

Report to the Council on the audit of
Wellington City Council
for the year ended 30 June 2011

Management report

Audit New Zealand has carried out this audit on behalf of the Controller and Auditor-General.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

Our audit has been carried out in accordance with the Auditor-General's auditing standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity, or inefficiency that is not material to your financial statements.

Implementing and maintaining systems of internal control for detecting these matters remains the responsibility of the Council and management.

Statement of auditor independence

We confirm that, for the audit of the Wellington City Council's financial statements for the year ended 30 June 2011, we have maintained our independence in accordance with the requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants.

During the year we undertook a review of the Clifton Terrace Carpark managed by the City Council on behalf of the New Zealand Transport Agency. Other than the audit, the review of the Clifton Terrace Carpark and the audit of the long-term community plan, we have no relationship with or interests in the Council or any of its subsidiaries.

Unresolved disagreements

We have no unresolved disagreements with management about matters that individually or in aggregate could be significant to the financial statements. Management has not sought to influence our views on matters relevant to our audit opinion.

Other relationships

We are not aware of any situations where a spouse or close relative of a staff member involved in the audit occupies a position with the Wellington City Council that is significant to the audit.

We are aware that during the 2010/11 financial year one employee from Audit New Zealand accepted a position at the Wellington City Council. This role is not directly related to the preparation of the financial statements or non-financial performance information, we do not believe this has impacted on our audit independence.

A B Burns
28 September 2011

Report to the Council

for the audit for the year ended 30 June 2011.

We have completed the audit for the year ended 30 June 2011. This report sets out our findings from the audit and draws attention to areas where Wellington City Council (the Council) is doing well or where we have made recommendations for improvement.

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Key messages

An unmodified opinion was issued

This means that we were satisfied that the financial statements and statement of service performance fairly reflected the Wellington City Council's (the Council) activity for the year and its financial position at the end of the year.

The Council's leaky homes liability now includes an estimate of future, presently unreported claims from homeowners

The Council's total leaky homes liability has increased by \$33.9m. The majority of this increase (\$24.4m) is due to the first time recognition of claims not yet reported to Council. Previously these unreported claims were disclosed as contingent liabilities.

Unreported claims represent a current obligation for the Council. Recognition of a provision is appropriate as the obligation can be estimated reliably.

The provision will need to be revised in future periods as more information becomes available, particularly around the impact of the new financial assistance package now operating.

The Council's service performance reporting continues to be of a high standard

We are satisfied that the Council's performance for the year is fairly reflected in the statements of service performance. Performance information is presented with useful graphs and narrative to illustrate performance trends and put results in context.

The Council has appropriately accounted for its revaluation of its infrastructural assets

The Council performed a planned revaluation of its infrastructure assets as at 30 June 2011. The depreciated replacement cost value of infrastructure assets has increased by some \$252.4m.

We are satisfied that the Council has appropriately revalued and accounted for its infrastructural assets in accordance with NZ IAS 16 – *Property, plant and equipment*.

Thank you

We would like to thank the Council and management for their assistance and cooperation throughout the audit. Documentation provided to support the audit continues to be of a good standard. This allowed us to complete the audit within two months of balance date and within our agreed timetable.

Section A: Significant matters arising during the audit

1 Our audit opinion

1.1 We issued an unmodified audit opinion

We issued an unmodified audit opinion on 31 August 2011. This means that we were satisfied that the financial statements and statement of service performance fairly reflects the Council's activity and performance for the year and its financial position at the end of the year.

In forming our audit opinion, we considered the following matters:

1.2 Subsidiary audits - unresolved matter at the time the audit opinion was issued

As at the date of this report there was one unresolved matters which may impact on the Council and group's reported result:

- Wellington Cable Car Limited – the valuation of the company's overhead line network has yet to be completed.

We have estimated the likely impacts on the Council if a misstatement is identified.

We have assessed that the potential misstatement from this matter is not material to the Council and group.

For more information including the estimated correcting entry refer to the schedule of unadjusted misstatements in Appendix 1.

1.3 Other unadjusted misstatements

Refer to Appendix 1 for the schedule of unadjusted misstatements at the time of our audit opinion. These are also not material.

2 Areas of audit focus

During the planning stage of the audit, we identified key areas of focus for the audit, and documented these in our arrangements letter. In this section of our report we comment our findings on those matters.

2.1 Weather tightness (leaky homes) provision

We have assessed that Council has appropriately accounted for and adequately disclosed the leaky homes provision in its financial statements.

