
REPORT 1
(1215/52/IM)

**REPORT FROM AUDIT AND RISK MANAGEMENT
SUBCOMMITTEE – MEETING OF MONDAY 21 AUGUST
2006: 2005/2006 FINANCIAL STATEMENTS**

1. Purpose of Report

The purpose of this report is to present the financial statements and additional information contained within the Annual Report for Wellington City Council (Council) for the year ended 30 June 2006 to the Strategy and Policy Committee (Committee) for review and confirmation.

2. Recommendations

It is recommended that the Committee:

1. *Receive the information.*
2. *Note that the Audit and Risk Management Subcommittee has reviewed the financial statements in detail, with the exception of the contingency disclosures for Wellington Waterfront Project, which will be reviewed by the Subcommittee at its reconvened meeting on 28 August 2006.*
3. *Note that Audit New Zealand have indicated their likely audit clearance by way of a letter of comfort dated 21 August 2006.*
4. *Recommend that Council confirm the Statement of Accounting Policies, as contained within the financial statements, for Wellington City Council for the year ended 30 June 2006.*
5. *Recommend to Council the adoption of the annual report for Wellington City Council for the year ended 30 June 2006 (attached in Appendix One), subject to Subcommittee review of the contingency disclosures relating to the Wellington Waterfront Project on 28 August 2006.*
6. *Note that the Management Letter of Representation, signed by the Mayor, Chief Executive and Chief Financial Officer, will be provided to Audit New Zealand once the annual report is adopted by Council.*

3. Consultation

The 2005/06 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. 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 financial statements. In accordance with this mandate the Subcommittee reviewed the draft financial statements at its meetings on 27 June 2006 and 21 August 2006, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2006. All substantive issues raised and discussed by the Subcommittee were satisfactorily resolved at those meetings, with the exception of the finalisation of the Wellington Waterfront Project's (WWP) contingency disclosure.

This disclosure has been confirmed by Wellington Waterfront Limited (WWL) following the High Court summary judgement hearing of a dispute between WWL and the former Waitangi Park contractor on 24 August 2006. As the Subcommittee is due to reconvene on Monday 28 August 2006 to confirm the revised disclosures, we expect to table a revised Note 30 to the financial statements at the 30 August 2006 Committee meeting.

Other than the receipt of updated information in respect of contingencies outlined above, no significant issues impacting on the financial statements have arisen subsequent to the Subcommittee's 21 August 2006 meeting.

Therefore the Subcommittee recommends the formal adoption of the financial Annual Report to the Committee and Council.

4. Background

4.1 Legislative Requirement to Prepare Financial Statements

Section 98 of 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.

Section 99 of the Act requires that the Annual Report must contain the auditor's report on the financial statements 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 proposed adoption process agreed to by the Subcommittee at its meeting on 27 June 2006 is as follows:

Date:	Action:
6 March 2006	Audit New Zealand commenced interim audit visit 1
5 June 2006	Audit New Zealand commenced interim audit visit 2
9 June 2006	Subcommittee reviewed and approved draft format for the 2005/06 financial statements and the proposed sign-off process.
7 August 2006	Audit New Zealand commenced final audit fieldwork
14 August 2006	Final consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2006 and the financial position as at 30 June 2006 available for final internal review.
21 August 2006	Audit and Risk Management Subcommittee Meeting Subcommittee to review consolidated draft financial statements for the year ending 30 June 2006, including Statements of Service Performance, subject to Audit New Zealand clearance. Subcommittee to recommend adoption of 2005/06 financial statements to Strategy and Policy Committee.
25 August 2006	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.
30 August 2006	Strategy and Policy Committee Meeting Committee to recommend adoption of 2005/06 financial statements to Council.
30 August 2006	Council Meeting Council to adopt 2005/06 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 2006.

Date:

Action:

29 September 2006 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 structure and layout of our reporting is simple and logical, so it is easy to find in one place, all the relevant information on any activity of interest. Each KAA section details the link between outcomes and activities, and for each activity: what the Council did; how we performed against the annual plan target; how we performed against budget; the result of Council's performance; and what it cost. As with last year, significant variances in performance and budgets are commented on.

The layout of this year's publication will retain the basic structure of last year's report. It continues the improvements that were made by:

- presenting for each activity the statements of service performance and financial performance together
- presenting trend data for performance where it is applicable
- providing an executive summary
- providing a summary table of the performance of Council Controlled Organisations
- providing summaries of milestones for the year. Each key achievement area has a "case study" section that tells a brief story of a notable activity from the year.

