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27 June 2023

Ref.: 60822158/66703572

The Councillors

Kapiti Coast District Council
Private Bag 60601
Paraparaumu 5254

Copy: Director Auditor Appointments
Office of the Auditor-General
PO Box 3928
Wellington

Dear Councillors

Proposal to conduct the audit of Kapiti Coast District Council on behalf of the Auditor-General for the 2023, 2024 and 2025 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 2023, 2024 and 2025. 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 years ending 30 June 2023, 2024 and 2025 and reasons for any change;
- assumptions relating to the proposed audit fees, including what we expect of your organisation;
- what the OAG Audit Standards and Quality Support 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, 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 Public Audit Act 2001. However, you and I have the opportunity to reach agreement first and recommend those fees for approval. The Auditor-General, with assistance from the OAG, will set audit fees directly only if we fail to reach agreement.

Our proposed audit fees are set out in this letter and include an estimate of the reasonable cost of disbursements (including travel and accommodation where necessary).

3 Entities covered by this proposal

This proposal covers the audit of Kapiti Coast District Council and reporting to the Trustee pursuant to the Debenture Trust Deed dated 19 September 2012. The Trust Deed provides security for those that provide debt financing to the Council.

4 Key members of the audit team

Appointed Auditor
Audit Manager

Sam Nicolle
Shiela Mae Guardo

5 Estimated audit hours

We estimate that the following hours will be required to carry out the audits (compared to budgeted and actual data from the previous financial year):

Audit team member	2022 budget	2022 actual	2023	2024	2025
Appointed Auditor	56	65	66	63	63
Review Partner	12	1	-	-	-
Audit Manager	136	77	159	151	151
Other CA qualified staff	210	489	295	260	260
Non CA qualified staff	486	932	531	523	523
Technical Accounting Specialists	28	1	29	28	28

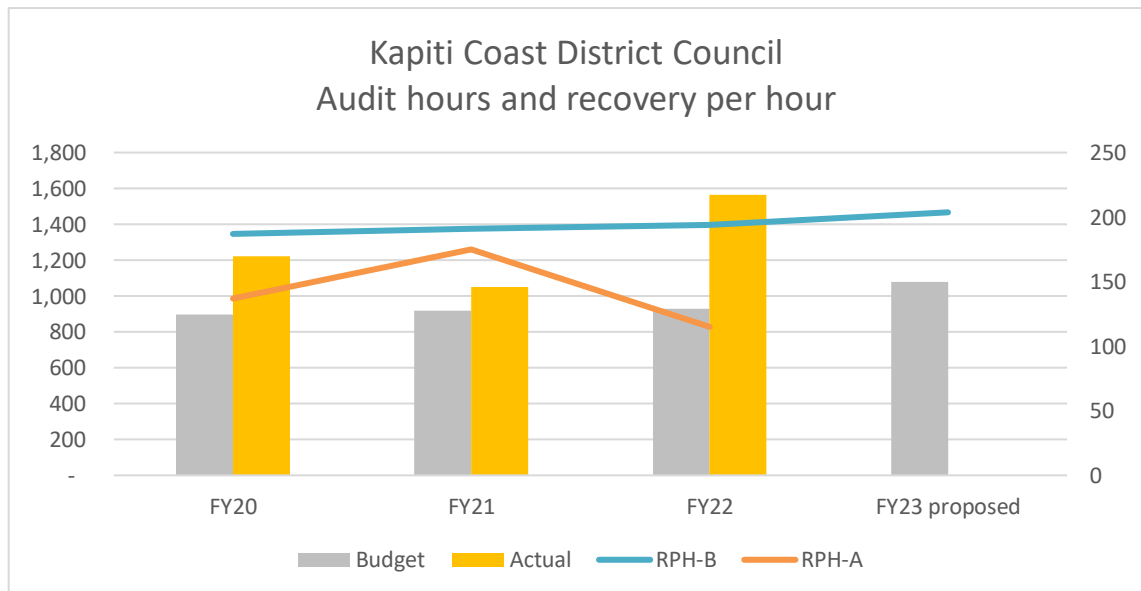
Audit team member	2022 budget	2022 actual	2023	2024	2025
Total audit hours	928	1,565	1,080	1,025	1,025

Three Waters Reform

Given the uncertainty related to the Three Waters Reform we have not adjusted audit hours or fees for the implications of this reform program. If there are changes from the Three Waters Reform programme that impact the 2023-2025 period covered by this letter we will agree changes to hours and fees with you at the point in time there is clarity regarding the changes.

