

Draft: 1 March 2017

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

Dear Hon Phil Goff

### **Audit for the year ending 30 June 2017**

I am writing to outline our arrangements for the audit of Auckland Council and group for the year ending 30 June 2017. This letter has two main sections – an agreement to be signed, and details of the audit.

The following arrangements relate to our audit of the Auckland Council parent and group 2017 Annual Report. Separate engagement letters have been issued to the boards and management of Council's substantive CCOs.

#### **Agreement to be signed**

On the next page is an agreement that you need to sign. Your signature confirms that the details of the audit match your understanding of the arrangements for this year's audit.

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

#### **Details of the audit**

Here we set out the proposed arrangements for this year's audit. These include:

- significant business and reporting risks/issues and our audit response; and
- logistics (such as our audit team, timing, and fees).

#### **Additional information attached**

We have attached two appendices for your information:

- Appendix 1: Additional information about the audit;
- Appendix 2: Other areas of interest across the Local Government sector

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

Yours sincerely

Greg Schollum  
Deputy Auditor-General

---

**Agreement to be signed**

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

Signed \_\_\_\_\_ Date \_\_\_\_\_  
Hon Phil Goff  
Mayor of Auckland

## **Details of the audit**

### **1 Introduction**

This document sets out the arrangements for the audit of Auckland Council (the Council) and group for the year ending 30 June 2017. These include:

- Group key audit matters, significant business and reporting risks and issues and our audit response; and
- Logistics (such as our audit team, timing, and fees).

The Group comprises the Council Parent and a number of substantive Council Controlled Organisations (CCOs) and multiple smaller entities. The following CCOs have been identified as material to the group, due to their financial significance, the nature of their services and activities, or both. These are:

- Auckland Transport (AT)
- Watercare Services Limited (Watercare)
- Regional Facilities Auckland (RFA)
- Auckland Council Investments (ACIL)
- Auckland Tourism, Events, and Economic Development (ATEED)
- Development Auckland Limited (Panuku)

### **2 Inclusion of Key Audit Matters in our audit report**

In October 2015 the New Zealand Auditing and Assurance Standards Board finalised new auditing standards, which include a requirement for auditors of listed issuers, and FMC reporting entities considered to have a higher level of public accountability (as referred to in the Financial Markets Conduct Act 2013), to communicate details of key audit matters in the auditor's report.

We will report on key audit matters as part of the audit report on the Council and group's financial and service performance statements for the year ending 30 June 2017.

Key audit matters are defined as those matters that, in the auditor's professional judgement, are of the most significance in the audit of the financial and service performance statements of the current period. The focus will be on areas of significant auditor attention, including:

- areas identified as significant risk or involving significant auditor judgement;
- areas in which the auditor encountered significant difficulty during the audit, including with respect to obtaining sufficient appropriate audit evidence; and

- circumstances that required significant modification of the auditor’s planned approach to the audit, including as a result of the identification of a significant deficiency in internal control.

Based on our work to date and assessment of risks, it is likely that the matters included under section 3: Significant areas of audit focus will form part of our Key Audit Matters reporting in the 2016/17 audit report. As with previous years, other matters may arise during our audit, some of which may be of such significance as to become a key audit matter. We will discuss any such matters with the Council, the Audit and Risk Committee and senior management throughout the year as they arise.

### **3 Significant areas of audit focus**

Significant areas of audit emphasis are matters that, in our judgement, require special audit consideration. Factors that we consider when selecting significant areas include recent economic, accounting or other developments, the complexity of transactions, the degree of subjectivity in the measurement of financial and service performance information, and whether significant transactions are outside the normal course of business.

Our assessment of significant areas is based on the risks inherent in the related transactions or balances, or in the performance reporting. The four significant areas of audit focus that have been identified to date are:

- valuation of operational and infrastructure assets;
- valuation of derivatives;
- valuation of the weathertightness provision; and
- significant performance reporting issues – housing and transport.

The following sets out in detail what each audit issue is, why it is significant and what our audit response to address each issue will be.

#### **3.1 Valuation of operational and infrastructure assets**

The group owns a large portfolio of operational and infrastructure assets. At 30 June 2016 the group had infrastructure assets of \$27.2 billion, operational assets of \$8 billion and restricted assets of \$5.9 billion.

A number of asset classes are carried at fair value with revaluations performed on a regular basis or when the fair value is materially different to the carrying value. The accuracy of the valuation of material classes of assets depends on the completeness and accuracy of the underlying information, judgements of useful lives to determine depreciation and the appropriateness of the assumptions used in the revaluations. Some valuations are inherently more complex and involve the use of numerous data sources from several different parties. Because of the large value of the assets held by the group a small movement in the valuation or expected useful life of some components can have a significant impact on the depreciation expense recognised in the financial statements. The large more complex asset classes include:

- Water, wastewater and stormwater: These asset classes account for \$11.1 billion of the group’s total infrastructure asset balance. Each asset

class is broken down into numerous components with some of these being below ground. This makes verification of existence, condition and capacity for valuation purposes difficult.

- Roads: Roads account for nearly 30 per cent (\$8 billion) of the total value of the infrastructure assets held by the group. The valuation is determined by separately valuing each of the various components, such as land, formation and bridges, and adding these together. Different price indices are used for valuing each component and some components cannot be physically inspected as they are beneath other layers.

We will review the Council's assessment that needs to be undertaken before the end of the financial year, to determine if an asset class needs to be revalued. For those classes of assets being revalued we will work with the Council and the Appointed Auditors of entities within the group that manage significant asset classes to assess the key inputs used, competence and objectivity of any specialists involved, and reasonableness of assumptions applied. We will also review the completeness and accuracy of related disclosures such as the sensitivity of the valuation to key assumptions.

