



New South Wales  
Treasury Corporation

10 April 2013

The General Manager  
Gilgandra Shire Council  
Warren Road,  
Gilgandra NSW 2827

Dear Sir/Madam,

#### **Financial Assessment of NSW Councils – LIRS Applicants**

As part of TCorp's work for the Independent Review Panel chaired by Professor Graham Sansom, New South Wales Treasury Corporation (TCorp) has undertaken an assessment of the financial capacity and sustainability of all 152 Councils in New South Wales. Each Council has received, or is about to receive, a report prepared by TCorp that provides an assessment of the following key areas:

- The financial capacity of the Council to undertake additional borrowings
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

In addition, TCorp has also prepared a Financial Sustainability Rating (FSR) and Outlook for each Council. These FSRs and Outlooks have been developed by TCorp to provide an overall position of the sustainability of Councils when compared with each other Council within NSW.

The Appendix attached to this letter provides details of the seven FSR categories and the three Outlook categories that have been used in arriving at the assessed FSR and Outlook of each Council.

The Council has been assessed as:

FSR	Weak
Outlook	Neutral

The FSR of each Council has been determined based on TCorp's review and consideration of the historical and forecast financial results and against a set of benchmark indicators. TCorp has categorised the benchmark ratios into four broad categories and then considered the relative importance of each category in terms of a Council's financial capacity and sustainability. The category of financial flexibility has been assigned a greater weighting because it measures two key measures for sustainability, the Council's revenue raising capacity, and its ability to sustain financial



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shocks, which are important factors for sustainability. As a Council's core servicing function and main asset is its infrastructure, its asset renewal and capital works program is an important factor in its long term sustainability. Debt servicing has been given the least weighting because most Councils are lowly geared.

The Outlook is TCorp's assessment of the potential movement of a Council's FSR within the next three years. A Positive Outlook indicates that a Council's FSR is likely to improve in the short term, whilst a Neutral Outlook indicates that the FSR is likely to remain unchanged. A Negative Outlook indicates that a Council's FSR is more likely to deteriorate and is a sign of a general weakening in performance and sustainability.

For example, a Council with a FSR of Moderate and an Outlook of Negative, is assessed as being in a deteriorating position or at risk of being downgraded from Moderate to Weak. As TCorp considers a FSR of lower than Moderate to be at much greater risk of being unsustainable, Councils in this position need to be considering options for addressing the areas of poor performance that are contributing to Council's assessed FSR and Outlook.

The Outlook is TCorp's current assessment of the potential movement of a Council's FSR and will change as a Council undertakes actions to reduce perceived risks, such as completing Asset Management Plans, or obtaining approval for a special rate variation to increase investment in renewal capital expenditure.

TCorp's Report to the Independent Review Panel is expected to be released in mid-April and the FSR and Outlook for each Council will be included in TCorp's Report.

TCorp would be happy to discuss with you any questions that you may have in regard to the assessed FSR or Outlook for the Council.

Yours Sincerely  
New South Wales Treasury Corporation

A handwritten signature in black ink, appearing to read 'K Pugh'.

Kevin Pugh  
Senior Manager Corporate Finance



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## **Gilgandra Shire Council**

### **Financial Assessment and Benchmarking Report**

**13 March 2013**

**Prepared by NSW Treasury Corporation as part of the Local Infrastructure Renewal Scheme**



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## Disclaimer

This report has been prepared by New South Wales Treasury Corporation (TCorp) in accordance with the appointment of TCorp by the Division of Local Government (DLG) as detailed in TCorp's letters of 22 December 2011 and 28 May 2012. The report has been prepared as part of the Local Infrastructure Renewal Scheme (LIRS) announced by the NSW Government.

The report has been prepared based on information provided to TCorp as set out in Section 2.2 of this report. TCorp has relied on this information and has not verified or audited the accuracy, reliability or currency of the information provided to it for the purpose of preparation of the report. TCorp and its directors, officers and employees make no representation as to the accuracy, reliability or completeness of the information contained in the report.

In addition, TCorp does not warrant or guarantee the outcomes or projections contained in this report. The projections and outcomes contained in the report do not necessarily take into consideration the commercial risks, various external factors or the possibility of poor performance by the Council all of which may negatively impact the financial capability and sustainability of the Council. The TCorp report focuses on whether the Council has reasonable capacity, based on the information provided to TCorp, to take on additional borrowings within prudent risk parameters and the limits of its financial projections.

The report has been prepared for Gilgandra Shire Council, the LIRS Assessment Panel and the DLG. TCorp shall not be liable to Gilgandra Shire Council or have any liability to any third party under the law of contract, tort and the principles of restitution or unjust enrichment or otherwise for any loss, expense or damage which may arise from or be incurred or suffered as a result of reliance on anything contained in this report.



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## Section 1 Executive Summary

This report provides an independent assessment of Gilgandra Shire Council's (the Council) financial capacity and its ability to undertake additional borrowings. The analysis is based on a review of the historical performance, current financial position, and long term financial forecasts. It also benchmarks the Council against its peers using key ratios.

The report is primarily focused on the financial capacity of the Council to undertake additional borrowings as part of the Local Infrastructure Renewal Scheme (LIRS).

Council has made two LIRS applications. One application is for a Bridge Replacement Project for \$1.2m to be repaid over 10 years. The second application is for the provision of Residential and Industrial land Infrastructure for \$0.4m to be repaid over five years.

TCorp's approach has been to:

- Review the most recent three years of Council's consolidated financial results
- Conduct a detailed review of the Council's 10 year financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. As Gilgandra Shire Council operate three funds we focused our review on the General Fund as the loan will be attached to the General Fund

The Council has been reasonably managed over the review period based on the following observations:

- Council's underlying operating performance (measured using EBITDA) has been improving over the three year period
- Council has secured IPART approval to a 6.8%SRV with the income generated to be used to fund infrastructure maintenance and renewal and improve financial sustainability
- Council has posted an operating deficit in the last three years when capital grants and contributions are excluded

Council's reported infrastructure backlog of \$2.7m in 2011 represents 0.8% of its infrastructure asset value of \$326.4m. Other observations include:

- Council's infrastructure backlog has remained static between 2010 and 2011. Council do not have any water, sewerage or drainage backlog
- Council appear to be spending sufficient to maintain their existing assets at current service levels
- Compared to benchmark ratios Council appear to be underspending on asset renewal

The key observations from our review of Council's 10 year forecasts for its General Fund are:

- The LTFP Scenario used is based on current levels of service, reduced capital works, lower growth in roads expenditure and increased rates income
- The forecast shows deficit positions are expected in all 10 years when capital grants and contributions are excluded. This highlights that Council could face long term sustainability issues
- Council's own source revenue is below benchmark for the entire forecast period

In our view, the Council does have the capacity to undertake the combined additional borrowings of \$1.6m for the LIRS project. This is based on the following analysis:

- Council's DSCR is above benchmark in four of the 10 years forecast. It is maintained at reasonable levels from 2015 on after the \$0.4m LIRS land loan is repaid
- The Interest Cover Ratio is above benchmark in six of the 10 years forecast
- If Council postpone their proposed future capital projects on new assets and concentrate on the LIRS projects these ratios will improve, and they may also enhance their current asset base

In respect of the Benchmarking analysis TCorp has compared the Council's key ratios, on a consolidated basis, with other councils in DLG group 9. The key observations are:

- Council's financial flexibility as indicated by the Operating Ratio, over the review period has been generally in line with benchmark levels and tracking the group average, although 2012 performance declined
- Council's Own Source Operating Revenue Ratio is below benchmark but in line with its peer group
- Council's DSCR and Interest Cover Ratio while marginally below the group's average, were above benchmark over the review period and are forecast to remain at this level
- Council was in an acceptable liquidity position and this is forecast to remain acceptable in the medium term
- Council has a comparatively low level of Infrastructure Backlog.
- The Asset Maintenance Ratio is at benchmark levels and tracks the group average.
- The Building and Infrastructure Asset Renewal was below benchmark and underperformed against its peer group over the review period. Council's Capital Expenditure Ratio has been below benchmark and the group average since 2011 and is forecast to remain at this level

## Section 2 Introduction

### 2.1: Purpose of Report

This report provides the Council with an independent assessment of their financial capacity and performance measured against a peer group of councils which will complement their internal due diligence, and the IP&R system of the Council and the DLG.

The report is to be provided to the LIRS Assessment Panel for its use in considering applications received under the LIRS.

The key areas focused on are:

- The financial capacity of the Council to undertake additional borrowings
- The financial performance of the Council in comparison to a range of similar councils and measured against prudent benchmarks

### 2.2: Scope and Methodology

TCorp's approach was to:

- Review the most recent three years of the Council's consolidated audited accounts using financial ratio analysis. In undertaking the ratio analysis TCorp has utilised ratio's substantially consistent with those used by Queensland Treasury Corporation (QTC) initially in its review of Queensland Local Government (2008), and subsequently updated in 2011
- Conduct a detailed review of the Council's 10 year financial forecasts including a review of the key assumptions that underpin the financial forecasts. The review of the financial forecasts focused on the particular Council fund that was undertaking the proposed debt commitment. For example where a project is being funded from the General fund we focussed our review on the General fund
- Identify significant changes to future financial forecasts from existing financial performance and highlight risks associated with such forecasts
- Conduct a benchmark review of a Council's performance against its peer group
- Prepare a report that provides an overview of the Council's existing and forecast financial position and its capacity to meet increased debt commitments
- Conduct a high level review of the Council's IP&R documents for factors which could impact the Council's financial capacity and performance

In undertaking its work, TCorp relied on:

- Council's audited financial statements (2008/09 to 2010/11)
- Council's financial forecast model
- Council's IP&R documents
- Discussions with Council officers
- Council's submissions to the DLG as part of their LIRS application
- Other publicly available information such as information published on the IPART website





### Benchmark Ratios

In conducting our review of the Councils' financial performance and forecasts we have measured performance against a set of benchmarks. These benchmarks are listed below. Benchmarks do not necessarily represent a pass or fail in respect of any particular area. One-off projects or events can impact a council's performance against a benchmark for a short period. Other factors such as the trends in results against the benchmarks are critical as well as the overall performance against all the benchmarks. As councils can have significant differences in their size and population densities, it is important to note that one benchmark does not fit all.

For example, the Cash Expense Ratio should be greater for smaller councils than larger councils as a protection against variation in performance and financial shocks.

Therefore these benchmarks are intended as a guide to performance.

The Glossary attached to this report explains how each ratio is calculated.

