

# Annual governance report

Kent County Council

June 2011



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## Traffic light explanation

■ Red ◆ Amber ● Green

# Key messages

**This report summarises the findings from the 2010/11 audit which is substantially complete. It includes the messages arising from my audit of your financial statements, which include the Kent Pension Fund Accounts, and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

	Traffic light
Unqualified audit opinion	●
Adequate arrangements to secure value for money	●

## Audit opinion and financial statements

The financial statements submitted for audit on 10 June 2011 were of a good quality. The Council did well to produce complete accounts within this short timescale as the requirements of International Financial Reporting Standards means they are significantly more complex. Subject to satisfactory completion of the remainder of the audit work, I expect to issue an unqualified opinion before the statutory deadline.

With the assistance of officers responding promptly to audit enquiries, I have completed the majority of planned work. Inevitably, given the tight timelines, there are some matters that remain outstanding. Key items outstanding at the time of writing this report (24th June) are:

- review of the Annual Governance Statement;
- review of the PFI scheme assumptions and accounting entries;
- sample testing of items written off as revenue expenditure funded by capital under statute;
- review of provisions; and
- review of amendments to the final version of the financial statements, including the Pension Fund accounts.

The following items are specific work outstanding on the Pension Fund accounts audit:

- sample testing of benefits payable;
- sample testing of contributions;

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- sample testing of investment income;
  - cash and cash equivalents balance; and
  - agreement of future investment commitments.

During the audit I identified a small number of errors in the financial statements. Management has agreed to adjust the financial statements for all but two of the errors. Subject to satisfactory completion of the remainder of the audit work, I expect to be able to issue an unqualified opinion by the end of July 2011.

### Value for money

My work to arrive at a value for money conclusion is still in progress. I will report on this more fully at the next Governance and Audit Committee meeting. Subject to the satisfactory completion of this work, I intend to issue an unqualified value for money conclusion on the arrangements Kent County Council has in place for securing economy, efficiency and effectiveness in the use of its resources. However, the Audit Commission requires me to report by exception where significant matters come to my attention, which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in your use of resources. Such a matter is the findings from the Ofsted inspection of the Council's safeguarding children and young people services and services for looked after children.

# Before I complete my audit

**I confirm to you**

My report includes only matters of governance interest that have come to my attention in performing my audit. My audit is not designed to identify all matters that might be relevant to you.

## **Independence**

I can confirm that I have complied with the Auditing Practices Board's ethical standards for auditors, including ES 1 (revised) - Integrity, Objectivity and Independence. I can also confirm there were no relationships between members of the audit team and officers or members of the Council, resulting in a threat to independence, objectivity and integrity of the audit team.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2010/11.

**I ask you to confirm to me**

## **I ask the Governance and Audit Committee to:**

- take note of the adjustments to the financial statements which are set out in this report (Appendix 2);
- correct the unadjusted misstatements which are set out in Appendix 3 and if you decide not to amend, please tell me why in the representation letter;
- approve the letter of representation, provided in Appendix 6, on behalf of the Council before I issue my opinion and conclusion;
- agree appropriate delegated arrangements to consider any further changes to the accounts that should prove necessary from my outstanding work; and
- agree your response to the proposed action plan (Appendix 5).



# Financial statements

## Opinion

### Opinion on the financial statements

Subject to satisfactory clearance of outstanding matters, I plan to issue an audit report including an unqualified opinion on the financial statements. Appendix 1 contains a copy of my draft audit report.

### Errors in the financial statements

My audit seeks to ensure that the accounts are materially correct and present a true and fair view of the financial transactions of the Council in 2010/11. The concept of materiality is defined at Appendix 4. For the 2010/11 accounts I have set materiality levels as follows: £24.8 million for the Council and £16.0 million for the Pension Fund. Under International Standards on Auditing I also set a threshold below which I judge any errors to be 'trivial' and do not ask for the accounts to be amended. For 2010/11 the triviality threshold is set at £248k for the main statements and £160k for the pension fund.

Where I identify errors above this triviality threshold, under auditing standards I must request officers to amend the accounts. Where officers choose not to do so, and the Governance & Audit Committee agrees, I ask that the reasons for not adjusting the accounts are set out in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

During the audit I identified a small number of errors in the financial statements. Officers agreed to adjust the financial statements for all but two of the errors. All adjusted non trivial amendments are highlighted in appendix 2 for information. The unadjusted errors are set out in appendix 3 for your consideration.



