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**REPORT 1**  
*(1215/52/IM)*

**REPORT FROM AUDIT AND RISK MANAGEMENT  
SUBCOMMITTEE: 2006/2007 FINANCIAL STATEMENTS  
AND ANNUAL REPORT**

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**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 2007 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 24 August 2007 (attached in Appendix Two).*
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 2007.*
5. *Recommend to Council the adoption of the annual report for Wellington City Council for the year ended 30 June 2007 (attached in Appendix One).*

**3. Consultation**

The 2006/07 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 2 March 2007 and 17 August 2007, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2007. All substantive issues raised and discussed by the Subcommittee at those meetings have been satisfactorily resolved.

No significant issues impacting on the financial statements have arisen subsequent to the Subcommittee's 17 August 2007 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 Council has adopted NZ IFRS for the year ended 30 June 2007. Therefore 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 proposed adoption process agreed to by the Subcommittee at its meeting on 2 March 2007 is as follows:

<b>Date:</b>	<b>Action:</b>
<b>17 August 2007</b>	<b>Audit and Risk Management Subcommittee Meeting</b> Subcommittee reviewed final consolidated draft financial statements, including results of operations and cashflows for the year ended 30 June 2007 and the financial position as at 30 June 2007, subject to Audit New Zealand clearance. Subcommittee also reviewed Statements of Service Performance, report on CCOs and report on mana whenua partnership.  Subcommittee recommended adoption of 2006/07 financial statements to Strategy and Policy Committee.
<b>24 August 2007</b>	Audit New Zealand issued letter of comfort to Strategy and Policy Committee as to whether an unqualified, or qualified, audit opinion will be issued.
<b>29 August 2007</b>	<b>Strategy and Policy Committee Meeting</b> Committee to recommend adoption of 2006/07 financial statements to Council.
<b>29 August 2007</b>	<b>Council Meeting</b> Council to adopt 2006/07 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 2007.
<b>28 September 2007</b>	Release of published Annual Report.

In developing this year's timetable we have been mindful that local elections will occur in October. The Auditor-General has advised local authorities to be particularly careful about the content of annual reports and summaries in a local government election year, to ensure that these publications are politically impartial.

Over the past few years (including the 2004 local election year), the Council has consistently published its annual financial statements in the final week of September. We take particular care to ensure the content of the Annual Report is politically impartial, and that both the report and the summary are a fair representation of the Council's results for the financial period. We are therefore satisfied that the proposed publication timeframe remains appropriate.

### **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 strategy section includes: a state of the city section that is drawn from our outcome indicators; commentary on what the Council did during the year; how we performed against target;<sup>1</sup> and how we performed against budget. As with last year, significant variances in performance and against budgets are commented on.

The Statements of Service Performance section of our annual report will be a little shorter than in the past. That's because we've been able to integrate elements of work within our seven strategies. We've grouped some information together so the reader can more easily see our work in its proper context. For example, we describe all of our work relating to the transport network (footpaths, signage, roads etc) in one place rather than separating these out over several pages. Though this section of the report is shorter, it contains just as much detail about our work programme and our financial and service performance as previous reports. By contrast, our financial statements section is slightly longer than previously, due to the impact of the adoption of NZ IFRS (refer paragraph 5 below).

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.

## **5. Discussion**

The Annual Report for the year ended 30 June 2007 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2007, including:
  - financial performance for the year ending 30 June 2007
  - financial position
  - capital expenditure program
  - Statements of Service Performance
- Group Reporting
- Clearance processes

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<sup>1</sup> Note: to illustrate trends in information the activity performance measures will be presented in graphs in the final publication, rather than table form as stated within the report.

## **5.1 Results of Operations and Financial Position for the Year Ended 30 June 2007**

### **5.1.1 Financial Performance**

The Statement of Financial Performance reports an overall surplus for the Council's activities of \$35.7 million compared with a budgeted surplus of \$1.8 million. A full explanation of the significant factors contributing to the favourable variance is outlined in the table below. 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 surplus results primarily from changes in accounting as a result of the adoption of NZ IFRS. The most significant change is the requirement to account for fair value changes in investment properties within the Statement of Financial Performance. In the table below, we have separated these NZ IFRS related adjustments out to enable a more meaningful analysis of the underlying variance.

