



## **East Ayrshire Council**

### **Planning report to the Governance and Scrutiny Committee on the audit for the year ending 31 March 2020**

Issued 4 February for the meeting on 20 February 2020

# Contents

---

## 01 Planning report

Introduction	3
Responsibilities of the Governance and Scrutiny Committee	5
Our audit explained	6
Continuous communication and reporting	7
Materiality	8
Scope of work and approach	9
Significant risks	11
Other areas of focus	15
Wider scope requirements	17
Maintaining audit quality	24
Purpose of our report and responsibility statement	26

---

## 02 Appendices

Fraud responsibilities and representations	28
Independence and fees	30
Our approach to quality	31

---

## 03 Sector developments

Accounting Standards: IFRS 16 Leases	33
State of the State	34
What does climate change mean for business?	36

# Introduction

## The key messages in this report

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

- A robust challenge of the key judgements taken in the preparation of the financial statements.
- A strong understanding of your internal control environment.
- A well planned and delivered audit that raises findings early with those charged with governance.

I have pleasure in presenting our planning report to the Governance and Scrutiny Committee (“the Committee”) of East Ayrshire Council (“the Council”) for the year ending 31 March 2020 audit. I would like to draw your attention to the key messages of this 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. 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.

### **Key Risks**

We have taken an initial view as to the significant audit risks the Council faces. These are presented as a summary dashboard on page 11.

### **Audit Dimensions**

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our work in prior years to develop an understanding of the Council’s key priorities and risks as well as any risks identified by Audit Scotland. The following specific risks have been identified:

**Financial sustainability** – There is a risk that the detailed service redesign and savings plans are not robust enough to allow the benefits to be realised. We will assess the progress being made in developing the benefits monitoring system and consider whether the intended outcomes of the transformation strategy are being achieved and evidenced effectively.

We will also consider the progress being made with the projects identified and funded through the Ayrshire Growth Deal and how these are being integrated into the Council’s transformation work.

**Financial management** – While we have not identified any specific risks in this area during our audit planning, we will continue to review the Council’s financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as delivery of savings plans. Our work will consider the extent to which the performance impact of in year savings is monitored.

**Governance and transparency** – While we have not identified any specific risk, we will continue to monitor the Council’s approach to governance and transparency, specifically focusing on the work around the transformation strategy.

# Introduction (continued)

## The key messages in this report (continued)

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

There continues to be concern at a national level that the (Integration Joint Boards) IJB's do not achieve the full benefits of integration. We will consider the ongoing work to review the key governance documents of the IJB and its plans to deliver transformational change.

**Value for money** – While we have not identified any specific risks in this area during our audit planning, we will continue to review the Council's performance against the Performance Management Framework, the Council's reporting and monitoring of these and the actions taken to improve the performance of the Council.

Our audit work on the four audit dimensions incorporates the specific area of focus highlighted by Audit Scotland in relation to fraud and corruption in the procurement function. Should any further risks emerge during the year, we will provide an update to the Governance and Scrutiny Committee.

### **Other Responsibilities**

As part of our work on the audit dimensions, we will assess the effectiveness and appropriateness of the arrangements for each of the Accounts Commission's **Strategic Audit Priorities** and the requirements under the **2018 Statutory Performance Information Direction**. We will also continue to follow-up on the findings and recommendations made in the Accounts Commission's **Best Value Assurance Report (BVAR)** on East Ayrshire Council which was published in May 2018.

### **Regulatory Change**

IFRS 16 *Leases* will apply from 2020/21, and will require disclosure in the 2019/20 financial statements of the expected impact on transition.

We would suggest that the Governance and Scrutiny Committee receive reporting from management on the implementation of the new standard. We will report specifically on the scope of our work this year, and recommendations for 2020/21.

### **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 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.

We have also shared our recent research, informed perspectives and best practice from our work across the wider public sector on pages 32 to 35 of this paper.

