AUDIT SCOTLAND

AUDIT MANAGEMENT LETTER
FOR THE YEAR ENDED 31 MARCH 2011

Report Date: 16 September 2011
1. INTRODUCTION

1.1 As the external auditor of Audit Scotland, we are required by legislation to report to the Scottish Commission for Public Audit (the ‘Commission’) our findings from the annual audit of the financial statements of Audit Scotland.

1.2 The purpose of this report is to summarise for the Commission the key issues arising from our audit of the Financial Statements for the year ended 31 March 2011 and report any material weaknesses in the accounting and internal controls that have come to our attention during the audit.

1.3 A copy of this letter was sent to Audit Scotland’s management team and the Audit Committee for review prior to submission of the report to the Commission.

2. AUDIT OBJECTIVES

2.1 The main objective of the audit is to form an opinion as to whether the Financial Statements of Audit Scotland give a true and fair view of the state of affairs of Audit Scotland at 31 March 2011 and of its net resource outturn for the year, and confirm that the Financial Statements are prepared in accordance with the Public Finance and Accountability (Scotland) Act 2000 and Directions by Scottish Ministers.

2.2 As part of our audit we carry out the following work:
   - Examine, on a test basis, evidence relevant to the amounts and disclosures in the Financial Statements.
   - Assess any significant estimates and judgements made by Audit Scotland in the preparation of the Financial Statements.
   - Assess whether the accounting policies are appropriate to Audit Scotland's circumstances, consistently applied and adequately disclosed.
   - Evaluate the overall adequacy of the presentation of information in the Financial Statements to ensure compliance with the Financial Reporting Manual (FReM).
   - Report to you our opinion as to whether the Financial Statements give a true and fair view and are properly prepared in accordance with relevant legislation.
   - Report to you if in our opinion the information contained within the Foreword and the Management Commentary is inconsistent with the Financial Statements.
   - Consider whether based on our audit testing the expenditure has been incurred and the receipts have been applied in accordance with section 22(1)(a) and (b) of the Public Finance and Accountability (Scotland) Act 2000.

2.3 Our audit methodology for the collection of audit evidence is based on our own Audit Manuals, which are continuously updated to reflect current auditing standards. The methodology adopts a risk-based approach in accordance with International Auditing Standards (UK & Ireland).
2. AUDIT OBJECTIVES (Continued)

2.4 Although we are required under International Standards on Auditing to consider fraud when carrying out our audit, the purpose of our audit is not the detection of fraud. Responsibility for the prevention and detection of fraud rests with the Board of Audit Scotland who should not rely wholly on the external audit function to discharge these responsibilities. We noted no incidents of misconduct, fraud or irregularity during the course of our audit.

3. CHANGES TO ACCOUNTS AND SIGNIFICANT MATTERS

3.1 The financial statements of Audit Scotland follow the same format as in the previous year.

3.2 In the year to 31 March 2011 there has been an increase to the Provision for Early Retirement and Settlement as a result of the recognition of a provision for £776,000 arising from Audit Scotland’s Voluntary Early Release Arrangement (VERA) scheme.

3.3 Audit Scotland has included a creditor this year for VAT liabilities relating to the secondment of staff to external organisations in the current and previous years.

3.4 During our audit we have considered Audit Scotland’s assessment that the organisation is a going concern. Based on discussions with the Management team, review of budgets and as there is no expectation that funding will be withdrawn, we are satisfied that the organisation’s assessment is appropriate.

4. AUDIT OPINION

4.1 Based on our detailed audit work which is carried out in accordance with International Standards on Auditing we have been able to satisfy ourselves that the Financial Statements provide a True and Fair view of Audit Scotland’s affairs and have therefore issued an unqualified audit opinion on the Financial Statements.
5. INTERNAL CONTROLS

5.1 In accordance with International Standards on Auditing (UK & Ireland) we have included a summary of matters which arose during the course of our audit and which we consider should be brought to the attention of the Commission.

5.2 It should be noted that the matters dealt with in this letter came to our attention only during the normal course of our audit work and is not as a result of a special review of Audit Scotland’s systems, procedures and controls.

5.3 Overall responsibility for maintaining adequate financial reporting systems and systems of internal control, as well as for the prevention and detection of fraud, irregularities, and other errors, rests with the Accountable Officer.

5.4 Please note that these comments are not intended to reflect in any way on the integrity or competence of any member of Audit Scotland’s staff from whom we have received every assistance and co-operation.

5.5 We shall be grateful if, in due course, you will advise us of the actions the Audit Committee of Audit Scotland is taking with regard to each point. If you so wish, we shall be happy to discuss any of these points further with you and assist with their implementation.
## 5. INTERNAL CONTROLS (Continued)

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<tr>
<th>Observation and Implication</th>
<th>Recommendation</th>
<th>Client’s Response</th>
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<tr>
<td><strong>Corporation Tax</strong> -</td>
<td>We would recommend that Audit Scotland considers its corporation tax position. The organisation should take professional advice as appropriate and, if tax is due, the organisation should bring its tax affairs up to date as soon as possible.</td>
<td>We accept the recommendation and will take steps to secure professional advice as to the potential for any Corporation Tax liability. We estimate any potential Corporation Tax liability at 31 March 2011 at less than £3,000. Action: Corporate Finance Manager</td>
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<td>During our audit work we identified the possibility that Audit Scotland could be subject to Corporation Tax on their earnings from bank interest, letting income and any capital gains that may arise.</td>
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<td>HMRC published guidance in 2009 that suggests public bodies may be liable to tax on their non-business income.</td>
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<td>Audit Scotland could be liable both for future taxable income and also subject to back-dated corporation tax liabilities.</td>
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<td>We acknowledge that any potential liability would not be significant.</td>
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<td><strong>Related Party Transactions and Disclosures</strong> – During our audit work, procedures for identifying related party transactions for disclosure in the financial statements were discussed. We note that there are no annual declarations made by the Board Members and Directors confirming that they are not aware of any related party transactions in the year.</td>
<td>We would recommend that, in addition to the Notices of Interests, Board Members and Directors sign an annual declaration at the financial year-end stating that they were not aware of any related party transactions in the year.</td>
<td>We accept the recommendation. At present we undertake an annual refresh of Board Members and Directors notices of interest. From March 2012 we will ensure that Board Members and Directors sign a financial year-end declaration stating that they are not aware of any related party transactions in the year. Action: Chief Operating Officer</td>
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6. FUTURE ISSUES

6.1 There are no significant future issues to which we should draw your attention.

7. FURTHER INFORMATION

7.1 If you require any further information regarding any of the issues outlined in this Management Letter please contact the Partner or Senior Manager who will be pleased to assist you:

<table>
<thead>
<tr>
<th>Position</th>
<th>Name</th>
<th>Telephone</th>
<th>E-Mail</th>
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<tbody>
<tr>
<td>Partner</td>
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</table>

Alexander Sloan
Chartered Accountants
& Statutory Auditors

16 September 2011