Kapiti Coast District Council

Report on Control Findings

10 September 2015

Building a better working world

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Building a better working world

10 September 15

Wayne Maxwell
Kapiti Coast District Council
Private Bag 601
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Dear Wayne

Report to Management

We have completed our audit of the financial statements of Kapiti Coast District Council ("the Council") for the year ended 30 June 2015.

This management letter includes all control matters and issues arising from our audit findings that we consider appropriate for review by management.

In accordance with New Zealand Auditing Standards we performed a review of the design and operating effectiveness of Kapiti Coast District Council's significant financial reporting processes. Our audit procedures do not address all internal control and accounting procedures and are based on selective tests of accounting records and supporting data. They have not been designed for the purposes of making detailed recommendations. As a result our procedures would not necessarily disclose all weaknesses in Kapiti Coast District Council's internal control environment.

We wish to express our appreciation for the courtesies and co-operation extended to our representatives during the course of their work. If you have any questions or comments, please do not hesitate to call me on (04) 470 8641.

Yours faithfully

Grant Taylor
Partner

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1. Overview

1.1 Overview of Risk Ranking System

High Needs significant improvement	**Immediate corrective action is required.** These recommendations relate to a serious weakness which exposes the organisation to a material extent in terms of achievement of corporate objectives, financial results or otherwise impair the Council's reputation.
Moderate Needs substantial improvement	**Corrective action is required, generally within 6 months**. A control weakness, which can undermine the system of internal control and/or operational efficiency and should therefore be addressed.
Low Needs some improvement	**Corrective action is required, generally within 6 to 12 months**. A weakness which does not seriously detract from the system of internal control and/or operational effectiveness/efficiency but which should nevertheless be addressed by management.

1.2 Summary of Recommendation Issues/Risk Ranking

The following is a profile of the management recommendations that have been submitted to local management:

Kapiti Coast District Council	**High** Needs significant improvement	**Moderate** Needs substantial improvement	**Low** Needs some improvement
Capital Work In Progress (WIP)		✓	
Non-financial performance reporting – review of underlying data		✓	
Treatment of replaced assets cost		✓	
Fixed Assets Register			✓
Timely review of policies			✓
Building Consents			✓
Capital expenditure policy			✓
Total	**-**	**3**	**4**

1.3 Disclaimer

Issues identified are only those found within the course of the audit for year ended 30 June 2015. Recommendation issues are intended solely for the use of Council's management. We disclaim any assumption of responsibility for any reliance on this report, to any person other than the Council or for any purpose other than that for which it was prepared.

2. Observations

Medium Risk Category Issue

Issue: Timely Capitalisation of Capital Work In Progress (WIP)	
Observation	As at 30 June 2015 the Council had capitalised $24.1 million of work in progress (WIP) in relation to a range of projects that were active during the period. Approximately 80% of this was capitalised in the months of May and June 2015 respectively. It is our understanding that the capitalisation process tends to occur at later parts of the year as a result of the Council's project cycle. However we have identified instances where it has taken a lengthy period to capitalise items. For example library books that were purchased on 26 June 2014 were not capitalised until 30 June 2015. There are also instances where the project has been capitalised but certain costs have been left in WIP; for instance engineering work of $151,771 has been in WIP since 2012 and an audit adjustment was raised to capitalise this at year end. Failure to capitalise WIP on a timely manner results in depreciation expense not being recognised appropriately. As depreciation is funded by rates there is a risk that the Council could not only understate depreciation expenditure but also have funding shortfalls.
Recommendation	The risks we identified in our prior year review continue to be apparent, albeit at a much lower level. We recommend that management perform an overall review on a periodic basis of each WIP project to ensure items are capitalised on a timely basis. We expect management to implement adequate processes and controls in place to identify assets that are no longer WIP in nature.
Management Response	An external resource was engaged to focus solely on fixed asset recognition and accounting in early January. This dedicated focus also contributed to asset capitalisations in May and June 2015. Management will however continue to implement adequate resource, processes and controls to identify assets that are no longer WIP in nature.
Responsibility	Mark de Haast, Financial Controller

Issue: Non-financial performance reporting – review of underlying data	
Observation	Council uses its management information system, “Magiq”, to report results relating to achievement of service performance measures contained in the statement of service performance. We noted the following: ▶ In most cases, the information is maintained on spreadsheets stored on common directories accessible by a wide range of Council staff prior to being uploaded into NCS. ▶ For some measures data is maintained by the external contractors and uploaded directly into NCS without a peer review. ▶ There were no formal mechanisms designed to ensure the integrity of reported results once the data has been uploaded into NCS. As part of the LTP we understand KCDC has undertaken a review of tier 1 KPIs and their measures and these have been included in the Long Term plan that was adopted on 25 June 2015. Further work is also scheduled in 2015/16 to further streamline data collection methods during the 2015/16 in line with our recommendation on the NCS systems.
Recommendation	We recommend KCDC to continue to streamline the systems, processes and quality control over KPI reporting necessary to ensure actual performance is captured, recorded and reported appropriately.
Management Response	Council will continue reviewing all KPI’s and improving how KPI data is collected and stored. Magiq now provides functionality to capture KPI data. This will be further investigated against the above observations.
Responsibility	Kevin Black, Manager Corporate Planning and Reporting