<b>Ratio</b>	<b>Benchmark</b>
Operating Ratio	> (4.0%)
Cash Expense Ratio	> 3.0 months
Unrestricted Current Ratio	> 1.50x
Own Source Operating Revenue Ratio	> 60.0%
Debt Service Cover Ratio (DSCR)	> 2.00x
Interest Cover Ratio	> 4.00x
Infrastructure Backlog Ratio	< 0.02x
Asset Maintenance Ratio	> 1.00x
Building and Infrastructure Asset Renewal Ratio	> 1.00x
Capital Expenditure Ratio	> 1.10x

### 2.3: Overview of the Local Government Area

Gilgandra Shire Council LGA	
Locality & Size	
Locality	Central West NSW
Area	4836km <sup>2</sup>
DLG Group	9
Demographics	
Population	4,368
% under 18	27%
% between 18 and 59	46%
% over 60	27%
Expected population 2021	4,368
Operations	
Number of employees (FTE)	199
Annual revenue	\$21.1m
Infrastructure	
Roads	612km
Bridges	7693m <sup>2</sup>
Infrastructure backlog value	\$2.8m
Total infrastructure value	\$326.4m

Gilgandra Shire Council Local Government Area (LGA) is located in the Orana Region of NSW on the banks of the Castlereagh River and at the junction of the Oxley, Newell and Castlereagh highways. The LGA is bounded by Coonamble Shire in the north, Warrumbungle Shire in the east, Dubbo city in the south and Narromine Shire and Warren Shire in the west. Gilgandra is approximately half way between Melbourne and Brisbane and approximately 30 minutes north of the regional centre of Dubbo.

The LGA includes the townships and localities of Armatree, Balladoran, Bearbong, Breealong, Curban, Gilgandra, Kickabil and Tooraweenah.

The LGA is predominantly a rural agricultural area with sheep, beef cattle and winter cereal cropping being the main enterprises. The local economy also relies on business that the traffic on the Newell highway provides.

The current population of 4,368 is expected to remain unchanged over the next 10 years with a slight decline expected in rural areas and a slight increase expected in urban areas.

Council had 199 full-time equivalent employees at the end of 2011.



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## 2.4: LIRS Application

Council has made two LIRS applications.

### Project 1: Replacement of Terrabile Creek Bridge at Curban

Description: The projects aims to replace the current single lane, load restricted bridge with a dual lane, unrestricted bridge which will increase capacity and efficiency in the transportation of commodities to the respective markets. It is an important road link for tourists to the Warrumbungle National Park.

Amount of loan facility: \$1.2m

Term of loan facility: 10 years

### Project 2: Infrastructure to provide industrial and residential land

Description: This is stage one of a project to extend infrastructure for residential and industrial subdivisions planned by Council. Funds will be used to meet design costs, upgrade access to both proposals, provide internal access roads, stormwater and provide services such as electricity and communications.

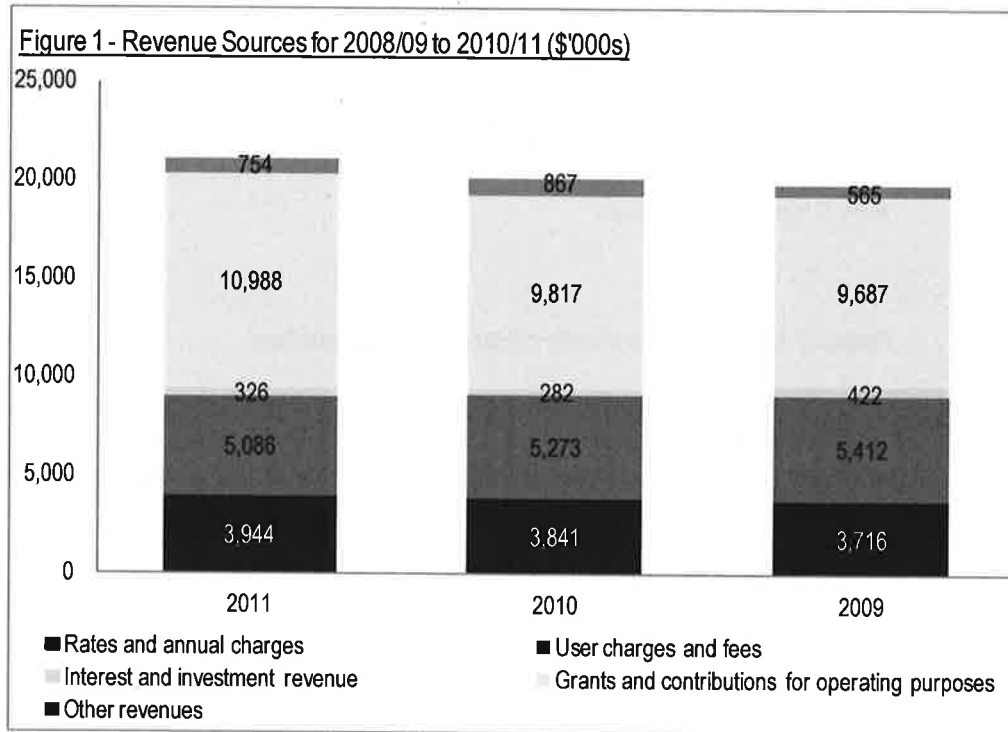
Amount of loan facility: \$0.4m

Term of loan facility: 5 years

### Section 3 Review of Financial Performance and Position

In reviewing the financial performance of the Council, TCorp has based its review on the annual audited accounts of the Council unless otherwise stated.

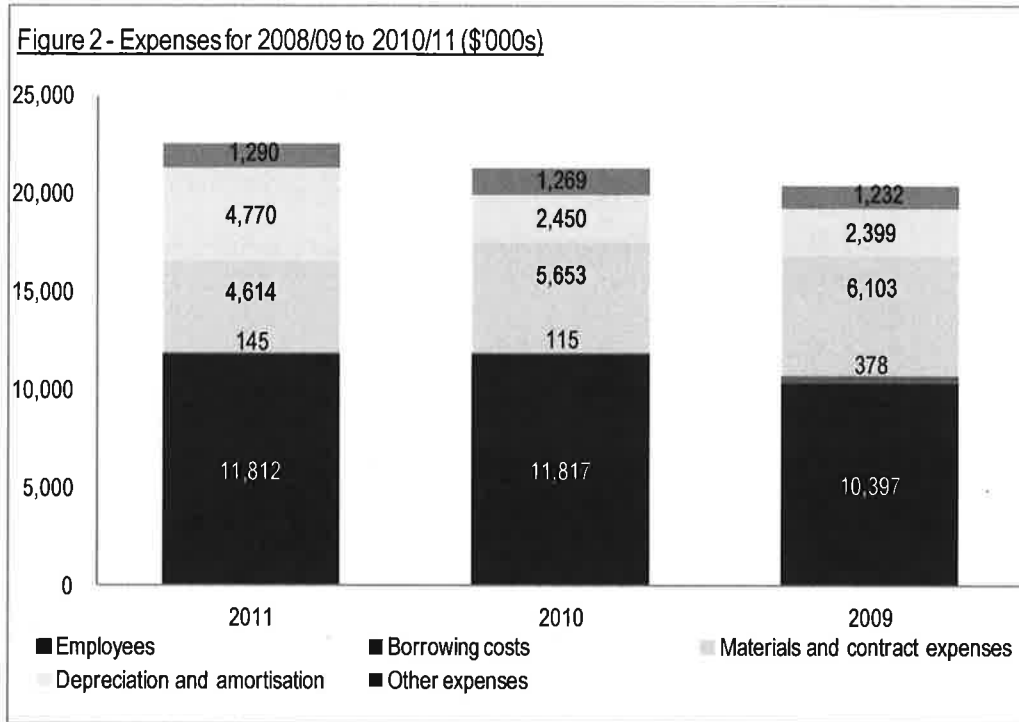
#### 3.1: Revenue



#### Key Observations

- Rates and annual charges increased by 2.7% in 2011 and 3.4% in 2010 in line with CPI.
- User fees and charges decreased by 3.5% in 2011 and 2.6% in 2010. The 2011 decrease was driven by a decline in private works fees. The decrease in 2010 was due to a decline in water and sewage supply services.
- Council own an aged care facility, Cooee Lodge Retirement Village, which helps generate significant revenue each year from aged care and disability services. In 2011 this amounted to \$1.3m. RMS charges also generated \$2.3m in 2011.
- Grants and contributions for operating purposes is Councils largest source of revenue at 52.0% of their overall operating result (excluding capital grants and contributions) for 2011. Grants and contributions for operating purposes increased by \$1.0m in 2011 which was driven by an increase in roads and bridges funding due to flood damage. Aged care and disability services contributions also increased in 2011 by \$0.5m due to a donation from a deceased estate to be used at Cooee Lodge.

### 3.2: Expenses



#### Key Observations

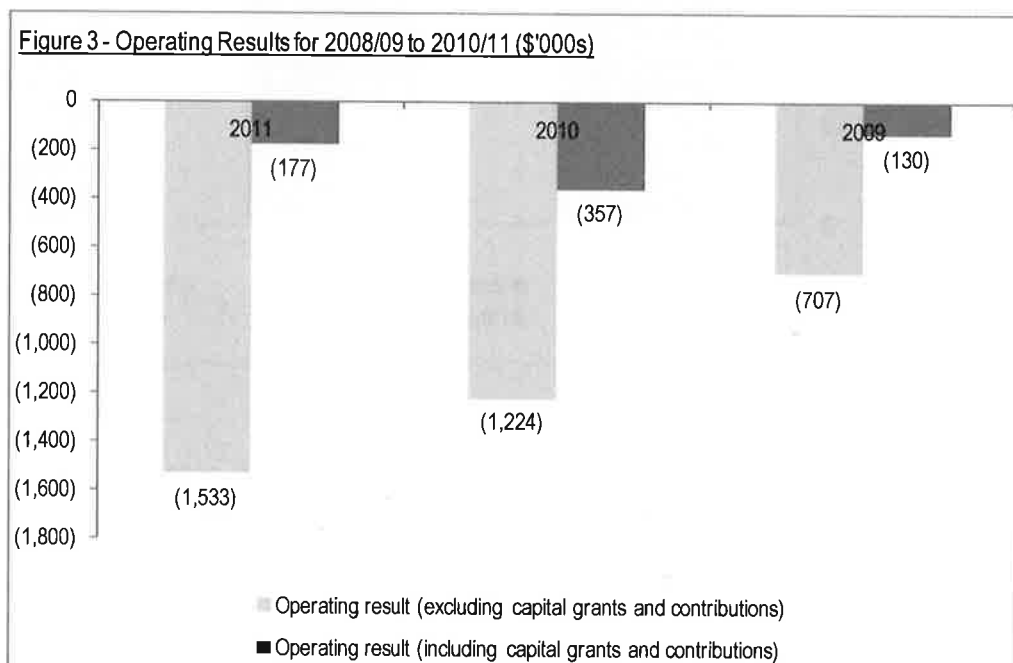
- Employee costs remained static between 2010 and 2011. In 2010 employee costs increased by 13.7% (\$1.5m) driven by increases in workers compensation insurance and salaries and wages. The increases in salaries and wages in 2010 were due to increases in the number of casual employees required during disaster periods as well as upward movements in grades and skill steps.
- Materials and contracts expenses decreased over the three year period with a decrease of 18.4% in 2011. This was due to the timing and extent of various projects relating to flood damage which carried over to 2011/12.
- In 2010 the Asset Revaluation process increased the value of Council's infrastructure assets. This resulted in the annual depreciation charge increasing by 94.7% to \$4.7m in 2011.

