



Audit New Zealand
AUDIT AND ASSURANCE SERVICES

Our ref: W010 02J

6 December 2002

Howard Stone
General Manager
Wellington Regional Council
PO Box 1 1-646
WELLINGTON

Dear Howard

WELLINGTON REGIONAL COUNCIL AUDIT FOR THE YEAR ENDED 30 JUNE 2002

1 INTRODUCTION

We have completed the audit of Wellington Regional Council (“the Council”) for the year ended 30 June 2002. This letter provides a summary of

- ▲ the audit opinion
- A our assessment of your financial and non financial management
- A our assessment of your compliance with legislative requirements
- A significant matters arising from the audit

We also refer you to the interim management report dated 29 April 2002.

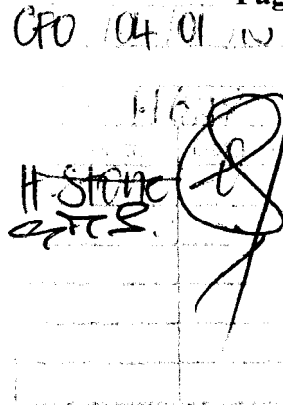
2 AUDIT OPINION

An unqualified audit opinion was issued on the Council’s financial statements.

3 FINANCIAL AND SERVICE PERFORMANCE MANAGEMENT

Our interim report dated 29 April 2002 included an interim assessment of the Council’s control environment for 2001/02 based on the work performed to date. We have since completed our assessment of both systems and the management control environment for service performance information, and these grades, together with an update of the financial grades, are included below.

Matters identified in the “comments” column are reported more fully in section 5 of this letter.



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Management aspect	Assessment	Comment
Financial control systems	Excellent (200 1: Excellent)	<p>The Council continues to maintain its strong control environment. Our work in this area indicated the following:</p> <ul style="list-style-type: none"> ▲ Sound controls operate over Council’s key financial systems. Transactions are authorised and changes to the masterfile systems are monitored and reviewed. ▲ Key asset management plans have been updated and the information is linked into the long-term financial strategy. These appear to be in the nature of working documents by which Council can more effectively manage key assets and feed appropriate information into Council’s planning process. ▲ We are satisfied with the level of controls over the purchasing system and sensitive expenditure. During the year Council completed the first stage of procurement review, which concluded that the current system of using SAP, supplemented by manual purchase orders where necessary, remained appropriate. The second stage of this review, which is ongoing, will examine where efficiencies can be gained in the Council’s procurement practices.
Financial management information systems	Excellent (2001: Excellent)	<p>Overall the information systems to support the operational activities of Council are well managed. Work is continuing in some areas to move procedures further towards good practice, specifically:</p> <ul style="list-style-type: none"> A controls over the use and monitoring of super user access to SAP A establishment of an Information Systems Management Group to provide direction for future IT requirements.

Management aspect	Assessment	Comment
Financial management control environment	Excellent (200 1: Excellent)	<p>The financial control environment is sound. This is evident by the following:</p> <ul style="list-style-type: none"> A Budgets are reviewed at departmental level, divisional level and overall Council level. ▲ Monthly reports are produced at divisional level while, both financial and performance reports are provided to the Policy, Finance and Strategy Committee on a quarterly basis, with monthly reporting by exception in between. A The Policy, Finance and Strategy Committee fulfils the function of an Audit Committee.
Service performance information and information systems	Excellent (200 1: Excellent)	The Council has good systems to record service performance and the internal controls over non-financial data are well established.
Service performance management control environment	Excellent (200 1: Excellent)	<p>The Council has excellent higher level controls including:</p> <ul style="list-style-type: none"> A Quality assurance A Self-review procedures ▲ Planning processes A Exception reporting <p>Performance standards are outcome focused and are linked to the day-to-day operations of the Council.</p>

4 COMPLIANCE WITH LEGISLATIVE REQUIREMENTS

We have reviewed the systems and procedures that you employ to identify and comply with legislative requirements. We note that, as part of its overall approach to meeting its legal compliance obligations, Council has joined the SOLGM Legal Compliance project. Please refer to appendix one for further commentary on this project.

With the exception of the ongoing technical breach of legislation arising from the Council's continued ownership of the Waterloo Interchange, we did not note any instances of non-compliance with legislation.

5 SIGNIFICANT MATTERS

5.1 Infrastructural assets revaluation: Flood protection assets

Flood protection assets were revalued as at 30 June 2002 as part of the Council's fixed asset revaluation cycle. We noted the following matters during our review of the revaluation:

- ▲ Baker and Associates revalued Wairarapa flood protection land as at 30 June 2002. This valuation was not carried out in accordance with Financial Reporting Standard No.3 (FRS-3) as the valuer did not physically inspect the properties and therefore was not able to confirm that FRS-3 had been complied with.

