North Ayrshire Council

Planning report to the Audit and Scrutiny Committee on the audit for the year ending 31 March 2018

27 March 2018

Deloitte Confidential: Public Sector

Contents

Planning report

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.

We have pleasure in presenting our draft planning report to the Audit and Scrutiny Committee of North Ayrshire Council (the Council) for the year ending 31 March 2018 audit. We would like to draw your attention to the key messages of this draft audit plan:

Audit Plan

We have updated our understanding of the Council including discussion with management and review of relevant documentation from across the Council as well as Audit Scotland performance audit reports published during the year.

Based on these procedures, we have developed this plan in collaboration with the Council to ensure that we provide an effective audit service that meets your expectations and focuses on the most significant areas of importance and risk to the Council.

We have taken an initial view as to the significant audit risks the Council faces. These are presented as a summary dashboard on page 18.

- In accordance with auditing standards, we have identified a significant risk associated with income. This risk is pinpointed to the recognition of grant income (excluding General Revenue Grant and Housing Benefit income) as this involves a degree of complexity and management judgement in determining whether or not grant conditions have been met and the income can be recognised in the year. In 2016/17 the total grant income received excluding General Revenue Grant and Housing Benefit income was £57,185k, which was 13.3% of total grant income received in the year (£428,695k).

- In accordance with auditing standards, management override of controls has also been identified as a significant audit risk.

- We have also identified the valuation of property assets as a significant risk in line with the prior year given the degree of judgement and complexity involved and its material impact on the financial statements.

Director introduction (continued)

The key messages in this report (continued):

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 the Council is addressing these and report our conclusions in our annual report to the Audit and Scrutiny Committee in September 2018. In particular, our work will focus on:

  - ***Financial sustainability*** – the Council continues to face significant financial challenges. The overall 2017/18 forecast position as at 30 November 2017 projects a net underspend of £2,332k in its revenue budget and £507k in its capital budget. This is based on the assumption that total expenditure incurred by the Integration Joint Board (IJB) in the year will be within budget and that the Council will not fund any overspend – however, the IJB is projecting an overspend in the year of £5,315k, of which £2,242k relates to Council commissioned services.

  - The Council has proposed that the net in-year underspend for 2017/18 is utilised as part of the budget strategy for 2018/19 to address the identified funding gap, as noted below.

  - The Council's Medium Term Financial Plan is refreshed and approved annually and includes savings targets linked to the Long Term Financial Plan. Estimated funding gaps of £16,180k and £9,371k have been identified for 2019/20 and 2020/21 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.

- The Council anticipates that there will be further significant cash reductions in the General Revenue Grant from the Scottish Government over the forthcoming years, and 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.

- The Accounts Commission raised concern in its 2016/17 financial overview report regarding the level of reserve drawdowns made by North Ayrshire Council to fund its services, stating that the Council's General Fund could run out within two years if its planned reliance on reserves in 2017/18 continued. During the 2016/17 audit we found that the Council agreed to retain unearmarked reserves at 2% of budgeted net expenditure which is at the lowest end of best practice percentage. We also noted that a sum of £2,600k arising from the in year underspends was earmarked to support a range of non-recurring investments in 2017/18, including the establishment of the 'Challenge Fund' in collaboration with the IJB. We will assess the Council's reserves position going forward and the plans put in place to ensure reliance on reserves is maintained at a sustainable level.

- 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. Currently, there is a risk around how benefits are realised from service redesign projects and how this impacts on achieving financial targets.

Director introduction (continued)

The key messages in this report (continued):

- ***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 financial control environment to assess whether financial management and budget setting is effective. We will also assess the capacity of the finance team in view of the recent departure of the Head of Finance and a separate interim appointment of the Chief Finance and Transformation Officer for the IJB.

- From our audit work in 2016/17 we found that the Council had strong financial monitoring arrangements and is robust enough to sufficiently capture and changes in the achievement of financial targets, including budgeted use of reserves.

- There remains a general risk that a lack of appropriate financial management could result in the Council not achieving its financial targets.

- ***Governance and transparency*** – from our review of Council papers and attendance at Audit and Scrutiny Committees we will assess the effectiveness of governance arrangements and Audit and Scrutiny Committee attendance. We will also review the governance arrangements in relation to the Integrated Joint Board (IJB). As the IJB is still relatively new and faces significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the Council and the IJB (and the partner NHS Board) are not effective.

- ***Value for money*** – from our 2016/17 audit work we concluded that the Council had a well established performance management framework in place, with performance regularly considered by management, and the Council. During 2017/18 we will review how the Council is addressing areas where targets are not being met and also how the implementation of strategic change is impacting on how the Council's performance is measured and reported. There is a risk that insufficient resources are targeted to areas of under performance.

Best Value and Strategic Audit Priorities

As part of our best value work, we will consider the five Strategic Audit Priorities agreed by the Accounts Commission and update our assessment of the baseline position of the Council's performance established in 2016/17 against these priorities. We will assess how effectively the Council undertakes transformational change through its T2 programme, and whether savings targets are being achieved.

Director introduction (continued)
The key messages in this report (continued):

Other wider scope work

We will continue to monitor the Councils participation and progress with the National Fraud Initiative (NFI) during 2017/18 and completed an Audit Scotland audit questionnaire by 28 February 2018.

In accordance with Audit Scotland guidance, we will be requested to provide information to support national performance audits on Digital and Health and Social Care Integration.

Regulatory Change

There are limited changes this year affecting the audit, through the Code of practice on local authority accounting or statutory guidance.

We would highlight that new accounting standards on financial instruments will apply from 2018/19, and for leases from 2019/20, and it is important that the Council considers their impact ahead of implementation. See pages 33-34 for more details.

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.

Adding value

Our aim is to add value to the Council through our external audit work by being constructive and forward looking, by identifying areas of improvement and by recommending and encouraging good practice. In this way, we aim to help the Council promote improved standards of governance, better management and decision making and more effective use of resources.

Pat Kenny
Audit director

Responsibilities of the Audit and Scrutiny Committee

Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Audit and Scrutiny Committee:

- Clearly communicate the planned scope of the financial statements audit
- Provide timely observations arising from the audit that are significant and relevant to the Audit and Scrutiny Committee's responsibility to oversee the financial reporting process
- In addition, we seek to provide the Audit and Scrutiny Committee with additional information to help fulfil your broader responsibilities

As a result of regulatory change in recent years, the role of the Audit and Scrutiny Committee has significantly expanded. We set out here a summary of the core areas of Audit and Scrutiny Committee responsibility to provide a reference in respect of these broader responsibilities and highlight throughout the document where there is key information which helps the Audit and Scrutiny Committee in fulfilling its remit.

