Report on the 2011-12 Annual Accounts Audit

Inverclyde Council

For the year ended 31 March 2012

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To the Audit Committee of Inverclyde Council, the Controller of Audit, and the Accounts Commission for Scotland

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The purpose of this memorandum is to highlight the key issues affecting the results of the Council and the preparation of the Council's group financial statements for the year ended 31 March 2012. It is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260. Our annual audit report, due in October 2012 will summarise the results of our audit work for the year against the Code of Audit Practice.

We take responsibility for this memorandum, which has been prepared on the basis of the limitations set out in 'The small print' (Section 8).

We would like to take this opportunity to record our appreciation for the kind assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP

Contents

1 Executive summary

1.1 Introduction

This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and Inverclyde Council (the Council). The purpose of this report is to highlight the key issues arising from the audit of the Council's financial statements for the year ending 31 March 2012.

This report meets the mandatory requirements of International Standard on Auditing 260 (ISA 260) to report the outcome of the audit to 'those charged with governance', designated as the Audit Committee and Council. The requirements of ISA260, and how we have discharged them, are set out in more detail at Appendix A.

The Council is responsible for the preparation of financial statements which record its financial position as at 31 March 2012, and its income and expenditure for the year then ended. We are responsible for undertaking an audit and reporting whether, in our opinion, the Council's financial statements present a true and fair view of the financial position.

1.2 Financial Results

The Council reported an increase in General Fund balances of £11.5 million at 31 March 2012. In line with the budget strategy to manage the pressure on future budgets and utilise reserves over the period of the corporate plan. The Council had a total general fund reserve balance of £40.6 million, of which £34.4 million is earmarked for specific purposes, leaving £6.2 million available for new expenditure or to meet the costs of contingencies and unforeseen events. Uncommitted balances represent 2% of income for 2011/12, and are therefore within the Council's target range.

1.3 Financial Statements

We expect to provide an unqualified opinion on the Council's 2011-12 financial statements and conclude that the financial statements are prepared in accordance with Part VII of the Local Government (Scotland) Act 1973 and the Code.

A matter of emphasis paragraph will be included in the opinion to draw attention the failure of the Building Services Significant Trading Operation (STO) to meet the statutory target to break even over a rolling three year period. We note that the Chief Finance Officer is currently undertaking a review of the Council's STO arrangements.

1.4 Audit Adjustments

Our audit identified six adjustments in respect of the current year and two in relation to the disclosure of heritage assets as at 31 March 2010 and 2011.

The Council identified several minor adjustments, the aggregate impact of the adjustments is included at adjustment 7 in table 5.4.

1.5 Design effectiveness of internal controls

We have applied our risk methodology to the audit, which allows us to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit identified a number of control improvement opportunities, relating to the IT control environment.

Our detailed findings are contained at Section 6 of this report.

1.6 Acknowledgements

Draft financial statements and working papers were presented for audit on 28 June 2012, in line with our audit timetable and were of a high quality.

Council officers have been responsive and supportive throughout the audit process and we therefore wish to record our thanks to all staff, particularly the Finance team.

2 Financial Position

2.1 Introduction

The Statement of Accounts is one of the main means by which the Council accounts for the stewardship of resources and its financial performance in the use of those resources. The Chief Financial Officer uses the foreword within the accounts to explain key areas of financial performance.

2.2 Budget Strategy

The Council has adopted a Medium Term Financial Strategy to prepare for lower financial settlements from the Scottish Government in future years. The financial strategy is based on:

- target savings of £20 million to the period March 2015
- maintaining uncommitted reserves balances as per the Council's reserve strategy of 2% of budget.

In 2011-12, the Council set target savings of £4.7million for the year, representing £1.5 million over that required to deliver a balanced budget, to ease the pressure on budgets in future years. The Council has exceeded this target by £3.7 million, the key reasons for additional underspend relate to strike payroll deductions of £221k, additional service savings of £668k, release of contingencies amounting to £750k, reduced client commitments and equipment £593k, underspend on waste strategy £229k and benefit subsidy payments of £252k.

We provide a more detailed analysis of the Council's performance against target budget savings within our Annual Report to Members, due in October 2012.

2.3 General Fund

For the year ending 31 March 2012, the Council had a total general fund reserve balance of £40.6 million, of which £34.4 million was earmarked for specific purposes, leaving £6.2 million available for new expenditure or to meet the costs of contingencies and unforeseen events. Income from general revenue grant, NDR and Council Tax income totalled £207million for 2011/12, non-earmarked reserves at 31 March 2012 equate to 2.96%, which is slightly higher than the target set in the reserves strategy of 2%. From 2012/13 non-earmarked balances are to be maintained at a level of 2%.

Figure 1 highlights that the overall General Fund balance has increased.

