

Chairperson and Committee Members
AUDIT AND RISK COMMITTEE

21 SEPTEMBER 2017

Meeting Status: **Public**

Purpose of Report: For Information

**AUDIT REPORT TO MANAGEMENT FOR THE YEAR ENDED
30 JUNE 2017**

PURPOSE OF REPORT

- 1 This report provides the Audit and Risk Committee with a summary of Ernst & Young's Report on Control Findings for the year ended 30 June 2017.

DELEGATION

- 2 The Audit and Risk Committee has delegated authority to consider this report under the following delegation in the Governance Structure, Section B.3.
 - *Reviewing and maintaining the internal control framework*
 - *Obtaining from external auditors any information relevant to the Council's financial statements and assessing whether appropriate action has been taken by management in response to the above.*

BACKGROUND

- 3 In accordance with New Zealand Auditing Standards, Ernst & Young (Audit) performed a review of the design and operating effectiveness of the Council's significant financial reporting processes as part of their audit for the year ended 30 June 2017.
- 4 As at 30 June 2016, Council had eight open control findings which ranged from high to low risk. Two of these control findings were identified during the 2015/16 audit with the remaining six control findings originating from 2014/15.
- 5 Regular progress updates on the 2015/16 control findings were provided at each Audit and Risk Committee meeting.
- 6 In addition to this, a separate detailed report on the six open control findings from 30 June 2015 was tabled at the Audit and Risk Committee meeting on 27 April 2017, with a further progress update provided to the Committee at its meeting on 10 August 2017.
- 7 Audit's Report on Control Findings for the year ended 30 June 2017 is attached as Appendix 1. This report details all of the internal control matters that were considered appropriate for review by management.

CONSIDERATIONS

Summary Report on Control Findings

- 8 Control risk matters and/or issues are classified as either high, moderate or low. Control risk definitions are as follows:
- **High Risk** – matters and/or issues are considered to be fundamental to the mitigation of material risk, maintenance of internal control or good corporate governance. Action should be taken either immediately or within three months.
 - **Moderate Risk** – matters and/or issues are considered to be of major importance to maintenance of internal control, good corporate governance or best practice for processes. Action should normally be taken within six months.
 - **Low Risk** – A weakness which does not seriously detract from the internal control framework. If required, action should be taken within 6 to 12 months.
- 9 Audit identified one new control risk in 2016/17 (low risk) regarding the completeness and accuracy of reports prepared and issued by Council's external valuers. Management accepts Audit's recommendation and will now ensure that clerical accuracy and completeness checks of all valuers reports are completed as part of Council's due diligence programme and are also required to be completed by Council's valuers as part of their new terms of engagement. Given no further action is possible by Management further progress updates thereon will not be provided to the Committee during 2017/18.
- 10 Audit cleared the two control risk findings raised in 2015/16 as well as the control risk raised in 2014/15. As agreed with the committee, the five IT general controls findings raised in 2014/15 remain open and are planned to be closed by Audit either on or before 30 June 2018.

Financial Considerations

- 11 Financial issues have been covered as part of this report.

Legal Considerations

- 12 There are no legal considerations.

Consultation

- 13 There are no consultation issues.

Policy Implications

- 14 There are no policy implications.

Tāngata Whenua Considerations

- 15 There are no tāngata whenua considerations.

Publicity Considerations

16 There are no publicity considerations.

SIGNIFICANCE AND ENGAGEMENT

Significance policy

17 This matter has a low level of significance under the Council Policy.

RECOMMENDATIONS

18 That the Audit & Risk Committee receives Ernst & Young's Report on Control Findings for the year ended 30 June 2017 and notes that Audit has raised one new control risk in 2016/17, deemed to be of low risk to the Council's control environment.

19 That the Audit and Risk Committee notes that regular progress updates will continue to be provided on the remaining five open IT general control findings.

Report prepared by:

