

Report to the Council on the audit of

Wellington City Council

for the year ended 30 June 2012

Management report

1 Introduction

This report summarises the findings of our 2012 audit, and discusses any significant accounting and other issues considered.

This report focuses on the issues that we wish to bring to the attention of Council. Other reporting during the period has been in an interim progress report to management on 13 August 2012. We will also provide a report to management with some minor recommendations for improvement relating to the final visit.

2 Our audit opinion

We issued an unmodified audit opinion on 29 August 2012.

2.1 Significant accounting matters considered during the audit

Matters that required significant audit judgement, or involve a high degree of estimation, are discussed in appendix 1 below. There are no significant issues arising from these.

3 Assessment of your control environment

Consistent with previous years, the Council operates an effective control environment.

Our high-level review of your control environment included a consideration of Council and management's overall attitude toward, awareness of, and actions in establishing and maintaining effective management procedures and internal controls. Internal controls are operating effectively.

Particular positive attributes to highlight in relation to the annual report are:

- The draft annual report provided to us for audit was prepared to a high standard. This reflects the efforts of staff and strong quality assurance procedures in place.
- The Council has sought to improve the transparency of the financial information by adding information to explain the reported results. This includes greater analysis of the Council's net surplus, and disclosure of the funding available for use in future years. The role of the Audit and Risk Subcommittee was demonstrated in their contribution to this discussion.

Asset management is an important aspect of the financial and non-financial control environment, as the reliability of asset information is directly linked to both the financial statements and reporting on service levels.

In our LTP audit we noted that minimum expected levels of asset renewals, particularly in the "three water" services, are forecast to increase significantly in the medium to long term. Work is underway to improve the Council's knowledge of asset condition. This will be key to maximise the effectiveness of the renewals spend and reduce the risk of asset failure. In future audits we will monitor progress on the work being done to improve the Council's knowledge of asset condition.

Council may wish to consider the following opportunities to improve the control environment:

- A significant function of the Council's governance arrangements is the oversight of its CCOs, primarily through the CCOP subcommittee. We are aware that the Council's relationships with its CCOs are a matter being considered at present. We obtained a high level understanding of the committee's processes and terms of reference, and considered what opportunities exist to further strengthen the Council's mechanisms to safeguard its interests in these entities.

The Council may wish to consider asking for access to the external audit letters, which are produced separately for the Council's significant CCOs. While the auditor is not able to issue these to Council directly, the Council may wish to consider whether requesting these from significant group entities may be beneficial to its oversight role.

- Recommendations for improving the Council's information systems processes and controls have been reported to management. These are:
 - finalise and communicate updated IS policies;
 - finalise Business Continuity and IT Disaster Recovery plan and testing;
 - formalise management of generic and powerful user accounts for key systems;
 - the IT - IM team establish a risk assessment framework that can be used periodically to assess information risk to achieving business objectives; and
 - limit the number of staff with access to the main computer room.

More detail on these matters, and management's response, are set out in appendix 2 below.

4 Matters from prior audits

A summary of the Council's progress in addressing matters from prior audits follows:

- **Sensitive expenditure policies - cleared.** We recommended the Council could consider further guidance around travel, in particular the public perception implications of the use of 5-star accommodation. This has been included in the revised travel and accommodation policy.
- **Annual leave balances – cleared.** We previously recommended the Council monitor and manage the number of employees with high annual leave balances. A number of system controls have been introduced, and the number has significantly reduced in 2012.

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- **Information systems security policy – good progress is being made.** We recommended Council develop and implement an IS/IT Security Policy. Follow up of this is detailed in appendix 2 below.

5 Thank you

We would like to thank the Council and management for the consistent high level of support we received in performing our work.



A P Burns
Audit New Zealand
On behalf of the Auditor-General
Wellington, New Zealand
13 September 2012

Appendix 1: Significant accounting matters considered during the audit

1 Review of leaky homes liability

We are satisfied that the provision for leaky homes is fairly stated.

The Council's provision for leaky homes is the most significant accounting estimate in its financial statements. The total provision of \$56.1 million is a \$5.3 million increase from the 2011 year.

There is a high inherent degree of estimation and uncertainty in this balance. Single large claims can significantly impact the result, as well as changes in other factors such as take-up of the Government's Financial Assistance Package (FAP), and the success or otherwise of legal claims.

The Council's estimation process has two major elements:

1 \$27.7 million provision for assessed claims.

This is for claims that have been received and assessed by the Council's staff and legal advisors. The estimate of liability is provided by external legal advisors Heaney and Co Limited, and then discounted for the estimated payment dates.

