



## **North Ayrshire Council**

Planning report to the Audit and Scrutiny Committee  
on the 2016/17 audit

16 February 2017

# Contents

## Our planning report

- 3 Director introduction
- 5 Our audit explained
- 6 An audit tailored to you
- 7 Scoping
- 9 Materiality
- 10 Significant risks
- 14 Wider scope requirements
- 20 Audit quality
- 21 Purpose of our report and responsibility statement

## Appendices

- 23 Fraud responsibilities and representations
- 25 Your audit team and timetable
- 27 Independence and fees
- 28 Technical developments
- 29 Our approach to quality

# Director introduction

## The key messages in this report

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

A robust challenge of the key judgements taken in the preparation of the financial statements.

A strong understanding of your internal control environment.

A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our planning report to the Audit and Scrutiny Committee for the 2016/17 audit. I would like to draw your attention to the key messages of this paper:

### Financial challenges

- As with all public sector bodies, North Ayrshire Council continues to face significant financial challenges. Whilst the overall 2016/17 forecast position as at 30 November 2016 is projecting a net in-year surplus of £2.771m (net of transfers to reserves), this is based on the assumption that the North Ayrshire Health and Social Care Partnership will breakeven. As at 30 November 2016, the Partnership is projecting an overspend of £5.351m, of which £3.006m relates to the Council services element.
- In addition, the Council anticipates that there will be further significant cash reductions in the general revenue grant from the Scottish Government over the forthcoming years, whilst simultaneously the Council will have to manage an ever increasing demand for Council services and manage cost pressures that apply to the models of service delivery. Although budgets have reduced in recent years to move the Council to a position where it is closer to a sustainable footing, North Ayrshire Council is still able to provide a good level of services to the public and is continually looking to improve on service delivery through its 'Good to Great' strategy.
- The Council's achievement of savings set out within the Medium Term Financial Outlook will be a key area of audit focus in our audit dimensions work discussed further below.

### Significant risks

- We have identified the following financial statement significant risks:
- recognition of grant income;
  - valuation of property assets; and
  - management override of controls.

### Audit Dimensions

- The 2016 Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. Our audit work will consider how North Ayrshire Council is addressing these and report our conclusions in our annual report to the Council in September 2017. In particular, our work will focus on:
  - **Financial sustainability** – we will monitor the Council's actions in respect of its short, medium and longer term financial plan to assess whether short term financial balance can be achieved, whether there is a long-term financial strategy and if investment is effective.
  - **Financial management** – we will review the budget and monitoring reports to the Council during the year and liaise with internal audit in relation to their work on the key financial controls to assess whether financial management and budget setting is effective.

# Director introduction (continued)

## The key messages in this report (continued)

Audit quality is our number one priority. We plan our audit to focus on audit quality and have set the following audit quality objectives for this audit:

A robust challenge of the key judgements taken in the preparation of the financial statements.

A strong understanding of your internal control environment.

A well planned and delivered audit that raises findings early with those charged with governance.

### **Audit Dimensions (continued)**

- **Governance and transparency** – from our review of Council papers and attendance at Audit and Scrutiny Committees we will assess the effectiveness of governance arrangements. We will also share best practice from elsewhere from our dedicated governance team, particularly on integration as the Council's relationship with the Integrated Joint Boards develops.
- **Value for money** – we will gain an understanding of the Council's self-evaluation arrangements to assess how it demonstrated value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.

### **Other wider scope work**

- As part of our best value work, we will consider the five Strategic Audit Priorities agreed by the Accounts Commission and undertake a baseline analysis of the Council's performance against these priorities. We will also conclude how our work in these areas will be planned and reported across the five year appointment.
- We will assess how effectively the Council undertakes transformational change as it drives forward its journey from 'Good to Great' and whether savings targets set out in the 2016/17 budget have been achieved.
- We will monitor the Council's participation and progress with the National Fraud Initiative (NFI) during 2016/17 and complete an Audit Scotland audit questionnaire by 30 June 2017.
- In accordance with Audit Scotland guidance, we will be requested to provide information to support national performance audits and to inform wider analysis on the following subjects:
  - Arms-Length External Organisations (ALEOs)
  - European Funding
  - Health and Social Care Integration
  - Follow-up of Role of Boards report.

