

East Ayrshire Council

Report to the Governance and Scrutiny Committee, Members
of the Council and the Controller of Audit on the 2018/19 audit

Issued 19 September 2019 for the meeting on 24 September 2019

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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 final report to the Governance and Scrutiny Committee of East Ayrshire Council (the Council) for the 2019 audit. The scope of our audit was set out within our planning report presented to the Audit and Scrutiny Committee in March 2019.

This report summarises our findings and conclusions in relation to:

- The audit of the **financial statements**; and
- Consideration of the **four audit dimensions** that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of Best Value and the five Strategic Audit Priorities agreed by the Accounts Commission.



Introduction (continued)

The key messages in this report (continued)

I would like to draw your attention to the key messages of this paper:

Conclusions from our testing

Based on our audit work completed to date we expect to issue an unmodified audit opinion.

The management commentary and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of the Council.

The auditable parts of the remuneration report have been prepared in accordance with the relevant regulation.

A summary of our work on the significant risks is provided in the dashboard on page 8.

Audit adjustments in excess of our materiality threshold (see page 6) have been identified in relation to valuations (see pages 12-13) and the pension liability (see pages 17-18) and have been corrected by management. It should be noted that adjustments relating to the pension liability are as a result of a post balance sheet event rather than an error by management. No disclosure deficiencies have been identified.

We have also audited the Council's charitable trusts, which are the Archibald Taylor Fund, East Ayrshire Council Charitable Trust and Miss Annie Smith Mair Newmilns Trust Fund. We expect to issue unmodified opinions following these audits based on our audit work completed to date. See page 19 for further discussion.

Conclusions on audit dimensions

As set out on page 3, our audit work covered the four audit dimensions. This incorporated the specific risks highlighted by Audit Scotland, in particular, the impact of EU withdrawal, the changing landscape for public financial management, dependency on key suppliers, care income and increased focus on openness and transparency.

Our detailed interim report, presented to the Governance and Scrutiny Committee in August 2019, set out our findings and conclusions on each dimension. We have updated this for any significant changes since that report and our overall conclusion on each dimension is summarised on page 5.

Introduction (continued)

The key messages in this report (continued)

Conclusions on audit dimensions (continued)

Financial sustainability

The Council has achieved short-term financial balance and has set a balanced budget for 2019/20.

In June 2018 the Council reported that it is facing a funding gap of between £23m and £53m in the period 2019/20-2021/22. Following an effective transformation strategy carried out during 2012-2017, the Council has implemented a new transformation strategy covering the period 2017-2022. Management is currently in the process of implementing a complete benefits monitoring system so that benefits realised through transformation can be effectively measured against intended outcomes.

Financial management

The Council has effective financial management processes in place.

We have identified examples of good practice in relation to Council management's financial reporting to Members, and the Council's use of its internal audit function particularly as part of transformation activity. We have recommended further enhancements in relation to reporting on changes made to budgeted figures during the year which management has already implemented.

Governance and transparency

The council has effective leadership and governance structures. Regular training is provided to members, with one to one sessions offered as part of the Elected Members Development Strategy to consider new and emerging training needs.

The Council operated in an open and transparent manner throughout the year.

Value for money

Based on the Council's recent reported performance against core indicators, it has recorded strong performance across a number of areas. Actions to address areas for improvement have been identified, as appropriate, and are being progressed through the Single Outcome Agreement Improvement Plan. The most recent Local Government Benchmarking Framework (LGBF) data set available indicates areas where relative performance is strong and where improvements are possible, however, this should be considered relative to the Council's socio-economic challenges faced as highlighted within the 2018 BVAR.

The Council reports on its performance and contribution to national outcomes primarily through its Annual Performance Reporting.

Our conclusions are included on pages 23-25 of this report, with the detailed findings and agreed Action Plan included in our interim report presented in August 2019. We will consider progress with the agreed actions as part of our 2019/20 audit.

Added value

Our aim is to add value to the Council by providing insight into, and offering foresight on, financial sustainability, risk and performance by identifying areas for improvement and recommending and encouraging good practice. In so doing, we aim to help the Council further promote improved standards of governance, better management and decision making, and more effective use of resources.

This is provided throughout this report and our separate interim report. In particular, our separate "Sector Developments" reports share our research, informed perspective and best practice from our work across the wider public sector that are specifically relevant to the Council.

Our audit explained

Area dimensions

In accordance with the 2016 Code of Audit Practice, we have considered how you are addressing the four audit dimensions:

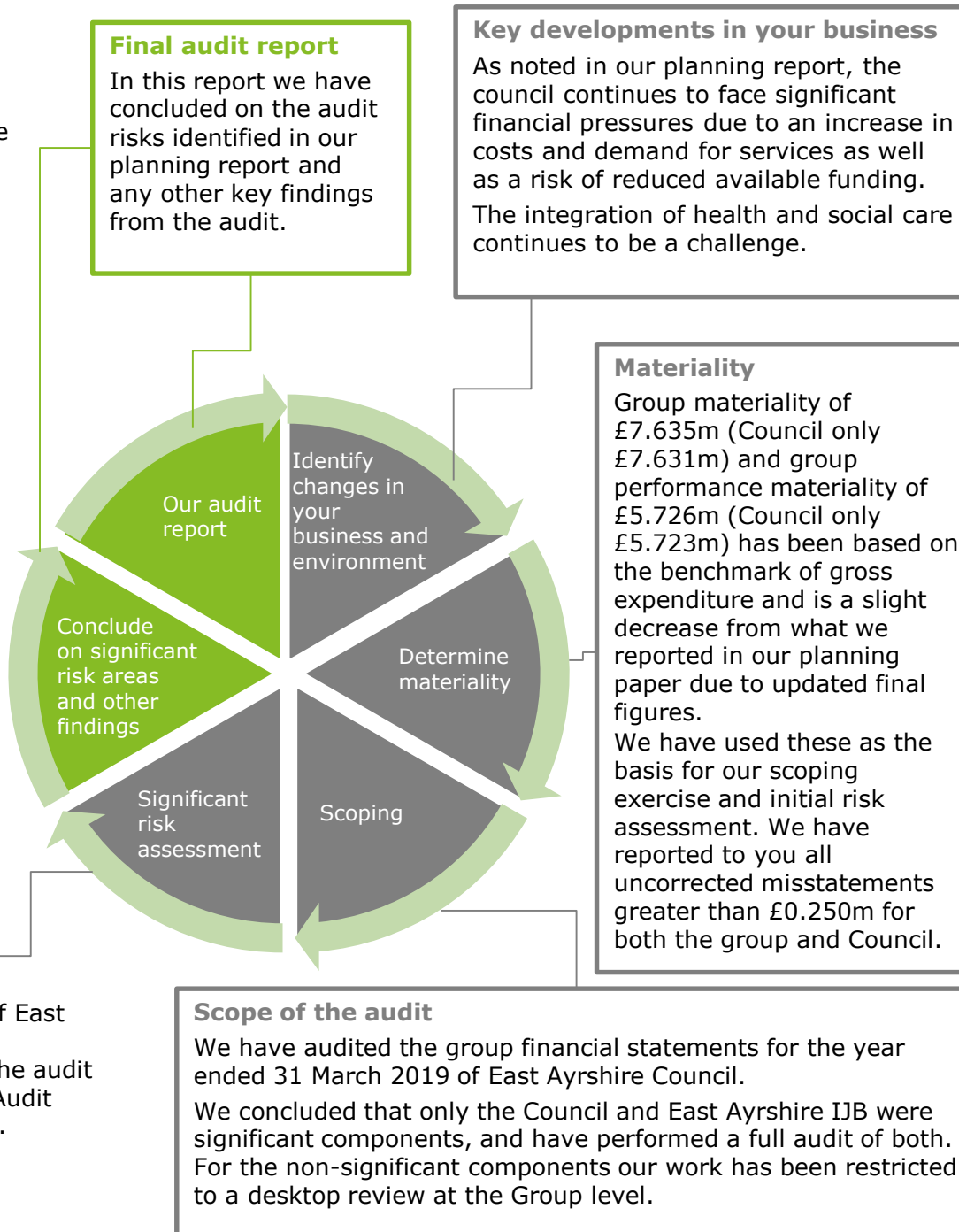
- Financial sustainability
- Financial management
- Governance and transparency
- Value for money

Significant risks

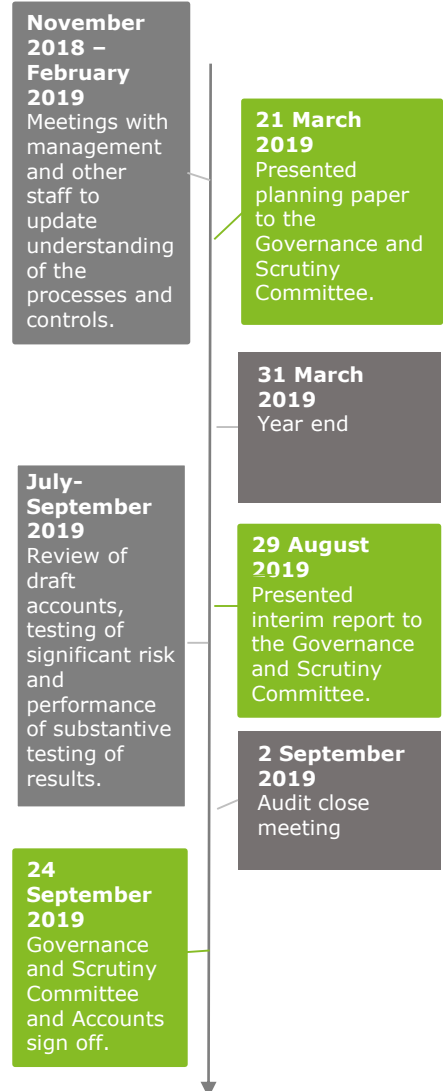
Our risk assessment process is a continuous cycle throughout the year. Page 8 provides a summary of our risk assessment of your significant risks.

Quality and Independence

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











Timeline 2018/19



Financial statements audit



Significant risks Dashboard

Risk	Material	Fraud risk	Planned approach to controls testing	Controls testing conclusion	Consistency of judgements with Deloitte's expectations	Conclusions	Page no.
Recognition of grant income			D+I	Satisfactory		Satisfactory	9
Management override of controls			D+I	Satisfactory		Satisfactory	10
Valuation of property assets			D+I	Finding raised		Satisfactory with findings / adjustments raised	12

Overly prudent, likely to lead to future credit



Overly optimistic, likely to lead to future debit

D+I: Testing of the design and implementation of key controls

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 are summarised in the table below. The Revenue Support Grant and Non Domestic Rates income 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%. Council tax 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, which includes fees and charges across all Services, and IJB income are set through formal approval processes, with no history of fraud or error.

The significant risk is pinpointed to the recognition of grant income, comprising capital grants and grants credited to services.



Key judgements and our challenge of them

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.



Deloitte response

We have performed the following:

- Assessed management's controls around recognition of grant income; and
- tested a sample of capital grants and grants credited to services and confirm these have been recognised in accordance with any conditions applicable and applicable accounting standards.

