

AUDIT NEW ZEALAND

Mana Arotake Aotearoa

Report to the Council on the annual audit of

**Thames-Coromandel District Council**

for the year ended 30 June 2016

**Key messages**

We have completed the audit for the year ended 30 June 2016. This report sets out our findings from the audit and draws attention to areas where Thames-Coromandel District Council (Council) is doing well or where we have made recommendations for improvement.

We issued an unmodified audit opinion on 25 October 2016.

Council has continued to make progress with how it budgets for, and manages, capital projects. Capital expenditure is \$17.8 million compared to a capital budget of \$21.1 million. We found carry forward projects have been approved and delayed for appropriate reasons. Further improvements have been introduced as part of the 2016/17 annual plan process.

Council continues to verify and refine the data in its asset management systems. As a result of improved information, a number of adjustments have been put through comprehensive income in this year's revaluation movements. The net impact of all the adjustments on Property, Plant & Equipment was minimal.

The crown land on which Council's forestry is situated is in the process of being transferred to local iwi as part of the Treaty Settlement process. This may impact on Council's ability to discharge treated effluent to that land in the future and will need to be included in Council's risk management processes.

Professional auditing standards require us to consider the risk of management override of controls in all audits we perform. Management is in a powerful position to perpetrate fraud due to its ability to override controls that appear to be operating effectively. Our tests did not give any indication of inappropriate adjustments or management override of controls.

**Issues identified during the audit**

The following table summarises our recommendations and their priority:

Recommendation	Urgent	Necessary	Beneficial
PPE valuations: Continue to validate and refine data in the asset management system. See item 2.2.		✓	
Changes to capital budget and carry forwards: Continue focusing on the accurate determination of capital budgets and executing the capital spend within budget timeframes. See item 2.4.		✓	

Recommendation	Urgent	Necessary	Beneficial
Project and contract management: The Project Centre to provide guidelines regarding payments around balance date and making payments in advance of work being completed. See item 2.6.		✓	
Conflict of interests: Ensure there are appropriate policies, procedures and staff awareness to mitigate the risks arising from conflict of interests. See item 2.7.		✓	
Forestry used for wastewater disposal: Incorporate the risk of not being able to discharge wastewater to forestry land into the risk management process. See item 2.8.		✓	
Super user access: The "TSADMIN" network administrator account to be disabled as soon as possible after disengaging from system service functions. See item 2.9.		✓	
Variance between general ledger and rates systems: Perform a reconciliation between the general ledger and rates systems as part of the month end process. See 3.1.2.		✓	
Review of policies: Ensure the policy register is kept up to date, and policies are reviewed in a timely manner. See 3.5.			✓

There is an explanation of the priority rating system in Appendix 1.

Thank you

We would like to thank the Council, management and staff for their assistance during the audit.



David Walker  
 Audit Director  
 21 November 2016

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## **1 Our audit opinion**

### **1.1 We issued an unmodified audit opinion**

We issued an unmodified audit opinion on 25 October 2016. This means that we were satisfied that the financial statements and statement of service performance fairly reflected Council's activity for the year and its financial position at the end of the year.

As the Council's appointed auditor, we also intend to issue a Limited Independent Assurance Report to the Council and Covenant Trustee Services Limited on the Debuture Trust Deed in accordance with clauses 1.2.2.6 of the Deed.

In forming our audit opinion, we considered the following matters.

### **1.2 Uncorrected misstatements**

The financial statements are free from material misstatements, including omissions. During the audit, we have discussed with management any misstatements that we found, other than those which were clearly trivial. There were no significant misstatements identified during the audit that have not been corrected.

## **2 Significant risks and issues for the Council**

Based on our planning work and discussions we had at the beginning of the audit process, we identified some key business risks that Council faces. These were outlined in our audit arrangements letter dated 24 February 2016.

During the course of the audit we also encountered other significant issues that we considered in reaching our audit opinion.

Our findings on these issues are contained in this section of the report.

### **2.1 Commitment to the annual audit process**

We commend Council on their continued commitment to the annual audit process. In particular:

- providing a quality set of financial statements prior to the start of the audit which had been subjected to appropriate levels of quality review;
- providing a detailed work paper file which supported all relevant disclosures in the financial statements; and
- ensuring all queries raised through our audit work were addressed as a priority.

