



**Local Excellence**

Councils Working Together for Communities

*Financial Sustainability*

## Information Paper 8

# Long-term Financial Plans

Revised January 2012



## Introduction

This Information Paper is one of a series of Information Papers about Financial Sustainability and Financial Governance in Local Government.

The series of Information Papers was originally published in 2006 to 2011 as part of the Financial Sustainability Program. The history of that program and a complete list of Information Papers and other resources, including a glossary of terms and abbreviations, is provided on the LGA's "Financial Sustainability" web page: <http://www.lga.sa.gov.au/goto/fsp>.

The entire series of Papers was revised in early 2012 to take account of legislative changes and other developments. These Papers are addressed to, and written primarily for the benefit of Council Members and staff, but they are also available as a resource for the general public and students of Local Government.

This Information Paper combines what were previously published as two separate Information Papers:

- No 8 – *Long-Term Financial Plans*
- No 16 – *Long-term Financial Plan (A Model Format for Financial Information)*

The previous Information Paper No. 16 has been discontinued and most of its contents merged into this revised Information Paper.

## Long-term financial plans – an overview

When setting the annual budget, a Council is exposed to financial risk over the longer term if little regard is given to both operating revenue and expenses implications beyond the budget period. Long-term financial planning is arguably more critical for Councils than many other organisations. All Councils have made significant investments in long-term assets. A high proportion of these assets are reaching the stage where they will require renewing, replacing or upgrading in the foreseeable future. In addition Councils face continuing expectations and pressures to augment service levels and keep rate rises to moderate levels.

The need for and importance of long-term financial planning in Local Government was reaffirmed in the findings and recommendations of the 2005 [\*Independent Inquiry into the Financial Sustainability of Local Government\*](#).

## What does a LTFP do?

The purpose of a Council's long-term financial plan ("LTFP") is to express, in financial terms, the activities that the Council 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 Council to think about not just one year but the longer-term impact of capital investment 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.

Operating without a LTFP is like driving a car at night in the country at the open-road speed limit without the car's lights on 'high-beam'. You can see the road immediately ahead but not far enough into the distance to be able to anticipate and respond quickly to needed turns in direction. A driver might get by in familiar surroundings but will be unprepared to appropriately respond to hazards that would have been recognised if the car's lights and the driver's eyes had been set on a longer-distance horizon.

The preparation of a LTFP generates improved information to guide decisions about the mix and timing of outlays on operating activities, renewal and replacement of existing assets, future additional assets and the funding implications of these. Without a soundly based LTFP a Council and its management team will have insufficient financial information to determine sustainable service levels and affordable asset strategies, appropriate revenue targets or optimal treasury management.

A LTFP, just like the annual budget, should be developed in an iterative way. If a draft version of a LTFP showed that proposed activities over the course of future years would have a detrimental effect on a Council's financial sustainability, and did not project the Council achieving responsible financial indicator targets, then the Council should consider:

- reducing or deferring proposed outlays; and/or
- identifying additional revenue.

On the other hand, a LTFP showing a very sound ongoing financial performance and position would allow a Council to consider:

- raising service levels; and/or
- introducing additional activities to further satisfy community wants and needs; and/or
- reducing future proposed increases in rates and charges.

### **What does legislation require?**

The [Local Government Act 1999](#) ("the Act") requires each Council to develop and adopt a Long-Term Financial Plan ("LTFP") covering a period of at least 10 years, along with an Infrastructure and Asset Management Plan (I&AMP) also covering a period of at least 10 years. There is a direct link between the development and implementation of these two plans. They both form part of Councils' suite of Strategic Management Plans ("SMPs").

[The Act](#) requires a Council's SMPs to address:

- the sustainability of the Council's financial performance and position;
- the maintenance, replacement or development needs for infrastructure within its area;
- proposals with respect to debt levels; and,
- identification of any anticipated or predicted changes that will have a significant effect upon the costs of the Council's activities/operations.<sup>1</sup>

Each Council is required to review its LTFP annually; as soon as practicable after the adoption of its annual business plan.<sup>2</sup> There is an express statutory obligation on the Council's CEO to report, as part of the annual review of the LTFP, on the sustainability of the Council's long term financial performance and position, having taken into account the annual business plan and SMPs.<sup>3</sup> Ideally, if the CEO's report concluded that a Council was not financially sustainable under existing revenue and expenditure policy settings, the report would identify strategies to achieve financial sustainability in the future.

