28. ANNUAL REPORT 2011

General Manager responsible:	General Manager, Corporate Services, DDI 941-8528
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PURPOSE OF REPORT

1. The purpose of this report is to present the 2011 Annual Report containing the audited financial statements of Christchurch City Council for the year ended 30 June 2011 for adoption by the Council. The Audit and Risk Management Subcommittee considered the 2011 Draft Annual Report and discussed the audit opinion with Audit New Zealand at its meeting on 14 October and resolved unanimously to recommend the report to Council for adoption.

2. Under section 98 of the Local Government Act 2002, a local authority must prepare and adopt in respect of each financial year, an annual report. Each annual report must be completed and adopted by resolution, and within one month after the adoption of its annual report, the local authority must make publicly available;

   (a) its annual report; and

   (b) a summary of the information contained in its annual report.

EXECUTIVE SUMMARY

3. Separately circulated (as **Appendix 1**) is a copy of the Annual Report for the year ended 30 June 2011.

4. The key point to note in this Annual Report is that it does not comply with generally accepted accounting practice (GAAP). Section 111 of the Local Government Act 2002 requires Council to comply with GAAP. This is not possible for the 2011 financial year because of difficulties around the measurement and treatment of earthquake-damaged assets, and the valuation of assets.

5. The series of earthquakes following that on 4 September 2010 have caused significant damage to the Council's assets. Because of the nature of those assets, many of which are underground and difficult to inspect, and the sheer scale of the damage, Council does not yet have an assessment of the value of that damage that is precise enough to satisfy the requirements of GAAP.

6. The best information currently available estimates damage to Council's horizontal infrastructure of $2.2 billion and $0.2 billion of damage to non-infrastructure buildings. In addition there are expected to be $0.2 billion of costs to maintain services temporarily until permanent repairs can be completed. However, this estimate is still being refined and the final cost of horizontal infrastructure repair is expected to range somewhere between $1.8 billion and $3.0 billion. The total carrying value of the Council's property, plant and equipment is $5.4 billion. In addition, any land remediation costs have not yet been estimated.

7. Accounting standards require that when an asset has been destroyed it should be removed, or written off, from the financial statements. Similarly, where there is an indication that the value of an asset as recorded in the financial statements is greater than its actual value, the value of that asset must be reduced (this is known as impairment).

   (i) some of its infrastructural and building assets have been damaged beyond repair, and NZ International Accounting Standard 16 *Property Plant and Equipment* (NZIAS 16) requires Council to write-off those assets. This write-off would be expensed in the Statement of Comprehensive Income and impact the surplus or deficit for the year.

   (ii) much of its infrastructural and building assets have been impaired, and NZ International Accounting Standard 36 *Accounting for Impairment* (NZIAS 36 requires Council to recognise an impairment loss on those assets. An impairment is recognised in other comprehensive income against revaluation reserves for that class of asset. Only any excess of impairment above the revaluation reserve is expensed.

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8. Based on the information available to date, it is generally not possible to determine whether individual assets are damaged beyond repair and should be written off or can be repaired and therefore should be impaired. In most cases final decisions about write-off versus impairment of individual assets cannot be made until detailed engineering reports are available and a repair/replace decision has been agreed with the Council's insurers and/or Government agencies and resolved on by Council.

9. Council staff consider that any attempt to recognise impairment in the financial statements may provide readers with the erroneous impression that it is possible to assess impairment with some level of accuracy. We have therefore not complied with the requirements of GAAP and with the exception of buildings, have not recognised any earthquake related impairment or disposal in these financial statements.

10. Council revalues the following items of property, plant and equipment to fair value:
    - Land (other than land under roads)
    - Buildings
    - Infrastructure assets
    - Heritage assets
    - Works of art

11. Fair value for a public benefit entity like the Council is depreciated replacement cost. Under GAAP the Council needs to be able to demonstrate that the carrying value of its assets is recorded at fair value at balance date. However, the unit rates being proposed for replacement or repair of assets are significantly higher than the unit rates included in the current valuations.

12. In addition to the higher unit rates there is an expectation that costs will increase further due to allowances for items such as increased wage costs likely to result from a shortage of labour and other cost escalations. These are expected, but cannot be accurately quantified yet until contracts are let and work gets underway.