Type of income	2018/19 (£m)	Significant risk
Taxation and Non-Specific Grant Income		
Council tax income	48.0	
Non domestic rates	26.1	
Revenue Support Grant	195.4	
Capital Grants and contributions	26.0	✓
Service Income		
Grants credited to services	25.8	✓
Housing Benefit Subsidy	34.6	
Housing Revenue Account	44.8	
IJB income	98.2	
Other Service Income	33.1	
Total Service Income	236.5	

Deloitte view

We have concluded that grant income has been correctly recognised in accordance with the requirements of the Code of Practice on Local Authority Accounting.

Significant risks (continued)

Risk 2 - Management override of controls

Risk identified

In accordance with ISA 240 (UK) 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.



Deloitte response

We have considered the overall sensitivity of judgements made in preparation of the financial statements, and note that:

- The Council's results throughout the year were projecting overspends in the year. This was closely monitored and whilst projecting overspends, the underlying reasons were well understood; and
- Senior management's remuneration is not tied to particular financial results.

We have considered these factors and other potential sensitivities in evaluating the judgements made in the preparation of the financial statements.

Significant and unusual transactions

We did not identify any significant transactions outside the normal course of business or any transactions where the business rationale was not clear.

Journals

We have performed design and implementation testing of the controls in place for journal approval.

We have used Spotlight data analytics to risk assess journals and select items for detailed follow up testing. The journal entries were selected using computer-assisted profiling based on areas which we consider to be of increased interest.

We have tested the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting. No issues were noted.

Deloitte view

We have not identified any bias in the key judgements made by management based on work performed to date.

We have not identified any instances of management override of controls in relation to the specific transactions tested based on work performed.

Accounting estimates (see next page)

We have performed design and implementation testing of the controls over key accounting estimates and judgements.

We reviewed accounting estimates for biases that could result in material misstatements due to fraud. See summary on the following page. We note that overall the changes to estimates in the period were balanced and did not indicate a bias to achieve a particular result.

We tested accounting estimates and judgements including Provisions, Property Valuations, Pension Liability and consideration of any adjustments required for the transition to the new standards (IFRS 15 Revenues from contracts with customers and IFRS 9 Financial Instrument), focusing on the areas of greatest judgement and value. Our procedures included comparing amounts recorded or inputs to estimates to relevant supporting information from third party sources.

Significant risks (continued)

Risk 2 - Management override of controls (continued)

Key estimates The key estimates in the financial statements are those which we have selected to be the significant audit risks around the recognition of grant income (see page 9) and the valuation of property assets (see page 12). In addition, whilst not considered to be a significant audit risk, we have considered the assumptions used to calculate the pension liability (see pages 17-18) and to determine provisions (see below). These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

As part of our work on this risk, we reviewed and challenge management's key estimates and judgements.

Estimate / judgement	Details of management's position	Deloitte Challenge and conclusions
Provisions	Provisions held by the Council predominantly comprises a number of employee related potential claims outstanding at 31 March 2019 and the Council's share of the former Strathclyde Regional Council's insurance claims.	We examined the rationale for each provision, including a retrospective review of amounts provided in 2017/18. We have also challenged the completeness of the provisions made through discussion with the Council's legal advisors and benchmark with our industry knowledge. We concluded that the provisions made were reasonable.

Significant risks (continued)

Risk 3 – Valuation of property assets

Risk identified

The Council holds £758.4m of property assets at 31 March 2019. The financial year to 31 March 2019 represented year one of a five year rolling programme in which the full council dwellings portfolio in addition to some other land and buildings were revalued.

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.

Given the level of judgement required for such a high-value asset class and from our experience of testing previous revaluation movements, we deem there to be a significant risk attached to the valuation of property assets.

Key judgements and our challenge of them

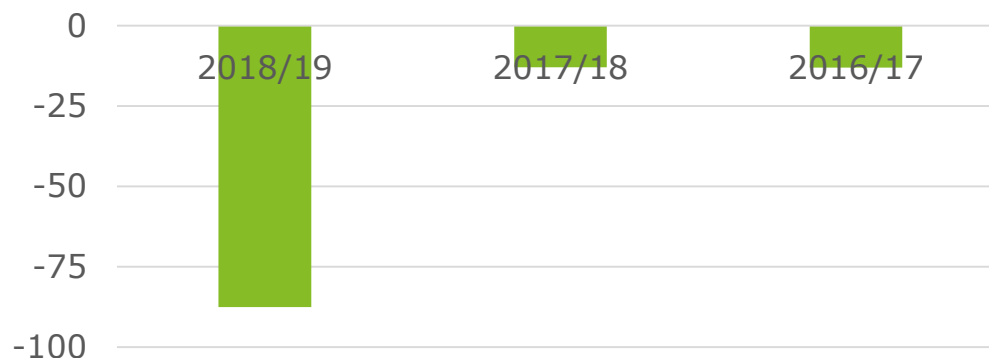


Valuation of property assets is a significant risk due to the inherent degree of complexity, estimation and potential variability in the valuation methodologies that can be applied. The council held a sizeable opening balance of £802.2m in property assets in the year, hence there is an increased potential for material error.

We have assessed the valuation methodology applied against relevant professional standards and standard practice, and considered the reasonableness of the assumptions applied to generate the valuation estimates.

The graph below shows a movement in the net revaluation movement of £95.1m between 2018/19 and 2017/18. Whilst we have identified issues in relation to valuations (see page 13), we are satisfied that this an appropriate movement in the year. The difference between the revaluation movements in 2018/19 and 2017/18 is largely as a result of the net impairment of £84.1m posted against council dwellings. This is as a result of changes to the valuation methodology applied following the last full council dwellings revaluation performed five years ago, which would not be captured by higher level impairment reviews performed in interim years. Deloitte Real Estate is satisfied that the overarching methodology applied for 2018/19 is appropriate (aside from issues detailed further on).