Figure 1: Usable reserves

Source: Inverclyde Council Annual Accounts

Figure 2: Earmarked reserves

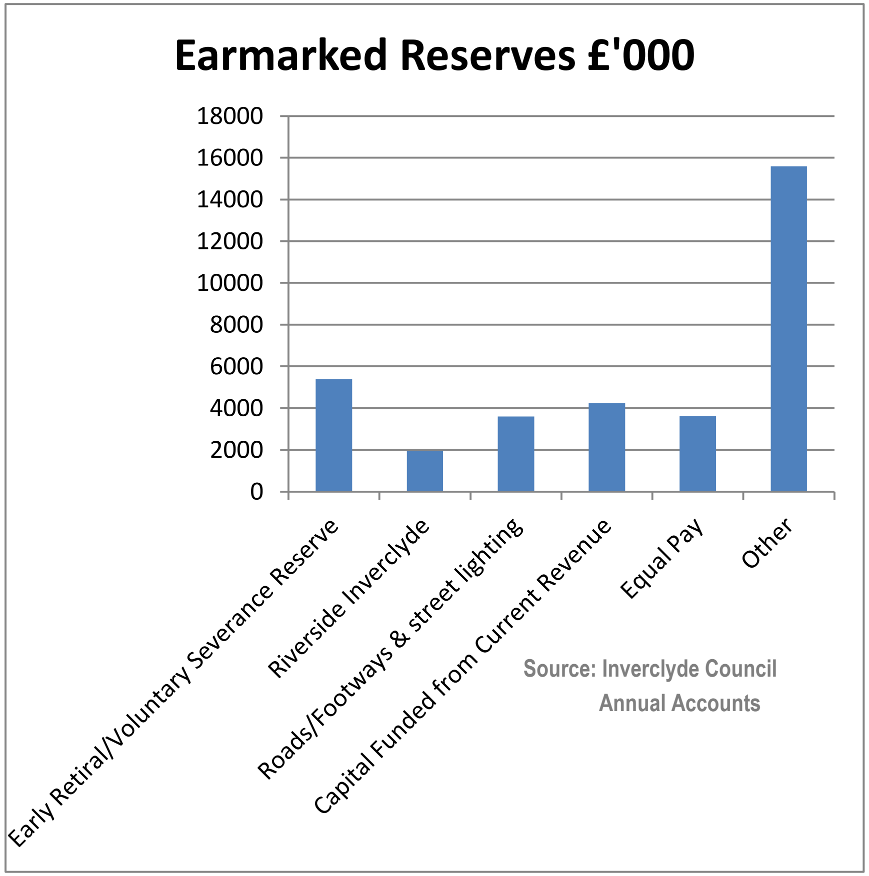


Figure 2 identifies the five largest individual earmarked reserves.

2.4 Statement of Comprehensive Income and Expenditure

The Council reported total net comprehensive expenditure for 2011-12 of £61.2 million, compared to net comprehensive income of £70.1 million in 2010-11.

Table 1: Financial results for 2011-12

	2012 £'000	2011 £'000
Net Cost of Services	208,798	166,925
Other operating expenditure	(15)	732
Financing and investment income and expenditure	10,418	9,391
Taxation and non-specific grant income	(214,425)	(213,711)
(Surplus)/deficit on the provision of services	**4,776**	**(36,663)**
(Surplus)/deficit arising on revaluation of non-current assets	11,822	1,403
Actuarial (Gains) / Losses on Pension Assets and Liabilities	44,638	(34,851)
Total Comprehensive (Income) and Expenditure	**61,236**	**(70,111)**

Source: Inverclyde Council Annual Accounts 2011-12

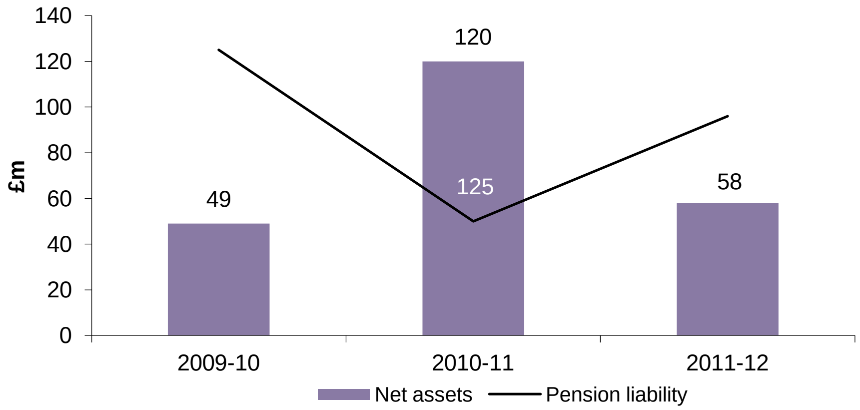
The net cost of services rose from £166.9 million in 2011 to £208.8 million in 2012, primarily as a result of a significant movement in IAS 19 accounting entries for the costs of pensions. During 2011-12, the Council reported a post-employment benefit loss of £13.5m, whereas the equivalent entry in 2010-11 was a post-employment benefit gain of £29.5m, an annual swing of £43.0m. This swing is a result of the past service credit of £39.8m in 2011 being replaced by a past service cost in 2012 of £3.8m The past service costs or gain recognise a change in the obligation for employee service in prior periods, arising as a result of changes to plan arrangements in the current period. These movements, and the actuarial gains and losses also reflected in the Net Comprehensive Expenditure Statements, are due to an actuarial assessment that the financial assumptions at 31 March 2012 are less favourable than they were in 2011. If we strip out the impact of pensions adjustments on net cost of services the surplus would be higher than the prior year by £1.6m.

