financial sustainability, a long-term financial plan should in particular specify and take account of:

- capital outlays and receipt of gifted assets for each year split between
 - new additional assets including upgrading of existing assets, such that in either case that additional or enhanced services are provided or increased, people or properties are served or capable of being served
 - replacement or renewal of existing assets that is associated with maintaining service level capabilities similar to those that the former assets were designed to provide⁷.

⁷ In many instances expenditure on a replacement asset may materially enhance service level capabilities. A broad estimate should be made as to what the cost would have been to replace or renew the asset to maintain existing service level capabilities. This amount should be allocated as a replacement/renewal outlay and the balance of the actual outlay treated as a new additional asset outlay.

-
- expected operating expenses for each year inclusive of the impact on depreciation expenses in future years of depreciable assets acquired during the planning period (acquisition of replaced or renewed assets is not likely to result in a material change in depreciation expenses relative to that of the replaced assets but acquisition of additional assets will do so)
 - expected revenues for each year apportioned as either operating revenue or amounts received specifically to acquire new assets or upgrade existing assets
 - expected cash in-flows and out-flows for each year
 - any increase in or repayment of borrowings or variation in the level of financial assets arising as a result of expected cashflow needs or availability, and the implications these variations have for future operating revenue and operating expenses.

Appendix I includes a simple template format for inclusion of financial data that would meet the above suggested financial information requirements. It would also enable calculation of projected results for the three financial indicators recommended in *Section 7* for inclusion in a long-term financial plan.

The financial data listed in *Appendix I* would be sufficient to enable projected financial and asset management performance and financial capability to be measured and assessed and allow judgments to be made regarding the organisation's financial sustainability and the impacts on it arising from the long-term financial plan's proposals. Slightly more detail would be required in order to calculate outcomes for each of the financial indicators recommended in the AIFMG. Entities also need to be mindful of any jurisdictional requirements regarding the form and content of long-term financial plans that apply in their circumstances. For example, in some states there are requirements on local governments to provide particular financial information content and in a specific format in their long-term financial plans.

How much financial data to include?

Caution is recommended when considering how detailed a breakdown of financial data to include in a long-term financial plan. Extra detail may be of little if any material additional value even if it is reasonably reliable (which it is often impossible to be confident about – summary level information can usually be predicted more reliably).

Detailed financial information (whether financial stocks or financial flows) shouldn't be the focus of a long-term financial plan. Such an approach can divert attention from big picture projections. A plan's purpose and value is in providing insights into trend or under-lying future expected overall financial performance and capacity.

Each organisation should have regard to its current and projected operating circumstances and strategic priorities in determining the level of financial data to include. For example after consideration it might believe it warranted to show a breakdown of operating revenue and operating expenses in one or more of the following formats;

1. By nature and type,

For example, operating revenue could be shown by:

- Rates
- User Charges
- Grants
- Investment Income
- Other

And operating expenses by:

- Employee Costs
- Materials & Contracts
- Finance charges
- Depreciation
- Other

Where the value of some material types of financial data is likely to vary over time relative to other types in real terms, it may be worthwhile to show these components separately. Such variations might arise from movements in real prices. For example, if average wage/salary and related costs per employee are expected to rise in future at a higher rate than other operating expenses, this could be allowed for and this class of operating expenses be shown separately. Variations may also arise because of changes in quantities (for example, because of growth or variations in service levels).

2. By amounts associated with existing service levels and policy positions and separately for proposed variations to these. E.g.:

- existing service levels and policy positions (in aggregate for each of operating revenue and operating expenses)
- variations in operating expenses and operating revenue where material for
 - i. projected changes in discretionary service levels (additional services or changes in range or level of existing services)
 - ii. policy changes (e.g. a proposal to increase real rate levels in future above previous stated position),
 - iii. additional mandates (e.g. higher performance standards for landfill operations) and
 - iv. changes in the operating environment (e.g. impact of forecast growth or estimated effects of climate change).

A supporting table of data could also possibly be provided showing a breakdown of major variations.