The annual budget must include budgeted financial statements that must be presented in a manner consistent with the [Model Financial Statements](#).<sup>4</sup> Likewise, the LTFP must include several components, each of which must be presented in a manner consistent with the

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<sup>1</sup> Section 122 (1) (ab)

<sup>2</sup> Section 122 (4)

<sup>3</sup> Section 122 (4a)

<sup>4</sup> [Local Government \(Financial Management\) Regulations 2011](#) – regulation 7

Model Financial Statements, for each future year covered by the LTFP. These components are:

- estimated financial statements;
- a summary of proposed operating and capital investment activities;
- estimates with respect to the Council's:
  - operating surplus ratio,
  - net financial liabilities ratio; and
  - asset sustainability ratio.<sup>5</sup>

### **What should a LTFP include?**

A LTFP should specify and take account of:

- expected expenses and capital outlays for each year of the plan;
- expected revenues for each year and their source;
- financial indicators to enable assessment of the Council's financial sustainability over the period of the plan;
- other documents in the Council's suite of SMPs, and in particular its I&AMP;
- assumptions that have been used in the development of the LTFP including any proposed variations to service standards that underlie expenditure plans; and
- sensitivity analyses performed, which highlight the factors or assumptions most likely to affect long-term financial sustainability.

It should also include a brief narrative overview describing key financial content and conclusions that can be drawn from the financial data.

The above matters are discussed in more detail in the balance of this paper.

The first year of the LTFP should be consistent with the current annual budget. The content of the LTFP may become progressively less detailed in subsequent years with an emphasis on:

- ensuring that aggregate projected operating revenue can accommodate the additional operating expenses associated with discretionary new capital expenditure; and,
- proposed variations in the range and level of services provided to operate within acceptable limits of overall financial sustainability.

The starting point for the development of the following year's budget should then be the data set out in year 2 of the LTFP. Significant variations that are made in finalising that budget need to be fed back into the next update of the LTFP, including in particular any flow-on implications for subsequent years.

### **What should be the financial sustainability indicators of a LTFP?**

Councils need to develop targets or target ranges for financial *sustainability* indicators.<sup>6</sup>

The LTFP should include tabular and graphical information showing a year by year analysis of the Council's projected financial performance and position. This gives the reader a summary of the Council's long-term financial trends. The tabular and graphical information

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<sup>5</sup> [Local Government \(Financial Management\) Regulations 2011](#) – regulation 5

<sup>6</sup> Indicators for financial *performance*, if reported alone, do not provide a basis or context for assessing actual performance. See Financial Sustainability Information Paper No. 9: *Financial Indicators* at <http://www.lga.sa.gov.au/goto/fsp>

should include a comparison of LTFP projections against financial indicator targets set by the Council and any other appropriate Local Government benchmark comparisons.

A LTFP that showed sustained annual operating deficits over the projected 10 year period would in most circumstances imply that the proposals included in the plan, if acted upon, would result in the Council operating in a financially unsustainable manner over the period. If so it would mean, in effect, that the present generation of ratepayers would not be paying their share of the services they would be receiving.

If the LTFP showed an annual operating deficit that was improving over time it would indicate that the planned level of operating revenue was increasing relative to the planned level of operating expenses, and that the Council was proposing to take incremental steps to improve its financial sustainability.

### **LTFPs in the context of strategic planning**

#### Linkages between plans

[The Act](#) requires Councils to have a suite of up to date documents that collectively form their SMPs. At the simplest level Councils must have a Strategic Management Plan (SMP), a LTFP and an I&AMP.<sup>7</sup>

It is critical that a Council's SMP, LTFP and I&AMP are all consistent. Operating expenses and capital outlays associated with both existing and new infrastructure and other assets as projected in the LTFP must reflect the activities proposed in the I&AMP. Initiatives proposed in both the LTFP and I&AMP must be appropriate for the pursuit of the Council's objectives and aspired outcomes as stated in its SMP.

#### Community consultation

A LTFP and an I&AMP need to not only reflect community wants and needs but also what can be afforded without detriment to the Council's longer-term financial sustainability. Community input is vital if a Council is to achieve the best results from the development of its suite of SMPs.

