



Government of **Western Australia**
Department of **Local Government**

LONG TERM FINANCIAL PLANNING

FRAMEWORK AND GUIDELINES

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Department of Local Government

GPO Box R1250, Perth, WA 6844

Telephone: (08) 9217 1500 ((08) 6552 1500 from 27 June 2011)

Fax: (08) 9217 1555 ((08) 6552 1555 from 27 June 2011)

Free call: 1800 620 511 (Country Only)

Email: info@dlg.wa.gov.au

Website: www.dlg.wa.gov.au



Australian Government

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FOREWORD

It is my pleasure to introduce the *Long Term Financial Planning Framework and Guidelines* for Western Australian Local Governments.

The Framework was developed in consultation with the local government sector and is an important tool for local governments to manage their services and assets in a sustainable way.

The Framework provides general guidance to assist local governments in developing financial plans that meet the long term aspirations of their communities.

It also highlights the fundamental link between long term financial planning, asset management, workforce planning and strategic planning; and will provide local governments with practical guidance on how to fully integrate these different components.

The Framework is supported by the *Model Long Term Financial Plan* issued as an appendix which is available on the Department's website (www.dlg.wa.gov.au).

It is my intention to amend the *Local Government Act 1995* and regulations to promote integrated planning and ensure that long term financial planning, asset management planning and workforce planning become standard business practices for all local governments.

These Framework and Guidelines are an important part of the improvements being adopted by the sector to embed sustainable practices. I commend the *Long Term Financial Planning Framework and Guidelines* to assist all local governments to achieve best practice in their financial planning.



Hon G M (John) Castrilli MLA

**MINISTER FOR LOCAL GOVERNMENT; HERITAGE;
CITIZENSHIP AND MULTICULTURAL INTERESTS**

LONG TERM FINANCIAL PLANNING FRAMEWORK AND GUIDELINES

The background is a solid teal color with several overlapping, semi-transparent circles of varying shades of teal. In the lower half, there are several thin, white, curved lines that sweep across the page, creating a sense of motion and depth. The overall aesthetic is modern and professional.

