
**DRAFT 2006/2007 FINANCIAL STATEMENTS AND
PROPOSED SIGN-OFF PROCESS**

1. Purpose

The purpose of this report is to obtain the agreement of the Subcommittee as to the proposed format and disclosures for the Council's 2006/07 financial statements and the associated sign-off process for those financial statements.

2. Recommendation

It is recommended that the Subcommittee:

1. *Receive the information*
2. *Note that this is the first financial year for which the financial statements template has been prepared in accordance with New Zealand International Financial Reporting Standards (NZ IFRS)*
3. *Note that the draft 2006/07 financial statements reporting template is being reviewed by Audit New Zealand and that their comments/recommendations will be adopted as appropriate.*
3. *Approve the proposed format and disclosures for the 2006/07 financial statements subject to:*
 - (a) *consideration of the implications of any changes in NZ GAAP arising up to 30 June 2007 which may be required to be applied retrospectively*
 - (b) *the determination and disclosure of the final results of operations, cashflows and financial position for the year ending 30 June 2007 (and any subsequent impact on the Notes to the financial statements); and*
 - (c) *receiving final clearance from Audit New Zealand.*
4. *Approve the sign-off process for the 2006/07 financial statements (refer Appendix 1).*

3. Background

Section 98 of the LGA 2002 requires the Council to prepare and adopt an Annual Report containing specified disclosures within four months after the end of the financial year. Section 111 of the LGA 2002 requires the Council to comply with generally accepted accounting practice (GAAP) in preparing the Annual Report.

GAAP is defined by the Accounting Standards Review Subcommittee to encompass all Financial Reporting Standards (FRSs) and other sources of appropriate authoritative support (for example; exposure drafts of financial reporting standards, international accounting standards etc). Non-compliance with GAAP and FRSs would therefore represent a breach of the LGA 2002.

Council Officers will prepare the 2006/07 Annual Report for adoption on 29 August 2007. In order to achieve this timeframe, a draft reporting template has been prepared for the Subcommittee's review. The reporting template identifies the proposed Financial Statement format and disclosures. This report also outlines the appropriate sign-off process for the adoption of the 2006/07 Annual Report.

The draft 2006/07 financial statements reporting template (as attached to this report) is the first the Council has prepared in accordance with NZ IFRS. The template is currently being reviewed by Audit New Zealand as part of their financial statements audit for the year ending 30 June 2007.

4. Significant Changes in the Content and Format of the Council's Financial Statements

4.1 Process

The template has been drafted by the Council's NZ IFRS working group. The process to date has involved extensive research of available (non PBE) NZ IFRS models, recently published annual reports prepared in accordance with NZ IFRS and other relevant material (NZ IFRS checklists, training materials etc).

The first draft of the template was made available to Subcommittee members at the 1 December 2006 meeting. We then presented a workshop in mid February to work through the information in detail. The workshop focused on those areas of the financial statements which have changed significantly as a result of NZ IFRS (such as taxation; financial instruments; etc.) The template has been updated to reflect comments made by the Subcommittee at the February workshop.

It is important to note that the template reflects applicable NZ IFRS as at the date of preparation. As it will need to be updated to reflect ongoing amendments to New Zealand IFRS, the Subcommittee will not be able to finally

approve the template until the time of finalisation of the 30 June 2007 financial statements. However, we have prepared an early draft to provide sufficient time for the Subcommittee time to work through the practical changes that have arisen from NZ IFRS. Preparing the template early also ensures sufficient time for audit, and for Officers to collate the information required as a result of the new disclosures.

4.2 Changes as a result of NZ IFRS

The most obvious change in the financial statements is the size of the template. As the Subcommittee is aware, the extent of disclosure required under NZ IFRS is greater than previous NZ GAAP. Therefore, the template is larger than prior years.

