

14 November 2017

Hon Phil Goff  
Mayor of Auckland  
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 Hon Phil Goff and Stephen

**Confirmation of Engagement – Review Engagement of the Interim Financial Statements of the Auckland Council Group for the six month period ended 31 December 2017**

The 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 month period ended 31 December 2017.

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 11 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 is 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 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

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**

The Auditor-General has 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;
- Watercare Services Limited;
- Regional Facilities Auckland;
- Development Auckland Limited;
- Auckland Tourism, Events and Economic Development Limited; and
- Auckland Council Investments Limited.

We have also assessed City Rail Link Limited, which is a joint arrangement between the Council and the Crown, as significant to the Auckland Council Group six month interim financial statements.

### **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 2017 (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 2017, unless we have been given reason to believe that the systems of controls have changed significantly, or are not operating as intended.

## 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 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 and the above listed substantive CCOs currently revalue 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 2017.

Where classes of assets need to be revalued, we will work with management to agree the timing of the valuations and complete the audit work required to ensure assets are reflected at fair value in the Auckland Council Group's six month interim results.

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

We will review the 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.

### **5.4 Valuation of derivatives**

The group uses a number of different types of derivative financial instruments to mitigate risks associated with foreign currency and interest rate fluctuations that affect the group's debt. 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.

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 31 December 2017 are materially correct.

### **5.5 Provisions**

We will update our understanding of the Council's systems and processes for valuing and accounting for leaky building liabilities, including contingent liability disclosures. We will also consider management's assessment of the effect of recent court cases.

We expect this will be based on an assessment by the actuary the Council uses to value the weathertightness provision.

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

## **5.6 City Rail Link Limited**

Following the signing of the Sponsors agreement in June 2017 and the Settlement Agreement in September 2017, the City Rail Link project has now fully transferred to City Rail Link Limited (CRL). CRL is a schedule 4A Crown Entity company through which the government and the Council will oversee delivery of the project.

We understand the Council intends to account for its interest in CRL as a joint operation and proportionately consolidate it into the Council's six month interim results. These are then consolidated into the Group's interim financial statements.

The Council should ensure that

- there are appropriate mechanisms to report performance of the new entity up to the Council; and
- its interest in the CRL entity, including its share of commitments and contingencies, are appropriately recognised in the 2017 Group interim financial statements.

We will consider whether the Council's interest in CRL is fairly stated and appropriately accounted for and disclosed in the Group's interim financial statements.

## **5.7 Early adoption of accounting standards**

The Council intends to account for its interest in CRL as a joint operation, which requires early adoption of the following new Public Benefit Entity accounting standards:

- PBE IPSAS 34 Separate Financial Statements;
- PBE IPSAS 35 Consolidated Financial Statements;
- PBE IPSAS 36 Investments in Associates and Joint Ventures;
- PBE IPSAS 37 Joint Arrangements; and
- PBE IPSAS 38 Disclosure of Interests in Other entities.

These standards replace PBE IPSAS 6, PBE IPSAS 7 and PBE IPSAS 8. Early application of these standards are permitted, as long as all the standards are applied at the same time.

The new standards:

- introduce an amended definition of control and extensive guidance on control (and continues to require all controlled entities to be consolidated in the controlling entity's financial statements, except as noted below);
- introduce the concept of "investment entity", exempts investment entities from consolidating controlled entities, and requires investment entities to recognise controlled entities at fair value through surplus or deficit instead;
- introduce a new classification of joint arrangements, set out the accounting requirements for each type of arrangement (joint operations and joint ventures), and remove the option of using the proportionate consolidation method; and
- require PBEs to disclose information on their interests in other entities, including some additional disclosures that are not currently required under PBE IPSAS 6, 7 and 8.

The Council should ensure that as well as assessing the accounting treatment for CRL, the impact of early adopting the above standards on the Council's other joint arrangements is also considered, and any additional disclosure requirements are reviewed.

We will review the Council's assessment of the impact of early adopting the new standards has on all of the Council's joint arrangements.

## **5.8 Treasury and funding management**

As the Auckland 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.

We understand that the Public Transport Operating Model (PTOM) arrangements created leases and commitments at the Auckland Council Group level. The Council should ensure that the impact on its debt ratings and ratios is recognised in the Auckland Council Group six month interim financial statements.

To gain assurance over the valuation of financial instruments, borrowings 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 2017).

We will review the accounting treatment and disclosure for financial liabilities to ensure that these are in line with the applicable standards.

We will also review the Council's assessment of the impact PTOM will have on the Auckland Council Group's financial results and commitments.

## **5.9 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 maintain an awareness for the risk of management override of controls as we perform our review procedures including controls assessment and analytical review.

## **5.10 Accounting for impairment and capitalisation of work in progress**

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.

The Auckland Council Group 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.

We will review the assessment of impairment, including for all significant WIP balances.

We will review management's processes and controls for ensuring WIP costs are capitalised in a timely manner.

## **5.11 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 2017/18 financial year, and appropriately discounted for rates yet to be received.

We will ensure the 2017/18 rates are correctly classified and accounted for at 31 December 2017, including undertaking a review of the discount rate applied and the underlying assumptions used.

