

Chairperson and Subcommittee Members
AUDIT AND RISK SUBCOMMITTEE

29 SEPTEMBER 2015

Meeting Status: **Public**

Purpose of Report: For Information

**AUDIT REPORT TO MANAGEMENT FOR THE YEAR ENDED
30 JUNE 2015**

PURPOSE OF REPORT

- 1 This report provides the Subcommittee with a progress update against Ernst & Young's previous recommendations arising from their review of the Council's Information Technology General Controls (ITGC) environment.
- 2 This report also provides the Subcommittee with a summary of Ernst & Young's Report on Control Findings for the year ended 30 June 2015.

DELEGATION

- 3 The Audit and Risk Subcommittee has delegated authority to consider this report under the following delegation in the Governance Structure, Section C.3.
 7. Without limiting the generality of this delegation the Subcommittee has the following functions, duties and powers:

Internal Control Framework

- 7.1 *Review whether management's approach to maintaining an effective internal control framework is sound and effective.*

External Audit

- 7.13 *Receive the external audit report and review action to be taken by management on significant issues and audit recommendations raised within.*

BACKGROUND

- 4 On 7 January 2015, Ernst & Young (Audit) reviewed the Council's ITGC environment and reported a number of control findings for consideration by management.
- 5 Ernst & Young's Report on Control Findings for the year ended 30 June 2015 is attached as Appendix 1. This report details all of the internal control matters that were considered appropriate for review by management.
- 6 All of the control findings for the year ended 30 June 2014 have been closed.

CONSIDERATIONS

Summary Report on Control Findings

Context of the internal control findings

- 7 In accordance with New Zealand Auditing Standards, Audit performed a review of the design and operating effectiveness of the Council's significant financial reporting processes and Council's ITGC environment as part of their audit for the year ended 30 June 2015.
- 8 In addition, Audit also reviewed aspects of Council's ITGC environment that were considered significant to their audit of Council's 2015/35 Long Term Plan.
- 9 During the course of their work, Audit identified a number of control risk issues, classified as either high, moderate or low risk. Control risk definitions are as follows:
 - **High Risk** – These recommendations relate to a serious weakness which exposes the organisation to a material extent in terms of the achievement of departmental objectives, financial results or otherwise impair the Council's reputation. Immediate corrective action is required.
 - **Moderate Risk**- A control weakness, which can undermine the system of internal control and/or operational efficiency and should therefore be addressed by management generally within 6 months.
 - **Low Risk**- 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 generally within 6 to 12 months.

Summary of internal control findings

- 10 Table 1 summarises the control findings for the year ended 30 June 2015 including Council's responses and action plans to address these findings.
- 11 Table 2 provides a progress update against Audit's ITGC findings.

Table 1 - Summary of Control Findings for the year ended 30 June 2015

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
1	Timely Capitalisation of Capital Work in Progress (Moderate)	March 2016 (Not started)	<ul style="list-style-type: none"> • Library books purchased in 26 June 2014 were not capitalised until 30 June 2015. • Engineering work of \$151,771 has been in WIP since 2012 (Now adjusted). • 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. 	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.	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.	Each quarter, Asset Managers and Group Managers will be required to: <ol style="list-style-type: none"> 1. Approve all WIP assets 2. Provide forecast asset completion schedules 	Mark de Haast, Financial Controller

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
2	<p>Non-financial performance reporting – review of underlying data (Moderate)</p>	<p>March 2016 (Not started)</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>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.</p>	<p>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.</p>	<ol style="list-style-type: none"> 1. Review KPIs 2. Investigate and test MagiQ functionality to capture KPI data. 	<p>Kevin Black, Manager Corporate Planning and Reporting</p>

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
3	Subsequent Costs and de-recognition of Replaced Asset (Moderate)	Sept 2016 (Not started)	<ul style="list-style-type: none"> ▪ The Council is regularly renewing or upgrading fixed assets, for instance road assets are resurfaced every few years. ▪ The carrying amount of those parts that are replaced should be derecognised. ▪ We understand this is not occurring at present. 	We recommend the asset costs and accumulated depreciations be de-recognised when assets are replaced.	Historically, this formed part of the three yearly asset revaluations. From 1 July 2015, 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.	Each quarter, Asset Managers and Group Managers will be required to approve all assets to be derecognised due to replacement.	Mark de Haast, Financial Controller

