COOTAMUNDRA-GUNDAGAI REGIONAL COUNCIL

ABN: 46 211 642 339
PO Box 420, Cootamundra NSW 2590
Ph: 1300 459 689 Fax:02 6940 2127
Email: mail@cgrc.nsw.gov.au
www.cgrc.nsw.gov.au

Cootamundra Office
81 Wallendoon Street,
Cootamundra NSW 2590

Gundagai Office:
255 Sheridan Street,
Gundagai NSW 2722

REC-210706-MMC-153700

The Hon. Shelley Hancock, BA, DipEd, MP
Minister for Local Government
Member for South Coast
PO Box 2015
Sydney NSW 2001

Dear Minister,

RE: Business Case for the Demerger of Cootamundra-Gundagai Regional Council

At its Ordinary Meeting held 29th June, 2021 Council Resolved (Min. no.163/2021):

That Council writes to the Minister for Local Government to ensure that the current proposal of de-amalgamation, including Business Case as previously submitted, and now resubmitted, is considered in line with the new Section 218CC of the Local Government Act.

Should you require further information or wish to discuss the matter please do not hesitate to contact me on 0428 441 300.

Yours faithfully

Abb McAlister
Mayor

6 July 2021

Business Case under S218(cc) of the Local Government Act, 1993 Proposal for De-amalgamation of Cootamundra-Gundagai Regional Council

Executive Summary

A de-amalgamation of Cootamundra-Gundagai Regional Council will cost under $1.75 million, which will have a payback period of just over eight years. From the tenth year onwards, a de-amalgamation should save at least $451,000 per annum. It should be noted that the aforementioned figures are worse-case scenarios based on very detailed examination of cost structures which do not include any items which cannot be assured. The figures quoted are therefore completely reliable and stand in stark contrast to the guesswork used for projections of supposed amalgamation savings. In all likelihood, a well-managed de-amalgamation will cost less upfront and will reap greater savings.

De-amalgamation will not immediately fix all of the problems that currently afflict the local government area. There will still likely be a need for increases to rates and charges to mitigate the financial problems that the community now faces, and it would be critical for any new local governments that might emerge to practice strict cost control for the foreseeable future. However, it seems that by removing substantial diseconomies of scale, political uncertainty, and righting the strong sense of injustice that pervades much of the community that we might better lay the foundations for a more promising future.

It would not be reasonable to lay *any* of the blame for the current circumstances with the existing cohort of Councillors and executive management at Cootamundra-Gundagai Regional Council. As will be shown in the remainder of this report, there were gross failures by KPMG and the (then) Boundaries Commission Delegate back in 2016 that have contributed strongly to the circumstances now faced. In addition, some of the previous Administrators and executives did not perform as well as one might have expected. The current leadership team, by way of contrast, have done an extraordinary job of trying to address the problems caused by others and should be congratulated for their fine efforts on behalf of the community.

It is also important to be mindful that the decisions made back in 2016 were made under a different Minister for Local Government and a different Premier. Moreover, the poor advice that was received came from agents who are not involved in this present process. Indeed, the current Minister and Boundaries Commission have acted with great integrity and wisdom thus far, and the community therefore have reason to feel confident that this process in 2020 will be handled fairly and be based on robust evidence.

In sum, this Boundaries Commission and the current Minister are provided with a unique opportunity to right past injustices, remove the burden of otherwise unavoidable diseconomies of scale, and set the people of the local government area on a course to better financial sustainability outcomes and I commend this expert report to their attention.

About the Author:

Joseph Drew is Associate Professor of Public Policy and Local Government in the Institute for Public Policy & Governance at the University of Technology Sydney and adjunct Professor at the Department of Business Administration, Tokyo Metropolitan University. His research interests focus on public finance, performance measurement, local government structural reform, natural law philosophy and corporate governance. Previously he worked in executive positions in the retail banking sector. His work has been recognised in the 2004 Australian College of Educators awards and he is the recipient of the University Medal (Griffith University, 2003) and the D H Drummond award (University of New England, 2014). Recent publications have appeared in *Public Administration, Local Government Studies, Public Administration Quarterly, Publius: The Journal of Federalism, the Australian Journal of Public Administration, Australian Journal of Political Science,* and *Policy & Politics*. He has consulted with numerous Victorian, Tasmanian, South Australian and New South Wales councils on accounting, finance and economic matters. Joseph has also been called as an expert witness for multiple Australian State and Federal Government Upper House inquiries into local public finance, as well as working on a number of projects of national significance abroad. His Co-authored book *Local Government in Australia: History, Theory and Public Policy* has recently been published by Springer Palgrave and he is contracted for a new book titled *Reforming Local Government*, for delivery in 2020. Joseph serves on the Editorial Board of Australia's highest ranked public administration journal – the *Australian Journal of Public Administration*.

Introduction

The Cootamundra-Regional Council was formed by Governor's proclamation on the 12 May 2016 from a forced amalgamation of the former Cootamundra and Gundagai councils respectively. This amalgamation was the culmination of a lengthy, and at times unpredictable, process stretching back to a 2011 inquiry into the financial sustainability of local government in New South Wales. During the course of this process the Independent Local Government Review Panel (ILGRP, 2013) suggested that Gundagai be amalgamated with Tumut and Cootamundra with Junee. Moreover, IPART (2015) provided its endorsement of both a voluntary proposal for Cootamundra to amalgamate with Harden and the suggestion for Gundagai to amalgamate with Tumut. It therefore came as something of a surprise when the (then) Minister of Local Government released his proposal to amalgamate Cootamundra with Gundagai in January 2016.

The Minister's proposal was based heavily on the work of KPMG which has been widely discredited in the media and scholarly literature (see, for example, Drew and Grant, 2017; Dollery and Drew, 2016). KPMG's 'analysis' was largely based on assumptions without any empirical evidence. By way of contrast, the former Gundagai council engaged a *bona fide* expert who conducted rigorous empirical analysis based on scholarly theory and concluded that the proposed amalgamation would result in diseconomies of scale and thus reduce the financial sustainability of the local government community (Drew, 2016). In his deliberations, the Boundaries Commission Delegate chose to place full reliance on the work of KPMG and disregarded the body of scholarship to which his attention had been drawn (Turner, 2016).

Three full financial years have passed, and we are now in a good position to test the assumptions made by KPMG (2016). It is important to do so, because the analysis can clarify the likely outcomes should a decision be made to reverse the earlier amalgamation. Indeed, s263(3) of the Local Government Act (NSW 1993) lists the financial advantages or disadvantages (including economies or diseconomies of scale) as the first of a series of matters that a Boundaries Commission must examine. Notably, the legislation does *not* list the correction of past injustices as a valid consideration for the Boundaries Commission. However, the Minister will no doubt wish to include these matters in her considerations, and I therefore detail some of the perceived injustices in the material that follows.

De-amalgamation is not a novel concept in the context of Australian local government. Delatite Shire in Victoria was de-amalgamated in October 2002, and four Queensland councils (Cairns, Rockhampton, Sunshine Coast, and Tablelands) were de-amalgamated in 2013 (Drew and Dollery, 2014b; 2015a). Moreover, two of these de-amalgamations have been studied in detail by scholars, and we thus have a good body of knowledge to draw on should a decision be made to de-amalgamate Cootamundra-Gundagai. Inevitably, de-amalgamation will involve extra work and some stress for staff. However, a recent survey of staff suggests that the far majority (around 73%) are in favour of de-amalgamation (a further 12.5% are undecided) largely because they believe it will result in significant benefits for the community over the medium term. These views should be given some serious consideration, given that it is the staff who work in the Council who are most likely to understand the full implications of a de-amalgamation. Moreover, the work and stress associated with de-amalgamation needs to be set against the substantial work that is still outstanding with respect to the 2016 amalgamation (harmonisation of rates and many fees and charges), as well as the stress engendered by constant uncertainty. Notably, the state political opposition has publicly declared, on a number of occasions, that they will allow de-amalgamation should they gain office and many people therefore consider de-amalgamation to be an inevitability given the strength of feeling in the community. Clearly if de-amalgamation is inevitable (as believed by many) then it is better that this occurs early on before more damage is inflicted on the community and under the current government which will be better able to protect its legacy (Drew, 2018).

