
REPORT 2
(1215/52/IM)

REPORT FROM AUDIT AND RISK MANAGEMENT SUBCOMMITTEE: 2007/2008 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 2008 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 2008 (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 2008.*
- 5. Recommend to Council the adoption of the annual report for Wellington City Council for the year ended 30 June 2008 (attached in Appendix One).*
- 6. Delegate to the Chief Executive Officer the authority to make minor editorial changes to the publication as required.*

3. Consultation

The 2007/08 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 3 March 2008 and 15 August 2008, the latter involving a comprehensive review of financial and service performance results for the year ending 30 June 2008. 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 15 August 2008 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 proposed adoption process agreed to by the Subcommittee at its meeting on 3 March 2008 is as follows:

Date:	Action:
15 August 2008	Audit and Risk Management Subcommittee Meeting Subcommittee reviewed final consolidated draft financial statements, including results of operations and cashflows for the year ended 30 June 2008 and the financial position as at 30 June 2008, 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 2007/08 financial statements to Strategy and Policy Committee.
25 August 2008	Audit New Zealand issue letter of comfort to Strategy and Policy Committee as to whether an unqualified, or qualified, audit opinion will be issued.
27 August 2008	Strategy and Policy Committee Meeting Committee to recommend adoption of 2007/08 financial statements to Council.
29 August 2008	Council Meeting Council to adopt 2007/08 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 2008.
29 September 2008	Release of published Annual Report.

4.3 The Annual Report Publication

The Annual Report is one of the Council's core publications. A clear, concise and readily accessible document is important in conveying the organisation's strengths and achievements over the last year.

The publication itself will be prepared following Council's approval of the 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 2008 is attached to this report. The following discussion analyses:

- The results of operations and financial position for the year ended 30 June 2008, including:
 - financial performance for the year ending 30 June 2008
 - financial position
 - capital expenditure program
 - Statements of Service Performance
- Group Reporting
- Clearance processes

5.1 Results of Operations and Financial Position for the Year Ended 30 June 2008

5.1.1 Financial Performance

The Statement of Financial Performance reports an overall surplus for the Council's activities of \$25.515 million compared with a budgeted surplus of \$3.960 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 operations 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 overall favourable variance (\$21.555 million) results primarily from fair value changes which are not budgeted as part of the annual planning process. The remainder of the 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. 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 \$34.9 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)	\$25,515
Fair value adjustments:	
Fair value gain on revaluation of investment properties ¹	22,620
Cash Flow hedge gains transferred from equity	309
Interest rate swap movements	(851)
Fair value adjustment on loans ²	<u>(7,356)</u>
Total fair value adjustments	\$14,722
Underlying Council Actual Net Surplus/(Deficit)	\$10,793
Council Budget Net Surplus/(Deficit)	\$3,960
Favourable Variance – Actual vs Budgeted Net Surplus/(Deficit)	\$6,833

EXPLANATION OF UNDERLYING VARIANCE:

Vested Assets ³	10,859
Gain on disposal of property, plant and equipment	846
Unbudgeted external funding towards capital projects ⁴	1,214
Bequests, special and reserve funds revenue received	190
Loss on disposal of assets	(267)
Insurance costs (net of recoveries) funded through self insurance reserve	(531)
Restatement of Provisions	(2,838)
Additional net expenditure from Wellington Waterfront Project and Porirua Joint Ventures	(2,204)
Additional dividend from Wellington International Airport Limited	964
Reduction in rates revenue	(636)
Reduction in Development Contributions revenue	(385)
Plimmer Trust capital funding requirement deferred	(450)
Other net variances ⁵	71
Total Factors Contributing to the Underlying Favourable Variance	\$6,833

Notes:

1. The fair value 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 fair value movements relate to the Wellington Regional Stadium Trust (WRST) and Karori Wildlife Sanctuary Trust (KWST) loans. The WRST loan was written down to fair value to reflect an extension in the anticipated repayment period. The fair value of the KWST loan was written down to reflect the interest free nature of the loan. Both loans will be amortised back to nominal value by maturity.
 3. Vested assets are those assets where ownership and control are transferred to the Council from a third party. For the 30 June 2008 financial year, the majority (\$10.5m) relates to infrastructural assets received from developers.
 4. The Council has received unbudgeted external revenue for a number of projects, including the Mt Victoria upgrade, bus lane improvements, Newlands Community Centre and Chews Lane Precinct.
 5. Other net variances comprise 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 \$5,813.1 million for the Council entity as at 30 June 2008, an overall increase of \$215.187 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 2008	\$25.515 m
Movements in Cash Flow hedging reserve	(\$2.411)m
Movement in revaluation reserve	\$192.083m
	<hr/>
Total Net Movement in Equity	<u><u>\$215.187m</u></u>

In analysing the Council's overall financial position at 30 June 2008, compared to the position at the previous balance date, the most significant movements relate to property, plant and equipment, investments and borrowings.