Oversight of external audit

- At the start of each annual audit cycle, ensure that the scope of the external audit is appropriate.

- Implement a policy on use of the external auditor for non-audit services and approve if arise.

Integrity of reporting

- Make an impact assessment of key judgements and the level of management challenge.

- Review the external audit findings, key judgements and level of misstatements.

- Assess the quality and capacity of the internal team.

- Assess the completeness of disclosures, including consistency with disclosures on business model and strategy and, where requested by the Council, provide advice in respect of the fair, balanced and understandable statement.

Internal controls and risks

- Review the internal control and risk management systems.

- Explain what actions have been, or are being taken to remedy any significant failings or weaknesses.

-Oversee the work of the Council's local counter fraud service.

Oversight of internal audit

- Consider annually whether the scope of the internal audit programme is adequate.

- Monitor and review the effectiveness of the internal audit activities.

Whistle-blowing and fraud

- Ensure that appropriate arrangements are in place for the proportionate and independent investigation of any concerns that are raised by staff in connection with improprieties.

Our audit explained

We tailor our audit to your Council and your strategy

Identify changes in your Council and environment

The Council continues to face significant financial pressures due to an increase in costs and demand for services as well as a risk of reduced available funding.

The integration of health and social care also continues to be a challenge, as discussed in page 12.

Scoping

Our scope is in line with the Code of Audit Practice issued by the Audit Scotland.

More detail is given on pages 16-17.

In our final report

In our final report to you we will conclude on the significant risks identified in this paper, report to you our other findings, and detail those items we will be including in our audit report.

Determine materiality

We have determined a materiality of £7,891k (2016/17: £9,064k) with a performance materiality of £5,918k (2016/17: £6,797k). This is based on gross expenditure adjusted for net contributions made to the IJB. We have reduced the benchmark percentage applied from 1.6% to 1.4% as explained on page 15. We will report to you any misstatements above £250k (2016/17: £250k). More detail given on page 15.

Significant risk assessment

We have identified significant audit risks in relation to the Council. More detail is given on pages 18-21. These significant risks are consistent with those identified in our prior year audit.

Quality and Independence

We confirm all Deloitte network firms are independent of the Council. We take our independence and the quality of the audit work we perform very seriously. Audit quality is our number one priority.

Deloitte Confidential: Public Sector

Continuous communication and reporting
Planned timing of the audit

Planning
- Planning meetings to inform risk assessment and identify judgemental accounting issues.
- Update understanding of key business cycles and changes to financial reporting, particularly in relation to the new finance ledger system.
- Document design and implementation of key controls.
- Review of key Council documents including Council and Committee minutes.
- Planning work for wider scope responsibilities.

Interim
- Update planning procedures for any changes in the interim period – refresh our risk assessment, understanding of business cycles etc.
- Perform procedures to test the implementation of the new finance ledger system.
- Initiate substantive audit procedures addressing the significant risk around management override of control.
- Initiate audit procedures for wider scope responsibilities, including Strategic Audit Priorities and Best Value.

Year end fieldwork
- Audit of grant claims.
- Audit of charitable trusts.
- Review of draft accounts.
- Substantive testing of all material areas.
- Finalisation of work in support of wider scope responsibilities.
- Detailed review of annual accounts and report, including Annual Governance Statement.
- Review of final internal audit reports and opinion.
- Completion of testing on significant audit risks.
- Review of SPI arrangements.

Reporting
- Final Audit and Scrutiny Committee meeting.
- Issue final Annual Report to the Council and the Controller of Audit.
- Issue audit report and submission of audited financial statements to Audit Scotland.
- Issue audited Whole of Government Accounts (WGA)
- Audit feedback meeting.
- Submit BV data return
- Submission of remaining certified grant claims.

Audit Team

Pat Kenny, Audit Director

Karlyn Watt, Senior Manager

James Corrigan, Manager

Martin Clark, Field Manager

2017/18 Audit Plan — December

Final report to the Audit and Scrutiny Committee — April | June - August | September

Ongoing communication and feedback

An audit tailored to you
Focusing on your business and strategy

	Impact on our audit
Future financial strategy and sustainability	North Ayrshire Council's overall 2017/18 forecast position as at 30 November 2017 projects an underspend of £507k in its capital budget and an underspend of £2,332k in its revenue budget. However, this is on the basis that the IJB achieves a breakeven position. Currently the IJB is forecasting an overspend for 2017/18 of £5,315k, of which £2,242k relates to Council specific elements. The Council, in partnership with the IJB, has established a 'Challenge Fund' of £4,000k to help fund transformational change to the service delivery of health and social care. £2,600k of this is funded by the Council and £1,400k is to be funded though efficiencies made by the IJB. However, the Council has received a request for permission from the IJB to offset £1,400k of this fund against overspend on Council commissioned IJB services in the year in an effort to reduce the £2,242k overspend. The Council carried forward a General Fund reserve balance of £32,049k from 2016/17. This included unearmarked reserves of £6,380k, which was 2% of budgeted net expenditure, however the Council had agreed to retain reserves at 2% of budgeted net expenditure going forward. We concluded in the prior year audit that whilst reserves were at an acceptable level, they were at the lowest end according to best practice guidance and that the Council should consider adopting a more prudent approach in the long term. The Accounts Commission has highlighted the potential for the Council to become over-reliant on reserves to fund services in the medium term, thereby depleting the General Fund and reducing unearmarked reserves further. However, this assessment did not consider the allocation of £2,600k from reserves to the Challenge Fund. The Council anticipates that there will be further significant cash reductions in the General Revenue Grant from the Scottish Government over the forthcoming years, adding to the challenge of the increasing demand and cost of Council services. Estimated funding gaps of £16,180k and £9,371k have been identified for 2019/20 and 2020/21 respectively. We will monitor the Council's plans to achieve short, medium and long term financial sustainability.

