



South Lanarkshire Council

2011/2012 External Audit Plan

February 2012



South Lanarkshire Council
Almada Street
Hamilton
ML3 0AA

14 February 2012

Dear Risk and Audit Scrutiny Forum Members

We are delighted to present to you our summary audit strategy, which includes an analysis of our assessment of significant audit risks, our proposed audit strategy, audit and reporting timetable and other matters. Discussion of our strategy with you enables our engagement team members to understand your concerns and agree on mutual needs and expectations to provide the highest level of service quality. Our approach is designed to be responsive to the many changes affecting South Lanarkshire Council.

If you have any questions regarding matters in this document please contact Cameron Revie on 0141 355 4255.

Yours faithfully

PricewaterhouseCoopers LLP

Contents

1. Introduction	5
The Code of Audit Practice	5
Financial Statements	5
Performance Management and Audit	5
2. Audit approach	6
Scope of the audit	6
Internal Audit	7
Significant audit risks	7
Materiality	7
Group Audit Arrangements	8
Communications plan	8
3. Governance and Financial Statements	9
Local Government Scrutiny	9
Audit Scotland National Performance Reports	9
National Fraud Initiative	10
Whole of Government Accounts (WGA)	10
4. Risk of fraud	11
Auditors' responsibility	11
Management's responsibility	11
Responsibility of those charged with governance / the Risk and Audit Scrutiny Forum	11
5. Our team and independence	12
Independence conclusion	12
Appendices	13
<i>Timetable and Communications</i>	14
<i>Significant audit risks</i>	15
<i>Audit fees</i>	17

1. *Introduction*

- 1.01 Our external audit work is undertaken in accordance with Audit Scotland's Code of Audit Practice ("the Code"). Our annual audit plan sets out how we will undertake our external audit work for the year ending 31 March 2012 and how we plan to communicate with management and the Risk and Scrutiny Forum (in its governance role) throughout 2011/12.
- 1.02 This audit plan is an annual document that has been prepared to inform management and the Risk and Scrutiny Forum of South Lanarkshire Council ("the Council") of our responsibilities as your external auditors and how we plan to discharge these responsibilities in accordance with the Code. This plan outlines our audit approach for the financial year 1 April 2011 to 31 March 2012, including the 2011/12 final accounts audit.

The Code of Audit Practice

- 1.03 We are appointed to provide an independent and objective appraisal of the discharge by management of its stewardship responsibilities. In that regard, our principal objective is to perform an audit in accordance with the Code. The code set out those areas for consideration relating to:

Financial Statements

- 1.04 It is the responsibility of the Council's management to prepare the financial statements in compliance with statutory and other relevant requirements. We are responsible for providing a true and fair opinion on the financial statements of the Council and whether those statements have been properly prepared in accordance with relevant legislation, accounting standards and other reporting requirements.

Corporate Governance

- 1.05 It is the responsibility of the Council to establish arrangements for ensuring the proper conduct of its affairs, the legality of activities and transactions and for monitoring the adequacy and effectiveness of these arrangements. We review and report on the Council's corporate governance arrangements, as they relate to:
- The Council's reviews of systems of internal control, including their reporting arrangements;
 - The prevention and detection of fraud and irregularity;
 - Standards of conduct and arrangements for the prevention and detection of corruption; and
 - The financial position of the Council.

Performance Management and Audit

- 1.06 It is the responsibility of the Council to make arrangements to secure Best Value as well as having a duty for community planning. The audit function has a duty under the Local Government (Scotland) Act 1973 to consider arrangements for securing Best Value and in relation to community planning. This area is principally fulfilled by Audit Scotland's directly employed performance function.

2. *Audit approach*

Scope of the audit

- 2.01 Our approach to the audit is based upon a broad understanding of the Council and its business, in particular the Council's arrangements and processes for decision making, accountability, controls and approach to risk. Compliance with International Standards on Auditing (ISAs) is integral to our approach.

