Kaipara District Council

Constructive Report to Management

for the year ended 30 June 2020

Deloitte
Deloitte Centre
80 Queen Street
Auckland 1010

Private Bag 115033
Shortland Street
Auckland 1140
New Zealand

Tel: +64 9 303 0700
Fax: +64 9 303 0701
www.deloitte.co.nz

18 December 2020

Louise Miller
Chief Executive
Kaipara District Council
Private Bag 1001
DARGAVILLE

Dear Louise

Constructive Report to Management for the year ended 30 June 2020

In accordance with our normal practice, we enclose our detailed comments on the points that were discussed with management at the conclusion of the audit which relate to certain internal controls and accounting practices which came to our attention during our audit of the financial statements of Kaipara District Council ("the Council") for the year ended 30 June 2020 The matters raised in this report have been discussed and agreed with management of the Council and their comments have been included. This report supplements the report to the Councillors dated 19th November 2020 which concluded on the areas of focus addressed as part of the audit.

We remind you that our audit was not designed to provide assurance as to the overall effectiveness of the controls operating within the Council, although we have reported to management any recommendations on controls that we identified during the course of our audit work. The matters being communicated are limited to those matters 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.

This correspondence is part of our ongoing discussions as auditor in accordance with our engagement letter and master terms of business dated 18 August 2020 and as required by the Office of the Auditor General's auditing standards which incorporate the New Zealand 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 management. The audit of the financial statements does not relieve management or the Council of their responsibilities. The ultimate responsibility for the financial statements and the design, implementation and maintenance of an appropriate internal control system to prevent and detect and fraud rests with the Council.

We have prepared this report solely for the use of the Council and management and it would be inappropriate for this report to be made available to third parties and, 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. If you would like to discuss any matters raised in this report please do not hesitate to contact us.

Yours sincerely

Bryce Henderson
Partner
for Deloitte Limited
On behalf of the Office of the Auditor General

Contents

1. New points raised in current year		
Observation	**Recommendation**	**Management Response**
1.1 Incomplete Fixed asset information provided		
We encountered numerous difficulties in receiving matching and reconciled data provided by the Council to the valuers and the data that was included in the financial system. These include: Lack of timely reconciliation between the RAAM data and the financial ledger. We raised this recommendation in our last year management letter. As part of our planning and interim visit, we followed up on all recommendations made in our prior year letter and noted to management the importance of implementing this recommendation. However, this recommendation was not actioned when we came back for our year end visit. Issues with reconciling the valuations reports to underlying financial and RAAM data. There is a time lag between recording the assets in the financial ledger and recording within the RAAM database. This is because assets are constructed across a period of time hence not recorded in the RAAM database until completion but contract payments have been made which are recorded in the financial ledger. This timing issue complicates the required reconciliations. Construction and renewal information are not always updated in the underlying fixed asset database on a timely basis. There is no central point of contact within Council to take ownership of the data recorded in the fixed asset database and what is provided to the valuers.	We recommend that Council perform regular reconciliations between the Asset system and their Fixed Asset Register. Additionally, Deloitte recommends the Finance team and Asset Manager actively communicates together to prevent variances between the Asset System and the FAR in the future. A review of the respective processes of both the Finance and Asset team should occur to understand the reasons for reconciling items occurring in the first instance and then instigating a process to allow such items to be quantified. As assets are regularly revalued ensuring a coordinated approach to what information is provided to the values is also required to ensure that the valuations are both complete and accurate.	Management concur with the recommendations made. A Fixed Asset Accountant will be recruited early in 2021 so that a dedicated resource can be assigned to review and implement improved recording processes and undertake the necessarily reconciliations more frequently.

1. New points raised in current year

Observation	Recommendation	Management Response
1.1 Breach of Treasury Policy – Debt Maturity Profile		
The debt maturity profile ratio as per the Council's Treasury Policy was breached in FY20 and is still in breach as at 30 June 2020. 30- years maturity - 15% - 60% per policy; KDC position = 83% 3 -5 years maturity - 15% - 60% per policy; KDC position = 9% 5 years + maturity - 10% - 60% per policy; KDC position = 7% **This is due to $25mil of the total debt maturing in the next year.**	We recommend Council perform a review of their debt and ensure any future breaches of debt do not arise. Where it is forecast to occur, then raising in advance to key stakeholders should occur for increased transparency including appropriate calculations within the LTP.	Agreed.
1.2 Building Consent Revenue Recognition Error		
Council incorrectly recognises building consent revenue when the invoice is issued to the customer which can occur before any consent work is performed by Council. Under PBE IPSAS 23, 'Revenue arising from non-exchange revenue', revenue is only recognised when goods or services are provided. As such, Council should defer revenue recognition to when building consent work is completed, i.e. Code Compliance Certificate issuance.	We recommend Council perform a detailed review of all Building Consent Revenue at the end of every financial year, to determine how much revenue should be recognised and how much revenue should be deferred.	Management has agreed to perform a review at year end, and accrue any revenue where work has not yet been performed for the consent.
1.3 Contributions Revenue Recognition Error		
Similar to Building Consent revenue (1.2), Contributions revenue has been incorrectly recognised upon issuance of invoice. However, Contribution revenue should be recognised when the work has been completed i.e. consent is approved.	We recommend Council perform a detailed review of Contribution Revenue at the end of every financial year, to determine how much revenue should be recognised and how much revenue should be deferred.	Management has agreed to perform a review at year end, and accrue any revenue where work has not yet been performed for the consent.

