OCTOBER 2021

Local government **sustainability framework**

Discussion paper

Business-ready councils delivering liveable communities through the right foundations, infrastructure and outlook

Queensland Government

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Executive Summary

Queensland's local governments play a critical role in supporting the safety, liveability and prosperity of local communities right across the State.

All of Queensland's 77 councils face unique financial, service delivery and community need circumstances. The challenge of ensuring local government sustainability, is an important issue for all councils and the Queensland Government.

In recent times the COVID-19 pandemic, which has impacted communities right across Queensland, has presented challenges to local governments on a scale not seen before and has further exacerbated the sustainability challenges already faced by the sector.

This was demonstrated through the Auditor-General's 2021 Report to Parliament 17: 2020-21, which raised concerns about local government financial sustainability, rating 24 out of 77 councils as having a higher risk of sustainability issues in the short- to medium-term. The report also recommended the Department of State Development, Infrastructure, Local Government and Planning (the department) consider broadening its view of sustainability to include other elements such as governance, compliance, and asset management and consider developing new financial sustainability ratios for councils that consider the different sizes, services, and circumstances of the various councils.

The diversity of the sector means that no single solution or approach will address the sustainability challenges faced by many local governments. Given this, the department is proposing a new Sustainability Framework that enables the sustainability of councils to be assessed against a tailored framework that more appropriately reflects the diverse nature of Queensland councils and considers a number of factors ranging from finances, asset management and compliance through to operating environment and governance.

The department is also proposing that new sustainability ratios and associated benchmarks be introduced. These would be applied by grouping councils on a population basis and establishing relevant benchmarks for each grouping that is reflective of what is achievable for that particular group of councils. The new ratios focus on how the council is performing from a financial and asset management perspective with the other elements of the Sustainability Framework (governance, compliance, and operating environment) being addressed through future work the department will undertake.

Through the implementation of the new Sustainability Framework and the new financial and asset ratios, department and councils will be provided with greater insight into the challenges faced by the sector which will support the development of more tailored and relevant solutions. This will also support the vision of having business ready councils – today and into the future - that enable liveable communities to grow and prosper by focusing on the principles of:

- Foundations: Councils doing the basics well across finances, governance, and service delivery
- Infrastructure: Councils delivering infrastructure that the community needs, wants, and can afford
- Outlook: Councils investing in ideas that are right for the future community.

The department is proposing to implement the new Sustainability Framework, including revised ratios during 2022. The Financial Management Guideline which sets out the agreed financial and asset ratios will be released in early 2022 to take effect for the 2022-23 financial year reporting. A phased transition will be implemented to support councils to adequately meet their obligations under the new reporting requirements. The department will work with councils to develop training and guidance material to support the implementation of the agreed financial and asset sustainability ratios.

The department is seeking stakeholder feedback on the contents of this discussion paper and in particular the following key areas:

Elements of the framework

Operating environment, financial performance, asset management, governance and compliance.

Grouping of councils

Based on population, to enable a tailored approach for considering sustainability.

Financial and asset sustainability ratios and benchmarks

What councils will be required to report on.

Refer to ***page 20*** on how to *Have your Say* on this very important topic.

1. Background

Councils are impacted by a range of factors that affect their long-term sustainability. These include size and location, population, ability to raise or increase own source revenue, governance frameworks, and an increasing requirement to fill service delivery gaps to meet community expectations.

Over time, sustainability pressures on councils have increased, with the impacts of the COVID-19 pandemic adding to these challenges. The department is responsible for monitoring the overall health of the Queensland local government sector and supporting councils to ensure strong and sustainable communities into the future.

The *Local Government Act 2009* and *City of Brisbane Act 2012* set out the broad accountability framework for local governments in Queensland. These Acts and their associated Regulations work with other State and Commonwealth legislation to establish the obligations expected of all councils, covering areas such as governance, financial accountability, environmental management, urban planning, and community consultation. The proposed Sustainability Framework underpins these existing legislative requirements.

The establishment of a new Sustainability Framework will form the basis of the department's monitoring of councils' performance and sustainability and will assist the department in providing more targeted support.

Council sustainability has been an increasing challenge. The Auditor-General's 2021 Report to Parliament 17: 2020-21, raised concerns about local government financial sustainability, rating 24 out of 77 councils as having a higher risk of sustainability issues in the short to medium-term.

The report recommended the department develops new financial sustainability ratios for councils, and that these ratios consider the different sizes, services, and circumstances of the various local governments. Previous reports to Parliament have included these recommendations made by the Auditor-General.

The Auditor-General has also recommended the department broaden its view of sustainability to include other elements such as governance, compliance, and asset management.

Feedback gathered from councils and other stakeholders over time has also identified significant challenges with the selection and/or application of the current three financial sustainability measures. As a result of these issues many councils, regardless of size, fail to meet all three ratios. The ratios also do not necessarily give an accurate picture of a council's or the sectors financial sustainability.

Given these challenges, the proposed Sustainability Framework has been developed to not be a one-size fits all approach but rather one that is:

- **Holistic**
  Acknowledges that councils' sustainability is influenced and affected by more than just financial elements.
- **Tailored**
  Councils are grouped to recognise the clear structural differences that exist. It is proposed councils are grouped based on population.
- **Relevant**
  Financial and asset sustainability ratios are expanded from three to eight and will include benchmarks that will provide councils with more relevant and council specific information.

