

Argyll and Bute Council
Comhairle Earra Ghaidheal agus Bhoid

Customer Services
Executive Director: Douglas Hendry



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28 February 2011

SUPPLEMENTARY PACK 1

AUDIT COMMITTEE – FRIDAY 4 MARCH 2011 AT 11.00 AM IN THE COUNCIL CHAMBER, KILMORY, LOCHGILPHEAD

I enclose herewith items 13 (**STRATEGIC AND AUDIT PLAN 2011-2014**) and 16 (**AUDIT PLAN 2010-2011**) which were marked to follow on the above agenda.

Douglas Hendry
Executive Director - Customer Services

TO FOLLOW ITEMS

- 13. STRATEGIC AND AUDIT PLAN 2011 - 2014**
Report by Internal Audit Manager (Pages 1 - 14)

- 16. AUDIT PLAN 2010 - 2011**
Report by Grant Thornton UK LLP, External Auditors (Pages 15 - 42)

AUDIT COMMITTEE

Martin Caldwell
Councillor George Freeman
Councillor David Kinniburgh
Ian M M Ross (Chair)

Councillor Gordon Chalmers
Councillor Daniel Kelly
Councillor James Robb

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**ARGYLL & BUTE COUNCIL
STRATEGIC FINANCE**

**AUDIT COMMITTEE
4 MARCH 2011**

STRATEGIC AUDIT PLAN 2011 - 2014

1. SUMMARY

This report introduces the draft Strategic Audit Plan for 2011 – 2014 and Annual Audit Plan for 2011 - 2012. See Appendix 1.

2. RECOMMENDATIONS

2.1 The draft Strategic Audit Plan 2011 – 2014 and Annual Audit Plan for 2011 – 2012 are approved.

3. DETAILS

3.1 The draft Strategic Audit Plan 2008 - 2011 as well as including the Annual Audit Plan for 2011 - 2012 covers planned core and non financial audits.

3.2 Internal Audit in preparing the strategic audit plan for 2011 – 2014 carried out an exercise to determine the audits that will enable Internal Audit over the next 3 years to provide an assurance statement on the Council's overall internal control framework.

3.3 Audits within the strategic audit plan have been derived from a review of 4 areas financial materiality, risk, and controls effectiveness plus performance management. This provided a substantial review of the challenges that face the Council. It replaced the previous analysis method which was predominately financial based. The collected data was analysed and prioritised with audits assigned to 5 audit areas: Core Financial Audits, Business Systems, Corporate Performance, Corporate Plan and Service Plans.

3.4 The audit plan presented in Appendix 1 provides the Financial Control Audits which are routinely undertaken each year. These audits provide a level of assurance for external audit, the section 95 officer and senior management that finances are appropriately controlled. They will be commenced with the new financial year as will the audit of the councils Statutory Performance Indicators (SPIs), which provides assurance to external audit that the figures achieved are accurate. The detail analysis for the audit headings other than the Financial Control Audits will be presented to the Audit Committee once discussions over audit topics have been concluded.

4. CONCLUSION

The Strategic Audit Plan and Annual Audit Plan will be progressed by Internal Audit.

5. IMPLICATIONS

5.1 Policy: None

5.2 Financial: None

5.3 Personnel: None

5.4 Legal: None

5.5 Equal Opportunities: None

For further information please contact Ian Nisbet, Internal Audit Manager (01546 604216)

Ian Nisbet

Internal Audit Manager 23 February 2011

23Febfinalrep23feb



INTERNAL AUDIT
STRATEGIC AUDIT PLAN
2011 - 2014
&
ANNUAL PLAN
2011 - 2012
24 February 2011

Draft for Audit Committee Approval

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1. Strategic Audit Plan 2011 – 2014

The Strategic Audit Plan covering financial years 2011 – 2014 has been compiled using a wider base of primary data than previous plans which were predominately finance and risk register based, with management input. The current environment in which the Council operates provides a wide range of challenges and opportunities. It is therefore important that the new strategic audit plan takes cognisance of this environment, in order to develop the next 3 years audit plan. To achieve this objective, 4 primary headings were devised Materiality, Risk, Control Effectiveness and Performance Management. The 4 areas were informed through reference to external and internal audit reports, operational and strategic risk registers, internal performance plans, financial data, corporate and service plans, etc. The data extracted from these reference areas was mapped to Council activity areas such as Financial Control, Business Systems operated by the Council, Corporate Performance activities, Corporate and Service Plan objectives. This provided a comprehensive database of performance, risk and scrutiny information from which to compile the Strategic Audit Plan for 2011 – 2014.

This strategic audit plan provides a framework within which Internal Audit work will be carried out over the next 3 years and ensures that resources are effectively planned and controlled. It should be seen as a flexible management tool, which meets the following objectives:

- A clear view of the workload of the internal audit section;
- A base for assessment of the adequacy and future deployment of internal audit resources;
- A yardstick against which progress and performance can be measured;
- The authority to act once it is approved by the Audit Committee; and
- A permanent record of the factors considered and judgements made.

2. Internal Audit Responsibilities

In preparing this strategic audit plan Internal Audit has taken consideration of the following:

Section 95 Officer

Internal Audit has a responsibility to inform the Section 95 Officer, the Head of Strategic Finance, of the effectiveness of the system of internal control operated within the Council. A Statement of Governance and Control was prepared for inclusion in the Council's Annual Accounts of 2009 – 2010. The new statement replaced the Internal Control Statement of previous years. The Statement of Governance and Control comments on both financial and the wider controls operated within the Council.

