

# Financial Sustainability Review

**Prepared for Nebo Shire Council | April 2007**

An assessment of Nebo Shire Council's capacity to meet its financial commitments in the short, medium and long-term.



QUEENSLAND  
TREASURY  
CORPORATION



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# 1 | EXECUTIVE SUMMARY

Nebo Shire Council (Council) has asked Queensland Treasury Corporation (QTC) to review its financial capacity to service current and future obligations (ie, its financial sustainability).

To reach our conclusions and recommendations we:

- evaluated Council's historical performance and forecast financial outcomes
- reviewed business drivers and regional economic information, and
- tested the impact of various events on Council's financial forecasts.

## 1.1 Rating

Our rating of Council's financial sustainability is moderate with a positive outlook.

See section 3 for further details.

## 1.2 Key observations

Key observations include:

- Favourable economic outlook for the Shire, associated with comparatively young age profile, low unemployment rate and expanding mining activities.
- Forecasts indicate moderate fiscal flexibility and sound liquidity.
- Forecast average depreciation expense and useful lives of assets are within the usually observed range, following Council's review of asset values and depreciation costs in FY2006.
- Positive operating results are forecast in each financial year.
- Minimal borrowings forecast and significant capacity to borrow, if required.
- Total operating expenses are forecast to grow at a faster rate than total operating revenues.
- Adverse economic impact on agricultural production due to prolonged drought.
- No formalised ten year capital works program and Asset Management Plan.
- Difficulty in recruiting and retaining qualified staff.
- Council's liquidity and financial position is susceptible to unexpected cost overruns occurring on forecast capital programs (see section 8 *Scenario Analysis*, testing a 20.0 per cent increase in capital expenditure).

See section 4 for further details.

## 1.3 Recommendations

Nebo Shire is experiencing substantial regional growth as a result of the mining industry and this trend is expected to continue over the forecast period. Council has a challenging time ahead with the consequences of a growing economy, mainly through the provision of additional infrastructure facilities and maintenance of existing infrastructure.

To manage the financial risks associated with the large capital works program forecast and to achieve the forecast financial position, Council should ensure the continuation of a disciplined approach to planning and scheduling of required capital works and to financial management which has seen Council's financial position steadily improve over recent years. This is particularly important as scenario analysis shows Council's financial position will be affected negatively, if capital expenditure increases at a higher rate than that forecast.

We offer the following six strategic recommendations:

1. Commit to balanced or surplus operating results.
2. Carefully consider any future decisions that may constrain the level of rates and utilities increases.
3. Prioritise the completion and implementation of comprehensive ten year capital works program and Asset Management Plans encompassing all of Council's assets.
4. Establish management strategies and monitor risks associated with Council's large capital works program, in particular rising construction costs.
5. Develop and implement a resourcing plan to address the risks associated with high staff turnover and succession planning difficulties.
6. Conduct a follow-up review of the capital expenditure outlook, if population growth forecasts are underestimated or Council's operating position changes.

See section 5.1 for further details.

We make the following three general recommendations:

1. Continue to investigate resource sharing and shared service options with a view to gaining economies of scale benefits.
2. Continue to regularly review and update a three-way ten-year financial forecasting tool (such as QTC Local Government Forecasting Model) to assist decision making.
3. Conduct a Financial Sustainability Review every three years as part of Council's regular review processes.

See section 5.2 for further details.

## 2 | SCOPE AND APPROACH

Nebo Shire Council (Council) has asked Queensland Treasury Corporation (QTC) to review its financial capacity to service current and future obligations.

Our approach was to:

- evaluate Council's historical performance and forecast financial outcomes through financial ratio analysis
- review business drivers and regional economic information
- test the impact of various scenarios on Council's financial forecasts
- draw conclusions on Council's financial sustainability, and
- provide recommendations on the risks and issues facing Council.

We relied on:

- discussions with Council's senior management
- Council's historical financial information (FY2001 to FY2006)
- Council's financial model, containing high level financial forecast information (FY2007 to FY2016)
- the Office of Economic and Statistical Research's (OESR) economic profile for the Shire, and
- the Department of Local Government, Planning, Sport and Recreation's (DLGPSR) *Annual Comparative Data*, issued May 2006.

We have not:

- been provided with detailed information of individual business units
- been asked to comment on the financial position of individual business units
- audited or independently verified Council's financial model, or
- made any representation as to the accuracy or completeness of Council's financial model.

## 3 | RATING

**Financial sustainability is the capacity to service current and future financial obligations**

**Rating:**

Very strong
Strong
<b>MODERATE</b>
Weak
Very Weak
Distressed

**Outlook:**

<b>POSITIVE</b>
Negative
Neutral
Developing

Our rating of Council’s financial sustainability is moderate with a positive outlook.

The moderate rating was determined after considering the following:

- business and economic environment
- financial forecast reasonableness
- forecast capital expenditure
- liquidity position
- maintenance of community equity
- fiscal flexibility
- capacity to manage core business risks, and
- operating result (excluding capital items).

A positive outlook has been assigned for the next two year period reflecting the:

- Growing local economy (mining), younger population profile than State, lower than State unemployment rate and forecast population growth.
- Continued projected operating surpluses, healthy cash balance and ability to maintain its capital works program.

See Appendix A *Financial Sustainability Review Ratings and Outlook Definitions*.

## 4 | KEY OBSERVATIONS

The following key observations were drawn from the financial, and business and economic analyses.

### 4.1 Positive indicators

**Strong economic outlook and low unemployment**

**Relatively young population with positive growth projection**

**Moderate fiscal flexibility**

**Operating surpluses recorded in all forecast years**

**Sound liquidity**

**Significant capacity to borrow, if required**

**43% of capital expenditure funded from own cash flows**

**Forecast significant increase in community equity**

- Favourable economic outlook associated with growth in the mining sector.
- The Shire has a very low unemployment rate of 0.5 per cent (September 2006 quarter) which is well below the State's average of 4.5 per cent for the same period.
- The Shire has one of Queensland's youngest regional populations. In 2004–05, the 45 years and over age group (ie, those who are of traditional retirement age or will reach retirement in the next twenty years) accounted for 27.9 per cent of the Shire's population (State's average 36.7 per cent). Population projections for the Shire are also positive.
- Moderate fiscal flexibility with 65.0 per cent of forecast total revenue generated from net rates, utilities and charges (historically 53.9 per cent).
- Forecast average depreciation expense as a percentage of property, plant and equipment is 3.0 per cent, which is within the usually observed industry range of between 2.5 per cent and 3.3 per cent.
- The average useful life of Council's assets has increased from 16.3 years historically to 33.3 years over the forecast period as a result of asset revaluations and increases in asset useful life estimates in FY2005. This issue had impacted Council's historic financial position.
- Council's forecast shows a cumulative net operating surplus (excluding capital items) of \$8.0 million with all forecast years recording operating surpluses.
- Sound liquidity is forecast with the current ratio averaging 8.0 times and cash holdings equivalent to an average of 7.8 months of cash expenses.
- Capacity to borrow, if required, with a forecast interest cover ratio of 80.4 times and debt service cover ratio of 8.5 times.
- Council is expected to fund 43.0 per cent of its capital expenditure program from its own cash flows, 45.0 per cent from cash subsidies, donations and contributions, 10.0 per cent from the sale of property, plant and equipment and 2.0 per cent from new borrowings.
- Forecast large increase in community equity (\$52.2 million at 30 June 2006, \$86.2 million at 30 June 2016).

## 4.2 Risks

**Operating expenses forecast to grow at faster rate than operating revenues**

- Operating deficits were recorded in five out of six historical years. Council is forecasting operating surpluses in all years, however, this turnaround has to be proven to be sustainable.
- Total operating expenses are forecast to grow at a faster rate than total operating revenues (5.1 per cent per annum and 4.1 per cent per annum respectively). This suggests that Council may incur deficits during the forecast period unless budgets are monitored carefully.

**Difficulty recruiting and retaining staff**

- Council is experiencing difficulty in recruiting and retaining qualified and experienced staff.
- The prolonged drought in the Shire is having an adverse impact on agricultural production, one of the Shire's main industries.

**Environmental concerns with coal mining**

- There are longer-term risks associated with coal mining activities resulting from environmental concerns.

**No formalised capital works program in place**

- Due to the expanding coal mining industry the Shire has a transient workforce and given the size of Council's capital expenditure program over the forecast period, which is large compared to historical levels, Council may face risks in project delivery.
- Although Council has forecast a significant capital expenditure program, it does not have a formalised ten year capital works program.
- Sensitivity analysis demonstrates that if the scenario of a 20.0 per cent increase in capital expenditure occurs, Council's liquidity and financial position would be negatively impacted, however, Council would have sufficient time to address the increased costs as operating surpluses would not drop to unacceptable levels.

# 5 | RECOMMENDATIONS

## 5.1 Strategic

There are six strategic recommendations for Council.

**Carefully consider revenue needs**

1. Carefully consider any future decisions that may constrain the level of rates and utilities revenue increases. Increases to own source revenues should be considered in the context of the number and level of services provided, scheduled capital works program, and movements in construction work costs, wages and salaries expenses and materials and services costs.

**Prioritise implementation of capital works program and Asset Management Plans**

2. Prioritise the completion and implementation of comprehensive ten year capital works program and Asset Management Plans. These plans will improve Council's decision support and financial forecast systems by providing a profile of future asset developments, replacement, renewal and disposal. Such information must be incorporated into Council's financial forecast to aid decision making.

**Capital expenditure monitoring**

3. Regularly examine actual results and industry data against Council's forecasts and amend forecasts as required by paying particular attention to the following:

- Data regarding the movement of construction industry costs. This will assist with the integrity of financial forecasting, resulting in a realistic picture of Council's future financial requirements and potential funding sources.
- Suitable processes to manage and monitor expenditure, so as to reduce the risk of budget overruns.

This may involve developing a strategy for managing expense increases above forecast levels.

**Retention of staff and succession planning**

4. Develop and implement a plan for retention of staff and succession planning, to ensure the retention of experience and knowledge within Council.

**Maintain operating surpluses**

5. Commit to balanced or surplus operating results. Council should seek to maintain forecast operating surpluses. Operating deficits will affect a local government's future financial flexibility and potentially transfer a liability to future ratepayers. This will ensure Council's ongoing financial sustainability is not impacted.

6. Council should undertake a follow up review of its capital expenditure program and update financial forecasts if required, with a view to ensuring integrity in Council's financial forecasts, resulting in a realistic picture of Council's future financial commitments and potential funding requirements and sources, including:

- monitor population growth forecasts when updated for significant changes

- continual monitoring of construction industry costs
- maintain tight controls over expenditure to mitigate risks (this may involve strategies for managing expense increases above forecast levels), and
- review optimal use of debt funding for long term assets.

## 5.2 General

There are three general recommendations.

### **Economies of scale benefits**

1. Council should continue to investigate shared service options with a view to gaining economies of scale benefits, particularly through a regional approach to service provision and resource sharing.

