



## **Ayrshire Valuation Joint Board**

Planning report to the Board on the audit for the year ending 31 March 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.

We have pleasure in presenting our planning report to the Ayrshire Valuation Joint Board (the Board) for the year ending 31 March 2019. We would like to draw your attention to the key messages of this audit plan:

### **Audit Plan**

We have updated our understanding of the Board including discussion with management and review of relevant documentation from across the Board.

Based on these procedures, we have developed this plan in collaboration with the Board 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 Board.

### **Key Risks**

We have taken an initial view as to the significant audit risks the Board faces. These are presented as a summary dashboard on page 13.

In accordance with auditing standards, we have identified a significant risk associated with income. This risk is pinpointed to the occurrence of income received from the Ayrshire Councils given the reliance of the Board on this income and the potential that funding partners may not provide additional income to cover overspends.

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

### **Audit Dimensions**

The Code of Audit Practice sets out four audit dimensions which set a common framework for all public sector audits in Scotland. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the Board, we have concluded that the full wider scope audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on:

- The appropriateness of the disclosures in the governance statement; and
- The financial sustainability of the Board and the services that it delivers over the medium to longer term.

Our audit work on the audit dimensions will incorporate 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 and increased focus on openness and transparency.

# Introduction (continued)

## The key messages in this report (continued):

### **Regulatory Change**

New accounting standards on revenue and financial instruments will apply for 2018/19, and for leases from 2020/21. While we do not expect these standards to have a significant impact on the Board, we recommend that the Board review the impact of IFRS 9 and 15 before the year-end, including calculating any adjustments that will be required as at 31 March 2018 for transition. We would suggest that the Board 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.

We have reported on other regulatory changes in our sector updates in our separate report.

### **Our Commitment to Quality**

We are committed to providing the highest quality audit, with input from our market leading specialists, sophisticated data analytics and our wealth of experience.

