

Report to the Governing Body on the audit of

**Wellington City Council**

for the year ended 30 June 2009

**Audit New Zealand has performed 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 generally accepted audit standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency that is not material in terms of your financial statements.**

**The implementation and maintenance of your systems of controls for the detection of these matters remains the responsibility of the Council and management.**

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## **Executive Summary**

for the audit for the year ended 30 June 2009

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### **Audit opinion**

An unqualified audit opinion was issued on the Council's financial statements on 26 August 2009.

### **Management control environment**

Overall we found all major financial controls continue to operate effectively, however we could not rely on one new key control introduced in the payroll area for the purposes of the audit, as the documentation to evidence that control was operating was not retained during the year. We are satisfied that payroll documentation is now being retained.

### **Compliance with legislation**

There were no breaches of significant legislation.

### **Issues for your attention**

We have identified an issue in relation to future legal costs for Weathertight homes of \$5.4 million – the Council does not provide for these. Please refer to paragraph 4.3.1. We have accepted that the Council has not provided for these in the financial statements on the basis that the amount is immaterial in terms of financial statements materiality.

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# Management report to the Governing Body

for the audit for the year ended 30 June 2009.

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Audit New Zealand has completed the audit of the Wellington City Council (the Council) for the year ended 30 June 2009. This report summarises our findings from the audit and draws attention to areas where the Council is doing well or could improve.

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## 1 Audit opinion

An unqualified opinion was issued on the Council's and group's financial statements.

## 2 Management control environment

### 2.1 Background

The management 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 importance of 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 its attitude and approach to planning, budgeting, performance monitoring and compliance with legislative requirements. These translate into internal control procedures that are established to provide reasonable assurance that entity objectives will be achieved. The internal controls build into the following processes:

- Governance structures and mechanisms.
- Risk management.

- Financial planning, budgeting, reporting and monitoring.
- Operational financial controls.
- Quality assurance procedures.

The stronger the management control environment, the greater the likelihood that these processes at different levels within the organisation will operate as designed and that organisations' objectives will be achieved.

## 3 Our approach

Our approach for the audit of the financial statements was, where possible, to place reliance on the Council's control environment and management systems, including reviews performed by the Council's Risk Assurance division, with a view to minimising the level of detailed transaction testing performed.

### 3.1 Assessment

We found that, consistent with previous years, the Council continues to operate a sound management control environment and there are effective financial management processes in place. We have identified the following as some of the key aspects of the management control environment:

- The Council and management have demonstrated a commitment to appropriate management control systems being in place and operating effectively. This includes both the maintenance of essential transactional recording systems as well as detailed financial analysis and management reporting throughout relevant levels of the Council.
- Budgeting and monitoring of financial performance is very effective due to the systems and processes in place. A key aspect of this is the role of the business analysts in budgeting and monitoring processes. In addition, the Finance and Treasury Committee meets weekly to, amongst other things, monitor and review financial and operational performance and business cases.
- There is an experienced executive team which displays a consistent level of commitment to maintaining a strong control environment.
- The Council's governance structures provide a clear division of responsibilities between the Council and management.
- There is an active and effective Audit and Risk Management Subcommittee, which brings a high level of scrutiny to organisational risk and general management issues. There is an effective risk assurance (internal audit) function with

appropriate mandate and internal accountabilities.

- The Council maintains an established annual planning process, which includes regular reviews of the Council's long-term financial strategy, and a substantial public consultation process.
- There are sound structures and robust processes through which financial performance against budgets is monitored on a monthly basis by both management and the Council.

## 4 Compliance with legislative requirements

### 4.1 Legislative compliance systems

We reviewed the Council's overall approach to identifying and complying with legislative requirements. We also reviewed compliance with specific legislative obligations directly related to the Council's annual planning and reporting processes.

Managers completed a legislative sign-off form to the Manager, Risk Assurance confirming:

- the lead manager's responsibility for their key legislation;
- that the information the lead manager holds on each piece of key legislation is completed and up

to date, and that systems, processes, training programmes and manuals are adequate for all staff to know their compliance responsibilities; and that to the best of the lead manager's knowledge their key legislation has been complied with and there has been no legislative breaches during the past year.