2. Sustainability Framework

Establishing a new framework to monitor council sustainability will support better long-term planning from the State, provide a more informed basis for council decision-making and support improved outcomes for local communities.

2.1 Principles

The proposed approach to defining and measuring local government sustainability is driven by the vision of having business ready councils – today and into the future – that enable liveable communities to grow and prosper by focusing on the principles of:

Foundations
Doing the basics well across finance, governance, and service delivery.

Infrastructure
Delivering infrastructure the community needs, wants, and can afford.

Outlook
Investing in ideas that are right for the future community.

To achieve this, it is proposed that the new framework considers the broad range of elements impacting on council sustainability which are detailed in Table 1 below.

2.2 Elements

In the past, monitoring of sustainability has focused on a council's financial and asset management performance.

However, individual council performance and sustainability is driven by a broad range of financial and non-financial factors, some of which are within the control of local governments, and others which are not. For this reason, a more holistic approach to defining sustainability is required.

Feedback from councils and work with stakeholders has identified five broad elements of council sustainability (Table 1):

Operating environment	Finances	Assets	Governance	Compliance
Impact of the external environment on councils and their capacity to respond effectively.	Performance of councils in managing their finances over the long term.	Performance of councils in managing assets over the long term.	Performance of councils in understanding and managing risks and embedding effective governance practices.	Performance of councils in meeting legislative requirements.

Table 1: Elements impacting council sustainability

An overview of each of the five elements and the outcomes from implementing the proposed Sustainability Framework is provided below.

Operating Environment

Impact of the external environment on councils and their capacity to respond effectively.

Outcomes

- Councils are aware of their operating environments and respond appropriately
- Local communities are supported socially and economically by their councils
- Councils are resilient and equipped to respond to natural disasters

A council's operating environment represents those factors which are primarily outside its control but still affect its ability to operate. This includes drivers such as remoteness, demographic and socio-economic characteristics, industry composition, as well as an area's exposure to natural disaster events. While councils cannot control these factors, their ability to respond to and/or influence them can affect their long-term sustainability.

Finances

Performance of councils in managing their finances over the long-term.

Outcomes

- Service levels are maintained at appropriate levels over time
- Services are delivered efficiently and effectively
- Councils are operating within their means
- Appropriate levels of debt are maintained relative to council's servicing capacity

Councils that cannot afford to deliver the necessary levels of service to their communities over the longer term are not sustainable. For all councils, regardless of size, this requires operating within their means and managing resources efficiently and effectively to minimise the need for external financial support, to the extent possible.

Assets

Performance of councils in managing assets over the long term.

Outcomes

- Assets are well managed and maintained
- Capital expenditure is adequately funded when it falls due
- Projects are appropriately prioritised and costed
- Councils are planning for future community needs

Service delivery is closely aligned with how well a council manages its assets, including critical water and waste infrastructure, road networks, community amenities, and airports. Poor asset management impacts the quality and reliability of community services, increased costs to councils and ratepayers and compromises long-term sustainability.

Governance

Performance of councils in understanding and managing risks and embedding effective governance practices.

Outcomes

- Decisions are made responsibly and in accordance with governance framework
- Core business risks are identified and managed
- Suitably qualified staff are employed and retained
- Community is satisfied with council performance

Councillors and council staff are expected to make decisions in the best interests of the community and manage risks to ensure council success. Effective governance and decision-making frameworks and controls reduce the potential for adverse impacts on community service delivery and confidence from failures of planning, integrity, and accountability. Councils with strong governance practices are better placed to make informed decisions that consider the long-term risks, affordability and impacts.

Compliance

Performance of councils in meeting legislative requirements.

Outcomes

- Financial accountability and corporate planning documents are prepared on time and to a high standard
- Council complies with all State and Commonwealth statutory requirements
- Documents are made publicly available as required by regulation
- Grant funded projects are delivered on time and within budget

It is imperative that councils are effective managers of their regulatory obligations. Councils without the organisational behaviours and systems in place to consistently meet their regulatory requirements in a timely and effective manner attract financial and other statutory penalties, which can compromise their ongoing sustainability.

Question 1

Do you consider the proposed elements of the framework:

- **capture the core areas that impact a councils' sustainability?**
- **appropriately reflect the varied nature and circumstances of Queensland's local governments?**

Question 2

Are some of the proposed sustainability elements more important than others and therefore should be given a higher priority?

3. Measuring financial and asset sustainability

3.1 Grouping of Councils

Queensland has one of the most diverse local government sectors in Australia, covering a large geographic area. Across the State, individual councils face a unique set of financial, service delivery and community need circumstances and are impacted by a wide range of social and economic drivers.

For this reason, grouping local governments within the Sustainability Framework according to common attributes is proposed as a mechanism to acknowledge the significant diversity across the sector. This enables like-for-like comparisons between councils in the same group. There is no benefit from comparing very large councils with very small councils given their vastly different operating environments.

Grouping councils allows fit-for-purpose measures and/or benchmarks for each council group, increasing the relevance of the information communicated to stakeholders and enabling the department to identify and provide more targeted support where required.

