Annual governance report

Kent Superannuation Fund

August 2011

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Traffic light explanation

■ Red ◆ Amber ● Green

Key messages

This report summarises the findings of my audit of the Kent Superannuation Fund 2010/11 financial statements.

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Audit opinion and financial statements

I issued an unqualified audit opinion on the 2010/11 financial statements on 26 July 2011.

The financial statements submitted for audit on 10 June 2011 were of a good quality. The Council produced the accounts earlier than the statutory deadline. A number of amendments were required to the financial statements, including adjustments to meet the requirements of the International Financial Reporting Standards. Management agreed to adjust the financial statements for the errors.

Matters of interest

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 identified the following threat to independence:

- *One member of the audit team has immediate family employed at the County. I have concluded that this does not pose a risk to the auditor's independence and objectivity, but as a safeguard have set clear parameters over what work he can be involved in during this year's audit. I bring this to your attention in the interests of transparency. The threat has been reduced to an acceptably low level.*

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 Superannuation Fund Committee to:

- take note of the matters raised in this report; and
- note officers' response to the action plan (Appendix 3).

Financial statements

Opinion

Opinion on the financial statements

I issued an unqualified audit opinion on the 2010/11 Superannuation Fund financial statements on 26 July 2011.

This report outlines the key findings of my work on the financial statements for the year ended 31 March 2011. I will present the information within this report to the Governance and Audit Committee on 14 September 2011 as part of the updated Annual Governance Report on the Council's financial statements.

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 level at £16.0 million for the Superannuation 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 £160,000.

Where I identify errors above this triviality threshold, under auditing standards I must request officers to amend the accounts. During the audit I identified a small number of errors in the financial statements. In agreement with the Governance and Audit Committee, officers agreed to adjust the financial statements for all errors identified within the Superannuation Fund accounts.

The misstatements identified in the accounts are set out in appendix 1 of this report.

Financial statements

The Superannuation Fund financial statements and annual governance statement of the Council are important means by which the Council accounts for its stewardship of public funds. As Council members you have final responsibility for these statements.

In planning my audit I identified specific risks and areas of judgement that I have considered as part of my audit. I reported these to the Committee as part of my audit plan on 20th May 2011.

Key audit risk and our findings

Key Audit Risk	Finding:
1. 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.	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 per cent whereas the actual growth is nearer 11 per cent as at 31 March 2011. This difference resulted in the County's share of the pension fund assets, estimated at approximately 46 per cent, being significantly different between the IAS 19 actuarial report (£1,450k) and the actual year end asset figure (£1,471k). The actuary produced a revised IAS 19 report to reflect the actual growth of 11 per cent and the accounts were amended 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.

Key Audit Risk	Finding:
2. 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 Local Authority Accounting Practice Bulletin before the financial statements audit.	The Council has correctly charged the impairment of the Icelandic bank deposits to expenditure in accordance with the latest accounting advice from CIPFA.
3. Pension fund bank account: As of 1 April 2011 the County Council and Superannuation Fund will have separate bank accounts. The Council transferred the cash held on behalf of the Superannuation Fund on 1 July 2010. There is a risk that the Council fails to correctly separate all income or expenditure.	The Council and Superannuation Fund have correctly separated the bank balances. However, my review of the year end cash balance held by the Superannuation Fund identified that it was incorrectly stated on two accounts: • understated by £21,000 due to the exclusion of interest received on the call account as at 31 March 2011; and • overstated by £13,082,000 due to the Icelandic deposits being included in the balance. These should be recognised as a debtor in ‘other current assets’. The accounts were amended to state the correct year end the cash balance position of £14,652,000.

Key Audit Risk	Finding:
4. 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.	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. All the required disclosures were included in the final statement of accounts.
5. 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.	Audit testing confirmed that the valuation of the freehold property is materially correct.

Recommendation

1. 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 could be improved by adding narrative information and providing all papers requested in the protocol.

We had difficulty in obtaining all the required reports for audit testing. Officers responded well to audit enquiries but did not always produce additional information in a timely manner.

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:
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 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 contact relevant bodies to ensure they are aware payment is late. The timeliness of receiving contributions within 19 days improved by year end.

Financial instruments (note 17)	The CIPFA Code of Practice on Local Authority Accounting 2010/11 requires the Pension Fund Accounts to disclose a financial instruments note. Officers omitted the note from the draft financial statements. This was corrected in the final statement of accounts.
Disclosure amendments to notes	The draft financial statements were amended as follows: • Three new notes were added disclosing the 'actuarial valuations as at 31 March 2010' which was previously disclosed in the introduction section of the accounts, the 'International Accounting Standards 26 disclosure' and 'Property' setting out the valuation of, and income from, investment properties; • Note 5 was expanded to disclose the 'other investment management expenses'; and • Note 8 'cash and cash equivalents' was reduced by £13,082,000 and 'other current assets' were increased by this amount.