#### **4.2 Breaches of significant legislation**

During our audit we did not identify any breaches of significant legislation that need to be brought to your attention.

#### **4.3 Matters arising from the audit**

##### **4.3.1 Weathertight homes legal costs**

The Council has recognised a provision in respect of weather tight homes claims with the Weathertightness Homes Resolution Service (WHRS) which are measured on the basis of the estimated cost of settlement by the Council in conjunction with an actuary. The Council has accrued for claims from Riskpool for the shortfall in funds from previous fund years which Riskpool have advised the Council of.

We found that the potential legal costs of \$5.4 million associated with settling the claims have not been included in the measurement of the provision.

We considered whether legal costs associated with the settlement of claims be included in the measurement of the provision. We note that the Council has taken independent advice to support its view that legal costs need not be included.

Our view is that a provision is required to be measured at the best estimate of the expenditure required to settle the present obligation at the balance sheet date. In measuring the amount of the provision for WHRS claims, the expected legal costs associated with settling claims recognised as a liability should be included in the liability measurement. Where amounts are clearly not incremental costs, it would be reasonable to exclude such costs from the measurement of the liability. For example, for general counsel costs that would be incurred regardless of the existence of the WHRS claims.

In our view, this conclusion is consistent with:

- The provision recognition criteria of NZ IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 37.14(b);
- The estimate of future legal costs would be included in any sum required to be paid to a third party to transfer the claims portfolio at balance date (NZ IAS paragraph 37.37);
- The measurement of other provisions such as environmental obligations; and

- The advice provided to the Council states that a provision for future legal costs might also be recorded when an entity has a portfolio of very similar claims, some of which might be won but others lost. In this scenario, the recognition criteria has been met because an outflow of economic benefits is probable at least in respect of a portion of the claims.

The Council has not recognised the legal costs associated with the settlement of claims recognised as a provision. We have accepted the Council's treatment on the basis that the amount of the legal costs is not material to the financial statements.

We recommend that the Council consider providing for future legal costs.

We will review the matter again next year given the expected legal costs associated with settling the claims are likely to change and the Government's recent announcement and discussions with Councils on finding a solution to the weathertight homes issue.

#### **Management comment**

*Management believe it is not appropriate to provide for future legal costs to defend these claims as lawyers have not yet performed their service and therefore no liability has yet been established. The Council's position has been supported by independent accounting advice.*

*There are significant uncertainties in this area and the Minister for Building and Construction recently reported that the Government is working closely with local councils on finding a solution to the problem. We will continue to monitor the situation and review the impact of any proposed solutions when assessing the provision in the future.*

#### **4.4 Fraud policy**

It is the expectation of the Auditor-General that every public entity should formally address the matter of fraud, and formulate an appropriate policy on how to minimise it and (if it occurs) how it will be dealt with.

The Council has an appropriate fraud policy, which was updated during the year and sets out the strategy for deterrence and prevention. Risk Assurance has provided business unit managers with an updated fraud policy and advice on Fraud Prevention and detection.

Risk Assurance has developed a continuous auditing programme that examines sensitive and fraud risk areas including, discretionary expenditure, accounts payable and payroll systems transactions for control effectiveness and/or fraud, waste and abuse.

The Council are using ACL software to analyse data in various financial systems. We reviewed the work performed by Risk Assurance on an audit of payroll where ACL was used to provide summaries of data for further analysis. We are pleased that ACL software has worked



well for the Council and is meeting the objective of improving the productivity, efficiency and effectiveness of audit activities.

Risk Assurance reported against its continuous audit programme as part of its reporting to the Audit and Risk Management Sub-committee.

Risk Assurance reported that none of the issues investigated or arising from the continuous controls testing programme have given concern regarding significant or systematic breakdown in controls.

