INTERNATIONAL REPORTING STANDARDS (IFRS)

General Manager responsible:	General Manager Corporate Services
Officer responsible:	General Manager Corporate Services
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PURPOSE OF REPORT

1. The purpose of this report is to:

    1. Inform the Audit and Risk Management Subcommittee of the progress made to date with the adoption of NZ IFRS.

    2. Seek the Audit and Risk Management Subcommittee's adoption of the recommendations related to issues addressed to date and not covered at the previous meeting.

CONTENT

2. Five papers are attached to cover this topic:

    Paper 1A: Progress Report
    Paper 1B: First IFRS Bulletin
    Paper 2: Definition of 'Cash and Cash Equivalents' for the Purposes of the Statement of Cashflows
    Paper 3: Presentation of Expenses by Nature or Function
    Paper 4: Decision Whether to Re-open Business Combinations
    Paper 5: Policy for Determining Investment Properties

STAFF RECOMMENDATIONS

It is recommended to the Audit and Risk Management Subcommittee that:

(a) The progress report be received (Paper 1A).

(b) The Council adopt the new definition of 'Cash and Cash Equivalents' set out in NZ IAS 7, Cash Flow Statements (Paper 2).

(c) The Council adopt a group accounting policy to the effect that:

- the Council reports expenses in its parent and group financial statements by function rather than nature; and

- advantage be taken of the cost of sales reporting exemption for public benefit entities. (Paper 3)

(d) It be recommended to subsidiary companies that they continue to report expenses by nature. (Paper 3)

(e) The Council adopt a group accounting policy to the effect that the members of the Council Group do not re-open business combinations. (Paper 4)

(f) The Subcommittee confirm that the draft policy contained in Appendix I is appropriate for the Council Group and authorise the General Manager Corporate Services to refer it to the Assistant Auditor-General as a basis for him to provide guidance to the local government sector on 'Investment Property'. (Paper 5)

Update on Progress

Substantial progress has been made across the Council group.

We believe that we are close to having identified all the significant issues for the Group.

Responsibility for addressing these issues has been allocated to the individual IFRS workstream teams and work has been continuing on identification of the most appropriate accounting policies to adopt and the strategies to follow to ensure that the relevant systems are in place to record the required comparative information while minimising the work that is involved.

Major issues being addressed are:

1. First-time adoption options for Property, Plant and Equipment.
2. Related party disclosures – a paper has been prepared and is being considered by relevant parties.
3. Redeemable Preference Shares (RPSs) – debt or equity- changes are needed to the redemption rights for Christchurch City Facilities Ltd & Jet Engine Facility Ltd RPSs. Orion is awaiting PwC advice on the RPSs in its group.
4. Possible Accumulated Sick Leave accrual – issue is being advanced slowly due to the lack of any clear guidance on how it can be practically done.
5. Valuation and impairment of Goodwill - issue being advanced slowly by City Care.
6. Identification of and putting in place systems to facilitate making all the new disclosures required under NZ IFRS – the best method of doing this is being evaluated.
7. Valuation of ‘community’ loans issue is being advanced slowly due to the lack of any clear guidance on how it can be practically done.

Members of the teams believe at this stage that the deadlines set for the workstream teams can be met **provided** the required guidance is received from the Office of the Auditor-General and other parties.

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Workstream teams

Workstream teams, comprising representatives from the all the group entities, have been formed to address the critical areas identified in Phase 1. All teams have met at least once, and made good progress in achieving a common level of understanding about the key issues and determining priorities.

The teams are reporting progress to the Council's IFRS steering committee on a monthly basis.

Project manager

John Mackey is the IFRS project manager, and is coordinating the work of all the workstreams, as well as playing a key role in several of them.

Steering Committee

The Steering Committee is meeting on a weekly basis to monitor progress and address issues as they arise.

Dealing with accounting issues

A key output of the CCC/CCHL IFRS implementation process will be a set of consistent accounting policies across the whole group. To achieve this, it will be necessary to have a common acceptance of the accounting policy to be adopted where options are available under IFRS.

The process for dealing with accounting issues is to document them in a formal "issues paper", which is reviewed by PwC and considered/approved by the steering committee and subsequently the Council's Audit and Risk Committee.

The issues papers will then be circulated to each company for sign off. If there are significant objections raised by any company, the relevant issues will need to resolved through discussion and negotiation.

There will always be a balancing act between the need for consistency of accounting policies throughout the group, and the priorities of individual companies. We envisage that in the overwhelming majority of cases, there will be no major issues. However, we need to be prepared to have constructive discussion where there is a potential difference of opinion.

To date, four issues relevant to the operating companies – accounting for hedging, the accounting treatment of parent company investments in subsidiaries, capitalisation of interest costs and accounting for revaluations – have been signed off by the Council's Audit and Risk Committee. These papers are on the IFRS portal and we seek your company's confirmation that their conclusions are acceptable.

