OFFICE OF THE AUDITOR-GENERAL
Te Mana Arotake

Audit plan

Auckland Council

For the year ending 30 June 2018

Audit plan

I am pleased to present the arrangements for the audit of Auckland Council (the Council) and group for the year ending 30 June 2018. The purpose of this audit plan is to discuss**:**

The contents of this plan should provide a good basis for discussion when we meet with you.

While I am the auditor of Auckland Council and group I will be using my staff and resources, and appointed auditors and their staff to complete the audit work that will enable me to report on the information in Auckland Council's 30 June 2018 annual report.

The Group comprises the Council Parent, 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 Limited (ACIL);
- Auckland Tourism, Events, and Economic Development (ATEED); and
- Development Auckland Limited (Panuku).

We have also assessed City Rail Link Limited (CRLL), which is a joint arrangement between the Council and the Crown, as significant to the Council and group financial statements.

We would be happy to elaborate further on the matters raised in this plan.

We are committed to delivering a high-quality audit. Our audit is risk based, which means that we focus on the areas that matter.

If there are additional matters that you think we should include, or any matters requiring clarification, please discuss these with me or Jo Smaill, Audit Director.

Yours sincerely

Greg Schollum
Deputy Auditor-General
Draft: 15 November 2017

Audit risks and issues

Key audit matters

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 Financial Markets Conduct Act 2013 (FMC) reporting entities considered to have a higher level of public accountability, to communicate details of key audit matters in the auditor's report. Our first key audit matters report was issued on your 30 June 2017 annual 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 2018.

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, including:

- areas identified as significant risk or involving significant 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.

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.

Our assessment of the significant areas for audit focus are based on the risks inherent in the related transactions or balances, or in the performance reporting. The five 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;
- City Rail Link; 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.

Valuation of operational and infrastructure assets

The group owns a large portfolio of operational and infrastructure assets. At 30 June 2017 the group had infrastructure assets of $29.2 billion, operational assets of $8 billion and restricted assets of $6.1 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 $11.2 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 33 per cent ($9.7 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 this year. 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 ensure related disclosures such as the sensitivity of the valuation to key assumptions have been made in accordance with the requirements of the accounting standards

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. The types of derivative instruments used as at 30 June 2017 were:

- 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;

- forward rate agreements and foreign currency swaps, which lock in interest or foreign exchange rates at a future date; and
- basis resetting swaps, which are new instruments the Council parent entered into in 2017 to partially hedge against interest rate risk on its cross currency interest rate swaps.

At 30 June 2017, the Council and group had derivative assets with a fair value of $170 million and derivative liabilities with a fair value of $872 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 2017 there was a gain on derivatives of $237 million recognised by the Council and group as a result of the continuing unanticipated decrease in interest rates and changes in the foreign currency rates.

During our audit 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 2018 are materially correct.

Valuation of the weathertightness provision

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

The Council recognised a weathertightness provision of $265 million for the year ended 30 June 2017. Multi-unit claims make up 89% of this provision.

There are three different types of claims:

- active claims: those which have been lodged and are progressing through the resolution process;
- reported claims: those which have been lodged but are not yet progressing through the resolution process; and
- unreported claims: 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 significant uncertainty the Council 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 obtain an understanding of any significant court action or legislative change during the year that could affect the value of the Council's actual or contingent liabilities.

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.

City Rail Link (CRL)

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 (CRLL). CRLL is a schedule 4A Crown Entity company through which the government and the Council will oversee delivery of the project.

City Rail Link is the largest infrastructure project of its kind ever undertaken in New Zealand and it is expected to cost over $3 billion. While the project is being delivered by CRLL the Council have an obligation to ensure that the project is being managed effectively and efficiently to minimise the risk of performance, waste and probity issues. The establishment of effective project governance and reporting mechanisms will be a key mechanism for the Council to get this assurance.

We will review the reporting mechanisms the Council has established to report financial performance and project delivery progress and consider the reasonableness of these.

We will consider whether the Council's interest in CRLL is fairly stated in the Council's 30 June 2018 financial statements, with a focus on:

- the appropriateness of the accounting treatment used for the Council's interest; and
- the recognition and disclosure of any commitments and contingencies related to CRLL in the Council's financial statements.

Significant performance reporting issues – housing and transport

Housing and transport continue to be 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. The 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

The 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. The Council is also required to give effect to the policy statements applicable to a high growth urban area from the National Policy Statement on urban development capacity 2016.

Because of the significance of these issues we expect they will continue to be a key feature of the 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 made towards implementing the national policy statement;
- 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;
- 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; and
- where information on the housing and transport activities is included in the annual report but outside the statement of service performance, we will review this information for consistency with the audited financial statements and statement of service performance, and our knowledge obtained during the audit of the Council and the Group.