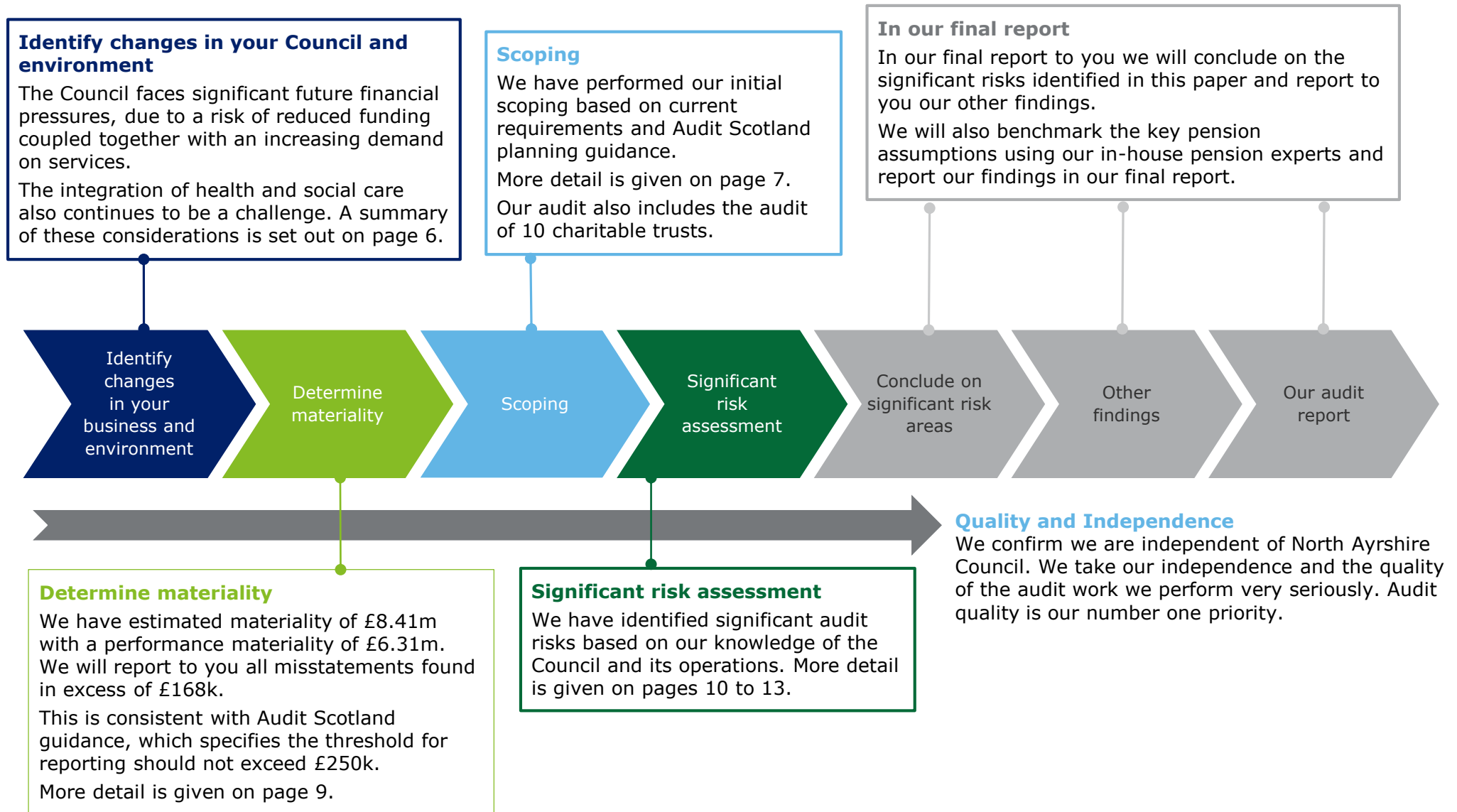
### **Our commitment to quality**

- We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience. Further information is presented on page 20.

**Pat Kenny**  
**Audit Director**

# Our audit explained

We tailor our audit to your business and your strategy



# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

#### Future financial strategy and sustainability



North Ayrshire Council continues to face significant financial challenges. Whilst the overall 2016/17 forecast position as at 30 November 2016 is projecting a net in-year surplus of £2.771m (net of transfers to reserves), this is based on the assumption that the North Ayrshire Health and Social Care Partnership will breakeven. As at 30 November 2016, the Partnership is projecting an overspend of £5.351m, of which £3.006m relates to the Council services element.

In addition, the Council anticipates that there will be further significant cash reductions in the general revenue grant from the Scottish Government over the forthcoming years. Simultaneously the Council will have to manage an ever increasing demand for Council services, such as in Community Care, and manage cost pressures that apply to the models of service delivery, such as pay awards and national policy changes.

The Council's Medium Term Financial Outlook was updated and approved in February 2016 as part of the budget setting process and covers the period from 2016/17 to 2018/19. The aim of the plan is to help the Council approve annual budgets that are balanced and affordable in the medium term. The plan projects a balanced budget for 2016/17, however, an estimated funding gap of £3.8m and £17.0m have been identified for 2017/18 and 2018/19 respectively. The Council will have to find solutions to the emerging funding gap and there is a risk that they will not be able to achieve the savings required in order to achieve this. This could impact on funding available for Council services and lead to the Council not being able to achieve priority outcomes.

We will monitor the Council's plans to achieve long term financial sustainability.

#### Health and social care integration



Following the establishment of a Shadow Integration Board on 1 April 2014, 2015/16 saw the first year of North Ayrshire Integration Joint Board (IJB), with the IJB being established from 1 April 2015. The results from 2016/17 will be consolidated into the Council's accounts for the second year. The IJB is now responsible for the distribution of resources to partner bodies to achieve what it set out in its strategic plan. The risk remains, however, that the Council and NHS Board encounter problems in working together in these new arrangements.

We will review the current arrangements and plan in place to develop the Health and Social Care Partnership with NHS Ayrshire and Arran. As part of our year-end procedures we will test the consolidation process and have regular communication with the IJB audit team to ensure timescales are met. Additionally, as part of our commitment to sharing best practices and insights we will consider the lessons learned from our wider health and transformation work in the sector including our work on increasing productivity, demand management and financial turnaround.

#### New Finance Ledger



In the 2015/16 annual report prepared by Audit Scotland, it noted that a new system is scheduled to be in place by April 2017 to replace the Council's Masterpiece system as the primary source of financial information across services. Transition arrangements are in place and testing is underway. The new system aims to deliver benefits including; more integration within the financial system; more user friendly and less resource intensive; and improved reporting and forecasting. We will monitor progress with the implementation of the system as part of our 2016/17 audit work.



Significant risk



Normal risk



Considered as part of wider scope audit requirements



# Scoping

## Our key areas of responsibility under the Code of Audit Practice



### Core audit

Our core audit work as defined by Audit Scotland comprises:

- providing the **Independent Auditor's Report** on the annual accounts (and any assurance statement on whole of government accounts);
- providing the **annual report** on the audit addressed to the Council and the Controller of Audit;
- communicating **audit plans** to those charged with governance;
- providing **reports to management**, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code (including auditors' involvement in the NFI exercise);
- preparing and submitting **fraud returns**, including nil returns, to Audit Scotland where appropriate;
- identifying significant matters arising from the audit, alert the Controller of Audit and support Audit Scotland in producing statutory reports as required;
- undertaking work requested by Audit Scotland or local performance audit work;
- certifying all **grant claims** submitted by the Council that have been approved for certification by Audit Scotland;
- discharging our responsibilities in connection with the Councils publication of **Statutory Performance Indicators (SPIs)** in accordance with the Account Commission 2015 Direction;
- setting out an outline **five year plan** for auditing Best Value (BV);
- reporting on the results of follow-up on Councils progress in implementing existing **BV improvement plans** where requested; and
- providing existing evidence and intelligence for, and participate in, **Shared Risk Assessment (SRA)** processes leading to the preparation of a Local Scrutiny Plan for the Council and a national scrutiny plan.

### Wider scope requirements

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland:

- **Financial sustainability** – looking forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.
- **Financial management** – financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.
- **Governance and transparency** – the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.
- **Value for money** - using resources effectively and continually improving services.

The Accounts Commission is reviewing its strategic planning arrangements and has agreed five **Strategic Audit Priorities** that will be built into audit expectations. The priorities are:

- The clarity of Council priorities and quality of long-term planning to achieve these.
- How effectively Councils are evaluating and implementing options for significant changes in delivering services.
- How effectively councils are ensuring members and officers have the right knowledge, skills and time to lead and manage delivery of the Council priorities.
- How effectively Councils are involving citizens in decisions about services.
- The quality of Council public performance reporting to help citizens gauge improvement.

It is not anticipated that Annual Audit Reports will report on all of the Strategic Priorities in this first year but will consider how these should be planned and reported across the five year appointment.

