Annual Governance Report (updated)

Kent County Council

Audit 2008/09

August 2009

Contents

Key messages

This report updates the Annual Governance Report that was presented to the Governance and Audit Committee on 30 June 2009 for issues that arose in finalising the audit opinion on the 2008/09 financial statements.

I issued an unqualified opinion on the Council's financial statements on 31 July 2009. I also certified that the Council has established appropriate arrangements for securing economy, efficiency and effectiveness in the use of its resources in 2008/09. This is known as the value for money conclusion.

Financial statements

1 On 30 June 2009, I reported the results of my opinion audit to the Governance & Audit Committee. At that time there were a number of items that were still being reviewed. As agreed, I wrote to the Committee Chairman with the results of these outstanding matters, inviting him on behalf of the Committee to request officers to amend the accounts for a small number of errors identified. Given the nature and size of the errors, the Council decided not to amend the accounts that were approved by the Governance & Audit Committee on the 30th June. For completeness, I now report all the issues arising from the audit of the financial statements. Issues not previously raised in my report of 30 June, are shown in italics in this report for easy identification.

2 The financial statements were submitted for audit on the 5 June 2009 and were of a good quality. The audit identified a small number of errors and omissions that officers corrected within the accounts presented for members' approval on 30 June 2009. In my view, none of these need to be brought to your attention to assist you to fulfil your governance responsibilities. Some errors and omissions were identified that have not been amended for. I am satisfied that these are not material to the Council's financial statements and issued an unqualified audit opinion on 31 July 2009.

Value for money conclusion

3 Based on the results of my work undertaken in relation to the Council's arrangements to secure economy, efficiency and effectiveness in the use of its resources, I issued an unqualified value for money conclusion for the year ending 31 March 2009 on 31 July 2009.

Next steps

4 I ask the Governance and Audit Committee to note the matters raised in this updated report and the action plan at Appendix 2.

Financial statements

The financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As the Governance & Audit Committee you have final responsibility for these statements. It was important that you considered my findings before you adopted the financial statements and the annual governance statement and that you are made aware of any additional findings from the final stages audit of the statements.

5 This report outlines all the key findings of our work on the Council's financial statements for the year ended 31 March 2009. It includes any findings in respect of the superannuation fund accounts which are contained within the Council's financial statements. We presented an abridged version of this report which focussed specifically on the Fund's accounts to the Superannuation Fund Committee on 3 July 2009.

6 The draft statement of accounts was presented to us for audit on the 5 June 2009, five weeks after the end of the financial year which is a positive achievement. Officers were responsive to audit enquiries which allowed us to complete the majority of our planned work by 30 June 2009 when the Governance & Audit Committee approved the accounts. I stated in my report to that Committee meeting that given the tight timelines there were some matters that remained to be completed and I set out an update on these in my letter to the Chairman of the Committee on 20 July 2009. The Chairman provided me with a letter of representation in line with our standard audit procedures and I gave my audit opinion on 31 July 2009.

7 In line with auditing standards we are required to report to you our views on accounting practices and financial reporting, errors in the financial statements and weaknesses in internal control.

8 In the earlier version of this report I set out the key areas of judgement and audit risk together with the audit findings up to 30 June 2009. These are reproduced again for the Committee's information in Table 1 below and the matters contained in my letter to the Chairman of the Committee have been added.

Table 1 Key areas of judgement and audit risk

Potential issue or risk	Finding
For a number of the material financial systems there is no effective control over the year end cut off. This is not an unexpected situation but does mean that we have to carry out specific audit testing for cut off in those systems.	Testing of a sample of income and expenditure recorded at the year end identified a small number of errors. These have been corrected by officers in the accounts presented for approval. We considered the risk that further errors may exist in the remainder of the population not tested. Applying the error rate to the population gave an estimated error of £939,000 understatement of both expenditure within the income and expenditure account, and creditors on the balance sheet.
Ongoing problems from 2007/08 were identified in the related systems Swift and TDM. The adult social care packages for individuals are detailed on the SWIFT database which establishes the cost of care packages and is also used to authorise electronic invoices paid via the domiciliary care payment system. There are ongoing discrepancies between the SWIFT and TDM records for individuals' care packages.	The Council undertook a significant amount of work on the Swift and TDM systems to understand the differences in the systems. We reviewed this work and although we are unable to confirm fully the entries originating from these systems within the financial statements 2008/09 we concluded that the entries within the accounts are not materially misstated.
Impairment of investments: Accounting practice requires the value of assets in the balance sheet to be reviewed regularly to ensure that they are not overstated in light of known events. The Council has investments in Icelandic Banks that following their collapse it may not realise. We will review how the Council has reflected the impairment of its investments against accountancy advice from CIPFA.	We reviewed the accounting treatment to appropriately reflect the value of investments in Icelandic banks recorded on the balance sheet. We confirmed that the accounting follows guidance. Since the accounts were produced for audit there has been a court decision in Iceland that allows depositors with Landsbanki and Glitnir to claim interest up to 22 April 2009. This has not been reflected in the accounts presented for approval.

