REPORT TO: **SCRUTINY COMMITTEE – 18 APRIL 2012**

REPORT ON: **EXTERNAL AUDIT REPORT - KPMG EXTERNAL AUDIT STRATEGY OVERVIEW AND PLAN FOR THE YEAR ENDED 31 MARCH 2012**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **173-2012**

1 PURPOSE OF REPORT

To submit to elected members the above report that describes how KPMG will deliver the audit of Dundee City Council for the year ending 31 March 2012. This includes the opinions on the financial statements in accordance with relevant legal and accounting requirements.

2 RECOMMENDATIONS

It is recommended that elected members note the information included in the attached report.

3 FINANCIAL IMPLICATIONS

None.

4 MAIN TEXT

4.1 The Accounts Commission for Scotland has appointed KPMG LLP as auditors of the Council under the Local Government (Scotland) Act 1973. The period of appointment is 2011-12 to 2015-16, inclusive. This document summarises their responsibilities as external auditors for the year ended 31 March 2012 and their intended approach to issues impacting the Council's activities in that year.

4.2 The report sets out the statutory and regulatory framework under which the audit is conducted, and the objectives of the audit. The audit approach focuses on the key issues and risks facing the Council in terms of corporate governance arrangements, systems of internal control, performance management and other issues important to their opinion on the financial statements. The Auditors have performed initial risk assessment procedures to identify focus areas for the 2011-12 audit. Areas of audit focus identified include opening balances, financial position, organisational restructuring, valuation of property, plant and equipment, and implementation of new reporting requirements for heritage assets.

4.3 The document also sets out the key stages of the planned audit process together with a summary of procedures for working with internal audit, consideration of audit materiality and the timetable and arrangements for communication and reporting with management and those charged with governance.

5 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

6 CONSULTATION

The Chief Executive and Head of Democratic and Legal Services.

7 BACKGROUND PAPERS

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **4 APRIL 2012**

cutting through complexity™

Dundee City Council

Audit strategy overview and plan

Year ending 31 March 2012

26 March 2012

Overview

This document describes how we will deliver our audit for Dundee City Council ("the Council") for the year ending 31 March 2012.

This includes the opinions on the financial statements in accordance with relevant legal and accounting requirements.

Experience *Page 17*

Your audit team has strong sector experience and is developing a sound understanding of the Council and its aims and objectives, for example, through our introductory meetings with senior management.

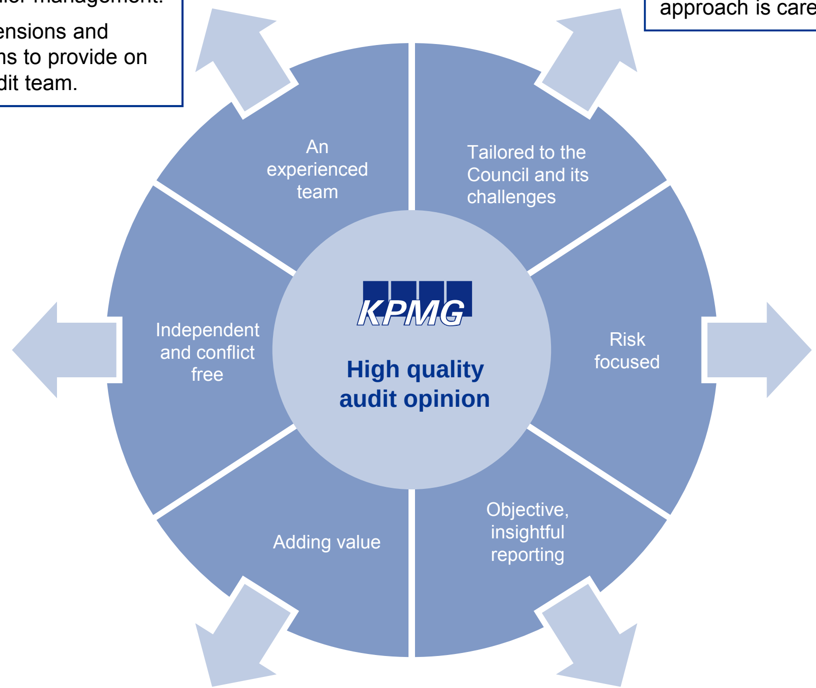
We will use specialists from our pensions and information risk management teams to provide on the ground support to our core audit team.

Tailored approach *Pages 4 to 7*

We invest the time to understand the key challenges and drivers affecting your operations. Our audit approach is carefully designed to align with these.

Independence *Page 18*

Independence and quality are at the foundation of our approach. We have systems and processes to ensure our ongoing independence and will report formally on this, together with any non-audit fees received. We are satisfied that we are independent.



Risk based approach *Pages 5 to 7*

We work closely with management to inform our understanding of the business and its challenges to ensure our audit responds to changes in the business.

Our audit plan outlines the specific areas of focus for 2011-12.

Adding value

We keep you advised of new accounting standards and accounting issues as they arise.

We will report on identified material control weaknesses and other performance improvement observations as well as unadjusted audit differences.

Insightful reporting

You expect us to form independent views on the key accounting issues. We will express these clearly and concisely in a way that is understandable to accountants and non-accountants alike.

Our audit gives us an independent view on your key results drivers. We use this knowledge to challenge the key messages delivered by your internal reporting systems.

We will discuss these areas with those charged with governance.

Contents

About this report
This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of only Dundee City Council and is made available to the Accounts Commission for Scotland and Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Complaints
If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Stephen Reid, who is the engagement leader for our services to Dundee City Council, telephone 0131 527 6795 email stephen.reid@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, our Head of Audit in Scotland, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Introduction

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. This specifies a number of objectives for our audit.

The Accounts Commission for Scotland has appointed KPMG LLP as auditors of Dundee City Council ("the Council") under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive. This document summarises our responsibilities as external auditors for the year ending 31 March 2012 and our intended approach to issues impacting the Council's activities in that year.

We carry out our audit in accordance with our statutory responsibilities under the Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board ("APB") and the wider responsibilities embodied in Audit Scotland's *Code of Audit Practice*. Under this *Code of Audit Practice* auditors address and comment upon a number of objectives, together with complying with a number of obligations. The *Code of Audit Practice* also places a number of obligations on the Council.