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 statement 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).

The following tables identify each risk and issue, the associated audit risk and our proposed audit response. The full detail behind each issue and risk is included in Appendix 1.

Please tell us about any additional matters we should consider, or any specific risks that we have not covered. Additional risks may also emerge during the audit. These risks will be factored into our audit response and our reporting to you.

Business risks

<table>
<tr><th>Business risk/issue</th><th>Our audit response</th></tr>
<tr><td colspan="2">Tamaki Redevelopment Company (the Council only)</td></tr>
<tr><td>Audit risks include:
• misstatement of assets and liabilities in the Council and group’s 30 June 2018 financial statements; and
• exposure to risks associated with a large scale redevelopment.</td><td>We will remain current with developments at TRC and TRL and the impact, if any, at the 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.</td></tr>
<tr><td colspan="2">Crown Funding Initiatives (the Council and group)</td></tr>
<tr><td>Audit risks include:
• non-compliance with funding covenants and ratios imposed under the Council’s borrowing and trust deed arrangements;
• non-compliance with balanced budget and other requirements under section 100 of the Local Government Act;
• financial impacts of Crown funding initiatives not fairly reflected in the 2018 financial statements;
• Investment or financing decisions that lead to decreases in levels of service not clearly signalled to the public.</td><td>Our areas of audit focus will include :
• reviewing the impact of funding and financing decisions on treasury policies;
• obtaining an understanding of the proposed delivery options and their potential for impact on levels of service; and
• obtaining an understanding of the strategic context for investment decisions.
We will remain aware of how the Council maintains compliance with commitments to funders imposed under borrowing and trust deed arrangements.
We will also consider the financial and disclosure implications, if any, of the HIF and other Crown funding initiatives on the Council’s 2018 financial statements.</td></tr>
<tr><td colspan="2">Prudent expenditure decisions (the Council and group)</td></tr>
<tr><td>Audit risks include:
Expenditure decisions are not in line with our expectations of a public sector entity.</td><td>We need to remain alert to public sector concerns, including issues and risks about effectiveness and efficiency, waste, and a lack of probity or financial prudence. This means looking a little closer at some transactions or other arrangements we come across during your audit, as well as assessing the policies the Council has in place to ensure expenditure is in line with the public sector principles and expectations.
Aside from specific testing across a sample of sensitive transactions, we will also remain alert for issues of waste and probity and make certain enquiries of the governing body, management, and staff throughout our audit work.
We will also remain up-to-date with the progress being made by the Council to achieve planned budget savings.</td></tr>
</table>

Business risk/issue	Our audit response
Performance information reporting (the Council and group)	
Audit risk include: Service performance is not fairly stated in the 2017/18 annual report.	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. We will form a view on whether the Council's performance information fairly reflects the actual levels of service of the Council for the year. This will involve: • considering how the Statement of Service Performance and related information such as reporting on outcomes collectively tell the performance story of the Council; and • reviewing and testing the systems and processes that capture and provide information for non-financial performance reporting, as well as ensuring that the content of the Statement of Service Performance is verifiable and appropriate. We will pay particular attention to the reported levels of service for significant performance measures and targets, including explanations of variances across the group.
Auckland Council Investment Limited (ACIL) (the Council and group)	
Audit risks include: • Exposure to tax risks; and • Incorrect disclosures included in the 30 June 2018 financial statements.	We will remain up-to-date with any structural changes that occur during the 2017/2018 financial year and review the impact of these, including any tax implications, on the Council and group financial statements for the year ending 30 June 2018.
Public Transport Operating Model (PTOM) (the Council only)	
Audit risks include: Breach of the Council and group debt ratio.	We will: • look at the assessment completed by the Council of the impact PTOM has on the Council and group's financial results and commitments; and • review the disclosures included in the Council and group financial statements to ensure they are in compliance with the applicable accounting standards.

Business risk/issue	Our audit response
Project management (the Council and group)	
Audit risks include: • non-compliance with the Council's policies, procedures and good practice; • waste and probity; and • misstatement of the financial impact of significant projects in the 2018 financial statements.	We will follow up on progress made against our previous recommendations, and gain an understanding of improvements and emerging issues since our last review. We understand the 2015 Review of Service Performance report into the AMETI project made 12 recommendations and work on these is either progressing or complete. We will follow up on the progress made on ongoing work throughout the programme's life. We will continue to review the status and governance arrangements in place over the large projects. 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. We will also test a sample of smaller projects to ensure the Council's processes and polices are consistently applied. Where appropriate, this work will be conducted in conjunction with CCO auditors and supported by our Specialist Audit and Assurance Services (SAAS) team.
Procurement (the Council and group)	
Audit risks include: • non-compliance with the Council's policies, procedures and good practice; • procurement processes resulting in poor purchasing decisions; and • contracting arrangements not following good practice.	We will follow up on the status of our previous recommendations and update our understanding of progress made and emerging issues since our last review. We will gain an understanding of the Ariba system and the controls that exist within this system and assesses whether they are effective. We will follow up the progress and impact of the SAP system (Ariba) on the Council's procurement practices, and whether the capabilities identified are taken up and implemented. 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. We will also review the application and effectiveness of procurement controls over a sample of smaller procurement contacts.

