

Draft: 24 November 2016

Phil Goff  
Mayor  
Auckland Council  
Private Bag 92300  
Victoria Street West  
Auckland 1142

Stephen Town  
Chief Executive  
Auckland Council  
Private Bag 92300  
Victoria Street West  
Auckland 1142

Dear Phil and Stephen

**Confirmation of Engagement – Review Engagement of the Interim Financial Statements of the Auckland Council Group for the six months ending 31 December 2016**

This purpose of this letter is to confirm the terms of our engagement in respect of the review of the Auckland Council Group's interim financial statements for the six months ending 31 December 2016.

This letter also serves to ensure a clear understanding of the scope of our responsibilities with respect to this review engagement, as opposed to your responsibilities.

**Agreement to be signed**

On page 9 of this letter is an agreement that you need to sign. Your signature confirms that the details of the review engagement as described in this letter match your understanding of the arrangements for this review.

Please sign and return one copy of the agreement, along with a copy of the details of the review.

## Details of the review engagement

### **1 Scope of our responsibilities**

You have requested that we conduct a review, consisting primarily of enquiry, and analytical procedures, in accordance with the Review Engagement Standard NZ SRE 2410 issued by the External Reporting Board (the XRB).

The objective of our review will be to provide a negative assurance review report.

The review that we perform will not constitute an audit. Accordingly this review is not intended to, and will not, result in the expression of an audit opinion, nor the fulfilling of any other statutory audit or other requirements.

Our review, in terms of the Review Engagement Standards issued by the XRB, is designed primarily to enable us to provide a moderate level of negative assurance. It is not designed to disclose defalcations or other irregularities and should not be relied on for that purpose.

Note that the terms “auditor” and “audit team” are used throughout this letter, consistent with NZ SRE 2410, not because we are performing an audit function, but because we are performing this review in our role as the independent auditor of your statutory financial statements.

### **2 Scope of your responsibilities as members of the Governing Body**

It is understood and agreed that:

- you will provide all of the information required for us to complete the review;
- you will provide us with unrestricted access to staff from whom we determine it is necessary to obtain evidence;
- the responsibility for the accuracy and completeness of the interim financial statements remains with you;
- the responsibility for such internal controls as management and those charged with governance deem necessary to enable the preparation of financial statements free from material misstatement remains with you;
- if our name is to be used in connection with any interim financial statements reviewed in terms of this engagement, you will ensure that our full report is attached and the limited extent of our review is clear when distributing the interim financial statements to third parties; and
- each page of the interim financial statements will be clearly marked “unaudited”.

The review report will be prepared for your sole use. It should not be used for any other purpose, nor given to any other party without our prior written consent.

### **3 Auditor-General's wider responsibilities**

As Auditor-General I have wider responsibilities to generally oversee the appropriate use of a public entity's resources. As part of my review I will maintain an alertness for such matters, although any observations are unlikely to affect my review report. Any observations will become part of my annual statutory audit of your financial statements.

### **4 Auckland Council Group**

It is my understanding that the six month interim financial statements of the Auckland Council Group comprises Auckland Council (the Council), Legacy Council Controlled Organisations (CCOs) and other controlled entities as per Appendix 1 and the following substantive CCOs:

- Auckland Transport (100% controlled substantive CCO);
- Watercare Services Ltd (100% owned substantive CCO);
- Regional Facilities Auckland and its subsidiaries (100% controlled substantive CCO);
- Development Auckland Limited and its subsidiaries (100% owned substantive CCO);
- Auckland Tourism, Events and Economic Development Ltd and its subsidiaries (100% owned substantive CCO); and
- Auckland Council Investments Limited and its subsidiaries (100% controlled substantive CCO).

Please inform me if this is incorrect.

### **5 Areas of review focus**

This review will be carried out in accordance with the review engagement standards issued by the XRB. The specific objective of the engagement is that I be provided with sufficient assurance to enable me to state whether anything has come to my attention that causes me to believe that the interim financial statements do not fairly reflect the Auckland Council Group's financial position, performance and cash flows for the period to 31 December 2016 (negative assurance).

The review is primarily based on an understanding of the impact of any substantive changes in the Council and Auckland Council Group's control environment with respect to the effectiveness of that control environment, together with analytical review procedures and enquiries of Council management and the CCO boards and management. We will only carry out more extensive procedures should, based on our work, we have reason to believe that the interim financial statements of the Auckland Council Group do not fairly reflect the financial position, performance and cash flows.

My specific areas of review focus are as follows.

