
REPORT 1
(1215/52/IM)

REPORT FROM AUDIT AND RISK MANAGEMENT SUBCOMMITTEE: 2008/2009 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 2009 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.*
3. *Note that Audit New Zealand have indicated their likely audit clearance by way of a letter of comfort dated 21 August 2009 (attached in Appendix 2).*
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 2009.*
5. *Recommend to Council the adoption of the annual report for Wellington City Council for the year ended 30 June 2009 (attached in Appendix 1).*

3. Consultation

The 2008/09 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 12 June 2009 and 19 August 2009, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2009. 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 have arisen subsequent to the Subcommittee's 19 August 2009 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 (the Act) 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 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 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 the Council's compliance with the requirements of Part 3 of Schedule 10 of the Act. All requirements of Schedule 10 have been incorporated within the audited sections of the Annual Report.

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

The adoption process agreed to by the Subcommittee at its meeting on 12 June 2009 is as follows:

Date:	Action:
12 June 2009	Subcommittee to review and conditionally approve draft format for the 2008/09 financial statements and the proposed sign-off process.
3 August 2009	Audit New Zealand commence final audit fieldwork
10 August 2009	Consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2009 and financial position as at 30 June 2009 available for final internal review.
19 August 2009 (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 2009 and financial position as at 30 June 2009, subject to 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 2008/09 financial statements to Strategy and Policy Committee.
21 August 2009	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.
26 August 2009 (scheduled)	Special Strategy and Policy Committee Meeting Committee to recommend adoption of 2008/09 financial statements to Council.
26 August 2009 (scheduled)	Council Meeting Council to adopt 2008/09 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 2009.

29 September 2009 Release of published Annual Report.

The Subcommittee also agreed to an additional interim briefing on matters related to the annual report to be scheduled for 10 August 2009.

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 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 and financial position; outline highlights for each and provide information on key facts about the city. This will be provided to every household in the city.

5. Discussion

The Annual Report for the year ended 30 June 2009 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2009, including:
 - financial performance for the year ending 30 June 2009
 - 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 2009

5.1.1 Comprehensive Financial Performance

The Statement of Comprehensive Financial Performance reports an overall surplus for the Council's activities of \$16.057 million compared with a budgeted surplus of \$19.919 million. This Council budgeted for the surplus of \$19.919 million in the 2008/09 Annual Plan. The majority of this surplus represents funding received from third parties for capital purposes (e.g. the Housing New Zealand grant for the upgrade project). As this income is received for specific capital purposes it cannot be used to offset rates. A full explanation of the

significant factors contributing to the variance is outlined on the next page. 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 operation of both the Wellington Waterfront Project (WWP) and the Joint Venture arrangements with Porirua City Council (PCC JVs). Both the WWP and PCCJV are consolidated on a line by line basis into the Council's financial statements. The Council also recognised Other Comprehensive Income totalling \$78.288 million. Total Comprehensive Income is made up of the following:

Net surplus for the year	\$16.057m
Revaluations of property plant and equipment	\$80.427m
Movement in cash flow hedge reserve	(\$2.196m)
Other Comprehensive Income	\$78.231m
Total Comprehensive Income	\$94.288m

The consolidated Group results reflect an overall net surplus of \$15.968 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 \$92.185 million. Total Comprehensive Income is made up of the following:

Net surplus for the year	\$15.968m
Revaluations of property plant and equipment	\$80.427m
Movement in cash flow hedge reserve	(\$2.196m)
Share of revaluations of associates	\$18.046m
Share of movement in associates cash flow hedge reserve	(\$4.092m)
Other Comprehensive Income	\$92.185m
Total Comprehensive Income	\$108.153m

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)	\$16,057
Less:	
Fair value movements:	
Investment property revaluation ¹	(2,775)
Cash flow hedge movements reclassified from hedging reserve ²	268
Fair value hedge movements ³	552
Fair value adjustment to borrowings ³	(552)