Business risk/issue	Our audit response
	Where appropriate, this work will be conducted in conjunction with affected CCO auditors and supported by our Information Systems (IS) and Specialist Audit and Assurance Services (SAAS) teams.
Contract management (the Council and group)	
Audit risks include: • contract monitoring arrangements not being fit for purpose; • processes not in line with good practice; and • poor or non-delivery by contractors (waste and probity).	We will update our understanding of the Council's contract management practices. In particular, we will review the progress the Council has made addressing our previous recommendations. We will, through discussions and high level review, update our understanding of the 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.
Legislative compliance (the Council and group)	
Audit risks include: • non-compliance with legislation; • material error in revenue due to errors in the rates setting process; and • breach of FMC or NZX listing requirements.	We will update our understanding of the Council's progress embedding their "do it right" legislative compliance process. We will consider how this and other measures addressed specific risks. We will also ensure the 2018 rates are correctly classified and accounted for at 30 June 2018.
The risk of management override of internal controls (the Council and group)	
There is an inherent risk in every organisation of fraud resulting from management override of internal controls. Management are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to treat this as a risk on every audit.	Our audit response to this risk includes: • testing the appropriateness of selected journal entries; • reviewing accounting estimates for indications of bias; and • evaluating any unusual or one-off transactions, including those with related parties.

Financial statement risks

Accounting risk/issue	Our audit response
Accounting for impairment and capitalisation of work in progress (the Council and group)	
Audit risks include: • assets not accounted for at fair value in the financial statements; and • understatement of impairment and depreciation expense in the financial statements.	We will assess the processes used by management to assess for impairment, including for all significant WIP balances. We will review management’s processes and controls for ensuring that the capitalising of WIP costs occurs in a timely manner. We will ensure impairment and depreciation expenses are recognised and accounted for correctly at year-end.
Other provisions (the Council and group)	
Audit risks include: Misstatement of provisions in the 30 June 2018 financial statements.	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. We will assess whether other provisions including the provision for Holidays Act non-compliance are based on appropriate underlying information. We will follow up on progress made against previous recommendations, and gain an understanding of emerging issues since our last review.
Early adoption of accounting standards (the Council and group)	
Audit risks include: Misstatement of the Council’s interest in joint arrangements in the Council and group financial year end 30 June 2018 financial statements.	We will review the Council’s assessment of the impact from early adopting the new standards have on all the Council’s joint arrangements. We will ensure that the disclosures made in the 30 June 2018 financial statements are in accordance with the requirements of the new standards.
Unallocated receipts (the Council only)	
Audit risks include: Misstatement of accounts receivables balances in the Council and group financial year end 30 June 2018 financial statements.	We will obtain an update on progress made by the Council to reduce these credit balances and in addressing the system issues that have led to their build up. We will ensure that remaining unallocated receipt balances at 30 June 2018 are appropriately recognised in the Council and group financial year end 30 June 2018 financial statements.

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. These 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. We intend to issue these to you in a separate letter once the specific areas of interest for the 2017/18 year have been determined.

Auditor-General's work programme – Water

Alongside our annual auditing work, the Office of the Auditor-General completes a programme of work under a particular theme. The theme for 2017/2018 is water. We use our unique view of the entire public sector to add relevant comment and objectivity to assist in improving the performance of, and the public's trust in, the public sector. This can be in the form of a sector report, performance audit, inquiry or other special study.

Any specific requests for information by the OAG for input into the work programme planning process will be communicated to the Council through supplementary communications.

Fraud risk

Misstatements in the financial statements and performance information can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action is intentional or unintentional. In considering fraud risk, two types of intentional misstatements are relevant – misstatements resulting from fraudulent reporting, and misstatements resulting from misappropriation of assets.

The primary responsibility for the prevention and detection of fraud and error rests with the Council, with assistance from management. In this regard, we will discuss the following questions with you:

- What role does the Council play in relation to fraud? How do you monitor management's exercise of its responsibilities?
- Has a robust fraud risk assessment been completed? If so, is the Council satisfied that it had appropriate input into this process?
- How does management provide assurance that appropriate internal controls to address fraud risks are in place and operating?
- What protocols/procedures have been established between the Council and management to keep you informed of instances of fraud, either actual, suspected, or alleged?
- Are you aware of any actual, suspected, or alleged fraud? If so, have the results of management's investigation been reported to the Council? Has appropriate action been taken on any lessons learned?