### **Adding value**

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

**Pat Kenny**  
Audit director

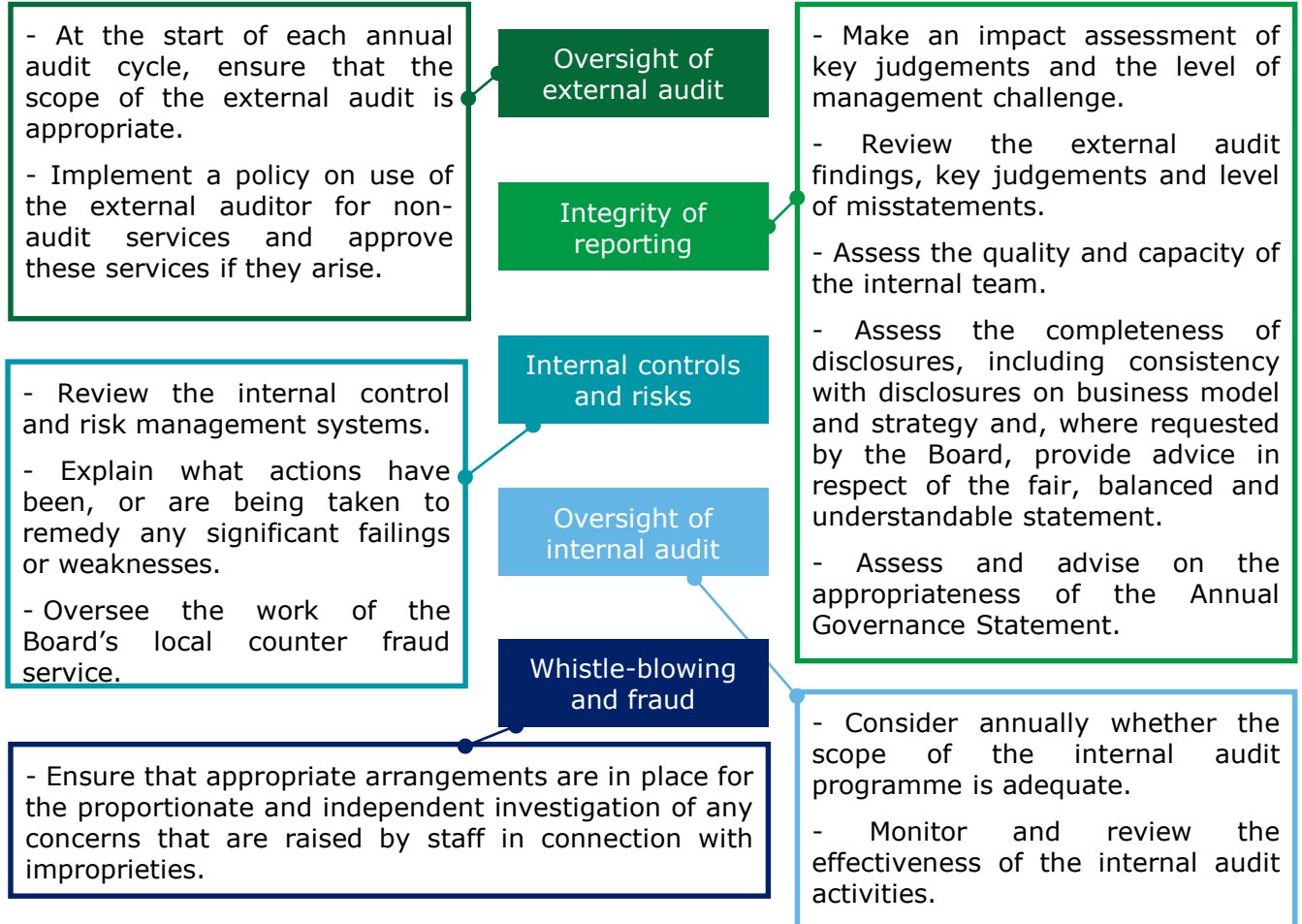
# Responsibilities of the Board

## Helping you fulfil your responsibilities

The primary purpose of the Auditor's interaction with the Board:

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

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

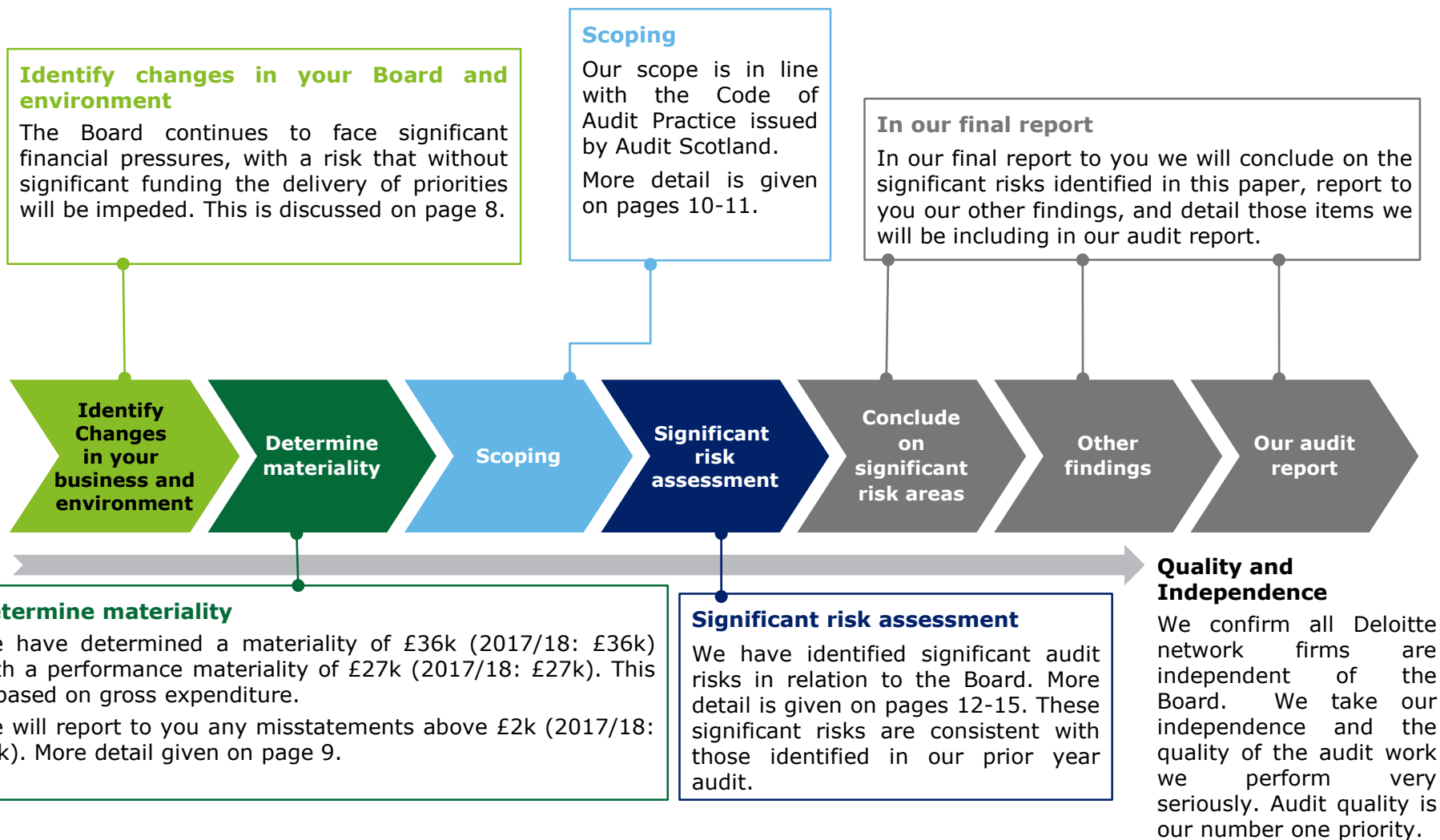


We use this symbol throughout this document to highlight areas of our audit where the Board needs to focus their attentions.



