

3 March 2011 [DRAFT]

Celia Wade-Brown  
Mayor  
Wellington Council  
101 Wakefield Street  
PO Box 2199  
Wellington 6140  
New Zealand

Your worship,

## **Audit for the year ending 30 June 2011**

I am writing to outline our arrangements for the audit of Wellington Council for the year ending 30 June 2011. This letter has two main sections – an agreement to be signed, and details of the audit.

### **Agreement to be signed**

Below is an acknowledgement that this letter matches your understanding of the audit arrangements for this year's audit.

Once signed, I would be grateful if you return this to me.

### **Details of the audit**

Here we set out the proposed arrangements for this year's audit. This includes:

- Areas of audit focus specific to the Wellington Council;
  - weathertightness (leaky homes);
  - procurement of goods and services / contract management;
  - changes to Council-Controlled Organisations;
  - the Local Government Funding Agency;
  - revaluation of assets; and
  - other emerging issues such regional governance, changes to local government legislation, and preparations for the rugby world cup
- Areas of audit focus across all Local Authorities; and
- logistics (such as our audit team, timing, and fees).

# APPENDIX THREE

Please take the time to read this document thoroughly before returning the signed agreement. If there are additional matters that should be included, or any matters requiring clarification, please contact me.

Yours sincerely

Andy Burns  
Director

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## Agreement to be signed

*I acknowledge that the details of the audit set out here are in keeping with my understanding of the arrangements for the audit.*

Signed \_\_\_\_\_ Date \_\_\_\_\_  
Celia Wade-Brown  
Mayor

## Details of the audit

### 1 Introduction

This document sets out the arrangements for the audit of Wellington Council (the Council) for the year ending 30 June 2011.

### 2 Areas of audit focus

#### 2.1 Matters specific to Wellington Council

Based on the planning work and discussions that we have completed to date, we have identified what we consider to be the main matters facing the Council.

Many of these matters are relevant to the audit because they affect our ability to form an opinion on your financial statements and/or service performance reporting. As part of the wider public sector audit, we are also required to be alert to issues of performance, authority, waste, and probity.

The table below sets out the matters and other areas of audit focus that we have identified, and our proposed audit response.

Matter/area of focus	Our audit response
<p><b>Weathertightness (leaky homes)</b></p> <p>Exposure to liabilities from leaky home claims remains a significant issue for both the Council and wider sector. While solutions are being sought at a political level to limit or cap the extent of individual party's liability, at this stage there is nothing concrete in place.</p> <p>The government has proposed to establish new financial assistance package (FAP) to help homeowners repair their leaky homes faster. The FAP will see the Government meet 25 per cent of homeowners' agreed repair costs and Local Authorities contributing 25% per cent. The option exists for Local Authorities to opt into the scheme.</p>	<p>We will keep up to date with developments.</p> <p>We will consider the information obtained by the Council to determine its financial exposure to weathertightness claims, how this is accounted for and disclosed in the annual report.</p>
<b>Procurement of goods and services / contract management</b>	
<p>The Council procures significant goods and services on a routine basis.</p> <p>In our previous audit we reviewed the procurement policies and procedures used by the Council and found them to be consistent with good practice.</p> <p>Contract management is an important component of procurement. Contract management includes the effective management and monitoring the delivery of goods or services to the agreed levels.</p>	<p>We will</p> <ul style="list-style-type: none"> <li>• review a sample of significant procurement decisions made during the year to ensure consistency with policy;</li> <li>• review any changes made in response to the procurement function, including the recent establishment of the project management office; and</li> <li>• discuss the Council's contract management processes.</li> </ul>