IFRS adoption date

A key issue that requires agreement across the group is the date of implementation of IFRS. All of the work completed to date has been on the basis that IFRS will be adopted by the group with effect from the 2006/07 financial year.

The Council's Audit and Risk Committee has now formally signed off on this adoption date, and we now seek confirmation from each of the companies that they will also adopt this date.

The principal reason for adopting a year earlier than the mandatory deadline relates to the requirement for the Council to prepare its Long Term Council Community Plan ("LTCCP") for a 10 year period from 1 July 2006 to 30 June 2016. Under the requirements of FRS-29: Prospective Financial Information, prospective financial information must be presented in the format that it is expected to be reported on. It is therefore logical for the Council adopt NZ IFRS from 1 July 2006 to avoid having to present information under two different sets of financial reporting standards in one LTCCP.

If the Council were to adopt IFRS from the latest possible adoption date (1 July 2007), the first year of the financial statements in the LTCCP would have to be presented under the requirements of NZ GAAP, with the following nine years being presented under the requirements of IFRS, which would make comparison between the first year and final nine years of the LTCCP difficult. There would be an enormous amount of work required to report in the two different formats. It is understood that most, if not all, Councils in New Zealand are adopting the same approach.

Component evaluations

The key project that has been worked on over the last few weeks has been the completion of the 40 individual "component evaluations" by each entity within the group.

Project: CCC IFRS

Issue Number: 7
Issue Name: Decision as to whether to adopt the wider definition of 'Cash and Cash Equivalents' for the purposes of the Statement of Cashflows?

Issue Owner: John Mackey
PwC Adviser: Michele Embling

Background

The purpose of this memo is to make recommendations with regard to the CCC group's accounting policy covering the definition of 'Cash and Cash Equivalents' for the purposes of the Statement of Cashflows under NZ IFRS.

NZ IAS 7, Cash Flow Statements, provides a wider definition of 'Cash and Cash Equivalents' for the purposes of the Statement of Cashflows than FRS-10, Statement of Cashflows. Therefore, the members of the CCC group need to include short term investments within 'Cash and Cash Equivalents' that were previously regarded as Investments.

Analysis

The definition of 'Cash and Cash Equivalents' for the purposes of Cash Flow Statements in NZ IAS 7 is as follows:

7. Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it is of a short maturity of, say, three months or less of the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents. For example, in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

8. Bank borrowings are generally considered to be financing activities. However, in some countries, bank overdrafts which are repayable on demand form an integral part of an entity's cash management. In these circumstances, bank overdrafts are included as a component of, cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

9. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents. Interest paid interest and dividends received are usually classified as operating cash flows for a financial institution. However, there is no consensus on the classification of these cash flows for other entities. Interest paid interest and dividends received may be classified as operating cash flows because they enter into the determination of profit and loss. Alternatively, interest paid interest and dividends may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or obtaining returns on investments.

The definition of 'Cash and Cash Equivalents' for the purposes of the Statement of Cashflows in FRS-10, Statement of Cashflows, is as follows:

4.1 "Cash" means coins and notes, demand deposits and other highly liquid investments in which an entity invests as part of its day-to-day cash management. "Cash" includes borrowings from financial institutions such as bank overdrafts, where such borrowings are at call and are used as part of day-to-day cash management.

4.2 A highly liquid investment is an investment where there is a recognised ready market to convert unconditionally the investment to coins and notes at the investor's option within no more than two working days. Cash does not include:

(a) accounts receivable;

(b) equity securities;

(c) accounts payable;

(d) borrowing subject to a term facility.

4.3 As the items included as cash for day-to-day cash management may vary between entities, the entity's financial report is to provide a reconciliation of these items to the appropriate items shown in the statement of financial position and, where appropriate, provide narrative on which items comprise "cash" as reported.

4.4 Treasury bills, Reserve Bank bills, commercial bills or similar debt securities may be considered as cash where:

(a) the securities are readily convertible to a known and certain amount of coins and notes at the investor's option in no more than two working days; and

(b) the securities are used as part of the entity's day-to-day cash management.

The CCC group has a statutory obligation to comply with NZ IAS 7, Cash Flow Statements. Therefore it needs to adopt the new definitions.

Impact

The amended definition does NOT change the Council or the Group's reported Operating Surplus, the value of its Assets or the total Operating or Financing cashflows reported.

Its only potential impact is to increase the amount shown as the 'Cash Balance' in the Cash Flow Statement and reduce total cash outflows reported for Purchase of Investments and therefore the net cashflow for Investing Activities. However, the Council's current cash management and investment policies mean that there is currently no change.

