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6 May 2020

Garry Webber  
Mayor  
Western Bay of Plenty District Council  
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Ref: EN/LCA/3-0051 [T933]  
Copy: Director Auditor Appointments  
Office of the Auditor-General  
PO Box 3928  
Wellington 6140

Dear Garry

## **Proposal to conduct the audit of Western Bay of Plenty District Council on behalf of the Auditor-General for the 2020, 2021, and 2022 financial years**

### **1 Introduction**

The Auditor-General proposes to appoint me to carry out the audit of your organisation for the next three years. As required by the Office of the Auditor-General (OAG), I set out below information relating to the audit for the three financial years ending 30 June 2020, 2021 and 2022. The purpose of this proposal is to provide information on:

- the statutory basis for the audit and how audit fees are set;
- the entities covered by this proposal;
- key members of the audit team;
- the hours we plan to spend on the audit and reasons for any change in hours;
- our proposed fees for the audit for the financial year ending 30 June 2020 and reasons for any change. We will agree the fees for the financial years ending 30 June 2021 and 30 June 2022 at a future date;
- assumptions relating to the proposed audit fees, including what we expect of your organisation;
- what the OAG Audit Standards and Quality Support fee (previously OAG Overhead charge) provides;
- certification required by the Auditor-General; and
- our commitment to conduct the audit in accordance with the Auditor-General's Auditing Standards.

## **2 Statutory basis for the audit and how audit fees are set**

The audit of your organisation is carried out under Section 15 of the Public Audit Act 2001 (the Act), which states that “the Auditor General must from time to time audit the financial statements, accounts, and other information that a public entity is required to have audited”.

Fees for audits of public entities are set by the Auditor General under section 42 of the Act. The Act requires the Auditor-General to make sure that audit fees are “reasonable” for both the auditors who complete the audits for the Auditor-General, and for each of the entities audited. The Auditor-General wrote to your Council recently letting you know that he has carefully considered the matter of annual audit fees for all Councils who do not currently have a contract in place. He has decided that for the 30 June 2020 audit, audit fees are to be held to a 1.5% increase over the agreed fee for the 30 June 2019 audit. This attempts to balance the very real cost pressures that your Council and his Office currently face. The Auditor-General also noted that he expects that there will be a range of effects of the COVID-19 pandemic that may require additional audit work, and that auditors will need to discuss recovery of costs for that with Councils in due course, once these costs are known.

The Auditor-General also advised that for a number of years there has been a significant and growing under recovery of audit fees across much of the local government sector, for a range of reasons. Because Parliament has indicated that it expects the cost of annual audits under the Act (including an OAG Audit Standards and Quality Support fee) to be funded by public entities, this is clearly not a sustainable position. It is also potentially creating a very real risk to maintaining consistent audit quality over time, which has been raised by audit regulatory bodies here and overseas.

Audit fees will, in the future, need to be increased to reflect the real costs. These increases will vary depending on the reasonableness of the current fee. So for the subsequent years of the contract, 2021 and 2022, your Council and I will in, due course, have the opportunity to discuss those real costs, and endeavour to reach agreement about reasonable fees that can be recommended to the Auditor-General for approval. The Auditor General, with assistance from the OAG, will directly set audit fees, but only if we fail to reach agreement.

To ensure that the level of audit effort required (and the reasons for it) are visible to your Council, this proposal includes an estimate of the total hours and indicative cost required to complete an efficient and quality audit of your Council (this is set out in sections 5 and 6). We expect to incur these hours in 2020, although the constrained fees will clearly not reflect the full cost of them.

## **3 Entities covered by this proposal**

This proposal covers the audit of Western Bay of Plenty District Council.

## 4 Key members of the audit team

Clarence Susan	Appointed Auditor
Maree Procter	Audit Manager
Alan Clifford	Information Systems Specialist
Jason Biggins	Tax Specialist

## 5 Estimated audit hours

We estimate that the following hours will be required to carry out the 30 June 2020 audit (compared to the budgeted hours set out in your last APL and actual data from the previous financial year):

Audit team member	2019 budget	2019 actual*	2020
Appointed Auditor	60	43	60
Second Director -Peer Reviewer	-	-	12
Audit Manager	90	90	90
Other CA qualified staff	244	314	220
Non CA qualified staff	244	438	358
Information Systems Specialist	45	30	45
Tax Specialist	2	1	2
<b>Total audit hours</b>	<b>685</b>	<b>916</b>	<b>787</b>

**\*Note** – actual hours are all hours incurred. These hours have not been adjusted to eliminate any hours that were due to auditor inefficiencies.