**Pat Kenny**  
**Audit director**

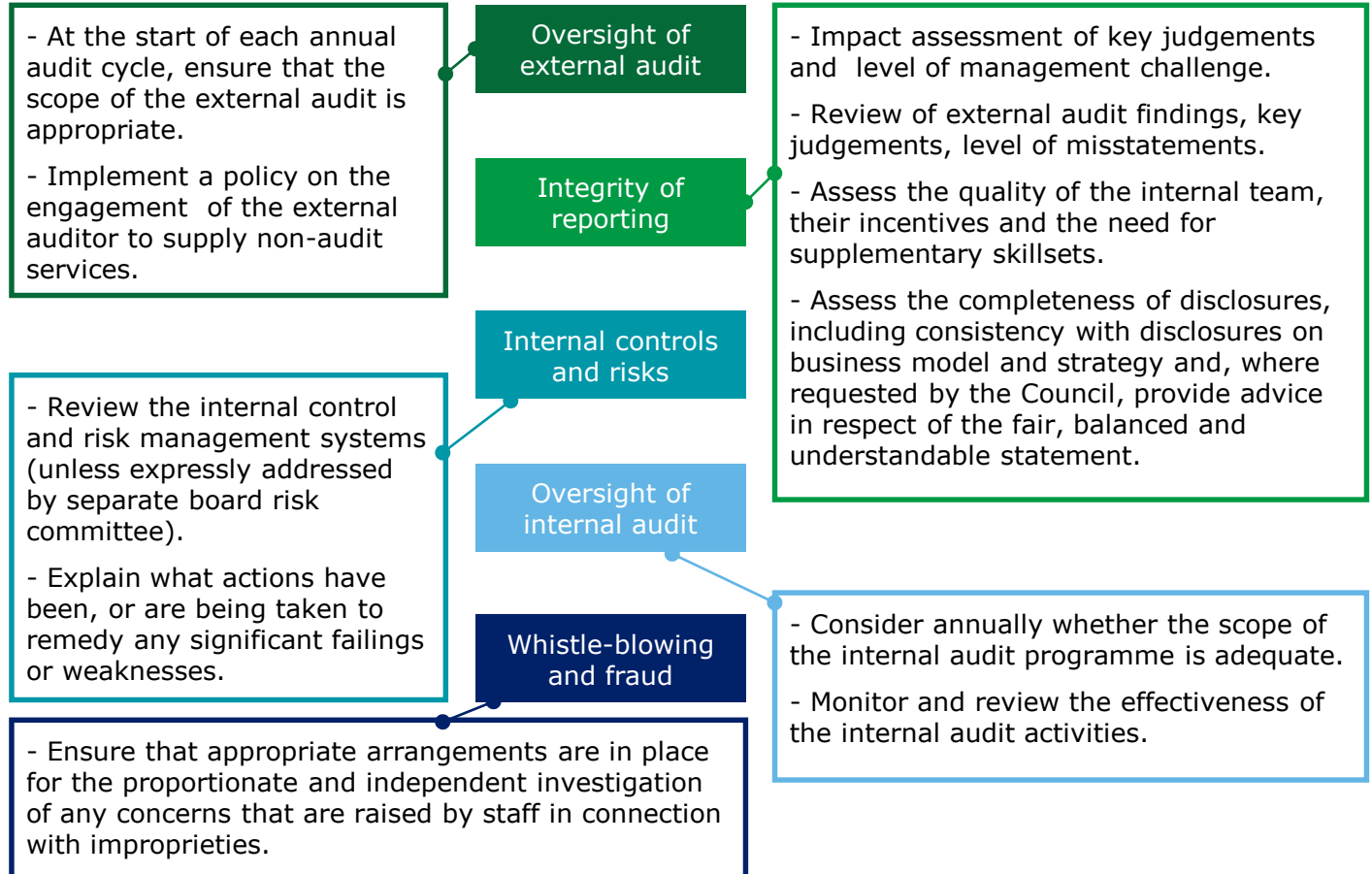
# Responsibilities of the Governance and Scrutiny Committee

## Helping you fulfil your responsibilities

Why do we interact with the Governance and Scrutiny Committee?



As a result of regulatory change in recent years, the role of the Governance and Scrutiny Committee has significantly expanded. We set out here a summary of the core areas of Governance 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 Governance and Scrutiny Committee in fulfilling its remit.



# Our audit explained

## We tailor our audit to your Council and your strategy

### Identify changes in your body 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.

### Scoping

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

More detail is given on page 9.

### In our final report

In our final report to you we will conclude on the significant risks identified in this paper and report to you our other findings.



### Determine materiality

We will use a materiality level of £8.245m (2018/19: £7.635m) in planning our audit. This is based on forecast gross expenditure, consistent with the basis used in the prior year. We will report to you any misstatements above £250k (2018/19: £250k).

Further details on our materiality considerations are provided on page 8.

### Significant risk assessment

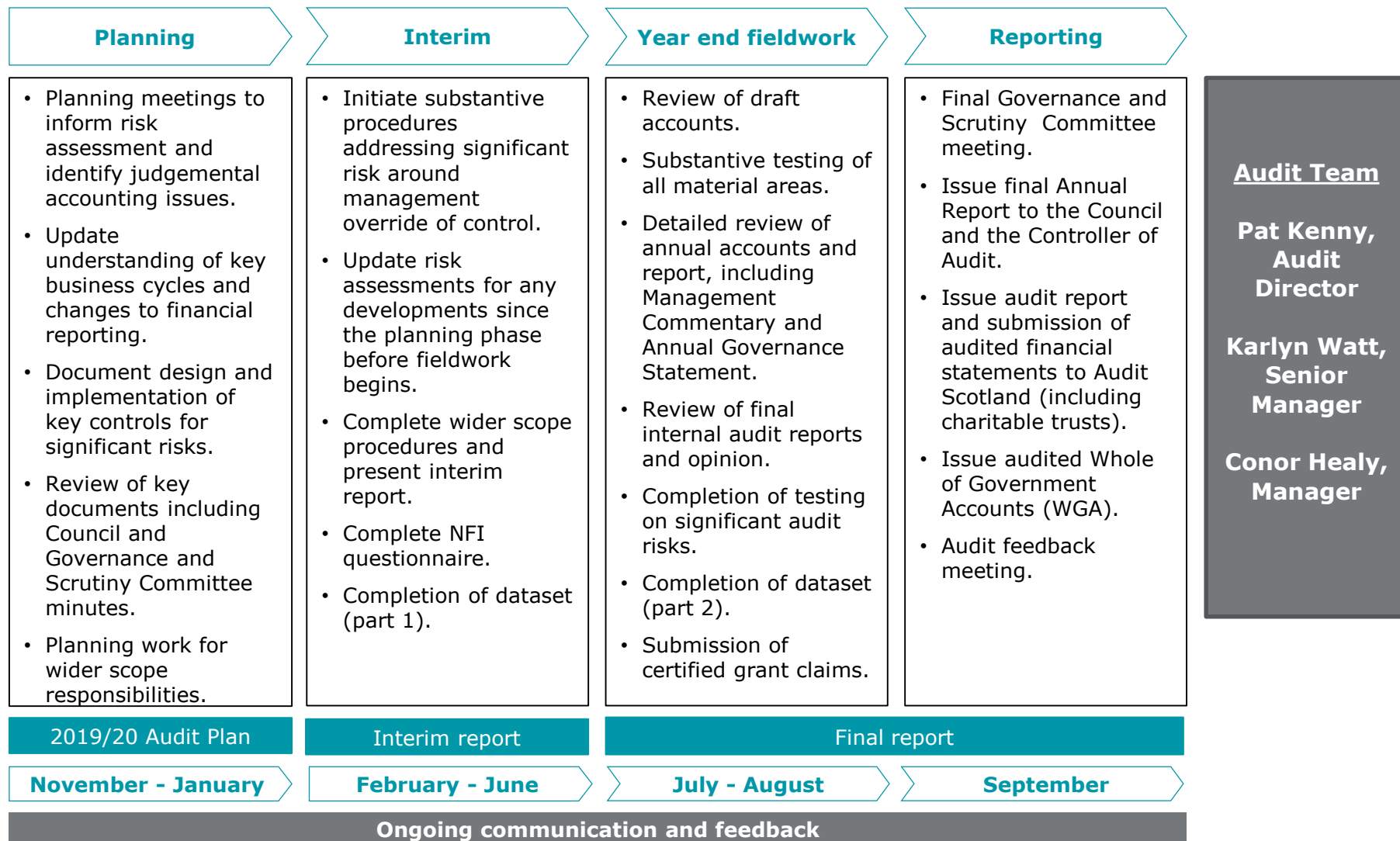
We have identified significant audit risks in relation to the Council. More detail is given on pages 11 to 14. These are consistent with our prior year audit.

