



Management report on the audit of
Wellington Regional Council
for the year ended 30 June 2006



Attachments

29 November 2006

Ian Buchanan
Chairman
Greater Wellington Regional Council
PO Box 11-646
WELLINGTON

Dear Ian

We have completed our audit of the Greater Wellington Regional Council for the year ended 30 June 2006 and are pleased to report to you the findings arising from the audit. This report provides a summary of:

- the audit opinion;
- our assessment of your management control environment;
- the significant matters arising from the audit.

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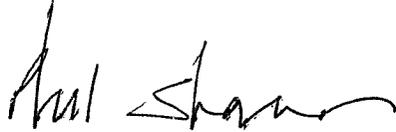
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AUDIT NEW ZEALAND
Mana Arotake Aotearoa

Acknowledgement

We wish to acknowledge the assistance provided by management and staff during the audit. Should you require clarification on any other matters raised in this letter please contact Karen Young or me on 496-3099.

Yours sincerely



Phil Sharman
Director

cc Judith Aitken, Chair, Planning & Monitoring Sub-Committee
Dave Benham, Chief Executive
Barry Turfrey, Chief Financial Officer

Audit for the year ended 30 June 2006

1 Introduction

We have completed our audit of the Greater Wellington Regional Council (the Regional Council) for the year ended 30 June 2006 and are pleased to report to you the findings arising from the audit. This report provides a summary of:

- the audit opinion;
- our assessment of your management control environment;
- the significant issues arising from the audit.

2 Audit opinion

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

3 Management control environment

3.1 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 control.

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. These internal controls are built into the following processes:

- Governance structures and mechanisms
- Risk management
- Financial planning, 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 the organisation's objectives will be achieved.

3.2 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.

3.3 Assessment

Our assessment of aspects of the Council's financial and service performance management is summarised in the table below. This assessment is entirely voluntary for the Local Government audit sector. Explanations of the assessment terminology are included in Appendix 2.

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. The resultant assessment scores are therefore 'Good' and 'Excellent'.

MANAGEMENT ASPECT	ASSESSMENT	COMMENT
Financial control systems	Good (2005: Good)	<p>The Regional Council has good systems of financial control. Our work in this area indicated the following:</p> <ul style="list-style-type: none"> ■ Sound controls operate over the Regional Council's key financial systems. ■ Formal delegations are in place and are appropriate. ■ Key asset management plans operate in the nature of working documents. This allows the Regional Council to more effectively manage key assets and feed appropriate information into planning documents. ■ We are satisfied with the level of controls over the purchasing system and sensitive expenditure. <p>However, we have outlined some areas in sections 4 and 5 and Appendix 1, which require improvement. Our recommendations include the following:</p> <ul style="list-style-type: none"> ■ An independent review of month end reconciliations including a review of manual journals processed. ■ The retention of payroll masterfile change reports. ■ The review of data entered from the fixed asset module to the general ledger.
Financial management information systems	Excellent (2005: Excellent)	<p>Overall the information systems to support the operational activities of the Regional Council are well managed.</p> <p>Although there is no information systems strategic plan to support the strategic direction and objectives of the organisation, this risk is managed by the close involvement of IT in the business planning process.</p> <p>The Regional Council have adopted IT security and use policies, which cover key areas.</p>

