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**REPORT 1**  
*(1215/52/IM)*

**REPORT FROM AUDIT AND RISK MANAGEMENT  
SUBCOMMITTEE: MEETING OF MONDAY 16 AUGUST  
2010 - 2009/2010 FINANCIAL STATEMENTS**

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**1. Purpose of Report**

The purpose of this report is to present the financial statements, Statements of Service Performance and additional information contained within the Annual Report for Wellington City Council (the Council) and Group for the year ended 30 June 2010 to the Strategy and Policy Committee (the Committee) for review and confirmation.

**2. Executive Summary**

The 2009/10 Annual Report is attached in Appendix 1 for the Committee's review. Audit New Zealand has now provided written clearance to the Council on the financial statements and Statements of Service Performance. A copy of the letter of clearance is included in Appendix 2.

The Audit and Risk Management Subcommittee (the Subcommittee), under delegation from the Committee, has the primary responsibility for reviewing and recommending the adoption of the Council's Annual Report. In accordance with this mandate the Subcommittee reviewed the draft financial statements and Statements of Service Performance at its meetings on 29 June 2010 and 16 August 2010, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2010. All substantive issues raised and discussed by the Subcommittee at those meetings have now been satisfactorily resolved.

No significant issues impacting on the financial statements and Statements of Service Performance have arisen subsequent to the Subcommittee's 16 August 2010 meeting. Therefore the Subcommittee recommends the formal adoption of the Annual Report to the Committee and Council.

### **3. Recommendations**

Officers recommend that the Strategy and Policy Committee:

1. *Receive the information.*
2. *Note that the Audit and Risk Management Subcommittee has reviewed the financial statements and Statements of Service Performance in detail.*
3. *Note that Audit New Zealand have indicated their likely audit clearance by way of a letter of comfort dated 18 August (attached in Appendix 2).*
4. *Recommend that Council confirm the Statement of Accounting Policies, as contained within the financial statements, for Wellington City Council and Group for the year ended 30 June 2010.*
5. *Recommend to Council the adoption of the Annual Report for Wellington City Council and Group for the year ended 30 June 2010 (attached in Appendix 1).*
6. *Recommend to Council that it delegate to the Chief Executive the authority to make minor editorial changes that may arise as part of preparing the 2009/10 Annual Report document for publication.*

### **4. Background**

#### **4.1 Legislative Requirement to Prepare Financial Statements**

Section 98 of the Local Government Act 2002 (the Act) requires the Council to prepare and adopt an Annual Report containing audited financial statements and Statements of Service Performance within four months of balance date. Section 111 requires the Council to comply with generally accepted accounting practice (GAAP) in preparing the Annual Report.

GAAP is defined by the Act to mean:

- a) approved financial reporting standards (within the meaning of section 2(1) of the Financial Reporting Act 1993) so far as those standards apply to local authorities and council-controlled organisations; and
- b) in relation to matters for which no provision is made in approved financial reporting standards (within the meaning of section 2(1) of the Financial Reporting Act 1993) and that are not subject to any applicable rule of law, accounting policies that –
  - (i) are appropriate to the local authority or council-controlled organisation; and
  - (ii) have authoritative support within the accounting profession in New Zealand.

The approved financial reporting standards referred to in section a) above are the New Zealand International Financial Reporting Standards (NZ IFRS) issued by the Accounting Standards Review Board.

Section 99 of the Act requires that the Annual Report must contain the auditor's report on the financial statements and Statements of Service Performance and the Council's compliance with the requirements of Part 3 of Schedule 10 of the Act. All requirements of Schedule 10 have been incorporated within the audited sections of the Annual Report.

