
REPORT 2
(1215/52/01/IM)

IMPLICATIONS FOR COUNCIL OF NEW AND PROPOSED FINANCIAL REPORTING STANDARDS

1. Purpose

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

2. Recommendations

It is recommended that the Subcommittee:

1. *Receive the information*
2. *Note the developments in New Zealand generally accepted accounting practice (GAAP) since the Subcommittee meeting in June 2005*
3. *Note the work programme for the New Zealand International Financial Reporting Standards (NZ IFRS) project for the quarter to 31 December 2005.*

3. Background

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

Council Officers have undertaken to report to the Subcommittee on a regular basis in relation to any new FRSs and any exposure drafts currently on issue by the New Zealand Institute of Chartered Accountants (the Institute). This report outlines new developments in GAAP and the implications for the Council since the last Subcommittee meeting on 17 June 2005.

4. Developments in Financial Reporting Standards

4.1 History

On 24 November 2004 the ASRB approved the suite of NZ IFRS. This means that there is now a reasonably stable platform of standards which reporting entities such as the

Council can use to assess the implications of implementation. However, the approved NZ IFRS are subject to change and we would expect further amendments to reflect international developments as well as the issuance of further guidance material for public benefit entities. We will maintain a watching brief over developments in this area and keep the Subcommittee informed of any exposure drafts which may impact the Council.

4.2 Submissions Made

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

Since the last Subcommittee meeting in June, one submission has been made on behalf of the Council. This related to ED-101: *New Zealand application guidance: When is an entity a public benefit entity?* ED-101 is of particular significance for the Council as it determines which entities can apply the public benefit entity (PBE) exemptions within the NZ IFRS.

We generally agreed with the guidance contained within ED-101 and expressed this within our submission. A copy of the submission is included in Appendix One.

4.3 Exposure Drafts on Issue

As the stable platform of NZ IFRS has now been approved, there are now less exposure drafts on issue. The following exposure drafts are currently open for comment:

- ED-105 *Proposed Amendments to New Zealand Equivalent to IAS 19 Employee Benefits: Actuarial Assumptions—Allowance for Taxes in Defined Benefit Plans*
- ED-104 *Proposed Differential Reporting Concessions for the forthcoming New Zealand Equivalent to IFRS 7 Financial Instruments: Disclosures and Amendments to New Zealand Equivalent to IAS 1 Presentation of Financial Statements—Capital Disclosures*
- IASB Invitation to Comment: *Policy for Technical Corrections*
- Exposure Draft *Proposed Amendments to New Zealand Equivalent to IAS 37 Non-Financial liabilities (formerly known as Provisions, Contingent Liabilities and Contingent Assets and New Zealand Equivalent to IAS 19 Employee Benefits*
- Exposure Draft *Proposed Replacement of the New Zealand Equivalent to IFRS 3 Business Combinations*
- Discussion Paper: *Control and Public Benefit Entities that have Autonomy and Independence*

Council Officers expect to submit on the final exposure draft listed as this is particularly relevant for our consolidated group financial statements. We will provide copies of any submissions made at the next Subcommittee meeting.

5. NZ IFRS Project

5.1 Update

As the Subcommittee is aware, the Council has established an NZ IFRS working group within the Financial Accounting Team to prepare the Council for the transition towards the implementation of NZ IFRS.

Since the last Subcommittee meeting in June, the production of the Council's Annual Report has been the primary focus of the Financial Accounting Team. As a result there has been less progress on the NZ IFRS project during this period. Nevertheless, the following has been achieved since the last Subcommittee meeting:

- Completion of final component evaluations, signalling the end of phase two of the project
- Establishment of systems to comply with the requirements of hedge accounting for derivative financial instruments
- Preparation of NZ IFRS Statement of Intent for inclusion in the Council's Annual Report for the year ended 30 June 2005 (refer Appendix Two).