### Quality and Independence

We confirm all Deloitte network firms and engagement team members 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.

# Continuous communication and reporting

## Planned timing of the audit



# Materiality

## Our approach to materiality

### Basis of our materiality benchmark

- The audit director has determined materiality for the group as £8.245m (2018/19: £7.635m) and performance materiality as £6.183m (2018/19: £5.726m) based on professional judgement and risk factors specific to the Council, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
  - We have used 1.6% of forecast gross expenditure as the benchmark for determining materiality and applied 75% as performance materiality.
  - This approach is consistent with our prior year materiality calculation.
  - For the audit of East Ayrshire Council (Council only) a materiality of £7.832m (2018/19: £7.631m) has been determined, and performance materiality of £5.874m (2018/19: £5.723m).
- Our approach to determining the materiality benchmark is consistent with Audit Scotland guidance which states that the threshold for clearly trivial above which we should accumulate misstatements for reporting and correction to audit committees must not exceed £250k.

### Our annual audit report

We will:

- Report the group materiality, Council only materiality and the range we use for component materialities;
- 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.

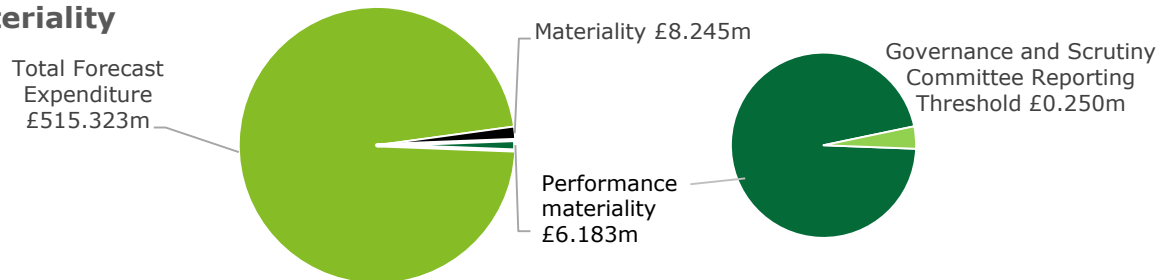
### Group scoping

The only significant components for the group are East Ayrshire Council and East Ayrshire Integration Joint Board (IJB). Full audit procedures will be performed on both of these component. All non-significant components will be covered by desktop reviews at the group level.

### Reporting to those charged with governance

- We will report to you all misstatements found in excess of our clearly trivial threshold which is £250k (2018/19: £250k) for both the group and Council only.
- We will report to you misstatements below this threshold if we consider them to be material by nature.

### Materiality



Although materiality is the judgement of the Audit Director, the Governance 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 work	Planned output	Timeline
Perform an audit of the annual accounts and express specified audit opinion	Annual audit plan Independent auditor's report	23 January 2020 24 September 2020
Consider and report on the audit dimensions, Best Value arrangements, Strategic Audit Priorities and Statutory Performance Information	Annual audit plan Interim report Annual audit report	23 January 2020 18 June 2020 24 September 2020
Contribute to performance audits (including performance audit reports, overview reports and impact reports)	Dataset returns	8 May 2020 (part 1) 14 August 2020 (part 2)
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	Current issues returns	17 January 2020 20 March 2020 7 August 2020 23 October 2020
Provide assurance on Whole of Government Accounts (WGA)	Assurance statement on WGA returns	28 September 2020
Provide information on cases of fraud	Fraud Returns	30 November 2019 28 February 2020 31 May 2020 30 August 2020
Contribute to National Fraud Initiative (NFI) report	NFI audit questionnaire Reference, if necessary, in annual audit report	28 February 2020 24 September 2020
Contribute to the Shared Risk Assessment	Information returns Any locally agreed output	As required
Certify grant claims	Certificate in support of grant claims	As required

# 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 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.

### 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.

Audit Scotland has published good practice guides in relation the Annual Report and the Governance Statement to support the Council in preparing high quality drafts of the Annual Report and financial statements, which we would recommend the Council consider during drafting.