### 3.3: Operating Results

TCorp has made some standard adjustments to focus the analysis on core operating council results. Grants and contributions for capital purposes, realised and unrealised gains on investments and other assets are excluded, as well as one-off items which Council have no control over (e.g. impairments).

TCorp believes that the exclusion of these items will assist in normalising the measurement of key performance indicators, and the measurement of Council's performance against its peers.

All items excluded from the income statement and further historical financial information is detailed in Appendix A.



#### Key Observations

- Council has posted increasing net operating deficits excluding capital grants and contributions for the last three years. The deficit increased in 2011 due to increased depreciation charges. The 2010 increase was driven by increased employee costs.
- Council expenses include a non-cash depreciation expense, (\$4.7m in 2011), which has increased over the past three years following the Asset Revaluations process. Whilst the non-cash nature of depreciation can favourably impact on ratios such as EBITDA that focus on cash, depreciation is an important expense as it represents the allocation of the value of an asset over its useful life.

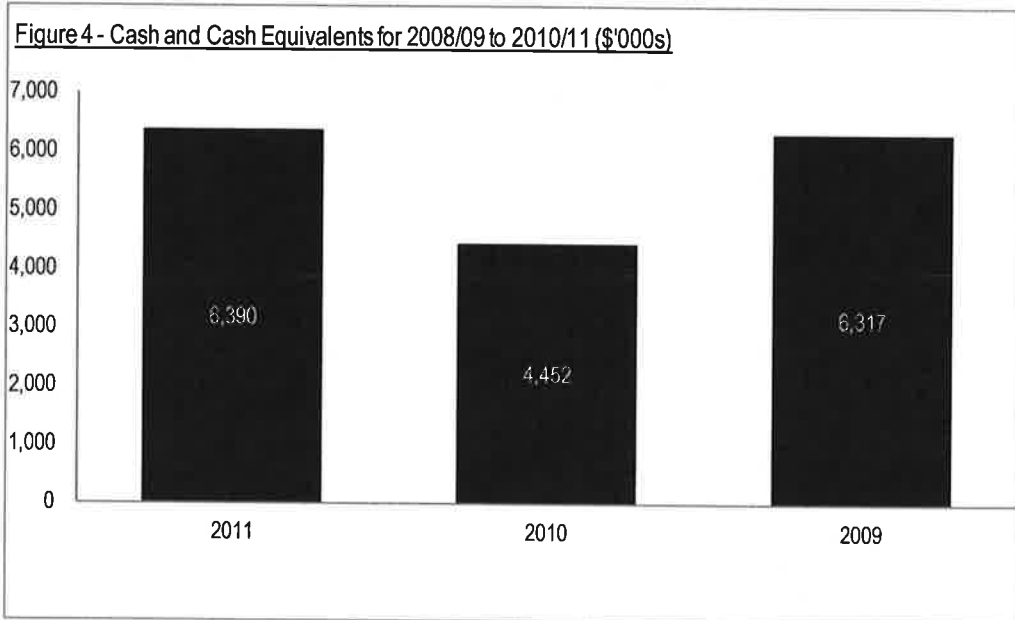
### 3.4: Financial Management Indicators

Performance Indicators	Year ended 30 June		
	2011	2010	2009
EBITDA (\$'000s)	3,382	1,341	2,070
Operating Ratio	(7.3%)	(6.1%)	(3.6%)
Interest Cover Ratio	23.32x	11.66x	5.48x
Debt Service Cover Ratio	7.90x	3.89x	3.26x
Unrestricted Current Ratio	1.85x	1.29x	1.86x
Own Source Operating Revenue Ratio	40.2%	43.5%	44.8%
Cash Expense Ratio	4.3 months	2.9 months	4.3 months
Net assets (\$'000s)	332,930	322,031	95,256

#### Key Observations

- Council's underlying operating performance (measured using EBITDA) has increased year on year.
- The Operating Ratio is well below the benchmark in 2010 and 2011 driven by increased employee costs and depreciation charges.
- Council's Interest Cover Ratio and DSCR were above their respective benchmarks indicating Council had flexibility in regard to carrying more debt.
- The Unrestricted Current Ratio was above benchmark of 1.5x in two of three years. It was below benchmark in 2010 due to increased capital expenditure in that year.
- The Own Source Operating Revenue Ratio is below the 60% benchmark. This indicates that Council did not have sufficient financial flexibility, and rely on revenue streams outside of their control.
- The Cash Expense Ratio was above benchmark in 2009 and 2011. In 2010 it fell below benchmark due to increased employee costs that year.
- Council's Net Assets have increased by \$240.0m since 2009 due to Asset Revaluations which have increased the value of roads, bridges and drainage infrastructure.
- When the Asset Revaluations are excluded, the underlying trend in all three years has been an increase in the infrastructure, property, plant and equipment (IPP&E) asset base with asset purchases being greater than the combined value of disposed assets and annual depreciation. Over the three years this amounted to a \$2.6m increase in IPP&E assets.
- Council has total borrowings of \$1.5m representing 0.4% of Net Assets.

### 3.5: Statement of Cashflows



#### Key Observations

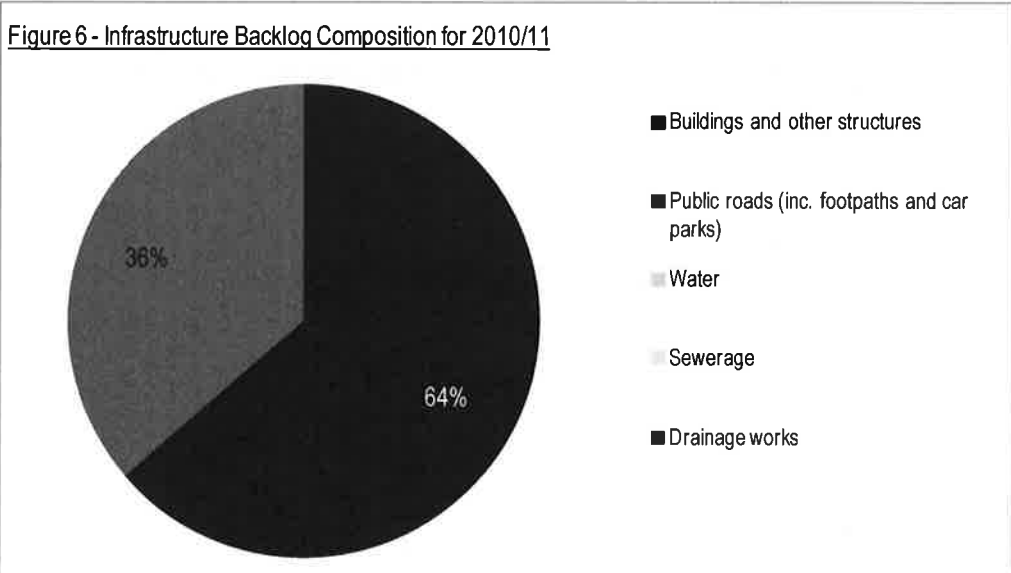
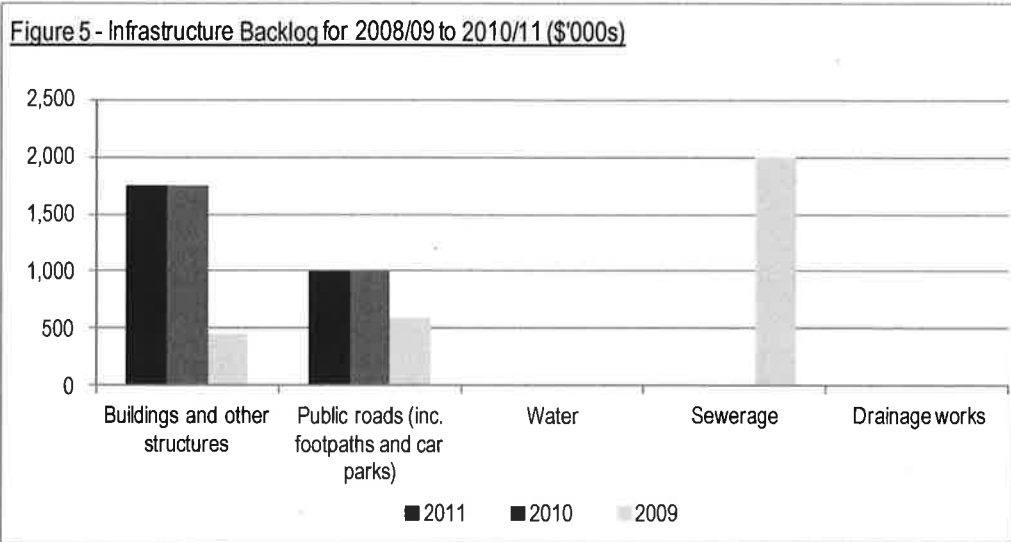
- Cash and equivalents have fluctuated between 2009 and 2011. Decreased operating grants and increased spending on infrastructure, property, plant and equipment in 2010 reduced the cash balance for that year.
- The cash balances along with the Unrestricted Current Ratio indicate Council had sound liquidity.
- Of the \$6.3m in cash and investments, \$2.3m is externally restricted, \$1.9m is internally restricted and \$2.1m is unrestricted.
- In 2011, Council's investment portfolio comprised of \$0.6m in CDO's and \$0.6m in long term deposits.
- According to the Independent Auditors Report 2011 Council's Auditors are unable to obtain sufficient appropriate evidence to satisfy themselves as to the fair value and recoverability of \$0.6m of Council's total investment portfolio (being the CDO's).
- Included in Council's cash flow are Proceeds and Repayments of Retirement contributions. These aged care contributions are accommodation bonds which are held by Council and included on the balance sheet as liabilities. They are not operational transactions and as a result, these transactions apply to the balance sheet only and not operations. They have not been included in the LTFP.



### 3.6: Capital Expenditure

The following section predominantly relies on information obtained from Special Schedules 7 and 8 that accompany the annual financial statements. These figures are unaudited and are therefore Council's estimated figures.

#### 3.6(a): Infrastructure Backlog



Council reported \$2.7m in Infrastructure Backlog in 2011, of which 64.0% (\$1.7m) relates to buildings assets which increased by 84.2% since 2009 following the revaluation of Council's backlog. Council is seeking to address part of their roads infrastructure backlog in one their LIRS projects. Council do not have any water, sewerage or drainage backlog however they are currently in the process of completing their Asset Management Plan and this may change in 2012.