### **Continue to maintain financial forecasting**

2. Council should continue to maintain a three way ten year financial forecast (such as the QTC model). This model should be regularly updated and used as an aid to decision making.

### **FSR part of Council's regular review process**

3. A Financial Sustainability Review should become part of Council's regular review processes. We would suggest that this be done on say a rolling three year basis.

## 6 | BUSINESS AND ECONOMIC ANALYSIS

### 6.1 Economic information

The following table summarises the key economic information for Nebo Shire Council and, where appropriate, comparative information with Queensland.

**Table 1: Comparison of key economic information for Nebo Shire Council against Queensland**

	Nebo Shire Council	State of Queensland
See attached OESR <i>Economic Profile</i> .		
Also refer DLGPSR <i>Annual Comparative Data</i> , issued May 2006.		
Australian Classification of Local Government	Rural Agricultural Medium (RAM)	
Population (at 30 June 2005)	2,107	4.0 million
Population forecast growth	0.9 per cent per annum	1.7 per cent per annum
Median age	32.7 years	36.0 years
45+ age group (per cent of population)	27.9 per cent	36.7 per cent
Forecast median age 2026	35.6 years	40.8 years
Average taxable income	\$59,396	\$40,037
Unemployment rate (September 2006)	0.5 per cent	4.5 per cent
Rateable properties	1,038	
Council employees	53	
Council employees per 100 persons	2.52	

### 6.2 Inflation factors

	2004 %	2005 %	2006 %
CPI	2.6	2.8	3.3
CCI	5.4	5.7	4.5
QLPI	3.6	3.8	N/a

When developing a financial forecast or a budget, each local government must consider the impact of changes to the price of a range of items. This data is used for strategic and operational planning and decision making.

Generally, the movement of the price of goods in an industry is considered by reference to an appropriate price index (ie, a measure of the average prices of a group of goods relative to a base year).

There are numerous industry cost indices published by Government and industry bodies. In a local government context, the most relevant industry cost indices are the Consumer Price Index, LGAQ's Council Cost Index and the Queensland Labour Price Index. A brief explanation of these indices is as follows:

- Consumer Price Index (CPI) is a general indicator of the rate of change in prices for consumer goods and services. It measures movements in a list of consumer goods and services, with about 100,000 prices regularly collected for each quarter's result. CPI for 2006 was 3.3 per cent.
- Although CPI is generally used as a standard inflation factor by the Australian community, it is not truly indicative of local government cost structures. Consequently, each year the Local Government Association of Queensland publishes the Council Cost Index (CCI).

The CCI assumes that engineering work, which represents 50.0 per cent of Council outlays, is driven by the general construction index, and that the remaining costs are driven by CPI. Therefore, the CCI is determined by the increase in the general construction index and the average increase in CPI. The CCI for the year 2005 was 5.7 per cent.

- The Queensland Labour Price Index (QLPI) is a broad measure of annual changes in the price of labour in the labour market. The QLPI for 2005 was 3.8 per cent.

Generally when producing financial forecasts, it is standard practice to use the latest historical inflation figures as a guide. Accordingly, QTC uses historical inflation figures to help determine the reasonableness of forecast assumptions.

## 6.3 Industry

- Nebo Shire has an extremely diversified economy dominated by mining. It has experienced significant regional growth through the operation of eight coal mines within the Shire. While the economy is enhanced by the rural interests based on cattle grazing and agriculture, the forestry, fishing, transport and storage industries also contribute substantially to the economy.
- Beef cattle production accounts for the majority of the contribution by the agricultural sector, while crop cultivation (including sugar cane, sorghum and grain) forms the rest.

## 6.4 Economic outlook

- The economic outlook for Nebo is favourable with further significant regional growth expected in both the mining and agricultural sectors.
- The outlook for coal mining appears promising with eight mines in operation and new mines such as the Daunia Coal Project and the Wards Well-Lancewood Coal project currently being evaluated.

- The Shire is predominately dependant on the beef cattle industry, which is exposed to the global markets and fluctuations in local rainfall. Economic outlooks expect saleyard prices of cattle to decline due to growing supply and increasingly competitive export markets.
- A lack of rainfall in the Shire affects the growth prospects in both cattle grazing and crop cultivation.
- Population and employment growth is expected to continue due to the increasing mining activity. A key factor in the population outlook is the extent to which the expansion of mining employment translates to growth in the Shire’s resident population and/or the requirement for provision of additional services for the transient workforce.
- The Shire’s population has a relatively young age profile. Hence, Nebo Shire is one of Queensland’s youngest regional populations. In 2004–05, the 45 years and over age group (ie, those who are of traditional retirement age or will reach retirement in the next twenty years) accounted for 27.9 per cent of the Shire’s population, compared with the State average of 36.7 per cent. Further, the Shire’s unemployment rate has trended downwards with a rate of 0.5 per cent for the September 2006 quarter, compared to the State’s unemployment rate of 4.5 per cent for the same period.

## 6.5 Infrastructure

Although Nebo Shire is expected to experience minimal population growth over the foreseeable future, Council does not have a formalised 10 year capital works program in place. It does, however, have a 10 year works program for Roads and Plant projects.

**Significant increase in infrastructure expenditure over forecast period**

Council estimates a capital expenditure program of approximately \$54.3 million over the forecast period, with \$20.2 million assigned for upgrading the roads, drainage and bridge network, \$12.0 million for new and/or upgrade to buildings and \$9.6 million to renew and/or upgrade water and sewerage infrastructure.

## **6.6 Corporate and operational plans**

Council has a Corporate Plan in place, which is current for the six year period from FY2005 to FY2010. Council has an Operational Plan which is prepared annually and identifies those parts of the Corporate Plan which will be achieved in the financial year.

We understand Council has the following additional plans:

- Pest Management Plan for the period 2005–2009
- Lake Elphinstone Management Plan
- Tourism Implementation Plan
- Snow's Place Business Plan
- Nebo Economic Development Strategy, and
- Nebo Sport and Recreation Facility Needs Study

## 7 | FINANCIAL ANALYSIS

The overall financial sustainability of a local government is its ability to maintain the required range of services and facilities at desired levels of quality in the short and long term.

A local government's deteriorating financial position (evidenced by budgetary or financial stress) will adversely affect its ability to provide services to the local community in the short, medium or long term. Indicators may include a combination of the following:

- poor or poorly maintained infrastructure
- inappropriate depreciation program
- poor range and/or quality of services
- impaired borrowing ability
- liquidity difficulties
- reserves being drawn down, and/or
- ratepayers subjected to relatively high levels of rating stress.

Council's historical and forecast financial data is discussed in section 7.1, 7.2 and 7.3.

See Appendix B *Historical Financial Summary (FY2001–FY2006)*.

See Appendix C *Forecast Financial Summary (FY2007–FY2016)*.

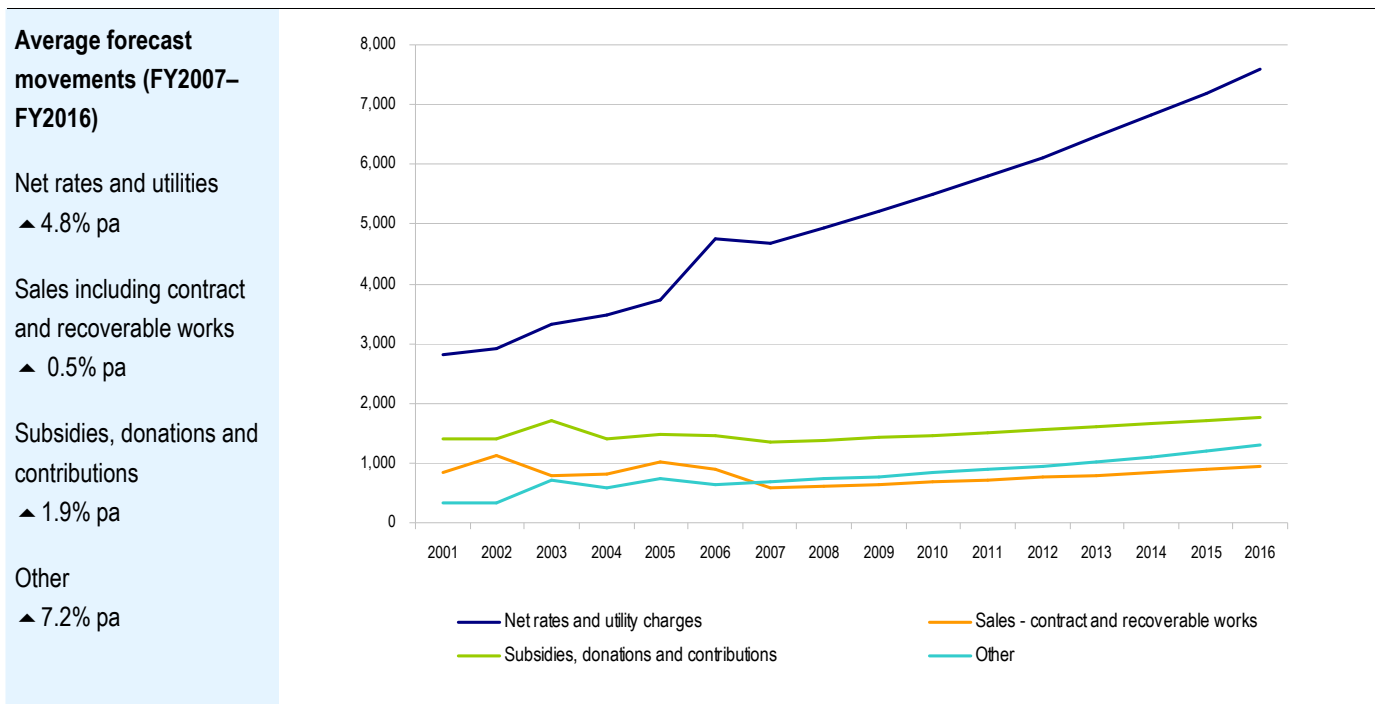
## 7.1 Income Statement

### 7.1.1 Historical and forecast performance

#### Revenue

The following graph illustrates Council's revenue for the historical period (FY2001 to FY2006) and forecast period (FY2007 to FY2016):

Figure 1: Operating revenue (\$'000)



Average forecast movements (FY2007–FY2016)	
Net rates and utilities	▲ 4.8% pa
Sales including contract and recoverable works	▲ 0.5% pa
Subsidies, donations and contributions	▲ 1.9% pa
Other	▲ 7.2% pa

#### Key observations

**Total operating revenue increase 4.1 per cent**

- Total operating revenue is forecast to increase from \$7.8 million in FY2006 to \$11.6 million in FY2016. This represents an average net increase of 4.1 per cent per annum compared to the historical average of 7.6 per cent per annum.

**Net rates and utilities 65.0 per cent of total operating revenue**

- Council's own source revenue, being net rates, utilities and charges, represents on average 65.0 per cent of forecast total operating revenue (historical average of 53.9 per cent).