This allowed for an effective and efficient audit to be completed within the agreed timeframes. We will continue to meet regularly with the Council's staff to discuss the audit process going forward.

### **2.2 Property, plant and equipment revaluations**

Council continues to verify and refine the data in its asset management systems. Council made the following adjustments in the current year:

- two bridges that Council had always owned had been identified as erroneously excluded from prior years transportation valuations. This year these bridges were included in the valuation and recognised as a revaluation increase of \$719k;
- the wastewater valuation included reticulation assets that Council had always owned, but had been erroneously left out of prior year valuations. This year these assets have been recognised as a revaluation increase of \$785k;
- the parks valuation included decorative road assets, such as signage, that Council had always owned, but had not been specifically identified and valued in prior years. This year these assets have been recognised as a revaluation increase of \$200k; and
- the transportation valuation previously double counted a significant number of walkways (access ways) under footpaths. This year the duplication has been eliminated resulting in a devaluation of \$1.7 million.

The omissions or double counting noted above all arose through revaluation movements recognised through comprehensive income. We were satisfied that correcting these issues through revaluation movements is appropriate, noting also that the overall net effect for this year is minimal.

A number of recommendations for improvements to asset data were made in the valuers' reports and these have

been incorporated into Council's improvement plans going forward.

### **Recommendation**

We recommend Council continue to validate and refine data in the asset management system to improve asset management planning and the quality of data used for future valuations.

### **Management comment**

*This is an ongoing body of work we have committed to. It has been signalled and budgeted for in the 2015-25 Long-term Plan.*

## **2.3 Property, plant and equipment fair value assessment**

Council revalued most of its infrastructure assets as at 1 July 2015. The exception was land which was not scheduled for revaluation this year.

As required by the accounting standards, Council completed a fair value assessment of all asset classes as at 30 June 2016 to ensure the fair value of the asset classes were not materially different to their carrying values.

We concurred with Council's assessment that the potential difference between the carrying values and the fair values was not significant and therefore a formal revaluation was not required at 30 June 2016.

## 2.4 Large changes to capital budgets

Council has a history of carrying forward large unspent budgets on capital projects each year. In recent years Council has introduced more rigour around the approval of projects for inclusion in planning documents.

We reviewed the Council's carry forward projects and discussed these with management to get an understanding of the impact on the organisation and any risks associated with the level and nature of these projects.

As per the funding impact statement, capital expenditure is \$17.8 million compared to a capital budget of \$21.1 million. The shortfall of \$1.6 million is a significant decrease compared to the capital shortfalls experienced in prior years.

Overall the carry forward projects have been approved and delays occurred for appropriate reasons. We have not identified any level of service impacts from our work on the SSPs.

### Recommendation

We recommend management continue focusing on the accurate determination of capital budgets and executing the capital spend within budget timeframes.

### Management comment

*Audit New Zealand's comments are noted. This area continues to be a major focus for senior management.*

## 2.5 Management override of controls

Professional auditing standards require us to consider the risk of management override of controls in all audits we perform. Management is in a powerful position to perpetrate fraud due to its ability to override controls that appear to be operating effectively.

In response to the risk of management override of controls, we have reviewed the journals system to ensure there is sufficient segregation of duties in the process. The control environment has been assessed as effective in ensuring that all journals have been appropriately approved and are valid. We have considered the control environment in place sufficient to mitigate the risk of fraud through management override.

We have also performed testing and analysis of journals and other adjustments identified during the audit process. In this testing, we have included journal entries and other adjustments applied to accounts that are complex in nature, involve significant judgement, and contain significant period end adjustments and/or significant transactions outside of the normal course of business. We also incorporated an element of unpredictability in our audit testing through random sampling where appropriate.

No indications of inappropriate adjustments or management override of controls were identified during this testing.

## 2.6 Project and contract management

We commented on the progress Council is making in improving the policies and systems for project and contract management in our interim report issued on 1 August 2016.