Property, Plant and Equipment

Property, plant and equipment assets have increased by \$236.1m to \$5,854.4m as at 30 June 2008. The majority of the increase (\$192.1m) relates to the revaluation of the Council's infrastructure and library assets as at 30 June 2008.

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 \$14.0m to \$374.2m as at 30 June 2008. 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.

Borrowings

The Council's gross borrowings have increased by \$22.2 million to \$251.6 million as at 30 June 2008. The increase in the Council's level of borrowings reflects the utilisation of funds to complete the 2007/08 capital expenditure programme. The Council borrows to fund the purchase of new assets that Councillors have approved through the Annual Plan process.

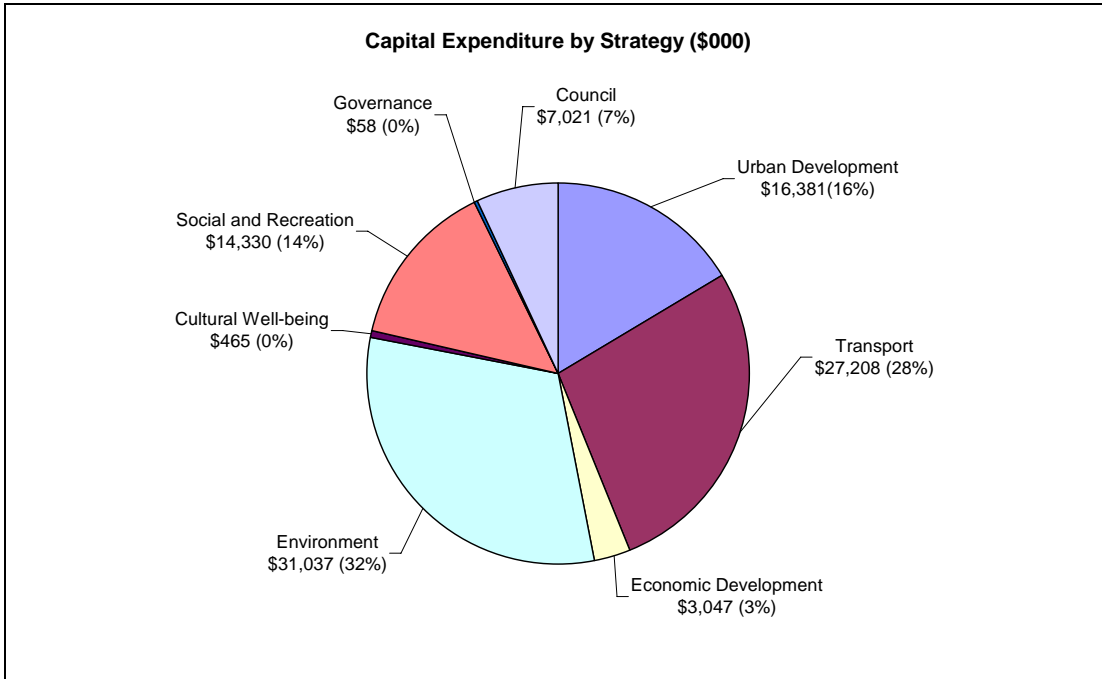
The increase in borrowings is lower than that budgeted by \$43.7m as a result of rephasing of delivery of the capital expenditure programme to reflect changes in project timing.

As at 30 June 2008, \$108.2 million of borrowings were short-term (2007: \$104.5 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.

5.1.3 Capital Expenditure Programme

Total capital expenditure (capex) completed for the year ended 30 June 2008 was \$99.547 million, compared with the total budgeted capex programme of \$128.592 million.

Total capital expenditure budget that will be carried forward to future financial periods is \$27.8 million (2007: \$28.3 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, renewal of library collections, and refurbishment of housing stock.

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.
- 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 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; and how we performed against budget. As with last year, significant variances in performance and against budgets are commented on.

We have continued the approach from last year that aims to integrate elements of work within our seven strategies. We group some information together so the reader can more easily see it 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.

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.

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 34 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 29 August 2008. 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 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 2007/08 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 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 2007/08 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 2008

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 2008. 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.