
REPORT 1
(1215/52/IM)

**REPORT FROM AUDIT AND RISK MANAGEMENT
SUBCOMMITTEE: MEETING OF MONDAY 22 AUGUST
2011 - 2010/2011 FINANCIAL STATEMENTS AND
STATEMENTS OF SERVICE PERFORMANCE**

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 2011 to the Strategy and Policy Committee (the Committee) for review and confirmation.

2. Executive Summary

The 2010/11 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 8 June 2011 and 22 August 2011, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2011. 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 22 August 2011 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 24 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 2011.*
5. *Recommend to Council the adoption of the Annual Report for Wellington City Council and Group for the year ended 30 June 2011 (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 2010/11 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 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 8 June 2011 is in the table below:

Date:	Action:
8 June 2011	Audit and Risk Management Subcommittee Meeting Subcommittee to review and conditionally approve draft format for the 2010/11 financial statements and the proposed sign-off process.
1 August 2011	Audit New Zealand commences final audit fieldwork.
11 August 2011	Consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2011, financial position as at 30 June 2011 and financial overview available for final internal review and management sign off.
22 August 2011	Audit and Risk Management Subcommittee Meeting Subcommittee to review consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2011, financial position as at 30 June 2011 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.
24 August 2011	Subcommittee to recommend adoption of 2010/11 financial statements to Strategy and Policy Committee. 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.
31 August 2011	Strategy and Policy Committee Meeting Committee to recommend adoption of 2010/11 financial statements to Council.
31 August 2011	Council Meeting Council to adopt 2010/11 financial statements. Management Letter of Representation issued to Audit New Zealand.
30 Sept 2011	Audit New Zealand sign Audit Opinion. 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 2011 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2011, including:
 - financial performance for the year ending 30 June 2011
 - 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 2011*

5.1.1 *Comprehensive Financial Performance*

The Statement of Comprehensive Financial Performance reports an overall surplus for the Council's activities of \$16.0 million compared with a budgeted surplus of \$49.0 million resulting in an unfavourable variance to budget of \$33.0 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 \$247.1 million, the large majority relating to revaluations of property, plant and equipment. Total Comprehensive Income is made up of the following:

Net surplus for the year	\$16.047m
Revaluation movement – PP&E	\$252.408m
Impairment through revaluation reserve *	(\$0.257m)
Movement in cash flow hedge reserve	(\$4.708m)
Movement in fair value through other comprehensive income reserve	(\$0.332m)
Other Comprehensive Income	\$247.111m
Total Comprehensive Income	\$263.158m

* 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 \$9.2 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 \$8.2 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 \$250.5 million. Total Comprehensive Income is made up of the following:

Net surplus for the year	\$8.220m
Revaluation movement – PP&E	\$254.281m
Impairment through revaluation reserve	(\$0.257m)
Movement in cash flow hedge reserve	(\$4.708m)
Movement in fair value through other comprehensive income reserve	(\$0.332m)
Share of movement in associates cash flow hedge reserve	\$1.429m
Effect of change in shareholding – Chaffers Marina	\$0.087m
Other Comprehensive Income	\$250.500m
Total Comprehensive Income	\$258.720m

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.

	\$000
Council actual net surplus	16,047
Less:	
Fair value movements:	
Cash flow hedge movement reclassified from hedging reserve ¹	(268)
Fair value hedge movements ²	(360)
Fair value hedge adjustments to borrowings ²	360
Derivatives at fair value through surplus or (deficit) ³	(107)
Loan amortisation ⁴	(3)
Investment property revaluation ⁵	10,473
Total fair value movements	10,095
Additional net expenditure from WWP, WVP and PCC JVs	1,284

Total changes to external funding for capital expenditure	(275)
Vested assets – income 6	(4,256)
Vested assets – expenditure 6	1,190
Gain on disposal of property, plant and equipment	(1,009)
Loss on disposal of property, plant and equipment	1,313
Additional expenditure not funded (section 100 of LGA) 7	
Clearwater sewerage treatment plant	(36)
Living Earth	(6)
Total additional expenditure not funded	(42)
Ring-fenced surpluses and deficits	
City Housing – deficit from budget	991
Waste Activity – surplus from budget	(735)
Underlying Council actual net surplus	24,603
less Council budget net surplus	48,989
Underlying variance	(24,386)

EXPLANATION OF UNDERLYING VARIANCE:

Unbudgeted revenue/expenditure:

Restatement of provisions	(33,875)
Insurance costs funded through self-insurance reserve	(1,323)
Total unbudgeted revenue/expenditure	(35,265)

Significant variations from budget:

Dividends in excess of budget (inc Wellington International Airport)	3,811
Increase in rates revenue and rates penalties	1,039
Decrease in interest expense	2,147
Decrease in general expenses	2,107
Other net variances 8	1,708
Total significant variations from budget	10,812

Total factors contributing to underlying variance	(24,386)
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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. Relates to the current year portion of the amortisation of related party loans back to their nominal value.
5. This gain 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.
6. Vested assets are those assets transferred between the Council and an external party and recognised as revenue or expense accordingly. The majority relates 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.
7. Depreciation on the three assets shown above is not funded through rates as it is either fully or partially funded by external parties.
8. Other net variances comprise other reduced costs in programmes, projects and organisational costs.