MANAGEMENT ASPECT	ASSESSMENT	COMMENT
Financial management control environment	Good (2005: Good)	<p>The financial control environment is sound. This is evidenced by the following:</p> <ul style="list-style-type: none"> ■ Budgets are reviewed at divisional level and overall Council level. The Regional Council's budgetary processes are rigorous with close monitoring of expenditure throughout the financial year. ■ The Planning and Monitoring Sub-Committee enhances corporate governance and fulfils the function of an Audit Committee. ■ There is comprehensive reporting to the Policy, Finance and Strategy Committee (the Committee) on a quarterly basis. Additionally, the Committee receives a high level report on a monthly basis. <p>We have outlined some for further development and note that the Regional Council intend to:</p> <ul style="list-style-type: none"> ■ Develop and implement a fraud policy and response plan. ■ Consider establishing an internal audit function.
Service performance information and information systems	Excellent (2005: Excellent)	<p>Service performance information systems are appropriate for the nature of the organisation.</p> <p>The Regional Council has good systems to record service performance and the internal controls over non- financial data are well established.</p>
Service performance management control environment	Good (2005: Excellent)	<p>Performance standards are outcome focused and are linked to the day-to-day operations of the Regional Council and to the community outcomes defined in the LTCCP. The Regional Council reports regularly on service performance, enabling the effective monitoring of service provision.</p> <p>Through the LTCCP process the Council recognised the need to further develop the performance management framework. During the LTCCP audit we worked with the Regional Council to enhance the SSP measures so that they provide a more meaningful view of the Regional Council's objectives and achievements.</p> <p>These improvements will become apparent in the reporting of performance for 2006/07.</p>

Management comment

A number of the matters raised which have caused the reduction from "excellent" to "good" were in existence when we achieved five "excellents" two years ago. We are concerned the ratings can change without corresponding changes in our systems.

4 Significant matters

The following significant matters are raised for your consideration together with the comments received from management. Minor matters arising from the audit have been discussed and 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. Furthermore there are no new internal control issues arising other than those already reported in previous periods.

4.1 Reassessment of fair value of assets

The Regional Council's policy is to revalue its classes of property, plant and equipment assets on a five yearly basis. Flood Protection infrastructure assets were last revalued at 30 June 2002, Parks and Forests infrastructural assets were last revalued at 30 June 2003 and Regional water supply wholesale water assets and Water Catchment land and other land and buildings were last revalued at 30 June 2004.

Financial Reporting Standard 3 *Property Plant and Equipment* requires that revaluations be performed with sufficient regularity to ensure that there is no material difference between carrying value and fair value.

The Council undertook an assessment of the fair values of Council held assets against their carrying value. This was a high level review based on data from the Statistic New Zealand indices as an indicator of changes in values. We concur with this approach.

We reviewed the indicative movements and agree with the Council that the movement is not material and therefore a full revaluation was not required for the 2005/06 financial year. However, we recommend with the advent of IFRS IAS 16, the Regional Council will need to continuously monitor asset values and adjust revaluation cycles to ensure fair value reporting is maintained.

Management comment

In accordance with our normal valuation cycle, flood protection assets will be revalued on a basis of a full valuation during 2006/07. However, it is not our intention to carry out a full revaluation of the parks and water assets. The reasons for this are that revaluations are very expensive and time consuming. The Regional Council will look at carrying out a high level valuation of these assets. This type of valuation may not satisfy the Audit Office's interpretation of the accounting standards. As such, this matter will be considered by Council in their meeting in December 2006.

4.2 New Zealand equivalents of International Financial Reporting Standards (NZ IFRS)

The Regional Council has taken the option of early adoption of NZ IFRS. It will be implementing NZ IFRS in its consolidated financial statements with effect from 1 July 2006. This means that the first set of audited consolidated financial statements under NZ IFRS will be for the year ending 30 June 2007.

In order to comply with the requirements of NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards*, the Regional Council's financial statements for the year ending 30 June 2007 will need to include comparatives to 30 June 2006 restated in accordance with NZ IFRS and some detailed reconciliations explaining the impact of the transition to NZ IFRS. In order to meet these

requirements the Regional Council will need to produce an opening balance sheet at 1 July 2005 in accordance with NZ IFRS.

We have issued a separate audit arrangements letter for providing assurance on the NZ IFRS provisional opening balance sheet as at 1 July 2005, NZIFRS accounting policies, and 2005/06 comparative figures together with any further *significant* audit work that may arise. We have also discussed with the Regional Council its progress for the adoption of NZ IFRS. An impact assessment was completed for the opening balances on the LTCCP. There were some issues identified which the Regional Council are working through.

Management comment

We are working through the process of completing the opening balance sheet. We are not aware of any outstanding issues.