The land subject to revaluation by Baker & Associates is not a significant portion of total flood protection assets and therefore we assessed that the likelihood of material misstatement was low.

- ▲ The Landcare division engaged Riskworks Ltd to carry out a peer review of the valuation of its infrastructure assets, however did not specify that the work should comply with FRS-3. Consequently Riskworks were only prepared to certify that the valuation was in accordance with the *NZ Infrastructure Asset Valuation and Depreciation Guidelines*, however we were able to satisfy ourselves this complied with FRS-3.

We recommend that in the future, all valuers used by the Council be explicitly engaged on the basis that the valuation is in accordance with FRS-3, and that the external auditors will be seeking to rely on the valuation for financial reporting purposes.

- ▲ Our review of the valuation of the flood protection **infrastructural** assets ascertained that it is possible that previously unrecorded assets may have been included in the current valuation.

Previously, valuations in the local **government** sector took a global approach and the asset registers compiled were often not detailed enough to provide the breakdown at component level required by FRS-3. For the Council, this lack of detail meant that it was difficult to determine whether all assets in existence were included in previous valuations. The total revaluation increase disclosed in the financial statements for the year is \$20,192,000. We have assessed that the risk of material misstatement as low.

We recognise that, following the 2002 valuation, the Council now has good asset information at component levels for flood protection assets. We therefore recommend that the Council maintain this level of detail. We also recommend that any assets "found" subsequent to 30 June 2002 be treated as additions, rather than be wrapped-up in the next revaluation cycle.

Management Response

A debrief has been held with key staff to ensure the lessons learned from the revaluation of flood protection assets are applied during asset revaluations in future.

Also, once assets have been recorded at component level they will continue to be recorded at that level.

5.2 Parks and reserves: Vested and heritage assets

During our audit we discussed with the Council the scheduled revaluation of its parks and reserves for the 2003 financial statements. We raised four matters, which the Council should consider as part of the revaluation exercise:

Completeness of existing data

Similar to the flood protection assets, the Council will be using the 2003 parks and reserves revaluation to update its asset databases to separately record assets at component level.

However, the current information is not sufficiently detailed to allow the Council to determine whether any previously unrecorded assets are detected in the 2003 valuation. We therefore recommend that, as with flood protection, the Council critically reviews the results of the valuation to determine whether the revaluation has been impacted by previously unrecorded assets being included.

Environmental obligations

The Council undertook an exercise this year to identify all environmental obligations it has. While we are satisfied this was comprehensive, there is the possibility that the 2003 revaluation of parks and reserves may identify further environmental obligations.

Should any instances occur, the Council will need to determine the correct accounting treatment between whether the obligation is a liability on the Council or whether the underlying asset has been impaired.

Vested assets

Vested assets are assets that have been placed in the Council's control but may have restrictions as to their use. These restrictions are attached to the asset and do not include restrictions specific to the owner. The Council should consider the following recommendations in regards to these assets:

- a An independent valuer will need to consider the vested nature of parks and reserves when they are valuing the assets. That is, the market value of surrounding properties may not be a good indication of value as the parks and reserves may not be able to be sold without a lengthy public consultation process.
- a The Council should consider whether it needs to disclose in its financial statements that any assets may be restricted in their use and may not be available for sale. It is recommended practice that such restrictions be disclosed.

Heritage assets

Heritage assets are those assets that are held for the duration of their physical lives because of their unique cultural, historical, geographical, scientific and/or environmental attributes. To date the Council has not formally reviewed whether it owns any assets that fall into this category. However, officers believe that the Council may own a small number such as the Rimutaka Incline, which may be considered a heritage asset due to its historical significance.

We therefore recommend as part of its revaluation exercise that the Council also consider the potential existence of heritage assets. The Treasury Accounting Policy Team have written a draft guidance on this area called *'The Valuation of Cultural and Heritage Assets'*, dated 10 June 2002, which the Council may find helpful to refer to.

We welcome the opportunity to be involved in preparatory and ongoing discussions regarding the revaluation exercise.

Management response

We intend to work closely with Audit NZ to adequately deal with all issues associated with the Parks and Forests asset revaluation, including those highlighted above.

5.3 Doubtful debts provision

The Council has a general provision for doubtful debts of \$1,150,000 to cover rates receivable of \$2,620,049 (that is, 44% of rates receivable as at 30 June 2002 have been provided for as possibly uncollectible). Our discussions with Council personnel highlighted that this provision for rates receivable is a general rather than a specific provision. The provision has been increased in the current financial year by \$264,000 as the Council expects that there may be objections over rates payable by utility companies from 1 July 2002. This method of determining the doubtful debts provision has been followed in prior years.