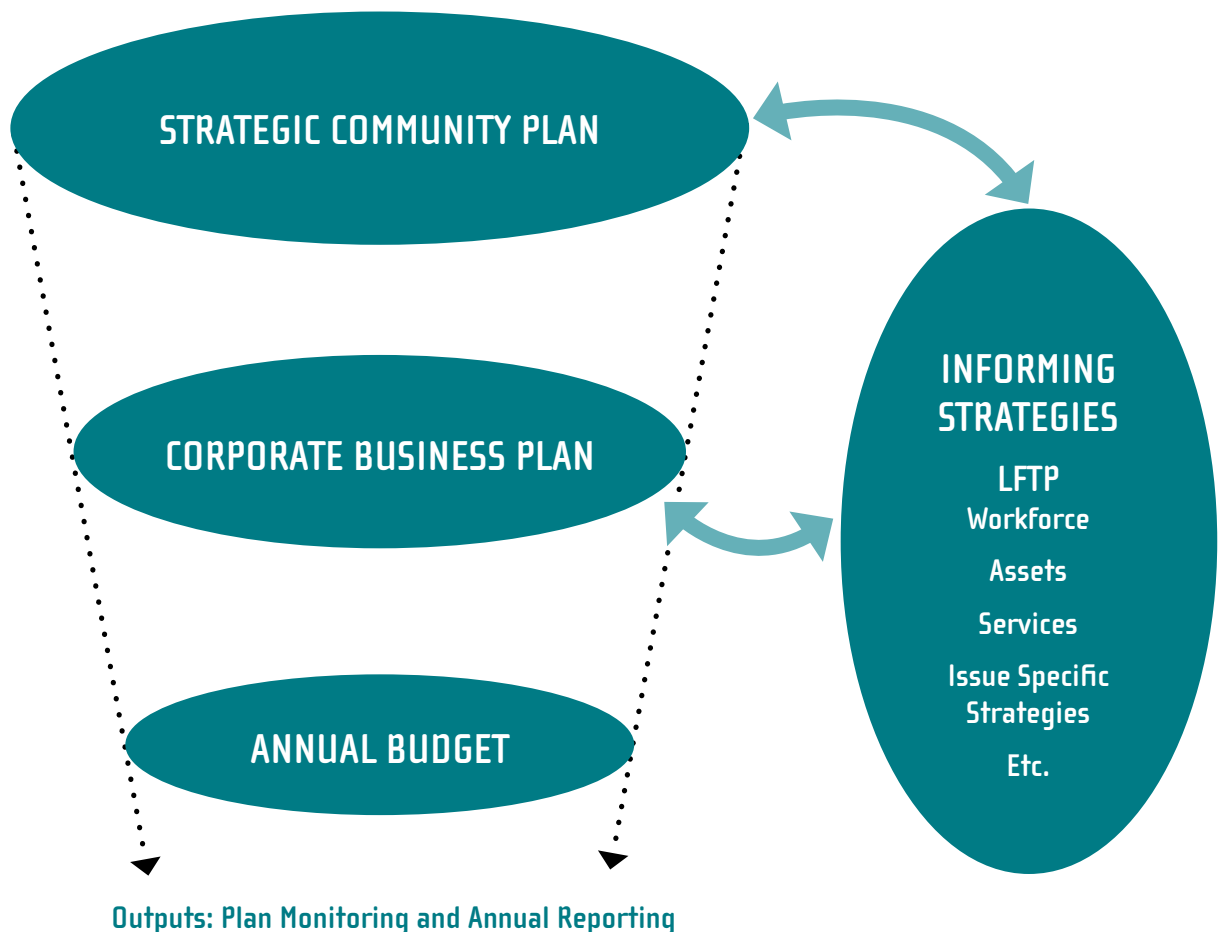
1. INTRODUCTION

Long term financial planning is a key element of the Integrated Planning and Reporting Framework. It enables local governments to set priorities, based on their resourcing capabilities, for the delivery of short, medium and long term community priorities.

The Long Term Financial Plan (LTFP) is a ten year rolling plan that informs the Corporate Business Plan to activate Strategic Community Plan priorities. From these planning processes, Annual Budgets that are aligned with strategic objectives can be developed.

The LTFP indicates a local government's long term financial sustainability, allows early identification of financial issues and their longer term impacts, shows the linkages between specific plans and strategies, and enhances the transparency and accountability of the Council to the community.

The following figure illustrates how the LTFP informs the Integrated Planning and Reporting Framework:



2. PURPOSE OF GUIDELINES

The Long Term Financial Planning Framework and Guidelines outline a suggested methodology for local governments to develop a LTFP to inform the Corporate Business Plan.

The LTFP should be a high-level document that can be easily understood by the community.

The high-level LTFP should be supported by detailed spreadsheets and other information that would usually be prepared for internal use, although not included in the published plan.

A LTFP can be presented separately as part of a range of other informing plans and documents, or can be included in the Corporate Business Plan document.

Alternatives to the methodology and format suggested in these Guidelines can be used, but as a minimum the LTFP should include 10 year financial forecasts comprising:

- Forecast income statement.
- Statement of cash flows.
- Rate setting statement.
- Statement of financial position.
- Equity statement.

These statements must be supported by:

- Details of assumptions on which the plan has been developed.
- Projected income and expenditure.
- Methods of measuring performance - Key Performance Indicators (KPIs).
- Scenario modelling and sensitivity analysis.
- Major capital works schedules.
- Risk assessments of major projects.

Larger local governments may develop more detailed and complex plans.

The Long Term Financial Planning Framework and Guidelines should be read in conjunction with the *Western Australian Local Government Accounting Manual (Edition 2)*.