Potential issue or risk	Finding
	The income not accounted for is approximately £640,000. This situation was fluid and we assessed all known information before issuing the audit opinion to ensure that there was not a material misstatement in the accounts.
The Council changed the date of the Kings Hill valuation in accordance with the Statement of Recommended Practice (SoRP) from 31 March to 1 April. However, there has not been any consideration of a reduction in the value of the estate due to current economic circumstances.	The Council had assessed the impact of the economic downturn on the value of Kings Hill site. The value may have reduced by £773,000. Given the relatively small reduction, this is not reflected in the accounts. The Audit Commission appointed an independent valuer, to provide a basis for auditors to assess the reasonableness of councils' assumptions. Whilst the downward trend from the Commission's valuer is greater than that assumed by the Council, the difference is not material.
The SoRP remodels the Fixed Asset note to the accounts. This has led to a change in the treatment of impairments.	We have confirmed that the treatment adopted by the Council is in line with recommended practice.
There are changes to the SoRP requirements in relation to accounting for revenue expenditure funded from capital under statute. This will be a change in accounting policy and gives rise to risks in both treatment and presentation of material amounts.	We have confirmed that the SoRP changes have been correctly implemented by the Council.
The SoRP allows authorities to account for the Performance Reward Grant dependent on their achievement of targets. This could lead to incorrect treatment.	We reviewed the accounting treatment and have confirmed that it is appropriate in our view.
Review of the accounts of East Kent Opportunities LLP (EKO) and the impact on the Council's accounts.	*In our view, the land sold to EKO should not remain on the KCC's balance sheet as a fixed asset as at*

Potential issue or risk	Finding
The Council sold some land to EKO, which is a joint arrangement (50:50 ownership) between Kent County Council (KCC) and Thanet DC. KCC built a spine road (£4.368 million cost) to allow access to the development site. *A management agreement states that EKO will reimburse the cost of the road within two years of signing the agreement.* *As a separate entity, EKO has to prepare its own accounts. Under accounting rules, as a joint owner, KCC has to recognise its share of the balances and transactions of EKO in its own accounts.* *Our audit work identified several issues relating to:* • *the accounting treatment of the sale to EKO of land owned by the KCC;* • *the lack of recognition of EKO's liability to contribute to the cost of the Eurokent spine road within KCC's financial statements;* • *the lack of recognition of EKO's transactions and balances in KCC's accounts and* • *the late preparation of EKO's own accounts.*	*31 March 2009. As a result, fixed assets are overstated by £5.62 million and the income and expenditure account and Statement of Movement on General Fund Balance do not reflect the disposal of the land.* *KCC's accounts do not include as a debtor, the £4.37 million due from EKO in respect of the costs of construction of the spine road.* *EKO's draft accounts (still to be audited by its own independent auditor) show assets (of £10.2 million), reserves and liabilities. Currently the accounts do not include a liability of £4.37 million (as above) due to KCC.* *Recognising KCC's share of EKO's balances and transactions in KCC's accounts would change its balance sheet and Income & Expenditure account in a number of areas. A detailed schedule of the accounting entries has been shared with KCC.* *Some of the issues noted above are offsetting. For example, writing out the fixed asset (£5.62 million) would be offset by recording the KCC's share of EKO's fixed assets, resulting in fixed assets reducing by £0.6 million. Correcting for all of the above, would not have a material impact on KCC's accounts.* *This is an unadjusted error.*
Foundation schools have remained on the Council's balance sheet after achieving foundation status.	We confirmed that the foundation schools are correctly included in the balance sheet as the risks and rewards remain with the Council.
Receipt of direct confirmation of year end investment balances from external counterparties.	We have now completed this work and confirmed the existence of investments held by the Council at the balance sheet date.
Review of all related party	*The Council's arrangement for*