Audit Committee

Internal Audit has a responsibility to the Audit Committee to report on the progress of the audit programme in terms of planned time against actual time, and provide extract summary reports plus action plans from audits. Action plan recommendations made by external and internal audit are followed up using the internal audit database. Progress regarding implementation by local management of agreed recommendations is followed up and reported on a monthly basis to Departmental Management Teams (DMTs) and the Strategic Management Team (SMT) with a quarterly progress report provided to the Audit Committee. At the culmination of each year's audit work an annual report is prepared by Internal Audit and presented to the Audit Committee along with the Statement of Governance and Control.

External Audit

Internal Audit has a responsibility to co-ordinate its activities with Grant Thornton UK LLP. The relationship operated by Internal Audit with the Council's external auditor, is one of joint working. We try to avoid areas of duplication and in other instances work jointly on large system control issues. Consultations are held on a regular and informal basis to co-ordinate work and where appropriate develop audit programmes and methodology to assist in the carrying out of our systems audit work.

3. Gaining Assurance

The 3 year strategic audit plan has been compiled in accordance with the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom ('the Code'). This requires the Internal Audit section to provide an objective assessment of the adequacy, reliability and effectiveness of the Council's internal control system. The strategic audit plan takes account of the Internal Audit Mission Statement and Terms of Reference both of which have previously been approved by the Audit Committee.

The Code requires that Internal Audit not only audit financial systems controls but also other systems of management control used to ensure the Council's corporate objectives and core values are being addressed. Internal audit has adopted the CIPFA systems based audit (SBA) control matrices which incorporate governance and risk as well as financial control checks, which enhances internal audit's scrutiny role and adherence to the CIPFA Code. Adopting the SBA control matrices has enabled external audit to place greater reliance on the work of internal audit and engage departments and services in the audit process.

In addition to compliance with the Code, it was important that the next 3 year strategic audit plan reflected the new environment in which the Council operates which is challenging for both members and services.

Audit Plan Analysis

The analysis undertaken for the Strategic Audit Plan 2011 – 2014 to identify and rank the main financial systems covered 4 broad headings. These are set out below:

- Materiality – an assessment of financial data;
- Risk - operational and strategic risk registers, the risk associated with a particular activity due to its very nature, and the level of sensitivity attached to a possible breakdown in the effective operation of that system;
- Control Effectiveness - an assessment based on external and internal audit report agreed recommendations, corporate governance and other external and internal inspection reports regarding the degree of control management currently has over the inherent risks; and
- Performance Management – an assessment based on corporate and service plans and improvement plans.

The data from the 4 headings was collated using a spreadsheet and in order to compile the Strategic Audit Plan for 2011 – 2014 a methodology was prepared that would enable equal weighting to the data located within the 4 headings. In order to provide equity for the collected data under the 4 headings a weighting was added to all headings, Materiality was given a weighting of 6, Risk a weighting of 3, Control Effectiveness a weighting of 2 and Performance Management a weighting of one. Each of the 4 headings had a maximum weighted total of 30 and a cumulative total of 120 which when divided by 1.2 provided a final percentage figure. The scores achieved from this exercise were then sorted under the following audit headings:

- Core financial and control audits;
- Business systems;
- Corporate performance;
- Corporate plan; and
- Service plans.

The scores are provided on pages 4 to 6. As an example of the new comprehensive audit planning approach is Budget Preparation and Control. The Materiality score is 30 based on the financial value of budgets. The Risk ranking is 0 based on the review of both the operational and strategic registers. The Control Effectiveness ranking score is 18 based on internal and external audit report recommendations, corporate governance and Best Value 2 requirements. A Performance Management score of 11 reflects the importance that Audit Scotland and the Scottish Government are placing on budgetary control for councils as national funding is constricted.

The obtained scores were then ranked highest to lowest and allocated a 'total risk ranking' score based on an objective evaluation for each audit area with the highest risk scores ranked one reducing to 4. The audit analysis scores for the Core Financial Control Audits for 2011 – 2014 are provided on page 7. On page 8 the assigned risk ranking is provided and direct audit days assigned relational to the risk ranking obtained for each financial control system. In addition, a summary of the allocation of days is provided by audit heading totalling 890 direct audits days per year 2011 to 2014. The detail analysis for the audit headings other than the Financial Control Audits will be presented to the Audit Committee once discussions over audit topics have been concluded.

The Financial Control Audits are routinely undertaken each year and provide a level of assurance for external audit, the section 95 officer and senior management that finances are appropriately controlled. They will be commenced with the new financial year as will the audit of the councils Statutory Performance Indicators (SPIs), which provides assurance to external audit that the figures achieved are accurate.

Table 3.1 – Calculation of Audit Risk Financial & Control Audits 2011 – 14

CORE FINANCIAL & CONTROL AUDITS	Materiality factors	Risk	Control rating	Performance Management	Total audit risk score	Spreadsheet Final risk score	Ranking
(Weightings applied)	(x6)	(x3)	(x2)	(x1)	(Total Risk Total 120)	(120/1.2 =100)	-
Budgetary Preparation and Control	30	27	18	11	86	72	1
Government & European Grants	30	12	10	6	58	48	1
Council Tax and Non-Domestic Rates	30	9	4	8	51	43	1
Capital Contracts	30	9	4	8	57	48	1
Payroll	30	9	12	2	53	44	1
Capital Accounting	30	9	14	0	53	44	1
Debtor Accounts	30	9	10	2	51	43	1
Treasury Management	30	9	10	2	51	43	1
Creditor Payments and Purchasing	30	9	10	1	50	42	1
Cash Income and Banking	30	9	10	0	49	41	1
General ledger operations	30	9	10	0	49	41	1
Tendering Procedures	24	9	10	0	49	41	1
Contract Operating Leases	24	9	4	0	37	31	2
Car Allowances and Subsistence	24	9	2	0	43	36	2
Stock Taking / Work in Progress	12	9	10	0	31	26	2

