

Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

13 SEPTEMBER 2012

Meeting Status: **Public**

Purpose of Report: For Information

DRAFT AUDIT REPORT AS AT 30 JUNE 2012

PURPOSE OF REPORT

- 1 This report provides the Committee with the closing Audit Report for the year ended 30 June 2012 prepared by Ernst & Young and also to update the Committee on the draft financial results for the year ended 30 June 2012 and provides an explanation of key issues.

SIGNIFICANCE OF DECISION

- 2 The Council's Significance Policy is not triggered by this report.

BACKGROUND

- 3 Ernst & Young, Council's Auditors has almost completed the audit fieldwork in relation to the draft Annual Report to 30 June 2012. A draft Closing Audit Summary report is attached at Appendix 1 and it covers an overview of the audit process, significant accounting and audit matters and the Draft Audit report. Also included in this report is an update of the draft financial results and specific items which will be explained in more detail in this report.

CONSIDERATIONS

Audit Report

- 4 The Closing Audit Summary Report has not identified any significant audit issues or risks in relation to the Draft Annual Report for the year ended 30 June 2012. The summary of audit differences includes differences identified by audit that have been agreed and adjusted in the Draft Annual Report. There may be further differences that are identified as part of the completion of the audit that will be discussed and agreed between the auditors and management.
- 5 The significant accounting and audit matters cover the areas of audit focus and audit conclusions. Any outstanding issues will be included in an Audit Management Report which will be prepared by Ernst & Young following the adoption of the audited Annual Report by Council.
- 6 The Audit & Risk Subcommittee will review this report when received and also review the action to be taken by management on significant issues in relation to any audit recommendations raised.
- 7 There are issues raised such as improvements to IT controls which will be included as part of the Audit Management Report.

Financial Results

- 8 The organisation's financial performance continued to be managed in line with the Council's overall objectives. Given the impacts of the economic recession on the levels of activity during the year the Council has ended the year in a satisfactory financial position mainly, due to savings in loan servicing costs.
- 9 A copy of the draft Statement of Comprehensive Income and the draft Statement of Financial Position for the year ended 30 June 2012 are attached as Appendix 2 and 3.
- 10 The operating surplus before one off items was \$3.632 million. These one off items included the following:

Unrealised loss on valuation of interest rate swaps	\$5.935 million
Loss on Asset Disposal	\$0.934 million

- 11 When these one off items are deducted from the operating surplus, it results in a net operating deficit of \$3.24 million as follows:

	Actual to 30 June 2012 \$m	Budget 2011/12 \$m
Operating Surplus (before the following items)	\$3.632	\$1.575
Less unrealised loss on valuation of interest rate swaps	-\$5.935	-
Less Loss on Asset Disposal	-\$0.934	-
Net Operating Surplus (Deficit)	(\$3.24)	\$1.575

- 12 The operating surplus (before one off items) of \$3.632 million compares to a budgeted surplus of \$1.575 million. The additional surplus of over \$2 million related mainly to the following items:

	\$m	
Debt Servicing Savings	\$1.551	Savings in operating expenditure
Additional NZTA Subsidy	\$0.631	Additional Revenue
	\$2.182	

- 13 The debt servicing savings resulted from savings through the management of Council's interest rate swaps and the timing of the Capital Works programme. The additional NZTA subsidy of \$0.631 million received relating to capital roading projects in the 2011/12 year.

- 14 The Statement of Comprehensive Income covers all revenue and expenditure funded from all sources not just rates. When the income and expenditure, funded from rates only, is taken into account the Council ended the year with a rates surplus.
- 15 There was a rates surplus of \$691,000 as at 30 June 2012 which was reported to the Corporate Business Committee on 16 August 2012. This rates surplus has been partly used to offset the 2012/13 rates increase and the balance was used to offset the additional costs for the District Plan and Expressway work. This additional costs for this work was required as a result of delays in the externally driven NZTA Expressway programme and impacts on staff time allocated to the District Plan review.

Unrealised Loss on the Value of Council's Interest Rate Swaps

- 16 The main reason for the operating deficit as 30 June 2012 is the unrealised loss on the revaluation of Council's interest rate swaps of \$5.936 million. This loss is unrealised as at 30 June 2012 and will never be realised and only reflects the change in the market valuation of Council's interest rate swaps between 30 June 2011 and 30 June 2012. In late March 2012, long term interest rates decreased significantly as a result of the European debt crisis. Interest rates are now at historical lows and will increase as the global financial crisis eases.
- 17 Council takes out interest rate swaps for the long term to protect Council's exposure to changes in interest rates on its debt levels out to 10 years. As the market interest rates increase, (as they are predicted to do as the economy moves out of recession) the market valuation of Council's interest rate swaps will increase in value and unrealised gains will be reported in the future financial statements. A 1% increase in market interest rates equates to a \$5.325 million gain in market value of Council's swaps. With market interest rates at historically low levels (3% to 4% below long term averages), there is plenty of potential for large gains in the future. Careful management of interest rate swaps has saved the Council up to \$700,000 over the past 12 months in loan servicing costs.
- 18 The interest rate swaps will continue to provide significant savings in debt servicing costs over the long term. Using interest rate swaps to secure our fixed debt interest costs is a far more flexible and pragmatic way of managing our interest rate costs compared to using fixed rate loans. If fixed rate loans were required to be valued at the end of each year the unrealised losses would be far greater than those for interest rate swaps and there would be less flexibility in terms of being able to lower the average interest cost of Council's debt.

Loss on Asset Disposal

- 19 Another contributor to the operating deficit is a loss on asset disposal amounting to \$934,000. The book value of the remaining building structure was \$1.394 million prior to the new work being undertaken on the Civic Building.
- 20 This loss in historic value needed to be recognised as an accounting transaction as part of the 30 June 2012 Annual Report. Following the upgrade the building will be revalued to reflect its increased value.

Financial Considerations

21 Financial issues have been covered as part of this report.

Legal Considerations

22 There were no legal issues identified during the Audit process.

Delegation

23 The Audit and Risk Subcommittee has delegated authority to consider this report under the following delegation in the Governance Structure, Section C.4.

6. Without limiting the generality of this delegation the Subcommittee has the following functions, duties and powers:

External Audit

6.11 receive the external audit report and review action to be taken by management on significant issues and audit recommendations raised within.

Consultation

24 There are no consultation issues associated with this report.

Policy Implications

25 There are no policy implications arising from this report.

Tāngata Whenua Considerations

26 Tāngata whenua are preparing their message for inclusion in the draft Annual Report and this will be included in the Annual Report to be adopted by Council on 4 October 2012.

Publicity Considerations

27 A press release will be prepared to explain Councils' financial results and the unrealised loss on the valuation of interest rate swaps.

Other Considerations

28 There are no other considerations.

RECOMMENDATIONS

29 That the Audit and Risk Subcommittee receive the Closing Audit Report from Ernst & Young and notes that there are no significant accounting issues that have not been agreed and adjusted in the Draft Annual Report.

- 30 That the Audit & Risk Subcommittee notes that an Audit Management Report will be prepared by Ernst & Young following the adoption of the audited Annual Report by the Council and the Subcommittee will review this Report along with action to be taken by management on significant issues and the audit recommendations raised.

Report prepared by:

Warwick Read
Group Manager Finance

ATTACHMENTS:

- Appendix 1: Closing Report to the Audit & Risk Subcommittee for the year ended
30 June 2012
Appendix 2: Statement of Comprehensive Income
Appendix 3: Statement of Financial Performance