### **3.2 Valuation of derivatives**

The group uses three types of derivative financial instruments to mitigate risks associated with foreign currency and interest rate fluctuations that affect the group's debt. The three types of derivative instruments used are:

- interest rate swaps: which swap a fixed interest rate on a principal balance to a floating rate on the same balance (or vice versa);
- cross currency interest rate swaps: which are a variation on interest rate swaps where one of the legs is denominated in a foreign currency; and
- forward foreign currency swaps, which lock in a foreign currency rate at a future date.

At 30 June 2016, the Council had derivative assets with a fair value of \$255 million and derivative liabilities with a fair value of \$903 million. There is a level of judgement required when valuing these derivatives and a level of sensitivity around the assumptions and rates used in the valuation. A small market movement in interest rates and foreign exchange rates can have a significant effect on the value of the derivatives and the consequential unrealised gain or loss that is recognised in the financial statements. For the year ended 30 June 2016 there was a loss on derivatives of \$523 million recognised by the Council as a result of the continuing unanticipated decrease in interest rates and changes in the foreign currency rates.

We will obtain assurance that:

- processes applied to value the derivatives are designed and operating effectively;
- the methodology and source information applied in valuation models is appropriate; and
- the valuations as at 30 June 2017 are materially correct.

### **3.3 Valuation of the weathertightness provision**

The group recognises its estimated liability towards the cost of repairing Auckland homes impacted by weather tightness issues. The group's obligation extends to multi-unit dwellings as well as single homes.

As outlined in note D5 of the 30 June 2016 financial statements the group recognised a provision of \$257 million for the year ended 30 June 2016. Multi-unit claims make up 83% of this provision.

There are three different types of claims:

- active claims: are those which have been lodged and are progressing through the resolution process;
- reported claims: are those which have been lodged but are not yet progressing through the resolution process; and
- unreported claims: are those which have yet to be reported or identified but the group could have a liability.

The valuation of the provision is complex and subject to a high degree of judgement and estimation. The provision is significantly impacted by the discount rates applied and the timing of the expected future cash outflows. There is also inherent uncertainty in the quantum and value of unreported claims. Due to the level of significant uncertainty the group also recognises an unquantified contingent liability.

We will obtain the actuarial valuation and confirm:

- that the methodology applied is consistent with the previous year and still appropriate; and
- whether the significant assumptions used by the group were reasonable, that the underlying data is complete and that claims have been correctly classified for the purpose of the valuation.

We will review the completeness and consistency of the disclosures within the notes to the financial statements that illustrate the sensitivity of valuations to key assumptions.

### **3.4 Significant performance reporting issues – housing and transport**

Housing and transport are high priority issues being dealt with by the group when planning for the future of the city. The issues related to housing and transportation impact on perceptions about Auckland as an international city. They are also important as they impact the productivity, affordability and future growth of Auckland and New Zealand.

#### **Housing**

Auckland's housing issues are well documented and in recent years the Council has been working with the Government to establish special housing areas to help address the city's housing shortage and increase the availability of affordable homes. Council contributes to the resolution of the housing issues through:

- establishing the rules for development under the Unitary Plan;
- its role as a building consent authority responsible for issuing building consents and code of compliance certificates; and
- working with developers to agree on the timely release of land for developments.

## **Transport**

Council and its CCOs, primarily Auckland Transport, have a key role in working with the Government to address a history of underinvestment in public transport and roads in Auckland. The aim is to enable efficient and cost effective transportation services around and through the city in the future. Solutions to the current transport issues continue to evolve and include a number of large projects requiring significant local and national funding over an extended period.

## **Reporting of housing and transport performance**

The complexity of these issues requires innovative planning solutions and sustainable funding options, including the collaboration between key local stakeholders, CCOs and the Government.

Because of the significance of these issues we expect they will continue to be a key feature of Council and group's performance reporting framework and of the information reported in the Council and group Annual Report. The reported information should enable a reader to understand:

- the key issues;
- the strategic initiatives and projects to address the issues;
- the progress being made by the group towards its planned achievements, timetable and costs;
- any ongoing challenges that are yet to be addressed;
- the level of service members of the public should expect to be provided with; and
- how the Council and group are tracking towards achieving the agreed levels of service.

As part of our audit we will:

- maintain an awareness of the key issues facing the Council and group, the strategic initiatives and projects to address these and the progress being made to deliver them;
- update our understanding of the systems and processes used by the Council and group to identify and measure the levels of service expected to be achieved; and

- review the reported levels of service to ensure they are an accurate reflection of the results achieved and ensure there is enough information reported so a reader of the Annual Report has a good understanding of the progress being made by the Council and group towards addressing the housing and transport issues identified.

#### **4 Management override of controls**

Professional auditing standards require us to consider fraud risks in all audits we perform, including the risk of management override of controls. Management is in a powerful position to perpetrate fraud due to its ability to override controls that appear to be operating effectively.

We will test the appropriateness and existence of controls over journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements. We will also perform testing and analysis of journals and other adjustments that we identify as being of higher risk. In this testing, we will include entries and adjustments applied to accounts that are complex in nature, involve significant judgement, and result in significant period end movements.

We will review accounting estimates for bias and evaluate whether the circumstances producing the bias, if any, represent a risk of material misstatement due to fraud. This includes considering what estimates have a material and significant impact on the Council's accounts, and reviewing the basis for these estimates.

For any significant transactions that are outside the normal course of business, or that otherwise appear to be unusual, given our understanding of the entity and its environment and other information obtained during the audit, we will evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets.