Estimates of this nature are subjective. The leaky homes provision as at 30 June 2011 was calculated by management utilising the support of an actuary. The provision will need to be revised in future periods as more information becomes available, particularly around the impact of the new Financial Assistance Package (FAP).

Discussion

Council provides for its future obligations relating to leaky homes. This represents an estimate of future payments to homeowners and associated legal costs, or costs from the FAP.

In 2011, Council provided for both reported (i.e. known) claims and unreported (i.e. unknown) claims. Previously unreported claims were reported as a contingent liability.

Claims not yet reported to Council are at present unknown, but represent a current obligation of the Council. Recognition of a provision is appropriate as the obligation can be estimated reliably.

The Council's total leaky homes liability has increased by \$33.9 million. The majority of this increase (\$24.4 million) is due to the recognition of unreported claims noted above.

There are a number of assumptions applied to calculate the leaky homes liability. A sensitivity analysis is disclosed in the notes to the accounts showing the impact of changes to each assumption. We recommend that Council considers the value of reporting an overall high and low estimate to help readers assess a range of outcomes. We understand that the actuary is able to provide such information.

Management comment

Based on several discussions with Audit New Zealand and with independent external advisors we concluded that it is appropriate to recognise an additional provision at 30 June 2011 for the Council's unreported leaky home claims totalling \$24.4 million. This estimate of the value of claims has been made by our actuaries. The nature of the liability means that there are significant inherent uncertainties in estimating these likely costs that will be incurred in the future. We will discuss this further with our actuaries over the next 12 months and consider the reporting of a high and low estimate of expected values in future years.

2.2 Revaluations of assets have been appropriately accounted for

Infrastructural assets

The Council revalued its infrastructural assets in accordance with the relevant accounting standard (NZ IAS 16) and its revaluation cycle.

We reviewed the Council's revaluation and are satisfied that the revaluation was appropriately accounted for and adequately disclosed in the Council's financial statements.

Other assets

The Council has a three-yearly revaluation cycle. Operational land and buildings are due to be revalued in 2012. The relevant accounting standard (NZ IAS 16) requires an assessment of off-cycle revalued assets at each balance date. If the fair value differs materially from its carrying amount, the valuation should be brought forward.

We reviewed Council's assessment and are satisfied that a revaluation of Council's operational land and buildings was not required this year.

2.3 Audit of Service Performance

We audited the reported service performance information in the Annual Report.

We focused on:

- the quality of the overall "story" the performance reporting tells;
- the reliability and accuracy of reporting;
- the completeness of the reporting against the performance framework as outlined in the LTCCP; and

- compliance with relevant legislation (in particular the Local Government Act 2002, Schedule 10).

When we performed the audit of Council's 2009-19 LTCCP we concluded that the performance framework provided an appropriate basis for meaningfully assessing Council's actual performance. We have updated our assessment to take into account any changes in Council's business and activity since the LTCCP was adopted. We are satisfied that Council's performance framework continues to provide an appropriate basis on which to assess Council's performance.

We are satisfied that the service performance statements comply with generally accepted accounting practice and fairly reflected the actual achievements and performance of Council.

2.4 Control environment

Overall we found all key financial controls continue to operate effectively.

Consistent with previous years, the Council continues to operate an effective control environment. There are good financial management processes in place.

The control environment is determined by the attitude, awareness, and actions of the governing body, management and others, who have the ability to

influence the reliability of control systems concerning the internal controls.

The control environment encompasses the entity's control culture and values, organisation and governance structures and its commitment to designing and maintaining reliable accountability systems. It also includes the attitude and approach to planning, budgeting, performance monitoring and compliance with legislative requirements. The stronger the management control environment, the greater the likelihood that these processes at different levels of the organisation will operate as designed and that the organisation's objectives will be achieved.

Our findings:

- The Council and management continue to demonstrate a commitment to operating and monitoring appropriate management control systems. This includes both the maintenance of transactional recording systems and the monitoring of results through detailed analysis and appropriate reporting.
- Budgeting and monitoring procedures continue to be effective. A key aspect of this is the role of the business analysts in the budgeting and monitoring process.
- Council has an experienced executive and management team which displays a consistent

level of commitment to operating and maintaining a strong control environment.

- There is an effective Risk Assurance (internal audit) function operating within the Council.
- The Audit and Risk Management (ARMS) sub-committee brings a high level of scrutiny to organisational risk and management issues.

2.5 Risk management

The Council has a sound organisational wide approach to risk management. Steps have been taken to further improve the operation of the ARMS sub-committee

The Council has effective risk management processes, overseen by ARMS. Last year ARMS members were asked to complete an audit committee effectiveness evaluation checklist in order to review the effectiveness of the subcommittee.