#### **4.2 Process and Timetable for Adoption of the Council's Annual Report**

The adoption process agreed to by the Subcommittee at its meeting on 29 June 2010 is in the table below:

<b>Date:</b>	<b>Action:</b>
<b>29 June 2010</b>	Subcommittee to review and conditionally approve draft format for the 2009/10 financial statements and the proposed sign-off process. <b>Completed</b>
<b>26 July 2010</b>	Audit New Zealand commence final audit fieldwork. <b>Completed</b>
<b>4 August 2010</b>	Consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2010, financial position as at 30 June 2010 and financial overview available for final internal review and management sign-off. <b>Completed</b>
<b>16 August 2010 (scheduled)</b>	<b>Audit and Risk Management Subcommittee Meeting</b>  Subcommittee review consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2010, financial position as at 30 June 2010 and financial overview, subject to final Audit New Zealand clearance. Subcommittee to also review Statements of Service Performance, report on CCOs and report on mana whenua partnership.  Subcommittee to recommend adoption of 2009/10 financial statements to Strategy and Policy Committee. <b>Completed</b>
<b>18 August 2010</b>	Audit New Zealand to issue letter of comfort to Strategy and Policy Committee as to whether an unqualified, or qualified, audit opinion will be issued. <b>Completed</b>

<b>Date:</b>	<b>Action:</b>
<b>25 August 2010 (scheduled)</b>	<b>Special Strategy and Policy Committee Meeting</b>  Committee to recommend adoption of 2009/10 Annual Report to Council.
<b>25 August 2010 (scheduled)</b>	<b>Council Meeting</b>  Council to adopt 2009/10 Annual Report. Management letter of representation issued to Audit New Zealand. Audit New Zealand sign Audit Opinion. Media Release – financial results for the year ending 30 June 2010.
<b>24 September 2010</b>	Release of published Annual Report.

#### **4.3 The Annual Report publication**

The Annual Report is one of the Council's core publications. A clear, concise and readily accessible document is important in conveying the organisation's strengths and achievements over the last year.

The publication itself will be prepared following Council's approval of the version presented here. A summary of the Annual Report will also be produced following its adoption by Council. The summary, which is subject to audit clearance, will provide an overview of the Council's performance and financial position; outline highlights for each strategy and provide information on key facts about the city. This summary will be provided to every household in the city.

## **5. Discussion**

The Annual Report for the year ended 30 June 2010 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2010, including:
  - financial performance for the year ending 30 June 2010
  - financial position
  - capital expenditure program
  - Statements of Service Performance
- Group reporting
- Clearance processes

## 5.1 *Comprehensive Financial Performance and Financial Position for the Year Ended 30 June 2010*

### 5.1.1 *Comprehensive Financial Performance*

The Statement of Comprehensive Financial Performance reports an overall surplus for the Council's activities of \$30.3 million compared with a budgeted surplus of \$24.1 million resulting in a favourable variance to budget of \$6.2 million. The majority of the budgeted surplus represents funding received from third parties for capital purposes (e.g. the Housing New Zealand and New Zealand Transport Agency grants). As this income is received for specific capital purposes it cannot be used to offset rates.

In addition the financial overview section of the Annual Report provides extensive commentary in relation to the financial performance of the Council and Group. The Council's financial performance includes the results of the Wellington Waterfront Project (WWP) and the Joint Venture arrangements with Porirua City Council (PCC JVs). Both the WWP and the PCC JVs are consolidated on a line by line basis into the Council's financial statements. The Council also recognised Other Comprehensive Income totalling -\$4.5 million. Total Comprehensive Income is made up of the following:

<b>Net surplus for the year</b>	<b><u>\$30.330m</u></b>
Movement in cash flow hedge reserve	(\$5.326m)
Impairment through revaluation reserve *	(\$0.234m)
Movement in fair value through other comprehensive income reserve	\$1.080m
<b>Other Comprehensive Income</b>	<b><u>(\$4.480m)</u></b>
 <b>Total Council Comprehensive Income</b>	 <b><u>\$25.850m</u></b>

\* Relates to an impairment loss on one of the Council's revalued assets which is recognised within the revaluation reserve.

The Council currently has a debit balance in its hedging reserve totalling \$4.5 million. This represents the difference between the current floating interest rate and the fixed swap interest rate. This will reduce to zero as these swaps reach the end of their lives.