5.2 Work Programme

With the completion of the Annual Report, the focus is now on taking the NZ IFRS project into phase three. The tangible outputs from phase three will include:

- Development of the NZ IFRS Statement of Accounting Policies;
- Completion of a trial run of NZ IFRS financial statements for the Subcommittee's review; and
- Preparation of an opening balance sheet reconciliation between existing NZ GAAP and NZ IFRS as at 1 July 2005.
- Preparation of the 2006/07 – 2015/16 Long Term Council Community Plan in full compliance with NZIFRS (during the period December 2005 – February 2006)

The NZ IFRS Statement of Accounting Policies will apply to the financial statements within the Council's Annual Plan/LTCCP for the year ending 30 June 2007. This is planned to be published in draft form in April 2005. We will present the NZ IFRS Statement of Accounting Policies to the Subcommittee in December for approval.

We will continue to report the progress of the project to the Subcommittee on a quarterly basis. We anticipate the achievement of all phase three deliverables by 31 December 2005.

6. Council Representation on NZICA Committees

The Council's Manager of Financial Accounting, Helen Rogers has recently been invited on to the Institute's Public Benefit Entity Working Group. This Group reports to the Financial Reporting Standards Board (FRSB) and has been established to ensure that financial reporting pronouncements address issues faced by public benefit entities.

Council representation provides increased opportunity for input into future accounting pronouncements, with particular emphasis on ensuring that implications for public sector entities (including local authorities) are represented.

7. Conclusion

Since the last Subcommittee meeting, the Council's NZ IFRS working group has achieved several milestones.

A significant number of achievements are planned for the final quarter of 2005. This will enable us to report model NZ IFRS financial statements (incorporating NZ IFRS Statement of Accounting Policies and opening balance sheet reconciliation) to the December Subcommittee meeting.

We will continue to report developments to the Subcommittee on a quarterly basis.

Report prepared by:

Helen Rogers
MANAGER-FINANCIAL ACCOUNTING

Supporting Information

1) Strategic Fit / Strategic Outcome

The implementation of NZIFRS forms part of the overall financial accountability framework and effectively discharges the Council's financial management obligations under the Local Government Act 2002. Specifically, the Council is required to prepare its financial statements in accordance with GAAP. This report provides an update on Council's project to implement NZIFRS.

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

There is no Annual Plan impact. The long term financial impact of NZIFRS is yet to be determined, although will not impact the Council until the 2006/07 financial year.

3) Treaty of Waitangi considerations

There are no Treaty of Waitangi considerations.

4) Decision-Making

The Audit and Risk Management Sub-Committee will monitor progress in implementing Audit New Zealand's recommendations. There are no decisions required by the Sub-Committee.

5) Consultation

a) General Consultation

There is no requirement for general consultation.

b) Consultation with Maori

There is no requirement for consultation with Maori.

6) Legal Implications

There are no legal implications arising from the report.

7) Consistency with existing policy

There are no existing policy implications. The recommendations in the report are consistent with the financial management obligations under the Local Government Act 2002.

APPENDIX ONE

14 June 2005

File ref: NZ IFRS

Simon Lee
The Director – Accounting Standards
Institute of Chartered Accountants of New Zealand
PO Box 11342
WELLINGTON

Dear Simon

SUBMISSION ON ED-101: NEW ZEALAND APPLICATION GUIDANCE

Wellington City Council welcomes the development of ED-101: *New Zealand application guidance: when is an entity a public benefit entity* and is pleased to provide comments on the ED. In one of our earlier submissions, dated 30 October 2003, we noted that the definition of a Public Benefit Entity (PBE) required further clarification and recommended that additional guidance be developed. We therefore support the development of the ED and note that it addresses our earlier concerns.

Our specific comments on the ED are outlined in Appendix 1. In forming our views we have focused on the application of the Guideline by the local government sector. If you would like further clarification on the issues raised in our submission please don't hesitate to contact me.