**Forecast growth rate of 4.8 per cent in net rates, utilities and charges**

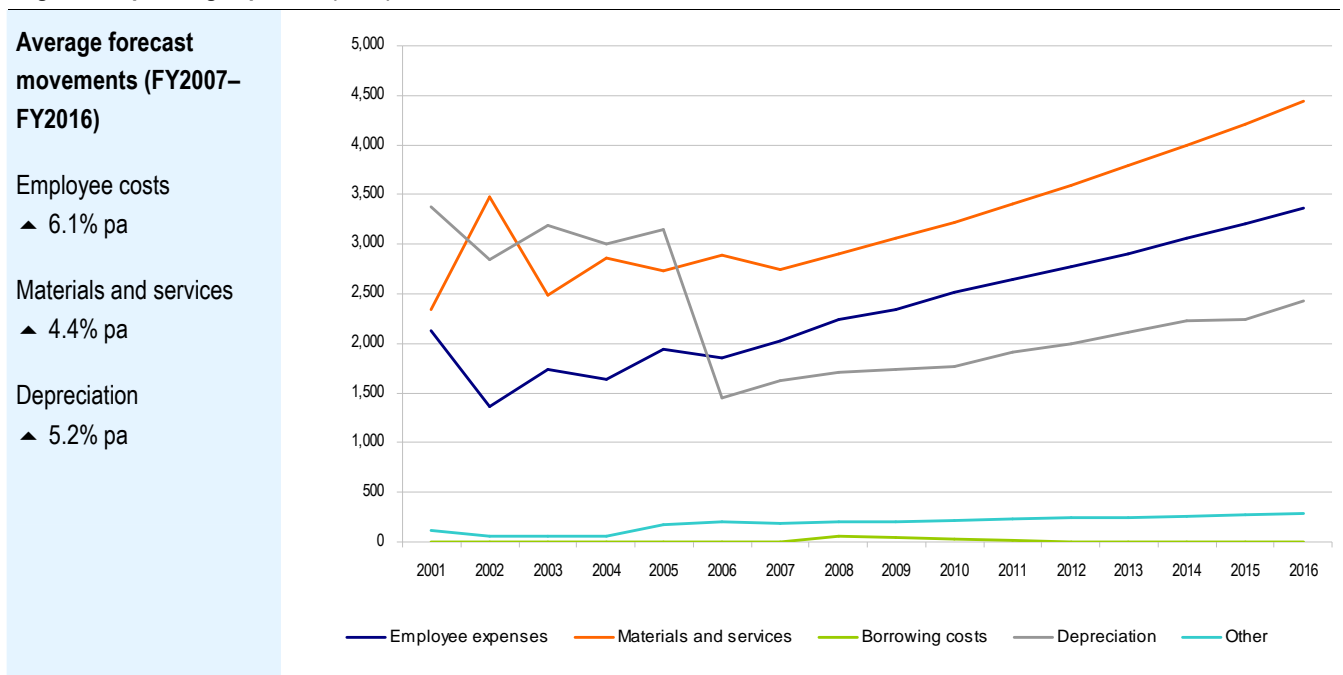
- Net rates and utility charges are forecast to grow on average by 4.8 per cent per annum over the forecast period. However, during the historical period this revenue source has shown a comparatively higher growth rate of 11.2 per cent per annum. Council's forecast assumes an annual CPI increase of 5.5 per cent and a 0.7 per cent per annum increase in rateable properties, from FY2008–FY2016. The higher growth rate during the historical period is attributed to the special levies charged to coal mines.
- Subsidies, donations and contributions are forecast to average 16.8 per cent of total operating revenue (historically 23.2 per cent) and are expected to increase by an average of 1.9 per cent per annum compared to the historical average increase of 0.7 per cent per annum.

- Sales (contract and recoverable works) accounts for 8.1 per cent of forecast total operating revenue (14.5 per cent historically). This source of revenue has been volatile over the historical period and forecasts show annual growth of 5.5 per cent from FY2008. This revenue is primarily derived from works carried out for the Department of Main Roads, with revenue reflecting the amount of contracted work in each year. Although, private works were included in sales (contract and recoverable works) in the historical period, they are shown separately in the forecast period.
- Other operating revenue, which includes fees and charges, rent from Council-owned housing and interest revenue, accounts for 10.1 per cent of forecast total operating revenue (8.4 per cent historically). Other operating revenue is forecast to increase on average by 7.2 per cent per annum compared to the historical growth of 14.4 per cent per annum. This difference is due to the fact that historical figures include gain or loss on sale of land whereas forecast figures show this item separately.

## Expenses

The following graph illustrates Council's expenses for the historical period (FY2001 to FY2006) and forecast period (FY2007 to FY2016):

**Figure 2: Operating expenses (\$000)**



## Key Observations

**Total operating expense growth of 5.1% p.a.**

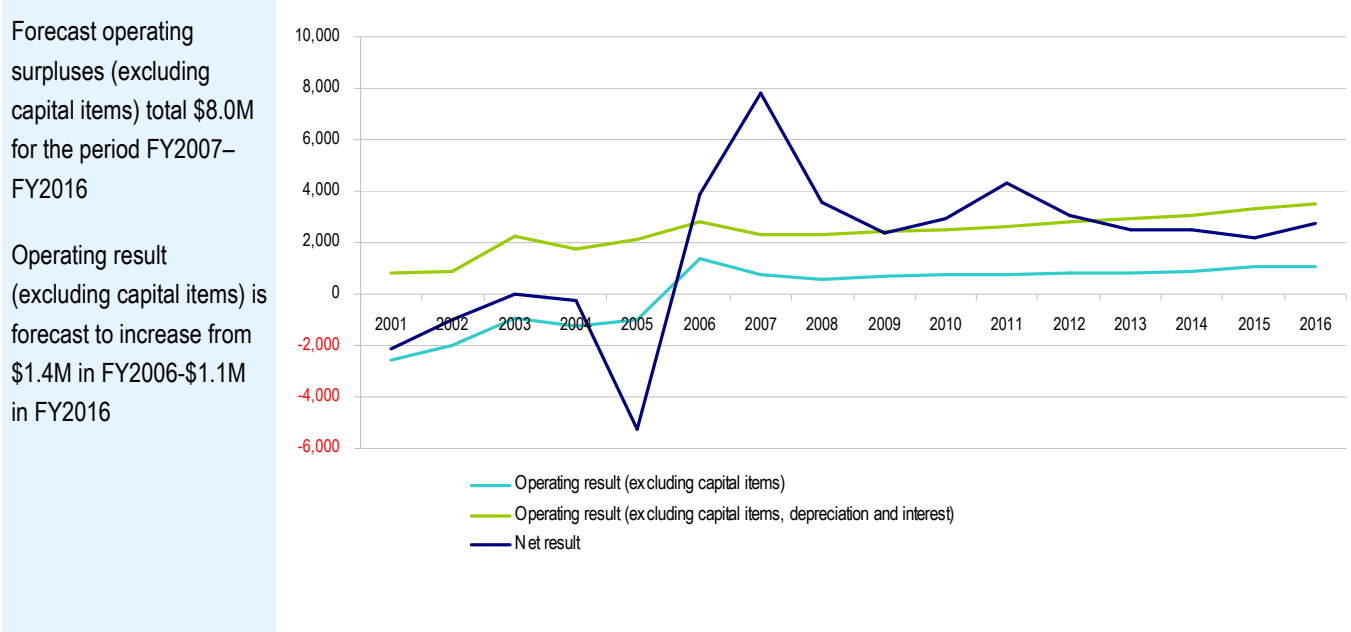
- Total operating expenses are forecast to increase from \$6.4 million in FY2006 to \$10.5 million in FY2016 representing an average annual increase of 5.1 per cent per annum. Historically total operating expenses decreased on average by 4.3 per cent per annum but this is impacted by the \$1.6 million decrease in depreciation in FY2006.

- Employee costs increase by 6.1% pa**
- Employee costs are expected to increase on average by 6.1 per cent per annum over the forecast period (this is well above the 2005 QLPI average rate of 3.8 per cent). Historically employee costs decreased on average by 2.7 per cent per annum, from \$2.1 million in FY2001 to \$1.9 million in FY2006 mainly due to high staff turnover and an inability to fill all vacant positions. Forecast employee costs are higher than the QLPI index as Council is expecting to fill all vacancies over the forecast period. Employee costs represent on average 32.0 per cent of total operating expenses over the forecast period compared to the historical average of 23.8 per cent, and are forecast to increase by approximately 5.0 per cent per annum from FY2009 to FY2016.
- Materials and services largest expense**
- Materials and services costs are forecast to increase on average by 4.4 per cent per annum. However, this includes annual increases of 5.5 per cent per annum from FY2009. Historically, materials and services costs increased on average by 4.3 per cent per annum. Materials and services costs are expected to average 41.8 per cent of total operating expenses during the forecast period (historically 37.5 per cent).
  - Depreciation expense is forecast to increase on average by 5.2 per cent per annum. Historically depreciation has decreased on average by 15.5 per cent per annum. This includes a decrease of 53.7 per cent in FY2005 as a consequence of a downward revaluation of Council's roads and bridges network and an increase in the useful lives of a number of Council's assets in FY2005. This has also resulted in the average useful life of Council's assets increasing to 33.3 years over the forecast period, from 16.3 years in the historical period.
- Depreciation expense within industry ranges**
- Depreciation expense, as a percentage of property, plant and equipment, is forecast to average 3.0 per cent over the forecast period (6.1 per cent historically). The comparatively low percentage over the forecast period is due to the recognition of a lower depreciation expense resulting from asset revaluations (downwards) and increases in the useful lives of Council's assets in FY2005. This forecast level of 3.0 per cent is within the usually observed range for the local government industry of between 2.5 per cent and 3.3 per cent.

