

Report to the Council on the audit of
Greater Wellington Regional Council
for the year ended 30 June 2013

Introduction

We have completed the audit for the year ended 30 June 2013. This report sets out our findings from the audit and draws attention to areas where Greater Wellington Regional Council (the Regional Council) is doing well or where we have made recommendations for improvement.

We would like to thank the Council, management and staff for the cooperation we received during the audit.

Karen Young
Audit Director
31 March 2014

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1 Our audit opinion

1.1 We issued an unmodified audit opinion

We issued an unmodified audit opinion on 9 October 2013. This means that we were satisfied that the financial statements and statement of service performance fairly reflected the Regional Council's activity for the year and its financial position at the end of the year.

In forming our audit opinion, we considered the following matters and we have raised some suggestions for improvement.

1.2 Uncorrected misstatements

The financial statements are free from material misstatements, including omissions. However, in the course of the audit, we have found:

- certain misstatements that are individually and collectively not material to the financial statements and the statement of service performance; and
- certain immaterial disclosures, required by generally accepted accounting practice, that have been omitted from the financial statements.

We have discussed any misstatements that we found with management. All significant misstatements and disclosures have been corrected.

2 Control environment

We performed a high-level review of the control environment. We considered the overall attitude, awareness and actions of the Regional Council and management in establishing and maintaining effective management procedures and internal controls. Our assessment of these areas was based on regular discussions with key members of senior management, members of the Regional Council and our accumulated knowledge of the Regional Council's business.

In performing this assessment we consider both the “design effectiveness”¹ and “operational effectiveness”² of internal control. The explanation of these terms is outlined below. However, it is not the purpose of our assessment to provide you with assurance on internal control in its own right. As such we provide no assurance that our assessment will necessarily identify and detect all matters in relation to internal control.

2.1 Compliance with significant legislation

We did not identify any breach of legislative requirements during our audit.

We reviewed the systems in place to ensure that significant legislation has been complied with. The Regional Council have a number of policies and business processes that ensure the appropriate management of legislative obligations.

I refer you to section 3.2 below also.

We have no other matters to draw to your attention.

3 Matters arising from the audit

3.1 Performance reporting

We found that the performance reporting on the new performance measurement framework and performance measures in in the 2012 to 22 long-term plan was very good.

The outcomes are ones which the Regional Council are able to influence and the linkages between outcomes and outputs are stronger.

¹ Control is effective to either prevent or detect a material error in either the financial statements and/or non-financial information. The control is “fit for purpose”.

² Control has operated effectively throughout the period tested.

We found ownership by the business groups of these measures is very good.

3.2 Asset management plans

Further progress has been made on asset management planning. In particular, it has reviewed the way it does asset planning across the Regional Council and its business groups, adopted a prioritisation framework for minor transport assets and maintenance and are finalising public transport and updating water supply asset management plans.

During our 2014 interim audit, we will follow up on the recommendations from our review of the draft water supply and transportation asset management plans provided to management when the plans were being developed.

3.3 Local Government Rating Act 2002

From time-to-time issues have been highlighted on a local authority's compliance with the Local Government Rating Act 2002. The consequences of non-compliance can be serious.

We reviewed the Regional Council's process for the setting of 2012/13 rates. We did not find any issues with the way the Regional Council sets its rates.

As part of our review, we enquired into the systems and processes that the Regional Council has in place for overseeing the collection of rates by territorial local authorities (TAs). The Regional Council relies on the territorial authorities in the region to collect rates on their behalf under an agency arrangement. The TAs are collecting the amount of rates that the Regional Council expects: The Regional Council has an expectation from when the rates are struck as to how much rates (broken down to general rate, targeted transport rate, water levy etc) they are expecting

to receive and the Regional Council receives monthly rates summaries from the TAs and reviews them.

The Regional Council does not audit or review TA systems to ensure their processes are compliant with legislation. However, we understand that the TAs have not given the Regional Council reason to believe they are anything other than compliant.

The Regional Council may wish to review the processes it currently employs with a view to gaining a greater level of assurance that TAs are collecting the correct rates. For example, we are aware that at least one other regional council has implemented processes for spot checking the rates collected by territorial authorities.

Management response:	GWRC places reliance on the fact that Audit New Zealand audit each of the councils and that no issues have been identified or reported on these processes.
Responsibility for implementation:	Finance has regular meetings with Rates staff in each territorial authority.
Action by:	Ongoing

3.4 Sale of forestry cutting rights

Regional Council has appointed marketing agents for the sale of forestry cutting rights in June 2013. The tender for the sale of 60 years' forestry cutting rights closed on 22 August 2013.