PwC Approach

- 2.02 Our audit approach starts with a broad understanding of how the Council, sector and the external environment operate. At a top level we examine your strategic intent, objectives, risks and major activities. We also look at how management - not just in the finance function, but also across all key functional areas - runs the Council and manages risk on a day-to-day basis. This Council-wide view of risk enables us to identify issues that could potentially pose audit risks and endanger the accuracy and integrity of your financial reports.
- 2.03 These areas of audit risk serve as the foundation for planning and guiding all subsequent audit activities. We judge how well your control structure mitigates the risks identified and verify that judgement through testing underlying information and transactions where necessary.

We obtain our audit evidence from the following:

- meetings with senior management to understand the business, the risks and the control processes upon which management rely, building on our previous knowledge and experience
- evaluation of how well management manages the business, with a focus on key operational targets relevant to our audit
- testing of that assessment/gathering evidence
- assessment of the materiality of each financial component, the risks attached, the effectiveness of management's control processes and the relevance to the financial statements
- analytical review and other substantive procedures, as necessary

- 2.04 Our aim is to deliver a rigorous and efficient audit, supported by regular communication and contact between senior members of your team and ours. We do this by:
- Focussing on the significant risks, drawing on our knowledge and experience of the Council and the sector;
 - Where possible, deriving comfort from your controls and systems, both formal and informal, manual and automated. In areas where such controls, in their broadest sense, do not appear to be as effective, and where there is significant financial risk, we drill down until we are satisfied, undertaking extended testing of transactions;
 - On-going communication to avoid last minute surprises and to streamline the year-end reporting process;
 - Making added value recommendations wherever identified from our normal audit testing; and
 - Attending your Risk and Scrutiny Forum meetings to present our reports and discuss our findings.
- 2.05 Our methodology is also undertaken to ensure compliance with the additional requirements of the APB's Practice Note 10 – Audit of the Financial Statements of Public Bodies in the United Kingdom, for example materiality and going concern in the public sector context and audit of the regularity of expenditure.

Internal Audit

- 2.06 We will continue to liaise with Internal Audit in order to minimise duplication of audit effort. We will also consider the work of Internal Audit in line with the International Standard on Auditing (UK and Ireland) 610: The auditor's consideration of the internal audit function.
- 2.07 International Standard on Auditing (UK and Ireland) 610: "The auditor's consideration of the internal audit function" requires us to: This standard requires us to:
- Consider the activities of Internal Audit and its effect, if any, on external audit procedures;
 - Obtain sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach; and
 - Evaluate and test the work of internal audit, where use is made of its work, in order to confirm its adequacy for our purposes.
- 2.08 We will continue to liaise with Internal Audit, using the work of internal audit to inform our planning arrangements and internal risk assessment. Internal Audit has actively sought our input to the 2012/13 Internal Audit plan to ensure their work can also provide assurance for the external audit. We have welcomed this increased communication and coordination of audit work.

Significant audit risks

- 2.09 Set out in **Appendix 2** is our assessment of the more significant audit risks which could potentially impact on our external audit for the financial statements for the year ended 31 March 2012 and our financial statement assurance work.
- 2.10 The audit risks outlined in the appendix have been determined based on our understanding of your organisation and discussions with management.

Materiality

- 2.11 Materiality is an expression of the relative significance or importance of a particular matter in the context of a set of financial statements.
- 2.12 We consider a matter to be material if its omission or misstatement would reasonably influence the users of the financial statements; although it is emphasised that we do not have a duty of care to individuals or all users of the financial statements.

- 2.13 Assessment of what is constituted material is a professional judgement and includes consideration of materiality by nature, by value and by context. Our base calculation for materiality is based on total expenditure in year and our approach is in line with Accounting Standards Guidance. For 2011/12 our planning materiality is £11 million, based on expected annual expenditure.
- 2.14 ISA (UK&I) 450 (revised) requires that we record all misstatements identified except those which are “clearly trivial”. Matters which are clearly trivial are matters which we expect not to have a material effect on the financial statements even if accumulated. When there is any uncertainty about whether one or more items are clearly trivial, the matter is considered not to be clearly trivial. Usual practice is to report misstatements which are greater than 5% of materiality.
- 2.15 However, in practice we record all potential adjustments we identify. On this basis we propose to report all unadjusted differences in excess of £100,000 to the Risk and Audit Scrutiny Forum, this is based on our knowledge of the Council’s financial statements and previous year adjustments.