Our responsibility

Our responsibility is to obtain reasonable, but not absolute, assurance that the financial statements and performance information are free from material misstatement resulting from fraud. Our approach to obtaining this assurance is to:

- identify fraud risk factors and evaluate areas of potential risk of material misstatement;
- evaluate the effectiveness of internal controls in mitigating the risks;
- perform substantive audit procedures; and
- remain alert for indications of potential fraud in evaluating audit evidence.

Group audit considerations

The following is a description of:

> The Auditor-General has published useful information on fraud that can be found at oag.govt.nz/reports/fraud-reports.

- 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.

Significant components

On my behalf, component auditors will perform an audit of the financial and service performance information of the substantive CCOs and of CRLL which will be consolidated into the Council and group Annual Report, using component materiality 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 and CRLL. These are included in the tables above. Through our audit we will continue to update our understanding of the work to be performed at the substantive CCOs and CRLL 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 and CRLL on which to base the group audit opinion.

As group auditor, my team 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.

Non-significant components

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

Our audit process

Initial planning

Initial planning activities include verifying compliance with independence requirements and building the audit team.

Understand your business and environment

We use our extensive sector and business knowledge to make sure we have a broad and deep understanding of you, your business, and the environment you operate in.

Assess audit risk

We use our knowledge of the business, the sector and the environment to identify and assess the risks that could lead to a material misstatement in the financial statements and performance information.

Evaluate internal controls (interim audit)

During our first interim audit, we update our understanding of internal control. This includes reviewing the control environment, risk assessment processes, and relevant aspects of information systems controls.

Finalise the audit approach

We use the results of the internal control evaluation to determine how much we can rely on the information produced from your systems during our second interim and final audits.

Gather audit evidence (final audit)

During the final audit we will be auditing the balances, disclosures, and other information included in the Council and group's financial statements and performance information.

Conclude and report

We will issue our audit report on the financial statements and performance information. We will also report to the Council covering any relevant matters that come to our attention.

Materiality

In performing our audit, we apply the concept of materiality. In the public sector, materiality refers to something that if omitted, misstated, or obscured could reasonably be expected to:

- influence readers' overall understanding of the financial statements and performance information; and
- influence readers' in making decisions about the stewardship and allocation of resources, or assessing your performance.

This definition of materiality is broader than the one used in the private sector.

Accounting standards also require the Council and management to consider materiality in preparing the financial statements. IFRS Practice Statement 2, Making Materiality Judgements, provides guidance on how to make materiality judgements from a financial statements preparer's perspective.

Whether information is material is a matter of judgement. We consider the nature and size of each item judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor. Materiality will be lower for some items due to their sensitivity.

Misstatements

Misstatements are differences in, or omissions of, amounts and disclosures that may affect a reader's overall understanding of your financial statements and performance information. 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, other than those that are clearly trivial. Where management does not wish to correct a misstatement we will seek written representations from the Council that specify the reasons why the corrections will not be made.

Professional judgement and professional scepticism

Many of the issues that arise in an audit, particularly those involving valuations or assumptions about the future, involve estimates. Estimates are inevitably based on imperfect knowledge or dependent on future events. Many financial statement items involve subjective decisions or a degree of uncertainty. There is an inherent level of uncertainty which cannot be eliminated. These are areas where we must use our experience and skill to reach an opinion on the financial statements and performance information.

The term "opinion" reflects the fact that professional judgement is involved. My audit report is not a guarantee but rather reflects our professional judgement based on work performed in accordance with established standards.

Auditing standards require us to maintain professional scepticism throughout the audit. Professional scepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. Professional scepticism is fundamentally a mind-set. A sceptical mind-set drives us to adopt a questioning approach when considering information and in forming conclusions.

Exercising professional scepticism means that we will not accept everything we are told at face value. We will ask you and management to provide evidence to support what you tell us. We will also challenge your judgements and assumptions and weigh them against alternative possibilities.

How we consider compliance with laws and regulations

As part of my mandate, my team consider compliance with laws and regulations that directly affect your financial statements or general accountability. Our audit does not cover all of your requirements to comply with laws and regulations.

Our approach involves first assessing the systems and procedures that you have in place to monitor and manage compliance with laws and regulations relevant to the audit. We may also complete our own checklists. In addition, we will ask you about any non-compliance with laws and regulations that you are aware of. We will evaluate the effect of any such non-compliance on our audit.