13. While the exact level of cost increase cannot be determined, there is sufficient evidence to suggest that the unit rates (e.g. per metre of road) underpinning the valuation of assets included in the financial statements are no longer appropriate. Given the size of the differences in rates, the difference between the carrying values and the fair value (even ignoring the impact of impairment and disposals not recognised) could be substantial. In these circumstances to comply with GAAP the Council would need to revalue its assets. However, it cannot because of uncertainties around the damage or the appropriate unit rates to use.

14. In addition the Council was unable to revalue land and buildings. This is due to the uncertain extent of damage and because the firm commissioned to complete the Council's land valuation, Knight Frank Christchurch, advised that in the wake of the earthquakes there was insufficient market activity to provide reliable market valuations.

15. In summary, the Council has not been able to determine the fair value of the remaining undamaged assets and cannot assert compliance with GAAP for this.

16. Because of the above, the values reflected in the financial statements for all balances impacted by impairment or revaluation reflect pre-Earthquake values and do not take into account damage estimates. This includes depreciation, property plant and equipment, revaluations, loss on disposal, surplus/ deficit, asset revaluation reserves and retained earnings. Notwithstanding this, the Annual Report contains a comprehensive note explaining the impact of the earthquakes on the financial statements. Consequently, except for the Council's and group's cash flow statement, Audit New Zealand have been unable to form an opinion on this Annual Report and have issued a disclaimer of opinion.

17. The financial tables within the Group of Activity Statements have received a qualified opinion as they are derived from the data within the financial statements.

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18. The disclaimer of opinion from Audit New Zealand reflects the fact that because of the scale of the earthquake, it is impossible to comply with GAAP. However, the audit opinion specifically identifies the cash flow statement for the Council and group as complying.

19. The Canterbury Earthquake (Local Government Act 2002) Order 2011, modified the normal requirements of schedule 10 of the local Government Act 2002 to exclude the obligation to report on non- financial KPIs. However, where information was available we preferred to make that information public, at least in part, as a recognition of the high degree of commitment of staff to maintain damaged or otherwise compromised services, either in their Council role or as a Civil Defence volunteer.

20. The results are not complete, and due to damage to some of the underlying measurement system in some cases are not robust enough to withstand the full audit process. In agreement with Audit New Zealand they have been moved to the non-audited section of the Annual Report.

21. A reconciliation is attached of the profit of $21.9 million reported to Council as part of the June Performance report to the accounting surplus of $44.1 million shown in the Annual Report.

22. The Council would like to recognise the support received both from staff and from Audit New Zealand in preparing this report under difficult conditions.

FINANCIAL IMPLICATIONS

23. There are no financial implications.

Do the Recommendations of this Report Align with 2009-19 LTCCP budgets?

24. Not applicable.

LEGAL CONSIDERATIONS

25. Section 111 of the Local Government Act 2002 requires Council to comply with generally accepted accounting practice (GAAP), and section 99 of the Act requires the Annual Report to be audited. As noted above, because of uncertainty around the exact nature and quantum of earthquake damage to infrastructural assets the Council is unable to comply with GAAP requirements.

26. Because the Council has not been able to comply with GAAP Audit New Zealand will issue a disclaimer of opinion on Council's 2011 Annual Report.

27. While a qualified audit opinion must be reported by the Auditor General to Parliament, and Council must advise its bankers and credit rating agencies, there are no direct consequences of the qualification.

Have you considered the legal implications of the issue under consideration?

28. Not applicable.

ALIGNMENT WITH LTCCP AND ACTIVITY MANAGEMENT PLANS

29. Not applicable.

Do the recommendations of this report support a level of service or project in the 2009-19 LTCCP?

30. Not applicable.

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ALIGNMENT WITH STRATEGIES

31. Not applicable.

Do the recommendations align with the Council's strategies?

32. Not applicable.

CONSULTATION FULFILMENT

33. Not applicable.

STAFF AND COMMITTEE RECOMMENDATION

It is recommended that the Council:

(a) Resolve to adopt the 2011 Annual Report as presented.

(b) Authorise the General Manager Corporate Services to make changes as required for publishing the Annual Report.

(c) Authorise the General Manager Corporate Services to produce and publish the Annual Report and the Summary Annual Report within the statutory timeframes.