## Results

The following graph illustrates Council's operating result (excluding capital items) for the historical period (FY2001 to FY2006) and forecast period (FY2007 to FY2016):

**Figure 3: Operating result, operating result before interest and depreciation and net result (\$'000)**



**Historical operating deficits except FY2006 and operating surpluses forecast**

**Positive cash flow historically as well as over forecast period**

**Historical net deficits except FY2006**

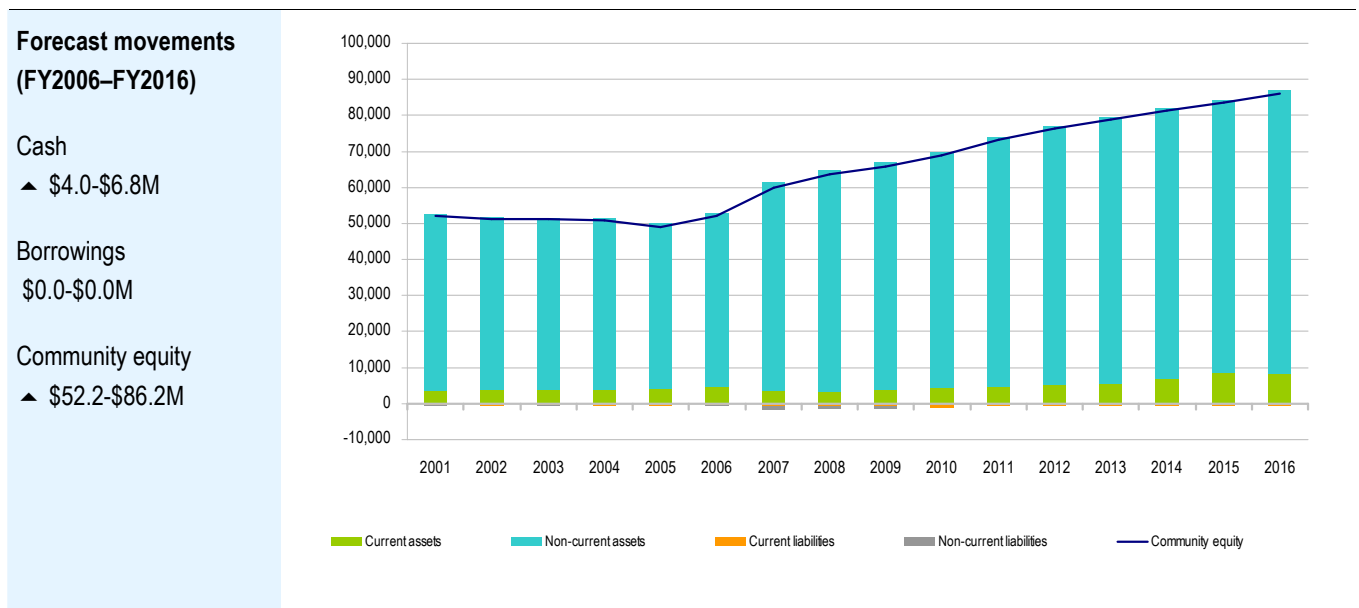
- Council recorded total net operating deficits (excluding capital items) of \$6.4 million over the historical period, with operating losses in all years except FY2006. Council has forecast net operating surpluses of \$8.0 million with all years recording operating surpluses.
- Depreciation charges are forecast to total \$19.8 million and interest and capital costs to total \$0.3 million, resulting in a total cash contribution from operating results before capital, interest and depreciation of \$28.1 million.
- Council recorded a net deficit of \$4.8 million during the historical period with all years except for FY2006 recording net losses. The net loss in FY2005 is comparatively very high due to the recognition of a loss on the revaluation (downward) of Council's assets in that year. Council has forecast a cumulative net result of \$34.0 million with each forecast year recording a net surplus. Council's forecasts indicate a higher capital income of \$7.1 million (relating to subsidies, donations and contributions for the installation of a sewerage treatment plant and the construction of buildings) resulting in a net result of \$7.8 million.

## 7.2 Balance Sheet

### 7.2.1 Historical and forecast performance

The following graph summarises Council’s historical and forecast financial position for the financial years ending 30 June 2001 to 30 June 2016:

Figure 4: Historical and forecast data from Statement of Financial Position (\$000)



#### Key observations

##### Reasonable cash position

- Council’s cash position is forecast to increase from \$4.0 million at 30 June 2006 to \$6.8 million at 30 June 2016 (see section 7.3 *Statement of Cash Flows* for further details).

##### Sound liquidity

- The current ratio (a measure of current assets to current liabilities), which assesses Council’s ability to pay its obligations as and when they fall due, is forecast to decrease from 10.2 times as at 30 June 2006 to a low of 4.25 times in FY2008 before increasing to 11.9 times at 30 June 2016.

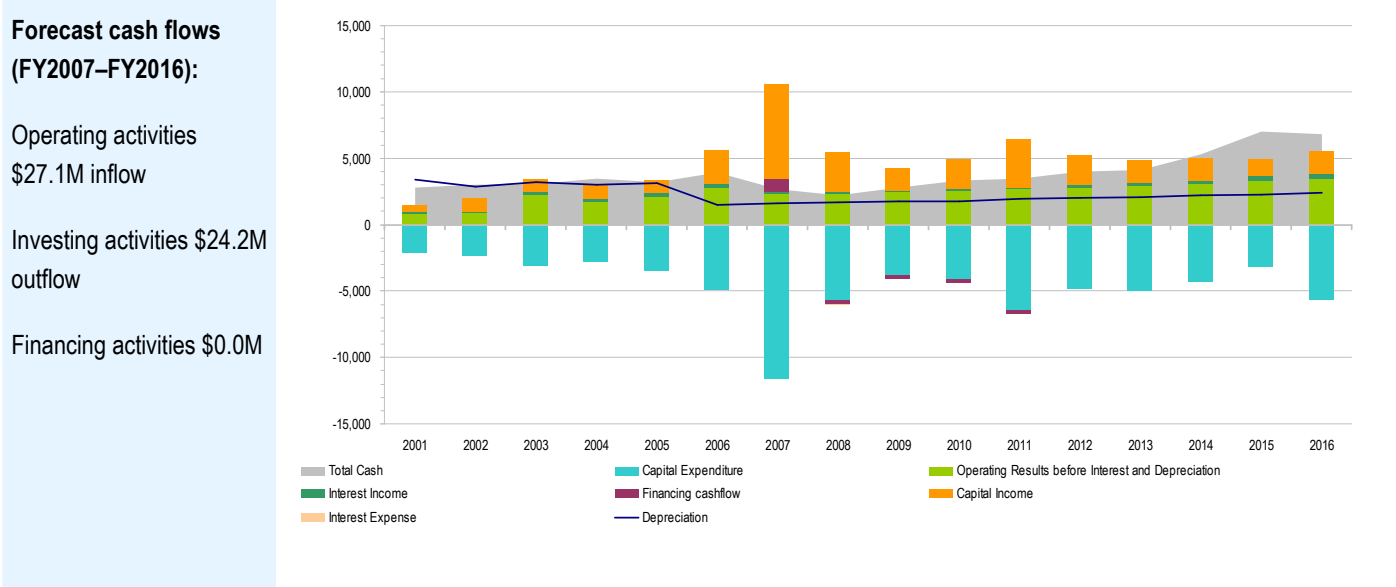
##### Forecast capital expenditures at 1.2 time depreciation

- The written down value of property plant and equipment increases from \$44.7 million at 30 June 2006 to \$75.2 million at 30 June 2016 as a result of the significant forecast capital expenditure program of \$54.3 million.
- Community equity is forecast to increase from \$52.2 million at June FY2006 to \$86.2 million at June FY2016.
- Council currently has no debt and has forecast a nil balance as at 30 June 2016. While Council is planning to borrow \$1.0 million in FY2007 the loan is forecast to be repaid by FY2009 (see section 7.3 for further discussion). The average debt service cover ratio for the period from FY2007–FY2009 is 8.5 times. Council’s average interest cover ratio is forecast extremely high signifying a strong capacity to service further debt if required.

### 7.3 Statement of Cash Flows

The following graph illustrates Council’s cash flow for the historical period (FY2001 to FY2006) and forecast period (FY2007 to FY2016):

**Figure 5: Historical and forecast data incorporating cash flows, depreciation and cash levels (\$000)**



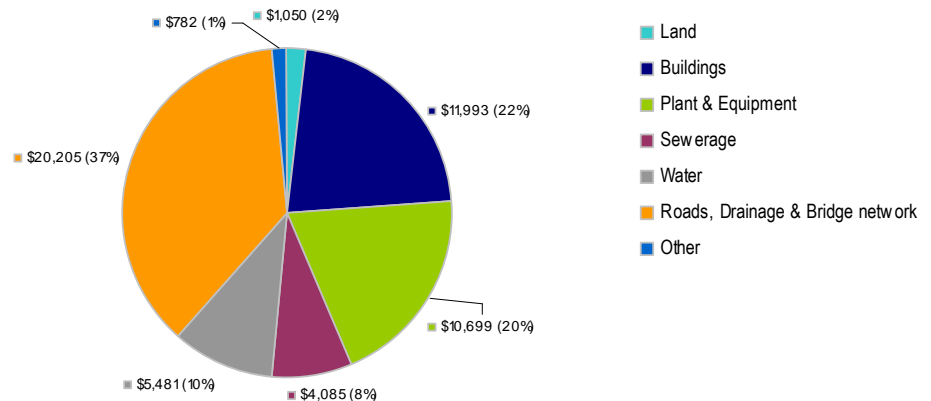
#### Key observations

- Council’s cash balance increases from \$4.0 million at 30 June 2006 to \$6.8 million at 30 June 2016. Council has maintained positive cash balances in all years during the historical period and is also expected to be positive over the forecast period.
- Net cash outflows from investing activities total \$24.2 million over the forecast period. Net cash flows from financing activities is nil as Council currently has no debt, and has forecast to repay all new borrowings drawn down during the forecast period. Consequently, the total cash balance is expected to progressively increase by \$2.8 million over the forecast period.

**Net cash accumulation of \$2.8M over the forecast period**

- Council has forecast sound cash holdings, which equate to approximately 7.8 months of cash expenses over the forecast period (historic average 8.3 months). While each local government is different, a reasonable assumption is that a local government would need sufficient liquidity to cover, at a minimum, three months of its recurrent expenditure obligations.
- Council has a capital expenditure program over the forecast period of \$54.3 million and is summarised as follows:

**Figure 6: Forecast capital expenditure (\$000)**

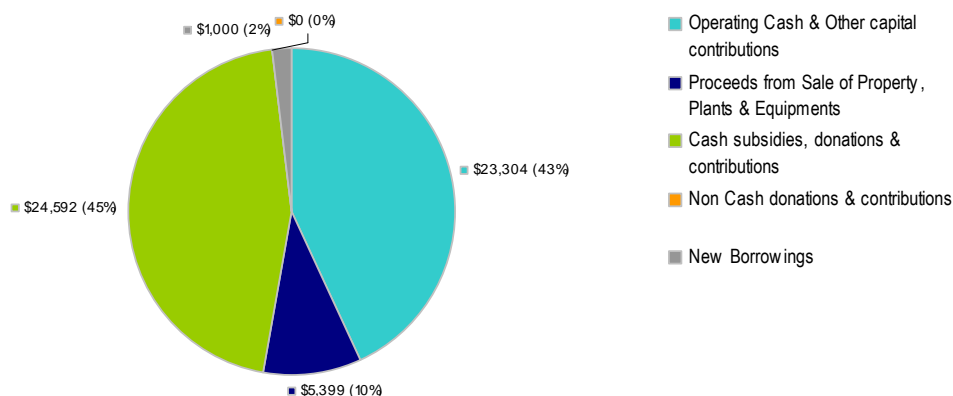


- Major projects (representing approximately 18.0 per cent of total capital expenditure) to be undertaken by Council over the forecast period are:
  - Tourism, arts and cultural centre – \$3.5 million in FY2007
  - Water treatment plant – \$2.4 million) in FY2011, and
  - Sewerage treatment plant – \$4.1 million in FY2007 to FY2009.
- The majority of the Council’s capital expenditure program (ie, 37.0 per cent of total capital expenditure) has been allocated for the maintenance of Council’s roads, drainage and bridge network.
- Council expects to undertake approximately 22.0 per cent of the total capital expenditure program in FY2007.
- Forecast capital expenditure averages 2.9 times annual depreciation, which is significantly higher than the historical average of 1.3 times. The large difference between historical and forecast figures is a result of adjustments to both the value and the useful lives of a number of Council’s assets in FY2005. These adjustments have resulted in Council’s forecast depreciation expense being lower than over the historical period. Notwithstanding this, Council’s ratio is above 1.0 indicating that Council is investing in its own asset base.

