South Ayrshire Council
Report to the Audit and Governance Panel, Members of the Council and the Controller of Audit on the 2018/19 audit
Issued 18 September 2019 for the meeting on 26 September 2019
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Introduction
The key messages in this report

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

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

• A strong understanding of your internal control environment.

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

I have pleasure in presenting our final report to the Audit and Governance Panel and Members of South Ayrshire Council (the Council) for the 2019 audit. The scope of our audit was set out within our planning report presented to the Audit and Governance Panel in March 2019.

This report summarises our findings and conclusions in relation to:

• The audit of the financial statements; and

• Consideration of the four audit dimensions that frame the wider scope of public sector audit requirements as illustrated in the following diagram. This includes our consideration of Best Value and the five Strategic Audit Priorities agreed by the Accounts Commission.
I would like to draw your attention to the key messages of this paper:

**Conclusions from our testing**

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

Following amendments to points identified through the audit process, the management commentary and annual governance statement comply with the statutory guidance and proper practice and are consistent with the financial statements and our knowledge of the Council.

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

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

A small number of audit adjustments in excess of our reporting threshold of £250,000 have been identified up to the date of this report, as discussed further in the Appendix on page 25. It should be noted that the adjustments relating to the pension liability are as a result of a post balance sheet event rather than an error by management.

No material uncorrected disclosure deficiencies have been noted.

Our audits of South Ayrshire Charitable Trust, South Ayrshire Council Charitable Trusts and the McKechnie Library Trust are complete and plan to issue unmodified audit opinions, as discussed further on page 14.

**Status of the financial statements audit**

Outstanding matters to conclude the audit include:

- Receipt of signed management representation letter; and
- Our review of events since 31 March 2019.

**Conclusions on audit dimensions**

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

Our detailed interim report, presented to the Panel in June 2019, set out our findings and conclusions on each dimension. We have updated this for any significant changes since that report and our overall conclusion on each dimension is summarised on page 5.
Introduction (continued)
The key messages in this report (continued)

Conclusions on audit dimensions (continued)

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

It is important that detailed plans are developed for the next phase of the Council’s Change Programme, which are clearly linked to the savings targets required so that the Council has a clear understanding of what transformational change is required in order to achieve savings targets. Given the financial challenges the Council faces, a formalised transformation programme should be put in place as a matter of urgency.

Financial management
The Council has strong financial management arrangements which are robust enough to sufficiently manage financial activity and address any challenges to the achievement of financial targets.

Governance and transparency
A restructuring of the Council’s management structure was completed in 2018/19 to align with the Council’s Plan. Whist we have not identified any specific issues, the Council should continue to ensure that the change in structure will not have an adverse impact on capacity to deliver services.

The Council has agreed to fund the IJB’s £3.28m deficit on an interim basis, on the assumption that this will be repaid in future years. Whilst the IJB has agreed a balanced budget for 2019/20 incorporating a repayment plan for the £3.28m, the IJB accepted there are still high risks in the delivery of efficiencies. This therefore represents a recoverability risk to the Council.

Through the South Ayrshire Community Planning Partnership, the Council is committed to engaging with local communities in order to work effectively in partnership to deliver sustained improvements to residents.

Value for money
There is a clear framework in place to ensure that council performance is monitored and reported.

Performance against national outcomes has improved and the council clearly reports on its contribution towards national outcomes by carrying out comprehensive analysis for each performance area.

Our conclusions are included on pages 20 to 22 of this report, with the detailed findings and agreed Action Plan included in our interim report in June 2019.

We will consider progress with the agreed actions as part of our 2019/20 audit.

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

This is provided throughout this report and our separate interim report. In particular, our separate “Sector Developments” report, presented along with our interim report shared our research, informed perspective and best practice from our work across the wider public sector that are specifically relevant to the Council.

Pat Kenny
Audit Director
Our audit explained

Area dimensions
In accordance with the 2016 Code of Audit Practice, we have considered how you are addressing the four audit dimensions:
• Financial sustainability
• Financial management
• Governance and transparency
• Value for money

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

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

Final audit report
In this report we have concluded on the audit risks identified in our planning report and any other key findings from the audit.

Key developments in your business
As noted in our planning report, 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 continues to be a challenge.

