Report **06.58**
Date 6 March 2006
File G/4/1/5
CFO/13/2/1
Committee **Policy, Finance and Strategy**
Author **Chris Gray, Finance Manager**

Half Year Review to 31 December 2005

1. Purpose

- To inform the Committee of the financial performance for the first half of the 2005/06 financial year and to provide an explanation of major variances by division.
- To forecast the end of year position based on the management reviews completed by division.
- To provide an interim position in terms of achievement against the published performance targets in the Council's 2005/06 Annual Plan.
- To seek the approval of the Council to additional expenditure requests from each Divisional Manager.

2. Significance of the decision

The matters for decision in this report do not trigger the significance policy of the Council or otherwise trigger section 76(3)(b) of the Local Government Act 2002.

3. Background

Quarterly reviews between the Chief Executive/Chief Financial Officer and the Divisions were recently completed. It is timely, as a result of those reviews, to present to Council a summary of the half year's performance and to seek approval for unbudgeted expenditure.

Copies of the Divisional quarterly reviews will be sent out to Councillors in the next few days.

4. Financial Performance

4.1 Year to date Operating Performance

Divisional performance against budget remains varied across the Council. The major contributor to the variance remains the delays in transport heavy rail maintenance and the reclassification of this work to operational expenditure. We have separated this accounting reclassification on the detailed financial summary in section 4.4 below.

On a consolidated Council basis the actual surplus is $1,713,000 compared with budget of $3,236,000, an unfavourable variance of $1,523,000. The delays in Transport capital expenditure projects ($3,342,000 capital) and heavy maintenance expenditure ($2,135,000 operational spend) flow through the accounts. These are partially offset by Utility Services being ahead of budget at this stage.

The Council Statement of Financial Performance is included as **Attachment 1**.

Further details of the variances are explained below.

4.2 Funding Statement

This report continues to highlight the lower capital spending driving a lower external funding requirement at the stage. Interest expense savings from the lower debt is being partly offset by higher than budgeted interest rates and is reflected in the full year forecast.

The Funding statement is included as **Attachment 2**.

4.3 Statement of Financial Position

The Council Statement of Financial Position shows the current, budget and last year-ends financial position.

The Statement of Financial position is included as **Attachment 3**.

4.4 Financial Summary

The following table shows the year to date variance by division.

OPERATING SURPLUS (DEFICIT)	Year to Date 31 December 2005			
$(000)'s	Last Year	Actual	Budget	Variance
Water Group	339	386	(493)	879
Plantation Forestry	(169)	(47)	(175)	128
Utility Services	**170**	**339**	**(668)**	**1,007**
Transport	(256)	84	1,517	(1,433)
Landcare	1,566	1,091	613	478
Environment	257	123	142	(19)
Wairarapa	340	(363)	(646)	283
Corporate	(59)	(132)	(83)	(49)
Finance & Admin	377	581	217	364
Investment in Democracy	(171)	18	34	(16)
Divisional Surplus (Deficit)	**2,224**	**1,741**	**1,126**	**615**
Transport - heavy maintenance	-	-	2,120	(2,120)
Landcare: Sale of Mabey Road	3,155	-	-	-
Investment Management	3,839	3,850	3,869	(19)
Business Unit Rates Contribution	(3,810)	(3,878)	(3,879)	1
Council Operating Surplus (Deficit)	**5,408**	**1,713**	**3,236**	**(1,523)**
* Regional Strategy Actuals removed				

4.4.1 Water, Favourable variance of $879,000

Savings on a year to date basis have occurred in a number of areas, specifically:

- External consultants, $295,000, mainly due to timing delays and reduced maintenance.

- Materials and suppliers, $278,000, primarily in power and chemicals.

- Personnel costs, $75,000.

- Internal revenue is up $192,000.

4.4.2 Plantation Forestry - favourable variance of $128,000

Log volumes were up 2,570 tonnes on budget, with a small increase in log prices. Overall this contributes to a $70,000 favourable variance.

Operating expenses are also tracking below budget, $58,000, mainly in personnel, materials and finance costs.

