

INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

East of Scotland European Consortium

Annual audit report for 2004-05 and 2005-06 to the Consortium
Members and the Controller of Audit

20 November 2006

AUDIT

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This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ('the Code') and *Statement of Responsibilities of Auditors and Audited Bodies*.

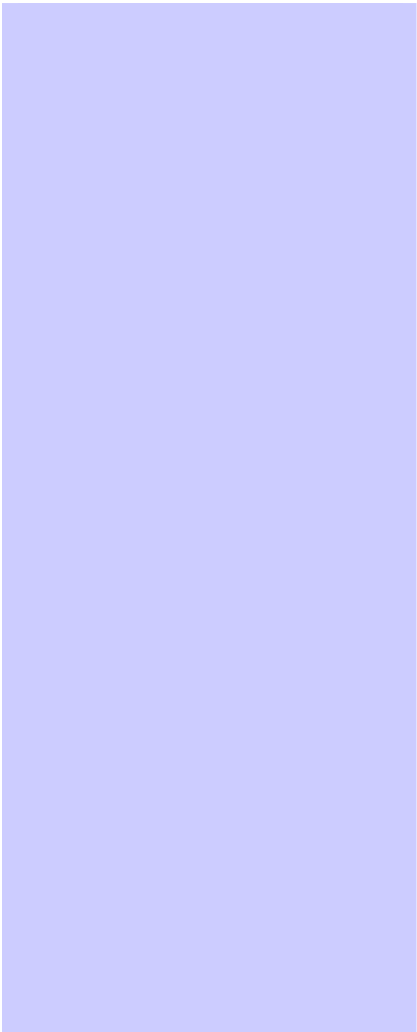
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Introduction

Background

Having identified that the status of the East of Scotland European Consortium ("ESEC") was such that it fell within the ambit of the Accounts Commission for Scotland, KPMG LLP was appointed as ESEC's auditors in 2004. Because of the need to secure support for the preparation of financial statements for audit, financial statements for the year ended 31 March 2005 were not prepared and submitted for audit on a timeous basis. It was subsequently agreed that the financial statements for both 2004-05 and 2005-06 should be audited concurrently within the context of the 2006 reporting timescales.

This report summarises our opinion and conclusions and highlights significant issues arising from our work.

The scope of the audit was to:

- provide an opinion on whether the financial statements present fairly the financial position of ESEC in accordance with standards and guidance issued by the Auditing Practices Board; and
- review and report on corporate governance arrangements.

No performance audit studies were identified by Audit Scotland for ESEC during 2004-05 or 2005-06.

Basis of information

External auditors do not act as a substitute for ESEC's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

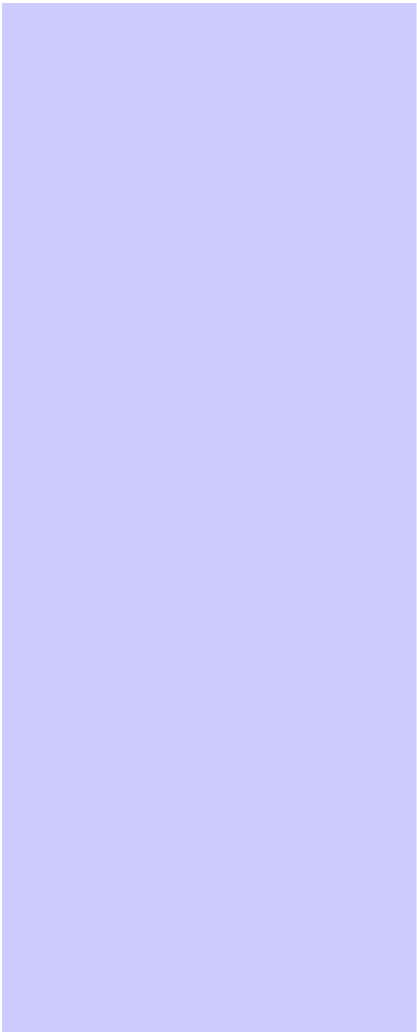
To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with management and staff of ESEC. Except to the extent necessary for the purposes of the audit, this

information has not been independently verified. The contents of this report should not be taken as reflecting the views of KPMG LLP except where explicitly stated as being so.

Acknowledgement

Our audit has brought us in contact with a number of ESEC staff, together with those of Clackmannanshire Council. We wish to place on record our appreciation of the continued co-operation and assistance extended to us by staff in the discharge of our responsibilities.

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Corporate governance

Introduction

The membership of ESEC is comprised of 14 member authorities with one member acting as chair. Meetings are held four times per year. In 2005-06 ESEC made arrangements for Clackmannanshire Council ("the Council") to chair. During 2005-06 ESEC made arrangements for the Council to prepare the 2004-05 and the 2005-06 financial statements.

Staff of ESEC is employed by the Council and currently has 1.5 full-time employees. ESEC maintain its own records and accounting services are provided by the Council. A separate bank account is not maintained for ESEC, instead the bank transactions flow through the Council's bank accounts.