## 5.1 Control environment

For the Council and the above listed substantive CCOs, we will update our understanding of the management control environment (MCE) to assess the controls in place. We will assess whether there have been any significant changes to the MCE. This will be based on enquiries of management, together with walkthroughs of relevant systems to confirm our understanding.

Specifically our review will encompass the overview aspects of the control environment, including:

- control consciousness and culture;
- governance structures and mechanisms;
- risk management;
- financial planning reporting and monitoring;
- information systems environment; and
- legislative compliance monitoring and reporting.

Our review will also encompass the adequacy of internal controls over the following key financial systems:

- expenditure;
- payroll;
- revenue;
- fixed assets;
- treasury (including accounting for derivatives); and
- general ledger reconciliations and journals.

We will not be performing extended compliance testing of key controls throughout the six month period to 31 December 2016, unless we have been given reason to believe that the systems of controls have changed significantly, or are not operating as intended.

Management is in a powerful position to perpetrate fraud due to its ability to override controls that appear to be operating effectively. We will maintain an awareness for the risks of management override of controls and fraud as we perform our review procedures including controls assessment and analytical review.

## 5.2 Overall analytical review

For the Council and the above listed substantive CCOs, we will make enquiries of management as to year to date performance of the Council and its subsidiaries as compared to budget and the prior year. We will satisfy ourselves as to the reasons for any significant variations. Integral to this will be updating our understanding of

the Council and Auckland Council Group's business, and assessing the effect of this on the financial position, performance and cash flows.

### **5.3 NewCore valuation**

We are aware that with the successful go live of NewCore in June and October 2016 the Council have already capitalised a large portion of the expected capital costs for this project. However, the Council must continue to ensure that the value of work in progress (WIP) for the NewCore project is fairly stated as at 31 December 2016. The appropriateness of capitalised staff and consultant costs should be reviewed by management as part of the overall impairment assessment.

We will obtain an update on the progress of the project, including whether any impairment has been identified. We will also update our understanding of systems for allocating capital costs, and perform a walkthrough to gain assurance they are operating as expected.

### **5.4 City Rail Link (CRL) valuation**

The City Rail Link project is building in momentum with the commencement of the enabling works.

In September 2016, Central Government and the Council signed an agreement on funding for the CRL. Features of the agreement include:

- A 50/50 funding arrangement where the Council (through Auckland Transport) and the Crown each pay half of the total capital costs of the project.
- The establishment of a jointly owned Crown Entity Company (51% Crown, 49% Council) under schedule 4A of the Public Finance Act that will oversee the delivery of the project – the final role and structure is yet to be agreed.

We will consider whether year end work in progress balances for the City Rail Link project are fairly stated in the 2016 half year financial statements.

We will consider what if any other financial reporting and disclosure requirements arise as at the reporting date or as a post reporting date event, particularly relating to:

- Crown funding for costs already incurred; and
- the establishment of the new entity.

### **5.5 Treasury and funding management**

As the Council Group continues its debt programme, it needs to ensure that debt levels and interest exposure remain within its policy settings, and that all debt and associated instruments are accounted for correctly.

To gain assurance over the valuation of financial instruments and compliance with policy limits, we will update our understanding of the Council's systems and processes for:

- managing the treasury function, including borrowing and cash flow management; and
- valuing and accounting for financial instruments, borrowing and hedges (including the Council's reconciliations to counter party valuations as at 31 December 2016).

## **5.6 Fair value assessment of fixed assets**

Public Benefit Entity International Public Sector Accounting Standard 17 (PBE IPSAS 17), Property, Plant and Equipment, requires that valuations are carried out with enough regularity to ensure that the carrying amount does not differ materially from fair value.

The Council currently revalues its physical assets on a cyclical basis for each class of assets, or where there are indicators of a significant out-of-cycle change in fair value. We will review and discuss with management the work completed to determine whether any asset classes will need to be revalued at 31 December 2016.

Where classes of assets need to be revalued, we will work with management to agree the timing of the valuations and complete the work required to ensure assets are reflected at fair value in the Council's financial statements.

Where necessary we will engage with the Council's external valuers to ensure timely identification of current valuation issues.

We will review the Council's assessment of whether there is any significant difference between the carrying amount and fair value of assets that have not been subject to a full revaluation during this period.

We will review management's processes to assess for evidence of impairment, including for all significant WIP balances.

## **5.7 Rates**

In compliance with PBE IPSAS 23, the Council's annual rates revenue must be recognised from the date of issuing the rating notices for the 2017 financial year, and appropriately discounted for rates yet to be received.

We will ensure 2017 rates are correctly classified and accounted for at 31 December. We understand that the Council has decided not to discount the balance recognised at 31 December 2016. We will review this decision to reconfirm (consistent with last year) that it does not have a material effect on the six-month accounts.