1. Materiality ranking = 6
2. Risk ranking = 3
3. Control effectiveness ranking = 2
4. Performance Management = 1

Table 3.2 – Internal Audit Plan Financial & Control Audits 2011 – 14

FINANCIAL & CONTROL AUDITS	Risk ranking	Last audited	2011-12	2012-13	2013-14
Budgetary Preparation and Control	1	2011	25	20	25
Government & European Grants	1	2010	25	20	25
Council Tax and Non-Domestic Rates	1	2010	25	20	25
Capital Contracts	1	2010	25	20	25
Payroll	1	2010	25	20	25
Capital Accounting	1	2010	25	20	25
Debtor Accounts	1	2011	20	25	20
Treasury Management	1	2010	20	25	20
Creditor Payments and Purchasing	1	2011	20	25	20
Cash Income and Banking	1	2010	20	25	20
General ledger operations	1	2011	20	25	20
Tendering Procedures	1	2010	20	25	20
Car Allowances and Subsistence	2	2010	15	15	20
Contract Operating Leases	2	2011	15	15	20
Stock Taking / Work in Progress	2	2010	15	15	20
			330	315	330

DIRECT AUDIT DAY ALLOCATION	2011-12	2012-13	2013-14
FINANCIAL & CONTROL AUDITS	330	315	330
BUSINESS SYSTEMS	135	150	135
CORPORATE PERFORMANCE	225	225	225
CORPORATE PLAN	100	100	100
SERVICE PLANS	100	100	100
TOTAL	890	890	890

4. Contingency Days 2011 – 2014

Audit days have been included within the strategic audit plan for contingency.

Special Investigations - This is audit time for unforeseen events which, by their nature, cannot be planned for, e.g.:

- Notification of frauds, significant weaknesses or loss;
- Consideration of controls for new or amended systems; and
- Reviews of significant breakdown of internal control that cannot be accommodated within planned audits.

Clearly, the extent to which any contingency requirement will arise depends on the soundness of the Council's systems of control and the incidence of fraud or irregularity. Internal Audit reports on a monthly basis to both the Strategic and Departmental Management Teams and the Audit Committee on a quarterly basis, detailing management progress in implementing agreed audit report recommendations and a number of days have been allocated within the plan for this task. Strategic/Annual Audit Plans - Time has been allocated for audit planning within the allocation for Contingency days.

Table 4 – Assessment of Audit Days: 2011 - 2014

Contingency days	2011-12	2012-13	2013-14
Special investigations contingency	100	100	100
Follow-up external & internal audit management letter points	52	52	52
National Fraud Initiative (NFI) Exercise	25	25	25
Strategic plan, annual plans	18	18	18
Sub Total	195	195	195

If the level of direct audit day input alters in any of the areas detailed above throughout 2011 – 2014 an adjustment will be made and the Audit Committee informed.

5. Internal Audit Resource 2011 – 2014

Tables 5.1 and 5.2, in Appendix 2 sets out the resources and number of days available for 2011 - 2014. There are 3 elements to the tables:

- Total working days available;
- Non-direct audit days; and
- Direct audit days.

In arriving at the number of working days available for 2011 - 2014 deductions for annual leave and a potential sickness provision a total of 1,308 working days are available for direct and non-direct audit work.

The non-direct audit day allocation covers tasks such as management; provision of advice and information, continuing professional development (CPD). Cognisance has also been taken of the fact that one member of staff will be involved in professional training. As a result the total day's allocated to non-direct audit for 2011 – 2014 and the following year is estimated to be 223 as set out in Table 5.1.

Table 5.2 provides the direct audit days for audits. The audit days assigned to the audit areas includes time for Planning, Fieldwork, Report Writing and Management Review. In addition, a number of days have been included for special investigations; follow up reporting of recommendation implementation progress, the national fraud initiative annual exercise and audit planning see Section 5 above. The total number of days allocated to direct audits for 2011 - 2014 is 1,085 and represents 83% of total working days available.

APPENDIX 1

Table 5.1 – Internal Audit Resources 2011 - 2014

	Chief Internal Auditor	Audit Manager	Accountant	Trainee Accountant	Senior Audit Assistant	Contract Auditors	Total
Number of Days in full year	261	261	261	261	261	220	1,525
Less:							
Public Holidays	8	8	8	8	8		40
Annual Leave	32	32	32	24	32		152
Sickness Provision	5	5	5	5	5		25
Working Days Available	216	216	216	224	216	220	1,308
Non-Direct Audit Work							
IA Management	30	10	-	-	-	-	40
Planning and Reporting	25	10	-	-	-	-	35
Training, Development & Audit Internal Meetings	10	10	10	34	20	-	84
Advisory	8	8	6	6	6	-	34
	20	10	-	-	-	-	30
Total for Non-Direct Audit Support Work	93	48	16	40	26	-	223
Time Available for Direct Audit Work	123	168	200	184	190	220	1,085

Table 5.2 – Internal Audit Resource Days 2011 - 2014

DIRECT AUDIT DAYS	2011 - 2012	2012 - 2013	2013 - 2014
Direct Audit Work			
Core Financial Audits	315	285	315
Business Systems	150	180	150
Corporate Performance	225	225	225
Corporate Plan	100	100	100
Service Plans	100	100	100
Sub Total	890	890	890
Contingency			
Special Investigations	100	100	100
Follow Up Reviews	52	52	52
NFI Exercise	25	25	25
Risk Analysis	18	18	18
Sub Total	195	195	195
Total Direct Audit Days	1,085	1,085	1,085

Audit Approach Memorandum

Argyll and Bute Council

For the year ended 31 March 2011

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To the Members of Argyll and Bute Council

We have been appointed as external auditors to Argyll and Bute Council for a five year period to the year ended 31 March 2011. This is, therefore, the final year of our appointment under the current framework contract with the Accounts Commission for Scotland. We would like to thank all staff and members of the Council for the kind help and support during the period of our appointment.