4.4.3 Transport, Unfavourable variance of $3,533,000 comprising heavy maintenance $2,120,000 and other $1,433,000.

The Rail Contract remains unsigned and this has caused delays in a number of rail projects.

The change to the accounting for heavy maintenance from capital expenditure to operating expenditure has been separated out to allow better comparison between actual and budget.

The budget assumed that heavy rail maintenance expenditure would be capitalised. GWRC will not own the assets involved, therefore they must be treated as operating expenditure and expensed in the year. The effect of this is to move expenditure from capital expenditure to operating expenditure, reducing the surplus accordingly. The funding from rates and Land

Transport's contribution for this expenditure will still be treated as revenue in the financial statements.

Due to the delay in signing the Rail Contract none of this heavy maintenance expenditure has been incurred. This has reduced revenue as Land Transport's share of this expenditure is not paid to GWRC until it is incurred. As approximately $2.1 million of heavy maintenance was budgeted to be spent in the first half, this has reduced the operating surplus by the amount to be funded from Land Transport grants.

Excluding heavy maintenance revenue is down by $3.7 million. This is largely due to no capital expenditure being incurred to date with the loss of the associated revenue from Land Transport.

There are a number of expenditure items on a year to date basis which are at variance to budget. In summary, these are:

Favourable (unfavourable)	**$'000's**
Delays in bus, rail and trolley contracts	832
Inflation – diesel	(1,311)
Delay in rail carriage refurbishment	764
Various rail projects	1,944
Other	56
Total	**2,285**

The increasing inflation factors for diesel and wages have also impacted on the half year with payments to operators being $1.3 million above budget (GWRC share of this is $644,000). These increases are calculated from a Land Transport index.

The continuing delays in signing the Rail and Trolley Bus Contracts have reduced expenditure in these areas as well as delaying rail carriage refurbishment.

The various rail projects which are behind schedule include integrated ticketing, real time information, Wairarapa log freight and those associated with the Western Corridor project.

4.4.4 Landcare - Favourable variance of $478,000

Savings in personnel costs of $100,000 due to the Divisional Manager and Accountant having resigned and not been replaced. This has been partly offset by internal charges.

Flood Protection – favourable variance $139,000

Flood Protection has achieved higher revenue than budgeted from gravel extraction sales ($112,000).

Direct expenditure overall is $74,000 under budget. External contractor expenditure is $293,000 less than budget, primarily arising from a temporary under spend due to delays in getting rock for flood damage repair work. Offsetting this are increases in materials and supplies which are $120,000 above budget due to higher costs for rock. Internal charges are $79,000 above budget.

Parks – favourable variance $102,000

The favourable variance due primarily to the delay in the removal of the storm damaged trees in the Korokoro Valley, Belmont Regional Park. It is anticipated that this work will be completed this financial year.

4.4.5 Environment - Unfavourable variance $19,000

Total revenue is $95,000 ahead of budget primarily due to the increased consents fees from the Meridian wind farm consent application.

The Division's expenditure is some $113,000 more than budget.

The main reasons for this variance are:

- Personnel costs were slightly under budget by $31,000.
- Materials and supplies were higher than budget by $198,000 due to the Meridian consent costs amounting to $132,000.
- Consultant costs were less than budget by $52,000 due to less activity than expected.

4.4.6 Wairarapa – Favourable variance of $283,000

The favourable variance is primarily due to timing differences and is expected to be back in line with budget by year end. The main variances include:

- Biosecurity operating surplus surplus is $543,000 ahead of budget. Monitoring has indicated lower possum densities resulting in less work being required this year.
- Land and River Operations operating $190,000 ahead of budget. This is due to Reserve Forests revenue being $169,000 higher than budget due to acceleration in the first half year of the logging programme.
- Bioworks year to date result is running $350,000 behind budget with a operating deficit of $314,000. This is due to delays in signing contracts in the first six months of the year. This is expected to reverse in the second half of the year.

4.4.7 Corporate – Unfavourable variance of $49,000

Materials and supplies were higher than budget due to timing of the expenditure. This is expected to reverse by year end.