## **5.12 Legislative compliance**

We understand that the Council's legal team will complete a comprehensive internal legal review over the six month interim financial statements. 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 \$1 17,085 (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 their 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 your 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>
December 2017	29,271
January 2018	58,542
February 2018	29,272
Total	<u>117,085</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)**

Greg Schollum Deputy Auditor-General

### **Audit New Zealand**

Jo Smaill	Engagement Director
Andy Burns	Engagement Quality Control Director
Jennifer Tupou	Audit Manager
Celia Zhang	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:

	<b>Appointed Auditor</b>
Auckland Transport	Leon Pieterse
Watercare Services Limited	Andrew Burgess
Regional Facilities Auckland	David Walker
Development Auckland Limited	David Walker
Auckland Tourism Events and Economic Development Limited	Leon Pieterse
Auckland Council Investments Limited	Brendan Lyon

## 7.1 Timetable

Our proposed timetable is:

	<b>Date</b>
The Council review of controls fieldwork commences	30 October 2017
CCO review of controls fieldwork commences (varies)	November and December 2017
The Council and CCO reporting packs available (balance sheet and profit and loss only)	15 January 2018
The Council and CCO, review teams commence review of reporting packs and final Trial Balance	15 January 2018
The Council and CCO reporting packs available (complete except for cash flow statement)	22 January 2018
Cash flow statement for the Council	25 January 2018
CCO signoff of reporting packs	26 January 2018
The Council signoff of reporting pack	31 January 2018
Auckland Council Group consolidation review available (balance sheet and profit and loss only)	5 February 2018
Auckland Council Group consolidation review available (including cash flow, variance commentary and operating cash reconciliation)	12 February 2018
Full draft Auckland Council Group Interim Financial Statements available	14 February 2018
Draft NZX Preliminary release available	14 February 2018
Full final Auckland Council Group interim report available (including AIAL adjustment)	19 February 2018
NZX announcement including AIAL adjustment available	19 February 2018
Verbal clearance	22 February 2018
Draft Management Report issued	28 February 2018
Review report issued	28 February 2018

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 Smail on 021 222 7545.

Yours sincerely

Greg Schollum  
Deputy Auditor-General

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

\_\_\_\_\_  
*Hon Phil Goff  
Mayor of Auckland*

*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
- North Tugz Limited
- Waste Disposal Services
- PortConnect Limited
- New Zealand Food Innovation Auckland Limited
- New Lynn Central Limited Partnership
- Tamaki Redevelopment Company Limited
- Longburn Intermodal Freight Hub Limited

## Appendix 2: Team mix and hours

### Auckland Council 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	117,085
Estimated disbursements*	<u>1,000</u>
Total fee (including disbursements)	118,085
GST	<u>17,713</u>
Review Engagement fee for the 31 December 2017 interim financial statements	<u>135,798</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 (the 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>15 January 2018</p> <p>15 January 2018</p> <p>18 January 2018</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 2017).</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 2017/18) and comparative period (31 December 2016).</li> </ul> <p>Reconciliation of budget comparatives to Annual Plan 2017/18. 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>18 January 2018</p> <p>18 January 2018</p> <p>25 January 2018</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 2017 - 31 December 2017.</li> <li>Impairment assessment for investments.</li> </ul>	<p>15 January 2018</p>	
<p><b>Debtors</b></p> <ul style="list-style-type: none"> <li>Details of provision for doubtful debts calculation as at 31 December 2017.</li> <li>Schedule of debtors written off during the period.</li> <li>Credit notes report for the period to 22 January 2018.</li> </ul>	<p>15 January 2018</p> <p>(excluding credit notes report, to be received by 26 January 2018)</p>	



<b>Requirement</b>	<b>Date (by midday)</b>	<b>Responsibility</b>
<ul style="list-style-type: none"> <li>WIP reports as at 31 December 2017.</li> </ul>		
<b>Subsidiaries</b> <ul style="list-style-type: none"> <li>Inter-company confirmations matrix agreed with all CCOs.</li> </ul>	26 January 2018	
<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 2017.</li> <li>Schedule of any major changes (for example, wage increases) since 30 June 2017 and effective date.</li> <li>List of severances, redundancies and bonuses paid since 30 June 2017.</li> </ul>	19 January 2018	
<b>Minutes</b> The Council and relevant sub-committee confidential minutes for the period ended 31 December 2017 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.	5 February 2018 12 February 2018	
<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 2017/18) and comparative period (30 June 2017).</li> <li>P&amp;L variance explanations: variance explanations for variances over \$2 million/10% compared to budget (Annual Plan 2017/18) and comparative period (31 December 2016).</li> </ul>	12 February 2018	
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).	14 February 2018 14 February 2018 19 February 2018	
<b>Cash flow statement</b> Cash flow proof to support group cash flow statement based on P&L and movement between balance sheet accounts.	12 February 2018	
<b>PPE: Group</b> Fair value assessment as at 31 December 2017.	16 January 2017	
<b>Investment property: Group</b> Fair value assessment as at 31 December 2017.	2 February 2018	

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>	2 February 2018	
<p><b>Legal sign off</b></p> <p>Confirmation of legal review and sign off on the Interim release</p>	20 February 2018	

DRAFT