This memorandum highlights the key elements of our proposed audit strategy for the benefit of those charged with governance, in accordance with the requirements of International Standard on Auditing (UK & Ireland) 260 and the Code of Audit Practice issued by Audit Scotland

We have considered our independence and objectivity in respect of the audit and do not believe there are any matters which should be brought to your attention. This memorandum has been prepared on the basis of the limitations set out in 'The small print' in Section 7.

We look forward to working with you during the course of the audit.

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1 Introduction

1.1 Introduction

Grant Thornton UK LLP has been appointed by the Accounts Commission for Scotland as the external auditor of Argyll and Bute Council (the Council) for the five year period commencing 2006-07. This memorandum outlines how we will approach the audit of the council in the final year of our appointment, and reflects our statutory duties and risk based approach.

Specific duties for external auditors are concerned principally with the Local Government (Scotland) Act 1973, the Code of Audit Practice and in the audit engagement letter issued to auditors by Audit Scotland. These include undertaking the audit in accordance with relevant legislation and Statements of Internal Auditing Standards and applicable Practice Notes issued by the Auditing Practice Board.

1.2 Roles and Responsibilities

The Code of Audit Practice (the Code) is issued by Audit Scotland on behalf of the Auditor General and the Accounts Commission for Scotland. The Code defines responsibilities of appointed auditors when auditing public sector bodies.

The Code requires us to take a risk based approach. Our risk assessment in relation to each of the above areas is therefore summarised in the following sections of this plan. We will keep our initial risk assessment under review and discuss any significant changes to the nature and scope of our audit with you.

1.3 Summary of audit objectives

Area	Audit Objectives
Financial statements	To provide an opinion on the council's financial statements for the year ended 31 March 2011. Further details are provided in Section 2.
Governance	To review and report on the council's corporate governance arrangements, including systems of internal control. Further details are provided in Section 3.
Performance	To review and report on the council's arrangements to achieve best value and economy, efficiency and effectiveness in the use of resources. Further details are provided in Section 4.
Grant Claims	We will provide independent auditor's reports on specific grant claims in accordance with Audit Scotland guidelines. Further details are provided in Section 5.

A summary of planned audit outputs and reports for the 2010-11 audit is set out in Appendix A, and our planned reliance on internal audit is set out in Appendix B.

1.4 Other matters

We set out in Section 6 details of our audit team and our proposed fee, based on our responsibilities and risk assessment.

2 Financial statements

2.1 Introduction

The Council's financial statements are an essential means by which it accounts for the stewardship of resources and its financial performance in the use of those resources. It is the responsibility of the council to:

- ensure the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority
- maintain proper accounting records
- prepare financial statements which give a true and fair view of the financial position of the council and its expenditure and income in accordance with the Code of practice on local authority accounting in the United Kingdom (the Code).

The auditor is required to audit the financial statements and to give an opinion as to:

- whether they give a true and fair view of the financial position of the council and its expenditure and income for the period in question
- whether they have been prepared properly in accordance with the Code, relevant legislation, applicable accounting standards and other reporting requirements
- whether the Statement on Internal Control has been presented in accordance with relevant requirements and to report if it does not meet these requirements, or if the statement is misleading or inconsistent with our knowledge.

2.2 Overall approach

In order to gain sufficient assurance to support our opinion on the financial statements, we will carry out a review of:

- internal audit, to determine the extent of reliance we can place on it for the purposes of our audit (Appendix B summarises the areas of internal audit work we plan to place reliance on)
- the internal control framework for key financial systems
- review of computerised controls operating across major IT systems
- the materiality of balances and transactions impacting on the financial statements
- the key risks relevant to the preparation and audit of the group financial statements
- the council's arrangements for the preparation of its group financial statements and for the Whole of Government Accounts consolidation pack.

Materiality

An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true and fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than 2% of materiality will be recorded on a schedule of potential misstatements. These are assessed individually and in aggregate and discussed with you. Where management choose not to adjust their accounts for identified differences, we will require

them to confirm in a letter of representation to us, their view that these differences are not material to the financial statements.

An item of low value may be judged material by its nature, for example any item that affects the disclosure of remuneration. An item of higher value may be judged not material if it does not distort the truth and fairness of the financial statements.

Internal controls

Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify potential areas of higher audit risk that could lead to material misstatement. These areas normally represent the higher value and/or more complex financial systems, and do not necessarily reflect an assessment that controls are not operating effectively. The higher risk areas we have identified for 2010-11 are:

- creditor payments
- payroll
- council tax and non-domestic rates
- fixed assets.

We are also required to assess whether the controls have been implemented as intended. We will do this through a combination of inquiry and observation procedures, and, where appropriate, systems walkthroughs. However, our work cannot be relied upon necessarily to identify defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

2.3 Risk assessment and response

Our audit work is risk based and proportionate. On the basis of our preliminary work to date, we have identified the audit risks outlined within Section 2.4 in relation to the financial statements aspect of our audit:

We will report to you in our Report on the 2010-11 Accounts Audit our findings and conclusions in respect of each of the risks that we have identified at the planning stage of the audit.