New significant risk — Continuing significant risk — Considered as part of wider scope audit requirements

An audit tailored to you

Focusing on your business and strategy (continued)

	Impact on our audit
Health and social care integration	2016/17 was the second full financial year of the Health and Social Care Partnership between NHS Ayrshire and Arran and the North Ayrshire Council through the IJB. This follows on from the Shadow Integration Board which operated for one year in 2014/15. As reported in our 2016/17 annual audit report, the biggest risk facing the IJB was the projected overspend in 2017/18 and the efficiencies required over the next three years to achieve a balanced budget. It is critical that the Council works closely with the IJB and the NHS Board to focus on implementing recurring savings through efficiencies or service redesign. This has already been evidenced through the establishment of the Challenge Fund in partnership with the IJB, and we will continue to monitor progress made as a result of this fund or otherwise. We will continue to review the work being done both at the Council and the IJB to address these funding gaps.
Local Government in Scotland – Financial Overview 2016/17	Audit Scotland published its annual overview report **Local Government in Scotland: Financial Overview 2017** in November 2017. It concluded that, in general, councils' financial challenges continue to grow and they are showing increasing financial stress. As mentioned previously, it also specifically highlighted North Ayrshire Council's position with regards to reserves and the potential for over-reliance on the General Fund. Throughout the report, Audit Scotland has identified examples of questions that councillors may wish to consider to help them better understand their council's financial position and to scrutinise financial performance. The key messages and example questions from the report are summarised on page 28. We note that the report was presented to the Council meeting on 20 December 2017 where members were asked to note the findings of the report, the current position for North Ayrshire Council and consider these as part of the budget deliberations. We will evaluate North Ayrshire Council against these as part of our wider scope work.

New significant risk

Continuing significant risk

Considered as part of wider scope audit requirements

An audit tailored to you

Focusing on your business and strategy (continued)

	Impact on our audit
New finance ledger	In June 2017, the Council's Masterpiece system was replaced by Integra as the new finance ledger system to be used as the primary source of financial information across services. The main aims of the new system were to improve reporting and forecasting capabilities, and to further integrate the financial system across services and operations. The implementation has been considered a success by the Council thus far. However, there are some ongoing issues, particularly in relation to automated reconciliation controls in place, which can often occur following the implementation of a new ledger system. Should these issues remain unresolved at year end, they have the potential to cause significant issues during the audit and could ultimately lead to material misstatements within the financial statements. The key audit risk of implementing a new ledger system relates to the completeness and accuracy of the transfer of information to the new system. As part of our planning procedures we have already updated our understanding of key business processes to reflect changes made as a result of the new system. During our interim and year end fieldwork phases we will perform the following: - Assess the design and implementation of management controls around the transfer of data from the old to new system, in particular the opening and closing trial balances; - Perform a reconciliation between the opening and closing trial balances, taken from the new and old systems respectively, to assess whether all balances have been transferred accurately; - Review the Council's project monitoring arrangements and follow up any issues arising from the Council's implementation processes to ensure that they have been appropriately addressed; and - Review any relevant reports produced by internal audit. We will follow up progress with implementation as part of our wider scope audit requirements and assess any impact on our financial statements audit work.

New significant risk   Continuing significant risk   Considered as part of wider scope audit requirements

Deloitte Confidential: Public Sector

An audit tailored to you

Focusing on your business and strategy (continued)

	Impact on our audit
Finance team capacity	We note that the Head of Finance of the Council, who also had the role of S95 Officer for the IJB has recently left the Council. A permanent replacement for both roles has still to be made, however, the IJB has recently approved the appointment of a full time Chief Finance and Transformation Officer (and s95 officer) specifically for the IJB, recognising the challenges and financial responsibilities it faces. In view of this change in senior role, we will assess the capacity of the finance team.

New significant risk

Continuing significant risk

Considered as part of wider scope audit requirements

Materiality

Our approach to materiality

Basis of our materiality benchmark

- The audit director has determined materiality as £7,891k (2016/17: £9,064k) and a performance materiality of £5,918k (2016/17: £6,797k), based on professional judgement and risk factors specific to North Ayrshire Council, the requirement of auditing standards and the financial measures most relevant to users of the financial statements. Performance materiality is the benchmark used as part of our detailed audit procedures, and is set at a lower level to reduce the probability that the aggregate of individually immaterial uncorrected and undetected misstatements exceeds overall materiality.
- We have used 1.4% of forecasted gross expenditure adjusted for net contributions to the IJB as the benchmark for determining materiality in line with prior year. This is a decrease from 1.6% applied in 2016/17 – this is the result of our professional judgement in response to the increased audit risk resulting from Accounts Commissions' concerns regarding North Ayrshire Council's reduction is unearmarked reserves.

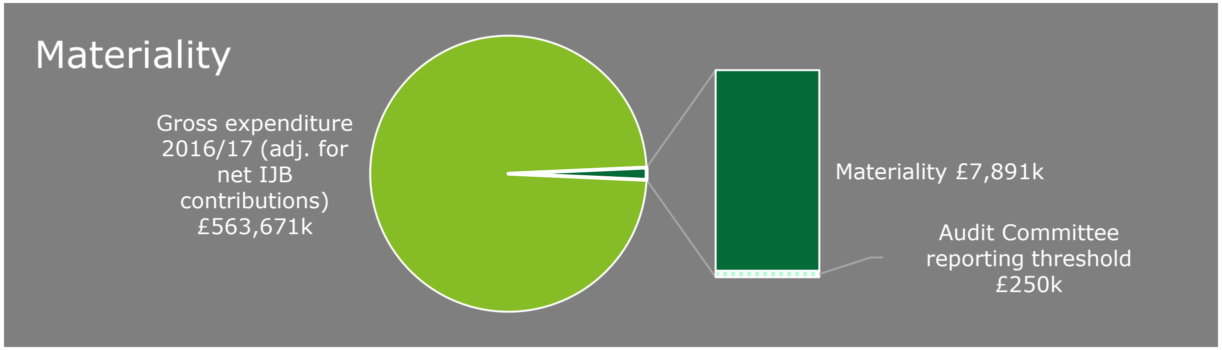
Reporting to those charged with governance

- We will report to you all misstatements found in excess of our clearly trivial threshold (CTT) which is £250k (2016/17: £250k).
- As in prior year, we have followed Audit Scotland guidance by ensuring this threshold does not exceed £250k. As a result of the decrease in materiality, the level of our CTT has increased to 3.2% (2016/17: 2.8%) of materiality.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

Our annual 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.

Scope of work and approach
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 consolidation packs);
- 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 Auditor General for Scotland 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 has reviewed 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 Councils are ensuring members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future.
- How well Councils are involving citizens in decisions about services and empowering local communities to identify and help deliver services they need.
- The quality of Councils' reporting of their performance to enhance accountability to citizens and communities.

Scope of work and approach (continued)
Our approach

Liaison with internal audit

The Auditing Standards Board's version of ISA (UK) 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 their reports and meet with them to discuss their work. We will discuss the work plan for internal audit, and where they have identified specific material deficiencies in the control environment we consider adjusting our testing so that the audit risk is covered by our work.