Systems and controls

For the years ending 31 March 2005 and 2006 we reviewed the design and operating effectiveness of high level controls to assess if they were operating effectively to prevent or detect a material misstatement of the financial statements or had implications for ESEC's governance framework.

Our audit testing confirmed that controls were operating as intended.

It is noted that a separate bank account is not maintained for ESEC due to operational reasons. Cash balances are held within the bank accounts of Clackmannanshire Council. The Council does maintain separate general ledger codes to track transactions specific to ESEC. A separate bank account would ensure that the cash balance at the year end accurately reflected the activities of ESEC and that interest earned from ESEC funds is appropriately allocated to ESEC.

Internal audit

ESEC has no arrangements in place for an internal audit function.

Statement on internal control

As part of the development of corporate governance, public sector bodies are required to make a statement of how they have applied the principles of corporate governance. We are required to review this to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process.

We are not required to provide an opinion on the ESEC's systems of internal control. The statement provides details of the processes and controls highlighted by management that were in place during 2004-05 and 2005-06, including:

- regular reviews of periodic financial reports; and
- preparation of regular financial reports which indicate actual expenditure against targets.

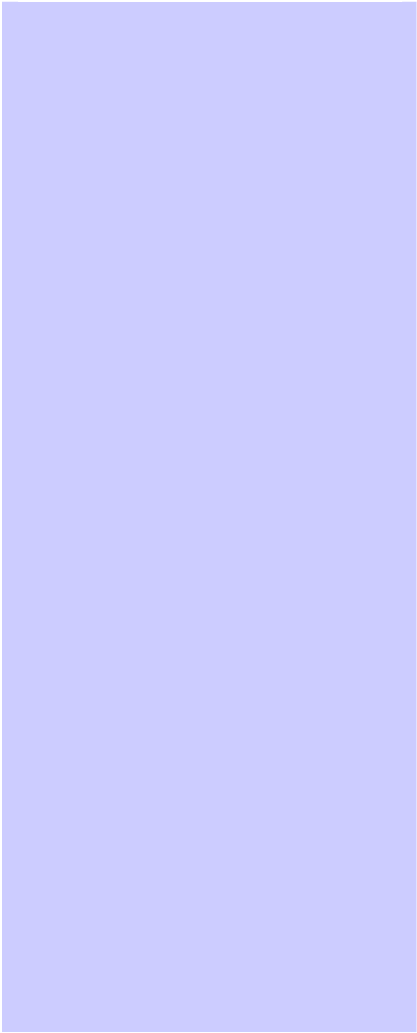
The statement of internal control identified some areas where the effectiveness of internal controls could be enhanced, including:

- detailed budgeting systems;
- setting targets to measure financial and other performance; and
- appointment of internal audit function of the relevant host authority to further review the adequacies of systems of internal financial control.

Fraud and irregularity and standards of conduct

As part of the audit we completed a review of the high level arrangements in respect of the prevention and detection of fraud and irregularity. We had regard to Statement of Auditing Standards 110: *Fraud and Error* and International Standards on Auditing 240: *The Auditor's Responsibility to Consider Fraud in the Audit of Financial Statements* when completing our work in this area. No key weaknesses were identified related to fraud and irregularity and standards of conduct.

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Audit opinions

Year ended 31 March 2005

On 29 September 2006 we issued an audit certificate expressing an unqualified opinion on the financial statements for the year ended 31 March 2005.

ESEC is reporting income from subscription fees and ERDF project income of £113,000 for 2004-05. Expenses of £70,400 (primarily staff costs) were incurred, resulting in a net surplus of £42,800. The overall reserves position as at 31 March 2005 was an accumulated surplus of £59,400.

Year ended 31 March 2006

On 29 September 2006 we issued an audit certificate expressing an unqualified opinion on the financial statements for the year ended 31 March 2006.

During 2005-06 ESEC generated income from subscription fees and ERDF project income of £114,000 and incurred expenses of £147,400, primarily related to subscriptions and payments to subcontractors. This resulted in a deficit of £33,600 for the year reducing the accumulated balance on reserves to £25,800 as at 31 March 2006.

Financial adjustments and confirmations

In Figure 1a and 1b we draw attention to adjustments to the financial statements for 2004-05 and 2005-06 made by management during the course of the audit.

Figure 1a: financial statement adjustments (2004-05)

	Income and expenditure account £'000	Balance sheet £'000
Expense (2004-05)	4,133	
Accruals (2004-05)		4,133
Net adjustment	4,133	4,133

Figure 1b: financial statement adjustments (2005-06)

	Income and expenditure account £'000	Balance sheet £'000
Expense (2005-06)	6,175	
Accruals (2005-06)		6,175
Net adjustment	6,175	6,175

Confirmations and representations

We confirm that as of 29 September 2006, in our professional judgement, KPMG LLP was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff is not impaired. This has been confirmed separately in writing to the audit committee.

In accordance with auditing standards, we obtained representations from the board members on material issues prior to signing our opinion. Management have adjusted all audit differences.