REPORT TO: TAYSIDE VALUATION JOINT BOARD - 11 JUNE 2012

REPORT ON: EXTERNAL AUDIT ANNUAL AUDIT PLAN 2011/12

REPORT BY: TREASURER

REPORT NO: TVJB 13-2012

1 PURPOSE OF REPORT

To present to the Board the External Audit Annual Audit Plan, attached as an Appendix to this report.

2 RECOMMENDATIONS

2.1 The Board is asked to note the content of the External Audit Annual Audit Plan for 2011/12.

3 FINANCIAL IMPLICATIONS

The cost of External Audit Services is provided for in the Assessor's Revenue Budget.

4 MAIN TEXT

Introduction

4.1 The external audit of the Board for the financial year 2011/12 will be carried out by Mr Stephen Reid, Engagement Director, KPMG. The Joint Board's External Auditors are appointed for a five year period and the financial year 2011/12 marks the first year of KPMG's current appointment to the Board.

External Auditor's Annual Audit Plan

4.2 The External Auditor's annual audit plan summarises the key challenges and risks facing the Board and sets out the proposed audit work to be undertaken in 2011/12. The plan reflects:

- the risks and priorities facing the Board
- current national risks relevant to local circumstances
- the impact of changing international auditing and accounting standards
- External Audit's responsibilities under the Code of Practice as approved by the Auditor General and the Accounts Commission
- issues brought forward from previous audit reports.

4.3 External Auditor's responsibilities

External Audit's responsibilities as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Audit Practice, and guided by the auditing profession's ethical guidance.

In carrying out their audit, External Audit seek to gain assurance that the Board:

- has good corporate governance arrangements in place which reflect the three fundamental principles of openness, integrity and accountability
- has systems of recording and processing transactions which provide a sound basis for the preparation of financial statements and the effective management of its assets and interests

- prepares financial statements which give a true and fair view of the financial position at 31 March 2012 and the income and expenditure for the year then ended, in accordance with the Local Government (Scotland) Act 1973 and other applicable laws and regulations, including the 2011 Code
- has systems of internal control which provide an adequate means of preventing or detecting material misstatement, error, fraud or corruption
- complies with established policies, procedures, laws and regulations
- has made proper arrangements for securing best value in its use of resources.

4.5 Reporting Arrangements

Under the Local Government (Scotland) Act 1973, there is a requirement for unaudited financial statements to be presented to the Board and the Controller of Audit within 3 months of the financial year end i.e. 30th June. The non-statutory target for audit completion is 30th September.

The External Auditor provides an independent auditor's report to the Board and the Accounts Commission that the audit of the financial statements has been completed in accordance with applicable statutory requirements, including an opinion on those financial statements. An annual report to members and the Controller of Audit will also be produced to summarise all significant matters arising from the audit. This will be presented to the Board at the meeting in November 2012.

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 identified.

6 CONSULTATIONS

The Assessor and the Clerk to the Board have been consulted on the content of this report.

7 BACKGROUND PAPERS

None

MARJORY M STEWART
TREASURER **24 MAY 2012**

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Tayside Valuation Joint Board

Audit strategy overview and plan

Year ending 31 March 2012

7 March 2012

Overview

This document describes how we will deliver our audit for Tayside Valuation Joint Board ("the Joint Board") for the year ending 31 March 2012.

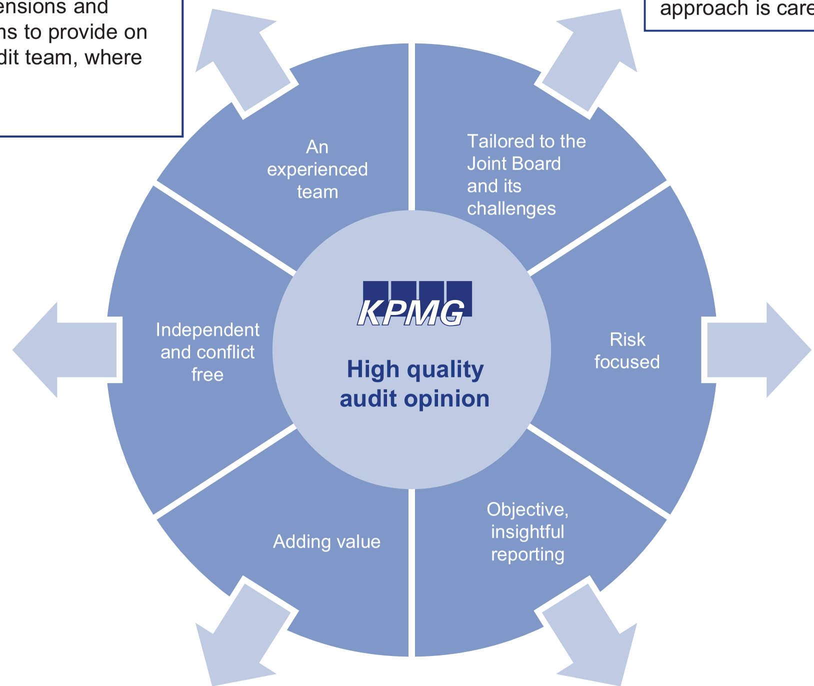
This includes the opinions on the financial statements in accordance with relevant legal and accounting requirements.