The publication itself will be prepared following Council's approval of the Word version presented here. A summary of the annual report will also be produced following its adoption by the Council. The summary, which is subject to audit clearance, will provide an overview of Council's performance, detail key highlights for each KAA and provide information on key facts about the city.

5. Discussion

The Annual Report for the year ended 30 June 2006 is attached to this report. The following discussion analyses:

- the results of operations and financial position for the year ended 30 June 2006, including:
 - financial performance for the year ending 30 June 2006
 - financial position
 - capital expenditure program
 - Statements of Service Performance
- Changes to Accounting Policies
- Group Reporting
- NZ IFRS
- Management Letter of Representation

5.1 Results of Operations and Financial Position for the Year Ended 30 June 2006

5.1.1 Financial Performance

The Statement of Financial Performance reports an overall surplus for the Council's activities of \$5.2 million compared with a budgeted deficit of \$3.9 million.

The overall favourable variance (\$9.1 million) can be primarily attributed to items that are non-cash or generally not budgeted for as part of the Council's Annual Plan. For example, it is not considered financially prudent to budget for gains and losses on disposal of assets, or the recognition of vested assets. For the year ended 30 June 2006 the Council recognised vested assets of \$6.6 million. As the items contributing to the surplus are predominantly non-cash in nature, there is no cash surplus available for carry forward to offset future rates requirements.

A full explanation of the significant factors contributing to the favourable variance is outlined in the table below. The Council's financial performance includes the results of operation of both the Wellington Waterfront Project (WWP) and the Joint Venture arrangements with Porirua City Council (PCCJV). Both the WWP and PCCJV are consolidated on a line by line basis into the Council's financial statements.

The consolidated Group results reflect an overall net surplus of \$7.3 million. The Group results consolidate the operations of 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 difference between the Council and Group results arises from the elimination of "inter-group" transactions and the recognition of the Group's share in the results of subsidiaries and surpluses of the associate entities.

The following high level analytical review identifies the significant contributing factors to the overall favourable financial performance of the Council's operations:

	\$000
Council Actual Net Surplus/(Deficit)	\$5,215
Council Budget Net Surplus/(Deficit)	(\$3,928)
Favourable Variance – Actual vs Budgeted Surplus/(Deficit)	\$9,143

Revenues / Expenditure Not Budgeted for in 2005/06 Annual Plan:

Vested Assets (non-cash in nature) ¹	6,556
Bequests, special and reserve funds revenue	589
Insurance Costs funded through the Self-Insurance Reserve	(608)
Gain on sale of assets	2,962
Loss on sale of assets	(217)
Bad debts written off	(217)
Release of investment property revaluation reserve on disposal	815
Total Revenue / (Expenditure) from Non-budgeted items	\$9,880

Significant changes in Revenue / Expenditure:

Additional net income from Wellington Waterfront Project and Porirua Joint Venture Arrangements	(464)
Additional dividend income (WIAL) ²	1,917
Additional LTNZ subsidies	171
Additional depreciation arising from revaluations and vested assets	(5,585)
Favourable interest revenue and financing costs	876
Unfavourable development contributions revenue ³	<u>(165)</u>
<i>Total Significant changes in Revenue / Expenditure</i>	(3,250)
Other net variances⁴	\$2,513
	<hr/>
Total factors contributing to the favourable variance	<u>\$9,143</u>

Notes:

1. Vested assets are those assets where ownership and control are transferred to the Council from a third party. The total for the year ending 30 June 2006 comprises primarily infrastructural assets received from developers.
2. The Council budgeted to receive dividends of \$4 million from our shareholding in Wellington International Airport Limited (WIAL). We received a dividend of \$5.917 million in early December 2005, in respect of the company's financial performance for the year ended 31 March 2005.
3. The Council levies development contributions to fund growth related capital expenditure. Development contributions have been applied to any application for resource consent, building consent or service connection received by the Council on or after 1 July 2005, as applicable. Development contributions revenue is below that expected due to the backlog of consent applications received prior to the implementation of the new policy. These applications are subject to impact levies under the Resource Management Act as opposed to development contributions.
4. Other net variances comprise increased revenue and net savings in programmes, projects and organisational costs. These variances are further explained in the cost of service statements in the Statement of Service Performance.