Wider public sector considerations

A public sector audit also examines whether:

- the Council carries out its activities effectively and efficiently;
- waste is occurring or likely to occur as a result of any act or failure to act by the Council;
- there is any sign or appearance of a lack of probity as a result of any act or omission by the Council or by one or more of its members, office holders, or employees; and
- there is any sign or appearance of a lack of financial prudence as a result of any act or omission by the Council or by one of more of its members, office holders, or employees.

Reporting protocols

Communication with management and the Council

We will meet with management and the Council throughout the audit. We will maintain ongoing, proactive discussion of issues as and when they arise to ensure there are “no surprises”.

We have also planned fortnightly meetings with the Finance team.

We will provide a briefing paper to the Audit and Risk Committee prior to each meeting and brief the Committee as required.

We will also follow up on your progress in responding to our previous recommendations.

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.

Audit logistics

Our team

My senior audit team members are:

Jo Smaill	Audit Director
Athol Graham	Second Director
Andy Burns	Engagement Quality Control Director
Jennifer Tupou	Audit Manager
Lauren Clark	Audit Supervisor
Alan Clifford	Information Systems Auditor
John Mackey	Tax Director
Martin Richardson	Specialist Audit and Assurance Services Director

My engagement team has been selected to ensure that we have the right subject matter expertise and sector knowledge. Each member of the audit team has received tailored training to develop their expertise.

Timetable

Our proposed timetable is:

30 October 2017	Interim audit begins
19 March 2018	Second interim audit begins
19 March 2018	Draft pro forma financial statements provided by the Council
10 May 2018	Draft interim management report issued
30 May 2018	Audit NZ and OAG sign off on pro forma financial statements
11 June 2018	Pre-final audit begins
9 July 2018	Draft financial statements available for audit (including notes to the financial statements) with actual year-end figures
9 July 2018	Final audit begins
6 August 2018	Final financial statements available, incorporating all the amendments agreed to between us
TBC	NZX verbal audit clearance
TBC	NZX release by the Council
TBC	Audit opinion issued
TBC	Draft final detailed management report issued

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 due course.

Expectations

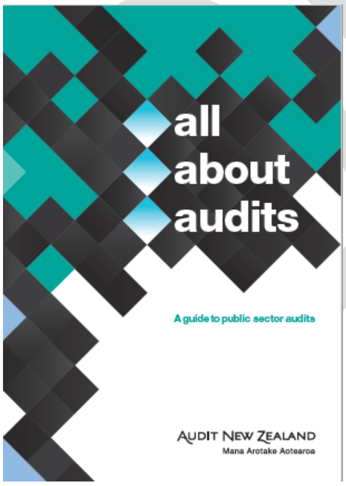
For the audit process to go smoothly for both you and us, there are expectations that each of us need to meet.

Our respective responsibilities are set out in our audit engagement letter dated 3 March 2017.

We expect that:

- you will provide us with access to all relevant records and provide information in a timely manner;
- staff will provide an appropriate level of assistance;
- the draft financial statements, including all relevant disclosures, will be available in accordance with the agreed timetable;
- management will make available a detailed workpaper file supporting the information in the financial statements; and
- the annual report, financial statements and performance information will be subjected to appropriate levels of quality review before being provided to us.

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. Audit New Zealand have also published information to explain what to expect from your audit:



Health and safety

I take seriously my and Audit New Zealand’s responsibility to provide a safe working environment for audit staff.

Under the Health and Safety at Work Act 2015, we need to make arrangements with management to keep our audit staff safe while they are working at your premises.

We expect you to provide a work environment for our audit staff that minimises or, where possible, eliminates risks to their health and safety. This includes providing adequate lighting and ventilation, suitable desks and chairs, and safety equipment where required. We also expect management to provide them with all information or training necessary to protect them from any risks they may be exposed to at your premises. This includes advising them of emergency evacuation procedures and how to report any health and safety issues.

Appendix 1: Other areas of audit emphasis

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.

Business risks

<table>
<tr><th>Business risk/issue</th><th>Our audit response</th></tr>
<tr><td colspan="2">Tamaki Redevelopment Company (the Council only)</td></tr>
<tr><td>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.

In the 2017 audit, we were satisfied that the 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.

With the change in Government and social housing initiatives, the Council needs to maintain an awareness of developments at the JV, and where relevant assess any impact it may have on the Council's shareholding.

