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WELLINGTON CITY COUNCIL

AUDIT AND RISK MANAGEMENT SUBCOMMITTEE
6 OCTOBER 2006

REPORT 2
(1215/52/01/IM)

IMPLICATIONS FOR COUNCIL OF NEW AND PROPOSED FINANCIAL REPORTING STANDARDS

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1. Purpose

The purpose of this regular report is to inform the Subcommittee of new and proposed Financial Reporting Standards and their likely impact for the Council.

2. Recommendation

It is recommended that the Subcommittee:

1. Receive the information

2. Note the developments in New Zealand generally accepted accounting practice (GAAP) since the last Subcommittee meeting in June 2006.

3. Background

The Local Government Act 2002 requires the Council to comply with GAAP in preparing the Annual Report. GAAP is defined by the Accounting Standards Review Board (ASRB) to encompass all applicable Financial Reporting Standards (FRSs) and other sources of appropriate authoritative support (for example; exposure drafts of financial reporting standards, international accounting standards etc).

Council Officers have undertaken to report to the Subcommittee on a regular basis in relation to any new FRSs and any exposure drafts currently on issue by the New Zealand Institute of Chartered Accountants (the Institute). This report outlines developments in GAAP and the implications for the Council since the last Subcommittee meeting on 27 June 2006.

4. New Zealand International Financial Reporting Standards (NZ IFRS) Project

As the Subcommittee is aware, most local authorities will adopt NZ IFRS for external reporting purposes for the accounting period ending 30 June 2007. This means we are now three months into our first NZ IFRS reporting period.

The areas of major focus for the Council's NZ IFRS working group since the last Subcommittee meeting have been:

- Ensuring that any new systems (eg chart of accounts changes, recording systems for new disclosures) and processes were in place for the 1 July 2006 implementation date.

- Processing our opening balance sheet adjustments, and any subsequent 2005/06 adjustments into the NZ IFRS ledger opening position.

- Working with our Group entities to finalise the Group opening balance sheet and finalising our transitional arrangements for 1 July 2006.

- Translating the 2005/06 financial statements from current NZ GAAP to NZ IFRS as part of the 2005/06 annual report process.

- Progressing the template financial statements for the 30 June 2007 financial year. There are very few model New Zealand IFRS financial statements specifically targeted for PBEs, and none specifically for local authorities. As a result, we have had to develop our own template model. We will circulate the template for the Subcommittee's review when available. It is important to note that the template will reflect applicable New Zealand IFRS as at the date of preparation. As it will need to be updated to reflect ongoing amendments to New Zealand IFRS, the Subcommittee will not be able to finally approve the template until the time of finalisation of the 30 June 2007 financial statements. However, we are aiming to table a draft template at the earliest opportunity to enable the Subcommittee to see the practical changes that have arisen from New Zealand IFRS.

5. Developments in Financial Reporting Standards

5.1 Submissions Made

The Council makes submissions on exposure drafts where there is potential for a significant impact on either the Council as a reporting entity or the level of funding provided by ratepayers. We also consider whether the proposals are appropriate, in our opinion, from a standard setting perspective.

Two new submissions have been made by the Council since the last Subcommittee meeting in June. These relate to heritage assets and the presentation of financial statements and are attached as Appendix One to this report.

5.2 Exposure Drafts on Issue

The following exposure drafts are currently open for comment:

- Not-for Profit Financial Reporting Guide
- NZ IFRIC Draft Interpretation D20 Customer Loyalty Programmes
- NZ IFRIC Draft Interpretation D19 NZ IAS 19 – The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements
- ED 107 Summary Financial Statements
- ED 108 Omnibus Amendments
- IASB DP Preliminary Views on an Improved Conceptual Framework for Financial Reporting
- ED 109 Proposed Amendments to NZ IAS 27: Consolidated and Separate Financial Statements

We are currently reviewing these exposure drafts to determine any potential impacts on the Council. We will provide copies of any submissions made at the next Subcommittee meeting.