4.4.8 Finance and Admin – Favourable variance of $364,000

Rates revenue is running $140,000 ahead of budget, partly offset by decrease in external revenue. Operating expenditure is some $299,000 below budget, which are in the areas of personnel costs, materials and supplies and contractors and consultants. These are expected to reverse by year end.

4.5 Forecast to 30 June 2006

The forecast surplus is $1.3 million compared with the budget surplus of $8.1 million, a $6.8 million variance as detailed in the next table.

The primary driver of this change is Transport and to a lesser extent Landcare.

OPERATING SURPLUS (DEFICIT)	**Full Year Forecast 30 June 2006**			
$(000)'s	Last Year	Budget	Forecast	Variance
Water Group	873	(817)	(1,000)	(183)
Plantation Forestry	(302)	(365)	(183)	182
Utility Services	**571**	**(1,182)**	**(1,183)**	**(1)**
Transport	1,104	3,796	659	(3,137)
Landcare	1,697	648	1,007	359
Environment	280	(186)	(100)	86
Wairarapa	(24)	(406)	(469)	(63)
Corporate	(127)	(124)	(291)	(167)
Finance & Admin	950	342	358	16
Investment in Democracy	(129)	68	68	-
Net Divisional Surplus (Deficit)	**4,322**	**2,956**	**49**	**(2,907)**
Transport - heavy maintenance	-	4,239	-	(4,239)
Landcare: Sale of Mabey Road	3,155	-	-	-
Investment Management	10,940	8,674	9,043	369
Business Unit Rates Contribution	(7,623)	(7,761)	(7,761)	-
Council Operating Surplus (Deficit)	**10,794**	**8,108**	**1,331**	**(6,777)**
* Regional Strategy Actuals removed				

4.5.1 Water – Unfavourable variance of $183,000

The major contributor to the unfavourable variance is the increase in consultant costs of $199,000 due to investigation work starting on the new water source. There are a number of other savings in operating costs namely power ($62,000), chemicals ($113,000), insurance ($107,000), other materials ($28,000). These have been offset by the write-off of assets forecast at year end of approximately $500,000.

4.5.2 Transport - Unfavourable variance of $7,376,000.

The table below details the movements in the transport forecast between revenue and expenditure items. It should be noted that increased/(decreased) expenditure usually means increased/(decreased) revenue from Land Transport. Thus, while GWRC still receives rate income for unspent monies, it does not receive any monies from Land Transport.

$(000)'s	Revenue	Expenditure	Surplus
Budget	**81,842**	**73,807**	**8,035**
Less Accounting change Heavy maintenance	-	4,270	(4,270)
Adjusted amount	**81,842**	**78,077**	**3,765**
Extra Investment Revenue	77		77
Funding for diesel increase	1,161	2,364	(1,203)
Funding for Bus & Rail Contract	510	1,024	(514)
Funding for Trolley contracts	(491)	(999)	508
Funding for Rail Projects	(18)	(35)	17
Western Corridor Consultation	(166)	(190)	24
Western Corridor Project	617	705	(88)
Heavy Maintenance deferred	(942)	(1,570)	628
Capital Expenditure deferred	(2,720)	-	(2,720)
Other	(396)	(554)	158
Overhead	(6)	(13)	7
Forecast Surplus	**79,468**	**78,809**	**659**

Apart from the increased costs for diesel the major variances in transport are due to the delays in signing the Rail and Trolley Bus Contracts, coupled with the accounting treatment change for heavy maintenance.

The $1,203,000 net increased costs for diesel reflects the sharp rise in the diesel price over the last few months based on the Land Transport index. The diesel price is not expected to fall over the forecast period and there is a risk that the NZ dollar will continue to fall against the US dollar, further increasing the diesel price and index.

The operating costs for rail are expected to be higher than budget due to, amongst other things, increases in the access fees charged by Ontrack.

The delay in signing the Trolley Bus Contract is forecast to save approximately $508,000 due mainly to higher budgeted maintenance costs for the overhead wires.

After allowing for the accounting treatment change, heavy maintenance expenditure is forecast to be $2,700,000 behind budget due to the delays in signing the Rail Contract. The delay in signing this contract is also delaying other capital expenditure in respect of rail to the tune of $2,720,000. The effect of this on the forecast is a reduction in the revenue from Land Transport for their share of this capital expenditure.

