

1 Purpose and scope

1.1 Purpose of report

This report is prepared for the Audit and Risk Committee as part of our ongoing reporting and in accordance with our audit engagement letter dated 18 December 2013. Council's finance team have also presented you with a report about the preparation of the financial statements, which complements and builds on some of the matters raised in this report.

1.2 Scope of our audit

Audit New Zealand carries out this audit on my behalf. I am responsible, under section 15 of the Public Audit Act 2001, for expressing an independent opinion on the financial statements and statement of service performance, and reporting that opinion to you. I am also responsible for reporting on whether the Council has complied with the requirements of schedule 10 of the Local Government Act 2002 that apply to the annual report.

The audit has been carried out in accordance with New Zealand auditing standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency that are immaterial to your financial statements. The implementation and maintenance of your systems of controls for detecting these matters remains the responsibility of the Council and management.

2 Final audit status

2.1 Audit status update

The final audit of the Auckland Council and Group financial statements and the statement of service performance commenced in July 2016. As at 5 September 2016 we have not provided final clearance on all volumes of the Annual Report. However, we expect to be well placed to issue our audit opinion on 29 September as required.

The audit team are working closely with the Council's finance team to finalise all outstanding matters.

2.2 Audit opinion

Once all outstanding matters are satisfactorily resolved, and subject to any significant changes, I am intending to issue an unmodified audit opinion at the Council meeting to be held on 29 September 2016.

2.3 Unadjusted misstatements

At the present time the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements and statement of service performance as a whole.

A list of the uncorrected misstatements is included in the attached draft letter of representation.

At this time we are not aware of any material disclosures that have been omitted from the financial statements and statement of service performance that have not been or are in the process of being adjusted.

2.4 Representation letter

As already noted a copy of the draft representation letter is attached as Appendix 1. This letter will be agreed with management prior to signing on 29 September 2016.

3 Key matters from the audit

3.1 Overall performance

We are satisfied that Council have provided a materially accurate account of their performance for the year ended 30 June 2016 in their annual financial statements, and explanations of why actual performance varied from that budgeted in the 2015/16 Long Term Plan.

The Council reported their full year preliminary announcement on Monday 29 August 2016 thereby meeting the NZDX reporting obligations. This release was based on unaudited results for the year.

3.2 Significant areas of focus during the audit

Our draft management report to the Council will be issued on 29 September 2016. This report will update the Council on the status of the business, financial and statement of service performance risks we identified in our audit arrangements letter.

The following are the significant areas we focused on during our year end audit.

- **Asset valuations**

The Auckland Council group completed an out-of-cycle revaluation of both operational and restricted land and buildings after fair value assessments indicated significant movements had occurred. When revalued the operational land and buildings had an increase in fair value of \$885m (an increase of approximately 19% on the 2015 carrying value), restricted land and buildings increased by approximately \$690m (an increase of approximately 16% on the 2015 carrying value). The majority of the movement in both asset classes is due to the increase in land values. Other valuations completed across the Group were completed as part of the Council's usual revaluation cycle.

- **Newcore valuation**

As certain modules within the overall NewCore project were available for use towards the end of the financial year, the costs attributable to these modules, plus an allocation of the project's capital overhead costs, were transferred out of work in progress and into the computer software intangible asset category at year end.

We reviewed Auckland Council's processes and controls for capitalisation of costs to the project, with a particular focus on staff and contractor costs, and council's assessment of whether any impairment was required. We also performed a review of the costs capitalised. We are satisfied the costs capitalised to the project during the financial year,

the impairment recognised and the closing work in progress balance are materially appropriate.

We have sought specific assurance from the Council and management in the letter of representation that they are satisfied that the value of \$90m capitalised as an operational intangible asset plus \$28m currently included in work in progress for Newcore is fairly stated in the financial statements.

- Derivatives valuation

Council's derivatives are primarily floating to fixed rate swaps, with the Council predominantly being the fixed rate payer. This position is consistent with swaps taken out by other debt holders in the NZ market.

A declining floating interest rate has led to significant fair value losses on the Group's derivatives during the 2016 year, with a net unrealised loss of \$661m by year end. We are aware that adverse market conditions following the Brexit decision in late June contributed to the magnitude of this loss, with some recovery in the current financial year. We are satisfied as to the correct valuation of financial instruments in the financial statements.

We have verified the Council's valuation of the cross currency interest rate swaps (CCIRS). In line with previous years we continue to recognise an immaterial unadjusted error relating to the accounting treatment of the de-designation of six CCIRS in the 2013/14 financial year. This error is included on our schedule of uncorrected misstatements.