Audit risks include:
• misstatement of assets and liabilities in the Council and group's 30 June 2018 financial statements; and
• exposure to risks associated with a large scale redevelopment.</td><td>We will remain current with developments at TRC and TRL and the impact, if any, at the 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.</td></tr>
</table>

Business risk/issue	Our audit response
Crown Funding Initiatives (the Council and group)	
Housing Infrastructure Fund The Crown announced $300 million of new funding through the Housing Infrastructure Fund (HIF) that will unlock new housing development in Auckland's north-west through investment in transport, greenfield and water projects earmarked as priority, fast-track initiatives. This will be provided via accelerated New Zealand Transport Agency (NZTA) funding and Crown loans. **Crown Infrastructure Partners** The Crown announced further funding of $600 million for network infrastructure for housing developments through Crown Infrastructure Partners (CIP) with a purpose of setting up special purpose companies to build and own new trunk infrastructure for housing developments. Two of the earliest projects to be assessed by CIP for investment will be the Auckland North and Auckland South projects previously submitted by the Council through the HIF bid submission process. The impact on housing infrastrucutre to the Group's results and financial position is dependent on finalising the terms of agreement. The Council will need to assess whether the new arrangements will create any liability for the Council that will impact on funding covenants and debt ratios. When the new agreements are reached with CIP, the Council will need to ensure it applies the correct accouting treatment given the complexities of these types of arrangements. ***Audit risks include:*** • non-compliance with funding covenants and ratios imposed under the Council's borrowing and trust deed arrangements; • non-compliance with balanced budget and other requirements under section 100 of the Local Government Act;	Our areas of audit focus will include: • reviewing the impact of funding and financing decisions on treasury policies; • obtaining an understanding of the proposed delivery options and their potential for impact on levels of service; and • obtaining an understanding of the strategic context for investment decisions. We will remain aware of how the Council maintains compliance with commitments to funders imposed under borrowing and trust deed arrangements. We will also consider the financial and disclosure implications, if any, of the HIF and other Crown funding initiatives on the Council's 2018 financial statements.

Business risk/issue	Our audit response
• financial impacts of Crown funding initiatives not fairly reflected in the 2018 financial statements; • Investment or financing decisions that lead to decreases in levels of service not clearly signalled to the public.	
Prudent expenditure decisions (the Council and group)	
We expect all public entities to apply a number of principles to expenditure decisions, including that the expenditure has a justifiable business purpose, preserves impartiality, is made with integrity, is moderate and conservative in respect of the circumstances and is made transparently. Given the nature, size and complexity of the Council there is a high level of public interest in how efficient the Council is, what it is spending its money on and how it minimises waste. We are aware that the Council has a number of reviews being undertaken to see, amongst other things, where efficiency savings can be made. Current budgets also have savings targets built in. ***Audit risks include:*** Expenditure decisions are not in line with our expectations of a public sector entity.	We need to remain alert to public sector concerns, including issues and risks about effectiveness and efficiency, waste, and a lack of probity or financial prudence. This means looking a little closer at some transactions or other arrangements we come across during your audit, as well as assessing the policies the Council has in place to ensure expenditure is in line with the public sector principles and expectations. Aside from specific testing across a sample of sensitive transactions, we will also remain alert for issues of waste and probity and make certain enquiries of the governing body, management, and staff throughout our audit work. We will also remain up-to-date with the progress being made by the Council to achieve planned budget savings.
Performance information reporting (the Council and group)	
The reported levels of service achieved in the Council's annual report are a key indicator for the public as to whether the Council is delivering what it said it would deliver in its long term plan. The audit opinion includes our assessment of whether the Council's performance reporting fairly reflects the Council's performance in full. We would expect the Council to include commentary that explains the service performance results, including linkages to impacts and outcomes the Council is seeking to achieve or contribute towards, and historical data to illustrate performance trends. The Council needs to ensure that there are adequate systems in place to capture, monitor, and manage performance against intended levels of service for the 2018 financial year.	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. We will form a view on whether the Council's performance information fairly reflects the actual levels of service of the Council for the year. This will involve: • considering how the Statement of Service Performance and related information such as reporting on outcomes collectively tell the performance story of the Council; and • reviewing and testing the systems and processes that capture and provide information for non-financial performance reporting, as well as ensuring that the content of the Statement of Service Performance is verifiable and appropriate.

Business risk/issue	Our audit response
In the 2017 year we noted continued issues with reporting mandatory performance measures related to the stormwater activity. The Council needs to resolve this issue and is currently looking at either improving the information sharing process by working with the New Zealand Fire Service or developing a new measure by working with other Local Authorities and the Department of Internal Affairs (DIA). The building and resource consent activities also faced a number of challenges during the 2017 year which adversely impacted the level of performance achieved and the accuracy of underlying performance systems. The Council need to continue work on improving the systems and controls in place over consent processing and document management in order to enhance the reliability of the consenting data used for monitoring and reporting performance. ***Audit risk include:*** Service performance is not fairly stated in the 2017/18 annual report.	We will pay particular attention to the reported levels of service for significant performance measures and targets, including explanations of variances across the group.
Auckland Council Investment Limited (ACIL) (the Council and group)	
ACIL has transferred its shares in the Auckland Film Studio to the Council, which is in the process of being disestablished by the Council. We also understand that ACIL is also considering the possible transfer of Auckland Airport shares to the Council. The Council will need to assess the effect of this change in shareholding and any potential tax implications that could arise. The Council will also need to ensure appropriate disclosures, following any change in ownership structure, are included in the 30 June 2018 financial statements.	We will remain up-to-date with any structural changes that occur during the 2017/2018 financial year and review the impact of these, including any tax implications, on the Council and group financial statements for the year ending 30 June 2018.