1. New points raised in current year

Observation	Recommendation	Management Response
1.4 Deposits, Retentions and Bonds Reconciliation		
Council does not maintain a reconciliation for their deposits, retentions and bonds in the general ledger, as such at any point in time, Council does not have a visibility on receipts or payments that are outstanding.	We recommend Council reconcile the transactions to provide a clear view on what receipts and payments are due at the end of each month, and perform a monthly reconciliation to track such receipts and payments.	Management agree and a reconciliation will be performed in FY21.
1.5 Review of Sensitive Expenditure and Fraud Policies has not occurred		
Council's Sensitive Expenditure and Fraud policies were due to be reviewed in March and May 2020 respectively. However, these policies were not reviewed as scheduled.	We recommend Council review these policies and ensure it is done in a timely manner. If Council decides that no change needs to be made to the current policies, Council should maintain appropriate documentation evidencing this.	Policies will be reviewed in FY21.
1.6 Significantly aged infringement debts		
The infringement debtors ageing analysis showed that a number of debtors were significantly aged, with some being outstanding for up to 3 years. It was apparent these balances had not been appropriately followed up for payment during the year. Further, management had not completed a sufficient review of these balances leading to an audit adjustment to the financial statements being required.	We recommend Council review these aged debts at the end of each financial year. Debtors that are significantly aged should be written off given there is a remote chance of recovery.	Council are currently establishing a process for a third party contractor to follow up and monitor their debts.

1. New points raised in current year

Observation	Recommendation	Management Response
1.7 Reconciliation between daily cash worksheet and cash deposited into the bank		
Per our consideration of Kai Iwi Lakes Controls, the Campsite Administrator completes a daily cash balance worksheet reconciling cash on site, direct credits and EFTPOS transaction per the till, highlighting the physical amount of cash to be banked pertaining to that day. However there is no reconciliation between monies deposited into the bank and the daily cash balance. Accordingly, we noted variances between the daily cash balance worksheet and cash in the bank. We also noted that although Villie Kayryakova (Finance Manager) performs a sense check over the reconciliation, we note there is no formal review process.	We recommend Council perform a timely reconciliation between the daily cash balance and cash deposited into the bank. The reconciliation should also be reviewed by someone that is not managing the campground. Any variances between cash in the bank and reconciliation is investigated on a timely basis.	Agreed – as part of the banking sector discounting cheques all banking procedures are being reviewed.
1.8 Community Loans should be reviewed		
We note Council has multiple significantly aged community loans. There is $100,000 that relates to the loan provided to Mangawhai Historical Society (MHS). Given that the entity does not have sufficient working capital, it is doubtful that Council is able to recover its debts. Council also has a loan to Hakaru Hall Society (HHS) of $15k which has been outstanding since 2014. The loan document states that KDC has a legal claim to revert the ownership of the Hakaru Hall if its defaults on the loan.	Council should review the community loans to assess if they are recoverable. A provision should be made if it is doubtful that the Council is able to recover its monies.	Agreed – management will review as part of the FY21 annual report preparation.

1. New points raised in current year

Observation	Recommendation	Management Response
1.9 GST reconciliation		
Monies refunded by the IRD as reflected in the bank statement do not always match the monies filed in its GST. This is because the IRD can refund monies relating to PAYE accounts and any remaining monies will get allocated to the GST account. Therefore, it is potentially challenging to track what monies are due. At year end there are monies outstanding from the IRD which are unable to be reconciled and audit has raised this as a potential adjustment.	We recommend that Council perform a reconciliation between monies filed to GST and cash received to ensure that it informs IRD on a timely basis any monies that it is due but not received.	Agreed – this will be reviewed and reconciled in 2021.
1.11 Depreciation of Pavement Subbase Assets		
Council is not currently depreciating Pavement Subbase Roading assets as recommended by both WSP valuers and AME peer reviewers. Per further discussion with Andy Brown (NTA - KDC Roading Team), KDC agree that this should be the case, and NTA are currently formulating a plan to quantify the depreciation amount. At this stage, KDC are unable to provide an estimate of what this amount should be and audit has provisionally estimate an amount to ensure it is not material.	We recommend Council accelerate its plan to identify all pavement subbases which require or have undergone rehabilitation, and quantify depreciation required to be recognized in the forthcoming financial year.	At the time of writing a response from NTA was still pending. A further update will be provided at the interim FY21 audit.