A Model Long-term Financial Plan is available on the Department's website as an appendix to these Guidelines.

3. FORECASTING ISSUES

Forecasting aims to quantify the future impacts of current decisions and identify the available options to close the gap between revenues and expenditure. It informs decision making and priority setting, and assists in the management of the local government's response to community growth or contraction. It also assists in the management of cash flows and funding requirements, community assets and risk.

To be useful, forecasting should use the most current information available. Forecasting processes should be accurate, reliable and easily understood, and forecasts should be regularly reviewed and updated.

Critical considerations in forecasting include:

- The purpose of the forecast.
- The level of accuracy required.
- Who to involve in data gathering and preparing forecasts.
- The frequency of reviews to ensure currency of information.
- The internal systems required to bring processes together.
- Across organisation reporting.
- Identification of data sources and indices.
- Inclusion of 'whole-of-life' costing for major projects.
- Comprehensive Asset Management Plans.
- The ability to interpret historical data and forecast financial ratios.

Robust forecasts should underpin the 10 year LTFFP. There should be a high level of accuracy in the forecasts for the first 2 or 3 years, a good level of accuracy for years 4 and 5 and a reasonable level of accuracy for the remaining 5 years of the plan.

4. RISK MANAGEMENT

A local government's activities expose it to a variety of risks which need to be considered in preparing the LTFF. Asset Management Plans should identify assets that are critical to a local government's operations and outline specific risk management strategies for these assets.

However, long term planning in a dynamic environment has to accommodate some level of uncertainty. For specific projects, the ability to accurately define risks over a long period may be hampered by uncertainties surrounding the availability of funding such as grants. Uncertainty can be dealt with in two ways:

- By identifying priority projects and focusing on these.
- By defining a period of the project plan during which certainty is required. This is necessary as project lead times for consultation, design, grant applications and funding confirmation can often take 2 years with project delivery occurring in Year 3 with the possibility of carry-over into Year 4.

When long term planning is undertaken, the key risks to projects are:

- Approvals – projects may require approvals from agencies such as the Department of Environment and Conservation or the Western Australian Planning Commission. When a project is some years away, it is not possible to determine the outcome of such applications in advance, particularly where the future extent of activities such as land clearing is not well defined.
- Land acquisition – if a project relies on land acquisition, its viability can be affected by land price movements.
- Funding – many projects are funded through grants. It is often not possible to submit grant applications several years in advance, and a subsequent failure to receive grant funding may severely affect the ability of the local government to deliver a project.

The timescale of a long term plan makes it impractical to attempt to identify and manage all risks for all projects included in the plan.

Risk management assessment should be undertaken in accordance with the International Risk Management standard - *ISO 31000 Risk Management*.

5. STARTING THE PROCESS – ASSUMPTIONS UNDERPINNING THE LTFP

A decision has to be made on the level from which the LTFP will be developed. This could be on a detailed Chart of Accounts basis, or from an activity or program level. Whichever level is chosen, it should allow modelling to be undertaken to test the local government's ability to deliver community services and assets under various scenarios.

An initial model should show the local government's position over the next 10-years without any changes to current policy. Further models should explore alternative community priority scenarios, so that the local government can determine (and the community can see) if, and how, those various community priority scenarios could be resourced.

In any planning or review process, a number of assumptions will need to be made, and these will form a foundation for the development of the plan.

Changes in the internal and external environments will impact on the operations of local governments. A local government may be able to control or influence most of the internal impacts, but has little influence over external factors.

Internal factors can include community expectations, financial capacity, service delivery areas and levels, infrastructure needs and asset quality, and the local government's capabilities and resources. External factors could include changes in population and demographics such as age dispersion, income and unemployment levels, diversity of the local economy, economic growth, legislative requirements and government policy.

Assumptions relating to internal and external influences will need to be made in the development of the LTFP, and these should be documented and explained in the plan.

