

REPORT 1
(1215/52/IM)

**REPORT OF THE AUDIT AND RISK MANAGEMENT
SUBCOMMITTEE - MEETING OF WEDNESDAY 22
AUGUST 2012**

- **2011/2012 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 the Council and Group for the year ended 30 June 2012 to the Strategy and Policy Committee (the Committee) for review and confirmation.

2. Executive summary

The 2011/12 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 18 June 2012 and 22 August 2012, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2012. All substantive issues raised and discussed by the Subcommittee at those meetings have now been satisfactorily resolved.

No significant issues impacting the financial statements or Statements of Service Performance have arisen subsequent to the Subcommittee's 22 August 2012 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 2012 (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 2012.*
5. *Recommend to Council the adoption of the Annual Report for Wellington City Council and Group for the year ended 30 June 2012 (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 2011/12 Annual Report document for publication.*

4. Background

4.1 Legislative Requirement to Prepare Financial Statements

The Local Government Act 2002 requires the Council to prepare and adopt an Annual Report containing audited financial statements 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 Local Government 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.

4.3 Process and Timetable for Adoption of the Council's Financial Statements

The adoption process agreed to by the Subcommittee at its meeting on 18 June 2012 is as follows:

Date:	Action:
18 June 2012 (scheduled)	Audit and Risk Management Subcommittee Meeting Subcommittee reviewed and conditionally approved draft format for the 2011/12 financial statements and the proposed sign-off process.
30 July 2012	Audit New Zealand commenced final audit fieldwork.
1 August 2012	Consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2012, financial position as at 30 June 2012 and financial overview available for final internal review and management sign off.
13 August 2012	Audit and Risk Management Subcommittee briefing on major provisions and issues.
22 August 2012 (scheduled)	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 2012, financial position as at 30 June 2012 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 2011/12 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.
29 August 2012 (scheduled)	Strategy and Policy Committee Meeting Committee to recommend adoption of 2011/12 financial statements to Council.
29 August 2012 (scheduled)	Council Meeting Council to adopt 2011/12 financial statements. 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 2012.
28 Sept 2012	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.

5. Discussion

The Annual Report for the year ended 30 June 2012 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2012, including:
 - financial performance for the year ending 30 June 2012
 - 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 2012*

5.1.1 *Comprehensive Financial Performance*

The Statement of Comprehensive Financial Performance reports an overall surplus for the Council's activities of \$62.2 million compared with a budgeted surplus of \$51.1 million resulting in a favourable variance to budget of \$11.1 million. The majority of the budgeted surplus represents funding received from third parties for capital purposes (e.g. Housing New Zealand and NZTA grants). This income is received for specific capital projects it cannot be used to fund operating expenditure.

In addition the financial overview section of the Annual Report provides 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 \$47.9 million:

Net surplus for the year	\$62.2m
Revaluation movement – PP&E	\$48.6m
Movement in cash flow hedge reserve	(\$14.7m)
Movement in fair value through other comprehensive income reserve	(\$0.6m)
Adjustment for wind up of St James	\$14.6m
Other Comprehensive Income	\$47.9m
Total Comprehensive Income	\$110.1m

The Council currently has a debit balance in its hedging reserve totalling \$23.9 million. This will reduce to zero as these swaps reach the end of their lives.

The consolidated Group results reflect an overall net surplus of \$50.0 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 elimination of "inter-group" transactions and the recognition of the Group's share of the results of subsidiaries and surpluses or deficits of the associate entities. The Group also recognised Other Comprehensive Income totalling \$69.5 million:

Net surplus for the year	\$50.0m
Revaluation movement – PP&E	\$48.6m
Share of movement in associates revaluation reserve	\$33.4m
Movement in cash flow hedge reserve	(\$14.7m)
Share of movement in associates cash flow hedge reserve	\$1.1m
Movement in fair value through other comprehensive income reserve	(\$0.6m)
Adjustment for sale of i-site by WIAL	\$1.7m
Other Comprehensive Income	\$69.5m
Total Comprehensive Income	\$119.5m

The table below 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.

	2012	2011
	\$000	\$000
Council actual net surplus	62,186	16,017
Adjustments:		
Investment property revaluation ¹	3,418	10,473
Other fair value movements ²	468	(378)
Total fair value movements	3,886	10,095
Additional net expenditure from WWP, WVP and PCC JVs	3,678	1,284
Changes to external funding for capital expenditure	(2,081)	(275)
Vested assets - net ³	(7,163)	(3,066)
Net (gain) / loss on disposal of PPE / intangibles	(6,471)	304
Additional expenditure not funded under section 100 of LGA ⁴	(1,797)	(42)
Underlying Council actual net surplus	52,238	24,317
less Council budget net surplus	51,148	48,989
Underlying net variance	1,090	(24,672)
Unbudgeted revenue/expenditure:		
Restatement of provisions	(9,903)	(33,875)
Insurance costs funded through self insurance reserve	(915)	(1,323)
Total unbudgeted revenue/expenditure	(10,818)	(35,198)

Significant variations from budget		
Dividends in excess of budget (inc Wellington International Airport Limited)	13,138	3,811
Increase in rates revenue and rates penalties	134	1,039
Decrease in income from activities	(2,366)	(2,992)
Decrease in interest expense	986	2,147
Decrease in other general expenses	265	2,107
Other net variances ⁵	601	4,670
Total significant variations from budget	12,758	10,782
Underlying variance available to carry forward	1,940	(24,416)
Ring-fenced City Housing - deficit	(1,581)	(991)
Ring-fenced Waste Activity - surplus	731	735
Council underlying variance	1,090	(24,672)

Notes:

1. 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 Plan (LTP)/Annual Plan.
2. Other fair value movements include movements related to interest rate swaps and related party loans.
3. 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.
4. Represents depreciation not funded through rates as renewals on these assets are either fully or partially funded by external parties.
5. 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 \$6,306.3 million for the Council entity as at 30 June 2012, an overall increase of \$110.1 million from the opening balance.

