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Chief Executive Officer,  
City of Joondalup  
Boas Avenue  
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**Attention:** Alexander Scott

25 June 2002

Ref: JO278

Dear Sir,

### **REVIEW OF THE NEW FINANCIAL ARRANGEMENTS WITH THE MINDARIE REGIONAL COUNCIL**

The following comments are made following my review of the proposal to change the business arrangements with Mindarie Regional Council (MRC). These arrangements were passed by the Regional Council in February 2002 and will form the basis for a new establishment agreement between its members in due course. As part of the MRC resolution each of the members of the Regional Council would be asked to approve these new arrangements.

I have used the report and resolutions in the Mindarie Regional Council resolution of February 2002 as the basis for my review. In addition I have had discussions with G McHarrie of Deloitte Touche Tohmatsu, K Poynton and J Goulias from MRC, following our briefing session of 6 June 2002.

The proposed changes have been discussed at two workshops at which all members were represented.

The key changes to the existing financial arrangements are as follows---

1. Funding Capital Works,
2. Calculating the tipping fees charged to member Councils, and
3. Method of distributing operational "profits".

### **FUNDING CAPITAL REQUIREMENTS**

The capital requirements of the operations at Tamala Park can be defined as either being for current or future capital development. The current capital relates to infrastructure, plant and equipment required to maintain the day to day operations. These costs (through depreciation and interest, if applicable) are charged to the current operations of the site and will influence the tipping fees to be paid by the users of the facility. The future funding of capital for secondary waste treatment and the second cell will need to generate sufficient cash to enable these processes to be advanced.

**Current arrangement:** Current capital needs are met by applying depreciation expense to the operations, retaining profits from the disposal of assets and interest on cash backed reserves from profit distributions.

Future capital needs were initially addressed by creating a cash backed reserve (Stage 2 Excavation Reserve) from tipping fees. The funds were raised by adding a levy of \$3.00 (1999/2000) and \$5.00 (2000/2001) per tonne to the tipping fees to all the users during that period. This process was discarded in 2001/2002. The reserve has a balance of \$2.7m.

In essence the future capital needs were being met by the users according to the volume of waste deposited at the site.

**Proposed Change:** Additional funds for future capital requirements are to be raised through the retention of surpluses, external borrowings or a combination of both. These will be charged against members according to their equity holding in the Regional Council.

The proposed arrangements provide that where funds are to be retained by the MRC the member Councils have an election whether to participate or not. The proposal is silent on the ramifications of members not participating in the retention of funds. It would be assumed that the MRC would borrow the shortfall in funding.

For those that participate in this arrangement an interest rate will be applied to all funds retained. This does not apply under the current arrangements. The new agreement provides that the interest applicable for member's contributions will be set between the deposit rate and the borrowing rate for funds. This would make it an attractive arrangement for both parties.

**Implications for the City of Joondalup:** As the existing contributions for capital are based on tonnages (either in fees or reserve contributions) and the City of Joondalup is one of the largest users of the facility there is a financial advantage to the City with the new arrangements.

If the members contributions to the reserve (Stage 2 Excavation Reserve) had been based on equity holdings the City of Joondalup would have been required to pay \$.340m over 1999/2000 and 2000/2001. It actually contributed \$.484m through tip fees for the same period. The new agreement further provides that the contributions already made to the Stage 2 reserve will be recognized on the basis of actual contributions rather than equity basis.

#### **TIPPING FEES FOR MEMBER COUNCILS**

Concessional fees are available to member Councils of the Mindarie Regional Council.

**Current arrangement:** A fee based on the cost per tonne is charged to members using the facility. As previously stated a reserve component was added to the fees paid by members in 1999/2000 and 2000/2001.

**Proposed Change:** The new arrangements would determine the fee paid by members as the "cost" as determined by the operating statement of the facility. In addition this arrangement states that the operating expenses used to determine costs would not include any interest costs associated with funding future capital requirements.

**Implications for the City of Joondalup:** The new arrangement excludes "capital" funding from member's fees which is an advantage to the City of Joondalup.

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## DISTRIBUTION OF OPERATIONAL SURPLUSES

Surpluses arising from the MRC operations since 1991 have been distributed to participating members on the basis of annual tonnage disposal.