[The Act](#) simply says that:

*"a council must adopt a process or processes to ensure that members of the public are given a reasonable opportunity to be involved in the development and review of its strategic management plans"*<sup>8</sup>

How this happens is up to each individual Council. Where significant changes are proposed, a Council could, for example, consult on the annual review of its LTFP at the same time as it undertakes community consultation on its annual business plan. Even if it chooses to do these consultations separately, processes followed in consulting on the annual business plan are likely to be relevant for consulting on the LTFP, given the common themes in both. However, straightforward updates to the LTFP normally would not warrant separate community consultation.

#### Roles and responsibilities

Without a LTFP, a Council would be at risk of providing additional services without careful consideration of the implications for the Council's financial sustainability.

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<sup>7</sup> [Local Government Act 1999](#) - Section 122

<sup>8</sup> Section 122 (6)

Even where a Council considers a service to be needed, it does not automatically follow that the Council should take responsibility itself for the provision of this service. As part of its strategic planning considerations, a Council should be clear about those activities and services for which it should take responsibility and those where it should instead advocate for another sphere of government or entity to provide the service. There are various service delivery models that are available to Councils.<sup>9</sup> Careful, strategic thinking by a Council in determining its roles and responsibilities can have a significant impact on the Council's overall financial sustainability.

### Infrastructure and Asset Management Plans

Councils' activities typically are far more asset-intensive than those of the other spheres of government. Many Council assets also have very long lives. Asset maintenance, rehabilitation and replacement are critical issues for Councils. For these reasons [the Act](#) requires each Council to prepare an I&AMP covering a period of at least 10 years.<sup>10</sup>

Long-term financial sustainability, ensuring an optimal balance between revenue needs and service levels, depends crucially on strategic decisions by Councils on:

- the overall level and quality of assets;
- the acquisition and specification of new assets; and,
- the timing of asset disposal, rehabilitation or replacement

having regard to not only initial capital investment expenditure, but also ongoing operating expenses. Councils need to plan for the long-term and ensure that funds are made available to maintain assets as required so that the assets achieve their full intended service life and whole-of-life asset costs are minimised.

Often the initial capital cost of an asset is only a very small part of the total costs associated with owning, operating and maintaining it over its lifetime. The 2005 [Independent Inquiry into the Financial Sustainability of Local Government](#) found that many Councils were not spending optimally on asset management.

An I&AMP should attempt to predict new and renewal infrastructure needs to meet future community service expectations and the expected associated maintenance costs based on expert technical assessment. Costs identified in a draft I&AMP need to be fed into a draft LTFP to ensure projected capital investments can be accommodated without detriment to a Council's financial sustainability. If cuts need to be made to the I&AMP then deletion or deferral of additional new assets could be the source of these savings. The rationalisation of existing assets also could be a source of savings if it results in surplus assets being identified and sold. If a Council has decided to maintain existing service levels from an asset,<sup>11</sup> then a reduction in a well-developed proposal for maintenance, renewal or replacement of that asset is unlikely to be cost-effective. Savings are likely to be short-term with subsequent higher maintenance costs later and will therefore impact negatively on a Council's longer-term financial sustainability.

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<sup>9</sup> See Financial Sustainability Information Paper No. 7: *Service Delivery Framework Including the Role of Shared Services* at <http://www.lga.sa.gov.au/goto/fsp>

<sup>10</sup> See Financial Sustainability Information Paper No. 6: *Infrastructure and Asset Management (Policy and Planning)* at <http://www.lga.sa.gov.au/goto/fsp>

<sup>11</sup> See Financial Sustainability Information Paper No. 26: *Service Range and Levels* at <http://www.lga.sa.gov.au/goto/fsp>

## **Funding strategy**

### Funding sources

An integral part of developing a LTFP is determining proposed funding sources and funding amounts to meet projected outlays. Councils need to determine an appropriate mix of rates, fees, charges and grant revenue having regard to expenditure proposals and long-term financial sustainability. Borrowings are not a funding source but additional borrowings may be warranted to meet cash flow needs, providing overall financial sustainability targets can be met.<sup>12</sup>

The funding strategy needs to weigh up:

- whether today's ratepayers 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 (general rates).