Group Audit Arrangements

- 2.16 We are the Group Auditor for South Lanarkshire Council. In our role as group auditor, we work with the various subsidiary external audit teams, in particular:
- Agreeing timescales and group auditor reporting arrangements;
 - Sharing significant audit and business risks and building these into the external audit approach where applicable;
 - Confirming materiality calculations for the group;
 - Ensuring that all staff working on the significant subsidiaries are independent of South Lanarkshire Council; and
 - Liaising in respect of agreed audit adjustments and year end unadjusted differences, including the consolidation of the subsidiaries into South Lanarkshire Council’s consolidated accounts.

Communications plan

- 2.17 We will regularly report to the Council at key stages throughout our audit. **Appendix 1** summarises our reporting timetable for the year ended 31 March 2012. We are committed to meeting these deadlines.

3. Governance and Financial Statements

- 3.01 In addition to performing the audit of the financial statements, Audit Scotland requires us to undertake a number of additional areas of work as part of our contract with them. These additional tasks are communicated to us annually through their Planning Guidance document. This section outlines the additional areas of work that we will be undertaking as part of the 2011/12 external audit process.

Local Government Scrutiny

- 3.02 Following the publication of the Crerar report in September 2007, the Scottish Government response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny.
- 3.03 Local Area Networks (LANs) have been created to 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 process.
- 3.04 The LAN representatives for the Council (which includes PwC) have prepared the Council's draft Assurance and Improvement Plan for the period 2011/12. This is now subject to a national quality assurance process prior to finalisation.

Audit Scotland National Performance Reports

- 3.05 Audit Scotland undertakes a series of studies on financial management, governance and performance across the Local Government sector and other public organisations on behalf of the Accounts Commission. For the 2011/12 year we are required to consider the Council's response to those national performance reports which are relevant to the organisation.
- 3.06 Audit Scotland periodically undertakes studies on topics relevant to the performance of local authorities. While the recommendations from some of the studies have a national application, elements of the recommendations are also capable of implementation at Council level. As part of our 2011/12 audit plan we will request evidence of how the Council has responded, at a local level, to *Maintaining Scotland's Roads: a Follow Up Report*, preparing a brief response to Audit Scotland by 31 August 2012.
- 3.07 Audit Scotland requests information on the following areas:
- Completion of a self-assessment by the audited body against the relevant findings in the national report;
 - Evidence of discussion of the reports at any committee meetings;
 - Details of any action plan resulting from the self-assessment; and
 - Monitoring of progress against the action plan by management.
- 3.08 We would also request that management or internal audit follows up on this matter, and other similar Audit Scotland National Reports, prior to our input.
- 3.09 The purpose of this review is to identify whether Audit Scotland needs to do more work to promote its national reports, provide initial information for any more detailed local follow up that may take place and inform Audit Scotland's annual report.

National Fraud Initiative

- 3.10 During the 2011/12 audit we will continue to monitor the Council's participation in NFI, following up on actions taken on matches from the last exercise. Audit Scotland requires auditors to monitor local government organisations' participation in NFI during 2011/12 audits, in terms of:
- Conducting further enquiries and tests to respond to questions issued by Audit Scotland;
 - Monitoring the Council's preparations for NFI 2011/12; and
 - Reference to NFI will be included in the 2011/12 Annual Report to Members and the Controller of Audit, where appropriate.

Whole of Government Accounts (WGA)

- 3.11 The UK Government's aim in respect of WGA is to develop a fully audited set of accounts covering virtually all of the UK public sector. WGA treats Government as if it were a single, consolidated entity by eliminating all significant transactions and amounts owed between public sector bodies and harmonising accounting policies. WGA is intended to present a true and fair view of Government activities.
- 3.12 Work on the Whole of Government Accounts consolidation pack is included in the scope of the accounts audit as detailed in the audit timetable included in Appendix 1.