Using these discussions to inform our risk assessment, we can 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.

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.

- 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.

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 five other bodies. These will be included in the group accounts for the year ended 31 March 2018. The named bodies are all audited separately to the Council by us. The consolidation of the five 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 Report and financial statements, which we would recommend the Council complete during drafting.

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.

Significant risks
Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
Recognition of grant income	✓	✓	Design and implementation	⚠	19
Management override of controls	✓	✓	Design and implementation	⚠	20
Valuation of property assets	✓	✗	Design and implementation	⚠	21

⚠ Some degree of management judgement

⚠ Limited management judgement

Deloitte Confidential: Public Sector

Significant risks (continued)

Risk 1 – Recognition of grant income

Risk identified

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.

Key components of income for the Council, as summarised in the table to the left, are the General Revenue Grant and non-domestic rates which are 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 General Revenue Grant income). Council tax, non-domestic rates and housing rent income are set through the annual budget process with no management judgement and 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.

Type of income	2016/17 (£m)	Significant risk
Taxation and Non-Specific Grant Income		
Council Tax income	47.9	
Non domestic rates	41.5	
General Revenue Grant	227.1	
Capital grants and contributions	25.2	✓
Service Income		
Grant income	32.0	✓
Housing Benefit Funding	55.0	
Housing rent	45.4	
IJB commission income (book entry)	113.4	
Other Service Income	60.9	

Our response

Grant income is a significant risk due to:

- management judgement in 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.

Deloitte Comment

We are not aware of any issues arising during our planning work which would impact on the treatment of income during the year.

Significant risks (continued)
Risk 2 – Management override of controls

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

Risk identified	In accordance with ISA 240 (UK and Ireland) management override is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council's controls for specific transactions. The key judgments in the financial statements are those which we have selected to be the significant audit risks around recognition of grant income and valuation of property assets. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.
Planned audit challenge	In considering the risk of management override, we plan to perform the following audit procedures that directly address this risk: • We will test journals, using our Spotlight data analytics tool, to focus our testing on higher risk journals; • We will review accounting estimates for bias that could result in material misstatements due to fraud; • We will obtain an understanding of the business rationale of significant transactions that we become aware of that are outside of the normal course of business for the entity, or that otherwise appear to be unusual, given our understanding of the entity and its environment.
Deloitte Comment	We have not identified in our prior year audit work any transactions which appear unusual or outside the normal course of business. We have completed our testing on the design and implementation of controls around management override of controls and note no issues.

Significant risks (continued)
Risk 3 – Valuation of property assets

We will engage Deloitte Real Estate specialists to assist our testing of the revaluation of the £947m property asset portfolio.

Risk identified	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.
Planned audit challenge	The Council held £946,871k of property assets at 31 March 2017. The financial year to 31 March 2018 will represent year 2 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 • review and challenge the assumptions and methodology adopted by the Council's external valuer, including sample testing of inputs to the valuations.
Deloitte Comment	A number of areas for improvement were highlighted in the prior year audit in relation to the valuation process. We noted that these areas needed to be addressed to prevent future material errors in the financial statements. We will assess progress made in relation to these recommendations following the current year end. We are aware that the Council is in the midst of a tendering process for an external valuer to perform this year's valuation.

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 the 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 2017/18 Audit
Financial sustainability 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.	• The financial planning systems in place across the shorter and longer terms • The arrangements to address any identified funding gaps • The affordability and effectiveness of funding and investment decisions made • Workforce planning	From our work in 2016/17 we found that the Council has been successful in making significant savings over the previous 6 years, however further savings were required to reduce reliance on reserves to a sustainable level going forward. We also found that the Council had effective medium to long term financial planning procedures in place. We will assess whether the Council continues to have effective short, medium and long term financial planning systems in place so it can achieve financial sustainability over the next 5-10 years. We will also assess the effectiveness of the Council's efforts to achieve further sustainable efficiencies, in particular through the T2 transformational change programme. **Audit Risk:** There is a risk that the plans for medium to long term efficiencies and transformational change are not robust enough to allow benefits to be realised. Adequate efficiencies also may not be identified, hindering the Council's ability to achieve sustainability.
Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively	• Systems of internal control • Budgetary control system • Financial capacity and skills, including plans for replacing the recently departed Head of Finance. • Arrangements for the prevention and detection of fraud	We will review the budget and monitoring reporting to the Council during the year to assess whether financial management and budget setting is effective. From our audit work in 2016/17 we found that the Council had sound financial management procedures in place. Our fraud responsibilities and representations are detailed on pages 38-39. **Audit Risk:** A lack of appropriate financial management could result in the Council not achieving its financial targets.

Wider scope requirements (continued)

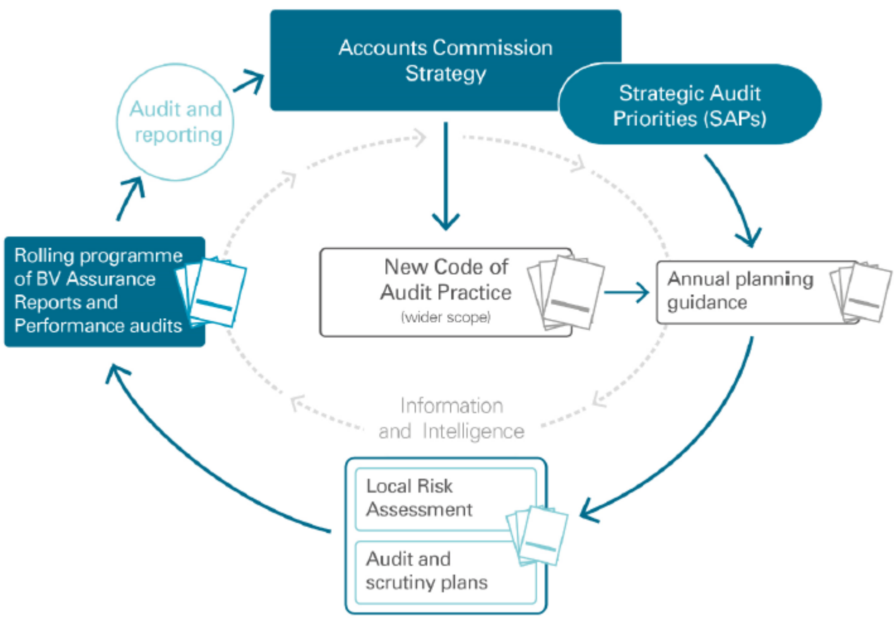
Audit dimensions (continued)