### 3.6(b): Infrastructure Status

Infrastructure Status	Year ended 30 June		
	2011	2010	2009
Bring to satisfactory standard (\$'000s)	2,750	2,750	3,050
Required annual maintenance (\$'000s)	3,436	3,030	2,962
Actual annual maintenance (\$'000s)	3,486	3,094	2,962
Total value of infrastructure assets (\$'000s)	326,373	317,473	88,045
Total assets (\$'000s)	346,692	333,895	106,769
Building and Infrastructure Backlog Ratio	0.01x	0.01x	0.03x
Asset Maintenance Ratio	1.01x	1.02x	1.00x
Building and Infrastructure Asset Renewals Ratio	0.35x	0.42x	0.80x
Capital Expenditure Ratio	0.69x	2.04x	1.65x

The Infrastructure Backlog Ratio has been above benchmark for the past two years, however it is noted that Council has not completed its Asset Management Plan and therefore any requirements from this plan are not included in the LTFP.

The Asset Maintenance Ratio has been at or above benchmark over the three year period indicating Council is spending at the required level on asset maintenance.

The Building and Infrastructure Asset Renewal Ratio has been decreasing for the past two years which indicates Council is spending at levels below the benchmarks on asset renewal.

In 2011 the Capital Expenditure Ratio which takes into account capital expenditure which improves performance or capacity, decreased well below benchmark caused by increased depreciation in 2011.

Council are currently finalising their Asset Management Plan and while they anticipate that there will be minimal to no backlog in water there is likely to be backlog in sewer and stormwater, the extent of which is not yet known.

### 3.6(c): Capital Program

The following figures are sourced from the Council's Annual Financial Statements at Special Schedule No. 8 and are not audited. New capital works are major non-recurrent projects.

Capital Program (\$'000s)	Year ended 30 June		
	2011	2010	2009
New capital works	2685	2000	2
Replacement/refurbishment of existing assets	1258	846	2
<b>Total</b>	<b>3,943</b>	<b>2,846</b>	<b>4</b>

Extensive damage caused to Council's road networks due to the 2010 flooding halted many major projects as all resources were allocated to repairing flood damage and returning roads to an acceptable standard. At the end of the 2010/11 financial year much of this work still needed to be done and will be progressed through 2011/2012.

Other works completed in 2010/11 included construction of 5x2 bedroom self care units within the Cooee Lodge Retirement Village and completion of sewer extension to units at Cooee Lodge

#### Future significant capital works projects:

- Terrabile Creek Bridge \$1.2m
- Industrial Subdivision \$0.4m
- Residential Subdivision \$0.3m
- CBD Upgrade \$0.3m
- IT Upgrades \$0.2m
- Shire Depot Improvements: \$0.1m
- Youth Club Improvements: \$0.1m
- Parks & Playground Equipment Upgrades: \$0.05m

### 3.7: Specific Risks to Council

Grants and contributions make up over 50.0% of Councils operating result. While Council continue to pursue grant opportunities any decrease in grant funding will have a negative impact on their overall operating result and financial position as can be seen from the LTFP forecast from 2013.

Rates and annual charges are only 18.6% of Councils overall revenue. While they have tried to address this through a multi-year SRV application this was declined and Council may need to implement increases in other areas or may need to review service levels.

**Agricultural Development:** Farming is the main economic activity in Gilgandra LGA. Council want to develop appropriate land use planning strategies for sustainable development which embraces the community's unique and valued environment, as well as optimising economic opportunities

**Population profile:** Gilgandra has an increasing ageing population with 27% of their population currently over 60 compared with approximately 23% in the larger Orana region. Their estimated population movement over the next 10 years is nil. With an increasing older population the demand for services and aged care facilities will increase which will place pressure on existing infrastructure assets.

As part of their Strategic Plan Council hope to address a number of key issues relating to their economy. They are aware of the need to retain younger people in the area and create more opportunities for their existing residents. They have identified the lack of readily available residential and industrial/commercial land and part of this issue is being addressed in one of the LIRS projects.

Council also hope to develop employment and training programs by attracting new business and support existing business, particularly rural business, in the area. Council hope to assist and facilitate the creation of an education strategy that links key institutions in the area.

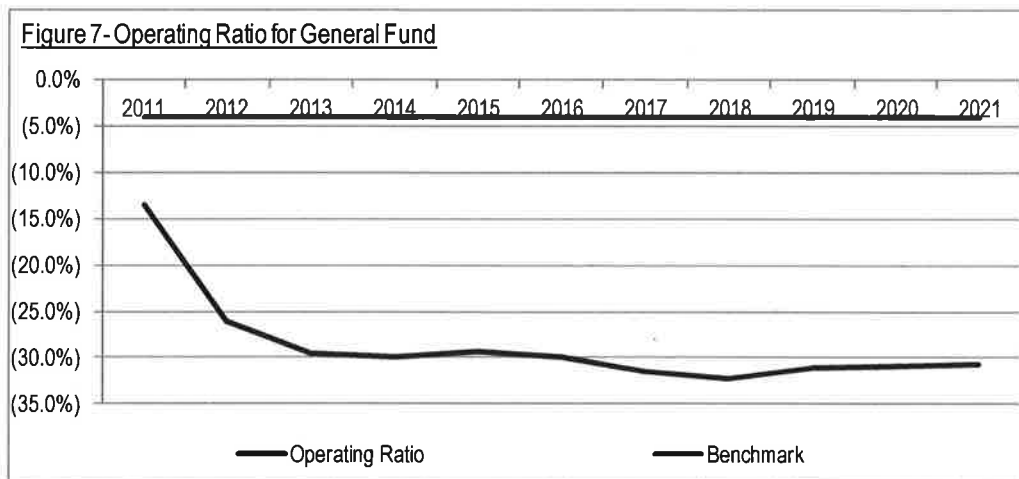


## Section 4 Review of Financial Forecasts

The financial forecast model shows the projected financial statements and assumptions for the next 10 years. The model includes the \$1.6m loan without any LIRS subsidy.

The LIRS loan relates to the General Fund, therefore we have focused our financial analysis solely upon this Fund. Council's consolidated position includes both a Water and Sewer Fund however these are operated as independent entities, which unlike the General Fund are more able to adjust the appropriate fees and charges to meet all future operating and investing expenses.

### 4.1: Operating Results



Council's Operating Ratio forecasts shows significant deficit positions are expected in all 10 years when capital grants and contributions are excluded.

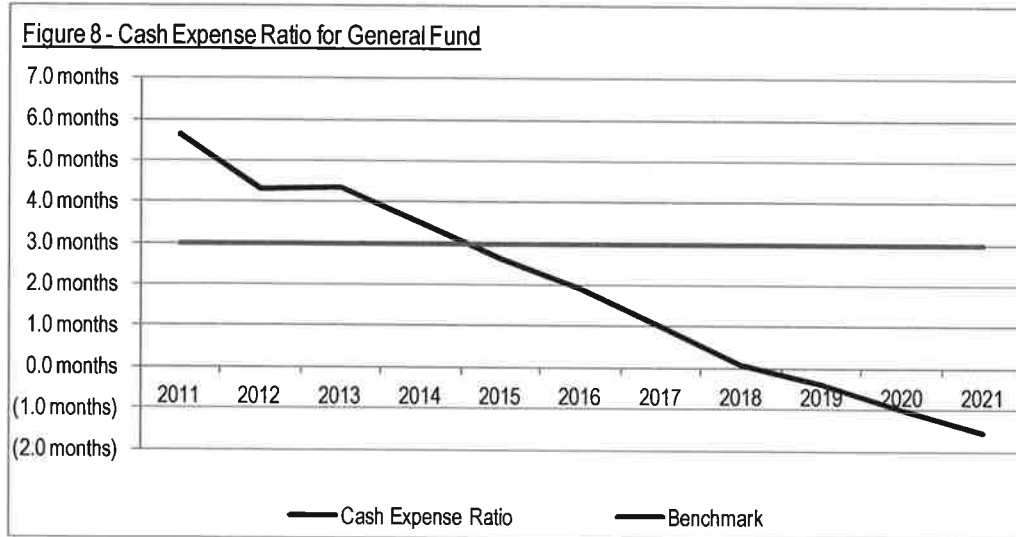
The Operating Ratio decreases in 2013 due to decreased operating grants forecast from 2011/12. In 2011 grant figures included \$0.9m in flood damage funding and the 2012 figures includes \$1.5m in flood damage funding which has not been included in ongoing forecasts.

Overall Council expenses are increasing at a much higher rate than revenue with continued high employee expenses and materials costs having a negative impact on this result. This indicates Council faces sustainability issues in the future.

#### 4.2: Financial Management Indicators

The financial management indicators are linked to the utilisation of debt in early years and some of them improve over time as the amortising debt reduces.

##### Liquidity Ratios



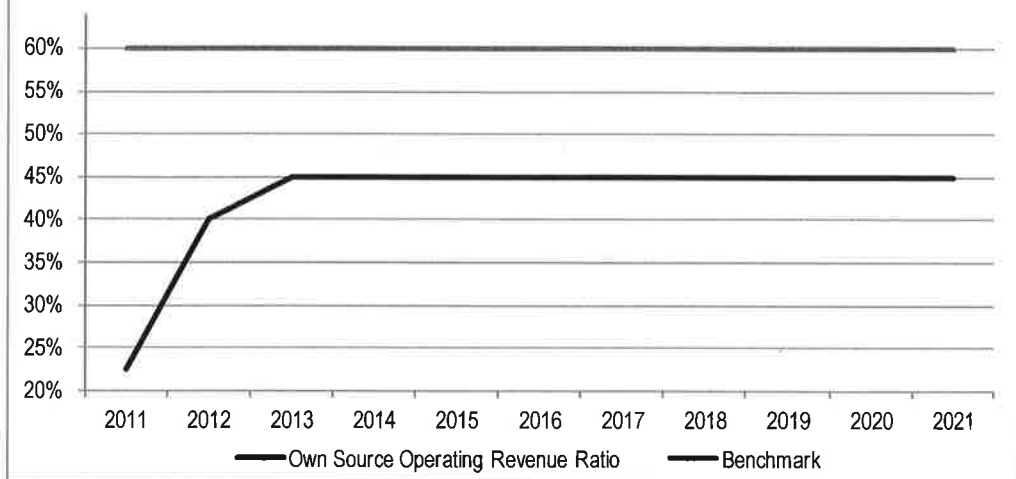
This ratio indicates council will operate with little room for flexibility in regard to liquidity. The ratio falls below benchmark in 2015 and continues to decrease for the remainder of the forecast period. Post 2018 the General Fund is in a negative position which is unsustainable.