In the next section I briefly outline the projections made by KPMG in the Ministers' Proposal of January 2016. I also provide a brief account of the TCorp assessments of financial sustainability for both councils prior to amalgamation, a review of the expert evidence tendered by the former Gundagai, as well as an evaluation of the performance of the Delegate in executing his duties. Following this I review the financial performance of the local government area prior to and since amalgamation, in addition to reviewing the relevant financial performance ratios over the same period. I then analyse the relative technical efficiency of the local government area prior to and following amalgamation which is particularly important given that the relevant legislation places great emphasis on efficiency and associated concepts (such as economies and diseconomies of scale). Thereafter, I outline both the one-off costs of de-amalgamation as well as the ongoing savings that might be reasonably expected to arise from a boundary change. In the penultimate section I comment on the remainder of the criteria set out for the Boundaries Commission in Section 263 of the Act (1993). I conclude the report with some observations regarding the benefits of de-amalgamation for the citizens of Cootamundra-Gundagai.

Financial Sustainability, Amalgamation Projections and Boundaries Commission

The New South Wales (NSW) Treasury Corporation (TCorp) undertook financial sustainability reviews for the (then) Division of Local Government, following appointment in 2012. The reviews were based largely on ten financial sustainability ratios as well as some desktop analysis of financial statements. The ratios and benchmarks were the subject of some serious scholarly criticism in the peer review literature, as was the lack of transparency in arriving at an overall rating (see, for example, Drew and Dollery, 2014a; 2016). However, the sub-optimal assessments are the best evidence we have regarding the sustainability of these councils prior to amalgamation and are also important because the ILGRP and IPART both made later reliance on this work.

The TCorp completed its financial sustainability review of Cootamundra Council in March 2013 and concluded 'Council to be in a satisfactory[1] financial position' (TCorp, 2013a, p. 31). Moreover, it noted that 'both past performance and the financial forecasts support our findings that Council has sufficient financial capacity to service the additional borrowings proposed' (TCorp, 2013a, p. 31).

TCorp conducted a similar inquiry into the financial sustainability of Gundagai Council in April 2013. It concluded 'Council to be moderately sustainable in the short term with Council finding it increasingly difficult to fund infrastructure renewals in the medium to long term' (TCorp, 2013b, p. 28). The report expressed a concern that 'Council will not be able to maintain its assets at the current service level in the long term' (TCorp, 2013b, p.28).

To understand the conclusions reached by TCorp one must know the definitions of the terms 'sound' and 'moderate', as well as the distribution of councils. I reproduce the definitions from TCorp (2013c, p. 69) below:

> **Sound:** · A local government with an adequate capacity to meet its financial commitments in the short, medium and long term. While it is likely that it may have a record of minor to moderate operating deficits, the local government is expected to regularly report operating surpluses. It is likely able to address its operating deficits, manage major unforeseen financial shocks and any adverse changes in its business with minor or moderate revenue and/or expense adjustments. The expense adjustments are likely to result in some changes to the range of and/or quality of services offered. Its capacity to manage core business risks is sound.
>
> **Moderate** · A local government with an adequate capacity to meet its financial commitments in the short to medium term and an acceptable capacity in the long term. While it has some record of reporting minor to moderate operating deficits the local government may also have

[1] Curiously TCorp did not use the words later employed for the financial sustainability rankings in the case of Cootamundra. I have concluded that the word 'satisfactory' was used in a manner consistent with the later term 'sound' give the context of its use.

recently reported a significant operating deficit. It is likely able to address its operating deficits, manage unforeseen financial shocks and any adverse changes in its business, with moderate revenue and/or expense adjustments. The expense adjustments are likely to result in a number of changes to the range of and/or quality of services offered. Its capacity to manage core business risks is moderate.

The distribution of financial sustainability ratings is reproduced from page 10 of TCorp (2013c):

Table 1 - FSR Distribution

Rating	Count	Percentage
Very Strong	0	0.0%
Strong	2	1.3%
Sound	32	21.1%
Moderate	79	52.0%
Weak	34	22.4%
Very Weak	5	3.3%
Distressed	0	0.0%
Total	**152**	**100.0%**

Thus, it can be seen that TCorp considered Cootamundra to be somewhere in the top 20% of sustainable NSW councils, and Gundagai somewhere in the third quartile. Moreover, consistent with both of the definitions reproduced above, TCorp clearly believed both councils to have *at least* 'adequate capacity to meet its financial commitments in the short to medium term and an acceptable capacity in the long term' (TCorp, 2013c, p. 69).

Otherwise stated, the NSW Treasury Corporation believed both councils to be financially sustainable at the time of their review.

Some readers will be aware that a Fit for the Future ratio analysis was then completed by IPART (with contributions by Ernst & Young and Mr John Comrie a local government 'expert' from South Australia). To the dismay of many, this analysis of fitness for the future was even more unsatisfactory (in terms of methodology) than the earlier extremely synecdochical effort of TCorp (2013c). Now, the community was asked to believe that the financial sustainability of complex local governments could be somehow guessed at by the use of just seven ratios, one of which (the so-called efficiency ratio) didn't even measure what it purported to report on (IPART, 2015). Benchmarks were changed (for example, the Operating Ratio which previously had a benchmark of -4% was now assigned a higher benchmark of 0%), data known to be inaccurate was employed (see Drew and Dollery, 2015b; Drew and Grant, 2017), and implausible and inappropriate analytical techniques (linear regression for data which was clearly not linear) were used by IPART (2015) and collaborators. An over-arching criteria was introduced (a subjective judgement on adequate scale and capacity which essentially boiled down to whether the council had previously been identified by the Independent Local Government Review Panel, on the basis of no empirical evidence whatsoever, to be a suitable subject for amalgamation) with the effect that if a Council failed on this judgement then it was deemed to be *not* fit for the future. Clearly this work (ridiculed in the media and scholarly literature) can only be described as 'amateurish' by even the most well-disposed person and is thus not worthy of any consideration at all by anyone, given its obvious flaws.

Sometime towards the end of 2015 the Minister engaged the services of KPMG to 'model' the benefits of an amalgamation between Cootamundra and Gundagai Shires which formed the basis of the January 2016 Minister's proposal. Modelling is a generous term for what actually took place –KPMG made some assumptions (based on no evidence whatsoever, which means they were truly 'guestimates'), put the numbers into a spreadsheet to do some rudimentary arithmetic, made some more assumptions about future inflation rates to put the questionable arithmetic into nett present value terms (which made it sound far more sophisticated than it was), added in some substantial state government grants to make matters look more convincing, and declared a 'benefit by up to $18 million from a merged council' (NSW Government, 2016, p. 3).

When one reads into the report it becomes clear that the headline figure of $18 million included 'NSW government funding of $15 million' – which was a political decision to reward communities for submitting to amalgamations (there is no reason in principle why this $15 million could not have been given to non-amalgamated councils, in which case not amalgamating would have had a benefit of up to $15 million) (NSW Government, 2016, p. 3). So truly the projected benefit was really just up to '$3 million in net financial savings over 20 years' (NSW Government, 2016, p. 3).The KPMG (NSW Government, 2016, p. 8) work proposed that the savings would occur in the following areas of expenditure:

- 'streamlining senior management roles ($4 million);
- The redeployment of back office and administrative functions ($3 million); and
- Efficiencies generated through increased purchasing power of materials and contracts ($500,000)'

Otherwise stated KPMG predicted that there would be savings in the order of $7 million in employee costs, and savings of $500,000 in materials and contracts (both are specific line items in the audited financial statements). Both of these figures were apparently arrived at by guessing a percentage saving that might occur following amalgamation and multiplying the income statement line items through by the said percentage (see, KPMG, 2016). Moreover, the Ministers' merger proposal informs us that we might 'also expect to generate, on average, around $400,000 in savings every year from 2020 onwards' (NSW Government, 2016, p. 8). Furthermore we were informed that merger savings could be reinvested to 'improve infrastructure...enhance service delivery....reduce rate pressures'. This was the essence of the Ministers' Proposal that the 'suitably qualified' Boundaries Commission Delegate – Mr John Turner – was asked to assess (NSW Government, 2015, p. 2).