Audit dimension	Areas to be considered	Impact on the 2017/18 Audit
Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.	• governance arrangements • Scrutiny, challenge and transparency on decision making and financial and performance reports • Quality and timeliness of financial and performance reporting	We will review the financial and performance reporting to the Council during the year as well as minutes of all Council and key Committee meetings to assess the clarity and effectiveness of the governance arrangements. Our attendance at Audit and Scrutiny Committees will also inform our work in this area. We will also review the governance arrangements in relation to the IJB. **Audit Risk:** As the IJB is still relatively new and has significant challenge around long term financial sustainability, there is a risk that the governance arrangements between the Council and the IJB (and the partner NHS Board) are not effective.
Value for money is concerned with using resources effectively and continually improving services.	• Value for money in the use of resources • Link between money spent and outputs and the outcomes delivered • Improvement of outcomes • Focus on and pace of improvement.	From our 2016/17 audit work we concluded that the Council had a well established performance management framework in place, with performance regularly considered by management and the Council members. During 2017/18 we will review how the Council is addressing areas where targets are not being met and also how the implementation of transformational change is impacting on how the Council's performance is measured and reported. **Audit Risk:** There is a risk that insufficient resources are targeted to areas of under performance.

Wider scope requirements
Best value

In June 2016 the Accounts Commission formally agreed the overall framework for a new approach to auditing Best Value (BV). This framework introduced a five year approach to auditing BV. 2017/18 represents year two of the BV audit plan. Under this approach, the Controller of Audit will provide a Best Value Assurance Report (BVAR) to the Commission for each Council at least once in a five year period. The national five year BVAR programme is updated each year reflecting changes to risk assessments identified from the SRA process or annual audits. North Ayrshire Council has not been identified for a BVAR report in 2017/18.

The audit planning framework is set out below.



In 2016/17, as well as assessing the Council's performance against the Strategic Audit Priorities (page 25), we considered the following key areas in relation to best value:

- Transformational Change
- Use of Reserves
- Achievement of Savings Targets

In 2017/18, we will follow up on the above areas, and also continue to focus on the Council's arrangements for demonstrating Best Value.

Our work will be integrated into our audit approach, including our work on the audit dimensions discussed on pages 22-23, and will be reported in our annual audit report.

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 1 October 2018.

Wider scope requirements (continued)
Strategic Audit Priorities

In its Strategy, which is updated annually, the Accounts Commission sets out an overall aim of holding councils to account for their pace, depth and continuity of improvement facilitated by effective governance. Within this, the Commission also sets out five **Strategic Audit Priorities** that will be built into audit expectations, which are set out below.

Council Priorities and Long Term Planning

The clarity of Council priorities and quality of long-term planning to achieve these.

Changes in Service Delivery

How effectively Councils are evaluating and implementing options for significant changes in delivering services.

Members and officers knowledge, skills and support

How Councils are ensuring members and officers have the right knowledge, skills and support to design, develop and delivery effective services for the future.

Citizen involvement

How well Councils are involving citizens in decisions about services and empowering local communities to identify and help deliver services they need.

Quality of reporting

The quality of Councils' reporting of their performance to enhance accountability to citizens and communities.

During our 2016/17 audit, we worked with our colleagues in Audit Scotland's Performance Audit and Best Value group (PABV) to undertake a baseline assessment of the Council's position across these Strategic Audit Priorities, which was reported in our Annual Audit Report to the Audit and Scrutiny Committee in September 2017.

During 2017/18, we will assess what progress the Council has made in each of these priority areas. The 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 key documents such as the Council's Long Term Financial Plan, Medium Term Financial Plan and T2 Transformation Programme.

Wider scope requirements (continued)

Specific risks

As part of the 2017/18 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. While we have not identified any specific risks in relation to these areas for the Council, we will continue to monitor these areas as part of our audit work.

Risk	
EU withdrawal	There remains significant uncertainty about the detailed implications of EU withdrawal. Nonetheless, given the potential timetables involved, it is critical public sector bodies are working to understand, assess and prepare for the impact on their business. Key aspects of this are likely to include three broad areas: - Workforce - Funding - Regulation
New Financial Powers	The provisions of the 2012 and 2016 Scotland Acts and the accompanying Fiscal Framework agreement are leading to fundamental changes to the Scottish public finances. New tax raising, borrowing and social security powers provide the Scottish Parliament with more policy choice, but also mean the Scottish budget is subject to greater volatility, uncertainty and complexity. There is also a stronger link between the performance of the Scottish economy (relative to the rest of the UK) and available funding. The changes are likely to impact across public sector bodies to varying degrees, both directly (for example where an organisation's activities include additional responsibilities as a result of the new powers) and indirectly (for example as a result of potential changes to the way the Scottish Government manages its overall budget).

Wider scope requirements (continued)

Specific risks (continued)

Risk	
Ending of public sector pay cap	Pay increases in the public sector have been frozen and then capped at 1% for seven years. Politicians in both Westminster and Holyrood are talking about ending the public sector pay cap. When introducing the Programme for Government 2017-18, the First Minister confirmed that the Scottish Government will lift the 1% public sector pay cap. All public bodies need to consider the potential impact of the ending the pay cap as they prepare their budgets and consider their financial sustainability. Whilst separate pay bargaining arrangements are in place for local government, Scottish Government pay policy states that the lifting of the cap and the promise that workers earning less than £36,500 a year will receive a 3% pay increase in 2018 should act as a 'benchmark' for all major public sector workers.
Response to cyber security risks	Audit Scotland has issued further guidance in relation to this risk, setting out the risk context for public bodies, the new cyber resilience requirements being introduced by the Scottish Government and questions that auditors can pose to bodies to understand the risk and mitigating action in a local context. We will share this with management as part of our wider scope audit work.
Openness and transparency	There are signals of changing and more challenging expectations for openness and transparency in public business. In view of this direction of travel, Audit Scotland noted that 2016/17 annual audit reports highlighted the need for public bodies to keep this area under review and to consider whether there is scope to enhance transparency.

Wider scope requirements (continued)

Local Government in Scotland: Financial Overview 2016/17

Audit Scotland published its annual overview report **Local Government in Scotland: Financial Overview 2017** in November 2017. It concluded that Council's financial challenges continue to grow and they are showing increasing financial stress. Throughout the report, Audit Scotland have identified examples of questions that councillors may wish to consider to help them better understand their council's financial position and to scrutinise financial performance. The key messages from the report are summarised below. We will evaluate North Ayrshire Council against these as part of our wider scope work. We note that the report was presented to the Council meeting on 20 December 2017 where members were asked to note the findings of the report, the current position for North Ayrshire Council and consider these as part of the budget deliberations.