2.4 Key audit issues

Issue	Response
<p>International Financial Reporting Standards</p> <p>2011 is the first year that the local authority accounting code is based on international financial reporting standards (IFRS). The move to an IFRS-based Code from a UK GAAP-based SO RP has resulted in a number of significant changes in accounting practice that the Council will need to take into account when preparing the 2010/11 financial statements. A key aspect of IFRS accounting in respect of private finance initiative and similar contracts was introduced in the 2009 SO RP. The key accounting changes for 2010-11 include:</p> <ul style="list-style-type: none"> • a greater emphasis on depreciation of asset components, and a new classification of assets held for sale' • changes in the classification of leases, and a new requirement to account for arrangements containing a lease • a change in accounting treatment for grants and contributions used to fund capital expenditure • a requirement to recognise a liability for untaken annual leave and flexi-time accruals • new disclosure requirements for accounting standards not yet adopted, key assumptions and judgements, changes in respect of prior period adjustments, and operating segments. 	<p>We carried out an interim review of the council's preparations for IFRS as part of our 2009-10 annual audit. The council has adopted detailed planning arrangements and has created an IFRS Working Group to take forward preparations for full adoption.</p> <p>We have continued to liaise with the finance team on issues relating to the implementation of IFRS as they arise. In addition, we will address key IFRS accounting issues in our finance team workshop arranged for 1 March 2011.</p> <p>We will work with the council's finance team throughout the year and monitor the Working Group's progress early in the audit year to ensure that the Council remains on track to meet the final accounts deadline.</p>
<p>The Council is also required to restate its 2009-10 accounts under IFRS to report comparative information.</p>	

Financial Position

The Scottish Government announced the financial settlement for local authorities for 2011-12 in December 2010. Argyll and Bute's settlement for 2011-12 will be £220.059 million (£231.448 million 2010-11).

The initial reduction in the Council's budget settlement for 2011-12 was £11.389 million (4.9%), which is significantly higher than the national average of 2.59%. The Council's higher share of the cuts reflects significant variation in funding for two areas:

- the Special Islands Needs Allowance (SINA) following the reclassification of Seil as an island which leads to a reduction of £400,000
- Supporting people allowance - a reduction of £5.6 million due to an alteration in the distribution process for this allowance by the Scottish Government.

A later re-allocation of government funding provided an additional £1.3 million in funding to the Council, giving a total reduction for 2011-12 of £10 million.

The Council had already planned for expected budget reductions, however the actual reductions for 2010-11 are significantly higher than expected. The Council has now finalised its proposals to set a balanced budget for 2011-12, with the budget approved on 10 February 2011.

Throughout 2009-10 the Council has been analysing the impact of reductions in central government support, and performing scenario planning to determine the likely impact on its financial position. As part of this, the Council has asked services to perform service reviews to identify options if they had to operate on 15% less budget. A key risk going forward is ensuring that budget savings identified are realized.

We will review the Council's progress in meeting its cost reduction and efficiency improvement plans. We will also consider the adequacy of the Council's financial management and budgetary control procedures.

3 Governance

3.1 Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The council is responsible for putting in place arrangements for the conduct of its affairs, including compliance with applicable guidance, ensuring the legality of activities and transactions and monitoring the adequacy and effectiveness of these arrangements in practice. The council's Audit Committee should have a role in monitoring these arrangements.

The Code gives the auditor a responsibility to review and, where appropriate, report findings on the council's corporate governance arrangements as they relate to:

- the council's review of its systems of internal control, including its reporting arrangements
- the prevention and detection of fraud and irregularity
- standards of conduct, and arrangements in relation to the prevention and detection of corruption
- the financial position of the Council.

3.2 Overall Approach

We will assess the adequacy of the council's governance arrangements by:

- reviewing the council's overall arrangements in relation to each of the above areas
- reviewing the extent of compliance with the Code of Practice for Internal Audit in Local Government
- evaluating the council's approach to risk management, including arrangements to address the key risks identified in this section of the audit plan.

3.3 Risk assessment and response

On the basis of our preliminary work to date, we have identified the audit risks outlined in section 3.4 in relation to the governance aspects of our audit:

3.4 Key governance issues

Issue	Response
<p>National Fraud Initiative</p> <p>The National Fraud Initiative (NFI) is a nationwide data matching exercise run jointly by Audit Scotland and the Audit Commission. The 2010-11 exercise is now underway. The role of external audit in NFI is to review the Council's procedures for managing the exercise and the progress in pursuing potential frauds highlighted by the data matching exercise.</p>	<p>We have followed up the Council's progress in processing NFI matches, and all the relevant matches have now been assigned.</p> <p>We will report on the Council's performance in the NFI cycle and summarise our findings in our Interim Management Report.</p>
<p>In previous years we have highlighted weaknesses in the Council's arrangements for processing matches, in particular:</p> <ul style="list-style-type: none">• The Council should prioritise the review and processing of the highest quality data matches and ensure these are processed in a timely manner• Staff in relevant departments should be assigned responsibility to review and process the NFI matches• The Council should consider submitting creditors data for the next NFI exercise• The key contact should review the required access to the NFI system for the 2010-11 exercise and ensure only appropriate staff have been given access.	
<p>We are aware the Council are working to address these issues in the 2010-11 cycle.</p>	

Contract management

Internal audit carried out a review of the Port Askaig redevelopment project during 2009-10, and a report was submitted to the Audit Committee in September 2009 highlighting the findings. The project relates to redevelopment of the harbour and associated facilities in Port Askaig on the island of Islay.

The report made a number of recommendations on contract management and the approval process for capital projects, the majority of which are addressed by the new Gateway procedures and the role of the Council's Asset Management Board.