A number of alternative approaches for grouping councils have been considered including grouping by population, population density, council-controlled revenue, Australian Bureau of Statistics Disadvantage Index and borrowings. Analysing the results of the alternative grouping options, population is considered the most reasonable approach because it is a key driver of a councils' ability to fund the delivery of services to the community. Further, the size of the population often drives the types of services provided e.g., councils with small populations often provide services as the provider of last resort such as aged care and childcare.

Grouping by population also avoids anomalies seen when alternative options were considered. For example, grouping on a population density basis resulted in some small remote and Indigenous councils being grouped with large, urban SEQ councils. Grouping on this basis would limit like-for-like comparisons and the option to tailor benchmarks to suit the cohort of councils. Grouping by population is also considered the most stable and reliable method, compared with other potential methods. As a council's circumstances change over time, they will change groups, allowing them to report on and be measured based on their current circumstances.

Proposed Grouping

A summary of the proposed population groupings and the number of measures to be reported for each is set out in Table 2.

Group	Population Band	No. of Councils
Very Large	450,000+	3
Large	80,000-449,999	11
Medium	25,000-79,999	14
Small	10,000-24,999	11
Very Small	< 10,000	22
Indigenous	< 10,000	16

Table 2: Proposed Grouping of Councils

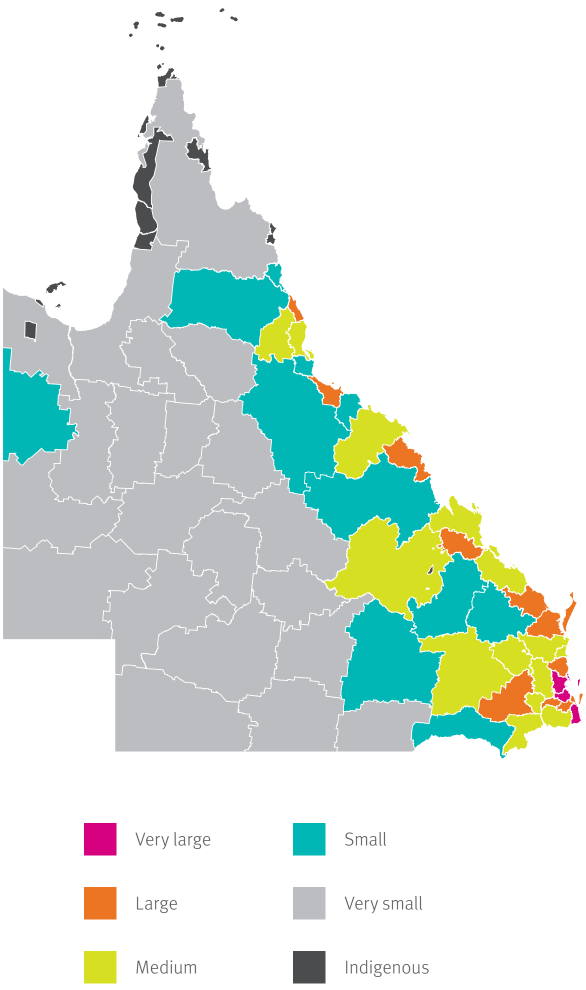

Figure 1: Map representation of Council Groups

Very large		
Brisbane	Gold Coast	Moreton Bay
Large		
Logan	Toowoomba	Fraser Coast
Sunshine Coast	Cairns	Bundaberg
Ipswich	Redland	Rockhampton
Townsville	Mackay	
Medium		
Gladstone	Livingstone	South Burnett
Noosa	Southern Downs	Cassowary Coast
Gympie	Whitsunday	Central Highlands
Scenic Rim	Western Downs	Somerset Tablelands
Lockyer Valley		
Small		
Mareeba	Banana	Goondiwindi
Isaac	Maranoa	Hinchinbrook
Mount Isa	Douglas	North Burnett
Burdekin	Charters Towers	
Very small		
Cook	Blackall-Tambo	Quilpie
Balonne	Paroo	Boulia
Murweh	Flinders	Burke
Torres	Winton	Bulloo
Longreach	McKinlay	Diamantina
Cloncurry	Richmond	Croydon
Barcaldine	Etheridge	Barcoo
Carpentaria		
Indigenous		
Torres Strait Island	Aurukun	Kowanyama
Northern Peninsula Area	Cherbourg	Pormpuraaw
Yarrabah	Mornington	Lockhart River
Palm Island	Hope Vale	Mapoon
Doomadgee	Napranum	Wujal Wujal
	Woorabinda	

Table 3: List of Councils in each Group

Question 3

Do you support the proposed grouping of councils by population under the Sustainability Framework?

Question 4

Is population a sound basis for grouping councils for sustainability monitoring and reporting?

Question 5

Is there another way to group councils that you consider more appropriate for the purpose of sustainability monitoring and reporting that will stand the test of time and evolving nature of Queensland councils?

3.2 Proposed Financial and Asset Ratios

This discussion paper focuses on the financial and asset ratios. The measures or indicators for the other elements of the Sustainability Framework (governance, compliance, and operating environment) will be addressed and captured through other work the department undertakes.

Currently the Local Government Regulation 2012 requires local governments to calculate and publish three financial sustainability ratios annually:

- **Asset Sustainability Ratio** – an approximation of the extent to which the infrastructure assets managed by a local government are being replaced as they reach the end of their useful lives.
- **Operating Surplus Ratio** – an indicator of the extent to which revenues raised cover operational expenses only or are available for capital funding purposes or other purposes.
- **Net Financial Liabilities Ratio** – an indicator of the extent to which the net financial liabilities of a local government can be serviced by its operating revenues.