The results of the evaluation indicated that current ARMS processes and practise are in line with the principles and good practices set out in the OAG Guidelines.

The ARMS also identified several areas for improvement, and has taken positive actions to progress these matters. These include:

- The appointment of a new and qualified external member to the subcommittee, to add independent oversight, and fresh perspective.
- An induction of new and existing committee members lead by the committee chair and supported by Risk Assurance.
- A review of the ARMS terms of reference (Charter).
- A review of the ARMS Forward Programme to ensure alignment with its terms of reference.
- A review of the ARMS terms of reference.

We also note that an independent peer review of the activities of the internal audit function is planned for late 2011.

Management comment

Agreed. All areas identified for improvement by the ARMS have been completed.

2.6 Information systems

The Council's high level information systems controls remain effective.

We have completed our work on the information systems general control environment.

We found that information systems controls remain effective, and no new significant issues are arising.

In last year's audit we recommended that the Council:

- Develop and implement and IS/IT Security Policy.
- Formally documents the results of the IT disaster recovery test.
- Considers carrying out a post-implementation review of projects during the financial year and last financial year.

We update these findings in Appendix 2 of this report. The matters are being progressed.

Management comment

An ICT Security Framework has been developed together with individual security policies. The draft security policies have been reviewed by Audit NZ. The ICT Security Framework was signed off by IT Management in March 2011.

A review of organisational policies and standards is being undertaken. Discussions are to be held regarding how the draft security policies can be incorporated into the overall organisational standards programme.

The issue of formal documentation of the results of the next IT disaster recovery (DR) test is being progressed. An Infrastructure DR test is scheduled to be carried out prior to June 2012 and will be documented.

2.7 Procurement of goods and services

We have previously assessed the Council's procurement policy as very good. The documentation is reflective of modern, public sector procurement standards.

Council recognises that formal mechanisms to support staff to undertake procurement and contract management need to be further strengthened.

The Council's procurement team are developing a contracts and procurement strategy to support the Council to achieve its procurement and contractual outcomes. The key areas of focus of the strategy include:

- Developing best practice procurement
- Improving process efficiencies
- Achieving benefits realisation
- Building capacity-training and education
- Developing collaboration.

Risk Assurance undertakes reviews of a number of procurements each year using a risk based approach.

We understand these findings indicate policy is generally being complied with, however opportunities for improvement were identified.

Management comment

Agreed. The contracts and procurement strategy is being developed for presentation to the Management Board before the end of 2011.

2.8 Sensitive expenditure

Effective steps have been taken to manage discretionary expenditure

New discretionary expenditure guidelines were rolled out to business units in October 2010. Our review of the policies found them to be consistent with the OAG good practice guidelines.

The Council could consider further guidance around travel, in particular the public perception implications of the use of 5-star accommodation.

The Council's Risk Assurance team has maintained a continuous monitoring programme to assess compliance with the new policies. We have been advised that they have seen an improvement in practice during the year.

Our sample testing to date of credit cards and travel and entertainment expenses did not identify any matters of concern. Documentation of business purpose and some

context was lacking in some instances, mirroring findings of Risk Assurance. Risk Assurance are taking steps to reinforce this expectation across Council.

Management comment

Agreed. We will look to provide further guidance regarding the public perception implications of the use of 5-star accommodation through the planned review of the travel policy.

2.9 Changes to Council Controlled Organisations: Wellington Venues Limited

We will complete our audit of Wellington Venues Limited in September 2011. The balances within Wellington Venues Limited are not material to the Council's financial statements.

The Council established Wellington Venues Limited (WVL), a new council-controlled trading organisation, to manage the operations of venues. These include the Wellington Town Hall, Michael Fowler Centre, TSB Bank Arena and Shed 6 with St James Theatre and the Opera House included from 1 July 2011.

WVL is the management company for the Wellington Venues Project, which remains within Council. The underlying assets and revenue/expenses for each venue rest within the Wellington Venues Project (similar to the existing arrangements with the Wellington Waterfront Project).

The scope of this audit is limited to selected administrative costs within WVL and does not cover the Wellington Venues Project. We are currently completing this audit and will report our findings in a separate report to their Board.

2.10 Audit of the LTCCP amendment for the Local Government Funding Agency

The Council's LTCCP has been amended to allow Council to invest in the new Local Government Funding Agency.

During the year we identified and audited the Council's Summary of Proposal (*Proposal to amend the Investment and Liability Management policies contained in the Wellington City Council's Long Term Council Community Plan 2009-19 and to invest in the Local Government Funding Agency*).