- Provisions

The provision for leaky home claims (weathertightness) continues to be the most significant provision on the Council's balance sheet. There is a continuing shift in the balance of the remaining provision from single unit to multi-unit claims with multi-unit claims now making up \$214m of the \$257m provision. Settlements during the 2016 year have been lower than forecast in the 2015 provision. We expect to see continuing volatility relating to multi-unit claims over the short term, particularly as the 10 year statute of limitations comes to an end for the more high risk period of construction. We also note that the Financial Assistance Package scheme agreed with the Crown (FAP) is winding up with no new claims accepted after 25 July 2016. We do not expect this to have much impact on the provision going forward, as the value of claims through FAP has been relatively low.

We are satisfied that the value of the weathertightness provision in the 2016 accounts is soundly based and appropriate, while acknowledging an increasing degree of inherent uncertainty in the balance related to multi-unit claims, this also being reflected in the contingent liability note.

We will continue to report in our management letter on the need for Council to be clear in its reporting on the composition of this provision and in particular the shift in risk to multi-unit claims where Council exposure is more uncertain and potentially volatile while largely outside of the FAP funding arrangement with the Crown.

- Debt

Group debt has increased by \$277m during the year, which is far lower than the \$1.1b increase in the previous year and is under budget due to unbudgeted fair value gains as at balance date, a delay in the issue of planned offshore debt until after balance date due to unfavourable Brexit effects and capital deferrals/delays leading to lower funding needs during 2015/16.

Balances remain within treasury ratios. However, budgeted debt continues to rise as a % of total revenue.

- Service performance reporting

We are having difficulties confirming Council information on the stormwater flooding response times. At the time of this report we are still working with the Council on this to ensure the results for this measures are accurately reported.

3.3 Acknowledgements

We would like to thank Council and management for their assistance during this yeas audit process and we look forward to working with you again in the future.

Appendix 1:

[Entity Letterhead]

29 September 2016

Lyn Provost
Auditor-General
c/o J R Smaill
Audit Director
Audit New Zealand
PO Box 1165
Auckland 1140

Dear Lyn

Letter of representation for the year ended 30 June 2016

This representation letter is provided to you in connection with your audit of the financial statements and statement of service performance for the year ended 30 June 2016 of:

- Auckland Council; and
- the group, comprising Auckland Council and its subsidiaries.

The purpose of the audit is to express an independent opinion about whether:

- the financial statements comply with generally accepted accounting practice and present fairly, in all material respects, the financial position of Auckland Council and group as at 30 June 2016 and the results of its operations and its cash flows for the year ended on that date; and
- the statement of service performance complies with generally accepted accounting practice and presents fairly, in all material respects, the service performance for the year ended 30 June 2016.

We understand that your audit was carried out in accordance with your Auditing Standards, which incorporate the International Standards on Auditing (New Zealand). We also understand that your examination was (to the extent that you deemed appropriate) for the objectives of:

- providing an independent opinion on Auckland Council and group's financial statements and performance information; and
- reporting on other matters relevant to Auckland Council and group's financial and other management systems that come to your attention and are material (for example, compliance with statutory obligations or probity).

General responsibilities

To the best of our knowledge and belief:

- the resources and activities under our control have been operating effectively and efficiently;

- we have complied with our statutory obligations including laws, regulations and contractual requirements;
- we have carried out our decisions and actions with due regard to minimising waste;
- we have met Parliament's and the public's expectations of appropriate standards of behaviour in the public sector (that is, we have carried out our decisions and actions with due regard to probity); and
- any decisions or actions have been taken with due regard to financial prudence.

We also acknowledge that we have responsibility for designing, implementing, and maintaining internal control (to the extent that is reasonably practical given the size of Auckland Council and group) to prevent and detect fraud.