These ratios are reported in councils General Purpose Financial Statements (GPFS). The calculation of these ratios and specified target benchmarks are detailed in a statutory guideline, the Financial Management (Sustainability) Guideline. The Auditor-General certifies the accurate calculation of these ratios each year as part of the audit of each local government and assigns a relative risk rating to each council[1].

To achieve a more tailored and fit-for-purpose approach to measuring financial and asset management it is proposed to:

- increase the number of financial and asset ratios from three to eight, and
- set target benchmarks for different groups of councils.

Increasing the number of ratios enables the introduction of new ratios that collectively provide a better reflection of councils' operating performance, liquidity, asset management, and debt servicing capacity. While the department cannot change the accounting standards that govern the preparation of GPFS, it can change how financial and asset sustainability is calculated, measured and assessed. This addresses some of the limitations that exist with the current approach to measuring financial sustainability through a narrow one-size-fits-all lens.

To provide greater insight and account for the impacts of events such as natural disasters, it is proposed that some ratios are reported as both a single year and historical five-year rolling average and that the asset sustainability ratio is reported by infrastructure asset type.

[1] Operating surplus ratio and asset sustainability ratio assessment based on five-year average, net financial liabilities ratio based on point in time.

A summary of the proposed financial and asset ratios is set out in Table 4.

Financial and Asset Ratios	Type of Measure	Currently Reported	Proposed Reporting Requirement
Operating Surplus Ratio	Operating Performance	Yes	Single year and historical five-year rolling average, all councils
Operating Cash Ratio (Earnings Before Interest Depreciation and Amortisation)	Operating Performance	No	Single year and historical five-year rolling average, all councils
Unrestricted Cash Expense Cover Ratio	Liquidity	No	Single year, all councils
Asset Sustainability Ratio	Asset Management	Yes	Single year Only medium, small, very small and Indigenous councils reporting requirement This ratio will be calculated by infrastructure type (ie roads, buildings etc) There will be a staged transition until the 2027-28 financial year for medium and small councils to move from reporting on this ratio to the Asset Renewal Ratio (very small and Indigenous councils will continue to report on this ratio)
Asset Consumption Ratio	Asset Management	No	Single year, for medium, small, very small and Indigenous councils Only medium, small, very small and Indigenous councils reporting requirement There will be a staged transition until the 2027-28 financial year for medium and small councils to move from reporting on this ratio to the Asset Renewal Ratio (very small and Indigenous councils will continue to report on this ratio)
Asset Renewal Ratio	Asset Management	No	Single year, large and very large councils (initially)
Net Financial Liabilities Ratio	Debt Servicing Capacity	Yes	Removed
Leverage Ratio	Debt Servicing Capacity	No	Single year, all councils with debt
Debt per Capita	Debt Servicing Capacity	No	Single year, all councils with debt

Table 4: Summary of Financial and Asset Ratios

These proposed measures will be required to be published by local governments each year in their GPFS. As is currently the case, councils may choose to report additional measures to those required to be reported as a means of providing additional information to their communities and other stakeholders about their performance.

Proposed ratios

Operating Surplus Ratio and Operating Cash (EBIDA[2]) Ratio:

The Operating Surplus Ratio is an indicator of the extent to which revenues raised cover operational expenses only or are available for capital funding purposes or other purposes. This is one of the existing three financial sustainability ratios. While a number of councils fail to report a positive Operating Surplus Ratio the department consider this to be an important ratio as it provides a good indication on a councils' capacity to fund its asset renewals. The proposed target benchmark for this measure (discussed in section 3.3) acknowledges the reduced revenue-generation ability of smaller councils and the correspondingly larger role grant funding plays in supplementing these councils' capital programs.

The Operating Cash Ratio is a new measure and is an indicator of a council's ability to cover its core operational expenses (not including depreciation, amortisation and financing costs).

The Operating Cash Ratio does not include depreciation. Therefore, for councils who predominantly rely on grants to fund capital expenditure, the impact of accounting rules on where and how capital grant funding is reported and the recognition of the reduction in the value of the asset over time (ie depreciation) do not impact the results of this ratio. A negative operating cash ratio is a key indication that the business is not operating effectively.

Collectively, both ratios provide good information about the councils operating position and indicates its capacity to fund renewal of assets.

External events such as natural disasters can have a material impact on a council's operating performance from year to year. To normalise the impacts of these one-off events it is proposed that both ratios are reported on a historical rolling five-year average basis, as well as a single year result. This would provide more context for councils and stakeholders about the long-term trend of these ratios.

Unrestricted Cash Expense Cover Ratio:

The Unrestricted Cash Expense Cover Ratio is an indicator of the unconstrained liquidity available to a council to meet ongoing and emergent financial demands. This is a key solvency indicator.

The addition of the Unrestricted Cash Expense Cover Ratio enables councils and stakeholders to understand the amount of cash a council has available to it at a point in time.

Asset Ratios:

The department proposes to expand the number of asset ratios to include the Asset Renewal and Asset Consumption Ratios.