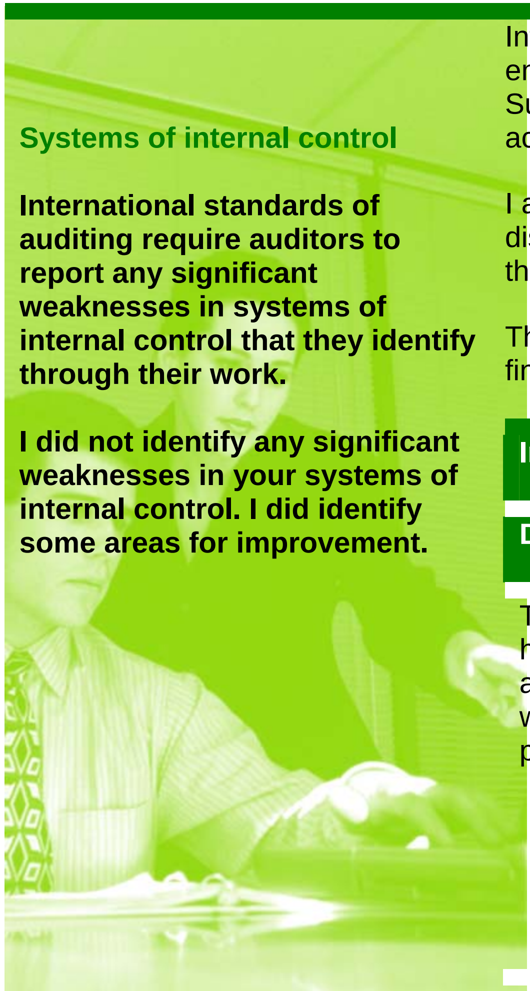
Recommendation

2. 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

A letter of representation, covering the Council's financial statements including the Superannuation Fund accounts, was prepared by officers for the 2010/11 audit opinion. This was approved by the Chairman and Liberal Democrat member of the Governance and Audit Committee on 25 July 2011. It was signed by officers on the 26 July 2011.

Financial statements



Systems of internal control

International standards of auditing require auditors to report any significant weaknesses in systems of internal control that they identify through their work.

I did not identify any significant weaknesses in your systems of internal control. I did identify 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 relating to the Superannuation Fund accounts as set out below. Officers acknowledge the weakness and have agreed to take action to correct it.

I also identified three other potential issues in relation to the Council's general IT environment that I have discussed with officers. I am satisfied that officers have put in place appropriate controls to mitigate the risk of these so am not required to report them to you.

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

Recommendation

3. 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.

Appendix 1 - Amendments to the financial statements

I identified the following misstatements during my audit. Officers have corrected these in the final version of the financial statements. I bring them to your attention to aid you in fulfilling your governance responsibilities.

		Fund Account		Net Assets Statement	
Adjusted misstatement	**Nature of adjustment**	**Dr £'000s**	**Cr £'000s**	**Dr £'000s**	**Cr £'000s**
1) Investment valuations (Net Assets Statement and note 7): 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: • Aurora £17,232,000; and • YFM £2,039,000. And overstatement of 1 valuation: • HarbourVest £1,199,000.	The investment values have been amended to correct the £508k understatement of the net assets. The values as at 31 March 2011 are now: • Aurora £17,741,000; • HarbourVest £1,147,000; and • YFM £2,091,000.		508	508	
2) Benefits payable (note 3): The increases in the lump sums of £1,957,000 were incorrectly disclosed in the pension	The benefits payable note has been amended to state the correct figures. The total values as at 31	1,957	1,957		

increases line of the note.	March are now: • Pensions increase £39,376,000; and • Lump sums (retirement) £37,379,000.
3) Future investment commitments (note 12): The disclosure included two errors within the note: • Total commitment with HarbourVest is overstated as one of the contracts for the reported £75m has not yet been signed; and • Total amounts invested with Partners Group and HarbourVest were disclosed against the incorrect Fund. Audit testing also identified that officers did not maintain records of the exchange rate used for the commitment or invested amounts so the exact disclosures could not be verified.	The disclosure note has been correctly amended to state the following: • HarbourVest commitment £60m • Invested amounts for HarbourVest are £1.6m and Partners Group £14.7m.

Recommendation

4. Officers should maintain records of the exchange rate used for commitments in foreign currencies on the date of investment.

Appendix 2 – 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 2 – 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 3 – Action plan

Page no.	Recommendation	Priority 1 = Low 2 = Med 3 = High	Responsibility	Agreed	Comments	Date
8	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	Yes	We will carry out checks before the reports are issued.	Year end March 2012
10	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	Yes	The timing of the receipts is a key performance indicator and will continue to be monitored monthly. We have no legal remedy in respect of late payments but employers are being reminded of the deadlines and new monitoring arrangements are being established.	Implemented
12	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	Yes	All PAYMAn journals are now retained even when blank	Implemented
14	Officers should maintain records of the exchange rate used for commitments in foreign currencies on the date of investment.	1	Treasury and Investments Manager	Yes	A memorandum record is being maintained of the FX rate.	Implemented