We asked our internal actuaries to review the assumptions used by Hymans Robertson, the Council's actuaries. We found that the assumptions were reasonable and in line with the sector.

2.5 Balance Sheet

The total net worth of the Council at 31 March 2012 was £58.4 million (2011: £119.6 million). As Figure 2 indicates, the main reason for this movement, again, related to changes in the actuarial valuation. The pension liability within the Balance Sheet increased from £49.9 million in 2011 to £96.2 million in 2012.

Figure 3: Changes within the actuarial valuation have a significant impact on the net worth of the Council



Source: Inverclyde Council Annual Accounts

Long-term assets have increased from £360.8m to £387.0m. There have been several movements within Property, Plant and Equipment for additions, depreciation, revaluations and impairment.

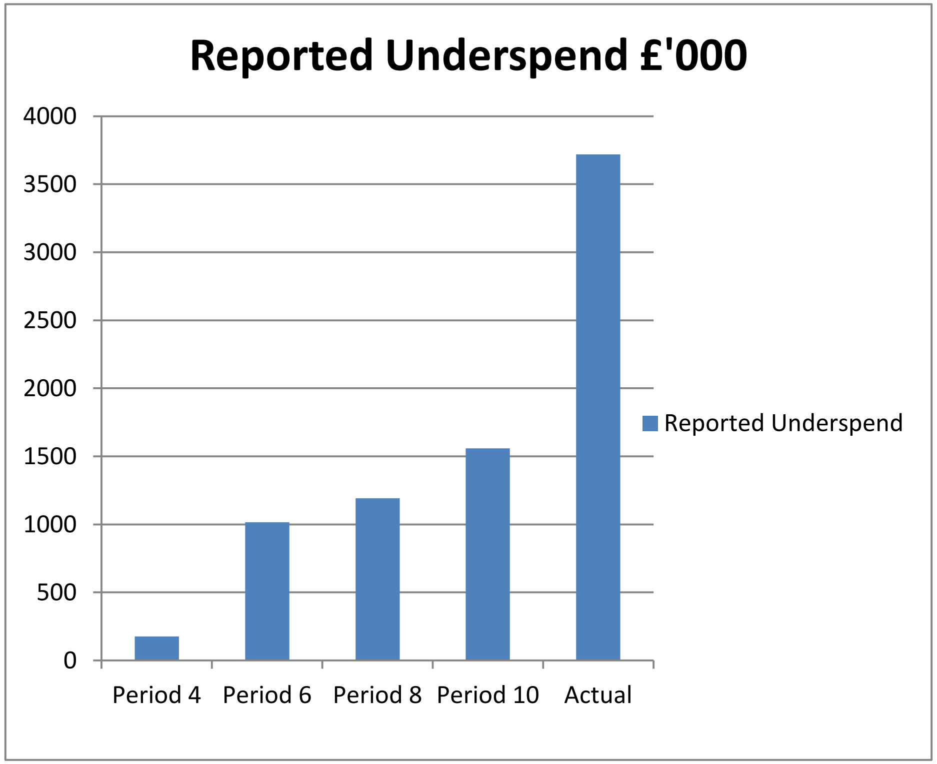
Heritage assets have been required to be included in the Council's accounts for the first time. These have a net book value of £17.9m in 2012 compared to £18.1m for the 2011 comparative. Key heritage assets include the council's museum collections incorporating a collection of rare books and various works of art

Net current assets remain broadly consistent year on year at £36.9m in 2012 and £35.9m in 2011. Cash has decreased by £5.9 million in line with reduced short term borrowing of £4 million and provisions of 1.6 million.

Long term liabilities in relation to PWLB and market loans has stayed consistent with no new borrowing entered into during 2011-12. Financing arrangements for two new schools for £54.5 million have been entered into under PPP arrangements. The schools were completed in the year and have been brought on to the balance sheet.

2.6 Performance against Budget

Performance against service budgets were reported to the Council's Policy and Resources Committee throughout the year. As Exhibit 1 demonstrates, the actual performance against outturn was better than forecasted during the year. Overall, service expenditure delivered a surplus of £3.7 million against budget.



3 Key audit issues

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and we provide details of additional matters that arose during the course of our work.

3.1 Status of audit

The draft accounts were presented for audit on 28 June 2012 and were of a high quality. Detailed working papers were available to support the accounts and the Finance Team were very helpful and co-operative throughout the audit. Our audit is substantially complete although we are finalising our procedures in the following areas:

- audit of the Whole of Government Accounts submission
- certification of Housing Benefit and Council Tax Benefit Grant
- external audit reports for group component bodies.