# Financial statements

The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for these statements. It is important that you consider my findings before you adopt the financial statements and the annual governance statement.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit.

## Key audit risk and our findings – Kent County Council

### Key Audit Risk

#### 1. International financial reporting standards

The financial statements will have to reflect for the first time the requirements of International financial reporting standards. This is a significant risk as the changes to reporting standards affect all main statements. This is a major workstream for the Finance Department at a time when its capacity is stretched.

#### 2. Accounting for leases:

The definition of leases is wider under IFRS and many more arrangements may conceivably be recognised as and have to be accounted for as leases.

### Finding:

I worked with officers throughout the closedown period to review their working papers on the proposed amendments under International Financial Reporting Standards (IFRS). As part of this review, I provided challenge to the judgements being made by officers, resulting in some changes to the restated accounts. As a result, the full version of the restated 2009/10 accounts, received in late May, correctly reflected the requirements of IFRS.

I have identified some minor issues in the 2010/11 financial statements which I report in the 'quality of the financial statements' section of this report.

The Council undertook an extensive review of its leases during 2010/11. Audit testing confirms that the financial statements correctly reflect the categorisation of leases as either operating or financial leases.

## Key Audit Risk

### 3. Public Finance Initiative (PFI) accounting:

Three PFI schools became operational during the year. The Council has to review the schemes and assess whether the assets are brought on to the Balance Sheet with an appropriate finance liability.

I reported in the 2009/10 annual governance report that there was an uncertainty over the valuation of a PFI school. The Council has to value all the PFI schools, including the three new build schools if on Balance Sheet, in 2010/11. PFI accounting is a significant risk.

### 4. Restructuring

The Council is currently undertaking a large restructuring exercise of its directorates and central departments. This will involve redundancies and restructure costs that will need to be accounted for in 2010/11 financial statements. These are likely to be material estimates.

### 5. Foster care system

As part of documenting the material financial systems I identify key controls to gain assurance over the system. I was unable to identify key controls in the foster care system.

## Finding:

The Council has brought these assets on to the Balance Sheet. My review of the accounting treatment is nearing completion and I will report my findings to you once this work is complete.

The valuation of the PFI schools has been undertaken by Mouchel using a specialist valuation model for PFI assets. Audit testing confirmed that the revaluation of PFI assets in 2010/11, which also includes the Kent Adult Social Services PFI, were impaired by £24 million.

The Council has correctly accounted for restructuring costs in the financial statements.

There is a weak control environment in this system which the manager is aware of. The foster care system covers two main areas of expenditure: foster care (£29m) and adoption (£7m). Substantive sample testing has found that the foster care payments are supported by original documentation and are correctly stated.

We are currently undertaking sample testing on the adoption payments and will report our findings to you once the work is complete.



## Key Audit Risk

### 6. Related party transactions

'Clarity' International Standards of Auditing have increased the audit work required on related parties and in particular the investigation of management controls.

**The following audit risks relate to both the Council and Pension Fund Accounts:**

### 7. Actuary's assumptions:

Barnett Waddingham carried out a full triennial valuation as at 1 April 2010. I am aware that different assumptions will be used from the previous actuarial valuation which may give rise to a material change to the Pension Fund's liabilities.

### 8. Icelandic bank deposits

The Council must write out the balance of the impairment as changes to accounting standards remove entries in the adjustment account. This is a sensitive issue for the readers of the accounts. I am expecting further guidance in a LAAP Bulletin before the financial statements audit.

## Finding:

Audit testing has confirmed that the related party transactions note discloses all required declarations and payments made to those bodies.

The actuary provided the assumptions for the roll forward of the triennial valuation. Audit testing completed under International Accounting Standard 19 (Employment Benefits) identified that the actuary estimated the growth in the Fund's asset base as 6.9% whereas the actual growth is nearer 11% as at 31 March 2011. This difference resulted in the County's share of the pension fund assets, estimated at approximately 46%, being significantly different between the IAS 19 actuarial report (£1,450k) and the actual year end asset figure (£1,471k). The actuary has now produced a revised IAS 19 report and the Council will amend its accounts to reflect the new figures. I recommend that a control needs to be implemented by management to check the reasonableness of the assumptions against the net assets statement.

