Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

5 MAY 2015

Meeting Status: **Public**

Purpose of Report: For Information

PUBLIC BENEFIT ENTITY ACCOUNTING STANDARDS IMPACT ASSESSMENTS

PURPOSE OF REPORT

1 This report provides the Committee with a summary of the key changes required to the Financial Statements to be presented in the 2014/15 Annual Report due to Council's transition to new Public Benefit Entity (PBE) Accounting Standards.

DELEGATION

2 The Audit & Risk Subcommittee has delegated authority to consider this report under the following delegation in the Governance Structure, Section C.3.7

External Reporting

7.5 Consider the appropriateness of the Council's existing accounting policies and principles and any proposed changes.

BACKGROUND

3 Under the New Zealand Accounting Standards Framework, public sector benefit entities (PBEs) must transition to PBE Accounting Standards for periods beginning on or after 1 July 2014.

4 The PBE Accounting Standards are mainly based on International Public Sector Accounting Standards (IPSAS). IPSAS are based on International Financial Reporting Standards (IFRS) but adapted to a public sector context where appropriate by using more suitable terminology and additional explanation where required.

5 Council's auditors, Ernst & Young, were engaged to provide guidance and advice on the impacts of transitioning to the PBE standards (as issued in May 2013). Ernst & Young's detailed impact assessment is provided as Appendix 1.

6 Audited financial results for the year ended 30 June 2014 must be restated to comply with PBE Accounting Standards in the 2014/15 Annual Report.

7 Council's audited Prospective Financial Statements in the draft 2015 to 2035 Long Term Plan are fully compliant with PBE Accounting Standards. This represents a significant achievement for Council and Council's auditors.

CONSIDERATIONS

Impact Assessment Report Summary

The key matters impacting Council's financial statements are outlined below:

Classification of Revenue

8 PBE Accounting Standards require the distinction of revenue streams from exchange transactions and non-exchange transactions.

9 Revenue from exchange transactions arises when two parties enter into a contract for a direct exchange of economic benefits or service potential between the parties and the exchange is of approximately equal value. Approximately equal value includes full cost recovery (i.e. there is no requirement for a profit margin).

10 Revenue from non-exchange transactions arises when revenue is subsidised. These non-exchange transactions occur when an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

11 Revenue derived from non-exchange transactions can only be deferred as a liability if there is both a performance <u>and</u> return obligation relating to this revenue. If there is no performance <u>and</u> return obligation, the revenue from non-exchange transactions is recognised in surplus/deficit when received or earned.

Implication on Council's Classification of Revenue

12 Revenue has been split between exchange and non-exchange transactions. The presentation of the financial statements will reflect the split on the basis as outlined below.

<u>Revenue from non-exchange transactions</u>

Rates
Grants and subsidies
Fines and penalties
Direct charges – subsidised
Development and financial contributions revenue

<u>Revenue from exchange transactions</u>

Rental revenue
Sale of goods and services
Direct charges – full cost recovery

13 Income from development and financial contributions is now recognised as revenue. Previously this income was classified as a liability in the balance sheet until the work is completed. The income is a non-exchange transaction and does not have a return obligation.

Valuation of Property, Plant and Equipment (PPE)

14 Council applied optimised depreciated replacement cost (ODRC) as its valuation method in the 30 June 2014 financial statements. This is permitted by PBE Accounting Standards.

15 In addition to ODRC, the PBE Accounting Standards allow for the use of restoration cost and service units as alternative valuation techniques to be applied in the determination of fair value. These alternative techniques are only allowed when there is an identifiable impairment of the asset being revalued.

Implication on Council’s Valuation of Property, Plant and Equipment

16 The valuation techniques applied by Council are unlikely to change under the PBE Accounting Standards however the PBE Accounting Standards allow two further techniques which may be applied.

17 Council will need to consider which of the valuation techniques is most appropriate and ensure that the updated guidance outlined in the PBE Accounting Standards is applied by its valuers.

Related Party Transactions

18 The entities and person identified as related parties may differ under PBE Standards compared to NZ IFRS PBE and in particular the consideration of who are classified as key management personnel.

19 The definition of key management personnel under PBE Accounting Standards is wider and also includes all senior management and their key advisors that have authority and responsibility for planning, directing and controlling the activities of the Council. Council does not currently engage any key advisors that have authority and responsibility for planning, directing and controller Council activities.

Implication on Council’s Related Party Transactions

20 The actual disclosures required under PBE Standards are different; Council will no longer need to disclose any transactions (other than key management personnel remuneration) that occur on normal terms and conditions.

21 The disclosures relating to key management personnel remuneration must now be reflected by the type of person receiving the payment rather than the type of payment being made, as was the requirement under NZ IFRS PBE.