3.2 Matters identified at the planning stage

In the conduct of our audit, we have not had to alter or change our audit plan, which we communicated to you in our Audit Approach Memorandum dated 7 February 2012.

3.3 Matters identified during the course of the audit in relation to related parties

As part of our work on the financial statements we conducted a review of the transactions occurring throughout the financial year. We found no matters arising in relation to the disclosure of related parties.

3.4 Matters identified at the planning stage

	Issue	Auditor commentary
1	**Changes to the Code** There were a number of changes to the Code of Practice on Local Authority Accounting to be reflected within the 2011-12 accounts, the most significant for the Council was the requirement to disclose heritage assets as a separate category of asset.	Heritage assets are assets held and maintained principally for their contribution to knowledge and culture, and are assets that have no operational use. We reviewed the Council's approach to identifying heritage assets and found it was satisfactory. The assets identified include artworks and exhibits held at the museum and art gallery and civic regalia and effects. These items have been included within the Balance Sheet at insurance valuations, as a proxy for fair value. We note that a number of public space monuments and memorials have not been included on the balance sheet. We considered that this was reasonable.

2	**Achieving statutory targets** The Local Government in Scotland Act 2003 requires that Significant Trading Operations (STOs) break even over a three year period. For the three year period to 31 March 2011, the Building Services STO achieved this target with a reported surplus of £229,000. However following a tender exercise during 2011, the STO was unsuccessful in retaining its contract with River Clyde Homes. At the time of drafting our Annual Accounts Memorandum, the Council expected the STO to report a loss for the year that will lead to it breaking its three year break even target.	The STO did not meet the statutory breakeven target. We are required to include a matter of emphasis paragraph in the audit opinion to draw attention to this matter. The proposed audit opinion has been included at section 10 of this report.

3.5 Matters identified during the course of the Council audit

	Issue	Auditor commentary
1	**Police and Fire Merger** Royal Assent was given in August 2012 for the Police and Fire Reform (Scotland) Act 2012. This will mean a change both to the way Police and Fire services are governed, and funded. There is likely to be a financial impact on the Council as they will not receive income for the police and fire requisitions, beginning in 2013-14.	We have agreed with management that the Police and Fire merger is a non-adjusting post balance sheet event. A disclosure has therefore been added to the notes to the accounts to explain the impact of the decision on the Council.

4 Financial reporting matters

4.1 Introduction

We use this section to comment on the key judgements, estimates and policies adopted by the Council that have an impact on the financial statements.

4.2 Commentary on key judgements and estimates

The accounts are prepared under the 'going concern' basis because there are no indications that funding will cease, or that the Council will not remain in operation for the foreseeable future.

Impairment

The Council has drawn attention to the critical judgements and assumptions made in producing the financial statements within Notes 3 and 4 to the Accounts. Note 3 refers to the high degree of uncertainty about the future levels of funding for local government.

We agree with the Council's assessment that the uncertainty is not sufficient to provide an impairment trigger.

Equal Pay Provision

The Council has reviewed the provision it has set aside to meet any future equal pay claims. In 2011-12, the Council reduced the provision by £2.137 million. The extent of future claims against the Council is not certain, but we agreed that this provision is sufficient to meet future liabilities that may arise from the application of known case law.

4.3 Review of principal accounting policies

We have reviewed the financial statements and present our view of the key accounting policies below.

Accounting area	Summary of policy	Comment
Consolidated reporting	• The Financial Statements in the Group Accounts have been prepared in accordance with the Council's accounting policies. Where materially different, accounting policies of group members have been aligned to those of the Council. Where group members are not required to prepare their financial statements on an IFRS basis, consolidation adjustments have been made where applicable.	• We agreed that this policy is appropriate. We also reviewed the Group Boundary with the Finance Team and we are satisfied with consolidation procedures.

Accounting area	Summary of policy	Comment
Revenue recognition	• The predominant source of revenue for the Council is from Grants and Taxation. Revenue for this category of receipts is recognised when the amounts become due. Revenue with regard to goods and services is recognised when it becomes probable that economic benefits will flow to the Council.	• The basis of revenue recognition was found to be appropriate.
Depreciation	The depreciation policies are outlined in the notes to the accounts as follows: • Heritage Assets: Depreciation is not charged on heritage assets that have indefinite lives • Buildings - straight line allocation over 10 to 50 years • Vehicles, Plant and Equipment - straight line allocation over 2 to 10 years • Infrastructure - straight line allocation over 40 years • Intangible Assets - The depreciable amount of an intangible asset is amortised over its useful life (assessed as between one to six years)	• We reviewed each policy and checked for compliance with the Code, as well as consistency with the prior year and the rest of the sector. The infrastructure assets policy does not take full account of the range of useful lives of assets within this class. The policy should state assets have useful lives of 20 to 40 years. We are satisfied this issue relates to incorrect disclosure only and have not found assets that breach the Council's accounting policy. This disclosure will be updated in the final accounts.