Although a significant number of examples are detailed below, it is better for a local government to thoroughly understand the key assumptions it has used in developing its LTFP, and have the ability to change these over time, than it is to expend resources and effort on the analysis of a wide range of variables for which accurate current information may not be available.

Assumptions could include those made on the basis of:

- **A demographic analysis of the local government area**

Examines past demographic trends and anticipates future changes that will impact the LTFP. It may involve:

- Examination of population data over the past 10 years, identifying any demographic trends and reasons for these, and projecting likely trends over the next 10 years.
- Determining the impact of an ageing population on future service needs.
- Identifying demographic changes occurring in neighbouring local governments that could impact on the local government.

- **Economic growth and development of the local government area**

Identifies economic growth and development issues that could impact in the future. It may involve:

- Analysis of economic growth over the past 10 years, identifying any trends and reasons for these, and projecting likely trends over the next 10 years.
- Analysis of any local government plans that will affect future economic growth.
- Anyalsis of the impacts of population and demographic changes on economic growth.
- Identifying new industrial or business subdivisions or developments that will affect economic growth.

- **National / state economic factors**

Identifies national and state factors that will have impacts. Analysis could include:

- Future inflation forecasts (ABS or treasury forecasts).
- Interest rate movements – over the past 10 years and forecasts for the next 10 years (WATC forecasts).
- Any known state or federal government policies that will impact in future.

- **Service delivery and service levels**

Service delivery and service levels are critical to any financial forecasts. Service levels are the link between community needs and the cost of providing the services to meet those needs. Increased service levels are likely to involve increased costs. Considerations could include:

- Will the existing services and level of service delivery be maintained?
- Do the Strategic Community Plan or Asset Management Plans indicate a change in service levels?
- What is included in the Strategic Community Plan that may impact service delivery?
- Will new services be implemented (for example, seniors' services for an ageing population)?
- What is included in existing service plans that could affect service delivery (for example, a Recreation Plan, Active Ageing Plan, Paths and Trails Plan and the like)?

- **Major planned expenditure and capital works**

- Major expenditures and capital works included in the Strategic Community Plan and Asset Management Plan should be included in the assumptions detailed in the LTFP.

- **Financial strategies**

A local government may need to make assumptions based on the financial strategies underpinning the LTFP. These could include:

- Continuous improvement in the financial position of the local government.
- The achievement or maintenance of operating surpluses each year.
- The maintenance of a fair and equitable rating structure.
- Maintaining or improving service level standards.
- Reliance on debt to fund capital works.
- Maintenance of cash reserves for future commitments.
- Increasing funding for asset maintenance and renewal.
- Achieving full cost recovery for provision of services.

Revenue and expenditure forecasts can be developed using the assumptions adopted.

6. REVENUE PROJECTIONS

The principal sources of revenue for local governments are rates and service charges, user charges and fees, grants, contributions and donations, interest on investments, net gains on the disposal of assets, and 'other revenue'. Each of these sources needs to be assessed in light of the relevant assumptions and the Strategic Community Plan to forecast future revenues.

- **Rates and service charges**

Matters to consider could include:

- The impact of the local government's rating policy.
- Is the basis of rates suitable (UV / GRV)?
- Are there inequities that need to be addressed and which will impact on revenue levels (for example, significant non-rural activities on rural land that should be rated on GRV)?
- Are there new or planned subdivisions or developments that will impact on rate growth?
- What annual increases should be applied?
- Are there specific works, services or facilities to be provided by the local government for which special area rates are likely to be introduced?
- Are there economic factors that will impact on rate collections (and hence cash flows)
 - for example, industry downturns?
- Are late payment penalty interest rates sufficient?
- Should statutory service charges be introduced or reviewed?
- Is the local government's rate coverage ratio sufficient?

The LTFP should include details of how rates and service charges have been calculated over the period and details of the assumptions applied.