**37% of total capital expenditure over forecast period on roads, drainage and bridge network**

- Funding for the capital expenditure program is summarised as follows:

**Figure 7: Forecast capital expenditure funding (\$000)**



- Council forecasts 43.0 per cent of its capital program will be funded by cash generated from its own operations, 45.0 per cent by subsidies, donations and contributions, 10.0 per cent by sale of property, plant and equipment and 2.0 per cent by new borrowings.
- Council has forecast new borrowings totalling \$1.0 million in FY2007 to fund its capital works program. These borrowings are expected to be repaid in full by FY2011. As noted previously, Council has significant capacity for further borrowings, if required.

**Significant capacity for further borrowings**

## 8 | SENSITIVITY ANALYSIS

A significant risk Council faces over the next 10 years is increased capital expenditure. This is underpinned by the following:

- Council has advised that road maintenance has suffered over the last few years due to the water shortage. As such, to clear the backlog of maintenance work, Council may need to spend more on its capital program during the forecast period than has been included in forecasts.
- Growth associated with the mining industry may supersede the planned infrastructure.

To appreciate the potential impact on Council's financial position, we have conducted a basic sensitivity analysis assuming:

- A 20.0 per cent increase in capital expenditure from FY2008, adding \$8.5 million to the existing capital program of \$54.3 million.
- No adjustments in revenue, cost recovery or debt funding have been made in association with this increased expenditure.
- No adjustments were made regarding the timing, useful life, capital subsidies and other capital funding. However, where a percentage of capital expenditure is expected to be received in the form of capital subsidies, these percentages still apply to the increased amount.
- No adjustments to operating costs, other than the increase of depreciation associated with higher capital programs.

It should be noted that the following analysis is conducted to test Council's capacity to manage an 'unexpected' financial shock. As such, adjustments have been made to Council's forecast capital expenditure. The impact of this event has flowed through to Council's operating results (excluding capital items) and cash holdings.

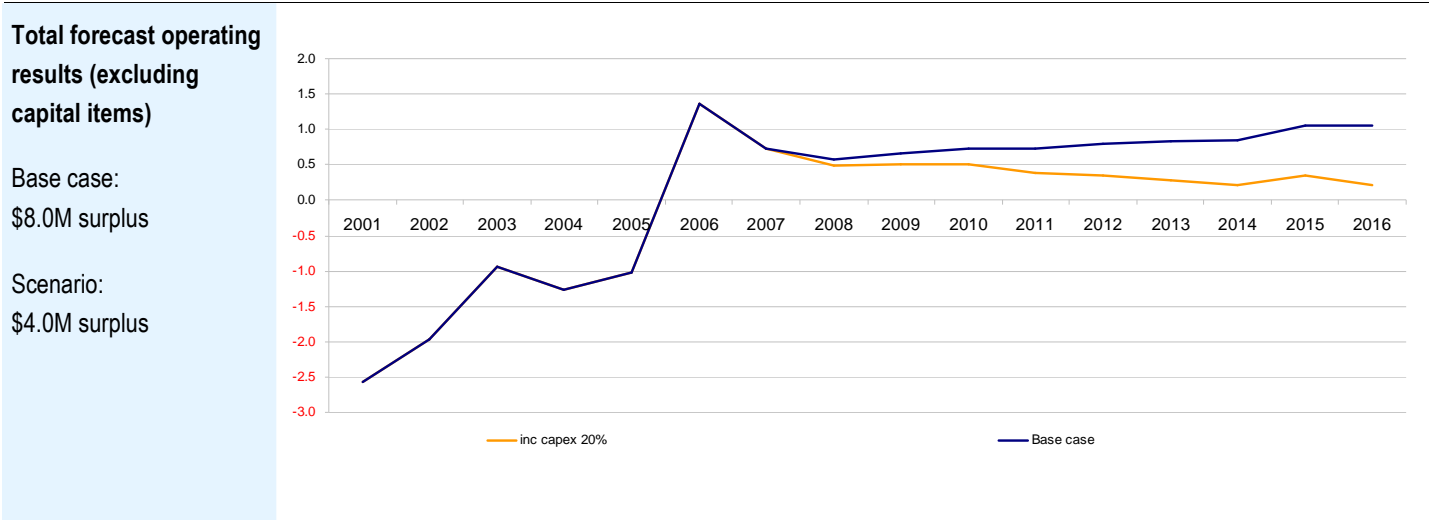
In regards to this scenario, we have made no 'funding' decisions on behalf of Council, as the possible outcomes to address increased capital expenditure are too numerous to address in this review.

A full table of results of the sensitivity analysis is shown in Appendix D *Sensitivity Analysis*.

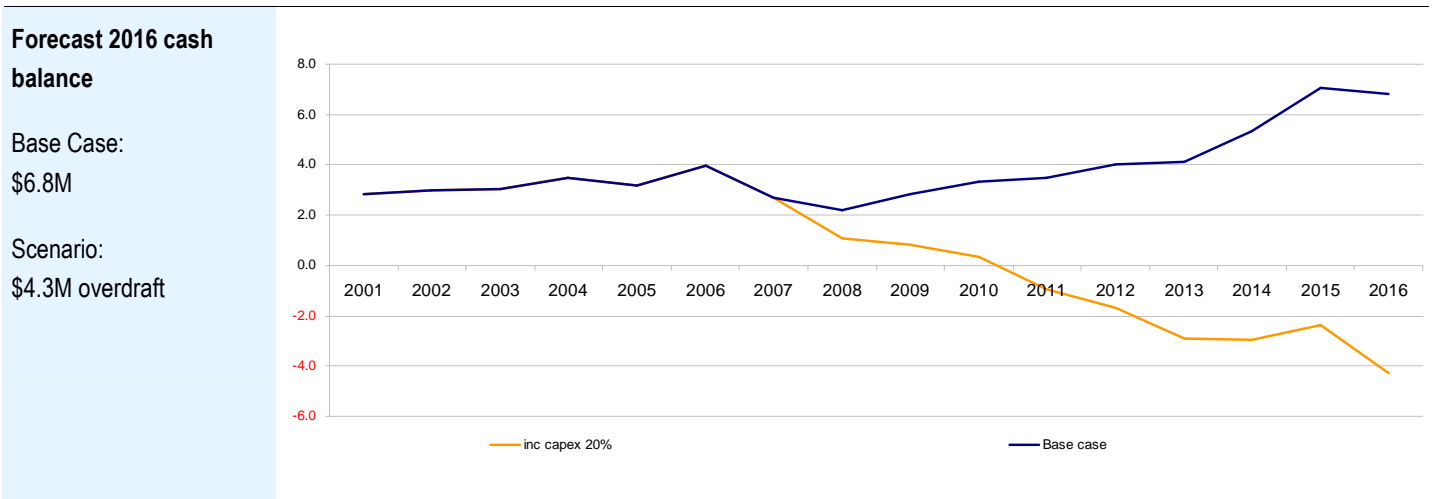
For further information relating to risks faced generally by local governments see Appendix E *Generic Financial Risks and Mitigation Strategies for Local Government*.

The following graphs summarise the key impacts of an unexpected increase in capital expenditure by 20.0 per cent:

**Figure 8: Net operating result (excluding capital items)—base case and scenario comparison (\$'000)**



**Figure 9: Total cash balance—base case and scenario comparison (\$'000)**



**Key observations**

The key observations regarding the financial impact of an increase in capital expenditure by 20.0 per cent from FY2008 are as follows:

- Council’s forecast cumulative net operating result (excluding capital items) reduces to \$4.0 million from \$8.0 million in the base case. Small operating surpluses would still be achieved in all forecast years under this scenario.
- Cumulative cash holdings decrease to a deficit of \$4.3 million in FY2016 from a positive balance of \$6.8 million in Council’s base case. Council would need to consider future funding decisions if this scenario occurs.

- This scenario results in capital expenditure increasing from \$54.3 million in the base case forecast, to \$62.8 million; an increase of \$8.5 million.

The sensitivity analysis demonstrates that if the scenario occurs, Council's financial position would be impacted. While Council would still achieve small operating surpluses under this scenario, Council's cash holdings and liquidity would weaken and it would be unlikely in the long term that Council would be able to absorb the cost increase in capital expenditure without an impact to its operating result. Council would need to address the increased costs and carefully monitor liquidity.

Therefore Council should monitor actual costs to budget, industry cost movements, particularly the construction industry, and movements in revenues. Adjustments to forecasts should be made where required and these adjustments should be reflected in updated Council financial models.

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# APPENDIX A: FINANCIAL SUSTAINABILITY REVIEW RATING AND OUTLOOK DEFINITIONS

## Ratings

<b>Very Strong</b>	A local government with a very high capacity to meet its financial commitments in the short-, medium- and long-term. It is highly likely to be able to manage major unforeseen financial shocks and any adverse changes in its business and in general economic conditions, without revenue or expense adjustments. Its capacity to manage core business risks is very strong.
<b>Strong</b>	A local government with a high capacity to meet its financial commitments in the short-, medium- and long-term. It is likely to be able to manage major unforeseen financial shocks, and any adverse changes in its business and in general economic conditions, with only minor revenue or expense adjustments. Its capacity to manage core business risks is strong.
<b>Moderate</b>	A local government with a high capacity to meet its financial commitments in the short- to medium-term and an acceptable capacity in the long-term. It is expected to be able to manage unforeseen financial shocks and any adverse changes in its business and in general economic conditions, with minor to moderate revenue or expense adjustments. Its capacity to manage core business risks is acceptable.
<b>Weak</b>	A local government with an acceptable capacity to meet its financial commitments in the short- to medium-term and a limited capacity in the long-term. It is unlikely to be able to manage unforeseen financial shocks, and any adverse changes in its business and in general economic conditions, without the need for significant revenue or expense adjustments. It may experience difficulty in managing core business risks.
<b>Very weak</b>	A local government with a limited capacity to meet its financial commitments in the short and medium-term, and a very limited capacity long-term. It is highly unlikely to be able to manage unforeseen financial shocks and any adverse changes in its business and in general economic conditions without the need for some structural reform and major revenue and expense adjustments. Managing core business risks may test its capacity.
<b>Distressed</b>	A local government with a very limited capacity to meet its short-term financial commitments and no capacity to meet its medium- to long-term financial commitments. To be able to manage unforeseen financial shocks and any adverse changes in its business and in general economic conditions, major revenue and expense adjustments and structural reform will be required to meet its medium- and long-term obligations. It will have difficulty in managing core business risks.