6. Conclusion

This is the first Subcommittee meeting since the transition date of 1 July 2006 – the start of our first NZ IFRS reporting period. The initial NZ IFRS reporting period is progressing well, and we are currently finalising a template set of financial statements for the Subcommittee's review.

We will circulate any key documents prepared to Subcommittee members as they become available. We will also continue to report developments to the Subcommittee on a quarterly basis.

Contact officer: *Helen Rogers*
Financial Controller

APPENDIX ONE

31 May 2006 File ref: International Financial Reporting Standards

The Director – Accounting and Professional Standards
Institute of Chartered Accountants of New Zealand
PO Box 11342
WELLINGTON

Dear Sir

SUBMISSION ON RECENT EXPOSURE DRAFT

Thank you for the opportunity to comment on the recent discussion paper and exposure draft issued by the Institute and the International Public Sector Accounting Standards Board (IPSASB). Wellington City Council (the Council) is pleased to provide comments on the IPSASB Consultation Paper: *Heritage Assets.*

In developing our comments we have considered the impact of the proposals on the Council as a reporting entity (for example, compliance costs and changes to information and reporting systems), and whether the proposals are appropriate, in our opinion, from a standard setting perspective.

General Comments

We acknowledge the efforts of the UK Accounting Standards Board in developing the discussion paper on heritage assets on which the IPSASB Consultation Paper is based. However, we believe that heritage assets should not be treated separately from other property, plant and equipment.

The problem with establishing a separate standard for accounting for heritage assets is that the definition of these assets then becomes critical. In local government, items that could be classified as heritage assets include art works, sculptures, heritage furniture, artefacts, monuments, historical items and archives. The items that have become known as heritage assets are generally a disparate group of assets. This is evidenced in the wide definition advanced by the UK discussion paper – including assets with historic, artistic, scientific, technological, geophysical or environmental qualities.

The risk of establishing a separate standard is that there is a lack of clarity around when an item is a heritage asset versus property, plant and equipment. For example, some land features could easily fall within either definition. Equally, some assets may change categories (and hence accounting treatments) as a result of the objectives of the entity owning them, or with the passage of time (as older assets are more likely to be considered as heritage due to their historical nature.) We do not believe that this is desirable.

It could be argued that the most common attributes of heritage assets are the issues associated with the accounting thereof. We see three main issues in relation to items commonly termed heritage assets:

Ownership and control

In some cases the ownership of heritage items is unclear. In many cases, these items are gifted to PBEs to hold on behalf of a section of the wider public. While the PBE may be required to maintain the items, there are often caveats restricting the entity's level of control – such as an inability to sell or otherwise dispose of the items. Therefore, in some cases the relationship is more akin to an agency or trust situation, rather than ownership and control.

Valuation

Arguably the valuation of these items is the most significant issue for PBEs in particular. There is a general presumption that the benefits derived from information should exceed the cost of providing it. It is this presumption which is often debated by preparers in respect of the valuation of heritage assets.

We note that there is no compulsion in New Zealand to revalue heritage assets on an ongoing basis, and this is rarely done in practice. It is therefore generally accepted that the benefits of revaluation are not considered to exceed the costs on an ongoing basis.

The issue that remains is measurement on initial recognition. We note that the UK paper states that initial measurement at "historical cost would not be permitted except where it provides a good proxy for current value." As many heritage items are either donated or heavily subsidised, historical cost is unlikely to be an option in many cases.

We believe that this area requires substantial further work and guidance. We are concerned that the requirement to recognise assets at fair value results in significant cost to some entities for limited or no benefit. This is particularly relevant for PBEs as they are more likely to receive heritage items at nil or nominal cost.

We note that the UK paper proposes "wider use of internal valuations and indices based on reference guides or recent transactions". While this has merits, some items are still so unique that individual, specialist valuation would be required. This is likely to be expensive and does not address the sensitivities around putting a financial value on something which may be considered priceless.