The remainder of the \$33.9 million variance 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 2007 the Council recognised vested assets of \$6.2 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.

The consolidated Group results reflect an overall net surplus of \$36.1 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.

	<b>\$000</b>
<b>Council Actual Net Surplus/(Deficit)</b>	<b>\$35,722</b>
<b>NZ IFRS related adjustments:</b>	
Fair value gain on revaluation of investment properties <sup>1</sup>	31,750
Amortisation of Wellington Regional Stadium Trust loan <sup>2</sup>	(349)
Cash Flow hedge gains transferred from equity <sup>3</sup>	234
Impairment of property, plant and equipment	(79)
Impairment of loan to subsidiary <sup>6</sup>	(211)
<b>Total NZ IFRS related adjustments</b>	<b>\$31,345</b>
<b>Underlying Council Actual Net Surplus/(Deficit)</b>	<b>\$4,377</b>
<b>Council Budget Net Surplus/(Deficit)</b>	<b>\$1,778</b>
<b>Favourable Variance – Actual vs Budgeted Net Surplus/(Deficit)</b>	<b>\$2,599</b>

#### **EXPLANATION OF UNDERLYING VARIANCE:**

##### **Revenues / Expenditure Not Budgeted for in 2006/07 Annual Plan:**

Vested Assets (non-cash in nature) <sup>4</sup>	6,169
Unbudgeted external funding towards capital projects <sup>7</sup>	885
Bequests, special and reserve funds revenue	404
Gain on disposal of assets	1,162
Insurance costs (net of recoveries) funded through the self insurance reserve	(451)
Restatement of provisions	(2,774)
<b>Total Revenue / (Expenditure) from Non-budgeted items</b>	<b>\$5,395</b>

##### **Significant changes in Revenue / Expenditure:**

Additional net expenditure from WWP and Porirua Joint Ventures	(2,948)
Additional dividend income (WIAL) <sup>5</sup>	1,643
Additional depreciation arising from revaluations and vested assets	(750)
Unfavourable interest income (early retirement of WIAL debt)	(487)

<i>Total Significant changes in Revenue / Expenditure</i>	(\$2,542)
<b>Other net variances<sup>8</sup></b>	<b>(\$254)</b>
<b>Total factors contributing to the underlying favourable variance</b>	<b><u>\$2,599</u></b>

**Notes:**

1. The fair value gain relates to the annual revaluation of Council and WWP investment properties. The result of this revaluation was previously accounted for within revaluation reserves. With the adoption of NZ IFRS, changes in fair value must be recognised in the Statement of Financial Performance. Due to the level of uncertainty in forecasting investment property revaluations, these movements are not budgeted within the LTCCP/Annual Plans.
2. The amortisation of the Wellington Regional Stadium Trust loan results in a gain in the Statement of Financial Performance. The loan was written down to fair value in the Council's NZ IFRS opening position to reflect its interest free nature. A gain is subsequently recognised each year for the increase in fair value as the loan approaches repayment date. The amount shown in the table above represents the difference between the budgeted and actual amounts.
3. In accordance with NZ IAS 39, the Council is required to recognise derivative financial instruments (interest rate swaps) within the Statement of Financial Position. Where these derivatives met hedge accounting criteria, any changes in fair value are accounted for within a hedging reserve in equity. Where hedging relationships are ineffective, or interest rate swaps terminate in advance of maturity, the associated amount in the hedging reserve is released to the Statement of Financial Performance.
4. Vested assets are those assets where ownership and control are transferred to the Council from a third party. For the 30 June 2007 financial year, this relates to infrastructural assets received from developers.
5. The Council budgeted to receive dividends of \$4.0 million from our shareholding in Wellington International Airport Limited (WIAL). We received a dividend of \$5.643 million in July 2006, in respect of the company's financial performance for the year ended 31 March 2006.
6. The impairment in the loan to subsidiary relates to Positively Wellington Business (PWB). When PWB was initially established, the Council provided assets to the Trust in exchange for a long term loan. As the Trust is to be disestablished, the Council has reassessed the likelihood of repayment of the loan and consequently established a provision for potential impairment for accounting purposes.
7. The Council has received unbudgeted external funding for the Johnsonville Community Centre and Zoo upgrades.
8. Other net variances comprises net increased 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 \$5,597.9 million for the Council entity as at 30 June 2007, an overall increase of \$39.163 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 2007	\$35.722 m
Movements in Cash Flow hedging reserve	\$3.441m
<b>Total Net Movement in Equity</b>	<b><u><u>\$39.163m</u></u></b>