The consolidated Group results reflect an overall net surplus of \$23.5 million. The Group results consolidate the operations of the Council's subsidiaries (on a line by line basis) and associates (using the equity method of consolidation) together with the results from the Council's operations. The difference between the Council and Group results arises from the recognition of the Group's share of the results of subsidiaries and surpluses or deficits of the associate entities and the elimination of intergroup transactions. The Group also recognised Other Comprehensive Income totalling -\$3.0 million.

Total Comprehensive Income is made up of the following:

<b>Net surplus for the year</b>	<b>\$23.545m</b>
Movement in cash flow hedge reserve	(\$5.326m)
Impairment through revaluation reserve	(\$0.234m)
Movement in fair value through other comprehensive income reserve	\$1.080m
Share of movement in associates cash flow hedge reserve	\$1.461m
<b>Other Comprehensive Income</b>	<b>(\$3.019m)</b>
 <b>Total Group Comprehensive Income</b>	 <b>\$20.526m</b>

The following high level review identifies the significant contributing factors to the overall favourable financial performance of the Council's operations and shows the Council's "underlying" variance. The underlying variance from budget excludes fair value (non-cash) movements and any other items that cannot be used to fund our operating expenditure.

<b>Council actual net surplus</b>	<b>\$000</b> <b>30,330</b>
<b>Less:</b>	
<b>Fair value movements:</b>	
Cash flow hedge movement reclassified from hedging reserve <sup>1</sup>	(268)
Fair value hedge movements <sup>2</sup>	(364)
Fair value hedge adjustments to borrowings <sup>2</sup>	364
Derivatives at fair value through surplus or (deficit) <sup>3</sup>	(759)
Loans to related parties <sup>4</sup>	2,410
Loan amortisation <sup>5</sup>	(263)
Investment property revaluation <sup>6</sup>	5,405
<b>Total fair value movements</b>	<b>6,525</b>
 <b>Additional net expenditure from Wellington Waterfront Project and Porirua Joint Ventures</b>	 <b>2,334</b>
 <b>External funding for capital expenditure:</b>	
Additional external funding towards capital projects	93
<b>Total changes to external funding for capital expenditure</b>	<b>93</b>
 <b>Vested assets <sup>7</sup></b>	 <b>(15,194)</b>
 <b>Additional expenditure not funded under section 100 of LGA <sup>8</sup></b>	
New Zealand Transport Agency funded transport projects	5
Clearwater sewerage treatment plant	1,846
Living Earth	(172)
<b>Total additional expenditure not funded</b>	<b>1,679</b>
 <b>Increased surplus from City Housing</b>	 <b>(141)</b>

<b>Underlying Council actual net surplus</b>	<b>25,626</b>
<b>less Council budget net surplus</b>	<b>24,128</b>
<b>Underlying Council net surplus</b>	<b>1,498</b>

**EXPLANATION OF UNDERLYING VARIANCE:**

**Unbudgeted revenue/expenditure:**

Restatement of provisions	(14,195)
Insurance costs funded through self-insurance reserve	(1,314)
Gain on disposal of property, plant and equipment	207
Loss on disposal of assets	(743)
<b>Total unbudgeted revenue/expenditure</b>	<b>(16,045)</b>

**Significant variations from budget:**

Dividends in excess of budget (inc Wellington International Airport)	10,329
Decrease in interest expense	4,008
Decrease in general expenses	2,005
Decrease in personnel expenses	552
Other net variances <sup>9</sup>	649
<b>Total significant variations from budget</b>	<b>17,543</b>

<b>Total factors contributing to underlying variance</b>	<b>1,498</b>
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**Notes:**

