Report to the Governing Body on the audit of

Greater Wellington Regional Council

for the year ended 30 June 2008

Audit New Zealand has performed this audit on behalf of the Controller and Auditor-General.

We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

Our audit has been carried out in accordance with generally accepted audit standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency that is not material in terms of your financial statements.

The implementation and maintenance of your systems of controls for the detection of these matters remains the responsibility of the Council and management.

Executive Summary

for the audit for the year ended 30 June 2008.

Audit opinion

An unqualified audit opinion was issued on the Greater Wellington Regional Council's financial statements.

Compliance with legislation

There were 2 (they are related) breaches of the Local Government Act 2002. Refer to paragraph 4.2.

Issues for your attention

There are no significant issues arising from the audit which require your attention.

We have identified an opportunity to improve Information System, refer to paragraph 5.1.

Management report to the Governing Body

for the audit for the year ending 30 June 2008.

Audit New Zealand has completed the audit of the Greater Wellington Regional Council (Council) for the year ended 30 June 2008. This report summarises our findings from the audit and draws attention to areas where the Council is doing well or could improve.

Contents

1 Audit opinion

An unqualified opinion was issued on the Council's and group's financial statements.

2 Management control environment

2.1 Background

The management control environment is determined by the attitude, awareness and actions of the governing body, management and others, who have the ability to influence the reliability of control systems concerning the importance of internal controls.

The control environment encompasses the entity's control culture and values, organisation and governance structures and its commitment to designing and maintaining reliable accountability systems. It also includes its attitude and approach to planning, budgeting, performance monitoring and compliance with legislative requirements. These translate into internal control procedures that are established to provide reasonable assurance that specific entity objectives will be achieved. The internal controls build into the following processes:

- Governance structures and mechanisms.
- Risk management.
- Financial planning, budgeting, reporting and monitoring.
- Operational financial controls.
- Quality assurance procedures.

The stronger the management control environment, the greater the likelihood that these processes at different levels within the organisation will operate as designed and that organisation's objectives will be achieved.

3 Our approach

Our approach for the audit of the financial statements was, where possible, to place reliance on the Council's control environment and management systems, with a view to minimising the level of detailed transaction testing performed.

3.1 Assessment

We found that, consistent with previous years, the Council continues to operate a sound management control environment and there are effective financial management processes in place. We have identified the following as some of the key aspects of the management control environment:

- The Council and management have demonstrated a commitment to appropriate management control systems being in place and operating effectively. This includes both the maintenance of essential transactional recording systems as well as financial analysis and management reporting throughout relevant levels of the Regional Council.

- Budgeting and monitoring of financial performance is effective due to the systems and processes in place.

- There is an experienced executive team which displays a consistent level of commitment to maintaining a strong control environment.

- The Council's governance structure provides a clear division of responsibilities between the Council and management.

- The Council maintains an established annual planning process, which includes annual reviews of Council's long-term financial strategy, and a substantial public consultation process.

- There are structures and processes in place through which financial performance against budgets is monitored on a monthly basis by both management and the Council.

- The Finance, Evaluation and Risk Committee brings a level of scrutiny to organisational risk and general management issues.

  In March 2008, OAG released a good practice guide entitled: *Audit Committees in the Public Sector*[1]. This guide sets out the principles and good practices needed to effectively operate an audit committee in the public sector. It also includes examples of charters and checklists, and a list of other useful resources (such as an audit committee effectiveness evaluation checklist which an audit committee with input from management and Regional Council, can self review its performance by, example charters etc.), to help public entities operate effective audit committees.

  We recommend that the Council considers the Guide and how the way the audit committee currently operates against good practice to confirm whether in its view it has the most appropriate form of governance arrangements for its specific circumstances.

- We believe that the overall risk management and quality assurance would be strengthened by the introduction of an internal review function. During the year the Council considered this. As an initial step, the Council has engaged an external

1 http://www.oag.govt.nz/2008/audit-committees/

consultant to make an assessment of the organisation's risks, which will inform the Council's requirements for an internal review function.

4 Compliance with legislative requirements

4.1 Legislative compliance systems

We reviewed the Council's overall approach to identifying and complying with legislative requirements. We also reviewed compliance with specific legislative obligations directly related to Council's annual planning and reporting processes.