In analysing the Council's overall financial position at 30 June 2007, compared to the position at the previous balance date, the most significant movements relate to investments, borrowings and property, plant and equipment.

#### *Investments*

Investments comprise as follows:

- Cash and cash equivalents
- Other financial assets (including loans to other entities, and shareholding in NZ Local Government Insurance Corporation Limited)
- Investment properties
- Investment in associates and subsidiaries

The Council's total investments have increased by \$27.3m to \$360m as at 30 June 2007. Note that the Council's investment in associates (including WIAL) 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.

The increase in investments primarily relates to the revaluation of the Council's investment property portfolio, offset by the early repayment of the Council's loan to WIAL.

#### *Borrowings*

The Council's gross borrowings have increased by \$19.1 million to \$229.4 million as at 30 June 2007. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2006/07 capital expenditure programme. The Council borrows to fund the purchase of new assets that Councillors have approved through the Annual Plan process.

The increase in borrowings is lower than that budgeted by \$29.8m as a result of:

- Rephasing of delivery of the capital expenditure programme to reflect changes in project timing
- Deferred drawdown of loans to external entities of \$2m; and

- Unbudgeted early repayment of WIAL loans of \$13.75m, applied to repayment of borrowings.

As at 30 June 2007, \$104.5 million of borrowings were short-term (2006: \$104.8 million). 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.

### ***Property, Plant and Equipment***

The third major category within the Statement of Financial Position is Property, plant and equipment. Property, plant and equipment assets have increased by \$37.1m to \$5,618.4m as at 30 June 2007. The increase relates to the completion and capitalisation of the capex program for 2006/07, as outlined in section 5.1.3. This has been offset by the annual depreciation expense of \$62.7m.

#### **5.1.3 Capital Expenditure Programme**

Total budgeted capital expenditure for the year ended 30 June 2007 comprised \$121.3 million. Total capital expenditure actually incurred for the year ended 30 June 2007 was \$95.4 million. In addition, capital expenditure project budgets of \$21.2 million will be carried forward to 2007/08.

Significant capex projects undertaken during the year, in addition to the Council's infrastructural capex programme include Greening the Quays, the upgrade of Karori Park, renovation of the Zoo chimp enclosure, renewal of library collections, refurbishment of housing stock, and the upgrade of Tawa Pool and extension of the Wellington Regional Aquatic Centre.

#### **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 outline **how we performed** against the targets set for our activities in the 2006-16 Long Term Council Community Plan (LTCCP).

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 includes: commentary on what the Council did during the year; how we performed against target;<sup>2</sup> and how we performed against budget. As with last year, significant variances in performance and budgets are commented on.

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<sup>2</sup> Note: to illustrate trends in information the activity performance measures will be presented in graphs in the final publication, rather than table form as stated within the report.

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 29 August 2007. The summary will provide an overview of Council's performance, detail key highlights for each strategy 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 detailed information contained in the report.

## **5.2 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 opinions have been issued for a number of entities within the Group, with the remaining audits in progress and expected to be completed by 30 August 2007. 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.

### **5.3 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 2006/07 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. Overall, the favourable surplus position, compared to that budgeted, can be primarily attributed to changes in accounting treatment as a result of the adoption of NZ IFRS and a number of significant one-off transactions recognised during the 2006/07 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 2006/07 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**

**APPENDIX 1**

**ANNUAL REPORT**

**FOR THE YEAR ENDED 30 JUNE 2007**

## **APPENDIX 2**

### **AUDIT CLEARANCE**

## 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 2007. 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.*