#### **5 Other areas of audit emphasis**

Based on the planning work and discussions that we have completed to date, we have identified what we consider to be the other main business, financial statements and service performance risks and issues facing the Council and group.

Many of these risks and issues are relevant to the audit because they affect our ability to form an opinion on your financial statements and statement of service performance. As part of the wider public sector audit, we are also required to be alert to issues of effectiveness and efficiency, waste and a lack of probity or financial prudence (as set out in the Audit Engagement Letter).

Each of the tables below set out the risks and issues that we have identified in line with these requirements. The left-hand column describes these risks and issues. In the right-hand column, we describe how we plan to respond to these during the audit.

We will also follow up on progress made by the Council in its response to our previous recommendations.

Please tell us about any additional matters that we should be aware of as your auditor, and any specific significant business risks that we have not covered.

## 5.1 Business risks

Your business issues	Our audit response
<b>City Rail Link (CRL) (Council and group)</b>	
<p>The City Rail Link project is building in momentum, with enabling work construction now well underway.</p> <p>In September 2016, Central Government and Auckland Council signed an agreement that outlined the funding arrangement for the CRL.</p> <p>Features of the agreement include:</p> <ul style="list-style-type: none"> <li>• a 50/50 funding arrangement whereby Auckland Council and the Crown each pay half of the total capital cost of the project; and</li> <li>• the establishment under the Public Finance Act of a schedule 4A Crown Entity company through which the Government and Council will oversee the delivery of the project – the final structure is yet to be formally agreed.</li> </ul> <p>The Council and its CCO Auckland Transport should ensure that:</p> <ul style="list-style-type: none"> <li>• robust project governance and management arrangements are in place that are in line with best practice; and</li> <li>• costs incurred as part of this project are appropriately accounted for and disclosed in the 30 June 2017 financial statements. This should include the recognition of operational and capital costs, including both work in progress and impairment costs, if applicable.</li> </ul> <p><b>Audit risks include</b></p> <ul style="list-style-type: none"> <li>• disruption to project governance and project management practice on transfer to the new entity;</li> <li>• non-compliance with the Council's policies, procedures and good practice; and</li> <li>• misstatement in the 30 June 2017 financial statements.</li> </ul>	<p>We will review the funding/cost sharing agreement once finalised, and the role of respective parties (including the new entity) to consider the appropriate accounting treatment for the Council.</p> <p>We will continue to review the progress being made towards the completion of the project, with particular focus on project governance and management and procurement and contract management practices. We will consider whether transactions incurred during the year have been appropriately accounted for and ensure year end work in progress and impairment balances are fairly stated in the 2017 financial statements.</p> <p>We will consider what other financial reporting and disclosure issues arise at balance date with a particular focus on:</p> <ul style="list-style-type: none"> <li>• the accounting treatment of Crown funding received during the year or receivable at year end;</li> <li>• the establishment of and reporting arrangements at year end for the new entity; and</li> <li>• the treatment of any other commitments arising from the agreement with the Crown.</li> </ul> <p>Please also refer to section 3.4 for transport risks identified under the heading performance reporting and our audit response to these.</p>

Your business issues	Our audit response
<b>NewCore (Council only)</b>	
<p><b>Risk management</b></p> <p>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.</p> <p>However, this project still has a way to go with the remainder of the legacy council systems being migrated to Newcore at the end of the 2016/17 financial year. We expect Council to continue to effectively manage the project's risks within its risk appetite.</p> <p><b>Data Migration</b></p> <p>The migration of data from legacy systems onto the new SAP platform continues in 2016/17. Previous go-lives have been successfully completed, and this experience should leave Council well placed to manage the deployment of future module releases. However, there remains a high inherent risk of flaws associated with the larger scale and more complex data migration processes occurring this year, which could increase Council's exposure to project delays, budget overruns, and ineffective data loaded to new systems, including those used for Council's regulatory activities.</p> <p><b>Benefits and Valuation</b></p> <p>As stages of the project continue to go-live, Council should reassess the appropriateness of its capitalisation decisions, including the value of the completed assets, the existence of any impairment in the balance, and the estimated life of the completed assets.</p> <p>At the same time, Council must ensure that the value of costs incurred in the 2016/17 financial year for the project are fairly stated. In particular, the appropriateness of capitalised staff and consultant costs should be reviewed by management on an ongoing basis.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• inappropriate capitalisation decisions leading to misstatement of the value of completed assets and amortisation expense;</li> </ul>	<p>We will continue to maintain an understanding of how the Council is managing the risks associated with the NewCore project, including those risks inherent in the remaining go-live phases.</p> <p>We will maintain an understanding of the Council's processes to ensure effective data migration from legacy regulatory and financial systems.</p> <p>We will review whether year end WIP balances are fairly stated in the 2017 financial statements. This will require us to review management's assessment of the level of impairment required to the project costs, as well as looking at the controls over what is capitalised compared to what is expensed with a particular focus on staff costs.</p> <p>We will also look at the process for capitalising stages of the project completed in the 2016/17 financial year.</p>