Key messages

1. Councils' financial challenges continue to grow. Funding reductions are compounded by increasing costs and demands on services. In response, councils have needed to achieve ambitious savings plans, including around £524 million of savings for 2016/17.
2. Councils are showing signs of increasing financial stress. They are finding it increasingly difficult to identify and deliver savings and more have drawn on reserves than in previous years to fund change programmes and routine service delivery. Some councils risk running out of General Fund reserves within two to three years if they continue to use them at levels planned for 2017/18.
3. Debt increased by £836 million in 2016/17 as councils took advantage of low interest rates to borrow more to invest in larger capital programmes. Councils' debt levels are not currently problematic, but some are becoming concerned about affordability of costs associated with debt within future budgets.
4. Councils' budget-setting processes for 2016/17 were complicated by late confirmation of funding from the Scottish Government and the funding arrangements for integrating health and social care. Councils' expenditure and use of reserves often differed noticeably from that originally planned, indicating the need for budget-setting to become more robust and reliable.
5. All councils received an unqualified audit opinion on their 2016/17 accounts but auditors found that in several councils financial management could be improved. Councils can use their accounts to more clearly explain their financial performance over the whole year to support better scrutiny.
6. The financial outlook for councils continues to be challenging, with the need to deliver savings being increasingly critical to their financial sustainability. As such, robust medium-term financial strategies and effective leadership to deliver them are of increasing importance.

Example Questions for Councillors to consider

Part 1 - Councils' income and budget 2016/17

- Does your council have a charging policy? Is this in line with corporate plans and objectives?
- What information do you need to be able to explain increases in fees and charges to your constituent?

Part 2 - 2016/17 financial performance

- How does the Council ensure that council staff have the capacity to deliver transformational change?
- What have reserves been used for in recent years? Supporting services and bridging the funding gap or transforming services? What are the level of reserves held by your Council's IJB? Are these in line with the IJBs reserves policy?

Part 3 – Financial Outlook

- How is your Council preparing for any further real term reduction in Scottish Government funding?
- If your Council plans to raise council tax, do you know how much it will raise? How will you communicate and explain the reasons for the rise to constituents?
- Does your council have a savings plan? What are the options to close future gaps?
- What is the likely use of reserves for 2017/18? How does this compare to forecast funding gaps?
- What is your Council's financial position? What particular challenge does it face?
- Does your council have a medium term financial strategy aligned with corporate objectives?
- What impact will savings have on the delivery of services? What are the potential risks?
- What additional training would you like to receive to develop your knowledge and skills in financial scrutiny?
- What measures in the council's corporate and transformational plans are aimed at addressing the underlying demand for services.

Note: The full list of questions are available in **Supplement 1: Scrutiny tool for councillors**, available on Audit Scotland's website.

Wider scope requirements (continued)

NFI, Performance audits and impact reports

National Fraud Initiative (NFI)

All Councils are participating in the NFI 2016/17. All data was submitted in October 2016 and Councils received matches for investigation in January 2017. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud. Match investigation work should have largely been completed by 30 September 2017 and the results recorded on the NFI system.

In accordance with Audit Scotland planning guidance, we are required to monitor the Council's participation and progress during 2016/17 and 2017/18 and complete an NFI audit questionnaire which was submitted on 5 March 2018. The information contained in this questionnaire will be used for Audit Scotland's NFI report to be published in June 2018. When our 2016/17 audit report was presented the NFI system recommended 1,201 matches to be investigated, this subsequently increased to 1,203 matches. As of 5 March 2018 the Council have processed all 1,203 recommended matches to be investigated and an additional 247 matches. We are satisfied that the Council is fully engaged in the NFI exercise.

Performance Audits

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

Performance audit title	Appointed auditor input
Digital – cross cutting	No formal return. Audit Scotland will provide information and guidance on current issues and risks to consider as part of planning process.
Health and social care integration part 2 – publication Autumn 2018	There is a requirement for a minimum data set in support of this audit. Specific requirements will be confirmed, however, it will encompass information such as: timescales for agreeing budgets; shifts in resources from acute to community-based care; progress in agreeing budgets and publishing meaningful strategic plans; governance arrangements

Impact reports

We will be requested to provide information to support Audit Scotland's Performance Audit and Best Value (PABV) team in assessing the impact of the following performance audits during 2017/18: Changing models of health and social care; roads maintenance follow-up; Social work in Scotland; and Supporting Scotland's economic growth.

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 material issues and significant judgements identified, by using our expertise in the health sector and elsewhere to provide robust challenge to management.

We have obtained a deep understanding of your business, its environment and of your processes in income and expenditure 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 specialists to support the audit team in our work.

In order to deliver a quality audit to you, each member of the core audit team has received tailored learning to develop their expertise in audit skills, delivered by Pat Kenny, Audit Director. 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 local government 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 will be aware, our audit is not designed to identify all matters that may be relevant to the Council.

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

We will update you if there are any significant changes to the audit plan.

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. Except where required by law or regulation, it should not be made available to any other parties without our prior written consent.

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

P. Kenny

Pat Kenny, CPFA

for and on behalf of Deloitte LLP

Glasgow

9 March 2018

Technical update

Information on sector developments

IFRS 9 *Financial Instruments*

In a nutshell

- In July 2014, the IASB published a final version of IFRS 9. This version supersedes all previous versions.
- IFRS 9 *Financial Instruments* will replace IAS 39 *Financial Instruments: Recognition and Measurement*, and has three main impacts
    - *Classification and measurement* - introduces new approach for the classification of financial assets driven by cash flow characteristics and the business model in which an asset is held. This classification determines how financial assets are accounted for in financial statements and, in particular, how they are measured on an ongoing basis.
    - *Amortised cost and impairment of financial assets* – introduces an "expected losses" impairment model where entities are required to account for expected credit losses from when financial instruments are first recognised.
    - *Hedge accounting* - introduces new general hedge accounting model that aligns the accounting treatment with risk management activities and allows for better reflection of the hedging activities in the financial statements.
- One of the key impacts of IFRS 9 will be that gains and losses arising from changes in the fair value of some categories of investments will be recognised in the comprehensive income and expenditure statement, with a consequent impact on the general fund. This is a particular issue for the various collective investment vehicles that form part of some local authorities' investment portfolios.
- CIFPA/ LASAAC has advised that representatives from central and devolved governments, including the Scottish Government, have confirmed that they would be willing to consider representations from local authorities for a statutory mitigation.