ILLUSTRATIVE EXAMPLE										
Year	1	2	3	4	5	6	7	8	9	10
All in (\$'M real)										
Base Operating Revenue	20.0	20.4	20.8	21.2	21.6	22.1	22.5	23.0	23.4	23.9
Base Operating Expenses	19.0	19.4	19.8	20.2	20.6	21.0	21.4	21.8	22.3	22.7
Base Operating Surplus	1.0	1.0	1.0	1.0	1.0	1.1	1.1	1.2	1.1	1.2
Additional Operating Revenue (detail below)	0.0	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Addn Operating Expenses (detail below)	0.0	0.4	0.4	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Impact on Operating Surplus	0.0	0.2	0.2	-0.3	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2
Total Operating Surplus	1.0	1.2	1.2	0.7	0.7	0.8	0.9	1.0	0.9	1.0
Additional Operating Revenue										
• 4% real increase in rate levels in year 2	0.0	0.6	0.6	0.6	0.6	0.6	0.7	0.7	0.7	0.7
Additional Operating Expenses										
• opening of 2nd library in year 4	0.0	0.0	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5
• domestic green waste collection service from year 2	0.0	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4	0.4

3. By programs or functions.

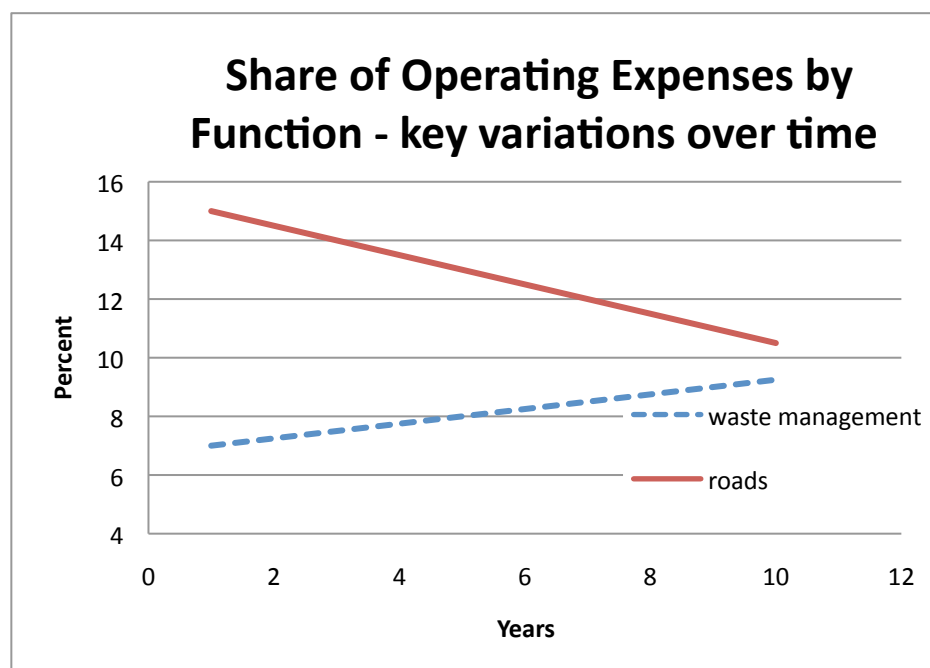
For local governments, programs or functions which align with the organisation's strategic plan headings. These could include for example:

- Governance
- Administration
- Community Services
- Sports & Recreation
- Waste Management & Recycling
- Roads
- Environmental Protection
- Stormwater Drainage
- Regulatory Services
- Parks & Gardens

Again, such a breakdown is likely only to be of value in particular circumstances, e.g.

- A financially significant service has a material dedicated income stream (e.g. water supply and wastewater services and possibly kerbside waste collection). In these cases, showing such activities separately can help guide service level and revenue raising decisions.
- There is a significant shift over time in the relative share of total operating expenses arising from particular programs or functions. If the variations are only significant in a couple of major functions this information could possibly be better portrayed graphically, e.g. as per the example below.

Figure 9.1



9.3 Specified assumptions and basis of a long-term financial plan

The financial performance information included in the long-term financial plan needs to be considered in the context of the assumptions and basis upon which it has been built.

The long-term financial plan needs to specify any proposed or assumed material changes in price, quality or volume of services and changes in the price or volume of major revenue sources. In each instance, the financial impact should be clearly expressed.