# APPENDIX THREE

Matter/area of focus	Our audit response
<b>Changes to Council-Controlled Organisations</b>	
<p>The Council has established a new council-controlled trading organisation to manage the merged operations of the St James Theatre Charitable Trust (from 1 July 2011) and the Wellington Convention Centre (from 1 February 2011). In addition, it was agreed that the ownership of the built assets of the St James Theatre and the Opera House be transferred to the Council who will take responsibility for their maintenance and upkeep.</p>	<p>We will maintain an understanding of the changes to CCOs and assess whether there are any wider impacts to consider relevant to the audit.</p>
<b>Local Government Funding Agency</b>	
<p>Local authorities have been progressing an initiative to consider the benefits of establishing a company which will borrow funds and lend them on to local authorities at lower interest margins than would be paid to other lenders.</p> <p>This has now progressed to the stage where there is a firm proposal in place and a number of key steps are about to take place. We understand that the Council is currently considering the implications of the scheme and potential risks, before submitting a proposal.</p>	<p>We will keep up to date with progress. The nine councils involved will need to consult under S56 as they are proposing to form a CCO.</p> <p>This consultation may also be an LTCCP amendment because we expect some councils will be making changes to their Liability Management policy and their Investment policy to reflect the new scenario around investing in and using the Agency.</p> <p>Should an amendment be required to the Council's LTCCP, we will liaise with management about the required audit of the statement of proposal.</p>
<b>Revaluation of assets due this year</b>	
<p>The Council periodically revalues certain operational and infrastructural asset classes. In the current year infrastructural assets are due for valuation. This will significantly impact the Council's 2011 balance sheet, as well as the income statement in future years</p> <p>The Council will also need to formally review whether a revaluation is needed this year over the land and buildings assets last revalued in 2009.</p>	<p>We will:</p> <ul style="list-style-type: none"> <li>• ensure the revaluation of infrastructural assets has been appropriately performed and accounted for in the Council's annual report; and</li> <li>• review the Council's assessment of whether there is any significant difference between the carrying amount and fair value of its operational land and building assets.</li> </ul>

# APPENDIX THREE

Matter/area of focus	Our audit response
<b>Emerging matters that may impact the audit</b>	
<p>Below are other emerging matters potentially affecting the Council that do not directly affect our audit:</p> <ul style="list-style-type: none"> <li>• <b>Wellington regional governance arrangements</b> – An independent report on the existing structure of local government in the region and outlines potential future options. The report is currently out for consultation and will next be considered by the Mayoral forum in April 2011.</li> <li>• <b>Ownership of water assets</b> – An independent report has been prepared to explore options for the optimal ownership structure of the region’s water assets. This is currently being discussed between councils.</li> <li>• <b>Local Government Amendment Act 2010</b> – This Act, previously known as Transparency, Accountability and Financial Management (or TAFM), has recently been passed. The changes generally affect future financial years, but do impact the audit of LTCCP amendments.</li> <li>• <b>Council Committee structure</b> - The election of a new Council and Mayor has led to changes to the Council’s committee structure. We note the appointment of a new independent member of the audit committee.</li> <li>• <b>Rugby World Cup</b> – Significant effort is underway to prepare for the successful operation running of this event in the city.</li> </ul>	<p>We will maintain an awareness of progress in these areas.</p> <p>If any further audit work is required we will discuss with management in the first instance.</p>

## 2.2 Matters relevant across all Local Authorities

As well as the matters noted above, there are also other matters common to the Local Authorities sector. The table below outlines our areas of interest for this year’s audit.

Areas of interest	Audit response
<b>Emissions Trading Scheme</b>	
<p>Councils who operate landfills will have obligations to report their emissions and surrender New Zealand Units (NZUs) under the Emissions Trading Scheme (ETS). From 1 January 2012 land fill operators will be required to report their greenhouse gas emissions.</p>	<p>We will liaise with the Council to confirm that management are aware of this requirement and discuss how they will measure the gas emissions, including whether unique or default emissions factors will be used.</p>