4.4 Disclosure omissions

The table below summarises all the disclosure amendments we asked the Council to make. All disclosures were updated within the finalised financial statements. Our review found no significant omissions in the financial statements.

	Issue	Commentary
1	**Exit Packages** We asked the Council to amend the Remuneration Report to reflect three exits packages which had been agreed in April 2012 and therefore should not be disclosed in the current year. We also noted a number of additional exit packages agreed during 2011-12 that had not been disclosed within the Remuneration Report.	The Remuneration Report has been amended to reflect these disclosure adjustments.
2	**Exit Packages** We also noted that due to unavailability of information directly from the Scottish Teachers' Superannuation Fund, the full capitalised cost of teachers' severance packages had not been disclosed. The value of the capitalised costs not disclosed was £4.326m, £2.47million for 2010-11 and £1.856 million for 2011-12	The Remuneration Report has been amended to reflect these disclosure adjustments.

5 Audit adjustments

5.1 Misstatements

We are required to communicate all uncorrected misstatements to you, other than those considered to be clearly trivial. We have requested that management correct these misstatements and have included (where applicable) the reasons given by them as to why the misstatements remain uncorrected (Section 5.3). There is no impact on the audit report as a result of these unadjusted misstatements.

5.2 Impact of misstatements

All adjusted misstatements are set out in detail in section 5.4 below. The overall impact was a decrease in the deficit for the year by £80k.

5.3 Unadjusted misstatements

There are no unadjusted misstatements arising.

5.4 Adjusted misstatements

		Comprehensive Income and Expenditure Statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
Current Year					
1	**Accounting for exit packages** Three employees included within the exit packages charge for the year were not formally informed of this arrangement until April 2012. In accordance with IAS 37 these amounts should not be recognised in the current year's accounts.		(265)	265	
2	**Accounting for exit packages** Employer's National Insurance was included in error on the same three exit packages. Regardless of the year of recognition, employers' NIC is not due on these payments. This will be recovered on future returns to HMRC.		(6)	6	

		Comprehensive Income and Expenditure Statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
3	**Recognition of heritage assets** The history of this adjustment is explained more fully below. This amount is to recognise the revaluation of heritage assets for 2011/12. The net book value of heritage assets at 31 March 2012 remains unchanged.			165	(165)
4	**Credit balances on the debtors ledger** Credit balances included in the debtors ledger should be reanalysed to ensure assets and liabilities are stated gross unless it is appropriate to offset balances and charges.			274	(274)
5	**VAT incorrectly included on a trade debtor** Included in debtors is an amount due for grant income in relation to the Food Waste Scheme trial, this amount incorrectly includes VAT and the VAT liability is overstated by an equal amount.			69	(69)
6	**Capital grant income incorrectly applied** To reallocate grant from the cost of services to taxation and non-specific grant income. A corresponding adjustment has been made to Note 34.	1,108	(1,108)		
7	**Council adjustments** The Council has made several adjustments as part of the accounts finalisation process. These mainly relate to reallocations within the general ledger. The total net effect of these adjustments is an increase in net expenditure by £191k. The main constituent element of this charge is £142k for an under provision against bad debts in 2009/10. This is not a current year cost and should be allocated against reserves as opposed to the CI&E however the Council's treatment has been agreed on the basis of materiality.	191			(191)

		Comprehensive Income and Expenditure Statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
Prior Year					
8	**Recognition of heritage assets** Heritage assets have been adjusted in 2010 and 2011 to recognise their insurance value at each of these year's balance sheet dates within the accounts. The allocation of heritage assets in the draft accounts did not correlate to the insurer's value at 31 March 2010 and 31 March 2011. The adjustment takes the following stages: 1) Derecognise 2011's value of £5,851k and recognise this as 2010's carrying value (2010 originally at £0); 2) Revalue 2010 upwards by £12,212k to the insurer's value at 31/03/10; 3) Revalue 2011 upwards by £6k to the insurer's value at 31/03/11. The additional adjustment above incorporates the revaluation down in 2012 to arrive at the insurer's value at 31 March 2012. This value of £17,905k is unchanged from the draft accounts. It is the allocation of values and revaluations across the 3 years that has been amended.			1) 5,851 2) 12,212 3) 6	1) (5,851) 2) (12,212) 3) (6)

6 Design effectiveness of internal controls

6.1 Accounting system and internal control

During our interim audit, we undertook reviews of the internal controls associated with key financial systems including:

- Internal audit
- Payroll
- Operating expenses
- Property, Plant and Equipment
- Cash and bank
- Income and Debtors
- Non-domestic rates
- Council tax

The outcome of this work will be reported in our Annual Report.

Our audit is not designed to identify all significant weaknesses in the Council's internal controls but is designed primarily for the purpose of expressing our opinion on the financial statements of the Council. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

6.2 Key findings during the final audit visit

The table on the following page outlines the internal control observations we made during our final accounts visit. Our IT Audit Manager completed a high level review of the Council's IT systems to support our opinion. We therefore include the observations and recommendations that emerged from this work.