2 \$28.4 million provision for future claims and claims not yet assessed

This liability is estimated by external actuaries Melville Jessup Weaver (MJW). The estimate includes consideration of the Government's FAP scheme.

Assumptions have been reviewed since the 2011 valuation to account for latest actual data on claim, settlement rates and values, as well as the experience to date with the FAP scheme.

The most significant change is the prevalence rate, which represents the 'population' of homes certified by Council during the 10 year statutory limitation period that may result in a claim. The prevalence rate has been significantly reduced, affecting the future claims liability. The reduction is based on an analysis review of all consents issued by the Council and actual claims to date.

2 Valuation of assets

Land and buildings

The Council has appropriately revalued its operational land and buildings assets.

The valuation was performed by independent valuers CBRE. Buildings were valued at market value or if specialised, optimised depreciated replacement cost.

Where appropriate, the 'raw' values of buildings were adjusted to reflect the estimated costs to strengthen the Council's earthquake prone buildings. These cost estimates were provided by the Council's engineers, and reflect the best available information at the current time.

Management also considered whether the significant earthquake strengthening work planned for Council's Civic Buildings, primarily the Town Hall and administration buildings in Civic Square, would require them to be written down. We concur with management's assessment that the current asset values remain appropriate.

3 Wellington Waterfront Project – newly identified assets

The Council's accounting treatment of newly identified assets in the Wellington Waterfront Project (WWP) is materially correct.

WWP is reported within the Council's financial statements. There was a change in the professional advisors used to value WWP assets in 2011/12. The new valuers had previously advised the Company in the preparation of its Asset Management Plan.

The detailed asset knowledge that the new valuers had from having previously provided assistance with in the preparation of the Asset Management Plan resulted in the identification of additional assets that had not previously been valued. The re-valued amount of these assets is \$77,453,000. The types of assets identified were:
Infrastructure assets: including some wharf structures, seawalls, "3 water" assets and
Buildings: including Bus parks, parts of the promenade, public toilets etc

The indications are that a large majority of these were not new assets, but rather they are some of the assets originally vested with the Company by the Council when the Company was formed in 1987.

The auditor of the WWP is currently considering the appropriate accounting treatment as a result of this new information. At the time the Council's annual report was approved, this matter was not resolved.

The Council has recognised the assets in its financial statements as a revaluation adjustment. This and other accounting options being considered affect the Statement of Financial Position only. The Council's reported revenue, expenditure or surplus is not affected.

Therefore, while the matter is not yet resolved, we do not consider this matter to be material in the context of the Council and group's overall asset holdings. The current accounting treatment is materially correct.

4 Long term lease of the Overseas Passenger Terminal

We accept the accounting treatment for the long term lease of the Overseas Passenger Terminal (OPT) as materially correct.

WWP has entered into an agreement with a developer for the long-term lease for the OPT. A gain on sale of \$5.2 million has been recognised for this transaction.

At the time the Council's annual report was approved, the auditor of the WWP was still considering whether this transaction represents a sale or a lease, specifically a finance lease. In 125 years time the title to the OPT will pass back to WWP. The view of Wellington Waterfront is that a 125 year arrangement is in substance a sale and it has accounted for the transaction as such.

Given the nature of this agreement and the full consideration of the lease payable early in the 125 year term, we are satisfied that any difference in accounting treatment between a sale or a finance lease would not be material to the group.

5 Movement in Karori loan

The Council has appropriately adjusted the carrying value of its loan to the Karori Wildlife Sanctuary Trust to reflect the new terms of repayment.

The Council has provided a loan (face value \$10.3 million) to the Karori Wildlife Sanctuary Trust (KWST) for the building of their visitors centre. This has no specified maturity and no interest.

Repayments on the loan were scheduled to start in 2012/13, should the KWST generate sufficient surpluses. However, current forecasts show operating deficits for the next three years and therefore it is unlikely that the Trust will make any repayments for at least three years. Accordingly the repayment profile of the loan has been pushed back by three years.

To reflect the above, the carrying value of the loan was reduced from \$4.7 million to \$3.7 million.

Appendix 2: Matters arising - information systems controls

1 Finalise and communicate updated IS policies

We recommend that the Council prioritise the rollout of the IS Security Framework and develop a communication plan for the policies.

A Security Framework and Security policies are in place, and a Security Architect has been appointed. However we note that the policies have not yet been included in Councils policies and are not being communicated to all staff

Management comment

Agreed. A Senior Security and Telecommunications Engineer has been appointed and tasked with the development and the rollout of the IS Security Framework and the development of a communication plan for the policies. The time frame and priority of policy rollout to be agreed with Manager Risk Assurance. The initial rollout of high priority policies will be complete by end September 2012.