Net revaluation movements per annum (£m)



Significant risks (continued)

Risk 3 – Valuation of property assets (continued)



Deloitte response

- We have tested the design and implementation of key controls in place around the property valuation.
- We have engaged with the Council valuers, using our valuation specialists to challenge the assumptions applied by management in the valuations.
- We have used our valuation specialists, Deloitte Real Estate, to review and challenge the appropriateness of the assumptions used in the year-end valuation of the Council's dwellings and other land and buildings, including considering assumptions relative to those used by other Councils.
- We have considered the potential for material changes in the values of assets not subject to full valuation in the year.
- For valuations performed prior to the year end, where the valuer confirmed to the Council that there were no significant differences between the valuation date and 31 March 2019, we have considered whether any potential impact of a "Brexit shock" (depending on the final deal outcome) has been included in the estimates and judgements, owing to the timing of the Brexit date and year end date.

Deloitte view

The Council's valuation assumptions are materially in line with other councils and fall within the expected range as assessed by Deloitte Real Estate. However, we did identify a number of material errors in relation to the revaluation movements recognised which have been corrected by management.

These errors have arisen as a result of deficiencies in the valuation process. A number of the issues have been raised with management in previously years however have not been adequately addressed. Further work is required to ensure similar errors do not recur in future years.


In order to gain sufficient assurance over valuations following the errors identified, we increased the scope of our testing to ensure the errors were not representative of the remainder of the revalued population.

We have also raised a number of recommendations regarding the valuation process and methodologies applied and regarding key internal controls that should be in place (see page 14).

Other significant findings

Internal control and risk management

During the course of our audit we have raised two internal control and risk management insights which we have included below for information. Both have been included within our action plan at page 29:

Area	Observation	Priority
Valuation of property assets – process, methodology and controls	<p>We have noted a number of deficiencies in the process, methodology and controls applied as part of the valuation of property assets. A detailed report of our recommendations has been passed onto management for consideration ahead of the 2019/20 annual accounts process. Decisive action is needed from management to address these deficiencies ahead of the 2019/20 audit.</p> <p>Please see below for some of the key recommendations raised:</p> <ul style="list-style-type: none">• Effective review controls should be implemented by management. These controls should review the valuation outputs at various stages before valuation adjustments are recognised within the annual accounts. A number of the errors identified through our reviews would be identified through effective internal controls.• An overarching valuation methodology report should be prepared. This should detail the overall valuation process including details of the rolling programme, statements of valuation approach and methodology, key assumptions applied and other information relied upon.• An impairment review report should be prepared detailing how the potential for impairment has been considered for assets not revalued in the year.• The estimates of useful economic lives should be determined for each individual asset on the basis of type, age and use, instead of applying the same useful economic life to the vast majority of assets.	

The purpose of the audit was for us to express an opinion on the financial statements. The audit included consideration of internal control relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters being reported are limited to those deficiencies that we have identified during the audit and that we have concluded are of sufficient importance to merit being reported to you.


Low Priority

Medium Priority

High Priority

Other significant findings (continued)

Internal control and risk management (continued)

Area	Observation	Priority
Preparation for IFRS 16	<p>The implementation of IFRS 16, Leases, for 2020/21 is expected to have a greater and more complex impact upon most Councils than the adoption of IFRS 9 and 15. The scope and potential complexity of work required, which may require system or process changes to underpin correct accounting under the standard, will require work to be completed at a significantly earlier stage than has been the case for IFRS 9 and 15 to allow for financial reporting timetables to be met.</p> <p>As reported in our previous "Sector developments paper", the changes introduced by the standard will have substantial practical implications for Councils that currently have material leases, and also likely to have an effect on the capital financing arrangements of the authority. CIPFA/LASAAC included a readiness assessment questionnaire in the consultation document which will help Councils consider their own preparedness.</p> <p>We recommend the Council targets completion of its IFRS 16 impact analysis during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit. We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council's underlying accounting systems.</p>	

Other matters

Implementation of IFRS 9 and IFRS 15

Matter identified	The Council is required to adopt the new accounting standards IFRS 9 <i>Financial Instruments</i> and IFRS 15 <i>Revenues from contracts with customers</i> in the year ended 31 March 2019. In both cases, the cumulative impact of transition to 1 April 2018 would be posted as an adjustment to reserves. However, the Council has posted no retrospective adjustments with regard to IFRS 9 or IFRS 15 as there is no material impact on the financial statements.
Response	<p>Management held discussions regarding the accounting impact of the new standards on the Council for the period and determined that the impact is immaterial.</p> <p>The key element impacted by IFRS 9 is the accounting for the bad debt provision, which must move to a methodology of expected credit losses. A practical expedient available for portfolios of debt is to use a matrix based on past experience, and modified in specific cases where more information is available, in order to provide at a suitable percentage. IFRS 9 also introduces new or changed disclosure requirements. The Council's accounts draft accounts were updated for these changes and as a result, complies with the Code.</p> <p>Regarding IFRS 15, officers were satisfied that no transitional adjustments would be required as the Council's larger sources of income including grant income, rents and taxation are outside of the scope of the standard and in other income streams which fall within the scope of IFRS 15 there are not material performance obligations which span the year end. This is consistent with a general expectation for local authorities which have not entered into material unusual transactions.</p> <p>IFRS 15 introduces new disclosures around the amount of income, deferred income and receivables which are accounted for under the standard. We have reviewed and challenged management's assumptions in light of the Council's contractual arrangements with no issues noted.</p>

Deloitte view

Officers conclusion that the new accounting standards do not have a material impact for the Council is consistent with the conclusion of other local authorities and the absence of unusual transactions or income streams which may require a different accounting treatment.

Other matters (continued)

Defined benefits pension scheme

Background

The Council participates in two defined benefits schemes:

- Scottish Teachers' Superannuation Scheme, administered by the Scottish Government; and
- The Strathclyde Pension Fund, administered by Glasgow City Council.