Yours sincerely

Neil Cherry
FINANCIAL CONTROLLER
Wellington City Council

APPENDIX 1:

1) Do you agree that the proposed guidance on determining whether an entity is a PBE is useful? If not, why not?

Yes, we consider the guidance is useful. However, we consider that an issue which requires further clarification in the Guideline is whether a PBE can elect to asset compliance with IFRS and elect to fall under the profit-orientated entity designation. It is our understanding that once an entity falls within the definition of a PBE it must designate itself as a PBE and must apply the mandatory NZ IFRS PBE requirements. Assuming the impact of adopting the mandatory NZ IFRS PBE requirements is materially different to the impact of applying IFRS, a PBE will not be able to assert compliance with IFRS. We note that ED-100: *Proposed amendments to the NZ equivalent to IAS 1: Presentation of financial statements* provides further guidance on this issue and we consider that it should be reiterated or summarised in the final pronouncement based on ED-101.

2(a) Do you agree that the key indicators listed are appropriate for determining whether an entity is a public benefit entity? If not, why not?

Yes, we consider the key indicators are appropriate although refer to our response to question 2(b).

2(b) Can you think of any situations where applying these criteria would result in inappropriate classification of an entity?

No, we are not aware of any situations in the local government sector. Although we note that the key indicators could conflict in some situations and therefore significant judgement will be required in applying the criteria.

For example, a situation could arise whereby an entity is set up with the primary purpose to provide goods and services and is not set up to make a commercial return (as stated in its founding documents). However, in future years the entity could start generating a significant financial surplus which would equate to a good commercial return. In those future years the entity's annual budget may be set at a level whereby the entity is expected to continue to make a good commercial return. The return is then passed back to the owners in the form of a distribution. The question then arises as to whether the entity should in those future years be classified as a PBE or at what point the entity should be classified as a profit-orientated entity. This situation has arisen in relation to the Council's joint venture landfill arrangement with Porirua City Council. When the arrangement was first established the primary rationale for establishing the operation was to provide landfill services to residents and to recover the associated costs. However, the joint operation is now making significant returns

and the joint venturers are expecting and budgeting for significant surpluses and commercial returns in future years. These returns are being distributed back to the venturers.

We consider further guidance should be included in the Guideline which considers the circumstances when an entity's designation may change from a PBE to a profit-orientated entity and vice-versa and that the designation should be reassessed on an annual basis.

- 3) Do you agree that if, after consideration of the key indicators, an entity's primary objective remains unclear, consideration should be given to the other indicators outlined in the proposed New Zealand Application Guidance? If not, why not?**

Yes, we agree.

- 4) Are there any other indicators (whether key indicators or other indicators) that should be included in the proposed New Zealand Application Guidance? If so, please specify.**

No we are not aware of any other indicators.

- 5(a) Do you agree with the assessments included in the examples in Table 1? If not, why not?**
5(b) Did you find the examples helpful? If not, why not?
5(c) Should these examples be retained as part of the New Zealand Application Guidance?
5(d) Are there any other examples that should be included? If so, please specify.

Yes, we agree with the examples, and consider that they are a useful part of the Guideline and should be retained.

- 6) Are you aware of any entities where application of this guidance would not resolve the classification issue? If so, please provide details.**

No, we are not aware any other situations in the local government sector where the Guideline would not resolve a classification issue.

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

c) **the Privacy Act 1993.**

No, we are not aware of any regulatory or other issues.

8) Is the proposed New Zealand Application Guidance in the best interests of users of general-purpose financial reports in New Zealand?

Yes, we agree that the Guideline is in the best interest of users of general-purpose financial reports in NZ.

