

Interim management report on the audit of

Tasman District Council

for the year ended 30 June 2011

Audit New Zealand has performed this audit on behalf of the Controller and Auditor-General.

We are responsible for expressing an independent opinion on the financial statements and statement of service performance, and reporting that opinion to you. This responsibility arises from section 15 of the Public Audit Act 2001.

Our audit has been carried out 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 is not material in terms of your financial statements.

The implementation and maintenance of your systems of controls for detecting these matters remains the responsibility of the governing body and management.

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1 Assessment of your control environment

We performed a high-level review of your control environment. This included considering the council and management's overall attitude toward, awareness of, and actions in establishing and maintaining effective management procedures and internal controls.

The purpose of our review was to:

- identify aspects of the control environment that can be relied on during the audit;
- identify potential areas for improvement; and
- gain a better understanding of the issues facing council and how these were being addressed.

Our conclusions are made in the context of our work in conducting the audit. They are not an assessment of overall management performance or of council's effectiveness in achieving its objectives.

Overall, we assessed the control environment as effective

We have assessed the control environment as "effective". This means that we believe the control environment supports the effective operation of accounting processes and systems, including internal control process.

We reviewed the internal control systems and, where appropriate, tested those systems to confirm that the key controls identified had been operating effectively throughout the period. We use this information in planning our final audit.

Particular aspects of the control environment that we comment on are:

1.1 Organisation and governance structures

We reviewed council's organisational and governance structures. We consider that council has a clearly defined organisation structure with an audit committee and various sub-committees to oversee its operations and governance. In addition council has appropriate reporting lines in place.

We believe this structure is appropriate for the size and complexity of the council.

1.2 Planning and budgeting

We continue to assess council's budgeting, monitoring and forecasting procedures to be sufficiently robust for us to place reliance on them for the purposes of our audit of its financial statements. We arrived at this assessment during our audit of council's LTCCP and through our understanding of the annual plan process during 2011.

1.3 Risk assessment process

We enquired into council's current approach to risk management and the processes in place to identify and manage these risks. Council recommenced work in this area from the 2010 financial year. We updated our understanding of council's current progress to risk management.

We noted that a formal risk register has been set up. This register captures service delivery, social/cultural, environmental, and economic risks each council department faces. Risks are rated according to the seriousness of their consequences and the likelihood of happening. Risk treatment actions are determined for each risk

identified, and residual risks are assessed and recorded in the risk register.

We understand that management is planning to select critical risks from the register and implement mitigation actions accordingly. We will maintain a watching brief as the mitigation plans are implemented and will provide updated comments on this as part of our final audit or the 2012 audit depending on progress with this.

1.4 Internal controls

We reviewed the internal controls in place for your key financial and non-financial information systems. Internal controls are the policies, procedures, and activities that are in place to provide reasonable assurance that processes operate as designed. They are important because effective controls help to minimise the risk of fraud or error.

Overall, we found that council's controls are operating effectively. Our detailed findings on internal controls are included in section 4 of this report.

The council and senior management are continuously looking for opportunities to improve internal control systems. This is evidenced by the recent implementation of the online timesheet system and the online purchase order system.

2 Our areas of focus for this year

The areas that we are paying particular attention to this year are outlined in our audit arrangements letter, dated 10 January 2011. We will comment in full on these matters in our final management report. However, based on our work to date, we make the following comments:

2.1 Amalgamation

The Local Government Commission completed its hearings on the proposed amalgamation of the Tasman District and Nelson City Councils. The preliminary decision has been to propose a draft reorganisation scheme for a unitary authority covering the Nelson–Tasman district. The draft reorganisation scheme is open for submissions until 19 August.

We understand that council has prepared a paper outlining a number of flaws within the draft reorganisation scheme report and these have been submitted to the Commission. We will maintain a watching brief as to further developments once the submission period ends and subsequent announcements are made.

2.2 Aorere river flood

Severe flooding occurred over the Christmas/New Year period in the Tasman district causing damage to river protection works, bridges and other roading infrastructure. We discussed the extent of damages and disruption to services from this event with management. We understand that the damage was mainly to river protection works and several bridges. Council have estimated the cost of repairs to be around \$6m. This will be funded through a combination of LAPP fund, NZTA emergency fund and council's budget.

The serious damages to council's bridges and river protection assets may have resulted in these assets being impaired. NZ IAS 16, *Property, Plant and Equipment*, requires an impairment test to be carried out each year to consider if there has been any impairment. We will review council's impairment assessment during our final audit.

The disruptions to services resulted from the flood may have an implication on meeting some of council's non-financial performance

targets. We will review council's disclosure of the impact on the provision of services such as river protection and roading during our final audit.

Management comment

Agree, the flood directed focus away from routine river work. Assets will be reviewed for impairment or write-off.