During the year, the Council improved the way in which the Chief Executive obtains assurance that significant legislation has been compiled with. Specifically, the Council developed legislative compliance checklists and asked divisional managers to complete the applicable ones for their division. The results are collated and reviewed by Council management. The Council reported to the Finance, Evaluation and Risk Committee on the results of the Council's legal compliance review.

4.2 Breaches of significant legislation

During our audit we identified 2 breaches of significant legislation.

There were 2 breaches of the Local Government Act 2002:

- Schedule 8 Statement of Intent, paragraph 2 requires the board of a council-controlled organisation to deliver to its shareholders a draft statement of intent (SOI) on or before 1 March each year. The Wellington Regional Holdings Ltd and its subsidiaries draft SOI was not delivered to its shareholder, the Council until 19 May 2008.

- Schedule 8 Statement of Intent, paragraph 3(b) requires the board of a council-controlled organisation to deliver to its shareholders the final SOI on or before 30 June each year. The final SOI was not presented to the Council until 11 August 2008.

There were no other breaches of significant legislation noted.

Management comment

The delay in providing the SOI was a deliberate decision as the Council wanted to give as much time as possible to CentrePort to provide the most up-to-date and reliable data for inclusion in the SOI. To meet the 1 March deadline requires CentrePort to provide the information prior to Christmas as it requires board approval and their board's first meeting for the year is not until late February.

5 Matters arising from the audit

The following significant matters are raised for the Council's consideration together with the comments received from management. Minor matters arising from the audit will be reported separately to the Chief Executive.

There are no significant issues arising from the audit of the financial statements which remained unresolved at the conclusion of the audit.

5.1 Information systems

For the Information systems environment we focused on:

- technology systems/processes (general IT environment);
- review and discussion of IT governance and management processes;
- testing and verification of general IT controls.

We found weaknesses in the Council's IT environment which taken together means the IT governance structures and the controls in place for their IT environment requires improvement. The weaknesses are:

- Council does not have an IT strategic plan.

  It is unclear to all stakeholders at the Council whether and/or to what extent IT strategies and activities align with the business strategies.

- There is no overall IT information security policy in place.

  The lack of such an overarching policy increases the risks of unauthorised access to systems and data allowing fraudulent, malicious or unintended transactions to be posted, and changes to be made to system performance.

- There are no standard policies/procedures in place for performing program changes.

  This exposes Council to unauthorised or poorly tested changes of systems - which may have a negative impact on mission-critical system, business decisions and / or financial reporting.

- Council does not have an overall vendor management policy.

  This introduces the risk that vendor managed systems are not appropriate controlled resulting in unauthorised access and / or unauthorised changes which result in incomplete or inaccurate (financial) transactions.

We recommend that the Council develop and implement:

- An IT strategic plan to demonstrate the alignment of business objectives with IT strategies and activities. This plan should be communicated to and shared with all business process owners who ideally were consulted during the development phase of the plan.

  Management comment

  We have just appointed a new manager for IT. One of his objectives will be to prepare an IT strategic plan.

  In respect of your other comments, we note that Greater Wellington manages its IT systems within two categories, Corporate Systems and Line of Business Systems.

  Corporate systems include Finance, HR, Payroll, Document Management, and general infrastructure. These are planned for within the Finance IT and Support Services Division. Alignment with Greater Wellington requirements are ensured through discussions with the Executive Management team and the CEO.

  Line of Business systems are planned for, acquired and managed by the user divisions to meet their specific needs. Alignment with the divisions' business strategies is therefore taken into consideration directly by the division concerned. The IT department provides advice and assistance to the divisions so as to ensure that interoperability and duplication is avoided wherever possible.

- An IT information security policy which would help to secure systems and prevent unauthorised use, disclosure, damage or loss of data.

  Management comment

  As there is a wide variation in the security requirements for different information systems it is appropriate that a tailored approach is taken rather than any attempt to create a one size fits all rule. The requirements for information security are a consideration in the selection, design, configuration and operation of each and every system we use. For example the Finance system has its security and authorisation controls configured to mirror the approved delegations manual.

- A change management policy.

  Management comment

  As there are a number of different information systems it is appropriate that a tailored approach is taken rather than any attempt to create a one size fits all rule. Each operational system has its own procedures around changes, testing and sign off. The limited number of people who manage and *utilise individual systems also means that changes and tests can be carried out quickly without the risk of negative impacts.*

- A vendor management policy.

