THE MINISTRY OF SOCIAL DEVELOPMENT AND INNOVATION

REPORT TO THOSE CHARGED WITH GOVERNANCE ON THE 2025 AUDIT

June 2026

To help the public service spend wisely

TABLE OF CONTENTS

REPORT TO THOSE CHARGED WITH GOVERNANCE

INTRODUCTION

1. We have completed our audit of the 31 December 2025, financial statements of the Ministry of Social Development and Innovation (the "Ministry"). International Standards on Auditing (ISAs) require that we communicate certain matters to those charged with governance of the Ministry in sufficient time to enable them to take appropriate action. The matters we are required to communicate under ISAs include:

   - Auditors' responsibilities in relation to the audit
   - The overall scope and approach to the audit, including any expected limitations, or additional requirements
   - Relationships that may bear on our independence, and the integrity and objectivity of our staff
   - Expected modifications to the audit report
   - Significant findings from our audit.

2. This report sets out for the consideration of those charged with governance, those matters arising from the audit of the 2025 financial statements that we consider worthy of drawing to your attention.

3. This report has been prepared for the sole use of those charged with governance, and we accept no responsibility for its use by a third party. Under the Freedom of Information Act (2021 Revision), it is the policy of the Office of the Auditor General to proactively release all final reports through our website: www.auditorgeneral.gov.ky.

AUDITOR'S RESPONSIBILITIES IN RELATION TO THE AUDIT

AUDITOR'S RESPONSIBILITY UNDER INTERNATIONAL STANDARDS ON AUDITING (ISAs)

4. ISAs require that we plan and perform the audit to obtain reasonable, rather than absolute, assurance about whether the financial statements are free of material misstatement. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. Accordingly, the audit does not ordinarily identify all such matters, and this report includes only those matters of interest that came to our attention during the performance of our audit.

RESPONSIBILITIES OF MANAGEMENT AND THOSE CHARGED WITH GOVERNANCE

5. Management's responsibilities are detailed in the engagement letter dated 21 August 2025. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.

OTHER INFORMATION IN DOCUMENTS CONTAINING AUDITED FINANCIAL STATEMENTS

6. While we have no responsibility to perform any audit work on other information, including forward-looking statements containing audited financial statements, we have read the other information contained in the Ministry's annual report and noted that it is materially consistent with information appearing in the financial statements or our knowledge of the operations of the Ministry. We have not reviewed other documents containing the Ministry's audited financial statements.

CONDUCT, APPROACH AND OVERALL SCOPE OF THE AUDIT

7. Information on the integrity and objectivity of the Office of the Auditor General and audit staff and the nature and scope of the audit were outlined in the engagement letter presented to the CHIEF Officer and follow the requirements of the ISAs. We are not aware of any impairment to our independence as auditors.

AUDIT REPORT, ADJUSTMENTS AND MANAGEMENT REPRESENTATIONS

8. We have issued an unmodified audit report on the 31 December 2025 financial statements.

9. A summary of audit adjustments made to the financial statements is attached in Appendix 1. There were no uncorrected misstatements.

10. As part of the completion of our audit, we obtained written representations from management on aspects of the accounts, judgments and estimates made. These representations were provided to us on 30 April 2026.

SIGNIFICANT FINDINGS FROM THE AUDIT

SIGNIFICANT ACCOUNTING PRACTICES

11. We are responsible for providing our views about qualitative aspects of the Ministry's significant accounting practices, including accounting policies, accounting estimates and financial statement disclosures.

12. Generally accepted accounting principles provide for the Ministry to make accounting estimates and judgments about accounting policies and financial statement disclosures. We are, however, not aware of any new or controversial accounting practices reflected in the Ministry's financial statements.

MANAGEMENT'S JUDGMENTS AND ACCOUNTING ESTIMATES

13. Management has made judgments and estimates with regard to the following financial statement items:

    - Useful lives of property, plant and equipment - $2,813,176

GOING CONCERN DOUBTS

14. As a result of our audit, we did not become aware of any events and conditions that may cast significant doubt on the Ministry's ability to continue as a going concern.