# APPENDIX THREE

Areas of interest	Audit response
<b>Council Governance Role in completion of Council Controlled Organisation (CCO) Statement of Intents (SOIs)</b>	
<p>CCOs are responsible for meeting the accountability requirements of the Local Government Act 2002 (LGA), including preparing SOIs with appropriate involvement from their parent Local Authorities.</p> <p>Local Authorities are responsible for the effective oversight of their CCOs. This includes reviewing and commenting on draft SOIs of their CCOs within the timeframe in the LGA and ongoing monitoring of performance.</p>	<p>We will consider whether the Council has appropriate arrangements in place for effectively fulfilling its oversight responsibilities relating to CCOs.</p>
<b>Possible LTCCP amendments</b>	
<p>Every proposed amendment must be audited. An amendment arises where the Council makes a significant decision not provided for in the LTCCP, as outlined in section 97 of the Local Government Act, or makes changes to the policies outlined in Section 102 of the Local Government Act.</p>	<p>We will remain alert for possible amendments throughout the year, particularly during the preparation of the annual plan. We will maintain contact with Council management and discuss potential amendments as they arise.</p>
<b>Development contributions</b>	
<p>Development contributions (and financial contributions, which are levied under the Resource Management Act) are an important funding tool for many local authorities.</p>	<p>We will assess the results of the Council's review of its development contributions policy.</p> <p>We will review the Council's controls to ensure the development contribution is charged in accordance with the policy. We will also review whether the use and application of funds received is appropriate and that they have been correctly accounted for.</p>
<b>Elected members – remuneration and allowance</b>	
<p>The Local Government Act gives the Remuneration Authority responsibility for setting the remuneration of local government elected members. The Authority also has the role of approving a Local Authority's policy on allowances and expenses.</p> <p>The Council's annual report must disclose the total remuneration received by or payable to each member of the local authority in the reporting period.<sup>1</sup> A local authority must disclose remuneration paid or payable to each member from both the local authority and any council organisation of the local authority.</p>	<p>We will assess the Council's compliance with the requirement to disclose the remuneration of each member of the local authority in the annual report against the Local Government Elected Members Determination and Local Government Elected Members (2010/11) (Except Auckland) Determination 2010.</p>

<sup>1</sup> Schedule 10, clause 18, Local Government Act 2002

# APPENDIX THREE

Areas of interest	Audit response
<b>Severance payments</b>	
<p>The Auditor-General's 2002 report <i>Severance Payments in the Public Sector</i> discusses the risks facing public sector employers when they make voluntary payments to employees (especially at the end of the employment relationship). It suggests a principled approach to employment settlements, aimed at reducing those risks.</p>	<p>We will examine severance payments made to employees as part of exit settlements – especially when senior ex-staff are the recipients – to ensure a principled approach as been followed in reaching settlement.</p> <p>Our focus will be on settlements which could be seen to be, excessive or unusual. For example this would include settlements which include a large tax-free payment, provide a guaranteed contract role of the departing employee. We will also examine any payments significantly in excess of contractual entitlements.</p>
<b>Sensitive expenditure</b>	
<p>In February 2007 the OAG published: <i>Controlling sensitive expenditure; Guidelines for public entities</i> (the Sensitive Expenditure Guidelines). We expect the Council's policies and practices to be consistent with this guidance.</p>	<p>We will follow up the recommendations made in our 2010 audit around improving the level of guidance provided to staff about sensitive expenditure, and compliance with set policies.</p>
<b>Conflicts of interest</b>	
<p>Conflicts of interest are a generic area of concern because where these are not well managed there can be legal and reputation risks. During 2007 the OAG published two sets of guidance for entities in this area:</p> <p><i>Managing conflicts of interest: guidance for public entities</i>, explains how to understand conflicts of interest in the public sector, and how to identify, disclose, and manage them. It also considers both the legal and ethical dimensions of conflicts of interest.</p> <p><i>Guidance for members of local authorities about the law on conflicts of interest</i>, provides more specific guidance for councillors. This is an updated version of previously published guidance about the legal requirements that apply to council members in formal decision-making at meetings of their authority.</p> <p>The Local Government (Members' Interests) Act 1968 controls the making of contracts between Councillors and the Council and prevents Councillors from participating in Council matters in which they have a pecuniary interest.</p>	<p>While it is primarily the responsibility of the Council to identify and manage conflicts of interest, in the course of our usual audit work we will remain alert for conflicts of interest.</p> <p>It is important that both the Council and Councillors identify and manage compliance with the Local Government (Members' Interests) Act 1968.</p>

