

# Highland and Islands Fire Board

Annual Audit Plan 2010/11

February 2011



 AUDIT SCOTLAND



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# Summary plan

## Summary of planned audit activity

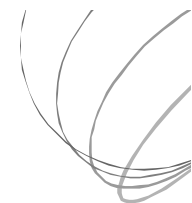
Based on our analysis of the risks facing Highland and Islands Fire Board, our planned work in 2010/11 includes:

- an audit of the financial statements and provision of an opinion on whether:
  - they give a true and fair view of the financial position of Highland and Islands Fire Board as at 31 March 2011 and its income and expenditure for the year then ended
  - the accounts have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the Code of Practice on Local Authority Accounting (the Code) including for the first time on 2010/11 the full application of International Financial Reporting Standards (IFRS)
- provide the annual report on the audit addressed to Highland and Islands Fire Board and the Controller of Audit
- review and assessment of governance and performance arrangements in a number of key areas including: review of adequacy of internal audit, evaluation of key systems of internal financial controls and assessment of the robustness of the system in collecting and reporting performance indicators.
- provision of an opinion on the Whole of Government Accounts
- review of National Fraud Initiative arrangements throughout 2010/11.

## Introduction

1. Our audit is focused on the identification and assessment of the key challenges and risks to the Board in achieving its business objectives. We also assess the risk of material misstatement or irregularity in the Board's financial statements. This report summarises specific governance and other risks that may affect the financial statements of the Board and sets out the audit work that we propose to undertake in 2010/11 to address these. Our annual audit 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
- our responsibilities under the Code of Audit Practice as approved by the Auditor General for Scotland and the Accounts Commission
- issues brought forward from previous audit reports.

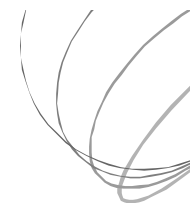


## Our responsibilities

2. Our responsibilities, as independent auditor, are established by the Local Government (Scotland) Act 1973 and the Code of Practice, and guided by the auditing profession's ethical guidance.
3. Audit in the public sector goes beyond simply providing assurance on the financial statements and the organisation's internal control environment. We are also required to provide a view on performance and the organisation's use of resources. In doing this, we aim to support improvement and accountability.
4. In carrying out our audit, we seek to gain assurance that Highland and Islands Fire 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 provides 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 2011 and 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 2010 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
  - proactively manages and reviews its performance in line with its strategic and operational objectives
  - has made proper arrangements for securing best value in its use of resources and is complying with its community planning duties.

## Our approach to the audit of the accounts

5. Our audit approach is based on an understanding of the characteristics, responsibilities and principal activities, risks and governance arrangements of the Board, and identification of the key audit risks and challenges in the local government sector generally. This approach includes:
  - understanding the business of the Board and the risk exposure which could impact on the financial statements
  - assessing the key systems of internal control, and considering how risks in these systems could impact on the financial statements
  - identifying major transaction streams, balances and areas of estimation, understanding how the Board will include these in the financial statements and developing procedures to audit these



- assessing the risk of material misstatement in the financial statements, in conjunction with our evaluation of inherent risk, the control environment and control risk as part of our risk assessment
  - determining the nature, timing and extent of our testing programme to provide us with sufficient appropriate audit evidence as to whether the financial statements are free of material misstatement.
6. Through this approach we have also considered and documented the sources of assurance which will make best use of our resources and allow us to focus testing on higher risk areas during the audit of the financial statements. The main areas of assurance for the audit come from planned management action and reliance on systems of internal control. Management action being relied on for 2010/11 includes:
- comprehensive closedown procedures for the financial statements accompanied by a timetable issued to all relevant staff
  - clear responsibilities for provision of accounts and working papers being agreed
  - delivery of unaudited accounts to agreed timescales
  - a comprehensive working papers package and supporting records to demonstrate full compliance with the requirements of IFRS
  - completion of the internal audit programme for 2010/11.
7. 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 early assessment of the internal audit function. Internal audit is provided by the audit team within The Highland Council. Based on our review of internal audit we plan to place formal reliance on the areas of work set out in Appendix D.
8. Our approach to the audit of the financial statements is based on an integrated assessment of risk across the Code of Audit Practice responsibilities in relation to governance, performance and opinion.
9. At the completion of the audit we will provide Members and the Controller of Audit with an annual report on the audit containing observations and recommendations on significant matters which have arisen in the course of the audit.