  Management comment

  As there is a number of different suppliers for information systems of different sizes and complexities it is appropriate that a tailored approach is taken rather than any attempt to create a one size fits all rule. Greater Wellington's purchasing policy and IT acquisition strategy dictates purchasing procedures to follow. User access to Greater Wellington systems is maintained by the system owners and in conjunction with the IT department where access by non Greater Wellington staff is required. Contracts are in place where external suppliers have access (eg to SAP) and access is monitored.

5.2 Fraud policy

It is the expectation of the Auditor-General that every public entity should formally address the matter of fraud, and formulate an appropriate policy on how to minimise it and (if it occurs) how it will be dealt with.

The Council has an appropriate fraud policy.

The next steps would be to operationalise the policy, including performing a fraud risk assessment for the Council of the areas that are susceptible to fraud. These areas should be reviewed on a regular basis.

No frauds have been identified during the year.

Management comment

Greater Wellington is in the process of reviewing and renewing its entire risk program. As part of this activity a transactional review was under taken with no findings of note. All staff are briefed on policies as part of our comprehensive induction program, and all polices are maintained in a central location on the Greater Wellington intranet.

6 Follow-up of issues raised in the audit arrangements letter for Regional Council

6.1 Reassessment of fair value of assets

The Council's policy is to revalue its classes of property, plant and equipment assets on a five yearly basis. Water assets (includes regional water supply assets, wholesale water assets, water catchment land, and other land and buildings) were last revalued at 30 June 2004. NZ IAS 16 *Property, Plant and Equipment* requires that when the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required against its carrying value.

The Council carried out a high level review based on appropriate indices from Statistics New Zealand that uses the costs indices as an indicator of changes in values. We concur with this approach.

In summary, the results of the reassessment of fair values indicate a potential increase in values of around $59 million or 9.7% over four years.

We agree with the Council that the movement is not material and therefore a full revaluation was not required for the 2007/08 financial year. The assets are due to be revalued next year.

Management comment

An external water revaluation is being undertaken this year with a valuation date of 1 July 2008.

Management reiterates that it disagrees with Audit NZ's interpretation of NZ IFRS 16:

Paragraph 35.3, for plant and equipment, where there is an active market or readily available price indices that establish the item's fair value with reasonable reliability, the valuation need not be conducted or reviewed by an independent valuer or experienced employee.

6.2 Matangi train project – high level review of the project management plan

During the year the Council signed a $210 million contract for the procurement of 70 new electric motorised units (EMUs) and the option to purchase a further 26 EMUs. These trains are due to come into operation in 2010. Extensions and modifications to signals, platforms and tunnels are required before the trains become operational.

The project to purchase the trains is managed through the Council's subsidiary Greater Wellington Rail Limited (GWRL). The bulk of the project focuses on the design and build of the fleet of trains, with an expected delivery period of February 2010 to January 2011. This project also includes managing improvements to the associated rail infrastructure. The genesis of this project was born out of a 2004 Wellington Commuter Rail Network business case. The current revised project cost and revised forecast is $235.777 million. The new Matangi trains are being purchased by GWRL. The improvements to the rail infrastructure are the responsibility of ONTRACK, a Crown entity owned by Kiwi Rail. There are a number of processes and structures in place to ensure the appropriate level of coordination is in place between the various projects. ONTRACK, Kiwi Rail and consultants Halcrow form the Matangi Project Management Team (PMT) which is the main body responsible for delivering the project.

The Council has its own reporting and governance structure overseeing the project.

The Matangi project approach to Project Management utilises a number of individual Project Management and Process Plans:

- Project Planning and Programme Management Plan: Setting out the project phases at a high level to monitor progress or delays in delivery. Inclusion of Supplier Delivery Programme, monitoring and recognising delays and addressing mitigations measures offered. Also managing the Matangi Master Project Delivery Programme (MPP).

- The Risk Management Plan: How the Project Risks are dealt with, how it is monitored, how mitigations can be identified, initiated, and reviewed. The Risk Management plan contains templates for raising and recording Project risk. The Matangi Project Risk Register is recorded and updated on a specialist developed system using Microsoft Access.

The contract price for the delivery of the Matangi fleet is fixed. The payment schedule is pre determined and requires the supplier to meet standards the PMT are satisfied with before payments can be made. Based on PMT recommendations GWRL then approves payments. A range of other cost controls are in place:

- Performance bonds held over the supplier that the Council can claim on.

