

15 March 2019

Jenny Shattock
Mayor
South Waikato District Council
Private Bag 7
TOKOROA

Dear Councillors

Planning Report to the Councillors for the year ended 30 June 2019

In accordance with our normal practice, we include in the attached report all planning matters arising from our audit of the financial statements and performance information of South Waikato District Council ("Council") for the year ended 30 June 2019 which we consider appropriate for the attention of Council.

We look forward to the meeting on 4 April 2019 where we will have the opportunity to discuss this report. In the interim should you require clarification on any matter in this report please do not hesitate to contact us.

This correspondence is part of our ongoing discussions as auditor in accordance with our engagement letter date 15 March 2019 and as required by the Auditor-General auditing standards which incorporate the New Zealand auditing standards. The ultimate responsibility for the preparation of the financial statements and performance information rests with the Councillors.

We have prepared this report solely for the use of the Council and it would be inappropriate for this report to be made available to third parties. If such a third party were to obtain a copy without our prior written consent, we would not accept responsibility for any reliance that they might place on it.

We would like to take this opportunity to extend our appreciation to management and staff for their assistance and cooperation during the course of our audit to date.

Yours faithfully



**Bruno Dente
for Deloitte Limited
On behalf of the Auditor-General**

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Audit scope



Our key audit objective is to obtain reasonable assurance to enable us to form and express an opinion on the financial statements and performance information.

The audit is to be completed under the terms of our audit with the Office of the Auditor-General (OAG). We are required to report to the OAG any issues identified in relation to the audit.

Materiality levels are calculated on the basis of expenditure. We expect materiality based on expected results for the year to be \$542,000 (2018: \$492,500). We will report to the Council on all unadjusted misstatements greater than \$27,100 (2018: \$24,625) and other misstatements where they are qualitatively material.

Areas of focus



The areas of focus, which we have identified as part of our overall audit strategy are:

- Asset revaluations
- Rates
- Public sector specific procedures
- Procurement
- National Policy Statement

Internal controls



Our audit approach requires us to obtain an understanding of an entity's internal controls, sufficient to identify and assess the risks of material misstatement of the financial statements and performance information whether due to fraud or error.

Other communications



Various matters are communicated in accordance with the requirements of New Zealand auditing standards:

- Independence
- Professional fees/Relationships
- Consideration of fraud
- Management override of controls



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This years timetable has been outlined in the "Timetable" section of our report.

All local authorities must prepare an annual report for the year ending 30 June 2019 containing the information required by Part 3 of Schedule 10 of the LGA. This must be adopted, by resolution, within 4 months after 30 June 2019, i.e. by the end of October 2019.

Our team



Our audit engagement team has been outlined in the "Our team" section of this report.



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Purpose of report

This report has been prepared for South Waikato District Council's Councillors and is part of our ongoing discussions as auditor in accordance with our engagement letter dated 15 March 2019 and as required by the Auditor-General auditing standards which incorporate the New Zealand auditing standards. This report includes only those matters that have come to our attention as a result of performing our audit procedures to date and which we believe are appropriate to communicate to the Councillors. The ultimate responsibility for the preparation of the financial statements and performance information rests with the Councillors.

Responsibilities

We are responsible for conducting an audit of South Waikato District Council ("Council") for the year ended 30 June 2019 in accordance with the Auditor-General auditing standards which incorporate the New Zealand auditing standards issued by the NZ Auditing and Assurance Standards Board. Our audit is performed pursuant to the requirements of the *Local Government Act 2002* and the *Financial Reporting Act 2013*, with the objective of forming and expressing an opinion on the financial statements and performance information that have been prepared by management with the oversight of the Councillors. The audit of the financial statements and performance information does not relieve management or the Councillors of their responsibilities.

Materiality

We consider materiality primarily in terms of the magnitude of misstatement in the financial statements and performance information that in our judgement would make it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced (the 'quantitative' materiality). In addition, we also assess whether other matters that come to our attention during the audit would in our judgement change or influence the decisions of such a person (the 'qualitative' materiality). We use materiality both in planning the scope of our audit work and in evaluating the results of our work.

