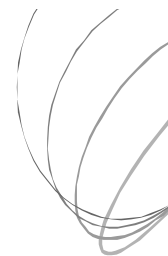


Highland and Western Isles Valuation Joint Board

Report to Members on the 2005/06 Audit

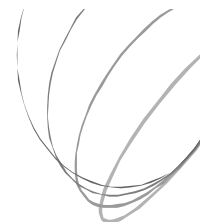
October 2006





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Key Messages

In 2005/06 we have audited the financial statements and looked at aspects of governance within Highland and Western Isles Valuation Joint Board. This report sets out our main findings.

Overall, we found the financial stewardship of Highland and Western Isles Valuation Joint Board during the year to be satisfactory. The main conclusions and outcomes from the audit are highlighted below:

- An unqualified audit opinion has been issued on the financial statements for 2005/06
- The Statement on the System of Internal Financial Control included in the accounts complies with accounting requirements and is not inconsistent with audit findings
- Final accounts preparation procedures and working papers were good and this enabled the audit to progress smoothly
- The Board has a sound corporate governance framework in place
- A strategy for the prevention and detection of fraud and corruption is in place, supported by written procedures for the investigation of suspected cases of fraud and corruption

The Board's internal auditors undertook a high level review of the Board's systems of internal financial control and concluded that, based on the audit work carried out during the year, *'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'*.

The Board operates the corporate financial systems of the Highland Council. As external auditor of the Council, we have also been able to take assurance from our work on these systems.

Key issues for the Board in the future include the increasing cost of pension contributions and financial reporting changes introduced by the 2006 SORP.

This is the final year of our current appointment to the audit of the Board. From 2006/07, however, Audit Scotland will remain as the Board's appointed auditor and Bob Clark will be the engagement lead. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Board over the five years of our audit appointment.

**Audit Scotland
October 2006**

Introduction

1. The members and officers of the Board are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
 - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed;
 - the Board's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests;
 - the Board has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability;
 - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption;
 - the Board has proper arrangements for securing best value in its use of resources.
2. This report summarises the most significant issues arising from our work during 2005/06.

Financial statements & financial position

3. In this section we summarise key outcomes from our audit of the Board's financial statements for 2005/06, aspects of the Board's reported financial position and performance to 31 March 2006, and provide an outlook on future financial prospects and financial reporting issues.

Auditor's report

4. We have given an unqualified opinion on the financial statements of Highland and Western Isles Valuation Joint Board for 2005/06, concluding that:
 - the financial statements present fairly the Board's financial position at 31 March 2006 and income and expenditure during the year;
 - the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973.
5. The Board's balance sheet has an excess of liabilities over assets of £2.5 million due to the accrual of pension liabilities in accordance with accounting standards. Auditing standards require auditors to consider an organisation's ability to continue as a going concern when forming an opinion on financial statements. One of the indications that may give rise to going concern considerations is an excess of liabilities over assets.
6. The Board has considered it appropriate to adopt a going concern basis for the preparation of the financial statements as future actuarial valuations of the pension fund will consider the appropriate employer's contribution rate to meet the fund's commitments. The constituent authorities of the Board are also liable to fund the Board's liabilities as they fall due. We are satisfied that the process the Board has undertaken to consider going concern is reasonable.

Financial position

7. The Board's net expenditure amounted to £2.231 million in 2005/06, representing an underspend of £144,000 against budget which has been returned to constituent authorities. The Treasurer's report on pages 2 to 4 of the Statement of Accounts includes a summary of the main factors underlying the financial out-turn.

Issues arising

8. The Board's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation procedures and working papers were good and this enabled the audit to progress smoothly.
9. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the Board and for publication. The financial statements are an essential means by which the Board accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.
10. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom —A Statement of Recommended Practice (the 'SORP'). There were no adjustments made to the figures in the unaudited accounts made available for public inspection.

Matters from previous years

11. In my Report on the 2004/05 Audit, I recommended that procedures should be put in place to:
 - ensure that payroll accruals are included within the financial statements in future years;
 - enable members to regularly monitor progress made in implementing the recommendations included within External Audit reports.
12. Both these recommendations were implemented during 2005/06.