Key changes to the financial statements include:

□ General – Main Statements

- Private sector entities now revert back to use of Income Statement and Balance sheet for the main statements. Public sector entities however are given the option of alternative terminology, which effectively means retaining the slightly more cumbersome but arguably more descriptive headings. These being the now familiar Statement of Financial Performance and Statement of Financial Position respectively.
- The same alternative terminology option also means that Council can still report a surplus or deficit rather than a profit or loss, and the net worth of ratepayers funds in the Council can remain as equity instead of capital.
- The order in which the financial statements appear is unchanged although some models have chosen to reflect the greater emphasis NZ IFRS places on the Statement of Financial Position (Balance sheet) by including this as the first of the statements.

□ Statement of Financial Performance

- NZ IFRS has a revenue standard, something we didn't have under the old standards. This introduces some new terminology – so we now have income consisting of revenue and gains. Gains include the movements in investment property revaluations – these gains could be significant and the Subcommittee may therefore determine that separate disclosure is preferred.
- Interestingly, our share of our associates' surpluses (Wellington International Airport and Capacity) is back on the face of the financials. This disclosure was previously required on the face of the financial statements, then moved to the notes a few years ago, and has now reverted to the face again.

□ Statement of Financial Position

- The greater emphasis on the balance sheet means that new assets and liabilities are now recognised. These include Deferred Tax assets or liabilities, any derivative financial assets or liabilities and explicit disclosure of any intangible assets.

- ***Statement of Cashflows***
 - The Statement of Cashflows now allows more choice in how some items of income or expense are categorised. We have elected to take advantage of these options in the draft template by moving interest and dividend income from operating to investing activities to align the disclosure of these revenues with the underlying assets. Similarly interest expense has been shown as part of cashflows from financing activities for the same reason.
 - To better identify both sources and recipients of Council cashflows we have chosen to expand the breakdown of cashflows. In particular separate line disclosure is made for receipts from Government grants and subsidies and grant payments made by Council.

- ***Statement of Changes in Equity (formerly Statement of Movements in Equity)***
 - The Statement of Changes in Equity changes little in title but greater emphasis is now placed on explaining the movements within each reserve that equity is comprised of.
 - A new reserve has been established in equity for the fair value adjustment for cash flow hedges held by council as part of its financial risk management policy.

- ***Statement of Accounting Policies***
 - The Council's first NZ IFRS Statement of Accounting Policies was reviewed by the Subcommittee for inclusion in the Council's 2006/07 Long Term Council Community Plan (LTCCP). The Statement of Accounting Policies was reviewed by Audit New Zealand during the LTCCP audit.
 - The Statement has been updated to reflect its position in the annual financial statements (rather than forecast financial statements for the LTCCP), for emerging best practice and for subsequent changes in applicable NZ IFRS.

- ***Notes to the Financial Statements***
 - *Note 3* - Unrealised fair value gains or losses on the revaluation of investment property are now recognised directly in the surplus or deficit, whereas previously they went directly to equity (revaluation reserves). This is an important change, which may result in significant volatility in the Statement of Financial Performance.

 - *Note 3* - Royalties are now required to be shown separately

 - *Note 4* – The amortisation of the amortised interest on the Wellington Regional Stadium Trust loan is required to be recognised as financial income. This is due to the initial write-down of the loan to fair value in the opening NZ IFRS balance sheet and now subsequent increase back up towards the original nominal value over the remaining life of loan.