# Scoping (continued)

## Our approach



### Liaison with internal audit

The Auditing Standards Board's version of ISA (UK and Ireland) 610 "Using the work of internal auditors" prohibits use of internal audit to provide "direct assistance" to the audit. Our approach to the use of the work of Internal Audit has been designed to be compatible with these requirements.

We will review reports prepared by Internal audit and meet with them to discuss their work. We will also discuss the work where they have identified specific material deficiencies in the control environment and we will consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we will work together with internal audit to develop an approach that avoids inefficiencies and overlaps, therefore avoiding any unnecessary duplication of audit requirements on the Council's staff.

Obtain an understanding of the Council and its environment including the identification of relevant controls.

Identify risks and controls that address those risks.

Carry out "design and implementation" work on relevant controls.

If considered necessary, test the operating effectiveness of selected controls

Design and perform a combination of substantive analytical procedures and tests of details that are most responsive to the assessed risks.

### Approach to controls testing

Our risk assessment procedures will include obtaining an understanding of controls considered to be 'relevant to the audit'. This involves evaluating the design of the controls and determining whether they have been implemented ("D & I").

The results of our work in obtaining an understanding of controls and any subsequent testing of the operational effectiveness of controls will be collated and the impact on the extent of substantive audit testing required will be considered.

### Consideration of group entities

We expect North Ayrshire Council to consolidate the IJB, the Ayrshire Valuation Joint Board (VJB), Common Good and Trust Funds and 6 other bodies. These will be included in the group accounts for the year ended 31 March 2017. The named bodies are all audited separately to the Council by us. The consolidation of the 6 other bodies is not expected to be individually or cumulatively material.

### Promoting high quality reporting to stakeholders

We view the audit role as going beyond reactively checking compliance with requirements: we seek to provide advice on evolving good practice to promote high quality reporting.

We will utilise the "Code of practice on local authority accounts in the UK disclosure checklist" to support the Council in preparing high quality drafts of the Annual Accounts. We would recommend that the Council also complete this during drafting the accounts.

The Disclosure Checklist reflects the cutting clutter agenda and includes a "not material" column. We would encourage the Council to exclude disclosure if the information is not material.

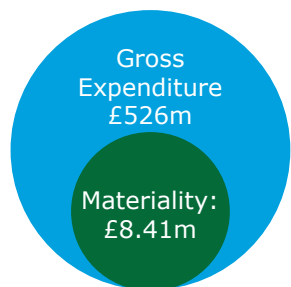


# Materiality

## Approach to materiality



### Basis of materiality – benchmark



- The audit director has estimated materiality as £8.41m and a performance materiality of £6.31m, based on professional judgement, the requirements of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 1.6% gross expenditure less IJB contributions as the benchmark for determining materiality. As the monthly management accounts are prepared on a net expenditure basis, we have estimated that the gross expenditure will be broadly in line with the prior year and will be recalculated on receipt of draft accounts.
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

### Reporting to those charged with governance

Under the current materiality level based on gross expenditure, we will report to you all misstatements found in excess of £168k.

We will report to you misstatements below this threshold if we consider them to be material by nature.

### Our audit report

We will:

- Report the materiality benchmark applied in the audit of the Council;
- Provide comparative data and explain any changes in materiality, compared to prior year, if appropriate; and
- Explain any normalised or adjusted benchmarks we use, if appropriate.

Although materiality is the judgement of the audit director, the Audit and Scrutiny Committee must satisfy themselves that the level of materiality chosen is appropriate for the scope of the audit.

# Significant risks

# Other income recognition

## Recognition of grant income

### Nature of risk

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

The main component of income for the Council, as summarised in the table below is the revenue support grant which is directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%. The significant risk is pinpointed to the recognition of grant income (excluding non ring fenced government grants). Council tax, non-domestic rates and housing rent income are set through the annual budget process, with no management judgement therefore have a low risk of fraud. Similarly, other Service Income includes fees and charges across all Services, which are set through formal approval processes, with no history of fraud or error.

### The key judgement areas, its potential impact on the financial statements and our planned audit challenge

Grant income is a significant risk due to:

- Significant management judgement around determining if there are any conditions attached to a grant and if so whether the conditions have been met; and
- Complex accounting for grant income as the basis for revenue recognition in the accounts will depend on the scheme rules for each grant.

We will perform the following:

- assess management's controls around recognition of grant income; and
- test a sample of capital grants and contributions and grant income credited to Service Income and confirm these have been recognised in accordance with any conditions applicable.

Type of income	2015/16 (£m)	Significant risk
<b>Taxation and Non-Specific Grant Income</b>		
Council Tax income	47.72	
Non domestic rates	42.94	
Revenue support grant	234.95	
Capital grants and contributions	21.25	✓
<b>Service Income</b>		
Grant income (including Housing Benefit)	76.74	✓
Housing rent	44.95	
IJB commissioning income (book entry)	99.06	
Other Service Income	15.86	

### Deloitte comment

We are not aware of any issues arising which would impact on the treatment or recoverability of income during the year

# Valuation of property assets

The valuation of the Council's £900 million of property assets (as at 31 March 2016) is inherently judgemental

## Nature of risk

The Council is required to hold property assets within Property, Plant and Equipment at a modern equivalent use valuation. The valuations are by nature significant estimates which are based on specialist and management assumptions and which can be subject to material changes in value.

## The key judgement areas, its potential impact on the financial statements and our planned audit challenge

The Council held £900 million of property assets at 31 March 2016. The financial year to 31 March 2017 will represent year 1 of a 5 year rolling programme in which 20% of the portfolio will be revalued along with 100% of Council dwellings.

We will perform the following:

- assess management's controls around the valuation of property assets;
- review any revaluations performed in the year, assessing whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified individuals;
- test a sample of revalued assets and re-perform the calculation assessing whether the movement has been recorded through the correct line of the accounts;
- consider material changes of assets not subject to full revaluation during the year;
- consider assets classified as surplus or held for sale to assess whether these have been valued and disclosed in line with IFRS; and
- involve the use of our internal property specialists to review and challenge the assumptions and methodology adopted by the District Valuer and the Council's internal valuation specialist, including sample testing of inputs to the valuations.

## Deloitte comment

We note that regular discussions have taken place with North Ayrshire Council, the internal valuations specialist and the District Valuer. We will use our property specialists to assist in our testing of the Council's property assets.

# Management override of controls

We will use computer assisted audit techniques, to support our work on the risk of management override

## Nature of risk

International Standards on Auditing requires auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor. This recognises that management may be able to override controls that are in place to present inaccurate or even fraudulent financial reports.