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
2.1 Reconciliation of Property, plant and equipment.		
Property, plant and equipment balances were not reconciled from the fixed asset register and RAMM database. Refer current year issues raised for more information.	We recommend there should be a three way match between the General ledger, fixed asset register and RAMM database. Any variances should be investigated on a monthly basis.	Agreed. **Updated Response:** See comments above under 1.1
2.2 Level of borrowings vs. interest rate swaps		
The level of debt is materially less than the interest rate swaps (FY19: $46m versus $64m, FY20: $44m versus $54m). This has resulted from an accelerated debt repayment schedule occurring but not closing out the swaps. As such there is a significant mismatch between the fixed and floating rates impacting the financial statements.	We recommend management review the ongoing level of expected borrowings and consider whether aligning this to the level of swaps held would be advantageous both economically and from an accounting perspective.	Council and PWC reviewing current level of swaps. In the next financial year $10m of swaps will mature and not be replaced. **Updated Response:** Under the current market conditions, no further swaps will be taken and Council will wait for the current ones to lapse as it is uneconomic to buy them out.
2.3 Processes around aged rate debtors (non-rateable properties)		
Council's policy is for all non-rateable properties to be assessed on a yearly basis and reviewed by a manager. The purpose of this control is to ensure the non-rateable properties listing is accurate and that the rateable and non-rateable properties are mutually exclusive. We were unable to sight evidence of an assessment completed in the current year.	We recommend that any assessment of this is properly documented evidencing that review has taken place.	Agreed this should be signed off by the GM Risk, IT, and Finance. **Updated Response:** Agreed. Process surrounding non-rateable property should be improved.

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
2.4 No evidence of review between reconciliation of strike rates and budget rates		
Council's control around rates legislative compliance is to review the reconciliation between the strike and budget rates. We note this was prepared by the Revenue Manager in July 2020 and was emailed to the GM of Finance. However we were unable to sight evidence of review of the reconciliation.	We recommend a process be put in place to ensure that the reconciliation is reviewed regularly.	Agreed will be completed in the next financial year. **Updated Response:** No further update. This will be completed as part of the next rates strike.
2.5 Review of Ventia (Broadspectrum) meter readings uploaded into Magiq		
During our walkthrough of the Water rates revenue process, we note that there was no manager review performed on the water meter readings (total for each area). The reviewing of the meter readings is important to address the accuracy and reasonableness of water rates charged.	We recommend that Council implements detective or preventative controls ensuring the accuracy and reasonableness of water rates.	Agreed, Finance is working with the Infrastructure team to automate the recording process so the system can highlight anomalies. **Updated Response:** Reporting at the end of the process identifies outliers which are investigated by the Revenue Officer.

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
2.6 Amounts provided to NRC does not agree to GL		
The Council collects rates on behalf of Northland Regional Council (NRC). At the end of the year, the council provides NRC with a copy of amounts outstanding and cash received from ratepayers to be paid to NRC. In FY19, there is a variance of $20k between the Council's GL and confirmation provided by the Council to NRC. This variance of $20k still exists in FY20. This indicates that KDC indicates on its books that it owes NRC $20k more than what NRC believes it is owed. Given that the Council controls this process i.e. collects money from ratepayers, provides NRC with the amounts payable and cash received, there should be no difference between its GL balance and the balance provided to NRC.	The Council should perform a reconciliation between its GL and its rating database to reduce the risk it pays NRC rates that have not been collected or holds rates inadvertently.	This has not been investigated at the time of the report being issued. **Updated response:** No further update. The Revenue Manager and Financial Service Manager will review this in FY21.
2 .7 Reconciliation to be performed on deposits received and paid.		
There is no reconciliation between the levies received from customers and owing to suppliers. Council is only able to produce a transaction listing of all monies received and paid out during the year. It is unable to pinpoint which customers it has received cash from but not paid out to suppliers.	We recommend that Council performs a reconciliation between monies received from customers and monies owed to suppliers.	This covers building consents, resource consents, and bonds. Reconciliation will be completed annually by Finance Manager. **Updated response:** Refer comments above under 1.4