After taking into account the adjustments noted on the following page in relation to the McCloud judgement and Guaranteed Minimum Pension (GMP) indexation, the net pension liability has increased from £117.6m in 2017/18 to £204.3m in 2018/19. The increase is as a result in changes in assumptions, specifically the discount rate has reduced and salary increase rate has increased, together with the impact of McCloud and GMP indexation.



Deloitte response

- We obtained a copy of the actuarial report produced by Hymans Robertson, the scheme actuary, and agreed in the disclosures to notes in the accounts;
- we reviewed and challenged the assumptions made by Hymans Robertson, including benchmarking as shown the table opposite;
- we assessed the reasonableness of the Council's share of the total assets of the scheme with the Pension Fund financial statements;
- we have reviewed and challenged the calculation of the impact of the McCloud case and GMP on pension liabilities;
- we reviewed the disclosures within the accounts against the Code; and
- we assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.

	Council	Benchmark	Comments
Discount rate (% p.a.)	2.40	2.43	Reasonable, slightly prudent
Consumer Price Index (CPI) Inflation rate (% p.a.)	2.50	2.17	Prudent
Salary increase (% p.a.) (over CPI inflation)	1.20%	Council specific	Prudent
Pension increase in payment (% p.a.)	2.50	2.22	Reasonable
Pension increase in deferment (% p.a.)	2.50	2.17	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)	21.40	21.20	Reasonable
Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)	23.40	23.00	Reasonable

Other matters (continued)

Defined benefits pension scheme (continued)

Impact of McCloud ruling

Two employment tribunal cases were brought against the Government in relation to possible discrimination in the implementation of transitional protection following changes made to public service pension scheme legislation in 2014. The claimants challenged the transitional protection arrangements on the grounds of direct age discrimination, equal pay and indirect gender and race discrimination.

In December 2018, the Court of Appeal ruled that the transitional protection gave risk to unlawful discrimination on the basis of age. The Government requested leave to appeal the decision to the Supreme Court, however the request was denied on 27 June 2019. As a result, certain scheme members will need to be compensated for any discrimination suffered as a result of the transitional protections. As Scottish Public Service Pension Schemes implemented the changes to the legislation in 2015, this may impact benefits accrued from 1 April 2015 for these members.

The Council's actuary has provided an updated results schedule which included an allowance for the additional liability potentially arising as a result of the McCloud ruling. This has resulted in an audit adjustment of £10.8m for past service costs (c.1.8%) arising from this post balance sheet event.

The calculation of this amount was based on the Government Actuary Departments (GAD's) analysis, adjusted for local circumstances. Based on the limited information available, the amount appears reasonable.

Impact of GMP indexation

In order to ensure smooth transition to the single tier State pension and equalisation of GMP benefits between males and females, the Government introduced an interim solution in 2016 in respect of people, who are in public service pension schemes and who have a State Pension Age (SPA) between 6 April 2016 and 5 December 2018, where full inflationary increases will be provided by the scheme.

In January 2018, this interim solution was subsequently extended to members who reach SPA between 6 December 2018 and 5 April 2021.

Details of any permanent solution are still unknown.

The Council's actuary has provided an updated results schedule including an allowance for the estimated additional liability arising as a result of GMP indexation. An amount of £3.0m has been identified as the additional liability for paying all GMP increases for members reaching SPA from 6 April 2016.

The allowance equates to c.1.5% of the total defined benefit obligations. Typically, we would expect to see an allowance of between 0% and 0.4% of total defined benefit obligations, therefore the allowance made is within this range.

Deloitte view

On the whole, the set of assumptions is reasonable and lies towards the prudent end of the reasonable range when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS19.

The allowances made for the McCloud ruling and GMP are reasonable and within the expected range.

Other matters (continued)

Charitable trusts

Risk identified

From 2013/14, all Scottish Councils who act as sole trustees for any registered charities have to fully comply with the Charities Accounts Regulations. This requires Charities SORP compliant accounts to be prepared for each charity, and a separate audit of each. East Ayrshire Council administers three such registered charities – Archibald Taylor Fund, East Ayrshire Council Charitable Trust and Miss Annie Smith Mair Newmilns Trust Fund.

As the gross income of each of the Trust is less than £0.1m, the Council has opted to prepare the charitable trust accounts on a receipts and payments basis in accordance with The Charities Accounts (Scotland) Regulation 2006. Fully compliant Charities SORP accounts are therefore not required and disclosure is limited to that specified in the Regulations.



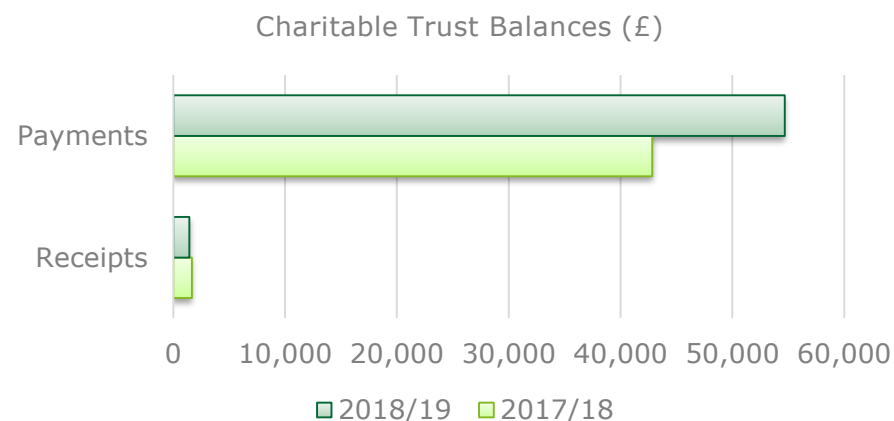
Deloitte response

We have assessed that the Statement of Receipts and Payments and the Statement of Balances have been prepared in accordance with the Charities Accounts (Scotland) Regulations 2006. No issues have been noted.