## The key judgement areas, its potential impact on the financial statements and our planned audit challenge

Our work will focus on:

- the testing of journals, using data analytics to focus our testing on higher risk journals;
- significant accounting estimates. In addition to the estimates discussed above in respect of property valuations, we will also consider any other provisions and accruals; and
- any unusual transactions or one-off transactions, including those with related parties.

Our wider response to the risk of fraud is set out in the Appendix of this report.

In considering the risk of management override, we will:

- assess the overall position taken in respect of key judgements and estimates;
- consider the sensitivity of the financial statements with respect to the achieving financial balance;
- consider remuneration plans and whether there is any linkage with key management judgements; and
- consider our view on the overall control environment and 'tone at the top'.

## Deloitte comment

No testing has been performed to date as we will complete the above as part of our year-end visit.

# Wider scope requirements

## Audit dimensions

The Code of Audit Practice sets our four audit dimensions which set a common framework for all public sector audits in Scotland. We will consider how North Ayrshire Council in addressing these areas, including any risks to their achievement, as part of our audit work as follows:

Audit dimension	Areas to be considered	Impact on the 2017 Audit
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"><li>• The financial planning systems in place across the shorter and longer terms</li><li>• The arrangements to address any identified funding gaps</li><li>• The affordability and effectiveness of funding and investment decisions made</li></ul>	<p>We will monitor the Council's actions in respect of its short, medium and longer term financial plans to assess whether short term financial balance can be achieved, whether there is a long-term (5-10 years) financial strategy and if investment is effective.</p> <p>As set out on page 18, as part of our best value work, we will also assess the Council's performance in undertaking transformational change, reliance on reserves and achievement of savings targets.</p>
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p>	<ul style="list-style-type: none"><li>• Systems of internal control</li><li>• Budgetary control system</li><li>• Financial capacity and skills</li><li>• Arrangements for the prevention and detection of fraud</li></ul>	<p>As noted on page 8, we will review internal audit reports in relation to their work on the key financial controls. We will review the budget and monitoring reporting to the Council during the year to assess whether financial management and budget setting is effective.</p> <p>We will invite North Ayrshire Council to take part in the Deloitte benchmarking survey to assess the level of financial capacity and skills within the Council.</p> <p>Our fraud responsibilities and representations are detailed on pages 24 and 25.</p>



# Wider scope requirements (continued)

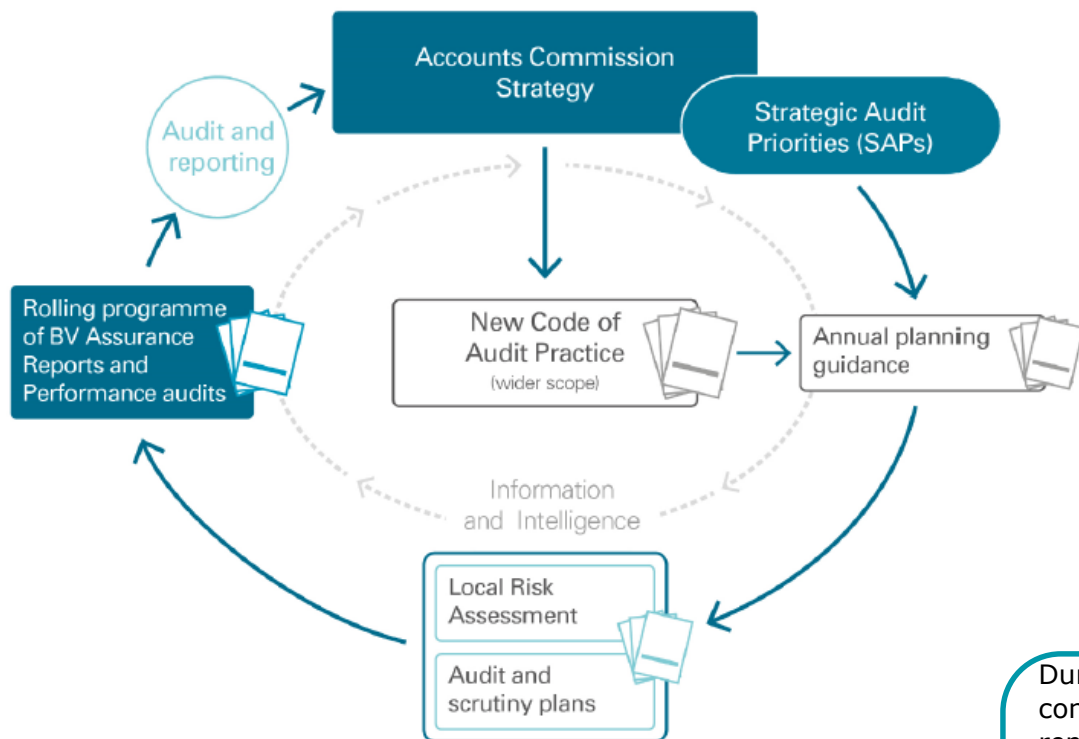
## Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2017 Audit
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<ul style="list-style-type: none"> <li>• governance arrangements</li> <li>• Scrutiny, challenge and transparency on decision making and financial and performance reports</li> <li>• Quality and timeliness of financial and performance reporting</li> </ul>	<p>We will review the financial and performance reporting to the Council during the year as well as minutes of all Committee meetings to assess the effectiveness of the governance arrangements. Our attending at Audit and Scrutiny Committees will also inform our work in this area.</p> <p>We will also review the governance of the Medium Term Financial Outlook and the benefits realisation process.</p> <p>We will review the current arrangements and plans in relation to the IJB as they develop, sharing best practice.</p>
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<ul style="list-style-type: none"> <li>• Value for money in the use of resources</li> <li>• Link between money spent and outputs and the outcomes delivered</li> <li>• Improvement of outcomes</li> <li>• Focus on and pace of improvement.</li> </ul>	<p>We will gain an understanding of the Council's self-evaluation arrangements to assess how it demonstrates value for money in the use of resources and the linkage between money spent and outputs and outcomes delivered.</p> <p>We will also consider the arrangements the Council has in place to monitor how it is achieving its targets and addressing areas of poor performance. This will include following up on progress with the improvement plan which was developed to address the areas for improvement arising from the Recognised for Excellent assessment and award feedback report.</p>

# Wider scope requirements (continued)

## Best value

In June 2016 the Accounts Commission formally agreed the overall framework for a new approach to auditing Best Value (BV). This new approach fulfils the Commission's desire that it is proportionate, risk-based and outcome-focused, providing the Commission and the public with more regular assurance about the performance of Councils. Audit Scotland are bringing together audit work on Best Value, the annual financial audit and the multi-agency shared risk assessment process, and this will continue to support its work with its strategic scrutiny partners. The audit planning framework is set out below.