Depreciation

The final issue relates to whether heritage assets should be depreciated. We support the New Zealand approach to this issue which links back to the assessment of useful lives.

As the general approach to management of heritage assets is one of preservation (often in perpetuity), in practice the lives of such assets is often assessed as indeterminate.

In general, we believe that the focus of standard setters should be to develop better guidance around the areas noted above. This will ultimately assist in improving the consistency and comparability of accounting treatment across reporting entities. We believe that the best place to do this is within the Property, Plant and Equipment Standard. This will ensure that the focus is on resolving the issues, rather than creating a new set of rules specifically for heritage assets. It is worth noting that many assets in the PBE sector are difficult to value for a range of reasons, rather than just those assets with heritage features. Better guidance within the Property, Plant and Equipment standard should help address this.

If you would like further clarification on the issues raised in our submissions please don't hesitate to contact me.

Yours sincerely

Neil Cherry
CHIEF FINANCIAL OFFICER
Wellington City Council

10 July 2006 File ref: IFRS

The Director – Accounting and Professional Standards
Institute of Chartered Accountants of New Zealand
PO Box 11342
WELLINGTON

Dear Sir

SUBMISSION ON RECENT EXPOSURE DRAFT

Thank you for the opportunity to comment on the recent exposure drafts issued by the Institute and the International Accounting Standards Board (IASB). Wellington City Council (the Council) is pleased to provide comments on the following pronouncement:

- Proposed Amendments to NZ IAS 1 Presentation of Financial Statements as a consequence of the IASB's Exposure Draft of Proposed Amendments to IAS 1 *Presentation of Financial Statements: A Revised Presentation.*

In general we agree with the proposals to allow the choice of presenting income and expenses in one or two statements, and to change the standard names of the statements. However, we disagree with the proposal to require three statements of financial position and the requirement for the inclusion of capital disclosures.

In developing our comments we have considered the impact of the proposals on the Council as a reporting entity (for example, compliance costs and changes to information and reporting systems), and whether the proposals are appropriate, in our opinion, from a standard setting perspective.

If you would like further clarification on the issues raised in our submissions please don't hesitate to contact me.

Yours sincerely

Neil Cherry
CHIEF FINANCIAL OFFICER
Wellington City Council

APPENDIX 1:

PROPOSED AMENDMENTS TO NZ IAS 1 PRESENTATION OF FINANCIAL STATEMENTS AS A CONSEQUENCE OF THE IASB'S EXPOSURE DRAFT OF PROPOSED AMENDMENTS TO IAS 1 *PRESENTATION OF FINANCIAL STATEMENTS: A REVISED PRESENTATION.*

1. **Do you agree with the FRSB's proposal to exempt qualifying entities from the requirement to present three statements of financial position (paragraphs 31(a) and 39)?**

   While we agree with the proposal to exempt qualifying entities from the requirement to present three statements of financial position, we disagree with the requirement itself. The Basis for Conclusions states that the reason for the proposed amendment is to "provide a basis for investors and creditors to evaluation information about the entity's performance during the period." It also states that this requirement should impose "no additional cost" for reporting entities.

   We disagree with these comments and therefore the basis upon which the amendment is proposed. We believe that the proposal would increase costs to reporting entities through the requirement to prepare an additional set of published figures for the opening balance sheet. While we accept that entities have to establish an opening position, it is a different matter to require it to be published in a form which is consistent with the current period. This additional information would also need to be audited, which may further increase costs.

   In addition, we believe that the perceived benefits would not be evident for many New Zealand entities, including public benefit entities. Much of the required information is already able to be sourced by those who require it. For instance, under IFRS a number of movements reconciliations are required which necessitates the inclusion of opening balances (eg Property, Plant and Equipment). In addition, the influence of the internet means that those who wish to calculate ratios can easily source prior year annual reports.

