

# Annual governance report

South Kesteven District Council

Audit 2011/12



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# Key messages

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**This report summarises the findings from the 2011/12 audit which is substantially complete. It includes the messages arising from my audit of your financial statements and the results of the work I have undertaken to assess your arrangements to secure value for money in your use of resources.**

## Financial statements

As at 13 September 2012 I expect to issue an unqualified audit opinion.

I identified three material errors in your financial statements and a number of non-trivial misstatements, which have all been corrected by management.

This year there have been more adjustments to the accounts that you presented for audit, reflecting the loss of a key member of the finance team at a crucial time of year. Your finance team recognised the risks, and the greater involvement by the Head of Finance and close working with my audit team ensured that the fieldwork was concluded in line with planned timescales.

## Value for money (VFM)

I expect to conclude that you have made proper arrangements to secure economy, efficiency and effectiveness in your use of resources.

## Certificate

I plan to award the audit certificate by the deadline of 30 September.

# Before I give my opinion and conclusion

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**My report includes only matters of governance interest that have come to my attention in performing my audit. I have not designed my audit 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 am not aware of any relationships that may affect the independence and objectivity of the Audit Commission, the audit team or me, that I am required by auditing and ethical standards to report to you.

The Audit Commission's Audit Practice has not undertaken any non-audit work for the Council during 2011/12.

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

- take note of the adjustments to the financial statements included in this report (appendix 2); and
- approve the letter of representation (appendix 3), on behalf of the Council before I issue my opinion and conclusion.

# Financial statements

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**The Council's financial statements and annual governance statement are important means by which the Council accounts for its stewardship of public funds. As elected 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.**

## 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.

## Corrected errors

All material and non-trivial misstatements identified during the audit have been amended by management. There were some areas of non-compliance with the CIPFA<sup>i</sup> Code of Practice on Local Authority Accounting, which have been corrected. I have set out below the three material corrections.

The Council misclassified £6.5m of cash equivalents as short term investments. Cash equivalents are short-term, highly liquid investments. The Council maintains a proportion of its investments in instant access accounts, which fall within this definition, and so to comply with the Code they have been reclassified as cash equivalents.

The 2010/11 balances in the comprehensive income and expenditure statement (CIES) had not been correctly restated following the required reclassification of the service expenditure analysis. For 2011/12 CIPFA replaced the Best Value Accounting Code of Practice, which sets out the service expenditure analysis for the CIES, with the Reporting Code of Practice for Local Authorities (SeRCOP). This replaced cultural, environment, regulatory and planning services with:

- Cultural and Related Services.
- Environment and Regulatory Services.
- Planning Services:

<sup>i</sup> Chartered Institute of Public Finance and Accountancy

The Council properly applied the new requirements for 2011/12 balances in its draft financial statements but did not restate the 2010/11 comparators or provide an explanatory note. These omissions have now been rectified.

The impact of the Housing Revenue Account (HRA) settlement was reflected properly in the main financial statements, but not in the on capital expenditure and capital borrowing note to the accounts (see table 1 below).

All significant adjustments are set out in Appendix 2. All other errors identified during our audit were corrected and we have provided the Head of Finance with a full breakdown of them.

## Significant risks and my findings

I reported to you in my February 2012 Audit Plan the significant risk that I identified relevant to my audit of your financial statements. In Table 1 I report to you my findings against this risk.

Table 1: **Risks and findings**

Risk as per audit plan	Finding
<p><b>HRA reform</b></p> <p>The government has set out its plans to reform local authority housing finance by adopting a self-financing model from 1 April 2012. For South Kesteven DC, this will be through a one-off settlement payment of approximately £122m to central government on or before 28 March 2012. This will adjust the Housing Revenue Account (HRA) debt of the Council. Due to the complexity, magnitude and timing of the reform there is risk of material errors in:</p> <ul style="list-style-type: none"> <li>■ your disclosures within the HRA; and</li> <li>■ property, plant and equipment (PPE) and borrowing in the balance sheet and supporting financial notes.</li> </ul>	<p>The disclosure of the £121.652m self financing settlement was correctly shown in the main statements, but it was omitted from the capital financing and capital expenditure note.</p> <p>I have evaluated management’s oversight of HRA reforms and the transactions required by the Council and found that the settlement was successfully transacted in March 2012.</p> <p>I have audited the treatment of the settlement within the financial statements and found that the capital expenditure and the increased borrowing are disclosed correctly in the CIES and the balance sheet, respectively. However, the Council omitted to disclose the capital expenditure and increase in borrowing in note 36, capital expenditure and capital financing. This material omission has been corrected.</p>