Decreasing cash balances caused by decreased operating results and high IPP&E costs are having a negative impact on this ratio.

Council have forecast investments at \$1.1m p.a. from 2012 however they have little impact on the overall result.

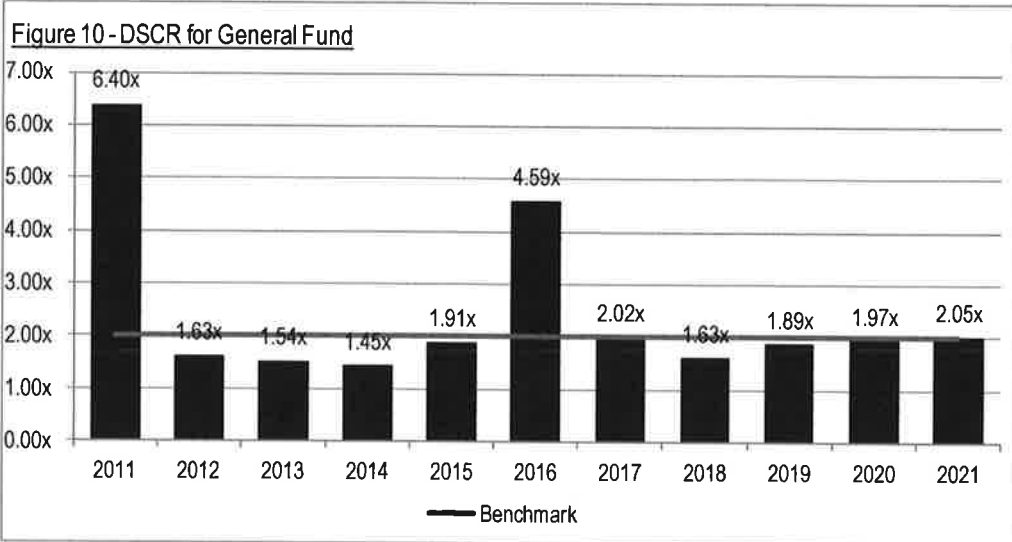
Fiscal Flexibility Ratios

Figure 9 - Own Source Operating Revenue Ratio for General Fund

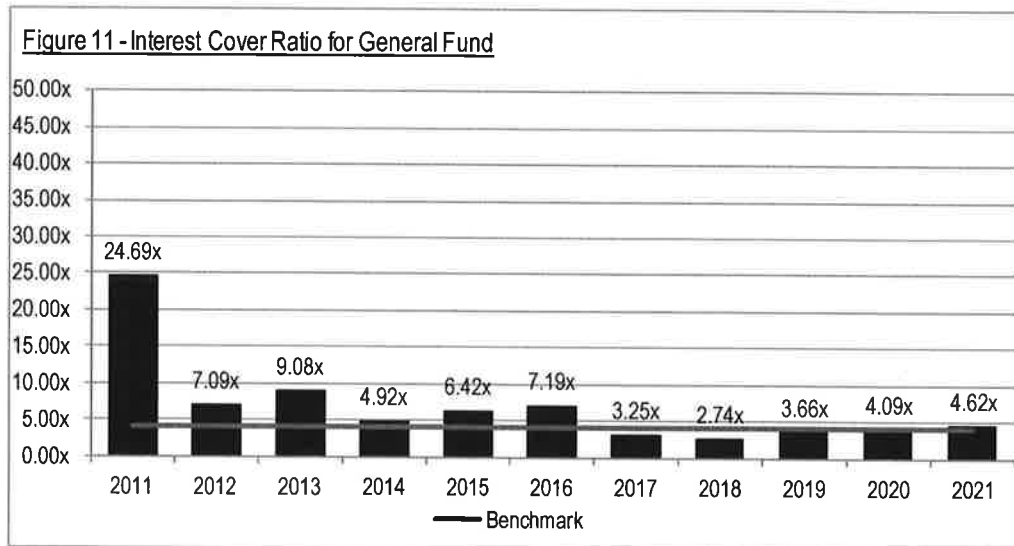


The Own Source Operating Revenue Ratio is below benchmark of 60% for the entire forecast period. This is due to Council forecasting expenses to increase at a higher rate than revenue over the forecast period.

Gilgandra Shire Council applied for a multi-year Special Rate Variation (SRV) in 2012/13. Council requested an increase of 6.8% in 2012/13 and 6.2% p.a. until 2018/19, a cumulative increase of 53.2%. IPART did not approve this request however they did approve a single year increase of 6.8% (including rate peg of 3.6%) in 2012/13. The income generated is to be used to fund infrastructure maintenance and renewal and improve financial sustainability.



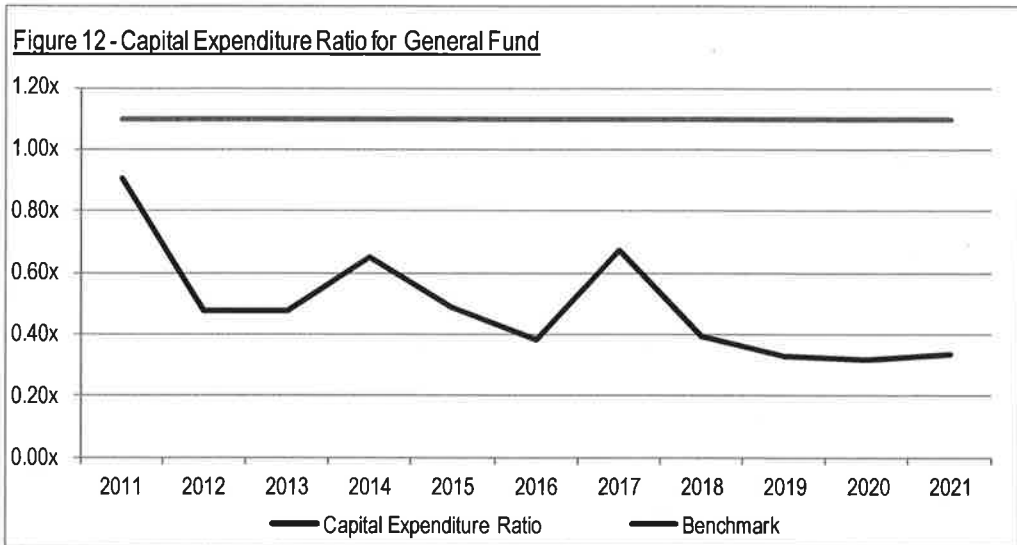
The DSCR is above the benchmark of 2.00x in four of the 10 years forecast. The DSCR is well above benchmark in 2011 due to increased EBITDA. In 2016 the LIRS loan for Councils land project will be repaid which is causing the DSCR to spike again in 2016. After this the DSCR is at more realistic levels for the remainder of the forecast period.



The Interest Cover Ratio, similar to the DSCR, falls below benchmark in 2017 until 2019. This corresponds with an additional loan of \$1.3m Council are drawing down in 2017 for a number of projects including subdivisions, depot improvements and playground improvements.



### 4.3: Capital Expenditure



The Capital Expenditure Ratio is below benchmark for the entire forecast period. These forecast levels of capital expenditure will increase pressure on existing assets. The total deficit for capital expenditure versus depreciation between 2011 and 2022 amounts to \$25.0m.

#### 4.4: Financial Model Assumption Review

Councils have used their own assumptions in developing their forecasts.

In order to evaluate the validity of the Council's forecast model, TCorp has compared the model assumptions versus TCorp's benchmarks for annual increases in the various revenue and expenditure items. Any material differences from these benchmarks should be explained through the LTFP.

TCorp's benchmarks:

- Rates and annual charges: TCorp notes that rates increased by 3.4% in the year to September 2011, and in December 2011, IPART announced that the rate peg to apply in the 2012/13 financial year will be 3.6%. Beyond 2013 TCorp has assessed a general benchmark for rates and annual charges to increase by mid-range LGCI annual increases of 3.0%
- Interest and investment revenue: annual return of 5%
- All other revenue items: the estimated annual CPI increase of 2.5%
- Employee costs: 3.5% (estimated CPI+1%)
- All other expenses: the estimated annual CPI increase of 2.5%

#### Key Observations and Risks

- The LTFP forecast rates and annual charges to increase by 4.7% in 2012 and 6.3% in 2013 due to the IPART approved SRV. They increase by 2.98% for the remainder of the forecast period which is considered reasonable.
- User fees and charges are forecast to decrease in 2012 by 6.2%. In 2011 RMS contract work increased due to flood damage. This has not been included in 2012 hence the decrease. From 2014 user fees and charges are forecast to increase by approximately 3.0% p.a. Following the historic decreases this would appear ambitious however Council plan to increase all fees and charges by 3.0% overall from 2014. The assumption is that usage should remain the same over the term of the plan.
- Grants and contributions have been forecast to increase by 17.4% in 2012 and decrease by 22.5% in 2013. The 2012 figures include \$1.5m in flood damage funding which has not been included in the ongoing forecast.
- Employee costs have been forecast to decrease by 7.13% in 2012 due to reduced workers compensation insurance and a staff restructure. From 2013 they increase by up to 3.0% p.a. In 2018 employee costs spike to 5.5%. Council feel at this point additional staff will be required to keep in line with increased regulatory requirements.
- Materials and contracts expenses forecast significant increases for much of the forecast period due. An increase of 53.6% in 2012 is due to flood works that were carried over. Other increases have been forecast in line with future planned projects.
- Overall we feel Councils assumptions are reasonable.



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#### **4.5: Borrowing Capacity**

When analysing the financial capacity of the Council we believe Council will not be able to incorporate additional loan funding in addition to the LIRS loan facilities and other proposed borrowings already included in Council's financial forecasts.

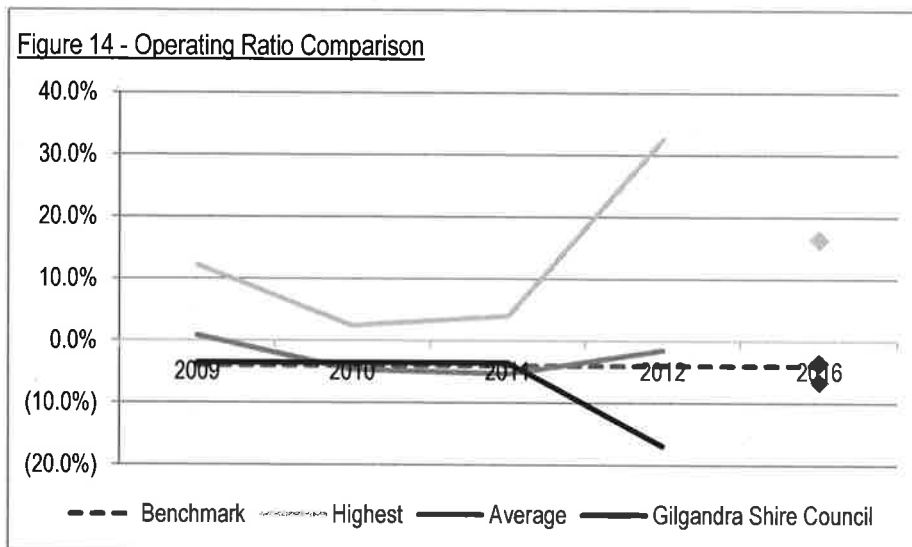
## Section 5 Benchmarking and Comparisons with Other Councils

As discussed in section 2 of this report, each council's performance has been assessed against ten key benchmark ratios. The benchmarking assessment has been conducted on a consolidated basis (that is, for councils that operate more than one fund, the results of all funds are included). This section of the report compares the Council's performance with its peers in the same DLG Group. The Council is in DLG Group 9. There are 21 councils in this group and at the time of preparing this report, we have data for all of these councils.