### Statutory Other Information

In addition to the financial statements, we are required to consider whether the Management Commentary and Governance Statement is consistent with the financial statements and has been prepared in accordance with applicable requirements. In performing this work, we will refer to the Financial Reporting Council report issued in December 2018 following an audit quality thematic review of auditors' work on other information which identified a number of instances when insufficient work was performed to ensure that good practice is followed.

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.

# 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		12
Management override of controls			Design and implementation		13
Valuation of property assets			Design and implementation		14



Some degree of management judgement



Limited management judgement

# 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 to the left. The Government Grant and non-domestic rates income 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% to third party evidence therefore little scope for manipulation. Similarly, the income from the IJB relates to services Commissioned from the Council 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 includes fees and charges across all Services, which 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 contributions and service specific grants.

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.

Type of income	2018/19 (£m)	Significant risk
<b>Taxation and Non-Specific Grant Income</b>		
Council Tax income	48.0	
Non domestic rates	26.1	
Government Grant	195.4	
Capital Grants and Contributions	<b>26.0</b>	✓
<b>Service Income</b>		
Service Specific Grant income	<b>25.8</b>	✓
Housing Benefits Subsidy	34.6	
Housing Revenue Account	44.8	
IJB commission income (book entry)	98.2	
Other Service Income	33.1	

### Our response

We will perform the following:

- assess the design and implementation of the 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.

# 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) 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.

We have identified a significant audit risk around recognition of grant income as this is an area where 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:

**Journal testing**

- We will test the design and implementation of controls over journal entry processing.
- Using our Spotlight data analytics tool, we will risk assess journals and select items for detailed follow up testing. The journal entries will be selected using computer-assisted profiling based on areas which we consider to be of increased interest.
- We will test the appropriateness of journal entries recorded in the general ledger, and other adjustments made in the preparation of financial reporting.

**Accounting estimates**

- We will test the design and implementation of controls over key accounting estimates and judgements.
- We will review accounting estimates for biases that could result in material misstatements due to fraud. This will include both a retrospective review of 31 March 2019 estimates and a review of the corresponding estimates as at 31 March 2020.

**Significant and unusual transactions**

- 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 Council, or that otherwise appear to be unusual, given our understanding of the Council and its environment.
-

# 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 £758m property asset portfolio.

---

### **Risk identified**

The Council held £758.4m of property assets at 31 March 2019. The financial year to 31 March 2020 will represent year two of a five year rolling programme in which 20% of the land and buildings portfolio will be 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.

As reported in our 2018/19 annual audit report, we identified a number of material errors in relation to the revaluation movements recognised in the 2018/19 financial statement which were corrected by management. These errors arose as a result of deficiencies in the valuation process. There is therefore a significant risk of material misstatement in 2019/20.

---

### **Planned audit challenge**

We will perform the following procedures to address the above risk:

- test the design and implementation of key controls in place around the property valuation;
- follow up on the recommendations made in previous years' audits to assess whether management's actions to address deficiencies in valuation process have been implemented;
- engage early with the Council, using our valuation specialists to challenge the assumptions applied by management in the valuations;
- use 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 Land and Buildings, including considering movements compared to those of other Council's performing valuations for 2019/20;
- assess management's review of assets not subject to revaluation during the year for potential material changes; and
- consider the impact of uncertainties relating to the UK's exit from the EU upon property valuations in evaluating the property valuations and related disclosures.

# Other areas of focus

## Pension Liability

We will engage our pension specialists to challenge the actuarial assumptions

---

### **Risk identified**

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.

The Council recognised a net pension liability of £204.3m in 2018/19, an increase from £117.6m in 2017/18. The increase was 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.

Hymans Robertson LLP are the Council's appointed actuary, who produce a detailed report outlining the estimated liability at the year-end along with the associated disclosure requirements.

The pension liability valuation is an area of audit focus due to the material value and significant assumptions used in the calculation of the liability. The valuations are prepared by a reputable actuary using standard methodologies which have been considered as appropriate in previous years and no significant changes in the membership of the scheme or accrued benefits are expected in the current year. As a result, we have not identified this as a significant risk.

---

### **Planned audit challenge**

We will perform the following procedures to address the above risk:

- obtain a copy of the actuarial report produced by Hymans Robertson LLP and agreed in the disclosures to notes in the accounts;
  - review and challenged the assumptions made by Hymans Robertson LLP, including benchmarking by our pension specialists;
  - review the disclosures within the accounts against the Code; and
  - assess the independence and expertise of the actuary supporting the basis of reliance upon their work.
-

# Other areas of focus (continued)

## Expenditure recognition

---

**Risk identified**

In accordance with Practice Note 10 (*Audit of financial statements of public sector bodies in the United Kingdom*), in addition to the presumed risk of fraud in revenue recognition set out in ISA (UK) 240, as discussed further on page 12, auditors of public sector bodies should also consider the risk of fraud and error on expenditure. This is on basis that most public bodies are net spending bodies, therefore the risk of material misstatement due to fraud related expenditure may be greater than the risk of material misstatement due to fraud related to revenue recognition.

We have considered this risk for the Council and concluded that we are satisfied that the control environment is strong and there is no history of errors or audit adjustments. This has therefore not been assessed as a significant risk area, but will continue to be an area of audit focus.