It is generally accepted accounting practice to provide for existing rather than future debtors that may be difficult to collect. Where general provisions are used they

should be calculated on a reasonable basis, such as the Council's past history of debts written off as uncollectible or all debts that a certain number of days old.

Although we have assessed that the impact of the above on the financial statements as not material, it is significant enough to cause us some concern and we recommend that the Council reassess the rationale it uses to provide for doubtful debts.

Management response

It is accepted that the provision is a general rather than specific one. However, we are mindful of the risk of successful challenge to past rates which could go beyond the extent of unpaid rates at 30 June in any given year (i.e. rate refunds).

5.4 Provisions and accruals

As part of our audit review we assessed whether the Council's provisions complied with the definition of a liability as defined in the Statement of Concepts prepared by the Institute of Chartered Accountants of New Zealand. Liabilities are the future sacrifices of service potential or of future economic benefits that the Council is presently obliged to make to other entities as a result of past transactions or other past events.

We noted several provisions with a total value of \$903,000 where the definition above was not met. For example, the Council has a provision of \$100,000 to cover costs that the Council may incur as a result of non-compliance with legislation and tax laws. To have met the above definition the Council would need to have breached legislation (past event) and have a present payment obligation as a result of the breach (for example, tax penalties).

We also noted that one division of the Council accrued costs of \$288,000 against two capital projects where the actual service had not yet occurred in order to meet budget targets. In this case the 'past event' has not occurred and therefore the definition is not met. We recognise that the Council does have a mechanism in place for re-budgeting at year-end, and that there is a quality review by finance of all accruals submitted by the divisional accountants. However, these two items were not detected.

We have assessed the impact of the above on the financial statements as not material. However, we strongly recommend that the Council comply with generally accepted accounting practice.

Management response

Comments noted, The accrual of \$288,000 against two capital projects was an isolated incident.

5.5 Statement of Service Performance

As part of our audit we reviewed the Council's Statement of Service Performance for 2001-02 and the Annual Plan for 2002-03. We continue to be satisfied that the Council has made progress in developing its performance indicators, and these are backed up by appropriate systems for recording performance.

The Council has commenced a project to move towards a version of sustainable development reporting, which focuses on ten key community outcomes. The Council is currently developing this, with the aim of incorporating it into the 2003-2012 Long Term Council Community Plan (LTCCP). We support Council's work in this area, and make the following observations as part of this process:

- a Council needs to ensure that in developing outcomes measures, it also retains appropriate output measures;
- ▲ the intervention logic on how individual outputs relate to the achievement of outcomes also needs to be developed in order that the Council is able to direct its own operations and activities, and also that ratepayers are able to comprehend how Council's actions contribute to the achievement of community outcomes; and
- ▲ output measures need to be developed to include the quality and timeliness of Council's outputs, as opposed to just reporting on what was done.

We will continue to work with Council during its preparation of the 2003-2012 plan, and provide assurance over its performance reporting for the future.

Management response

We will continue to liaise with Audit NZ as we look to further improve our performance reporting.

5.6 Public entities review

Our audit brief from the Office of the Auditor General asks us to identify entities that fall under the Public Audit Act 2001 and which are therefore subject to audit by the Auditor-General. By default, the following are considered public entities: the Council's subsidiaries, the Sinking Fund Commissioners and the Stadium Trust. Our work in this area is ongoing, however during our audit we considered three entities:

Wellington Region Environmental Agency

The membership of this agency consists of territorial Councils in the Wellington region and individuals/organisations that are involved in the environment field and can make a significant contribution to the agency. All members have full speaking and voting rights.

We have reviewed the structure of the Agency, and have determined that it is not a separate legal entity. Hence we are satisfied that it does not fall under the Public Audit Act.

Pauatahanui Inlet Community Trust

The Pauatahanui Inlet Community Trust was launched on 1 May 2002. The Trust Deed stipulates that the Trust Board shall comprise of not less than six persons and not more than fourteen, of whom three shall be nominated trustees. The three nominated trustees comprise of one trustee appointed by the Wellington Regional Council, one trustee appointed by the Porirua City Council and one trustee appointed by Te Runanga o Toa Rangatira Incorporated.

The Trust currently has six Board members, two of whom are representatives of local governmental entities. Therefore we have determined that public entities do not have control over decision making at the Trust, and consequently the Trust is not a public entity.

However, if additional public entity representatives are appointed by the Trust via the Appointments Committee the balance of control may shift thereby making the Trust a public entity under the Public Audit Act 2001 and therefore subject to audit. We recommend that the Pauatahanui Trust be advised of the above.

Airtel Ltd

The Council, along with Masterton and Carterton District Councils, was given shares in Airtel Ltd upon its incorporation during the year. We have reviewed the shareholders' register, and are satisfied that public entities do not have control of Airtel, and consequently Airtel itself is not a public entity.