- **User charges and fees**

Matters to consider could include:

- To what extent are user charges and fees based on user-pays and full cost recovery principles?
- Are there new services proposed for which new fees can be introduced?
- Are there existing services for which fees should be introduced?
- Do existing fees need to be reviewed?
- Do existing fees cover costs?

- **Grants**

Matters to consider could include:

- Are special grants programs likely to continue in the future (for example Roads to Recovery)?
- Are there capital or operating grants available for new services or planned infrastructure?
- What is the long term estimate for FAG grants and untied road grants? What is the likely future impact if these are planned to reduce?
- If existing grants are withdrawn, how would this impact the local government's service delivery?
- Can the local government achieve any matching criteria that may apply to grants?

- **Contributions and donations**

Matters to consider could include:

- Is there a likelihood of increasing or decreasing contributions and donations?
- Are there opportunities to introduce new developer contributions?

- **Interest revenue**

Matters to consider could include:

- How will the local government's investment policy affect likely income from investments?
- Are there likely to be cash flow issues that will positively or negatively impact on investment revenue (for example, an increase in outstanding rates debtors, or a reduction in available cash reserves)?
- What are forecast future interest rates?

- **Net gain on disposal of assets**

The local government's Asset Management Plans should detail assets it plans to sell. Based on past experience, an estimate of gains on similar assets disposed could be determined.

- **Other revenue**

Matters to consider could include:

- What other revenue sources exist?
- Does the local government have the capacity to undertake private works to increase revenue?
- Can the local government provide services to neighbouring local governments?
- Does the local government have underutilised assets (buildings) that can be leased commercially?
- Does the local government have surplus road making materials that could be sold?

7. EXPENDITURE PROJECTIONS

The local government will need to consider its regular and ongoing expenditure commitments arising from existing services and operations. Asset Management Plans, the Workforce Plan, loan repayments on existing borrowings (and proposed new borrowings) and existing contractual commitments are useful sources of information. New capital projects and additional services included in the Strategic Community Plan will also need to be costed.

- **Employee costs**

Matters to consider could include:

- Existing staff FTE numbers and if increases or decreases in FTEs are anticipated over the life of the plan.
- Anticipated wage and salary increases, including likely new enterprise agreement impacts.
- Are there future government policy decisions that will impact on employee costs (for example, increases in Superannuation Guarantee costs)?
- Will the local government's past claims experience impact on future workers' compensation insurance premiums?

- **Materials and contracts**

Matters to consider could include:

- New or proposed changes in service delivery.
- Changes in the cost of materials and contract rates.

- **Utilities**

Matters to consider could include:

- New or proposed buildings, parks, street lighting and the like.
- Impacts of proposed energy and water efficiency programs.

- **Depreciation**

Depreciation costs should be sourced from the local government's Asset Management Plans.

- **Interest expense**

Matters to consider could include:

- The local government's debt policy.
- The local government's debt ratio and debt service ratios – compared to benchmarks.
- Loan repayments on existing borrowings (and proposed new borrowings).
- Proposed draw-down dates.
- Loan terms.
- Forecast future interest rates (WATC).

- **Insurance**

Matters to consider could include:

- Values of new insurable assets to be developed.
- Revaluations of insurable assets.
- Past claims experience that may affect future premiums.
- Any new insurances planned.

- **Other expenditure**

Matters to consider could include:

- Statutory fees including ESL levies.
- Membership fees or levies.
- Provision for bad debts.
- Donations and subsidies to community groups.

- **Net loss from disposal of assets**

The local government's Asset Management Plans should detail assets that are planned to be sold. Based on past experience, an estimate of losses on similar assets disposed could be determined.

8. ASSET MANAGEMENT

Asset Management Plans should contain a complete record of a local government's infrastructure and other fixed assets and include 'whole-of-life' costings that incorporate operating, scheduled maintenance and depreciation costs, capital costs incurred on renewals, replacement costs on asset retirement and costs involved in expanding the asset base.

