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# Informing the audit risk assessment for Kent County Council and Kent Pension Fund 2019/20

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## Purpose

The purpose of this report is to contribute towards the effective two-way communication between Kent County Council's and Kent Pension Fund's external auditors and the Council's and Pension Fund's Governance and Audit Committee, as 'those charged with governance'. The report covers some important areas of the auditor risk assessment where we are required to make inquiries of the Governance and Audit Committee under auditing standards.

## Background

Under International Standards on Auditing (UK) (ISA(UK)) auditors have specific responsibilities to communicate with Governance and Audit Committee. ISA(UK) emphasise the importance of two-way communication between the auditor and the Governance and Audit Committee and also specify matters that should be communicated.

This two-way communication assists both the auditor and the Governance and Audit Committee in understanding matters relating to the audit and developing a constructive working relationship. It also enables the auditor to obtain information relevant to the audit from the Governance and Audit Committee and supports the Governance and Audit Committee in fulfilling its responsibilities in relation to the financial reporting process.

## Communication

As part of our risk assessment procedures we are required to obtain an understanding of management processes and the Council's and Pension Fund's oversight of the following areas:

- General Enquiries of Management
- Fraud,
- Laws and Regulations,
- Going Concern,
- Related Parties, and
- Accounting Estimates.

## Purpose

This report includes a series of questions on each of these areas and the response we have received from Kent County Council's management. The Governance and Audit Committee should consider whether these responses are consistent with its understanding and whether there are any further comments it wishes to make.

## General Enquiries of Management

Question	Management response
1. What do you regard as the key events or issues that will have a significant impact on the financial statements for 2019/20?	<p>We have changed our valuer this year which has resulted in a significant change in the value of our PPE assets. This has resulted in the requirement for all our PPE assets to be revalued to ensure there is no material error.</p> <p>We have had the triannual valuation which often affects the pensions liability significantly but we haven't received the actuarial reports yet to substantiate this.</p>
2. Have you considered the appropriateness of the accounting policies adopted by the Council? Have there been any events or transactions that may cause you to change or adopt new accounting policies?	No
3. Is there any use of financial instruments, including derivatives?	Yes, but no derivatives
4. Is Are you aware of any significant transaction outside the normal course of business?	No

## General Enquiries of Management

Question	Management response
5. Are you aware of any changes in circumstances that would lead to impairment of non-current assets?	No
6. Are you aware of any guarantee contracts?	No
7. Are you aware of the existence of loss contingencies and/or un-asserted claims that may affect the financial statements?	No, Not aware of any loss contingencies or unasserted claims that may affect financial statement.
8. Other than in house solicitors, can you provide details of those solicitors utilised by the Council during the year. Please indicate where they are working on open litigation or contingencies from prior years?	Invicta Law, the Council's retained (and owned) legal provider. Bevan Brittan LLP, Browne Jacobsen, Burgess Salmon. No significant or material litigation from prior years.
9. Have any of the Council's service providers reported any items of fraud, non-compliance with laws and regulations or uncorrected misstatements which would affect the financial statements?	No – some low level fraud has been reported but it would not affect the financial statement.
10. Can you provide details of other advisors consulted during the year and the issue on which they were consulted?	Arlingclose on Group Accounts

# Fraud

## Issue

### Matters in relation to fraud

ISA (UK) 240 covers auditors responsibilities relating to fraud in an audit of financial statements.

The primary responsibility to prevent and detect fraud rests with both the Governance and Audit Committee and management. Management, with the oversight of the Governance and Audit Committee, needs to ensure a strong emphasis on fraud prevention and deterrence and encourage a culture of honest and ethical behaviour. As part of its oversight, the Governance and Audit Committee should consider the potential for override of controls and inappropriate influence over the financial reporting process.

As Kent County Council's and Kent Pension Fund's external auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error. We are required to maintain professional scepticism throughout the audit, considering the potential for management override of controls.

