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Northland Regional Council

Report to the Council

for the year ended 30 June 2018

19 September 2018

Bill Shepherd
Chair, Northland Regional Council
Private Bag 9021
Whangarei 0148

Dear Mr Shepherd

Report to the Council & Audit Working Party for the year ended 30 June 2018

In accordance with our normal practice, we include in the attached report all matters arising from our audit of the consolidated financial statements of Northland Regional Council (NRC or Council) and its subsidiaries (Group) for the year ended 30 June 2018 which we consider appropriate for the attention of the Audit Working Party ("the Committee"). These matters have been discussed with management of the Company and their comments have been included, where appropriate.

We look forward to the Committee meeting on 26th September 2018 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.

We have substantially completed our audit subject to the satisfactory resolution of the outstanding matters detailed in this report.

This correspondence is part of our ongoing discussions as auditor in accordance with our engagement letter dated 24 January 2017 and as required by the Office of the Auditor General's auditing standards. The ultimate responsibility for the preparation of the financial statements rests with the Council.

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.

Yours faithfully



Peter Gulliver
Partner
for Deloitte Limited
On behalf of the Auditor-General

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Status of the audit

Our audit of the consolidated financial statements is substantially complete, subject to the outstanding matters noted in the *Audit scope* section.

Audit scope

We have performed an audit of Council and Group for the year ended 30 June 2018 in accordance with the Office of the Auditor General's (OAG) auditing standards. Our audit is performed pursuant to the requirements of the Local Government Act 2002 (the Act), with the objective of forming and expressing an opinion on the financial statements, performance information, and other requirements of Schedule 10.

Areas of focus

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

1. Legislative compliance: rates revenue
2. Asset valuations and assessment of carrying value for infrastructure assets
3. Governance and valuation of investment assets
4. Financial reporting associated with the Marsden to Oakleigh rail corridor
5. Validity of fees and charges revenue



Additional areas of focus required by the OAG:

1. Fraud
2. Performance, waste, and probity
3. Managing conflicts of interest and related party transactions
4. Legislative compliance and more specifically of rates
5. Financial prudence



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In performing our audit we have not identified any material weaknesses in internal controls which would impact upon our ability to provide our opinion on the financial statements.

We have identified a number of recommendations which will be communicated under separate cover in the management letter.

Summary of unadjusted differences



In performing our audit of Northland Regional Council for the year ended 30 June 2018 we have not identified any uncorrected misstatements or omitted disclosures that could, either individually or in aggregate, have a significant effect on the financial statements for the year ended 30 June 2018.

There are no unadjusted items relating to NRC.

The only unadjusted item relates to Marsden Maritime Holdings Ltd, and is therefore outside of Council's control.

Other communications



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

- Independence
- Professional fees / relationships
- Written representations
- Non-compliance with laws and regulations
- Accounting policies / financial reporting
- Related parties

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Appendix A: Analysis of professional fees



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Purpose of report

This report has been prepared for Council and the Audit Working Party (“Committee”) and is part of our ongoing discussions and as required by the OAG’s auditing standards. This report includes only those matters that have come to our attention as a result of performing our audit procedures and which we believe are appropriate to communicate to the Council and the Committee. The ultimate responsibility for the preparation of the financial statements rests with the Council.

Responsibilities

We are responsible for conducting an audit of Council and Group for the year ended 30 June 2018 in accordance with the OAG’s 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 with the objective of forming and expressing an opinion on the financial statements, performance information, and other requirements of Schedule 10 that have been prepared by management with the oversight of the Councillors. The audit of the financial statements does not relieve management or the Councillors of their responsibilities.

Outstanding matters

As at the date of preparing this report the following matters in respect of our audit are outstanding:

- Procedures relating to the final disclosures in the financial statements;
- Appropriate procedures relating to subsequent events up to the date of our audit opinion;
- Receipt of the signed management representation letter; and
- Adoption of the financial statements and annual report by Council.



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Audit risks

Our audit procedures were focused on those areas of the Council's activities that are considered to represent the significant risk areas which include:

- 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.

These areas of focus were identified as a result of:

- the risk assessment process undertaken during the planning phase of our engagement and presented to the Committee in our audit strategy documents dated 1 June 2018;
- our understanding of the risks faced by the 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 organisation and the environment it operates in since the last annual report and financial statements.