Auditors' objectives in relation to the *Code of Audit Practice* are to:

- audit the financial statements and provide an independent auditor's report, in accordance with the Act;
- satisfy ourselves that:
  - the financial statements have been prepared in accordance with all applicable statutory requirements;
  - proper accounting practices have been observed in the preparation of the financial statements;
  - the body has made proper arrangements for securing Best Value and is complying with its community planning duties; and
  - the local authority has made adequate arrangements for collecting, recording and publishing prescribed performance information.

We conduct our audit of the financial statements in line with International Standards on Auditing (UK and Ireland), taking into account the UK Auditing Practices Board's Practice Note 10 (revised). We have a professional responsibility to report if the financial statements do not comply, in any material respect, with the IFRS-based *Code of Practice on Local Authority Accounting in the United Kingdom 2011-12* ("the Code"), taking account of the international financial reporting standards issued by the International Accounting Standards Board and relevant guidance issued by the Chartered Institute of Public Finance and Accountability ("CIPFA") / Local Authorities (Scotland) Accounts Advisory Board ("LASAAC").

As part of our audit we also review the financial information contained in the foreword to the financial statements to ensure that it is consistent with the financial statements. We also review the governance statement and remuneration report to ensure they have been prepared in accordance with the Code and other requirements, taking account of the financial statements and other information gained by us as auditors.

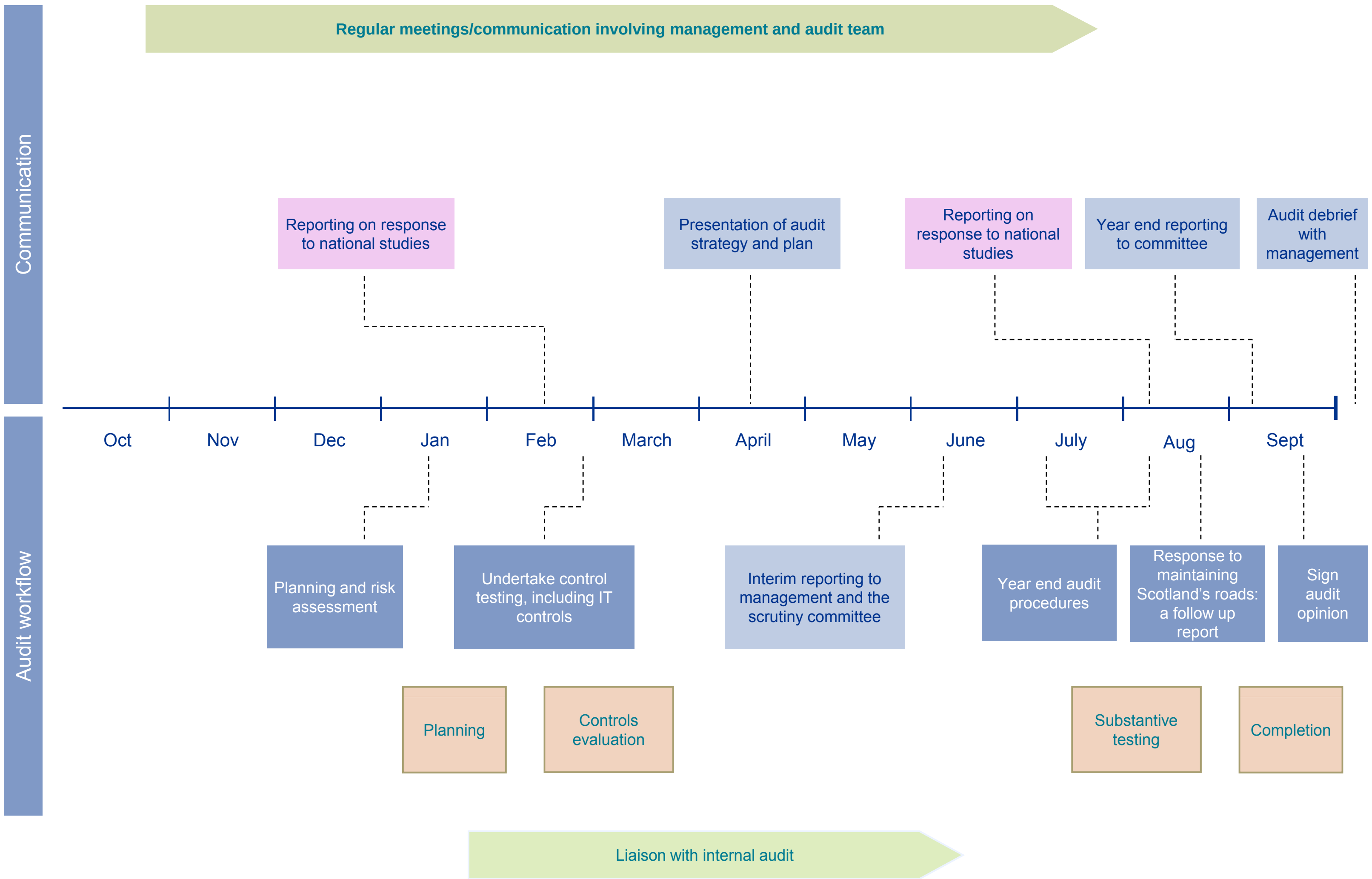
International Standard on Auditing (UK and Ireland) 240: *The auditor's responsibility to consider fraud in an audit of financial statements* applies to our work. In particular, this Standard requires us to consider directly the possibility that management may choose to override the system of internal controls that otherwise may appear to be operating effectively. The Standard requires the auditor to maintain an attitude of professional scepticism, recognising the possibility that a material misstatement due to fraud could exist – notwithstanding the auditor's experience with regard to the honesty and integrity of management and those charged with governance.

In accordance with International Standard on Auditing (UK and Ireland) 260: *Communication with those charged with governance* we will report to you all non-material, non-trivial errors, which have not been adjusted.

Audit timeline

We have developed a proposed timetable to discharge our responsibilities based on initial discussions with management.