At the final audit visit, we considered whether in-complete projects are correctly accounted for in the financial statements, including whether cut-off (of invoices) / progress certificates had been appropriately captured (representing completed work in the correct period) and included in Work-in-Progress.

One of our sample seemed to indicate that the contractor had invoiced for work not yet complete. The invoice was authorised and council had paid in advance of the related construction being completed. While the implication for the financial statements is the over and/or under-statement of year-end account balances, the risk to council is ensuring that the work paid for is completed.

#### **Recommendation**

We recommend the Project Centre (Centre for excellence for project and contract management) established by Council provides guidelines, particularly for project managers, regarding payments around balance date and making payments in advance of work being completed.

#### **Management comment**

*Reminders will be provided to all Project Executives, Project Boards and Project Managers about their responsibilities in this regard. We will also spot check project budget forecasts against project schedules provided in the monthly Project Status Reports and escalate any anomalies.*

risk of fraud, etc. As a result, the recognition of conflicts of interest and the declaration of interests has now become widely recognised as good standard practice.

While the declaration of a conflict of interest is commonly practiced by Boards, at Councillor level and by senior management, it is less frequently practiced at lower levels of management. However, each entity is different and circumstances change. Generally in smaller communities the risk of conflicts of interest increases simply because of the nature of the environment. As a result entities need to be constantly alert to the possibility of conflicts of interest and to ensure internal processes, procedures and staff awareness is at a level to avoid such conflicts.

While the responsibility of minimising conflicts of interest remains with Council, during the course of our normal audit work we are alert to the possibility of conflicts of interest and test a sample, generally to public documents such as the Companies Register.

One sample identified a project manager who had a potential conflict of interest. Our further enquiry did not indicate that there were any issues, although no declaration of interest had been made. The fact that the declaration had not been made exposed the project manager and council to the risks noted above.

#### **Recommendation**

We recommend council consider the Thames Coromandel environment combined with employee roles and responsibilities, and ensures appropriate policies, procedures and staff awareness to mitigate the risks arising from conflict of interests.

## **2.7**

### **Conflict of interests**

Conflict of Interests creates several related risks for any entity including; not getting the best value for money, the



**Management comment**

*Further training has been provided to the wider organisation regarding the need to consider potential conflicts of interest. A conflict of interest declaration form has been created for staff undertaking procurement to complete. Filing protocols are also being developed so that declaration forms are stored within Council's document management system, ECM, for easy retrieval.*

**Management comment**

*This risk has been placed on the risk register and assigned to the Group Manager of Infrastructure.*

**2.9**

**Super user access**

We noted the IT team use their own unique user accounts to perform their administrative tasks. The account that was used for administrative tasks (that is, "TSADMIN") is to be disabled when all the system/service tasks that use it have been identified and re-allocated.

**2.8 Forestry used for wastewater disposal**

Council owns standing forests on 286 hectares of Crown land in Whangamata and Tairua for the primary purpose of disposing of wastewater.

The Crown land is in the process of being transferred to local iwi in the near term (1-3 years) as part of the Treaty Settlement process. This transfer may impact on Council's ability to dispose of wastewater.

We understand that discussions with iwi to date indicate that it is likely the Council will retain the ability to discharge the treated effluent to the forest, should the transfer of land ownership occur. Currently Council's only other option is for the disposal of treated effluent to water.

**Recommendation**

We recommend Council incorporate the risk of not being able to discharge wastewater to this land into the risk management process.

Generic accounts are targets for people attempting to mask their activities and the use of this type of account is often not picked up until it is too late. The ability to hold a person accountable is significantly reduced when a generic account is involved.

**Recommendation**

We recommend the "TSADMIN" network administrator account is disabled as soon as possible after disengaging from system service functions.

**Management comment**

*The "disengagement" of the TSADMIN account from system service functions is a work in progress. Given that the risk is*

contained and considered acceptable (as the password is only known to a small number of trusted IT staff), it is being replaced wherever it is discovered as we progressively upgrade/replace our systems, rather than simply disabled in a "big bang" approach that might have unforeseen consequences. The remaining significant system where it is used is within our VMWARE environment. It will be disabled there as part of upgrading to vSphere 6.0 - this will be happening in the next 12 months, with the precise timing dependent on some answers from our infrastructure supplier.