Asset Management Plans provide information on cost/value, depreciation, residual value and useful life that is used in the accounting process for financial reporting. They also have an essential role in providing information for accurate and effective long term financial planning.

For a local government to be financially sustainable, it needs to be able to maintain the condition of its infrastructure and non-current assets at predetermined levels in order to deliver services to the community over the longer term. The consumption of assets should not exceed asset renewal or replacement based on Fair Value. Investment in new assets when existing assets are not being maintained adequately should be avoided.

The 'whole-of-life' costing of assets is therefore important in achieving financial sustainability, and so it is critical that the LTFP include 'whole-of-life' financial forecasts from the Asset Management Plans.

The LTFP should also consider options to fund, or reduce, future asset management costs. Rate increases is one funding option, however, better management of assets may reduce future costs. Possible asset management initiatives could include rationalising assets, improving the efficiency of assets, or increasing their utilisation. It may also be possible to consider the use of debt, undertake cost/benefit analysis of services provided, and reassess service levels and standards.

9. WORKFORCE PLANNING

A comprehensive Workforce Plan is a key component of local government service delivery.

The plan details the human resourcing requirements to deliver local government operations and how those requirements will need to change over the short and long terms to meet the priorities set by Council, and the aspirations of the community as detailed in the Strategic Community Plan.

A fully-costed Workforce Plan will inform the LTFP.

10. PERFORMANCE MEASURES

Local governments should develop key performance indicators (KPIs) to measure performance against the LTFP and Annual Budget and to assess their long-term financial sustainability.

KPIs included in the LTFP provide performance measures against which a local government can report its progress to the community.

A number of statutory KPIs focusing on financial and asset management performance will be regulated. Other financial sustainability measures can also be developed by individual local governments, however, these need to be simple, measurable and understandable.

The statutory KPIs, which will specify performance targets, will require local governments to report on:

Ratio	What it Measures
<ul style="list-style-type: none"> Current Ratio 	<ul style="list-style-type: none"> A measure of a local government's liquidity and its ability to meet its short term financial obligations from unrestricted current assets.
<ul style="list-style-type: none"> Operating Surplus Ratio 	<ul style="list-style-type: none"> An indicator of the extent to which revenue raised not only covers operational expenses, but also provides for capital funding.
<ul style="list-style-type: none"> Rates Coverage Ratio 	<ul style="list-style-type: none"> An indicator of a local government's ability to cover its costs through its own tax revenue efforts.
<ul style="list-style-type: none"> Debt Service Cover Ratio 	<ul style="list-style-type: none"> An indicator of a local government's ability to generate sufficient cash to cover its debt payments.
<ul style="list-style-type: none"> Asset Sustainability Ratio 	<ul style="list-style-type: none"> An indicator of the extent to which assets managed by a local government are being renewed or replaced as they reach the end of their useful lives.
<ul style="list-style-type: none"> Asset Consumption Ratio 	<ul style="list-style-type: none"> This ratio highlights the aged condition of a local government's physical assets.
<ul style="list-style-type: none"> Asset Renewal Funding Ratio 	<ul style="list-style-type: none"> Indicates whether the local government has the financial capacity to fund asset renewal at existing revenue and service levels.

11. SCENARIO MODELLING AND SENSITIVITY ANALYSIS

Scenario modelling will determine the level of flexibility in the LTFP to inform the local government of the best strategy to adopt to meet community expectations should variations occur in a range of factors or assumptions.

Modelling should be undertaken on the basis of optimistic, conservative and worst case scenarios to understand the impacts of variation.

This modelling could, for example, focus on population growth, where different models would be prepared for rapid, moderate, or low growth.

Sensitivity analysis can be used to test the financial impacts of variations in the factors or assumptions underlying the plan.

Analysing the sensitivity of the LTFP to variations in assumptions such as CPI estimates, employee cost increments, interest rates, annual rate increases, recurrent grants, and others, will indicate those assumptions which have the greatest impact when varied.