The identification of areas of focus included consideration of the significant qualitative aspects of the entity's accounting practices, including judgements about accounting policies, accounting estimates and financial statement disclosures identified during the course of our audit of the financial statements.

On the following pages we provide a summary of our audit findings in relation to each of our areas of focus. These findings are based on our audit procedures performed for the year ended 30 June 2018.

Enhancements Planned for FY19

During the year end audit one item was identified that required adjustment. This related to the fair value of the loan made to NEST, reflecting the fact the loan was advanced at a lower than market interest rate. This resulted in a \$295k "accounting adjustment" to the value of the loan which will unwind over the term of the loan.

In order to reduce the chances of such items being identified at year end in the future we have discussed with management the following enhancements to the audit process for FY19:

- Deloitte to review Council meeting minutes on a quarterly basis to identify any matters of audit interest;
- Management to provide us with a copy of the quarterly reporting pack (incorporating management accounts); and
- Scheduling of quarterly catch up phone calls to enable relevant issues to be discussed and accounting outcomes agreed.

These enhancements will provide more structure to ensure any accounting, audit and relevant business related matters are identified, discussed and agreed with management during the year.



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Audit risks dashboard

Area of focus	Significant risk	Auditing Standard Fraud risk	Planned controls testing approach	Controls testing conclusion	Level of management judgement required	Consistency of judgements with Deloitte expectations
Legislative compliance: rates revenue	✓	✗	D+I OE	Satisfactory		
Fees and charges revenue	✓	✓	D+I	Satisfactory		
Asset valuations and assessment of carrying values of infrastructure assets	✗	✗	D+I OE	Satisfactory		
Governance and valuation of investment assets	✗	✗	D+I	Satisfactory		
Financial reporting associated with the Marsden to Oakleigh rail corridor	✗	✗	D+I	Satisfactory		

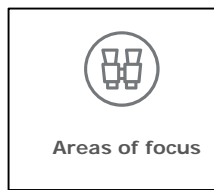
Level of management judgement required



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

Consistency of judgements with Deloitte expectations

Overly prudent, likely to lead to future credit Overly optimistic, likely to lead to future debit.



Areas of focus - continued

Audit findings

Area of focus	Audit response	Audit findings
<p>Legislative Compliance: Rates Revenue</p> <p>Over recent years there have been a number of issues within the Local Government sector arising from rates not being set in accordance with the Local Government (Rating) Act 2002(LGRA). Compliance with the detail of the LGRA is critical: if the rate is not within the range of options and restrictions provided for in that Act, it may not be valid.</p> <p>Management and Council need to continue to ensure that the requirements of the LGRA are adhered to and that there is consistency between the rates resolution, the Funding Impact Statement for that year, and the Revenue and Financing Policy in the respective LTP or Annual Plan (AP).</p> <p>We note that on 27 March 2018 the Court of Appeal validated NRC's rates collected in the Kaipara District for the years 2011 to 2015, effectively overturning the High Court decision to quash these rates from the previous year. This means the rates and penalties are valid and payable.</p>	<p>We addressed this issue by:</p> <ul style="list-style-type: none"> • Keeping up to date on the status of the legal issue and in particular whether any leave to appeal is granted; • Where applicable, reviewing relevant legal documentation and correspondence with legal advisors; • Evaluating the requirement for provisions and contingent liability disclosures, if required; • Completing a 'rates questionnaire' compiled by the OAG, (similar to that completed in the prior year), to assist us in assessing legislative compliance in a broader sense with respect to rates. 	<p>The Court of Appeal decision in March 2018 and the subsequent denial of leave for this decision to be appealed in the Supreme Court concludes the historical rating issues associated with legal challenges in relation to NRC's rates.</p> <p>The Council has, since balance date, settled its interest in rates claimed in RB and HE Rogan v KDC and NRC.</p> <p>We identified no material misstatement during our testing on rates.</p> <p>We note that Council uses Simpson Grierson to review its rating documentation prior to its adoption. This is a good process that should be continued.</p>



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Audit findings - continued

Area of focus	Audit response	Audit findings
<p>Fees and charges revenue</p> <p>There is a risk that fees and charges revenues may be misstated if they are calculated incorrectly or revenue is recognised incorrectly.</p>	<p>We tested a sample of fees and charges revenue for accuracy and ensured that revenue is recognised at the right time.</p>	<p>We identified no material misstatement in respect of fees and charges revenue</p>