## **Responsibility for the preparation of accounts**

10. It is the responsibility of Highland and Islands Fire Board and the Treasurer as Accountable Officer to prepare the financial statements in accordance with the Code. This means:
- acting within the law and ensuring the regularity of transactions by putting in place systems of internal control to ensure that financial transactions are in accordance with the appropriate authority
  - maintaining proper accounting records



- preparing financial statements timeously which give a true and fair view of the financial position of Highland and Islands Fire Board as at 31 March 2011 and its expenditure and income for the year then ended
- preparing an explanatory foreword.

## Format of the accounts

11. The financial statements should be prepared in accordance with the Code which constitutes proper accounting practice for the purposes of section 12 of the Local Government Scotland Act 2003. The Board prepares a Whole of Government Accounts consolidation pack annually for the Scottish Government and is required to prepare its accounts using common accounting principles and standard formats for summarisation.

## Audit issues and risks

12. This annual audit plan focuses on governance and other risks specific to the financial statements of Highland and Islands Fire Board. Based on our discussions with staff, attendance at the Best Value and Audit Working Group meetings and a review of supporting information, we have identified the following main risk areas for your organisation.
13. **Budget savings and financial pressures:** Local government faces substantial real-term reductions in financing over the next three years and beyond. The need to address the challenging funding gaps for 2011/12 and beyond will place considerable pressure on the Board's ability to provide services and may deplete the reserve balance which is necessary to fund future unforeseen costs. Strong financial management and governance arrangements are increasingly important including effective budgetary control systems and internal audit functions.
14. **Risk management:** The Board's risk strategy states that "The Board will oversee the Service's risk management policies and strategies and consider reports annually from the Chief Fire Officer on risk management plans for the Service. Members have a responsibility to understand the strategic risks that the Service faces, and will be made aware of how these risks are being managed through the annual strategic and service planning process." Whilst we recognise that the Board has received regular updates in regard to the improvement plan, Integrated Risk Management Plan, and financial plans we have not seen a summarised risk management plan nor a summary of strategic risks going up to the Board. Members have included risk management in their training needs analysis and we will continue to monitor progress in the Board's development of its risk management framework.
15. **New pension account:** The Firefighters' Pension Scheme Amendment (Scotland) (No. 2) Order 2010 and The Firefighters' Pension Scheme (Scotland) Order 2007 Amendment (No. 2) Order 2010 provide for the establishment of a firefighters pension account for the old and new scheme respectively from 2010/11. Authorities are required to set up and maintain a new pension account into which defined



income will be made and out of which pensions in payment will be made. Income comprises employee contributions and a new actuarially-based employer's contribution calculated as a percentage of pensionable pay. Any shortfall between the pension account income and expenditure will be met by top up payments from the Scottish Government and any surpluses will be taken into account as part of future pension funding. It is important that the operation of and accounting for the new pension account comply with regulation and that supporting analyses and evidence are maintained.

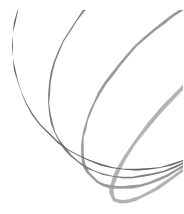
16. **Accounts presentation and disclosure:** 2011 is the first year that the local authority accounting code is based on international financial reporting standards (IFRS). The move to an IFRS based Code from a UK GAAP based SORP has resulted in a number of significant changes in accounting practice. The key changes include :
- 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
  - new disclosure requirements for accounting standards not yet adopted , key assumptions and judgements, changes in respect of prior period adjustments, and operating segments.
17. It is essential that the Board ensures that their financial statements work programme and templates have been updated to reflect all the relevant changes in presentation and disclosure in the 2010/11 financial statements, in particular those related to the application of IFRS.