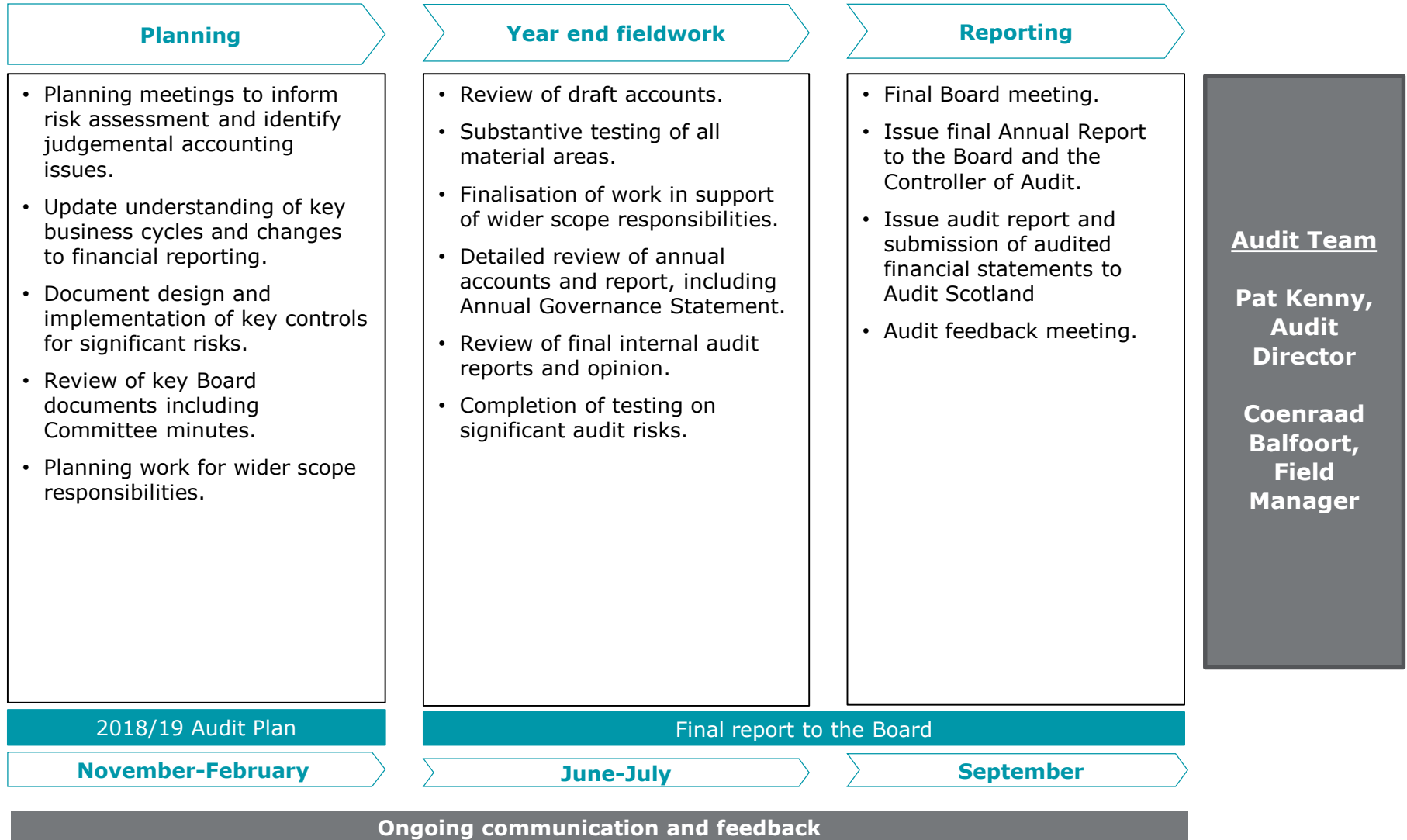
# Our audit explained

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



# Continuous communication and reporting

## Planned timing of the audit



# An audit tailored to you

## Focusing on your business and strategy

### Impact on our audit

#### Future financial sustainability



As with all public sector bodies, the Board continues to face significant financial challenges. Deloitte have noted that as at 30 November 2018, the Board is forecasting a slight budget underspend of £97k owing primarily to projected full year underspends of £125k for employee costs due to vacancies and overtime, offset by projected full year overspends of £18k for administrative costs (postage and training costs) and £10k for supplies and services costs relating to the digitisation (document scanning) project. The Board expects to be able to meet its responsibilities within budget in the current year, to be partially met by a £49k contribution from reserves, which is down from the original budgeted contribution from reserves of £146k.

As part of our prior year audit work, we recommended that efforts continue to extend the timeline of medium term financial planning to 2-4 years by looking at finalising savings and efficiency options for the 2019/20 budget and future years. We do note that modernisation efforts are ongoing to achieve savings and efficiencies, which includes digitisation of records and the implementation of a new operating system, and that quantification of the savings and efficiencies is difficult to gauge at this early stage of the implementation. We will continue to monitor progress against these modernisations and whether savings and efficiencies are achieved over the remainder of the 5 year Audit Scotland contract.



New significant risk



Continuing significant risk



Considered as part of wider scope audit requirements



# Materiality

## Our approach to materiality

### Basis of our materiality benchmark

- The audit director has determined materiality as £36k (2017/18: £36k) and a performance materiality of £27k (2017/18: £27k), based on professional judgement and risk factors specific to the Board, the requirement of auditing standards and the financial measures most relevant to users of the financial statements.
- We have used 1.6% of forecasted gross expenditure as the benchmark for determining materiality and applied 75% as performance materiality.
- This approach is consistent with our prior year materiality calculation.

### Reporting to those charged with governance

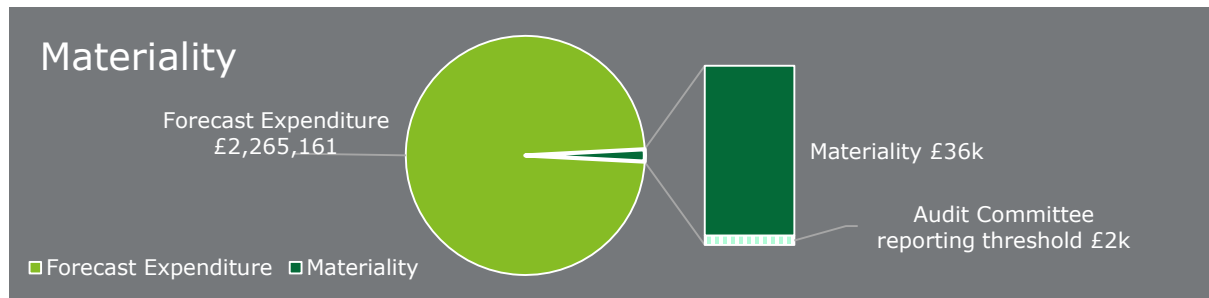
- We will report to you all misstatements found in excess of our clearly trivial threshold which is £2k (2017/18: £2k).
- We will report to you misstatements below this threshold if we consider them to be material by nature.

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



Although materiality is the judgement of the Audit Director, the Board 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 ISA (UK) compliant audit of the annual accounts	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Interim report (if required)</li> <li>Independent auditor's report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>April 2019</li> <li>September 2019</li> </ul>
Audit and report on the audit dimensions	<ul style="list-style-type: none"> <li>Annual audit plan</li> <li>Annual audit report</li> </ul>	<ul style="list-style-type: none"> <li>March 2019</li> <li>September 2019</li> </ul>
Contribute to performance audits (including performance audit reports, overview reports and impact reports)	<ul style="list-style-type: none"> <li>Data returns</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Share audit intelligence with Audit Scotland including highlighting potential statutory reports	<ul style="list-style-type: none"> <li>Current issues returns</li> </ul>	<ul style="list-style-type: none"> <li>January, March, August and October 2019</li> </ul>
Carry out preliminary enquiries into referred correspondence	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>N/A</li> </ul>
Provide information on cases of fraud	<ul style="list-style-type: none"> <li>Fraud returns</li> </ul>	<ul style="list-style-type: none"> <li>November 2018, February, May and August 2019</li> </ul>
Provide information on cases of money laundering	<ul style="list-style-type: none"> <li>Audit Scotland to advise</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>
Contribute to technical guidance notes	<ul style="list-style-type: none"> <li>Consultation comments on draft technical guidance notes</li> </ul>	<ul style="list-style-type: none"> <li>As required</li> </ul>