Key to assessment of internal control deficiencies

	Material weakness - risk of material misstatement
	Significant deficiency - risk of significant misstatement
	Deficiency - risk of inconsequential misstatement

	Assessment	Issue and risk	Recommendation
1		**Information technology - Disaster recovery** The Council applications are hosted in a data centre located in the Municipal building at Greenock. There is also a Disaster Recovery (DR) facility, sited in Newark Primary School, Port Glasgow that supports the recovery of telephony, email, network folder access and Internet services. This facility was originally planned as an interim arrangement until a new production data centre was built. However, this project was cancelled due to budget pressures and the interim facility will be used for the foreseeable future. No support for the recovery of applications is available at the Newark DR site. As a result, if a disaster affected the main data centre, hardware would have to be procured to recover the Council applications at an alternative site. Additionally, there is no documented disaster recovery plan detailing the instructions to recover the ICT systems in the event of a disaster. However, we understand that this plan was being developed in conjunction with the Joint Civil Contingencies Service at the time of our visit. Giving the absence of a documented ICT disaster recovery plan and the limited ICT infrastructure existing at the secondary data centre, there is a significant risk that ICT systems could not be recovered within a reasonable time in the event of a disaster affecting the main data centre. This could have a detrimental impact on the Council Services and lead to loss of reputation.	1.1. The Council should carry out a business impact analysis. This process consists of Services working jointly with the ICT department in establishing their recovery requirements. This analysis should detail the priorities for the recovery of applications and target recovery times. Once this analysis is completed, a recovery strategy should be designed and implemented to meet these recovery targets. This strategy should be documented in the ICT disaster recovery plan. The disaster recovery plan should be tested at least on an annual basis to validate the effectiveness of the recovery arrangements. Test results should be documented and analysed to identify any improvements to the recovery plan. **Management response** ICT Recovery Plan is being developed in conjunction with the Joint Civil Contingencies Service. The DR Facility at Newark is not on 'Hot Standby' – CMT Report states that 24hrs are required to reinstate core ICT facilities. Any required applications over and above these will be reinstated on a best endeavours basis.

	Assessment	Issue and risk	Recommendation
2	●	**Information technology - ICT strategy** We understand that the ICT strategy in the Council has not been updated since 2007. There is a risk that ICT could not be effectively supporting the provision of Council Services.	We recommend that the ICT strategy is revised at least every three years to ensure that it remains aligned with the Council strategy and to revalidate it taking into consideration developments in the ICT industry. **Management response** The Council's ICT strategy will depend largely on the future of shared support services. The Council will decide in late 2012 whether it will be participating in the Clyde Valley proposal for shared support services. It would make sense to wait until this decision is taken before developing a new ICT strategy.
2	●	**Information technology - Password settings** Network users are forced to change their passwords every 42 days. However, users of the following systems are forced to change their passwords after a longer period of time: a. Iworld (Council tax): 90 days b. Orbis (Non-domestic rates): 100 days c. Terrarius (fixed assets): passwords are not forced to be changed on a regular basis Additionally, network passwords are not forced to be complex and network user accounts are not locked out after a number of invalid logon attempts. There is a risk that unauthorised access to the Council network or applications could be gained if a password is guessed or compromised.	Passwords should be forced to be changed across the Council applications at least every 42 days. User accounts on the network should be locked out for a period of time after a number of invalid logon attempts and network passwords should be forced to be complex. Before changing any password settings, the Council should perform a communication campaign to inform users about these changes and remind them about guidelines to set adequate passwords. **Management response** Agreed.

	Assessment	Issue and risk	Recommendation
3		**Information technology - Leavers** Human Resources sends a monthly leavers report to the ICT Service Desk. ICT staff disables the network accounts for the users listed on this report after confirming them with the corresponding Council Services. A leaver was randomly selected from the February 2012 report and it was noted that his network account was still enabled. This monthly HR report is not sent to the System Administrators of Council applications like Task FMS or iWorld as they rely on line managers reporting staff leavers. No review of inactive network user accounts is performed. A report of network accounts that had been inactive for at least 90 days was generated at the time of our visit and it contained approximately 600 user accounts. There is a risk that unauthorised access to the network or Council applications could be gained through a user account belonging to a former member of staff.	Human Resources should send the monthly leavers report to System Administrators in addition to the ICT Service Desk. The user accounts of all staff listed in this report should be initially disabled and only enabled upon satisfactory confirmation of their continuous employment or need to access the Council systems. A procedure to review inactive user accounts on the network should be performed on a monthly basis. The Council should define the thresholds (ie 90 days) after which accounts would be disabled or deleted. **Management response** ICT will investigate software utilities available to assist with this process.
4		**Information technology - Data transfers** The Council has a number of data transfers with third parties as part of the regular operation of its Services. However, there is no documented procedure detailing the minimum confidentiality controls that Council Services should adhere to when transferring personal data outside the Council. There is a risk that a data transfer could not have an appropriate level of encryption and unauthorised access to data might be gained with the consequential adverse publicity for the Council.	The Council should set up a procedure whereby Services consult with a central team before setting up any transfers of personal data. This consultation should confirm the adequate security (ie encryption) controls that should be in place before any data is transferred outside the Council. This central team could incorporate members of staff from ICT, data protection and other areas that the Council considers relevant for its purpose. **Management response** This item will be referred to the Council's Information Governance Group for consideration.