Your business issues	Our audit response
<ul style="list-style-type: none"> <li>• overstatement of NewCore costs and impairment expenses not being recognised in a timely manner; and</li> <li>• inappropriate data migration processes resulting in insufficient or inaccurate information for financial and non-financial reporting purposes and for management of core operations.</li> </ul>	
<b>Project management (Council and group)</b>	
<p>Across the group there are a number of major infrastructure projects at various stages of development, from conception through to completion. These include:</p> <ul style="list-style-type: none"> <li>• CRL (discussed separately above);</li> <li>• AMETI;</li> <li>• NewCore (discussed separately above);</li> <li>• Hunua 4 Watermain Project;</li> <li>• Central Interceptor wastewater tunnel;</li> <li>• NorsGa; and</li> <li>• SkyPath.</li> </ul> <p>These large projects are high risk due to their scale, prominence, the complexity of the procurement arrangements, and their financial impact. Therefore it is vital that Council has an appropriate monitoring and governance framework over these projects to manage delivery.</p> <p>The Council also needs to ensure that its smaller value projects comply with its policies and processes, as there is a risk that the project management practices applied to smaller projects may not be as rigorous.</p> <p>Project management practices should be considered in light of our reported findings and recommendations to date in this area.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• non-compliance with the Council's policies, procedures and good practice;</li> <li>• waste and probity; and</li> <li>• misstatement of the financial impact of significant projects in the 2017 financial statements.</li> </ul>	<p>We will follow up on progress made against our previous recommendations, and gain an understanding of improvements and emerging issues since our last review. As part of this, we will consider the findings from the OAG report into the AMETI project and the progress being made to address the recommendations made.</p> <p>We will continue to review the status and governance arrangements in place over the large projects.</p> <p>We will use our understanding of the risks and status of high value projects to assess what if any financial reporting and disclosure issues arise and how management is addressing these.</p> <p>We will also test a sample of smaller projects to ensure the Council's processes and policies are consistently applied.</p> <p>Where appropriate, this work will be conducted in conjunction with CCO auditors and supported by our Specialist Audit and Assurance Services (SAAS) team.</p>

Your business issues	Our audit response
<b>Procurement ( Council and group)</b>	
<p>Council's major projects involve significant procurement decisions. In addition, many of Council's existing contracts are due for renewal in the near future.</p> <p>The Council also needs to ensure that lower value procurements and contract renewals are carried out in accordance with to the appropriate policies and processes, as there is a risk that procurement practices applied to these arrangements may be less robust.</p> <p>Procurement practices should be considered in light of our reported findings to date in this area, including the areas for improvements noted following the 2016 audit.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• non-compliance with the Council's policies, procedures and good practice;</li> <li>• procurement processes resulting in poor purchasing decisions; and</li> <li>• contracting arrangements not following good practice.</li> </ul>	<p>We will follow up on the status of our previous recommendations and update our understanding of progress made and emerging issues arising since our last review.</p> <p>We will update our understanding of large value procurements and contract renewals entered into during the year to determine an appropriate level of audit focus.</p> <p>We will also review the application and effectiveness of procurement controls over a sample of smaller procurement contacts.</p> <p>Where appropriate, this work will be conducted in conjunction with CCO auditors and supported by our Specialist Audit and Assurance Services (SAAS) team.</p>
<b>Contract management (Council and group)</b>	
<p>The Council has many significant goods and service delivery contracts in place. To reduce the risk of poor or non-delivery it is important that the Council has in place effective contract management processes that ensure delivery against contracts is timely, to the right quality and is within budget.</p> <p>In the 2016 audit, we noted a number of areas where improvements could be made in Council's management of contractual arrangements.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• contract monitoring arrangements not being fit for purpose;</li> <li>• processes not in line with good practice; and</li> <li>• poor or non-delivery by contractors (waste and probity).</li> </ul>	<p>We will obtain an update on the Council's contract management practices. In particular, we will review the Council's progress towards addressing our previous recommendations.</p> <p>We will, through discussions and high level review, update our understanding of Council's Contract Management framework in respect to compliance with good practice. We will test a small sample of contracts to ensure they are being monitored in line with the Council's policies.</p>

Your business issues	Our audit response
<b>Infrastructure and financial strategies ( Council and group)</b>	
<p><b>Financial strategy</b></p> <p>Council’s LTP financial strategy envisages maintaining a conservative margin against treasury limits while increasingly funding capital projects from operational cash inflows.</p> <p>In addition, the review of investments carried out in 2015/16 identified further opportunities to reduce exposure to debt funding sources.</p> <p>Key financial decisions in 2015/16 included the decision to maintain a rates increase for 2016/17 lower than that set out in the LTP, and to gradually liquidate \$100 million annually from the diversified asset portfolio over the next two years.</p> <p><b>Asset management</b></p> <p>Asset management is a core part of the Council’s business and critical to the prudent and sustainable use of public funds. Moving into the next LTP round, Council should be focusing on the quality of its asset management planning. Council should also be assessing how it is performing against its current infrastructure strategy and asset management plans, including delivery of renewals and planned levels of service.</p> <p><b>Housing Infrastructure fund</b></p> <p>In 2016, the Crown announced the creation of a \$1 billion Infrastructure Fund to support four local authorities to provide infrastructure investments relating to new housing developments.</p> <p>We understand decisions have yet to be reached about how the Funds will be distributed and accounted for.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• awareness of strategic context for investment decisions including decisions that could trigger an amendment to the LTP;</li> <li>• compliance with funding covenants and ratios imposed under Council’s borrowing and trust deed arrangements;</li> <li>• compliance with balanced budget and other requirements legislated</li> </ul>	<p>As part of our audit and heading into the next LTP round, we will continue to build on our understanding of how Council is progressing and developing its asset management, infrastructural and financial strategies. We will consider the potential reporting impact from investment decisions and from variations to significant assumptions, particularly growth and delivery of levels of service.</p> <p>We will remain aware of how Council maintains compliance with commitments to funders imposed under borrowing and trust deed arrangements.</p> <p>We will also consider the financial and disclosure implications, if any, of the Housing Infrastructure Fund on the Council’s 2017 financial statements.</p>

Your business issues	Our audit response
<p>under section 100 of the Local Government Act;</p> <ul style="list-style-type: none"> <li>• funding and financing impacts on treasury policies;</li> <li>• awareness of delivery options and potential for impact on levels of service; and</li> <li>• financial impacts of Housing Infrastructure Fund not fairly reflected in the 2017 financial statements.</li> </ul>	