NZ IFRS 5 *Non-current Assets held for Sale and Discontinued Operations* requires an entity to classify a non-current asset as "held for sale" if its carrying amount will be recovered principally through a sale transaction rather than through continuing use.

We recommended the Regional Council assess whether the forestry investments meet the criteria to be classified as "held for sale" in

accordance with this standard. The Regional Council's view was it is too early to reclassify the investment since expressions of interest had been received and assessed. We accept the Regional Council's decision.

We will keep-up-to date with developments in this area.

3.5 Going concern and possible sale of the Regional Wellington Centre or Pringle House Limited

In 2012, Regional Wellington Centre was assessed by Wellington City Council as an earthquake prone building because the building is below the current building standard. By 2018 it is required to meet new building code minimum requirements, which are higher than the current building standard.

The Regional Council decided it was uneconomical in terms of cost to bring the building up to the current building standard. However, it decided to defer any decision on the future of the Regional Wellington Centre or its property investment company, Pringle House Limited (PHL), until the local government reform options in the Wellington region have been crystallised.

Following the severe earthquake in July 2013, the Regional Wellington Centre was damaged to the extent that it is uninhabitable without considerable repair costs. The Regional Council relocated to temporary accommodation, then to its new offices. It was determined by the Board of PHL, that the building had minimal leasing potential. This and a significant write-down of the investment property, mean that there were concerns as to whether the preparation of the financial statements on the going concern assumption is appropriate. In response, the Regional Council provided the Board with a letter of financial support (to the extent necessary to meet its on-going operational and capital expenditure obligations) for PHL, which will continue for at least one year from the date of the issuance of the audit opinion for PHL.

The Regional Wellington Centre is leased to the Regional Council to June 2019. Therefore, there is six years remaining in the current lease. Given the building is uninhabitable; the Regional Council may seek to cancel the lease. As yet, no arrangements have been made between the Regional Council and PHL.

We will keep-up-to date with developments in this area.

3.6 Property, plant and equipment revaluation

The Regional Council's policy is to revalue its property, plant and equipment every five years. In between revaluations, management make assessment of whether there is any significant difference between the carrying amount and fair value of assets which are not the subject of a full revaluation each year.

Asset Class	Date of previous revaluation
Water infrastructure	30 June 2007
Public transport infrastructure	30 June 2008
Parks and forests	30 June 2008
Flood protection	30 June 2012

Regional Council's transport infrastructure was last revalued in 2008. They were due for revaluation as at 30 June 2013. With the transfer of rail assets on 30 June 2011 to Greater Wellington Rail Limited, the cost or revalued amount of the remaining transport infrastructure assets in the Regional Council's financial statements totals to \$13.7 million only. The Regional Council decided to defer the revaluation of these assets until the next financial year when they will be revalued at the same time as the rail assets in Greater Wellington Rail Limited, because based on the value of the assets, any movement is unlikely to have a significant impact on the financial statements.

Water infrastructure, and parks and forest assets were revalued at 30 June 2013.

We reviewed the revaluation of water infrastructure and the parks and forests. The total revaluation movement of \$111 million was due to an increase in the value of water assets by \$108 million and parks and forests by \$3 million. The revaluation methodology, accounting treatment and disclosure are appropriate.

We found that not all of the assets in the parks and forest asset class were included in the revaluation. Management were unaware until the audit that not all of the assets were included in the revaluation. We understand that different valuer(s) are required to be engaged to revalue these particular assets. However, the oversight and general lack of good processes over the revaluation process meant that this did not happen. Once it became known, management were of the view that, based on the value of the assets not valued any movement is unlikely to have a significant impact on the financial statements. We agree. However, we note that significant improvements are required to the controls and process used for revaluing parks and forest assets.

We recommend that the Regional Council:

- revalues in the 2013/14 financial year, the assets in the parks and forest asset class that were not revalued; and
- has a debrief of the revaluation process, with a view to improving the instructions, documentation, controls and process for revaluing parks and forests.