## Summary assurance plan

18. Within these identified risk areas there is a range of more specific risks and these are summarised at Appendix A. In most cases, actions to manage these risks are either planned or already underway within the organisation. Details of the sources of assurance that we have received for each of these risks and any audit work we plan to undertake is also set out in the appendix. In the period prior to the submission of the unaudited financial statements, we will liaise with senior officers on any new or emerging issues.

## Materiality

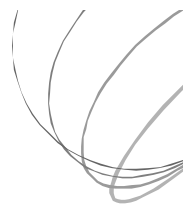
19. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.



20. International Standard on Auditing 320 states that, *“Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements; judgments about materiality are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both; and judgments about matters that are material to users of the financial statements are based on a consideration of the common financial information needs of users as a group. The possible effect of misstatements on specific individual users, whose needs may vary widely, is not considered.”*
21. When considering, in the context of a possible qualification to the audit opinion, whether the misstatement of an item, or a number of items taken together, is material in terms of its monetary value, we use professional judgement, experience and internal guidelines from peers as broad guidance in regard to considering whether the results of tests of detail are material.
22. An item may be judged material for reasons other than its monetary or quantitative value. An inaccuracy, which would not normally be regarded as material by amount, may be important for other reasons. When such an item affects a critical point in the accounts, its materiality has to be viewed in a narrower context (for example the failure to achieve a statutory requirement, an item contrary to law, or areas affected by central government control). Again we use professional judgement, experience and internal guidelines from peers to determine when such matters would fall to be covered in an explanatory paragraph, rather than as a qualification to the audit opinion.

## Reporting arrangements

23. 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. 30 June. The non-statutory target for audit completion is 30 September. To achieve this target, it is critical that a timetable for the audit of the accounts is agreed with us. An agreed timetable is included at Appendix B of this plan, which takes account of submission requirements, planned audit committee dates and audit resources.
24. Matters arising from our audit will be reported on a timely basis and will include agreed action plans. Draft management reports will be issued to the Chief Fire Officer and the Treasurer to confirm factual accuracy. Responses to draft reports are expected within three weeks of submission.
25. A copy of all final agreed reports will be sent to the Chief Fire Officer and the Treasurer and Audit Scotland's Performance Audit Group.
26. We will provide an independent auditor's report to Highland and Islands Fire Board and the Accounts Commission for Scotland 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 and overall conclusions about the Board's management of key risks.

27. All annual reports produced by Audit Scotland are published on our website, ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

28. The full range of outputs to be delivered by the audit team are summarised below:

Planned outputs	Target delivery date
Annual audit plan	28 February 2011
Report to the Best Value and Audit Working Group in terms of ISA 260 (Communication of audit matters to those charged with governance)	16 September 2011 (TBC)
Independent auditor's report on the financial statements	30 September 2011
Audit opinion on Whole of Government Accounts	30 September 2011
Annual report to the Members and the Controller of Audit	31 October 2011

## Quality control

29. We are committed to ensuring that our audit reflects best practice and demonstrates best value to Highland and Islands Fire Board and the Accounts Commission. We operate a strong quality control framework that seeks to ensure that your organisation receives a high quality service. The framework is embedded in our organisational structures and processes and includes an engagement lead for every client; in your case this is, Pearl Tate, who is responsible for ensuring that our work is carried out on time and to a high quality standard.

30. As part of our commitment to quality and continuous improvement, we may periodically seek your views. We would be grateful for any feedback on our services.