We will consider judgements in key areas before the audit fieldwork begins.



Audit focus areas

We have performed initial risk assessment procedures to identify focus areas for the 2011-12 audit.

Areas of audit focus are:

- **opening balances;**
- **financial position;**
- **organisational restructuring;**
- **valuation of property, plant and equipment; and**
- **implementation of new reporting requirements for heritage assets.**

We have developed an understanding of your key audit risk areas based on our initial risk assessment procedures, including discussions with management. Key areas identified are detailed below.

Issue	Key risk and implications	Our planned audit approach
Opening balances	International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* requires us as auditors to obtain sufficient appropriate audit evidence about whether: ▪ opening balances contain misstatements that materially affect the current period's financial statements; and ▪ appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements, or changes are appropriately accounted for, presented and disclosed in accordance with the applicable financial reporting framework.	We will undertake a number of specific procedures to allow us to confirm this. We have already had discussions with your previous external auditors to consider issues from the 2010-11 audit. In addition, we will review your accounting policies from 2010-11, the annual audit report, certain work papers and may also review certain areas of prior year audit files, if considered relevant. This will include specific consideration of balances held with Dundee Energy Recycling Limited. We will consider the year-end journals posted for financial year 2010-11 to understand the process and operation of controls and consider the presentation of information in the financial statements.
Financial position	The Council achieved a 'statutory' deficit in 2010-11 of £2.7 million, against a budget deficit of £1.7 million. The higher deficit arose due to the additional costs of £2.8 million incurred following approval in-year of the voluntary early retirement / voluntary redundancy scheme. These extra costs were funded from general reserves as the scheme is expected to deliver ongoing annual savings of £6.0 million in future years. The budget for 2011-12 was approved assuming no use of reserves. The 2011-12 forecast outturn now anticipates that £0.8 million of general fund balances and £0.1 million of the repairs and renewals fund will require to be utilised.	We will review the budget setting process and approval of the 2011-12 budget, as well as 2012-13. We will also understand how management monitors the budget during each year and how budget changes are processed. This will include looking at how the financial position of the Council has changed during the financial year and how the financial position, and associated risks, are reported to the Council and those charged with governance.

Audit focus areas (continued)

Issue	Key risk and implications	Our planned audit approach
Organisational restructuring	During 2011-12, as part of the Changing for the Future programme, the Council has undertaken organisational restructuring. The Council previously had the highest number of chief officers / departments of any Scottish local authority. The restructuring has rationalised the structure with the aim of producing a more efficient operating model for the senior management structure.	We will discuss with management the proposed changes, and give consideration to IAS 37 *Provisions, contingent liabilities and contingent assets* in respect of severance packages and disclosure necessary in the financial statements at 31 March 2012. We will also review the disclosures of exit packages within the remuneration report to ensure these comply with the requirements of the Code, and the associated regulations.
Valuation of property, plant and equipment	IAS 16 *Property, plant and equipment,* as adapted by the Code, requires assets to be measured at fair value, unless there is no market-based evidence of fair value because of the specialist nature of the asset and the asset is rarely sold. In this case depreciated replacement cost may be used to estimate fair value. Property, plant and equipment is valued by internal estates staff. Valuations are conducted on a five year rolling cycle by department. Valuations are also conducted of properties where there is an indicator of impairment. Following completion of Dundee House during the year, management should ensure the building is valued on transfer from assets under construction to operational land and buildings.	We will review the process for requesting valuation of property, plant and equipment, the process followed by the valuers, and any revaluation gains or impairment losses subsequently recognised. We will meet with the Council's internal valuers to obtain an understanding of the valuations. We may involve KPMG property valuation specialists if we identify high risk or unusual transitions.

Audit focus areas (continued)

Issue	Key risk and implications	Our planned audit approach
Heritage assets	The Code includes the requirement to account for heritage assets in line with FRS 30 (as interpreted by the Code). Implementation of this new accounting policy may require a prior year adjustment if the impact on the 2010-11 comparatives meets set criteria. Heritage assets are those assets that are intended to be preserved in trust for future generations because of their cultural, environmental or historical associations. Where an authority has information on the cost or value of a heritage asset, the authority is required to recognise the asset. This may require reclassification of assets previously reported as community assets, or in other categories, or first time recognition of assets not previously capitalised and included on the balance sheet.	Management has commenced the process of identifying assets that meet the definition of heritage assets and to obtain appropriate valuations, which must comply with specific guidance set out in accounting standards. The 2010-11 financial statements disclosed that the potential impact on the comparatives is £7.2 million, which may not require a prior year adjustment. We will consider the robustness of management's process to identify heritage assets and the appropriateness of the valuation basis.

Group financial statements

IFRS and the Code require the Council to prepare group financial statements.

The Council uses a range of service delivery vehicles to facilitate the discharge of its functions which, whilst technically independent, are effectively under the Council's influence or control. The Council is required under the Code to prepare group financial statements which include the Council's interest in subsidiaries, associates and joint ventures.

The Code requires the following accounts to be prepared, together with appropriate notes:

- Group Movement in Reserves Statement: this statement summarises all movements in reserves.
- Group Comprehensive Income and Expenditure Statement: this statement summarises the Group's Income and Expenditure for the year.
- Group Balance Sheet: this statement sets out the overall financial position of the Group at the year end.
- Group Cash Flow Statement: the Group Cash Flow Statement includes the cash flows of the Council and the Common Good Funds and Trusts. Cash receipts and payments that flow to and from the Council and its subsidiaries only (full group members) must be included. Cash flows to and from the Council to its associates are included within the cash flow statement of the Council.

Subsidiaries

These are entities in which the Council either:

- controls the majority of equity capital or equivalent voting rights;
- appoints the majority of the governing body; or
- exercises (or has the right to exercise) influence (i.e. give direction which must be complied with) over the entity's operating and financial policies.

The Council assessed its relationships with other entities in 2010-11 and concluded that only Trust Funds and Common Good Funds, in respect of which the Council is sole trustee, fall to be treated as subsidiaries.