INTERNAL CONTROL MATTERS AND SIGNIFICANT FINDINGS

15. Significant internal control and other findings are noted in Appendix 2, along with management's response. Control deficiencies found during the audit but not deemed significant will be reported to management in a separate letter.

FRAUD OR ILLEGAL ACTS

16. Applicable auditing standards recognize that the primary responsibility for the prevention and detection of fraud and compliance with applicable acts and regulations rests with both those charged with governance of the entity and with management. It is important that management, under the oversight of those charged with governance, places a strong emphasis on fraud prevention and deterrence.

17. They are also responsible for establishing and maintaining controls pertaining to the Ministry's objective of preparing financial statements that are presented fairly, in all material respects, in accordance with the applicable financial reporting framework and managing risks that may give rise to material misstatements in those financial statements. When exercising oversight responsibility, those charged with governance should consider the potential for management to override controls or exert other inappropriate influences over the financial reporting process.

18. As auditors, in planning and performing the audit, we are required to reduce audit risk to an acceptably low level, including the risk of undetected misstatements in the financial statements due to fraud.

19. However, we cannot obtain absolute assurance that material misstatements in the financial statements will be detected because of such factors as the use of judgment, the use of testing, the inherent limitations of internal control and the fact that much of the audit evidence available to the auditor is persuasive rather than conclusive in nature.

20. No fraud or illegal acts came to our attention as a result of the 2025 audit.

SIGNIFICANT DIFFICULTIES ENCOUNTERED DURING THE COURSE OF OUR AUDIT

21. The audit team experienced delays in obtaining information during the audit process. This matter has been discussed further in Appendix 2.

DISAGREEMENTS WITH MANAGEMENT

22. We have had no disagreements with management resulting from our audit.

ANY OTHER SIGNIFICANT MATTERS

23. There were no other significant matters noted during the audit.

ACKNOWLEDGEMENTS

We would like to express our thanks to the staff of the Ministry for their help and assistance during the audit of this year's financial statements. This enabled us to provide an audit report within the agreed timetable.

Yours sincerely,

Patrick O. Smith CPA, CFE
Auditor General

APPENDIX 1 – SUMMARY OF ADJUSTED MISSTATEMENTS

Number	Account description and adjustment details	Account Number	Debit	Credit	Identified by: (Client/ OAG)
1	Output revenue Debtors – sale of outputs *Reversal of overbilling*	46001 12402	447,856	 447,856	OAG
2	Accruals – Other Software licensing fee *Reversal of credit card charges relating to software*	20150 54352	1,863	 1,863	Client
3	Accruals -Other Bank charges *Reversal of credit card bank charges*	20150 54227	2,014	 2,014	Client

4	Software licensing fee Accruals -Other *Reversal of credit card charges*	54352 20150	2,198	 2,198	Client
5	Contributed capital Work in progress *Reallocating working capital for improvements of Phoenix House*	35001 17021	500,000	 500,000	OAG
6	Accrued prepayments Computer software maintenance *Correction of computer software maintenance*	12009 54351	5,276	 5,276	Client
7	Accrued prepayments Computer software maintenance	12009 54351	16,199	 16,199	Client

	Correction of computer software maintenance				
8	Accumulated depreciation - Right of use asset Right of use asset *Adjustment of lease balance to correctly reflect IPSAS 43*	16112 16105	3,644	 3,644	Client
9	Short term lease liability Lease of buildings Long term lease liability Lease interest Depreciation - Right of use asset *Adjustment of lease balance to correctly reflect IPSAS 43*	20110 58001 29704 58200 60206	2,347,325 1,826,959	 4,170,552 88 3,644	Client
10	Long term lease liability	29704	1,101,004		Client

	Lease of buildings *Adjustment of lease balance to correctly reflect IPSAS 43*	58001		1,101,004	
11	Capital withdrawal Movement in annual leave *Adjustment for movement in annual leave of transferring departments*	35002 50150	46,240	 46,420	Client
12	Long term lease liability Lease of buildings Adjustment of lease balance to correctly reflect IPSAS 43	29704 58001	922,267	 922,267	Client
13	Surplus payable Surplus repayment	23422 32007	178,417	 178,417	Client

