

Part Four – Funding and Financial Policies

FUNDING POLICY

FUNDING OF DEPRECIATION/ USE OF DEPRECIATION RESERVES

Council has decided the policy on the funding of depreciation, and the uses of depreciation reserves.

Under section 101(1) a local authority must manage its revenues, expenses, assets, liabilities, investments and general financial dealings prudently and in a manner that promotes the current and future interests of the community. Council is required to ensure that the funding needs of Council are met from the sources of finance deemed appropriate taking account of the distribution of benefits, the periods that benefits occur, the costs and benefits of funding the activities, and the community outcome, which the activity promotes. Also, Council is required to consider the impact on the social, economic, environmental, and cultural well being of the community.

Council is required to fund the economic use of its assets to match the cost of delivering its services to the appropriate revenue sources, in compliance with generally accepted accounting practice. Those who benefit from the use of an asset should contribute towards its cost.

Depreciation is defined as the measure of consumption of the economic benefits of an asset arising from its use. Depreciation Reserves are the accumulated funds retained by each activity from the depreciation funded each financial year, less any outgoings to pay for capital renewal of assets or debt prepayment.

Depreciation is calculated on all Council fixed assets excluding Land. Depreciation is an operating expense recorded in Council's financial statements. Council raises revenue from rates, user charges or other sources to fund its operating expenses including depreciation, as required under s100 of the Local Government Act 2002.

In certain instances the effect of fully funding depreciation may result in current ratepayers bearing a funding burden that is not entirely fair and equitable. This includes circumstances where the assets have a very long useful life, where assets are young and in relatively good condition, where the renewal of assets would not require a major contribution from depreciation reserves, or when the asset will not be replaced. Fully funding in these circumstances will result in depreciation reserves increasing over time. The interest earned on these reserves can be used to offset the need to fund depreciation in future years. Council is also entitled to retire debt from depreciation reserves.

Council will for the 2006-07 year be funding depreciation for the first time on the Peri Urban, Frasertown and Mahanga Water supplies, because the water supply network in its entirety is listed as a strategic asset in the policy on Significance, which requires Council to fully fund depreciation on these assets. Council also considers that pensioner housing is a significant strategic asset, and has also funded depreciation on this asset for 2006-07.

The following assets have depreciation that has not been funded, to the amount as specified for each asset for 2006-07: -

- Community halls and buildings on reserves \$5,700
- Parks & Reserves \$64,000
- Cemeteries \$1,800
- Camping ground \$6,200
- Staff housing \$5,100
- Fire appliances located at Ruakituri (\$18,700) & Mahia (\$6,000)
- LTNZ portion of subsidised roading \$1,235,362
- AFFCO portion of the costs of running the treatment plant \$139,920

The above assets will be maintained on an ongoing basis at a level that meets the needs of the community. Where appropriate Council will cover each asset with an insurance cover for fire, earthquake and natural catastrophe. It is acknowledged that the above assets will

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cease to meet community needs over time and will be withdrawn from service. This is expected to be beyond the term of the current LTCCP.

In respect of Water Production, Council's share will be funded while AFFCO is not required to fund depreciation under the 1984 Water Supply agreement. In the event of asset renewal, Council will only renew the asset at a level that meets the needs of the community (excluding AFFCO). Should AFFCO require to be considered in any future upgrade or renewal programs it is expected that it will fund their share at the time of renewal or upgrade. In respect of the LTNZ portion of subsidised roading, Council is not funding the LTNZ share of depreciation. LTNZ have indicated that it will fund its share (66%) of capital expenditure as and when physical works occur.

Revenue collected to fund depreciation will be retained by the activity and utilised to fully fund the replacement of existing assets at the end of their useful lives, or to repay debt. Balances held in depreciation reserves will earn interest that will be credited to rates account. Council approves the use of interest earned on depreciation reserves to offset the need to fund depreciation in future years.

Council also approves the use of depreciation reserves to retire debt.