Associates

These are entities in which the Council can exercise a significant influence without support form other participants. The reassessment of relationships with other entities in 2010-11 concluded that the following required to be treated as associates:

- Tayside Fire and Rescue Board;
- Tayside Joint Police Board;
- Leisure and Culture Dundee (previously Dundee Leisure Limited);
- Tayside Valuation Joint Board; and
- Dundee City Development Limited.

Joint ventures

These are entities in which the Council has an interest on a long-term basis and are jointly controlled by it and one or more other entities under a contractual or other binding arrangement. The re-assessment of relationships with other entities in 2010-11 concluded that the following required to be treated as joint ventures:

- Tayside Contracts Joint Committee; and
- Dundee Energy Recycling Limited.

The inclusion of the group entities had a significant impact on the Council's single entity position on provision of services. Because of, principally, the Council's share of operating results of associates, the surplus of £36.6 million on the Council's single entity Comprehensive Income and Expenditure Statement became a group surplus of £46.5 million. Inclusion of pension liabilities for group entities had the overall effect of reducing net assets of £613.4 million to £266 million as at 31 March 2011.

Group financial statements (continued)

Our responsibilities as auditors of the group financial statements are the same as for the Council only financial statements. In planning our work on the Group financial statements we have taken into account Group materiality to consider which members of the Group will be within the scope of our audit, and, those that will be outwith this scope:

In scope	Outwith scope
Tayside Joint Police Board	Tayside Valuation Joint Board
Tayside Fire and Rescue Board	Dundee City Development Limited
Tayside Contracts Joint Committee	Dundee Energy Recycling Limited
Leisure and Culture Dundee	Common Good Funds
	Trust Funds

As a number of these entities have different auditors, we are required to undertake certain procedures to enable us to rely on their work. Our requirements for reliance on the work of other auditors ("component auditors") for a group audit are set out in International Standard on Auditing 600 ("ISA 600") *Using the work of another auditor*.

This requires us to consider:

- the materiality of the portion of the financial statements which we will audit;
- our knowledge regarding the business of the components;
- the risk of material misstatements in the financial statements of the components audited by the other auditor;
- the performance of additional procedures as set out in ISA 600 regarding the components audited by the other auditor resulting in our participation in the audit;
- the nature of our relationship with the other auditor; and
- the professional competence of the other auditor.

In order to fulfil our obligations, we will perform the following:

- discuss audit procedures performed by the other auditors;
- review any significant findings of the component auditors;
- consider reviewing the component auditor's files to ensure procedures in are appropriate; and
- consider whether we require to perform additional procedures in relation to the work of the component auditor.

We will consider the outcome of this work and the impact on our audit approach (and findings) will be reported in our annual audit report.

Given this is the first year of our appointment as the Council's external auditors, we will also consider the completeness and appropriateness of entities included / excluded from the Council's group financial statements.

Mandatory communications

Auditing standards specify a number of matters for communication with those charged with governance. Matters relating to fraud and related party transactions are given here.

Mandatory communications in relation to independence are included within appendix one.

Area	Issue	KPMG response
Fraud risks	▪ It is the responsibility of senior officers and staff to implement accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements caused by fraud or error. ▪ Those charged with governance must ensure, through oversight of management, the integrity of these systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with laws. ▪ This is in the context of preparing financial statements that give a true and fair view and that do not contain material misstatements arising from fraudulent reporting (intentional misstatements / omissions to deceive the financial statement user) or from the misappropriation of assets.	▪ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error. The audit team will review and discuss fraud related risks and controls with the chief executive, director of corporate services, the Council's monitoring officer, internal audit and other members of senior management. ▪ Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud. ▪ The Code of Audit Practice requires us to report fraud over £5,000 to Audit Scotland.
Related party transactions	▪ All material related party transactions must be disclosed in the financial statements. ▪ Management has processes to identify related party transactions and a number of related parties and transactions were disclosed in the 2010-11 financial statements.	▪ We will ensure that there continues to be appropriate processes as part of the financial statements preparation process to identify any related party transactions.

Materiality

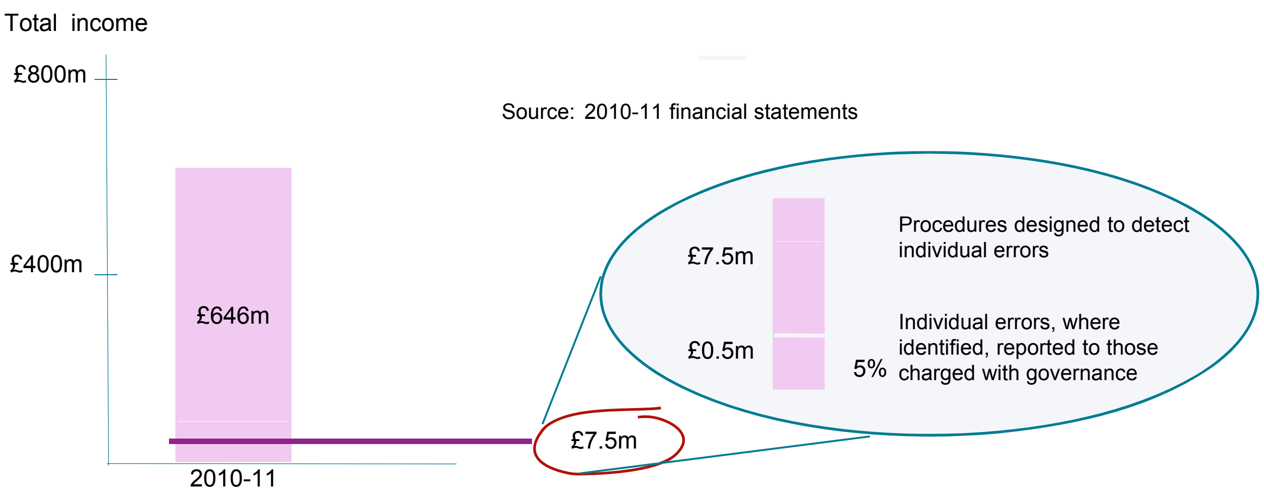
Our audit is geared to identify material errors in the financial statements.