Business risk/issue	Our audit response
Public Transport Operating Model (PTOM) (the Council only)	
In 2011, Cabinet approved the introduction of a new framework for the provision of urban bus and ferry services, known as the Public Transport Operating Model (PTOM). The model is a combination of planning, funding and procurement tools all aimed to enable less reliance on public subsidies and ensure services are procured effectively. PTOM subsidises passenger routes and incentivises service providers to maximise efficient and effective delivery of public transport in a partnering arrangement with Auckland Transport (AT). Under PTOM, AT receives the fare revenue and pays service providers the total cost in monthly instalments, rather than the previous system, which saw the service provider receiving the revenue and being paid a subsidy. This changes the risk profile for the service providers. We understand that the PTOM arrangements have created leases and commitments at the Council and group level. ***Audit risks include:*** Breach of the Council and group debt ratio.	We will: • look at the assessment completed by the Council of the impact PTOM has on the Council and group's financial results and commitments; and • review the disclosures included in the Council and group financial statements to ensure they are in compliance with the applicable accounting standards.
Project management (the Council and group)	
Across the group there are a number of major infrastructure projects at various stages of development, from conception through to completion. These include: • CRL (discussed separately above section 2.4); • AMETI; • Hunua 4 Watermain Project; • Central Interceptor wastewater tunnel; • NorsGa; and • SkyPath. 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 the Council has an appropriate monitoring and governance framework over these projects to manage delivery.	We will follow up on progress made against our previous recommendations, and gain an understanding of improvements and emerging issues since our last review. We understand the 2015 Review of Service Performance report into the AMETI project made 12 recommendations and work on these is either progressing or complete. We will follow up on the progress made on ongoing work throughout the programme's life. We will continue to review the status and governance arrangements in place over the large projects. 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. We will also test a sample of smaller projects to ensure the Council's processes and polices are consistently applied.

Business risk/issue	Our audit response
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. Project management practices should be considered in light of our reported findings and recommendations to date in this area. ***Audit risks include:*** • non-compliance with the Council's policies, procedures and good practice; • waste and probity; and • misstatement of the financial impact of significant projects in the 2018 financial statements.	Where appropriate, this work will be conducted in conjunction with CCO auditors and supported by our Specialist Audit and Assurance Services (SAAS) team.
Procurement (the Council and group)	
The Council's major projects involve significant procurement decisions. In addition, many of the Council's existing contracts are due for renewal in the near future. The Council also carries out large numbers of lower value procurements and contract renewals each year. There is a risk that procurement practices applied to these arrangements may be less robust. We understand that the Council has started to use Ariba, a SAP system, to track the procurement lifecycle and ensure that key steps in each procurement phase are completed in line with policy. The capabilities of this system extend to tracking of contract management activities, supplier performance and contract and procurement benefits. Procurement practices should be considered in light of our reported findings to date in this area, including the areas for improvements noted in the 2016 and 2017 audits. ***Audit risks include:*** • non-compliance with the Council's policies, procedures and good practice; • procurement processes resulting in poor purchasing decisions; and • contracting arrangements not following good practice.	We will follow up on the status of our previous recommendations and update our understanding of progress made and emerging issues since our last review. We will gain an understanding of the Ariba system and the controls that exist within this system and assesses whether they are effective. We will follow up the progress and impact of the SAP system (Ariba) on the Council's procurement practices, and whether the capabilities identified are taken up and implemented. 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. We will also review the application and effectiveness of procurement controls over a sample of smaller procurement contacts. Where appropriate, this work will be conducted in conjunction with affected CCO auditors and supported by our Information Systems (IS) and Specialist Audit and Assurance Services (SAAS) teams.

Business risk/issue	Our audit response
Contract management (the Council and group)	
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. In the 2016 and 2017 audits, we noted a number of areas where improvements could be made to the way the Council manages its contractual arrangements. We understand that the Council is working to address these through: • the introduction of the contract management centre of excellence; • development of a contract management framework; and • a range of tools, templates, training, support and guidance from the centre of excellence. ***Audit risks include:*** • contract monitoring arrangements not being fit for purpose; • processes not in line with good practice; and • poor or non-delivery by contractors (waste and probity).	We will update our understanding of the Council's contract management practices. In particular, we will review the progress the Council has made addressing our previous recommendations. We will, through discussions and high level review, update our understanding of the 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.