Asset Renewal Ratio

The Asset Renewal Ratio represents the extent to which required capital expenditure on renewals as set out in a council's asset management plans, has been incorporated into its 10-year financial forecasts.

The QAO has previously recommended that the Asset Renewal Ratio be included in the sustainability measures once council asset data improves.

The department recognises the differing circumstances and capacities of councils and that not all councils are currently able to report on this ratio. Therefore, the requirement to report on the Asset Renewal Ratio will initially not be mandatory for all councils.

Reporting on the Asset Renewal Ratio will be implemented over a phased transition period to give councils sufficient time to develop processes to capture the requisite asset data. A councils grouping will determine when it will be required to report on the Asset Renewal Ratio. During the transition period, the department will work with councils to improve their asset management capability to enable them to report on this ratio in time.

The proposed transition period for each group of councils to report on the Asset Renewal Ratio is set out in Table 5.

Group	Proposed Transition Timeframe
Very Large	Commencing 2022-23 financial year
Large	Commencing 2022-23 financial year
Medium	Commencing 2024-25 financial year
Small	Commencing 2027-28 financial year
Very Small	Not applicable
Indigenous	Not applicable

Table 5: Proposed transition timeline to report on Asset Renewal Ratio

Very Small and Indigenous councils will not be expected to report on the Asset Renewal Ratio for the foreseeable future (if ever). However, over time the department will work with these councils to better understand the condition and renewal required for critical infrastructure requirements.

Feedback from the sector will be important to determine if the proposed transition timelines will be achievable for each group of council. Feedback on any additional support required will also be important.

[2] EBIDA – Earnings before interest, depreciation and amortisation.

All councils may choose to report on the Asset Renewal Ratio at any time.

Councils who do not report on the Asset Renewal Ratio will be required to report on both the Asset Sustainability and Asset Consumption Ratio.

Asset Sustainability and Asset Consumption Ratio

The Asset Sustainability Ratio is an approximation of the extent to which the infrastructure assets managed by a local government are being replaced as they reach the end of their useful lives. This is one of the existing three financial sustainability ratios.

The Asset Sustainability Ratio has some limitations in that large expenditure on a particular asset class can skew the results. Therefore, a proposed change for the reporting on the Asset Sustainability Ratio is for it to be broken down by infrastructure asset type. A break-down by infrastructure asset type enables both council and its stakeholders to get a better understanding of the investment in renewals of different asset classes and identify where investment may need to be prioritised. It is proposed that the infrastructure asset classes and relevant information reported in council's Property, Plant and Equipment note in their GPFS (excluding assets under construction) is the basis for this calculation.

The Asset Consumption Ratio is an indicator of extent to which an asset has been consumed. Collectively these two ratios will indicate the extent that assets being consumed are being replaced.

Leverage Ratio and Debt per Capita:

The Leverage Ratio is an indicator of a council's ability to repay its existing debt. The Debt per Capita is an indicator of a council's borrowings relative to the size of its rate base

Councils will only be required to calculate and report on these ratios if they have debt.

Detailed information about the rationale for, calculation of, and target benchmarks for each ratio is contained in Appendix A.

Question 6

Are there other financial and asset sustainability measures that should be required to be reported on by councils?

Question 7

Do you support a five-year rolling average for the operating surplus ratio and Operating Cash Ratio? Should this be expanded to other financial and asset sustainability ratios?

Question 8

Do you foresee any difficulties for your council reporting on the asset sustainability ratio by infrastructure asset class?

Question 9

Do you have any feedback on the proposed transition timeframe to implement the asset renewal ratio?

Question 10

Do you think a debt per capita or debt per rateable property ratio provides insight into a council's financial sustainability?

3.3 Target Benchmarks

The current approach to measuring financial sustainability provides a single target benchmark for each financial sustainability ratio. The current financial sustainability ratios and associated target benchmarks are set out in Table 6.

Current Measures	Target Benchmark
Operating Surplus Ratio	0% - 10%
Asset Sustainability Ratio	>90%
Net Financial Liabilities Ratio	<60%

Table 6: Current Financial Sustainability Ratios and Target Benchmarks

Acknowledging the differences between councils, it's proposed that for all sustainability measures except Operating Cash Ratio, target benchmarks are tailored based on the different groups of councils and set at a level appropriate for each group. Different target benchmarks enables councils and their communities to understand their council's sustainability taking into consideration their operating environment.

Table 7 sets out the proposed financial and asset ratios and target benchmarks to apply to each proposed local government group.

Group	Operating Surplus Ratio	Operating Cash Ratio (EBIDA)	Unrestricted Cash Expense Cover Ratio	Asset Renewal Ratio	Asset Sustainability Ratio	Asset Consumption Ratio	Leverage Ratio	Debt per Capita
Very Large	0% to 10%	> 0%	2 to 4 months	90% to 110%*	N/A*	N/A*	< 4 times	< $4,000
Large	0% to 10%	> 0%	3 to 6 months	90% to 110%*	N/A*	N/A*	< 4 times	< $4,000
Medium	-2% to 10%	> 0%	3 to 12 months	**	> 90%**	> 60%**	< 3 times	< $4,000
Small	-5% to 10%	> 0%	6 to 12 months	**	> 90%**	> 60%**	< 3 times	< $4,000
Very Small	-10% to 10%	> 0%	6 to 12 months	N/A	> 90%**	> 60%**	< 3 times	< $4,000
Indigenous	-10% to 10%	> 0%	6 to 12 months	N/A	> 90%**	> 60%**	< 3 times	< $4,000

* Very Large and Large group councils are required to publish the Asset Renewal Ratio

** Medium and Small group councils have the option of either publishing the Asset Renewal Ratio **or** publishing both the Asset Sustainability Ratio and Asset Consumption Ratio during the transition period. If a council does not to publish the Asset Renewal Ratio, it must include an explanation of why it is unable to report on this ratio.