We are required by Auditing Standards to report to those charged with governance unadjusted audit differences other than non-trivial items.

In accordance with International Standard on Auditing (UK and Ireland) 320 *Materiality in planning and performing an audit*, we plan and perform our audit to be able to provide reasonable assurance that the financial statements are free of material misstatement and give a true and fair view. The assessment of what is material is a matter of professional judgment and includes consideration of both the amount (quantity) and nature (quality) of misstatements.

Audit materiality is both a quantitative and qualitative measure and the figures below are a guide only and are based on total planned expenditure. We realise that the tolerance for error in certain disclosures in the financial statements is lower and therefore we will report to those charged with governance smaller errors in areas such as members' allowances, officers remuneration and related party transactions. The overriding objective is to preserve the true and fair view presented by the financial statements and we will consider any audit differences, individually and cumulatively, in that context.

Our planning materiality for the Council has been calculated on the basis of total income taken from the 2010-11 financial statements, as detailed below. On this basis, our procedures will be designed to detect individual errors over £7.5 million and we will report all errors over £500,000 to those charged with governance. Our final materiality will be based on the unaudited financial statements and we will inform you of any changes to our planning materiality.



Fraud versus error; legality and propriety

We distinguish between fraud and error and use our sector knowledge to inform specific control testing.

Fraud versus error

The term 'error' refers to an unintentional misstatement in the reporting of an entity. The term 'fraud' refers to an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception or misconduct to obtain an unjust or illegal advantage.

There are two types of misstatements relevant to an auditor's consideration of fraud:

- misstatements resulting from fraudulent financial reporting, which involves intentional misstatements or omissions of amounts or disclosures in financial reporting to ultimately deceive financial statement users; and
- misstatements resulting from misappropriation of assets, which typically involve theft of an entity's assets and is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing.

We use our knowledge of the sector to inform specific control testing in respect of fraud controls, and will therefore consider the following areas during our interim audit:

- procurement;
- purchasing cards; and
- supplier additions and amendments.

Legality and propriety

The special accountabilities that attach to the conduct of public business, and the use of public money, mean that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements but also providing a view, where appropriate, on matters such as the legality, propriety, performance and the use of resources in accordance with the principles of Best Value.

The Council is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of its arrangements. This includes involving those charged with governance in the monitoring of arrangements.

Presentation of financial statements

The Council is required to prepare financial statements in accordance with the Code. KPMG is committed to working with management to enhance the clarity and impact of the financial statements.

Presentation of financial statements

The year ended 31 March 2011 was the first year that the Code was based on International Financial Reporting Standards ("IFRS"). The transition to IFRS typically had the effect of increasing the length and complexity of financial statements.

The Audit Commission issued a briefing for those that prepare IFRS-based financial statements in local government, "Let's be clear" in January 2012. The briefing notes that the financial statements of those applying the Code are, on average, 113 pages long and while this supports transparency, there is a risk that the users of the financial statements are daunted by their complexity and find them difficult to interpret and understand.

Much of this complexity comes from the need to reconcile financial statements, prepared in accordance with IFRS, with the control framework imposed by government. This includes a series of adjustments necessary to reconcile the accounting cost of services, with the cost which is used to determine council tax charges.

This briefing, and CIPFA's publication, "IFRS: how to tell the story" suggest a number of ways in which accessibility and clarity of financial statements could be improved including:

- the use of summaries and extracts which provide key elements of information;
- Reducing and / or eliminating unnecessary disclosures; and
- critically reviewing the financial statement template to reduce the length and focus of reporting.

It is likely that there will be continued focus on the presentation of information and we will work with management to consider the implications of any updated guidance and support management to enhance the clarity and impact of the financial statements.

Governance and scrutiny arrangements

We review governance and scrutiny arrangements in light of the shared risk assessment, Best Value and single outcome agreement.

Shared risk assessment

Following the publication of the Crerar report in September 2007, the Scottish Government's response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies. Scrutiny bodies that engage with local government established a shared assessment of the risks in each council and developed a range of proportionate approaches in response to the risk assessment.

Local area networks ("LANs") have been established for each council. These bring together local scrutiny representatives in a systematic way with the common aims of joint scrutiny scheduling and planning, shared risk assessment and the delivery of a single corporate assessment through the Best Value 2 audit process.

As your external auditor, we are a key member of the LAN for Dundee City Council.

The role of LAN representatives is to ensure that relevant data collected from councils and other sources by their organisation is analysed and bought to the LAN for discussion. All LAN members discuss and agree a shared risk assessment and identify a proportionate scrutiny response.

A national scrutiny plan sets out how Scotland's scrutiny agencies coordinate their work and focus on the key issues at each council. This plan is underpinned by an assurance and improvement plan ("AIP") for individual councils. The Dundee City Council LAN is in the process of updating the AIP for the period 2012-15.

Best Value

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of best value and community planning under section 52 of the 2003 Act. Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

Following completion of local government baseline audits, the Accounts Commission revised its approach to be more risk based. The timing, nature and extent of Best Value work is now determined as part of the shared risk assessment process ("SRA").

A key component of the SRA will be the extent to which implementation of the existing Best Value improvement plan has had the anticipated impact. As your external auditor, we are responsible for conducting follow-up reviews to assess the Council's progress against its agreed improvement priorities.

Governance and scrutiny arrangements (continued)

Single outcome agreement

Single outcome agreements (“SOAs”) are a mechanism for aligning public sector activity to national priorities. The Accounts Commission has no immediate plans to audit their delivery. Best Value audits will draw upon evidence contained within a council's SOA in order to consider outcomes more widely, as planning for, and managing the delivery of, outcomes should be central to all aspects of a local authority's activity. Successful delivery of SOAs will depend on the degree to which they are supported by effective planning, budgeting and performance management arrangements at service-level, within councils and across partner agencies.