	Assessment	Issue and risk	Recommendation
5	●	**Information technology - Privileged access** A member of Council staff has privileged access to the Orbis system (Non-domestic rates) and a person from the software vendor has a privileged user account in the Task FMS system without requiring this level of access. There is a risk that unauthorised access to the Council applications could be gained.	Privileged access to the Council applications should be revalidated on a monthly basis. Privileged access should only be granted to members of staff that require it to perform their job duties **Management response** ICT will issue a communication to Heads of Service regarding Systems Administrators carrying out this task.
6	●	**Information technology - Audit log** We noted that there is no formal process to review the network security log on a regular basis. There is a risk that unauthorised activity on the network might go undetected. As an example, if a user tries to guess a password through repeating logon attempts onto the network, this incident might not be promptly detected. Additionally, as network user accounts are not locked out after a number of invalid logon attempts, the owner of the user account might not be aware of this unauthorised attempt to access data.	A process to review the network security log on a regular basis should be implemented. This process should involve the definition of the events to be monitored (ie failed logon attempts or changes to user access rights) and the frequency for this review. Any unusual activity on the network should be investigated and documented. **Management response** This task is not currently undertaken due to the significant resource and time required to monitor and analyse security logs. ICT will investigate whether any suitable and affordable software tools are available that would facilitate this process.
7	●	**Information technology - Change management** There is no documented change management process for key Council applications or the overall ICT infrastructure. Although some changes are documented in the Helpdesk system, there is no standard methodology to document, approve, and test changes to the ICT environment. There is a risk of unauthorised changes being moved into the live environment. There is also a risk of changes being inadequately	The Council should develop a documented change management process for changes to applications or ICT infrastructure. This process should detail the steps and approvals that an ICT change should go through in its lifecycle. 1.2. Changes should be subject to testing by ICT staff and business users. Test plans should be developed and results documented. Once the results of user acceptance testing are satisfactory, a lead user should document their confirmation to

	Assessment	Issue and risk	Recommendation
		tested before being promoted to live due to non-rigorous user acceptance testing. This could lead to data corruption, unauthorised access to data, and service interruptions.	the ICT function that the change is ready to be moved to the live environment. **Management response** ICT produced a formal Change Management procedure in 2007 in response to a previous audit. This procedure was reviewed by the Directorate Management Team and the view at that time was that it was a too onerous procedure for the organisation to adopt. ICT will discuss this issue with the relevant Corporate Director for further guidance.

7 Looking ahead

7.1 Reporting on Financial Performance

We started this report by reiterating that the Statement of Accounts is the key method Council's use to report to elected members and the public on how effectively they use public funds. However, local authorities are large and complex organisations, and the nature of the regulatory framework means that large accounting adjustments are made to accounts that are difficult to explain or understand.

We reviewed the Chief Finance Officer's Foreword and concluded that it provides a good explanation of the Council's financial performance during the year, including performance against budget, and outcomes against the prudential indicators. The positioning and disclosures within the Remuneration Report provide a good level of transparency.

There may be scope to include additional information, such as the use of ratio analysis to compare Inverclyde's position to other Scottish councils, although the benefits of doing this must be weighed against the further complexity and length of the document.

7.2 2012-13 budget

Like most public sector bodies, Inverclyde Council is facing a period of significant financial restraint, however savings are being achieved in order to offset future reduced revenue allocations. The 2012-13 budget projects a £4.053 million surplus which will be retained to offset future years' expenditure.

We will use our final audit report, due in October 2012, to report on the progress that the Council has made across the workstream savings programme.

8 Recommendations

	Issue	Recommendation	Risk	Management Response
1	**Annual Governance Statement** Although there is currently no requirement to produce an Annual Governance Statement, it is considered best practice.	The Council should consider the adoption of an Annual Governance Statement for the 2012-13 financial statements.	Low	A review will be undertaken to consider the recommendation.
2	**Valuations** Currently the process for the valuations team notifying finance of revaluations is informal.	A formal report would improve the Audit trail	Low	There has been some work undertaken in order to formalise the process of communicating changes to the valuations, disposals and acquisitions of fixed assets. This will continue to ensure the information held reflects the latest valuations.

9 The small print

Purpose of memorandum

This Key Issues Memorandum has been prepared for the benefit of discussions between Grant Thornton UK LLP, the Audit Committee of **Error! Reference source not found.**

The purpose of this memorandum is to highlight the key issues affecting the results of the Group and the preparation of the Council's financial statements for the year ended 31 March 2012.