## **5.8 Provisions**

We will update our understanding of the Council's systems and processes for valuing and accounting for provisions for leaky building liabilities, including contingent liability disclosures. We will also consider your assessment of the effect of recent court cases. We expect this will be based on an assessment by the weathertightness actuary.

We will assess whether other provisions, including the contaminated land provision and the Eden Park loan guarantee provision, are based on appropriate underlying information.

## **5.9 Creditor cut-off**

As noted in previous years, the Council's early cut-off dates for invoice processing, necessitated by tight reporting timeframes, increases the risk of material misstatement of expenses in the interim financial statements. This risk is heightened by the decentralised management of accruals, with reliance on Council's various business units to appropriately accrue capital and operational expenditure.

In the 2015/16 annual audit, we were pleased to find that Financial Control had implemented a centralised process to ensure that invoices received after the cut-off date were appropriately accrued where required. We expect this process to also be in place for the interim reporting period, to provide Council and my auditors with an appropriate level of assurance that all capital and operational expenditure incurred by 31 December 2016 is reflected in the interim financial statements.

## **5.10 Legislative compliance**

We understand that the Council's legal team will complete a comprehensive internal legal review over the interim six month accounts. We also understand this will address compliance with applicable legislation, which includes compliance with NZ stock exchange reporting rules (including continuous disclosure requirements). We will follow up on completion of this work and sign-off by your legal team.

## **6 Fees**

The Council's fee for the review of the Auckland Council Group's interim financial statements is \$115,699 (GST exclusive) plus disbursements.

Note: Each substantive CCO noted in section 4 above (excluding the legacy CCOs) will agree and pay their own fees for the review of their interim period consolidated reporting pack with the respective Appointed Auditor.

We expect this to be a maximum fee estimate. If actual costs are less than the fee estimate we will only invoice for actual costs incurred. Should actual costs unexpectedly significantly exceed my initial expectation outlined above we will seek to recover the actual costs incurred from the Council. I will discuss this with you before billing any additional costs.

The fee assumes:

- information will be provided in a timely manner;
- there will be the appropriate level of assistance from staff; and
- the interim financial statements will be subject to appropriate levels of quality review before submission for our review. The interim financial statements will include all relevant disclosures.

We wish to interim bill as work progresses. We propose the following billing arrangements:

	<b>Amount</b>
	<b>\$</b>
January 2017	57,849
February 2017	28,925
March 2017	28,925
Total	<u>115,699</u>

Disbursements incurred are charged on an actual and reasonable basis.

Please see Appendix 2 for more details on the expected team hours and fee calculation.

## **7 Review team**

### **Office of the Auditor-General (OAG)**

Lyn Provost Auditor-General

### **Audit New Zealand**

Jo Smail	Engagement Director
Andy Burns	Engagement Quality Control Director
Jade Schiebler	Audit Manager
Lauren Clark	Audit Supervisor
Alan Clifford	Information Systems Director
Martin Richardson	Specialist Audit and Assurance Services Director
John Mackey	Tax Director

The component auditors involved in the management of the review engagement of the substantive CCOs are as follows:

Auckland Transport  
 Watercare Services Limited  
 Regional Facilities Auckland  
 Development Auckland Limited  
 Auckland Tourism Events and Economic Development Limited  
 Auckland Council Investments Limited

### **Appointed Auditor**

Leon Pieterse  
 Andrew Burgess  
 David Walker  
 David Walker  
 Leon Pieterse  
 Brendan Lyon

## 7.1 Timetable

Our proposed timetable is:

	<b>Date</b>
Council review of controls fieldwork commences	14 November 2016
CCO review of controls fieldwork commences (varies)	November and December 2016
Council and CCO reporting packs available (balance sheet and profit and loss only)	18 January 2017
Council and CCO, review teams commence review of reporting packs and final Trial Balance	18 January 2017
Council and CCO reporting packs available (complete except for cash flow statement)	20 January 2017
Cash flow statement for Council	24 January 2017
CCO signoff of reporting packs	27 January 2017
Council signoff of reporting pack	1 February 2017
Group consolidation review available (balance sheet and profit and loss only)	8 February 2017
Group consolidation review available (including cash flow, variance commentary and operating cash reconciliation)	13 February 2017
Full draft Group Interim Financial Statements available	15 February 2017
Draft NZX Preliminary release available	15 February 2017
Full final group interim report available (including AIAL adjustment)	21 February 2017
NZX announcement including AIAL adjustment available	21 February 2017
Verbal clearance	23 February 2017
Draft Management Report issued	27 February 2017
Review report issued	27 February 2017

A more detailed schedule of our requirements is included at Appendix 3.