	Adjustment surplus payable for effects of adjustments				
Total			**7,401,260**	**7,401,260**	

APPENDIX 2 – INTERNAL CONTROL MATTERS AND SIGNIFICANT FINDINGS

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
Non-compliance with Acts and Regulations					
1. Employee paid acting allowance for longer than 12 months An employee remained in an acting position for a period exceeding twelve (12) months and was paid for the entire duration. Section 31(1) of the Personnel Regulations, 2022 states that an employee may not hold an acting appointment for a period exceeding twelve months without the vacant position being advertised for recruitment.	**<u>Risks/Implication</u>** Non-compliance with the Personnel Regulations, 2022. Prolonged acting arrangements weaken workforce planning and governance processes **<u>Recommendation</u>** Management should ensure that acting appointments are monitored to ensure compliance with the timelines	Y	Y	It is not always practical to harden a post, especially in an Election year where changes to the government structure are expected. I refer to a past OAG report that criticized the Ministry for hiring staff around election time.	

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
	prescribed by the Personnel Regulations, 2022.				
Financial Management					
2. Unit Cost Calculations did not reflect all performance measures within Output Groups For certain output groups, Management calculated unit costs using only some of the approved performance measures (documented in the Budget Statement) while ignoring all other measures included within the output group. As a result, the total units used in the calculation do not fully represent the scope of outputs delivered for those groups.	<u>**Risks/Implication**</u> The inconsistent approach to calculating unit costs may result in inaccurate or incomplete cost allocation across output groups. By excluding certain approved performance measures from the calculation, the reported unit costs may not fairly represent the full extent of services delivered. This reduces the reliability and comparability of performance and financial information used for budgeting,	N	N	Many outputs have extensive performance measures which are desirable for reporting purposes. However, it is impractical to include all in a costing calculation for outputs. This would not only seriously complicate the calculation of Cabinet billing beyond reasonable comprehension but also increase the cost as the staff time required would be extended.	January 2028

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
	funding decisions, and performance assessment. **Recommendation**			In addition, not all indicators are equal. Various indicators have different weightings of importance. The determination can be arbitrary. The Ministry recognizes however, that there are potential improvements that should be made to some indications and we will address them at the next budget cycle.	
3. Inconsistent Methodology Applied in Revenue Recognition Across Output Groups	**Implication** The inconsistent application of revenue recognition methodologies may result in revenue being recognised in a	N	Y	One show does not fit all in this case. Each output is billed based on what is reasonable.	January 2028

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
Management used different methodologies across output groups in billing and recognising revenue. In some instances, revenue was recognised based on evenly-distributed monthly output units across the financial year, irrespective of actual outputs delivered. In other cases, revenue was recognised based on actual outputs delivered during the reporting period. Additionally, for two output groups, revenue recognition was based on actual expenditure incurred rather than the delivery of outputs. These observations indicate that a uniform and consistently applied basis for recognising output revenue was not applied across all output groups.	manner that is not comparable, reliable, or reflective of actual service delivery. This increases the risk of misstatement within the financial statements and may reduce the usefulness and transparency of financial and performance reporting for decision-making purposes. **Recommendation** We recommend that management establish and formally document a consistent methodology for recognising output revenue across all output groups. The methodology should clearly define the basis upon which revenue is recognised and ensure that the approach			The management agrees thar some streamlining is necessary, but the same methodology will not apply to all services in a Ministry this diverse in the subject matters. For example; In 2009 the Fire department had an output billing based on the number of fires they responded to. This was highly impractical because if there were no fires, fire officers could not get paid. The solution was not to start fires but bill based on the Capacity to respond to fires. This coupled with emphasis on	