4.3 Legal compliance

Our review of the Regional Council's legal compliance focussed primarily on how it had met its accountability obligations in respect of its annual report. These are contained in the Local Government Act 2002, specifically, and more generally in its obligation to comply with generally accepted accounting practice (GAAP). We also reviewed the Regional Council's compliance with key aspects of the Rating Act 2002 and maintained a watching brief for any possible non-compliance with any other legislation coming to our attention.

The Regional Council has been using the SOLGM Legal Compliance modules as a guide for formalising and improving its practices and processes. The Regional Council's systems are designed to ensure that employees comply with legislation. Where a new process is developed, the Regional Council engage with lawyers and any relevant bodies to make sure that they develop processes that will ensure compliance

with legislative requirements. The Regional Council has an employee whose specific duty is to inform employees of all updates in legislation and that where necessary employees attend courses that ensure they are up-to-date with legislation. This process provides a forum whereby awareness of legislative requirements and related issues can be highlighted, and through this becomes a mechanism to mitigate the risk of non-compliance.

Within the scope of our work performed, no instances of non-compliance with significant legislative requirements were identified during the course of the audit.

Management comment

Noted.

4.4 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.

We reviewed the Regional Council's draft fraud policy and have made some recommendations which we have discussed with management and will be incorporated into the fraud policy and response plan to be promulgated by the Chief Executive.

Council are in the process of appointing an external party to develop an internal audit programme for the Regional Council. Their programme may include a fraud risk assessment for Council.

Management comment

Noted.

5 Reviews on behalf of the Auditor-General

We completed the reviews required by the Auditor General, as set out in our audit arrangements letter, and cleared them with management. These are set out in Appendix One.

6 Audit independence

We confirm that for the audit of the financial statements of the Regional Council and its controlled entities for the year ended 30 June 2006, we have maintained our independence in accordance with requirements of the Auditor-General, which incorporate the independence requirements of the Institute of Chartered Accountants of New Zealand (ICANZ).

During the year we reviewed the tendering processes over the Greater Wellington Rail Project for the Regional Council and group, which is compatible with those independence requirements.

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

Unresolved disagreements

We have not had any unresolved disagreements with management about matters that individually or in aggregate could be significant to the financial statements. Furthermore, management has not sought to influence our views on matters relevant to our opinion.

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 Regional Council or its controlled entities 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 Regional Council or its controlled entities during or since the end of the financial year.

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Appendix 1

Reviews on behalf of the Auditor-General

ISSUE	STATUS/FINDINGS
<p>Asset Management Information</p>	<p>The OAG wished to assess the current state of asset management plans (AMPs) and evaluate the extent to which asset management has improved (compared to the evaluation done in 2002/03).</p> <p>We reviewed the Water and Transport Asset Management Plan (AMPs) as part of the LTCCP audit.</p> <p>BULK WATER</p> <p>Our review identified that financial forecasts included in the asset management plan whilst sound in the 2004 year the AMP was prepared were not sufficiently current to be relied upon to support cost estimates included in the LTCCP. In particular there are significant new capital projects now being planned, which were not anticipated, in the previous AMP. The findings of the AMP audit reported as follows:</p> <ul style="list-style-type: none"> ■ Asset Management of the bulk water supply assets is in place and current levels of service are being effectively delivered. However, the Asset Management Plan is out of date, and the links to strategic corporate planning could be enhanced. More recent, separate financial forecasts will feed the LTCCP. ■ Forecasts of Maintenance and Operating expenditure cannot be relied on to support the LTCCP. Population projections show that the water supply system will reach capacity much early than originally anticipated (2007). Increasing supply by 2007 is substantially reliant on the Council getting resource consent to increase abstraction from the Hutt River in the short term and represents a significant risk to achieving target Levels of Service in the near future.