The Council's Statement of Proposal dated 25 May 2011 is fairly presented and Council has complied with the applicable requirements of the Local Government Act 2002.

The amendment was adopted 31 August 2011.

Section B: Other matters

Every year, we identify common sector matters that are considered as part of the audits of all local authorities. Our findings on these sector matters, other than those already covered earlier in this report, are discussed in this section.

We have provided management with a supplementary report that discusses our findings and recommendations about less significant and miscellaneous matters.

The status of the matters outstanding from last year's report to the Council is included in Appendix 2.

3 Sector matters

We completed reviews on our areas of interest across all Local Government. Most of our findings have been incorporated in the relevant sections of this report. Our comments on the issues not already addressed elsewhere are as follows:

3.1 Council's fraud policy and assessment of areas susceptible to fraud

The Council has an appropriate fraud policy. Risk Assurance has a continuous auditing programme that examines sensitive and fraud risk areas including, discretionary expenditure, accounts payable and payroll

system transactions. The reviews consider control effectiveness and mitigation of fraud, waste and abuse.

3.2 Severance payments

We reviewed a sample of severance payments that occurred during the year with a focus on settlements which could be seen to be excessive or unusual.

We found:

- the process used by Council management for identifying severance payments is adequate;
- the basis for calculation of severance payment were appropriate;
- there were no issues from a performance, waste or probity perspective, that is, no settlements were assessed as excessive or unusual; and
- the disclosure in the Annual Report is in accordance with Schedule 10 of the Local Government Act 2002.

3.3 Conflicts of interest and related party disclosures

We remained alert for conflicts of interest in the course of our audit work.

We reviewed the Council's conflicts of interest policies and procedures and assessed these as adequate.

We found that:

- The Council has implemented an annual declaration process for senior management. We reviewed the process and assessed it as effective for identifying related party transactions.
- Related party disclosures were appropriate and in accordance with the appropriate accounting standard, NZ IAS 24 – *Related Party Transactions*.
- No conflict of interests issues were identified as part of our audit.

We reviewed the Council compliance with the Local Government Act (Members Interest) Act 1968. No issues were identified.

3.4 Elected members – remuneration and allowances

We reviewed 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.

We reviewed disclosures for Councillor (Member's) fees, Director Trustee fees and Community Board remuneration.

We did not identify any issues. The Council complies with requirements and disclosure is appropriate.

3.5 Emissions Trading Scheme

Council is aware of the requirement to report their emissions and surrender New Zealand Units (NZUs) under the Emissions Trading Scheme (ETS). We also discussed how they will measure the gas emissions from 1 January 2012, including whether unique or default emissions factors will be used.

We did not identify any issues of concern in relation to the Emissions Trading Scheme.

3.6 Development contributions

As part of the audit we reviewed Council's controls to ensure the development contribution is charged in accordance with the policy and whether the use and application of funds received is appropriate and that it has been correctly accounted for.

We did not identify any significant issue in relation to development contributions.

4 Reviews on behalf of the Auditor-General

We completed the reviews required by the Auditor-General, as set in our audit arrangements letter, and cleared them with appropriate members of your management team. Appendix 3 sets out the results of the reviews. There are no issues that need to be brought to your attention.

4.1 Council's governance role in completion of Council Controlled Organisation (CCO) Statements of Intent

We are satisfied that the Council has appropriate arrangements in place for effectively fulfilling their oversight responsibilities relating to CCOs.

Consistent with the prior year, the Council has a dedicated CCO unit which manages relations with CCOs.

The Council has a relationship manager assigned to each CCO. There are clear accountabilities and reporting requirements. These managers work closely with the relevant business units of Council.

Appendices

Appendix 1: Unadjusted misstatements

Appendix 2: Status of recommendations made last year

Appendix 3: Details of reviews on behalf of the Auditor-General

Appendix 1: Uncorrected misstatements

Note	Statement of comprehensive income		Statement of financial position	
	Dr \$000	Cr \$000	Dr \$000	Cr \$000
1	1,070		430	(1,500)
2			432	(432)

Explanation for uncorrected differences

- 1 Wellington Cable Car Limited – This is presently an uncertainty, rather than a firm uncorrected misstatement, as this subsidiary audit has not been cleared. If the recent expenditure on the trolley bus overhead assets was to be expensed rather than capitalised, the impact would be as above, and represents our present assessment of the maximum impact on the group Statement of Financial Performance.

Management comment

The audit of Cable Car is still ongoing so the nature and value of any adjustment has not yet been finalised. Amount is immaterial for adjustment in the financial statements.