- Potential for large claim costs on failure to deliver on pre agreed dates

- All variations are investigated, and require GWRL approval before acceptance

- Monthly reporting on financial status of Matangi project.

Rotem Mitsui is required to deliver the trains to specification and within an agreed time period or face the potential of severe financial penalties.

Halcrow have been appointed as the project director and advisors to the project. Halcrow has extensive experience in the field of traction and rolling stock engineering.

During the audit we undertook a high level review of the Project Plan and have since discussed progress with management. We note that:

- A number of project procedures that are good practice, such as the way the Council manages its project risks and management of the risk register.

- At project initiation many of the 'operational plans' i.e. Risk Management Plan, Document Control Plans etc were in place. From project delivery in January 2008 each process and plan was being reviewed and updated as the GWRL considered necessary. The Council and GWRL recognise that the completeness and currency of its plans need to be kept under continuous review as the project evolves.

- The Matangi train project is running three months behind the original schedule. The reasons for this have been documented and communicated to the board of GWRL along with the reasons why, and the remedial actions being taken. It should be noted that it is Rotem Mitsui's role to design, build and commission the trains, not GWRL.

- The new approved budget and revised forecast has increased by $14.067 million over the original budget of $221.710 million, as a decision was taken (as per the contract's terms) to purchase and additional six rolling stock. The financial budget was originally for 70 units, due to the price offered by Rotem Mitsui this allowed GWRL to extend the order by a further 20 units by exercising an option as allowed for in the contract. This was achieved within the original financial budget for 70 units. The additional six units were also allowed for in the original contract; however, the purchase of these required the budget to be increased by $14.067 million. This was approved by GWRL, the Council, and the Crown's funding agency the New Zealand Transport Authority.

Our review has focussed on the Council (and GWRL's) responsibilities as part of this project. We will continue to keep developments and these governance arrangements under review and will report further as appropriate.

Management comment

Noted.

6.3 Performance framework

During the 2007/08 audit our primary focus was on:

- The Council's reporting against the levels of service as set out in the 2006/16 LTCCP [Schedule 10 clause 15(e)(i)]. Where the 2007/08 Annual Plan sets out a different level of service, Council will need to consider reporting against both LTCCP and Annual Plan to provide full transparency and to meet reporting obligations.

  Initially the Council reported on the performance measures in the 2007/08 Annual Plan only. A subsequent draft of the Statement of Service included reporting on both the LTCCP and Annual Plan. Where there were significant changes between the performance measures in the LTCCP and Annual Plan, these were adequately explained in the Annual Report.

- Ensuring the Council has systems in place to report against the performance measure. We found one exception in the transport area:

  Performance measure: *"Journey to work trips using public transport will increase by 4% days".*

  The data collected assumes that all peak time travel is 'journey to work'. This is not appropriate as there are other patrons (eg students) using the service for non-work travel.

  We recommend that the Council ensure that the performance measure is capable of being reported against.

Management comment

The measure for calculating performance for this target was updated for the 2007/08 annual report.

6.4 Asset management plans

We will be appraising the Councils' asset management plans as part of our work in auditing LTCCPs. We have provided Council a self-assessment questionnaire on the asset management environment and asset management plans in use. The objective of understand the extent of asset management planning and the environment within which each Regional Council uses it.

The Council is implementing a new asset management system (SAP). Unfortunately it will not be completed in time for use during the development of the 2009/19 LTCCP.

Management comment

Plans are reviewed and updated in cycles and when necessary. The SAP asset management project will assist in monitoring and recording asset management activity.

6.5 Performance, waste and probity

6.5.1 Sensitive expenditure policies

We reviewed the Council's cell phone and credit card policies against the OAG's *Controlling sensitive expenditure: Guidelines for public entities*. These policies are consistent with accepted public sector practice.

6.5.2 Testing of sensitive expenditure

We tested a sample of Councillor, CEO and senior managers' remuneration, redundancy and severance payments, related party transactions, cell phone and credit card transactions to ensure the Council is complying with its own policies and procedures.

There were no significant issues identified during our testing. Minor issues were included in the interim management report to the Chief Executive.