As part of our audit risk assessment procedures we are required to consider risks of fraud. This includes considering the arrangements management has put in place with regard to fraud risks including:

- assessment that the financial statements could be materially misstated due to fraud,
- process for identifying and responding to risks of fraud, including any identified specific risks,
- communication with the Audit Risk & Assurance Committee regarding its processes for identifying and responding to risks of fraud, and
- communication to employees regarding business practices and ethical behaviour.

We need to understand how the Governance and Audit Committee oversees the above processes. We are also required to make inquiries of both management and the Governance and Audit Committee as to their knowledge of any actual, suspected or alleged fraud. These areas have been set out in the fraud risk assessment questions below together with responses from the Council's management.

## Fraud risk assessment

Question	Management response
<p>1. Have the Council assessed the risk of material misstatement in the financial statements due to fraud?</p> <p>How has the process of identifying and responding to the risk of fraud been undertaken and what are the results of this process?</p> <p>How do the Council 's risk management processes link to financial reporting?</p>	<p>The risk is considered to be minimal. Controls are in place through the budget setting, budget monitoring and year-end analytical review. We now have details on a business intelligence dashboard of cost centres per budget manager, key service lines and manager analysis enabling an easily accessible view at a detailed level allowing us to target and challenge any budget manager where we perceive there may be anomalies. We also have a regular balance sheet management review. Variances must be explained and validated. Significant changes from previous year's spend must also be explained.</p> <p>Fraud risks have been developed through the analysis of fraud referrals both within the organisation and through engagement with other public/ private sector organisations and publications such as fighting fraud locally. This has resulted in an overall risk of fraud included in the corporate fraud risk register (CRR0049). There is a specific risk within Libraries, Registration and Archive (LRA0008) on internal fraud. There is also a specific risk in relation to employee pay and expenses (PC0004). There is also a specific fraud risk relating to procurement fraud (SC006). These risks have been considered and relevant controls have been put in place to help mitigate against the risk event.</p> <p>In addition to the above work has started with engaging with Divisional Management Team in embedding fraud risk assessments and the mapping out of controls to mitigate the risk, this work is expected to be completed by quarter 2 of 2020/2021.</p>
<p>2. What have you determined to be the classes of accounts, transactions and disclosures most at risk to fraud?</p>	<p>Financial assessments for personal budgets, use of direct payments, imprest accounts, procurement fraud have been considered as most at risk, however these have not resulted in values of fraud that would be material to the accounts.</p>
<p>3. Are you aware of any instances of actual, suspected or alleged fraud, errors or other irregularities either within the Council as a whole or within specific departments since 1 April 2019?</p> <p>As a management team, how do you communicate risk issues (including fraud) to those charged with governance?</p>	<p>We are aware of instances of actual, suspected or alleged fraud, errors or other irregularities. A Counter Fraud Report is provided to the Governance and Audit committee which is also provided for information to the Corporate Management Team.</p>

## Fraud risk assessment

Question	Management response
<p>4. Have you identified any specific fraud risks?</p> <p>Do you have any concerns there are areas that are at risk of fraud?</p> <p>Are there particular locations within the Council where fraud is more likely to occur?</p>	<p>Areas of concerns currently relate to imprest accounts, this prompted a substantive audit in this area which resulted in a limited opinion being given. Fraud with the Blue Badge scheme is another area of concern. Financial Assessments will continue to be an area of focus, with work on data matching continuing to assess the levels of fraud in this area.</p>
<p>5. What processes do the Council have in place to identify and respond to risks of fraud?</p>	<p>There is through the report to G&amp;A analysis of the fraud types (existing and emerging), volumes and amounts, this is derived from the reporting for financial irregularities by services to the Counter Fraud Team, this processes is a requirement of the financial regulations of the council.</p>
<p>6. How would you assess the overall control environment for the Council, including: the process for reviewing the effectiveness the system of internal control; internal controls, including segregation of duties; exist and work effectively?</p> <p>If not where are the risk areas and what mitigating actions have been taken?</p> <p>What other controls are in place to help prevent, deter or detect fraud?</p> <p>Are there any areas where there is a potential for override of controls or inappropriate influence over the financial reporting process (for example because of undue pressure to achieve financial targets)?</p>	<p>Each year an annual audit plan is developed that take into account the risks of the council, including fraud risks. Where there is a significant risk (such as imprest accounts) this has prompted a full review to assess the effectiveness of internal controls.</p> <p>In addition the Counter Fraud Team have developed and are progressing a work programme to assess the Counter Fraud Culture within business units to support management in ensuring there is a robust culture within the 1<sup>st</sup> and 2<sup>nd</sup> lines of defence.</p> <p>Not that we are aware of, nothing has been reported by management in this respect.</p> <p>Yes, this is a risk applicable to any budget manager, as their performance against budget is a factor in their annual performance assessment. However, this is a relatively minor risk and is mitigated by the budget monitoring, schemes of delegation and year end processes, as well as setting realistic budgets to start with. The creation of KCC Companies does increase risk but appropriate controls /governance are in place.</p>