In analysing the Council's overall financial position at 30 June 2012, 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 \$139.2 million to \$6,501.7 million as at 30 June 2012. Movements in property, plant and equipment for the Council are shown below:

Opening balance	\$6,362.5m
Revaluation movement	\$48.6m
Additions (completed capex)	\$226.2m
Disposals	(\$1.9m)
Depreciation expense	(\$85.4m)
Movement in WIP	(\$47.4m)
Other movements	(\$0.9m)
Closing balance	<u><u>\$6,501.7</u></u>

The additions figure above represents completed capex (including vested assets) so will not agree directly to the total capex spend. It should also be noted that some capex will still be held within work in progress at 30 June 2012 and therefore not be included within the additions figure.

- ***Net borrowings***

The Council's net borrowings have increased by \$27.2 million to \$339.0 million as at 30 June 2012. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2011/12 capital expenditure programme. The Council borrows to fund the purchase or construction of new assets or renewals as approved through the Annual Plan process. The Council's closing net borrowings is lower than budget by \$27.661 million as a result of re-phasing of delivery of the capital expenditure programme to reflect changes in project timing.

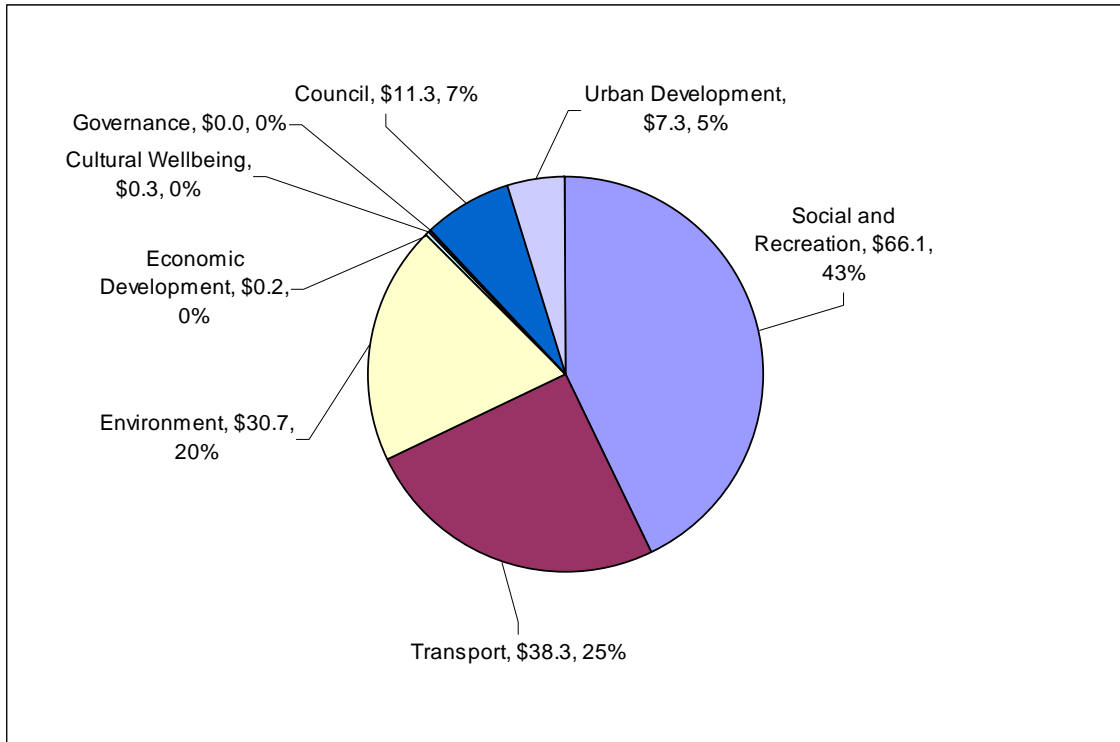
As at 30 June 2012, \$107.0 million of net borrowings were short-term i.e. due within 12 months (2011: \$72.4 million) and \$232.0 million were long-term i.e. due after 12 months (2011: \$239.4 million). This is consistent with the Council's borrowing strategy to ensure long-term liquidity and access 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 2012 was \$154.2 million, compared with the total budgeted capex programme (including carry forwards from 2010/11) of \$182.2 million. Total capital expenditure budget that will be carried forward to future financial periods is \$31.6 million (2011: \$26.8 million).

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

The following pie chart shows total capital expenditure by strategic areas:



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 that were set in the long-term plan
- performance measures and targets for 2011/12.

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 steps through each activity in more detail. They will include:

Overview

- A case study of one of our activities showing the complexity and planning surrounding our work. These will be provided in a graphical format in the final publication.
- Some quick facts that show the impact of our activities on our outcomes.

Activity statements

- What we do: An outline of the scope of our work under the activity.

- **Contribution:** How our activities contribute towards our stated outcomes.
- **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.

An executive summary will also be prepared. This covers introductions from the mayor and chief executive, a section outlining the role of Council and our vision and provides an overall summation of performance.

Appendices will include a schedule outlining the performance of our Council Controlled Organisations, a report outlining how we're structured as an organisation, our corporate environmental impact and a monitoring section showing our progress against our long-term outcome indicators.

A summary of the Annual Report will be produced following its adoption. 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.

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.

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 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 2011/12 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 – Acting Chief Planning Officer*

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 2012. The adoption of the Annual Report is a statutory responsibility.

2) LTP/Annual Plan reference and long term financial impact

There is no impact on the LTP 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 2012

APPENDIX 2

AUDIT CLEARANCE