Table 7: Proposed Financial and Asset Ratios and Target Benchmarks

Rationale for proposed target benchmarks

Operating Surplus Ratio:

The minimum target benchmark has been progressively reduced to negative 10 per cent from zero per cent in acknowledgement of the reduced revenue-generation ability of smaller councils and the correspondingly larger role grant funding plays in supplementing these councils' capital programs. It is proposed that this ratio be reported as both a single year result and on a historical five-year rolling average.

Operating Cash (EBIDA) Ratio:

The target benchmark for all groups is set at a minimum of zero as all councils (even those with a high reliance on external funding for operational and capital purposes) should be operating their core business at least break-even. It is proposed that this ratio be reported as both a single year result and on a historical five-year rolling average.

Unrestricted Cash Expense Cover Ratio:

The target benchmarks for different groups of local governments ranges from 2 months to 12 months. This acknowledges the different capacities councils have to generate cash and the base cost of running a council regardless of size.

Asset Sustainability Ratio:

The benchmark for this ratio will remain the same for all councils required to report on it. A council with an Asset Sustainability Ratio too far below 90 per cent is unlikely to be sufficiently maintaining, replacing, or renewing existing infrastructure assets as they are depreciated, potentially resulting in a renewals backlog and reduced levels of service delivery to the community. It is proposed that this ratio be calculated for individual infrastructure asset types so that results are not skewed by significant investment in certain asset types to the detriment of others.

Asset Consumption Ratio:

A minimum benchmark of 60 per cent indicates that a council's assets are being broadly consumed in line with their estimated useful lives. A lower ratio may however not be a cause for concern where a council is operating sustainably and is responsibly maintaining, replacing, and renewing its assets in accordance with a well-prepared asset management plan.

Asset Renewal Ratio:

The benchmark of 90 per cent to 110 per cent was set based on comparisons of other jurisdictions using this measure. A ratio which is too far above or below 100 per cent suggests a mismatch between a council's capital investments compared with its actual needs. Reporting on this ratio initially will only be required for very large and large councils.

Leverage Ratio:

At a leverage ratio of greater than 3, medium and smaller councils are more likely to experience difficulties in servicing their borrowings, which in turn affects service delivery to the community as well as future capital investment. Larger councils, with bigger ratepayer bases, have the capacity to service higher levels of borrowings, and therefore a higher target benchmark is considered appropriate.

Debt per Capita:

A maximum of $4,000 per person is suggested as a reasonable maximum for all councils, above which a community is more likely to experience adverse intergenerational impacts from excessive debt levels.

Question 11

Do you agree with the proposed target benchmarks for the different groups of councils?

Question 12

Do you think implementing the new ratios for the 2022-2023 reporting is appropriate?

Question 13

What training and guidance material would assist your council to implement the proposed financial and asset ratios?

4. Have your Say

The discussion paper poses various questions for your consideration and welcomes your written feedback on some or all the questions raised. You can email any submissions, questions, or concerns to **lgsustainability@dsdilgp.qld.gov.au** with the subject line '2021 Sustainability Framework Feedback'.

The feedback period on this discussion paper has been extended to Tuesday, 30 November 2021 .

The department will also be attending Regional Organisations of Councils (or similar) meetings, local government professional forums and conferences to discuss this review directly with councils.

A list of the questions posed throughout this discussion paper is set out below:

Question 1: Do you consider the proposed elements of the framework:

- capture the core areas that impact a councils' sustainability?
- appropriately reflect the varied nature and circumstances of Queensland's local governments?

Question 2: Are some of the proposed sustainability elements more important than others and therefore should be given a higher priority?

Question 3: Do you support the proposed grouping of councils by population under the Sustainability Framework?

Question 4: Is population a sound basis for grouping councils for sustainability monitoring and reporting?

Question 5: Is there another way to group councils that you consider more appropriate for the purpose of sustainability monitoring and reporting sustainability that will stand the test of time and evolving nature of Queensland councils?

Question 6: Are there other financial and asset ratios that should be required to be reported on by councils?

Question 7: Do you support a five-year rolling average for the Operating Surplus Ratio and Operating Cash Ratio? Should this be expanded to other financial and asset sustainability measures?

Question 8: Do you foresee any difficulties for your council reporting on the asset sustainability ratio by infrastructure asset class?

Question 9: Do you have any feedback on the proposed transition timeframe to implement the asset renewal ratio?

Question 10: Do you think a debt per capita or debt per rateable property ratio provides insight into a council's financial sustainability?

Question 11: Do you agree with the proposed target benchmarks for the different groups of councils?

Question 12: Do you think implementing the new ratios for the 2022-2023 reporting is appropriate?

Question 13: What training and guidance material would assist your council to implement the proposed financial and asset ratios?