## Fraud risk assessment

Question	Management response
7. Are there any areas where there is potential for misreporting?	Not that we have been made aware of.
<p>8. How do the Council communicate and encourage ethical behaviours and business processes of it's staff and contractors?</p> <p>How do you encourage staff to report their concerns about fraud?</p> <p>What concerns are staff expected to report about fraud? Have any significant issues been reported?</p>	<p>There are KCC standards which include the Nolan principles, staff code of conduct, Anti-Fraud and Corruption Strategy and Anti Bribery Policy. There is e-learning provided to support the prevention and detection for fraud. There is a whilst blowing policy which encourages staff to report there concerns, the Counter Fraud Team is included in this policy as an alternative to raising concerns with management.</p> <p>As part of Fraud Awareness presentations whistleblowing is covered, through the Counter Fraud Culture work staff are engage with to asses how confident they are in raising concerns with management, counter fraud or external sources, this is then fed back to management with advice and support on how to raise, if needed, the trust in staff to raise concerns.</p> <p>Staff are expected to raise all financial irregularities with Internal Audit. Significant issues that have been raised have resulted in audits being conducted, such as imprest accounts.</p>

## Fraud risk assessment

Question	Management response
<p>9. From a fraud and corruption perspective, what are considered to be high-risk posts?</p> <p>How are the risks relating to these posts identified, assessed and managed?</p>	<p>Currently KR16 and above have delegated authority to spend up to £1m without member decisions, these posts are considered high risk due to no separation of duty being required, however in practice, Heads of Service will present business cases to support spending the councils money.</p> <p>There is an enhanced vetting process in place when recruiting into a KR16 and above, this ensures that not only the information provided on the application form is correct, but also ensures there are no financial or reputational risks to the authority.</p> <p>Furthermore through the development of the fraud, bribery and corruption risk assessment, further areas of high risk will be identified with relevant controls being identified to mitigate the risk, for example regular reminders on declarations of interest, budget monitoring, separation of duties, rotation of duties.</p>
<p>10. Are you aware of any related party relationships or transactions that could give rise to instances of fraud?</p> <p>How do you mitigate the risks associated with fraud related to related party relationships and transactions?</p>	<p>As part of the NFI exercise we are alerted to potential conflicts of interest, these are investigated and where needed a formal investigation is progressed, however the matches have resulted in the need to update declarations of interests for members and officers who sit on charity boards as part of their position within KCC.</p> <p>Regular reminders of declarations are issued. As part of the supplier set up process requestors are required to confirm there is no conflict of interest when setting up a supplier, it also requires the budget holder to authorise the setting up of the supplier, as well as authorisation from the commissioning category manager. In addition reminders on whistle blowing procedures are issued to all staff to prompt any concerns being raised with either management or Internal Audit.</p>