The Council has correctly charged the impairment of the Icelandic bank deposits to expenditure in accordance with the latest accounting advice from CIPFA.

## Key Audit Risk

### 9. Pension fund bank account:

As of 1 April 2011 the County Council and Pension Fund will have separate bank accounts. The Council transferred the cash held on behalf of the Pension Fund on 1 July 2010. There is a risk that the Council fails to correctly separate all income or expenditure.

## Finding:

The Council and Pension Fund have correctly separated the bank balances. However, further testing is being completed on the pension fund bank account as a small number of admitted and scheduled bodies are still paying contributions to Kent County Council's bank account. I will report findings to you once this work is complete.

## Key audit risks and our findings – Kent Pension Fund

## Key Audit Risk

### 1. International Financial Reporting Standards (IFRS):

The pension fund statements will have to reflect, for the first time, the requirements of the International Financial Reporting Standards.

## Finding:

There is a requirement to disclose the 'actuarial present value of promised retirement benefits' in the 2010/11 accounts. In advance of the accounts production, officers selected the option of disclosing this value in a note to the accounts. The accounts submitted for audit did not contain the note.

The IAS 26 report from the actuary states that this value is £4,523 million.

The accounts also omitted the following requirements:

- note on defined benefit schemes; and
- note explaining the move to IFRS, which is required even if there are no material changes to the accounts.

These will be amended by officers.

## Key Audit Risk

### 2. Valuation of freehold property:

The accounting for freehold property is a material accounting estimate. The portfolio is managed by DTZ and was valued by Colliers CRE at 31 March 2010 at £168 million.

## Finding:

Audit testing has provided assurance that the valuation of the freehold property is materially correct.

## Recommendations

1. The control weaknesses within the foster care system should be resolved.
2. The Treasury and Investments Manager should carry out a reasonableness check of the actuary's IAS 19 reports before issuing to Kent County Council and other admitted and scheduled bodies for inclusion in their financial statements.

# Financial statements

## Quality of your financial statements

The quality of the draft financial statements presented for audit was good.

Working papers supporting the accounts were not provided on the first day of the audit. These could be improved by adding narrative information to ledger extracts.

Officers responded promptly to audit enquiries and were helpful in producing further information for audit. However, annual leave within the pension team has led to delays in producing reports for sample testing.

Generally accounting practices, policies, estimates and financial disclosures were appropriate. I identified some areas for improvement.

I consider aspects of your accounting practices, accounting policies, accounting estimates and financial statements disclosures.

These are the issues I want to raise with you.

## Accounting practices, policies, estimates and financial disclosures

### Issue

### Findings and recommendations:

#### Kent County Council:

Explanatory Foreword

I recommend that reference is made to the aborted Building Schools for the Future wave 4 project.

Internal consistency of the financial statements

I identified a small number of areas where the notes to the accounts are not internally consistent. Officers are reviewing these and plan to amend the accounts if appropriate.

Financial instruments (note 15)

The review of the financial instruments note has identified a number of presentational and disclosure issues. This note is being revised by officers.

#### Kent Pension Fund:

Accounting policies

The accounting policies were prepared on the Pensions Statement of Recommended Practice. They should have been prepared based on the CIPFA Code of Practice for Local Authority Accounting. Some amendments were required to ensure compliance with the Code, for

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example, disclosures required under International Accounting Standard 26 (see page 10 for further detail).

Contributions receivable (note 1)

Audit testing on the timing of contributions receivable by the pension fund identified that payment from admitted and scheduled bodies of the scheme are in breach of regulation 42(2) of the Local Government Pension Scheme (Administration) Regulations 2008. This requires employer authorities to pay employee contributions to the administering authority within 19 days of the end of the month to which they relate. Testing found that the regulation had been breached throughout the year by admitted and scheduled bodies. Officers monitor this on a monthly basis through a key performance indicator and payment within 19 days has improved by year end.

### **Recommendation**

3. Officers should continue improvements made at the end of the year in taking prompt corrective action to ensure payments from admitted and scheduled bodies do not breach 19 days in the 2011/12 year.