## Outlooks

A ratings outlook generally focuses on the potential movement in local government’s rating in the short-term (ie, less than 2 years) and, to a lesser extent, differentiating a local government’s rating within a rating category. Outlooks may be positive, neutral, negative or developing.

<b>Positive</b>	As a result of a foreseeable event or circumstance occurring, there is the potential for enhancement in the local government’s capacity to meet its financial commitments (short- and/or long-term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.
<b>Negative</b>	As a result of a foreseeable event or circumstance occurring, there is the potential for deterioration in the local government’s capacity to meet its financial commitments (short- and/or long-term) and resulting change in its rating. However, it does not necessarily indicate that a rating change may be forthcoming.
<b>Neutral</b>	There are no known foreseeable events that would have a direct impact on the financial sustainability of the local government. It may be possible for a rating upgrade or downgrade to occur from a neutral outlook, if such an event or circumstance warranted as such.
<b>Developing</b>	A current situation exists that could have a direct impact (positive or negative) on the financial sustainability of the local government, but the impact of that situation is uncertain.

## APPENDIX B: HISTORICAL FINANCIAL SUMMARY, FY2001 TO FY2006

	% Increase / (Decrease) over historical period from 30/06/2001 to 30/06/2006	Average over historical period 30/06/2001 to 30/06/2006	FY2001 \$'000	FY2002 \$'000	FY2003 \$'000	FY2004 \$'000	FY2005 \$'000	FY2006 \$'000
<b>1. Summary of Financial Information</b>								
<b>1.1 Operating Results</b>								
Net rates and utility charges	70.09%	11.21%	2,802	2,912	3,329	3,467	3,726	4,766
Sales - contract and recoverable works	5.56%	1.09%	846	1,132	799	824	1,029	893
Subsidies, donations and contributions	3.41%	0.67%	1,406	1,402	1,719	1,405	1,473	1,454
Other operating income	96.08%	14.42%	332	322	715	586	730	651
Total operating income	44.15%	7.59%	5,386	5,768	6,562	6,282	6,958	7,764
Total borrowing costs	N/A	N/A	-	-	-	-	-	-
Employee expenses	(12.58)%	(2.65)%	2,123	1,359	1,745	1,639	1,938	1,856
Materials and services	23.47%	4.31%	2,339	3,478	2,489	2,858	2,727	2,888
Depreciation expense	(56.94)%	(15.51)%	3,381	2,850	3,195	2,997	3,142	1,456
Other operating expenses	66.10%	10.68%	118	51	63	60	170	196
Total operating expenses (including borrowing costs)	(19.66)%	(4.28)%	7,961	7,738	7,492	7,554	7,977	6,396
Operating result (after interest but excluding capital revenues & expenses and extraordinary items)	153.13%	(188.12)%	(2,575)	(1,970)	(930)	(1,272)	(1,019)	1,368
Net operating cash flow	156.89%	20.77%	1,603	2,352	2,537	2,759	2,570	4,118
Net cash flow	1339.68%	(265.45)%	(63)	155	58	431	(308)	781
<b>1.2 Capital Expenditure</b>								
Gross total capital expenditure	131.35%	18.26%	2,083	2,344	3,064	2,823	3,436	4,819
New borrowings	N/A	N/A	-	-	-	-	-	-
Net unfunded depreciation	(100.00)%	(100.00)%	2,575	1,970	930	1,272	1,019	-
<b>1.3 Financial Position</b>								
Total current cash assets (includes unrestricted, restricted & overdraft)	39.41%	6.87%	2,834	2,989	3,047	3,478	3,170	3,951
Restricted cash (eg. unspent loan monies, grants & subsidies, developer contributions)	N/A	N/A	-	-	-	-	-	-
Current assets	21.66%	4.00%	3,805	3,870	3,981	4,106	3,923	4,629
Non-current assets	(1.75)%	(0.35)%	48,967	47,926	47,686	47,421	45,976	48,109
Total assets	(0.06)%	(0.01)%	52,772	51,796	51,667	51,527	49,899	52,738
Current interest bearing liabilities (including overdraft)	N/A	N/A	-	-	-	-	-	-
Current liabilities (includes overdraft)	(1.74)%	(0.35)%	460	616	401	587	635	452
Non-current interest bearing liabilities	N/A	N/A	-	-	-	-	-	-
Non-current liabilities	(50.57)%	(13.15)%	174	63	149	79	144	86
Total liabilities	(15.14)%	(3.23)%	634	679	550	666	779	538
Community equity	0.12%	0.02%	52,138	51,117	51,117	50,861	49,120	52,200

	% Increase / (Decrease) over historical period from 30/06/2001 to 30/06/2006	Average over historical period 30/06/2001 to 30/06/2006	FY2001 \$'000	FY2002 \$'000	FY2003 \$'000	FY2004 \$'000	FY2005 \$'000	FY2006 \$'000
<b>2. Profitability and Efficiency</b>								
<b>2.1 Forecasting Integrity</b>								
Change in net rates and utilities charges (%)	70.09%	11.21%		3.93%	14.32%	4.15%	7.47%	27.91%
Change in employee expenses (%)	(12.58)%	(2.65)%		(35.99)%	28.40%	(6.07)%	18.24%	(4.23)%
Change in materials and services (%)	23.47%	4.31%		48.70%	(28.44)%	14.83%	(4.58)%	5.90%
Change in depreciation (%)	(56.94)%	(15.51)%		(15.71)%	12.11%	(6.20)%	4.84%	(53.66)%
Change in operating revenues(%)	44.15%	7.59%		7.09%	13.77%	(4.27)%	10.76%	11.58%
Change in operating expenditure (%)	(19.66)%	(4.28)%		(2.80)%	(3.18)%	0.83%	5.60%	(19.82)%
Change in operating result (excl. capital grants) (%)	153.13%	(188.12)%		23.50%	52.79%	(36.77)%	19.89%	234.25%
Change in cash balances (%)	39.41%	6.87%		5.47%	1.94%	14.15%	(8.86)%	24.64%
Interest expense / average debt (%)		N/A		nm	nm	nm	nm	nm
Interest revenue / average cash balance (%)		6.21%		3.57%	6.46%	7.23%	7.64%	6.15%
Employee costs / total operating expenses (excl. borrowing costs) (%)		23.76%	26.67%	17.56%	23.29%	21.70%	24.29%	29.02%
Materials and services / total operating expenses (excl. borrowing costs) (%)		37.45%	29.38%	44.95%	33.22%	37.83%	34.19%	45.15%
Depreciation / total operating expenses (excl. borrowing) (%)		37.30%	42.47%	36.83%	42.65%	39.67%	39.39%	22.76%
Gross interest expense / total operating expenses (excl. borrowing) (%)		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>2.2 Fiscal Flexibility Indicators</b>								
Net rates, utilities and charges / operating revenue (%)		53.89%	52.02%	50.49%	50.73%	55.19%	53.55%	61.39%
Subsidies, donations and contributions / operating revenue (%)		23.15%	26.10%	24.31%	26.20%	22.37%	21.17%	18.73%
Sales - contract and recoverable works / operating revenue (%)		14.49%	15.71%	19.63%	12.18%	13.12%	14.79%	11.50%
Operating results before interest and depreciation / interest expense (times) (interest cover)		N/A	nm	nm	nm	nm	nm	nm
(Net operating cash flow + interest expense) / (int expense + PY current int bearing liabilities) (times) (debt service cover)		N/A		nm	nm	nm	nm	nm
Restricted cash / total cash assets (%)		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Payback years - total debt / operating cash flows (excludes interest revenue)		-	-	-	-	-	-	-
Net operating cashflow / total capital expenditure (%)		86.35%	76.96%	100.34%	82.80%	97.73%	74.80%	85.45%
<b>2.3 Equity Maintenance Indicators</b>								
Operating results (\$'000)	153.13%	(188.12)%	(2,575)	(1,970)	(930)	(1,272)	(1,019)	1,368
Net results (includes capital revenues & expenses and extraordinary items) (\$'000)	282.77%	(212.82)%	(2,130)	(1,027)	-	(256)	(5,232)	3,893
Unfunded depreciation / total depreciation		41.54%	76.16%	69.12%	29.11%	42.44%	32.43%	0.00%
Annual capital expenditure / depreciation (times)		1.29	0.62	0.82	0.96	0.94	1.09	3.31
Operating revenue / operating expense (incl. int & depn) (%)		86.93%	67.65%	74.54%	87.59%	83.16%	87.23%	121.39%
<b>2.4 Liquidity indicators</b>								
Current assets / current liabilities (current ratio)		7.98	8.27	6.28	9.93	6.99	6.18	10.24

# APPENDIX C: FORECAST FINANCIAL SUMMARY, FY2007 TO FY2016

	% Increase / (Decrease) over forecast period 30/06/2006 to 30/06/2016	Average over forecast period 30/06/2006 to 30/06/2016	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
			\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>1. Summary of Financial Information</b>												
<b>1.1 Operating Results</b>												
Net rates and utility charges	59.11%	4.75%	4,684	4,942	5,214	5,500	5,802	6,121	6,460	6,815	7,188	7,583
Sales - contract and recoverable works	5.15%	0.50%	580	612	646	681	719	758	800	844	890	939
Subsidies, donations and contributions	20.56%	1.89%	1,344	1,385	1,425	1,468	1,512	1,558	1,605	1,652	1,703	1,753
Other operating income	100.15%	7.19%	692	732	770	833	887	952	1,010	1,089	1,214	1,303
Total operating income	49.12%	4.08%	7,300	7,671	8,055	8,482	8,920	9,389	9,875	10,400	10,995	11,578
Total borrowing costs	N/A	N/A	-	62	48	33	17	-	-	-	-	-
Employee expenses	81.36%	6.13%	2,031	2,235	2,347	2,512	2,638	2,769	2,909	3,054	3,206	3,366
Materials and services	53.95%	4.41%	2,746	2,897	3,056	3,224	3,402	3,589	3,786	3,995	4,214	4,446
Depreciation expense	66.55%	5.23%	1,619	1,712	1,740	1,767	1,916	2,002	2,105	2,232	2,246	2,425
Other operating expenses	47.45%	3.96%	184	198	206	216	226	238	251	263	275	289
Total operating expenses (including borrowing costs)	64.57%	5.11%	6,580	7,104	7,397	7,752	8,199	8,598	9,051	9,544	9,941	10,526
Operating result (after interest but excluding capital revenues & expenses and extraordinary items)	(23.10)%	(2.59)%	720	567	658	730	721	791	824	856	1,054	1,052
Net operating cash flow	(16.63)%	(1.80)%	2,068	2,245	2,367	2,464	2,603	2,756	2,890	3,048	3,258	3,433
Net cash flow	(127.14)%	N/A	(1,273)	(451)	598	504	165	517	91	1,238	1,710	(212)
<b>1.2 Capital Expenditure</b>												
Gross total capital expenditure	16.48%	1.54%	11,580	5,727	3,795	4,103	6,402	4,760	4,950	4,228	3,137	5,613
New borrowings	N/A	N/A	1,000	-	-	-	-	-	-	-	-	-
Net unfunded depreciation	N/A	N/A	-	-	-	-	-	-	-	-	-	-
<b>1.3 Financial Position</b>												
Total current cash assets (includes unrestricted, restricted & overdraft)	73.07%	5.64%	2,678	2,227	2,825	3,329	3,494	4,011	4,102	5,340	7,050	6,838
Restricted cash (eg. unspent loan monies, grants & subsidies, developer contributions)	N/A	N/A	-	-	-	-	-	-	-	-	-	-
Current assets	80.88%	6.11%	3,691	3,291	3,938	4,493	4,712	5,286	5,438	6,739	8,515	8,373
Non-current assets	63.34%	5.03%	57,911	61,662	63,153	65,298	69,151	71,643	74,030	75,253	75,679	78,580
Total assets	64.88%	5.13%	61,602	64,953	67,091	69,791	73,863	76,929	79,468	81,992	84,194	86,953
Current interest bearing liabilities (including overdraft)	N/A	N/A	228	242	257	273	-	-	-	-	-	-
Current liabilities (includes overdraft)	55.75%	4.53%	744	775	808	842	589	609	631	654	678	704
Non-current interest bearing liabilities	N/A	N/A	772	530	273	-	-	-	-	-	-	-
Non-current liabilities	0.00%	0.00%	858	616	359	86	86	86	86	86	86	86
Total liabilities	46.84%	3.92%	1,602	1,391	1,167	928	675	695	717	740	764	790
Community equity	65.06%	5.14%	60,000	63,562	65,924	68,863	73,188	76,234	78,751	81,252	83,430	86,163