## Fraud risk assessment

Question	Management response
<p>11. What arrangements are in place to report fraud issues and risks to the Governance and Audit Committee?</p> <p>How does the Governance and Audit Committee exercise oversight over management's processes for identifying and responding to risks of fraud and breaches of internal control?</p> <p>What has been the outcome of these arrangements so far this year?</p>	<p>A Counter Fraud Report is produced to the Governance and Audit Report at each meeting. This includes issues and risks identified during the reported period.</p> <p>Governance and Audit Committee has the ability to call in any manager to question their arrangements in addressing the risks of fraud.</p> <p>Relevant enquiries have been made by members of fraud figures and trends.</p>
<p>12. Are you aware of any whistle blowing potential or complaints by potential whistle blowers? If so, what has been your response?</p>	<p>Yes we have had a number of concerns raised through the whistle blowing hotline, depending on the nature of the concern these have either been addressed through management engagement or through an investigation by a member of the Counter Fraud Team.</p>
<p>13. Have any reports been made under the Bribery Act?</p>	<p>No</p>

## Law and regulations

### Issue

#### Matters in relation to laws and regulations

ISA (UK) 250 requires us to consider the impact of laws and regulations in an audit of the financial statements.

Management, with the oversight of the Governance and Audit Committee, is responsible for ensuring that Kent County Council's and Kent Pension Fund's operations are conducted in accordance with laws and regulations including those that determine amounts in the financial statements.

As auditor, we are responsible for obtaining reasonable assurance that the financial statements are free from material misstatement due to fraud or error, taking into account the appropriate legal and regulatory framework. As part of our risk assessment procedures we are required to make inquiries of management and the Governance and Audit Committee as to whether the entity is in compliance with laws and regulations. Where we become aware of information of non-compliance or suspected non-compliance we need to gain an understanding of the non-compliance and the possible effect on the financial statements.

Risk assessment questions have been set out below together with responses from management.

## Impact of laws and regulations

Question	Management response
<p>1. How does management gain assurance that all relevant laws and regulations have been complied with?</p> <p>What arrangements does the Council have in place to prevent and detect non-compliance with laws and regulations? Are you aware of any changes to the Council's regulatory environment that may have a significant impact on the Council's financial statements?</p>	<p>In addition to audit activity, contractual provisions are in place with legal services providers to escalate issues of legal compliance to the Monitoring Officer. Provisions on compliance with laws and regulations are included in the Council's Operating Standards and Constitution which are dip sampled through meeting attendance and decision review. Monitoring Officer is a Member of CMT and Corporate Board. Annual Governance Statement includes questions on compliance that are reviewed and tested throughout the year.</p>
<p>2. How is the Governance and Audit Committee provided with assurance that all relevant laws and regulations have been complied with?</p>	<p>Through the provision of an annual standalone report on the Annual Governance Statement. In 2019/20 this also included training from the Head of Internal Audit. From 2020/21 onwards there will be regular reporting on Governance issues using a tracker system.</p>
<p>3. Have there been any instances of non-compliance or suspected non-compliance with laws and regulation since 1 April 2019 with an on-going impact on the 2019/2020 financial statements?</p>	<p>No</p>
<p>4. Is there any actual or potential litigation or claims that would affect the financial statements?</p>	<p>No</p>

## Impact of laws and regulations

Question	Management response
5. What arrangements does the Council have in place to identify, evaluate and account for litigation or claims?	The Chief Accountant liaises with Legal Services team to capture all potential claims. Legal estimate the potential 'loss' as best they can. This is then reported to this Committee through the Statement of Accounts in July.
6. Have there been any report from other regulatory bodies, such as HM Revenues and Customs which indicate non-compliance?	No

# Going Concern

## Issue

### **Matters in relation to going concern**

ISA (UK) 570 covers auditor responsibilities in the audit of financial statements relating to management's use of the going concern assumption in the financial statements.

The going concern assumption is a fundamental principle in the preparation of financial statements. Under this assumption entities are viewed as continuing in business for the foreseeable future. Assets and liabilities are recorded on the basis that the entity will be able to realise its assets and discharge its liabilities in the normal course of business.

Going concern considerations have been set out below and management has provided its response.