### 3 Sector-wide and other matters

As well as the risks and issues noted above, there were also a number of other areas of interest common to the local authority sector, as well as other matters we identified during the audit.

Our findings on these issues are contained in this section of the report.

#### 3.1 Rates and rating

We considered Council's compliance with aspects of the Local Government (Rating) Act 2002 (LGRA) that materially impact on the financial statements.

From our review of the rates setting process for 2015/16 and 2016/17 we were satisfied, for the purposes of our audit, with:

- the consistency and completeness of the rates resolution and the Funding Impact Statement (FIS);

- the consistency of the matters and factors for differentially set and targeted rates with the LGRA; and

- the rates disclosures in the annual report and their consistency with the rates statement.

#### 3.1.1 Water by volume rates

For the 2015/16 water by volume rates an issue was identified where these rates were included in the rates resolution as GST exclusive (while all other rates were GST inclusive).

Council obtained legal advice from Simpson Grierson and at its 16 September 2015 Council meeting, Council corrected the error under section 13 of the Interpretation Act 1999.

The error was identified before the first water-by-volume meter readings were conducted. Therefore, only those customers with special readings before this date were affected. The actual shortfall in revenue was approximately \$2,700.

We understand management has reviewed the processes around rates setting and are comfortable the risk of future inaccuracies of this nature have been mitigated.

#### 3.1.2 Variance between general ledger and rates systems

There are minor differences between the general ledger (JDE) and the rates system (Pathways), with an overall variance \$14k.

Council performed a year end reconciliation between the two systems and has been unable to identify the reasons for the differences.

Regular reconciliations between the general ledger and rates systems would enable any variances to be identified in a timely manner. This could also help identify the explanations for any variances that arise.

**Recommendation**

We recommend reconciliations between the general ledger and the rates system be performed as part of the month end process.

**Management comment**

*Audit New Zealand's comments are noted. Reconciliations are now performed quarterly.*

**3.2**

**Elected members – remuneration and allowances**

Council is required to disclose in the annual report the total remuneration received by, or payable to, each member of the local authority in the reporting period.

We reviewed the disclosure to ensure the Council had complied with the requirements of the Local Government Elected Members' Determination and any amendments to that Determination.

We found that all payments made were within the limits set in the Determination.

**Weathertightness**

**3.3**

We considered the information obtained by the Council to determine its exposure to weather tightness claims. The overall contingency for weathertightness decreased from \$9,262k in 2015 to \$3,612k in 2016. The total provision recognised for weathertightness homes has decreased from \$2,580k to \$1,026k over the same period.

We reviewed Council's weathertightness calculations, noting they are derived from Ministry of Building Innovation and Employment (MBIE) information for the financial assistance package or relevant legal advice on individual claims.

We are satisfied Council's accounting treatment and related disclosures in the financial statements are adequate and appropriate.

**3.4**

**Audit of service performance reporting**

We reviewed the performance framework to confirm it remains appropriate given any changes in activity and issues since the 2015-2025 Long Term Plan was adopted.

The Council's performance framework continues to provide an appropriate basis on which to assess the Council's performance.

We reviewed in detail the supporting data for a sample of performance measures we selected as significant when considering the overall performance story for the Council. We also reviewed all performance measures for consistency with the financial information and our client knowledge.

We are satisfied that the service performance statements comply with generally accepted accounting practice and fairly reflected the actual achievements and performance of the Council.

#### 4 Interim management report

We have provided the Council with an interim management report on 1 August 2016. This report outlined our findings and recommendations arising from our interim audit visit.

### 3.5 Review of policies

We identified the policy register has not been kept up to date and there are a number of policies that have passed their review date.

We understand this is largely due to the impact of the Long Term Plan preparation process when the strategic planning team were short staffed. A programme has been put in place over the next year to see all overdue policies reviewed and brought up to date.

#### Recommendation

We recommend Council ensure the policy register is kept up to date, and policies are reviewed in a timely manner.