Attached is a schedule detailing the depreciation not funded for each activity for each year of the plan:-

Non-Funded Depreciation	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Community Halls	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700
Parks & Reserves	64,000	65,250	66,237	68,096	69,404	71,358	73,873	73,873	75,299	77,413
Cemeteries	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Camping Ground	6,200	6,200	6,334	6,991	6,991	7,326	7,783	8,075	8,075	8,377
Staff Housing	5,100	5,100	5,100	5,100	5,100	5,100	5,200	5,360	5,360	5,360
Fire Appliances - Ruakituri & Mahia	18,700	18,700	24,700	24,700	24,700	24,700	24,700	18,700	18,700	18,700
LTNZ portion Subsidised Roothing	1,235,362	1,267,512	1,300,537	1,334,406	1,363,201	1,455,918	1,491,974	1,528,655	1,565,867	1,603,642
AFFCO portion Water Production	139,920	142,921	149,165	153,805	154,809	171,325	172,034	172,762	173,507	174,649
	1,476,782	1,513,183	1,559,573	1,600,598	1,631,705	1,743,227	1,783,064	1,814,925	1,854,308	1,895,641

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USE OF CASH SURPLUS/ RESOLUTION NOT TO BALANCE BUDGET FOR 10 YEARS FROM 2006-07 to 2015-16

Council resolved at the meeting of 11 April 2006 that the \$1,733,616 cash surplus, representing an excess of funds held over and above the level of reserves held by Council in special reserve funds, and sinking reserve funds as at 30 June 2005 are transferred to the District Development Fund. Council also confirmed that \$225,518 be utilised to reduce the roading rate and thereby reduce the rating requirement, resulting in an operating budget that did not balance for the 2006-07 year.

An actual surplus arises at the end of a financial year where the revenue received from ratepayers exceeds the expenditure required to provide the services. The surplus funds of \$1,733,616 have been built up over a considerable period of time, and have been retained without any particular purpose being assigned for its use. The decision of Council on utilisation of the surplus funds must be prudent, and in the best interests of present and future ratepayers of the district.

Council when approving the Annual Plan and Budget/LTCCP sets the rates and fees and charges at a level that is predicted to adequately fund the next year's activities. Council must have a balanced budget under section 100(1) of the Local Government Act 2002. Council is required to ensure that each year's projected operating revenues are set at a level sufficient to meet that year's projected operating expenses.

However, under section 100 (2) a local authority may set projected operating revenues at a different level from that required by section (1) if the local authority resolves that it is financially prudent to do so, having regard to –

- (a) the estimated expenses of achieving and maintaining the expected levels of service provision set out in the LTCCP,

including the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life; and

- (b) the projected revenue available to fund the estimated expenses associated with maintaining the service capacity and integrity of assets throughout their useful life.
- (c) the equitable allocation of responsibility for funding the provision and maintenance of assets and facilities throughout their useful life.
- (d) the funding and financial policies adopted under section 102.

Under section 101(1) a local authority must manage its revenues, expenses, assets, liabilities, investments and general financial dealings prudently and in a manner that promotes the current and future interests of the community. Council is required to ensure that the funding needs of Council are met from the sources of finance deemed appropriate taking account of the distribution of benefits, the periods that benefits occur, the costs and benefits of funding the activities, and the community outcome, which the activity promotes. Also, Council is required to consider the impact on the social, economic, environmental, and cultural well being of the community.

Council confirmed that the use of the cash surplus to subsidise the rates requirement for 2006-07 was justified. The key reason is that the surplus was built up over a number of years, by current ratepayers, who have by and large made these contributions. Council has determined the policies that are appropriate to meet the funding needs of the district over the next ten years, and to meet the social, cultural, environmental and economic well beings of the community. The funds that have not been assigned to any purpose, are surplus to requirements, and are "floating" as cash within the financial system.

By tagging the money, and assigning a purpose and use of the funds, Council is being a responsible, and financially prudent custodian, by providing a source of funds within Council resources. To charge ratepayers again would be to penalise them, or double-rate them, by ignoring the funds that have accumulated from their own contributions over a long period of time.

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Similarly, the transfer of funds to the District Development Fund, is prudent, because the funds will be invested in capital projects over the 10 year period that we would otherwise have to charge ratepayers by way of rate increases over the period. We therefore believe that it is fair and equitable that the funds should be utilised in this manner.

Council considers that it is prudent to have a surplus with income exceeding expenditure for each year of the LTCCP from 2006-07 to 2015-16.