---

**Planned audit challenge**

We will perform the following procedures to address the above risk:

- perform focused testing of accruals and prepayments made at the year end; and
- performing focused cut-off testing of invoices received and paid around the year end.



# 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. Our planned audit work against the four dimensions is risk based and proportionate. Our initial assessment builds upon our work in prior years to develop an understanding of the Council's key priorities and risks as well as any risks identified by Audit Scotland. We have set out below our identified audit risks in relation to the audit dimensions and proposed response. In addition, we will follow up the progress made in relation to our previous years recommendations.

Audit dimension	Conclusions from previous years	2019/20 Audit Risks
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<p>As reported in our 2018/19 annual audit report, the Council agreed £9.0m of savings 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, we recommended that the Council should consider developing a detailed long-term financial plan that looks beyond the period covered by the current transformation strategy. We also recommended that the Council 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.</p> <p>The Council has a detailed transformation strategy for the period 2017-2022 which aligns with the Community Plan 2015-2030 and clearly considers the findings and recommendations raised within the 2018 BVAR</p>	<p>There is a risk that that the detailed service redesign and savings plans are not robust enough to allow the benefits to be realised.</p> <p>We will assess the progress being made in developing the benefits monitoring system and consider whether the intended outcomes of the transformation strategy are being achieved and evidenced effectively.</p> <p>We will also consider the progress being made with the projects identified and funded through the Ayrshire Growth Deal and how these are being integrated into the Council's transformation work.</p>
<p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively</p>	<p>We concluded in 2018/19 that the Council has effective financial planning and management arrangements in place.</p>	<p>While we have not identified any specific risks in this area during our audit planning, we will continue to review the Council's financial management arrangements including the extent to which there is effective scrutiny over both operational spend as well as delivery of savings plans. Our work will consider the extent to which the performance impact of in year savings is monitored.</p>
	<p>In accordance with Audit Scotland planning guidance, fraud and corruption in the procurement function (such as illicit rebates, kickbacks, and false invoicing) is a risk across the public sector. We will therefore consider the Council's controls and processes as a matter of particular focus.</p>	<p>There is a risk that controls around the procurement process are insufficient to prevent and detect fraud and corruption. We will therefore evaluate the arrangements that the Council has in place to mitigate this risk.</p>

# Wider scope requirements (continued)

## Audit dimensions (continued)

Audit dimension	Conclusions from previous years	2019/20 Audit Risks
<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p>	<p>In 2018/19 we concluded that the Council has good attitude to openness and transparency.</p> <p>We also concluded 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.</p>	<p>While we have not identified any specific risk, we will continue to monitor the Council's approach to governance and transparency, specifically focusing on the work around the transformation strategy.</p>
	<p>In relation to the IJB, our 2018/19 audit concluded that the IJB achieved financial balance in the year and set a balanced budget for 2019/20. We also noted that it was progressing with its transformation work through the Strategic Commissioning Board given the extremely challenging financial position for the medium term.</p> <p>We concluded that it was positive to note that the IJB, Council and NHS partners were reviewing and updating the governance arrangements for the IJBs to take cognisance of the experience from early integration..</p>	<p>In common with all IJB's there continues to be an ongoing risk that that the IJB does not achieve the full benefits of integration. We will consider the ongoing work to review the key governance documents of the IJB and deliver transformational change.</p>
<p><b>Value for money</b> is concerned with using resources effectively and continually improving services.</p>	<p>In 2018/19 we concluded that the Council has a well established performance management framework in place to monitor performance against national standards. While work had progressed during 2018/19 to address areas of poor performance, the impact was not yet evident in the performance data. There was evidence of the Council directing resources to address areas of poor performance.</p>	<p>While we have not identified any specific risks in this area during our audit planning, we will continue to review the Council's performance against the Performance Management Framework, the Council's reporting and monitoring of these and the actions taken to improve the performance of the Council.</p>

# Wider scope requirements (continued)

## Other responsibilities

### Best Value (BV)

We have a duty to be satisfied that local government bodies have made proper arrangement for securing BV. 2019/20 is year four of the agreed five-year approach to auditing BV in Councils. A key feature of the approach is the Controller of Audit providing a BVAR to the Accounts Commission for each Council once over the five year period. East Ayrshire Council's BVAR was published in May 2018 as part of the 2017/18 audit.

Our BV audit work in 2019/20 will be integrated into our audit approach, including our work on the audit dimensions discussed on pages 17 to 18, and will be reported in our interim and annual audit reports. In particular, we will continue to follow-up on the findings and recommendations made in the Accounts Commission report on East Ayrshire Council which was published in May 2018.

# Wider scope requirements (continued)

## Other responsibilities (continued)

### Strategic audit priorities

In its 2019-24 strategy, the Accounts Commission sets out five **Strategic Audit Priorities** as set out below. We will assess the effectiveness and appropriateness of the arrangements for each strategic audit priority based on our work carried out to date over the audit appointment and report in our overall conclusion in the corresponding audit dimension in our annual audit report.



# Wider scope requirements (continued)

## Other responsibilities (continued)

### Councils' Statutory Performance Indicators

The Accounts Commission has a statutory responsibility to define the performance information that councils must publish. This responsibility links with the Commission's BV audit responsibilities. In turn, councils have their own responsibilities, under their BV duty, to report performance to the public. The Accounts Commission issued a revised **2018 Statutory Performance Information Direction** in December 2018 which requires a council to report on:

- performance in improving local public services provided by the Council (on its own and with its partners and communities), and progress against agreed desired outcomes;
- Its own assessment and independent audit assessments of how it is performing against its duty of BV, and how it plans to improve these assessments; and
- how it (with its partners where appropriate) has engaged with and responded to its diverse communities.