1. The Council is required to recognise its interest rate swaps on the balance sheet and record any changes in fair value through the hedging reserve. This amount relates to early terminated swaps where the hedge reserve balance is required to be released to the Statement of Comprehensive Financial Performance over the remaining life of the swap.
2. Fair value hedge movements arising from the remeasurement of the Group's fair value hedges are offset by the fair value adjustment to borrowings. There is no net impact on the net surplus for the year.
3. Represents the fair value movements on interest rate swaps that do not meet the criteria for hedge accounting.
4. Most of this fair value movement relates to the Karori Wildlife Sanctuary Trust (KWST) loan. The fair value of the KWST loan was written down to reflect the interest-free nature of the loan. Both this loan and the loan to Wellington Regional Stadium Trust (written down to fair value in 2007/8) will be amortised back to nominal value by maturity.
5. Relates to the current year portion of the amortisation of the two loans mentioned in (4) back to their nominal value.
6. This decrease in value relates to the annual revaluation of Council and WWP investment properties. Due to the level of uncertainty in forecasting investment property revaluations, these movements are not

budgeted within the Long Term Council Community Plan (LTCCP)/Annual Plans.

7. Vested assets are those assets transferred to the Council from a third party. These are not-budgeted and the majority relate to infrastructural assets such as roading, drainage and waste and water assets that have been constructed by developers and transfer to the Council on completion.
8. Depreciation not funded through rates under section 100 of the Local Government Act as either:
  - the replacement of the asset at the end of its useful life will be funded by a third party
  - a third party has a contractual obligation to maintain the assets throughout all or part of its useful life or to replace the asset at the end of its useful life and the Council already effectively funds this through operating grants/tariffs payable to the third party
9. Other net variances comprise reduced costs in programmes, projects and organisational costs.

#### **5.1.2 Financial Position**

The Statement of Financial Position reflects an equity position of \$5,933.2 million for the Council entity as at 30 June 2010, an overall increase of \$25.9 million from the opening balance. The overall increase can be directly attributed to the following significant factors:

Net surplus for the year ended 30 June 2010	\$30.330m
Impairment through revaluation reserve	(\$0.234m)
Movement in cash flow hedge reserve	(\$5.326m)
Movement in fair value through other comprehensive income reserve	\$1.080m
<b>Total Net Movement in Equity</b>	<b><u>\$25.850m</u></b>

In analysing the Council's overall financial position at 30 June 2010, compared to the position at the previous balance date, the most significant movements relate to property, plant and equipment and borrowings.

- ***Property, Plant and Equipment***

Property, plant and equipment has increased by \$47.3 million to \$6,012.8 million as at 30 June 2010. This relates primarily to additions during the year of approximately \$117 million, offset by depreciation of approximately \$76 million.

- ***Borrowings***

The Council's gross borrowings have increased by \$20.3 million to \$283.2 million as at 30 June 2010. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2009/10 capital expenditure

programme. The Council borrows to fund the purchase or construction of new assets or renewals as approved through the Annual Plan process.