A summary is provided in the table adjacent. We note that the key change in the year has been the value of grants and donations paid by the East Ayrshire Council Charitable Trust, which resulted in an £0.01m increase in total payments. We would encourage the Council to continue to draw down the funds available, in accordance with the donors wishes.

Deloitte view

No issues noted from our testing of the Archibald Taylor Fund, East Ayrshire Council Charitable Trust and Miss Annie Smith Mair Newmilns Trust accounts in the year, which were found to be correctly accounted for in accordance with the Regulations.



Our audit report

Other matters relating to the form and content of our report

Here we discuss how the results of the audit impact on other significant sections of our audit report.



Our opinion on the financial statements

Based on our work completed to date, our opinion on the financial statements is unmodified.



Material uncertainty related to going concern

We have not identified a material uncertainty related to going concern and will report by exception regarding the appropriateness of the use of the going concern basis of accounting.

While the Council is faced with financial sustainability issues (as discussed on page 24), it achieved a balanced budget in 2018/19 and has set a balanced budget for 2019/20. There is also a general assumption set out in Practice Note 10 (Audit of financial statements of public sector bodies in the United Kingdom) public bodies will continue in operation, therefore it is appropriate to continue as a going concern.



Emphasis of matter and other matter paragraphs

There are no matters we judge to be of fundamental importance in the financial statements that we consider it necessary to draw attention to in an emphasis of matter paragraph.

There are no matters relevant to users' understanding of the audit that we consider necessary to communicate in an other matter paragraph.



Other reporting responsibilities

The Annual Report is reviewed in its entirety for material consistency with the financial statements and the audit work performance and to ensure that they are fair, balanced and reasonable.

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 21.

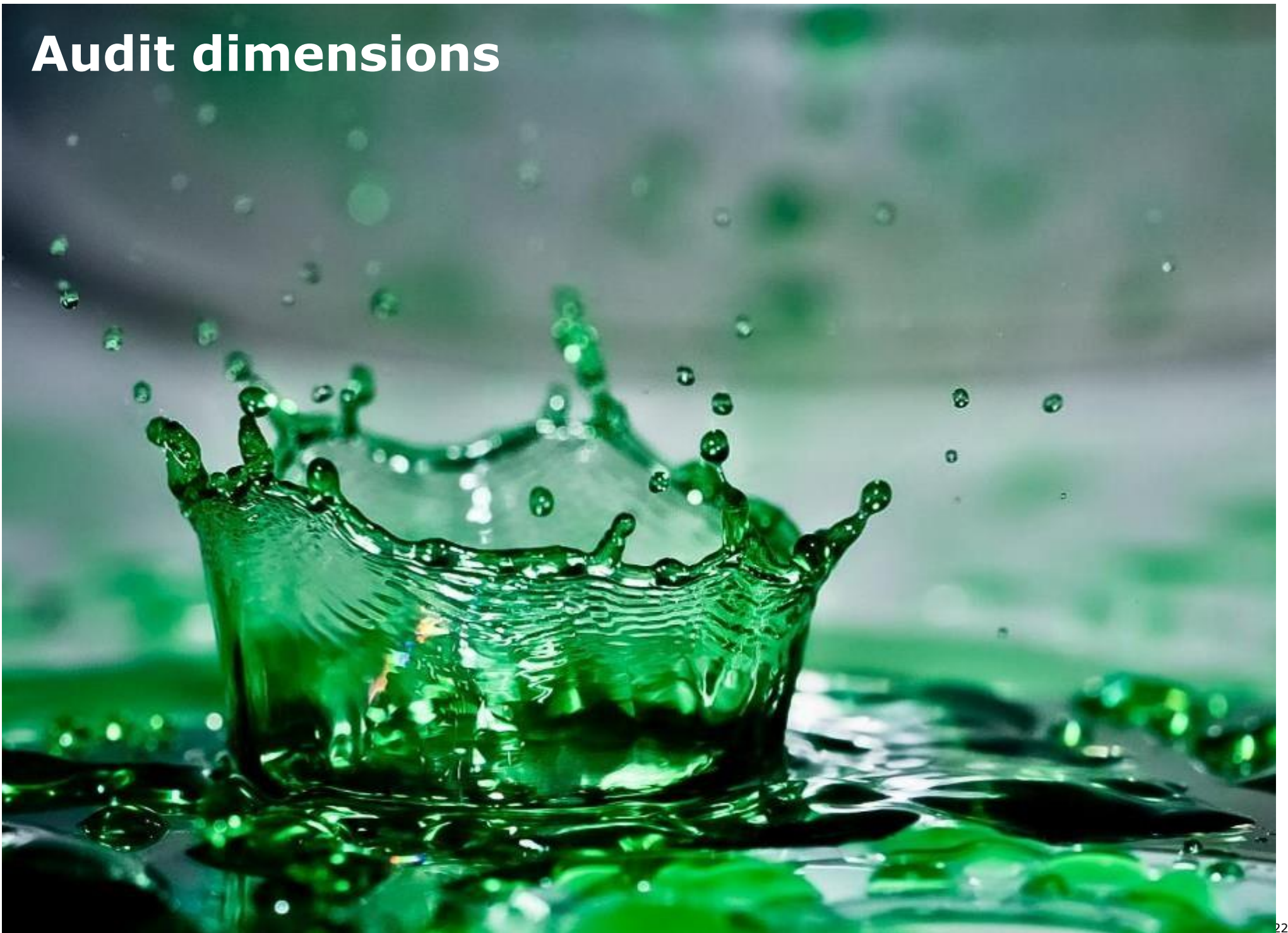


Your annual report

We are required to provide an opinion on the auditable parts of the remuneration report, the annual governance statement and whether the management commentary has been prepared in accordance with the statutory guidance.