### **Letter of representation**

Before I issue my opinion, auditing standards require me to ask you and officers for written representations about your financial statements and governance arrangements. I anticipate issuing my audit opinion by the end of July 2011 and will ask officers to send me a letter of representation nearer that time. However, for the purpose of this report, I include a draft letter of representation for members to understand and acknowledge the type and range of representations that officers will be making and on which I will rely for my audit opinion.

# Financial statements

## Significant weaknesses in internal control

I did not identify any significant weaknesses in the system of internal control. I identified some areas for improvement.

International Standards on Auditing requires auditors to carry out a risk assessment of the general IT control environment. My review for 2010/11 has identified a specific weakness in the IT environment as set out below. Officers acknowledge the weakness and have agreed to take action to correct it.

I also identified some other potential issues that I am currently discussing with officers to determine whether or not my understanding of the control environment is correct. I will update members at their next meeting.

These weaknesses are only those I identified during the course of the audit that are relevant to preparing the financial statements. I am not expressing an opinion on the overall effectiveness of internal control.

## Internal control issues and our findings

### Description of weakness

The Axise pension system has a generic user ID with administrative privileges which is being used by the payroll team.

### Potential effect:

There is a risk of potential misuse of the system by the payroll team as the user ID has full access to the pension system and the ID is being shared within the team.

### Management action:

Officers have confirmed that the user ID is only used for the purposes for which it was intended. The pensions payroll group carry out 100% checking of all input and this is backed up by a system journal for each user automatically created each night. This is sufficient to mitigate the risk in 2010/11.



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Disabling leavers' accounts on Oracle is not always completed in a timely manner.

This could lead to manipulation of financial data in Oracle by another user accessing the account after officers have left.

Officers confirm that this is a potential risk limited to users with administration access to Oracle and have highlighted alternative controls that limit the exposure to this risk to a period of 30 days. Officers have provided reports confirming that there were no leavers in the 2010/11 year that had administration access to Oracle so the risk of manipulation in 2010/11 has not materialised.

### Recommendations

4. The Council should improve the process for disabling user accounts on Oracle.
5. Stronger controls should be implemented in the Axise pension system to mitigate the risk of an administrative level user ID being used by multiple officers.

# Value for money

## Value for money conclusion

I am required to conclude whether the Council put in place proper corporate arrangements for securing economy, efficiency and effectiveness in its use of resources. This is known as the value for money conclusion.

I assess your arrangements to secure economy, efficiency and effectiveness in your use of resources against two criteria specified by the Audit Commission:

- **Financial resilience - The organisation has proper arrangements in place to secure financial resilience**

Focus for 2010/11:

The organisation has robust systems and processes to manage effectively financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

- **Securing economy efficiency and effectiveness - The organisation has proper arrangements for challenging how it secures economy, efficiency and effectiveness.**

Focus for 2010/11:

The organisation is prioritising its resources within tighter budgets, for example by achieving cost reductions and by improving efficiency and productivity.

In my audit plan to you in March 2011, I set out the work I intended to complete to allow me to issue a VFM conclusion. This work is currently in progress and I will provide an update to members at their next meeting. Subject to the satisfactory completion of this work, I intend to issue an unqualified conclusion stating that the Council had proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

## Report by exception

In addition to completing my planned work, I am required to consider any other significant matters that come to my attention and consider the impact on my value for money conclusion. A significant matter is one that could impact adversely on a council's 'proper arrangements' to secure economy, efficiency and effectiveness in its use of resources. 'Proper arrangements' are defined in the Audit Commission's Code of Audit Practice which is approved by Parliament. The relevant extract from the Code is :





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*“ It is the responsibility of the audited body to put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources and to ensure proper stewardship and governance, and regularly to review the adequacy and effectiveness of them. Such corporate performance management and financial management arrangements form a key part of the system of internal control and comprise the arrangements for:*

- *planning finances effectively to deliver strategic priorities and secure sound financial health;*
- *having a sound understanding of costs and performance and achieving efficiencies in activities;*
- *reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;*
- *commissioning and procuring quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;*
- *producing relevant and reliable data and information to support decision making and manage performance;*
- *promoting and demonstrating the principles and values of good governance;*
- *managing risks and maintaining a sound system of internal control;*
- *making effective use of natural resources;*
- *managing assets effectively to help deliver strategic priorities and service needs; and*
- *planning, organising and developing the workforce effectively to support the achievement of strategic priorities.”*

Ofsted’s inspection of the Council’s safeguarding children and young people services and services for looked after children raised significant concerns about operational practice (which is outside of the scope of my consideration) and aspects of the Council’s ‘proper arrangements. I consider that the inspection highlighted weaknesses in the Council’s arrangements for:

- producing relevant and reliable data and information to support decision making and manage performance; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

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I am required to recognise these weaknesses within the value for money conclusion as a 'report by exception'. Appendix 1 shows how the 'report by exception' sits within the context of the complete value for money conclusion.

