

LOCAL GOVERNMENT FINANCES

Financial performance and position

Table A below shows summary financial performance data for the local government sector as a whole for the financial years 2011-12 through to 2015-16. For interested readers, an explanation of terms used in the table is shown in this link: [Uniform Presentation of Finances](#).

Table A: Local Government operating statement (\$ million)

	2011-12	2012-13	2013-14	2014-15	2015-16
Income ^(a)	1 824	1 918	2 011	2 066	2 181
Operating Expenses ^(b)	(1 830)	(1 919)	(1 986)	(2 034)	(2 092)
Operating surplus / (deficit)	(6)	(1)	25	32	89
Net outlays on existing assets					
Capital expenditure on renewal and replacement of existing assets	(308)	(264)	(310)	(344)	(330)
Add back: Depreciation	419	418	440	449	471
Proceeds from sale of replaced assets	25	24	20	11	22
Net outlays on existing assets	136	178	150	116	163
Net outlays on new and upgraded assets					
Capital expenditure on new and upgraded assets	(289)	(311)	(326)	(299)	(315)
Amounts received specifically for new and upgraded assets	111	118	79	78	90
Proceeds from sale of surplus assets	11	10	28	33	32
Net outlays on new/upgraded assets	(167)	(183)	(219)	(188)	(193)
Net lending / (borrowing)	(37)	(6)	(44)	(40)	59

(a) Income excludes book gains on sale of assets and amounts received specifically for new/upgraded assets. Income figures have been adjusted to remove the material distortion otherwise caused by the irregular timing of receipt of Federal financial assistance grants in 2011-12, 2012-13, 2014-15 and 2015-16.

(b) Operating expenses include depreciation but exclude book losses on the sale or revaluation of assets.

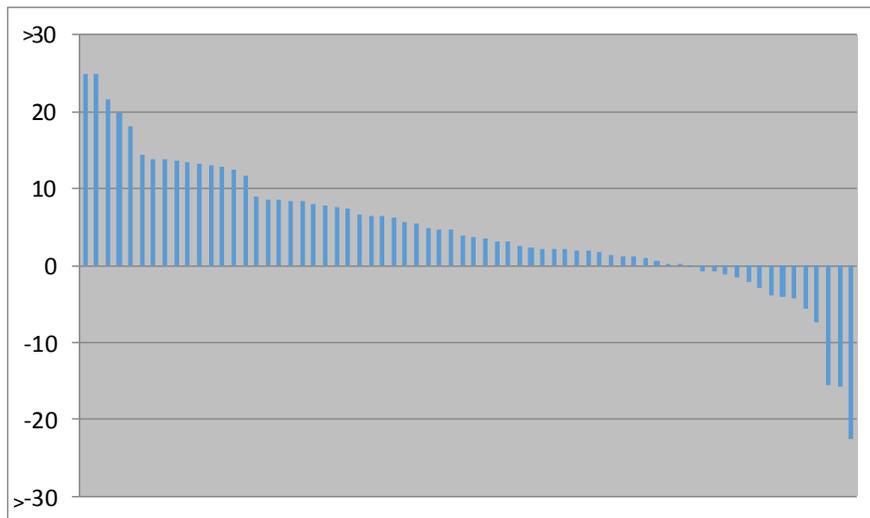
As noted above, figure-work in Table A has been adjusted to remove the distortion otherwise caused by the irregular timing of receipt of Federal financial assistance grants (FAGs) in recent years. By way of background, the aggregate level of local government's annual operating deficit (i.e. the excess of operating expenses over income) reduced steadily from 2000-01 when it was \$75 million. The operating deficit was eliminated for the first time on record in 2007-08.

Subsequently, an approximate 'break-even' operating result was recorded for five years up until 2012-13, with increasing operating surpluses recorded for each of the last three years (with an operating surplus of \$89 million in 2015-16).

The large and consistent shortfall in the level of capital expenditure on renewal and replacement of existing assets compared with depreciation may indicate that existing assets are deteriorating at a greater rate than the optimal level of expenditure on their renewal or replacement or that recorded useful lives of assets are understated. This underlines the importance of each council developing a rigorous Infrastructure and Asset Management Plan and, separately, carefully examining the accounting treatment of its assets (i.e. remaining useful lives, residual values, componentisation and valuations).