Derivatives at fair value through surplus or deficit ⁴	(2,082)
Related party loans ⁵	(3,445)
<i>Total fair value movements</i>	<u>(\$8,034)</u>
Additional net expenditure from Wellington Waterfront Project and Porirua Joint Ventures	(\$4,547)
External funding for capital expenditure:	
Housing NZ grant ⁶	(6,677)
Plimmer Trust capital funding requirement deferral	(470)
Increase in development contributions revenue	205
Increase in New Zealand Transport Agency subsidies - capex	1,035
Additional external funding towards capital projects ⁷	2,678
<i>Total changes to external funding for capital expenditure</i>	<u>(\$3,229)</u>
Vested Assets ⁸	\$10,851
Underlying Council Actual Net Surplus/(Deficit)	\$21,016
Council Budget Net Surplus/(Deficit)	<u>\$19,919</u>
Favourable Variance – Actual vs Budgeted Net Surplus/(Deficit)	<u>\$1,097</u>
EXPLANATION OF UNDERLYING VARIANCE:	
Unbudgeted revenue / expenditure:	
Restatement of provisions	(2,117)
Insurance costs (net of recoveries) funded through the self insurance reserve	(623)
Gain on disposal of property, plant and equipment	751
Loss on disposal of assets	(663)
<i>Total unbudgeted revenue / expenditure</i>	<u>(\$2,652)</u>
Significant variations from budget:	
Dividends in excess of budget (including WIAL)	2,820
Increase in rates revenue	2,075
Increase in New Zealand Transport Agency subsidies - opex	568
Increase in depreciation arising from revaluation of infrastructural assets	(2,125)
Other net variances ⁹	411
<i>Total significant variations from budget</i>	<u>\$3,749</u>
Total factors contributing to the underlying favourable variance	<u>\$1,097</u>

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 LTCCP/Annual Plans.
2. The Council is required to recognise derivative financial instruments (interest rate swaps) on the balance sheet and record any changes in fair value through the hedging reserve. In cases where derivatives do not meet the criteria for hedge accounting, where hedging relationships are ineffective, or where interest rate swaps terminate in advance of maturity, associated fair value movements are required to be released to the Statement of Comprehensive Financial Performance.

3. 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.
4. Represents the fair value movements on interest rate swaps that do not meet the criteria for hedge accounting. Movements in other interest rate swaps, that do meet the criteria for hedge accounting, are taken to the cash flow hedge reserve.
5. This fair value movement relates to the Karori Wildlife Sanctuary Trust (KWST) loan. The fair value of the KWST loan was written down to reflect the interest free nature of the loan. Both this loan and the loan to Wellington Regional Stadium Trust (written down to fair value in 2007/8) will be amortised back to nominal value by maturity
6. The grant received from Housing New Zealand Corporation (HNZC) for the upgrade of the Council's social housing stock was lower in year one than originally budgeted due to the timing of finalising the deed of grant. The revenue is recognised in proportion to the work completed. \$2.2m of deferred income relating to the Housing Upgrade represents income received in advance of the work being completed.
7. The Council has received additional unbudgeted external revenue for a number of projects including the upgrade to the Zoo hospital and amphitheatre and port and ferry access projects.
8. Vested assets are those assets transferred to the Council from a third party. The majority relate to infrastructural assets such as roading, drainage and waste and water assets that have been constructed by developers and transfer to Council on completion.
9. Other net variances comprise increased programmes, projects and organisational costs.

5.1.2 Financial Position

The Statement of Financial Position reflects an equity position of \$5,907.3 million for the Council entity as at 30 June 2009, an overall increase of \$94.3 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 2009	\$16.1m
Revaluation gains taken directly to Equity	\$80.4m
Movements in Cash Flow hedging reserve	<u>(\$2.2m)</u>
Total Net Movement in Equity	<u>\$94.3m</u>

In analysing the Council's overall financial position at 30 June 2009, 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 \$111.1 million to \$5,965.5 million as at 30 June 2009. This relates primarily to the results of the revaluation of the operational land and building assets as at 30 June 2009, which resulted in an increase of \$80.4m.

Investments

Investments comprise as follows:

- Investment properties
- Cash and cash equivalents
- Other financial assets (including loans to other entities)
- Investment in associates and subsidiaries

The Council's total investments have increased by \$15.9m to \$390.1m as at 30 June 2009.

The increase in total investments primarily relates to the Council recognising its share of the Comprehensive Income of its associates.

Note that the Council's investment in associates (including Wellington International Airport Limited) is reflected in these figures at the Council's share of the company's equity, not at the value recorded in the Council line within the financial statements where, in accordance with applicable financial reporting standards, this investment is reflected at original cost.

Borrowings

The Council's gross borrowings have increased by \$11.3 million to \$262.9 million as at 30 June 2009. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2008/09 capital expenditure programme. The Council borrows to fund the purchase or construction of new assets that Councillors have approved through the Annual Plan process.