#### **Management comment**

*No significant or systematic breakdown in controls noted during the year. Risk assurance will continue to monitor sensitive and fraud risk areas throughout the 2009/10 financial year and will report its findings to the Audit and Risk Management Subcommittee.*

## **5 Other matters**

Overall we found all major financial controls continue to operate effectively, however we could not rely on one new key control introduced in the payroll area for the purposes of the audit, as the documentation to evidence that control was operating was not retained during the year. We are satisfied that payroll documentation is now being retained.

Minor matters arising have been discussed and will be reported separately in our letter to the Chief Executive.

We wish to convey our appreciation to the Council's Finance and Planning, Performance and Research teams who again contributed to a smooth audit process. The robust process and thorough quality assurance regime over the draft financial statements meant that the documentation provided to audit was of a high standard. Wellington City Council was once again one of the first councils to adopt its annual report. We found the early liaison with officers particularly useful in agreeing mutual expectations. The setting up of an issues register and the regular discussion of the status of issues contained therein also assisted the audit process.

We thank too all the other Council officers who have during the year met with us, to discuss issues and answered our queries.

#### **Management comment**

*The Council's internal control environment continues to evolve and while we think there are some issues to be addressed, the system of payroll controls in place for 2009 are significantly improved over 2008. Additional controls were put in place during the year but copies of some reports were not consistently kept until March 2009 and audit therefore needed to perform additional testing in this area. The controls implemented in 2009 must be considered as part of overall systems of controls which includes all controls that*

were present in 2008 plus the additional control processes added during the 2009 year. Audit performed testing on the controls from March 2009 onwards, once the relevant documentation was being retained, and found no issues.

## **6 Follow-up of issues raised in the Planned Audit Approach for Council**

### **6.1 Housing upgrade project**

The Crown is providing the Council with financial assistance of to upgrade its housing portfolio to provide safe, secure housing to a good standard.

The Deed of Grant between the Council, the Crown and Housing New Zealand Corporation that governs the funding of the Housing Upgrade Project was signed on 26 August 2008. The Deed of Grant governs how the \$220 million funding from the Crown will be provided over a 10 year period. A work programme for the next 20 years has been agreed and Council has committed to remain in social housing until 2037.

During the year, the Council began putting in the management and support structures.

As part of our 2008/09 audit we carried out a brief overview of the governance and management arrangements for the Housing Upgrade Project. We found:

### *Housing Strategy*

There is a clearly defined, evidence based strategy for social housing in the city. It is jointly owned and supported by Council and its partners, in particular, the Crown and Housing NZ.

The Strategy has been appropriately informed by an assessment of stock condition, which in turn has lead to the development and adoption of “a basic housing standard that all units will meet at the end of the upgrade programme”.

The Strategy is also well informed and guided by matching housing stock to need in the city, considering the role of all social housing providers in the city. In particular the project is integrated with the 2008 “Housing Reconfiguration Strategy” which “seeks to identify the current and future social housing needs”. This has lead to reconfiguration of bedsits to one or two bedroom units to meet future needs, recognising the change in household demographics. The configuration of the stock is appropriately influenced by the constraints placed by the existing structures, need, demand and other social landlords’ portfolios.

The programme is appropriately prioritised, taking into consideration a range of factors linked to regulatory requirements as well as social factors and the programme’s overall objectives.

There is good integration between the programme and the overall approach to housing across Council.

*Project management arrangements*

Formal, strong, comprehensive project management arrangements are in place. These should be effective at ensuring that the programme has access to the right number of staff with the right skills and is adequately controlled.

*Project governance arrangements*

Governance arrangements are clear and documented, including arrangements for reporting to government.

*Management of upgrade work*

There are arrangements in place to manage the building works once they commence.

*Managing rents to contribute to the financial model*

The viability and modelling of the programme was completed before the Deed of Grant was signed with the Crown. The modelling was done over the 30 years to account for the agreement that the Council would remain in social housing for this duration. Based on the model assumptions, which includes annual rental increases, and post upgrade increases, the model is sustainable. The challenge is to balance housing affordability with the

financial sustainability of the upgrade. This balance has yet to be determined.