While the financial performance of the sector as a whole, as measured by the overall annual operating result, has improved significantly since 2000-01, it is emphasised that the current financial performance of individual councils varies substantially. Chart 1 below shows the wide range of results covering the operating surplus ratio of councils in 2015-16. The 'Financial Indicators' section shown later in this document includes trend data on individual councils. The operating surplus ratio is calculated by expressing a council's operating surplus as a percentage of income. The data in Chart 1 has been adjusted to remove the distortion otherwise caused by only two quarterly instalments of FAGs being received in 2015-16. A total of 53 councils recorded a positive operating surplus ratio in 2015-16 compared with only 16 councils in 2000-01.

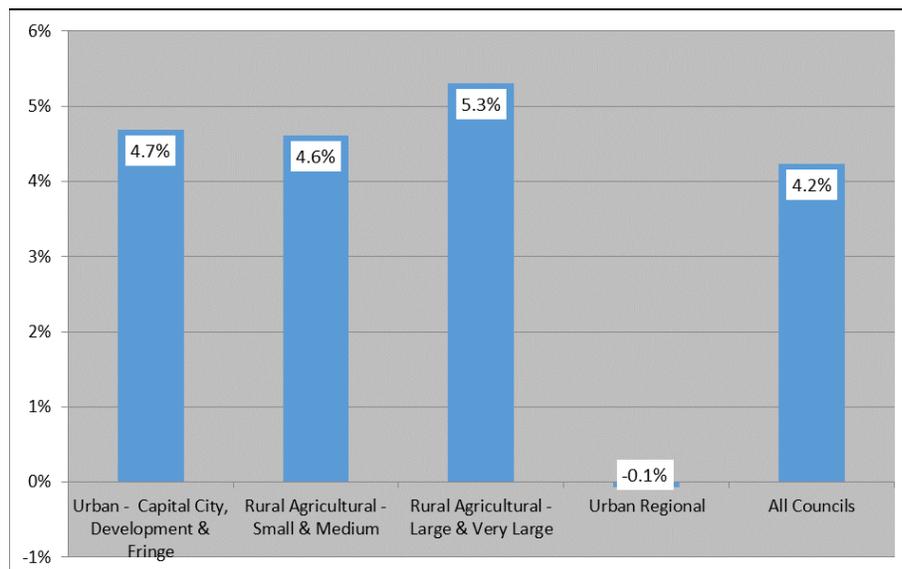
Chart 1: Operating Surplus Ratio (%): Size Distribution among Councils 2015-16



Source: South Australian Local Government Grants Commission

Chart 2 below shows the differences between categories of Councils in their operating surplus ratios in 2015-16 (again adjusted to remove the FAGs distortion).

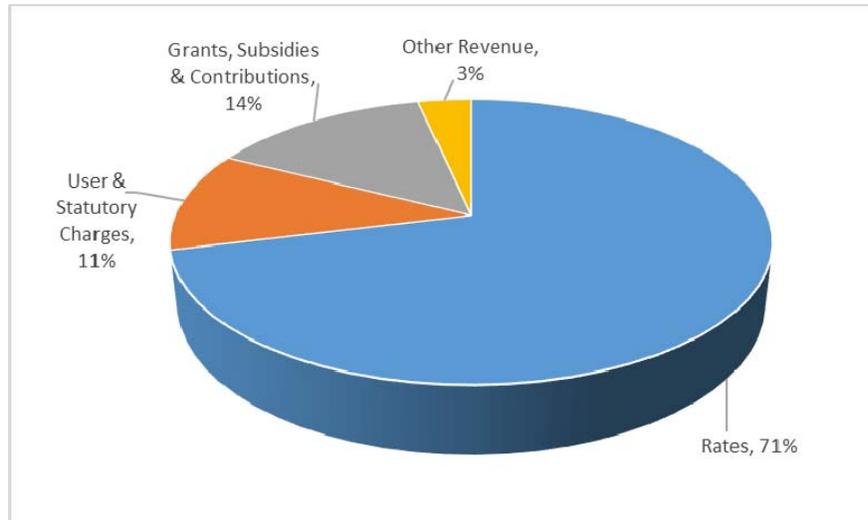
Chart 2: Operating Surplus Ratio (%): Differences between categories of Councils 2015-16



Source: South Australian Local Government Grants Commission

The main sources of local government income in 2015-16 are shown in Chart 3 below. In real terms, local government's income (as adjusted to remove the FAGs distortion) increased by 6.4 per cent over the four-year period from 2011-12 to 2015-16.

