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Chief Executive Officer,
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APPENDIX 7(b)

Attention: Alexander Scott

14 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 NEEDS-REQUIREMENTS

The capital requirements of the operations at Tamala Park can be defined as being either for current (current capital requirements) or future development (future capital requirements). ~~The -e~~Current capital requirements relates to infrastructure, plant and equipment required to maintain the day to day operations. These costs (~~through -~~ including 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. ~~F~~The future capital requirements funding are for capital items such as ~~of capital for~~ secondary waste treatment and the second cell ~~needs to generate sufficient cash to~~ enable these processes to be advanced.

Current arrangement:

Current capital requirements 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 requirements 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 requirements* 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* is to be raised through the retention of operating surpluses, external borrowings or a combination of both. These retentions or costs of borrowings will in essence be charged against members according to their equity holdings 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 effect of the impact of a selected number 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 do 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 as Joondalup is one of the largest users of the facility there is a financial advantage to the City of Joondalup 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 \$0.340m during over 1999/2000 and 2000/2001. Joondalup actually contributed \$0.484m 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.

DISTRIBUTION OF OPERATIONAL SURPLUSES

Operational sSurpluses 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:

—A—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 will 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 2000/2001 information the City would have been better off under the new arrangements.

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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.

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	Current	New
BASIS		
2000/2001 financial year (MRC annual report)		
MRC total tonnage	339,285	
Member tonnage	257,613	
City of Joondalup Tonnage	61,836	
COSTS		
Tipping - exclude reserve	726,223	747,958
Contribution to future capital	309,180	214,678
	1,035,403	962,635
RETURNS		
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 requirements 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 get achieve a better return of their investments by lending to the MRC at a better than rate of return that if -depositing with a financial institution-rate.

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 Bach