Mr Turner was required under Part 3 of the Local Government Act (1993) to assess the Minister's proposal against eleven specific criteria. It is not possible to comment on all of his report, due to a need for brevity, but the assessment of certain criteria do rate a mention given that the conclusions drawn by the Delegate seem unreasonable for anyone who had received a high school education, and provides additional weight for the community claims of a misapprehension of bias[2].

Financial Impacts

Mr Turner took note of the TCorp financial sustainability ratings (without defining what they meant), detailed the projected benefits of KPMG (noting that they 'have come under sustained questioning and criticism' (Turner, 2016, page 3)), and referred to the 'Drew Report' on an incidental matter (which confirms that he read it), but nevertheless concluded that 'there is strong evidence that there will be significant financial benefits to all residents and ratepayers as a result of the merger' (Turner, 2016, p. 19). This is an extraordinary conclusion for anyone of his education and experience to have arrived at – especially given the contents of the report by Dr Drew (then of UNE) that Mr Turner referred to, which provided robust empirical evidence from previous amalgamations, as well as sophisticated data envelopment modelling to conclude that:

(i) 'There is no reason to expect a significant and enduring reduction in staff expenditure' (based on a table of employee expenditure data from the Queensland amalgamations which demonstrated staff expenditure had indeed risen at a higher rate for amalgamated councils than their non-amalgamated peers following the 2008 Queensland amalgamations (Drew, 2016, p. 5)). I have reproduced this evidence on employee cost outcomes following amalgamation in the appendix.

(ii) Efficiency of the amalgamated cohort in Queensland had significantly under-performed relative to their peer group following amalgamations (Drew, 2016, p. 6) – therefore suggesting that hopes of realising economies of scale from amalgamation could well prove illusory.

(iii) An amalgamation of Cootamundra and Gundagai shires would result in 'decreasing returns to scale' in the order of 'just over $700,000' per annum, even in the unlikely event that the KPMG projections of savings 'of around $150,000 p.a.' did indeed come to pass. The diseconomies of scale were projected to be just over 8 percent.

In sum, Mr Turner was asked to weigh the arithmetic based on guestimates employed by KPMG (for which no evidence had been produced), against a widely published and respected scholar who had provided evidence based on the most recent Australian amalgamation program in addition to sophisticated modelling based on actual data drawn from the audited financial statements. I will let the reader of this report decide if a reasonable person with Mr Turner's education and

[2] Owing to his former position as Deputy Leader of the Nationals, and the Nationals' member of Parliament for Myall Lakes.

experience could have been expected to place such absolute faith in the KPMG work given the material set before him.

Resident and Ratepayer Attitudes

Mr Turner (2016, p. 31) states that he was presented with an 'IRS Research phone survey of 403 LGA residents aged over 18 commissioned by the Council and conducted at around the same time as the Public Inquiry recorded that around 90 per cent of those surveyed in every category disagreed with the proposal to merge Gundagai Shire with Cootamundra Shire'. On the basis of this evidence, numbers (which are hotly contested) of attendees at a public meeting (on Thursday February 4, 2016 between the working hours of 2pm to 5pm), and 'impressions' garnered from written submissions he concluded that:

> 'the majority of the population did not have a strong attitude one way or the other concerning the merger proposal'.

I will leave it to the readers of this report to decide whether it was reasonable for an educated person well acquainted with survey methods (such as those employed by political pollsters which he would have observed closely during his political career) to have ignored statistical evidence in favour of mere impressions formed from reading written submissions (in the full knowledge that the community had not been informed by him that the number of written submissions would be the deciding factor in his assessment of community attitudes).

Service Delivery and Access

In response to submissions made regarding the substantial distance between Cootamundra and Gundagai (in the order of 58 km which can only be traversed by a secondary local road), Mr Turner (2016, p. 36) stated:

'Given the distance covered under the proposed LGA it would be reasonable to retain the full-service offices in both towns to minimise any disadvantage to residents'.

Mr Turner goes on to note that 'Cootamundra Shire notes in its submission to the inquiry that the likely time and distance separation means that the new council will need to run operationally as two distinct halves, north and south, working in parallel'. He comments approvingly that 'this is a practice undertaken by many councils who are responsible for covering large areas' (Turner, 2016, p. 36). Later in the report he repeats the observation 'that the distance and time taken to travel between the two town centres means it is most likely that two completely separate and almost fully staffed offices will need to be maintained in order to ensure the effective and equitable delivery of services' (Turner, 2016, p. 39).

These various statements suggest that Mr Turner was: (i) well aware that the amalgamated entity would have to maintain essentially two separate sets of staff and assets (presumably with an additional layer of management to co-ordinate the two offices), and (ii) was cognisant of the time and cost required to travel between the two centres. The question arises whether it was reasonable to believe the projections of savings in employee costs in the order of $7 million (over 20 years) given the concession that the two existing organisational structures would largely have to continue unchanged. It must also be asked whether it was reasonable for a Boundaries Commission Delegate who noted the time and cost of travel between the two centres to not question why this time and cost of travel (which is substantial and in the order of $150,000 p.a.[3] in direct costs alone (see my breakdown of de-amalgamation costs and benefits, below)) had clearly not been included in the KPMG modelling which formed the basis of the Ministers' Proposal (NSW government, 2016).

Concluding Comment on the Amalgamation Process

Clearly the consultants engaged by the (then) Minister failed to provide him with a satisfactory level of advice. Moreover, it is equally clear that the Boundaries Commission Delegate failed to perform his duties diligently at the level that might have been reasonably expected of someone with his education and political experience. The Minister and the government were thus badly let down and mislead by the various parties that were engaged by them. However, it needs to be noted that none of the Boundaries Commission criteria in S263 of the Act (1993) direct it to consider changes on the basis of righting injustices or grievous errors of judgement committed by previous Boundaries Commissions or agents of previous Ministers. Notably, the current Minister and Premier are not constrained by the legislative vacuum and will no doubt be keen to ensure that natural justice is ultimately observed. Critical to their decision-making calculus must be the magnitude of the fiscal damage inflicted on the Cootamundra-Gundagai communities as a result of poor advice and decision-making conducted on behalf of the NSW government back in 2016. It is to this matter that I now turn my attention.

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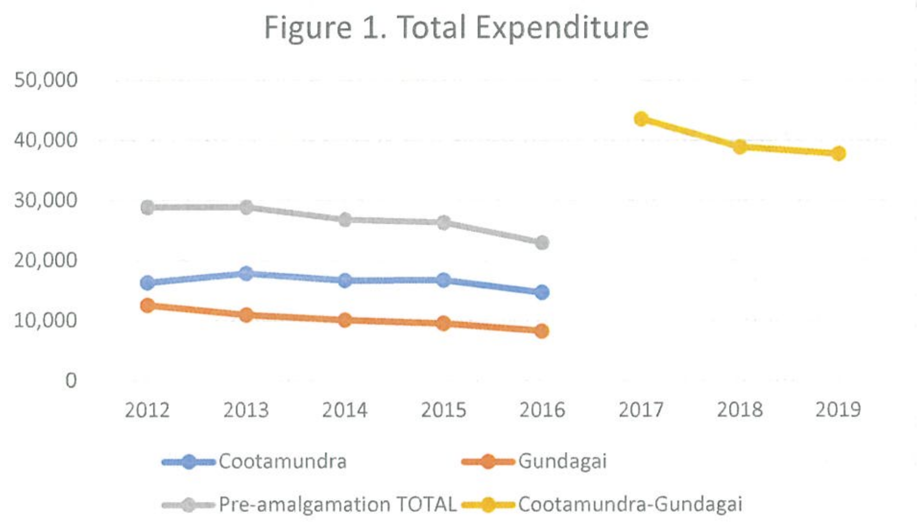
[3] Coincidentally this is the precise amount that Mr Turner (2016, p. 9) acknowledges was projected to be saved by KPMG – suggesting that the entire savings might have been eliminated had Mr Turner made reasonable inquiries regarding the obviously missing expenses from the 'modelling'.