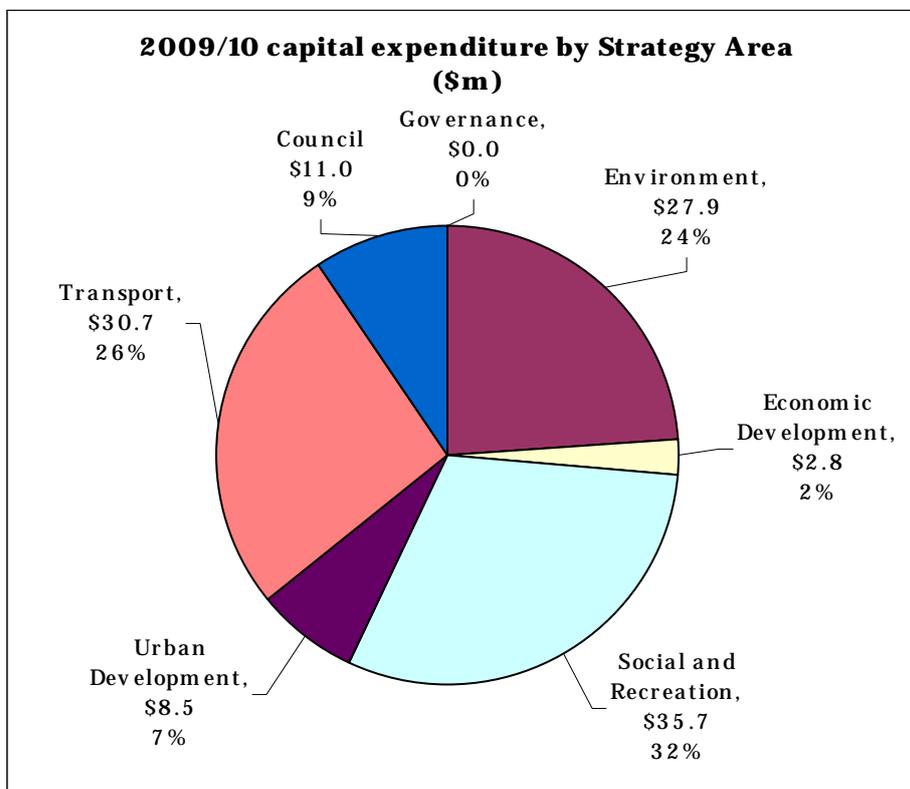
As at 30 June 2010, \$100.1 million of borrowings were short-term i.e. due within 12 months (2009: \$84.5 million) and \$183.1 million were long-term i.e. due after 12 months (2009: \$178.4 million). This is consistent with the Council's borrowing strategy to ensure long-term liquidity and access to funds. The Council's strong liquidity and treasury management means that it has been cost-effective to maintain a negative level of net working capital. Interest rate swaps are in place to ensure the Council's exposure to interest rate risk is managed appropriately.

### 5.1.3 Capital Expenditure Programme

Total capital expenditure (capex) for the year ended 30 June 2010 was \$118.2 million, compared with the total budgeted capex programme of \$151.8 million. Total capital expenditure budget that will be carried forward to future financial periods is \$26.8 million (2009: \$40.1 million).

Significant capex projects undertaken during the year, in addition to the Council's infrastructural capex programme include the Indoor Community Sports Centre, the Zoo capital upgrade programme and the continuing upgrade of the Council's housing stock.

The following pie chart shows total capital expenditure by strategy:



## **5.2 Statements of Service Performance**

The Statements of Service Performance (SSPs) outline what the Council has achieved over the past year in relation to:

- the outcomes and priorities that were set in the long-term plan
- performance measures and targets for 2009/10.

This year saw the introduction of AG4 – new audit standards that aim to ensure performance results are presented in a meaningful way. The Council has been well placed to meet these new requirements. We have a strong tradition of narrative based reporting that sets measures in a wider context. The overall performance framework was audited during the development of the long-term plan.

### **5.2.1 Presentation**

The SSPs are structured around seven strategic areas. Each chapter provides an overview and then steps through each activity in more detail. They specifically include:

#### *Overview*

- At a glance: a synopsis of the aim, key statutory requirements, strategic challenges, and outline of costs and funding for that area.
- State of the city: a summary of key indicators showing progress at a high level.
- A case study: a short narrative highlighting a key achievement or activity in the year.
- Progress against priorities and list of the outcomes sought.

#### *Activity statements*

- Outcomes: these cover the aims of the activity and headline indicators of progress.
- Key projects: a description of milestones and functions performed during the year.
- What it cost: summary financial table for that activity. This includes explanations for any notable budgetary variances.
- How we performed: outline of results against targets. We place these in the context of past results and next year's targets where appropriate (some measures are new, so no trend information is available)<sup>1</sup>.

Collectively this commentary illustrates the wide range of activities that the Council delivers and a sense of progress.

We also provide a schedule outlining the performance of our Council Controlled Organisations. An executive summary will also be prepared. This covers

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<sup>1</sup> Information used to measure performance comes predominantly from resident's satisfaction surveys, and from Council business units. Other information, particularly in relation to outcome indicators, comes from external agencies such as Statistics New Zealand. Audit New Zealand has reviewed the SSPs.

introductions from the Mayor and Chief Executive and provides an overall summary of performance. This is provided directly to the Strategy and Policy Committee.