This document is also used to report to management to meet the mandatory requirements of International Standard on Auditing (UK & Ireland) 260.

We would point out that the matters dealt with in this report came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements of the Council.

Responsibilities of the Council and auditors

The Council is responsible for the preparation of the financial statements and for making available to us all of the information and explanations we consider necessary. Therefore, it is essential that the Council confirm that our understanding of all the matters in this memorandum is appropriate, having regard to their knowledge of the particular circumstances.

Clarification of roles and responsibilities with respect to internal controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, for developing, operating and monitoring the system of internal control and for providing assurance to the Audit Committee that it has done so.

The Audit Committee is required to review the Council's internal financial controls. In addition, the Audit Committee is required to review all other internal controls and approve the statements included in the annual report in relation to internal control and the management of risk.

The Audit Committee should receive reports from management as to the effectiveness of the systems they have established as well as the conclusions of any testing conducted by internal audit or ourselves.

We have applied our audit approach to document, evaluate and assess your internal controls over the financial reporting process in line with the requirements of auditing standards.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you.

In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We would be pleased to discuss any further work in this regard with the Audit Committee.

Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opnion on the financial statements.

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

	£
Fees payable to Audit Scotland	270,000
Total audit fees	**270,000**

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
- significant findings from the audit

10 Letter of representation

Dear Sirs

Inverclyde Council Financial Statements for the Year Ended 31 March 2012

This representation letter is provided in connection with the audit of the financial statements of Inverclyde Council for the year ended 31 March 2012 for the purpose of expressing an opinion as to whether the financial statements give a true and fair view in accordance with the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003 and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the UK 2011/12 (the 2011/12 Code).

I confirm that to the best of my knowledge and belief having made such inquiries as I considered necessary for the purpose of appropriately informing ourselves:

Financial Statements

i I have fulfilled my responsibilities, as set out in the Statement of Responsibilities for the Statement of Accounts, for the preparation of the financial statements in accordance with the Local Government (Scotland) Act 1973, the Local Government in Scotland Act 2003. In particular the financial statements give a true and fair view of Inverclyde Council's state of affairs as at the 31 March 2012 and of its income and expenditure for the financial period (including the group).

ii I acknowledge my responsibility for the design and implementation of internal control to prevent and detect error and fraud.

iii Significant assumptions used by me in making accounting estimates, including those measured at fair value, are reasonable.

iv Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of the 2011/12 Code.

v All events subsequent to the date of the financial statements and for which the 2011/12 Code requires adjustment or disclosure have been adjusted or disclosed.

vi The financial statements are free of material misstatements, including omissions.

Information Provided

vii I have provided you with:

a. access to all information of which I am aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;

b. additional information that you have requested from me for the purpose of your audit; and

c. unrestricted access to persons within the entity from whom you determine it necessary to obtain audit evidence.

viii I have disclosed to you the results of my assessment of the risk that the financial statements may be materially misstated as a result of fraud.

ix All transactions have been recorded in the accounting records and are reflected in the financial statements.

x I have disclosed to you my knowledge of fraud or suspected fraud affecting the entity involving:

a. management;

b. employees who have significant roles in internal control; or

c. others where the fraud could have a material effect on the financial statements.

xi I have disclosed to you my knowledge of any allegations of fraud, or suspected fraud, affecting theentity's financial statements communicated by employees, former employees, analysts, regulators or others.

xii I have disclosed to my all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing financial statements.

xiii I have disclosed to you the identity of the Council's related parties and all the related party relationships and transactions of which I am aware.

Yours faithfully

Alan Puckrin

Chief Financial Officer

11 Audit Opinion

Independent auditor's report to the members of Inverclyde Council and the Accounts Commission for Scotland

We certify that we have audited the financial statements of Inverclyde Council and its group for the year ended 31 March 2012 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the group and authority-only Comprehensive Income and Expenditure Statements, Movement in Reserves Statements, Balance Sheets, and Cash-Flow Statements, the Council Tax Income Accounts, and the Non-domestic Rate Account and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2011/12 (the 2011/12 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Responsible Financial Officer and auditor

As explained more fully in the Statement of Responsibilities, the Responsible Financial Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the group's and the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Responsible Financial Officer; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the statement of accounts to identify material inconsistencies with the audited financial statements. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2011/12 Code of the state of the affairs of the group and of the body as at 31 March 2012 and of the income and expenditure of the group and the body for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2011/12 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In our opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 1985; and
- the information given in the Explanatory Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Statement on the System of Internal Financial Control does not comply with the 2011/12; or
- there has been a failure to achieve a prescribed financial objective.

Emphasis of matter

It has not been necessary to qualify our opinion in respect of the following matter. The Council has a statutory duty under section 10 of the Local Government in Scotland Act 2003 to conduct each of their significant trading operations so that income is not less than expenditure over each three year period.

The Council failed to comply with this statutory requirement for the three year period ending 31 March 2012 in respect of its Building Maintenance Service.

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