The Council's current cash management and investment policies provide that investments with terms of less than 12 months are held for cash management purposes and are not necessarily held to maturity. Investments with terms of more than 12 months are held for investment purposes and are held to maturity. As the assets that are held for terms of less than 12 months are liquid, they have previously been treated as 'Cash' for the purposes of the Statement of Cashflows.

It should be noted the 'Cash Balance' reported in the Council Parent Cash Flow Statement at 30 June 2004, was $288 million and $242 million in 2003.

Conclusion

The Council is bound by the Local Government Act 2002 that requires compliance with Generally Accepted Accounting Practice (GAAP). NZ IAS 7, Cash Flow Statements, with the implementation of NZ IFRSs will constitute NZ GAAP and therefore the Council and the CCC group have to adopt the new definition of 'Cash and Cash Equivalents'.

Recommendation

That the Audit and Risk Management Committee adopt the new definition of 'Cash and Cash Equivalents' set out in NZ IAS 7, Cash Flow Statements.

Project: CCC IFRS

Issue Number: 11
Issue Name: Decision on whether to present expenses by nature or function

Issue Owner: Richard Simmonds
PwC Adviser: Michele Embling

Background / Discussion

NZ IAS 1 “Presentation of Financial Statements” addresses the presentation of operating expenses in an entity’s income statement. It allows two alternative methods of analysing expenses – by function or by form. The two basic styles of presentation are as follows:

Analysis by nature of expense [IAS1.91]:

Revenue		X
Other operating income		X
Changes in inventories of finished goods and work in progress	X	
Raw materials and consumables used	X	
Staff costs	X	
Depreciation and amortisation expense	X	
Other operating expenses	X	
Total operating expenses		(X)
Profit from operating activities		X

Analysis by function of expense [IAS1.92]:

Revenue		X
Cost of sales		(X)
Gross profit		X
Other operating income		X
Distribution costs		(X)
Administrative expenses		(X)
Other operating expenses		(X)
Profit from operating activities		X

NZ IAS 1 requires that the style that will give the fairest presentation ('whichever provides information that is reliable and more relevant') is the one that should be used, and does not permit a mixture of the two styles to be used. An entity involved in providing services is more likely to classify expenses according to their nature, while a manufacturer or retailer will be more likely to disclose according to function.

If the function form is used, the entity is also required to disclose information on the nature of expenses including depreciation, amortisation and staff costs. However, under paragraph 92.1 of NZ IAS 1, a public benefit entity that elects to disclose expenses by function may disclose expenses classified by output and, if it does so, is exempted from the requirement to disclose cost of sales. We consider that this exemption would extend to the consolidated financial statements, but this will need to be confirmed with our auditors.

Current position

Council
Currently, the Council effectively presents its income statement in a functional format, disclosing revenue and expenses from significant activities on the face of its profit and loss account, with a number of subsequent pages providing detail on each significant activity.

It also presents a separate note analysing expenses by nature.

Operating subsidiaries
CCHL and the operating subsidiaries have always presented their expenses by nature.

Arguments against disclosing expenses by function

- The operating companies are more in the nature of service entities, rather than manufacturing or retailing entities, and disclosing expenses by nature is probably the more appropriate approach;

- Companies would be required to disclose their gross margin, which could prejudice their commercial position, particularly in respect of their major customers, suppliers and competitors;
    - Contracting companies City Care Ltd and Red Bus Ltd would be placed at a significant disadvantage to their competitors if they were required to disclose gross margin[1];
    - Orion's, CIAL's and LPC's counterparts in New Zealand (eg. Vector, Auckland International Airport, Port of Tauranga etc) may choose not to use the functional expense approach, meaning that the CCC/CCHL companies would be out on a limb;

- Orion and CIAL already prepare separate regulatory financial statements – using the functional expenses approach may require a considerable degree of time-consuming and non-productive reconciliation between the two;

- It would require additional analysis and time spent preparing financial statements (given that the nature of expenses would be required to be disclosed in any case).

Arguments against disclosing expenses by nature

1. The functional approach sits more comfortably with the way in which the Council reports its significant activities, and the emphasis of the Local Government Act on reporting on outputs rather than inputs.

[1] They could, however, presumably elect to use the "expense by nature" approach in their own financial statements, and then provide the required functional analysis for the consolidation, although this would require extra work and could have disclosure implications in the segmental reporting note in the CCHL group accounts.

Proposed approach

An option that might overcome all of the above objections would be for CCC to adopt the functional approach, taking advantage of the exemption for reporting cost of sales. This would require both the Council's own financial statements and the consolidated financial statements to be presented in a functional format, with supplementary disclosures of expenses by nature.

This approach need not change the way the operating companies report, as they could continue to present their expenses by nature in their own financial statements[2].