Where significant changes are indicated, the plan should provide brief supporting explanatory rationale. In particular, a long-term financial plan should specify:

- whether it is based on maintaining existing service levels and highlight any material increase or decrease in proposed or assumed service levels (i.e. variation in the range, quality or quantity of services)

-
- whether the price (as distinct from quality or quantity) of units of material services or material service inputs and taxes and charges is proposed to increase over the planning period (see *Section 9.5* below for a more detailed discussion on the use of real and nominal input values)
 - whether the quantity (as distinct from quality or price) of units of material services or material service inputs and taxes and charges is proposed to increase over the planning period. Local governments should for example specify their assumptions about rates of growth in population and property numbers and state the forecast impact on costs and revenue. It may be reasonable to assume that a 1% increase in the number of properties in a local government's area will result in the same increase in operating costs and operating revenue, in the absence of information to suggest otherwise. An organisation with more information and capacity for analysis may alternatively conclude that this level of growth will result in a lower or higher increase in operating costs. Economies of scale may arise or the locality and nature of the growth might mean additional average costs per new property are higher than the existing average.
 - whether the long-term financial plan takes account of the financial impact of projected trends and issues specified in the organisation's strategic plan and other related planning documents. Do these documents envisage that there is likely to be a change in the aggregate level of services preferred by the community or changes in the operating environment (for example impacts of climate change)? If so the long-term financial plan needs to accommodate the projected financial impacts. This includes in particular accommodating proposed service levels and outlays included in its asset management plans.

An illustrative example of descriptive content regarding the assumptions and basis on which a long-term financial plan has been prepared is included as Appendix II. Each organisation will of course need to determine the content and extent of the detail of such a statement suited to its own circumstances.

9.4 Specified project details

A tabulated listing of major capital works and other project proposals should also be included. It is not necessary to list detailed activity proposed in routine capital programs (e.g. the names of streets or roads proposed for work in footpath construction or road resheeting or resealing programs). Often this level of detail will not be available or may be subject to change over time. Details could possibly be shown in an attachment for specific projects in the first few years of the plan or for all (e.g. major) projects above a nominated threshold value. An illustrative example is included as *Appendix III*.

9.5 Price movements and the use of real or nominal values

The long-term financial plan should clearly specify whether dollar amounts in the plan are expressed in real (i.e. today's prices) or nominal (adjusted for each year by a forecast general inflation rate) values. Real values allow ready 'apples for apples' comparisons of projected outlays and inflows between years and evaluation of trends over time. It is for this reason that IPWEA recommends asset management plans be prepared in real values. Real values allow, for example, more meaningful graphical representation of financial data that attempts to highlight historic or forecast amounts of money spent, held or received in different years.

Whenever comparing money amounts that are associated with different points in time it is essential, because of the significant compounding effects of inflation over time, to be clear whether the amounts are expressed in real or nominal values.

Nominal values are the actual values of the day (or in the case of projected amounts at a future point in time - the expected values after allowing for estimates of the impact of future inflation).

Real values are values adjusted to a particular specified (historic, current or future) point in time such that the effects of inflation between the periods that the data relates to is removed.

Despite the advantages of use of real values, people often prefer to see and feel more comfortable and familiar with use of nominal ('actual dollars of the day') values when studying financial data. If a long-term financial plan is based on nominal values, it needs to be borne in mind that a small variation in an assumption about inflation rates, can lead to big variations in dollar values in the later years of a plan.

Having regard to the purposes for which a long-term financial plan is prepared it is likely that such a document prepared in real values will be of more value. Ideally any computer model used to produce the long-term financial plan should be capable of presenting key summary information in both real and nominal values. This can be facilitated by stating any projected price variations in real terms. For example a long-term financial plan may state that it assumes wage price increases over the life of the plan will exceed the general inflation rate by 1%. Thus expressed in real terms the long-term financial plan will show a price variation in labour costs of 1% pa. Expressed in nominal terms the long-term financial plan would factor in both the real 1% increase and the assumed general inflation rate.

Table 9.1

Year	1	2	3	4	5	6	7	8	9	10
All in (\$'000)										
Employee Expenses (Real Values - 1% pa increase)	1,000	1,010	1,020	1,030	1,041	1,051	1,062	1,072	1,083	1,094
Employee Expenses (Nominal Values - 1% real increase and assuming 3.5% pa inflation)	1,000	1,045	1,093	1,142	1,194	1,248	1,105	1,305	1,364	1,426

It is impossible to predict with confidence beyond the short to medium term (say 3 years) whether general inflation rates (e.g. the consumer price index (cpi)) in future are likely to be high or low. **For planning purposes inflation and its impacts is likely to make very little difference for many entities.** Higher inflation will increase nominal costs but organisations may be in a position where they can increase nominal revenue to offset this (e.g. councils in most jurisdictions can increase rating levels) and service recipients generally accept that charges need to rise to offset the effects of inflation. Where future inflation rates need to be projected they should be based on those forecast by an expert and independent source⁸.