The LTFP also needs to consider the implications for financial sustainability of any increase in net interest costs from increasing indebtedness (e.g. by running down financial assets or raising borrowings) to meet asset acquisition financing needs.<sup>13</sup>

### Rating considerations

A Council's rate revenue expectations (arising from forecast movements in the number of rateable properties) and proposals (any intended variation in average rates payable for all or some classes of ratepayers) are a crucial consideration in the final content of, and overall financial sustainability forecast by, the LTFP.

A Council may identify and determine as a result of rate revenue deliberations in the preparation of the LTFP that a review of the structure of its rating strategies is warranted. This could include:

- consideration of equity and capacity to pay by the community overall and different sections within it;
- benchmark comparisons of rating levels with other Councils as appropriate;
- analysis of the potential to reduce or increase reliance on rates through a variation in revenue from other sources such as user charges;
- assessment of the impact on rate revenue from projected land use and demographic change; and
- consideration of changes in rating policies, e.g. the introduction of fixed charges, service rates or targeted rate relief.

### Treasury management

The preparation of a LTFP is likely to help a Council determine whether its existing treasury management policies and practices could be improved. Treasury management policies should be explicit; but in the absence of explicit policies each Council will have practices and procedures that presumably reflect implicit policies.

Modern approaches to treasury management, that are consistent with accrual accounting concepts, clearly highlight that considerable savings can be made through an holistic focus on funds management compared with undertaking separate or specific borrowings to finance

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<sup>12</sup> See Financial Sustainability Information Paper No. 10: *Debt* at: <http://www.lga.sa.gov.au/goto/fsp>

<sup>13</sup> See Financial Sustainability Information Paper No. 20: *Rating Policy and Other Funding Options* at: <http://www.lga.sa.gov.au/goto/fsp>

particular projects or assets and quarantining existing financial assets in separate special purpose accounts.<sup>14</sup>

For the purposes of this paper it is sufficient to note that in developing a LTFP, the use of accumulated financial assets and borrowings can be identified as an important financing source.

While it is clearly desirable that levels of indebtedness be as low as possible (subject to intergenerational equity considerations and all other things being equal) soundly managed borrowings are an important and appropriate financing option available to Councils to help finance their ongoing infrastructure requirements. Councils must make treasury management policy decisions in the context of their overall financial management and service delivery decisions.

There are two distinct aspects of a Council's treasury management:

- a strategy covering the level of a Council's indebtedness over the planning cycle; and
- a strategy to minimise a Council's net interest costs over time in a risk averse manner.

The LTFP is a key financial management tool to optimise a Council's treasury management strategy. It needs to clearly highlight anticipated movements in annual cash flows linking movements in a Council's level of borrowings and financial assets over the planning period.

### **Narrative Overview**

A LTFP needs to include a brief narrative overview to help both decision-makers and stakeholders understand the purpose of the document and the key conclusions that can be drawn from the financial data. It should therefore help inform decisions and judgements regarding future proposed service levels and major initiatives and their funding and financing.<sup>15</sup>

### **Assumptions**

What will actually happen in future is uncertain. Differences in assumptions regarding future events can have a big impact on the financial projections in a LTFP. It is important therefore that key assumptions (those that, if varied, could have a significant impact on financial outcomes) should be documented in the LTFP and should be defensible. Examples could include:

- whether the LTFP has been prepared in real (net of inflation) or nominal (actual dollars of the day) values and anticipated general price movements over the planning period;
- any proposed increase in rating levels, and/or other revenue, clearly specified;
- expected relative price variations for particular classes of outlays (where different from the assumed general price movements and the impact is material);
- the projected rate of growth in properties served (and possibly population) and the impact on operating revenue and operating expenses;

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<sup>14</sup> See Financial Sustainability Information Paper No. 15: *Treasury Management* at:

<http://www.lga.sa.gov.au/goto/fsp>

<sup>15</sup> LGA Financial Sustainability Information Paper No. 20 *Rating Policy and Other Funding Options* at:

<http://www.lga.sa.gov.au/goto/fsp> draws a distinction between "funding" and "financing".

"Funding" refers to the raising of revenue whereas "financing" describes how payment for an outlay is accommodated (which might involve borrowing).