CCHL would also present its expenses (parent and consolidated) in its income statement by nature rather than function. However, the information in CCHL's segmental reporting note[3], analysing expenses company by company, would effectively be a functional analysis, which could then be consolidated into the CCC group financial statements.

This approach has the advantage of not requiring any change to the way the operating companies report, nor requiring any further disclosures, yet still satisfying the Council's preference for reporting on an activities basis.

Conclusion

Based on the above discussion, analysing expenses by function at CCC level and taking advantage of the public entity exemption for reporting cost of sales, while permitting the subsidiaries to continue to report expenses by nature, would seem to be the preferred approach.

Options

1. Present expenses analysed by nature; or

2. Present expenses analysed by function.

Recommendations

1. That the Audit and Risk Committee adopt a group accounting policy to the effect that:

   - the Council reports expenses in its parent and group financial statements by function rather than nature; and
   - advantage be taken of the cost of sales reporting exemption for public benefit entities.

2. That it be recommended to subsidiary companies that they continue to report expenses by nature.

[2] Although Lyttelton Port Company Ltd will have a separate issue with regard to segmental reporting, which is required for all issuers of securities.
[3] Assuming that CCHL elects to continue segmental reporting. If it did not, the required information could still easily be supplied for the purposes of the CCC consolidation.

Project: CCC IFRS
Issue Number: 13
Issue Name: Decision as to whether to re-open business combinations

Issue Owner: John Mackey
PwC Adviser: Michele Embling

Background / Discussion

The purpose of this memo is to make recommendations with regard to the CCC group approach to re-opening business combinations.

NZ IFRS 1, First-time Adoption of NZ Equivalents to IFRSs' purpose is as follows:

- Prescribes the specific requirements for an entity's first NZ IFRS financial statements, and its interim financial reports for part of the period covered by those financial statements, to ensure such statements contain high quality information.
- Also offers exemptions and exceptions available on first time adoption.
- Exemptions allow relief from complying with some requirements of other NZ IFRSs, whereas exceptions prohibit retrospective application of some aspects of other NZ IFRSs.

The section of NZ IFRS 1 covering the re-opening of business combinations is as follows:

'Business combinations

15 An entity shall apply the requirements in Appendix B to business combinations that the entity recognised before the date of transition to NZ IFRSs.'

Appendix B which contains the detail and the challenges is included in Appendix I of this issues paper. The requirements are lengthy, complex and onerous.

Analysis

The Council has reviewed this exemption in conjunction with PricewaterhouseCoopers (PwC).

The key points are as follows:

1. As the individual financial statements of members of the City Council group are consolidated into the consolidated financial statements of Christchurch City Holdings Limited (CCHL) or/and the Council, a decision to re-open a business combination means that all other members of the City Council group will also have to do so from that date.
2. To be able to re-open these business combinations the individual entities have to apply NZ IAS 36 *Impairment of Assets* (as revised in 2004) and NZ IAS 38 *Intangible Assets* (as revised in 2004) from that same date. This means that any Goodwill that was amortised during that period from the date of the earliest business combination re-opened has to be reversed. Instead, an impairment test will need to be performed at the end of each year from the date of the earliest business combination re-opened to adjust the value of the Goodwill on the Balance Sheet to that which would apply under NZ IFRS.
3. The impairment tests mentioned above requires 'subsequent measurement of some assets and liabilities on a basis that is not based on original cost, such as fair value'.
4. The information required to undertake the steps above will, at best, be difficult and expensive to obtain and, at worse, not be available.
5. PwC advise that the costs of undertaking the work required for retrospective application of NZ IFRS 3 to business combinations is very unlikely to be less than the benefits to be gained. As a result, they are unaware of any organisation that has decided to do this.

Conclusion

It is very unlikely that the costs of undertaking the work required for retrospective application of NZ IFRS 3 to business combinations for an entity will be less than the benefits to be gained by that entity. However, considered in a Group context, the benefits to be gained will certainly be outweighed by the costs involved.

Options

1. Re-open business combinations
2. Do not re-open business combinations.

Recommendation

That the Audit Subcommittee adopt a group accounting policy to the effect that the members of the Council Group do not re-open business combinations.

PAPER 5

Project: CCC IFRS
Issue Number: 16
Issue Name: Decision as to the appropriate policy to adopt with respect to ‘Investment Property’?

Issue Owner: John Mackey
PwC Adviser: Michele Embling

Background

The purpose of this memo is to make recommendations with regard to the CCC Group policy to adopt with respect to ‘Investment Property’.

NZ IAS 40, Investment Property, defines an ‘Investment Property’ and sets out the accounting requirements for it.

The objective of NZ IAS 40 is to ensure that changes in value of ‘Investment Property‘ are recognised in the Balance Sheet of the owner and that the gain or loss resulting from these changes in value is recognised in the Income Statement rather Reserves of the owner.