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
	applied appropriately reflects the delivery of outputs and is consistently implemented across reporting periods. Management should also strengthen review controls over output reporting and revenue recognition to ensure compliance with the approved accounting treatment.			fire prevention is what save lives and property.	
4. Outputs not billed despite being produced and delivered During our review of output revenue, we noted that the Ministry reached the maximum billable quantity under the relevant funding arrangement at the interim billing stage for five output	**<u>Risks/Implication</u>** May indicate weaknesses in the monitoring and management of output agreements, budget utilisation, and service delivery levels. This also reduces transparency over the full	N	Y	Efforts will be made to review and redraft all outputs and output groups as a part of the budget exercise in keeping with the government's push towards outcome budgeting.	October 2027

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
groups through the December billing process. At the final stage, the Ministry continued to deliver additional outputs and incur related costs; however, these additional outputs were not billed, as doing so would have exceeded the approved budget appropriation. Consequently, outputs were delivered and expenditure incurred without corresponding revenue being recognised or invoiced.	extent of outputs delivered during the year and may impact the accuracy and usefulness of both financial and performance reporting. **<u>Recommendation</u>** We recommend that management strengthen monitoring controls over output delivery and billable quantities throughout the financial year to ensure that output levels remain aligned with approved budget appropriations. Management should also establish formal escalation procedures where output delivery is expected to exceed approved quantities, including				

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
	timely engagement with Government to determine whether additional funding, revised output agreements, or supplementary appropriations are required.				
5. Deficiencies in the Initial treatment of $500,000 funding from Cabinet The Minsitry's original submission accounted for a $500,000 funding from Cabinet as an equity injection and work in progress. In the course of the audit, an audit adjustment was passed to correct management's initial treatment. According to Cabinet approvals, the amount was re-appropriated as Executive Assets. Effect, both equity injection and work			Y	A first-time occurrence that was corrected.	

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
in progress were reversed and in substance the amount merely passed through MSDI entity financial statements with net zero effect at year-end.					
Quality of Financial statements and submissions					
6. Quality gaps in the financial statements submitted to the OAG PMFA paragraph 44 requires that the financial statements and annual reports be prepared in accordance with IPSAS two months after year-end. When we reviewed the financial statements submitted, there were important gaps, including but not limited to: cash flow statements, budget disclosures, new lease	**<u>Risks/Implication</u>** Risks to completing the audit on time **<u>Recommendation</u>** Management should ensure that financial statements submitted to the OAG by the statutory deadline include all the required IPSAS disclosures.	N	Y	The radical staff shuffling after elections which continued through to the third quarter of the year was truly disruptive. The Ministry is currently restructuring the accounting functions and is formalizing and implementing a robust training plan to ensure that this issue does not recur. We appreciate the patience	September 2026

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
standards disclosures and segment reporting.				extended by the OAG through this process.	
7. Audit response times and deadlines During the audit, the OAG team experienced multiple delays in receiving information requests from the Ministry, contrary to the agreed-upon timeline of two days. Also, key supporting documentation, such as the budget disclosures, cash flow workings, procurement documentation, notices of interest, IPSAS 43 workings and adjusting entries initiated by the Ministry, were provided late in the audit cycle.	**<u>Implication</u>** Continued delays also place unnecessary pressure on both management and the audit process, and in the future, could result in statutory reporting and audit completion deadlines being breached. **<u>Recommendation</u>** Management should strengthen its year-end financial reporting and audit coordination processes to ensure that key audit schedules, supporting documentation, and proposed	N	Y	The radical staff shuffling after elections which continued through to the third quarter of the year for both Accounting and Human Resources was truly disruptive. The Ministry is currently restructuring the accounting functions and is formalizing and implementing a robust training plan to ensure that this issue does not recur. We appreciate the patience extended by the OAG through this process.	September 2026 for Accounting For HR 2027

Observation	Risk/Implication and Recommendation	Recurring issue (Y/N)	Observation accepted by Management (Y/N)	Management Response	Implementation Date
These factors contributed to the completion of planned audit procedures later than projected.	adjustments are prepared, reviewed and submitted within agreed timelines. Senior Management should ensure that Heads of Departments are providing information in a timely manner to support the efficient completion of future audits.				