Potential impact on the Council

IFRS 9 is expected to have relatively limited impact on most Councils, but will at least affect the process of assessing impairment of debtors and other financial assets. As part of the process of adoption, North Ayrshire Council will need to consider the impact on policies, processes, systems and people.

Effective date

The Standard has a mandatory effective date for annual periods beginning on or after 1 January 2018, with earlier application permitted.

CIPFA/ LASAAC has confirmed that it has approved the full adoption of IFRS9 into the accounting code and therefore will apply to local authority annual accounts from 2018/19.

Find out more on our website UK Accounting Plus by clicking here

Navigate to: Standards/ IFRS 9

IFRS 16 *Leases*

In a nutshell

- The new Standard supersedes IAS 17 *Leases* and its associated interpretative guidance.
- For lessees the distinction between operating and finance leases disappears.
- A lease conveys the right to control an identified asset for a period of time in exchange for consideration.
- The accounting for all leases is similar to finance lease accounting in IAS 17, which means all leases are recognised on the balance sheet (with some exceptions).
- The lease liability is measured at the present value of the future lease payments, using a lease term that includes periods covered by extension options if exercise is reasonably certain. Variable lease payments are only included in the liability if based on an index or rate.
- That right-of-use asset is initially measured at the amount of the lease liability, plus initial direct costs and adjustments for lease incentives, payments at or prior to commencement and dilapidations provisions.
- The right-of-use asset is subsequently accounted for by applying IAS 16 *Property, Plant and Equipment*, at cost less depreciation and impairment (unless it is an investment property that is fair valued or it belongs to a class of property, plant and equipment that is revalued).
- A lessee can elect to keep the following leases off-balance sheet and typically straight line the expense:
  - leases with a lease term of 12 months or less and containing no purchase option – this election is made by class of underlying asset; and
  - leases where the underlying asset has a low value when new, such as personal computers or small office furniture – this election is made on a lease-by-lease basis.
- Operating lease expenses, typically straight line, will be replaced with interest on the liability and depreciation of the asset, producing a front-loaded expense profile.
- Although any individual lease will have a front-loaded expense, portfolios of leases containing both new and mature leases may produce an overall expense profile similar to straight line expensing.
- HM Treasury has consulted across government and is considering specific interpretations and adaptions for consistency across the public sector, but which will follow the overall principles of IFRS 16. CIPFA/ LASAAC have recently issued a consultation paper on proposals for the accounting code's adoption of IFRS 16 from 2019/20.

Potential impact on the Council

The Council has relatively low operating lease commitments (with commitments at 31 March 2017 of £330k), mitigating the effect of the change and will have a relatively small impact.

Effective date

Periods commencing on or after 1 January 2019.

CIPFA/ LASAAC have recently issued a consultation paper on proposals for the accounting code's adoption of IFRS 16 from 2019/20.

Find out more on our website UK Accounting Plus by following the links to Standards -> IFRS 16

General Data Protection Regulation

The EU GDPR will come into effect from 25 May 2018, and will effectively supercede the existing Data Protection Act.

Issue

The EU General Data Protection Regulation ("GDPR") will come into effect in 2018, replacing the Directive that formed the basis for the Data Protection Act. The GDPR is expected to remain in effect for the foreseeable future, notwithstanding Brexit.

The key new concept is of "accountability" – being able to **demonstrate** compliance, with specific actions required with an evidence trail.

- Data Protection Impact Assessments are required for high risk processing of data, and there are specific requirements for transparency and fair processing of data. There are tighter rules where consent is the basis for processing data.
- There are requirements to keep records of data processing activities, with the removal of most charges for providing copies of records to patients or staff who request them.
- Penalties for breaches of the regulation are significantly higher than existing arrangements (up to €10m for data breaches and up to €20m for breaches of the principles), and apply to any breach of the regulation, not just data breaches.
- All public authorities, are required to appoint a suitably qualified and experienced Data Protection Officer.
- There is a legal requirement to notify security breaches to the Information Commissioner within 72 hours.

Getting ready to comply with the GDPR can start with reducing the risk of the data breaches – and reducing that risk doesn't need to be complicated. The biggest causes of data breaches can be avoided by making sure the basics are in place: keep all operating systems and software up to date, implement encryption for sensitive data, and educate all employees about the risk of phishing and other social engineering attacks.

Your organisation might also consider the Cyber Essentials scheme and the 10 Steps to Cyber Security, both developed by Government to ensure any organisation can protect themselves from common cyber-attacks.

The Information Commissioner's Office has also developed a useful 12 step guide to help organisations consider their current data protection activities and what needs to be done to comply with the new regulations. They will be developing guidance over the coming months so keep an eye on their website for more information.

Deloitte View

Privacy as a concept is broad and far-reaching. The GDPR impacts many areas of an organisation, and is not just a legal/compliance issue. The GDPR brings specific rights to the public, including the "right to be forgotten" and data portability.

The emphasis on organisational accountability will require proactive, robust privacy governance. A key challenge is the need to identify a suitably qualified Data Protection Officer, with an estimated need for 28,000 DPOs across Europe.

The requirements will change how information technologies are designed and managed, with a requirement for documented privacy risk assessments when implementing major new systems, with "Privacy by Design" now enshrined in law.

The requirement to notify security breaches within 72 hours will require new or enhanced incident response procedures.

Teams tasked with information management will need to provide clearer oversight on data storage, journeys and lineage. Greater clarity on what data is collected and where it is stored will make it easier to comply with the new data subject rights.

Next steps

The Audit and Scrutiny Committee should consider how it is obtaining assurance over the adequacy of the Council's action plans to ensure compliance with the GDPR.

Appendices

Prior year audit adjustments
Uncorrected and disclosure misstatements

Uncorrected misstatements

There were no uncorrected misstatements identified during the course of our prior year audit.

Disclosure misstatements

There were no uncorrected disclosure misstatements identified during the course of our prior year audit.

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 the achievement of expenditure resource limits 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 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

Inquiries

We will make the following inquiries regarding fraud:

Management:

- 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.
- Management's process for identifying and responding to the risks of fraud in the entity.
- 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.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.

Internal audit and Local Counter Fraud Specialist

- Whether internal audit and the Council's 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.