Experience *Page 11*
Your audit team has strong sector experience and is developing a sound understanding of the Joint Board and its aims and objectives.

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

Tailored approach *Pages 4 to 5*
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 13*
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 *Page 5*
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 management and the Joint Board.

KPMG

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 Tayside Valuation Joint Board 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 Tayside Valuation Joint Board, 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 Tayside Valuation Joint Board ("the Joint Board") 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 Joint Board'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 Joint Board.

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; and
- 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 local authority body has made proper arrangements for securing Best Value and is complying with its community duties; and
  - the local authority body 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 ensure that it is consistent with the financial statements. We also review the statement on the system of internal financial control and the 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.

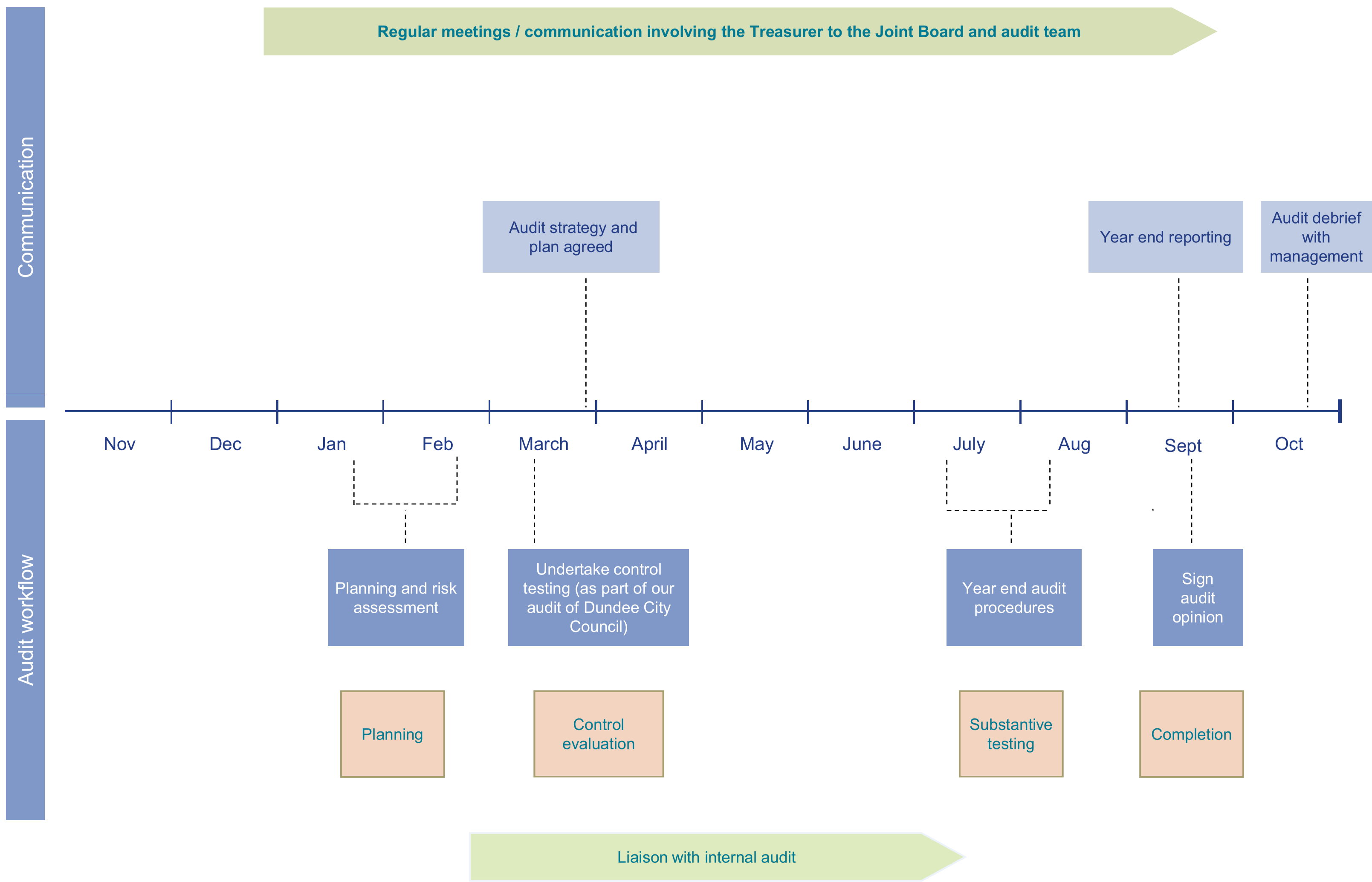
International Standard on Auditing (UK and Ireland) 240: *The auditor's responsibility to consider fraud in an audit of financial statements* applies to our work. In particular, this Standard requires us to consider directly the possibility that management may choose to override the system of internal 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; and**
- **financial position.**