6.5.3 Employee severance and redundancy payments

Employee settlements in the public sector continue to draw attention. The Auditor General's report *Severance Payments in the Public Sector* (May 2002) remains the point of reference for severance payments.

We reviewed the three severance payments (including redundancy payments) that occurred during the year.

No issues were noted. The disclosures have been made in accordance with clause 19, Schedule 10 of the Local Government Act 2002.

Management comment

Noted.

6.6 Provision for doubtful debts – rates

The Council made a provision for rates doubtful debts of $0.576 million. This provision does not meet the requirements of NZ IAS 39 as a general rate of 10% was applied to the total amount of rates debtors outstanding at 30 June 2008. There is no history of write-offs that this provision can be justified against.

The error was reported in this management letter and in the letter of representation as an "unadjusted misstatement".

Management comment

Management notes that some rates are written off, and some take a long time to collect. Greater Wellington takes a conservative approach to the provision.

6.7 Pringle House – depreciation

The property Pringle House is owned by Council's wholly owned subsidiary (via WRC Holdings Ltd), Pringle House Ltd. The majority of the building is occupied by the Council.

On consolidation at the WRC Holdings level, the property is classified as an investment property. As the Council is the main tenant, the property is correctly re-categorised from investment property to Property, Plant and Equipment (PPE) at the Council and group consolidation level. At this level depreciation expense should be calculated on the revalued amount of Pringle House. We calculated depreciation expense on Pringle House for the year to be approximately $200,000. Depreciation expense has not been accounted for in the Council and group financial statements. We have accepted that an adjustment is not required to be made to the financial statements as the amount is not material.

Management comment

Due to a refurbishment of parts of Pringle House in 2007/08 the valuation amount actually remained below cost. Management reviews this annually.

7 Our findings on sector-specific areas of focus

We completed the reviews required by the Auditor-General as follows:

7.1 Local Authority exemptions for CCOs

We have been asked to advise the OAG on the Council's use of Section 7 of the Local Government Act 2002. Under section 7 of the LGA 2002, a local authority may exempt a "small" CCO from the accountability regime that applies to CCOs under that Act.

The Council has not exempted any CCOs.

7.2 Annual Report adoption and public release dates

We have been asked to note the dates that the Council adopts its annual report, and make the full and summary annual reports available to the public. This information will be forwarded to the Office of the Auditor General.

The Council intends to make the full annual report and summary annual report available to the public on 20 October 2008.

8 Unadjusted misstatements

The financial statements are free from material misstatements, including omissions.

However, during the course of the audit, we detected an immaterial misstatements that are individually and collectively not material to the financial statements.

We have discussed this with management who are of the view that they do not need to be adjusted.

We have this item in the Appendix, together with management's rationale for not making this adjustment to the financial statements.

We are satisfied that these are individually and collectively immaterial.

9 Statement of auditor independence

We confirm that, for the audit of the financial statements of Regional Council for the year ended 30 June 2008, we have maintained our independence in accordance with the requirements of the Auditor-General, which incorporate the independence requirements of the New Zealand Institute of Chartered Accountants (NZICA).

During the year we undertook an assurance assignment reviewing the tendering processes over the Greater Wellington Rail Project for the Regional Council. We also performed an audit of the Long Term Council Community Plan.

Other than the assurance assignment and the audit of the Long Term Council Community Plan, we have no relationship with or interests in the Regional Council or any of its subsidiaries.

9.1 Unresolved disagreements

We have no unresolved disagreements with management about matters that individually or in aggregate could be significant to the financial statements. Management has not sought to influence our views on matters relevant to our audit opinion.

9.2 Other relationships

We are not aware of any situations where a spouse or close relative of a staff member involved in the audit occupies a position with the Council that is significant to the audit.

We are not aware of any situations where a staff member of Audit New Zealand has accepted a position of employment with the Council during or since the end of the financial year.

Appendix 1: Unadjusted misstatements

Current year misstatements **(Including explanation why not corrected)**	**Assets**	**Liabilities**	**Equity**	**Income Statement**
	Dr (Cr) $000	**Dr (Cr) $000**	**Dr (Cr) $000**	**Dr (Cr) $000**
Council				
Provision for doubtful debts (rates) not required	576	–	–	(576)
Management comment *This adjustment was not made.*				
Total known misstatements for Council	576	–	–	(576)
Group				
Nil	–	–	–	–
Total known misstatements	576	–	–	(576)