As this is the first year of the direction, we will evaluate the effectiveness and appropriateness of the arrangements at the Council to fulfil these requirements. This will be linked to our work carried out on the Commission's strategic audit priority in respect of reporting the Council's performance in a way that enhances accountability to citizens and communities as discussed further on page 20.

### National Fraud Initiative (NFI)

All Councils are participating in the NFI 2018/19. Audit Scotland expects bodies to investigate all recommended matches based on findings and the risk of error or fraud by 30 September 2019, with the results recorded on the NFI system.

We will be required to complete and submit a questionnaire by 28 February 2020. The information from this will be used in Audit Scotland's next NFI report due to be published in the summer of 2020.

# Wider scope requirements (continued)

## Other responsibilities (continued)

### Sector overview/ Annual performance reports

As in previous years, the Accounts Commission will publish an annual performance report covering the local government sector. This report uses information from the audited accounts and the Annual Audit Reports and therefore much of the required information is generally already available from the core audit work. However, we will be requested by Audit Scotland to provide important supplementary information collected as datasets. We will share these with management as soon as they are available.

### Performance Audits

As local auditors, we play a key role in delivering the five year rolling work programme for performance audits carried out by Audit Scotland's Performance Audit and Best Value Group (PABV). Audit Scotland plan to publish the following report which is anticipated to involve local auditor input during the 2019/20 audit year:

Title	Objective	Local auditor input	Timescale for input
Waste management	To assess how well Scotland is performing in meeting its current and future waste management targets	To provide information on local, regional and national waste management arrangements, including cost, investment, volume and Landfill Tax data. Guidance will be provided, if required	October to December 2020

### Impact reports

We will also be requested to provide information to support assessing the impact of previously published performance audit reports. Audit Scotland plan to assess the impact of the report "**Council's use of arm's length organisations**" between March and May 2020 and the report "**Children and young people's mental health**" during April/ May 2020.

# Wider scope requirements (continued)

## Other responsibilities (continued)

### Shared Risk Assessment and Joint Scrutiny Planning

The Accounts Commission, supported by Audit Scotland, chairs the Strategic Scrutiny Group (SSG). The SSG is made up of scrutiny bodies from across the public sector to make their work on local government more co-ordinated, better targeted and more proportionate to identified risks. The scrutiny bodies involved include the Care Inspectorate, Education Scotland and the Scottish Housing Regulator.

The Shared Risk Assessment (SRA) process was established by the SSG as the vehicle for scrutiny bodies to share intelligence and agree scrutiny risks at each council.

Following a review of the SRA, there will be a greater focus in 2019/20 on co-ordinating and reporting on scrutiny at a national level. An Operational Sub-group, chaired by the Care Inspectorate, is now responsible for producing, updating and reporting on the National Scrutiny Plan (NSP). The group has responsibility for the operational development of the new approach to sharing intelligence, including identifying and responding to any issues in how scrutiny bodies work together or escalating these to SSG if they cannot resolve them.

The arrangements for co-ordinating scrutiny at a local level continue to include a Local Area Network (LAN) for each Council. As your local auditor, we lead the LAN for East Ayrshire Council, and the results of discussions between the LAN and the Council feed into the NSP. We will provide a return to the Operational Sub group.

Greater clarity about the rationale for scrutiny activity will be provided in the NSP. The Operational Sub-group issued an NSP on 30 September and will update it every six months (planned for March and September 2020) which we will discuss with the Council.

Routine meetings of the LAN members are planned and there will ongoing engagement between LAN leads and the Operational Sub-group.

# Maintaining audit quality

## Responding to challenges in the current audit market

This is a time of intense scrutiny for our profession with questions over the role of auditors, market choice and the provision of non-audit services by an audit firm. We welcome the debate and are engaging fully with all parties who have an interest in the current audit market reform initiatives, so that our profession, our people, our clients and most importantly, the public interest, are served to the highest standards of audit quality and independence.

---

### The role of audit

- Public confidence in audit has weakened over recent years and the expectation gap has widened with differences between what an audit does and what people think it should do (largely in areas of internal controls, fraud, front half assurance and long-term viability).
- Deloitte fully supports an independent review into the role of auditors.
- The Government's Brydon Review will consider UK audit standards and how audits should evolve.

---

### Would it be better to have audit only firms?

- Deloitte believes that multidisciplinary firms have more knowledge, greater access to technology and a deeper talent pool. The specialist input from industry, valuation, controls, pensions, cyber, solvency, IT and tax services are critical to an effective audit.
- Our investment in audit innovation, training and technology is greater because of the multidisciplinary model.

---

### Is the current audit market uncompetitive?

- We recognise that the competition for large, complex clients is fierce, but we wholeheartedly support greater choice being available to stakeholders.
- There are barriers to entry in the listed market that are significant including the required global reach, unlimited liability, and the high cost of tendering.
- The audit profession has engaged with the Competition and Markets Authority with ideas on how to provide greater choice in the market, and responded to the CMA's suggested market remedies.

---

### Independence and conflicts from other services

- Legislation and the FRC's Ethical Standard restrict the services we may provide to audit clients
- Deloitte invests heavily in systems, processes and people to check for potential conflicts.
- We have governance arrangements in place to assess any areas of potential conflict, including where required to protect the public interest.
- Fees for non-audit services to audit clients have fallen since 2008 (17% to 7.3% of firm revenue).