**Approved for
submission:**

**Approved for
submission:**

**Anelise Horn
Manager, Financial
Accounting**

**Sarah Stevenson
Group Manager
Strategy & Planning**

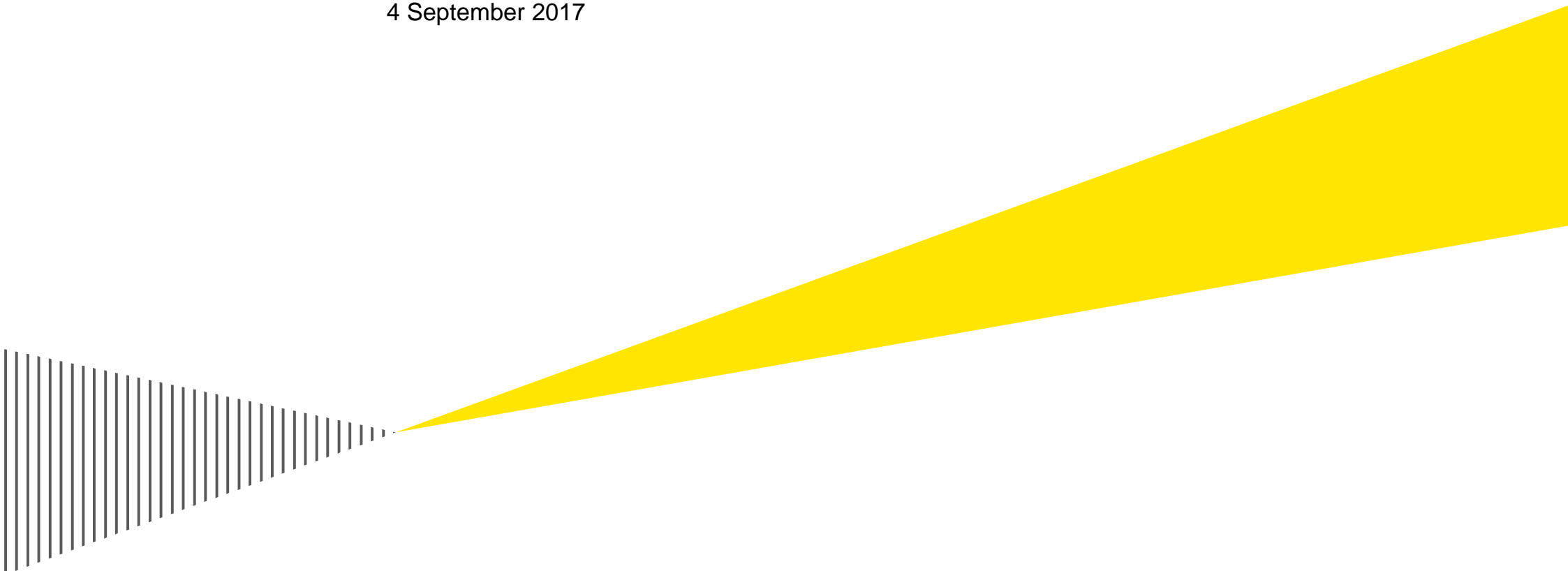
**Wayne Maxwell
Group Manager
Corporate Services**

Appendix 1: Ernst & Young's Report on Control Findings for the year ended 30 June 2017

Kapiti Coast District Council

Report on Control Findings

4 September 2017



Building a better
working world

4 September 2017

Wayne Maxwell
Group Manager Corporate Services
Kapiti Coast District Council
Private Bag 601
Paraparaumu 5254

Dear Wayne

Report to Management

We have completed our audit of the financial statements and service performance information of Kapiti Coast District Council ("Council" or "KCDC") for the year ended 30 June 2017.

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 KCDC's significant financial and non-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 KCDC'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 021 923 431.

Yours faithfully



David Borrie
Partner
Ernst & Young

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1. Overview

1.1 Overview of Risk Ranking System and Summary of Recommendations




As part of our audit of the financial statements, we obtained an understanding of the internal controls sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of the internal controls we are required to communicate to you significant deficiencies in the internal controls.

The matters reported below are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported to you.

The following table provides an overview of the number of observations and the risk ratings we have identified.

	High	Moderate	Low	Total
Open at 30 June 2016	4	2	2	8
Closed during FY17	0	(2)	(1)	(3)
New points raised in FY17	0	0	1	1
Total open points as at 30 June 2017	4	0	2	6

Key:

-  A weakness which does not seriously detract from the internal control framework. If required, action should be taken within 6-12 months.
-  Matters and/or issues are considered to be of major importance to maintenance of internal control, good corporate governance or best practice for processes. Action should normally be taken within 6 months.
-  Matters and/or issues are considered to be fundamental to the mitigation of material risk, maintenance of internal control or good corporate governance. Action should be taken either immediately or within 3 months.