During the audit cycle, our responsibilities extend to updating our understanding on the approach the Council and its partners are taking to:

- developing governance and accountability arrangements to support the SOA in line with Scottish Government advice;
- ensuring explicit links are made between high-level SOA outcomes and more detailed service-level outcomes, outputs and activities – both within the Council and across community planning partners;
- ensuring the SOA is supported by robust resource planning arrangements at a service-level within the Council and jointly with community planning partners;
- ensuring the SOA is supported by robust performance management and reporting:
  - corporately
  - at service level
  - jointly with partners;
- reporting progress towards SOA outcomes to the Scottish Government, in line with guidance on annual reporting; and
- undertaking Public Performance Reporting (“PPR”) on progress towards SOA outcomes, including linking SOA outcomes and indicators with other forms of PPR such as SPIs (specified and unspecified), other local performance indicators and community planning partners’ public performance reporting – all in accordance with statutory guidance on PPR issued in 2003.

We will report our findings during the year and will include a summary of our findings in our 2011-12 annual audit report to members and the controller of audit.

National Fraud Initiative

The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use.

NFI helps participating bodies to identify possible cases of fraud, and to detect and correct any under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud. The 2008-09 NFI exercise in Scotland helped to identify £21 million[1] of outcomes[2] since the previous exercise.

Councils were requested to submit electoral roll and council tax data in December 2011 for the mid-year cycle to identify potentially erroneous single person discount claimants.

Auditors are expected to monitor bodies' participation in NFI. In 2011-12 this will include:

- conducting enquiries and tests to confirm that the questionnaire prepared by the outgoing auditor and submitted to Audit Scotland in 2011 remains valid;
- monitoring that the Council has reviewed the council tax / electoral roll matches promptly when they were made available; and
- monitor the Council's preparations for NFI 2012-13.

We will include any significant findings in relation to our work on NFI within the annual audit report to members and the controller of audit.

Internal audit

We will liaise with your internal auditors to minimise duplication of effort.

Internal audit arrangements

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect, if any, on external audit procedures;
- obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;
- perform a preliminary assessment of internal audit when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and
- evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

We will liaise with your internal auditors and maintain an understanding of their approach to ensure duplication of effort is minimised. We will review the internal audit work proposed or completed during our interim audit visit to determine the extent of assurance that can be taken from the work performed.

The general programme of work will be reviewed for significant issues to support our work in assessing the Council's governance statement.

2011-12 internal audit plan

We will read the reports and consider the results of all internal audit work, and intend to place specific reliance on some areas of work. The table opposite highlights areas where we intend to place reliance and how this affects our planned audit approach (subject to a lack of significant risks being identified by internal audit).

Internal audit area	Impact on our planned audit approach
Debtors and debt management	We will review internal audit findings and reduce our control testing on debt management, subject to lack of significant risks being identified.
Amendment of creditors standing data	We will review internal audit findings and reduce our control testing on changes to creditors, subject to lack of significant risks being identified.
Payroll leavers	We will review internal audit findings and reduce our control testing of payroll leavers, subject to lack of significant risks being identified.

Performance management

Audit Scotland and the Accounts Commission periodically undertakes national studies on topics relevant to the performance of local government bodies.

We will review the Council's response to these and will report our findings to Audit Scotland.

Local response to national studies

Audit Scotland and the Accounts Commission periodically undertakes national studies on topics relevant to the performance of local government bodies. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at individual organisation level, as appropriate. In order to ensure that added value is secured through the role of the Accounts Commission, Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to reports from the Accounts Commission and Audit Scotland's programme of national performance audits. We will therefore be required to make returns to Audit Scotland that performance reports have been considered by the Council and that action has been planned in response.

We will assess how the Council has responded to relevant national reports, preparing two returns to Audit Scotland. These will cover the following reports published between May 2011 and April 2012:

- community health partnerships;
- transport for health;
- Scotland's public finances;
- reducing greenhouse gases;
- community planning partnerships; and
- modernising planning systems.

Auditors are required to provide the following information:

- was the report discussed at any executive board committee? If so, which committees and on which dates?
- did the body carry out a self-assessment against the national report's findings?
- did the body produce an action plan (a copy of which will be provided to Audit Scotland)?
- are there plans to provide the committee(s) with feedback on actions?

Maintaining Scotland's Road: A Follow Up Report

Maintaining Scotland's roads: a follow-up report was published by the Auditor General and the Accounts Commission in February 2011. The report examined progress by councils and Transport Scotland in implementing recommendations contained in a previous report on road maintenance published in 2004. It reviewed changes in the condition of the road network since 2004, how much was being spent on road maintenance and how road maintenance was being managed. The report contained three key recommendations for councils.

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified this report for follow-up in 2011-12.

Performance management (continued)

This will revolve around considering four key questions:

- How did the body respond to *Maintaining Scotland's roads: a follow-up report* following publication?
- Does the Council have appropriate plans in place to drive road maintenance activities?
- How does the Council manage the performance of its road maintenance activities?
- What is the Council doing to maximise value for money in its road maintenance service?

We will report our findings to Audit Scotland, management and members during the year.

Statutory performance indicators

The statutory deadline for publication by the Council of statutory performance indicators ("SPIs") is 30 September 2012. In 2009-10 there was a significant shift in approach, reflecting the changing environment in which local authorities operate. This change in approach significantly reduced the number of specific indicators that councils are required to use, and include measures designed to encourage councils to use a greater range of information as part of their mainstream performance management and reporting activities.

In 2011-12 the approach towards SPIs remains consistent with that adopted in recent years. During the audit cycle, we will understand the arrangements and systems that the Council uses to generate performance results and consequent reports. Our testing may require sampling of data to test reliability, but the risk of ensuring accuracy and relevance of performance indicators lies with the Council. Our work will include consideration of internal audit's role in testing SPIs and reporting the results.

Audit team; fee proposals; reporting

Our senior audit team brings strong experience of both local government and across the wider public sector.

Audit team

The senior members of the audit team are detailed below. The team has significant experience in the audit of local government bodies and will bring this to bear in your audit.

Team member	Role	Contact
Stephen Reid	Engagement director	0131 527 6795 stephen.reid@kpmg.co.uk
Keith Macpherson	Senior manager	0141 300 5806 keith.macpherson@kpmg.co.uk

Fee proposals

Audit Scotland requires that the fee for our work is set within an indicative range, depending on the assessment of risk and other factors facing the Council. Audit Scotland has notified us that the fee range for 2011-12 is £360,560 to £440,680.