## Fees and resources

31. Our agreed fee for the 2010/11 audit Highland and Islands Fire Board is £16,630. Our fee covers:

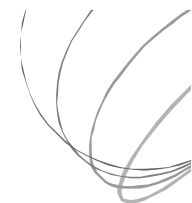
- all of the work and outputs described in this plan
- a contribution towards the costs of national performance studies and statutory reports by the Controller of Audit and the work of the Accounts Commission
- attendance at the Best Value and Audit Working Group and key Board meetings
- access to advice and information on relevant audit issues
- access to workshops/seminars on topical issues
- travel and subsistence costs.



32. In determining the agreed fee we have taken account of the risk exposure of Highland and Islands Fire Board, the management assurances in place, and the level of reliance we plan to take from the work of internal audit. We have assumed receipt of the draft accounts and working papers by 17 June 2011.
33. We reserve the right to charge an additional fee for further audit work in instances such as late receipt of the draft financial statements, the lack of agreed management assurances or being unable to take planned reliance from the work of internal audit. The impact of IFRS has been absorbed into the fee, however, an additional fee may be required where our audit cannot proceed as planned due to the Board's inadequate processes and working papers relating to the application of the international financial reporting standards.
34. An additional fee will be required in relation to any work or other significant exercises not within our planned audit activity.
35. Fiona Kordiak, Director, Audit Services is the appointed auditor for all local authorities audited by Audit Scotland. In practice, this operates by delegating management and certification responsibilities to Assistant Directors or Senior Audit Managers. For Highland and Islands Fire Board the Senior Audit Manager is Pearl Tate.
36. The local audit team will be led by Arlene Deeming who will be responsible for the day to day management of the audit and who will be your primary contact. Details of the experience/skills of our team are provided at Appendix C. The core audit team will call on other specialist and support staff, as necessary.

## Independence and objectivity

37. Auditing and ethical standards require the appointed auditor to communicate any relationships that may affect the independence and objectivity of audit staff. We are not aware of any such relationships within the audit team.
38. We comply with ethical standards issued by the Auditing Practices Board and with Audit Scotland's requirements in respect of independence and objectivity, as summarised at Appendix E.



# Appendix A - Summary assurance plan

In this section we identify a range of governance and other risks that may affect the financial statements of Highland and Islands Fire Board, the related source of assurance received and the audit work we propose to undertake to secure additional assurance. The management of risk is the responsibility of the Board and its officers, with the auditor's role being to review the arrangements put in place by management. Planned audit work, therefore, will not necessarily address all residual risks.

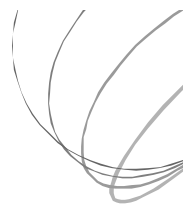
Risk	Source of assurance	Planned audit action
<p><b>Budget savings and financial pressures</b></p> <p>Local government faces substantial real-term reductions in financing over the next three years and beyond. The need to address the challenging funding gaps for 2011/12 and beyond will place considerable pressure on the Board's ability to provide services and may deplete the reserve balance which is necessary to fund future unforeseen costs</p> <p><b><i>Risk: The Board is unable to provide services and may deplete its reserve balance which is necessary to fund future unforeseen costs.</i></b></p>	<p>The Service has met with the Chief Executive Officers of each of the constituent authorities and has identified efficiency savings to cushion the impact of the recession. In addition, the Service is working with CFOA(S) on a three year strategy to address the financial challenges facing the eight Scottish Fire &amp; Rescue Services.</p>	<p>Monitor progress and include in Annual Report to Members and the Controller of Audit as appropriate.</p>
<p><b>Capital plan</b></p> <p>The Board already faced significant challenges in addressing its capital needs and capital funding is also anticipated to see significant cuts in each of the next three years.</p> <p><b><i>Risk: The Board is unable to deliver its capital plan and this could impact on health and safety requirements.</i></b></p>	<p>The Service will take to the April BVAWG meeting how it intends to address its capital challenges.</p>	<p>Monitor progress and include in Annual Report to Members and the Controller of Audit as appropriate.</p>