Chart 3: Sources of Income 2015-16

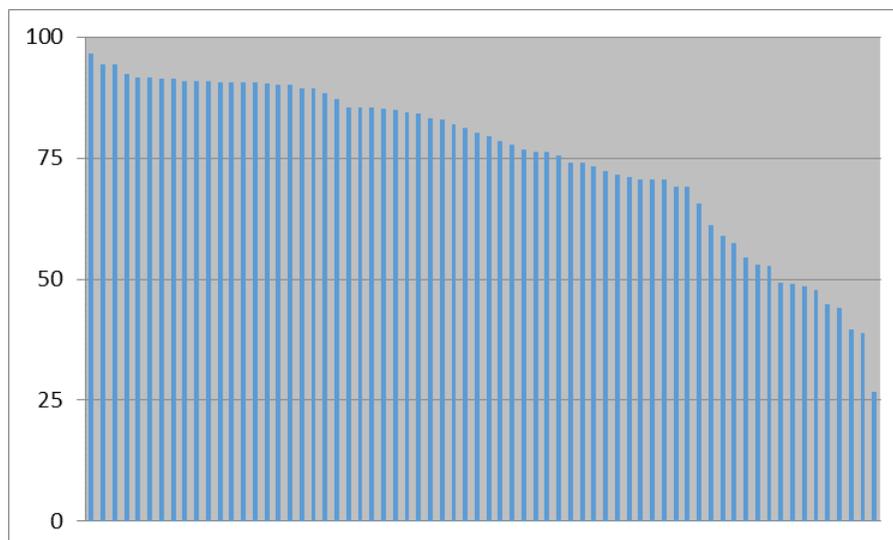


Source: South Australian Local Government Grants Commission

Taxation revenue (from general and other rates on property) was \$1,550 million in 2015-16 and is estimated to be approximately \$1,620 million in 2016-17. Together with other own-source funding (mainly user charges), approximately 86 per cent of local government income (as adjusted to remove the FAGs distortion) is from its own sources. In real terms, taxation revenue increased by 7.3 per cent over the four year period from 2011-12 to 2015-16.

Chart 4 below shows the significant differences in the funding self-sufficiency of individual Councils. In 2015-16, 27 Councils relied on Commonwealth and State Government grants, subsidies and contributions for between 25 per cent and 73 per cent of their income.

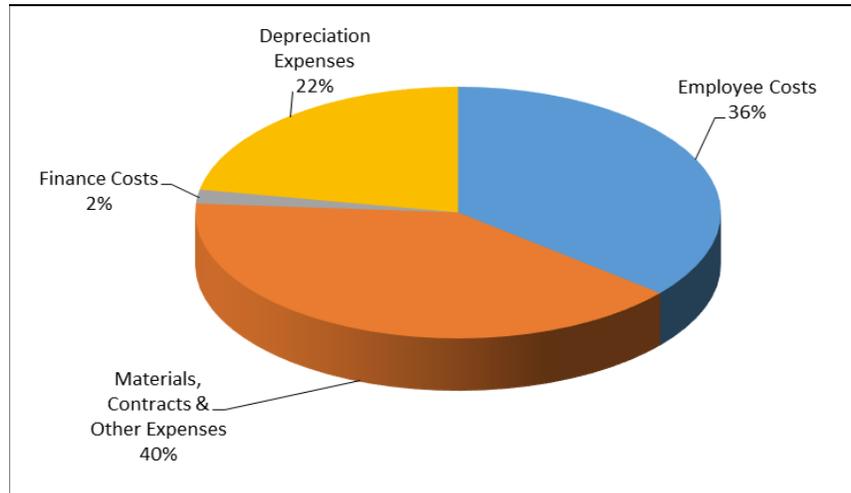
Chart 4: Own-source Income as a percentage of Total Income as adjusted to remove FAGs distortion (%): Size Distribution among Councils 2015-16



Source: South Australian Local Government Grants Commission

The main types of operating expenses in 2015-16 are shown in Chart 5 below. Operating expenses increased in real terms by 5.2 per cent over the four-year period from 2011-12 to 2015-16.