For the 30 June 2019 financial statements, we have used the 2018/19 budgeted expenditure from the annual plan as the benchmark for our quantitative materiality assessment. This benchmark is in accordance with the OAG's methodology.

We have applied 1.5% (2018: 1.5%) to this benchmark to determine a planning materiality of \$542,000 (2018: \$492,500). This percentage takes into account our knowledge of the Council, our assessment of audit risks and the reporting requirements for the financial statements.

Our materiality will be re-assessed at year end based on actual full year expenditure to ensure that this level remains appropriate.

The extent of our procedures is not based on materiality alone but also on the quality of systems and controls in preventing material misstatement in the financial statements, and the level at which known and likely misstatements are tolerated by you in the preparation of the financial statements.



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Audit risk

Our audit scope and approach emphasises careful planning and risk assessment to respond promptly to the risk of material misstatement, including engagement risk, significant risk and fraud risk factors. This approach helps to minimise year-end surprises and enhances the effectiveness of our audit.

Rather than treating all business activities as if they present equal risk, our procedures are designed to focus more attention on significant risk areas.

The following tables summarise our preliminary assessment of:

- the significant risks of material misstatement for our audit whether due to fraud or error; and
- other matters of significance which have not been identified as significant audit risks.

We continually update our risk assessment as we perform our audit procedures, so our areas of audit focus may change. We will report to you on any significant changes to our assessment as part of our final report to the Council.

These areas of audit focus were identified as a result of:

- the risk assessment process undertaken during the planning phase of our engagement;
- our understanding of the business risks faced by Council;
- discussions with management during the course of our audit
- the significant risks and uncertainties previously reported in the annual report and financial statements;
- our assessment of materiality; and
- the changes that have occurred in the Council and the environment it operates in since the last annual report and financial statements.

Based on our initial assessment, we will concentrate specific audit effort on the areas detailed below.



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Audit risk and proposed audit response

Area of the focus	Significant risk	Fraud risk	Planned controls testing approach
Asset Revaluations			D+I
Rates			OE
Public sector specific procedures			D+I
Procurement			D+I

D+I: Testing of the design and implementation of key controls

OE: Testing of the operating effectiveness of key controls



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Asset Revaluations

The Council has a significant asset base of infrastructural assets carried at fair value. Assets are revalued on a cyclical basis (at least every 3 years).

The valuation of assets can be a complicated process and management need to ensure that a robust review of the valuation process is performed irrespective of whether the valuation is being performed in-house or by an independent expert.

Given the time frame to complete a revaluation, management need to undertake the assessment as soon as possible.

We understand that in the current year the water assets are being revalued. For all other assets that are not revalued in the current year and not recorded at cost, management will need to perform an assessment that the carrying value and fair value do not materially differ.

Management will also need to assesses for indicators of impairment over all assets. We would like to highlight the Roding is a key area for review by management as last year it had increased by 3% alone.

Proposed audit response

As part of our audit process we will:

- Obtain the revaluation of the three waters asset classes;
- Obtain representation directly from the independent valuer or peer reviewer confirming their methodology;
- Review the key underlying assumptions used to ensure these assumptions are reasonable and in line with Public Benefit Entity International Public Sector Accounting Standards ('PBE IPSAS'); Ensure the revaluation transaction is correctly accounted for and disclosed in the financial statements in order to comply with PBE IPSAS
- For those assets that are not revalued in the current year, review managements assessment that the carrying value or assets is approximate to the fair value; and
- Review managements assessment of impairment of assets.



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Rates

Local authorities fund their operating and capital expenditure through rates as set out in the Local Government Act 2002 (LGA) and the Local Government (Rating) Act 2002 (LGRA).

To be lawful, rates must be set in accordance with the relevant provisions of the local authority's long-term plan and funding impact statement. There must be consistency between the rates resolution, the funding impact statement for that year, and the revenue and financing policy in the long-term plan.

Failure to comply with rating law and associated consultation requirements can create risks for rate revenue.