#### Management comment

*Comments are noted and a work programme to ensure all Council policies are current has been underway since June 2016, including revoking management and governance policies which are outdated, duplicated or redundant. We have established a “bring-up” system to advise policy and bylaw managers when their policy or bylaw requires review. This is particularly important for our bylaws which may be revoked under the Local Government Act if not reviewed within statutory timeframes.*

### 5 Summary of recommendations

We commented on most of the prior year issues in our interim report issues on 1 August 2016. The remaining issues are summarised below:

Number of recommendations from previous years' audits	Current status
1	Progress is being made, but not yet fully resolved.

This summary needs to be read in conjunction with the status of recommendations raised in previous years' management reports as detailed at Appendix 2.

### 6 Details of reviews on behalf of the Auditor-General

We completed the reviews required by the Auditor-General, as set out in our Audit Arrangements Letter. There are no issues to be brought to your attention as a result of these reviews.

## Appendix 1: Explanation of priority rating system

Our recommendations for improvement and their priority are based on our assessment of how far short Council is from a standard that is appropriate for the size, nature, and complexity of its business.

We have developed the following priority ratings for our recommended improvements:

### Urgent

Major improvements required

#### Needs to be addressed *urgently*

These recommendations relate to a significant deficiency that exposes the Council to significant risk. Risks could include a material error in the financial statements and the performance information; a breach of significant legislation; or the risk of reputational harm.

### Necessary

Improvements are necessary

#### Address at the earliest reasonable opportunity, *generally within 6 months*

These recommendations relate to deficiencies that need to be addressed to meet expected standards of good practice. These include any control weakness that could undermine the system of internal control or create operational inefficiency.

### Beneficial

Some improvement required

#### Address, *generally within 6 to 12 months*

These recommendations relate to deficiencies that result in the Council falling short of best practice. These include weaknesses that do not result in internal controls being undermined or create a risk to operational effectiveness. However, in our view it is beneficial for management to address these.

## Appendix 2: Status of previous recommendations

### Outstanding matters

Recommendation	Current status	Priority	Management's comments/proposed action
<p><b>Conflict of interest register</b></p> <p>Update the conflict of interest register to include information about the type of interest and any mitigation action.</p>	<p><b>Outstanding</b></p> <p>We understand the register will be updated but no changes have been made to date.</p>	<p>Necessary</p>	<p>The conflict of interests register contains information about the type of interest. We will add a column to the register to record any mitigating actions.</p>

### Appendix 3: Mandatory disclosures

Area	Key messages
Our responsibilities in conducting the audit	<p>We carried out this audit on behalf of the Controller and Auditor-General. We are responsible for expressing an independent opinion on the financial statements and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.</p> <p>The audit of the financial statements does not relieve management or the Council of their responsibilities.</p> <p>Our audit engagement letter contains a detailed explanation of the respective responsibilities of the auditor and the Council.</p>
Auditing standards	<p>We carry out our audit in accordance with generally accepted audit standards. The audit cannot and should not be relied upon to detect every instance of misstatement, fraud, irregularity or inefficiency that are immaterial to your financial statements. The Council and management are responsible for implementing and maintaining your systems of controls for detecting these matters.</p>
Auditor independence	<p>We confirm that, for the audit of the Thames-Coromandel District Council's financial statements for the year ended 30 June 2016, we have maintained our independence in accordance with the requirements of the Auditor-General, which incorporate the independence requirements of the External Reporting Board.</p> <p>In addition to this audit we have carried out assignments in the areas of the debenture trust deed trustee reporting certificate, which are compatible with those independence requirements.</p> <p>Other than these assignments, we have no relationship with, or interests in, the Council.</p>
Other relationships	<p>We are not aware of any situations where a spouse or close relative of a staff member involved in the audit occupies a position with the Thames-Coromandel District Council that is significant to the audit.</p> <p>We are not aware of any situations where a staff member of Audit New Zealand has accepted a position of employment with the Thames-Coromandel District Council during or since the end of the financial year.</p>
Unresolved disagreements	<p>We have no unresolved disagreements with management about matters that individually or in aggregate could be significant to the financial statements. Management has not sought to influence our views on matters relevant to our audit opinion.</p>