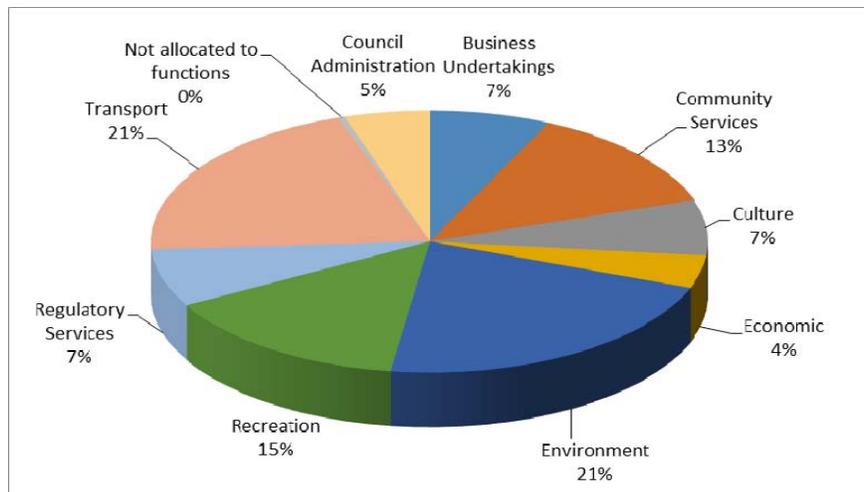
Chart 5: Operating Expenses by Type 2015-16



Source: South Australian Local Government Grants Commission

Operating expenses by function in 2015-16 are shown in Chart 6 below.

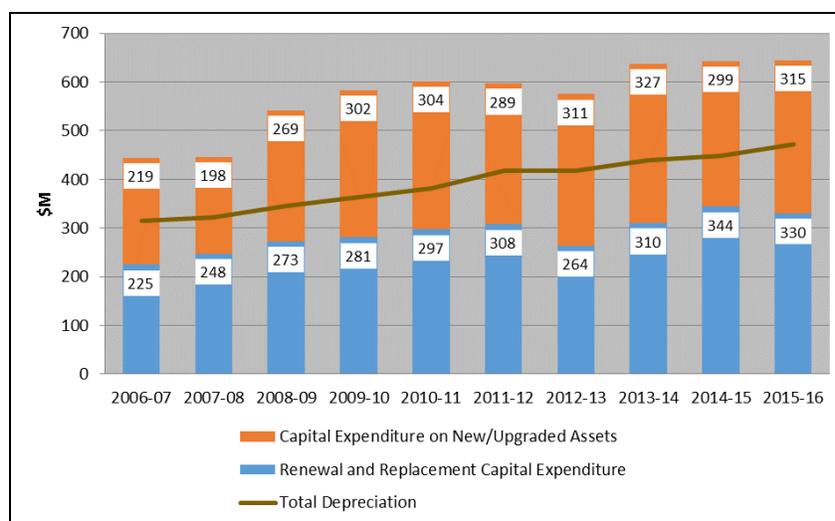
Chart 6: Operating Expenses by Function 2015-16



Source: South Australian Local Government Grants Commission

Chart 7 below shows, from 2006-07, the level of capital expenditure on renewal/replacement of existing assets on one hand and capital expenditure on new/upgraded assets on the other. Gross capital investment expenditure in 2015-16 was a record high \$645 million. There continues a worrying trend in the level of capital expenditure on new/upgraded assets by some councils which currently are recording operating deficits and therefore may not be able to adequately maintain and renew such assets in the future to provide desired and affordable service levels. In addition, in the absence of a rigorous Infrastructure and Asset Management Plan in some, mainly rural, councils, it is not possible for those councils to determine the optimal level of capital expenditure needed for renewing existing assets to minimise their whole-of-life-cycle costs.

Chart 7: Local Government sector – Capital expenditure and depreciation



Source: South Australian Local Government Grants Commission

Table B below shows an abridged balance sheet for the local government sector for five years through to 2015-16. Figure-work in Table B has been adjusted to remove the distortion otherwise caused by the irregular timing of receipt of FAGs in recent years.