Appendix A: Proposed Financial and Asset Ratios

The following are the proposed financial and asset ratios for the Queensland local government sector. Councils will be required to calculate and publish these ratios in their GPFS. The calculation of these ratios would continue to be audited annually by the QAO.

It is proposed to increase the number of ratios from three to eight. The new ratios will include a liquidity ratio as well as more meaningful operational, asset, and debt servicing ratios to provide greater context about council performance.

Further guidance about the definition and calculation of these measures will be provided in the revised statutory guideline document expected to be published in early 2022.

Operating Surplus Ratio (unchanged)

This measure is carried over from the 2013 Guidelines. The operating surplus ratio is an indicator of the extent to which revenues raised cover operational expenses only or are available for capital funding or other purposes. It is proposed that this ratio be reported as both a single year result and on a historical five-year rolling average.

Calculation

$$\frac{\text{Operating Result}}{\text{Total Operating Revenue}}$$

The calculation of this ratio only considers a council's operational revenues and expenditures (i.e., capital items are excluded).

Target Benchmark

The minimum target benchmark has been progressively reduced to negative 10 per cent from zero per cent in acknowledgement of the reduced revenue-generation ability of smaller councils and the correspondingly larger role grant funding plays in supplementing these councils' capital programs. The table below shows the proposed benchmarks for different groups of councils:

Proposed Operating Surplus Ratio Target Benchmarks by Council Group

Group	Target benchmark
Very Large	0% to 10%
Large	0% to 10%
Medium	-2% to 10%
Small	-5% to 10%
Very Small	-10% to 10%
Indigenous	-10% to 10%

Operating Cash (EBIDA) Ratio (new)

This is a new measure. The Operating Cash Ratio is an indicator of a council's ability to cover its core operational expenses (not including depreciation, amortisation and financing costs). which may or may not cover capital funding requirements. It is proposed that this ratio be reported as both a single year result and on a historical five-year rolling average

Calculation

$$\frac{\text{Operating Result add Depreciation and Amortisation add Finance Costs charged by QTC}}{\text{Operating Revenue}}$$

The numerator of this ratio calculation includes all operational expenditure except for depreciation and amortisation and finance costs associated with borrowings.

Target Benchmark

The target benchmark for all groups is set at a minimum of zero as all councils (even those with a high reliance on external funding for operational and capital purposes) should be operating their core business at least break-even.

Unrestricted Cash Expense Cover Ratio (new)

This is a new measure. The unrestricted cash expense cover ratio is an indicator of the unconstrained liquidity available to a council to meet ongoing and emergent financial demands. This is a key solvency indicator.

Calculation

$$\frac{\text{(Total Cash and Equivalents add Current Investments add Available Ongoing QTC Working Capital Facility Limit less Externally Restricted Cash)}}{\text{(Total Operating Expenses less Depreciation and Amortisation less Finance Costs charged by QTC)}} \times 12$$

The numerator of this ratio calculation does not exclude internally restricted cash as it is assumed that a council is able to access and repurpose these funds if needed.

Available ongoing working capital facility limits are included in acknowledgement of the ability of councils to draw on these funds as required for repayment at a later date, however facilities with an expiry date are not included as these are temporary in nature and less likely to be sustained into the future.

Target Benchmark

The target benchmarks for different groups of local governments ranges from 2 months to 12 months. This acknowledges the different capacities councils have to generate cash and the base cost of running a council regardless of size.

Proposed Unrestricted Cash Expense Cover Ratio Target Benchmarks by Council Group

Group	Target benchmark
Very Large	2 to 4 months
Large	3 to 6 months
Medium	3 to 12 months
Small	6 to 12 months
Very Small	6 to 12 months
Indigenous	6 to 12 months

The target benchmark ranges indicate a comfortable minimum liquidity level for councils. The upper limit indicates where councils may be unnecessarily accumulating cash, underinvesting in community assets and/or setting their rates too high.

Asset Renewal Ratio (new)

This is a new measure. The Asset Renewal Ratio represents the extent to which required capital expenditure on renewals as set out in a council's asset management plans, has been incorporated into its 10-year financial forecasts.

The Auditor-General's 2016 Report to Parliament Forecasting long-term sustainability of local government recommended that the department include the Asset Renewal Ratio as part of its sustainability measures once local governments have improved their asset condition data.

The department recognises the differing circumstances and capacities of councils and that not all councils are currently able to report on this ratio. Therefore, the requirement to report on the Asset Renewal Ratio will initially not be mandatory for all councils.

Reporting on the Asset Renewal Ratio will be implemented over a phased transition period to give councils sufficient time to develop processes to capture the requisite asset data. A councils grouping will determine when it will be required to report on the Asset Renewal Ratio.

While reporting on this ratio initially will only be required for very large and large councils, all councils may choose to report on it at any time.

Councils who do not report on the Asset Renewal Ratio will be required to report on both the Asset Sustainability and Asset Consumption Ratio, along with an explanation of why the asset renewal ratio was unable to be calculated.

During the transition period, the department will work with councils to improve their asset management capability to enable them to report on this ratio in time for audit by the QAO.