3 Common issues in the local authority sector

Every year, we identify key areas of focus and issues that we commonly find across the local authority sector. These were outlined in our audit arrangements letter. Based on the work we have completed so far, we make the following comments:

3.1 Audit of Service Performance Reports (AG-4 (revised))

We reviewed the performance framework from the LTCCP to reconfirm that it remains appropriate given any changes in activity since the LTCCP was adopted. We assessed the effectiveness of control environment around service performance reporting, and reviewed council's processes and systems for reporting against its key performance measures.

Overall, we were satisfied that council's non-financial reporting framework does provide an appropriate basis for the meaningful assessment of council's performance. Performance is monitored closely by the senior management team throughout the year, and there are sound systems in place for recording and reporting against service performance measures.

A minor issue was noted during our system review:

Measure: All solid waste activities comply with any required resource consent conditions and site management plans.

We understand that this measure is monitored by MWH. A spreadsheet is developed for each consent, listing all monitoring actions that are needed to be carried out each month for that consent. A compliance percentage is calculated for each consent based on information recorded on the spreadsheet. However, the overall compliance percentage is calculated as the average of compliance percentages of individual consent. Because the number of monitoring actions required for different consent varies substantially, averaging compliance percentages of individual consents is not going to provide a meaningful result.

We recommend council review its calculation method for this measure. An alternative way of calculating overall compliance percentage could be to base the calculation on the total number of monitoring actions performed during the year for all resource consents.

Management comment

Agree, Council no longer uses an averaging approach.

3.2 Council's assessment of areas susceptible to fraud

We checked to see that council has recently (within the last year) undertaken a robust review of transactions, activities or locations that may be susceptible to fraud. From discussion with management we understand that no such specific reviews have been performed which specifically cover off fraud risks. However, the internal controls in these areas are being constantly monitored to identify any weaknesses in their design or operations.

We noted that council has engaged WHK to perform a review on its internal controls around revenue. This may provide council with some level of assurance around fraud risk. However, we recommend council undertake a formal review of identified areas that may be susceptible to fraud to mitigate the risk of fraud occurring.

Management comment

Council does undertake reviews for fraud on sensitive expenditure items. A higher focus can be applied to this matter as resourcing permits.

3.3 Sensitive expenditure

We reviewed whether council has suitable expenditure policies in place covering the areas detailed in the Auditor-General's good practice guide: *Controlling sensitive expenditure: Guidelines for public entities*.

This year we reviewed travel expenses and training/conference expenses. Specific findings for travel and credit card expenditure are outlined below.

3.3.1 Policies

We reviewed council's policies and procedures for travel and training/conference expenses. We found that while council does not have specific guidelines covering conference expenditure, there are appropriate review and approval processes contained within council's delegation policy.

In our review of council's travel policy against the OAG's good practice guide, we noted the following:

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- the policy does not provide guidance on taking annual leave, staying away over weekends, stopovers, travelling with spouses when staff are travelling on council business; and
 - there are no policies detailing the specific amounts for meal allowances, the classes of flights and types of accommodation allowed when undertaking council related travel.

We recommend that council compare its sensitive expenditure policies with the best practice guide, and consider updating the relevant policies to align with best practice.

Management comment

Council's current approach is to apply the fair and reasonable test, rather than apply set amounts. Council will review current policies in line with the OAG guidelines.

3.3.2 Transaction testing

We tested a sample of transactions for compliance with council's sensitive expenditure policies. We noted one instance where the travel expense was authorised by the department manager's executive assistant rather than the manager directly.

Council's travel policy requires all travel expenses to be approved on a one-up basis. In this case the department manager was the appropriate authoriser. This is an important control to ensure the validity and reasonableness of expenditure. An executive assistant's approval would not be in accordance with a one-up approval policy. In addition, it is also unlikely that such a position is the most appropriate to assess the reasonableness of the expenditure or challenge the expenditure if it were considered to be inappropriate.

We recommend staff be reminded to obtain appropriate one-up approval for all sensitive expenditure items in accordance with council's policies.

Management comment

Agree with comment. A reminder will be delivered to management.

3.4 Procurement

In June 2008 the Office of Controller and Auditor-General (OAG) issued a good practice guide: *Procurement guidance for public entities*. The OAG expects public entities to develop their own procurement policies and procedures that reflect the value and risk of their procurement.

We understand that council is in the process of developing a procurement policy and are aware of the good practice guides available. We intend to review the policy against OAG's best practice guidelines when it is completed, and look to provide feedback on this where we consider it may enhance council's policy.

Procurement is an area of high focus and risk to entities. An appropriate policy across council's areas of procurement helps to protect council and provide guidance to staff when undertaking procurement practices.

Management comment

A procurement policy is being completed.

4 Internal controls

The systems that we reviewed included:

4.1 Payroll

Council implemented an online timesheet system during the year. Timesheet completion and approval are now all performed on-line. We reviewed the process and controls around the new system and noted that controls have been operating effectively throughout the year.

There are no issues that need to be brought to your attention.