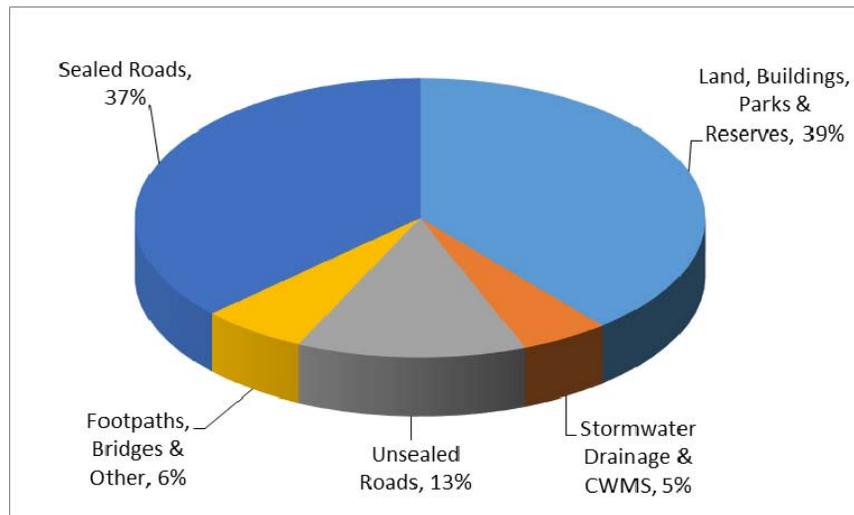
Table B: Local Government balance sheet (\$ million)

	2011-12	2012-13	2013-14	2014-15	2015-16
Assets					
Financial assets					
Cash and cash equivalents	319	267	298	287	307
Trade and other receivables	150	155	161	155	164
Equity accounted investments in Council businesses	69	77	79	67	71
Other financial assets	2	1	2	8	9
Non-financial assets					
Assets held for sale and inventories	71	51	42	45	34
Land, buildings, infrastructure, plant, equipment and other non-financial assets	20 174	21 123	21 625	22 356	22 861
Total assets	20 785	21 674	22 207	22 918	23 466
Liabilities					
Trade and other payables	326	330	321	310	309
Borrowings and finance leases	565	569	615	646	618
Employee entitlements and other provisions	118	130	175	196	189
Total liabilities	1 009	1 029	1 111	1 152	1 116
Net worth	19 776	20 645	21 096	21 766	22 230
Net financial liabilities^(a)	578	607	650	702	636

(a) Net financial liabilities equals total liabilities less financial assets (excluding equity accounted investments in council businesses).

Chart 8 below shows the make-up of local government's non-financial assets.

Chart 8: Local Government Non-Financial Assets (i.e. Infrastructure and other physical assets). Depreciated replacement cost at 30 June 2016 - \$22.9 billion.

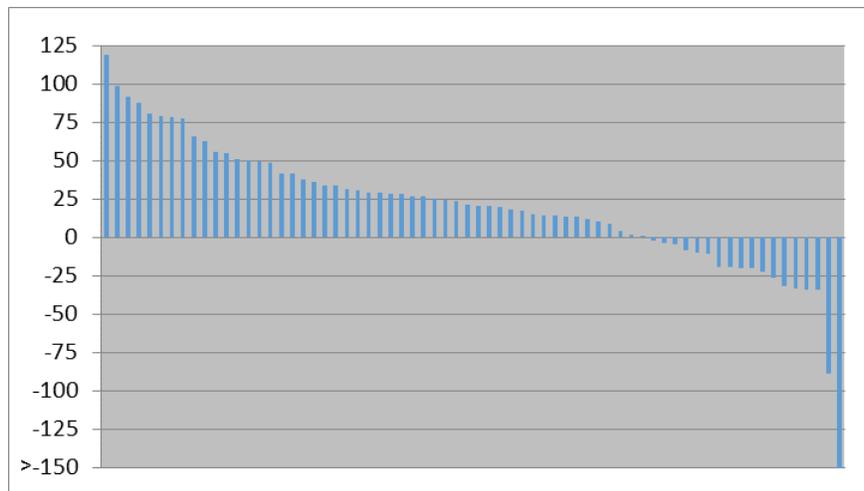


Source: Office of Local Government

As shown in Table B above, the level of net financial liabilities at 30 June 2016 was \$636 million. This represents 29 per cent of local government's income in 2015-16 (where income is adjusted for the FAGs distortion). This result, known as the net financial liabilities ratio, compares with a figure of 32 per cent in 2011-12 and 36 per cent in 2000-01. In the context of local government's infrastructure and other physical assets valued at \$22.9 billion at 30 June 2016, the level of net financial liabilities is extremely low. Perhaps surprisingly, one-quarter of councils had negative net financial liabilities at 30 June 2016 (i.e. their level of cash and investments exceeded their level of outstanding borrowings and other liabilities).