DRAFT

## 5.2 Financial statement risks

Accounting risk	Our audit response
<b>Accounting for impairment and capitalisation of work in progress (Council and group)</b>	
<p><b>Impairment</b></p> <p>Assets held at cost are required to be assessed for indicators of impairment on an annual basis. In addition, work in progress (WIP) values on projects that span an extended period of time should be assessed regularly for impairment over the period of the project.</p> <p><b>Completed projects</b></p> <p>The Council also needs to ensure that as phases of a project are completed, and assets become operational, capitalisation of the WIP balance occurs in a timely manner. This will ensure that depreciation expense on these assets is recognised and accounted for appropriately.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• assets not accounted for at fair value in the financial statements; and</li> <li>• understatement of impairment and depreciation expense in the financial statements.</li> </ul>	<p>We will assess the processes used by management to assess for impairment, including for all significant WIP balances.</p> <p>We will review management's processes and controls for ensuring capitalising of WIP costs in a timely manner.</p> <p>We will ensure impairment and depreciation expenses are recognised and accounted for correctly at year end.</p>
<b>Other Provisions (Council only)</b>	
<p>We will consider the following in relation to the valuation of provisions.</p> <p><b>Eden Park guarantee</b></p> <p>In the 2016 financial statements, Council recognised a circa \$14 million provision in relation to a guarantee given in favour of ASB Bank to secure a \$40 million advance by the bank to the Eden Park Trust Board. The value of this provision should be regularly reassessed, taking into consideration factors such as the financial position of the Trust and any decisions made over the Stadium's ownership.</p>	<p>We will update our understanding of circumstances relating to Eden Park and ensure accounting for and disclosure of the guarantee in the financial statements is accurate. We will also keep abreast of any governance changes that may arise.</p> <p>We will assess whether other provisions are based on appropriate underlying information.</p> <p>We will follow up on progress made against previous recommendations, and gain an understanding of emerging issues since our last review.</p>

Accounting risk	Our audit response
<p><b>Other provisions</b></p> <p>A number of other provisions are recognised in Council's financial statements. The accuracy and completeness of these provisions should be reassessed each year based on current information and historic evidence.</p> <p><b>Audit risks include:</b></p> <ul style="list-style-type: none"> <li>• misstatement of provisions in the Council and group's 30 June financial statements.</li> </ul>	
<b>Tamaki Redevelopment Company (Council only)</b>	
<p>TRC is a Joint Venture (JV) between the Council and the Crown, with shares held 41% and 59% respectively. The JV was established to progress housing and associated social issues in the Tamaki area.</p> <p>In the 2016 audit, we were satisfied that Auckland Council's shareholding did not currently expose it to redevelopment costs and market movements associated with the Tamaki Regeneration Limited (TRL – an entity owned by TRC but funded by the Crown through a convertible preference share arrangement) owned housing stock. However, Council needs to maintain an awareness of developments at the JV to ensure that this assessment remains appropriate.</p> <p><b>Audit risk includes:</b></p> <ul style="list-style-type: none"> <li>• misstatement of assets and liabilities in the Council and group's 30 June financial statements; and</li> <li>• exposure to risks associated with a large scale redevelopment.</li> </ul>	<p>We will remain current with developments at TRC and TRL and the impact, if any, at Council. We will ensure that the Council has adequate processes in place to capture and report its exposure to the JV's activities and risks.</p>

Accounting risk	Our audit response
<b>Legislative compliance (Council and group)</b>	
<p><b>Rates setting</b></p> <p>Council has continued to demonstrate an appropriate level of review over rating procedures, including carrying out a legal review of the Council’s resolutions and sign-off on compliance through the recent annual plan round. We would expect to see a similar review for the setting of rates for the 2018 financial year.</p> <p><b>Financial Markets Conduct Act</b></p> <p>Council needs to fully comply with the Financial Markets Conduct Act (FMCA) and NZ stock exchange (NZX) listing requirements and ensure adequate processes are in place to achieve this.</p> <p><b>Mandatory disclosures</b></p> <p>The Annual Report must contain the disclosures required under legislation, including:</p> <ul style="list-style-type: none"> <li>• the Local Government Act;</li> <li>• the Local Government (Financial Reporting and Prudence) Regulations 2014; and</li> <li>• the Non-Financial Performance Measures Rules 2013.</li> </ul> <p><b>Audit risk includes:</b></p> <ul style="list-style-type: none"> <li>• non-compliance with legislation;</li> <li>• material error in revenue due to errors in the rates setting process; and</li> <li>• breach of FMA or NZX listing requirements.</li> </ul>	<p>We will update our understanding of Council’s progress embedding their “do it right” legislative compliance process. We will consider how this and other measures addressed specific risks.</p> <p>We will carry out work on the 2018 rate setting process as required.</p> <p>We will ensure 2017 rates are correctly classified and accounted for at 30 June.</p> <p>We will also consider the processes and controls the Council has in place over the generation of rates in light of the transition to NewCore.</p>