Comparison to 2022 actual hours

Our recent experience completing the audit of the Council has required additional staff hours in excess of the hours budgeted in the 2020-2022 Audit Proposal Letter. The 2020 audit was impacted by COVID-19 and remote working. The chart below shows budget and actual hours and budget and actual fee per hour over the 2020-2022 period.



Actual hours for the 2022 audit were higher than the budgeted hours set out in the 2020 to 2022 audit proposal letter due to several reasons. We have examined these reasons and some are expected to reoccur in future years while others are not. This is explained for each matter as follows:

- The level of work required to audit areas where there are material estimates has been greater than budgeted in recent years arising from the application of ISA (NZ) 540 (revised) *Auditing Accounting Estimates and Related Disclosures*. The key areas of estimation in the financial statements are the measurement of infrastructure assets which is increasingly impacted by changing economic conditions.
- Council is required to report on mandatory measures in relation to drinking water, as required by the Department of Internal Affairs' rules for local authority performance reporting. Historically independent drinking water assessors have performed audits of sufficient regularity and quality to support the assurance needed for the audit of the annual report. Independent drinking water assessors weren't required to complete audits from November 2021 onwards. As a result we were required to perform additional audit procedures in order to gain assurance over these performance measures for the 2022 year. We have factored this into our estimate of audit hours going forward in section 5.1. The additional hours included going forward for this matter are less than those incurred in 2022 as we acknowledge that because 2022 included the impact of navigating the changes and there were some inherent inefficiencies and we expect the work to be more streamlined in future as we apply historical learnings.
- There were some inefficiencies in the 2022 audit relating to both working remotely due to COVID-19 restrictions and a reduced level of audit staff continuity. Increased hours in 2022 as a result of these matters have been assumed not to recur in future years.

The 2023 budgeted audit hours reflect the anticipated additional effort in adopting for the first time the PBE IPSAS 41 *Financial Instruments* and Revised auditing standard ISA (NZ) 315 (Revised) *Identifying and Assessing the Risks of Material Misstatement* as detailed below

We are committed to working with the Council to drive efficiency in the audit process and thereby contain future fee increases.

5.1 Reasons for changes in audit hours

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

Reasons for increased or decreased audit hours compared to previous period budgeted hours:	2023	2024	2025
Removal of independent partner no longer required by the OAG's policy	(12)	-	-
Audit of drinking water performance measures	50	(15)	-
Additional effort for auditing material estimates	57	-	-
Impact of adopting PBE IPSAS 41 Financial Instruments	12	(12)	-
Impact of ISA 315 auditing standard	45	(28)	-
Total increase (decrease) in audit hours	152	(55)	-

Application of the OAG's policy on Engagement Quality Review Partners

We refresh our risk assessment of the Council’s audit annually and we have not identified any high risk factors. We have considered the requirements of AG PES 3 *Quality management for firms that perform audits or review of financial statements, or other assurance or related services engagements* and determined that an engagement quality review Partner is not necessary for the Council’s annual audit.

Drinking water performance measures

- Changes to the use of independent drinking water assessors has meant we need to complete additional audit procedures in order to gain assurance over the drinking water performance measures. The incremental work required in 2022 was not included in our budget hours. New drinking water standards were introduced from November 2022 which we expect to have consequential changes to Council’s reporting. The 2023 year includes additional time in the year of transition.

ISA 315

- The revisions to the auditing standard on risk assessment (ISA (NZ) 315) are effective for the 2023 audit. The auditing standard impacts our risk assessment of the IT environment. Regardless of whether we plan to rely on controls, we are required to consider, in greater detail, the IT environment (applications, infrastructure and IT processes) that support key business processes and identify specific IT risks, and evaluate design and implementation of management’s IT general controls (“ITGCs”) that address those risks.