4. Risk of fraud

- 4.01 International Standards on Auditing (UK & Ireland) state that we as auditors are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

- 4.02 Our objectives are:
- to identify and assess the risks of material misstatement of the financial statements due to fraud;
 - to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
 - to respond appropriately to fraud or suspected fraud identified through our normal audit procedures relating to the financial statements.

Management's responsibility

- 4.03 Management's responsibilities in relation to fraud are:
- to design and implement programmes and controls to prevent, deter and detect fraud;
 - to ensure that the entity's culture and environment promote ethical behaviour; and
 - to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Responsibility of those charged with governance / the Risk and Audit Scrutiny Forum

- 4.04 Your responsibility as part of your governance role is:
- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
 - to investigate any alleged or suspected instances of fraud brought to your attention.

Conditions under which fraud may occur

Management or other employees have an incentive or are under pressure

Incentive / pressure

Why commit fraud?

Opportunity

Circumstances exist that provide opportunity – ineffective or absent control, or management ability to override controls

Rationalisation/attitude

Culture or environment enables management to rationalise committing fraud – attitude or values of those involved, or pressure that enables them to rationalise committing a dishonest act

5. *Our team and independence*

Audit Team	Responsibilities
Engagement Partner Cameron Revie 0141 355 4255 cameron.revie@uk.pwc.com	Engagement Leader responsible for independently delivering the audit in line with the Code of Audit Practice, including agreeing the Audit Plan, ISA (UK&I) 260 report and Annual Audit Letter, the quality of outputs and signing of opinions and conclusions. Also responsible for liaison with the Council Chief Executive and Members of the Council.
Engagement Manger Margaret Kerr 0141 355 4277 margaret.kerr@uk.pwc.com	Engagement Manager on the assignment responsible for overall control of the audit engagement, ensuring delivery to timetable, delivery and management of targeted work and overall review of audit outputs. Completion of the Audit Plan, ISA (UK&I) 260 report and Annual Audit Letter.
Audit In-Charge Alisdair Campbell 0141 355 4274 Alisdair.j.campbell@uk.pwc.com	Team Member on the audit responsible for coordinating resources and managing the team on site.

- 5.01 We will hold periodic client service meetings with you, separately or as part of other meetings, to gather feedback, ensure satisfaction with our service and identify areas for improvement and development year on year. These reviews form a valuable overview of our service and its contribution to the business. We use the results to brief new team members and enhance the team's awareness and understanding of your requirements.

Independence and objectivity

- 5.02 We have made enquiries of any potential PwC teams providing services to you and of those responsible in the UK Firm for compliance matters. There are no matters which we perceive may impact our independence and objectivity of the audit team.

Independence conclusion

- 5.03 At the date of this plan we confirm that in our professional judgement, we are independent accountants with respect to the Council, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit team is not impaired.

Appendices

Timetable and Communications

ISA (UK&I) 260 (revised) 'Communication of audit matters with those charged with governance' requires auditors to plan with those charged with governance the form and timing of communications with them. We have assumed that 'those charged with governance' are the Risk and Audit Scrutiny Forum members. Our team works on the engagement throughout the year to provide you with a timely and responsive service. Below are the dates when we expect to provide the Risk and Audit Scrutiny Forum with the outputs of our audit.

Stage of the audit	Output	Date
Audit planning	Audit Plan	February 2012
Audit findings	Interim Management Letter including internal control issues, recommendations for improvement and follow up of prior year recommendations.	May 2012
	Local responses to national performance audits	August 2012
	Audit fieldwork to assess preparation of the Performance Indicators	August 2012
Audit reports	Financial Statements Audit Opinion	September 2012
	Submission of audited financial statements to Audit Scotland.	September 2012
	Annual Report to Members and the Controller of Audit	October 2012
	<ul style="list-style-type: none"> Any expected modifications to the audit report Uncorrected misstatements, i.e. those misstatements identified as part of the audit that management have chosen not to adjust Material weaknesses in the accounting and internal control systems identified as part of the audit Our views about significant qualitative aspects of your accounting practices including accounting policies, accounting estimates and financial statements disclosures. Any significant difficulties encountered by us during the audit; Any significant matters discussed, or subject to correspondence with, Management; Any other significant matters relevant to the financial reporting process; and Summary of findings from our use of resources audit work to support our value for money conclusion. 	
	Submission of audited Whole of Government return to Audit Scotland	October 2012
	Submission of Annual Report to the Council and Controller of Audit	October 2012

Significant audit risks

Our risk assessment forms the basis for planning and guiding all subsequent audit activities. It allows us to determine where our audit effort should be focused and whether we can place reliance on the effective operation of controls implemented by management.