5.1.2 Financial Position

The Statement of Financial Position reflects an equity position of \$6,196.4 million for the Council entity as at 30 June 2011, an overall increase of \$263.2 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 2011	\$16.047m
Revaluation movement – PP&E	\$252.408m
Impairment through revaluation reserve	(\$0.257m)
Movement in cash flow hedge reserve	(\$4.708m)
Movement in fair value through other comprehensive income reserve	(\$0.332m)
Total Net Movement in Equity	<u><u>\$263.158m</u></u>

In analysing the Council's overall financial position at 30 June 2011, 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 \$349.7 million to \$6,362.5 million as at 30 June 2011. This relates primarily to revaluation increases during the year of \$252.4m, additions of \$127.8 million, offset by depreciation of \$78.5 million.

- ***Net borrowings***

Net borrowings comprises the gross borrowings of \$331.4 million less cash and cash equivalents of \$19.6 million. The Council's net borrowings have increased by \$30.9 million to \$311.8 million as at 30 June 2011. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2010/11 capital expenditure programme which included \$31.0 million on the Indoor Community Sports Centre. The Council borrows to fund the purchase or construction of new assets or renewals as approved through the Annual Plan process. The increase in borrowings is lower than that budgeted by \$45.9m as a result of re-phasing of delivery of the capital expenditure programme to reflect changes in project timing as well as capex savings. It is also \$42.0 million lower than the Long Term Plan net borrowings figure of \$353.8 million.

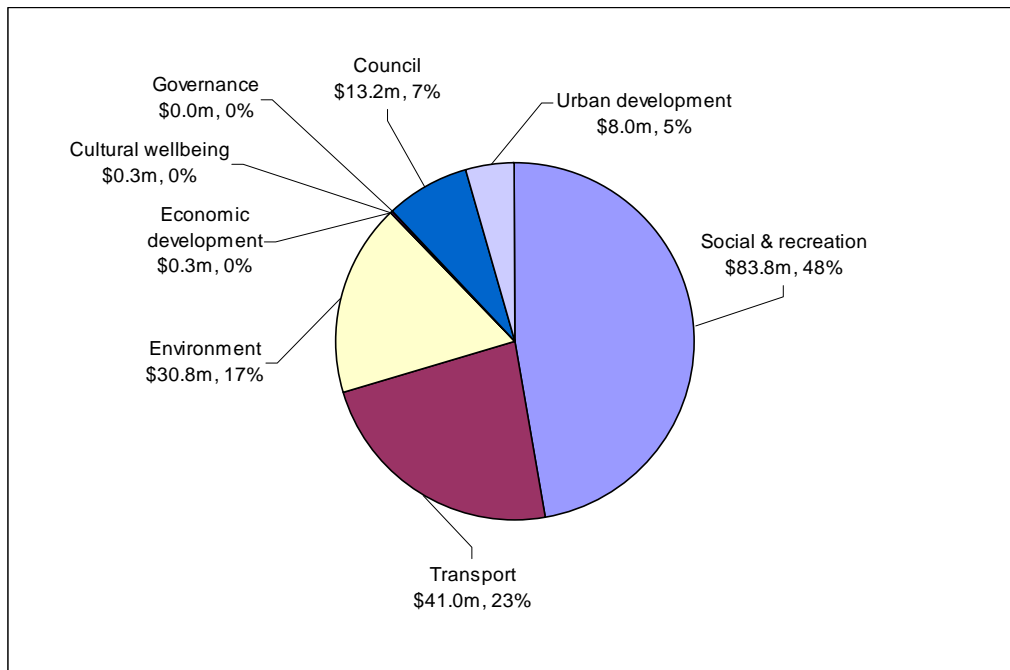
As at 30 June 2011, \$72.4 million of borrowings (net of \$19.6 million of cash and cash equivalents) were short-term i.e. due within 12 months (2010: \$97.8 million) and \$239.4 million were long-term i.e. due after 12 months (2010: \$183.1m). This is consistent with the Council's borrowing strategy 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 2011 was \$177.4 million, compared with the total budgeted capex programme (including carry forwards from 2009/10) of \$199.0 million. Total capital expenditure budget that will be carried forward to future financial periods is \$26.8 million (2010: \$26.8 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 2010/11.

They also provide a narrative around milestone and activities that occurred during the year.

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

- A snapshot of the key challenges, strategic approach and outcome that we are working towards.
- A summary of key indicators showing progress at a high level. These will be provided in a graphical format in the final publication.
- A feature article: a short narrative highlighting a key achievement or activity in the year.

Activity statements

- **Outcomes:** these cover the aims of the activity and its importance.
- **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 years targets where appropriate¹.

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 introductions from the mayor and chief executive and provides an overall summation 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 31 August 2011. The summary will provide an overview of 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 the 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 38 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;
- consolidation / financial statement templates allowing for effective consolidation of financial information; and
- 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

¹ The measures were developed as part of the long term plan and remain in place for a three year period. They were developed around a framework that covers: access; quality; volume; timeliness; and customer experience. We also provide milestones to demonstrate effectiveness at project management. The results are derived from official sources such as Statistics NZ and from internal systems and customer surveys. The performance measures are complemented by a set of 'outcome indicators' that show trends over the long term – and include activities that the Council has varying levels of influence over e.g. crime statistics.

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 2010/11 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 2010/11 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

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MANAGER – FINANCIAL ACCOUNTING

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MANAGER – STRATEGY, RESEARCH, URBAN DESIGN AND HERITAGE

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 2011. 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 2011

APPENDIX 2

AUDIT CLEARANCE