

Monday, 20 May 2024

Te Hui o Te Kaunihera ā-Rohe o Heretaunga

Hastings District Council

Risk and Assurance Committee Meeting

Kaupapataka

Attachments Under Separate Cover

Te Rā Hui:

Meeting date:

Monday, 20 May 2024

Te Wā:

Time:

10.00am

Te Wāhi:

Venue:

**Council Chamber
Ground Floor
Civic Administration Building
Lyndon Road East
Hastings**

ITEM	SUBJECT	PAGE
6.	ANNUAL REPORT - 2023 WRAP-UP AND 2024 UPDATE	
	Attachment 1: Financial Management - Audits - External audit - 2023 EY Report to Management Hastings DC - signed	3
	Attachment 2: Financial Management - Audits - External audit - 2024 HDC EY Audit plan	19
7.	LONG TERM PLAN RISK BASED INDICATORS	
	Attachment 1: Draft 2024-2034 Long Term Plan Financial Strategy	37

Report on Control Findings for the year ended 30 June 2023

Hastings District Council





Ernst & Young
40 Bowen Street
Wellington 6011 New Zealand
PO Box 490 Wellington 6140

Tel: +64 4 499 4888
Fax: +64 4 495 7400
ey.com/nz

29 January 2024

Bruce Allan
Deputy Chief Executive
Hastings District Council
Private Bag 9002
Hastings 4156

Dear Bruce

Control Findings for the year ended 30 June 2023

We have completed our audit of the financial statements and performance information of Hastings District Council ("HDC" or the "Council") for the year ended 30 June 2023.

This Report on Control Findings includes all control matters and issues arising from our audit findings that we consider appropriate for review by management. We recommend that it be read in conjunction with our Report to the Risk and Assurance Committee in October 2023.

In accordance with the Office of the Auditor General's auditing standards which include International Standards on Auditing New Zealand (ISA (NZ)), we have gained an understanding of your internal controls, as relevant to the audit in order to assist in the design of our audit procedures to gather sufficient appropriate evidence to form an opinion on the Council's financial statements and performance information. Our audit procedures do not address all internal control and accounting procedures and are based on selective tests of accounting records and supporting data and have not been designed for the purposes of making detailed

recommendations. As a result, our procedures would not necessarily disclose all weaknesses in Council's internal control environment, and you should not assume that there are no additional matters that you should be aware of in meeting your responsibilities. We have provided our comments with ratings as assessed by us during the procedures performed. It is possible that a combination of moderate or low risk issues may in combination create a high risk. We have not considered the impact on our risk assessments of such combinations.

We wish to express our appreciation for the courtesies and co-operation extended to our representatives during the course of their work. If you have any questions or comments, please do not hesitate to call me on 027 489 9378.

Yours faithfully

Stuart Mutch
Partner
Ernst & Young

Table of contents

1.	Overview	1
1.1	Overview of Risk Ranking System	1
1.2	Summary of current year audit observations	2
1.3	Disclaimer	3
2.	Current year observations	4
2.1	High Risk Matter	4
2.2	Moderate Risk Matters	5
2.3	Low risk matters	9

1. Overview

1.1 Overview of Risk Ranking System

To provide context around the seriousness of the matters we have raised we have ranked issues in this report by applying the following rating scale:

High Needs significant improvement	Immediate corrective action is required. These recommendations relate to a serious weakness which exposes the organisation to a material extent in terms of achievement of corporate objectives, financial results or may otherwise impair Hasting District Council's reputation.
Moderate Needs substantial improvement	Corrective action is required, generally within 6 months. A control weakness, which can undermine the system of internal control and/or operational efficiency and should therefore be addressed.
Low Needs some improvement	Corrective action is required, generally within 6 to 12 months. 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.

1.2 Summary of current year audit observations

The following table summarises the observations from our 2023 audit, including those unresolved from 2022, and the associated risk rankings:

	High Needs significant improvement	Moderate Needs substantial improvement	Low Needs some improvement
2.2.1 Performance Information in relation to Customer Complaints	-	✓	-
2.2.2 Tracking the Cost to Repair Infrastructure	-	✓	-
2.2.3 The Cost of Infrastructure Repairs Compared to Impairments Incurred	-	✓	-
2.2.4 The Valuation of Three Waters assets	-	✓	-
2.3.1 Management of Accounts Receivable Utilising Systems Based Reports	-	-	✓
2.3.2 Monitoring of Capital Work in Progress	-	-	✓
2.3.3 Capitalised on cost percentage	-	-	✓
2.3.4 De-Recognition of Replaced Reticulation Assets	-	-	✓
	0	4	4

1.3 Disclaimer

Issues identified are only those found within the course of the audit for year ended 30 June 2023. Recommendations are intended solely for the use of Hasting District Council's management. We disclaim any assumption of responsibility for any reliance on this report, to any person other than the Hastings District Council management team, Council and for any purpose other than that for which it was prepared.