Financial Performance of Cootamundra, Gundagai, and Cootamundra-Gundagai

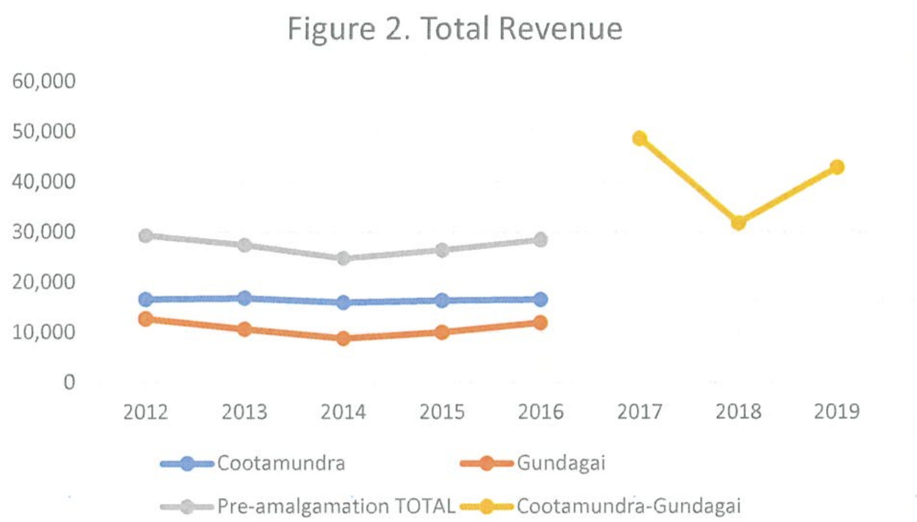
Three full financial years have now been completed since the amalgamation took place and we are thus in a good position to assess the accuracy of the KPMG projections upon which the (then) Minister, as well as the Boundaries Commission Delegate, placed so much reliance. Moreover, a review of the financial position of Cootamundra-Gundagai also provides us with an indication of the likely financial sustainability outcomes under the current boundary arrangements, and points to some of the benefits associated with the proposed de-amalgamation.

When examining the graphs that follow it is important to be mindful of a few matters. First, the 2016 financial year was cut short by a month-and-a-half, and the 2017 financial year was extended by the same time. Consequently, it is reasonable to expect a decrease in expenditure in 2016, and a concomitant increase in 2017. Accordingly, it might be prudent to emphasise comparisons between standard financial years – that is, the 2014 and 2015 financial years, compared to the 2018 and 2019 financial years. Second, to facilitate fair comparisons I have generated a pre-amalgamation total (coloured grey in the following graphs) which is simply the sum of the expenditure and other items of the two constituent councils for the period prior to amalgamation – this is completely reasonable and a common practice in the scholarly literature (see, for example, Drew and Dollery, 2014a). Third, the charts presented are in thousands of dollars, consistent with presentation of financial statements by NSW local governments. Fourth, 2019 figures were obtained from the most up-to-date version of the financial statements, which were in the process of being audited at the time that I wrote this report (significant changes to the draft numbers are not expected).

Figure 1 charts the total expenditure prior to and following amalgamation. Clearly there has been a large jump in expenditure (in the order of $12 million) which seems at odds with the projections made by KPMG. One must be mindful that in 2017 the reporting year was longer than usual and that there would have been one-off amalgamation costs in this period (and perhaps some even in the 2018 financial year). However, expenditure levels have only shifted down slightly in the most recent audited financial reports and it would be hard to argue that the 2019 financial year is not representative of the expenditure profile of Council.

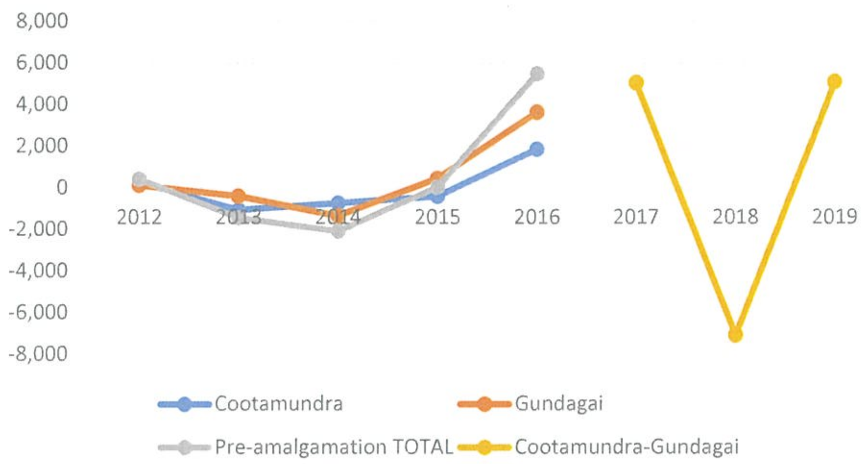


In Figure 2 I have plotted the revenue over time for the local government area. As can be seen from the graph, revenue has fluctuated significantly since amalgamation, principally as a result of extraordinary grant flows in 2017 (Stronger Community Fund $9 million), and 2019 (Stronger Communities Fund $3.4m), but also due to a doubling of fee revenue from the state government RMS in 2019. Thus, the increases in revenue seems to be very dependent on ongoing extraordinary grant income, which probably can't be relied on to continue into future years.



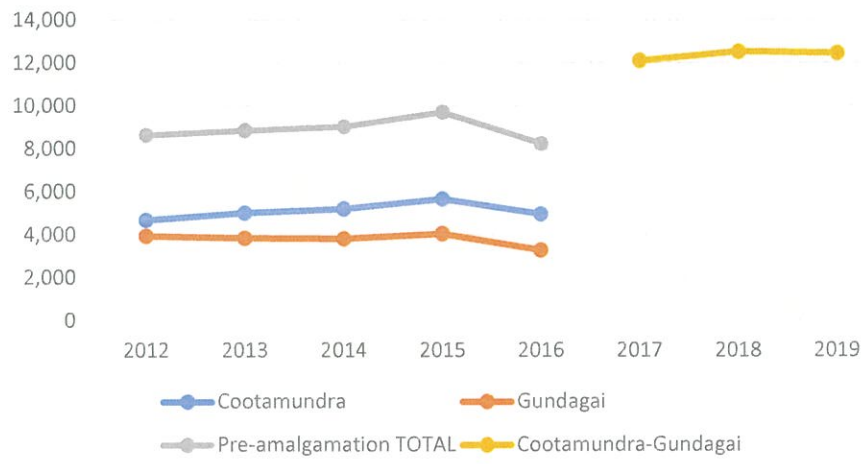
In Figure 3 I chart the nett operating result over time. As can be seen, the upward trend prior to amalgamation has been replaced by a highly fluctuating result since. Notably without the addition of $8.7 million in grant revenue in 2019, Cootamundra-Gundagai would still be well and truly in deficit. Moreover, by the NSW government preferred measure (operating result before grants provided for capital purposes) Council has been in deficit ever since amalgamation, and there is little reason to believe that this situation will change in the short term without considerable increases to fees and charges or local government taxation. One couldn't reasonably conclude on the basis of this data that the Cootamundra-Gundagai Regional Council is financially sustainable in the long-term.

Figure 3. Nett Operating Result



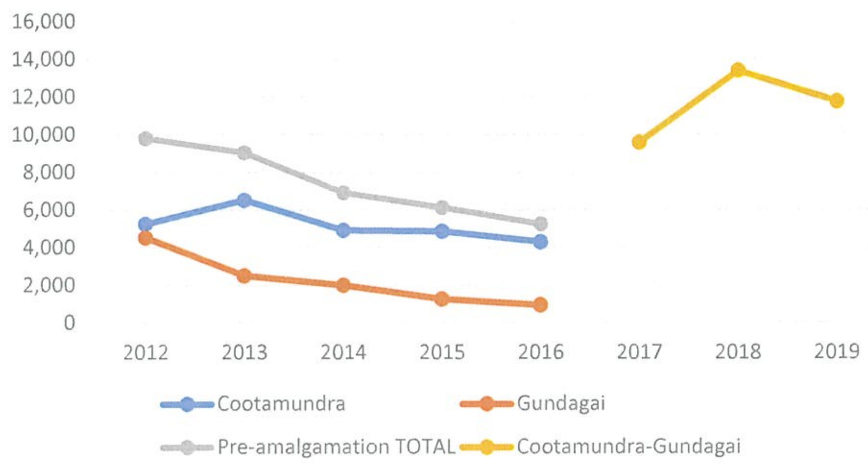
Readers will recall from the previous section that KPMG projected that the majority of the post-amalgamation savings would occur in the area of employee costs ($7 million over 20 years was predicted). Moreover, it will be remembered that Dr Drew (2016) had provided the Boundary Commission Delegate with evidence that suggested staff expenditure was more likely to *increase* following amalgamation (see the appendix for the table provide to Mr Turner). Figure 4 compares the employee cost item from the audited financial statements over time. Comparing full financial years prior to and after amalgamation it is clear that employee costs have risen substantially (in the order of some $2.7 million). Thus, it seems that KPMG's guesswork was badly in error and that the actual outcomes were consistent with the evidence-base placed before the Delegate. This result is hardly surprising, given that the Delegate acknowledged that the new council would have to operate as two separate operations at Cootamundra and Gundagai respectively. The additional management required to co-ordinate two disparate operations, along with higher salaries paid to management commensurate with broader responsibilities, likely accounts for a good deal of the increase to the employee expenditure

