

Appendix G: Financial sustainability indicators

Figure G1 lists and describes the financial indicators that we use to assess councils' financial sustainability risks. These indicators should be considered collectively and are more useful when assessed over time as part of a trend analysis.

Refer to the data dashboard on our website (www.audit.vic.gov.au/report/results-2022-23-audits-local-government) for individual council financial sustainability data and analysis.

Figure G1: Financial sustainability indicators, formulas and descriptions

Indicator	Formula	Description
Net result margin (%)	Net result/total revenue	<p>A positive result indicates a surplus. The larger the percentage, the stronger the result.</p> <p>A negative result indicates a deficit. Operating deficits cannot be sustained in the long term.</p> <p>The net result and total revenue are obtained from the comprehensive income statement.</p>
Adjusted underlying result (%)	Adjusted underlying surplus (or deficit)/adjusted underlying revenue	<p>This measures an entity's ability to generate surplus in the ordinary course of business, excluding non-recurrent capital grants, non-monetary asset contributions and other contributions, to fund capital expenditure from its net result.</p> <p>A surplus or increasing surplus suggests an improvement in the operating position.</p>
Liquidity (ratio)	Current assets/current liabilities	<p>This measures an entity's ability to pay existing liabilities in the next 12 months.</p> <p>A ratio of 1 or more means that an entity has more cash and liquid assets than short-term liabilities.</p>
Internal financing (%)	Net operating cash flow/net capital expenditure	<p>This measures an entity's ability to finance capital works from generated cash flow.</p> <p>The higher the percentage, the greater the ability for the entity to finance capital works from its own funds.</p> <p>Net operating cash flows and net capital expenditure are obtained from the statement of cash flows.</p>
Indebtedness (%)	Non-current liabilities/own-sourced revenue	<p>This assesses an entity's ability to pay the principal and interest on its borrowings when they are due from the funds it generates.</p> <p>The lower the ratio, the less revenue the entity is required to use to repay its total debt.</p> <p>Own-sourced revenue is used, rather than total revenue, because it does not include grants or contributions.</p>

Indicator	Formula	Description
Capital replacement (ratio)	Cash outflows for the addition of new property, infrastructure, plant and equipment/depreciation	<p>This compares the rate of spending on new infrastructure, property, plant and equipment with its depreciation. Ratios higher than 1 indicate that spending is faster than the depreciating rate.</p> <p>This is a long-term indicator, because capital expenditure can be deferred in the short term if there are insufficient funds available from operations and borrowing is not an option. Cash outflows for property, infrastructure, plant and equipment are taken from the statement of cash flows. Depreciation is taken from the comprehensive income statement.</p>
Renewal gap (ratio)	Renewal and upgrade expenditure/depreciation	<p>This compares the rate of spending on renewing, restoring and replacing existing assets with depreciation.</p> <p>Ratios higher than 1 indicate that spending on existing assets is faster than the depreciation rate.</p>

Note: The internal financing ratio cannot be less than zero. Where a calculation has produced a negative result, this has been rounded up to 0 per cent.
Source: VAGO.