# 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.

The Board uses the corporate financial systems of the Council as well as the Council's internal audit function. 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 Board and 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 Board in preparing high quality drafts of the annual report and financial statements, which we would recommend the Board complete during drafting.

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

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

Obtain an understanding of the Board 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

## Our risk assessment process

We consider a number of factors when deciding on the significant audit risks. These factors include:

- the significant risks and uncertainties previously reported in the annual report and financial statements;
- the IAS 1 critical accounting estimates previously reported in the annual report and financial statements;
- our assessment of materiality;
- the changes that have occurred in the business and the environment it operates in since the last annual report and financial statements; and
- the Board's actual and planned performance on financial and other governance metrics compared to its peers.

### Principal risk and uncertainties

- Financial pressures

### IAS 1 Critical accounting estimates

- Property, plant and equipment
- Pensions liability







### Changes in your business and environment

- Barclay Commission review of NDR – to include triennial valuations from 2022 but no impact for 2018/19

The next page summarises the significant risks that we will focus on during our audit. All the risks mentioned in the prior year Board report are included as significant risks in this year's audit plan.



# Significant risks Dashboard

Risk	Material?	Fraud risk identified?	Planned approach to controls testing	Level of management judgement	Page no.
Occurrence of income			Design and implementation		14
Management override of controls			Design and implementation		15



Some degree of management judgement



Limited management judgement

# Significant risks (continued)

## Risk 1 – Occurrence of income

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**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 income recognition, evaluate which types of income, income transactions or assertions give rise to such risks.

The main components of income for the Board are requisitions from all three of the Ayrshire Councils: South Ayrshire Council ('SAC'), North Ayrshire Council ('NAC'), and East Ayrshire Council ('EAC'). The significant risk is pinpointed to the recognition of this income, being occurrence of income received from the Councils given the reliance of the Board on this income and the potential that funding partners may not provide additional income to cover overspends.

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**Our response** We will perform the following:

- test the income to ensure that the correct contributions have been input and received in accordance with that agreed as part of budget process and that any reductions have been appropriately applied;
- test the reconciliations performed by the Board at 31 March 2019 to confirm all income is correctly recorded in the ledger;
- confirm that the reconciliations performed during 2018/19 have been reviewed on a regular basis; and
- assess management's controls around recognition of income.

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# 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

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**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 Board's controls for specific transactions.

The key judgments in the financial statements are those which we have selected to be the significant audit risks around completeness and accuracy of income. This is inherently the areas in which management has the potential to use their judgment to influence the financial statements.

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**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 2018 estimates and a review of the corresponding estimates as at 31 March 2019.

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

# 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. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the Board, we have concluded that the full wider scope audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on the following:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
The appropriateness of the disclosures in the <b>governance statement</b> .	<ul style="list-style-type: none"><li>• The completeness of the disclosures in meeting the requirements of the guidance note issued by CIPFA <i>Delivering good governance in local government: framework 2016</i>.</li><li>• Inconsistencies between the disclosures or information that is materially incorrect and audit knowledge.</li></ul>	<p>We will review the draft governance statement and assess whether there are any inconsistencies or omissions based on other audit evidence obtained throughout the audit. We did not note any issues from our work performed in the 2017/18 audit.</p> <p><b>Audit Risk:</b> The governance statement is not consistent with the wider disclosures in the accounts or compliant with the CIPFA guidance note.</p>



# 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. These are financial sustainability, financial management, governance and transparency and value for money. Due to the relative size and scale of the functions delivered by the Board, we have concluded that the full wider scope audit is not appropriate. In accordance with paragraph 53 of the Code, our work in this area will therefore be restricted to concluding on the following:

Audit dimension	Areas to be considered	Impact on the 2018/19 Audit
<p><b>Financial sustainability</b> looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.</p>	<ul style="list-style-type: none"> <li>• The financial planning systems in place across the shorter and longer terms</li> <li>• The arrangements to address any identified funding gaps</li> <li>• The affordability and effectiveness of funding and investment decisions made</li> <li>• Workforce planning</li> </ul>	<p>As part of our prior year audit work, we recommended that efforts continue to extend the timeline of medium term financial planning to 2-4 years by looking at finalising savings and efficiency options for the 2019/20 budget and future years.</p> <p>We do note that modernisation efforts are ongoing to achieve savings and efficiencies, which includes digitisation of records and the implementation of a new operating system, and that quantification of the savings and efficiencies is difficult to gauge at this early stage of the implementation. We will continue to monitor progress against these modernisations and whether savings and efficiencies are achieved over the remainder of the 5 year contract.</p> <p><b>Audit Risk:</b> the Board does not achieve financial balance in this financial year and is unable to identify future sources of savings and efficiencies to ensure future financial sustainability.</p> <p>In view of the Scottish Government’s Medium Term Financial Strategy (MTFS) (discussed further on page 19) we will consider the extent to which the Board has reviewed the potential implications of the MTFS for its own financial planning and whether it is taking these into account in its arrangement for financial management and financial sustainability.</p> <p><b>Audit Risk:</b> The Board’s long-term financial planning is inconsistent with the Scottish Governments five-year plan.</p>

# Wider scope requirements (continued)

## Specific risks

As part of the 2018/19 planning guidance, Audit Scotland have identified the following areas as significant risks faced by the public sector. Any specific risks in relation to these areas for the Board have been included in our audit risk under the audit dimensions, discussed on the previous pages. We will continue to monitor these areas as part of our audit work.

Risk	
<b>EU withdrawal</b>	<p>There are uncertainties surrounding the terms of the UK's withdrawal from the European Union in March 2019. Some arrangements have been provisionally agreed, such as a transition period to the end of 2020, although they are dependent on a final deal being reached between the UK Government and the remaining EU countries. The outcome of negotiations should become clearer in the weeks up to March 2019.</p> <p>Whatever the outcome, EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. Audit Scotland has identified three areas where EU withdrawal may have the most significant impact as summarised below:</p> <ul style="list-style-type: none"><li>• <b>Workforce</b> – Many public services are dependent on workers from EU countries, including health, social care and education. A decline in migration from the EU could potentially result in vacancies and skills gaps in some areas of the public sector. There is a risk that this could impact on some public bodies' ability to deliver 'business as usual' particularly given existing workforce and service pressures.</li><li>• <b>Funding</b> – Funding from the EU makes an important contribution to the Scottish public sector. The main sources of funding provide support to farmers and rural businesses, projects to encourage economic growth and support for research and education. The UK Government has made guarantees to meet some funding commitments to the end of existing programmes, but there are uncertainties about what any replacement funding may look like.</li><li>• <b>Regulation</b> – The EU Withdrawal Bill will transpose existing EU law into UK law immediately after the UK leaves the EU. Legislation in many devolved areas will transfer to the Scottish Parliament. The UK government has identified 24 devolved policy areas where it seeks to retain temporary control until UK-wide common legislative frameworks are developed.</li></ul> <p>In addition, some public bodies may be affected directly by changes to trade and customs rules, which could impact on supply chains and the procurement of goods or services from EU countries. This could influence the availability and cost of supplies and services (e.g. specialist medical equipment or drugs) with potential implications for public bodies' finances and their ability to deliver specific services.</p> <p>While there are considerable uncertainties about the detailed implications of EU withdrawal, at a minimum by the end of 2018/19, we would expect public bodies to have assessed the potential impact of EU withdrawal on their operations and identified any specific risks and how they will respond to them. We will assess how the Board has prepared for EU withdrawal and how it continues to respond to any emerging risk after March 2019. Some suggested key questions for the Board are included in our separate Sector Update paper.</p> <p>In addition, in accordance with the FRC guidance, the Board should consider the <b><u>disclosure within its annual report</u></b>, which distinguishes between the specific and direct challenges that it faces from the broader economic uncertainties. In some circumstances this may mean <b><u>recognising or re-measuring</u></b> certain items in the Balance Sheet. A comprehensive <b><u>post balance sheet events review</u></b> must be reflected in accounts and disclosures.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Changing landscape for public financial management</b>	<p>Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits worth over £3 billion a year. This provides the Scottish Parliament with more policy choices but also means that the Scottish budget is subject to greater volatility, uncertainty and complexity.</p> <p>Parliamentary scrutiny of the public finances is increasingly important in this changing landscape. A new Scottish budget process has been introduced, which is based on a year-round continuous cycle of budget setting, scrutiny and evaluation. This involves parliamentary committees looking back to explore what public spending has achieved, looking forward to longer-term objectives and challenges, and considering what this should mean for future budgets.</p> <p>As part of the new budget process, the Scottish Government published an initial five-year Medium Term Financial Strategy (MTFS) in May 2018. This five-year outlook for the Scottish budget provides useful context for audited bodies' financial planning. As part of our wider scope audit work on financial sustainability (discussed further on page 17), we will consider how the Board has reviewed the potential implications of the MTFS for its own finances, including longer-term financial planning.</p> <p>The new budget process places greater emphasis on assessing outcomes and the impact of spending. There is an expectation that the Scottish Government and public bodies will report on their contributions towards the national outcomes in their published plans and performance reports, including their annual reports. Increased complexity and volatility is also likely to mean that the Scottish Government will be increasingly active in managing its overall budget position in-year, engaging with public bodies closely on their anticipated funding requirements. As part of our wider scope audit work on financial sustainability (discussed further on page 17) we will consider the extent to which the Board's annual report provides an accessible account of the body's overall performance and impact of its public spending. We will also confirm that underlying financial performance, including any in-year changes to funding agreed with the Scottish Government, is transparently presented.</p>