Management response

Comments noted.

6 REVIEWS ON BEHALF OF THE AUDITOR-GENERAL

Appendix two details the results of the reviews we performed *on* behalf of the Auditor-General. No issues arose out of these reviews that would require your attention.

7 ACKNOWLEDGEMENT

I would like to express our appreciation for the assistance provided to us by your staff during our audit. If you have any queries on the above matters, please do not hesitate to contact me on 496 3025.

Yours sincerely

A handwritten signature in black ink that reads "Erica Mason". The signature is written in a cursive, flowing style.

Erica Mason
Director

cc Greg Schollum, Chief Financial Officer

Appendix 1

LEGISLATIVE COMPLIANCE

As part of its overall approach to meeting its legal compliance obligations, Council has joined the SOLGM Legal Compliance project. This project is a cooperative effort in which 83 Local Authorities are now participating.

Audit New Zealand is extensively involved in the project through representation on the steering group and in a peer review role. We have a high level of commitment to the project. Where possible, we wish to assist local authorities to fully realise the potential benefits of their participation. The project has formulated a Framework for Legal Compliance, which sets out six key principles. These are:

- A Commitment
- A Ownership
- A Transparency
- A Comprehensive
- A Systematic
- A Ongoing Development.

Beneath this framework, the project has issued a series of modules, each of which addresses a key local government function. Each module is set out as a series of flow diagrams, covering the key processes within that function. Each of these flow diagrams is in turn supported by detailed descriptions of each step, a “hot tips” section, and identification of specific legal obligations. Legal obligations outlined include both statutes and reference to case law.

These good practice guides have been developed by working groups of experienced local authority practitioners in each function. Their work has been supported by input from legal advisers and validated by a rigorous quality assurance regime. Overall each of the modules provides good practice guidance to local authorities, against which they can benchmark their own practices and processes.

The project has now been underway for two years and by the end of this calendar year it is envisaged that 11 modules will have been issued. They will all be accessible to participating local authorities on the project web site at www.solgm.co.nz. The modules cover the following areas:

- | | | |
|---|---------------------------------|-----------------------------------|
| A | Building Consents | <i>Issued August 2001</i> |
| A | Property Sales and Acquisitions | <i>Issued August 2001</i> |
| A | Tendering and Procurement | <i>Issued April 2002</i> |
| A | LIMs | <i>Issued April 2002</i> |
| A | Resource Consents | <i>Issued February 2002</i> |
| A | Employment | <i>To be issued November 2002</i> |
| A | Health & Safety | <i>Issued October 2002</i> |
| A | LGOIMA | <i>Issued October 2002</i> |

A	Enforcement	<i>To be issued late 2002 or early 2003</i>
A	Privacy	<i>To be issued late 2002 or early 2003</i>
A	Liquor Licensing	<i>To be issued late 2002 or early 2003</i>

In our 2002/03 audit, as part of our assessment of Council's management control environment, we intend to review the overall approach to legal compliance and specifically the implementation and utilisation of the legal compliance modules. We will review Council's approach and progress at both an organisational and individual function level. In doing this, we will focus on determining whether Council has developed its own framework for legal compliance and how effectively this is being applied across the organisation. We will also assess the extent to which Council is utilising the good practice guide modules to benchmark its own processes. We will report our findings as part of next year's audit.

APPENDIX 2

REVIEWS ON BEHALF OF THE AUDITOR-GENERAL

Issue	Status/Findings
<p>Collection of money at off-council sites</p> <p>The establishment of strong internal controls for the collection of cash is seen as necessary to prevent mishandling of funds and to safeguard against loss. The purpose of this year's work is to ensure that the processes in place at off-council sites are consistent with the written policy of the Council.</p>	<p><i>The nature of Regional Council operations means that there is minimal collection of money at off-council sites required. We visited the Akura Nursery site in Masterton and reviewed the policies and procedures in relation to cash collection.</i></p> <p><i>We concluded that there is a basic cash management process in place and accepted it as reasonable given the size of operations. Most transactions are via EFTPOS so the cash handled is minimal and the yearly sales were noted as being \$35,000.</i></p>
<p>Management of separate funds and reserves and investment portfolios</p> <p>In the 1998 audit round, a return was provided to the Office of the Auditor-General on local authority management of investments and surplus funds. Results indicated that local authorities were not fully aware of why funds and their related investment balances were held, the rationale for their ongoing existence and whether any restriction related to their use. Further many investments were not making a commercial rate of return.</p>	<p><i>The Council have a funding policy in place that covers the use of funds and reserves. Specific investments such as contingency reserves are allocated the actual interest earned, Other reserves are allocated 8% interest.</i></p> <p><i>We assessed the Council's policies, management and rates of return as part of the 30 June 2002 audit engagement as reasonable.</i></p>