1.2 Disclaimer

Issues identified are only those found within the course of the audit for year ended 30 June 2017. Recommendations 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

2.1 Open points raised in prior years

IT Control Environment Assessment and Recommendation	
Observation	<p>Prior year observation:</p> <p>We reviewed the core financial applications at the Council to assess whether we were able to rely on the IT general controls relating to the general ledger system (NCS). As a result of the work performed, we noted a number of weaknesses in the below areas which resulted in us concluding that we could not place reliance on the following IT environment general controls:</p> <ol style="list-style-type: none">1. Change Management2. Logical Access3. Segregation of Duties4. General System Security Settings. <p>This improvement point encompasses four high rated improvement findings and recommendations included in our IT Control Environment Assessment and Recommendations report dated 7 January 2015.</p> <p>Prior year management response:</p> <p>Change Management:</p> <ul style="list-style-type: none">- Council agrees with the recommendation and notes the significance of the implications outlined. Council is actively working on the practical implementation of sound change management processes across the organisation with the objective of mitigating the risks identified. <p>User access management processes:</p> <ul style="list-style-type: none">- Council agrees with the recommendations. Council is currently engaged in a review of the user management processes in place with the objective of developing and implementing suitable processes to ensure optimal management of the IT infrastructure system. <p>Segregation of Duties:</p> <ul style="list-style-type: none">- Council agrees with the recommendation. The process for identifying and authorising duties is currently being reviewed as part of the overall ITGC systems review and appropriate implementation will be actioned as a priority. <p>General System Security Settings:</p> <ul style="list-style-type: none">- Council agrees with the recommendations, plans are underway to engage an external consultant to conduct a wide ranging audit including a general IT architecture review. The recommendations arising from these audits will provide detailed information on both ICT Strategy and general IT security and will form the basis of the implementation for improvements as a priority item.

IT Control Environment Assessment and Recommendation

	<p>Current year update:</p> <p>We inquired about the status of the IT control environment and we understand management continues to explore workable solutions to address the findings from our review but that not all issues have yet been resolved. As a result of this we did not complete a review of the IT applications this year.</p>
Recommendation	We have agreed to re-review the IT control environment in 2018 once all improvements have been implemented and management is satisfied they are operating as intended.
Management Response	Council's programme to address these findings is on track and scheduled to be completed by April 2018. EY will be invited to audit Council's ITGC in March to June 2018.
Responsibility	Chief Information Officer

IT Control Environment Assessment and Recommendation

Observation	<p>Prior year observation:</p> <p>We reviewed the core financial applications at the Council to assess whether we were able to rely on the IT general controls relating to the general ledger system (NCS). As a result of the work performed, we noted a number of weaknesses around backup operations which resulted in us concluding that we could not place reliance on the IT environment general controls.</p> <p>Prior year management response:</p> <p>Backup Operations:</p> <ul style="list-style-type: none"> - Council agrees with the observation. Current back up operations are in place, however these processes are being reviewed along with the wide ranging audit and general IT architecture review. <p>Current year update:</p> <p>We inquired about the status of the IT control environment and we understand management continues to explore workable solutions to address the findings from our review but that not all issues have yet been resolved. As a result of this we did not complete a review of the IT applications this year.</p>
Recommendation	We have agreed to re-review the IT control environment in 2018 once all improvements have been implemented and management is satisfied they are operating as intended.
Management Response	Council's programme to address these findings is on track and scheduled to be completed by April 2018. EY will be invited to audit Council's ITGC in March to June 2018.
Responsibility	Chief Information Officer

2.2 New points raised in FY 2017

Revaluation of infrastructure assets	
Observation	<p>Infrastructure assets represent a significant component of KCDC's statement of financial position. As at 30 June 2017, Council engaged external qualified valuers to perform a revaluation of its infrastructure assets. The combined valuation resulted in the recognition of an uplift of \$114.5 million.</p> <p>As part of the financial statements review process, management has undertaken quality assurance procedures to ensure the valuations were appropriate and reliance could be placed on the work of the valuers. We noted management performed a detailed review of the methodology and the inputs used by the valuers, including reconciling the data used in the valuation report to the Fixed Asset Register. We acknowledge that this increased level of due diligence is the result of a conscious plan to improve the level of scrutiny applied to valuations used for financial reporting purposes.</p> <p>However, management's review process did not identify an error in a summary table in the valuation report which incorrectly excluded the value of car parks of \$1.5 million from the total value. Management has corrected this error for financial reporting purposes and has committed to take steps to mitigate the risk of such errors arising for future financial reporting.</p>
Recommendation	<p>As part of management's review of the revaluation reports we recommend that management complete sufficient due diligence, including checking completeness of the tables, to satisfy themselves that the information presented in the valuation report is complete and free of errors for financial reporting purposes. We understand that subsequent to year end management have addressed this point through making changes to the relevant processes.</p>
Management Response	<p>Agreed. From 1 July 2018, due diligence reviews pertaining to asset revaluations will now also include checking completeness of tables of reports, prepared and issued by independent and professional valuers.</p>
Responsibility	<p>Chief Financial Officer</p>