Responsibilities for the financial statements and the statement of service performance

We confirm that all transactions have been recorded in the accounting records and are reflected in the financial statements and statement of service performance, and that, to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves:

- we have fulfilled our responsibilities for preparing and presenting the financial statements and the statement of service performance as required by the Local Government Act 2002 and, in particular, that:
 - the financial statements comply with generally accepted accounting practice and present fairly, in all material respects, the financial position of Auckland Council and group as at 30 June 2016 and of the results of its operations and its cash flows for the year then ended; and
 - the statement of service performance complies with generally accepted accounting practice and presents fairly, in all material respects, the service performance for the year ended 30 June 2016;
- we have appropriately considered the implications of the new public benefit entity (PBE) accounting standards. In particular, the Auckland Council and group is correctly classified as a Tier 1 reporting entity;
- we believe the significant assumptions used by us in making accounting estimates, including those measured at fair value, are reasonable; and
- we have appropriately accounted for and disclosed related party relationships and transactions in the financial statements;
- all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to you and have been accounted for and disclosed in accordance with generally accepted accounting practice;
- we have adjusted or disclosed all events subsequent to the date of the financial statements and the statement of service performance that require adjustment or disclosure;
- we believe the effects of uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements and statement of service performance as a

whole. A list of the uncorrected misstatements is attached as Appendix 1 to this representation letter; and

- we believe we have appropriately identified and accounted for all expenditure incurred in developing the NewCore system for the year ended 30 June 2016. This includes the correct recognition of operating expenditure (including any impairment costs recognised against work in progress) and capital additions (which are recognised as work in progress), as well as the capitalisation of costs into the computer software asset class for the relevant aspects of the Newcore software that became operational in June 2016. We are satisfied that in respect of Newcore the value of \$90m capitalised as an operational intangible asset plus \$28m currently included in work in progress is fairly stated in the financial statements.

Responsibilities to provide information

We confirm that, to the best of our knowledge and belief, having made such enquiries as we considered necessary for the purpose of appropriately informing ourselves:

- we have provided you with:
 - all information, such as records and documentation, and other matters that are relevant to preparing and presenting the financial statements and the statement of service performance; and
 - unrestricted access to persons within Auckland Council and group from whom you determined it necessary to obtain audit evidence;
- we have disclosed to you the results of our assessment of the risk that the financial statements and statement of service performance may be materially misstated as a result of fraud;
- we have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects Auckland Council and group and involves:
 - management;
 - employees who have significant roles in internal control; or
 - others where the fraud could have a material effect on the financial statements and statement of service performance;
- we have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting Auckland Council and group's financial statements and statement of service performance communicated by employees, former employees, analysts, regulators, or others;
- we have disclosed to you all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements and the statement of service performance, including possible non-compliance with laws for setting rates; and
- we have disclosed the identity of the related parties, all of their relationships, and all of their transactions of which we are aware.

Going concern

We confirm that, to the best of our knowledge and belief, Auckland Council and group have adequate resources to continue operations at their current level for the foreseeable future. For this reason, the Council continues to adopt the going concern assumption in preparing the financial statements and the statement of service performance for the year ended 30 June 2016. We have reached this conclusion after making enquiries and having regard to circumstances that we consider likely to affect the Auckland Council and group during the period of one year from 29 September 2016, and to circumstances that we know will occur after that date which could affect the validity of the going concern assumption.

We consider that the financial statements and the statement of service performance adequately disclose the circumstances, and any uncertainties, surrounding the adoption of the going concern assumption by the Auckland Council and group.

Throughout the year, Auckland Council and group has conformed with the requirements of its banking arrangements, debenture trust deeds, or negative pledge agreements, including those relating to its net tangible assets ratios.

Publication of the financial statements and statement of service performance and related audit report on a website

The Council accepts that it is responsible for the electronic presentation of the audited financial statements and statement of service performance.

The electronic version of the audited financial statements and statement of service performance and the related audit report presented on the website are the same as the final signed version of the audited financial statements and statement of service performance and audit report.

We have clearly differentiated between audited and unaudited information on the website and understand the risk of potential misrepresentation without appropriate controls.

We have assessed the security controls over audited financial and service performance information and the related audit report and are satisfied that procedures are adequate to ensure the integrity of the information provided.

Where the audit report on the full financial statements and statement of service performance is provided on a website, the financial statements and statement of service performance are also provided in full.

Sign-off on these representations

These representations are made at your request, and to supplement information obtained by you from the records of the Auckland Council and group and to confirm information given to you orally.

Yours sincerely

Len Brown
Mayor

Stephen Town
Chief executive

Sue Tindal
Group Chief Financial Officer

Appendix 1: Uncorrected misstatements

Note	Statement of comprehensive income		Statement of financial position	
	Dr \$000	Cr \$000	Dr \$000	Cr \$000
	Hedge accounting error			
DR OCI/Equity: cashflow hedge reserve	8,813			
CR Fair value adjustment to debt				6,549
CR Other gains and losses: derivatives fair value movement		2,264		

Explanation for uncorrected misstatements

- 1 *To recognise the ongoing error from derecognition of the hedge instruments.*