5.1.2 Financial Position

The Statement of Financial Position reflects an equity position of \$5,562.8 million for the Council entity as at 30 June 2006, an overall increase of \$112.8 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 2006	\$5.215 m
Adjustment for disposal of investment properties	(\$0.815m)
Net increase in Revaluation Reserves (investment properties, land and buildings)	\$108.366m
Total Net Movement in Equity	<u>\$112.766m</u>

In analysing the Council's overall financial position at 30 June 2006, compared to the position at the previous balance date, the most significant movements relate to net borrowings and property, plant and equipment.

Net borrowings

As shown in the following table, the Council's net borrowings have increased by \$48.7 million to \$154.3 million as at 30 June 2006.

Net borrowings	Note	Council		Group	
		2006 \$000	2005 \$000	2006 \$000	2005 \$000
Total borrowings		210,250	162,976	211,625	164,493
Less total investments	10	(55,950)	(57,327)	(168,347)	(98,021)
Net borrowings		154,300	105,649	43,278	66,472

The increase in the Council's level of net borrowings reflects the utilisation of funds to complete the 2005/06 capital expenditure programme. The Council borrows to fund the purchase of new assets that Councillors have approved through the Annual Plan process. The significant variance between the Council and Group figures reflects the accounting treatment of our investment in Wellington International Airport Limited. In accordance with applicable financial reporting standards, this investment is reflected at cost in the Council, while the Group figures reflect our equity share in the company. As the Annual Plan identifies only the Council position this difference can result in a potentially confusing picture as to the Council's net borrowing position. In substance, the Council's net borrowing position is more appropriately derived from the Group position as this represents the full value of the Council's investments, including the Council's share of earnings / equity movements in Associate entities. Accordingly, the Council's net borrowing position, for accounting purposes, at 30 June 2006 is more appropriately represented at \$43.278m.

As at 30 June 2006, \$104.8 million of borrowings were short-term (2005: \$144.6 million). The Council's current borrowings have decreased due to greater utilisation of

longer term borrowing arrangements. Interest rate swaps are also in place to ensure the Council's exposure to interest rate risk is managed.

Property, plant and equipment

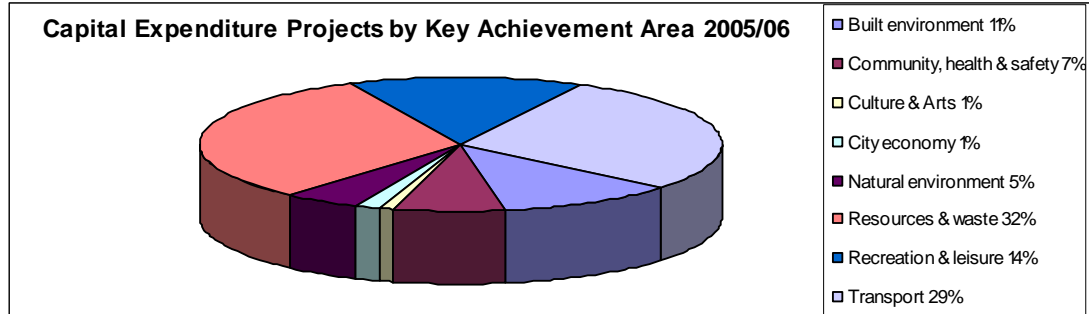
The Council's property, plant and equipment assets have increased by \$141.8 million during the period. This is primarily as a result of the revaluation of operational land and buildings as at 30 June 2006.

5.1.3 Capital Expenditure Programme

The Council reports against its capital expenditure programme as contained within the Annual Plan. Total budgeted capital expenditure for the year ended 30 June 2006 comprised \$109.3 million (including Annual Plan budget and Council approved additional expenditure). In addition, \$34.9 million capital expenditure was carried forward from the 2004/05 financial year.

Total capital expenditure actually incurred for the year ended 30 June 2006 was \$96.0 million. In addition, capital expenditure project budgets of \$41.4 million will be carried forward to future years.

The following pie chart shows total actual capital expenditure for the Council by class of property, plant and equipment.



The majority (62%) relates to infrastructural projects. Other capex projects undertaken during the year include the construction of the new Karori library, renovations to housing stock, progression of the inner city bypass, upgrade of Freyberg Pool and the refurbishment of the Cable Car winding house.