	% Increase / (Decrease) over forecast period 30/06/2006 to 30/06/2016	Average over forecast period 30/06/2006 to 30/06/2016	FY2007 \$'000	FY2008 \$'000	FY2009 \$'000	FY2010 \$'000	FY2011 \$'000	FY2012 \$'000	FY2013 \$'000	FY2014 \$'000	FY2015 \$'000	FY2016 \$'000
<b>2. Profitability and Efficiency</b>												
<b>2.1 Forecasting Integrity</b>												
Change in net rates and utilities charges (%)	59.11%	4.75%	(1.72)%	5.51%	5.50%	5.49%	5.49%	5.50%	5.54%	5.50%	5.47%	5.50%
Change in employee expenses (%)	81.36%	6.13%	9.43%	10.04%	5.01%	7.03%	5.02%	4.97%	5.06%	4.98%	4.98%	4.99%
Change in materials and services (%)	53.95%	4.41%	(4.92)%	5.50%	5.49%	5.50%	5.52%	5.50%	5.49%	5.52%	5.48%	5.51%
Change in depreciation (%)	66.55%	5.23%	11.20%	5.74%	1.64%	1.55%	8.43%	4.49%	5.14%	6.03%	0.63%	7.97%
Change in operating revenues(%)	49.12%	4.08%	(5.98)%	5.08%	5.01%	5.30%	5.16%	5.26%	5.18%	5.32%	5.72%	5.30%
Change in operating expenditure (%)	47.45%	5.11%	2.88%	7.96%	4.12%	4.80%	5.77%	4.87%	5.27%	5.45%	4.16%	5.88%
Change in operating result (excl. capital grants) (%)	(23.10)%	(2.59)%	(47.37)%	(21.25)%	16.05%	10.94%	(1.23)%	9.71%	4.17%	3.88%	23.13%	(0.19)%
Change in cash balances (%)	73.07%	5.64%	(32.22)%	(16.84)%	26.85%	17.84%	4.96%	14.80%	2.27%	30.18%	32.02%	(3.01)%
Interest expense / average debt (%)		7.01%	0.00%	7.00%	7.37%	8.22%	12.45%	nm	nm	nm	nm	nm
Interest revenue / average cash balance (%)		5.18%	4.56%	5.10%	5.11%	5.13%	5.13%	5.36%	5.35%	5.36%	5.36%	5.36%
Employee costs / total operating expenses (excl. borrowing costs) (%)		31.99%	30.87%	31.74%	31.94%	32.54%	32.24%	32.21%	32.14%	32.00%	32.25%	31.98%
Materials and services / total operating expenses (excl. borrowing costs) (%)		41.79%	41.73%	41.14%	41.58%	41.77%	41.58%	41.74%	41.83%	41.86%	42.39%	42.24%
Depreciation / total operating expenses (excl. borrowing) (%)		23.45%	24.60%	24.31%	23.68%	22.89%	23.42%	23.28%	23.26%	23.39%	22.59%	23.04%
Gross interest expense / total operating expenses (excl. borrowing) (%)		0.22%	0.00%	0.88%	0.65%	0.43%	0.21%	0.00%	0.00%	0.00%	0.00%	0.00%
<b>2.2 Fiscal Flexibility Indicators</b>												
Net rates, utilities and charges / operating revenue (%)		65.02%	64.16%	64.42%	64.73%	64.84%	65.04%	65.19%	65.42%	65.53%	65.38%	65.49%
Subsidies, donations and contributions / operating revenue (%)		16.78%	18.41%	18.06%	17.69%	17.31%	16.95%	16.59%	16.25%	15.88%	15.49%	15.14%
Sales - contract and recoverable works / operating revenue (%)		8.05%	7.95%	7.98%	8.02%	8.03%	8.06%	8.07%	8.10%	8.12%	8.09%	8.11%
Operating results before interest and depreciation / interest expense (times) (interest cover)		80.38	nm	37.76	50.96	76.67	156.12	nm	nm	nm	nm	nm
(Net operating cash flow + interest expense) / (int expense + PY current int bearing liabilities) (times) (debt service cover)		8.48	nm	7.96	8.33	8.61	9.03	nm	nm	nm	nm	nm
Restricted cash / total cash assets (%)		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Payback years - total debt / operating cash flows (excludes interest revenue)		0.12	0.52	0.36	0.24	0.12	-	-	-	-	-	-
Net operating cashflow / total capital expenditure (%)		57.35%	17.86%	39.20%	62.37%	60.05%	40.66%	57.90%	58.38%	72.09%	103.86%	61.16%
<b>2.3 Equity Maintenance Indicators</b>												
Operating results (\$'000)	(23.10)%	(2.59)%	720	567	658	730	721	791	824	856	1,054	1,052
Net results (includes capital revenues & expenses and extraordinary items) (\$'000)	(29.80)%	(3.48)%	7,800	3,562	2,362	2,939	4,325	3,046	2,517	2,501	2,178	2,733
Unfunded depreciation / total depreciation		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Annual capital expenditure / depreciation (times)		2.87	7.15	3.35	2.18	2.32	3.34	2.38	2.35	1.89	1.40	2.31
Operating revenue / operating expense (incl. int & deprn) (%)		109.39%	110.94%	107.98%	108.90%	109.42%	108.79%	109.20%	109.10%	108.97%	110.60%	109.99%
<b>2.4 Liquidity indicators</b>												
Current assets / current liabilities (current ratio)		7.95	4.96	4.25	4.87	5.34	8.00	8.68	8.62	10.30	12.56	11.89

# APPENDIX D: SENSITIVITY ANALYSIS

	% Increase / (Decrease) over forecast period 30/06/2006 to 30/06/2016	Average over forecast period 30/06/2006 to 30/06/2016	FY2007	FY2008	FY2009	FY2010	FY2011	FY2012	FY2013	FY2014	FY2015	FY2016
			\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000	\$'000
<b>1. Summary of Financial Information</b>												
<b>1.1 Operating Results</b>												
Net rates and utility charges	59.11%	4.75%	4,684	4,942	5,214	5,500	5,802	6,121	6,460	6,815	7,188	7,583
Sales - contract and recoverable works	5.15%	0.50%	580	612	646	681	719	758	800	844	890	939
Subsidies, donations and contributions	20.56%	1.89%	1,344	1,385	1,425	1,468	1,512	1,558	1,605	1,652	1,703	1,753
Other operating income	43.01%	3.64%	692	701	684	699	712	751	793	836	882	931
Total operating income	44.33%	3.74%	7,300	7,640	7,969	8,348	8,745	9,188	9,658	10,147	10,663	11,206
Total borrowing costs	N/A	N/A	-	62	48	33	43	77	134	171	155	193
Employee expenses	81.36%	6.13%	2,031	2,235	2,347	2,512	2,638	2,769	2,909	3,054	3,206	3,366
Materials and services	53.95%	4.41%	2,746	2,897	3,056	3,224	3,402	3,589	3,786	3,995	4,214	4,446
Depreciation expense	85.30%	6.36%	1,619	1,758	1,814	1,855	2,051	2,161	2,293	2,450	2,470	2,698
Other operating expenses	47.45%	3.96%	184	198	206	216	226	238	251	263	275	289
Total operating expenses (including borrowing costs)	71.86%	5.56%	6,580	7,150	7,471	7,840	8,360	8,834	9,373	9,933	10,320	10,992
Operating result (after interest but excluding capital revenues & expenses and extraordinary items)	(84.36)%	(16.93)%	720	490	498	508	385	354	285	214	343	214
Net operating cash flow	(30.35)%	(3.55)%	2,068	2,214	2,281	2,330	2,402	2,478	2,539	2,624	2,771	2,868
Net cash flow	(343.23)%	N/A	(1,273)	(1,627)	(247)	(451)	(1,316)	(713)	(1,250)	(32)	596	(1,900)
<b>1.2 Capital Expenditure</b>												
Gross total capital expenditure	39.77%	3.41%	11,580	6,872	4,554	4,924	7,682	5,712	5,940	5,074	3,764	6,736
New borrowings	N/A	N/A	1,000	-	-	-	-	-	-	-	-	-
Net unfunded depreciation	N/A	N/A	-	-	-	-	-	-	-	-	-	-
<b>1.3 Financial Position</b>												
Total current cash assets (includes unrestricted, restricted & overdraft)	(207.87)%	N/A	2,678	1,051	804	353	(963)	(1,676)	(2,926)	(2,958)	(2,362)	(4,262)
Restricted cash (eg. unspent loan monies, grants & subsidies, developer contributions)	N/A	N/A	-	-	-	-	-	-	-	-	-	-
Current assets	(66.84)%	(10.45)%	3,691	2,115	1,917	1,517	1,218	1,275	1,336	1,399	1,465	1,535
Non-current assets	76.99%	5.88%	57,911	62,761	64,845	67,698	72,569	75,827	78,954	80,674	81,434	85,150
Total assets	64.37%	5.09%	61,602	64,876	66,762	69,215	73,787	77,102	80,290	82,073	82,899	86,685
Current interest bearing liabilities (including overdraft)	N/A	N/A	228	242	257	273	963	1,676	2,926	2,958	2,362	4,262
Current liabilities (includes overdraft)	998.67%	27.08%	744	775	808	842	1,552	2,285	3,557	3,612	3,040	4,966
Non-current interest bearing liabilities	N/A	N/A	772	530	273	-	-	-	-	-	-	-
Non-current liabilities	0.00%	0.00%	858	616	359	86	86	86	86	86	86	86
Total liabilities	839.03%	25.10%	1,602	1,391	1,167	928	1,638	2,371	3,643	3,698	3,126	5,052
Community equity	56.39%	4.57%	60,000	63,485	65,595	68,287	72,149	74,731	76,647	78,375	79,773	81,633