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
4	Fully Depreciated Property, Plant & Equipment (Low)	Sept 2016 (Not started)	<ul style="list-style-type: none"> ▪ We identified a number of items where it is unlikely future economic benefits or service potential is expected and hence should be derecognised. ▪ 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. 	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 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.	Each quarter, Asset Managers and Group Managers will be required to approve assets to be derecognised due to them not providing any future economic benefit and / or service potential.	Mark de Haast, Financial Controller

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
5	Timely review of expenditure policies (Low)	Sept 2016 (Not started)	<p>We noted the following policies had not been reviewed for a considerable period:</p> <ul style="list-style-type: none"> ▪ Sensitive Expenditure ▪ Disposal of Assets ▪ Travel Expenditure ▪ EPO ▪ Office Supplies Purchasing <p>Council's own practice is to review these policies every two years.</p>	Policies should be reviewed periodically to ensure that they correctly reflect Council's expectations.	<p>Council's corporate policy review period has changed to five yearly or earlier, if required</p> <p>The policies identified by Audit have been rationalised into a draft Procurement and a draft Sensitive Expenditure Policy.</p>	<p>The draft Procurement Policy and the draft Sensitive Expenditure Policy are being processed for final approval by the Chief Executive before 30 November 2015.</p> <p>A corporate policy register (approximately 50 policies) has been created and a prioritised review cycle is underway.</p>	Mark de Haast, Financial Controller

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
6	Building and resource consents (Low)	Sept 2016 (Not started)	<p>We noted some deposits date back to 2007.</p> <p>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.</p>	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.	<p>Council has commenced regular monitoring of these bonds.</p> <p>During the year, Council refunded \$359,000 of bonds.</p>	<p>Council will continue to regularly monitor these bonds and return them when appropriate.</p> <p>Management will fully investigate the requirements and/or impacts on Council electing to be the holder and returning the money to the Inland Revenue Department if unclaimed.</p>	Mark de Haast, Financial Controller

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Observation	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Responsibility
7	Capital Expenditure Policy (Low)	Sept 2016 (Not started)	<p>We reviewed the capital additions for the year and noted a small number of items below the \$1000 threshold that had been capitalised.</p> <p>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.</p>	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 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.	Each quarter, Asset Managers and Group Managers will be required to approve all asset purchases below \$1,000.	Mark de Haast, Financial Controller

Table 2 - Summary of Information Technology General Control Environment Findings

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Progress to date
1	Change management (High)	Complete	<ul style="list-style-type: none"> ▪ Revisiting the Change Management control process documentation and updating it with current Council practices. ▪ Enforcing the use of the Change Management Policy to ensure that all changes are appropriately authorised, tested, approved, monitored and evidence documented. ▪ Optimising use of existing change management tools to ensure that all changes are adequately captured. ▪ Using a version management tool to ensure that Council controls and monitors all changes in the production environment. ▪ Reviewing of system generated list of changes within the existing Change Advisory Board process. 	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>Implement standard process utilising a specific Change Management tool (ManageEngine Service Desk) and rollout to key users.</p> <p>Regular Change Control Meetings, to be reported back to the Group Manager, Corporate Services.</p>	<ul style="list-style-type: none"> ▪ ManageEngine Service Desk application has been implemented. ▪ Weekly Change Advisory Board meetings held.