There are however a number of ongoing issues with the project, including a dispute with Caledonian Macbrayne on the compatibility of the ferry used for the Islay-Jura route.

Corporate Restructuring

The Council successfully completed a significant restructuring of the strategic management team and service heads in 2009-10. This involved replacing the four Strategic Directors with three Executive Directors, and a restructure of the services, with a realignment of services leading to the creation of 12 new services to replace the previous 15.

The next stage of the Council's restructuring is formal consultation with the trades unions and employee representatives on redundancy for all other staff members as part of its efforts to reduce its budget over the next three years. During 2010-11, the Council invited staff to apply for voluntary redundancy, although it is recognised that compulsory redundancies are likely to be required following the finalisation of the 2011-12 budget.

Internal Audit

We have continued to follow up our recommendations following our 2006-07 review of the Council's internal audit department against the requirements of the Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) issued by CIPFA. In

We will liaise with internal audit to update our review of this project in our 2010-11 audit.

Our findings will be reported in our Interim Management Report.

We reviewed the Council's arrangements for restructuring its strategic management team in our 2009-10 audit. As part of our 2010-11 audit, we will review the Council's arrangements for restructuring other parts of the organisation to ensure it is in compliance with relevant legislation and guidance. Our review will also consider the costs of the scheme and whether they offer best value to the Council.

We will apply Audit Scotland's guidance note on severance as a guide for completing this area of work.

We will continue to monitor the Council's future strategy for internal audit and consider ongoing compliance with the Code of Practice. We will also assess the extent to which the Council meets the requirements of CIPFA guidance on the role of the Head of Internal

addition, in our 2008-09 audit, we recommended that the Council Audit perform a review of the future strategic direction of internal audit and consider the best way of providing the service.

In June 2010, the Council appointed a head of internal audit to lead the internal audit section, and this implements one of the main areas of previous non-compliance with the Code.

The Council is currently undertaking a best value review of the internal audit department and expects to report the outcomes from this review alongside its overall review of support services.

4 Performance

4.1 Introduction

The Local Government in Scotland Act 2003 established Best Value as a statutory requirement for all councils. The Act defines Best Value as 'continuous improvement in the performance of the authority's functions'. The objective of Best Value is to ensure that councils deliver better and more responsive public services by:

- balancing the quality of services with cost
- continuously improving the services provided
- being accountable and transparent, by listening and responding to the local community
- achieving sustainable development in how the council operates
- ensuring equal opportunities in the delivery of services.

4.2 Audit Approach

Under the National Scrutiny Plan for Local Government 2010-11, Scotland's scrutiny agencies work together to develop a shared risk assessment and Assurance and Improvement Plan (AIP) for each council area. During 2009-10, we followed up the progress made by the council, both in addressing the improvement agenda and against specific areas of risk or uncertainty identified by scrutiny partners.

Any further work on Best Value will be determined by the updated risk assessment and Assurance and Improvement Plan for 2010-11, due in April 2011.

4.3 Risk assessment and response

On the basis of our preliminary work to date, we have identified the audit risks outlined in section 4.4 in relation to the governance aspects of our audit:

4.4 Key performance issues

Issue	Response
<p>Assurance and Improvement Plan (AIP)</p> <p>The Council is required to achieve best value in its use of resources and to have effective arrangements in place to ensure it can demonstrate how it does this. Our recent audit found that the council is making good progress in implementing its best value improvement plan.</p>	<p>We will continue to work with other scrutiny partners through the Local Area Network (LAN) to update the AIP which sets out a shared risk assessment of the council's arrangements for achieving best value. The LAN will issue its revised AIP by 1 April 2011.</p>
<p>The AIP, issued in June 2010, assessed the council as low risk overall but highlighted workforce management and management of the schools estate as areas of higher risk.</p>	
<p>Schools Estate Strategy</p> <p>In recent years our work has drawn the Council's attention to the relatively poor occupancy rates in the Council's schools and the significant backlog of maintenance in the schools estate (estimated at £25 million). The Council has responded with an undertaking to review its school estate and develop a strategic plan for addressing key areas of concern. The Council intends to bring forward options to address issues relevant to the school estate in the near future.</p>	<p>As part of the Council's Assurance and Improvement Plan (agreed with all scrutiny agencies), we will monitor the Council's progress in implementing this key policy commitment as part of our 2010-11 performance audit work.</p>

Single Outcome Agreement

Single Outcome Agreements (SOAs) are still a relatively new mechanism for aligning public sector activity to national priorities and the Accounts Commission has no immediate plans to audit their delivery. However, the SRA and BV2 processes draw upon evidence contained within SOAs in order to consider outcomes more widely, as planning for and managing the delivery of outcomes should be central to all aspects of the council's activity.

Successful delivery of SOAs depends 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.

In view of the significance of the SOA, during 2010-11, we will review the Council's approach to developing governance and accountability arrangements to support SOAs. In particular, we will review how effectively the council links high-level SOA outcomes and more detailed service-level outcomes, outputs and activities, both within the council and across community planning partners. The SOA should be supported by robust performance management and reporting arrangements, which include the role of the Audit Committee.

As part of our work on Statutory Performance Indicators, we will also review the Council's approach to public performance reporting on progress towards achieving SOA objectives.

Statutory Performance Indicators (SPIs)

The SPI direction for 2010-11 continues to incorporate two main requirements:

- that councils report a range of sufficient information to demonstrate best value in relation to corporate management (SPI 1); and
- that councils report a range of information sufficient to demonstrate best value in relation to service performance (SPI 2).