2.3 Points closed during FY 2017

Non-financial performance reporting - review of underlying data	
Observation	<p>Prior year observation:</p> <p>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:</p> <ul style="list-style-type: none"> ▶ 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 MagiQ. ▶ For some measures data is maintained by the external contractors and uploaded directly into MagiQ without a peer review. ▶ There were no formal mechanisms designed to ensure the integrity of reported results once the data has been uploaded into MagiQ. <p>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 MagiQ systems.</p>
Recommendation	We recommend KCDC streamline its systems, processes and quality control over KPI reporting necessary to ensure actual performance is captured, recorded and reported appropriately.
Management Response	Council agrees with the recommendation and will continue to investigate and determine how MagiQ can be best used to capture record and report KPI data.
Responsibility	Kevin Black (Manager Corporate Planning and Reporting) with the support from the Senior Leadership Team.
2017 Update	<p>Recommendation closed</p> <p>During the year, KCDC has utilised the functionality available within MagiQ to capture and record the data for performance reporting purposes. We noted improvements in the quality controls (such as service requests being raised and managed through MagiQ and statistics reports being generated directly from MagiQ at year end for reporting) over the KPI reporting process necessary to ensure the actual performance is captured, recorded and reported appropriately.</p> <p>We acknowledge that Council is currently completing a project that will further improve the way in which the underlying data is captured and reported for the purpose of service performance reporting. The recommendations for various measures have already been implemented and for the remaining measures, the improvements are in the process of being implemented in FY2018.</p>

Reconciliation between Asset Management System and the Fixed Assets Register

<p>Observation</p>	<p>KCDC engaged Opus International Consultants Ltd to carry out an asset valuation of the three waters infrastructure assets as at 30 June 2016. Opus' valuation is based on assets data stored and extracted from the Council's water assets management system (InforNet) which holds assets data at component level including asset ID, location, descriptions, age and capitalisation dates.</p> <p>InforNet does not contain asset cost values and in essence is different and separate from the MagiQ Fixed Assets Register (FAR), which only records summarised asset data for accounting purposes.</p> <p>The two systems currently do not inter-face and a regular reconciliation between the systems is currently not conducted. In the absence of a regular reconciliation between the two systems, there is an increased risk of inconsistent data being held in each system i.e. additions, disposals and useful lives might be included in one system but not in the other in a timely manner (or at all) and any valuations carried out by external parties could be prepared on the basis of incomplete information.</p> <p>Furthermore, the financial statements in years during which no valuations are undertaken, may not accurately reflect the water assets network.</p>
<p>Recommendation</p>	<p>A regular reconciliation should be conducted to ensure that the assets recorded in the FAR and General ledger are consistent with those held within the InforNet system. This helps to ensure data provided to the valuer is a full and complete record of the assets as at each balance date and that the FAR is accurate and complete in the intervening years.</p> <p>We understand Opus and AECOM have also made a number of improvement recommendations in this area and we believe these should be considered.</p>
<p>Management Response</p>	<p>Council agrees with the recommendation to complete regular reconciliations between the asset management system and the FAR and general ledger system.</p>
<p>Responsibility</p>	<p>Mark de Haast (Financial Controller) with the support from the Senior Leadership Team.</p>
<p>2017 Update</p>	<p>Recommendation closed</p> <p>We noted that a reconciliation between the Asset Management System and the Fixed Asset Registers was performed during the year and our review of the reconciliation did not identify any exceptions.</p>

Adequate documentation for Landfill Aftercare future nominal cash flows	
Observation	<p>During our review of the Landfill aftercare provision, we noted a revision to the estimated nominal future cash flows with a cost saving of approximately \$1.1m. At the time of our review, while the revised future cost estimates were adequately detailed, supporting documents such as vendor quotes to evidence the cost reduction were not readily available.</p> <p>Without adequate supporting documentation in place to support the changes to the nominal future cash flows, there is a potential risk for incorrect provision being recognised in the financial statements.</p>
Recommendation	We recommend management ensure proper documentation supporting the amount of each aftercare cost revision is retained.
Management Response	Council agrees with the recommendation to ensure that any changes to the nominal cash flow estimates are substantiated with supporting documentation. In addition, due to the inherent risks in estimating the nominal future cash flows of the landfill after-care costs, Council will seek to have these estimates peer reviewed at least every three years or more regularly if required.
Responsibility	Mark de Haast (Financial Controller) with the support of the Senior Leadership Team.
2017 Update	<p>Recommendation closed</p> <p>During the year KCDC engaged Jacobs New Zealand Limited, an external engineering firm, to conduct a review of the landfill capping costs and engineering assumptions used by management in arriving at the provision. The report from Jacobs supports the documentation of cost estimates and our review of the underlying documentation noted no issues.</p>

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