APPENDIX TWO

WELLINGTON CITY COUNCIL STATEMENT OF INTENT – ADOPTION OF NEW ZEALAND EQUIVALENTS TO INTERNATIONAL FINANCIAL REPORTING STANDARDS (NZ IFRS)

Background

In December 2002 New Zealand's accounting standard-setting bodies announced a significant change to financial reporting standards. For periods commencing on or after 1 January 2007, New Zealand reporting entities will be required to apply New Zealand equivalents to International Financial Reporting Standards (NZ IFRS). NZ IFRS must be applied by every local authority in New Zealand for accounting periods beginning on or after 1 January 2007. However, entities have the option to adopt the standards early, after periods beginning 1 January 2005 as appropriate. The Council intends to adopt NZ IFRS for external reporting purposes (Annual Report and Long Term Council Community Plan (LTCCP)) for the accounting period commencing 1 July 2006.

This purpose of this Statement of Intent is to identify the Council's planning for the transition to NZ IFRS, the likely changes to the Council's accounting policies and the financial impact of the transition (to the extent that the financial impact is known at the date these financial statements have been adopted).

Although the Council is not an Issuer for the purposes of the Financial Reporting Act 1993, this Statement of Intent is prepared in accordance with the requirements of FRS-41: *Disclosing the Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards*.

Planning for the transition to NZ IFRS

To achieve the above timeframe and in order to publish its first NZ IFRS compliant financial statements for the year ended 30 June 2007, the Council and Group will be required to:

- restate all of the 30 June 2005 closing balances in the Statement of Financial Position, prepared under NZ GAAP, to new opening balances in the Balance Sheet as at 1 July 2005 under NZ IAS 1; and
- prepare NZ IFRS compliant financial information for the financial period commencing 1 July 2005 (to be used as comparative figures in the financial statements for the period commencing 1 July 2006).

To manage the transition, the Council has established a project team to:

- identify and understand the impact of adopting NZ IFRS

- review and update, where necessary, the Council's accounting policies to ensure that they are fully compliant with NZ IFRS
- prepare the restated opening Balance Sheet as at 1 July 2005
- raise awareness and foster understanding among Council staff and Councillors of the implications of NZ IFRS
- ensure that the Council and Group have systems and processes in place to produce the information required by NZ IFRS
- liaise with other entities in the local government sector and to provide a leadership role in the development and application of NZ IFRS in the sector
- influence the requirements for Public Benefit Entity (PBE) application of NZ IFRS within the New Zealand environment.

The project team reports to the Council's Audit and Risk Management Subcommittee on a quarterly basis.

The Audit and Risk Management Subcommittee has the overall governance responsibility for the oversight and review of the Council's financial statements and the transition of these financial statements to NZ IFRS.

Key differences in accounting policies

During the 2004/05 financial year, the project team has reviewed the NZ IFRS to identify and understand the potential impact on the Council's financial statements and accounting policies of adopting NZ IFRS.

The Council is a PBE for the purposes of NZ IFRS and is entitled to take advantage of the PBE exemptions within the individual NZ IFRS. In principle, the Council intends to comply with the requirements applicable to all reporting entities in New Zealand and will take advantage of the PBE exemptions only where it is practicable and necessary to do so. In adopting specific PBE exemptions the Council will efficiently and cost-effectively manage the effect of the transition upon the Council and for the benefit of Wellington ratepayers.

As at the date of this statement of intent, the project team has identified the following key differences in the Council's accounting policies that will arise on the transition to NZ IFRS using the new terminology in NZ IAS 1: *Presentation of Financial Statements*:

1. Financial instruments – recognition of interest rate swaps

The Council will recognise and account for its interest rate swaps using the hedge accounting rules prescribed by NZ IAS 39: *Financial Instruments: Recognition and Measurement* (NZ IAS 39).

Under current NZ GAAP, the Council's interest rate swaps are not recognised in the Statement of Financial Position, but separately disclosed in the notes to the financial statements (see Note 29: *Financial Instruments*).

Under NZ IFRS, these interest rate swaps will be treated as effective cash flow hedges under NZ IAS 39 and will be recognised at their fair value in the Balance Sheet. Changes in the fair value of the interest rate swaps will be recognised through a separate reserve in Capital, to the extent that the interest rate swaps remain “effective”. In the event that the interest rate swaps are deemed “ineffective” then any change in the fair value of these interest rate swaps will be recognised in the Income Statement from the last date that the interest rate swaps were deemed to have been “effective”.