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Audit findings - continued

Area of focus	Audit response	Audit findings
<p>Asset valuations and assessment of carrying values of infrastructure assets</p> <p>NRC recognises the following classes of asset at fair value:</p> <ul style="list-style-type: none"> • Infrastructure assets (only revalued every 3 years – FY17 being the last valuation hence only a desk top exercise is required in FY18); • Land and buildings; • Investment properties; • Emissions trading units; and • Forestry assets <p>Determining the fair value of assets requires management and independent valuers to make a number of judgments around the appropriate valuation methodology and assumptions. Valuation outcomes are often sensitive to variations in the key assumptions.</p> <p>This gives rise to a risk around the valuation of these assets at year-end and the treatment of movements in fair value during the year.</p>	<p>In order to address this risk, we:</p> <ul style="list-style-type: none"> • Obtained the independent valuations of the relevant asset classes; • For infrastructure assets, reviewed the desk top reports from the valuers to identify any material fluctuations in value of assets not revalued in the current year; • Obtained representations directly from the independent valuers confirming their valuation methodology; • Reviewed the key underlying assumptions used by the independent valuers to determine whether these assumptions were reasonable and in line with NZ generally accepted accounting practice (NZ GAAP); • Held various discussions with the valuers as appropriate; and • Determined whether the revaluation transactions are correctly accounted for and disclosed in the financial statements in compliance with NZ GAAP. 	<p>We identified no material misstatement in respect of asset valuations.</p> <p>We have specifically reviewed and tested the assumptions for the following asset classes, which includes liaising with the valuers (as noted below):</p> <ul style="list-style-type: none"> • Infrastructure assets desk top review (Aon) • Land and buildings (Telfer Young) • Investment properties (Telfer Young) • Forestry assets (Jensmax) <p>ETU assets were assessed against a publically available market index.</p> <p>For completeness we note Council purchased a property referred to as the McEwan Road Property during the year. The price paid was \$717,500 and it was revalued down to \$400,000 at year end on the basis a portion of the property has a rail corridor designation. This strategic value to Council is not recognised by a fair value assessment by the valuer.</p> <p>Subsequent discussions with the valuer indicated that it may have been appropriate to assign a value to that rail corridor portion reflecting its use for grazing activities. We understand this would be an impact of less than \$100,000 and suggest it is picked up in next year's valuation process.</p>



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Area of focus	Audit response	Audit findings
<p>Governance and valuation of investment assets</p> <p>NRC has a significant portfolio of investment assets including property, funds under management and a controlling stake in Marsden Maritime Holdings which holds 50% of the region's port. The strategy around the use of this investment portfolio and the returns received are an important component of Council's funding of its activities. Council has recently reviewed its property portfolio and as a consequence a number of properties have moved between owner occupied properties, investment properties and held for sale.</p> <p>This gives rise to risks around the robustness of governance processes around these investments, the valuation of the investments at year-end, and whether the appropriate accounting treatment has been applied in respect of those valuations, of movements in value and gains/losses on sale during the year, and in the classification of items held for sale at year-end.</p>	<p>We addressed these risks through:</p> <ul style="list-style-type: none"> • Evaluating the governance processes and controls around investment assets. This involved determining whether investment mandates and parameters are monitored as part of governance arrangements, including the risk/return strategy employed and the adequacy of reporting in this area • Ascertaining the quality of controls in place at the investment manager and custodian by obtaining and reviewing internal control audit reports • Reviewing the accounting treatment applied to investment assets, including those held for sale at year-end, against relevant accounting standards • Reviewing the calculation of investment property asset fair values at year-end, to address any areas of complexity or judgement in the calculations 	<p>We identified no material misstatement in respect of investment assets and found the control environment to be appropriate in relation to monitoring investment mandates and performance.</p> <p>We note that Council has continued its policy of borrowing for certain projects rather than drawing down the investment funds. In the current year, the Council has borrowed \$8.5m (PY: nil) via its Local Government Funding Agency arrangements and repaid its \$3m fixed rate loan. The total borrowings at year end is \$18.5m (PY: \$13m).</p>