Those charged with governance

- 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.
- Whether those charged with governance have knowledge of any actual, suspected or alleged fraud affecting the entity.
- The views of those charged with governance on the most significant fraud risk factors affecting the entity.

Independence and fees

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

Independence confirmation	We confirm the audit engagement team, and others in the firm as appropriate, Deloitte LLP and, where applicable, all Deloitte network firms are independent of the Council and will reconfirm our independence and objectivity to the Audit and Scrutiny Committee for the year ending 31 March 2018 in our final report to the Audit and Scrutiny Committee.
Fees	The audit fee for 2017/18, in line with the fee range provided by Audit Scotland, is £295,060 as analysed below:

	£
Auditor remuneration	179,900
Audit Scotland fixed charges:	
Pooled costs	15,670
Performance Audit and Best Value	88,290
Audit support costs	11,200
Total proposed fee	**295,060**

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

Non-audit services	We continue to review our independence and ensure that appropriate safeguards are in place in relation to any non-audit services provided 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.
Relationships	We have no other relationships with the Council, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

Our approach to quality
AQR team report and findings

We maintain a relentless focus on quality and our quality control procedures and continue to invest in and enhance our overall firm Audit Quality Monitoring and Measuring programme.

In June 2017 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 2016/17 cycle of reviews.

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 provides insight which drives the developments in our quality agenda.

18 of the audits reviewed by the AQR were performed to a good standard with limited improvements required. We were disappointed that, despite the high standards we set and many areas of improvement in our quality record, the percentage of audits rated as requiring more than limited improvements has remained broadly similar to the previous year and that two reviews were identified as requiring significant improvement.

We have taken swift and decisive action to respond to the matters identified and will continue to monitor the implementation of these. We are firmly committed to achieving, and indeed exceeding, the FRC's objective that by 2019 90% of FTSE 350 audits reviewed will be assessed as requiring no more than limited improvements.

All the AQR public reports are available on its website.

The AQR's 2016/17 Audit Quality Inspection Report on Deloitte LLP

"We reviewed selected aspects of 23 individual audits in 2016/17. In selecting which aspects of an audit to inspect, we took 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. The communications with the Audit Committee and the audit of revenue were reviewed on nearly all of these audits…"

"The firm has taken the actions they committed to take following our last inspection. Some of the issues driving more adverse quality assessments this year are in similar areas to those reported last year, although some audits reviewed were undertaken before these actions had been carried out. Our main concern continues to be the adequacy of audit teams' challenge of management in key areas of judgment (particularly goodwill impairment) and further immediate action is required to improve audit quality in this area.

The firm has enhanced its policies and procedures in the following areas:

- Strengthened the evidence of the Engagement Quality Control Review ("EQCR") partner and audit technical reviewer involvement.
- Updated Deloitte's audit methodology to include additional focus on risk assessment and the related audit response (effective from 31 December 2016 year-end audits).
- Introduced more focused coaching for audit teams throughout the audit process.
- Issued more timely and focused guidance and reminders to the audit practice on key audit matters, to facilitate appropriate consideration by audit teams at the key stages of the audit.
- Increased mandatory technical training for qualified staff through to partner level

Our key findings in the current year requiring action by the firm, which are elaborated further in section 2 together with the firm's actions to address them, are that the firm should:

- Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.
- Strengthen the firm's audit of revenue recognition.
- Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.
- Continue to seek to improve the consistency of the quality of communications with Audit Committees."

Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
Strengthen the firm's audit of revenue recognition.	A key theme of the enhancements to our methodology in 2016, (deployed after these engagements reviewed by the AQR were complete), was to enhance our risk assessment procedures and, as a result, encourage our auditors to develop more robust responses to the largest most critical account balances, with a natural focus on revenue. This included the removal of capped sample sizes for very large balances and facilitation of a combination of test of details and substantive analytical procedures to enable more comprehensive audit responses to be designed. This theme has continued in 2017 when our Summer Technical Training showcased our investment in analytic tools applied to the audit of revenue, as well as training on the accounting and auditing of revenue as we prepare to audit the implementation of the new revenue standard IFRS 15 'Revenue from Contracts with Customers' which is effective for periods beginning on or after 1 January 2018.	This is a significant audit risk and is addressed in page 19 of this paper.
Continue to seek to improve the consistency of the quality of communications with Audit and Scrutiny Committees.	We take our responsibilities for reporting to the Audit and Scrutiny Committee very seriously. There is a natural follow on that if there is a failure in the underlying audit work we will inevitably fall short in our reporting on those areas. The majority of issues noted in the report linked directly to the review findings. We continue to stress the critical importance of reporting matters to the Audit Committee in the training we deliver and in the enhanced procedures we have established, in particular around key management estimates and judgments. We have issued refreshed Audit Committee reporting templates to the practice reflecting the observations of the reviews to ensure audit practitioners continue to focus on this critical aspect of our role.	We have reported to you in pages 16-17 of this paper the scope of work and the planned approach to the audit. We would welcome any feedback on our approach to communicating with you.

Our approach to quality

Areas identified for particular attention	How we have addressed these as a firm	How addressed in our audit
Improve the extent of challenge of management in key areas of judgment, in particular impairment reviews and valuation of acquired intangible assets.	We have developed an Impairment Centre of Excellence and have mandated its involvement in all public interest entity audits with a material goodwill or intangibles balance for years ending on or after 15 December 2016. The specialists within the Impairment Centre of Excellence, in addition to having significant experience auditing complex impairment issues, have had specialist training to be able to identify and respond to the issues raised in the AQR report. Our Summer Technical Training in 2017 included interactive workshops on this area including sharing anonymised findings from internal and external review to illustrate the types of challenge and extent of audit evidence that teams should seek to achieve in this area.	The Council does not have a goodwill balance or a material intangible asset balance, and so this is not applicable for the Council's audit.
Make further improvements to the audit of defined benefit pension scheme balances in corporate entities.	We have improved our procedures to ensure confirmations are obtained from asset custodians where appropriate. In December 2015 we introduced a detailed practice aid dedicated to all areas of corporate pension balance auditing together with increased training. We have also mandated consultation with our Pension Audit Centre of Excellence for years ending on or after 15 December 2016 and refreshed the practice aid. This ensures our corporate audit teams have access to our experts in the audit of pension balances.	The Council is a member of the Strathclyde Pension Fund. We will consult with our Pension Audit Centre of Excellence in advance of our year-end work.

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 affiliate of Deloitte NWE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee (“DTTL”). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NWE LLP do not provide services to clients. Please see www.deloitte.com/about to learn more about our global network of member firms.