Like their financial performance, the financial position of individual councils at 30 June 2016 (as measured by their net financial liabilities ratio) varies substantially. Chart 9 below shows the wide range of results covering the net financial liabilities ratio of councils in 2015-16 (with income figures used in the calculation being adjusted for the FAGs distortion). The 'Financial Indicators' section shown later in this document includes trend data on individual councils.

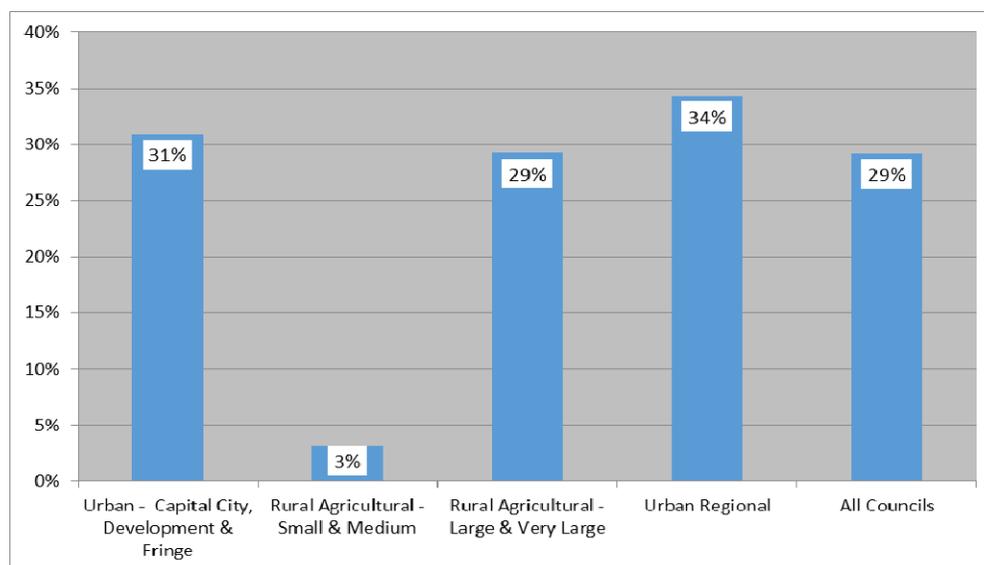
Chart 9: Net Financial Liabilities Ratio (%): Size Distribution among Councils 2015-16.



Source: South Australian Local Government Grants Commission

Chart 10 below shows the differences between categories of Councils in their net financial liabilities ratios in 2015-16 (with income figures again adjusted to remove the FAGs distortion).

Chart 10: Net Financial Liabilities Ratio (%): Differences between categories of Councils 2015-16



Source: South Australian Local Government Grants Commission

Council Indebtedness

Consistent with guidance material provided to councils under the Local Government Association's (LGA's) Financial Sustainability Program, most councils have adopted a contemporary approach to measuring, monitoring and reporting council indebtedness. The approach focuses on a measure entitled "net financial liabilities".

Net financial liabilities represent what is owed to others less money held, invested or owed to a council. Net financial liabilities is the most comprehensive measure of the indebtedness of a council as it includes items such as employee long service leave entitlements and other amounts payable as well as taking account of the level of a council's cash and investments. It is calculated as total liabilities of a council less its cash, cash equivalents and financial investments (excluding equity accounted investments in council businesses).

Past practice was to focus on the level of outstanding council borrowings or the level of net debt. The following table (with figure-work adjusted to remove the FAGs distortion) provides actual data for the local government sector over the three years to 30 June 2016, and may provide interested readers with a better understanding:

Net Financial Liabilities at 30 June

	2014 \$ million	2015 \$ million	2016 \$ million
Gross borrowings	615	646	618
Less: Cash, cash equivalents etc.	300	295	316
Equals: Net Debt	315	351	302
Add: Trade and other payables	321	310	309
Add: Employee entitlements and other provisions	175	196	189
Less: Trade and other receivables	161	155	164
Equals: Net Financial Liabilities	650	702	636

Financial indicators adopted by the local government sector include the "net financial liabilities ratio" as the key measure of the financial position (as distinct from the financial performance) of a council. The net financial liabilities ratio indicates the extent to which net financial liabilities of a council at a point in time could be met by its annual income. The ratio is calculated by expressing net financial liabilities at the end of a reporting period as a percentage of a council's income for the same reporting period.