	% Increase / (Decrease) over forecast period 30/06/2006 to 30/06/2016	Average over forecast period 30/06/2006 to 30/06/2016	FY2007 \$'000	FY2008 \$'000	FY2009 \$'000	FY2010 \$'000	FY2011 \$'000	FY2012 \$'000	FY2013 \$'000	FY2014 \$'000	FY2015 \$'000	FY2016 \$'000
<b>2. Profitability and Efficiency</b>												
<b>2.1 Forecasting Integrity</b>												
Change in net rates and utilities charges (%)	59.11%	4.75%	(1.72)%	5.51%	5.50%	5.49%	5.49%	5.50%	5.54%	5.50%	5.47%	5.50%
Change in employee expenses (%)	81.36%	6.13%	9.43%	10.04%	5.01%	7.03%	5.02%	4.97%	5.06%	4.98%	4.98%	4.99%
Change in materials and services (%)	53.95%	4.41%	(4.92)%	5.50%	5.49%	5.50%	5.52%	5.50%	5.49%	5.52%	5.48%	5.51%
Change in depreciation (%)	85.30%	6.36%	11.20%	8.59%	3.19%	2.26%	10.57%	5.36%	6.11%	6.85%	0.82%	9.23%
Change in operating revenues(%)	44.33%	3.74%	(5.98)%	4.66%	4.31%	4.76%	4.76%	5.07%	5.12%	5.06%	5.09%	5.09%
Change in operating expenditure (%)	47.45%	5.56%	2.88%	8.66%	4.49%	4.94%	6.63%	5.67%	6.10%	5.97%	3.90%	6.51%
Change in operating result (excl. capital grants) (%)	(84.36)%	(16.93)%	(47.37)%	(31.94)%	1.63%	2.01%	(24.21)%	(8.05)%	(19.49)%	(24.91)%	60.28%	(37.61)%
Change in cash balances (%)	(207.87)%	N/A	(32.22)%	(60.77)%	(23.51)%	(56.07)%	(372.92)%	(74.01)%	(74.56)%	(1.08)%	20.14%	(80.41)%
Interest expense / average debt (%)		5.87%	0.00%	7.00%	7.37%	8.22%	6.96%	5.83%	5.82%	5.81%	5.83%	5.83%
Interest revenue / average cash balance (%)		1.84%	4.56%	5.04%	4.64%	4.15%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Employee costs / total operating expenses (excl. borrowing costs) (%)		31.50%	30.87%	31.53%	31.62%	32.18%	31.72%	31.62%	31.49%	31.28%	31.54%	31.17%
Materials and services / total operating expenses (excl. borrowing costs) (%)		41.15%	41.73%	40.87%	41.17%	41.30%	40.90%	40.98%	40.98%	40.92%	41.46%	41.17%
Depreciation / total operating expenses (excl. borrowing) (%)		24.61%	24.60%	24.80%	24.44%	23.76%	24.66%	24.68%	24.82%	25.10%	24.30%	24.98%
Gross interest expense / total operating expenses (excl. borrowing) (%)		0.99%	0.00%	0.87%	0.65%	0.42%	0.52%	0.88%	1.45%	1.75%	1.52%	1.79%
<b>2.2 Fiscal Flexibility Indicators</b>												
Net rates, utilities and charges / operating revenue (%)		66.23%	64.16%	64.69%	65.43%	65.88%	66.35%	66.62%	66.89%	67.16%	67.41%	67.67%
Subsidies, donations and contributions / operating revenue (%)		17.08%	18.41%	18.13%	17.88%	17.59%	17.29%	16.96%	16.62%	16.28%	15.97%	15.64%
Sales - contract and recoverable works / operating revenue (%)		8.20%	7.95%	8.01%	8.11%	8.16%	8.22%	8.25%	8.28%	8.32%	8.35%	8.38%
Operating results before interest and depreciation / interest expense (times) (interest cover)		35.82	nm	37.26	49.17	72.61	57.65	33.66	20.24	16.58	19.15	16.09
(Net operating cash flow + interest expense) / (int expense + PY current int bearing liabilities) (times) (debt service cover)		4.30	nm	7.85	8.03	8.15	7.74	2.46	1.48	0.90	0.94	1.20
Restricted cash / total cash assets (%)		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Payback years - total debt / operating cash flows (excludes interest revenue)		0.69	0.52	0.36	0.24	0.12	0.40	0.68	1.15	1.13	0.85	1.49
Net operating cashflow / total capital expenditure (%)		43.28%	17.86%	32.22%	50.09%	47.32%	31.27%	43.38%	42.74%	51.72%	73.61%	42.58%
<b>2.3 Equity Maintenance Indicators</b>												
Operating results (\$'000)	(84.36)%	(16.93)%	720	490	498	508	385	354	285	214	343	214
Net results (includes capital revenues & expenses and extraordinary items) (\$'000)	(52.22)%	(7.12)%	7,800	3,485	2,110	2,692	3,862	2,582	1,916	1,728	1,398	1,860
Unfunded depreciation / total depreciation		0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Annual capital expenditure / depreciation (times)		3.13	7.15	3.91	2.51	2.65	3.75	2.64	2.59	2.07	1.52	2.50
Operating revenue / operating expense (incl. int & depn) (%)		105.00%	110.94%	106.85%	106.67%	106.48%	104.61%	104.01%	103.04%	102.15%	103.32%	101.95%
<b>2.4 Liquidity indicators</b>												
Current assets / current liabilities (current ratio)		1.48	4.96	2.73	2.37	1.80	0.78	0.56	0.38	0.39	0.48	0.31

## APPENDIX E: GENERIC FINANCIAL RISKS AND MITIGATION STRATEGIES FOR LOCAL GOVERNMENT

The following table summarises the key risks facing all local governments and some suggested actions for risk mitigation.

Risk	Cause	Effect	Mitigation actions
1. Operating revenues are not sufficient to support council's operations, including the funding mix for capital expenditure	Poor financial forecasting or forecasting model	Difficulty or inability to implement council's objectives	Ensure council has a rigorous budget process and budget review process
	Whole of life costs for major projects not recognised in forecasts	Run down of cash holdings	Monitor and gather relevant information on costs
	Inappropriate rate increases applied	Operating deficit recorded	Ensure adequate controls exist in terms of approving expenditure
	Population does not grow at forecast levels	Reputation damage	Ensure that depreciation is appropriate
	Failure to ensure that rate adjustments keep pace with increases in council's cost of goods/services	Financial loss / impact on council budget and ratepayers	Maintain a 10 year forecast model
	Expense overruns	Possible ratepayer and community dissatisfaction	Whole of life project costs analysis to be undertaken and incorporated into 10 year forecast model
	Poor control over expenses	Potential to default on loans	Review operating and service levels for all programs
	Poor budget process	Potential inability to pay suppliers	Monitor costs to budget
	Significant rate arrears	Unfunded depreciation increases	Review revenue and depreciation policy
	Rapid growth in shire requires additional expenditure	Council projects, programs / maintenance may be scaled back, deferred or cancelled	Benchmark and review against similar councils
	Increase in services and service levels provided to community without understanding financial impact	Council will need to consider revenue/expenditure adjustments	Establish appropriate management and budget monitoring reports
	Depreciation expenses not fully funded		Review and understand council's costs drivers
	Poor budgeting processes		
	FAGS do not grow in real terms		
2. Operating expenses are over budget and are in excess of requirements	Inadequate budget monitoring process		
	Own source revenue percentage not maintained		
2. Operating expenses are over budget and are in excess of requirements	Poor financial forecasting or forecasting model	Financial loss / impact on budget	Ensure council has a rigorous budget process and budget review process
	Whole of life cost analysis not undertaken for substantial projects or, not fed into budget process	Difficulty or inability to implement council's objectives	Monitor and gather relevant information on costs

Risk	Cause	Effect	Mitigation actions
for a council of this type	Materials and services expenses increase over budget forecasts Over servicing of functions (ie, roads, administration etc) Failure to manage expenses efficiently Insufficient reporting mechanisms Poor monitoring and review of budget Poor financial controls Poor budgeting processes Unique operating conditions impact on cost of service	Run down of cash holdings Operating deficit recorded Reputation damage Financial impact on council budget and ratepayers Possible ratepayer and community dissatisfaction Potential to default on loans Potential inability to pay suppliers Unfunded depreciation increases Council projects, programs / maintenance may be scaled back, deferred or cancelled Council will need to consider revenue/expenditure adjustments	Adequate controls exist in terms of approving expenditure Ensure that depreciation is appropriate Maintain a 10 year forecast model Whole of life project costs analysis to be undertaken and incorporated into 10 year forecasting model Review operating and service levels for all programs Monitor costs to budget Review revenue policy Benchmark and review against similar councils Establish appropriate management and budget monitoring reports Review and understand council's costs drivers
3. Insufficient working capital to manage the business appropriately	Poor or non-existent financial forecasting Major cost overruns on projects, etc Poor financial controls Large unforeseen expenditure arises Forecast revenues not received Gradual run down in cash holdings over time Rate arrears not managed Inappropriate revenue policy Expense overruns Inappropriate funding mix used to finance business Whole of life costs for major projects not recognised in forecasts Increase in services and service levels provided to community without understanding financial impact Poor budgeting process	Financial loss Difficulty in managing cash flow cycle Reputation damage Financial impact on council budget and ratepayers Possible ratepayer and community dissatisfaction Possible default on loans May need to secure short-term funding Possible inability to pay suppliers Possibility that capital works programs may be cancelled or delayed and/or maintenance programs may be cut or scaled back	Implement sound cash flow forecasting, short- and longer-term Maintain and regularly review 10 year forecast model Monitor actual cost to budget Actively manage rates arrears Review revenue policy Review services and service levels provided Review cash management processes

Risk	Cause	Effect	Mitigation actions
4. Capital expenditure costs are in excess of forecasts	Poor control over projects	Financial loss	Monitor the construction market for likely escalation in costs
	Costs escalate from forecasts	Budget over runs	Develop business cases and financial forecasts for major projects
	Significant scope change after contracts signed	Reputation damage	Implement sound project management and governance processes
	Poor capital expenditure forecasting	Financial impact on council budget and ratepayers	Ensure any significant changes to scope are approved before beginning
	Poor financial controls	Possible default on loans	Undertake whole of life project analysis and feed into budget process
	Major or unforeseen expenditure arises	Possible inability to pay suppliers	Review financial controls and monitor budget
	Failure to monitor industry costs	Possibility that capital works programs may be cancelled or delayed and/or maintenance programs may be cut or scaled back  May require additional funding to support business  Possible ratepayer and community dissatisfaction	