Management response:	All parks assets were reviewed and valued but not all valuation files were provided to Finance to load into the financial management information system (SAP). This was picked up too late to reflect in the 30 June 2013 accounts. As the value was not material it was decided to leave it until the
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	following year.
Responsibility for implementation:	Finance will work with Parks to have the valuations loaded effective 1 July 2013.
Action by:	30 June 2014

3.7 Funding of Greater Wellington Rail Limited through the issuance of share capital

The Regional Council asked if we have any issues if it funded its subsidiary, Greater Wellington Rail Limited (GW Rail), for the second tranche of Matangi trains through the issuance of share capital and have GW Rail call up that share capital when the funding is needed.

We have no issues with this aspect of the arrangement. However, we would like to draw the Regional Council attention to the following: if the funding from the Regional Council to WRC Holdings is provided to GW Rail as the trains are purchased then at each balance date, WRC Holdings (and therefore the Regional Council) will have to consider whether its investment in GW Rail is impaired.

Management response:	Impairment testing is carried out for all assets and investments every year. The Council's investment (share capital) represents only the non-granted share of the assets held by GW Rail meaning the net asset value is much greater than the investment value.
Responsibility for implementation:	Finance

3.8 SuperGold card travel scheme funding from New Zealand Transport Agency

We were asked to consider whether the Regional Council is the agent or principal when it receives New Zealand Transport Agency (NZTA) funding for subsidised off peak fares for SuperGold card holders.

We reviewed the contractual terms of the relationship between the Regional Council, NZTA and the transport operators. We found that on balance the Regional Council is acting as the principal. This is because the risks of the relationship with the operators reside with the Regional Council. The Regional Council bears the credit risk should operators default on an over-claim and operator contracts are not automatically cancelled should NZTA withdraw its funding. The continuation of contracts supports that this is a scheme that the Regional Council supports and would not necessarily cancel contracts should the funding be withdrawn.

The Regional Council is accounting for NZTA revenue for SuperGold correctly.

3.9 Revenue recognition from New Zealand Transport Agency on rail borrowings

We considered whether the funding that is to be received by the Regional Council from NZTA for repayment of loans for the funding shortfall of the purchase and upgrade of Matangi trains should be accounted for as revenue over the life of loan payments or upfront as loans are drawn down.

As the funding from NZTA is a contribution to costs of principal and interest payments to be incurred by the Regional Council, the subsidy funding from NZTA should be recognised as revenue over the life of the loan as the principal and interest payments are made by the Regional Council.

The Regional Council is correctly accounting for revenue over the life of the loan as it makes the principal and interest payments.

3.10 Sale of Ganz Mavag train fleet

Greater Wellington Rail Limited (GW Rail) entered into an agreement on 30 May 2013 to sell (for \$1 million) its 42 Ganz trains units, the delivery and payment of which will happen in two tranches: Tranche 1 – December 2013 and Tranche 2 – August 2016.

The 43 units have a carrying value of \$23.9 million at 30 June 2013.

We were asked to consider in respect of each tranche:

- how the units should be classified in the Balance Sheet: as assets “held for sale” or property, plant and equipment;
- when should it recognise the write-down from carrying value to sale price; and
- when should it recognise in the financial statements the sale of each tranche.

The following accounting treatment and disclosures have been made in the financial statements:

- Tranche 1: The assets have been classified as “held for sale” and accounted for under NZ IFRS 5 *Non-current assets held for sale and discontinued operations*, with the disclosures required by that standard. This is because the carrying amount will be recovered principally through the sale rather than through continuing use. Also, the sale is expected to take place within one year. The units have been written down to the sale price of \$348,000 in the financial statements as at 30 June 2013 and the loss on sale reflected in the Statement of Comprehensive Income.

- Looking forward, the units should be derecognised once the criteria for the recognition of revenue in NZ IAS 18 *Revenue*, is met. This is likely to be when the buyer takes delivery of the units in December 2013.
- Tranche 2: These units continue to be classified as property, plant and equipment in the financial statements as at 30 June 2013. This is because the conditions for classification of non-current assets as “held for sale” in NZ IFRS 5 have not yet been met. In order to be classified as “held for sale”, the asset must be available for immediate sale in its present condition and the sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Depreciation was accelerated to their residual value of \$652,000 to reflect the change in the remaining, shortened, useful life. The shortened life stems from the Regional Council’s decision to replace the Ganz Mavags rather than refurbish them. The accelerated depreciation was backdated from the date of that decision, that is, from 1 July 2012.

Looking forward, the units should be derecognised once the criteria for the recognition of revenue is in NZ IAS 18 *Revenue*, is met. This is likely to be when the buyer takes delivery of the units in August 2016.