This objective is sound for entities that invest in property to achieve rental returns and/or capital gain. However, this approach, if applied in other entities, can significantly increase the complexity of the financial statements and distort the results of those entities where they acquire property principally for the purpose carrying out the entities’ objectives.

The challenges principally arise due to the following requirements of NZ IAS 40 and NZ IAS 16:

1. NZ IAS 40, with a few exceptions, requires properties to be split into ‘Investment Property‘ and Property, Plant & Equipment (PPE) if part of the property (land or building) is leased to a third party.
2. ‘Investment Property‘ is required to be revalued annually and is not depreciated.
3. If the part of a property that was leased to a third party is subsequently used by the owner in its business, it is reclassified as PPE and therefore is revalued less frequently with revaluation movements accounted for on a different basis and depreciation charged.
4. NZ IAS 16, PPE, requires an entity to split the Gross Carrying Amount of an item of PPE into its cost and revaluation components so all the movements in the revaluation component of a property have to be recorded and tracked over the entire life of the property and be logically accessible to the asset systems.
5. For the trading entities, revaluations have to be accounted for on an ‘asset’ by ‘asset; basis. If part of a property is leased to a third party(ies) then one asset becomes two or three or more. The parts of the building leased over time could vary so the individual ‘assets’ change and the accounting for revaluations changes as parts of buildings move between ‘Investment Property‘ and PPE. This is a very real possibility for Christchurch International Airport Limited (CIAL) with the international and domestic terminals.
6. The complexities in 5 are magnified for the Council Group with the Council being a public benefit entity (PBE) and therefore it can account for asset revaluations on a ‘Class’ basis. Adjustments can therefore be needed when preparing the consolidated financial statements to convert the revaluation movements in 5 to a ‘Class’ basis.

The Investment Property workstream team was set up to address these issues and the added complication that IAS 24 was developed for the private sector and not the public sector. It has been chaired by Andrew Souness of CIAL. The team’s analysis highlighted these challenges and sought to develop a policy that promoted accountability for achieving achieve rental returns and/or capital gain on properties where this is the principal reason they were acquired. However, the team believes that where a property is acquired for strategic reasons or to provide services that are effectively contracted to third parties then it is more appropriate to account to stakeholders on the basis that the property is PPE rather than ‘Investment Property‘.

CIAL, with the assistance of PricewaterhouseCoopers (PwC), and input from the Investment Property workstream team, developed the draft policy contained in Attachment I. It seeks to ensure that where a property is acquired for strategic reasons or to provide services that are effectively contracted to third parties then it is accounted for as PPE.

This draft policy has not been reviewed by the Office of the Auditor-General yet. The Assistant Auditor-General has advised the writer that he will be issuing guidance to the local government sector on 'Investment Property' and he is interested in using the Council Group's guidance as a base if it is sound. Our intention is to refer the Council Group's policy to him once the Audit Subcommittee has confirmed its acceptance of the policy.

Analysis

1. The challenges above apply to the preparation of the Council's Long Term Council Community Plan (LTCCP). If properties are classified as 'Investment Property' then estimates of their movements in value each year would have to be incorporated into the Balance Sheet and the Income Statement for each year in a similar manner to which Depreciation has to be estimated and taken account of. It would not be acceptable to assume no movements in property values as this assumption would need to be disclosed and would not be reasonable.
2. The complexities outlined in the Background section above mean that both the actual and budgeted financial statements will become even more incomprehensible if an entity has a property, part of which is leased to a third party and is then subsequently used again by the owner in its business.
3. These complexities also mean that the maintenance and operation of the asset systems becomes very complex and more expensive to operate.
4. These complexities also mean that the systems and processes for budgeting will become more expensive and complex.
5. The draft policy prepared means that CIAL will be the only member of the Council Group with any significant holdings of property classified as 'Investment Property'. The Council may have two and Orion one.

   CTL Properties Limited will have to account for the Ferry Road site as 'Investment Property' but this becomes PPE in the financial statements of Red Bus Limited.

   Lyttelton Port Company may have none depending upon whether part of their main offices at Lyttelton is deemed to be 'Investment Property' or not. There is a strong case under this draft policy that it is not.

Conclusion

NZ IAS 40, Investment Property, presents major challenges to the Council Group in terms of significantly increasing the complexity of accounting for Land and Buildings and increasing the costs involved in doing this. All members of the Council Group favour the adoption of the attached draft policy because it seeks to minimise this complexity and the associated costs while maintaining appropriate accountability to stakeholders.

<u>Recommendation</u>

That the Audit Subcommittee confirm that the draft policy contained in Appendix I is appropriate for the Council Group and authorise the General Manager, Corporate Services to refer it to the Assistant Auditor-General as a basis for him to provide guidance to the local government sector on 'Investment Property'.