## Going concern considerations

Question	Management response
<p>1. Has the management team carried out an assessment of the going concern basis for preparing the financial statements for the Council ? What was the outcome of that assessment?</p>	<p>This assessment is carried out by the S151 officer on an ongoing basis but especially at the time of setting the budget and producing Final Accounts. The S151 officer also monitors the Council's cash position on a daily basis. Forecasts are robustly monitored and challenged to mitigate any potential impact on our reserves and ultimately our judgement of 'going concerns'.</p>
<p>2. Are the financial assumptions in that report (e.g., future levels of income and expenditure) consistent with Council's Medium Term Financial Plan and the financial information provided to the Council throughout the year?</p>	<p>Yes</p>

## Going concern considerations

Question	Management response
3. Are the implications of statutory or policy changes appropriately reflected in Financial Plan, financial forecasts and report on going concern?	Yes, including in the Medium Term Financial Plan, and regular monitoring reports.
4. Have there been any significant issues raised with the Governance and Audit Committee during the year which could cast doubts on the assumptions made? (Examples include adverse comments raised by internal and external audit regarding financial performance or significant weaknesses in systems of financial control).	Not of any significance.
5. Does a review of available financial information identify any adverse financial indicators including negative cash flow or poor or deteriorating performance against the better payment practice code? If so, what action is being taken to improve financial performance?	No

## Going concern considerations

Question	Management response
<p>6. Does the Council have sufficient staff in post, with the appropriate skills and experience, particularly at senior manager level, to ensure the delivery of the Council 's objectives? If not, what action is being taken to obtain those skills?</p>	<p>Yes, and training is regularly offered to support managers.</p>
<p>7. Does the Council have procedures in place to assess their ability to continue as a going concern?</p>	<p>Yes</p>
<p>8. Is management aware of the existence of events or conditions that may cast doubt on the Council's ability to continue as a going concern?</p>	<p>None in the short-medium term. We work closely with central Government to influence funding decisions wherever possible.</p>

## Going concern considerations

Question	Management response
<p>9. Are arrangements in place to report the going concern assessment to the Governance and Audit Committee ?</p> <p>How has the Governance and Audit Committee satisfied itself that it is appropriate to adopt the going concern basis in preparing financial statements?</p>	<p>This is reported through the S151 officer certification within the Statement of Accounts, and through his Section 25 Assurance on County Council Budget day. The budget monitoring reports to Cabinet are also the opportunity to report any concerns, and six monthly updates on delivery of savings is reported to Governance and Audit Committee.</p>

# Related Parties

## Issue

### Matters in relation to Related Parties

Kent County Council and Kent Pension Fund are required to comply with IAS 24 and disclose transactions with entities/individuals that would be classed as related parties. These may include:

- entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the Council;
- associates;
- joint ventures;
- an entity that has an interest in the authority that gives it significant influence over the Council;
- key management personnel, and close members of the family of key management personnel, and
- post-employment benefit plans (pension fund) for the benefit of employees of the Council, or of any entity that is a related party of the Council.

A disclosure is required if a transaction (or series of transactions) is material on either side, i.e. if a transaction is immaterial from the Council's perspective but material from a related party viewpoint then the Council must disclose it.

ISA (UK) 550 requires us to review your procedures for identifying related party transactions and obtain an understanding of the controls that you have established to identify such transactions. We will also carry out testing to ensure the related party transaction disclosures you make in the financial statements are complete and accurate.

## Relating Parties

Question	Management response
1. What controls does the Council have in place to identify, account for and disclose related party transactions and relationships ?	Members and Senior Officers are required to complete declarations of interest which are reviewed during the year end closure. Information is also collected via the early return process.

# Accounting estimates

## Issue

### Matters in relation to Related Accounting estimates

Kent County Council and Kent Pension Fund apply appropriate estimates in the preparation of their financial statements. ISA (UK) 540 sets out requirements for auditing accounting estimates. The objective is to gain evidence that the accounting estimates are reasonable and the related disclosures are adequate.

Under this standard we have to identify and assess the risks of material misstatement for accounting estimates by understanding how the Combined Authority identifies the transactions, events and conditions that may give rise to the need for an accounting estimate.