In Figure 14 to Figure 23, the graphs compare the historical performance of Council with the benchmark for that ratio, with the average for the Group, with the highest performance (or lowest performance in the case of the Infrastructure Backlog Ratio where a low ratio is an indicator of strong performance), and with the forecast position of the Council as at 2016 (as per Council's LTFP). Figures 21 to 23 do not include the 2016 forecast position as those numbers are not available.

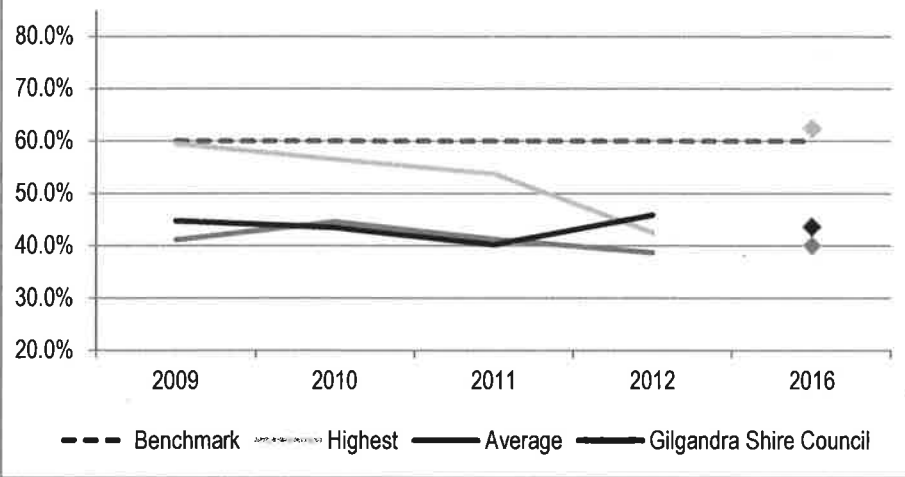
Where no highest line is shown on the graph, this means that Council is the best performer in its group for that ratio. For the Interest Cover Ratio and Debt Service Cover Ratio, we have excluded from the calculations, councils with very high ratios which are a result of low debt levels that skews the ratios.

### Financial Flexibility



Council's Operating Ratio generally tracks benchmark and the group average until 2012. In 2012 significantly increased materials and contract expenses cause the ratio to decrease. It is forecast to increase to historic levels tracking benchmark and the group average in the medium term.

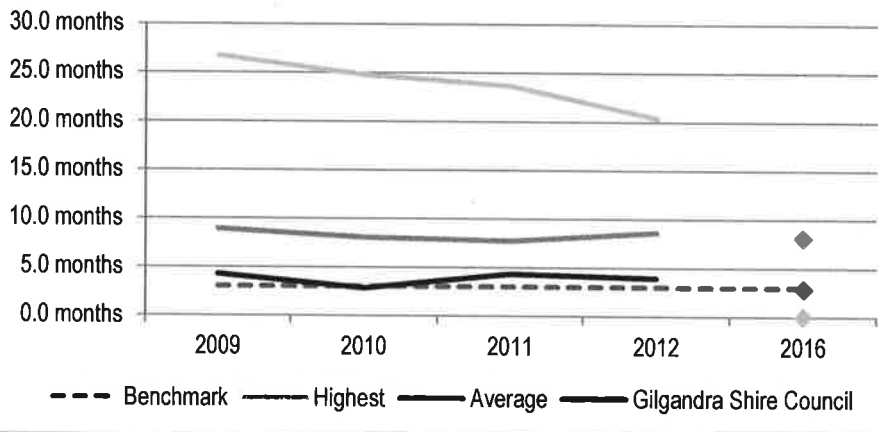
Figure 15 - Own Source Operating Revenue Ratio Comparison



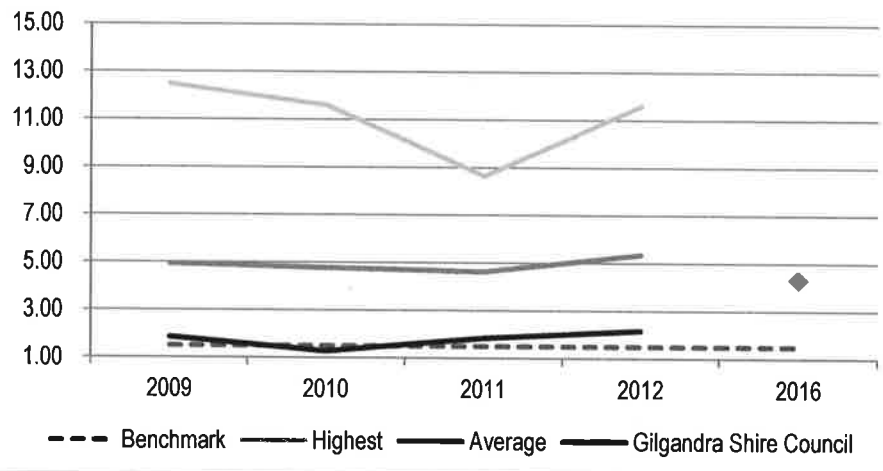
Council's Own Source Operating Revenue Ratio generally tracked the group average but was below benchmark for the review period. The ratio increased slightly in 2012 due to increased user fees and charges as well as a decrease in capital grants. The ratio is forecast to decline marginally in the medium term in line with the group average.

Liquidity

**Figure 16 - Cash Expense Ratio Comparison**



**Figure 17 - Unrestricted Current Ratio Comparison**



Council's Cash Expense Ratio while below the group average tracked benchmark over the review period and is forecast to remain at this level in the medium term.

The Unrestricted Current Ratio tracked benchmark but underperformed against its peer group. Council has not provided data for a forecast over the medium term.

Overall Council's liquidity position is sound.

Debt Servicing

Figure 18 - Debt Service Cover Ratio Comparison

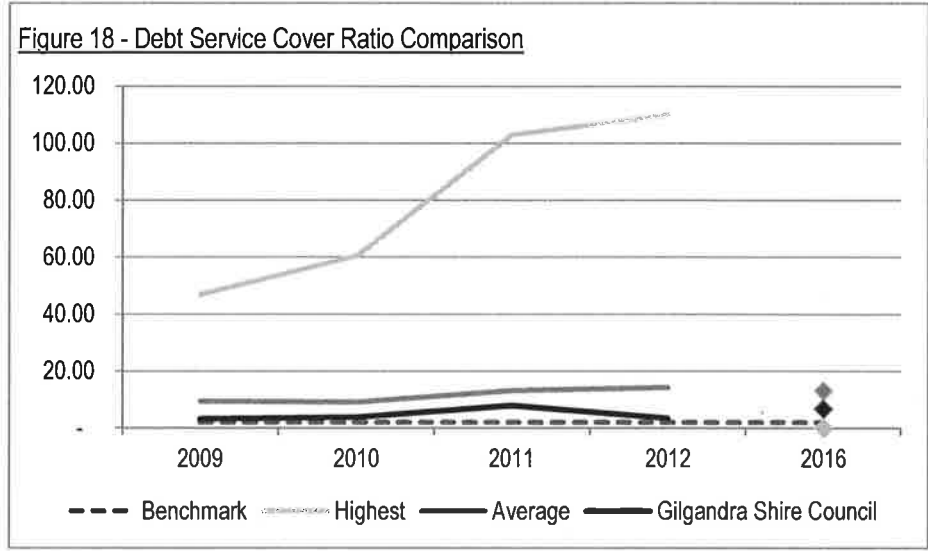
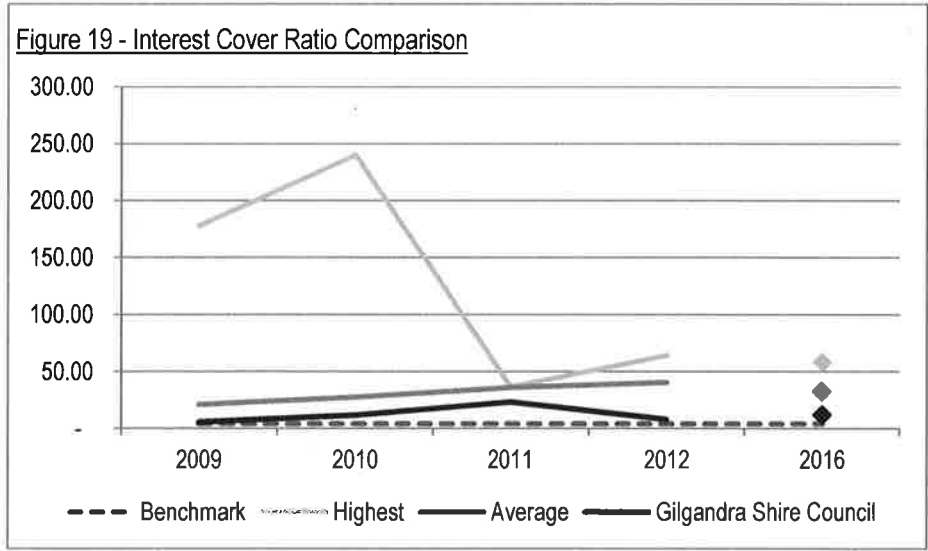


Figure 19 - Interest Cover Ratio Comparison



Council's debt servicing capacity was sound over the review period as indicated by being above benchmark for both DSCR and Interest Cover. The ratios are forecast to remain at this level in the medium term.