## 8 Agreement

Please sign and return the attached copy of this letter to indicate that it is in accordance with your understanding of the arrangements for this review.

If there are any matters requiring further clarification, please contact Jo Smaill on 021 222 7545.

Yours sincerely

Lyn Provost  
Auditor-General

*We acknowledge that this letter is in accordance with our understanding of the arrangements of the review engagement.*

\_\_\_\_\_  
Phil Goff  
Mayor

Date \_\_\_\_\_

\_\_\_\_\_  
Stephen Town  
Chief Executive

Date \_\_\_\_\_

## Appendix 1: Legacy CCOs and other controlled entities

- Community Education Trust Auckland (COMET).
- Highbrook Park Trust.
- Manukau Beautification Charitable Trust.
- Te Tuhi Contemporary Art Trust (formerly Pakuranga Arts and Cultural Trust).
- Te Puru Community Charitable Trust.
- North Shore Heritage Trust.
- Mt Albert Grammar School Community Swimming Pool Trust.
- Arts Regional Trust.
- Auckland Regional Migrant Services Charitable Trust.
- Keep Waitakere Beautiful Trust.
- Mangere Mountain Trust.
- Te Motu (Puketutu) Governance Trust.

## Appendix 2: Team mix and hours

### Auckland Council and Group

	<b>Total hours</b>
Appointed Auditor	70
Review Director	10
Audit Manager	130
Other staff (CA qualified and not yet CA qualified)	360
Total	<u>570</u>

### Fee calculations

	<b>\$</b>
Fee	115,699
Estimated disbursements*	<u>1,000</u>
Total fee (including disbursements)	116,699
GST	<u>17,505</u>
Review Engagement fee for the 31 December 2016 interim financial statements	<u>134,204</u>

\*Our estimate of disbursements, including travel, is \$1,000. Should actual and reasonable disbursements exceed that estimate for reasons beyond our control, we may seek to recover those additional costs.

## Appendix 3: Detailed schedule of requirements for the review engagement

Requirement	Date (by midday)	Responsibility
<p><b>Auckland Council Parent</b></p> <p>Parent (Council) Reporting pack balance sheet and profit and loss to Audit New Zealand.</p> <p>Balance sheet reconciliations for all balance sheet accounts, reviewed by Financial Control.</p> <p>Remainder of reporting pack (excluding cash flow statement) to Audit New Zealand, including variance explanations as below.</p>	<p>18 January 2017</p> <p>18 January 2017</p> <p>20 January 2017</p>	
<p><b>Variance explanations</b></p> <ul style="list-style-type: none"> <li>Balance sheet variance explanations: variance explanations for variances over (the greater of) \$2 million/10% compared to comparative period (30 June 2016).</li> <li>Variance explanations for YTD capital spend (PPE and Intangibles) and debt compared to YTD planned budget: variance explanations for variances over (the greater of) \$2 million/10%.</li> <li>P&amp;L variance explanations: variance explanations for variances over \$2 million/10% compared to budget (Annual Plan 2016/17) and comparative period (31 December 2015).</li> </ul> <p>Reconciliation of budget comparatives to Annual Plan 2016/17. This includes explanations of phasing and revisions to the budget.</p> <p>Complete Parent reporting pack including cash flows to Audit New Zealand.</p>	<p>20 January 2017</p> <p>20 January 2017</p> <p>24 January 2017</p>	
<p><b>Financial instruments</b></p> <ul style="list-style-type: none"> <li>Working papers for financial instruments (cash, investments, borrowings, and derivative instruments) including reconciliations to third party valuations/confirmations.</li> <li>Movements schedules for investments, borrowings, and derivatives for the period from 30 June 2016-31 December 2016.</li> <li>Impairment assessment for investments.</li> </ul>	<p>18 January 2017</p>	
<p><b>Debtors</b></p> <ul style="list-style-type: none"> <li>Details of provision for doubtful debts calculation as at 31 December 2016.</li> <li>Schedule of debtors written off during the period.</li> <li>Credit notes report for the period to 22 January 2017.</li> </ul>	<p>18 January 2017 (excluding credit notes report, to be received by 26 January 2017)</p>	
<ul style="list-style-type: none"> <li>File note on cut off procedures for revenue/debtors for the</li> </ul>		