Planning of our audit

We have considered the Council's operations and have assessed the extent to which we believe there are potential audit risks that need to be addressed by our audit. We have also considered our understanding of how your control procedures mitigate these risks. Based on this assessment we have determined the extent of our financial statements and use of resources audit work.

In this plan we have set out those areas which we consider to be significant risks relevant to our audit responsibilities and our planned response to those risks. Significant risks are those risks requiring special audit attention in accordance with auditing standards.

Our response includes details of where we are intending to rely upon internal controls, inspectors and other review agencies and the work of internal audit, if applicable.

Risk assessment results

Following the risk identification process, risks are subject to the following classification:

- Significant audit risk (as defined by ISA 315) requiring special audit consideration, including evaluation of related controls, testing of their operation in the year should we wish to rely upon them and design of specific audit procedures to respond to the risk with a high level of assurance;
- Elevated audit risk where the nature, likelihood or magnitude of the risk requires us to do a higher level of audit work to address the risk fully; and
- All other risks are deemed to be normal audit risks where we consider a low or moderate level of audit work will address the risk of material misstatement.

Areas of audit risk	Audit approach
Management Override of Controls	● Significant Risk
In any organisation, management may be in a position to override the financial controls established by management. A control breach of this nature may result in a material misstatement of your financial position. For all of our audits, we are required to consider this as a significant risk and adapt our audit procedures accordingly.	<p>We will undertake a review of management's overall fraud arrangements and fraud policies such as whistle blowing policies.</p> <p>We will perform audit testing of journals to ensure their legitimacy, and will incorporate unpredictability into our testing of income and expenditure.</p>
Expenditure Recognition	● Significant Risk
<p>It has been widely reported that the financial outlook in the public sector will become increasingly challenging through 2011/12.</p> <p>As 2011/12 is likely to be a less challenging year financially than those that will follow, there is a risk that expenditure may be recognised in the incorrect year.</p>	<p>During the year, we will hold discussions with management on the processes for monitoring performance against key financial targets.</p> <p>We will review the controls put in place by the Council to control expenditure as part of our work on Accounts Payable.</p> <p>As part of our substantive programme at year end we will include specific testing on cut-off and unrecorded liabilities.</p>
Revenue Recognition	● Significant Risk
There is a rebuttable presumption that there is a risk of material misstatement due to fraud relating to revenue recognition.	We plan our work to gain high levels of assurance over material revenue streams.
Budgetary Control	● Elevated Risk
The Council faces a range of challenges including the identification of saving areas, effective budgetary control and financial management.	We will undertake targeted work to assess the controls over areas which are material to the Council's performance.

Audit fees

Audit Scotland has provided indicative audit fee levels for Local Authorities for the 2011/12 financial year, which depend upon the level of expenditure and potential risk.

We propose a 2011/12 audit fee of £552,788 inclusive of VAT (2010/11: £604,338). The reduction of £51,550 demonstrates our commitment to contribute to the efficiency savings for the Council. This total fee includes the fees payable to PwC, the Audit Scotland fixed charge and VAT.

Our fee is based upon the following assumptions:

- Management will meet the agreed timescales for producing the financial statements and key audit deliverables within the agreed timeframe;
- That we are able to place reliance on the work of Internal Audit;
- Our accounts opinion being unqualified; and
- That we are able to obtain appropriate comfort from management's controls and key processes to reduce our required substantive audit testing at year end.

Should any of the above assumptions change, we will discuss with you the potential implications on our agreed fee and reach agreement on a way forward.

This report has been prepared for and only for South Lanarkshire Council in accordance with the terms of our engagement letter agreed with Audit Scotland and for no other purpose. We do not accept or assume any liability or duty of care for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

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