# Appendix 1 – Audit opinion

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## **INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF KENT COUNTY COUNCIL**

### **Opinion on the Authority accounting statements**

I have audited the accounting statements of Kent County Council for the year ended 31 March 2011 under the Audit Commission Act 1998. The accounting statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Kent County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

### **Respective responsibilities of the Corporate Director of Finance and Procurement and auditor**

As explained more fully in the Statement of the Corporate Director of Finance and Procurement's Responsibilities, the Corporate Director of Finance and Procurement is responsible for the preparation of the Authority's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Authority's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Authority; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited financial statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

## **Opinion on accounting statements**

In my opinion the accounting statements:

- give a true and fair view of the state of Kent County Council's affairs as at 31 March 2011 and of its income and expenditure for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

## **Opinion on other matters**

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

## **Matters on which I report by exception**

I have nothing to report in respect of the governance statement on which I report to you if, in my opinion the governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007.

## **Opinion on the pension fund accounting statements**

I have audited the pension fund accounting statements for the year ended 31 March 2011 under the Audit Commission Act 1998. The pension fund accounting statements comprise the Fund Account, the Net Assets Statement and the related notes. These accounting statements have been prepared under the accounting policies set out in the Statement of Accounting Policies.

This report is made solely to the members of Kent County Council in accordance with Part II of the Audit Commission Act 1998 and for no other purpose, as set out in paragraph 48 of the Statement of Responsibilities of Auditors and Audited Bodies published by the Audit Commission in March 2010.

## **Respective responsibilities of the Corporate Director of Finance and Procurement and auditor**

As explained more fully in the Statement of the Corporate Director of Finance and Procurement's Responsibilities, the Corporate Director of Finance and Procurement is responsible for the preparation of the pension fund's Statement of Accounts in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom. My responsibility is to audit the

accounting statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practice's Board's Ethical Standards for Auditors.

### **Scope of the audit of the financial statements**

An audit involves obtaining evidence about the amounts and disclosures in the accounting statements sufficient to give reasonable assurance that the accounting statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the fund's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the fund; and the overall presentation of the accounting statements. I read all the information in the explanatory foreword to identify material inconsistencies with the audited accounting statements. If I become aware of any apparent material misstatements or inconsistencies I consider the implications for my report.

### **Opinion on accounting statements**

In my opinion the pension fund's accounting statements:

- give a true and fair view of the financial transactions of the pension fund during the year ended 31 March 2011 and the amount and disposition of the fund's assets and liabilities as at 31 March 2011, other than liabilities to pay pensions and other benefits after the end of the scheme year; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom.

### **Opinion on other matters**

In my opinion, the information given in the explanatory foreword for the financial year for which the accounting statements are prepared is consistent with the accounting statements.

### **Conclusion on Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources**

#### **Authority's responsibilities**

The Authority is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

## **Auditor's responsibilities**

I am required under Section 5 of the Audit Commission Act 1998 to satisfy myself that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the Audit Commission requires me to report to you my conclusion relating to proper arrangements, having regard to relevant criteria specified by the Audit Commission.

I report if significant matters have come to my attention which prevent me from concluding that the Authority has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. I am not required to consider, nor have I considered, whether all aspects of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

## **Basis of conclusion**

I have undertaken my audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the Audit Commission in October 2010, as to whether the Authority has proper arrangements for:

- securing financial resilience; and
- challenging how it secures economy, efficiency and effectiveness.

The Audit Commission has determined these two criteria as those necessary for me to consider under the Code of Audit Practice in satisfying myself whether the Authority put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2011.

I planned my work in accordance with the Code of Audit Practice. Based on my risk assessment, I undertook such work as I considered necessary to form a view on whether, in all significant respects, the Authority had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

## **Conclusion**

On the basis of my work, having regard to the guidance on the specified criteria published by the Audit Commission in October 2010, I am satisfied that, in all significant respects, Kent County Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2011.