The continued delay in signing the Rail Contract is putting at risk the current levels of service for rail as units may have to be withdrawn from service due to monies not being spent on maintenance. There is also an additional problem with the existing Wairarapa carriages which may need significant monies being spent on them over the next few months to allow them to continue in service until the arrival of the refurbished carriages commencing in March next year. There is no amount included in the forecasts for these repairs but it is likely to be several hundred thousand dollars.

If the Rail Contract is not signed in the near future it is likely that the current forecasts for capital expenditure for this year will be reduced accordingly. This will put pressure on next year's programme for both operating and capital expenditure if these projects are transferred into next year. This matter will be further considered at the end of the year when rebudgets are approved by Council.

4.5.3 Landcare - Favourable variance of $379,000

Reorganisation savings of $200,000 is forecast in the financial year due to the Divisional Manager and Divisional Accountant having resigned and not been replaced.

Flood Protection – Favourable variance $159,000

The surplus has arisen from continued higher revenue arising from gravel sales ($70,000) and lower contractor costs ($89,000) due to delays in various projects due to a shortage of rock.

Parks – Favourable $20,000

Parks revenue and expenditure is forecast to track close to budget and there are no significant variances at this stage.

4.5.4 Environment – Favourable variance of $86,000

There are increases in external revenue of $147,000 due to increased consent fees, partly offset by increased consulting costs. This is largely due to the Meridian Wind Farm Project.

4.5.5 Wairarapa - Unfavourable variance of $63,000

The major saving in Wairarapa is in the Vector Tb programme, some $250,000 due to cutbacks in the Animal Health Board programme. These cutbacks may increase further depending on further information from the Animal Health Board. The Division is proposing using these savings and some transfers from reserves to do additional work on the projects noted in section 6. These projects have been included in the forecast.

4.5.6 Corporate – Unfavourable variance $167,000

Additional amounts for communications expenditure $70,000 due to higher printing costs.

4.5.7 Finance – Favourable variance $16,000

Additional revenue from rates has been partly offset by unbudgeted expenditure on Pandemic supplies for the Council.

5. Capital Expenditure

5.1 Year to date variances

Net Capital Expenditure $(000)'s	Year to Date 31 December 2005 Last Year	Actual	Budget	Variance
Water Group	947	3,404	3,337	67
Plantation Forestry	119	79	129	(50)
Utility Services	**1,066**	**3,483**	**3,466**	**17**
Transport	41	84	3,342	(3,258)
Landcare	1,764	1,924	1,634	290
Environment	169	132	94	38
Wairarapa	372	148	319	(171)
Corporate	56	52	24	28
Finance & Admin	500	288	240	48
Investment in Democracy	43	13	-	13
Net Divisional Capital Expenditure	**4,011**	**6,124**	**9,119**	**(2,995)**
Transport - heavy maintenance	-	-	2,135	-
Landcare: Sale of Mabey Road	(3,385)	-	-	-
Investment Management	326	2	-	2
Business Unit Rates Contribution	-	-	-	-
Net Divisional Capital Expenditure	**952**	**6,126**	**11,254**	**(2,993)**

Apart from Transport, year to date capital expenditure is running in line with budget. The reduction in Transport capital expenditure is detailed below.

5.2 Full year forecast variances

Net Capital Expenditure $(000)'s	Full Year Forecast 30 June 2006 Last Year	Budget	Forecast	Variance
Water Group	4,226	6,349	6,729	380
Plantation Forestry	277	238	237	(1)
Utility Services	**4,503**	**6,587**	**6,966**	**379**
Transport	204	7,725	2,950	(4,775)
Landcare	4,591	5,325	6,126	801
Environment	430	589	589	-
Wairarapa	1,370	634	587	(47)
Corporate	99	24	24	-
Finance & Admin	716	1,283	1,083	(200)
Investment in Democracy	49	5	5	-
Net Capital Expenditure	**11,962**	**22,172**	**18,330**	**(3,842)**
Transport - heavy maintenance	-	4,270	-	(4,270)
Landcare: Sale of Mabey Road	(3,385)	-	-	-
Investment Management	336	620	620	-
Business Unit Rates Contribution	-	-	-	-
Net Capital Expenditure	**8,913**	**27,062**	**18,950**	**(8,112)**

5.2.1 Water – $447,000 increase

A full report was prepared for the Utility Services Committee at their 16 February meeting, the minutes of which are subject to approval at this meeting.