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. We will considers 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 Joint Board achieved a surplus on the provision of services in 2010-11 of £1.54 million, representing a net underspend of £0.16 million against budget. After taking account of statutory adjustments and the return of £0.09 million to the constituent authorities, the Joint Board achieved a break even position. The general fund position therefore remained unchanged at 31 March 2011 at £0.1 million. The 2011-12 budgeted revenue expenditure of £2.9 7 million represents a 4.7% reduction in cash terms on 2010-11. The required cost savings are intended to be met through staff restructure.	We will review the budget setting process and approval of the 2011-12 budget. 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 Joint Board has changed during the financial year and how the financial position, and associated risks, are reported to the Joint Board and those charged with governance.

Mandatory communications

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 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

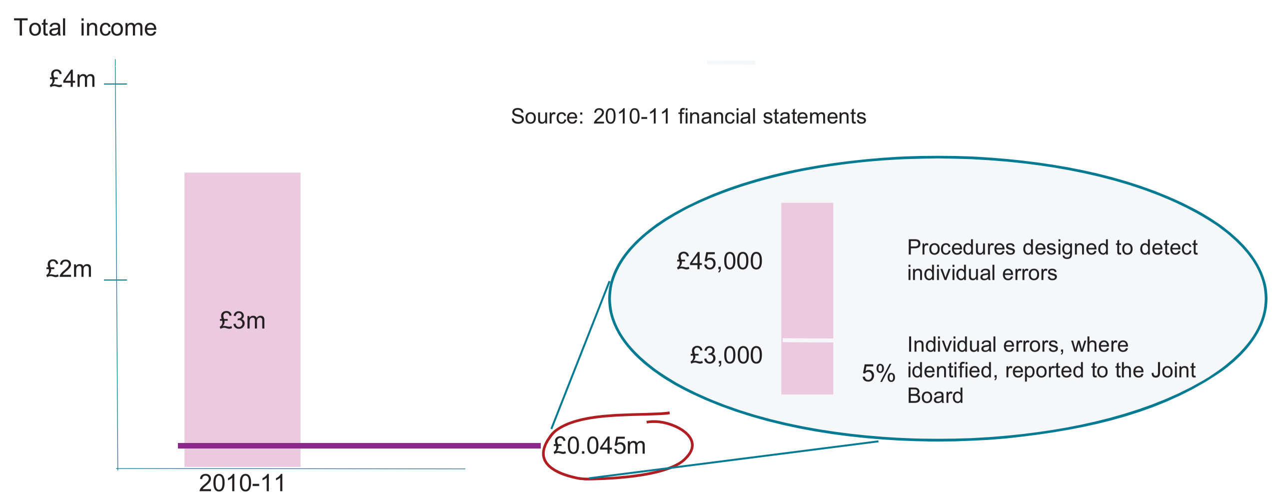
Our audit is geared to identify material errors in the financial statements.

We are required by Auditing Standards to report to the Joint Board 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 the Joint Board smaller errors in areas such as members' allowances and lease commitments. 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 Joint Board 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 £45,000 and we will report all errors over £3,000 to the Joint Board. Our final materiality will be based on the draft financial statements and we will inform you of any changes to our planning materiality.



Source: 2010-11 financial statements

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 Joint Board 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.

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. To date, valuation joint boards have not been subject to Best Value audits, however, police joint boards and fire and rescue joint boards, including Tayside Fire and Rescue, have been subject to recent audits.

The Joint Board established a framework for achieving Best Value and delivering continuous improvement through its service plan 2008-2013. We will review these arrangements as part of our work.

The Joint Board measures its performance through key performance indicators , producing an annual public performance report on its delivery against targets during the year.

Presentation of financial statements; internal audit

The Joint Board 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.

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

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 local authorities 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. While the accounts of the Joint Board are shorter than a local authority, the same principal applies.

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 Joint Board requisitions.

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.

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 general work in assessing the Joint Board's governance statement.

2011-12 internal audit plan

We will read the reports and consider the results of all internal audit work. In particular, the plan for the year includes specific reviews in the following areas where we would intend to place reliance:

- non-domestic rates;
- procurement and creditors / purchasing;
- IT network arrangements; and
- risk management / business continuity.

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 Joint Board's response to those reports relevant to its activities.

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 have consideration as to whether relevant national performance reports have been considered by the Joint Board and that action has been planned in response.

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 Joint Board. Audit Scotland has notified us that the fee range for 2011-12 is £6,620 to £8,090.

We have agreed a fee with management of £7,718. This fee reflects work on opening balances which is required by auditing standards in the first year of an audit appointment.

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

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 as appropriate 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:

- communication to those charged with governance setting out findings surrounding the financial statements process; and
- annual audit report to the Joint Board and the Controller of Audit.

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Appendix

Appendix one

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 the Joint Board.

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