As mentioned earlier, the net financial liabilities ratio for the local government sector in 2015-16 was 29 per cent. Charts 9 and 10 above show the distribution of values among councils and categories of councils. The 'Financial Indicators' section shown later in this document includes trend data on individual councils. Data on the level of the sector's overall net financial liabilities ratio for the last 16 years is shown in an update report assembled by the LGA for its 2017 Annual General Meeting. The report provides the latest values, history and comparisons of key financial indicators: [Financial Indicators Report 2017](#).

The LGA recommends that a well-managed council committed to sound financial strategies could comfortably manage with a net financial liabilities ratio of 100% or more¹. Councils with the need to accommodate significant outlays on new infrastructure associated with growth or to cost-effectively address large asset renewal or replacement needs may justifiably incur higher net financial liabilities ratios. All other things being equal, a council that provides Community Wastewater Management System (CWMS) services is likely to need to have higher net financial liabilities, as a result of financing associated with CWMS asset provision, relative to a council that does not provide such services.

The level of a council's net financial liabilities is likely to fluctuate significantly between years, including because of the lumpy nature of some capital expenditure. The Uniform Presentation of Finances report that councils are required to include in their budgets, long-term financial plans, annual financial statements and mid-year budget reviews shows a bottom line entitled "Net Lending/(Borrowing)". An explanation of terms in the uniform report is shown in this link: [Uniform Presentation of Finances](#).

A net borrowing result in a particular year increases a council's accumulated level of net financial liabilities in that year whereas a net lending result reduces the level of net financial liabilities. A council's net lending/(borrowing) result in a financial year is calculated as the operating surplus/(deficit) less net capital outlays on non-financial assets. Put another way, a 'net borrowing' result represents the extent to which operating expenses (excluding depreciation) and capital expenditure exceed funding provided by operating revenue, proceeds from sale of assets and amounts received specifically for new/upgraded assets.

In the absence of explanatory material, some Council Members and interested readers may find it difficult to distinguish between the abovementioned 'net financial liabilities' measure and the 'net lending/(borrowing)' measure. It may be helpful to think about the 'net financial liabilities' measure as the outstanding amount of liabilities (net of financial assets) that have accumulated since the creation of a council – it is 'stock' concept, with the data drawn from a council's Statement of Financial Position. On the other hand, the 'net lending/(borrowing)' measure is a 'flow' concept as it captures only the result of a council's operating and capital investment activities in a particular financial year – with the data being drawn from a council's Statement of Comprehensive Income and its Cash Flow Statement for the year.

Drawing on figures for the sector as a whole included in the above tables, local government had accumulated an amount of net financial liabilities of \$702 million at 30 June 2015.

¹ See, for example, LGA Financial Sustainability Information Paper Number 9 – 'Local Government Financial Indicators'.

The sector incurred a net lending result of \$59 million covering 2015-16 activities - which decreased the level of net financial liabilities by the same amount in that year. After taking account of several factors which affect a small proportion of councils, local government's net financial liabilities at 30 June 2016 was \$636 million.

Summary Data: 2015-16

Income	\$2,181 million
Less: Operating Expenses	\$2,092 million
Equals: Operating Surplus / (Deficit)	\$89 million
Less: Net Capital Outlays	\$30 million
Equals: Net Lending / (Borrowing)	\$59 million

Net Financial Liabilities at 30 June 2015	\$702 million
Less: Net Lending Result in 2015-16	(\$59 million)
Less: Other Miscellaneous Transactions (mainly the impact of capital works-in-progress)	(\$7 million)
Equals: Net Financial Liabilities at 30 June 2016	\$636 million

Some commentators on local government finances use the terms 'financing' and 'funding' interchangeably. In this document, the two terms are used with specific and very different meanings. 'Funding' refers to the raising of revenue (e.g. through rates, user charges or the receipt of grants). 'Financing' describes how payments for outlays are accommodated (e.g. by accessing cash held in a council's bank account or by taking out a loan with another entity). As shown in Table A above, the overall net lending result for the local government sector as a whole in 2015-16 was \$59 million. 'Financing' transactions covering the amount of net lending in 2015-16 occurred as follows:

	\$ million
New borrowings	(62)
Increase in cash, cash equivalents and financial investments	21
Principal repayments on past borrowings	93
Other, including net movements in receivables, payables and provisions	8
Total	59

Financial Indicators

The *Local Government (Financial Management) Regulations 2011* require a council to use three specific financial indicators in its long-term financial plan, annual budget and report on annual financial results:

- An operating surplus ratio;
- A net financial liabilities ratio; and
- An asset sustainability ratio.