Asset Renewal and Capital Works

Figure 20 - Capital Expenditure Ratio Comparison

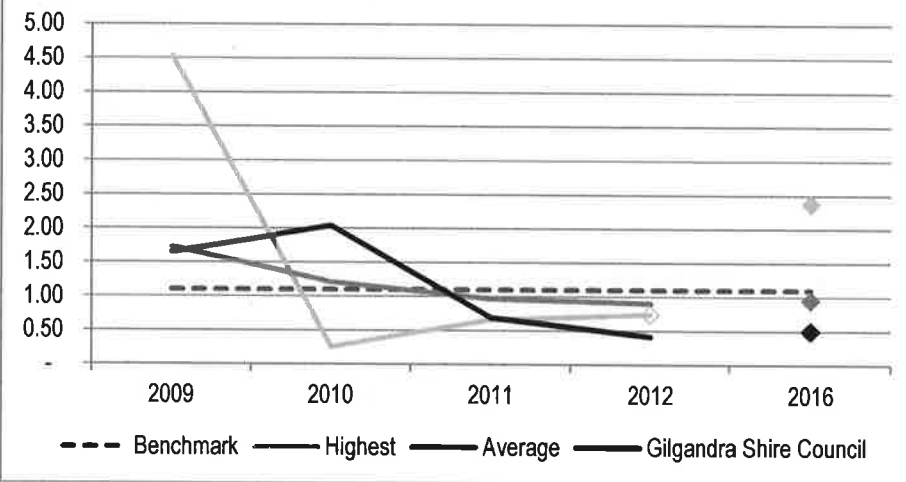


Figure 21- Asset Maintenance Ratio Comparison

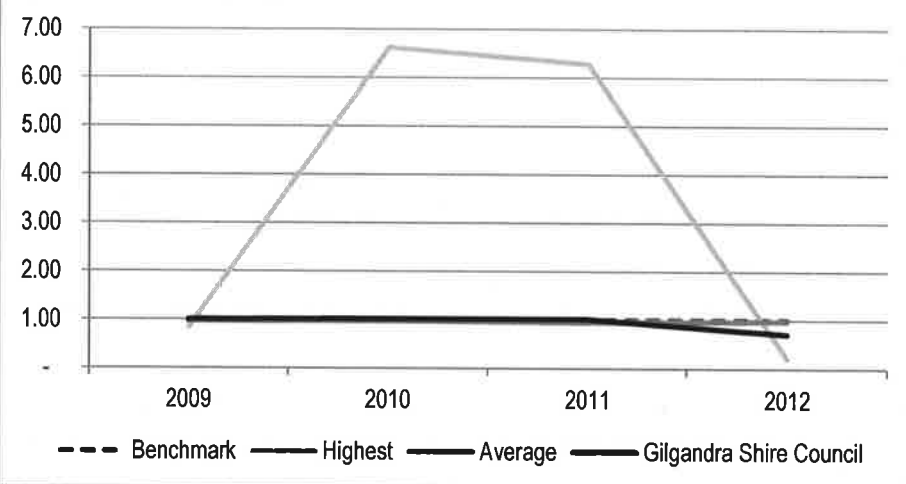




Figure 22 - Infrastructure Backlog Ratio Comparison

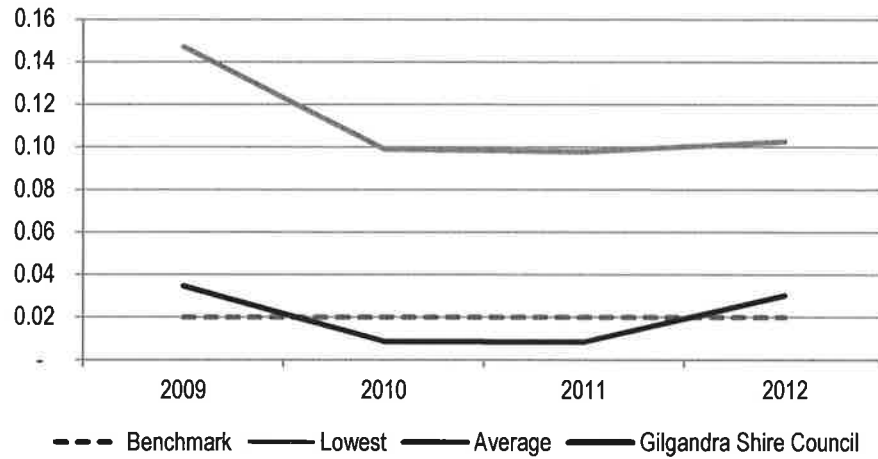
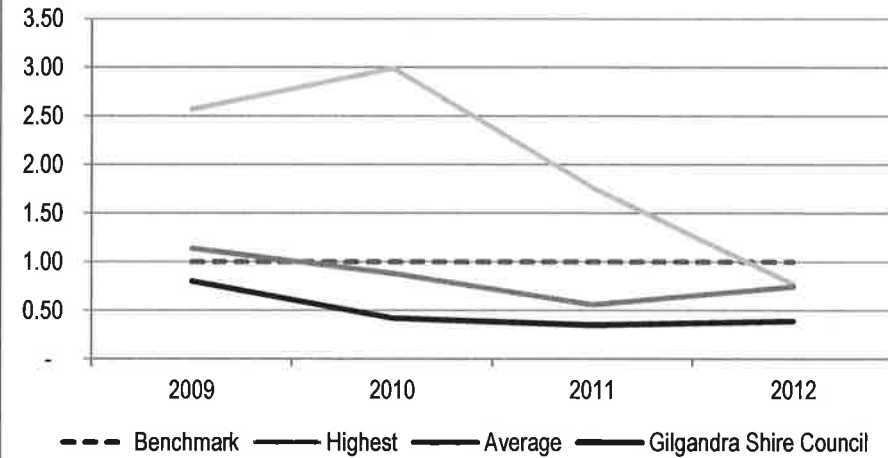


Figure 23 - Building and Infrastructure Asset Renewal Ratio



Council has the lowest reported Infrastructure Backlog in its group and was well below the group average and below benchmark for the majority of the review period. The ratio increased slightly in 2012 to above benchmark level but remained well below the group average. The Asset Maintenance Ratio tracked benchmark levels and the group average over the past four years. Council's Building and Infrastructure Asset Renewal Ratio underperformed against its peer group and remained below benchmark for the review period. The Capital Expenditure Ratio decreased below benchmark and the group average in 2011 as a result of increased depreciation and is forecast to remain at this level in the medium term.



## Section 6 Conclusion and Recommendations

Based on our review of both the historic financial information and the 10 year financial forecast within Council's LTFP we consider Council to be in a satisfactory financial position in terms of their operating performance. Both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed under its LIRS application.

We base our recommendation on the following key points:

- Council's DSCR is above benchmark in four of the 10 years forecast. It is maintained at reasonable levels from 2015 on after the \$0.4m LIRS land loan is repaid
- The Interest Cover Ratio is above benchmark in six of the 10 years forecast
- Council's own source revenue is increasing year on year without the assistance of an SRV
- If Council postpone their proposed future capital projects and concentrate on the LIRS project these ratios will improve, and they may enhance their current asset base
- The upgrade of Terrabile Creek Bridge will increase capacity for the transportation of goods and maintain business in the area

However we would also recommend that the following points be considered:

- It is recognised that Council require additional revenue to maintain their existing infrastructure and address their entire works program. The Council were not successful in obtaining a multi-year SRV as they did not satisfactorily meet all the criteria required for a special variation under section 508A, in particular the Implementation of the Integrated Planning and Reporting Framework' (IPRF). We recommend Council concentrate on completing their IPRF, including being able to demonstrate Community Support and reapply for their multi-year SRV in 2013
- Council's LTFP has been based on current levels of service with reduced capital works, lower growth in roads expenditure and increased rates income base. This is not considered to be sustainable
- While Council's Asset Maintenance Ratio and Buildings and Infrastructure Asset Renewal Ratio are currently above benchmark, this is likely to change when Council's Asset Management Plan is complete

## Appendix A Historical Financial Information Tables

Table 1- Income Statement

Income Statement (\$'000s)	Year ended 30 June			% annual change	
	2011	2010	2009	2011	2010
<b>Revenue</b>					
Rates and annual charges	3,944	3,841	3,716	2.7%	3.4%
User charges and fees	5,086	5,273	5,412	(3.5%)	(2.6%)
Interest and investment revenue	326	282	422	15.6%	(33.2%)
Grants and contributions for operating purposes	10,988	9,817	9,687	11.9%	1.3%
Other revenues	754	867	565	(13.0%)	53.5%
<b>Total revenue</b>	<b>21,098</b>	<b>20,080</b>	<b>19,802</b>	<b>5.1%</b>	<b>1.4%</b>
<b>Expenses</b>					
Employees	11,812	11,817	10,397	(0.0%)	13.7%
Borrowing costs	145	115	378	26.1%	(69.6%)
Materials and contract expenses	4,614	5,653	6,103	(18.4%)	(7.4%)
Depreciation and amortisation	4,770	2,450	2,399	94.7%	2.1%
Other expenses	1,290	1,269	1,232	1.7%	3.0%
<b>Total expenses</b>	<b>22,631</b>	<b>21,304</b>	<b>20,509</b>	<b>6.2%</b>	<b>3.9%</b>
<b>Operating result</b>	<b>(1,533)</b>	<b>(1,224)</b>	<b>(707)</b>	<b>(25.2%)</b>	<b>(73.1%)</b>

Table 2 - Items excluded from Income Statement

Excluded items (\$'000s)			
	2011	2010	2009
Grants and contributions for capital purposes	1,356	867	577
Fair Value Adjustments in Investments	650	0	0
Net gain (loss) from the disposal of assets	(309)	129	(27)



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Table 3 - Balance Sheet

Balance Sheet (\$'000s)	Year Ended 30 June			% annual change	
	2011	2010	2009	2011	2010
<b>Current assets</b>					
Cash and equivalents	6,390	44,52	6,317	43.5%	(29.5%)
Receivables	1,737	967	1,950	79.6%	(50.4%)
Inventories	464	205	98	126.3%	109.2%
Total current assets	8,591	5,624	8,365	52.8%	(32.8%)
<b>Non-current assets</b>					
Investments	1,159	700	700	65.6%	0.0%
Receivables	325	226	146	43.8%	54.8%
Infrastructure, property, plant & equipment	336,617	327,345	97,558	2.8%	235.5%
Total non-current assets	338,101	328,271	98,404	3.0%	233.6%
<b>Total assets</b>	<b>346,692</b>	<b>333,895</b>	<b>106,769</b>	<b>3.8%</b>	<b>212.7%</b>
<b>Current liabilities</b>					
Payables	9,292	7,212	7,721	28.8%	(6.6%)
Borrowings	292	272	215	7.4%	26.5%
Provisions	2,468	2,357	1,977	4.7%	19.2%
Total current liabilities	12,052	9,841	9,913	22.5%	(0.7%)
<b>Non-current liabilities</b>					
Borrowings	1,218	1,521	1,133	(19.9%)	34.2%
Provisions	492	502	467	(2.0%)	7.5%
Total non-current liabilities	1,710	2,023	1,600	(15.5%)	26.4%
<b>Total liabilities</b>	<b>13,762</b>	<b>11,864</b>	<b>11,513</b>	<b>16.0%</b>	<b>3.0%</b>
<b>Net assets</b>	<b>332,930</b>	<b>322,031</b>	<b>95,256</b>	<b>3.4%</b>	<b>238.1%</b>



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Table 4-Cashflow

Cashflow Statement (\$'000s)	Year ended 30 June		
	2011	2010	2009
Cashflows from operating activities	3,901	2,154	2,468
Cashflows from investing activities	(3,261)	(4,706)	(3,417)
Proceeds from borrowings and advances	0	675	250
Proceeds from Retirement Complex Contributions	2,593	1,097	1,990
Repayment of borrowings and advances	(283)	(230)	(550)
Repayment of Retirement Complex Contributions	(1,012)	(855)	(550)
Cashflows from financing activities	(283)	445	(7)
<b>Net increase/(decrease) in cash and equivalents</b>	<b>357</b>	<b>(2,107)</b>	<b>(956)</b>
Cash and equivalents	6,390	4,452	6,317



## Appendix B Glossary

### Asset Revaluations

In assessing the financial sustainability of NSW councils, IPART found that not all councils reported assets at fair value.<sup>1</sup> In a circular to all councils in March 2009<sup>2</sup>, DLG required all NSW councils to revalue their infrastructure assets to recognise the fair value of these assets by the end of the 2009/10 financial year.