Additionally, the disclosure arising from the sale of rail assets was made in accordance with NZ IAS 16 *Property, Plant and Equipment* and NZ IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. These standards required the disclosure of the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods.

3.11 Accounting for liquidated damages

Greater Wellington Rail Limited (GW Rail) purchased 48 train units from Hyundai Rotem. The units were delivered late and GW Rail claimed damages. A settlement was reached in the 2012/13 financial year.

We considered whether GW Rail's recognition of the liquidated damages was in accordance with Generally Accepted Accounting Principles. As there is no New Zealand International Financial Reporting Standard that specifically applies to the recognition of liquidated damages, we referred to a recent announcement of another standard-setting body that uses a similar conceptual framework to develop accounting standards.

Technical Practice Aid (TPA) issued by the American Institute of Certified Public Accountants in 2007 is relevant as it relates to accounting for liquidated damages by the buyer of property, plant and equipment.

The TPA states that the buyer should record liquidated damages as a reduction in the cost of property, plant and equipment.

GW Rail's accounting treatment of the settlement was consistent with the TPA.

The full amount of the liquidated damages was recognised in the 2012/13 financial year, because the settlement has been signed and therefore the realisation of the asset is virtually certain.

3.12 Amendments in the Local Government Act

The amendments in the Local Government Act specified a number of new disclosure requirements in annual reports. These include:

- Funding impact statements for each group of activity and for the whole of council.
- A capital expenditure statement comparing budgeted to actual expenditure classified into: meeting additional demand; improving service levels and replacing assets.
- A statement by group of activity with disclosures on internal borrowings; funds borrowed and repaid and interest on internal borrowings.

- A statement providing information on reserve funds set aside by council.
- Number of FTEs and remuneration disclosures.

We provided feedback to the draft disclosures proposed by the Regional Council. The necessary disclosures have been made.

4 Other matters

4.1 Preparation of the financial statements

During the year, the Regional Council decided to implement a new accounting package. The implementation took place near year end. Additional resources were employed to assist with the necessary preparatory work. The preparatory work included the mapping of the trial balance account codes for multiple years and at each layer of the Regional Council and group. This took considerably longer than anticipated. The Regional Council found the package was considerably more complex and the training it was receiving inadequate.

We experienced significant delays in receiving the financial statements for audit. Then, there were multiple versions of the financial statements, some of which were incomplete and had errors in it. The delays and multiple versions resulted in the audit taking significantly longer because we had to audit off the trial balance and agree them to the financial statements and audit the note disclosures and narratives when the financial statements were available.

In addition to the implementation of the new accounting package, there were other matters which made it an unusual year and contributed to the delay:

- The considerable disruption and upheaval the earthquakes in Wellington in July and August 2013 caused, at a critical time in the accounts preparation process.

- Accounting assistance provided to subsidiaries in the group which took longer than planned as they had some significant accounting matters to work through.
- Loading of property, plant and equipment revaluations into the financial system.

New reporting requirements as set out in the Local Government Act 2002. In particular, Schedule 10 and Funding Impact Statements (FIS): As a result of the Transparency, Accountability and Financial Management changes and the Better Local Government phase one amendment in 2012, there are a number of changes to the disclosure requirements included in Schedule 10 of the Local Government Act. This was the first year the Regional Council was required to report its actual financial performance in the FIS formats specified in forms 4 and 5 in the Schedule to the Local Government (Financial Reporting) Regulations 2011.

The above issues also meant that (as much as it would have liked to) there was insufficient time for the Finance team to perform its quality assurance review over the initial sets of accounts. This in turn led to multiple sets of accounts provided for review.

It is likely that the Regional Council will be better off next year, when the accounting package is no longer new, staff have been appropriately trained to use it and Finance becomes accustomed to it.

With the significant subsidiaries in the group (including CentrePort Limited) using the new accounting package, we think the group consolidation will be easier and management expect that it will take less time to prepare the financial statements, leaving time to perform quality assurance over them. Some of the subsidiaries' financial statements were prepared on spreadsheets previously, going forward the churning out of the accounts will be more automated/less manual.

We would like to acknowledge that despite the delays in receiving the accounts for audit and issues with the quality of the draft financial statements, we have had very good cooperation, dialogue and regular engagement with the Regional Council throughout the audit. In particular, during audit planning, we identified business issues and risks, these together with a number of technical accounting matters were considered and resolved during the year. The financial statements and associated disclosures reflect the outcome of these considerations and the agreed accounting treatment.