Potential issue or risk	Finding
transaction declarations from officers and members.	*obtaining related party declarations from members needs strengthening for the future. At the time of writing there are 3 outstanding from members of which two relate to members who are unable to make declarations as they are on long-term sickness absence. The completion of declarations is an important aspect of the Council's governance arrangements.*
Review of the PFI scheme assumptions and accounting entries.	*The off-balance sheet accounting treatment is appropriate for all schemes in our view but we are seeking specific confirmation in the letter of representation that the Council's assessment of the risk of lower pupil numbers at Swan Valley School does not affect the off-balance sheet treatment.*
Review of reconciliation of directorate bank accounts *Our work on these accounts included a review of Kent Adult Social Services' bank account which is used by Social Services for the collection of direct debit payments relating to clients' contributions towards care packages. The Council was due to receive payments from clients in March 2009 and £1.9 million was received in that month.*	*The payments received were not recorded in the financial statements such that debtors in the balance sheet are overstated by £1.9 million and cash overdrawn is overstated by a similar amount.* *This is an unadjusted error.*
We test the existence and confirm ownership of fixed assets recorded in the balance sheet. *This work has been completed and there is one matter arising which relates to land at Cradlebridge Farm, Ashford.*	*In our view, this is incorrectly classified as non-operational land with a value of £2.9 million.* *We have established that the land is valued at £1.2 million and £1 million has been spent as part of the construction of a depot which is now*

Potential issue or risk	Finding
	operational. This means that non-operational land is overstated by £2.9 million and operational assets are understated by £2.2 million. Assets under construction are understated by £0.7 million as costs incurred in the continuing development of other depots. *These items do not affect the total of fixed assets in the Council's balance sheet but the disclosures in Note 17 – Movements on Fixed Assets are not correctly stated.* *This is an unadjusted error.*

Recommendation	
R1	The Council should continue its work to resolve the differences between the adult social care systems.

Kent Superannuation Fund

9 In February 2009, we reported the planned audit testing for the superannuation fund accounts to the Superannuation Fund Committee. Set out below for members' information is Table 2 which summarises the results against the planned testing. Our overall conclusion is that the results were satisfactory.

Table 2 Superannuation Fund - key areas of judgement and audit risk

Issue or risk	Finding
Compliance with the Statement of Recommended Practice relating to the Superannuation Fund's financial statements.	The accounts submitted for audit comply with recommended practice.
Collection of contributions, payment of benefits and transfers in and out of the Superannuation Fund.	Our audit work confirmed that these transactions are completely and accurately included in the financial statements.
Investment portfolio There is a change in the SoRP requirement about valuing the investment portfolio. We need to ensure this has been reflected in the accounts.	We concluded that the net assets of the Superannuation Fund are fairly stated in the financial statements.
Impairment of investments Some of the Superannuation Fund cash was invested in Icelandic banks. We need to consider how this is now reflected in the superannuation fund accounts given the collapse of these banks.	We reviewed the accounting treatment to appropriately reflect the value of investments in Icelandic banks recorded on the balance sheet. We have confirmed that the accounting follows guidance. We considered how the Council ensures that investment income based on cash from the Superannuation Fund and the Council is accounted for.
Investment management fees: We will seek to ensure these are completely and accurately recorded.	We confirmed the costs included in the accounts.
Fraud and error We have to remain alert to the potential of fraud and error in the accounts.	There are no matters to bring to your attention.
Annual Report	We reviewed the Annual Report and there are no issues to bring to your attention.

Issue or risk	Finding
Superannuation Fund – Interest on investments *The Council pools its own excess cash and that of the fund when making investments. Following a review the Council identified that the superannuation fund had been credited with interest at the London Inter bank Bid Rate (LIBID) rate rather than the actual rate of interest earned for its cash invested in 2007/08. It has corrected this in 2008/09.* *Interest at actual rate was calculated from September 2007 when there was a significant change in policy to increase cash holdings. In the 2008/09 accounts the superannuation fund has been credited with the difference between actual interest rates on investments and LIBID, increasing income to the superannuation fund by £177k for 2007/08 and £1.3m for 2008/09.*	*The Council states that prior to September 2007 any excess short term Superannuation Fund cash holding was invested by the Council along with its own cash. Under this arrangement, the Council bore the risk for the money deposited. In September 2007, given the change in policy to hold cash to invest, the Council states that it could not bear this risk and therefore acted as a 'fund manager' for the Fund cash investment.* *As Council documentation does not clearly set out the distinct nature of these arrangements, I have considered the potential financial impact if the Council did not bear the risk of losing Superannuation Fund cash in the period 2002/03 to 2007/08 and should have paid interest at actual rate rather than LIBID. Under this situation, the Fund would have been credited with additional interest of £147k. This is not material to either the Council's or the Fund financial statements.* *To avoid any unnecessary concerns by other interested parties, the Council has indicated that it will amend the accounts in the current year.*