# APPENDIX THREE

Areas of interest	Audit response
<b>Risk management</b>	
<p>Sound risk management processes help to minimise the impact of risks on the organisation.</p> <p>Where a Local Authority has not identified risks, or has not put in place specific processes for managing these risks, they remain exposed to the full impact of the particular risk.</p>	<p>The Council has effective risk management processes. The ARMS committee is progressing a number of further enhancements to its processes following a self-review in 2010.</p> <p>We will review at a high level the broad approach taken to risk and the mitigation processes in place.</p>
<b>Annual Report Adoption and Public Release Dates Return</b>	
<p>The Local Government Act specifies a timeline for the adoption and public release of the Annual Report and Summary Annual Report.</p> <p>The OAG intends to monitor the Annual Report adoption and public release dates of all Local Authorities.</p>	<p>We will note the dates that the Council adopts its annual report, and makes its full and summary annual reports available to the public.</p> <p>This information will be forwarded to the Office of the Auditor-General.</p>
<b>Local Authority exemptions for Council Controlled Organisations (CCOs)</b>	
<p>Under section 7 of the LGA, a Local Authority may exempt a “small” CCO from the accountability regime that applies to CCOs under that Act.</p>	<p>We will advise the OAG on the Council’s use of Section 7 of the Local Government Act 2002 to exempt any CCOs since 1 July 2010.</p>
<b>Local Authorities emissions and measurement and reduction</b>	
<p>We will gather information about the activities of local authorities in the area of emissions measurement and reduction.</p>	<p>We will gather this information from the Council and report it to the OAG.</p>

## 3 Review of the management control environment

The management control environment reflects the overall attitude, awareness, and culture of an entity towards managing risk, and its focus on meeting its objectives. A stronger management control environment increases the likelihood that specific controls will operate as designed, and will therefore lower the risk of errors within the financial statements.

The areas we believe are the foundations of a good control environment include:

- clarity of strategic planning;
- communication and enforcement of integrity and ethical values;
- commitment to competence;
- participation by those charged with governance (for example, the involvement and influence of an audit committee or equivalent);
- management philosophy and operating style;

- organisational structure;
- assignment of authority and responsibility;
- risk assessment and risk management;
- key entity-level control policies and procedures;
- information systems and communication (including information technology planning and decision-making);
- monitoring; and
- arrangements for legislative compliance.

In previous years we assessed the management control environment of the Council as effective.

We will carry out a high-level review of the Council's management control environment in the areas mentioned above. The purpose of this review is to ensure that the management control environment remains effective.

## 3.1 IS systems environment

The design and operation of an effective IS control environment is critical to ensuring the accuracy, integrity and availability of the Council's information.

Information is one of the Council's key assets, as such, IT risk management procedures enables prevention and mitigation of risks to this asset. The Council should have good practices such as reviewing data, limiting user access, managing the abilities of "superusers" and external parties to change data and applications, and ensuring procedures for backup and recovery of data are tested and working.

As part of the 2011 audit we will complete a review of the Council's IT General Controls (ITGC).

The ITGC review forms two parts.

- 1 Risk assessment of the entity-level controls in place. These controls are management's activities in the following areas:
  - IT governance and strategic planning;
  - IT processes, organisation, and relationships;
  - assess and manage IT risks;
  - monitor and evaluate performance; and
  - monitor and evaluate internal control.
- 2 An assessment as to the design and operational effectiveness of activity level controls. These control areas cover the Council's ability to manage risk associated with the following areas:

- Systems acquisition/project management;
- Security (network and applications);
- Change management;
- Management of physical hardware;
- Management of third-party services;
- Data management;
- Operations management;
- Configuration management;
- Problems and incident management; and
- End-user computing (applications and development).