Accounting risk	Our audit response
<b>World Masters Games (Council and group)</b>	
<p>The World Masters Games will be held in Auckland in 2017. Due to the high public and political interest associated with major events such as this, we would expect Council through its CCO, ATEED, to have an appropriate monitoring and governance framework over the project to manage delivery. We would also expect a degree of direct Council oversight over the project.</p> <p>In addition we would expect Council to have appropriate mechanisms to capture financial and service performance achievements relating to this headline event.</p> <p><b>Audit risk includes</b></p> <ul style="list-style-type: none"> <li>• misstatement at the account balance level;</li> <li>• poor project management practices; and</li> <li>• inadequate reporting of performance and outcomes.</li> </ul>	<p>We will update our understanding of project management and ensure there are adequate mechanisms to capture performance at World Masters Games Limited through to ATEED and Council. We will ensure games outcomes are appropriately accounted for and reported on by the Council.</p>
<b>Unitary Plan (Council and group)</b>	
<p>The Unitary Plan was adopted by Council in August 2016. This allows for a greater level of intensification in the city and impacts on Council's long term infrastructure planning and property values across the city. Moving into the next LTP round, Council should ensure that its infrastructure strategy reflects the content of the Unitary Plan.</p> <p>We are aware that challenges have been lodged against the Plan which, if upheld, could affect planning and delay delivery of Council's infrastructure and financial strategies.</p> <p><b>Audit risk includes</b></p> <ul style="list-style-type: none"> <li>• delays to major housing and infrastructure initiatives; and</li> <li>• delays and increased complexities in carrying out Council's regulatory activities.</li> </ul>	<p>We will update our understanding of the status of legal challenges and consider the implications for Council's strategic initiatives.</p>

Accounting risk	Our audit response
<b>Mayor's office (Council only)</b>	
<p>As is usual on the election of a new Mayor the operation and staffing of the Mayor's office is subject to change. This will potentially include changes to personnel, policy and practices, albeit there is an expectation that where council wide policies and practices apply these will not change. Changes to people and process can give rise to elevated risks and it is our expectation that the operation of the office would be subject to an internal review to ensure that risks have been appropriately mitigated.</p> <p><b>Audit risk includes</b></p> <ul style="list-style-type: none"> <li>• loss of institutional knowledge giving rise to risks at the transactional level;</li> <li>• changes in systems and controls so that these are no longer effective to address office specific risks; and</li> <li>• inadequate level of internal review over the implementation and operation of Mayor's office policies and practices.</li> </ul>	<p>We will update our knowledge of the operation of the Mayor's office, including internal review of the office. We will test the operation of key controls in the Mayor's office and feedback our findings accordingly.</p> <p>We will specifically test a sample of outgoing and incoming staff and the Mayors expenses to ensure policies and procedures are being complied with.</p>

### 5.3 Statement of service performance risks

Statement of service performance risk	Our audit response
<b>Systems and controls over performance information (Council and group)</b>	
<p>Council needs to ensure that there are adequate systems in place to capture, monitor, and manage performance against intended levels of service for the 2017 financial year. This includes ensuring that the CCO's are able to report on the service performance measures that they are responsible for</p> <p>In the 2016 year we noted continued issues with the accuracy of systems and controls for reporting mandatory performance measures related to the stormwater activity.</p> <p><b>Audit risk includes</b></p> <ul style="list-style-type: none"> <li>• service performance is not fairly stated in the 2017 Annual Report.</li> </ul>	<p>We will follow up on the status of our previous recommendations related to these issues and update our understanding of progress made since our last review.</p> <p>We will review the Council's overall systems for capturing and reporting on the performance framework as a whole. A detailed review will be carried out over key measures across the group.</p> <p>Please also refer to section 3.4 for housing and transport risks identified under the heading performance reporting and our audit response to these.</p>

## 6 Group audit considerations

The following is a description of:

- the type of work to be performed on the financial information of group components; and
- the nature of the group engagement team's planned involvement in the work to be performed by the component auditors on the financial information of significant components.

### 6.1 Significant components

On our behalf, component auditors will perform an audit of the financial and service performance information of the substantive CCOs which will be consolidated into the Auckland Council and Group Annual Report, using component material which we have determined for them.

As part of our audit planning, we have agreed the significant risks that could potentially impact the group financial and performance statements with the component auditors of the substantive CCOs. These are included in the tables at sections 3 and 4 above. Through our audit we will continue to update our understanding of the work to be performed at the substantive CCOs to ensure that risks are appropriately addressed by the component auditors.

Our instructions to component auditors include the expected form and content of their communications to us. Based on these communications, we will evaluate whether sufficient appropriate evidence has been obtained on the substantive CCOs on which to base the group audit opinion.

As Group auditor, we will also evaluate the effect on the group audit opinion of any uncorrected misstatements either identified by the group engagement team or communicated by component auditors.

## 6.2 Non-significant components

For remaining components determined not to be significant, we will perform analytical procedures at a group level.

## 7 Other areas of interest across the Local Government sector

As part of our audit planning there are areas that are significant to the audit of all Local Authority clients. There include areas of interest that are not necessarily significant to the Council, but are areas we monitor as part of our responsibility to consider the broader risks affecting Local Authorities. These have been included in Appendix 2 of this letter.

Each year we also conduct work over matters of particular interest to me. During the 30 June 2016 audit the area focused on as part of the annual audits was "information". The information and examples collected will help inform the Office of the Auditor-General's work on the information theme this year. During this year's audit information will be collected for next year's theme which is water.

## 8 Logistics

### 8.1 Our audit team

Office of the Auditor-General

Greg Schollum  
Sarah Lineham

Deputy Auditor-General  
Sector Manager – Local Government

The Audit New Zealand staff involved in the audit are:

Jo Smaill  
Athol Graham  
Andy Burns  
Robert Sutherland  
Jade Schiebler  
Lauren Clark  
Alan Clifford  
John Mackey  
Martin Richardson

Director  
Second Director  
Engagement Quality Control Director  
Audit Manager  
Second Audit Manager  
Audit Supervisor  
Information Systems Auditor  
Tax Director  
Specialist Audit and  
Assurance Services Director

### 8.2 Important dates in the audit process

Our proposed timetable is:

Description	Date
Interim audit begins	27 March 2017
Draft pro forma financial Statements provided by Council	27 March 2017

Draft interim management report issued	10 May 2017
Audit NZ and OAG sign off on pro forma financial statements	30 May 2017
Pre-final audit begins	6 June 2017
Final audit begins	10 July 2017
Verbal audit clearance given on parent reporting pack	4 August 2017
NZX verbal audit clearance	TBC
NZX release by the Council	TBC
Audit Opinion issued	TBC
Draft Management Report issued	TBC

We note that these are indicative dates only and may be subject to change. We will provide a detailed update on milestones and expected deliverables (ours and yours) in the new-year.