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Area of focus	Audit response	Audit findings
<p>Financial reporting associated with the Marsden to Oakleigh rail corridor</p> <p>Council has a joint venture with Kiwirail in relation to a railway corridor. Whilst there is still significant time remaining with respect to the land use designation, this arrangement is tying up Council funds as a result of:</p> <ul style="list-style-type: none"> • The \$5.7m receivable due from Kiwirail reflecting costs incurred by Council on behalf of its JV partner; • Land and development costs of \$3.1m; and • Related investment property assets of \$3.4m <p>There is a valuation risk in relation to the receivable and investment property assets recognized in the statement of financial position.</p>	<p>We addressed this risk by:</p> <ul style="list-style-type: none"> • Understanding the intentions of the JV parties so as to determine how Council realises value from its investment in this venture; • Evaluating management's annual assessment as to whether any impairment charge on the value of the investment is required; • Reviewing the JV arrangements and discussing any changes in intentions with management; and • Reviewing the underlying assets forming part of the investment to ensure they are appropriately recognised and valued. <p>We also reviewed the financial statement disclosures to ensure they remain relevant and appropriate.</p>	<p>We identified no material misstatement in respect of financial reporting associated with the Marsden to Oakleigh railway corridor.</p> <p>We do note that judgement is required by management as to whether these assets will be recovered for their carrying value, and in particular the \$5.7m due from Kiwirail.</p> <p>We also note that the development land valued at \$3.1m (recognised as inventory in the financial statements) will be gifted to Kiwirail should the rail corridor proceed. Notwithstanding the fact the asset will be gifted (i.e. no value realised), the relevant financial reporting standards require it to be recognised at cost.</p>



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Other areas of focus

OAG and other audit brief requirements - Audit findings

Area of focus	Audit response	Audit findings
<p>Fraud</p> <p>The primary responsibility for the prevention and detection of fraud rests with management and the Council, 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 auditor, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.</p>	<p>Throughout the audit process we remained alert for issues that indicate fraud.</p> <p>Specifically our work involved:</p> <ul style="list-style-type: none"> • Formal inquiries of the Council, management and others within the entity regarding the risks of fraud within the Council including the processes in place to mitigate those risks; • Documenting systems and internal controls used by the Council to prevent and detect fraud; and • Reviewing the current fraud policy to ensure it follows OAG guidance and ensure management and employees are aware of the fraud policy and its content. 	<p>We identified no material misstatement in respect of fraud.</p>



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Area of focus	Audit response	Audit findings
<p>Performance, waste and probity</p> <p>Ensuring that Parliament's expectations are met with respect to use of rate payer funds is a key feature of any audit in the public sector.</p>	<p>Our audit approach included a specific programme of work covering the following aspects:</p> <ul style="list-style-type: none">• Confirming Council has the appropriate policy framework for areas such as delegated authorities, fraud, conflicts of interest etc.• Testing certain areas of sensitive expenditure to ensure spending is appropriate and authorised in accordance with policy and best practice.• Reviewing areas such as credit card expenditure, fuel card expenditure, and mobile phone expenditure.• Remaining alert for the existence of any confidentially clauses in employment contracts that may prevent disclosure of information and thus reduce the level of transparency of spending of public monies	<p>We did not identify any issues in respect of performance, waste, and probity.</p>



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OAG and other audit brief requirements - Audit findings

Area of focus	Audit response	Audit findings
<p>Managing conflicts of interest and related party transactions</p> <p>Councils are required 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.</p>	<p>Our audit procedures on related party disclosures included searching public records for potential related party relationships (such as the Companies Office website). We also ensured any entries in the interests register were individually assessed, and those which met the definition of a related party transaction during the year were disclosed in the Annual Report. This included remuneration disclosures relating to the Councillors and key management personnel.</p>	<p>We did not identify any issues in respect of conflicts of interest and related party transactions.</p>

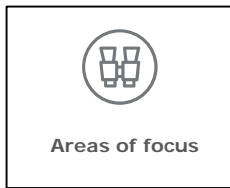
Area of focus	Audit response	Audit findings
<p>Legislative compliance and more specifically legality of rates</p> <p>The Council is subject to significant regulatory and legislative compliance requirements. The Council needs to have adequate systems in place to monitor compliance with legislation along with any changes occurring in the applicable legislation.</p>	<p>Our audit procedures included looking at Council's processes for ensuring legislative compliance, including specifically testing compliance with legislation that materially impacts on the financial statements. This included the Local Government Act 2002 and the Local Government (Rating) Act 2002. The impact of the Rogan case on rates was addressed through the Area of Focus identified above ('Legal proceedings regarding rates').</p>	<p>We identified no issues in respect of legislative compliance.</p>



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OAG and other audit brief requirements - Audit findings

Area of focus	Audit response	Audit findings
<p>Financial prudence</p> <p>Councils are required to include appropriate benchmarking reporting in the Annual Report as required by the Local Government (Financial Reporting and Prudence) Regulations 2014.</p>	<p>Our audit procedures included reviewing the disclosures and re-computing key ratios to determine whether Council was in compliance with these regulations.</p>	<p>We identified no issues in respect of the financial prudence disclosures.</p>



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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 whether due to fraud or error.