5.2.2 Landcare – $801,000 increase

Additional capital project expenditure approvals of $784,000 for Opahu Stream, Jim Cooke Park and Waiwhetu investigation have already been approved by Council.

5.2.3 Finance and Admin – $200,000 decrease

The SAP upgrade has been completed under budget.

5.2.4 Transport excluding heavy maintenance – $4,775,000 decrease

Transport Forecast Capital expenditure

Transport Capital Budget	**Year to Date**		**Full Year 30 June 2006**		
	Actual $000	**Budget $000**	**Budget $000**	**Forecast $000**	**Variance $000**
RS Capex - New EMU's	-	455	1,000	1,000	0
RS Capex - Rolling Stock Oth.	-	813	1,625	-	1,625
RI Capex - Station Maint.	84	1,200	2,400	1,000	1,400
RI Capex - Rail Security	-	640	1,280	530	750
J'Ville Mall Review Project	-	-	1,000	-	1,000
Concessionary ID Card	-	135	270	270	0
Total Mobility Project	-	-	50	50	0
Asset Management Database	-	50	50	50	0
Contract Management System	-	50	50	50	0
Total Capital Works	84	3,342	7,725	2,950	4,775
Transfer to Operating Expenditure RS Capex - Heavy Maint.	-	2,135	4,270	2,135	2,135
Total Per Original Budget	84	5,477	11,995	5,085	6,910

Note: RS – Rolling Stock

RI – Rail Infrastructure

As has been noted previously, the delay in signing the Rail Contract has put on hold virtually all of the capital expenditure programme in Transport.

After adjusting for the heavy maintenance Transport is forecasting to spend $2,950,000 for the year. However, apart from expenditure on the new EMUs, it is likely that the rest of the capital expenditure is at serious risk of not being spent in the current year. The reasons for these delays have been well documented, namely the delay in signing the Rail Contract and GWRC’s reluctance to spend this money without a contractual base.

6. Proposed New Expenditure and Reallocation of Projects

At the half year review the Divisions highlight any additional projects required Council approval. In addition, any reallocation of monies from budgeted projects to other projects are also presented for Council approval.

Flood Protection

Flood protection is forecasting a surplus of $159,000 for the year. Council policy requires that any expenditure on flood damage is first funded by operating surpluses, then from flood reserves. Therefore it is intended to use the $159,000 surplus for repairs on the flood damage caused by the January 2005 floods. The remaining work for these floods totals some $600,000. This will be funded (after deducting the operating surplus) from flood reserves.

The Council has committed to carry out remedial work on the Waiwhetu Stream. This involves both flood protection and environmental issues.

Flood protection will need to work in conjunction with the Hutt City and the Environment Division to complete this project.

Additional capital expenditure above current approvals is proposed for the Waiwhetu Stream project as follows:

Complete Phase 1	$45,000
Lower Waiwhetu options study	$50,000
Stream remediation investigations	$75,000
Total	$170,000

This additional expenditure is proposed to be funded $83,750 from Flood Protection (Phase 1, Lower Waiwhetu), $37,500 from Environment Division (stream remediation), $48,750 additional contribution from Hutt City Council (Phase 1 25% share, stream remediation 50% share). These amounts are included for approval by Council.

Environment

Additional expenditure of $37,500 is proposed for the Lower Waiwhetu stream remediation. As noted above, this has been included in the recommendations to Council.

Wairarapa

$40,000 for the completion of the Lower Wairarapa Valley Scheme rating classification review.

- This project is included in the budget but additional consultant costs are required to complete the review.

$43,000 for Key Native Ecosystems and Pest Animal programmes.