Figure 4. Employee Costs



It will be recalled that KPMG also projected savings in the order of half a million dollars in materials and contracts. Against this guesswork, the report by Drew modelled *dis*economies of scale of just over 8 percent (that is, higher expenditure than necessary in the order of 8 percent). Figure 5 charts the movement in this item from the audited financial statements over time. Once again, it seems that the KPMG projections were grossly inaccurate.

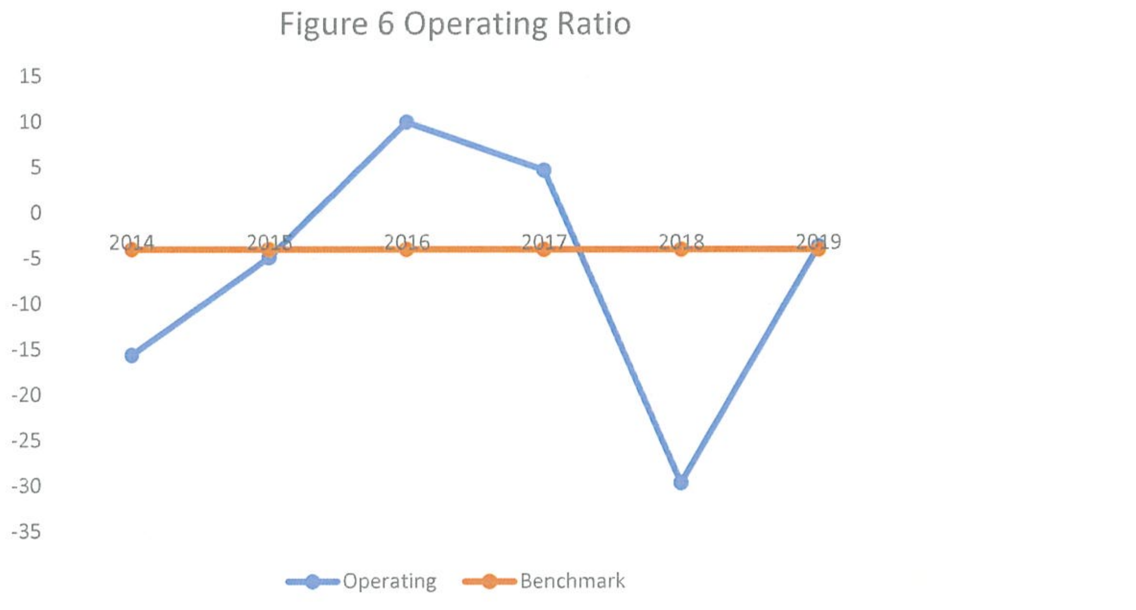
Figure 5. Materials & Contracts



In sum, the analysis of audited financial data confirms that the KPMG projections were completely wrong. The amalgamation – far from reducing expenditure – has instead resulted in substantial increases to expenditure, consistent with the evidence presented to the Boundaries Commission Delegate in 2016. There is absolutely no reason to expect that the new higher employee costs will reduce in the future, in the absence of boundary reform, (indeed expenditure will likely increase when key positions such as the Deputy General Manager are filled). However, there is some potential that materials and contracts could be reduced in coming years under very strict budget control. Moreover, it is hard to see how the strong flows of extraordinary grant revenue could be expected to continue into future years. Without this revenue the Cootamundra-Gundagai Regional Council will need to increase fees and rates substantially, in order to maintain a semblance of financial sustainability, in the absence of a de-amalgamation.

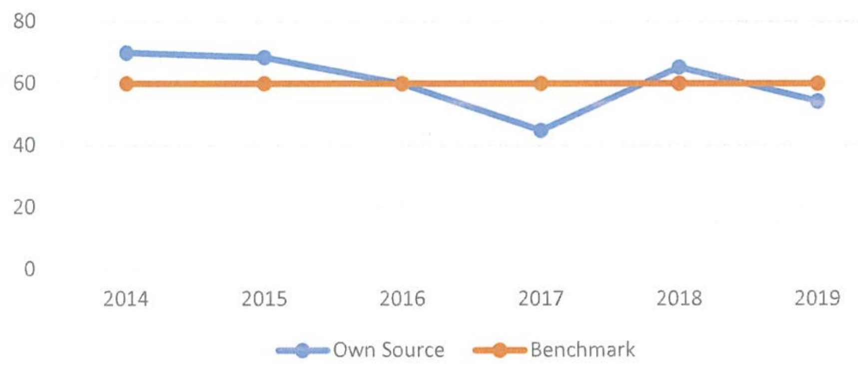
Readers will also recall that financial ratios were used by TCorp and IPART to measure the financial sustainability of local governments, and that performance against these (generally arbitrary) ratio benchmarks was used to determine which councils should be subject to amalgamation. If we follow the logic of this thinking through to its end, it is reasonable to expect that the ratios should be showing some sign of improvement after three full years since amalgamation. I have therefore charted the ratios for the period prior to and following the amalgamations. For the period prior to amalgamation I calculated a combined ratio which was the sum of individual ratio components of the constituent councils. This practice is consistent with the scholarly literature (see, Drew and Dollery, 2014a).

Figure 6 charts the operating ratio over time and I think it is pretty clear that the ratio fails to meet the benchmark for both of the standard financial years since amalgamation. Notably I have used the TCorp benchmark of -4%, were I to use the later IPART benchmark of 0, then matters would appear even less edifying.



A lot of emphasis was placed on the Own Source ratio during the amalgamation debates. Unfortunately, the ratio was poorly conceived and demonstrates a fundamental misconception of horizontal fiscal equalisation grants, as well as fiscal federalism. Nevertheless, the own source ratio has been below the NSW government benchmark since amalgamation, and by this measure suggests that the boundary change was not as successful as might have been hoped.

Figure 7 Own Source Ratio



The unrestricted current ratio is a measure of liquidity – that is the ability of council to meet its financial obligations when they fall due. As can be seen from the graph liquidity has been reducing quickly since the spike in 2017 – however, it is at a satisfactory level and isn't a matter for immediate concern.