In reporting against SPIs 1 and 2, the Council will be required to report performance against 25 indicators specifically defined by the Accounts Commission.

The Council has also taken the opportunity to develop and report on locally determined indicators that reflect how the Council is performing as a whole.

We will review the Council's arrangements for meeting SPI reporting requirements. Specifically, we will consider whether the range of performance information reported locally is sufficient to demonstrate whether the Council is achieving Best Value. We will also consider whether arrangements are in place to ensure the reliability and accuracy of the information to be reported.

Improving public sector purchasing

In March 2006, the Scottish Executive published the Review of Public Procurement in Scotland by John McClelland. The report

We will follow up the Council's progress in implementing Audit Scotland's recommendations. In particular, we will look at what

estimated that £740 million savings over the three years to 2008/09 could have been made if public bodies significantly improved how they purchased goods and service. The report made a range of recommendations aimed at raising purchasing standards and making savings while also maintaining high quality services.

In July 2009, Audit Scotland produced a report on the implementation of the Public Procurement Reform Programme, which the Scottish Executive launched in response to the McClelland Report. Improving public sector purchasing notes that there was no systematic basis for reporting procurement savings. There were also wide variations across public bodies in the quality of purchasing data and practice. Best Practice Indicators (BPIs) were not in use across all public bodies.

action has been taken in response to the Audit Scotland report, and others, and assess what difference this has made to the Council.

Impact of National Performance Audit Reports

As part of the development of joint scrutiny and shared risk assessments, Audit Scotland's national audit work will increasingly be informed by local risk assessments, with future studies programmes being more responsive to information and intelligence generated through local audit work. To maximise the impact of the national audit work programme, we are required to follow up national reports affecting the Council 3 and 12 months following publication.

We will review the progress that the Council has made in implementing recommendations from national reports. Where necessary, we will report on any weaknesses in our final audit report.

5 Grants

5.1 Introduction

We will audit the grant claims notified to us by the council at the start of the audit, and authorised for audit by Audit Scotland, which currently are:

- housing and council tax benefit subsidy
- education maintenance allowances
- criminal justice social work services grant
- non-domestic rates.

5.2 Overall approach

Audit Scotland issue guidance to auditors on the audit of grant claims authorised for audit in agreement with the Scottish Government. Audit Scotland's guidance determines the extent of audit testing required for each specific grant claim.

In order to gain sufficient assurance to support our opinion on each grant claim, we are required to carry out reviews of:

- the council's arrangements for the preparation of each claim submitted for audit
- internal audit to determine the extent of reliance we can place on it for the purposes of our audit
- the effectiveness of the internal control framework for key financial systems relevant to each grant claim
- the materiality of balances and transactions impacting on each grant claim
- the key risks relevant to the preparation and audit of each grant claim.

Any additional grant claims submitted for audit will be audited in agreement with Audit Scotland and subject to additional fee arrangements in negotiation with the council.

6 Logistics

6.1 Timetables and milestones

In accordance with the schedule in Appendix A, the following proposed timetable and deadlines have been set:

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable.

Audit Area	Fieldwork Timetable
Planning	January/February 2011
Interim Audit <ul style="list-style-type: none"> • Financial Systems • Governance 	March 2011
International Financial Reporting Standards <ul style="list-style-type: none"> • Review of the IFRS Shadow Accounts 	March 2011
Performance <ul style="list-style-type: none"> • Area Improvement Plan • Statutory Performance Indicators 	April/May 2011
Financial Statements Audit	July/August 2011
Whole of Government Accounts	August 2011
Education Maintenance Allowance Grant	July 2011
Housing Benefit and Council Tax Benefit Subsidy Audit	August/September 2011
Non Domestic Rates Audit	January 2012

6.2 Fees

Our fees are calculated in accordance with the guidance issued by Audit Scotland for determining the fee level for local government bodies. The fee is based on our professional assessment of the level of audit risk associated with a particular body. Audit Scotland requires that the agreed fee for the audit is set within the limits of the indicative fee range. Placement within the range depends on the level of work we consider necessary to perform the audit and is influenced by the number and level of risks facing the Council. In addition to the fee for the audit, Audit Scotland charges a fixed central overhead fee to meet its central running costs.

In recognition of the significant financial challenge facing local authorities, we are proposing a decrease in our 2010-11 audit fee of £3,000 (1.5%) on the 2009-10 fee level. Our fee level has been set to reflect the efficiencies gained from the 5th year of our audit appointment, offset by the additional work required to audit the Council's move to IFRS compliant accounts.

In addition, the fixed charge has been reduced by £12,700 (13.5%), giving a proposed audit fee for the year of £286,500, a reduction of £15,700 (5%) on the 2009-10 levels.

	Current period £	Prior period actual fees £	% Change
Indicative Fee	201,400	197,900	1.8%
Grant Thornton UK LLP fee	205,000	208,000	(1.5%)
Audit Scotland Fixed Charge	81,500	94,200	(13.5%)
Total	286,500	302,200	(5.2%)

We have proposed this fee on the basis that:

- IFRS restated 2009-10 accounts are presented to us by 31st March 2011 for our review
- draft statutory accounts are presented to us by 30th June 2011 for audit, subject only to routine audit adjustments
- supporting schedules for all figures in the accounts are supplied by the agreed dates
- a trial balance together with reconciled control accounts are presented to us by 4th July 2011
- your staff are available to help us locate information and to provide explanations
- all deadlines agreed with us are met.

Our ability to deliver to the agreed timetable and fee will depend upon this. If there are any variances to the above plan, we will discuss them with you and agree any additional fees before costs are incurred, wherever possible.