### Collateralised Debt Obligation (CDO)

CDOs are structured financial securities that banks use to repackage individual loans into a product that can be sold to investors on the secondary market.

In 2007 concerns were heightened in relation to the decline in the "sub-prime" mortgage market in the USA and possible exposure of some NSW councils, holding CDOs and other structured investment products, to losses.

In order to clarify the exposure of NSW councils to any losses, a review was conducted by the DLG with representatives from the Department of Premier and Cabinet and NSW Treasury.

A revised Ministerial investment Order was released by the DLG on 18 August 2008 in response to the review, suspending investments in CDOs, with transitional provisions to provide for existing investments.

### Division of Local Government (DLG)

DLG is a division of the NSW Department of Premier and Cabinet and is responsible for local government across NSW. DLG's organisational purpose is "to strengthen the local government sector" and its organisational outcome is "successful councils engaging and supporting their communities". Operating within several strategic objectives DLG has a policy, legislative, investigative and program focus in matters ranging from local government finance, infrastructure, governance, performance, collaboration and community engagement. DLG strives to work collaboratively with the local government sector and is the key adviser to the NSW Government on local government matters.

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<sup>1</sup>IPART "Revenue Framework for Local Government" December 2009 p.83

<sup>2</sup> DLG "Recognition of certain assets at fair value" March 2009



### Depreciation of Infrastructure Assets

Linked to the asset revaluations process stated above, IPART's analysis of case study councils found that this revaluation process resulted in sharp increases in the value of some council's assets. In some cases this has led to significantly higher depreciation charges, and will contribute to higher reported operating deficits.

### EBITDA

EBITDA is an acronym for "earnings before interest, taxes, depreciation, and amortisation". It is often used to measure the cash earnings that can be used to pay interest and repay principal.

### Grants and Contributions for Capital Purposes

Councils receive various capital grants and contributions that are nearly always 100% specific in nature. Due to the fact that they are specifically allocated in respect of capital expenditure they are excluded from the operational result for a council in TCorp's analysis of a council's financial position.

### Grants and Contributions for Operating Purposes

General purpose grants are distributed through the NSW Local Government Grants Commission. When distributing the general component each council receives a minimum amount, which would be the amount if 30% of all funds were allocated on a per capita basis. When distributing the other 70%, the Grants Commission attempts to assess the extent of relative disadvantage between councils. The approach taken considers cost disadvantage in the provision of services on the one hand and an assessment of revenue raising capacity on the other.

Councils also receive specific operating grants for one-off specific projects that are distributed to be spent directly on the project that the funding was allocated to.

### Independent Commission Against Corruption (ICAC)

ICAC was established by the NSW Government in 1989 in response to growing community concern about the integrity of public administration in NSW.

The jurisdiction of the ICAC extends to all NSW public sector agencies (except the NSW Police Force) and employees, including government departments, local councils, members of Parliament, ministers, the judiciary and the governor. The ICAC's jurisdiction also extends to those performing public official functions.

### Independent Pricing and Regulatory Tribunal (IPART)

IPART has four main functions relating to the 152 local councils in NSW. Each year, IPART determines the rate peg, or the allowable annual increase in general income for councils. They also review and determine council applications for increases in general income above the rate peg, known as "Special Rate Variations". They approve increases in council minimum rates. They also review council development contributions plans that propose contribution levels that exceed caps set by the Government.



## Infrastructure Backlog

Infrastructure backlog is defined as the estimated cost to bring infrastructure, building, other structures and depreciable land improvements to a satisfactory standard, measured at a particular point in time. It is unaudited and stated within Special Schedule 7 that accompanies the council's audited annual financial statements.

## Integrated Planning and Reporting (IP&R) Framework

As part of the NSW Government's commitment to a strong and sustainable local government system, the *Local Government Amendment (Planning and Reporting) Act 2009* was assented on 1 October 2009. From this legislative reform the IP&R framework was devised to replace the former Management Plan and Social Plan with an integrated framework. It also includes a new requirement to prepare a long-term Community Strategic Plan and Resourcing Strategy. The other essential elements of the new framework are a Long-Term Financial Plan (LTFP), Operational Plan and Delivery Program and an Asset Management Plan.

## Local Government Cost Index (LGCI)

The LGCI is a measure of movements in the unit costs incurred by NSW councils for ordinary council activities funded from general rate revenue. The LGCI is designed to measure how much the price of a fixed "basket" of inputs acquired by councils in a given period compares with the price of the same set of inputs in the base period. The LGCI is measured by IPART.

## Net Assets

Net Assets is measured as total assets less total liabilities. The Asset Revaluations over the past years have resulted in a high level of volatility in many councils' Net Assets figure. Consequently, in the short term the value of Net Assets is not necessarily an informative indicator of performance. In the medium to long term however, this is a key indicator of a council's capacity to add value to its operations. Over time, Net Assets should increase at least in line with inflation plus an allowance for increased population and/or improved or increased services. Declining Net Assets is a key indicator of the council's assets not being able to sustain ongoing operations.

## Roads and Maritime Services (RMS)

The NSW State Government agency with responsibility for roads and maritime services, formerly the Roads and Traffic Authority (RTA).

## Section 64 Contribution

Development Servicing Plans (DSPs) are made under the provisions of Section 64 of the Local Government Act 1993 and Sections 305 to 307 of the Water Management Act 2000.

DSPs outline the developer charges applicable to developments for Water, Sewer and Stormwater within each Local Government Area.





### Section 94 Contribution

Section 94 of the Environmental Planning and Assessment Act 1979 allows councils to collect contributions from the development of land in order to help meet the additional demand for community and open space facilities generated by that development.

It is a monetary contribution levied on developers at the development application stage to help pay for additional community facilities and/or infrastructure such as provision of libraries; community facilities; open space; roads; drainage; and the provision of car parking in commercial areas.

The contribution is determined based on a formula which should be contained in each council's Section 94 Contribution Plan, which also identifies the basis for levying the contributions and the works to be undertaken with the funds raised.

### Special Rate Variation (SRV)

A SRV allows councils to increase general income above the rate peg, under the provisions of the Local Government Act 1993. There are two types of special rate variations that a council may apply for:

- a single year variation (section 508(2)) or
- a multi-year variation for between two to seven years (section 508A).

The applications are reviewed and approved by IPART.

## **Ratio Explanations**

### Asset Maintenance Ratio

Benchmark = Greater than 1.0x

Ratio = actual asset maintenance / required asset maintenance

This ratio compares actual versus required annual asset maintenance, as detailed in Special Schedule 7. A ratio of above 1.0x indicates that the council is investing enough funds within the year to stop the infrastructure backlog from growing.

### Building and Infrastructure Renewals Ratio

Benchmark = Greater than 1.0x

Ratio = Asset renewals / depreciation of building and infrastructure assets

This ratio compares the proportion spent on infrastructure asset renewals and the asset's deterioration measured by its accounting depreciation. Asset renewal represents the replacement or refurbishment of existing assets to an equivalent capacity or performance as opposed to the acquisition of new assets or the refurbishment of old assets that increase capacity or performance.



### Cash Expense Cover Ratio

Benchmark = Greater than 3.0 months

Ratio = current year's cash and cash equivalents / (total expenses – depreciation – interest costs)\*12

This liquidity ratio indicates the number of months a council can continue paying for its immediate expenses without additional cash inflow.

### Capital Expenditure Ratio

Benchmark = Greater than 1.1x

Ratio = annual capital expenditure / annual depreciation

This indicates the extent to which a council is forecasting to expand its asset base with capital expenditure spent on both new assets, and replacement and renewal of existing assets.

### Debt Service Cover Ratio (DSCR)

Benchmark = Greater than 2.0x

Ratio = operating results before interest and depreciation (EBITDA) / principal repayments (from the statement of cash flows) + borrowing interest costs (from the income statement)

This ratio measures the availability of cash to service debt including interest, principal and lease payments

### Infrastructure Backlog Ratio

Benchmark = Less than 0.02x

Ratio = estimated cost to bring assets to a satisfactory condition (from Special Schedule 7) / total infrastructure, building, other structures and depreciable land improvement assets (from note 9a)

This ratio shows what proportion the backlog is against total value of a council's infrastructure.

### Interest Cover Ratio

Benchmark = Greater than 4.0x

Ratio = EBITDA / interest expense (from the income statement)

This ratio indicates the extent to which a council can service its interest bearing debt and take on additional borrowings. It measures the burden of the current interest expense upon a council's operating cash.



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### Operating Ratio

Benchmark = Better than negative 4%

Ratio = (operating revenue excluding capital grants and contributions – operating expenses) / operating revenue excluding capital grants and contributions

This ratio measures a council's ability to contain operating expenditure within operating revenue.

### Own Source Operating Revenue Ratio

Benchmark = Greater than 60%

Ratio = rates, utilities and charges / total operating revenue (inclusive of capital grants and contributions)

This ratio measures the level of a council's fiscal flexibility. It is the degree of reliance on external funding sources such as operating grants and contributions. A council's financial flexibility improves the higher the level of its own source revenue.

### Unrestricted Current Ratio

Benchmark = 1.5x (taken from the IPART December 2009 Revenue Framework for Local Government report)

Ratio = Current assets less all external restrictions / current liabilities less specific purpose liabilities

Restrictions placed on various funding sources (e.g. Section 94 developer contributions, RMS contributions) complicate the traditional current ratio because cash allocated to specific projects are restricted and cannot be used to meet a council's other operating and borrowing costs. The Unrestricted Current Ratio is specific to local government and is designed to represent a council's ability to meet debt payments as they fall due.