Management and Council need to ensure that the requirements of the LGRA are all adhered to and that there is consistency between the rates resolution, the Funding Impact Statement for the year, and the Revenue and Financing Policy in the respective Long Term Plan (LTP) or Annual Plan (AP).

Proposed audit response

As part of our audit we will:

- Complete a 'rates questionnaire' compiled by the OAG, to ensure that rates have been correctly set; and
- Review the meeting minutes recording the adoption of the rates resolution, ensuring the rates are in accordance with the Revenue and Financing Policy as well as reviewing any other information available with regards to rates.

Note that the overall responsibility for the compliance of rates rests with the Council.

If any other developments occur in the sector we will communicate with management as appropriate.



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Public sector specific procedures	Proposed Audit response
<ol style="list-style-type: none">Accounting for sensitive expenditure, including but not limited to:<ul style="list-style-type: none">Elected members remuneration and allowances;Sensitive expenditure (travel, entertainment etc.);Severance payments; andChairperson, Chief Executive and Senior Management expenditure (reimbursement).Policy and procedures in relation to fraud – the Council needs to ensure that the Council’s current fraud policy continues to be in place and implemented by managers and employees.Related party transactions and conflicts of interest – the Council needs to ensure that there are appropriate procedures in place to identify and manage conflicts of interest and that related party disclosures in the financial statements are complete.Legislative compliance – the Council needs to ensure there are appropriate procedures in place to identify, mitigate and prevent breaches of legislation.Non-financial Measures – The measures set out in the LTP are required to be reported against in the annual report.Employee remuneration and severance payment related matters - In the sector, there was an increase in public and media interest in employee remuneration and severance payment related matters. This will always be a high-risk and high public-interest part of a public sector audit.Reporting bribery and corruption - Parliament’s Finance and Expenditure Committee has expressed an interest in understanding whether the public sector has effective corruption prevention and detection processes in place.	<p>During the course of the audit we will:</p> <ul style="list-style-type: none">Continue to remain alert to issues and risks related to the effectiveness and efficiency, waste and a lack of probity or financial prudence. We will report any areas of concern with the Council and OAG;Check that the Council has a current fraud policy in place, and test that managers and employees know about the policy and its content;Make enquiries about fraud with the Council and senior management;Test related party disclosures within the financial statements;Gain an understanding of the legislative compliance processes in place and test key aspects;Audit the significant non financial performance measures in accordance with AG-4 <i>The Audit of Performance Reports</i>;Review elected member’s and CEO remuneration in accordance with guidance;Review severance payments (if any) and ensure annual report disclosures are appropriate; andAssess the controls to reduce the risk of wrongdoing in the public sector, particularly bribery and corruption.



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Procurement

The proposed theme for the 2018/19 work programme for the Officer of the Auditor-General (OAG) is 'Procurement'.

There are no specific projects identified in the OAG work programme relating to local government entities. However, we will consider procurement-related risks during our audit particularly significant procurement activity under way, including major capital projects

Proposed Audit response

As part of our audit we will update our understanding around procurement. The OAG are currently considering what data might usefully be gathered during the 2018/19 annual audit process for their work programme for the next three years. We will advise you of any work outside of the normal annual audit process related to the work programme (if any) in due course.



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Objective

Our audit approach requires us to obtain an understanding of an entity's internal controls, sufficient to identify and assess the risks of material misstatement of the financial statements and performance information whether due to fraud or error.

Obtaining an understanding of internal control relevant to the audit

Our audit approach includes an evaluation of the 'design and implementation' of internal controls at the entity level irrespective of whether or not we plan to rely on internal controls in performing the audit. This is because an understanding of the internal control environment is fundamental to our assessment of audit risk. In addition, we will evaluate the 'operating effectiveness' of internal controls at the business cycle level to rely on these underlying controls to address the risk of material misstatement of the financial statements and performance information.

Our understanding of the internal controls environment will include reviewing controls as applicable in the following areas:

- Entity level controls;
- Controls over the financial reporting process;
- Controls over the payroll, revenue and expenditure processes; and
- Controls over the IT systems and environment.

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

Our audit is not designed to provide assurance as to the overall effectiveness of the controls operating within the Council, although we will report to management any recommendations on controls that we may have identified during the course of our audit work.