Risk	Source of assurance	Planned audit action
<p><b>Asset management plan</b></p> <p>The Board does not currently have an asset management plan in place. The Service Plan for 2010-13 had highlighted the need to develop asset management and replacement plans to cover major resources including buildings, vehicle fleet and IT systems.</p> <p><b>Risk: Capital requirements are not affordable and sustainable.</b></p>	<p>The Service will take to the April BVAWG meeting how it intends to address its capital challenges.</p>	<p>Monitor progress and include in Annual Report to Members and the Controller of Audit as appropriate.</p>
<p><b>Shared services</b></p> <p>As part of the National Strategy Programme, the Board is looking for opportunities to share services with the wider Fire Service and with other bodies to achieve efficiencies.</p> <p><b>Risk: The Service is unable to maximise efficiencies to be gained in sharing services with other bodies.</b></p>	<p>The future structure of the Scottish Fire Services is currently being reviewed at a national level.</p>	<p>Monitor progress in this area as part of our 2010/11 audit.</p>
<p><b>Risk management</b></p> <p>The Board's risk management strategy 2006 requires the Board to oversee the Service's risk management policies and strategies and consider reports annually from the Chief Fire Officer on risk management plans for the Service. There is currently no formal annual reporting of risks to the Board. In addition members have identified risk management as a training need.</p> <p><b>Risk: The Board is unaware of the strategic risks facing the Service.</b></p>	<p>Action to address the corporate risks has been included in the Services improvement plan.</p> <p>Progress against the improvement plan is reported to the Board on a quarterly basis.</p>	<p>Monitor progress in this area.</p>

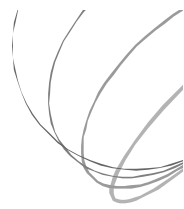


Risk	Source of assurance	Planned audit action
<p><b>New pension account</b></p> <p>The Board is required to set up and maintain a new pension account into which defined income and out of which pensions in payment will be made.</p> <p><b>Risk: The operation of and accounting for the new pension account do not comply with regulation and supporting evidence is not maintained.</b></p>	<p>The service established a separate pension account and this is monitored on a monthly basis.</p> <p>Payments in to the pension account include Income from employee contributions and a new actuarially-based employer's contribution calculated as a percentage of pensionable pay.</p> <p>Details of the balance on the pension account will be sent to the Scottish Government at the end of the financial year.</p>	<p>The pension fund account will be tested as part of our financial statements audit.</p>
<p><b>IFRS</b></p> <p>Local Authorities are required to prepare accounts under an IFRS basis with effect from 2010/11. Shadow IFRS accounts are also required for 2009/10.</p> <p><b>Risk: The staff involved in the process are not adequately trained and the Board is unable to produce IFRS compliant accounts.</b></p>	<p>Shadow accounts will be available by mid/end March 2011.</p>	<p>Undertake an early audit of the shadow accounts and report any issues that would need to be resolved prior to the preparation of the year-end financial statements.</p>



# Appendix B - Financial statements audit timetable

Key stage	Date
Testing and review of internal control systems and transactions	Jan – Mar 2011
Provision of closedown procedures to audit	15 Mar 2011
Meetings with officers to clarify expectations of detailed working papers and financial system reports	31 Mar 2011
Latest submission of unaudited financial statements with working papers package	17 June 2011
Progress meetings with lead officers on emerging issues	As required during audit process
Latest date for final clearance meeting with the Treasurer	07 September 2011
Report to the Audit & Best Value Working Group on the audit of financial statements (ISA 260)	16 September 2011 (TBC)
Latest date for submission of unaudited whole of government accounts return to external audit	21 September 2011
Independent Auditors Report signed	30 September 2011
Latest date for signing of WGA return	30 September 2011
Latest date for submission of Annual Report to Members and the Controller of Audit	31 October 2011
Annual report and certified accounts presented to the audit committee	November 2011