### 8.3 Our interim audit visit

In conjunction with audit work on the six month review engagement (balance date 31 December 2016) we are currently completing interim audit work confirming the operation of key systems and controls. We will complete further interim visits in March, April, and June, where we will focus on updating our understanding of and testing the Council's internal controls. This includes reviewing the control environment, risk assessment processes and relevant aspects of information systems controls. We will use the results of this assessment to determine how much we can rely on the information produced from your systems during our final audit.

### 8.4 Our final audit visit

Our final audit is scheduled to start on 10 July 2017. During this visit we will be auditing the balances, disclosures, and other information included in the Annual Report as well as completing our audit of the group consolidation.

### 8.5 Professional fees

Our audit fee estimate for the year ending 30 June 2017 will be confirmed in a separate Audit Proposal Letter.

The fee will be an estimate and assumes that the expectations discussed in Appendix 1 will be met. If this does not occur, or the scope of the audit changes, we will discuss this further with you.

We propose to bill as follows:

	<b>Amount</b>
December 2016	\$115,000
January 2017	\$115,000
February 2017	\$115,000
March 2017	\$115,000
April 2017	\$115,000
May 2017	\$115,000
June 2017	\$115,000
July 2017	\$115,000

August 2017	\$115,000
September 2017	TBC
Total	TBC

Disbursements will be invoiced as they occur throughout the year. To ensure we can complete the audit within the proposed time frame (see section 8.2) and agreed fee, it is critical that you make appropriate supporting documentation available to us on a timely basis. If this is not the case, it is likely to result in cost overruns, which we will seek to recover from you. To help you prepare for the audit, we will liaise with management and provide them with a detailed list of the information we will need for the audit.

DRAFT

# Appendix 1: Additional information about the audit

## Our reporting protocols

### Management reports

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

### Reporting of misstatements

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

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

## Our expectations of you to enable an efficient audit

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

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

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

## Using your internal auditors

Our approach will be to continue to liaise with your internal auditors to ensure appropriate co-ordination of effort. In keeping with the applicable auditing standard, ISA (NZ) 610, *Using the Work of Internal Auditors*, we will make a preliminary assessment of the internal audit function in terms of organisational status, scope, technical competence, and professional care.

If we determine from our preliminary assessment that the internal audit function could be relied on for external audit purposes then we will consider the internal audit work proposed or completed. We will then determine the extent to which we can use the internal audit work to supplement our audit work.

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

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

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

DRAFT

# Appendix 2: Other areas of interest across the Local Government Sector

Areas of Interest	Our audit response
<b>Auckland Council's 2018-28 LTP</b>	
<p>The key areas of audit focus that we would like to have early engagement with Council on the preparation of the 2018-28 LTP are:</p> <ul style="list-style-type: none"> <li>• Financial strategy – a clear financial strategy that underpins Council's LTP is essential to ensure that the community is aware of the effect that the Council's decisions have.</li> <li>• Performance reporting – Over the past few years Council has made improvements to the performance framework. It is important that these changes, as well as any further improvements deemed necessary, are included in the 2018-28 LTP.</li> <li>• Asset Management Plans – it is important for Council's AMP improvement programme timetable to align with the preparation of the LTP.</li> <li>• Strategic decisions that Council has made that will have an impact on the LTP.</li> <li>• Council's overall project plan for the preparation of the LTP.</li> <li>• Proposed approach to carry forwards in the capital programme, including any impact on the levels of service if projects are not completed on time and any potential for costs to increase.</li> </ul>	<p>We will liaise with Council over its planning process as it is gearing up for the preparation of the 2018-28 LTP.</p> <p>We will follow up with council to ensure that the recommendations made following the audits of both the last LTP and the amendment to the LTP are addressed.</p>

Areas of Interest	Our audit response
<b>Council's governance role over Council Controlled Organisations (CCOs)</b>	
<p>CCOs are responsible for meeting the accountability requirements of the Local Government Act 2002 (LGA). This includes preparing a Statement of Intent (SOI) with appropriate involvement from their parent Local Authorities.</p> <p>Local Authorities are responsible for the effective oversight of their CCOs. This includes monitoring their CCOs' performance and reviewing and commenting on their draft SOIs within the timeframe in the LGA.</p> <p>Local Authorities should ensure that they have a clearly articulated rationale for their investment in their CCOs.</p>	<p>We will review Auckland Council's arrangements for effectively fulfilling its oversight responsibilities relating to its CCOs. This includes establishing the rationale for its investment in its CCOs and the monitoring of their performance.</p>
<b>Treaty settlements and co-management</b>	
<p>The Government aims to settle all historical Treaty of Waitangi claims by 2017. One part of cultural redress provided by the Crown to claimant groups is the establishment of future relationships and arrangements ("co-management") with government agencies, such as local authorities, that play significant roles in the areas with which the claimant group has traditional and cultural associations.</p>	<p>We have been working with Council on identifying how they account for entities established under the treaty settlement process. This is an ongoing process and we will continue to monitor for developments through the audit.</p>
<b>Earthquake-prone buildings</b>	
<p>Exposure to earthquake-prone buildings is a common issue which affects, but is not limited to, the local government sector.</p> <p>The Building (Earthquake-prone Buildings) Amendment Act 2016 was passed by Parliament in May 2016. This has resulted in a more targeted approach by Government, focusing on the buildings that pose the greatest risk to life.</p> <p>The new legislation prioritises geographical areas, buildings, and parts of buildings which have the greatest risks. The threshold for defining an Earthquake Prone Building remains largely unchanged at less than 34% of the new building standard, although there are amendments to clarify aspects of this. The Act also imposes a number of new requirements on territorial authorities.</p> <p>Auckland is assessed under the Act as a low seismic hazard area, and therefore the council has longer deadlines for identifying, reporting progress on, and remediating earthquake prone buildings. However the Council still needs to</p>	<p>We will obtain an understanding of the implications of the law change for Council.</p> <p>In prior years, we have recommended that a group approach to completing seismic assessments on assets is considered both in terms of criteria for remedial works and the assessment of the financial and planning implications. During our 2017 audit, we will follow up on any progress made in this area.</p>