Actual hours were higher due to the additional work we have to do to meet increased audit quality standards and address increasing risk as detailed in section 5.1.

## 5.1 Reasons for changes in audit hours

The major reasons for the changes in hours for your organisation's audit are:

Reasons for changes in audit hours compared to estimated audit hours set out in previous APL:	2020
Changes within the council or the broader environment:	
<ul style="list-style-type: none"> <li>Asset revaluations: funding challenges, combined with greater community awareness and expectations over the resilience and performance of core assets, have increased the importance of and risks associated with council's asset related practices. Examples include continually improving its asset condition information and developing more advanced management practices. These in turn increase the complexity of council's asset revaluations and fair value assessments.</li> </ul>	40
<ul style="list-style-type: none"> <li>Non-financial reporting: in the light of recent events, including natural disasters, the results of the Havelock North water enquiry, and the impacts of climate change, ratepayers and other stakeholders focus on local authorities' core services has increased. This has increased our assessment of risk in these areas which in turn has increased both the number of measures we identify as material and the amount of testing we do on these. In addition, the mandatory performance measures present a heightened risk to council's reporting due to the range of interpretation and non-compliance issues that have been identified across the sector in recent years.</li> </ul>	10
<ul style="list-style-type: none"> <li>Rates: Recent court cases have highlighted the risks council faces in relation to its rating processes. Seemingly minor procedural or documentation errors have the potential to undermine council's major revenue stream. Council's increased risks have impacted on our approach to auditing Rates, and we now perform more testing on both individual rates and the information held in the RID.</li> </ul>	10
<ul style="list-style-type: none"> <li>Changes to better reflect the hours and team mix: Relates to additional work from quality assurance and methodology interpretations (for example: untested balances greater than performance materiality).</li> </ul>	8
<ul style="list-style-type: none"> <li>Estimations and judgements: significant accounting estimations, accruals and judgements, (i.e. employee entitlements), are significant to the council's financial statements and present a risk of material misstatement. As council's knowledge of the underlying issues improves, these estimations and judgements become more complex and present a higher risk, which increases our required audit response.</li> </ul>	10
As the total expected time now exceed 750 hours, a second director is required for peer review purposes.	12
<b>Total increase in audit hours</b>	<b>90</b>

## 6 Proposed audit fees

Our proposed fees for the 2020 audit (compared to budgeted and actual data from the previous financial year) is:

Structure of audit fees	2019 budget fees \$	2019 actual fees charged* \$	2020 \$
Net audit fee	126,520	143,254	128,418
OAG Audit Standards and Quality Support fee	10,536	10,536	10,694
Costs absorbed by Audit NZ	-	<b>(16,734)</b>	-
<b>Total audit fee (excluding disbursements)</b>	<b>137,056</b>	<b>137,056</b>	<b>139,112</b>
Estimated disbursements	2,500	2,790	3,000
<b>Total billable audit fees and charges</b>	<b>139,556</b>	<b>139,846</b>	<b>142,112</b>
GST	20,933	20,977	21,317
<b>Total (including GST)</b>	<b>160,489</b>	<b>160,823</b>	<b>163,429</b>

**\* Note** –These costs have not been adjusted to eliminate any matters arising from auditor inefficiencies.

The estimated cost of an efficient audit on a full recovery basis for your Council in 2020 is in the range of \$148,000- \$153,000 and your audit fees are already close to that range. Other than a small adjustment over the next 1 to 2 years for that, we expect that fee increases, other than for cost inflation, will only be necessary for changes or growth in your Council, or in audit requirements.

The audit fees allow for the audit team to carry out specific tasks identified in the OAG Sector Brief and for the OAG Audit Standards and Quality Support fees. As set out in section 2, these fees have been held at a 1.5% increase over the agreed audit fee for 2019.

We have also estimated the reasonable cost of disbursements (including travel and accommodation where necessary). Disbursement costs are indicative only and will be charged on an actual and reasonable basis.