- *Note 4* – Finance income and expense is brought together into one note, with greater analysis of the source financial instruments (e.g. Dividends from available-for-sale financial assets, dividends from investments in associates)
- *Note 4* – A net finance cost is now required to be disclosed
- *Note 6* - The amortisation of intangible assets (eg software) is now recognised separately from depreciation.
- *Note 7 & 8* – Disclosures around income tax are significantly greater under NZ IFRS. The Council is required to disclose the individual components of current tax expense, the individual components of deferred tax, and an explanation of the relationship between tax expense and accounting profit showing the effective tax rate of each component. In addition, a separate deferred tax note is required. The date tax losses and deductible temporary differences expire must be stated and if no deferred tax assets are recognised, then a statement outlining the reason for non recognition must be included.
- *Note 9* – This note includes “cash and cash equivalents”. Previously the definition of cash equivalents did not specify a particular time period. Under NZ IFRS, cash equivalents include short-term deposits up to three months
- *Note 11* - Trade and other receivables has been expanded to include loans to other organisations and related parties, including bank deposits over three months.
- *Note 11* - The provision for doubtful debts is now called a provision for impairment of receivables and has a separate movement analysis disclosed.
- *Note 13* – Inventories is a new note.
- *Note 15* – Intangibles is the separation of non-physical assets such as computer software from property, plant and equipment.
- *Note 16* – Investment properties – a fuller analysis is now required, such as any subsequent expenditure and disclosure of direct operating expenses.
- *Note 17* – Property, plant and equipment requires even fuller disclosure than previously, with all movements such as additions and disposals required to be clearly shown.
- *Note 21* – This note shows greater disclosure around the ACC Partnership programme

- *Note 29* – This note includes a significant increase in disclosure requirements such as collectability of trade and other receivables and equity management.
- *Note 36* – Any commitments and contingencies arising from the joint ventures with Porirua City Council must now be disclosed separately.
- *Note 38* - Investments in Associates requires additional disclosure of a summary of the financial position and performance of each entity.
- *Note 39* – In the Related Parties note the main change is more emphasis on the key management personnel remuneration and related party transactions.
- *Note 42* – First time adoption of IFRS. The reconciliation of opening equity and reconciliation of the surplus for the comparative year 2006 is required to be shown so readers can understand the financial impact of IFRS adoption. This is not new as it was also in the 2005/06 Annual Report, although it will have to be updated as any changes to NZ IFRS are retrospective.

5. Significant Issues affecting the Financial Statements for the year ending 30 June 2007

The following significant issues have been identified as part of the preparation of the financial statements for the year ended 30 June 2007:

5.1 NZ IFRS Implications

As the Subcommittee is aware there are a number of key financial implications arising as a result of the transition to NZ IFRS. Issues we anticipate reporting back to the Subcommittee on include:

- The impact of investment property revaluations
- The process by which the Council has determined potentially impaired assets, and any impairments which result
- The impact of fair value changes associated with interest rate swap recognition; and
- Any other new assets or liabilities arising from the implementation of NZ IFRS.

We recognise that NZ IFRS introduces a number of changes which may require additional explanation for readers. We therefore intend to revamp the Financial Overview section of the Annual Report to provide further guidance and analysis. As this section is not subject to specific NZ GAAP or audit requirements, there is greater freedom to provide plain English explanation of the implications of NZ IFRS on the year end results. We will also explore the potential usage of a multi

columnar financial statement approach (clearly highlighting NZ IFRS adjustments) within this section.

5.2 Implementation of NZ IFRS in WCC Group

Throughout the Council's NZ IFRS implementation project, we have recognised the importance of ensuring that our Group entities were equally well prepared for the change. We have worked closely with these entities to provide advice and guidance, and to ensure that NZ IFRS implementation issues are addressed as early as possible.

Once the Council's NZ IFRS financial statements template is finalised, we have made a commitment to provide Group entities with a short form version for their use. We are also assisting these entities with their opening balance sheet preparation and audit thereof.

5.3 Asset Revaluations

The Council revalues certain classes of property, plant and equipment on a rolling three year cycle. Revaluations are staggered over the three year period to spread the cost and workload involved. There are no classes of property, plant and equipment due to be revalued as at 30 June 2007. Of the classes subject to the revaluation model, Infrastructure (drainage, waste and water, and roading), infrastructural land and library collections were last revalued as at 30 June 2005 and operational land and buildings at 30 June 2006. At this point, these classes will be two years and one year into the three yearly revaluation cycle respectively.

Audit New Zealand have advised that an area of focus is to review the off-cycle classes to ensure their fair values do not vary significantly from carrying values. We will review these classes, applying indices to determine whether there is any indication that fair values have shifted materially. We intend to complete this work early, and to accordingly seek early advice from Audit New Zealand that the current revaluation cycle remains appropriate.