The objectives of the new approach include:

- the Controller of Audit providing a Best Value Assurance Report (BVAR) to the Commission for each Council at least once in a five year period;
- greater emphasis on driving continuous improvement in Councils;
- greater emphasis on the performance, outcomes and impact made by a Council;
- maintaining a proportionate and risk based approach;
- Performance Audit Best Value (PABV) and local auditors working together, and liaising with other scrutiny body representatives on an ongoing basis; and
- emphasising that it is first and foremost a Council's responsibility to demonstrate that it is meeting its statutory duties, and that its own self evaluation can accurately show its level of performance and that the pace, depth and continuity of its improvement is appropriate.

During 2016/17, we will work closely with PABV staff to plan and complete this work and report our findings and conclusions in our annual report to the Audit and Scrutiny Committee.

The PABV Contact from Audit Scotland for North Ayrshire Council is Mark MacPherson.

In addition, to inform the Controller of Audit's Annual Assurance and Risk Report to the Accounts Commission, we will submit a data return covering our audit work by 2 October 2017.

# Wider scope requirements (continued)

## Strategic audit priorities

As noted on page 16, the Accounts Commission is reviewing its strategic planning arrangements and has agreed five **Strategic Audit Priorities** that will be built into audit expectations which are set out below. We will consider these priorities as part of our audit work and report in in our Annual Report to the Audit and Scrutiny Committee in September 2017 how we will plan our work and report on these areas across the five year appointment.



We have reviewed the BV intelligence summary prepared by your previous auditors as part of handover to inform our planning.

During the 2016/17 audit, we will work with our colleagues in PABV to undertake a baseline assessment of the Council's position across these Strategic Audit Priorities. We will be able to use this baseline to monitor performance and improvement against these priorities across the next five years.

This basis for this assessment will include interviews with key Members, senior officers and other personnel across the Council, observance of committee meetings and review of documents such as Council Plan, Medium Term Financial Outlook, Council communications, consultations and performance data.

We will also consider the arrangements for induction and training of Members following the local election in May 2017.

# Wider scope requirements (continued)

## Best value (continued)

As well as assessing the Council's performance against the Strategic Audit Priorities, we will also consider the following key areas in relation to best value as part of our 2016/17 audit, which closely link to the audit dimensions discussed on pages 14 and 15:

### **Transformational Change**

Assessing the Council's performance in undertaking the transformational change required to drive the Council's journey from 'Good to Great' and meet the priorities set out in the 2015 to 2020 Council Plan and the Transformation 2 (T2) programme.

### **Use of Reserves**

Determining the Council's reliance on reserves to meet its ongoing budgetary pressures and investment in change, and whether this is sustainable in the medium to long term.

### **Achievement of Savings Targets**

Assessing how successful the Council has been in achieving its savings target of £8.818m in 2016/17, including achieving those savings linked to the 'Good to Great' transformation programme.

We will also add value by bringing our knowledge from working with local government and the wider public sector nationally to share examples of innovative approaches undertaken to address your key strategic priority of 'achieving the same or more with fewer resources', for example through initiatives relating to improving productivity, the delivery of a community and place based approach, demand management and digital roll-out.

# Wider scope requirements (continued)

## NFI and Performance audits

### National Fraud Initiative (NFI)

All Councils are participating in the NFI 2016/17. All data was submitted in October 2016 and Councils will receive matches for investigation in January 2017.

In the Council's 2015/16 annual report, Audit Scotland concluded that the Council actively investigated NFI matches and that there were no issues of concern regarding the 2014/15 exercise.

In accordance with Audit Scotland planning guidance, we are required to monitor the Council's participation and progress during 2016/17 and complete an NFI audit questionnaire by 30 June 2017. The information contained in this questionnaire will be used for Audit Scotland's NFI report to be published in June 2018.

### Performance audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits and to inform wider analysis on the following subjects during the year:

Purpose	Date
Contribute to report on ALEOs	Winter 2016/17
Contribute to informed analysis of European Funding	Spring 2017
Contribute to report on Health and Social care integration: part 2	Spring 2017
Contribute to follow up Role of Boards	30 June 2017

# Audit quality

## Our commitment to audit quality

Our objective is to deliver a distinctive, quality audit to you. Every member of the engagement team will contribute, to achieve the highest standard of professional excellence.

In particular, for your audit, we consider that the following steps will contribute to the overall quality:

- We will apply professional scepticism on the material issues and significant judgements identified, by using our expertise in the local government sector and elsewhere to provide robust challenge to management;
- We will obtain a deep understanding of your Council its environment and of your processes in key areas – such as income recognition, payroll expenditure, and capital expenditure - enabling us to develop a risk-focused approach tailored to the Council;
- Our engagement team is selected to ensure that we have the right subject matter expertise and industry knowledge. We will involve IT, Pensions and Estates specialists to support the audit team in our work, leading to high quality understanding and challenge; and
- In order to deliver a quality audit to you, each member of the core audit team has received tailored training to develop their expertise in audit skills which includes local Engagement Team Based Learning. This is a director led programme encouraging teams from across our practice to engage and discuss current sector and audit issues, sharing best practice and expertise. This is in addition to a practice wide health training day held prior to the end of the financial year to share key issues from across the country, to update on regulatory changes and provide early warning of issues other teams may have faced at the interim testing phase.

### Engagement Quality Control Review

We have developed a tailored Engagement Quality Control approach. Our dedicated Professional Standards Review (PSR) function will provide a 'hot' review before any audit or other opinion is signed. PSR is operationally independent of the audit team, and supports our high standards of professional scepticism and audit quality by providing a rigorous independent challenge.



# Purpose of our report and responsibility statement

## Our report is designed to help you meet your governance duties

### What we report

Our report is designed to establish our respective responsibilities in relation to the financial statements audit, to agree our audit plan and to take the opportunity to ask you questions at the planning stage of our audit. Our report includes:

- Our audit plan, including key audit judgements and the planned scope;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

- As you are aware, our audit is not designed to identify all matters that may be relevant to the Audit and Scrutiny Committee.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

### Other relevant communications

- This report should be read alongside the supplementary "Briefing on audit matters" circulated separately on 16 February 2017.
- We will update you if there are any significant changes to the audit plan.

We welcome the opportunity to discuss our report with you and receive your feedback.



**Deloitte LLP**

Chartered Accountants

Glasgow

16 February 2017

This report has been prepared for the Audit and Scrutiny Committee, as a body, and we therefore accept responsibility to you alone for its contents. We accept no duty, responsibility or liability to any other parties, since this report has not been prepared, and is not intended, for any other purpose.

# Appendices

# Fraud responsibilities and representations

## Responsibilities explained



### Your responsibilities

- The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations.