- details of anticipated/proposed changes in mandated and discretionary service levels where they are expected to have material impact on operating revenue or operating expenses;
- any assumed material changes in revenues beyond the Council's control (e.g. in grants from other spheres of government); and
- whether the projections are consistent with proposals specified in the Council's strategic management plans or other published commitments/statements of intention.

### **Sensitivity analysis**

A Council's finalised LTFP should outline the optimum balance of prioritised services that it considers can be funded with acceptable revenue raising proposals based on carefully considered assumptions and community consultation while ensuring achievement of responsible financial indicator targets.

When preparing its LTFP a Council needs to undertake sensitivity analyses to assess the impact of variations in underlying key assumptions. For example, small variations over time in the expected number of properties in the Council area may have a very significant impact on the Council's projected aggregate rate revenue and hence its financial capacity and financial sustainability over the planning period.

Ultimately a LTFP must be based on best assumptions but a Council should be mindful of the probabilities and risks associated with these assumptions in its decision making. As a minimum, assumptions need to be reconsidered, and if necessary updated, in the annual review of the LTFP.

### **Resources**

Integral to LTFPs are the financial projections which result from the assumptions adopted and on which the analysis, actions, responsibilities etc. of the plans are based.

A software product, "Long-term Financial Plan Model" has been developed by the [SA Local Government Financial Management Group](#) (SALGFMG) in association with the LGA, and has been made available to Councils.<sup>16</sup>

More recently, the [Australian Centre of Excellence for Local Government](#) (ACELG) has promoted a nationally consistent approach to the development of LTFPs. It has released a detailed and nationally applicable '[Practice Note](#)' to provide guidance on the preparation of LTFPs. The [ACELG Practice Note](#) recognises that some councils will prefer different levels of content detail in their LTFP. It nevertheless encourages a simple and strategic approach.<sup>17</sup> ACELG has arranged for the [Institute of Public Works Engineering Australia](#) (IPWEA) to develop a straightforward spreadsheet model intended to facilitate preparation of a LTFP on this basis. This spreadsheet model avoids the detailed calculation of double-entry accounting transactions for all reports that the [SALGFMG](#) model is predicated upon.<sup>18</sup>

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<sup>16</sup> The [SALGFMG](#) model provides LTFP outputs that are consistent with the requirements of regulation 5 of the [Local Government \(Financial Management\) Regulations 2011](#).

<sup>17</sup> The ACELG LTFP Practice Note includes (at Appendix IV) an illustrative example of a narrative overview, as discussed above.

<sup>18</sup> However, Regulation 5 of the [Local Government \(Financial Management\) Regulations 2011](#) currently requires greater detail in a LTFP than the detail envisaged in ACELG's proposal.

Regardless of the format in which a Council prepares its LTFP, it is recommended that the LTFP includes graphs which show projected performance of financial indicators against the Council's targets that have been set for these indicators.<sup>19</sup>

### **What are the issues for Councils?**

Councils typically have very significant investments in long-term assets. In many cases these will require substantial renewal, replacement or upgrading within a 10 year period. Community demands for better and additional Local Government services continue to grow. Accordingly, it is imperative that Councils have well-developed LTFPs to help guide decision-making and protect their future sustainability.

It is emphasised that a LTFP need not be detailed and complex. It is necessary though that a LTFP provide linkages, in financial terms, between a Council's objectives, goals and desired strategic directions. A LTFP must be consistent with a Council's strategic objectives and take into account prioritised needs, including those identified in the Council's I&AMP.

A well-developed LTFP will assist a Council to:

- set its future financial direction;
- protect future financial sustainability;
- assess revenue raising needs;
- assess the Council's capacity or need to vary service levels;
- assess its capacity to undertake any major additional capital works; and
- provide goal posts for the preparation of the following year's annual business plan and budget.

A Council's LTFP should encourage the Council to think about the impact of all its activities on future operating revenues and expenses. From this thinking comes a better understanding of the financial implications arising from community needs and preferences identified by the Council and the capacity to effectively plan for changes in service levels and infrastructure spending.

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<sup>19</sup> See LGA Financial Sustainability Information Paper No. 9: *Financial Indicators* at <http://www.lga.sa.gov.au/goto/fsp>