In these documents, councils effectively are required to evaluate past performance and project the future impact of strategies under consideration against financial indicators. The use of these financial indicators and associated targets determined by a council are intended to act like a roadmap to assist Council Members and management to steer their Council's financial performance and sustainability.

Detailed explanatory information about each financial indicator and trend data on individual councils is available [here](#). Up-to-date information about the current and future sustainability of each council's financial performance and position is available in council long-term financial plans. These plans put detailed information about financial indicators into context and explain a council's financial and asset management strategies. Interested readers are encouraged to study council long-term financial plans available on council websites.

Other selected financial and demographic information

The following tables provide an assortment of data on other local government financial and demographic characteristics. This data highlights the considerable diversity among councils.

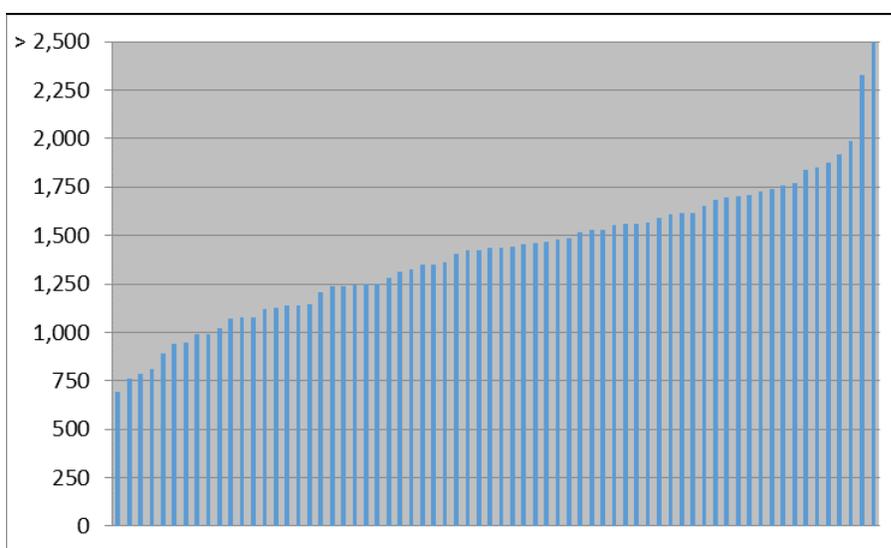
Item	
Operating expenses covering council services in 2015-16:	
Waste Management	\$174 million
Recreation	\$288 million
Library and Cultural Services	\$142 million
Community Services, Health Services and Public Safety	\$282 million
Transport	\$429 million
Estimated council population at 30 June 2016:	
Minimum	854
Average	25,015
Maximum	169,575
Total	1,701,014
Council road length:-	
Minimum	36 km
Average	1,105 km
Maximum	3,891 km
Total	75,139 km
Council employees at 30 June 2016:-	
Minimum	14 FTE's
Average	130 FTE's
Maximum	789 FTE's
Total	8,828 FTE's
Council area:-	
Minimum	356 hectares
Average	229,000 hectares
Maximum	886,000 hectares
Total	15,565,000 hectares

As shown in the below table, total rate revenue received by councils in 2015-16 was \$1,551 million. Of this amount, \$1,022 million was attributable to residential rates, representing about 66 per cent of total rate revenue and about 47 per cent of total income (where total income has been adjusted to remove the FAGs distortion).

Item	
Council Rating:-	
Capital value of properties in council areas at 1 January 2015	\$330 billion
Number of rateable residential properties in council areas at 1 January 2015	712,305
Total rate revenue for 2015-16	\$1,551 million
Total rates as a proportion of total adjusted income in 2015-16	71%
Increase in rate revenue from 2014-15 to 2015-16 (including rates from new development)	4.5%
Average residential rates in 2015-16 – also see Chart 11 below	\$1,434
Mandatory and discretionary rate rebates, remissions and write-offs for 2015-16	\$34 million

Chart 11 below shows average residential rates charged by each council in 2015-16. Information about the rating regime of individual councils is summarised in Database Report 6 published by the Local Government Grants Commission on its public website.

Chart 11: Average residential rates (excluding CWMS rates) per rateable residential property (\$): Size distribution among councils 2015-16



Source: South Australian Local Government Grants Commission