A summary of the Annual Report will be produced following its adoption at Council on 25 August 2010. The summary will provide an overview of the Council's performance, detail key highlights for each strategy area and provide information on key facts about the city. The summary will be particularly useful for residents who wish only to have an overview of the city's activities and performance rather than review all the detailed information contained in the report.

### **5.3 Group Reporting**

As previously noted, the Council prepares consolidated financial statements for the Council and Group. The Group results consolidate the operations of the Council's subsidiaries (using the purchase method of consolidation) and associates (using the equity method of consolidation) together with the results from Council's operations. The Group structure is outlined in Note 37 to the financial statements.

There are a large number of entities within the Group and tight timeframes for finalisation of the Group financial statements. Group entities are required to complete the following:

- year-end consolidation package, including their Statement of Significant Accounting Policies.
- consolidation / financial statement templates allowing for effective consolidation of financial information.
- a letter of representation to be signed by the Chief Executive.

In addition, we require early advice of any significant or material issues arising from the preparation of the financial statements or the completion of the audit. These reporting requirements continue even after the consolidation package has been prepared and submitted to the Council. The Council's finance team are in constant contact with Council Controlled Organisation (CCO) finance representatives to determine the status of their year-end audits, any arising issues, and any consequential impact for the Group financial statements. Due to the small size of most of the entities within the Group, the Group results are generally not materially different from those of the Council.

Overall, we do not anticipate any material adjustments being required to the consolidated Group financial statements. We will continue to liaise with all Group entities up to the date of adoption of the Council's Annual Report.

### **5.4 Clearance process**

The management letter of representation will be signed by the Mayor, Chief Executive (CE) and Chief Financial Officer (CFO). The letter of representation forms part of the overall audit procedures carried out by Audit New Zealand. The content of the letter of representation is consistent with that prescribed for use by auditors by the New Zealand Institute of Chartered Accountants.

As in previous years, the Subcommittee reviewed the Institute of Directors (IOD)/PricewaterhouseCoopers Director's checklist, together with a legislative checklist covering the Annual Report requirements stated in Schedule 10 of the Local Government Act 2002. These processes assisted the Subcommittee in forming its view that the financial statements for the 2009/10 financial year are fairly stated and provided the Subcommittee with comfort from which to recommend them to the Committee and Council.

## **6. Conclusion**

The Annual Report prepared for the Committee's review includes the financial statements and Statements of Service Performance which have been reviewed in detail by the Subcommittee.

The financial statements include all known year-end adjustments required in order to fairly reflect the Council's results of operation, cashflows and financial position for the 2009/10 financial period. Further, at the time this report was prepared there were no known issues identified by Audit New Zealand that would materially affect the recognition and measurement of reported balances in the Council's financial statements.

Report prepared by: *Councillor Ian McKinnon – Chair, Audit and Risk Management Subcommittee, Nicky Blacker - Manager – Financial Accounting and Brian Hannah - Manager – Strategy, Research and Performance*

## **Supporting Information**

### **1) Strategic Fit / Strategic Outcome**

*The report relates to review of the Council's achievement of its strategic outcomes for the year ending 30 June 2010. The adoption of the Annual Report is a statutory responsibility.*

### **2) LTCCP/Annual Plan reference and long term financial impact**

*There is no impact on the LTCCP or Annual Plan.*

### **3) Treaty of Waitangi considerations**

*There are no Treaty of Waitangi considerations.*

### **4) Decision-Making**

*This is not a significant decision in terms of the significance policy.*

### **5) Consultation**

#### **a) General Consultation**

*There are no parties significantly affected by this paper.*

#### **b) Consultation with Maori**

*Maori are not significantly affected by this paper.*

### **6) Legal Implications**

*This report supports compliance with the Local Government Act 2002 requirement to adopt an annual report within 4 months of balance date.*

### **7) Consistency with existing policy**

*This report is consistent with existing policy.*



**APPENDIX 1**

**ANNUAL REPORT**

**FOR THE YEAR ENDED 30 JUNE 2010**



**APPENDIX 2**

**AUDIT CLEARANCE**