Figure 8. Unrestricted Current Ratio

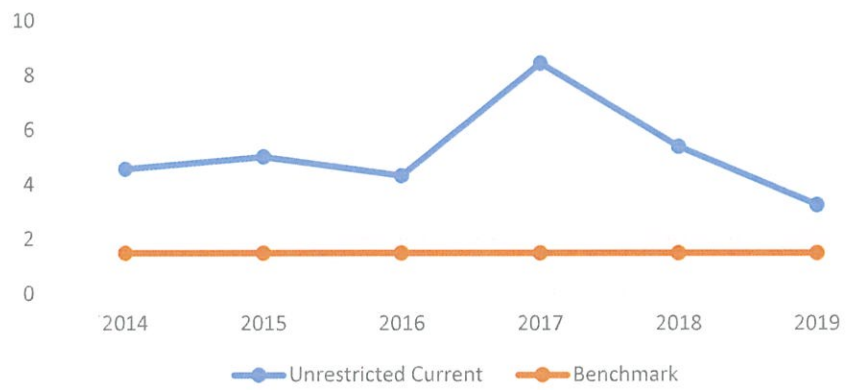
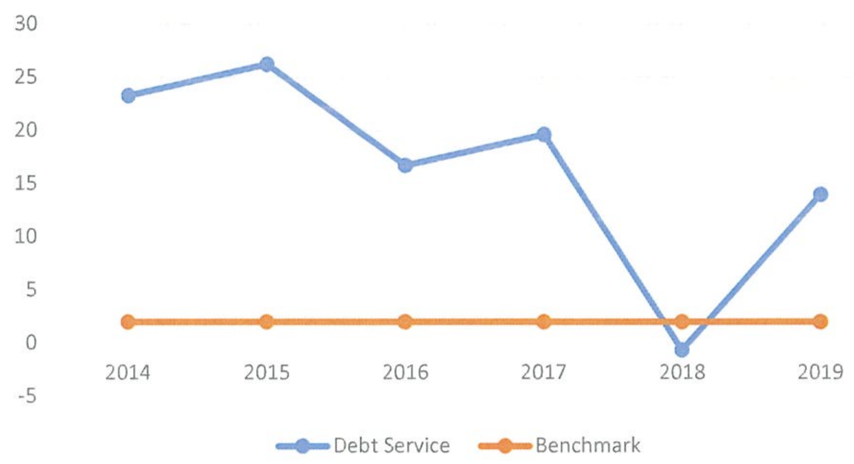


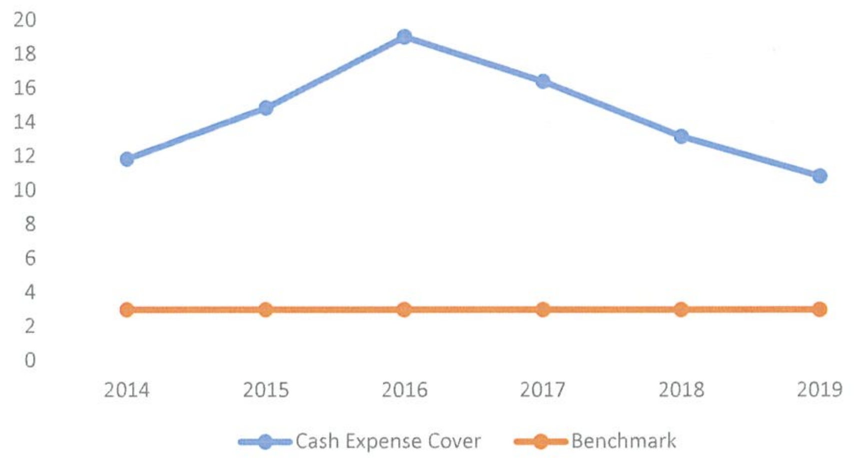
Figure 9 provides a picture of Council's ability to service debt. This has clearly diminished since amalgamation, and even dipped below the benchmark at one time, therefore suggesting that amalgamation may not have improved matters in this area of financial sustainability.

Figure 9. Debt Service Ratio



The cash expense ratio is another measure of liquidity. It has declined steadily since 2016, but is still well above the benchmark.

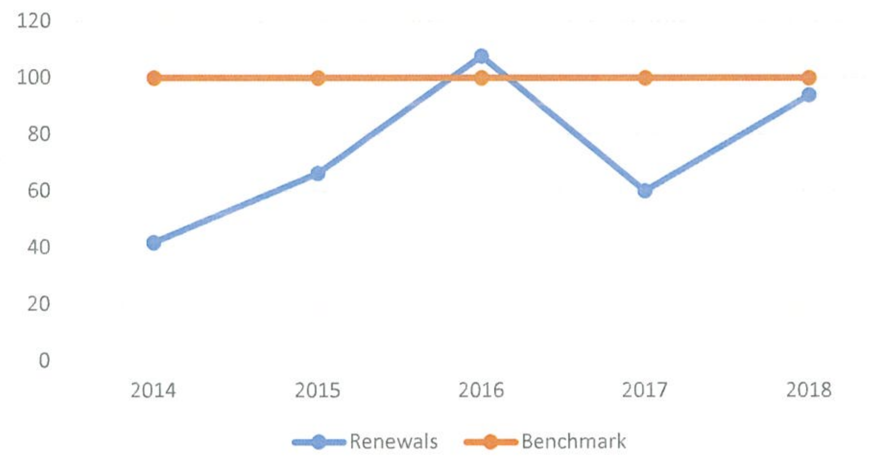
Figure 10. Cash Expense Ratio



The next three ratios refer to asset management and were the subject of considerable contention during the 2011-2016 debate. Part of the problem with these ratios are that they involve some data which may be based on subjective criteria (Drew and Dollery, 2015b). It should also be noted that at the time of writing I did not have access to the 2019 data for these ratios.

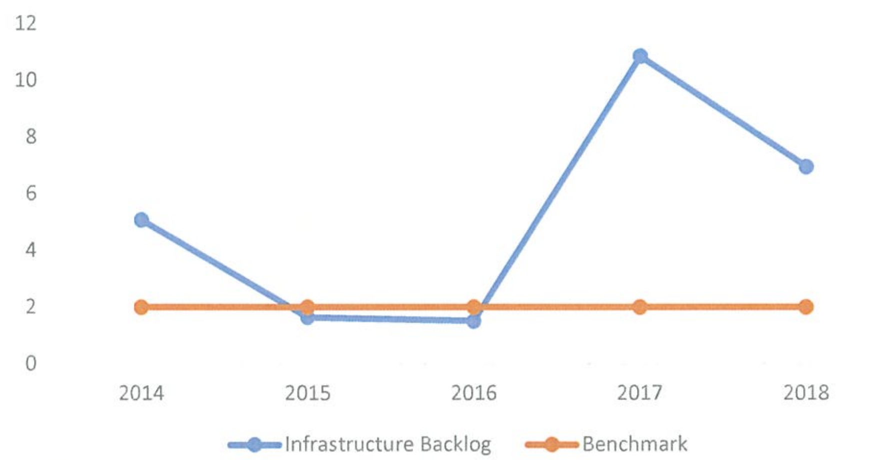
Figure 11 purports to measure whether Council has renewed assets according to need. Prior to amalgamation, the constituent Councils rarely met this benchmark, and since amalgamation the benchmark still fails to be met.

Figure 11. Renewals Ratio



The infrastructure backlog was a key factor referred to in the Minister's Proposal (2016) and it appears to have been a major motivation for amalgamation. This ratio is the opposite of other measures in that achievement of the benchmark occurs when the blue line dips *below* the orange benchmark line. I think there can be little doubt that, by the measures provided in the financial statements, things have deteriorated significantly since amalgamation.

Figure 12. Infrastructure Backlog Ratio



The asset maintenance ratio purports to measure whether Council has conducted required annual maintenance on its assets. I have set the last two years to '1000' because the Council has claimed that there is zero (0) required maintenance, which would yield the result of infinity[4]. By the data provided in the financial statements it appears that performance in this metric has benefited enormously by the amalgamation.