It is also very difficult to predict with any certainty whether particular classes of costs will increase in price by more or less than the general rate of inflation over the medium to longer term. For example, historically there have been periods of several consecutive years where fuel or labour prices have increased in real terms and other periods where they have fallen.

While an allowance can be made for prices for some classes of cost to increase or decrease in real terms, it is suggested that this should normally be assumed for only the early years of the plan. Any slight real increases or decreases in the price of various classes of costs in future years, is uncertain and usually unlikely to have any material impact on an entity's financial capacity, and therefore be of little consequence for planning purposes.

There are though three areas where particular care does need to be taken depending on whether a long-term financial plan is being prepared in real or nominal values. If the long-term financial plan is being prepared in nominal values it needs to be ensured that:

- proposed capital and maintenance outlays included in the asset management plan are adjusted to nominal values before inclusion in the long-term financial plan

⁸ Commonwealth and state Treasuries and the Reserve Bank include their forecasts in documents on their websites. Major private economic consulting firms also provide forecasts through various subscription-type service arrangements.

- infrastructure asset values and depreciation expenses that derive from them are periodically adjusted for inflationary effects. This could be achieved by either adjusting initial balance sheet infrastructure values and depreciation levels by the assumed general rate of inflation, (or other more suitable index factor) or alternatively allowing for a periodic revaluation of infrastructure (e.g. say every 3 years by adjusting values in these years with an appropriate adjustment factor).

If the long-term financial plan has been prepared in real values care needs to be taken to ensure that:

- liabilities and financial assets and loan repayments are discounted by the assumed general rate of inflation. Liabilities, financial assets and loan repayments usually don't increase with inflation, i.e. with inflation their value falls in real terms.

Example Real and nominal values

Goods or services costing \$10 million today would cost \$13,629,000 in 9 years time with 3.5% per annum inflation or \$14,861,000 with 4.5% per annum inflation. In real terms (i.e. adjusted to discount the effects of inflation) they would still cost \$10 million. If an organisation's income rises commensurately to offset the effects of inflation on the goods and services it purchases then all other things being equal, it will be unaffected by whether inflation is high or low.

Preparing a long-term financial plan in real rather than nominal values makes it easier to identify actual trends and variations in activity between years. E.g. in the example below it makes it easier to see that there is a projected real decrease in operating expenses in Years 4 and 6 and a real increase in Year 9.

Year	1	2	3	4	5	6	7	8	9	10
<i>All in (\$'000)</i>										
<i>Operating Expenses (real)</i>	10,000	10,000	10,000	9,700	10,000	9,800	10,000	10,000	10,300	10,000
<i>Operating Expenses (nominal - assuming 3.5% p.a. inflation)</i>	10,000	10,350	10,712	10,755	11,475	11,639	12,293	12,723	13,563	13,629
<i>Operating Expenses (nominal - assuming 4.5% p.a. inflation)</i>	10,000	10,450	10,920	11,069	11,925	12,213	13,023	13,609	14,648	14,861

9.6 Other specified assumptions

- If an organisation is heavily dependent on grants (for example local government general purpose financial assistance or 'Roads to Recovery' grants) or other forms of variable income, it should specify the assumptions built into the plan in this regard.
- If an organisation has reason to believe other external factors that have a degree of uncertainty are also likely to significantly influence its future decision making, it should state its assumptions and base the plan's content on them.

An organisation may have good reason to base its assumptions for the next few years on unique local knowledge and data. This is reasonable but the further out in time information is projected, the greater is the level of uncertainty. In the absence of a high degree of certainty justifying doing otherwise, longer-term projections should be heavily influenced by long-run historic trend data and future projections produced by State or Federal governments for wider regions.

9.7 Narrative overview

The long-term financial plan should include a brief narrative overview to help a reader understand the purpose of the document, the basis of its preparation and the key conclusions that can be drawn from the financial data. It should also assist decision-makers in future in considering decisions regarding proposals currently included and not included in the plan regarding service levels, projects and revenue raising and the implications of any changes in the operating environment within or beyond the entity's control. An example is provided as *Appendix IV*.

10. SENSITIVITY ANALYSIS

Key Points

- Sensitivity analyses should be undertaken of key factors or assumptions that are most likely to impact on the achievement of a long-term financial plan's financial targets.

Core Approach

A basic long-term financial plan's narrative includes reference to sensitivity analyses that have been undertaken and their outcomes.

Advanced Approach

The long-term financial plan incorporates sensitivity analyses of all key factors or assumptions that are most likely to materially impact on the achievement of the plan's financial targets.