Property Classification Under NZ IFRS

NZ IFRS Guidance

Under NZ IFRS, accounting for investment property is undertaken in accordance with the requirements of NZ IAS 40: *Investment Property*.

Paragraph 5 of NZ IAS 40 defines investment property as property (land or a building or part of a building) that is held to earn rentals or for capital appreciation or both, rather than for use in the production or supply of goods or services or for administrative purposes or sale in the ordinary course of business. If floors of a building are leased to other parties, those floors may be classified as investment property if they could be sold separately (or leased out separately under a finance lease).

Paragraph 7 states that “an investment property generates cash flows largely independently of the other assets held by an entity”, which distinguishes it from owner-occupied property, which “generates cash flows that are attributable not only to property, but also to other assets used in the production or supply process”. Thus, where an entity provides ancillary services to the occupants of a property it holds, the significance to the overall transaction of the services being provided will in part determine the appropriate accounting treatment.

Paragraph 8 lists examples of investment property:

- land held for long-term capital appreciation rather than for short-term sale in the ordinary course of business;
- land held for a currently undetermined future use (if an entity has not determined that it will use the land as owner-occupied property or for short-term sale in the ordinary course of business, the land is regarded as held for capital appreciation);
- a building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases;
- a building that is vacant but is held to be leased out under one or more operating leases.

Paragraph 9 lists examples of items that are not investment property – these include property held for future use as owner-occupied property and property held for future development and subsequent use as owner-occupied property, which should be accounted for in accordance with the requirements of NZ IAS 16: *Property, Plant and Equipment*.

Paragraph 14 notes that judgement is needed to determine whether a property qualifies as investment property and that an entity should develop criteria so that it can exercise that judgement consistently in accordance with the definition of investment property. The entity is required to disclose these criteria in the financial statements.

Policy

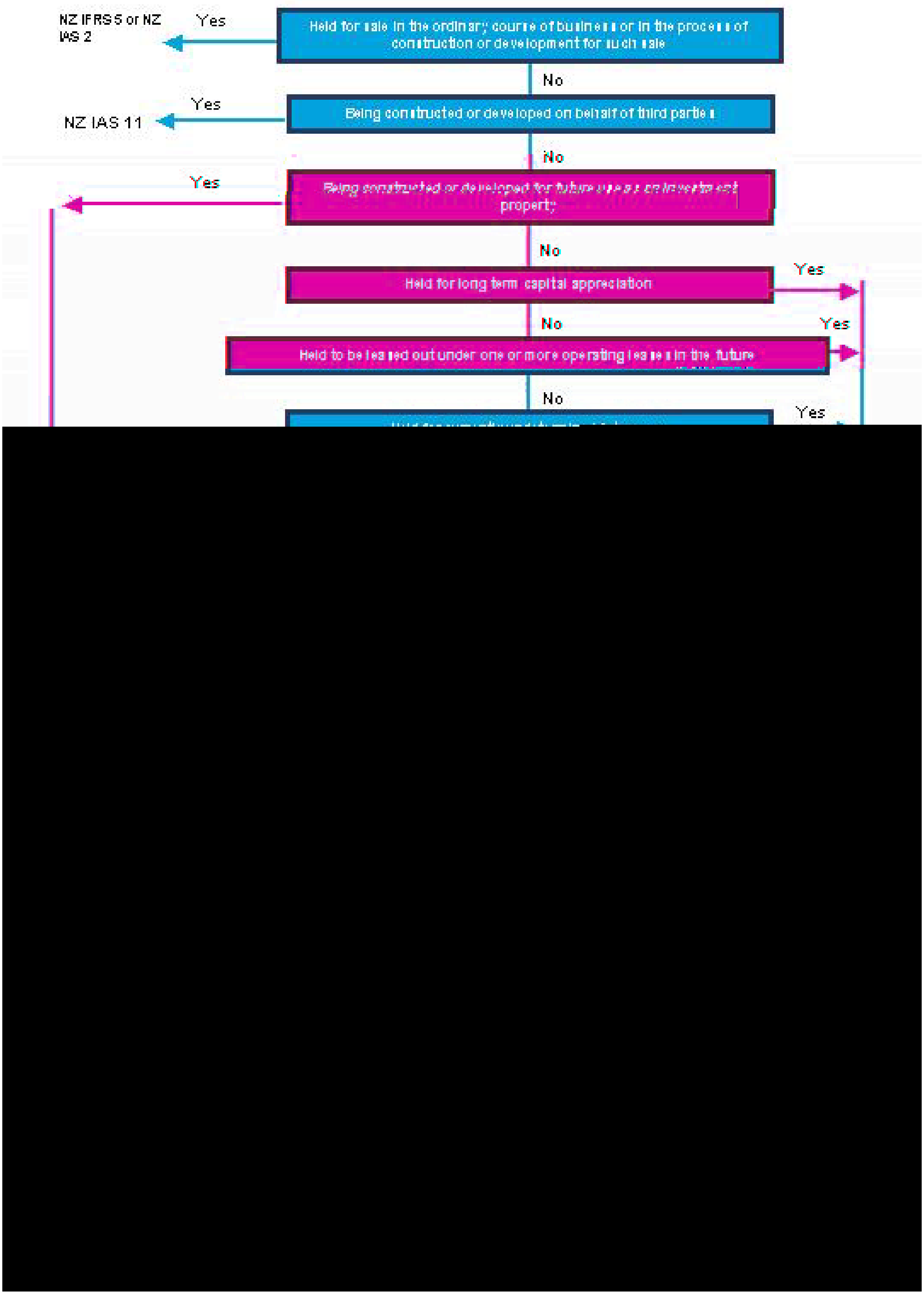
The classification of property is a matter of professional judgement that requires analysis of the substance of the circumstances surrounding its occupation.