## Significant weaknesses in internal control

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. My responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

I have tested the controls of the Council only to the extent necessary for me to complete my audit. I am not expressing an opinion on the overall effectiveness of internal control. I have reviewed the Annual Governance Statement and can confirm that:

- it complies with the requirements of CIPFA/SOLACE<sup>i</sup> Delivering Good Governance in Local Government Framework; and
- it is consistent with other information that I am aware of from my audit of the financial statements.

I have no weaknesses in internal control to report to you.

## Other matters

I am required to communicate to you significant findings from the audit and other matters that are significant to your oversight of the Council's financial reporting process including the following.

- Qualitative aspects of your accounting practices
- Matters specifically required by other auditing standards to be communicated to those charged with governance. For example, issues about fraud, compliance with laws and regulations, external confirmations and related party transactions.
- Other audit matters of governance interest

I have no significant matters I wish to report.

There is one matter I want to bring to your attention that has been resolved this year, but should also be considered for future reference. I did discuss with management that the explanatory foreword could be more useful to the reader. The aim of the explanatory foreword is to explain the main features of the financial statements, and it has an important role in local government because of the complexity of the accounts. However, its focus was sometimes on small balances, whereas material variances were not always explained. Management has redrafted it, providing greater focus on significant and material matters, and increased explanation for material variances.

## Whole of Government Accounts

Alongside my work on the financial statements, I review and report to the National Audit Office (NAO) on your Whole of Government Accounts return. The extent of my review and the nature of my report were specified by the NAO. I have no matters to report and expect to report to the NAO by the end of September.

<sup>i</sup> Society of Local Authority Chief Executives and Senior Managers

# Value for money

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

I assess your arrangements against the two criteria specified by the Commission. In my February 2012 Audit Plan I reported to you the significant risks that were relevant to my conclusion. I have set out below my conclusion on the two criteria.

I intend to issue an unqualified conclusion stating that the Council has proper arrangements to secure economy, efficiency and effectiveness in the use of its resources. I include my draft conclusion in Appendix 1.

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Table 2: **Value for money conclusion criteria and my findings**

Criteria	Findings
<p><b>1. Financial resilience</b></p> <p>The organisation has proper arrangements in place to secure financial resilience.</p> <p>Focus for 2011/12:</p> <p>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.</p>	<p>I am satisfied that the Council has proper arrangements in place to secure financial resilience.</p> <p>I identified no significant risks to this criterion during my audit planning. I have monitored your financial performance during 2011/12; you have maintained a stable financial position through the year and you successfully transacted the HRA self-financing settlement.</p> <p>Your level of earmarked reserves remain relatively high compared to other local authorities and have increased during the year. I have confirmed that plans are in place for these reserves and you should ensure that delivery is achieved within the planned timescales.</p>

## Criteria

### **2. Securing economy efficiency and effectiveness**

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

Focus for 2011/12:

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

## Findings

I am satisfied that the Council has proper arrangements for challenging how it secures economy, efficiency and effectiveness.

I identified no significant risks to this criterion during my audit planning. Through my monitoring of your responses to key challenges through the year, in particular the planning and modelling you have carried out in preparation for HRA self financing, localising support for council tax, and business rates retention, I concluded that proper arrangements are in place.

# Fees

## I reported my planned audit fee in the February Audit Plan.

I will complete the audit within the planned fee.

Table 3: Fees

	Planned fee 2011/12 (£)	Expected fee 2011/12 (£)
Audit	103,550	103,550
Claims and returns	18,000	18,000
Non-audit work	0	0
<b>Total</b>	<b>121,550</b>	<b>121,550</b>

The Audit Commission has paid a rebate of £8,284 on the audit fee to reflect the attainment of internal efficiency savings, reducing the net amount payable by South Kesteven District Council to £95,266

# Appendix 1 – Draft independent auditor’s report to the members of South Kesteven DC

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## **Opinion on the Council financial statements**

I have audited the financial statements of South Kesteven District Council for the year ended 31 March 2012 under the Audit Commission Act 1998. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement and Collection Fund and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC<sup>i</sup> Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

This report is made solely to the members of South Kesteven District 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 Chief Finance Officer and auditor**

As explained more fully in the Statement of the Chief Finance Officer Responsibilities, the Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which includes the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that they give a true and fair view. My responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require me to comply with the Auditing Practices Board’s Ethical Standards for Auditors.