Impairment of Assets

22 The impairment standards exclude all revalued property, plant and equipment from the requirement to determine whether any impairment has occurred. Council revalues the majority of property, plant and equipment and on that basis the impairment testing under PBE Accounting Standards will only apply to certain asset classes such as motor vehicles, plant and machinery, furniture and computer equipment. These assets will need to be considered for impairment testing on a regular basis.

23 Council is required to identify which assets are cash generating and which are non-cash generating. Management have applied the differentiation to Council’s assets and has determined that the majority of Council’s assets are non-cash generating, i.e. the assets are <u>not</u> held with the primary objective of generating a commercial return.

24 The PBE Standards state that the determination of impairment of a non-cash generating asset arises if there is a decline in the service potential of an asset. In the case where impairment has been established, the determination of the recoverable amount is dictated by the PBE Accounting Standards and allows the use of a number of different valuation techniques.

Implication on Council's Impairment of Assets

25 When preparing the financial statements, management must consider the appropriateness of the valuation technique being applied when evidence of impairment exists and will engage with the valuer to ensure the correct methodology is adopted.

Approach to 30 June 2015 Annual Report

Technical Review and Clearance

26 As part of the audit of Council's financial statements, a technical review is required to be undertaken by the auditors. The purpose of the review is to provide assurance that Council's financial statements comply with the requirements of the relevant accounting standards which it is obliged to report under.

27 Council's proposed financial statements template based on PBE Accounting Standards is attached at Appendix 2.

28 Following agreement with EY, the technical review of the proposed financial statements reflecting the adoption of the new PBE Accounting Standards will be completed during Stage 1 as referred to in the 2015 audit timetable, which includes a substantive audit of the draft financial statements for the eleven months ended 31 May 2015 including a draft financial overview and a draft Annual Report Disclosure Statement (Prudence Benchmarks). This is scheduled to take place from Monday 29 June 2015 to Friday 10 July 2015.

Restatement of 2013/14 Reported Financial Results

29 The 2014/15 financial statements also include the 2013/14 financial results as comparative information. Certain 2013/14 comparative amounts are required to be restated when reflected in the 2014/15 financial statements as a result of the first time adoption of the PBE Standards.

30 During the previous financial years cash was received for Development and Financial Contributions. These amounts had been classified as deferred revenue in liabilities to the extent that development work, which is funded by the levies, had not yet commenced. However, although the levy is paid as a contribution towards development, there is no obligation on Council to return funds to the Developer. As a result of the initial application of PBE IPSAS 23, the entire amount of cash received in connection with these grants must be recognised as revenue. The current year and comparative figures in the statement of financial performance and statement of financial position for 2013 and 2014 have been amended accordingly, as shown below:

31 Impact on statement of comprehensive revenue and expense:

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Increase in development and financial contributions revenue	714
Net impact on net surplus/deficit	**714**

32 Impact on net assets/equity:

Increase in opening accumulated comprehensive revenue and expense (as at 1 June 2013)	1,463
Increase in net surplus (as at 30 June 2014)	714
Total impact on net assets/equity	**2,177**

33 Impact on financial position:

Decrease in development and financial contributions liability	2,177
Total impact on liabilities	**2,177**

Policy considerations

34 The significant accounting policies applied in the preparation of Council's financial statements will reflect the requirements of the PBE Accounting Standards for the year ended 30 June 2015.

Legal considerations

35 Except for a legislative obligation to comply with the PBE Accounting Standards from 1 July 2014, there are no further legal considerations for Council.

Financial considerations

36 Ernst & Young were engaged to provide guidance and advice on the impacts of transitioning to PBE Accounting Standards. This engagement is separate to the Annual Report audit engagement. The fee payable for the engagement on the PBE Accounting Standards will be absorbed in the 2014/15 Annual Plan budget and will be detailed in the 2014/15 Annual Report.

Tāngata whenua considerations

37 There are no tāngata whenua considerations.

Degree of significance

38 This matter has a low level of significance under Council policy.

Consultation already undertaken

39 Due to the nature of the decision being made, no consultation process is required to be undertaken. As noted, our Auditors have provided advice on the transition requirements.

Publicity

40 There are no publicity issues to be considered at this stage.

RECOMMENDATIONS

41 That the Audit & Risk Subcommittee receives the report on guidance and advice on the impacts of transitioning to PBE Standards from Ernst & Young, as attached in Appendix 1.

42 That the Audit and Risk Subcommittee note that a formal work programme is in progress to ensure the implementation of the financial reporting changes is reflected in the annual report for the year ended 30 June 2015.

Report prepared by	Approved for submission	Approved for submission
Mark de Haast **Financial Controller**	**Stephen McArthur** **Group Manager Strategy & Planning**	**Wayne Maxwell** **Group Manager Corporate Services**

Appendix 1 – Ernst & Young report dated 11 February 2015

Appendix 2 – Council's proposed financial statements template based on PBE Accounting Standards.