# Wider scope requirements (continued)

## Specific risks (continued)

Risk	
<b>Dependency on key suppliers</b>	<p>It has become clear that the collapse of Carillion has had a significant impact across the public sector. This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions. The risk exists on two levels:</p> <ul style="list-style-type: none"><li>• Individual public sector bodies are dependent on key suppliers; and</li><li>• The Scottish public sector as a whole is subject to significant systematic risk.</li></ul> <p>We will determine as part of our detailed risk assessment the extent to which the Board is dependent on key supplier relationships. Where dependency is significant, we will consider this as part of our audit work and report back to the Board.</p> <p>We will also be requested to complete a short questionnaire to establish the extent, value and nature of key supplier dependencies that can inform the national position.</p>
<b>Openness and transparency</b>	<p>There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny. We will consider this as part of our wider scope work as well as from attendance at Board meetings, and from a review of Board minutes and availability of the Board minutes to the public via the website.</p> <p>We would expect to see public bodies reviewing their approach to openness and transparency to ensure they are keeping pace with public expectations and good practice. Evidence of progress might include:</p> <ul style="list-style-type: none"><li>• increased public availability of board papers;</li><li>• more insight into why some business is conducted in private; and</li><li>• development of the form and content of annual reports.</li></ul>

# Wider scope requirements (continued)

## Other responsibilities (continued)

### Performance Audits

In accordance with Audit Scotland planning guidance, we will be requested to provide information to support performance audits that Audit Scotland intends to publish during 2018/19 and 2019/20. There are no specific reports planned, other than the overview report, which directly impact on the Board. We will provide an update to the Board if there are any changes to this plan.

### Impact reports

We will also be requested to provide information to support assessing the impact of previously published performance audit reports. There are no specific impact reports which directly relate to the Board. We will provide an update to the Board if there are any changes to this plan.

### Anti-money laundering

The Money Laundering, Terrorist Financing and Transfer of Funds (Information on the Payer) Regulations 2017 came into force on 26 June 2017 and replace the Money Laundering Regulations 2007. The regulations impose an obligation of the Auditor General to inform the National Crime Agency if she knows or suspects that any person has engaged in money laundering or terrorist financing. As part of our audit work, we will ensure we are informed of any instances of money laundering at the Board so that we can advise the Auditor General.

# Audit Quality

## Our commitment to audit quality



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

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

- We will apply professional scepticism on material issues and significant judgements identified, by using our expertise in the 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 enabling us to develop a risk-focused approach tailored to the Board.
- 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;
- Key regulatory and corporate governance updates, relevant to you.

### What we don't report

As you will be aware, our audit is not designed to identify all matters that may be relevant to the Board.

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 Board, 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

26 February 2019

# Appendices





# Prior year audit adjustments

## Uncorrected and disclosure misstatements

### **Uncorrected misstatements**

There were no uncorrected misstatements above our clearly trivial threshold and no uncorrected material disclosure deficiencies.

# 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 revenue recognition and management override of controls as a key audit risk for your organisation.