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
2.8 Clarification required on sensitive expenditure policy		
Para 7.3.5 of the sensitive expenditure policy 2017 states “Officers will be reimbursed for actual and reasonable meal costs incurred during business activity”. The wording ‘reasonable’ can be subjected to various interpretations. In FY19, our expenditure testing showed one individual had spent $59 on dinner while on conference in Wellington. Whilst this may not be unreasonable, the level of ambiguity creates unnecessary risk.	We suggest that Council sets a limit or guideline to remove any subjectivity to what reasonableness means.	This will be put on the claim form itself. **Updated response:** A revised policy manual was issued in 2020, and although the wording still uses the word “reasonable” additional guidance has been given on what cannot be claimed for.
2.9 Description of accounts should represent the nature of the balance		
We note that when deferring rates revenue and health and dog licence revenue, KDC uses the balance sheet account #9998050 accured expenses. This is incorrect as deferred income should not be going through an accrued expense account.	Transactions should be appropriately separated into their respective assets and liability GL accounts unless there is a right of offset (PBE IPSAS 1 Para 48).	Process to be corrected in FY20 **Updated response:** No further update.

2.10 Roading Assets: Implementation of OPUS recommendations

We have noted the following recommendations that OPUS has raised as part of their FY19 which has been raised again in FY20 revaluation. It is important for management to address these matters so that the quality of the data underpinning the valuation continues to improve. This in turn impacts the accuracy of the valuation, the funding (or rating) requirement for the assets, and the operational issues around timing of renewals.

(a) Pavement subbase assets are not currently being depreciated. Experience has been that on many networks, including those in rural areas, by the time pavement rehabilitation occurs there is no pavement strength contribution from the existing subbase. Depreciation of subbase assets should be considered.

(b) Consideration should be given to depreciating subbase to provide funding for the new pavement. Replacement will occur in urbanised roads constrained by kerb and channel.

(c) Continue to maintain, develop and improve the asset component register including:
(i) Ensuring construction dates are applied to all components, as the construction date input is one of the most sensitive inputs to the valuation system. Where default dates are being used, these need to be of a realistic nature.
(ii) Where assets are replaced or upgraded, these changes must also be accurately recorded in the relevant asset tables in a timely manner to ensure everything is captured within the valuation.

(d) Care should be taken to ensure every asset has the asset owner field populated. While most asset tables do, some assets remain without this information. To ensure these assets are included in the valuation, this data could be extrapolated from a GIS analysis where no other source is available. Ensuring the asset owner field is populated for each new asset will increase the accuracy of the valuation process.

We recommend management implement ALL these recommendations as well as a timeline as we expect this will need to occur over an extended period. Progress should also be reported to the Audit, Finance and Risk Committee.

The roading team is preparing a report for the Audit & Risk Committee.

Updated Response:

No further update.

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
(e) Reconcile the work previously undertaken on the actual achieved lives for surfacing on the Kaipara network for each surface type and apply it to the valuation. Some of the default total useful lives that are currently being used appear to be overstated. (f) There is an identified issue in how bridges are being componentised in RAMM. It is recommended that review of Bridge asset in RAMM and analysis of life cycle aspects of bridge components be undertaken. Consider from this analysis how bridges may be broken down for management valuation purposes. (g) Field Data validation should be undertaken on a regular basis to confirm the accuracy and completeness of the data. A prioritised currency programme should be developed to ensure data currency. (h) Some Street Lighting assets are having their light component replaced with LEDs. These units have been replaced prior to them reaching their total useful life, causing a portion of their value being written-off. Analysis on the amount written-off and the effect on the ORC should be undertaken.		

2. Points raised in prior year still open in current year

Observation	Recommendation	Prior year Management Response
2.11 Terminated User Accounts Retained		
We have noted that IT never delete users when personnel leave the organization; instead they move the users to a disabled login. NCS users are never deleted to enable access to user history records.	Although we understand that KDC would like to retain the user history records, we would recommend that user accounts that have been disabled after a period of time are terminated to decrease the risk of misuse.	The Council is currently going through the process of auditing whose fixed term, permanent and consultants that keep coming back. Recurring people are not terminated. **Updated Response:** KDC acknowledges the recommendation, and deletes non-MAGIQ user accounts, but due to the limitations of the MAGIQ software the practice continues for users who had MAGIQ accounts.
2.12 Review of user access and modification rights		
We have noted that a review of the user access has not been performed given the small size of the team, and that Kaipara District Council (KDC) has an understanding of who the users are.	We recommend that user access reviews be conducted at least annually to ensure that redundant accounts are removed and user accounts are reflective of authorised access levels.	There are 9 user domain accounts of 185 (4.9%). These will be reviewed and the least privilege principle applied. **Updated Response:** Due to an expansion in service accounts there are 14 domain accounts. 5 user (down from 9) and 9 service accounts. User accounts are additionally protected by Microsoft Azure multi-factor authentication.