## 4 Logistics

### 4.1 Our audit team

The Audit New Zealand staff involved in the audit are:

Andy Burns	Director
Scott Tobin	Professional Standards Review Director
David Kidman	Audit Manager
Desikan Naidoo	Audit Manager
Alan Clifford	Information Systems Auditor
Martin Richardson	Specialist Assurance Director
Jason Biggins	Tax Director

### 4.2 Communication plan

Open, honest, timely communication between parties is fundamental to the audit process. We will maintain regular contact with the Council and management as specified in the table below:

Communication with	Purpose	Timing
Chief Executive.	<ul style="list-style-type: none"> <li>• To confirm major areas of audit focus and to discuss audit arrangements.</li> <li>• To discuss major findings from the audit process and add value to the Council through discussion of current and emerging sector issues.</li> <li>• To discuss emerging issues that may affect the Council's operations, as they arise.</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly, and as required.</li> </ul>

# APPENDIX THREE

Communication with	Purpose	Timing
Audit and Risk Management Subcommittee	<ul style="list-style-type: none"> <li>• To establish major areas of audit focus and discuss audit arrangements.</li> <li>• Discussion of emerging strategic, operational, accounting or financial issues facing the Council.</li> <li>• Consider timely action to resolve emerging issues and proactive identification and discussion of significant issues to ensure no surprises.</li> <li>• Discuss major audit findings from the Council's audit process including summary of issues material to the Council and Group audit resulting from the subsidiary audits.</li> </ul>	<ul style="list-style-type: none"> <li>• Attendance at each Audit and Risk Management Subcommittee meeting.</li> <li>• Prior to signing the audit opinion.</li> <li>• As required.</li> </ul>
Council	<ul style="list-style-type: none"> <li>• To discuss the major findings from the audit.</li> </ul>	<ul style="list-style-type: none"> <li>• At the conclusion of the audit – meeting scheduled for 31 August 2011</li> </ul>
Chief Financial Officer and/ or Manager, Financial Accounting and/ or Manager, Strategy Planning and Performance	<ul style="list-style-type: none"> <li>• To discuss major areas of audit focus.</li> <li>• Discuss operational and financial issues affecting the Council.</li> <li>• Discuss audit issues and obtain an operational perspective.</li> <li>• Identify and resolve financial reporting issues arising.</li> <li>• Monitor and manage audit process against agreed deliverables and timeframes.</li> </ul>	<ul style="list-style-type: none"> <li>• During the course of the planning and interim visits.</li> <li>• Throughout the course of the interim and final audits as required.</li> <li>• Bi-monthly, as required.</li> </ul>
Various Senior Management Team members	<ul style="list-style-type: none"> <li>• Discuss key and emerging issues and developments affecting the Council.</li> <li>• To provide appropriate advice as required.</li> </ul>	<ul style="list-style-type: none"> <li>• Quarterly or six monthly and as required.</li> </ul>
Director Risk Assurance	<ul style="list-style-type: none"> <li>• Discuss audit arrangements.</li> <li>• Discuss emerging issues that may impact on the Council's operations, as they arise.</li> <li>• To discuss internal audit activities and findings.</li> <li>• Discuss major findings from the audit process.</li> </ul>	<ul style="list-style-type: none"> <li>• During planning discussions.</li> <li>• Quarterly, as required.</li> <li>• After completion of audit work but prior to reporting finalisation.</li> </ul>

# APPENDIX THREE

Communication with	Purpose	Timing
Knowledge Solutions Business Unit Manager	<ul style="list-style-type: none"> <li>Discuss emerging Information Systems and Information Technology issues that may impact on the Council's operations, and service delivery.</li> <li>To discuss Information Systems Strategic Planning.</li> <li>Discuss major findings from the audit process and add value to the Council.</li> </ul>	<ul style="list-style-type: none"> <li>During planning discussions.</li> <li>After completion of work but prior to reporting.</li> </ul>

## 4.3 Important dates in the audit process

Our proposed timetable is:

	Date
Interim audit begins	7 March 2011
Draft interim management report to the Chief Executive	4 April 2011
Pre-final visit	7 June 2011
Draft annual report (including service performance information) available for audit	1 August 2011
Final audit begins	1 August 2011
Final financial statements available <sup>2</sup> for audit	1 August 2011
Provisional clearance to ARMS	15 August 2011
Audit opinion issued	31 August 2011
Draft Chief Executive report	31 August 2011
Draft Governing Body report	31 August 2011
Summary Annual Report received	5 September 2011
Summary Annual Report opinion issued	16 September 2011

## 4.4 Professional fees

Our audit fee estimate for the year ending 30 June 2011 is \$240,860 (to be agreed). We have provided the Council with a draft Audit Proposal Letter with our fee estimate for the audits ending 30 June 2011, 2012 and 2013.

## 5 Additional information about the audit

### 5.1 Our reporting protocols

#### 5.1.1 Governing body and Chief Executive reports

We will provide a draft of all reports to management for discussion/clearance purposes. In the interests of timely reporting, we ask management to provide their comments on the draft within 10 working days. Once management comments are received the report will be finalised.

<sup>2</sup> Financial statements incorporating all the amendments agreed to between the Council and Audit New Zealand.

## 5.1.2 Reporting of misstatements

We will include details of all non-trivial uncorrected misstatements in our Governing Body report. Misstatements are differences in, or omissions of, amounts and disclosures that may affect a reader's overall understanding of the Council's financial statements.

During the audit, we will provide details of any such misstatements we identify to an appropriate level of management. We will ask for each misstatement to be corrected in the Council's financial statements. Where management does not wish to correct a misstatement we will seek written representations from representatives of the Council's governing body that specify the reasons why the corrections will not be made.

## 5.1.3 Annotated audit opinion needed if the annual report is published on your website

We understand that the Council intends to publish its annual report on its website. We need to review the information before it is published on the website. An annotated audit report will need to be used for this purpose. This contains some additional paragraphs setting out the risks associated with documents published in an electronic environment. This version of the audit report needs to be published with the electronic version of the annual report.

Examining the controls over the electronic presentation of audited financial information on the Council's website is beyond the scope of the audit of the financial statements. When information is presented electronically on a website, the Council should address the security and controls over information on the website to maintain the integrity of the data presented.

## 5.2 Our expectations of you to enable an efficient audit

To enable us to carry out our audit efficiently within the proposed audit fee, we expect that:

- the Council will provide us with access to all relevant records and provide information in a timely manner;
- your staff will provide an appropriate level of assistance;
- the financial statements will be available at the start of the final audit, include all relevant disclosures, and be fully supported by a detailed workpaper file; and
- the annual report and financial statements (including the statement of service performance) will be subjected to appropriate levels of quality review before submission for audit.

Our audit fee is based on the assumption that we will review no more than two sets of the draft annual report, one printer's proof copy of the annual report, and one copy of the electronic version of the annual report for publication on the Council's website.

## 5.3 Co-ordination with Risk and Assurance

Our approach will be to continue to liaise with the risk assurance team at the Council to ensure appropriate co-ordination of effort. In keeping with the applicable auditing

standard, ISA (NZ) 610, Using the Work of Internal Auditors, we will make a preliminary assessment of the internal audit function in terms of organisational status, scope, technical competence, and professional care.

If we determine that the internal audit function could be used for external audit purposes, then we will consider the internal audit work proposed or completed.

Where possible we will seek to place reliance on internal audit work to reduce the level of testing we perform.

## **5.4 How we consider your compliance with statutory authority**

As part of the Auditor-General's mandate, we carry out an audit of compliance with statutory authority. Our audit is limited to obtaining assurance that you have complied with certain laws and regulations that may directly affect the Council's financial statements or general accountability. Our audit does not cover all of the Council's requirements to comply with statutory authority.

Our approach to this aspect of the audit will mainly involve assessing the systems and procedures that are in place to ensure compliance with certain laws and regulations that we consider to be significant. We will also complete our own checklists covering the key requirements of significant legislation. In addition, we will remain alert for any instances of non-compliance that come to our attention. We will evaluate the relevance of any such non-compliance to our audit.