This will assist a local government to ensure that the assumptions on which its LTFP is based are reasonable.

12. FORMAT OF LTFP

The following is a suggested format for a LTFP. This format is not mandatory, however, if local governments adopt their own format the LTFP should include, as a minimum, 10 year financial forecasts comprising:

- Forecast income statement.
- Statement of cash flows.
- Rate setting statement.
- Statement of financial position.
- Equity statement.

These statements must be supported by:

- Details of assumptions on which the plan has been developed.
- Projected income and expenditure.
- Methods of measuring performance - Key Performance Indicators (KPIs).
- Sensitivity analysis and financial modelling scenarios.
- Major capital works schedules.
- Risk assessments of major projects.

The LTFP should be updated annually and form the basis for the preparation of the following year's Annual Budget. The format suggested includes the statutory statements required to be included in Annual Budgets and Annual Reports to facilitate integration.

The suggested format could comprise the following:

12.1 BACKGROUND/COMMENTARY:

- An introduction to the plan including a brief description of the local government, its size and location within the state, demographics, available services and industries.
- Comment on the contents of the LTFP and how it links to the Strategic Community Plan, Corporate Business Plan, Asset Management Plans, Workforce Plan and other informing strategies, and Annual Budget.
- Details of existing services and infrastructure provided by the local government and whether there is any change of focus on specific services in the LTFP.
- Comment on asset management strategies.
- Comment on assumptions underpinning the plan including financial policies and strategies.
- Comment on each of the financial statements.
- Comment on the supporting schedules including operating revenue, operating expenditure and capital works schedules.
- Details of risk assessment.
- Comment on scenario modelling and sensitivity analysis.

12.2 FINANCIAL STATEMENTS (FORECASTS):

- Forecast income statement.
- Statement of cash flows.
- Rate setting statement.
- Statement of financial position.
- Equity statement.

12.3 SUPPORTING SCHEDULES:

- Schedule of new / capital works proposed.
- Schedule of assumptions underpinning financial forecasts.
- Schedule of income / expenditure estimates and assumptions used (e.g. CPI %)
- Schedule of key performance indicators (KPIs).
- Schedules and comments on scenario modelling and sensitivity analysis.

A model Long-term Financial Plan is available on the Department's website as an appendix to these Guidelines.

13. REVIEW

Local governments should develop a review schedule for the Strategic Community Plan and amend it based on performance information and changing circumstances.

As a minimum, a desktop review of the Strategic Community Plan should be undertaken every two years and a full review conducted every four years. This will ensure that community priorities are kept up to date and remain relevant.

The LTFP also needs to be reviewed in conjunction with the Strategic Community Plan so a local government can determine its capability to deliver any proposed changes in services and assets.

14. CONCLUSION

Long term financial planning is the mechanism that enables local governments to determine their capability to sustainably deliver the assets and services required by the community. It allows the local government to set priorities, within its resourcing capabilities, to deliver short, medium and long term community priorities.

The Framework and Guidelines provide details of the approach to be taken to undertake long term financial planning and the suggested minimum content of the subsequent Long Term Financial Plan.

The model Long Term Financial Plan Framework and Guidelines on the Department's website provides a practical example that can be adopted by local governments to assist them to achieve sustainable integrated planning outcomes.

15. GLOSSARY OF TERMS

The range of terminology that is used within the local government sector to describe the components and processes of integrated strategic planning can cause confusion. Terms that have been assigned a specific meaning within these Guidelines are defined below. These definitions aim to best describe an integrated strategic planning component or process in terms of its purpose, without restricting or mandating terminology.