- 2 Civic Assurance – Further impairment to the Council’s investment in Civic Assurance as at 30 June 2011.

Management comment

The value of our investment in Civic Assurance is based on audited accounts for 31 December 2010. Unaudited accounts obtained after the preparation of the Council’s 30 June 2011 financial statements showed a further impairment to our investment. Amount is immaterial for adjustment in the financial statements.

Unadjusted disclosure deficiencies

There were no unadjusted disclosure deficiencies.

Appendix 2: Status of recommendations made last year

Matter	Recommendation	Outcome and status
Information systems policies and procedures		
<p>Council does not have one overarching IS/IT Security Policy. This potentially allows unauthorised access to systems and/or fraudulent, malicious or unintended transactions to be posted.</p>	<p>We recommend Council develop and implement an IS/IT Security Policy as an overall statement of the importance of security to the organisation.</p>	<p>Issue being progressed</p> <p>A draft Security Framework has been developed and was presented to management for approval on 22 March 2011.</p> <p>This framework includes improved security settings and the requirements for reviews of users access.</p> <p>HR have a backlog of policies awaiting formal adoption and rollout across the Council.</p>
Annual leave management		
<p>The Council has been increasing its focus in recent years on the management of staff with high annual leave balances. A number of system controls have been introduced.</p> <p>We reviewed the number of employees with over 30 days leave owing. We were pleased to note that at 30 June 2010 the number of people with more than 30 days leave owing had fallen to 70 from 83 last year.</p>	<p>We believe that 70 people is a large number of employees with more than 30 days leave owing and we recommend the Council monitor this closely, and manage the number of people with high balances down.</p>	<p>Issue being progressed</p> <p>The Council is making progress in reducing the annual leave balances. There were 91 staff with balances over 30 days at the time of our audit, and increase over the 70 staff last year. However balances over 40 days are now 24, a significant reduction from 58 last year.</p> <p>We will continue to monitor Council's progress with this matter.</p>

Matter	Recommendation	Outcome and status
Sensitive expenditure		
<p>We selected a sample of transactions from areas of sensitive expenditure incurred during the year and reviewed them for compliance with the Council's practices and accepted good practice in the public sector.</p> <p>We identified some instances where more guidance is required to explain the Council's policies, to assist in ensuring that they are consistently applied.</p>	<p>We have raised the specifics of these findings with management, and discussed opportunities to further develop guidance in this area.</p>	<p>Issue being progressed</p> <p>Refer to section 2.8 above.</p> <p>Note that while the matter from 2010 is cleared, further improvement in documentation would be beneficial as described in 2.8 above.</p>
Audit Committees – Audit Risk Management Subcommittee (ARMS)		
<p>Current ARMS processes and practice are in line with the principles and good practices set out in the OAG Guidelines.</p> <p>Some areas for improvement were identified to further improve practice.</p>	<p>ARMS decided to re-visit the implementation of these recommendations after the elections. In our view ARMS should also consider:</p> <ul style="list-style-type: none"> • Its role in reviewing the integrity of non-financial performance information. • Reviews the effectiveness of the external audit process and performance. 	<p>Issue cleared</p> <p>Issues completed as part of the review of the ARMS terms of reference - both items are included in the terms of reference</p>

Appendix 3: Reviews on behalf of the Auditor-General

Issue	Status/findings
Annual Report adoption and public release dates	<p>We have been asked to note the dates that the Council adopts its annual report, and makes the full and summary annual reports available to the public. This information has been forwarded to the Office of the Auditor-General (OAG).</p> <p>We will submit this information to the OAG once the Council have released the Annual Report and Summary Annual Report to the public.</p>
Local Authority exemptions for Council Controlled Organisations (CCOs)	<p>We were asked to advise the OAG on the Council's use of Section 7 of the Local Government Act 2002. Under section 7 of the LGA 2002, a local authority may exempt a "small" CCO from the accountability regime that applies to CCOs under that Act.</p> <p>At the Council meeting dated 15 December 2010, the Council carried an exemption of the Joe Aspell Trust, in accordance with the provisions of Section 7 of the Local Government Act 2002.</p> <p>Last year the Hutt Minoh Friendship Trust was also exempted. This organisation is no longer a CCO of the Council.</p>
Local Authorities emissions and measurement and reduction	<p>We were asked to gather information about the activities of local authorities in the area of emissions measurement and reduction.</p> <p>We found that the Council has a system in place for measuring the Council's emissions information as well as a Climate Change Action Plan (CCAP) with the aim to reduce emissions.</p>