These sensitivity analyses include narrative and tabular and/or graphical details of impacts.

An organisation's long-term financial plan should outline the optimum balance of prioritised services that it considers can be funded based on carefully considered assumptions and service level preferences, while ensuring its long-term financial sustainability.

When preparing its long-term financial plan, an organisation needs to undertake sensitivity analyses to assess the impact of variations in underlying key assumptions. Ultimately, a long-term financial plan must be based on best estimate assumptions but an organisation needs to be mindful of the uncertainty of these assumptions and the risks of, and consequences from, actual events being different.

For example:

- i) A local government may expect a high rate of ongoing development and population growth in its area, that is expected to generate increases in operating revenue in excess of operating expenses. It would be appropriate for a sensitivity analysis to be undertaken showing the impact on financial sustainability from a rate of growth lower (and possibly higher) than expected. This would indicate whether service levels or rating proposals should be reviewed if growth varies from expectations.
- ii) A local government may wish to undertake a major new additional capital works project or a large program of smaller works. A sensitivity analysis could show the effects on achievement of its financial strategy and financial indicator targets over time from bringing forward, deferring or delivering a major project in stages or increasing or reducing its overall capital works program over several years. This would highlight whether an increase in the size of an ongoing capital works program, or accommodating expected peaks in capital expenditure outlays can be afforded, or whether scaling back and deferring some initiatives would be prudent.

- iii) A local government may be contemplating an enterprise bargaining agreement that will increase wage levels at a rate of 1% p.a. above the expected general inflation rate over the next 3 years. A sensitivity analysis could show the impact on financial sustainability over the medium-term of such a proposal.
- iv) A local government may be heavily dependent on ongoing grants, which are not guaranteed to continue indefinitely (such as the Commonwealth's 'Roads to Recovery' Program). It could produce a sensitivity analysis to show the percentage increase by which rates would need to increase to offset this source of revenue if the program was ever to be discontinued. It could also highlight the impact on service levels if the local government preferred to not increase rate revenue to make up this shortfall.
- v) If a local government needed to improve its financial sustainability, a sensitivity analysis could show the improvement in financial performance that could be expected to arise over time, from disposing of some assets that are currently providing little service benefits relative to costs (including holding costs) or from reducing costs by reducing service levels from assets.

Example

A council is projecting an increase in operating revenue from year 2 onwards as a result of increased rate revenue from expected development growth of 3% p.a. Rate revenue represents two-thirds of total operating revenue. The council expects this development growth will result in its operating expenses increasing by 1.5% p.a. This is represented in the 'base case' scenario below:

BASE CASE SCENARIO (Growth 3% p.a. & Resulting Increase in Operating Costs of 1.5% p.a.)

Year	1	2	3	4	5	6	7	8	9	10
All in (\$'M)										
Operating Revenue	19.0	19.4	19.8	20.2	20.6	21.0	21.4	21.8	22.3	22.7
Operating Expenses	20.0	20.3	20.6	20.9	21.2	21.5	21.9	22.2	22.5	22.9
Operating Surplus / (Deficit)	-1.0	-0.9	-0.8	-0.9	-0.6	-0.5	-0.5	-0.4	-0.2	-0.2
Op Surplus as % Op Revenue	-5%	-5%	-4%	-4%	-3%	-3%	-2%	-2%	-1%	-1%

It recognises that the growth rate may be less than forecast and that costs relative to the rate of growth may be higher. It models a scenario where growth from Year 2 onwards is 2% pa and the rate of increase in operating costs is 1.75% p.a. and includes the table below in its long-term financial plan.

Impact if growth is 2% p.a. & Operating Costs increase by 1.75% p.a.

Year	1	2	3	4	5	6	7	8	9	10
All in (\$'M)										
Operating Revenue	19.0	19.3	19.5	19.8	20.0	20.3	20.6	20.8	21.1	21.4
Operating Expenses	20.0	20.4	20.7	21.1	21.4	21.8	22.2	22.6	23.0	23.4
Operating Surplus / (Deficit)	-1.0	-1.1	-1.2	-1.3	-1.4	-1.5	-1.6	-1.8	-1.9	-2.0
Op Surplus as % Op Revenue	-5%	-6%	-6%	-7%	-7%	-7%	-8%	-8%	-9%	-9%

In addition to presenting the impact of particular outcomes in tabular form as shown above, key financial risks could be identified and their impact highlighted.

11. REFERENCES

IPWEA, 2009, 'Australian Infrastructure Financial Management Guidelines', Sydney, www.ipwea.org.au/aifmg.