Costs at this stage of the programme appear to be adequately controlled. Year 1 spend was behind original forecast due to the late signing of the Deed of Grant with the Crown.

**Management comment**

*Part of the agreement with the Crown required a review of the Housing Policy including the rent setting to be carried out within 2 years of the signing of the Grant. The Policy is currently being developed so that sustainability of the portfolio can be achieved. Councillors have had a workshop to discuss rent setting during August.*

**6.2 Facilities Maintenance Aggregation Project**

Council identified that bringing together its facility maintenance services into one contract would provide a range of savings and efficiencies.

Council has signed a contract with City Care.

The facilities maintenance contract is now operational. We understand that the contract started well during the early months, and that the Councils monitoring arrangements have subsequently identified and responded to any subsequent contract performance issues.

We have been advised that the Council has decided to carry out a post-implementation review of the contract letting process, to consider any lessons learned from this change management process and the extent to which the arrangement has achieved its intended objectives.

In light of this, we have deferred any further work in this area and will consider the outcome of the Council's review in due course.

#### **Management comment**

*There have been many benefits to Council with having one service provider, including better aligned asset management plans, systematic scheduled maintenance providing robust asset protection, automation of internal purchase order systems, and confirmed programme of works for renewal spend.*

### **6.3 Property, plant and equipment**

#### **6.3.1 Reassessment of fair values**

The Council's policy is to revalue its classes of property, plant and equipment assets on a three yearly basis. Infrastructural assets were last revalued at 30 June 2008. NZ IAS 16 *Property Plant and Equipment* requires that when the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required against their carrying value.

The Council carried out a high level review using data sourced from Business and Economic Research Limited (BERL). The Council estimated the infrastructure assets value movements using BERL indices.

In summary, the results of the reassessment of fair values indicate a potential movement of values of around 7.2%.

We agreed with the Council that the movement is not material and therefore a full revaluation was not required for the 2008/09 financial year.

Based on the movement of 7.2% in only one year, the Council may need to review its infrastructure assets in 2009/10.

#### **6.3.2 Revaluation of operational land and buildings assets**

We reviewed the operational land and buildings valuation and found that they have been appropriately accounted for in accordance with NZ IAS 16 and VS 3 *Valuations for Financial Statements*.

### **6.4 Asset management plans**

We appraised the Councils' asset management planning as part of our work in auditing LTCCPs.

We carried out a review of the Council's asset related management plans (AMPs) and the environment within which they operate. We used the framework and

processes for asset management set out in the International Infrastructure Management Manual (the manual) prepared by the National Asset Management Steering Group (NAMS) as a basis for the assessment.

We considered:

- The Council's corporate context for asset management planning;
- the quality and reliability of data and information in asset management plans, including financial forecasts;
- proposed levels of service and the arrangements for measuring attainment; and
- the Council's approach to lifecycle management, improvement planning and review and audit.

Our review has comprised the analysis of a self-assessment undertaken by the Council, consideration of past reviews of asset management at the Council, review of the Council's asset management plan for Wastewater, and interviews with the Manager, Infrastructure Planning and asset managers from the Council's service provider, Wellington Water Management Limited (Capacity).

We found that the quality of asset management planning is very good.

The Council has a well developed framework of policy and management practice to support its approach to asset management. The Council aims in the long term to achieve advanced asset management. All asset management plans meet the requirements of core, appropriate asset management with a number already at advanced practice.

The Wastewater plans we reviewed were very good. We also reviewed the Council's AMPs for City Housing Properties and the Wellington Convention Centre in August 2007, concluding that planning for these services was good. Key considerations in reaching this conclusion include:

- Asset management planning is integrated with other strategic and operational planning.
- There is a sound approach to data collection to ensure that Council databases are up to date.
- The Council undertakes condition assessment of its assets to inform its maintenance and renewals planning.
- Technical performance measures were in place for the service we reviewed (Wastewater).
- There are well documented links between the community outcomes, the strategic objectives of the Council and the contribution that the assets make within AMPs.

- Use of appropriate performance measures and trend data to demonstrate performance over time.