---

### Deloitte

- Our Impact Report and Transparency Report are available on our website <https://www2.deloitte.com/uk/en/pages/about-deloitte-uk/articles/annual-reports.html>



# Maintaining audit quality (continued)

## 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 local government 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 will receive tailored learning to develop their expertise in audit skills, delivered by Pat Kenny and other sector experts. This includes sector specific matters, and audit methodology updates.



### **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; and
- Key regulatory and corporate governance updates, relevant to you.

### What we do not 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.

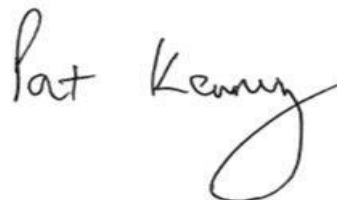
Finally, the views on internal controls and business risk assessment in our final report should not be taken as comprehensive or as an opinion on effectiveness since they will be based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed 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 Governance 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.



**Pat Kenny, CPFA**

for and on behalf of Deloitte LLP

Glasgow

4 February 2020

# Appendices



# Fraud responsibilities and representations

## Responsibilities explained



### Your Responsibilities:

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



### Our responsibilities:

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

## 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.
- We plan to involve management from outside the finance function in our inquiries.



### **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 Governance and Scrutiny Committee for the year ending 31 March 2020 in our final report to the Governance and Scrutiny Committee.

---

## Fees

The audit fee for 2019/20, in line with the fee range provided by Audit Scotland, is £284,720 as analysed below:

Auditor remuneration	£ 174,810
Audit Scotland fixed charges:	
Pooled costs	17,100
Performance Audit and Best Value	82,240
Audit support costs	10,570
<b>Total proposed fee</b>	<b>284,720</b>

In addition, the audit fee for the charitable trusts audit is £1,200.

There are no non-audit services fees proposed for the period.

---

## Non-audit services

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

---

## 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 Audit Quality Monitoring and Measuring programme. In July 2019 the Financial Reporting Council ("FRC") issued individual reports on each of the seven largest firms, including Deloitte, on Audit Quality Inspections providing a summary of the findings of its Audit Quality Review ("AQR") team for the 2018/19 cycle of reviews.

We greatly value the FRC reviews of our audit engagements and firm wide quality control systems, a key aspect of evaluating our audit quality. We have further transformed our internal review processes including a new focus for reviewing in progress audits, developing our Audit Quality Indicators ('AQI') which are monitored and reported to the firm's executive, and on enhanced remediation procedures.

Whilst we are pleased that overall our quality record, as measured by external inspections, has improved from 76% to 84%, we remain committed to continuous improvement and achieving as a minimum the 90% benchmark across all engagements. We are however, extremely disappointed one engagement received a rating of significant improvements required during the period. This is viewed very seriously within Deloitte and we have worked with the AQR to agree a comprehensive set of swift and significant firm wide actions. We are also pleased to see the impact of our previous actions on impairment, group audits and contingent liability disclosures reflected in the audits under review and there being limited or no findings in those areas. These continue to be a focus in our training, internal coaching and internal review programmes.

We invest continually in our firm wide processes and controls, which we seek to develop globally, to underpin consistency in delivering high quality audits whilst ensuring engagement teams exercise professional scepticism through robust challenge.

All the AQR public reports are available on its website.  
<https://www.frc.org.uk/auditors/audit-quality-review/audit-firm-specific-reports>

### The AQR's 2018/19 Audit Quality Inspection Report on Deloitte LLP

"We assessed 84% of the firm's audits that we reviewed as requiring no more than limited improvements, compared with 76% in 2017/18. Of the FTSE 350 audits we reviewed this year, we assessed 75% as achieving this standard compared with 79% in 2017/18. We note that our inspection results show only modest improvements in audit quality."

"We had no significant findings arising from our firm-wide work on internal quality monitoring, engagement quality control reviews and independence and ethics."

#### **"Our key individual review findings related principally to the need to:**

- Exercise greater professional scepticism in the audit of potential prior year adjustments and related disclosures in the annual report and accounts.
- Strengthen the extent of challenge of key estimates and assumptions in key areas of judgement, including asset valuations and impairment testing.
- Improve the consistency of the quality of the firm's audit of revenue.
- Achieve greater consistency in the audit of provisions and liabilities."

#### **"The firm has enhanced its policies and procedures during the year in a number of areas, including the following:**

- Through the firm's global audit quality programmes, there has been an increased focus on consistency of audit work across the audit practice. For certain account balances, standardised approaches have been adopted, further use has been made of centres of excellence and delivery centres and new technologies embedded into the audit process to support and enable risk assessments, analytical procedures and project management activities.
- Further methodology updates and additional guidance and training for the audit practice covering group audits, accounting estimates, financial services (including the adoption of IFRS 9) provisions and contingencies and the evidencing of quality control procedures (including EQCR) on individual audits.
- Increased support for audit teams throughout the audit cycle including coaching programmes for teams and greater use of diagnostics to monitor progress.
- Continued focus on the approach to the testing of internal controls. The firm provided additional training and support to audit teams adopting a controls-based audit approach, increased focus on reporting to Audit Committees on internal controls and on the wording of auditor's reports."

# Sector developments





# Accounting standards

## IFRS 16 - Leases

### Background

The new standard is being implemented in 2020/21 and will require adjustments to recognise on balance sheet arrangements currently treated as operating leases.

For 2019/20, the Council will need to include disclosures on the expected impact of the standard, but not make any adjustments in the financial statements in respect of IFRS 16. However, many organisations have identified previously unidentified leases (or arrangements that contain a lease, such as service contracts) as part of their transition project, and so there may be some 2019/20 impact.