Calculation

$$\frac{\text{Net Present Value of } \textbf{Planned} \text{ Capital Expenditure on Asset Renewals over 10 years}}{\text{Net Present Value of } \textbf{Required} \text{ Capital Expenditure on Asset Renewals over 10 years}}$$

The calculation of this ratio requires a council to have reasonably rigorous asset management planning and financial forecasting in place. Additionally, a suitable discount rate will need to be selected to accurately calculate the necessary net present values in the numerator and denominator.

Target Benchmark

The benchmark of 90 per cent to 110 per cent has been proposed based on comparisons of other jurisdictions using this measure. Over- or under-investment in capital results in undesirable outcomes for communities in either service delivery or maintenance of unnecessary assets.

Proposed Asset Renewal Ratio Target Benchmarks by Council Group

Group	Target benchmark
Very Large	90% to 110%
Large	90% to 110%
Medium	**
Small	**
Very Small	N/A
Indigenous	N/A

** Medium and Small group councils have the option of either publishing the Asset Renewal Ratio **or** publishing both the Asset Sustainability Ratio and Asset Consumption Ratio during the transition period. If a council does not to publish the Asset Renewal Ratio, it must include an explanation of why it is unable to report on this ratio.

Asset Sustainability Ratio (unchanged)

This measure is carried over from the 2013 Guidelines and will be optional for those councils who publish the Asset Renewal Ratio. The Asset Sustainability Ratio is an approximation of the extent to which the infrastructure assets managed by a council are being replaced as they reach the end of their useful lives.

A limitation of this ratio is that large expenditure on a particular asset class can skew the results. Therefore, a proposed change for the reporting on the Asset Sustainability Ratio is for it to be broken down by infrastructure asset type. It is proposed that the infrastructure asset classes reported on for this measure are based on council's Property, Plant and Equipment note included in their GPFS (excluding assets under construction).

Calculation

$$\frac{\text{Capital Expenditure on Replacement of Assets (Renewals)}}{\text{Depreciation Expenditure}}$$

Where these can be accurately ascertained, a council must use capital expenditure and depreciation figures for its individual infrastructure asset groups only.

Target Benchmark

The benchmark for this ratio will remain the same for all councils required to report on it. A council with an Asset Sustainability Ratio too far below 90 per cent is unlikely to be sufficiently maintaining, replacing, or renewing existing infrastructure assets as they are depreciated, potentially resulting in a renewals backlog and reduced levels of service delivery to the community

A key exception to this is the case of growing councils which are investing heavily in new infrastructure, where a low ratio is not considered a concern provided existing assets are also being appropriately maintained, replaced, and renewed.

Asset Consumption Ratio (new)

This is a new measure. Councils who do not report the Asset Renewal Ratio will be required to report on this ratio (and the Asset Sustainability Ratio). The Asset Consumption Ratio is an indicator of the extent to which an asset has been consumed.

Calculation

$$\frac{\textbf{Written Down}\text{ Replacement Cost of Depreciable Assets}}{\textbf{Current}\text{ Replacement Cost of Depreciable Assets}}$$

The calculation of this ratio requires a defensible estimate of the replacement cost for a council's assets as at the reporting date.

Target Benchmark

A minimum benchmark of 60 per cent indicates that a council's assets are being broadly consumed in line with their estimated useful lives. A lower ratio may however not be a cause for concern where a council is operating sustainably and is responsibly maintaining, replacing, and renewing its assets in accordance with a well-prepared asset management plan.

Leverage Ratio (new)

This is a new measure. Councils will only be required to report on this ration if they have debt with Queensland Treasury Corporation (QTC). The leverage ratio is an indicator of a council's ability to repay its existing debt.

Calculation

$$\frac{\textbf{Book Value}\text{ of Debt}}{\text{Operating Cash (EBIDA)}}$$

This ratio is calculated using the book value of a council's borrowings (rather than the market value), which provides a more accurate picture of a council's leverage and is less affected by change in prevailing interest rates.

Target Benchmark

At a leverage ratio of greater than 3, medium and smaller councils are more likely to experience difficulties in servicing their borrowings, which in turn affects service delivery to the community as well as future capital investment. Larger councils, with bigger ratepayer bases, have the capacity to service higher levels of borrowings, and therefore a higher target benchmark is considered appropriate. The table below sets out the proposed target benchmarks by council group.

Proposed Leverage Ratio Target Benchmarks by Council Group

Group	Target benchmark
Very Large	< 4 times
Large	< 4 times
Medium	< 3 times
Small	< 3 times
Very Small	< 3 times
Indigenous	< 3 times

These target benchmarks indicate debt levels above which councils are more likely to experience difficulties in servicing their borrowings, in turn affecting service delivery to the community as well as future capital investment.

Debt per Capita (new)

This is a new measure and is only required for councils who have QTC debt. Debt per capita is an indicator of the suitability of a council's borrowings relative to the size of its rate base.

Calculation

$$\frac{\textbf{Book Value} \text{ of Debt}}{\text{Estimated Population}}$$

This ratio is calculated using the book value of a council's borrowings (rather than the market value), which provides a more accurate picture of a council's leverage and is less affected by change in prevailing interest rates. A council will also need a defensible estimate of its population as at the reporting date to serve as the denominator for the calculation.

Target/Benchmark

A maximum of $4,000 per person is suggested as a reasonable maximum for all councils, above which a community is more likely to experience adverse intergenerational impacts from excessive debt levels.

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