## **7 Assumptions relating to our audit fee**

You are responsible for the production of your financial statements and anything else that must be audited. Our proposed audit fees are based on the assumption that:

- you will provide to us, in accordance with the agreed timetable, the complete information required by us to conduct the audit;
- your staff will provide us with an appropriate level of assistance;
- your organisation's annual report (including financial statements and statements of service performance) will be subject to appropriate levels of quality review by you before being submitted to us for audit;
- your organisation's financial statements will include all relevant disclosures;
- fair value assessments and valuation reports are available for interim audit visits where possible (for example, for 1 July valuations);
- we will review up to two sets of draft annual reports, one printer's proof copy of the annual report, and one copy of the electronic version of the annual report (for publication on your website);
- there are no significant changes to the structure and/or scale of operations of the entities covered by this proposal (other than as already advised to us);
- there are no significant changes to mandatory accounting standards or the financial reporting framework that require additional work (other than as specified in tables 5.1 and 6.1);
- there are no significant changes to mandatory auditing standards that require additional work other than items specifically identified in the tables above; and
- there are no significant changes to the agreed audit arrangements that change the scope of, timing of, or disbursements related to, this audit.

If the scope and/or amount of work changes significantly, including as a result of the effects of the COVID-19 pandemic, we will discuss the issues and potential recovery of costs with you and the OAG at the time. In order to minimise additional auditor time on the potential effects of COVID-19 on your financial statements and service performance information, the Council should ensure that it considers those potential effects as early as possible and discusses them with the appointed auditor to ensure "no surprises" to either party.

## 7.1 Exclusions

The proposed hours set out in section 5.1, and our fees do not include the potential impact of the following, which may affect your entity in 2020, 2021, and/or 2022, as we are unable to assess their impact at this time:

- The future impact of changes to accounting standards, including:
  - PBE IPSASs 34 to 38;
  - IFRS 9 – should the Council early adopt; and
  - PBE FRS 48.
- Changes to auditing standards including; NZ AS 1, ISA (NZ) 315 and ISA (NZ) 540.
- The government’s three waters review, including its announcement of a Crown Entity to regulate drinking water.
- Any future impact on the Council’s reporting due to the re-introduction of the four well-beings into the Local Government Act in May 2019.
- The Productivity Commission’s review of local government funding and financing.
- The impacts of future growth within the Council’s area.
- The impacts of any new initiatives or funding sources related to either the Provincial Growth Fund or the Housing Infrastructure Fund.

## 8 What the OAG Audit Standards and Quality Support fees cover

Parliament has indicated that it expects the cost of annual audits under the Public Audit Act (including an OAG Audit Standards and Quality Support fees) to be funded by public entities.

The OAG Audit Standards and Quality Support fees partially fund a range of work that supports auditors and entities, including:

- development and maintenance of auditing standards;
- technical support for auditors on specific accounting and auditing issues;
- ongoing auditor training on specific public sector issues;
- preparation of sector briefs to ensure a consistent approach to annual audits;
- development and maintenance of strategic audit plans; and
- carrying out quality assurance reviews of all auditors, and their audits and staff on a regular (generally, three-year) cycle.

Appointed Auditors are required to return the OAG Audit Standards and Quality Support fees portion of the total audit fee, to the OAG.

## **9 Certifications required by the Auditor-General**

We certify that:

- the undertakings, methodology, and quality control procedures that we have declared to the OAG continue to apply;
- our professional indemnity insurance policy covers this engagement; and
- the audit will be conducted in accordance with the terms and conditions of engagement set out in the audit engagement agreement and schedules.

## **10 Conclusion**

As the Appointed Auditor, I am committed to providing you and the Auditor-General with the highest level of professional service. I intend to work with you, the OAG, and the Auditor-General in a partnership environment to resolve any issues that may arise.

If you require any further information, please do not hesitate to contact me.



Please counter-sign this letter (below) to confirm that you, and the governing body of your organisation, agree with its contents. This letter will then form the basis for a recommendation to the Auditor-General on the audit fee that should be set. The schedules of audit hours and fees will also be incorporated into my audit engagement agreement with the Auditor-General to carry out the audit of your organisation as the agent of the Auditor-General.

Please send a copy of the signed letter to me for our records to [confirmationsnorthern@auditnz.parliament.nz](mailto:confirmationsnorthern@auditnz.parliament.nz)

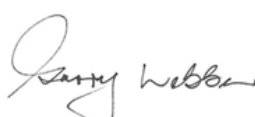
Yours sincerely



Clarence Susan  
Appointed Auditor  
Audit New Zealand

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I accept the audit fees for the audit of the three financial years as stated above.

Signed:  \_\_\_\_\_

Date: 7 May 2020

Garry Webber  
Mayor  
Western Bay of Plenty District Council