### Our responsibilities

- We are required to obtain representations from your management regarding internal controls, assessment of risk and any known or suspected fraud or misstatement.
- As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.
- As set out in the significant risks section of this document, we have identified the risk of fraud in income recognition and management override of controls as a key audit risk for your organisation.

### Fraud characteristics

- Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor between fraud and error is whether the underlying action that results in the misstatement of the financial statements is intentional or unintentional.
- Two types of intentional misstatements are relevant to us as auditors – misstatements resulting from fraudulent financial reporting and misstatements resulting from misappropriation of assets.

## We will request the following to be stated in the representation letter signed on behalf of the Council:

- We acknowledge our responsibilities for the design, implementation and maintenance of internal control to prevent and detect fraud and error.
- We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.
- We are not aware of any fraud or suspected fraud / We have disclosed to you all information in relation to fraud or suspected fraud that we are aware of and that affects the entity or group and involves:  
(i) management; (ii) employees who have significant roles in internal control; or (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

# Fraud responsibilities and representations (continued)



We will make the following inquiries regarding fraud:

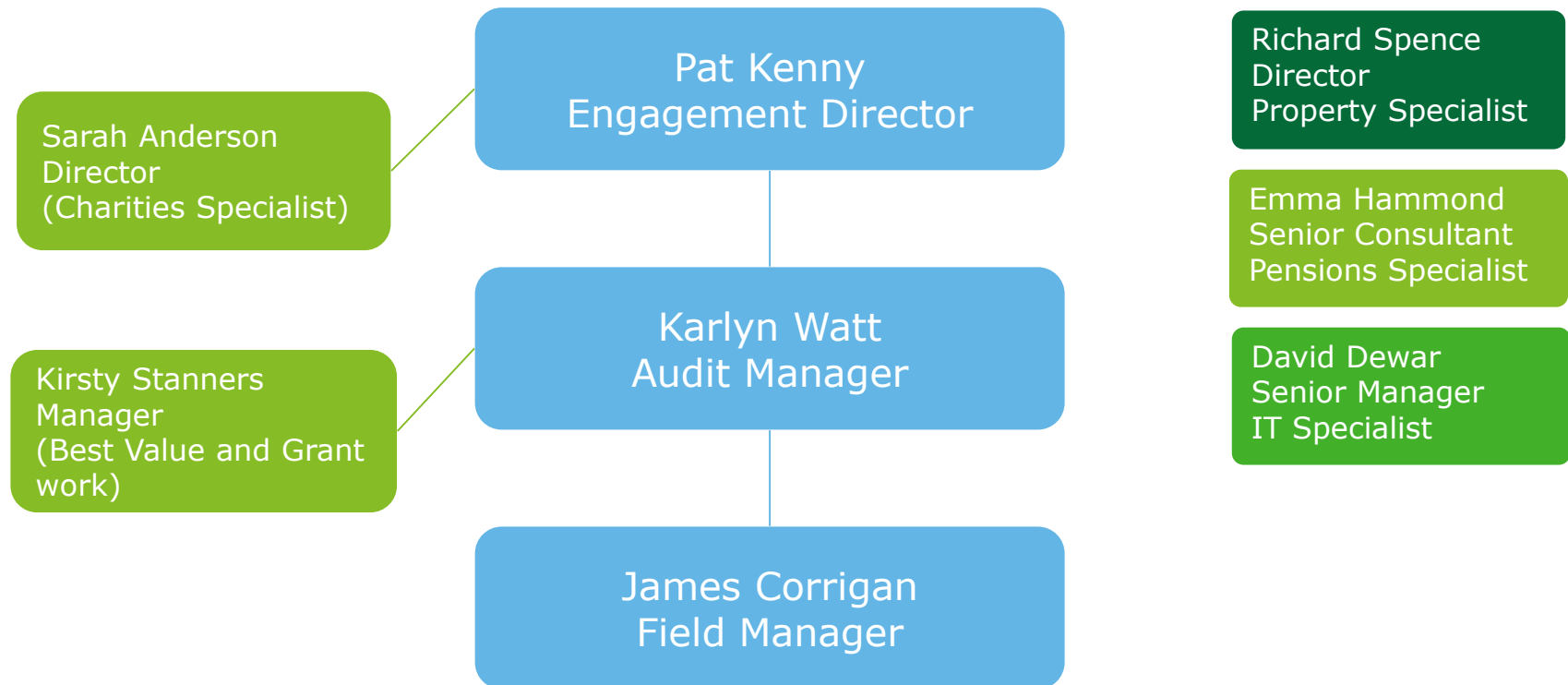
Management	Internal Audit & Local Counter Fraud Specialist	Those charged with governance
<p>Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.</p> <p>Management's process for identifying and responding to the risks of fraud in the entity.</p> <p>Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.</p> <p>Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.</p> <p>Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.</p> <p>We plan to involve management from outside the finance function in our inquiries.</p>	<p>Whether internal audit and the Local Counter Fraud Specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain its views about the risks of fraud.</p>	<p>How those charged with governance exercise oversight of management's processes for identifying and responding to the risks of fraud in the entity and the internal control that management has established to mitigate these risks.</p> <p>Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.</p> <p>The views of those charged with governance on the most significant fraud risk factors affecting the entity.</p>

We will also perform procedures in relation to the National Fraud Initiative as set out on page 19.