The current basis of distributing surpluses rewards members for higher volumes placed in sanitary landfill. Whilst in the early days of operation of the MRC the volume was important to reduce operating costs, it is no longer appropriate in determining the City's approach to waste management. The site has a limited life and volume reduction to landfill sites should be our objective. Based on this principle support should not be given to the current arrangements on "profit" distribution.

**Current arrangement:** The existing arrangements provides for the surplus to be determined from operations by excluding profit on sale of assets, interest on reserves and transfers to the Stage 2 reserve. The allocation of the surplus to members is based on each member's tonnage and their equity share of the surpluses from non member users of the site.

**Proposed Change:** The operational surplus available for distribution will not make any adjustments and be distributed on the member's equity holdings.

**Implications for the City of Joondalup:** As a high volume user of the site the existing arrangements provide a financial advantage to the City. The higher the City's proportion of the total member's tonnage the greater the result. However, based on 2001 information the City would have been better off under the new arrangements.

Based on the operations of 2000/2001 I have re-calculated the outcomes under both arrangements. The cost to the City of Joondalup is lessened under the new arrangements. However, this is sensitive to the amount of capital requirements to be funded and the relativity of the City's tonnage to the total of all member tonnage.

	Current	New
<b>BASIS</b>		
2000/2001 financial year (MRC annual report)		
MRC total tonnage	339,285	
Member tonnage	257,613	
City of Joondalup Tonnage	61,836	
<b>COSTS</b>		
Tipping - exclude reserve	726,223	747,958
Contribution to future capital	309,180	214,678
	1,035,403	962,635
<b>RETURNS</b>		
Lease	34,315	34,315
Surpluses	127,430	133,397
	161,745	167,712
Net Cost	(873,658)	(794,923)

## SUMMARY

The new arrangements use equity financing of future capital and an equity basis for distributing "profits". In addition it provides for a financial return to be paid to members for funds retained to meet future cash flow needs for capital and infrastructure development. The opportunity will also arise to allow members to achieve a better return on their investments by lending to the MRC at a better than deposit rate for financial institutions.

The new financial arrangements are more equitable, to all parties concerned, and provide a demonstratable process to allow the MRC to advance and fund future infrastructure needs. The proposed financial arrangements for the MRC should be endorsed.

Yours sincerely,

***Ron Back***

EXTRACT FROM MRC Agenda 14 February 2002

### **"RECOMMENDATION"**

That the Council:

- (i) note the work from two financial workshops conducted in December 2001 and February 2002
- (ii) approve a revised set of financial precepts as follows:
  - (a) Funds contributed by member Councils and retained surpluses will be subject to interest
  - (b) Additional funds for capital requirements to be raised either through retention of surplus or external borrowing, (including borrowing from member councils), or a combination of each. Timing of repayment of funds contributed, including retained surpluses, will be determined by Mindarie Regional Council.
  - (c) Operational surpluses a distributed to member Councils in ownership percentages, subject to (the retention of funds for future capital requirements)
  - (d) Where Mindarie Regional Council decides to raise funds by the retention of surpluses, member Councils may elect not to participate
  - (e) Members pricing is set at the actual cost of tipping
- (iii) approve associated financial business rules as follows:
  - (a) in setting members' prices, cost of tipping includes interest to the extent that it relates to funds required for current operations. / Interest on funds held for future requirements is not included in cost of tipping
  - (b) Interest on members' contributed funds will be set at a rate between externally available deposit and borrowing rates (specific rate yet to be determined)

- (c) Operational surpluses will be calculated in accordance with generally accepted account principles;
- (d) To the extent that member tipping fees differ from actual costs, an adjustment will be made to the distributable surplus at individual member Council level

(e) The distribution of operational surpluses will be calculated as follows:

• Operational surplus before member tipping lee adjustment	X
• Adjustment to member Council tipping charge according to tonnes tipped, where tipping lees differ from actual cost	<u>X/(X)</u>
• Operational surplus — distributed according to equity ownership percentages	X
• LESS: retention for capital requirements as requested by Mindarie Regional Council but at members Councils' option	(X)
• Adjustment to member Council tipping charges according to tonnes tipped, where tipping lees differ from actual cost	<u>X/(X)</u>
• Amount distributed/(reimbursed)	<u>X/(X)</u>

(e) Lease fee to be set on a commercial basis

(v) Seek individual member Council approval to these revised financial precepts, and associated business rules

(vi) Approve the retention of Stage 2 reserve funds, by the council, on the basis of actual, rather than equity contributions"