The classification of property is done at the lowest possible level. Thus, where part of a building is occupied by other than the owners, consideration must be given as to whether that portion of the building could be classified as an investment property.

Where property is unoccupied consideration should be given to the intended future use of such property. If the owner intends to occupy the property in the future, classification as owner occupied property is indicated. Where the property is held for long-term capital appreciation, to be leased out, or for an unspecified use, investment property is indicated. In some limited circumstances consideration of the intended future use of a property may be required even if the property is occupied (for example if there is a clear future use for the property and it is being partially occupied for a short term prior to being used for its intended purpose).

Where property or a section of a property is occupied by other than its owner, the matters that require

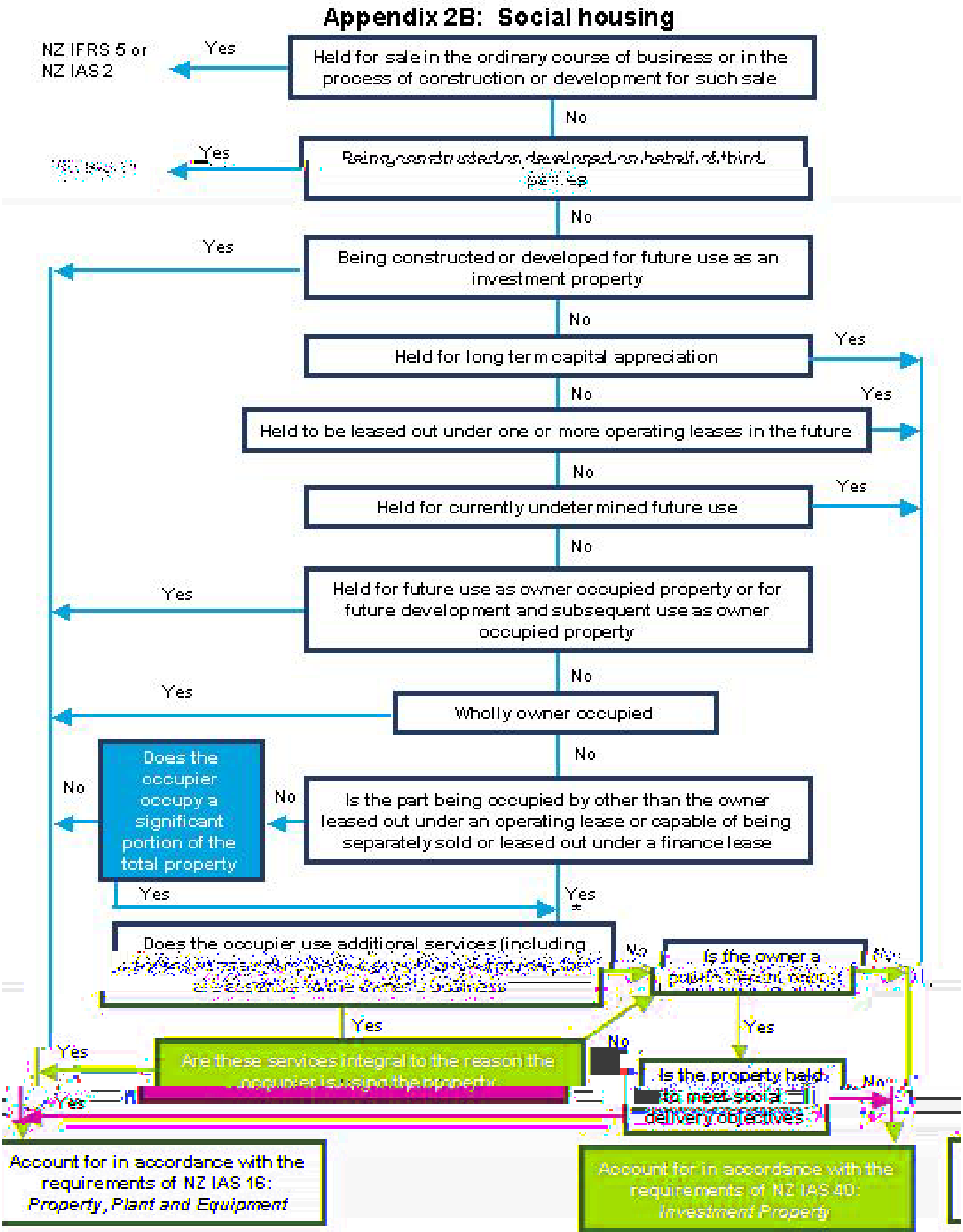
Property classification decision chart **Appendix 1**