Separate to the financial reporting impact, but potentially more critical, budgets for 2020/21, particularly capital budgets, will need to reflect the impact of the new standard (and require submissions well ahead of year-end).

In the local government context relatively small effects from standards can have a significant impact against performance metrics and targets, and so it is important to clearly understand the impact of the standards.

We have requested management's timetable for IFRS 16 work, and to understand the extent of testing required for 2019/20 disclosures.

---

### Next steps

We recommend that the Governance and Scrutiny Committee review the impact of IFRS 16 including calculating any adjustments that will be required as at 31 March 2020 for transition. We would suggest that the Governance and Scrutiny Committee receive reporting in year from management on the implementation of the new standard, and we will report specifically on the findings from our audit work in this area.

---

# State of the State

## The view from citizens, leaders and the frontline of public services

### Background and overview

Now in its eighth year, The State of the State brings together Deloitte and Reform to make an annual assessment of government and public services in the UK. As Brexit negotiations and parliamentary wrangling continues, The State of the State looks beyond the headlines to explore the UK's public sector from the view of citizens, public sector leaders and the frontline of public services.

The State of the State finds that the public want greater spending on services and perceptions of social inequality have grown. It finds that investment in skills could make a significant difference to some of the UK's pervasive economic issues including productivity and regional disparity. And it finds frontline public sector professionals are too often hampered by out-of-date technology and working environments.

But amid these challenges, The State of the State finds much to be positive about. Our research shows that public sector leaders are enthused by the prospect of increased spending, public support is strong for government action on big issues like climate change and the thriving public sector ethos at the frontline remains one of the UK's core strengths.



### The State of the State 2019-20

The view from citizens, leaders and the frontline of public services

### Next steps

A summary of the key conclusions are provided on the next page. The full report is available at <https://www2.deloitte.com/uk/thestateofthestate>

# State of the State (continued)

## The view from citizens, leaders and the frontline of public services

### Key conclusions

Combining the three perspectives in our research offers real insight into issues at the heart of a new domestic agenda. Our key observations are:

- **The public and the public sector want to know what post-austerity looks like.** Public service leaders are best placed to make their own devolved decisions, but many want direction from national governments on the shape of post-austerity, sector-wide reform. At the frontline, professionals want that reform to include greater use of mobile technology to reduce their administrative burden and boost their productivity.
- **Infrastructure and skills investment should be deployed to tackle economic inequalities.** The public think that economic inequalities in the UK are getting worse and public sector leaders believe transport infrastructure investment could tackle them if deployed with purpose. Our research also suggests that a range of the UK's economic and social challenges converge around skills – and so investment in skills provision could make a substantial difference to the UK's post-Brexit future.
- **The UK has an opportunity to consolidate its environmental leadership.** Public concerns on climate change have spiked in the past year, support for government intervention is strong and the UK has a window of opportunity to consolidate its environmental leadership when Glasgow plays host to the COP26 summit in 2020.
- **Resolving the social care crisis needs political will.** As the Queen's Speech recognised, underfunding in the social care system continues to blight lives and exacerbate demand on the NHS. Leaders across the public services want to see social care rise as a political priority and our survey finds it may be emerging as a priority for the public. Our research suggests that cross-party political leadership may be the best route to new funding arrangements – perhaps considering systems around the world as a starting point for UK options.
- **The UK could set the global gold standard in public administration.** Brexit may be dominating a substantial part of Civil Service capacity, but it has enhanced government capability and stimulated cross-departmental working. Leaving the EU is an era-defining challenge for government departments but beyond Brexit, the UK will be in a strong position to set the global gold standard for public administration, exporting UK expertise, experience of successful transformation and digital know-how.

# What does climate change mean for business?

## New website – learning, interviews and resources

### Background

Climate change is likely to drive some of the most profound changes to businesses in our lifetimes.

Impacts on products and services, supply chains, loss of asset values and market dislocation are already being caused by more frequent and severe climate-related events.

Discover how to think through the challenges and futureproof your business.

**The time to act is now!**

**Deloitte.**

IN COLLABORATION WITH  
 ICAEW

[Learning](#) | [Interviews](#) | [Resources](#) | [Contact us](#)



### What does climate change mean for business?

Understanding the role of finance professionals

Climate change is likely to drive some of the most profound changes to businesses in our lifetimes.

Impacts on products and services, supply chains, loss of asset values and market dislocation are already being caused by more frequent and severe climate-related events. These effects are now compounded by the accelerating pace of policy and regulatory change as humanity recognises the challenge we face and the drastic and rapid actions we all must take in order to protect our planet and our own livelihoods.

Discover how to think through the challenges and futureproof your business through [learning](#), [interviews](#) and [resources](#).

The time to act is now!

Supported by



### Next steps

Deloitte and the ICAEW have launched a site to support considering what climate change means for finance professionals at [www.deloitte.co.uk/climatechange](http://www.deloitte.co.uk/climatechange)



Deloitte LLP does not accept any liability for use of or reliance on the contents of this document by any person save by the intended recipient(s) to the extent agreed in a Deloitte LLP engagement contract.

If this document contains details of an arrangement that could result in a tax or National Insurance saving, no such conditions of confidentiality apply to the details of that arrangement (for example, for the purpose of discussion with tax authorities).

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London, EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE 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 NSE LLP do not provide services to clients. Please see [www.deloitte.com/about](http://www.deloitte.com/about) to learn more about our global network of member firms.