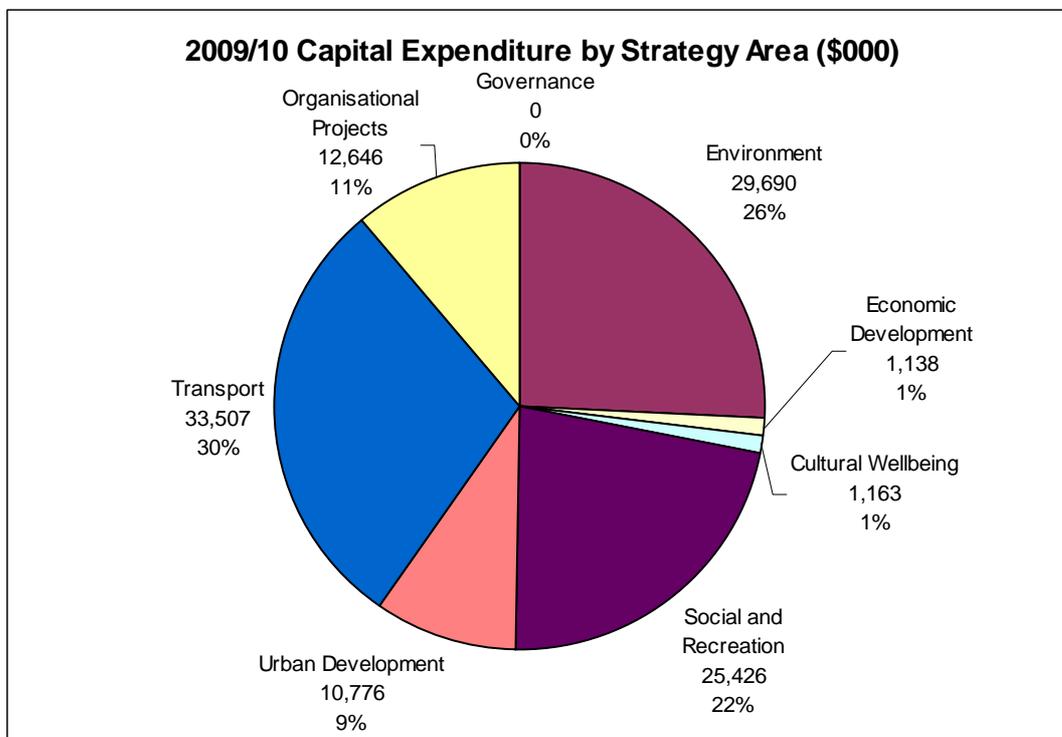
As at 30 June 2009, \$84.5 million of borrowings were short-term (2008: \$108.2 million) and \$178.4 million were long-term (2008:\$143.3m). This increase in long term borrowings is consistent with the Council's borrowing strategy to ensure the Council's long term liquidity and access to funds. The Council's 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) completed for the year ended 30 June 2009 was \$95.9 million, compared with the total budgeted capex programme of

\$138.2 million. Total capital expenditure budget that will be carried forward to future financial periods is \$40.1 million (2008: \$27.8 million).

The following pie chart shows total capital expenditure by strategy (excluding carry forwards):



Significant capex projects undertaken during the year, in addition to the Council's infrastructural capex programme, include the upgrade of the Events Centre, renovation of the Zoo hospital and amphitheatre, renovation of the Art Gallery, upgrade of Council's housing stock and the building of a new water reservoir in Granada.

5.2 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. These are covered under the heading '*progress towards our long-term goals*'.¹
- Activity performance measures which outline how we performed against the targets set for our activities in the 2008/09 Annual Plan.

The reporting is structured around Council's seven strategy areas. 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 section

¹ The data for these is contained in an appendix - *Monitoring Information* - to the annual report.

includes: commentary on Council's performance during the year against target and against budget. Significant variances in performance and budgets are commented on.

As this is the third and 'final' year of the 2006 long-term plan we have also included a brief summation of our progress towards the priorities contained in that plan. These are noted under the heading '*achievement of our strategic priorities*'.

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 indicators, comes from external agencies such as Statistics New Zealand. Audit New Zealand has reviewed the SSP results.

The Annual Report provides comprehensive information about Council's work and ensures that it is fully explained. We also provide a schedule outlining the performance of our Council Controlled Organisations.

A summary of the Annual Report will be produced following its adoption at Council on 26 August 2009. 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 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 35 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.

Audit clearance has been received for all entities within the Group. We do not anticipate any further adjustments within the consolidated Group which will require amendment to the Council's financial statements.

5.5 Clearance processes

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 2008/09 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 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 2008/09 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

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 2009. 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 2009

APPENDIX 2

AUDIT CLEARANCE