This page intentionally blank

APPENDIX I

Long-Term Financial Plan –Suggested Structure/Level of Presentation of Financial Information where ‘strategic minimalist’ approach favoured (more detail optional)
(State whether data is presented in real or nominal values)

	Y0 (Previous Year Actual) \$'000	Y1 Plan (Current Year Budget) \$'000	Y2 Plan \$'000	Y3 Plan \$'000	Y4 Plan \$'000	Y5 Plan \$'000	Y6 Plan \$'000	Y7 Plan \$'000	Y8 Plan \$'000	Y9 Plan \$'000	Y10 Plan \$'000
Operating Revenues											
<i>less</i> Operating Expenses											
Operating Surplus / (Deficit)											
Less: Net Outlays on Existing Assets											
Capital Expenditure on Renewal/Replacement of Existing Assets											
<i>less</i> Depreciation, Amortisation & Impairment											
<i>less</i> Proceeds from Sale of Replaced Assets											
Net Outlays on Existing Assets											
Less: Net Outlays on New and Upgraded Assets											
Capital Expenditure on New/Upgraded Assets											
<i>less</i> Amounts received specifically for New/Upgraded Assets											
<i>less</i> Proceeds from Sale of Surplus Assets											
Net Outlays on New and Upgraded Assets											
Equals: Net Lending / (Borrowing) for Financial Year¹											

¹ 'Net Lending / (Borrowing)' is a 'flow' measure that takes account of both operating and capital activities for the financial year. Achieving a zero result on the net lending / (borrowing) measure in any one year essentially means that all expenditure (both operating and capital) has been met from the current year's income (with income including amounts received specifically for new / upgraded assets). It is the term used for this measure by Commonwealth, State and Territory Governments (see AASB 109).

APPENDIX I cont

In any one year, the financing transactions identified below are associated with either applying surplus funds stemming from a net lending result or accommodating the funding requirement stemming from a net borrowing result.

Long-Term Financial Plan (cont'd) – Summary of Financing Transactions

FINANCING TRANSACTIONS	Y0 (Previous Year Actual) \$'000	Y1 Plan (Current Year Budget) \$'000	Y2 Plan \$'000	Y3 Plan \$'000	Y4 Plan \$'000	Y5 Plan \$'000	Y6 Plan \$'000	Y7 Plan \$'000	Y8 Plan \$'000	Y9 Plan \$'000	Y10 Plan \$'000
New Borrowings (Principal Repayments on Borrowings) (Increase)/Decrease in Cash and Cash Equivalents - Other											
Equals: Financing Transactions											

Long-Term Financial Plan – Estimated Balance Sheet Summary

	Y0 (Previous Year Actual) \$'000	Y1 Plan (Current Year Budget) \$'000	Y2 Plan \$'000	Y3 Plan \$'000	Y4 Plan \$'000	Y5 Plan \$'000	Y6 Plan \$'000	Y7 Plan \$'000	Y8 Plan \$'000	Y9 Plan \$'000	Y10 Plan \$'000
ASSETS											
Financial Assets											
Infrastructure and Other Non-Financial Assets											
Total Assets											
Total Liabilities											
TOTAL EQUITY											

APPENDIX I cont

ADDITIONAL INFORMATION TO DEMONSTRATE BASIS OF CALCULATION OF FINANCIAL INDICATOR PERFORMANCE	Y0 Plan (Previous Year Actual) \$'000	Y1 Plan (Current Year Budget) \$'000	Y2 Plan \$'000	Y3 Plan \$'000	Y4 Plan \$'000	Y5 Plan \$'000	Y6 Plan \$'000	Y7 Plan \$'000	Y8 Plan \$'000	Y9 Plan \$'000	Y10 Plan \$'000
Major Controllable Source of Operating Income (e.g. council rates)											
Asset Management Plan recommended Maintenance of Existing Assets											
Maintenance of Existing Assets accommodated in LTFP											
Difference in Asset Maintenance proposed in AMP and accommodated in LTFP											
Asset Management Plan recommended Capital Expenditure on Renewal/Replacement of Existing Assets											
Capital Expenditure on Renewal/Replacement of Existing Assets accommodated in LTFP											
Difference in Asset Renewal/Replacement proposed in AMP and accommodated in LTFP											