Areas of Interest	Our audit response
consider the implications of the law change and how to implement this.	
<b>Elected members remuneration and allowances</b>	
<p>The Local Government Act gives the Remuneration Authority responsibility for setting the remuneration of local government elected members. The Authority also has the role of approving a Local Authority's policy on allowances and expenses.</p> <p>The Council's Annual Report must disclose the total remuneration received by or payable to each member of the local authority in the reporting period (Schedule 10, clause 18, Local Government Act 2002). A local authority must disclose remuneration paid or payable to each member from both the local authority and any council organisation of the local authority.</p>	<p>We will assess Auckland Council's compliance with the requirement to disclose the remuneration of each member of the local authority in the Annual Report against the current Local Government Elected Members Determination and any amendment to that Determination.</p> <p>We will also confirm whether payments are within the Determination set by the Authority.</p>
<b>Information Technology (IT)</b>	
<p>Auckland Council is heavily dependent on its IT systems. The reliability of the IT systems, technology platforms, and associated controls is critical to maintaining the integrity of the Council's data and ensuring continuity of services to its customers.</p> <p>The integrity of the IT systems is also fundamental to the timely production of a quality annual report.</p> <p>We understand that the Council is continuing to implement changes and improvements to information technology systems and capability and reviewing how IT services should be delivered.</p>	<p>We will review the Council's IT General Controls (ITGC), which will include:</p> <ul style="list-style-type: none"> <li>• IT governance and Strategic planning.</li> <li>• Assessment and management of IT risks.</li> <li>• Monitoring and evaluating internal controls.</li> <li>• IT processes, organisation and relationships.</li> <li>• Systems acquisition and project management.</li> <li>• Security (network and applications).</li> <li>• Business Continuity and IT Disaster recovery.</li> <li>• Change management.</li> <li>• Operations, problems and incident management.</li> </ul> <p>We will also maintain an awareness of any planned or implemented initiatives and the impact these may have on the Council's processes and control environment. We will assess any impact such initiatives will have on our audit approach and requirements.</p> <p>To assist the audit team in performing their testing our IS auditors will perform data analysis on selected business processes, such as journals, and will perform testing on automated IT application controls.</p>
<b>Summary annual report</b>	
The Council is required to prepare and make publicly available, within one month of adopting its Annual Report, a summary of its annual report	As part of our audit of the Summary Annual Report we will review the content of the Summary

<b>Areas of Interest</b>	<b>Our audit response</b>
which represents, fairly and consistently, the information regarding the major matters dealt with in the annual report.	Annual Report for content inconsistent with the major matters dealt with in the Annual Report.
<b>Disclosure of severance payments</b>	
<p>Under section 33 of the Local Government Act 2002, a local authority's annual report must:</p> <ul style="list-style-type: none"> <li>• State the amount of any severance payments made in the year to any person who vacated office as chief executive of the local authority.</li> <li>• The number of employees of the local authority to whom severance payments were made in the year.</li> <li>• The amount of every such severance payment.</li> </ul> <p>This means that the total of each severance payment needs to be disclosed separately and not as a total for the local authority.</p> <p>The Local Government Act defines a "severance payment" as:</p> <p>"... any consideration that a local authority has agreed to provide to an employee in respect of that employee's agreement to the termination of his or her employment, being consideration, whether of a monetary nature or otherwise, additional to any entitlement of that employee to:</p> <p>(a) any final payment of salary; or  (b) any holiday pay; or  (c) any superannuation contributions."</p>	<p>As part of our audit we will review the Council's severance payment disclosures for completeness and legislative compliance.</p> <p>The definition of "severance payment" is complex and can be difficult to apply in practice. Therefore we would expect that disclosures are subject to a robust review process, including by the Council's legal team, prior to being included in the draft annual plan.</p>
<b>Public sector concerns</b>	
<p>It is expected that public entities apply a number of principles to expenditure decisions, including that the expenditure has a justifiable business purpose, preserves impartiality, are made with integrity, are moderate and conservative in respect of the circumstances and are made transparently.</p>	<p>During the audit, we will remain alert to issues and risks related to effectiveness and efficiency, waste, and a lack of probity or financial prudence. Aside from specific testing across a sample of sensitive transactions, this will also involve making certain enquiries of the governing body, management, and staff, and maintaining awareness of public sector concerns throughout our audit work.</p>
<b>Debenture Trust Deed</b>	
<p>This letter does not cover the debenture trust deed assurance engagement and master trust deed assurance engagement that will provide a report to Auckland Council and the Trustees. This will be subject to a separate engagement agreement.</p>	