4.2 Expenditure

We noted in the previous year's audit that there were limited controls over issuing purchase orders. The invoices are authorised by staff with delegated authority before payments are made, but purchase orders are not always issued/authorised by staff with delegated authority.

We understand that council is in the process of implementing an electronic purchase order system. The system will require authorisation before purchase orders are sent out. Properly implemented, this provides additional controls around council's expenditure.

There remains a risk with any purchase order system that the module is not always used. The risk of staff entering into purchase arrangements outside of the purchase order system is one that council needs to consider and monitor during the implementation of the system.

During our sensitive expenditure testing, we noted that the Chief Executive is not set up in the new purchase order system. This may be at odds with council's delegation limits where expenditure over a certain amount requires the Chief Executive's approval. A further situation may occur where expenditure of a certain nature specifically requires one-up approval. If this expenditure is incurred by managers then the one-up approval would come from the Chief Executive.

Council may need to consider alternative ways to maintain one-up approval, or compliance with delegations, when the new purchase order system is up and running.

Management comment

Agree with comments in general. Staff had identified these same issues, and they are being incorporated into the Purchase Order Policy. From a practical standpoint it is more appropriate that the CEO and 2nd tier have a peer responsibility rather than one up.

4.3 Revenue

We noted in the previous year that there had been delays in consent billing due to delays in updating the job costing system. This is no longer an issue after the implementation of the on-line timesheet system. Costs are coded to relevant jobs directly when timesheets are completed by employee via the on-line timesheet system. This enables timely billing of granted resource consents.

We also reviewed systems and controls around council's key revenue systems. There are no issues that need to be brought to your attention.

5 Matters raised last year

The status of matters raised in last year's management report is described in Appendix 1.

Appendix 1: Status of matters raised last year

Outstanding matters

| Matter | Recommendation | Outcome |
|--|--|--|
| <p>Accounts receivable balances</p> <p>We noted considerable aging of a number of minor categories of debtors including parking infringements and dog and sundry infringements.</p> | <p>We recommended that these infringement type debtors be reviewed more regularly for collectability and where this is not considered likely, a provision for impairment or write off of these balances be made.</p> | <p>We understand that these infringement accounts will be reviewed for doubtful debt impairment at the end of the financial year. We will review the provision during our final audit.</p> |
| <p>Maintenance of the interest register</p> | | |

| Matter | Recommendation | Outcome |
|--|---|---|
| <p>Councillors' interests are declared at council or committee meeting. These declarations are recorded in council minutes. However, these declarations are not always updated in council's formal interest register.</p> | <p>We recommended council update and maintain its interest register. This will assist with identifying previously declared interests and also for identifying and disclosing related party transactions within council's financial statements as required by relevant accounting standards.</p> | <p>Council's formal interest register has not been updated.</p> |
| <p>Cost allocation</p> <p>Council has historically allocated a portion of overhead costs to capital projects. This is based on a methodology adopted several years ago. There were some large balances being capitalised to the roading activity. It was unclear what the capital overhead costs were based on and therefore it was unclear whether they were directly attributable to the assets or not.</p> | <p>We recommended that council review their overhead allocation methodology in 2009/10 and consider using the job costing system to enable more accurate assessment for project management time.</p> | <p>The same approach has been used during the year. Council staff explained that changing the overhead allocation method may have an impact on Council's rates. We were informed that council is currently investigating possible solutions for this issue. The approach will be reviewed during the 2012-22 LTP process.</p> |
| <p>Purchase order authorisation</p> | | |

| Matter | Recommendation | Outcome |
|---|---|--|
| There were limited controls over issuing purchase orders. The invoices are authorised by staff with delegated authority before payments are made, but purchase orders are not issued/authorised by staff with delegated authority. | We recommended that purchase orders to be issued/authorised by staff members within delegated authority before they are sent to suppliers. | Council has developed an electronic purchase order system, which enables purchase orders to be authorised before they are sent out. This system is currently being rolled out in different departments. We will review effectiveness of the new system in the next financial year when it is fully in use. |
| Funding of depreciation We comment on council's policy of not funding depreciation at an activity level, instead it is funded at an income statement level. Long term this results in council having to fund major capital works by way of Public Debt. | No specific recommendation other than raising the issue of increasing levels of council debt and that we would maintain a watching brief over this. | There has been no change to council's policy of not funding depreciation. We understand that council is reviewing this approach in the 2012-22 LTP process. |

Matters that have been resolved

| Matter | Recommendation | Outcome |
|---------------|-----------------------|----------------|
|---------------|-----------------------|----------------|

| Matter | Recommendation | Outcome |
|---|---|---|
| Resource consent billing Granted resource consents are not invoiced on a timely basis due to delays in updating the job costing system. | We recommended that council could improve its current use of the job costing system to provide more timely information on resource consent costs incurred, work in progress, and timeliness of billing. | Granted consents are billed on a timely basis after the implementation of the on-line timesheet system. |