We will continue work with the Regional Council to further improve its processes and ensure quality assurance over the draft financial statements.

In 2013/14, we recommend that management prepare pro-forma financial statements in the proposed reporting format and provide this for our review before the commencement of the final audit. This would enable us to provide comments to management early and agree on the proposed disclosures.

We also recommend that the Regional Council ensures that it allows time in the account preparation process to conduct a thorough quality assurance review over the financial statements (including the notes to the financial statements) before providing the draft for audit.

Management response:	Noted that this caused issues and inefficiencies on auditing the final presentation but unchanged trail
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	balances were provided for all entities to enable the audit to progress. We look forward to working with Audit NZ to establish a working programme for the 2014 audit.
Responsibility for implementation:	Finance
Action by:	May 2014 or as agreed

4.2 Recovery of cost overrun

We have spent considerably more audit hours on this year's audit than anticipated. This was primarily due to the matters set out in section 4.1 above.

We will like to discuss with you the recovery of the additional costs to complete the audit.

5 Changes to public benefit entity accounting standards

The New Zealand Accounting Standards Board recently released new accounting standards that will apply to public benefit entities (PBE) with expenses greater than \$2 million. PBEs are required to transition to the new PBE standards for reporting periods beginning on or after 1 July 2014. This means the Regional Council's first financial statements, including its forecast financial statements, under the new standards are for the year ending 30 June 2015.

To ensure a smooth transition to the new standards, the Regional Council will need to plan and prepare in a timely manner for the transition to the new PBE accounting standards. This planning includes:

- Becoming familiar with the new standards and assessing the differences that may have a recognition, measurement, or disclosure effect on the financial statements.

- Determining any required system changes to comply with the new standards.
- Consider group reporting implications arising from accounting policy differences between the PBE group and for profit subsidiaries.

We will discuss the adoption of the new accounting standards with the Regional Council as appropriate.

6 Follow up of previous management report issues

6.1 Process for account user maintenance

Status of issue: This issue is closed. A formal manual process is in place for establishing users. IT is advised monthly by HR of users who have departed and their accounts are disabled. IT also has additional compensating controls in place that will disable accounts 90 days after inactivity. Contractors have an end date entered when the record is established.

The Regional Council have advised that they are looking in the future, to automating the process for account user maintenance.

In previous years, we reported that the process in place for establishing, changing and removing user accounts, contractors and external parties at the network and application levels could be improved upon and recommended that management review, document, centralise and communicate this to all staff.

6.2 Default domain password settings

Status of issue: This issue is closed. The current default domain settings meet best practice requirements with the exception of “complexity” (which is one of nine settings that ideally would be in place).

The Regional Council is of the view/has decided that the current settings provide it with the best user compliance and risk mitigation (the Regional Council advised us that in its experience, when very complex passwords are enforced, it may cause staff to write them down and leave them around their desktop, which defeats the purpose of having a personal password). While enabling complexity would further enhance security, the current settings for each of the remaining areas does provide adequate security and at the application level, security is managed through role based access that has to be approved by line managers. We accept the Regional Council's view.

In previous years, we reported that with the exception of minimum password age and complexity, the Regional Council's minimum password age and complexity meet international recommended best practice.

7 Mandatory disclosures

Our mandatory disclosures to the Regional Council in respect of our audit are in Appendix 1.

Appendix 1: Mandatory disclosures

Area	Key messages
Our responsibilities in conducting the audit.	<p>We carried out 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.</p> <p>The audit of the financial statements does not relieve management or the Council of their responsibilities.</p> <p>Our audit engagement letter contains a detailed explanation of the respective responsibilities of the auditor and the Council.</p>
Auditing standards	<p>We carry out our audit 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 are immaterial to your financial statements. The Council and management are responsible for implementing and maintaining your systems of controls for detecting these matters.</p>

Auditor independence	<p>We confirm that, for the audit of the Greater Wellington Regional Council's financial statements for the year ended 30 June 2013, 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.</p> <p>Other than the audit, we have not provided any engagements for the Greater Wellington Regional Council during the year ended 30 June 2013. In addition, we have no relationships with, or interests in, the Greater Wellington Regional Council.</p>
Other relationships	<p>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 Greater Wellington Regional Council that is significant to the audit.</p> <p>We are not aware of any situations where a staff member of Audit New Zealand has accepted a position of employment with the Greater Wellington Regional Council during or since the end of the financial year.</p>
Unresolved disagreements	<p>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.</p>