Issue: Subsequent Costs and de-recognition of Replaced Asset	
Observation	The Council is regularly renewing or upgrading fixed assets, for instance road assets are resurfaced every few years. According to NZ PBE IPSAS 17 para 24 the carrying amount of those parts that are replaced should be derecognised. We understand this is not occurring at present.
Recommendation	We recommend the asset costs and accumulated depreciations be de-recognised when assets are replaced.
Management Response	Historically, this formed part of the three yearly asset revaluations. From 1 July 2015/16, Council will undertake yearly asset revaluations. Management will however continue to implement adequate resource, processes and controls to identify assets that have been replaced and should be de-recognised.
Responsibility	Mark de Haast, Financial Controller

Low Risk Category Issues

Issue: Fully Depreciated Property, Plant & Equipment	
Observation	As at 30 June 2015 the Council has $12.3 million of fully depreciated assets on its fixed assets register, $5.5 million of this relates to Computers and Office Equipment. We have identified a number of items where it is unlikely future economic benefits or service potential is expected and hence should be derecognised. For example there are computers from 1999 with a cost value of $93,405 in the Fixed Asset Register. There is a risk that assets that are no longer in use remain in the Fixed Assets Register and the general ledger hence grossing up both the cost and accumulated depreciation on the balance sheet.
Recommendation	We recommend that management undertake a review of fully depreciated assets and where no future economic benefits or service potential is expected the asset be derecognised and removed from the fixed assets register.
Management Response	Management will continue to implement adequate resource, processes and controls to derecognise assets that have been fully depreciated and will only remove such assets from the fixed asset register where no future economic benefits and/or or no service potential is expected from such assets.
Responsibility	Mark de Haast, Financial Controller

Issue: Timely review of expenditure policies	
Observation	We noted the following policies had not been reviewed for a considerable period: ▶ Sensitive Expenditure ▶ Disposal of Assets ▶ Travel Expenditure ▶ EPO ▶ Office Supplies Purchasing Council's own practice is to review these policies every two years. In particular, we noted the sensitive expenditure policy was last updated in 2008 and was therefore due to be reviewed in 2010. We understand this policy has been drafted and is currently under review with an aim to implement it in the financial year ending 30 June 2016.
Recommendation	Policies should be reviewed periodically to ensure that they correctly reflect Council's expectations
Management Response	Council's corporate policy review period has changed to five yearly or earlier, if required. A corporate policy register (approximately 50 policies) has been created and a prioritised review cycle is underway. The policies identified above have been blended into a draft Procurement Policy and a draft Sensitive Expenditure Policy. These were discussed with the Senior Leadership Team in September 2015. Requested changes are being processed for final approval by the Chief Executive before 30 November 2015.
Responsibility	Mark de Haast, Financial Controller

Issue: Building and resource consents	
Observation	Council retain a bond when building and resource consents are requested. These are held as a liability until work is completed and the customer requests a refund. At 30 June 2015 bonds held for building consents totalled $428k and resource consents $403k. We noted some deposits date back to 2007. Given the age of some of these deposits we suggest the Council review the likelihood of work being completed and consider whether some of these liabilities can be released. We understand KCDC is in the process of reviewing the bonds with the aim of refunding where appropriate.
Recommendation	We reiterate our recommendation that Council continue to investigate the owners of these bonds and return them where appropriate or elect to be the holder and return the money to the Inland Revenue Department if unclaimed.
Management Response	During the year, Council refunded $359,000 of vehicle damage and resource consents bonds. Council will continue to regularly monitor these bonds and return them when appropriate. In addition, management will fully consider the requirements and/or impacts on Council electing to be the holder and returning the money to the Inland Revenue Department if unclaimed.
Responsibility	Mark de Haast, Financial Controller

Issue: Capital Expenditure Policy	
Observation	KCDC's capital expenditure policy states items below $1000 should not be capitalised regardless of the nature of the item. We reviewed the capital additions listing for the year and noted a small number of items below the $1000 threshold that had been capitalised. We further noted an instance where an operating expenditure items were recorded in the capital work in progress. For example a cost of a plumber to unblock drains has been recorded as capital, this is repairs & maintenance. Although the amounts were immaterial, we consider absence of adequate review of expenditure capitalisation creates a risk that there are items of expenditure that have been incorrectly capitalised during the period hence overstating assets while understating operating expenditures.
Recommendation	We recommend that KCDC capitalisation guidelines are followed when making the decision on whether to capitalise expenditure while at the same time reviewing the nature of items before being recorded as capital expenditure.
Management Response	Management will continue to implement adequate resource, processes and controls to ensure that assets capitalisation guidelines are followed including reviewing the nature of items before being recorded as capital expenditure.
Responsibility	Mark de Haast, Financial Controller

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