### **Fraud characteristics:**

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

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

- 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 and involves:
  - (i) management;
  - (ii) employees who have significant roles in internal control; or
  - (iii) others where the fraud could have a material effect on the financial statements.
- We have disclosed to you all information in relation to allegations of fraud, or suspected fraud, affecting the entity's financial statements communicated by employees, former employees, analysts, regulators or others.

# Fraud responsibilities and representations

## Inquiries

We will make the following inquiries regarding fraud:



### **Management**

- Management's assessment of the risk that the financial statements may be materially misstated due to fraud, including the nature, extent and frequency of such assessments.
- Management's process for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to those charged with governance regarding its processes for identifying and responding to the risks of fraud in the entity.
- Management's communication, if any, to employees regarding its views on business practices and ethical behaviour.
- Whether management has knowledge of any actual, suspected or alleged fraud affecting the entity.



### **Internal audit and local counter fraud specialist**

- Whether internal audit and the Board's local counter fraud specialist has knowledge of any actual, suspected or alleged fraud affecting the entity, and to obtain their 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:

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## 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 Board and will reconfirm our independence and objectivity to the Board for the year ending 31 March 2019 in our final report to the Board.

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## Fees

The audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £7,280 as analysed below:

	£
Auditor remuneration	6,280
Audit Scotland fixed charges:	
Pooled costs	610
Performance Audit and Best Value	0
Audit support costs	390
<b>Total proposed fee</b>	<b>7,280</b>

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

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## Non-audit services

In our opinion there are no inconsistencies between the FRC's Ethical Standard and the Board'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.

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## Relationships

We have no other relationships with the Board, its directors, senior managers and affiliates, and have not supplied any services to other known connected parties.

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# Our approach to quality

## AQR team report and findings

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

In June 2018 the Financial Reporting Council ("FRC") issued individual reports on each of the eight largest firms, including Deloitte, on Audit Quality Inspections which provides a summary of the findings of its Audit Quality Review ("AQR") team for the 2017/18 cycle of reviews.

We take the findings of the AQR seriously and we listen carefully to the views of the AQR and other external audit inspectors. We remediate every finding regardless of its significance and seek to take immediate and effective actions, not just on the individual audits selected but across our entire audit portfolio. We are committed to continuously improving all aspects of audit quality in order to provide consistently high quality audits that underpin the stability of our capital markets.

We have improved the speed by which we communicate potential audit findings, arising from the AQR inspections and our own internal reviews to a wider population, however, we need to do more to ensure these actions are embedded. In order to achieve this we have launched a more detailed risk identification process and our InFlight review programme. This programme is aimed at having a greater impact on the quality of the audit before the audit report is signed. Consistent achievement of quality improvements is our aim as we move towards the AQR's 90% benchmark.

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 2017/18 Audit Quality Inspection Report on Deloitte LLP

"The overall results of our reviews of the firm's audits show that 76% were assessed as requiring no more than limited improvements, compared with 78% in 2016/17. Of the FTSE 350 audits we reviewed this year, we assessed 79% as achieving this standard compared with 82% in 2016/17. We are concerned at the lack of improvement in inspection results. The FRC's target is that at least 90% of these audits should meet this standard by 2018/19."

"Where we identified concerns in our inspections, they related principally to aspects of group audit work, audit work on estimates and financial models, and audit work on provisions and contingencies. During the year, the firm has continued to develop the use of "centres of excellence", increasing the involvement of the firm's specialists in key areas of the audit. We have no significant issues to report this year in most of the areas we reported on last year."

"The firm has revised its policies and procedures in response to the revised Ethical and Auditing Standards. We have identified some examples of good practice, as well as certain areas for improvement."

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

- Increased use of centres of excellence ("CoE") involving the firm's specialists, including new CoEs focusing on goodwill impairment (established in response to previous inspection findings) and corporate reporting, to address increasing complexity of financial reporting.
- Further methodology updates and additional guidance issued to the audit practice including the audit approach to pension balances, internal controls, data analytics, group audits and taxation.
- A new staff performance and development system was implemented with additional focus on regular timely feedback on performance, including audit quality.
- Further improvements to the depth and timeliness of root cause analysis on internal and external inspection findings.

#### Our key findings in the current year requiring action by the firm:

- Improve the group audit team's oversight and challenge of component auditors.
- Improve the extent of challenge of management's forecasts and the testing of the integrity of financial models supporting key valuations and estimates.
- Strengthen the firm's audit of provisions and contingencies.

#### Review of firm-wide procedures. The firm should:

- Enhance certain aspects of its independence systems and procedures.



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