Impact on the Financial Statements of this accounting standard change

Under NZ IFRS, an estimated (i.e. unaudited) fair value of the interest rate swaps as at 1 July 2005 (\$1.0 million) would be recorded as an asset in the opening Balance Sheet with a corresponding credit to a cash flow hedge reserve in Capital. To the extent that they met the requirements of an effective hedge, subsequent movements in fair value would also be recognised within the reserve.

2. Financial instruments – measurement of financial assets

The Council will recognise and account for its loans and advances to other organisations (including interest free loans) as “available for sale financial assets” as prescribed by NZ IAS 39.

The Council’s current accounting policy is that where there is both the positive intent and ability to hold to maturity, investments are recorded at cost or at cost adjusted for the amortisation of premiums or discounts. Loans, or advances, to other organisations are stated at the lower of cost and expected realisable value after providing for doubtful loans.

Under NZ IFRS these loans, or advances, will be recognised at their fair value with any changes in fair value recognised in Capital until such time as the asset is derecognised.

Impact on the Financial Statements of this accounting standard change

The impact of this change on the Council’s financial statements is not yet known.

3. Investment properties

The Council will measure its investment properties at fair value with annual changes in fair value recognised in the Income Statement as income or expenditure.

Under current NZ GAAP (SSAP 17), the Council measures its investment properties at fair value less disposal costs. Any change in the fair value of investment properties is recognised in Equity (through a separate revaluation reserve) to the extent that the fair value is greater than the original cost. Where the fair value is less than the original cost then any change in the fair value of the investment property is expensed in the Statement of Financial Performance.

Impact on the Financial Statements of this accounting standard change

Under NZ IFRS, the revaluation reserve for investment properties would have been adjusted against opening Capital as at 1 July 2005. Any subsequent revaluation movements (for the year ending 30 June 2005 this was a \$20.4 million credit) will be recognised directly in the Income Statement.

4. Deferred Taxation

In accordance with current NZ GAAP, deferred taxation is calculated on an income statement approach. Under NZ IFRS, deferred taxation will be calculated based on the balance sheet approach. This method recognises deferred tax balances when there is a difference between the carrying value of an asset or liability, and its tax base.

Impact on the Financial Statements of this accounting standard change

The impact of this change on the Council's financial statements is not yet known.

5. Other accounting policies

As at the date of this Statement of Intent, the Council does not anticipate that the transition to NZ IFRS will result in any other material changes to its current accounting policies.

Future focus

The Council's NZ IFRS project team will continue to work towards implementation of NZ IFRS during the 2005/06 financial period. Specifically, the project team will:

- finalise the Council's NZ IFRS Statement of Accounting Policies,
- prepare an opening balance sheet reconciliation between current NZ GAAP and NZ IFRS as at 1 July 2005,
- prepare a draft set of NZ IFRS financial statements, incorporating all required disclosures,
- include progress results of this work in any Interim financial statements published during the 2005/06 period,
- manage the preparation of the Council's 2006/07 LTCCP in accordance with NZ IFRS as the budget information for this financial period will need to be prepared on a basis equivalent to the NZ IFRS reporting for that period

As a result of this work, the Council will be in a position to provide substantive disclosure of the impact of the transition from current NZ GAAP to NZ IFRS within the financial statements for the financial period ending 30 June 2006.

CAUTIONARY NOTE

This information provided in this Statement of Intent is for indicative purposes only and is unaudited. The information is consistent with the disclosure requirements of FRS-41: *Disclosing the Impact of Adopting New Zealand Equivalents to International Financial Reporting Standards*.

The actual impact of the transition to NZ IFRS on the Council's financial statements may vary from the information presented above. Accordingly, the impact of any variation from the information presented above may be material.

Neil Cherry
Acting Chief Financial Officer
31 August 2005