6 Proposed audit fees

Our proposed fees for the next three audits (compared to budgeted and actual data from the previous financial year) are:

Structure of audit fees	2022 budget fees \$	2022 actual fees charged \$	2023 \$	2024 \$	2025 \$
Net audit fee (excluding OAG Audit Standards and Quality Support and disbursements)	180,900	180,900	220,022	223,043	234,195
OAG Audit Standards and Quality Support charge	15,500	15,500	20,542	20,367	21,283
Total audit fee (excluding disbursements)	196,400	196,400	240,564	243,410	255,478
Estimated disbursements	3,400	3,400	3,400	3,400	3,400
Total billable audit fees and charges	199,800	199,800	243,964	246,810	258,878
GST	29,970	29,970	36,595	37,022	38,832
Total (including GST)	229,770	229,770	280,559	283,832	297,710

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 charge. 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.

As explained in Section 5, fees for the 2023, 2024 and 2025 audits have been based on our experience in completing the 2022 audit.

6.1 Reasons for changes in audit fees

In Section 5, we showed the factors that have resulted in a change of audit hours. The cost impacts of those changes are shown in the table below.

Reasons for increased or decreased audit fees compared to previous period budgeted fees.	2023 \$	2024 \$	2025 \$
Predicted staff salary cost movements	14,472	11,421	11,152
Audit of drinking water performance measures	7,000	(2,500)	
Additional effort for auditing material estimates	9,350		
Impact of adopting PBE IPSAS 41 Financial Instruments	2,000	(2,000)	0
Impact of revised auditing standard ISA (NZ) 315 (Revised) Identifying and Assessing the Risks of Material Misstatement	6,300	(3,900)	0
Total increase (decrease) in audit fees	39,122	3,021	11,152

Predicted staff salary cost movements

Audit service providers are currently working through a number of challenges that have substantially increased the cost of providing audits. These include:

- Significantly increasing payroll costs to retain an appropriately qualified workforce capable of delivering a quality audit. This is driven in part by increasing inflationary pressures but is primarily sector specific and relates to high market demand for those that have an appropriate skill set to fill audit roles.
- The time taken to prepare for, and respond to, file inspections that have increased in frequency and duration.
- Investments in audit tools to provide greater levels of assurance through examining large data sets rather than smaller statistical samples.

Of these, the primary pressure is the increased cost of retaining and attracting audit staff of an appropriate calibre. These increased costs of completing the Kapiti Coast

District Council audit have not been reflected in base audit fee increases for Kapiti Coast District Council over the past three years.

In response to market conditions, our direct costs, comprising salaries and direct employee expenses have increased by approximately 31% over the past 3 years (9.5% CAGR). By comparison, the base audit fee (excluding fee adjustments for scope increases and decreases) included in our previous letter remained almost flat.

We have included a direct cost increase of 8% in 2023 and 5% per annum for 2024 and 2025, which reflects us passing on only a part of the cost pressures we have experienced.

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 and financial statements (including 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 including, the impact of adopting PBE IPSAS 41 *Financial Instruments*.
- 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 items specifically identified in the tables above.
- There are no significant changes to mandatory auditing standards that require additional work other than items specifically identified in the tables above.

- There are no significant changes to the agreed audit arrangements (set out in an annual letter we will send you) that change the scope of, timing of, or disbursements related to, this audit.
- There are no changes to the Trust Deed and associated assurance requirements from the year ended 30 June 2022

If the scope and/or amount of work changes significantly, we will discuss the issues and any implications for our audit costs and your audit fees with you and the OAG at the time.

8 What the OAG Audit Standards and Quality Support charge provides

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

The OAG Audit Standards and Quality Support charge partially funds 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 charge portion of the 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 on 027 489 9693 or sam.nicolle@nz.ey.com.

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.

Yours sincerely

Sam Nicolle
Partner
Ernst & Young
On behalf of the Auditor-General

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

Full name: _____ Position: _____

Authorised signature: _____ Date: _____

Entity name: Kapiti Coast District Council



Actions to take when agreement has been reached:

- 1 Make a copy of this signed proposal and keep it for your file.
- 2 Send the original to:
Sam Nicolle
Ernst & Young
PO Box 490
Wellington 6140