   The main users of public benefit entity reports are likely to be the general public rather than investors. The increasing size of the report may actually be a disincentive for general users. The additional column of information for both parent and group would increase the Statement of Financial Position to seven columns for the Council. We are concerned that this is excessive, and has the effect of diminishing the value of the current year information.

   Finally, we are concerned that this proposal places excessive emphasis on historical information. There are arguments for inclusion of a huge range of additional information in financial statements which will have a benefit to particular users. For instance it is arguable that for public sector entities the inclusion of future forecast information would be more relevant than the opening balances of the prior period. Given the differing user needs, the requirement should not be mandatory for all reporting entities. Nothing would prohibit entities making additional disclosures around relevant opening balances and ratios if they saw them as necessary.

We do not believe that this proposal satisfies the cost/benefit proposition for public benefit entities in particular. Therefore, we do not support the proposed amendment. In the event that the amendment is approved, then we would be strongly in favour of exemptions for qualifying entities and public benefit entities.

2. **Do you believe that there should be any additional differential reporting concessions to the requirements of NZ IAS 1 as a result of the proposed amendments to IAS 1?**

   While we have not identified any other specific differential reporting concessions, our response to question 3 may have implications for differential reporting.

3. **Do the proposed amendments to IAS 1 give rise to any public benefit entity issues that you believe require additional requirements or guidance in NZ IAS 1?**

   Yes. Please refer to our answer to question 1. In addition to the requirement for three balance sheets, there are two other areas of significance for public benefit entities:

   Separating Owner Changes in Equity

   The ownership concept is more difficult to apply in public benefit entities, as they do not always have defined ownership structures. In the absence of further guidance in this area, we would expect the Statement of Changes in Equity to be fairly bland for many public benefit entities.

   Capital Disclosures

   We believe that Section 124 will cause issues for public benefit entities. For the reasons outlined previously, equity is not easily defined in the public sector. In many cases, equity is a residual and therefore not managed in the same manner as the capital structure of a private sector entity. Public benefit entities generally do not have the ability to issue capital, and do not distribute equity to shareholders. Therefore the disclosure is likely to be meaningless. We note that the AASB has decided that these disclosures should not be mandatory for not-for-profit entities and we support a similar public benefit exemption in New Zealand.

4. **Are there any regulatory issues or other issues arising in the New Zealand environment that may affect the implementation of the proposals, particularly any issues relating to:**
   a) public benefit entities
   b) profit-oriented entities

c) the Privacy Act 1993?

No, we are not aware of any other issues.

5. Do you consider that it is important that NZ financial reporting requirements for the presentation of financial statements converge with Australian financial reporting requirements?

We agree with this in principle, subject to due consideration of any New Zealand specific issues (particularly in relation to public benefit entities).

5. Do you consider that the proposed disclosure requirements are in the best interests of users of general purpose financial reports of entities in NZ?

Given the concerns we have raised in our response to questions 1 and 3 we do not consider that the adoption of all the proposed amendments to NZ IAS 1 is in the best interests of users of general purpose financial reports.

We are concerned with the requirement to present an additional statement of financial position. We consider that if this proposal is approved, then exemptions should be available.

Supporting Information

1) Strategic Fit/Strategic Outcome

This project supports Key Achievement Area 9 Governance and Citizen Information: As per the Annual Plan, Governance and Citizen Information includes all those activities that make the Council accountable to the people of Wellington and ensure the smooth running of the city. That includes all meetings of the Council and its committees.

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

Relates to C534: Committee and Council process

3) Treaty of Waitangi considerations

There are no Treaty of Waitangi implications

4) Decision-Making

This is not a significant decision

5) Consultation

a)General Consultation

Not required

b) Consultation with Maori

Not required

6) Legal Implications

None

7) Consistency with existing policy

This report is consistent with existing Wellington City Council policy