	Requirement	Deloitte response
Management Commentary	The Management Commentary comments on financial performance, strategy and performance review and targets. The commentary included both financial and non financial KPIs and made good use of graphs and diagrams. The Council also focuses on the strategic planning context.	<p>We have assessed whether the Management Commentary has been prepared in accordance with the statutory guidance.</p> <p>We have also read the Management Commentary and confirmed that the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading.</p> <p>We have noted a marked improvement in the quality of management commentary disclosures from prior year, particularly around presentation and the use of infographics. We have raised some comments regarding appropriate areas of focus within the management commentary which management will take under advisement next year.</p>
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior councillors and Senior Employees of the council.	We have audited the disclosures of remuneration and pension benefits, pay bands, and exit packages and confirmed that they have been properly prepared in accordance with the regulations.
Annual Governance Statement	The Annual Governance Statement reports that East Ayrshire Council governance arrangements provide assurance, are adequate and are operating effectively.	<p>We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions noted.</p> <p>We have raised some comments regarding appropriate areas of focus within the Annual Governance Statement which management will take under advisement next year.</p>

Audit dimensions



Audit dimensions

Overview

Public audit in Scotland is wider in scope than financial audit. This section of our report sets out our conclusions on our audit work covering the following area, with our detailed findings and conclusions reported to the Governance and Scrutiny Committee in August 2019 as part of our [Interim Report](#). Our report is structured in accordance with the **four audit dimensions**, but also covers our specific audit requirements on strategic audit priorities, best value, statutory performance indicators and specific risks as summarised below.



Audit Dimensions

Strategic Audit Priorities

As set out in our Annual Audit Plan, the Accounts Commission sets out five Strategic Audit Priorities that are built into audit expectations, as follows:

- Having clear priorities with a focus on outcomes, supported by effective long term planning;
- Demonstrating the effective appraisal of options for changing how services are delivered in line with their priorities;
- Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future;
- Empowering local communities and involving them in the design and delivery of local services and planning for their local area; and
- Reporting the council's performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

Best Value (BV)

The BV framework follows a five-year approach to auditing BV. 2018/19 represents year three of Audit Scotland's BV audit plan. The Best Value Assurance Report (BVAR) report for East Ayrshire Council was published in year two of the five-year programme (i.e. 2017/18).

The BV audit work in 2018/19 was integrated into our audit approach, including our work on the audit dimension.

Statutory Performance Indicators

We have assessed the suitability of the arrangements for preparing and publishing the information, closely linked to our work on the Strategic Audit Priority "Reporting the council's performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes".

Specific risks

As set out in our Annual Audit Plan, Audit Scotland had identified a number of specific risks faced by the public sector which we have considered as part of our work on the four audit dimensions:

- EU Withdrawal;
- Changing landscape for public financial management;
- Care income, financial assessments and financial guardianship;
- Dependency on key suppliers; and
- Openness and transparency.

Our conclusions on the above were reported in our [Interim Report](#) to the Governance and Scrutiny Committee in August 2019.

In recent weeks the Council has continued to prepare for the impact of EU withdrawal, as reflected by the weekly meetings held by the Council's 'UK Withdrawal from the EU Preparedness Group'. In line with our conclusions in our Interim Report, we are satisfied that the Council is fully prepared for the impact of EU withdrawal.

Audit dimensions (continued)

Financial sustainability and financial management

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.

Key facts:

2018/19 financial position

- The General Fund ended 2018/19 in a £0.8m overspend position after £6.7m was earmarked.

2019/20 financial position

- Approved a budget of £353.9m on 28 February 2019.
- Budget gap of £9m is forecasted to be recovered through savings as a result of transformation strategy.

Overall conclusions

The Council achieved financial balance in 2018/19, and has agreed a savings plan for 2019/20 to deliver a balanced budget. Management has developed a reasonable forecast of the medium term funding gap faced, estimated to be £32m. However, the Council should consider developing a detailed long term financial plan that looks beyond the period covered by the current transformation strategy. The Council should also look to ensure that the Scottish Government's Medium Term Financial Strategy is explicitly considered as part of any medium to long term financial planning.

The Council has developed a detailed transformation strategy for the period 2017-2022 which aligns with the Community Plan 2015-2030 and clearly considers findings and recommendations raised within the 2018 BVAR. Following a recent exercise to identify the workstreams which will be the focus of transformation efforts, management is now in the process of outlining detailed service redesign and savings plans and implementing a detailed benefits monitoring system. We have recommended that this is implemented as soon as possible to allow the intended outcomes of the transformation strategy to be achieved and evidenced effectively. Management aims to implement additional monitoring arrangements as part of the 2020/21 budget process.

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Key facts:

2018/19 budget

- The approved 2018/19 budget incorporated £3.5m of savings which were achieved in the year.
- Regular comprehensive reporting to Council Members through 'EA Performs' reports throughout the year.

Overall conclusions

The Council has effective financial management processes in place. It has outturned with a General Fund overspend of £0.8m in 2018/19 with very few individually significant variances to budget projected.

We have identified examples of good practice in relation to reporting to Members, and the Council's use of its internal audit function particularly as part of transformation activity. We have recommended improvements in relation to reporting on changes made to budgeted figures during the year which management has already implemented.

As reported in our return to Audit Scotland in June, the Council is fully engaged in the NFI exercise. The Council has continued to investigate and process matches, with all outcomes recorded in the system.

Audit dimensions (continued)

Governance and transparency and value for money

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.

Key facts:

- The Council has a closely linked Community Plan, Local Outcomes Improvement Plan and performance monitoring and reporting framework.