## **Report by exception**

The Audit Commission's guidance also requires me to report by exception on any other significant additional matters that come to my attention and which I consider to be relevant to proper arrangements to secure economy, efficiency and effectiveness in the use of resources. I consider the findings of the Ofsted inspection in October 2010 to be a significant matter. The inspection concluded that the overall effectiveness of safeguarding children and young people services and services for looked after children were inadequate, identifying significant weaknesses in the Authority's arrangements for:

- producing relevant and reliable data and information to support decision making and manage performance; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

The Council is working to an agreed improvement plan and will be re-inspected by Ofsted in due course.

## **Delay in certification of completion of the audit**

I am required to give an opinion on the financial statements of the pension fund included in the Pension Fund Annual Report of Kent County Council. The Local Government Pension Scheme (Administration) Regulations 2008 require authorities to publish the Pension Fund Annual Report by 1 December 2011. As the authority has not yet prepared the Annual Report I have not yet been able to read the other information to be published with those financial statements and I have not issued my report on those financial statements. Until I have done so, I am unable to certify that I have completed the audit of the accounts in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Darren Wells  
Officer of the Audit Commission  
2<sup>nd</sup> Floor, The Agora  
Ellen Street  
Hove  
BN3 3LN

XX July 2011

## Appendix 2 – Amendments to the draft financial statements

I identified the following misstatements during my audit and management have adjusted the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

Adjustment 1 was identified early in the audit and has been amended by officers in the version of accounts presented to you at Governance and Audit Committee for your approval. Officers have agreed to amend adjustments 2 and 3 in the tables below.

KENT COUNTY COUNCIL		Comprehensive income and expenditure statement		Balance sheet	
Adjusted misstatement	Nature of adjustment	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
<p><b>1) Unusable reserves (note 22):</b> Within the capital adjustment account the 'charges for depreciation and impairment of non-current assets' only includes the impairment figure for the current and previous year. Depreciation totalling £98,612k has been netted off minimum revenue provision in the 'statutory provision for financing of capital investment against the General Fund'.</p>	<p>The note has been amended to show the depreciation in the correct line of the note. Disclosed as follows:</p> <ul style="list-style-type: none"> <li>charges for depreciation and impairment of non-current assets £132,616k; and</li> <li>statutory provision for the financing of capital investment charged against the General Fund £(55,979)k.</li> </ul>				



**2) Pensions assets (Balance Sheet and note 39):** The actuary has produced a revised report for International Accounting Standards (IAS) 19 as there was a significant difference between the estimated fair value of the asset base (£3.156 billion) and the actual Net Asset Statement asset base as at 31 March 2011 (£3.202 billion). The Council has approximately 46% share of the asset base. The estimated asset share was £1,450 million and the actual share is calculated as £1,471 million

The Balance Sheet and note 39 entries will be amended to disclose the fair value of the assets as £1,471 million.

20,993

20,993

KENT PENSION FUND		Fund Account		Net Assets Statement	
Adjusted misstatement	Nature of adjustment	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
<p><b>3) Investment valuations (Net Assets Statement and note 7):</b> The direct confirmation of year end investments from the investment managers identified that 3 of the balances were incorrectly disclosed in the financial statements as the Pension Fund valuations were taken as at 31 December 2010. This led to understatement of 2 valuations:</p> <ul style="list-style-type: none"> <li>• Aurora £17,232k; and</li> <li>• YFM £2,039k.</li> </ul> <p>And overstatement of 1 valuation: HarbourVest £1,199k.</p>	<p>The investment values will be amended to correct the £1,540k understatement of the net assets. The values as at 31 March 2011 are now:</p> <ul style="list-style-type: none"> <li>• Aurora £17,741k;</li> <li>• HarbourVest £1,147k; and</li> <li>• YFM £3,123k.</li> </ul>		1,540	1,540	

## Appendix 3 – Unadjusted misstatements in the financial statements

I identified the following misstatements during my audit, but management has not adjusted the financial statements. I bring them to your attention to help you in fulfilling your governance responsibilities and ask you to correct these misstatements. If you decide not to amend, please tell me why in the representation letter. If you believe the effect of the uncorrected errors, individually and collectively, is immaterial, please reflect this in the representation letter. Please attach a schedule of the uncorrected errors to the representation letter.