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Progress to date
2	User access management process (High)	Dec 2015 (On track)	<ul style="list-style-type: none"> ▪ Document a user access management process which includes the access request, modification, removal, and review procedures. ▪ Ensure appropriate notification is provided from HR for terminated employees to ensure that access to systems is removed. ▪ Formalise a user access review process so that it is managed through a centralised location to ensure all reviews are completed. ▪ Implement regular review of user accounts to ensure that access is only granted to users with a need to access a system. ▪ Ensure that individuals that monitor and review these accounts are not administrators within these systems. 	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>User Register to be created and maintained with a process for the addition and removal of users based on recruitment and termination.</p> <p>User Review team (responsible to the audit and review of User access) to be created, with representatives from all key business units within the organisation.</p>	<p>A process for the addition and removal of users based on recruitment and termination has been created.</p> <p>A User Review Team has been established.</p>

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Progress to date
3	Segregation of duties (High)	Dec 2015 (At risk)	<ul style="list-style-type: none"> ▪ Ensure different individuals / system resources perform access requests, access approval, access provisioning, monitoring access violations for both IT privileged and Business end users. ▪ Ensure different individuals perform privileged user access reviews, monitoring of privileged accounts and monitoring system generated list of changes in production environment. ▪ Different individuals / system resources perform change requests, change approval, move programmes in and out of production and monitor changes and restrict developer access to the production environment. ▪ Apply a version management tool to ensure that Council controls and monitors all changes in production environment. 	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>Process for addition and removal of user duties to be identified and implemented.</p> <p>Audit and review of administration access to be undertaken with role segregation to be created via access specific logins (i.e. removal of generic admin users).</p>	Not started. Process for addition and removal of user duties will be initiated following approval of the ICT Strategy (target date: October 2015).

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Progress to date
4	General system security settings (Medium)	Dec 2015 (On track)	<p>The New Zealand Information Security Manual (NZISM), updated in November 2014 to be considered as a baseline for IT security practices.</p> <p>These policies should be reviewed and approved at least annually to make any necessary adjustments as a result of IT environment changes.</p>	<p>Council agrees with the recommendations and 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.</p>	<p>Process and policies based on the NZISM will be created and regularly reviewed.</p>	<p>Completed a review of the NZISM for relevance to Council.</p>

No.	Control finding and risk ranking	Target date for completion and current status	Ernst & Young Audit Recommendation	Council's Response	Action Plan	Progress to date
5	Back-up operations (Low)	Dec 2015 (On track)	<ul style="list-style-type: none"> ▪ Review current backup operations and approving back-up retention periods as part of the backup policy that is being developed. Business and system owners, in consultation with IT, should authorise and define the retention periods to ensure that these are practical and appropriate. ▪ Retain backup logs for all applications and recording corrective actions using the centralised incident management procedures. ▪ Implementing activities designed to perform regular testing of DLT tapes stored offsite at EOC, ensuring that critical data can be restored as and when it is required. ▪ Perform Disaster Recovery testing offsite. 	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>Review existing back-up hardware and software to ensure adequacy and implement changes when required.</p> <p>Detailed back-up processes and procedures to be created and reviewed regularly.</p>	The review of current back-up hardware and software was completed. Preferred back-up tool under evaluation.

Financial Considerations

12 Financial issues have been covered as part of this report.

Legal Considerations

13 There were no control findings that warrant legal consideration.

Consultation

14 There are no consultation issues associated with this report.

Policy Implications

15 A corporate policy register (approximately 50 policies) has been created and a prioritised review cycle is underway.

Tāngata Whenua Considerations

16 There are no tāngata whenua considerations.

Publicity Considerations

17 There are no publicity considerations.

SIGNIFICANCE AND ENGAGEMENT

Degree of significance

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

RECOMMENDATIONS

19 That the Audit & Risk Subcommittee receives Ernst & Young's Report on Control Findings for the year ended 30 June 2015 and notes that Council agrees with the seven internal control recommendations.

20 That the Audit and Risk Subcommittee notes that action plans are being implemented to remedy these control findings and progress updates will be provided at each Audit and Risk Subcommittee meeting.

21 That the Audit & Risk Subcommittee notes the progress to address the ITGC issues raised by Ernst & Young.

Report prepared by:

**Approved for
submission:**

**Approved for
submission:**

**Mark de Haast
Financial Controller**

**Wayne Maxwell
Group Manager
Corporate Services**

**Stephen McArthur
Group Manager
Strategy and Planning**

Appendix 1: Ernst & Young's Report on Control Findings for the year ended 30 June 2015