IT specialist involvement

In performing our audit of South Waikato District Council for the year ended 30 June 2019, we will also incorporate IT specialists within our engagement team to better understand and assess the IT processes and the control environment.

The areas which we have planned to engage specialists are:

- NCS
- LINUX
- Windows AD
- MYSQL Database



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The following matters are communicated in accordance with the requirements of the Auditor-General auditing standards which incorporate the New Zealand auditing standards:

<p>Independence</p>	<p>We confirm that we have maintained our independence in accordance with the independence requirements of the <i>Auditor-General's Statement on Professional and Ethical Standard 1 (Revised): Code of Ethics for Assurance Practitioners</i> issued by the Office of the Auditor-General and the <i>Professional and Ethical Standard 1 (Revised): Code of Ethics for Assurance Practitioners</i> issued by the NZ Auditing and Assurance Standards Board and, in our professional judgement, we are independent and the objectivity of the audit engagement partner and audit staff are not compromised.</p>
<p>Professional fees/ Relationships</p>	<p>Our fees for the year ending 30 June 2019 will be in accordance with our Audit Proposal Letter dated 19 May 2017.</p> <p>In performing our audit of South Waikato District Council for the year ending 30 June 2019 no relationships or other matters exist between the firm, network firms and the Council that, in our professional judgement, may reasonably be thought to bear on independence.</p>
<p>Consideration of fraud</p>	<p>The primary responsibility for the prevention and detection of fraud rests with management and the Councillors, including designing, implementing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements and performance information as a whole are free from material misstatement, whether caused by fraud or error.</p> <p>ISA (NZ) 240 <i>The auditor's responsibility to consider fraud in an audit of financial statements</i> requires us to obtain an understanding of how those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the Council and the internal control that management has established to mitigate these risks.</p> <p>We will make inquiries of management and others within the entity as appropriate, regarding their knowledge of any actual, suspected or alleged fraud affecting the Council. In addition we are required to discuss the following with the Council:</p> <ul style="list-style-type: none"> • whether the Council has knowledge of any fraud, suspected fraud or allegations of fraud; • the role that the Councillors exercises in oversight of Council's assessment of the risks of fraud and the design and implementation of internal control to prevent and detect fraud; • the Councillors' assessment of the risk that the financial statements may be materially misstated as a result of fraud. <p>We will be seeking representations in this area from the Council in due course.</p>



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The following matters are communicated in accordance with the requirements of New Zealand auditing standards:

Management override of controls

We are required to design and perform audit procedures to respond to the risk of management's override of controls which will include:

- having understood and evaluated the financial reporting process and the controls over journal entries and other adjustments made in the preparation of the financial statements, test the appropriateness of a sample of such entries and adjustments and make enquiries about inappropriate or unusual activities relating to the processing of journal entries and other adjustments;
- a review of accounting estimates for biases that could result in material misstatement due to fraud, including whether the judgements and decisions made in making the estimates included in the financial statements, even if individually reasonable, indicate a possible bias on the part of management. We will also perform a retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements; and
- obtain an understanding of the business rationale of significant transactions that we become aware of that are outside the normal course of business or that otherwise appear to be unusual given our understanding of the entity and its environment.