Application of the Policy to Social Housing

The Council rents houses to members of the Christchurch community who meet specified criteria, The housing is provided at below market rentals. The circumstances surrounding the Council's renting of these properties to others is indicative of 'Investment Property', as the properties are capable of being sold separately, the Council only provides limited additional services to the occupiers and the occupiers do not provide services that are integral to the activities that are undertaken by the Council. However, the Council is a public benefit entity and the property is held as part of its adopted Housing Policy by which the Council seeks to contribute to the Community's social well-being by ensuring safe, accessible and affordable housing is available to people on low incomes including elderly persons, and people with disabilities.

The decision chart in Appendix 2A also indicates that classification as 'owner occupied property' is warranted.



Note: From this point onwards:

If the part being occupied by other than the owner cannot be separately sold or leased out, the remaining questions are to determine the treatment of the entire property

If the part being occupied by other than the owner can be separately sold or leased out, the owner occupied part will be accounted for in accordance with the requirements of NZ IAS 16: Property, Plant and Equipment and the remainder of the questions are to determine the treatment of only that part of the property that is occupied by other than the owner.

Appendix 3

Application of the Policy to Heritage Buildings

In a local government setting, the lease of a heritage building under an operating lease is not an 'Investment Property' as the reason for holding the heritage building is to preserve it for future generations and not to earn rentals or for capital appreciation. That is, the property is leased to minimise the costs involved in retaining it and to help ensure that the property is secured and maintained on an ongoing basis in a way that is consistent with the objective of preserving it for future generations.

In this situation, the lessees are providing services that are integral to the Council's preservation of heritage buildings and therefore constitute 'owner occupied property'.

Appendix 4

Application of the Policy to Houses Rented to Park Rangers and Sextons

Local authorities provide housing to park rangers and sextons to help ensure that assistance is available to the public when they visit parks and cemeteries and also to improve the security of these sites. The reason for holding these houses is not to earn rentals or for capital appreciation.

In this situation, the tenants are providing services that are integral to the Council's operation of the parks and cemeteries and cannot be provided effectively and efficiently from another location and therefore constitute "owner occupied property".

Application of the Policy to Property Temporarily Rented Until Capital Works are Commenced

In a local government setting,, houses and commercial and industrial properties are temporarily rented or leased out awaiting roading or similar capital works being commenced. Local authorities rent or lease out these properties simply to minimise the cost to the ratepayers of undertaking the capital works and to minimise the risk of vandalism and other security issues. Therefore, these properties are not to earn rentals or for capital appreciation.

In this situation, the tenants and lessees are providing services that are integral to the Council's provision of infrastructure for its citizens and ratepayers in an efficient and effective manner. Therefore these properties constitute 'owner occupied property'.

Application of the Policy to Properties Leased to Community Organisations

Local authorities normally rent or lease out these buildings to these organisations to assist them to achieve their mutual objectives. The rentals are in nearly all cases concessionary and in many instances, nil.

In this situation, the lessees are providing services that are integral to the Council's delivery of the Community's Outcomes and therefore these properties are not to earn rentals or for capital appreciation. They constitute 'owner occupied property'.

Application of the Policy to Areas of Properties Leased to Organisations Providing Services Integral with those of the Council

The Local Government Act recognises that a local authority may be able to provide a service more efficiently and effectively to its community and ratepayers by ‘contracting’ with a third party to provide this service. This can be facilitated by leasing areas of a property to a third party who then charges users of their services for those services.

Common examples include cafes in libraries and leisure centres; areas for physiotherapists in leisure centres; areas for shops and restaurants on parks; and areas for golf driving ranges, fun boats, mini golf, hydroslides, etc, on parks

In this situation, the tenants and lessees are providing services that are integral to the Council’s provision of infrastructure for its citizens and ratepayers in an efficient and effective manner. Therefore these properties constitute “owner occupied property”.