APPENDIX I cont

KEY FINANCIAL INDICATORS	Y0 (Previous Year Actual) \$'000	Y1 (Current Year Budget) \$'000	Y2 Plan \$'000	Y3 Plan \$'000	Y4 Plan \$'000	Y5 Plan \$'000	Y6 Plan \$'000	Y7 Plan \$'000	Y8 Plan \$'000	Y9 Plan \$'000	Y10 Plan \$'000
Operating Surplus Ratio %											
Operating Surplus Ratio Target Range%											
Net Financial Liabilities Ratio %											
Net Fin Liabilities Ratio Target Range%											
Asset Renewal Funding Ratio %²											
Asset Renewal Funding Ratio Target Range%³											

² Asset Sustainability Ratio to be used in absence of reliable data (ie Asset Management Plan) on which to calculate Asset Renewal Funding Ratio

³ Asset Sustainability Ratio Target Range to be used where Asset Sustainability Ratio used in lieu of Asset Renewal Funding Ratio

ILLUSTRATIVE EXAMPLE OF ASSUMPTIONS**THAT MIGHT BE DISCLOSED IN A LONG-TERM FINANCIAL PLAN TO ASSIST A READER TO UNDERSTAND THE BASIS OF FINANCIAL CONTENT**

1. All figures are in real average 2010-11 (i.e. Dec 2010) values.
2. The plan assumes overall service levels will remain materially unchanged throughout the planning period except as specified below:
 - a. Provision has been made for outlays for major new/upgraded assets that will add to service levels as per the capital works listing included with this plan.
 - b. Provision has been made for the introduction of a fortnightly green-waste collection service in all built-up residential areas from the commencement of Year 2.

Some specific services may be varied or additional services added over time in response to changes in community needs and preferences. It is assumed that any such variations will be made without impacting on overall operating expense levels except where otherwise specified.

All initiatives and actions specified in Council's Strategic Plan are expected to be able to be accommodated within the overall resource allocation levels provided for in this financial plan. The plan also takes account of the impact of changes in Council's forecast operating environment over time identified in its Strategic Plan.

3. Provision has been made for outlays on renewal, replacement and maintenance of depreciable assets under the Council's care and control consistent with recommended outlay levels shown in Council's asset management plan. Some further details are also provided in the capital works listing included within this document.
4. The resident population and number of properties in the Council's area are both assumed to increase at 1.5% pa for the next 5 years and 1% pa thereafter.
5. Operating costs are predicted to increase as a result of growth (quantity increase) but at a lesser rate because of realisation of economies of scale. The estimated increase is 1% pa for next 5 years and 0.5% pa thereafter.
6. Rate increases are assumed to occur at an annual rate of 0.5%/average existing property above CPI.
7. Operating revenue from all sources except where otherwise stated is expected to remain constant in real terms over the planning period.
8. Operating revenue from grants is expected to remain constant in real terms over the planning period. (Note, Council anticipates receiving \$X from the Commonwealth Government's Roads to Recovery2 Program in 2010-11. It assumes that it will continue to receive a similar amount in real terms throughout the planning period even though the Program is currently due to expire in 2012-13. I.e. it anticipates the Program will be extended or a new program with similar financial benefits for Council will be introduced.)

9. The average nominal interest rate payable on outstanding borrowings in years 2 to 10 of the plan is expected to be consistent with the weighted average interest rate charged on outstanding borrowings in year 1.
10. The average nominal interest rate earned on invested funds in years 2 to 10 of the plan is expected to be consistent with the weighted average interest rate earned on funds invested in year 1.
11. Inflation as measured by the CPI is assumed at 3% p.a. and this rate has been used to deflate the projected value of liabilities and financial assets because actual nominal balances will remain relatively static regardless of the rate of inflation and hence their real value will vary with the rate of inflation.
12. The aggregate depreciable value of currently existing assets is assumed to remain constant in real terms throughout the planning period (after allowing for replacement and renewal of assets as required). As a result annual depreciation expenses have also been assumed to remain constant in real terms throughout the planning period except for increases that have been allowed for associated with upgrading of existing assets and the acquisition of new additional assets.
13. It is assumed that mandated requirements on Council will remain unchanged over the planning period. If there is an increase in Council's legal obligations in future this is likely to subsequently increase Council's annual operating expenses.