We have agreed a fee with management of £405,178. This fee reflects additional work on opening balances which is required by auditing standards in the first year of an audit appointment. A portion of this fee will be allocated for our work on the audit of the financial statements of the Council's Pension Fund and we will agree this with officers for the purposes of the re-charge to and disclosure in the Pension Fund's financial statements.

As with other audits, our fee proposals are based on the following assumptions to ensure an efficient audit process: draft report, financial statements and full electronic files of supporting work papers available at the start date of our on site visit agreed with officers preferably in electronic format; reliance on your internal controls; availability of key members of staff during the audit fieldwork; and, completion within the agreed timetable.

Reporting

Through regular meetings at appropriate levels, there will be open and regular discussion between management, auditors and management. Regular meetings with the director of corporate services have already commenced. As a result, accounting and control issues can be identified and reported to allow you to manage them throughout the year.

The *Code of Audit Practice* requires us to communicate to management findings arising as a result of the audit work completed. Reports to management will be submitted throughout the course of the year, with draft reports discussed and agreed with management and action plans developed to include the recommendations, target dates for implementation and the member of staff responsible for implementation.

We envisage submission of the following reports in respect of 2011-12:

- interim management reporting based on the findings of our organisation-wide and key financial control testing;
- report to those charged with governance setting out findings surrounding the financial statements process; and
- annual audit report to members and the controller of audit.

We will also submit information on the following areas during the year:

- NFI;
- fraud;
- Audit Scotland national reports;
- grant claims; and
- statutory performance indicators.

Appendix

Independence

Auditing standards require us to communicate to those charged with governance in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent.

Auditing standards require us to communicate to the audit and risk committee in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent. KPMG is committed to being and being seen to be independent. As part of our ethics and independence policies, all audit directors, KPMG partners and staff annually confirm their compliance with our ethics and independence manual, including in particular that they have no prohibited shareholdings. Our ethics and independence manual is fully consistent with the professional practice rules of the Institute of Chartered Accountants in England and Wales, by whom we are regulated for audit purposes.

In addition, we have underlying safeguards in place to maintain independence through:

- Instilling professional values:
  - Training courses
  - Policies and procedures
  - Annual confirmation of compliance with firm ethics and independence policies
- Communications:
  - Consultation requirements
  - Audit team disagreement resolution process
- Internal accountability:
  - Rotation of audit directors
  - Internal quality performance review
- Risk management:
  - Client and engagement acceptance and retention policies and procedures.
- Independent reviews:
  - Quality performance review – local
  - Internal peer review – national and international
  - External – audit inspection unit
- Our system of internal quality procedures (these we set out in detail previously and have not been repeated here).

The APB Ethical Standards are fully effective and our internal control procedures are designed to ensure our compliance with the requirements.

We are satisfied that our general procedures support our independence and objectivity in relation to non-audit services. There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to those charged with governance.

Financial statements – approach to major captions

We identify account balances and significant classes of transaction and focus our work on identified risks over completeness, existence, accuracy, valuation, ownership and presentation.