# Your audit team and timetable

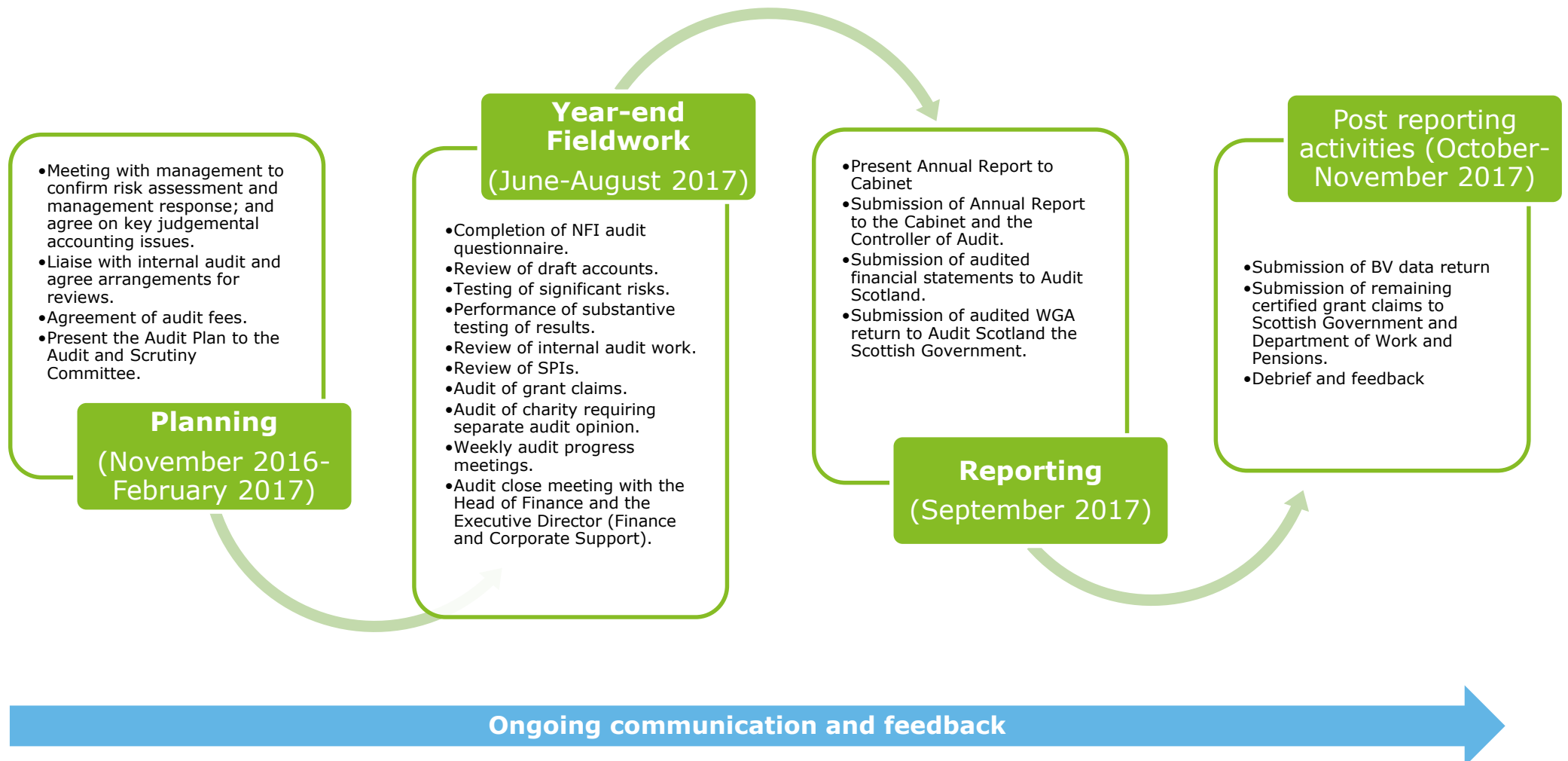
## We have a highly experienced audit team

We set out below our audit engagement team. We manage our audit on a basis that it draws on the expertise of our public sector group.



# Your audit team and timetable (continued)

Set out below is the approximate expected timing of our reporting and communication with North Ayrshire Council and Audit Scotland.





# Independence and fees



As part of our obligations under International Standards on Auditing (UK and Ireland), we are required to report to you on the matters listed below:

---

## Independence confirmation

We confirm we are independent of the Council and will reconfirm our independence and objectivity to the Audit and Scrutiny Committee for the year ending 31 March 2017 in our final report to the Audit and Scrutiny Committee.

---

## Fees

The audit fee for 2016/17, in line with the fee range provided by Audit Scotland in late December 2016, is £290,290 as analysed below:

	<b>£</b>
Auditor remuneration	174,550
Audit Scotland fixed charges:	
Pooled costs	15,200
Performance audit and Best Value	90,120
Audit support costs	10,420
<b>Total proposed fee</b>	<b>290,290</b>

Details of all non-audit services fees for the period will be presented in our final report.

---

## Non-audit services

In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the Council's policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.

# Technical developments

## Sector developments



### Code of practice on local authority accounting in the UK 2016/17

The main changes in this edition of the Code are as follows:

- The new requirement for an expenditure and funding analysis.
- Revised formats and reporting requirements for the comprehensive income and expenditure statement and movement in reserves statement. Authorities are now required to present service analysis based on the organisation structure under which they operate.
- A new section on measuring the highways network asset (however see update below)
- Amendments in respect of accounting and reporting by pension funds.
- Other changes relate to amendments to IFRS, the annual governance statement, and the new conceptual framework for public bodies.

### 2016/17 SeRCOP

Changes have been made to the social work Service Expenditure Analysis (SEA) in respect of the integration of health and social care. There is a new division of service for the contribution to integration joint boards that should be separately presented on the face of the comprehensive income and expenditure statement. As noted above, the accounting code has been amended to instead require the income and expenditure analysis to be based on the authority's organisation structure

### Revised good governance framework

CIPFA and Solace have issued a revised framework for good governance in local government from 2016/17. *Delivering good governance in local government framework 2016* defines the principles that should underpin the governance of each local government organisation. It provides a structure to help individual authorities with their approach to governance. Local authorities are required to prepare an annual governance statement in order to report publicly on the extent to which they comply with their own code of governance, which in turn is consistent with the good governance principles in the framework.

### Revised statement on CFO role in local government

CIPFA has issued a revised statement on The role of the chief financial officer in local government which aims to give detailed advice on how to apply within local government the overarching statement on the role of the public service chief finance officer (CFO). The *Delivering good governance in local government framework* requires authorities to ensure that their financial management arrangements conform with this statement, or explain why they do not and how they deliver the same impact.

### Highway network assets

CIPFA has issued a revised *Code of practice on the highways network asset* to support an asset management-based approach to the provision of financial information about the local authority highways network asset (HNA) from 2016/17.

At its meeting on 9 November 2016, CIPFA/ LASAAC Local Authority Accounting Code Board (CIPFA/ LASAAC) decided to postpone the full implementation of the move to measuring the HNA at Depreciated Replacement Cost in local authorities financial statements. It will issue an update to the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom to confirm this decision once it has completed the full due process.

# Our approach to quality

## AQR team report and findings

### Audit quality and regulation

We pride ourselves on our commitment to quality and our quality control procedures. We have an unyielding pursuit of quality in order to deliver consistent, objective and insightful assurance.

In May 2016 the Financial Reporting Council ("FRC") issued individual reports on each of the six largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the year ended 31 March 2016. We adopt an open and communicative approach with the regulator and their report is an accurate reflection of our efforts to improve audit quality across our practice over a number of years.

The review performed by the AQR forms an important part of our overall inspection process. We perform causal factor analysis on each significant finding arising from both our own internal quality review and those of our regulators to identify the underlying cause. This then drives our careful consideration of each of the FRC's comments and recommendations, as well as findings arising from our own reviews to provide further impetus to our quality agenda.