Attached at Appendix 1 on the following page is an analysis of the surpluses for each year, with adjustments for non-cash items, such as non-funded depreciation, transfer to reserves, the capital subsidy and rate-funded projects. Capital subsidy relates to a subsidy for the capital projects, including \$3.9 million for the Mahia Wastewater Scheme, and the balance is for subsidised roading projects. Rate funding projects is rate contributions for capital below the line items such as sinking funds and Mahia projects relating to Parks & Reserves.

Council has resolved that the following assets have depreciation that has not been funded: -

- Community halls and buildings on reserves
- Parks & Reserves
- Cemeteries
- Camping ground
- Staff housing
- Fire appliances located at Ruakituri & Mahia
- LTNZ portion of subsidised roading
- AFFCO portion of the costs of running the treatment plant

An analysis of the surpluses over the 10 years reveals that there is no cash surplus in 2006/07, a cash surplus of \$167,800 in 2007/08, and a small cash surplus of \$3400 to \$5600 in the other years of the LTCCP.

The surplus for 2008-09 includes \$3.9 million of capital funding for the Mahia Wastewater Treatment Scheme, which is a new capital project.

The remainder of the surplus relates to funding of depreciation associated with infrastructure assets, for capital expenditure that falls outside the 10-year period for the LTCCP. Renewal expenditure is less than the level of funding for depreciation throughout the 10-year period of the SOP and Draft LTCCP. Council has transferred \$1.251 million of the surplus to reserves over the ten years of the LTCCP from 2006-07 to 2015-16.

The total amount of the cash surplus over the 10 years is \$1.455 million made up of \$1.251 million in transfer to reserves and the resulting balance of \$0.2 million. Council has a number of possible capital requirements that are not included in the LTCCP, with the main one being the Tawhara Reservoirs, which are estimated to cost \$2.67 million, based on 2004 estimates. Council considers it prudent that provision is made for a sum of \$1.455 million to provide for contingencies that have not been budgeted in the 10-year LTCCP.

Council has set the expenditure and revenue at levels it considers appropriate to meet the funding needs of the district over the next ten years, and to meet the social, cultural, environmental and economic well-beings of the community. We therefore believe that it is fair and equitable that the funds should be utilised in this manner.

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Appendix 1 Reconciliation of Surplus (Deficit)

	2006/07	2007/08	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14	2014/15	2015/16
Surplus (Deficit) on Operations	75,761	540,926	4,154,393	336,643	373,513	384,122	405,735	448,131	502,033	556,160
Non-Funded Depreciation										
Community Halls	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700	5,700
Parks & Reserves	64,000	65,250	66,237	68,096	69,404	71,358	73,873	73,873	75,299	77,413
Cemeteries	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800	1,800
Camping Ground	6,200	6,200	6,334	6,991	6,991	7,326	7,783	8,075	8,075	8,377
Staff Housing	5,100	5,100	5,100	5,100	5,100	5,100	5,200	5,360	5,360	5,360
Fire Appliance - Ruakatori	18,700	18,700	24,700	24,700	24,700	24,700	24,700	18,700	18,700	18,700
LTNZ portion Subsidised Rooding	1,235,362	1,267,512	1,300,537	1,334,406	1,363,201	1,455,918	1,491,974	1,528,655	1,565,867	1,603,642
AFFCO portion Water Production	139,920	142,921	149,165	153,805	154,809	171,325	172,034	172,762	173,507	174,649
	1,476,782	1,513,183	1,559,573	1,600,598	1,631,705	1,743,227	1,783,064	1,814,925	1,854,308	1,895,641
Reserves Transfer	61,052	-215,410	7,151	-95,645	-105,211	-159,846	-127,847	-157,510	-157,277	-300,977
Capital Subsidy	-1,562,220	-1,607,524	-5,575,767	-1,693,446	-1,732,502	-1,768,433	-1,802,802	-1,834,046	-1,860,604	-1,888,724
Rate Funding Projects	-51,375	-63,375	-139,750	-142,750	-162,505	-194,470	-253,750	-267,500	-335,060	-258,500
Surplus (Deficit)	0	167,800	5,600	5,400	5,000	4,600	4,400	4,000	3,400	3,600