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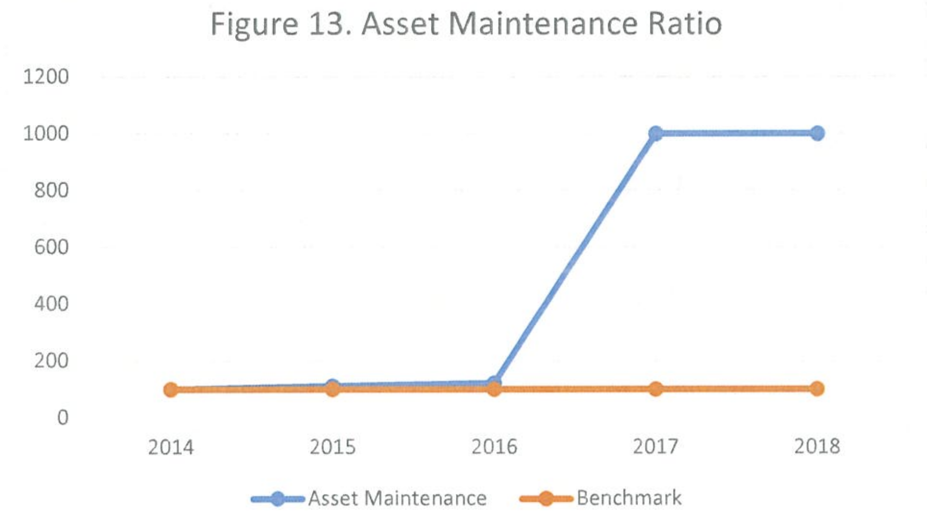
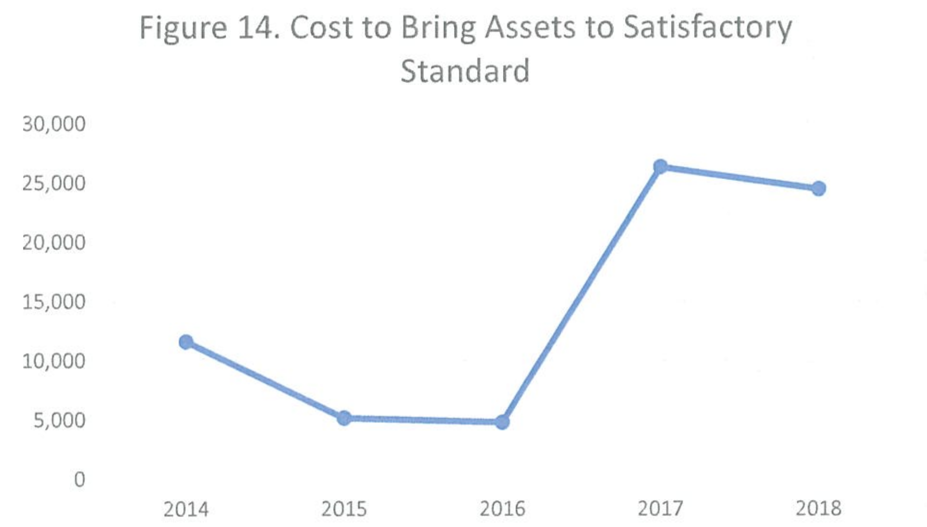
[4] Not zero as stated in the financial statements, because in mathematics anything divided by zero yields infinity.



In Figure 14 I provide details of the cost to bring assets up to a satisfactory standard, which was also a point of great contention during the amalgamation debate. The definition for this data is extremely subjective (what is 'satisfactory' or, more recently, 'agreed') and definitional drift means that it is difficult to form any reliable conclusions based on the data stated by *any* Council.



It might be noted that the 'efficiency' ratio (employed by IPART in its Fit for the Future assessments) has not been calculated and reported here as it was very misleading – given that it used data known to be inaccurate, and employed an empirical methodology that was obviously inappropriate (Drew and Dollery, 2015b). However, efficiency *is* an important aspect of financial sustainability and a major motivation for amalgamation according to the ILGRP, KPMG and NSW Government. Moreover, efficiency is specifically referred to in s263 of the Act (1993) as a matter that the Boundaries Commission must consider. It is therefore appropriate to measure Council efficiency over time and this is the matter to which I now turn my attention.

Efficiency of Cootamundra, Gundagai, and Cootamundra-Gundagai

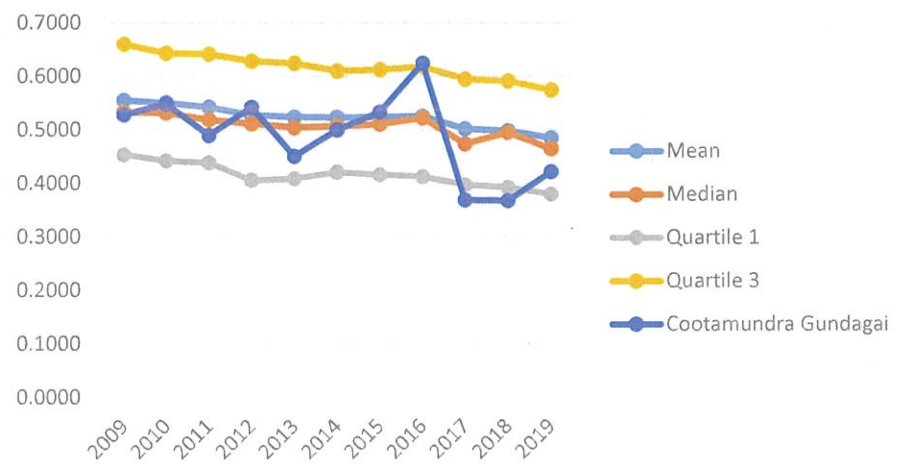
Efficiency in economics is a term that is used to refer to the conversion of inputs into outputs and can be measured quite precisely using a sophisticated technique called data envelopment analysis (DEA) (see, for example, Cooper et al., 2007; Coelli et al. 2005). It essentially extends one output and one input ratios that we are familiar with (for example, expenditure per person, or kilometres per hour) to *multiple* inputs and outputs. The advantages of using multiple inputs and outputs is that we can more accurately model what actually occurs in the local government production function.

The inputs to local government are money and local government staff time. The outputs are specific services provided to different types of properties (residential, farmland and business) as well as the provision of local government roads (the single largest item of expenditure for local government). This specification is consistent with the scholarly literature (see, for example, Drew et al., 2015a; 2015b; 2015c).

I conducted two intertemporal DEA on the Cootamundra-Gundagai Regional Council over the period 2009 to 2019 inclusive. The word 'intertemporal' just means that a particular type of DEA was done so that legitimate comparisons could be made between successive years (I also did a refinement of this which is called local intertemporal DEA, which can be found in the appendix). To make a comparison prior to amalgamation I, once again, followed the established procedure of combining the various inputs and outputs of the pre-amalgamated entities (for example to get residential outputs I simply added the number of residential assessments in Cootamundra to the number of residential assessments in Gundagai).

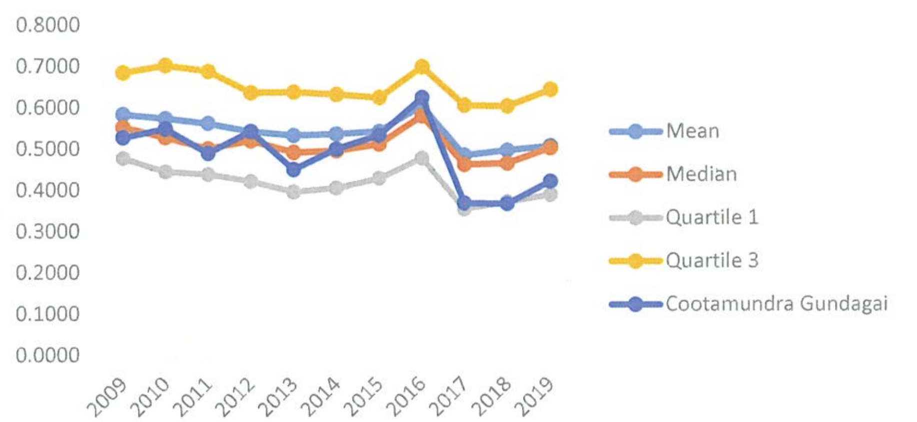
Figure 15 presents the results for Cootamundra-Gundagai along with various measures of what is called central tendency for the entire cohort of NSW councils. Thus, I include the mean (or average) of NSW local government efficiency, the median (which is the middle number if one puts all numbers in ascending order), and each quartile (Q1 and Q3, which are the median of the first half and second half of the data respectively). As will be noted there was a spike in improved efficiency for Cootamundra-Gundagai in 2016 (owing largely to the financial year being shortened by several weeks because of the amalgamation). Following this time efficiency dropped quite significantly to recover slightly in 2019. Notably, prior to amalgamation efficiency at Cootamundra and Gundagai councils was pretty typical of most NSW local governments (that is, it was close to the mean and median – where 50% of councils lie below the median). However, following amalgamation it suddenly dipped below the lowest quartile (bottom 25% of performance) and has slightly improved this year. It therefore appears that the promised economies of scale were illusory (consistent with the report brought to the attention of the Boundaries Commission Delegate in 2016).