However, within a generally strong performance framework, there is scope to be more explicit about what the actual Levels of Service are, as distinct from service objectives, activity measures and service performance measures.

We recommend that the Council draws together the performance framework for Wastewater (and any services in a similar position) with some clear statements of levels of service setting out a holistic expression of what the service does and to what standard. This would complement and provide a focus for the existing service objectives, performance measures and activity standards.

#### **Management comment**

*We thank Audit for their favourable comments. However there is a recommendation for more explicit levels of service (LOS) to be articulated in the Asset Management Plans. Currently the performance targets are detailed but there is a request for the LOS, which are currently implicit, to be better articulated. This will be attended to in our next review of the AMP.*

## **6.5 Performance, waste and probity**

### **6.5.1 Sensitive expenditure policies and testing of sensitive expenditure**

Last year we reviewed a sample of Council's sensitive expenditure policies:

- Guide to discretionary expenditure
- Delegations policy
- Travel and accommodation policy
- Purchase Cards

against the OAG's *Controlling sensitive expenditure: Guidelines for public entities*. The above Council's policies are consistent with good practice.

We tested a sample of CEO and councillors expenditure, credit card and consultancy expense transactions to ensure Council is complying with its own policies and procedures.

There were no issues identified during our testing.

### **6.5.2 Employee severance and redundancy payments**

Employee settlements in the public sector continue to draw attention. The Auditor General's report *Severance Payments*

*in the Public Sector (May 2002)* remains the point of reference for severance payments.

We reviewed a sample of severance and redundancy payments that occurred during the year.

No issues were noted.

### 6.5.3 Development contributions

Development contributions (and financial contributions, which are levied under the Resource Management Act) are an important tool for local government. However, development contributions have a high profile amongst a vocal development community.

We reviewed unpaid development contributions for collectability and enquired as to the existence of claims, threats of legal actions or other matter which may indicate that requiring or collection of development contributions is, or could be, challenged.

No issues were noted.

### 6.5.4 Audit Committees

Based on our review of the Audit Risk Management Sub-Committee's (ARMS) terms of reference, knowledge and our attendance at ARMS and interaction with members, we are of the view that ARMS operates in accordance with the

four main principles in the Auditor-General's Audit Committee Guide (the Guide):

- Independence;
- competence (prima facie this assessment was based on whether audit committee members have relevant experience and expertise);
- clarity of purpose; and
- open and effective relationships.

We understand that Risk Assurance has evaluated ARMS (in discussion with the Chair) and evaluated current practice against the Guide. As part of the review process audit committee members will be asked to complete the effectiveness self evaluation checklist. At this stage the completing of the self evaluation checklist and the review report is likely to be presented at the ARMS meeting in December 2009.

### 6.5.5 Managing conflicts of interest

During the course of the audit we remained alert for conflicts of interest.

No issues were noted.

**6.5.6 2009/19 Long Term Council Community Plan**

We audited the 2009/19 Long Term Council Community Plan (LTCCP) statement of proposal and the final LTCCP and signed unqualified audit reports on 9 April 2009 and 29 June 2009.

**6.5.7 Local Authority exemptions for Council Controlled Organisations (CCOs)**

We have been asked to advise the OAG on 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.

At Council's meeting of 29 August 2007, Council exempted the Hutt Minoh House Friendship Trust, and the Joe Aspell Trust.

**6.5.8 Annual Report adoption and public release dates**

We have been asked to note the dates that the Council adopts its annual report, and make the full and summary annual reports available to the public. This information will be forwarded to the Office of the Auditor General.

Council made the full annual report and summary annual report available to the public on 22 September 2009.

**7 Status of issues arising from the 2007/08 audit**

Appendix 1 details the current status of each item that was outstanding at the end of the 2007/08.

**8 Unadjusted misstatements**

The financial statements and non financial information are free from material misstatements, including omissions.

However, during the course of the audit, we detected:

- an immaterial misstatement that is not material to the financial statements

We have discussed this with management who are of the view that it does not need to be adjusted.