Accounting estimates are used when it is not possible to measure precisely a figure in the accounts. We need to be aware of all estimates that the Combined Authority is using as part of its accounts preparation; these are detailed in appendix 1 to this report. The audit procedures we conduct on the accounting estimate will demonstrate that:

- the estimate is reasonable; and
- estimates have been calculated consistently with other accounting estimates within the financial statements.

We would ask the Governance and Audit Committee to satisfy itself that the arrangements for accounting estimates are adequate.

## Accounting Estimates

Question	Management response
1. Are management aware of transactions, events, conditions (or changes in these) that may give rise to recognition or disclosure of significant accounting estimates that require significant judgement (other than those in Appendix A)?	Yes
2. Are the management arrangements for the accounting estimates, as detailed in Appendix A reasonable?	Yes
3. How is the Governance and Audit Committee provided with assurance that the arrangements for accounting estimates are adequate ?	They're detailed in the Statement of Accounts

## Appendix A Accounting Estimates

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Property, plant & equipment valuations	Fair value for land/buildings defined as 'existing use' by the Council.	Valuations are performed annually to ensure that the fair value of a revalued asset does not differ materially from its carrying amount. For land and buildings all material assets will be considered in 2019/20.	Yes	Degree of uncertainty inherent with any revaluation. We employ professional valuers and rely on expert opinion.	No
Estimated remaining useful lives of PPE	Each part of an item of property, plant and equipment with a significant cost in relation to the total cost is depreciated separately. Depreciation methods, useful lives and residual values are reviewed each financial year and adjusted if appropriate.	See left box	Discussion with internal asset team and where applicable Wilks Head & Eve as the valuer.	Depreciation is calculated on a straight line basis as this reflects consumption of assets and is a reasonable assumption.	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Depreciation and Amortisation	See above	See above	See above	See above	No
Impairments	Review of all assets undertaken annually.	See left.	Discussion with internal asset team as appropriate.	N/A.	No.
Measurement of Financial Instruments	Financial instruments are measured initially at cost and subsequently at amortised cost using the effective interest method or fair value.	Knowledge by the Investment team who manages the financial instruments in liaison with fund managers.	Fund advisers – Arlingclose	The portfolio is assessed on an individual borrower for its expected credit losses using: i) Probability of default ii) Loss of given default	No

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Provisions for liabilities	Provisions are identified through detailed monthly management accounts which flags any potential issues to management.	Each provision is separately reviewed by financial accounts and a working is put together to support the calculation.	As necessary on an individual basis	Each provision is assessed on an individual basis to ensure that it meets the criteria of a provision per IAS 37. The degree of uncertainty is assessed when determining whether a provision is the correct treatment for an item.	No.
Bad Debt Provision	Debts are reviewed monthly and any debts that are deemed to be irrecoverable are written off to Income and Expenditure.	Knowledge by the Accounts Receivables team in likelihood of recoverability and the aging of the debts.	N/A	N/A	No.

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Accruals	We use standard accruals accounting –accruals are based on expenses incurred that have not yet been paid.	Monthly management accounts provides rigorous analysis so that any accruals are highlighted and actioned throughout the year.	N/A.	N/A.	No.
Non Adjusting events – events after the balance sheet date	Monthly management accounts prepared would flag any adjusting/non-adjusting events.	See left.	N/A.	N/A.	No.

## Appendix A Accounting Estimates (Continued)

Estimate	Method / model used to make the estimate	Controls used to identify estimates	Whether Management have used an expert	Underlying assumptions: - Assessment of degree of uncertainty - Consideration of alternative estimates	Has there been a change in accounting method in year?
Pension Fund (LGPS) Actuarial gains/losses	The actuarial gains and losses figures are calculated by the actuarial expert Barnett Waddingham. These figures are based on making % adjustments to the closing values of assets/liabilities.	The Pension Fund responds to queries raised by the administering body, Kent County Council.	The Council are provided with an actuarial report by Kent Pension Fund (LGPS) provided by the actuary.	The nature of these figures forecasting into the future are based upon the best information held at the current time and are developed by experts in their field.	No.



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