6. Year-end Financial Results

This report has focused on the template for the year-end financial statements and the disclosures contained therein. Any significant movements or issues arising from the year-end results will be reported to the Subcommittee during the scheduled year end meeting on 17 August 2007.

7. Proposed Sign-off Process for the 2006/07 Financial Statements

On the basis that the Subcommittee has been delegated the primary responsibility for the audit of the Council's Financial Statements, a proposed sign-off process and timetable has been developed in order to adopt the 2006/07 Annual Report. This is outlined in Appendix 1 to this report.

8. Conclusion

Section 98 of the Local Government Act 2002 requires the Council to prepare and adopt an Annual Report that includes audited financial statements. The Act requires that the financial statements be prepared in accordance with GAAP.

The attached financial statements reporting template has been prepared for the Subcommittee's review and approval, as part of the overall sign-off process for the 2006/07 Annual Report.

Accordingly, it is recommended that the Subcommittee approve the reporting template for use in preparing the final consolidated financial statements subject to:

- consideration of the implications of any changes in NZ GAAP arising up to 30 June 2007 which may be required to be applied retrospectively
- the final determination and disclosure of the results of operations, cashflows and financial position for the year ending 30 June 2007 (and any subsequent impact on the Notes to the financial statements);
- reviewing the Statement of Service Performance, report on council-controlled organisations and report on mana whenua partnership; and
- receiving final audit clearance from Audit New Zealand.

In addition, it is recommended that the Subcommittee approves the proposed sign-off process as detailed in Appendix 1.

Contact officer: *Helen Rogers*
Financial Controller

APPENDIX ONE

PROPOSED SIGN-OFF PROCESS AND TIMETABLE FOR THE 2006/07 ANNUAL REPORT

Date:	Action:
2 March 2007	Subcommittee to review and conditionally approve draft format for the 2006/07 financial statements and the proposed sign-off process.
16 April 2007	Audit New Zealand commence interim audit visit 1 (2 weeks)
5 June 2007	Audit New Zealand commence interim audit visit 2 (1 week)
6 August 2007	Audit New Zealand commence final audit fieldwork (4 weeks)
10 August 2007	Final consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2007 and the financial position as at 30 June 2007 available for final internal review.
17 August 2007 (scheduled)	<i>Audit and Risk Management Subcommittee Meeting</i> Subcommittee to review final consolidated draft financial statements, including results of operations and cashflows for the year ending 30 June 2007 and the financial position as at 30 June 2007, 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 2006/07 financial statements to Strategy and Policy Committee.
24 August 2007	<i>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.</i>
29 August 2007 (scheduled)	<i>Special Strategy and Policy Committee Meeting</i> Committee to recommend adoption of 2006/07 financial statements to Council.
29 August 2007 (scheduled)	<i>Special Council Meeting</i>

Date:**Action:**

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.

28 September 2007

Release of published Annual Report.

APPENDIX TWO

DRAFT 2006/07 FINANCIAL STATEMENTS

Supporting Information
<p>1) Strategic Fit/Strategic Outcome</p> <p><i>This project supports Key Achievement Area 9 Governance and Citizen Information: As per the Annual Plan, Governance and Citizen Information includes all those activities that make the Council accountable to the people of Wellington and ensure the smooth running of the city. That includes all meetings of the Council and its committees.</i></p>
<p>2) LTCCP/Annual Plan reference and long term financial impact</p> <p><i>Relates to C534: Committee and Council process</i></p>
<p>3) Treaty of Waitangi considerations</p> <p><i>There are no Treaty of Waitangi implications</i></p>
<p>4) Decision-Making</p> <p><i>This is not a significant decision</i></p>
<p>5) Consultation</p> <p>a) General Consultation</p> <p><i>Not required</i></p> <p>b) Consultation with Maori</p> <p><i>Not required</i></p>
<p>6) Legal Implications</p> <p><i>None</i></p>
<p>7) Consistency with existing policy</p> <p><i>This report is consistent with existing Wellington City Council policy</i></p>