KENT COUNTY COUNCIL		Comprehensive income and expenditure statement		Balance sheet	
Unadjusted misstatement	Nature of required adjustment	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
<p><b>Adult Social Care (Comprehensive Income and Expenditure Statement):</b> The gross expenditure and gross income are overstated in the Statement by £3.9m. There is no effect on the net expenditure at 31 March 2011. Adult social care calculates the value of care packages on a means tested basis with some clients paying part of their package. Adult social care are accounting for the income paid by the client directly to the provider as notional income in the financial statements. This income is not received by Kent County Council, nor do they have the associated costs of that element of the care package. Therefore, the costs should not be included in the financial statements</p>	<p>The adult social care gross expenditure and gross income should be amended to remove the notional income and costs of £3.9m.</p>	3,900	3,900		

as it is not the Council's income or expenditure.

**Property, Plant and Equipment (note**

**12):** Audit testing of additions identified a duplicated asset in the infrastructure asset register. The Ashford Highways Super Depot had become operational in 2009/10 financial statements at a value of £7m. However, the costs of construction included in infrastructure asset register of £6.9m were accounted for as a capital addition in 2010/11. This means the Balance Sheet and Revaluation Reserve is overstated by £6.9m. There is no impact on the depreciation charge for 2010/11 as the asset added in 2009/10 has been correctly depreciated this year.

The construction costs of £6.9m should be removed from the Balance Sheet and Revaluation Reserve to ensure the accounts are not overstated. There would be a revenue amendment of approximately £2m. The changes required would cascade through a number of notes to the accounts.

2,000	2,000	6,953	6,953
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**Recommendation**

6. A manual adjustment should be made as part of accounts preparation to remove the notional income and associated expenditure from the adult social care accounts.

# Appendix 4 – Glossary



## **Annual governance statement**

A statement of internal control prepared by an audited body and published with the financial statements.

## **Audit closure certificate**

A certificate that I have completed the audit following statutory requirements. This marks the point when I have completed my responsibilities for the audit of the period covered by the financial statements.

## **Audit opinion**

On completion of the audit of the financial statements, I must give my opinion on the financial statements, including:

- whether they give a true and fair view of the financial position of the audited body and its spending and income for the year in question; and
- whether they have been prepared properly, following the relevant accounting rules.

## **Opinion**

If I agree that the financial statements give a true and fair view, I issue an unqualified opinion. I issue a qualified opinion if:

- I find the statements do not give a true and fair view; or
- I cannot confirm that the statements give a true and fair view.

# Appendix 4 – Glossary



## **Materiality and significance**

The Auditing Practices Board (APB) defines this concept as ‘an expression of the relative significance or importance of a particular matter for the financial statements as a whole. A matter is material if its omission would reasonably influence users of the financial statements, such as the addressees of the auditor’s report; also a misstatement is material if it would have a similar influence. Materiality may also be considered for any individual primary statement within the financial statements or of individual items included in them. We cannot define materiality mathematically, as it has both numerical and non-numerical aspects’.

The term ‘materiality’ applies only to the financial statements. Auditors appointed by the Commission have responsibilities and duties under statute, as well as their responsibility to give an opinion on the financial statements, which do not necessarily affect their opinion on the financial statements.

‘Significance’ applies to these wider responsibilities and auditors adopt a level of significance that may differ from the materiality level applied to their audit in relation to the financial statements. Significance has both qualitative and quantitative aspects.

## **Weaknesses in internal control**

A weakness in internal control exists when:

- a control is designed, set up or used in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements quickly; or
- a control necessary to prevent, or detect and correct, misstatements in the financial statements quickly is missing.

An important weakness in internal control is a weakness, or a combination of weaknesses that, in my professional judgement, are important enough that I should report them to you.

# Appendix 4 – Glossary



## Value for money conclusion

The auditor's conclusion on whether the audited body has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources based on criteria specified by the Audit Commission.