ILLUSTRATION OF CAPITAL WORKS LISTING IN LONG-TERM FINANCIAL PLAN

Asset Renewal as per Asset Management Plan*

Year	1	2	3	4	5	6	7	8	9	10
Footpaths	x	x	x	x	x	x	x	x	x	x
Road Reseals	x	x	x	x	x	x	x	x	x	x
Road Base Reconstruction	x	x	x	x	x	x	x	x	x	x
Resheeting of Unsealed Roads	x	x	x	x	x	x	x	x	x	x
Sport & Recreation Facilities	x	x	x	x	x	x	x	x	x	x
Community & Cultural Facilities	x	x	x	x	x	x	x	x	x	x
Stormwater Drainage	x	x	x	x	x	x	x	x	x	x
Plant and Equipment	x	x	x	x	x	x	x	x	x	x
Total	x	x	x	x	x	x	x	x	x	x

*Supporting this table could be a list detailing specific projects (or those above a threshold value) for the first one or more years and for all projects above a stated possibly higher value in any year.

Outlays on New or Upgraded Assets*

Year	1	2	3	4	5	6	7	8	9	10
Footpaths	x	x	x	x	x	x	x	x	x	x
Sealed Roads	x	x	x	x	x	x	x	x	x	x
Unsealed Roads	x	x	x	x	x	x	x	x	x	x
Sport & Recreation Facilities	x	x	x	x	x	x	x	x	x	x
Community & Cultural Facilities	x	x	x	x	x	x	x	x	x	x
Stormwater Drainage	x	x	x	x	x	x	x	x	x	x
Plant and Equipment	x	x	x	x	x	x	x	x	x	x
Total	x	x	x	x	x	x	x	x	x	x

*Supporting this table could be a list detailing specific projects (or those above a threshold value) for the first one or more years and for all projects above a stated possibly higher value in any year.

This page intentionally blank

ILLUSTRATIVE NARRATIVE OVERVIEW

This long-term financial plan was adopted by X Council on (date). It has been prepared to help determine and illustrate Council's capacity to optimally meet our community's affordable service level preferences and the associated financial implications.

Many of Council's services are asset based. Council, like other local governments, is responsible for managing a very large stock of assets relative to its annual income level. These assets are typically long-lived but as they age they require additional maintenance to preserve preferred minimum service levels. At a particular point in time it is necessary and cost effective that they be replaced. The long-term financial plan incorporates financial projections for future asset maintenance and renewal consistent with that identified as cost-effectively warranted in Council's Asset Management Plan.

Council has embarked on a strategy to improve its ongoing financial sustainability. This will assist it to be able to accommodate asset renewal needs as they fall due. The level of operating revenue generated by Council in recent years has been less than its operating expenses. Council is proposing to progressively turn this around. The long-term financial plan projects that the operating deficit will be eliminated within 5 years and a small operating surplus generated each year thereafter. Key measures proposed to help achieve this are as follows:

- ensuring through efficiency gains that average operating expenses/property don't increase in real terms (i.e. after adjustment for inflation as measured by the consumer price index),
- disposing of some Council land that is surplus to needs,
- deferring by 1 year the proposed new library, and
- increasing rates/property by 1% pa in real terms each year over the next five years.

In all other material respects, the long-term financial plan accommodates key priority projects and service levels identified in Council's Strategic Plan. That Plan was developed with considerable community input and was adopted by Council at the same time as this long-term financial plan.

Council's level of borrowings is currently very low when considered in the context of infrastructure and other assets for which Council is responsible. These assets are currently valued at approximately \$XXX million. The long-term financial plan projects that Council will need to borrow a net additional \$20 million over the planning period in order to meet cashflow needs arising from proposed capital works associated with provision of new assets and identified warranted asset renewal. These borrowings will enable Council to cost-effectively and equitably satisfy community service level preferences. Council's net financial liabilities ratio (its borrowings and all other liabilities less financial assets expressed as a percentage of its annual operating revenue) is expected to rise from 25% to 60% over the 10-year period of the long-term financial plan. This ratio is still nevertheless very modest taking into account the asset-intensive nature of Council's operations and net interest costs are expected to increase to only 3% of total annual operating expenses by the end of the planning period.

The Plan has been based on current best estimate forecasts of development growth of 1.5% p.a. ongoing throughout the 10-year period. A sensitivity analysis has been undertaken showing the impact of a significantly lower level of growth. The results are included in this document and indicate that there would be only a minor impact on Council's financial position should this occur.

This long-term financial plan will be reviewed and updated by no later than (date).

LONG-TERM FINANCIAL PLANNING

Practice Note 6
LTFP

www.ipwea.org.au

www.ancelg.org.au



IPWEA

INSTITUTE OF PUBLIC WORKS
ENGINEERING AUSTRALIA



ACELG

Australian Centre of Excellence
for **Local Government**



An Australian Government Initiative