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ISSUE	STATUS/FINDINGS
	<p>In the preparation for the next LTCCP for the period 2009-19 we would encourage the Council to bring forward the triennial updating of the Bulk Water AMP to come into phase with the LTCCP cycle and therefore enable the most up to date information to be available for the 10-year financial forecasts. This concept should similarly be applied to update cycles for revaluations and asset management plans for other significant asset classes including in due course Regional Transport.</p> <p>Management comment</p> <p><i>Some projects were beyond the 10-year planning horizon. They have been brought forward because Statistics New Zealand has revised its population forecast. The asset management plan will have to be altered because of the change in forecast in respect of the possible new timing of a major water source. In respect of the capacity of the system, the Council's customers are aware of the situation and we are prepared to manage demand should a one in 50 year drought situation arise before additional water is available.</i></p> <p>REGIONAL TRANSPORT</p> <p>Our review of the Transport division ascertained that there was no asset management plan yet in place, as the procurement of rolling stock and transport infrastructure is a development occurring over the lifetime of the LTCCP. The findings from the AMP work in transport reported as follows:</p> <ul style="list-style-type: none"> ■ Asset Management in relation to the Transportation assets is currently in development. There is currently no Asset Management Plan in place, but there is commitment to developing one alongside the purchase of the assets and the Regional Council resolving their future ownership. ■ The process by which the AMP will be drawn up has yet to be formally documented. However, a project manager is in place and much of the initial thinking by officers is in line with good practice, eg, proposals to have a project team, to complement internally available skills by engaging consultants and to have a formal peer review of the plan. ■ Thinking on Levels of Service and Financial Forecasting is at an early stage, linked to the early stage of the whole programme, which is still identifying precisely which assets to purchase.

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ISSUE	STATUS/FINDINGS
Local Authority Exemptions for CCOs	<p>We have been asked to advise the OAG on 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.</p> <p>The Regional Council has not resolved to exempt any CCOs under Section 7(3) of the Act.</p>
Annual Report Adoption and Public Release Dates	<p>We have been asked to note the dates that the Regional Council adopts its annual report, and makes the full and summary annual reports available to the public. This information will be forwarded to the Office of the Auditor-General.</p> <p>We found the Regional Council has adopted their annual report on 17 October 2006 and the summary annual report will be made available to the public within one month of the audit opinion being issued.</p>

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Appendix 2

Definition of terms

TERM	DEFINITION
Financial control systems	These are the individual systems that process financial data. For example, processing payments (expenditure and creditors), billing system (revenue and debtors), asset management (Fixed Asset Register), payroll and general ledger. This covers controls surrounding the processing of these transactions such as completeness and accuracy of data.
Financial management information systems	Reporting systems (to, for example, the Board, Chief Executive, Senior Management– linkage to external budgeting down to project management). This is the IS/IT control environment and includes such things as IS/IT strategic planning, disaster recovery provisions, data integrity, access controls, programme change controls, physical security of hardware and software, errors, estimation of data.
Financial management control environment	Financial management policies and decisions (for example, fixed asset management and replacement). These are the upper level controls and include such things as financial management policies and procedures, self-review (including Internal Audit), Assurance (Audit) Committees, budgeting processes, exceptions reporting, cash flows, other assurance measures.
Service performance information and information systems	These are the systems to record service performance (non-financial) data and the internal controls (manual and computer) to ensure the completeness and accuracy of the data and the appropriateness of your performance measures. This includes such things as monitoring/control systems, performance measures – robustness, usage as management tool – for example, linkage to Human Resources (performance agreements), errors, estimation of data.

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TERM	DEFINITION
Service performance management control environment	These are the upper level controls and include such things as operations policies and decisions, quality assurance (where appropriate), planning processes, Assurance (Audit) Committee, self-review (including Internal Audit), exception reporting, other assurance processes

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Definition of gradings

ASSESSMENT TERM	FURTHER EXPLANATION
Not adequate	Does not work needs complete review. We would have recommended major improvements to be made urgently.
Just adequate	Does work, but not well at all. We would have recommended improvements to be made as soon as possible.
Satisfactory	Works well enough, but improvements desirable. We would have recommended improvements (while having regard for costs and benefits) to be made during the coming year.
Good	Works well few or minor improvements only needed to rate as excellent. We would only recommend improvements where benefits exceed costs.
Excellent	Works very well no scope for cost-beneficial improvement identified.

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