Figure 15 Efficiency Relative to All Councils



It is one thing to know that Cootamundra-Gundagai efficiency dropped alarmingly following amalgamation with respect to all NSW local governments, but one may also reasonably ask how performance compares to just the cohort of councils which were amalgamated. In Figure 16 I chart the results of a second intertemporal DEA which looks at just Cootamundra-Gundagai relative to other amalgamated councils. Once, again performance fell from more or less typical (close to the mean and median – where 50% of councils lie below the median) in 2016, to something just a little over the first quartile (which is the bottom 25% of councils). So, it would be fair to say that even when measured against other amalgamated councils the efficiency of Cootamundra-Gundagai has deteriorated alarmingly, contrary to the predictions of KPMG. This suggests that the amalgamation configuration from Cootamundra-Gundagai was particularly unhelpful and contributed to particularly poor outcomes for the community of Cootamundra-Gundagai.

Figure 16. Efficiency Relative to Other Amalgamated Councils



The reason why efficiency reduced is because the amalgamation created a council that was too large – that is, the amalgamation generated diseconomies of scale. The report by Drew (2016) predicted that the amalgamation would shift the two former councils from having potential for economies of scale into a configuration that would result in diseconomies of scale (relative inefficiency) of just over 8 percent. This analysis was provided to the Boundaries Commission Delegate in 2016 because the s263(3)(a) of the Act (1993) specifically required the Delegate to give consideration to 'economies or diseconomies of scale'.

The analysis that I completed for Figure 15 suggests that council is indeed currently operating with diseconomies of just under 11 percent, more or less consistent with the empirical analysis by Drew in 2016, but inconsistent with the lofty assumptions of KPMG in 2016.

To complete my analysis of the financial advantages and disadvantages of boundary change – which is the first criteria that the legislation requires the Boundary Commission to weigh – I will now set forth the pecuniary costs and benefits of de-amalgamation.

De-amalgamation Cost and Procedure

A potential de-amalgamation of Cootamundra-Gundagai Regional Council will be associated with two distinct kinds of costs and benefits. First, there will be one-off costs required to execute the de-amalgamation. Second, there will be a series of ongoing costs *and* benefits directly attributable to the new boundary structure. It is important to note that all of the following costs and benefits have been thoroughly investigated and are based on audited financial statement data, Human Resource staff records, surveys of staff travel, historical data from previous de-amalgamations and the requirements of legislation. It is not the kind of guesswork previously inflicted on the community, and the people of Cootamundra-Gundagai can be assured that the projections will be realised under able stewardship. Indeed, I have painted the worst-case scenario in all of my calculations, and I would not be at all surprise to find that the costs have been over-estimated and the benefits under-estimated.

One-off Costs of De-amalgamation.

To determine the one-off costs of de-amalgamation I consulted the scholarly literature on previous de-amalgamations (see for example, Drew and Dollery 2014b; 2015a), made a study of the costs associated with the 2016 amalgamation, inquired into contracts for executive staff, received estimates for work by IT providers, and consulted with management on each relevant area of expense. When faced with two cost projections (for example the actual costs of legal work for amalgamation and the historical cost of legal work from previous de-amalgamations suitably inflated), I have taken the higher of the two estimates. I have also added in extra margins for several costs to account for potential contingencies.

The total one-off cost for de-amalgamation should not exceed $1.75 million[5]. This will be constituted as follows:

Table 2. One-Off Costs of De-Amalgamation ($'000)

Communications and Branding	477
staff expenditure	211
ICT and finance	600
Governance	108
Asset Management	18
Legal	177
Plant	0
Transition Manager	120
Other	39
TOTAL	**1,750**

A few notable matters. I have confirmed with both the Works Supervisor and Technical Operations Manager that no plant will be required to be purchased as a direct result of a de-amalgamation. This state of affairs has arisen due to the conduct

[5] This cost compares favourably to the $1 million cost of the similar Delatite de-amalgamation, which is equivalent to $1.5 million in today's dollars.

of the councils as separate operations as recommended by the former Boundaries Commission Delegate. In previous de-amalgamations, elsewhere in the country, additional plant was a major cost of de-amalgamation. Second, I have included the costs for a Transition Manager – ideally this position would be filled by someone that holds the trust of both communities and understands the operations of the council(s) and the costs and tasks required for de-amalgamation. This is a 10-week appointment and I have priced it in at a consultant's rate appropriate for the level of expertise required. Third, ICT costs are considerably over the estimate made by the Council's provider and better reflect historical costs from previous de-amalgamations (and hence should not be subject to the kind of budget blowout that occurred during many amalgamations). Fourth, the branding costs are based on the assumption that both emerging councils would revert to previous logos and branding strategies.

Ongoing Costs and Benefits

To calculate the ongoing costs I consulted with staff, conducted surveys of travel frequency, reviewed historical human resource records, reviewed the age profile of staff, consulted with department managers, referred to the most recent local government remuneration tribunal ruling, consulted with the current Mayor and Deputy Mayor, attempted to consult with the State local government grants commission (on several occasions), and took note of new legislative requirements.

According to my calculations the de-amalgamation cost payback period is just over 8 years. The ninth year should see a nett benefit, accounting for the cost of de-amalgamation, and from the tenth year onwards annual savings should be in the order of $451,000 per annum.

As noted earlier, where there was any doubt about savings, I opted to omit the saving or record the lesser assured amount. Therefore, it is reasonable to expect that the nett benefit will occur much sooner and be much greater in magnitude. Given the previous damage inflicted on this community I was not prepared to include any saving that I could not be completely certain of.

Notably, I have not modelled any forced redundancies (except for the current General Manager contract). Instead I have used data on staff age and information about retirement plans to model savings in staff expenditure based on natural attrition. Unlike KPMG and others, I refuse to countenance the idea that any ongoing staff member should have their job placed in jeopardy as a result of Ministerial decision-making.

Projected costs and savings are detailed below:

Table 3. Ongoing Costs and Savings Arising from De-Amalgamation ($'000)

	Year 1	Year2	Year 3	Year 4	Year 5	Year 6	Year 7	Year 8	Year 9	Year 10
Employee savings	112	259	398	408	545	558	729	747	766	785
Additional employee costs (key positions)	271	278	285	292	299	307	314	322	330	338
Additional Governance	0	0	0	0	0	0	0	0	0	0
Travel savings[6]	154	157	160	163	167	170	173	177	180	184
Additional Assurance costs	192	197	202	207	212	217	223	228	234	240
Additional operating grant income (non FAG)	60	60	60	60	60	60	60	60	60	60
Additional FAG income	Waiting for NSW Local Government Grant Commission response									
Savings from eliminating diseconomies of scale	Substantial in the order of 11% but cannot be assured therefore not included									
ANNUAL SAVING	-137	2	132	132	260	265	425	434	442	451
CUMULATIVE SAVING	-137	-135	-4	129	129	654	1,079	1,513	1,955	2,406

(Please note slight rounding error occurs in the table – totals reflect precise costs and savings)

A few more matters should be noted. First, governance costs relate directly to the overall increase in the numbers of Councillors arising from a de-amalgamation. I have conferred with the current Mayor and Deputy Mayor and they both agree that a reduced number of councillors (relative to what existed prior to amalgamation) would be appropriate. Accordingly, I have priced in a total of 5 Councillors for Gundagai and 7 for Cootamundra, using the current minimum rate of Councillor Allowance prescribed for the rural category of councils by the Local Government Remuneration Tribunal, plus overheads. This actually results in a small annual saving (of just under $3,000), but I have not modelled the saving in order to err on the side of caution consistent with my overall approach to this matter. Second, reduction in diseconomies of scale modelled in the data envelopment analysis have not been included as a separate item. Some of these diseconomies have been captured in more specific line items (for example, travel costs). However, there will likely be further diseconomies captured following de-amalgamation that will contribute to outcomes better than those that I project. I took the decision not to include savings from mitigating diseconomies in my calculations because, whilst they are very likely, they cannot be 100% assured. Third, I have only modelled in extra operating grant income relating to the libraries grant. I am aware that Council has effectively missed out on a number (or some portions) of one-off grants (like federal drought assistance), but these cannot be counted on in the future. Moreover, I have focussed on operating grants only, because capital grants are not included in the NSW government preferred operating result figure. Fourth, I have not modelled in the extra Financial Assistance Grant likely to be forthcoming following de-amalgamation. On the 7th February 2006, the responsible Federal Minister proclaimed a variation under

[6] This does not include the value of staff time lost through commuting. When staff are driving between centres they cannot be performing their usual duties, which represents a significant opportunity cost to Council.