# Appendix C - Audit team

A summarised curriculum vitae for each core team member is set out below:

***Pearl Tate BAcc (Hons) CPFA***  
***Senior Audit Manager***

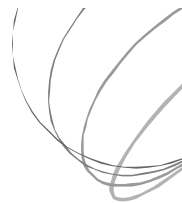
Pearl began her career as a finance trainee in the health sector and was then an internal auditor in health before joining Audit Scotland in 1996. As an external auditor she has covered a wide and varied portfolio of audits across the whole public sector and has specialised in local government audit for the last six years.

***Arlene Deeming CPA***  
***Senior Auditor***

Arlene joined Audit Scotland in 2003 and has been involved with both local government and health audit. Previous to this, she had occupied senior finance posts in private companies for more than 10 years. She also has 5 years experience as an auditor in a Firm carrying out audits of the private sector.

***Nick Smith MA (hons), MSc***  
***Professional Trainee***

Nick joined Audit Scotland as a professional trainee in August 2009.



# Appendix D - Reliance on internal audit

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 early assessment of the internal audit function. Our review of the internal audit service concluded that it operates in accordance with the CIPFA code of practice for internal audit in local government. We therefore plan to place reliance on the work of internal audit in the following areas:

- Accounts payable
- Payroll



# Appendix E - Independence and Objectivity

Auditors appointed by the Auditor General for Scotland are required to comply with the Code of Audit Practice and standing guidance for auditors, which defines the terms of appointment. When auditing the financial statements auditors are also required to comply with the auditing and ethical standards issued by the Auditing Practices Board (APB). The main requirements of the Code of Audit Practice, standing guidance for auditors and the standards are summarised below.

International Standards on Auditing (UK and Ireland) 260 (Communication with those charged with governance) requires that the appointed auditor communicates:

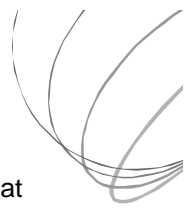
- A statement that the engagement team and others in the firm as appropriate, the firm and, when applicable, network firms have complied with the APB's Ethical Standards for auditors;
- All relationships and other matters between the firm, network firms, and the entity that, in the auditor's professional judgment, may reasonably be thought to bear on independence. This shall include total fees charged during the period covered by the financial statements for audit and non-audit services provided by the firm and network firms to the entity and components controlled by the entity. These fees shall be allocated to categories that are appropriate to assist those charged with governance in assessing the effect of services on the independence of the auditor; and
- The related safeguards that have been applied to eliminate identified threats to independence or reduce them to an acceptable level.

The standard defines 'those charged with governance' as "the person(s) or organization(s) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process." In your case, the appropriate addressee of communications from the auditor to those charged with governance is the Best Value and Audit Working Group. The auditor reserves the right to communicate directly with members on matters which are considered to be of sufficient importance.

Audit Scotland's Code of Audit Practice requires appointed auditors to carry out their work independently and objectively, and ensure they do not act in any way that might give rise to, or could reasonably be perceived to give rise to, a conflict of interest. Appointed auditors and their staff should avoid entering in to any official, professional or personal relationships which may impair their independence, or might lead to a reasonable perception that their independence could be impaired.

The standing guidance for auditors includes a number of specific requirements. The key requirements relevant to this audit appointment are as follows:

- during the currency of an appointment, auditors should not perform non-audit work for an audited body, consultancy or otherwise, without the prior approval of Audit Scotland



- the appointed auditor and key staff should, in all but exceptional circumstances, be changed at least once every five years in line with Audit Scotland's rotation policy
- the appointed auditor and audit team are required to carry out their duties in a politically neutral way, and should not engage in high profile public party political activity
- the appointed auditor and audit team must abide by Audit Scotland's policy on gifts and hospitality, as set out in the Audit Scotland Staff Code of Conduct.