Area	Summary of audit approach
Comprehensive income and expenditure statement	
Service level expenditure and payments to joint boards	*Completeness, existence, accuracy presentation of non-pay expenditure*: • identify and test the operation of controls over the payment and recording of expenditure to third parties; • discuss significant variances between management's expectations, based on internal budgets, and the year end outturn; • review and test management's process for recording transactions on and around 31 March to ensure that expenditure is recorded in the correct accounting period; and • discuss management's categorisation of expenditure across expenditure categories and compare to the service reporting accounting code of practice ("SeRCOP") and the Code requirements, while considering consistency with previous years.
Staff costs	*Completeness, existence and accuracy of pay expenditure*: • identify and test the operation of controls over access and amendments to the payroll system, including 'starters' and 'leavers'; • review and test controls in place to ensure that the financial ledger and the financial statements accurately reflect payments made to staff from the payroll system; • discuss significant movements between the current and prior year staff costs, taking into account pay movements, single status and changes in the staffing profile; • ensure that the Council has recognised short term employee benefits within the financial statements in accordance with the Code; and • agree disclosures in the financial statements for officers emoluments and members allowances to source documentation.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Significant trading operations ("STO")	*Completeness, existence and accuracy of STO income and expenditure:* • ensure the Council has reviewed its trading operations in the year against the Code criteria; • identify and test the operation of controls over the payment and recording of expenditure to third parties by the Council's STOs; • discuss significant variances between management's expectations, based on internal budgets, and the year end outturn; • review and test management's process for recording transactions on and around 31 March for STO income and expenditure to ensure that transactions are recorded in the correct accounting period; and • consider the financial performance of each STO over the previous three-year period against the statutory requirement to break even over a rolling three-year period.
Service level income and government grant income	*Completeness, existence and accuracy of service level income:* • identify and test the operation of controls over the receipt and recording of income from third parties; • discuss significant variances between management's expectations, based on internal budgets, and the year end outturn; • review and test management's process for recording transactions on and around 31 March to ensure that income is recognised in the correct accounting period; • discuss management's categorisation of income across categories and compare to the SeRCOP and Code requirements, while considering consistency with previous years; and • agree grant income to third party documentation.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Income from local taxes and housing rents	*Completeness, existence and accuracy of income from local taxes and housing rents:* • identify and test the operation of controls over the receipt and recording of income from tax payers and housing tenants, including controls over the council tax, non-domestic rate and housing rents systems and interface controls between these feeder systems and the financial ledger; • discuss significant movements between the current and prior years' income, taking into account changes in rates and charges and the profile of rate payers and housing stock; • review and test management's process for recording transactions on and around 31 March to ensure that income is recognised in the correct accounting period; and • ensure the housing revenue account, council tax income account and non domestic rates account have been prepared in accordance with the Code and are consistent with underlying records.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Balance sheet	
Property, plant and equipment ▪ additions ▪ disposals ▪ depreciation ▪ valuation and impairment	*Completeness, existence, valuation and accuracy of fixed assets*: • agree significant additions to invoices and physically verify a sample of these to confirm existence and ensure capital and revenue expenditure has been treated correctly in the financial statements; • discuss management's process for identifying disposals and review documentation, such as bank receipts and sales agreements, for significant disposals to ensure that income is correctly recorded; • discuss significant movements between the current and prior years' depreciation charge, taking into account additions and disposals during the year; • ensure that property, plant and equipment is valued in accordance with IAS 16 as interpreted by the Code. • agree movements in asset values, including surplus assets held for sale, to independent confirmation from the Council's valuer, ensuring the new revaluation reserve has been accurately constructed; and • review the Council's capital programme for evidence of potential impact on the current values of land, buildings and equipment.
Long term receivables	*Completeness, existence, valuation and accuracy of long term receivables*: • review long term receivables for reasonableness, comparing balances to expectations based on prior year comparatives; and • assess whether debt over one year is fully recoverable, or has been appropriately provided for.
Deferred premiums on early repayment of debt	*Completeness, existence and accuracy of deferred premiums*: • review movements in deferred premiums with reference to underlying treasury management documentation for accuracy; and • ensure amortisation of deferred premiums and the capitalisation of new premiums has been conducted in accordance with the Code.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Receivables due within one year: ▪ Local taxation ▪ Housing rents ▪ Government grants ▪ Trade receivables ▪ Prepayments, accrued income and other receivables	*Completeness, existence, accuracy and valuation of receivables*: • identify and test the operation of controls over recording and receipt of amounts due; • sample test receivables balance as appropriate; • review and discuss with management changes in the aging profile of receivables, including consideration of cash received after the year end; • sample test accruals and prepayments to invoices or other third party documentation and consider the appropriateness of accruing income, including consideration of cash received after the year end; and • review and test management's process for recording transactions on and around 31 March to ensure that income is recognised in the correct accounting period.
Borrowing	*Completeness, existence and accuracy of borrowing*: • identify and test the operation of controls over recording and monitoring of borrowing and loans, including reconciliations between underlying treasury management records and the financial ledger; • agree any significant loan balances at 31 March 2012 to independent confirmations; and • review minutes and Council papers to ensure that all treasury management activities in the year have been accounted for in accordance with the Code.
Cash and cash equivalents	*Completeness, existence and accuracy of cash in hand and at bank:* • identify and test the operation of controls in respect of cash balances, including bank reconciliations; and • agree bank balances at 31 March to independent confirmation from the bank and test significant reconciling items to bank records after the year end. *Completeness, existence and accuracy of short term investments*: • identify and test the operation of controls over recording and monitoring of short term investments, including reconciliations between underlying treasury management records and the financial ledger; and • agree any significant investment balances at 31 March 2012 to independent confirmations.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Payables due within one year: ▪ trade payables ▪ loan interest ▪ local taxation ▪ accruals ▪ payroll and taxes payables ▪ deferred income and other payables	*Completeness, existence and accuracy of creditors due within one year*: • identify and test the operation of controls in relation to recording and payment of payables; • sample test payables balances as appropriate, including agreement to post year end payments processed; • review and discuss with management changes in the length of time taken to process and make payment to payables; • test a sample of payments made after the year end to confirm that they have been recorded in the accounting period to which the goods or service relate rather than the period in which the invoice was paid; • ensure that deferred income creditor balances have been disclosed in accordance with the Code and other guidelines received from the Scottish Government and Audit Scotland according to terms and conditions set by the third party who has paid the funds to the Council; • agree a sample of payments received on account to invoices or other third party documentation; and • tax and social security payables will be agreed to payments made in April 2012.
Defined benefit pension scheme asset / liability	*Completeness, existence, valuation and accuracy of pension scheme asset / liability:* • evaluate the Council's arrangements for obtaining an actuarial IAS 19: *Employee benefits*, valuation of their share of the defined benefit pension scheme; • ensure the assumptions used in obtaining this valuation are appropriate and reasonable given our understanding of the Council and the local government sector in Scotland; • ensure management have satisfied themselves that the assumptions used in the valuation are reasonable and consistent with their expectations; and • agree the year end valuation and the in-year movements to the Council's financial statements for accuracy and compliance with the Code including the additional disclosure requirements of IAS 19.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Fund balances and reserves: ▪ revaluation reserve ▪ capital financing account ▪ useable capital receipts ▪ general fund / HRA reserve ▪ pension reserve ▪ other reserves	*Completeness, existence and accuracy of reserves*: • agree movements in reserves to the relevant note to the financial statements and other underlying records; • ensure fund balances and reserves have been disclosed in accordance with the Code • and the Council's statutory powers; • review reconciliations of fund balances and reserves for accuracy with reference to other notes in the financial statements and underlying documentation; and • ensure the revaluation reserve has been correctly constructed with reference to underlying records and ensure the prior year comparatives have been correctly restated in accordance with the Code.

Financial statements – approach to major captions (continued)

Area	Summary of audit approach
Cash flow, other statements and disclosures	
Cash flow statement	*Accuracy of cash flow statement and related notes:* • review the cash flow statement for accuracy with reference to other notes to the financial statements and underlying records; and • ensure the cash flow statement reconciles and is consistent with the other key balances in the financial statements.
Common good and trust funds	*Completeness, existence and accuracy of common good and trust funds:* • review movements in fund balances for accuracy with reference to underlying records; and • ensure that the Council has complied with the Code and OSCR requirements in relation to disclosures for its registered charities.
Other financial statement disclosures	*Completeness, existence and accuracy of other financial statement disclosures:* • ensure the Council's financial statements comply with the Code and that all required disclosures have been made, including publicity expenditure, members remuneration and operating and finance leases; and • agree all disclosures to other notes in the financial statements and underlying records.
Group financial statements	*Accuracy and presentation of group financial statements*: • ensure the Council has appropriate considered all its interests in related third parties for inclusion in the group financial statements and use our understanding of the Council and local government in Scotland to ensure the completeness of the group financial statements disclosures; and • review consolidation adjustments for accuracy with reference to final audited financial statements of subsidiaries, associates and joint ventures.

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