18 of the audits reviewed by the AQR were performed to a good standard with limited improvements required and four audits required improvements. No audits were assessed as requiring significant improvements. We have already taken action to respond to the key themes of the report and will continue to undertake further inputs to our audit quality improvement programmes to embed the changes into our practice.

### The AQR's conclusion on Deloitte

"We reviewed selected aspects of 22 individual audits in 2015/16. In selecting which aspects of an audit to inspect, we take account of those areas identified to be of higher risk by the auditors and Audit Committees, our knowledge and experience of audits of similar entities and the significance of an area in the context of the audited financial statements.

In response to our last inspection report, the firm has made a number of improvements to its policies and procedures:

- The firm's guidance regarding the testing of journals has been enhanced.
- Additional sector-specific training was provided for individuals involved in financial services audits, together with additional training on internal controls for all audit staff.
- The firm has made a number of improvements to its internal monitoring process, including the development of a moderation process in order to increase consistency.

Our key findings in the current year requiring action by the firm are that the firm should:

- Improve the extent of challenge of management in relation to areas of judgment, in particular for impairment reviews and judgmental valuations.
- Improve aspects of its audit approach in the areas of revenue and inventory.
- Ensure high quality reporting to Audit Committees is achieved on a consistent basis.
- Strengthen its audit approach in relation to defined benefit pension scheme balances and disclosures.
- Strengthen its policies and procedures regarding the engagement quality control review process."

### 2015/16 Audit Quality Inspection Report on Deloitte LLP

# Our approach to quality (continued)

## AQR team report and findings (continued)

### Review of individual audits

The following chart provides a summary of the AQR's assessment of the quality of our individual audits inspected in 2015/16, with comparatives for the previous 4 years. The chart also shows the 5 year average of Deloitte and the 5 year average of the 6 largest firms inspected by the AQR (which comprises Deloitte LLP, Ernst & Young LLP, KPMG LLP, PricewaterhouseCoopers LLP, BDO LLP and Grant Thornton UK LLP).

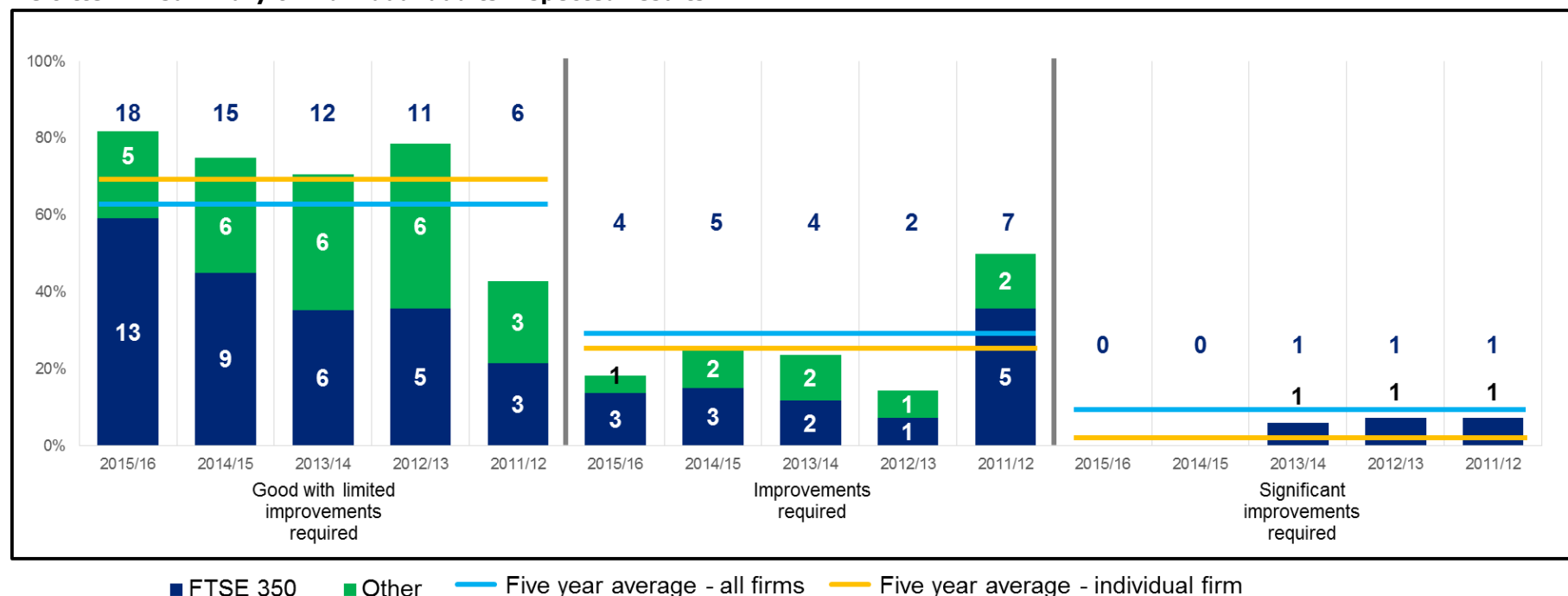
The AQR categorises audits as either:

- Good with limited improvements required
- Improvements required
- Significant improvements required

Changes to the proportion of audits reviewed falling within each grade from year to year reflect a wide range of factors, which may include the size, complexity and risk of the individual audits selected for review and the scope of the individual reviews. For this reason, and given the sample sizes involved, changes in gradings from one year to the next are not necessarily indicative of any overall change in audit quality at the firm.

All the AQR public reports on individual firms are available on its website <https://www.frc.org.uk/Our-Work/Conduct/Audit-Quality-Review/Audit-firm-specific-reports.aspx>

### Deloitte LLP summary of individual audits inspected results





Other than as stated below, this document is confidential and prepared solely for your information and that of other beneficiaries of our advice listed in our engagement letter. Therefore you should not, refer to or use our name or this document for any other purpose, disclose them or refer to them in any prospectus or other document, or make them available or communicate them to any other party. If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities). In any event, no other party is entitled to rely on our document for any purpose whatsoever and thus we accept no liability to any other party who is shown or gains access to this document.

© 2017 Deloitte LLP. All rights reserved.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 2 New Street Square, London EC4A 3BZ, United Kingdom.

Deloitte LLP is the United Kingdom member firm of Deloitte Touche Tohmatsu Limited ("DTTL"), a UK private company limited by guarantee, whose member firms are legally separate and independent entities. Please see [www.deloitte.co.uk/about](http://www.deloitte.co.uk/about) for a detailed description of the legal structure of DTTL and its member firms.