Term	Definition
Annual Budget	A statutory requirement outlining the financial estimates to deliver the Corporate Business Plan.
Asset Management Plans	Plans that guide the use, acquisition and disposal of assets to make the most beneficial use of their service delivery potential and to manage related risks and costs over their entire life.
Corporate Business Plan	A local government's internal business planning tool that translates Council priorities into operations, within the resources available. The Corporate Business Plan details the services, operations and projects a local government will deliver over a defined period.
Equity statement	Equity is the net worth of a local government measured as the difference between the total assets and total liabilities as reported in the statement of financial position. The equity statement details equity by its various classes (retained surpluses, cash-backed reserves and revaluation reserves) and reconciles the opening and closing balances of each class of the local government's equity over the reporting period. It also provides a summary of changes in composition of the local government's equity and the causes of those changes.
Financial capital	Refers to the funding capacity of the local government as disclosed in the statement of financial position. This is usually the net difference between current assets and current liabilities.
Forecast income statement	A statement that includes revenue and expenditure projections over the 10 year life of the plan.
Infrastructure	The non-current physical asset base of the local government. This can be more specifically defined as the major asset classes that have significant service potential – roads, drains, bridges, footpaths, sewerage assets and public buildings.
Integrated Planning and Reporting	A framework for establishing community priorities and linking these to different areas of a local government's functions.

Term	Definition
Rate setting statement	A statement that details budgeted expenditure and revenue and shows how much rate revenue is required to cover the budget deficit. It can be in a format that includes rates as an income type based on assumptions used in developing the LTFP, to show the extent to which planned services and assets can be funded.
Scenario modelling	Preparation of forecasts or estimates in the LTFP on optimistic, conservative and worst case scenarios to understand the impact of variations in factors or assumptions.
Sensitivity analysis	Determines those factors or assumptions that if varied have greater impacts on the LTFP.
Statement of cash flows	A statement that shows how changes in a local government's expenses and income affect cash and cash equivalents, and breaks the analysis down to operating, investing, and financing activities.
Statement of financial position	A statement that reports the value of a local government's current and non-current assets, current and non-current liabilities and equity as at a particular date (usually the end of a financial reporting period).
Strategic Community Plan	The strategy and planning document that reflects the longer term (10+ years) community and local government aspirations and priorities.
Workforce Plan	A coordinated plan that addresses the human resourcing requirements to deliver local government operations.

16. REFERENCES

These Guidelines have been informed by and produced with reference to the following:

NSW Department of Premier and Cabinet, Division of Local Government: *Integrated Planning and Reporting Long Term Financial Plan*, December 2010.

QLD Department of Infrastructure and Planning: *Financial management (sustainability) guideline 2009*.

QLD Department of Infrastructure and Planning: *A guide to asset accounting in Local Governments*, 2010

WA Department of Local Government: *Integrated Planning and Reporting Framework and Guidelines*, October 2010.

CONTACTS

For further information on long term financial planning contact:

Department of Local Government

GPO Box R1250, Perth, WA 6844

Telephone: (08) 9217 1500 ((08) 6552 1500 from 27 June 2011)

Fax: (08) 9217 1555 ((08) 6552 1555 from 27 June 2011)

Web: www.dlg.wa.gov.au

Western Australian Local Government Association

Western Australian Local Government Association

15 Altona Street, West Perth WA 6005

PO Box 1544, West Perth WA 6872

Telephone: (08) 9321 5055

Fax: (08) 9322 2611

E-mail: info@walga.asn.au

Web: www.walga.asn.au

Local Government Managers Association (WA Division)

17 Wickham Street, East Perth, WA 6004

Telephone: (08) 9218 8141

Fax: (08) 9225 6927

E-mail: admin@lgmawa.org.au

Web: www.lgmawa.org.au



Government of **Western Australia**
Department of **Local Government**

Department of Local Government

GPO Box R1250
PERTH WA 6844

Telephone: (08) 9217 1500 *{{08} 6552 1500 from 27 June 2011}*

Fax: (08) 9217 1555 *{{08} 6552 1555 from 27 June 2011}*

Free call: 1800 620 511 *{Country Only}*

Email: info@dlg.wa.gov.au

Website: www.dlg.wa.gov.au