We have detailed these items in Appendix 2, together with management's rationale for not making adjustments to the Annual Report.

We are satisfied that this is immaterial.

**9 Statement of auditor independence**

We confirm that, for the audit of the financial statements of Council for the year ended 30 June 2009, 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 (NZICA).

During the year we undertook an audit of the Clifton Terrace Carpark managed by Council on behalf of Transit New Zealand.

Other than the audit, and the audits of the Clifton Terrace Carpark and in conducting the audit of the Long Term Council Community Plan, we have no relationship with or interests in Council or any of its subsidiaries.

## **9.1 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.

## **9.2 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 Council that is significant to the audit.

We are not aware of any situations where a staff member of Audit New Zealand has accepted a position of employment with Council during or since the end of the financial year.

## Appendix 1: Status of issues reporting during the 2007/08 audit

Issue	Recommendation	Current status
<b>Systems in place for capturing interest and related party information</b>		
<p>Only 12 of the 14 elected members returned their Register of Interests.</p> <p>Council relies heavily on the honesty and good faith of its members to disclose relevant interests and related parties. There is no reasonableness check performed.</p>	<p>Follow up with members who have not provided their declarations, and remind and educate members on the importance of members' interests</p>	<p><b>Issue cleared.</b></p> <p>The Council completed a follow up declaration in September 2008. Members who had not completed their March declaration and members who had new declarations were required to make their declaration. All members have now made their declaration of interests. Democratic Services have advised us that they are changing the declaration process from Triennium to Annual.</p>
<p>There is no interest register kept for senior management.</p>	<p>Put in place an interest register for senior management.</p>	<p><b>Issue cleared.</b></p> <p>Interest register is in place for senior management.</p>

Issue	Recommendation	Current status
<b>Information Systems</b>		
<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>Develop and implement an IS/IT Security Policy as an overall statement of the importance of security to the organisation.</p>	<p><b>Progress has been made.</b></p> <p>A Security Officer has just been recruited. This person will deal with the issues.</p> <p>We will continue to follow the Council’s progress on this issue.</p> <p><b>Management comment</b></p> <p>A proposal to establish security function in Knowledge Solutions has been developed and is planned to be implemented over the next two years.</p>
<p>Council’s Knowledge Solutions (KS) organisation is not aware of the extent of end-user applications and does not have controls in place to manage end-user computing. The risk around end-user computing applications (such as Excel spreadsheets and Access databases) is that they might be used for key business processes, and/or business decisions and/or reporting without (at the same time) being subject to the same level of controls as business key systems.</p>	<p>Develop and implement a policy for end-user computing as a basis for controlling the employment of end-user application.</p>	<p><b>Progress has been made.</b></p> <p>Guidelines have been developed. The Council would like to migrate critical access applications to standard KS platforms when users request it.</p> <p>We will continue to follow Council’s progress on this issue.</p> <p><b>Management comment</b></p> <p>The development of an end-user computing policy has not been undertaken at this time. However we believe that the implementation of the EDRMS provides management of unstructured data, including spreadsheets.</p>

## Appendix 2: Unadjusted misstatements

<b>Current year misstatements</b>	<b>Assets</b>	<b>Liabilities</b>	<b>Equity</b>	<b>Income Statement</b>
<b>(Including explanation why not corrected)</b>	<b>Dr (Cr)</b>	<b>Dr (Cr)</b>	<b>Dr (Cr)</b>	<b>Dr (Cr)</b>
Provision for other liabilities – other provisions	-	(\$5,420,000)	-	-
Expenditure on operating activities	-	-	-	\$5,420,000
Expected legal costs associated with settling legal claims recognised as a liability have not been recognised as a liability in the financial statements				
<b>Management comment</b>				
<i>Management believe it is not appropriate to provide for future legal costs to defend these claims as lawyers have not yet performed their service and therefore not liability has yet been established. The Council's position has been supported by independent accounting advice.</i>				
<b>Total known misstatements</b>	-	<b>(\$5,420,000)</b>	-	<b>\$5,420,000</b>