2 Finalise Business Continuity and IT Disaster Recovery plan and tests

We recommend that Business Continuity Plans be finalised and tested as planned. The results should be documented and communicated to all affected staff so that improvements to procedures can be made.

Business Continuity and IT Disaster Recovery plans are now well developed, and tests of these plans are to be carried out this year.

Management comment

The intention was to carry out an IT DR test in August 2012. On the morning of 27 June a power surge took down all the council's computer systems. The directors on the BCP steering group met early to activate the BCP.

There was an independent inquiry into the BCP process as a result of a power failure which caused an IT Outage which focused on the response to the incident. This report was presented to the BCP steering group and the recommendations acted upon.

Given that this incident necessitated the initiation of the BCP, and lessons learned will be incorporated into DR and BCP planning, it was decided not to run another DR test. Further testing is deemed superfluous at this stage as the data centre environment is entering a transitional stage, due to earthquake strengthening of council buildings. These works will necessitate a move of the production centre from its current location. As such, an RFP has been issued for hosting of the current data centre and DR, in addition to other options. The RFP is currently under review. However, these developments have superseded the need for an IT DR test in the current environment.

3 Management of generic and powerful user accounts

We recommend that:

- When generic accounts are used they should be restricted to specific use situations and reduced to read only access wherever possible to prevent changes being made without accountability. For powerful users there is a higher risk of malicious or accidental changes having significant impacts on systems. These users should be known and adequately monitored.
- IT and business application owners should develop a process to document the current generic and powerful accounts within their network domain and various applications. This should include an assessment to determine the extent of their access and whether they are still required.

We found that although IT Management can identify generic and powerful accounts on their systems there is currently no process in place for documenting the existing accounts and what their purpose is.

We understand that IT Management performs periodic reviews approximately every 3 months but are not a complete review of all generic accounts.

Management comment

Agreed. A Review of generic and powerful accounts will be undertaken as part of the Security Framework and policy implementation rollout.

The review will document the current generic and powerful accounts and the extent of their access. A periodic review will be formalised with the business owners to confirm whether powerful accounts are still required.

Recommendations will be supplied to GM IT operations and Manager Risk Assurance for further action.

4 IT - IM Risk Framework

We recommend that IT-IM establish a risk assessment framework that is used periodically to assess information risk to achieving business objectives. Where risks are considered acceptable, there should be formal documentation and acceptance of residual risk with related offsets. Where risks have not been accepted, management should have an action plan to implement risk response (including system and data availability).

Whilst the council has an organisational risk framework in which major IT - IM risks are recorded, there is no risk framework or register within IT - IM itself to record and assess risk.

Management comment

Agreed. As part of 2012/13 work programme, a risk assessment framework based on NZ standards will be developed.

5 Unnecessary access to the computer room

We recommend that management limit the access to the main computer room and consider reviewing the appropriateness of the cardholders.

The main computer room houses the majority of the computers and network equipment supporting the key processes within the Council. A security swipe card device controls access to the computer room.

However, we noted that there are 81 cardholders that were authorised to gain access to the computer room. We consider the number of cardholder is higher than desirable.

Logical security relies upon an appropriate level of physical security being in place. If physical access to an IT system can be gained (for example the core application server in the computer room), it is highly likely that unauthorised access at a logical level can be gained without a great degree of difficulty.

Management comment

Agreed. A Review of existing Access to limit the access to the main computer room is being undertaken as part of the Security Framework and policy implementation rollout. A report and recommendations will be supplied to GM IT operations and Manager Risk Assurance. The initial rollout of high priority policies will be complete by end September 2012

The access list will be reviewed on an annual basis.

Appendix 3: Mandatory disclosures

Audit New Zealand has 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.

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.

Statement of auditor independence

We confirm that, for the audit of the Wellington City Council's financial statements for the year ended 30 June 2012 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.

During the year we undertook a review of the Clifton Terrace car park managed by the City Council on behalf of the New Zealand Transport Agency. Other than the audit, the review of the Clifton Terrace car park and the audit of the long-term plan, we have no relationship with or interests in the City Council or any of its subsidiaries.

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.

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 Wellington City Council that is significant to the audit.

We are aware that during the 2011/12 financial year to date two employees from Audit New Zealand have accepted a position at the Wellington City Council. Their roles are not directly related to the preparation of the financial statements, and we do not believe this has impacted on our audit independence.