Errors in the financial statements

10 The audit of the statements seeks to ensure that the statements are materially correct and present fairly a view of the financial transactions of the Council in 2008/09. Materiality is defined in auditing standards as "information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.

11 Our materiality for the audit was set at £22.9 million for the Council's own statements and £2 million (Fund Account) and £20 million (Net Assets Statement) for the Superannuation Fund statements. We also set, in accordance with International Standards on Auditing (UK and Ireland), a threshold below which we judge any errors to be 'trivial' and do not seek any amendments to the accounts. The trivial threshold was set at £229,000 for the Council's accounts and £20,000 and £200,000 respectively for the Fund.

12 During our audit we identified a small number of errors in the financial statements and reported these to management and a number of these have been corrected. None of these in my opinion need to be brought to your attention to assist you to fulfil your governance responsibilities. Unadjusted errors are set out within Tables 1 and 2 for your attention.

Material weaknesses in internal control

13 We have not identified any weakness in the design or operation of an internal control that might result in a material error in your financial statements of which you are not aware.

14 We have not provided a comprehensive statement of all weaknesses which may exist in internal control, or of all improvements which may be made. We have reported only those matters which have come to our attention because of the audit procedures we have performed.

Accounting practice and financial reporting

15 I consider the qualitative aspects of your financial reporting. Table 3 contains the issues I want to raise with you.

Table 3 Qualitative aspects of financial reporting

Issue	Finding
Under ISA (UK&I) 550 'Related Parties' we are required to consider the adequacy of control activities over the authorisation and recording of related party transactions.	We identified that there were a small number of related party transactions that have not been disclosed in the accounts, including transferred land to East Kent Opportunities and movements in loans made to KTT and Inside Out and the interest received in return. Officers have amended the accounts for this. The Council's arrangements for obtaining declarations from members and senior officers over any related party transactions should be strengthened to make it clear that the returns cover not only the main accounts but the Superannuation Fund accounts as well.
The Council creates manual creditors in the MIDAS system in respect of planned projects within environment and regeneration directorate.	The MIDAS system contains a number of balances that have remained dormant since 2007 and before. The Council has undertaken a review of the system and identified a potential error in the accounts of £895,000 for these balances. We agree that this amount cannot be quantified without significant work by the directorate and confirm that as the uncertainty is below our materiality level we did not expect this to be undertaken before giving the opinion on the accounts. We recommend officers review the balances and dispose of dormant balances during 2009/10.
The Council's approach to capitalising expenditure needs to be reviewed for compliance with financial reporting standards.	Our sample testing of capital creditors in the Communities directorate identified that an element of the costs were not capital in nature and should have been treated as revenue expenditure. A detailed review of the contract confirmed that the value is £450,000 a year over five years so we can conclude that there could not be a material misstatement in that the uncertainty over the period of the contract would not exceed £1,000,000. We have not identified this issue in other directorates.

Issue	Finding
Working papers supporting the statement of accounts should be sufficient to understand how the accounts have been constructed.	Last year, we identified some areas that working papers could be improved. Overall the working papers supporting the accounts were of an appropriate standard. As with last year, improvements could be made to the working papers with the use of narrative explanation and information sources.

Recommendations	
R2	The Council needs to improve the arrangements for making related party disclosures in respect of the Superannuation Fund Committee members.
R3	The Council should review the dormant creditor balances within the MIDAS system and dispose of any inappropriate amounts
R4	The Council should review the working papers to ensure they meet the best practice standards.

Other reporting issues

16 There are no other matters that we need bring to your attention.

Value for money conclusion

I am required to conclude whether the Council has put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion. I certified that the Council had put in place adequate corporate arrangements for securing economy, efficiency and effectiveness in its use of its resources in 2008/09 on 31 July 2009.