6.3 Engagement team

Our engagement team for the audit will include:

Name	Role	Contact details
Gary Devlin	Engagement Partner	T: 0131 659 8554 E: gary.devlin@uk.gt.com
Stephen Vallely	Audit Manager	T: 0141 223 0759 E: stephen.vallely@uk.gt.com
Grace Scanlin	Performance Manager	T: 0131 659 8526 E: grace.scanlin@uk.gt.com
Terence Brown Claire Oram Loren Arthur Lucy Naylor	Senior Auditors	E: terence.brown@uk.gt.com E: claire.oram@uk.gt.com E: loren.arthur@uk.gt.com E: lucy.naylor@uk.gt.com
Paul Spinks	Technical Manager	T: 0113 200 2554 E: paulspinks@uk.gt.com
Raul Rodriguez	Assistant Manager IT Audit	T: 0131 659 8534 E: raulrodriguez@uk.gt.com

The core audit team will call on other specialist and support staff, as necessary, during the course of the audit.

If at any time you wish to discuss how our services may be improved or if you are in any way dissatisfied with the audit service you are receiving please contact Sarah Howard, our National Head of Government Audit Services (sarah.howard@uk.gt.com , 0113 200 2530).

7 The small print

Engagement terms

The purpose of this memorandum is to highlight the key elements in the proposed strategy for the audit of Argyll and Bute Council for the year ended 31st March 2011.

The document is also used to report to management in order to meet the mandatory requirements of International Standard on Auditing (UK and Ireland) 260.

Ethical standards

We have implemented policies and procedures to meet the requirements of the Code of Audit Practice and Auditing Practices Board's Ethical Standards.

Roles and responsibilities

In planning our work, we have due regard to the Statement of Responsibilities issued by Audit Scotland, which sets out the respective roles and responsibilities of the council and its auditors.

As Section 95 Officer, the Head of Strategic Finance is responsible for the preparation of the financial statements which show a true and fair view of the council's affairs and for making available to us all the information and explanations we consider necessary.

The Head of Strategic Finance is also responsible for putting proper arrangements in place to ensure that public business is conducted in accordance with the law and proper standards, public money is safeguarded and properly accounted for, and ensuring that economy, efficiency, effectiveness and Best Value are achieved in use of resources.

Communication of adverse or unexpected findings

We will communicate any adverse or unexpected findings affecting the audit on a timely basis with those charged with governance, currently the Council and the Scrutiny Committee.

The actual or potential resolution of significant audit and accounting issues will be discussed and agreed with management and documented for the Scrutiny Committee's consideration.

Audit quality assurance

Grant Thornton's government audit practice is currently monitored by Audit Scotland. We also comply with Grant Thornton's internal quality standards and the firm is inspected by the Audit Inspection Unit, an arm of the Financial Reporting Council which has responsibility for monitoring the firm's public interest audit engagements. The audit practice is also monitored by the Quality Assurance Directorate of the ICAEW. Grant Thornton UK LLP also conducts internal quality reviews of engagements.

We would be happy to discuss further the firm's approach to quality assurance.

Independence and robustness

To maintain our independence as auditors we ensure that:

- Grant Thornton, its partners and the audit

team have no family, financial, employment, investment or business relationship with the Council.

- any non-audit fees do not represent an inappropriate proportion of total fee income for either the firm, office or individual partner.

At all times during the audit, we will maintain a robustly independent position in respect of key judgement areas.

Audit and non-audit services

In accordance with best practice, we analyse our fees below:

2009-10 Audit Fees	£ incl VAT
Grant Thornton UK LLP	208,000
Audit Scotland fixed charge	94,200
	<u>302,200</u>

We have not charged any non-audit fees during the year

Communication with those charged with Governance

Communication with those charged with governance

ISAUK 260 requires communication of:

- relationships that have a bearing on the independence of the audit firm and the integrity and objectivity of the engagement team
- nature and scope of the audit work
- the form of reports expected

is an essential element of the audit. We will discuss with management and the Scrutiny Committee the scope of our work in advance. We propose that we meet with them following the conclusion of our procedures in order to communicate the matters arising.

A Key Outputs and Deadlines

Audit Reports	To be issued to M anagem ent	M anagem ent response	Presented to Audit Com m ittee
Audit Planning			
Audit Approach M em orandum	11th February 2011	18 February 2011	M arch 2011
Financial Statement s			
Report on the IFRS 2009-10 Restated Accounts	29 April 2011	13 M ay 2011	June 2011
Report on 2010-11 financial statement s audit (ISA 260)	22nd August 2011	29th August 2011	Septem ber 2011
Governance			
Interim M anagem ent Report	27th M ay 2011	10th June 2011	June 2011
Overall Audit			
Final Report to M em bers and Accounts Com m ission for Scotland	7th O ctober 2011	28th O ctober 2011	D ecem ber 2011
Other Outputs			
	To be issued		
Perform ance audit			
Response to national studies	August 2011		
Assurance and Im provem ent Plan	1st April 2011		
Im proving Public Sector Purchasing Follow Up Report	30th August 2011		
Grant claim audits			
Non Dom estic Rates Incom e Return	25th February 2011		
Education M aintenance allow ance	31st July 2011		
Crim inal Justice Social W ork grant	30th Septem ber 2011		
H ousing benefit and council tax benefit	30th Novem ber 2011		

B Internal Audit

Introduction

Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible and as part of our planning process, we carry out an annual assessment of the internal audit function.

The Council operates with a small internal audit section which has undergone a period of significant change in recent years. We will review the work of internal audit to determine the extent of reliance we can place on it for the purposes of our audit. This avoids unnecessary duplication of audit work, and minimises any disruption to the Council caused by the audit process.