<table>
<tr><th>Business risk/issue</th><th>Our audit response</th></tr>
<tr><td colspan="2">Legislative compliance (the Council and group)</td></tr>
<tr><td>The following are the areas of focus for our review of the Council’s legislative compliance risks:

Rates setting

The 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 2019 financial year.

Financial Markets Conduct Act

The 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.

Mandatory disclosures

The Annual Report must contain the disclosures required under legislation, including:
• the Local Government Act;
• the Local Government (Financial Reporting and Prudence) Regulations 2014; and
• the Non-Financial Performance Measures Rules 2013.

Audit risks include:
• non-compliance with legislation;
• material error in revenue due to errors in the rates setting process; and
• breach of FMC or NZX listing requirements.</td><td>We will update our understanding of the Council’s progress embedding their “do it right” legislative compliance process. We will consider how this and other measures addressed specific risks.

We will also ensure the 2018 rates are correctly classified and accounted for at 30 June 2018.</td></tr>
<tr><td colspan="2">The risk of management override of internal controls (the Council and group)</td></tr>
<tr><td>There is an inherent risk in every organisation of fraud resulting from management override of internal controls. Management are in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Auditing standards require us to treat this as a risk on every audit.</td><td>Our audit response to this risk includes:
• testing the appropriateness of selected journal entries;
• reviewing accounting estimates for indications of bias; and
• evaluating any unusual or one-off transactions, including those with related parties.</td></tr>
</table>

Financial statement risks

Accounting risk/issue	Our audit response
Accounting for impairment and capitalisation of work in progress (the Council and group)	
Impairment 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. **Completed projects** The Council 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. ***Audit risks include:*** • assets not accounted for at fair value in the financial statements; and • understatement of impairment and depreciation expense in the financial statements.	We will assess the processes used by management to assess for impairment, including for all significant WIP balances. We will review management's processes and controls for ensuring that the capitalising of WIP costs occurs in a timely manner. We will ensure impairment and depreciation expenses are recognised and accounted for correctly at year-end.
Other provisions (the Council and group)	
We will consider the following in relation to the valuation of provisions. **Eden Park guarantee** In the 2017 financial statements, the Council recognised a $40 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. A key assumption in the valuation of this provision at 30 June 2017 was that, until the long-term future of the Eden Park Stadium is determined, the security held by the Council in relation to the guarantee had no current determinable value. 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.	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. We will assess whether other provisions including the provision for Holidays Act non-compliance are based on appropriate underlying information. We will follow up on progress made against previous recommendations, and gain an understanding of emerging issues since our last review.

Accounting risk/issue	Our audit response
Provision for Holidays Act non-compliance As at 30 June 2017, the Council and group recognised a provision of $18 million for leave entitlement calculation issues under the Holidays Act 2003. We understand that management expected final calculations at an employee by employee level to be completed and reconfiguration of the payroll system to occur by 31 December 2017. We also understand that Auckland Transport will be carrying out an assessment of their compliance with the Holidays Act 2003.	
Early adoption of accounting standards (the Council and group)	
The Council intends to account for its interest in CRLL 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);	We will review the Council's assessment of the impact from early adopting the new standards have on all the Council's joint arrangements. We will ensure that the disclosures made in the 30 June 2018 financial statements are in accordance with the requirements of the new standards.

Accounting risk/issue	Our audit response
• 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; • 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 CRLL, the impact on the Council's other joint arrangements of early adopting the above standards are also considered, and any additional disclosures are included in the 30 June 2018 financial statements. ***Audit risks include:*** Misstatement of the Council's interest in joint arrangements in the Council and group financial year end 30 June 2018 financial statements.	
Unallocated receipts (the Council only)	
As at 30 June 2017, there was $37 million of credit balances in the Council's accounts receivables/suspense account balances. This was primarily made up of unallocated funds, that is, receipts received for invoices issued which have not been matched against the specific invoice. We understand that the credit balances are reducing. However, we also note that new unallocated receipts are still coming through. We expect the Council to make significant progress clearing the credit balances during 2018, and in reviewing and amending business processes, where applicable, to prevent the build-up of credit balances in the future.	We will obtain an update on progress made by the Council to reduce these credit balances and in addressing the system issues that have led to their build up. We will ensure that remaining unallocated receipt balances at 30 June 2018 are appropriately recognised in the Council and group financial year end 30 June 2018 financial statements.

Accounting risk/issue	Our audit response
Audit risks include: Misstatement of accounts receivables balances in the Council and group financial year end 30 June 2018 financial statements.	

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