5.1.4 Statements of Service Performance

The Statements of Service Performance (SSPs) provide information on Council's performance against:

- **Outcome indicators** which help determine how much impact Council's work is having in shaping the state of the city – everything from economic growth to the state of the environment to the strength of Wellington's communities.
- **Activity performance measures** which measure how we performed against the targets set for activities in the 2005/06 Annual Plan.

The reporting is structured around Council's nine key achievement areas (KAAs). The structure and layout of our reporting is simple and logical, so it is easy to find in one place, all the relevant information on any activity of interest. Each KAA section details for each activity: what the Council did; how we performed against the annual plan target; how we performed against budget; the result of Council's performance; and what it cost. As with last year, significant variances in performance and budgets are commented on.

Information used to measure performance comes predominantly from Council's resident satisfaction surveys, and from Council business units. Other information, particularly in relation to outcome indicator measures, comes from external agencies such as Statistics New Zealand. Audit New Zealand has reviewed and confirmed the SSP results.

The annual report provides comprehensive information about Council's work and ensures that it is fully explained. In addition to this, to ensure the report captures its audience we will include an executive summary and add brief 'future focus' case studies within each KAA. The executive summary and case studies will be presented to Council.

A summary of the annual report will be produced following its adoption at Council on 30 August 2006. The summary will provide an overview of Council's performance, detail key highlights for each KAA 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 detailed information per activity.

5.2 Changes in Accounting Policies

The financial statements for the year ending 30 June 2006 include two changes to valuation methodologies. The measurement basis of restricted land and buildings, and land under roads has changed from fair value to historical cost. These classes will be carried at their net book value as at 30 June 2005, adjusted for subsequent additions and disposals.

The change reflects the decision of the Subcommittee on 27 June 2006 and has been made predominantly for cost/benefit reasons. The changes have been fully disclosed in the changes in accounting policy section of the Statement of Accounting Policies.

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 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 31 to the financial statements.

Given the number of entities within the Group and the tight timeframes for finalisation of the Group financial statements, the process for consolidating the Group entities must be appropriately planned and managed. During the planning phase of the report, Group entity finance representatives are briefed on key year end deadlines and requirements. Group entities are required to complete a year end consolidation package and return this

to the Council by the end of July. We also require a letter of comfort to be signed by all Group entity Chief Executives to support the information provided.

In addition we require early advice of any material issues arising subsequent to the provision of the consolidation package. In practice, this means that the Council's Finance team are in constant contact with CCO finance representatives to determine the status of their year end audits, any issues which are arising, 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.

At the time of writing this report, we have received all Group entity letters of comfort. Audit opinions have been issued for 7 entities within the Group, with the remaining audits in progress and expected to be completed by 30 August 2006. While we will continue to liaise with Group entities up to the date of adoption of the Council Annual Report, we do not anticipate any further adjustments within the consolidated Group.

5.4 New Zealand International Financial Reporting Standards (NZ IFRS)

As the Committee is aware, the Council has decided to adopt NZ IFRS for external reporting purposes for the period commencing 1 July 2006, one year earlier than the required deadline. This means that the financial statements for the year ended 30 June 2006 will need to be converted to NZ IFRS as they will represent the comparative year in the first NZ IFRS financial statements for the year ended 30 June 2007.

The Council has included disclosure of the impact of adoption of NZ IFRS within Note 38 to the financial statements in accordance with Financial Reporting Standard 41: Disclosing the Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards (FRS 41). This note builds on prior year's disclosures in respect to our intention to adopt NZ IFRS, and quantifies the changes for both the Council and Group.

The note also includes a reconciliation of the surplus under NZ GAAP and NZ IFRS for the year ending 30 June 2006 as identified to date. The key changes arising as a result of the adoption of NZ IFRS are consistent with those identified during the preparation of the 2006/07 Long Term Council Community Plan.

5.5 Management Letter of Representation / Financial Statements Checklist

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 2005/06 financial year are fairly stated and provided the Subcommittee with comfort from which to recommend them to the Committee and the Council.

6. Conclusion

The Annual Report prepared for the Committee's review includes the financial statements which have been reviewed in detail by the Subcommittee. The overall result reflects a favourable surplus in comparison with the Annual Plan for the 2005/06 period. The favourable surplus position, compared to that budgeted, can be attributed to a number of significant one-off transactions recognised during the 2005/06 financial period that were not budgeted for in the Annual Plan.

The draft 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 2005/06 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

Helen Rogers
FINANCIAL CONTROLLER

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 2006. 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

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 2006

APPENDIX 2

AUDIT CLEARANCE