Legality

13. Each year we request written confirmation from the Treasurer that the Board's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Treasurer has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of members and officials of Highland and Western Isles Valuation Joint Board, the financial transactions of the Board were in accordance with the relevant legislation and regulations governing its activities.
14. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Statement on the system of internal financial control

15. The 2005/06 financial statements include a Statement on the System of Internal Financial Control which highlights the Treasurer's view that reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal financial control system. Only one area, the preparation of consolidated procedural notes for the valuation systems, has been highlighted as requiring improvement.
16. The Board operates the corporate financial systems of the Highland Council. The Board's internal auditor (the Highland Council's Head of Internal Audit & Risk Management) has relied on his audits of these corporate financial systems in preparing his Annual Report to support the Treasurer in signing the Statement.
17. The Statement complies with accounting requirements and is not inconsistent with the findings of our audit.

Future outlook

Pension liabilities

18. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. In addition there are proposals to amend the Local Government Pension Scheme which are designed to reduce the ongoing cost, although these have not yet been implemented. In accounting for pensions, Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised in the annual accounts.
19. The Board participates in the Local Government Superannuation Scheme (Highland Council Pension Fund), a defined benefits scheme administered by the Highland Council. Note 3 to the Balance Sheet highlights that the Board's net liabilities at 31 March 2006 total £2.5 million, an increase of £0.4 million from the previous year. Although the Board's estimated pension liabilities increased by £1.7 million in the year this was offset by its pension fund assets increasing by £1.3 million as a result of improved stock market conditions.

20. The full triennial actuarial valuation of the Highland Council Pension Fund was reported in early 2006. Factors such as the volatile stock market and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 105% as at March 2002 to 92% as at March 2005. The actuary is required to make a 3-year assessment of the contributions that should be paid by the employing authorities as from April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. The current 3-year assessment shows that budgeted contributions are expected to rise from 270% of employee contributions to 290% by 2008/09.

Financial reporting

21. A number of changes have been made to the 2006 SORP, including:

- replacement of the consolidated revenue account with a traditional income and expenditure account;
- a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit;
- replacement of the statement of total movement in reserves with a statement of total recognised gains and losses.

22. These changes will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Board should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity is fully transparent.

Action point 1

Governance



23. In this section we comment on key aspects of the Board's governance arrangements during 2005/06.

Overview

24. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. The Board has a sound corporate governance framework in place.

25. Internal audit plays a key role in the Board's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. The Highland Council's Internal Audit section provided an internal audit service to the Board during 2005/06. We carry out an annual review of the Board's internal audit arrangements and, in 2005/06, concluded that these were sufficient to enable us to place reliance on the work of internal audit.

Anti-fraud and corruption arrangements

26. The Board has appropriate arrangements in place to prevent and detect fraud and corruption. These arrangements include the code of conduct for elected members and staff, a policy for the prevention and detection of fraud and corruption, written procedures for the investigation of suspected cases of fraud and corruption and a whistle blowing policy.

Systems of internal control

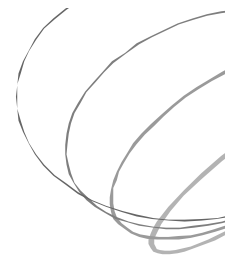
27. Internal Audit undertook a high level review of the Board's systems of internal financial control and concluded that, based on the audit work carried out during the year, *'reasonable assurance can be placed upon the adequacy and effectiveness of the Board's internal control system in the year to 31 March 2006'*.

28. We reviewed the following internal audit reports submitted to the Board and were pleased to note that:

- *Budgetary Control* concluded that control is stringent due to the small size of the organisation;

- *Data Protection* concluded that good procedures are in place in order to ensure that the registration with the Information Commissioner's Office is renewed on time and that data received from the Register of Electors is handled in accordance with the eight principles of the Data Protection Act 1998.

29. The Board operates the corporate financial systems of the Highland Council. As external auditor of the Council, we have also been able to take assurance from our work on these systems.



Risk summary and action plan

No.	Issue & risk	Responsible officer	Response & agreed action	Action date
1.	<p>Financial reporting</p> <p>Changes have been made to the 2006 SORP which will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Board should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity is fully transparent.</p> <p><i>Risk: in the event of insufficient preparation, the 2006/07 financial statements may not comply with accounting requirements. Differences between financial reporting requirements and budget monitoring during the year may result in a lack of transparency for members and the public.</i></p>	Treasurer	Procedures are in place to review the SORP and to ensure that the 2006/07 financial statements will comply with accounting requirements. A reconciliation will be provided at the year end to provide a transparent link between the monitoring information provided during the year and the financial statements.	30 June 2007