2. Current year observations

2.1 High Risk Matters

No High Risk Matters were identified during the course of our 2023 audit that were not resolved prior to the adoption of the 2023 Annual Report. The matter associated with the valuation of three waters assets noted as High in our 2022 Report to Management has been re-assessed as Moderate Risk due to the steps taken by management in 2023 to support the unit pricing of assets.

2.2 Moderate Risk Matters

2.2.1 Performance Information in relation to Customer Complaints	
Observation	<p>Historically information has been captured and maintained focused on where customer requests for support / intervention by Councils infrastructure maintenance providers are actioned. This could result in, for example, multiple calls in relation to the same water supply failure only being captured as a single matter, being the response by Council's contractor. Whilst this is the practically reasonable way of monitoring contractor performance in terms of response times and event closure times, the performance measures established by the DIA require information to be captured at the individual customer call level, presumably to support an understanding of how many customers are being impacted by infrastructure failure events.</p> <p>Council have taken steps over the last 12 to 24 months to improve their reporting of customer calls based on information / call type received. In 2022 and 2023 we have determined that Councils own Call centre function, during normal work hours, was collecting information correctly. However, the Palmerston North City Council call centre which takes over call management after hours continued to capture information in the old manner. Consequently, Hastings District's information was not able to be collated in a consistent manner.</p>
Recommendation	<p>Council work with Palmerston North City Council to align the manner in which customer calls are collated and reported.</p> <p>Council management review the ability to review call numbers by call centre operator so that there is adequate traceability of calls from collated annual and monthly data through to specific calls, call classification and call timing.</p>
Management response	<p>Council will continue to work with Palmerston North City Council to ensure Customer Complaint information is collected and reported in a manner consistent with Council's internal information capture processes.</p>
Responsibility	<p>Greg Britton</p>

2.2.2 Tracking the Cost to Repair Infrastructure	
Observation	<p>Hastings District Council suffered significant damage to its roading network during the course of Cyclone Gabrielle in February 2023. Extensive work was undertaken during 2023 to determine the extent of the damage incurred and for financial reporting purposes, the level of impairment of assets that required recognition.</p> <p>A key complexity associated with this work was the difficulty in determining:</p> <ul style="list-style-type: none"> a) The extent of damage to segments of the roading network, and whether this constituted an impairment to the extent that it inhibited the use of tangible sections of road beyond the initial clearance of silt and woody debris; and b) What costs incurred subsequent to the cyclone, represented costs towards the removal of silt, woody debris and general traffic management costs that did not actually represent the restoration of roading tangibly impaired as a part of the Cyclone. <p>Additional work was required by Council and the audit team during October to finalise an adequate understanding of the split in the nature of damage and the nature of rehabilitation work.</p>
Recommendation	<p>Specific rules be defined by Council and the appropriate treatment of damage or costs incurred against those rules be applied by Council at the time in which costs are incurred.</p>
Management response	<p>Council asset managers are expected to correctly identify restoration versus repair costs and code these accordingly in the finance system. Finance work closely with them to ensure this is being done correctly and consistently.</p> <p>We continued to see high levels of restoration work in the first few months of the 2023/24 financial reporting period but expect this to move to significant repair works to bring assets back to their prior levels of service for the remainder of the financial year.</p> <p>Council will also be engaging BECA to value the roading network at 30 June 2024 to assist in determining the level of impairment and the impact this may have for financial reporting purposes.</p>
Responsibility	<p>Jess Noiseux</p>

2.2.3 The Cost of Infrastructure Repairs Compared to Impairments Incurred	
Observation	<p>During the course of the 2023/24 financial year we expect Council to make significant progress towards the reconstruction or repair of significant elements of their roading infrastructure damaged during Cyclone Gabrielle. We note that the accounting for repairs can generate a number of complexities for the enduring asset, including:</p> <ul style="list-style-type: none"> a) The cost of repairs at present day costs will exceed the depreciated replacement cost of assets impaired, giving rise to the need for not just removing impairments but also potentially recognising higher values for assets. b) Assessing the remaining useful life of restored assets. Because new construction will be involved in repairs and restoration work it is likely that the repaired asset will have a remaining useful life that will exceed that of the assets impaired resulting in different levels of depreciation and a need to capture appropriate information for subsequent valuations. c) The restoration of assets may result in roads being re-routed and assets that were not destroyed or significantly damaged in the cyclone actually becoming redundant as they are in the wrong place or uneconomic to repair. Such redundant assets will required further de-recognition. d) Council may need to make the decision to diminish the level of service available to the Community as elements of assets may not be economically viable to restore. Where assets that have been impaired but not fully destroyed are abandoned, or passed into private hands, these adjustments will need to be applied against the remaining carrying value of these assets.
Recommendation	<p>Consideration be given to the risks noted within (a) to (d) above. We recommend that approaches to resolving these matters be documented, understood by management and adhered to.</p>
Management response	<p>The risks identified above are applicable to the detailed information held within the RAMM system. BECA are contracted to maintain this system alongside Council asset managers. We will work with BECA and the asset managers to ensure they are taking the above risks into account when managing the asset detail held within RAMM.</p> <p>Council will also ensure these risks are discussed and taken into consideration during the roading valuation carried out by BECA for 30 June 2024.</p>
Responsibility	<p>Aaron Wilson</p>