<sup>i</sup> Local Authority Scotland Accounts Advisory Committee

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

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial 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 Chief Finance Officer; and the overall presentation of the financial statements. In addition, I read all the financial and non-financial 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 financial statements**

In my opinion the financial statements:

- give a true and fair view of the financial position of South Kesteven District Council as at 31 March 2012 and of its expenditure and income for the year then ended; and
- have been prepared properly in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2011/12.

## **Opinion on other matters**

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

Matters on which I report by exception

I report to you if:

- in my opinion the annual governance statement does not reflect compliance with 'Delivering Good Governance in Local Government: a Framework' published by CIPFA/SOLACE in June 2007;
- I issue a report in the public interest under section 8 of the Audit Commission Act 1998;
- I designate under section 11 of the Audit Commission Act 1998 any recommendation as one that requires the Authority to consider it at a public meeting and to decide what action to take in response; or
- I exercise any other special powers of the auditor under the Audit Commission Act 1998.

I have nothing to report in these respects

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

### **Respective responsibilities of the Authority and the auditor**

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.

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.

### **Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources**

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 2011, 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 2012.

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 2011, I am satisfied that, in all significant respects, South Kesteven District Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2012.

## **Certificate**

I certify that I have completed the audit of the accounts of South Kesteven District Council in accordance with the requirements of the Audit Commission Act 1998 and the Code of Audit Practice issued by the Audit Commission.

Tony Crawley  
District Auditor

Audit Commission.  
Unit 10, Whitwick Business Centre,  
Whitwick Business Park,  
Stenson Road,  
Coalville,  
LE67 4JP

XX September 2012

# Appendix 2 – Corrected errors

I identified the following errors during the audit which management has addressed in the revised financial statements.

		Comprehensive income and expenditure statement		Balance sheet	
Item of account	Nature of error	Dr £'000s	Cr £'000s	Dr £'000s	Cr £'000s
CIES: new SERCOP headings covering cultural, environmental, regulatory, and planning services.	The 2010/11 comparators had not be restated for the change in classification of cost of services	Expenditure Cultural Services 5,991 Environmental Services 8,285 Planning Services 3,914	Cultural, environmental, regulatory and planning services 18,190		
		Income Cultural, environmental, regulatory and planning services 5,531	Cultural Services 1,953 Environmental Services 2,521 Planning Services 1,057		
		Net Cultural Services 4,038 Environmental Services 5,764 Planning Services	Cultural, environmental, regulatory and planning services 12,659		

		Comprehensive income and expenditure statement		Balance sheet	
		2,857			
Balance sheet: cash and cash equivalents	Investment monies lodged in instant access accounts were classified as short term investments whereas, under the Code, they should be classified as cash equivalents. Corresponding adjustments have been made to the cash flow statement.			Cash equivalents 6,500	Short-term investments 6,500
Balance sheet: assets held for sale	Council dwellings where the tenants are exercising their right to buy were not reclassified as held for sale.			Assets held for sale 189	Council dwellings 189
Cash flow statement	Impairment of council dwellings and the payments relating to council dwellings additions were not properly disclosed in the cash flow statement. Note 47 added to the financial statements to explain a material balance in the cash flow statement.	Non-cash movements 4,354	Downward revaluation (impairment) 4,354		
Note 8: adjustments between accounting basis and funding basis under regulations	Capital expenditure on council dwellings incorrectly classified within the note.	Revaluation losses on PPE 4,354	Capital expenditure 4,354		

		Comprehensive income and expenditure statement		Balance sheet	
Note 15 and HRA note 2: PPE	Brought forward balances for council dwellings and other land and buildings.			B/f cost or valuation 4,354	B/f cumulative depreciation and impairment 4,354
Note 27: capital adjustment account	Capital expenditure and impairments incorrectly classified in the note	Revaluation losses on PPE 4,354	Capital expenditure 4,354		
Note 36: capital expenditure and capital financing	HRA self-financing transaction of £121.652m not reflected in the note.			Not applicable note only	
Note 46: investments	Additional note added to the financial statements to explain material movements in investments.			Not applicable note only	

# Appendix 3 – Draft letter of management representation

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## **South Kesteven District Council - Audit for the year ended 31 March 2012**

I confirm to the best of my knowledge and belief, having made appropriate enquiries of other directors of South Kesteven District Council, the following representations given to you in connection with your audit of the Council's financial statements for the year ended 31 March 2012.