<b>Requirement</b>	<b>Date (by midday)</b>	<b>Responsibility</b>
period to 31 December 2016.		
<b>Creditors</b> <ul style="list-style-type: none"> <li>File note on cut off procedures for expenditure / Accounts Payable for the period to 31 December 2016.</li> <li>Follow up on invoices received to 22 January 2017 (for completeness).</li> </ul>	18 January 2017 (except follow up on invoices, to be received by 26 January 2017)	
<b>Provisions</b> <ul style="list-style-type: none"> <li>Movement schedule for the period 30 June 2016 to 31 December 2016.</li> <li>Weathertightness assessment as at 31 December 2016 (including reference to actuary's assessment).</li> <li>Supporting schedule for contaminated land provision including use of provisions.</li> </ul>	18 January 2017	
<b>PPE: Parent</b> <ul style="list-style-type: none"> <li>Movement schedule for the period 30 June 2016 to 31 December 2016, outlining additions, disposals, and depreciation.</li> <li>Reconciliation to the fixed asset register.</li> <li>Fair value assessment as at 31 December 2016.</li> <li>Impairment assessment as at 31 December 2016.</li> <li>Capital budget comparison to actual, with explanations for significant variances (over \$2 million/10%).</li> <li>WIP reports as at 31 December 2016.</li> </ul>	18 January 2017	
<b>Investment property: Parent</b> <ul style="list-style-type: none"> <li>Movement schedule for the period 30 June 2016 to 31 December 2016, outlining additions and disposals.</li> <li>Fair value assessment as at 31 December 2016.</li> </ul>	18 January 2017	
<b>Intangibles: Parent</b> <ul style="list-style-type: none"> <li>Movement schedule for the period 30 June 2016 to 31 December 2016, outlining additions, disposals, and amortisation.</li> <li>Fair value assessment as at 31 December 2016, including specific assessment for NewCore.</li> <li>Impairment assessment as at 31 December, including specific assessment for NewCore.</li> <li>Capital budget comparison to actual, with explanations for significant variances (over \$2 million/10%).</li> <li>WIP reports as at 31 December 2016.</li> </ul>	18 January 2017	

<b>Requirement</b>	<b>Date (by midday)</b>	<b>Responsibility</b>
<b>Subsidiaries</b> <ul style="list-style-type: none"> <li>Inter-company confirmations matrix agreed with all CCOs.</li> </ul>	26 January 2017	
<b>Payroll</b> <ul style="list-style-type: none"> <li>A reconciliation of the payroll system and the general ledger for the period to 31 December 2016.</li> <li>Schedule of any major changes (for example, wage increases) since 30 June 2016 and effective date.</li> <li>List of severances, redundancies and bonuses paid since 30 June 2016.</li> </ul>	18 January 2017	
<b>Minutes</b> The Council and relevant sub-committee confidential minutes for the period ended 31 December 2016 and all subsequent minutes up to the date the review opinion is signed.	Ongoing to date of review opinion	
<b>Consolidated</b> Group consolidation file to Audit New Zealand excluding cash flow and variance explanations. Completed group consolidation file to Audit New Zealand including cash flow and cash flow proof, including variance explanations as below.	8 February 2017 13 February 2017	
<b>Variance explanations</b> <ul style="list-style-type: none"> <li>Balance sheet variance explanations: variance explanations for variances over (the greater of) \$2 million /10% compared to budget (Annual Plan 2016/17) and comparative period (30 June 2016).</li> <li>P&amp;L variance explanations: variance explanations for variances over \$2 million/10% compared to budget (Annual Plan 2016/17) and comparative period (31 December 2015).</li> </ul> Group financial statements to Audit New Zealand. Draft NZX preliminary release to Audit New Zealand. Full final group interim report and NZ Announcement to Audit New Zealand (including AIAL adjustment).	13 February 2017 15 February 2017 15 February 2017 21 February 2017	
<b>Cash flow statement</b> Cash flow proof to support group cash flow statement based on P&L and movement between balance sheet accounts.	13 February 2017	
<b>PPE: Group</b> Fair value assessment as at 31 December 2016.	6 February 2017	
<b>Investment property: Group</b> Fair value assessment as at 31 December 2016.	6 February 2017	

Requirement	Date (by midday)	Responsibility
<p><b>Contingencies</b></p> <ul style="list-style-type: none"> <li>• Legal representation for the Auckland Council Group.</li> <li>• A schedule of matters (including financial guarantees) which are either new or have significantly changed from those matters identified in the legal representations made for the financial year ended 30 June 2016, as prepared and signed off by the Council's Legal and Risk Director.</li> </ul>	3 February 2017	
<p><b>Legal sign off</b></p> <p>Confirmation of legal review and sign off on the Interim release</p>	21 February 2017	

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