2.2.4 The Valuation of Three Waters assets	
Observation	<p>As a part of the preparation of the 30 June 2022 financial statements management utilised an internal methodology utilising information drawn from external specialists in regards to pricing datasets and unit cost trends over recent periods. In addition, Council obtained an external independent review of the valuation. Despite these procedures, the extent of the resulting valuation movements exceeded the expectations of all parties. Whilst the valuation was supportable, due to scale of the valuation movements arising from the unit pricing indices we made a recommendation at the conclusion of our 2022 audit that due to the significance of three waters assets to the Council we considered it prudent in 2023 to undertake a full asset valuation for financial reporting purposes.</p> <p>The impact of the weather events of early 2023 generated significant increased activity within Council. Rather than seek a full valuation in 2023, Council obtained a new set of third party unit pricing data to cross-validate the unit pricing applied in 2022. This unit pricing provided an increased level of confidence in the 2022 valuation and its ongoing use. However, given the amount of ongoing change in the sector, construction cost fluctuations and the scale of 3 waters assets (\$1.1 billion), the benefits of a full external valuation to verify the valuation of this asset base remains high.</p>
Recommendation	Given the scale of the valuation of three waters assets, and the different procedures applied in recent years, we recommend that Council consider that the 2024 valuation be undertaken by an external professional party with access to a full asset construction cost database and the asset database maintained by Council.
Management response	Council are currently in the process of engaging with an external professional to complete the Three Waters valuation for 30 June 2024.
Responsibility	Jess Noiseux

2.3 Low risk matters

2.3.1 Management of Accounts Receivable Utilising Systems Based Reports	
Observation	<p>As a part of our procedures to assess the completeness and the recoverability of accounts receivable we sought a range of reports from management to support the age profile and movements in key accounts receivable across a number of Council activities, such as consent cost recovery and other user pays based activities.</p> <p>Our overall observation of the reporting being utilised by Council, or able to be extracted from core systems was that the reports were cumbersome, required significant management intervention to provide effective insights and we not conducive to timely and effective management. Whilst we were satisfied that management had determined the right decisions in regards to matters such as the recoverability of accounts receivables and the identification of credit balances to recognise as liabilities rather than netting asset positions, the reporting appeared functionally limited and time consuming.</p> <p>We have maintained this matter as it was not resolved in the 2023 financial year.</p>
Recommendation	<p>Council give consideration to the review and improvement of the reporting functionality in place in regards to its core revenue and accounts receivable focused applications with a focus on ensuring the efficient and effective management of Councils Accounts Receivable management across the areas of services provided to users of Councils functions.</p>
Management response	<p>Noted, we aim to resolve this following upgrades to the property and rating system which is scheduled to take place in the 2024/2025 financial year.</p>
Responsibility	<p>Aaron Wilson</p>

2.3.2 Monitoring of Capital Work in Progress

Observation	During our review of Capital Project work in progress positions we undertook an analysis across reporting periods to assess whether the asset positions recognised were of risk of being stale, in that they either should be capitalised or written off as a consequence of projects not proceeding. This assessment identified a small number of projects that were completed for over 12 months but had not been capitalised. Whilst the impact of this on understated depreciation was immaterial, it is good practice to regularly review capital work in progress positions. This is particularly important at a time when Councils level of capital expenditure is at such high levels.
Recommendation	Council implement procedures to undertake regular reviews of capital work in progress positions to ensure that projects are closed and capitalised in a timely manner.
Management response	Council review infrastructure WIP on an annual basis due to the complexities within the project space for these assets. All other asset classes are regularly reviewed and works capitalised throughout the year. At year end discussions are held with the relevant water asset managers (all roading and parks WIP is fully capitalised at year end) and reliance is place on their expertise as to whether projects are complete and ready for capitalisation or not. Finance will continue to work with the asset managers and emphasis the importance of identifying completed projects for capitalisation.
Responsibility	Jess Noiseux

2.3.3 Capitalised On Cost Percentages

Observation	There is no formal review in place for the appropriateness of the on-cost percentages used when determining the initial cost of a water asset. During our testing of the cost of water assets we noted that there has been no documented basis for the level of on-costs applied. Where a project is totally outsourced, including matters such as professional engineering services, these costs are attributed directly to projects in line with expectations. However, where internal costs have been incurred we could not identify a standard policy or calculation methodology for applying an allocation of directly attributable costs for internal planning. Given the very high level of capital project work underway within Council such guidance would be beneficial to support the capturing of costs in line with project demands and accounting standards.
Recommendation	Document and apply a standard methodology and guidance for the capitalisation of internal costs associated with planning and managing capital projects.
Management response	Finance will work with the relevant asset managers to document and evidence the appropriateness of the on-cost percentages used.
Responsibility	Cambell Thorsen