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

I have fulfilled my responsibility under the relevant statutory authorities for preparing the financial statements in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on 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.

### **Supporting records**

I have made available all relevant information and access to persons within the Council for the purpose of your audit. I have properly reflected and recorded in the financial statements all the transactions undertaken by the Council.

### **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 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.

### **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.

### **Related party transactions**

I confirm that I have disclosed the identity of the 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 requirements of the Code.

### **Subsequent events**

I have adjusted for or disclosed in the financial statements all relevant events subsequent to the date of the financial statements.

Signed on behalf of South Kesteven District Council

I confirm that this letter has been discussed and agreed by the Governance and Audit Committee on 25 September 2012.

Signed

Name

Position

Date

# Appendix 4 – Glossary

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## **Annual Audit Letter**

Letter issued by the auditor to the Council after the completion of the audit that summarises the audit work carried out in the period and significant issues arising from auditors' work.

## **Annual Governance Report**

The auditor's report on matters arising from the audit of the financial statements presented to those charged with governance before the auditor issues their opinion and conclusion.

## **Annual Governance Statement**

The annual report on the Council's systems of internal control that supports the achievement of the Council's policies aims and objectives.

## **Audit of the accounts**

The audit of the accounts of an audited body comprises all work carried out by an auditor under the Code to meet their statutory responsibilities under the Audit Commission Act 1998.

## **Audited body**

A body to which the Audit Commission is responsible for appointing the external auditor.

## **Auditing Practices Board (APB)**

The body responsible in the UK for issuing auditing standards, ethical standards and associated guidance to auditors. Its objectives are to establish high standards of auditing that meet the developing needs of users of financial information and to ensure public confidence in the auditing process.

## **Auditing standards**

Pronouncements of the APB that contain basic principles and essential procedures with which auditors must comply, except where otherwise stated in the auditing standard concerned.

**Auditor(s)**

Auditors appointed by the Audit Commission.

**Code (the)**

The Code of Audit Practice for local government bodies issued by the Audit Commission and approved by Parliament.

**Commission (the)**

The Audit Commission for Local Authorities and the National Health Service in England.

**Ethical Standards**

Pronouncements of the APB that contain basic principles relating to independence, integrity and objectivity that apply to the conduct of audits and with which auditors must comply, except where otherwise stated in the standard concerned.

**Financial statements**

The annual statement of accounts that the Council is required to prepare, which report the financial performance and financial position of the Council in accordance with the Accounts and Audit (England) Regulations 2011 and the Code of Practice on Local Authority Accounting in the United Kingdom.

**Group accounts**

Consolidated financial statements of a Council and its subsidiaries, associates and jointly controlled entities.

**Internal control**

The whole system of controls, financial and otherwise, that the Council establishes to provide reasonable assurance of effective and efficient operations, internal financial control and compliance with laws and regulations.

**Materiality**

The APB defines this concept as 'an expression of the relative significance or importance of a particular matter in the context of the financial statements as a whole. A matter is material if its omission would reasonably influence the decisions of an addressee of the auditor's report; likewise a misstatement is material if it would have a similar influence. Materiality may also be considered in the context of any individual primary statement

within the financial statements or of individual items included in them. Materiality is not capable of general mathematical definition, as it has both qualitative and quantitative 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**

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

### **Those charged with governance**

Those entrusted with the supervision, control and direction of the Council. This term includes the members of the Council and its Governance and Audit Committee.

### **Whole of Government Accounts**

A project leading to a set of consolidated accounts for the entire UK public sector on commercial accounting principles. The Council must submit a consolidation pack to the department for Communities and Local Government which is based on, but separate from, its financial statements.

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**0844 798 7070**

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The Statement of Responsibilities of Auditors and Audited Bodies issued by the Audit Commission explains the respective responsibilities of auditors and of the audited body. Reports prepared by appointed auditors are addressed to non-executive directors, members or officers. They are prepared for the sole use of the audited body. Auditors accept no responsibility to:

- any director/member or officer in their individual capacity; or
- any third party.