Overall conclusions

The Community Plan 2015-2030 sets out how the Council and its partners are working to realise a shared Vision for East Ayrshire by aligning and combining resources to deliver better outcomes for local people and communities. The LOIP (formerly the Single Outcome Agreement) underpins the Community Plan and provides the performance management framework against which the partnership reports progress annually to the CPP Board and the Council at a joint performance event in September each year.

The council has effective leadership and governance structures. Regular training is provided to members, with one to one sessions offered as part of the Elected Members Development Strategy to consider outstanding training needs.

The Council prioritises the principles of openness and transparency, and operated in an open and transparent manner throughout the year.

Value for money is concerned with using resources effectively and continually improving services.

Key facts:

- In 2017/18, 34 of the 57 Local Government Benchmarking Framework (LGBF) service indicators (60%) either showed an improvement or no change year-on-year, whilst 23 indicators (40%) showed a decline. The Council is performing above the Scottish average against 26 indicators (46%) and below average against 31 indicators (54%).

Overall conclusions

Based on the Council's recent reported performance against core indicators, it has recorded strong performance across a number of areas. Actions to address areas for improvement have been identified, as appropriate, and are being progressed through the Single Outcome Agreement Improvement Plan. The most recent LGBF data set available indicates areas where relative performance is strong and where improvements are possible, however, this should be considered relative to the Council's socio economic challenges faced as highlighted within the 2018 BVAR.

The Council reports on its performance and contribution to national outcomes primarily through its Annual Performance Reporting.

Appendices



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 help the Governance and Scrutiny Committee and the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Our internal control observations.
- Other insights we have identified from our audit.

What we don't report

As you will be aware, our audit was 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, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

Our observations are developed in the context of our audit of the financial statements. We described the scope of our work in our audit plan and again in this report.

This report has been prepared for the Governance and Scrutiny Committee and Council, 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.

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



Pat Kenny

for and on behalf of Deloitte LLP
Glasgow

19 September 2019

Audit adjustments

Summary of uncorrected misstatements and disclosure deficiencies

Uncorrected misstatements

No uncorrected misstatements have been identified from our audit work performed to date.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable the Governance and Scrutiny Committee to evaluate the impact of those matters on the financial statements. We have noted no material disclosure deficiencies in the course of our audit work to date.

Action plan

Recommendations for improvement

Our interim report, submitted to the Governance and Scrutiny Committee in August 2019, reported the detailed recommendations arising from our work on the wider audit dimensions. We made a total of three recommendations which management have agreed to implement.

In the table below we have made two recommendations in relation to the financial statements audit:

Area	Recommendation	Management Response	Responsible person	Target Date	Priority
<i>Valuation of property assets – process, methodology and controls</i>	<p>Please see below for a summary of the key recommendations raised regarding the process, methodology and controls applied as part of the valuation of property assets:</p> <ul style="list-style-type: none"> • Effective review controls should be implemented by management. These controls should review the valuation outputs at various stages before valuation adjustments are recognised within the annual accounts. A number of the errors identified through our reviews would be identified through effective internal controls. • The estates team should provide explicit guidance and professional advice in respect of roles/responsibilities and requirements for forthcoming valuations as part of the terms of reference. This advice should include, but not be limited to, the programme of assets being valued in the year, the asset inspections taking place as part of the valuation process, and the impairment review and methodology applied. • An overarching valuation methodology report should be prepared. This should detail the overall valuation process including details of the rolling programme, statements of valuation approach and methodology, key assumptions applied and other information relied upon. • An impairment review report should be prepared detailing how the potential for impairment has been considered for assets not revalued in the year. • The estimates of useful economic lives should be determined for each individual asset on the basis of type, age and use, instead of applying the same useful economic life to the vast majority of assets. <p>Full detail of all recommendations raised have been communicated to management.</p>	<p>The valuation process will be redesigned to ensure that valuation outputs are subject to appropriate checks before being recognised in the accounts.</p> <p>This will include the preparation of a procedure document which will include the methodology to be employed and the roles and responsibilities of those involved.</p> <p>A review of asset lives will be undertaken to be completed in advance of March 2020.</p>	Chief Governance Officer	March 2020	High
<i>Preparation for IFRS 16</i>	<p>We recommend the Council targets completion of its IFRS 16 impact analysis during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit. We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council's underlying accounting systems.</p>	<p>Opening balances for leases as at 1 April 2019 are in the process of being finalised. All other work in respect of IFRS 16 leases is also well advanced following review of current leases and dialogue with colleagues.</p>	Corporate Accounting Manager	December 2019	Medium

Fraud responsibilities and representations

Responsibilities explained



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. 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.



Required representations:

We have asked the Council to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity or group.

We have also asked the Council to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.



Audit work performed:

In our planning we identified the achievement of recognition of grant income, management override of controls and valuation of property assets as key audit risks for your organisation.

During course of our audit, we have had discussions with management and those charged with governance.

In addition, we have reviewed management's own documented procedures regarding fraud and error in the financial statements.

We have reviewed the paper prepared by management for the Governance and Scrutiny Committee on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:

No concerns have been identified regarding fraud.



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 that we comply with FRC's Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.

Proposed fees The proposed audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £296,360 as broken down below:

£

Auditor remuneration	170,830
Additional fee*	17,000
Audit Scotland fixed charges:	
Pooled costs	16,570
Contribution to PABV	81,240
Audit support costs	10,720
Total agreed fee	296,360

**Additional fee for increased scope of work performed on the valuation of property assets (see page 13).*

In addition, the proposed audit fee for the charitable trusts audit is £1,800.

No non-audit fees have been charged by Deloitte in the period.

Non-audit services In our opinion there are no inconsistencies between FRC's Ethical Standards for Auditors and the company'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.

Relationships We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.

We are not aware of any relationships which are required to be disclosed.





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