We remind you that our audit was not designed to express an opinion on the effectiveness of the controls operating within the Council, although we will be reporting to management under separate cover any recommendations on controls that we identified during the course of our audit work. The matters being communicated are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported. Recommendations for improvement should be assessed by you for their full commercial implications before they are implemented.

Internal controls assessment

In performing our audit of Council for the year ended 30 June 2018 we have not identified any significant deficiencies in internal controls which would impact upon our ability to provide our opinion on the financial statements for the year ended 30 June 2018; however, we did note a number of control observations and expect to issue a Management Letter with our recommendations shortly.



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Unadjusted differences

For the consolidated financial statements our materiality was \$1,100,000 (prior year: \$500,000).

In performing our audit of Northland Regional Council for the year ended 30 June 2018 we have not identified any uncorrected misstatements that management believe could, either individually or in aggregate, have a material effect on the consolidated financial statements. The following unadjusted items are noted:

Unadjusted misstatements identified	Assets Dr/(Cr) (\$'000)	Liabilities Dr/(Cr) (\$'000)	Equity Dr/(Cr) (\$'000)	Profit or loss Dr/(Cr) (\$'000)
Current year:				
Council: No items noted				
Group: The following item was reported by MMHL's auditors. To record claims for remedial damages to the revetment walls that were damaged during the construction of the new boat ramp We note this was disclosed as a contingent liability whereas MMHL's auditors thought a provision was more appropriate.		(128)		128
Prior year:				
N/A				
Total		(128)		128



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Omitted disclosures assessed by management as not being material

In performing our audit of Northland Regional Council for the year ended 30 June 2018, no material uncorrected disclosure deficiencies were detected in the financial statements.



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

Independence	<p>We confirm that we have maintained our independence in accordance with the independence requirements of the OAG and <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>
Professional fees/ Relationships	<p>A summary of all fees charged during the year ended 30 June 2018 for audit and non-audit services provided by Deloitte Limited to the Council are detailed in Appendix A.</p> <p>In performing our audit of the Council for the year ended 30 June 2018 no other relationships or other matters existed between the firm, network firms and the Council that, in our professional judgement, may reasonably be thought to bear on our independence.</p>
Written Representation	<p>A copy of the representation letter to be signed on behalf of the Council has been circulated separately.</p>
Non-compliance with laws and regulations	<p>In performing our audit of Northland Regional Council for the year ended 30 June 2018 we did not become aware of any instances of non-compliance with applicable laws and regulations that may have an impact on the determination of material amounts and disclosures in the financial statements.</p>
Accounting policies / Financial reporting	<p>There were no material changes in accounting policies during the year ended 30 June 2018.</p> <p>In performing our audit of Northland Regional Council for the financial year ended 30 June 2018 we have not become aware of any significant qualitative aspects of the entity's accounting practices, including judgements about accounting policies, accounting estimates and financial statement disclosures that need to be communicated to the Committee, other than those in the <i>Areas of focus</i> section.</p>
Related parties	<p>In performing our audit of Council for the financial year ended 30 June 2018 no significant related party matters other than those reflected in the financial statements came to our attention that, in our professional judgement, need to be communicated to the Committee.</p>



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Appendix A: Analysis of professional fees

We summarise below our agreed audit fees and fees for other services performed during the current financial year. The fees below are exclusive of GST and disbursements.

Professional fees	2018 (CY) (\$)	2017 (PY) (\$)
Fees payable for the audit of the Council's annual report and summary financial statements	115,000	113,000
Audit of long term plan	76,125	-
Other assurance engagements relating to the Debenture Trust Deed and audit of the Register of Security Stock	5,500	5,000
Payroll review – extension of audit procedures	10,000	-
Total audit related and other assurance fees	206,625	118,000
Advisory services (accounting advice)	-	11,000
Total non-audit fees	-	11,000
Total fees	<u>222,125</u>	<u>141,000</u>



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