The Code of Audit Practice defines proper arrangements as corporate performance management and financial management arrangements that form a key part of the system of internal control. These comprise the arrangements for:

- planning finances effectively to deliver strategic priorities and secure sound financial health;
- having a sound understanding of costs and performance and achieving efficiencies in activities;
- reliable and timely financial reporting that meets the needs of internal users, stakeholders and local people;
- commissioning and buying quality services and supplies that are tailored to local needs and deliver sustainable outcomes and value for money;
- producing relevant and reliable data and information to support decision making and manage performance;
- promoting and displaying the principles and values of good governance;
- managing risks and maintaining a sound system of internal control;
- making effective use of natural resources;
- managing assets effectively to help deliver strategic priorities and service needs; and
- planning, organising and developing the workforce effectively to support the achievement of strategic priorities.

If I find that the audited body had adequate arrangements, I issue an unqualified conclusion. If I find that it did not, I issue a qualified conclusion.

# Appendix 5 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
11	The control weaknesses within the foster care system should be resolved.	2	Head of Financial Management			
11	The Treasury and Investments Manager should carry out a reasonableness check of the actuary's IAS 19 reports before issuing to Kent County Council and other admitted and scheduled bodies for inclusion in their financial statements.	3	Treasury and Investments Manager			
13	Officers should continue improvements made at the end of the year in taking prompt corrective action to ensure payments from admitted and scheduled bodies do not breach 19 days in the 2011/12 year.	1	Treasury and Investments Manager			
15	The Council should improve the process for disabling user accounts on Oracle.	2	Director of ICT			
15	Stronger controls should be implemented in the Axise pension system to mitigate the risk of an administrative level user ID being used by multiple officers.	1	Director of ICT			
27	A manual adjustment should be made as part of accounts preparation to remove the notional income and associated expenditure from the adult social care accounts.	1	Chief Accountant			

# Appendix 6 – Letter of Representation

To: Darren Wells  
Appointed Auditor

2<sup>nd</sup> Floor, The Agora  
Ellen Street  
Hove  
BN3 3LN

## **Kent County Council - Audit for the year ended 31 March 2011**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors and officers of Kent County Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2011. All representations cover the Council's accounts and Pension Fund accounts included within the financial statements.

### ***Compliance with the statutory authorities***

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Code of Practice for Local Authority Accounting in the United Kingdom which give a true and fair view of the financial position and financial performance of the Council, for the completeness of the information provided to you, and for making accurate representations to you as set out in the Opinion Audit Plan.

### ***Uncorrected misstatements***

The effects of uncorrected financial statements misstatements summarised in the attached schedule are not material to the financial statements, either individually or in aggregate.

These misstatements have been discussed with those charged with governance within the Council and the reasons for not correcting these items are as follows;

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- *Reasons....*
- 

### ***Supporting records***

All relevant information and access to persons within the entity as agreed in the Opinion Audit Plan has been made available to you for the purpose of your audit, and all the transactions undertaken by the Council have been properly reflected and recorded in the financial statements.

### ***Internal control***

I have communicated to you all deficiencies in internal control of which I am aware.

### ***Irregularities***

I acknowledge my responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud or error.

I also confirm that I have disclosed:

- my knowledge of fraud, or suspected fraud, involving either management, employees who have significant roles in internal control or others where fraud could have a material effect on the financial statements;
- my knowledge of any allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others; and
- the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

### ***Law, regulations, contractual arrangements and codes of practice***

I have disclosed to you all known instances of non-compliance, or suspected non-compliance with laws, regulations and codes of practice, whose effects should be considered when preparing financial statements.

Transactions and events have been carried out in accordance with law, regulation or other authority. The Council has complied with all aspects of contractual arrangements that could have a material effect on the financial statements in the event of non-compliance.

All known actual or possible litigation and claims, whose effects should be considered when preparing the financial statements, have been disclosed to the auditor and accounted for and disclosed in accordance with the applicable financial reporting framework.

### ***Accounting estimates including fair values***

I confirm the reasonableness of the significant assumptions used in making the accounting estimates, including those measured at fair value.

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***Related party transactions***

I confirm that I have disclosed the identity of Kent County Council's related parties and all the related party relationships and transactions of which I am aware. I have appropriately accounted for and disclosed such relationships and transactions in accordance with the requirement of the framework.

***Subsequent events***

All events subsequent to the date of the financial statements, which would require additional adjustment or disclosure in the financial statements, have been adjusted or disclosed.

Signed on behalf of Kent County Council

I confirm that this letter has been discussed and agreed by the Governance and Audit Committee on 30 June 2011.

Signed

Name

Position

Date

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