Value for money conclusion

17 I assessed your arrangements to secure economy, efficiency and effectiveness in your use of resources against criteria specified by the Audit Commission and certified that the Council had adequate arrangements in place on 31 July 2009. My conclusions on each of the criteria are set out in Appendix 1.

18 I reached my conclusion based on the results of the following work:

- Use of resources assessment;
- Review of commercial services;
- Review of health inequalities;
- Review of arrangements and practices in respect of staff severances.

Use of resources judgements

19 In forming my scored use of resources judgements, I have used the methodology set out by the Audit Commission. Judgements have been made for each key line of enquiry (KLOE) using the Commission's four point scale from 1 to 4, with 4 being the highest. Level 1 represents a failure to meet the minimum requirements which is the level set to score a 2. In undertaking my work I have taken into account, where appropriate, findings from previous use of resources assessments (updating these for any changes or improvements) and any other relevant audit work.

20 I have completed the use of resources assessment. The scores are not available for publication at the time of writing but I expect to be able to update the Committee verbally at its meeting on 16 September 2009 and summarise my findings in the annual audit letter presented to the Committee's meeting of 4 December 2009.

Independence

21 The Code of Audit Practice and the Audit Practices Board's (APB's) Ethical Standards with which auditors must comply require that auditors act, and are seen to act, with integrity, objectivity and independence.

22 We confirm that we comply with the APB's Ethical Standards, that we are independent and that our objectivity is not compromised.

23 We communicate to you:

- any relationships between us and the Kent County Council, and its senior management that might affect our objectivity and independence and any safeguards put in place;
- total fees charged to you for audit and non-audit services; and
- our arrangements to ensure independence and objectivity.

24 We have not identified any relationships that might affect our objectivity and independence.

Audit fees

25 We reported our fee proposals as part of the Audit Plan for 2008/09. The table below reports the outturn fee against that plan.

Table 4 Audit fees

	Plan 2008/09 £	Actual 2008/09 £
Total Audit Fees	**354,020**	**354,020**
Superannuation fund	**55,600**	**55,600**

26 The analysis above shows that we anticipate containing our audit fee within the totals you have already agreed.

Our arrangements to ensure independence and objectivity

27 We have comprehensive procedures to ensure independence and objectivity. These are outlined in Table 5.

Table 5 Arrangements to ensure independence and objectivity

Area	Arrangements
Independence policies	Our policies and procedures ensure that professional staff or an immediate family member: • do not hold a financial interest in any of our audit clients; • may not work on assignments if they have a financial interest in the client or a party to the transaction or if they have a beneficial interest in a trust holding a financial position in the client; and • may not enter into business relationships with UK audit clients or their affiliates. Our procedures also cover the following topics and can be provided to you on request: • the general requirement to carry out work independently and objectively; • safeguarding against potential conflicts of interest; • acceptance of additional (non-audit) work; • rotation of key staff; • other links with audited bodies; • secondments; • membership of audited bodies; • employment by audited bodies; • political activity; and • gifts and hospitality.
Code of Conduct	The Code of Conduct forms part of the terms and conditions of all Audit Commission employees. The Code of Conduct states that staff have to comply with ethical guidance issued by their relevant professional bodies.
Confidentiality	All staff are required to sign an annual undertaking of confidentiality as a condition of employment.

Appendix 1 – Value for money criteria

KLOE	Met
Managing Finances	
Planning for financial health	**Yes**
Understanding costs and achieving efficiencies	**Yes**
Financial reporting	**Yes**
Governing the business	
Commissioning and procurement	**Yes**
Use of information	**Yes**
Good governance	**Yes**
Risk management and internal control	**Yes**
Managing resources	
Natural resources	**Yes**
Strategic asset management	**Yes**

Appendix 2 – Action Plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
	Annual Governance Report 2008/09 - Recommendations					
	R1 The Council should continue its work to resolve the differences between the adult social care systems.	3	Michelle Goldsmith	Yes		
	R2 The Council needs to improve the arrangements for making related party disclosures in respect of the Superannuation Fund Committee members.	2	Nick Vickers	Yes		
	R3 The Council should review the dormant creditor balances within the MIDAS system and dispose of any inappropriate amounts.	2	Richard Hallet	Yes		
	R4 The Council should review the working papers to ensure they meet the best practice standards.	1	Cath Head	Yes		