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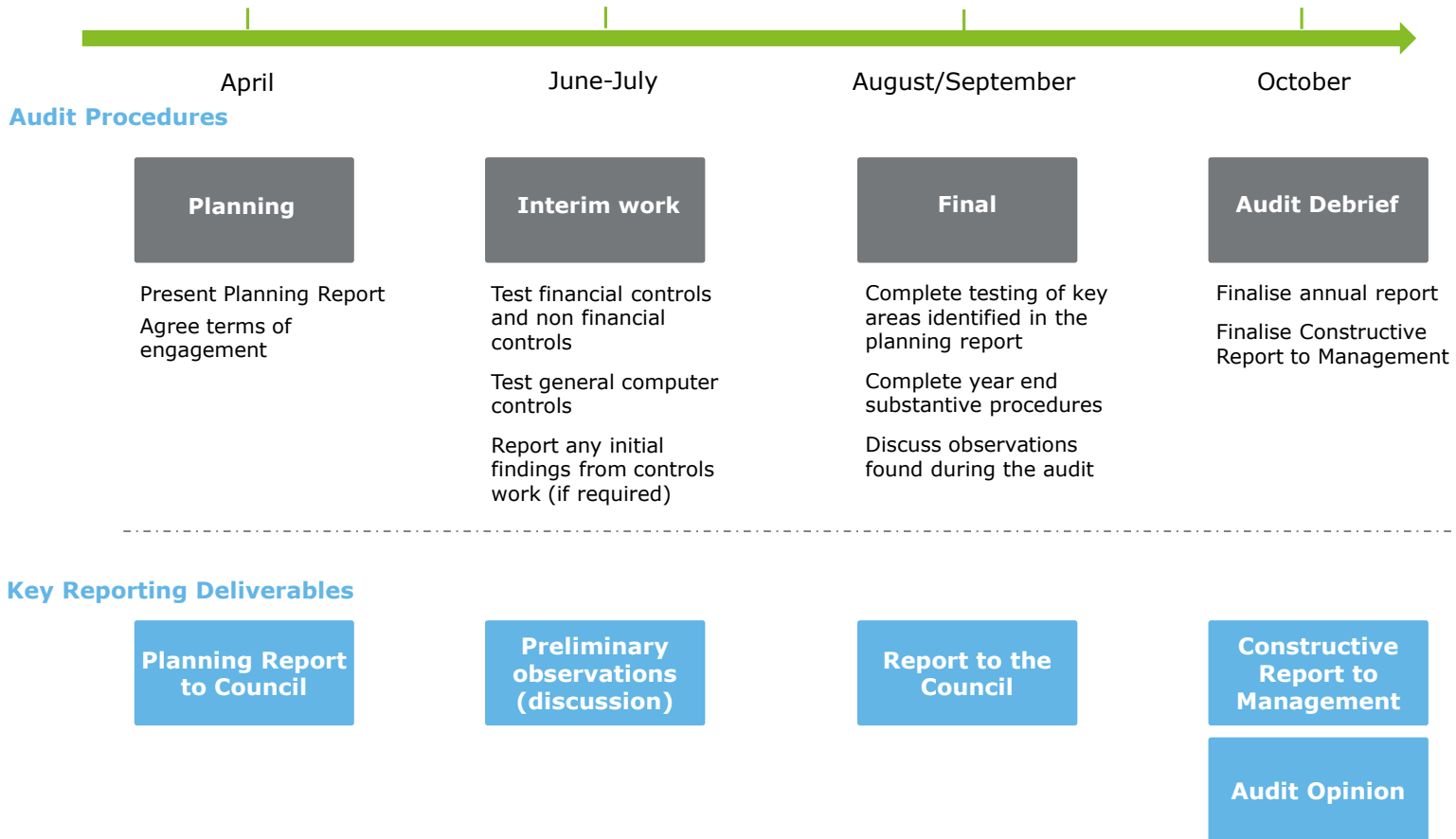


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All local authorities must prepare an annual report for the year ending 30 June 2019 containing the information required by Part 3 of Schedule 10 of the LGA. This must be adopted, by resolution, within 4 months after 30 June 2019, i.e. by the end of October 2019.

Set out below is the approximate expected timing of our reporting and communication with the Council.



Our team

We set out below our audit engagement team.

Client Service Team

Role and Responsibilities



Bruno Dente
Engagement Partner

- Appointed Auditor on behalf of the Auditor-General
- Provides oversight over the audit
- Ensures a quality audit service
- Liaises with the Councillors



Nalina Dheda
Associate Director

- Day-to-day oversight of the audit engagement and team
- Provides project management to ensure deadlines are being met
- Assists with technical and general queries
- Liaises with management



Courtney Andela
Supervisor

- Onsite management of the team
- Ensures appropriate staff delegation and review
- Liaises with management and staff

Other

Mike Hawken– Partner

Engagement quality control reviewer

Reenesh Bhana - Director

Information Technology Specialist



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