- Pest Animals - we have committed to jointly funded pest control programmes with all the Western Authorities under signed Memorandums of Understanding. The work occurs on Authorities land that falls under our KNE programme. Since developing these budgets (over a year ago) we have significant cost increases in the following areas - contractor prices, bait / hardware, signage costs (Ministry of Health requirements), and new Hazard Authorities Act risk management requirements. We have already re-prioritised a number of operations and advised some Authorities that approx. $100,000 worth of work will not commence. However, we have the existing (predominantly maintenance) contracts. In addition to this problem, we are being asked for assistance from landowners that have recently QEII covenanted parts of their properties. Under the Councils Biodiversity enhancement programme, we have obligations to assist landowners who commit to legal protection, and satisfy other qualifying criteria.

$50,000 for Pest Plants to complete Regional Pest Management Strategy requirements following a 42% increase in eradication and containment sites.

- Pest Plants - the funding deficit is directly linked to the results of recent property survey work for eradication and certain Containment species. GWRC has direct responsibility for controlling these species. The survey work identified a 42% increase in the number of sites requiring control. This new work has been costed at approx. $54,000. It is important that we do the work this year as contractors are already committed to working on adjacent sites. In addition, the department has applied for a resource consent to apply the new chemical Endothall throughtout the Region. This is a national test case with ERMA involvement. Unfortunately, we are likely to go to a formal hearing with costs expected to be $14,000. Whilst we have re-prioritised our pest plant programme, we are still likely to be $50,000 short.

$75,000 for the Lower Wairarapa Valley river scheme to widen the Mahaki culvert and relocate a section of the Vollebreght stopbank ($37,500 is from scheme reserves).

- Both of these works are outside the normal works programme and additional monies are required to complete this work over and above the budget.

$32,000 for Catchment scheme maintenance ($16,000 is from scheme reserves).

- This is for flood damage repairs in the Kaiwhata and Awhea-Opuawe Catchment Control Schemes following the floods of March 2005. It will entail construction of rock wiers, removal of flood debris, the realignment and protection of the river channel.

$58,000 for Drainage scheme maintenance ($58,000 is from scheme reserves, the drainage schemes meet 100% of the cost).

- This work involves the upgrading of pump drainage schemes above the normal maintenance programmes and has not been included in the budget.

7. Annual Plan Performance Targets

Divisional Managers have reported their expectation that all significant annual plan performance targets will be achieved by 30 June 2006 with the exception of Transport. The reasons for not meeting the targets have been noted above.

8. Compliance with Treasury Management Policy

As at 31 December 2005, all Treasury Management Policy limits have been complied with apart from internal borrowing limit for Forestry and hedging limits in the next five years. Refer to **Attachment 4**.

9. Communications

Council's half-year results again reflect solid operational and financial performance, which should be reported to the community.

10. Recommendations

That the Committee:

1. ***Receives*** *the report.*

2. ***Notes*** *the content of the report.*

3. ***Approve*** *the use of the Operating Surplus in the Wairarapa Division for the following projects:*

   a) *$40,000 for the completion of the Lower Wairarapa Valley Scheme rating classification review.*

   b) *$43,000 for Key Native Ecosystems and Pest Animal programmes.*

   c) *$50,000 for Pest Plants to complete Regional Pest Management Strategy requirements following a 42% increase in eradication and containment sites.*

   d) *$75,000 for the Lower Wairarapa Valley river scheme to widen the Mahaki culvert and relocate a section of the Vollebreght stopbank ($37,500 is from scheme reserves).*

   e) *$32,000 for Catchment scheme maintenance ($16,000 is from scheme reserves).*

   f) *$58,000 for Drainage scheme maintenance ($58,000 is from scheme reserves, the drainage schemes meet 100% of the cost).*

4. ***Approve*** *the following additional expenditure:*

   a) *Environment – Waiwhetu Stream remediation* *$37,500*

   b) *Flood Protection – Waiwhetu Stream remediation* *$83,750*

Report prepared by:	Report approved by:
Chris Gray	**Barry Turfrey**
Finance Manager	Chief Financial Officer

Attachment 1: Statement of Financial Performance

Attachment 2: Funding Statement

Attachment 3: Statement of Financial Position

Attachment 4: Compliance with Treasury Management Policy