Materiality
Group materiality of £6.331m (Council only £6.267m) and group performance materiality of £4.748m (Council only £4.700m) has been based on the benchmark of gross expenditure and is a slight decrease from what we reported in our planning paper due to updated final figures. We have used these as the basis for our scoping exercise and initial risk assessment. We have reported to you all uncorrected misstatements greater than £0.250m for both the group and Council.

Scope of the audit
We have audited the group financial statements for the year ended 31 March 2019 of South Ayrshire Council. We concluded that only the Council and South Ayrshire IJB were significant components, and have performed a full audit of both. For the non-significant components our work has been restricted to a desktop review at the Group level.

Timeline 2018/19

November 2018 – February 2019
Meetings with management and other staff to update understanding of the processes and controls.

20 March 2019
Presented planning paper to the Audit and Governance Panel

31 March 2019
Year end

26 June 2019
Presented interim report to the Audit and Governance Panel

21 August 2019
Audit close meeting

26 September 2019
Audit and Governance Panel

26 September 2019
Accounts sign off
Financial statements audit
## Significant risks

### Dashboard

<table>
<thead>
<tr>
<th>Risk</th>
<th>Material</th>
<th>Fraud risk</th>
<th>Planned approach to controls testing</th>
<th>Controls testing conclusion</th>
<th>Consistency of judgements with Deloitte’s expectations</th>
<th>Comments</th>
<th>Page no.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Recognition of grant income</td>
<td>✔️</td>
<td>✔️</td>
<td>D+I</td>
<td>Satisfactory</td>
<td></td>
<td>Satisfactory</td>
<td>9</td>
</tr>
<tr>
<td>Management override of controls</td>
<td>✔️</td>
<td>✔️</td>
<td>D+I</td>
<td>Satisfactory</td>
<td></td>
<td>Satisfactory</td>
<td>10</td>
</tr>
</tbody>
</table>

- **D+I**: Testing of the design and implementation of key controls
- Overly prudent, likely to lead to future credit
- Overly optimistic, likely to lead to future debit.
Significant risks (continued)

Risk 1 - Recognition of grant income

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

Key components of income for the Council are summarised in the table below. The general revenue grant and Non-domestic Rates income are directed by the Scottish Government and not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%. Council tax and housing rent income are set through the annual budget process with no management judgement and therefore have a low risk of fraud. Similarly, other Service Income 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 grants credited to services.

<table>
<thead>
<tr>
<th>Type of income</th>
<th>2018/19 (£m)</th>
<th>Significant risk</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Taxation and Non-Specific Grant Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Council tax income</td>
<td>54.555</td>
<td></td>
</tr>
<tr>
<td>Non domestic rates</td>
<td>38.299</td>
<td></td>
</tr>
<tr>
<td>General revenue grant</td>
<td>159.059</td>
<td></td>
</tr>
<tr>
<td>Received capital income</td>
<td>21.571</td>
<td>✓</td>
</tr>
<tr>
<td><strong>Service Income</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Grants credited to services</td>
<td>13.308</td>
<td>✓</td>
</tr>
<tr>
<td>Housing Benefit Subsidy</td>
<td>31.310</td>
<td></td>
</tr>
<tr>
<td>Housing Revenue Account</td>
<td>32.319</td>
<td></td>
</tr>
<tr>
<td>IJB commission income (book entry)</td>
<td>96.997</td>
<td></td>
</tr>
<tr>
<td>Other Service Income</td>
<td>27.421</td>
<td></td>
</tr>
<tr>
<td><strong>Total Service Income</strong></td>
<td><strong>201.355</strong></td>
<td></td>
</tr>
</tbody>
</table>

Key judgements and our challenge of them
Grant income is a significant risk due to:
• management judgement in determining if there are any conditions attached to a grant and if so whether the conditions have been met; and
• complex accounting for grant income as the basis for revenue recognition in the accounts will depend on the scheme rules for each grant.

Deloitte response
We have performed the following:
• Assessed management’s controls around recognition of grant income; and
• tested a sample of capital grants and grants credited to services and confirm these have been recognised in accordance with any conditions applicable and applicable accounting standards.

Deloitte view
We have concluded that grant income has been correctly recognised in accordance with the requirements of the Code of Practice on Local Authority Accounting. One error has been identified (£288,000) which was corrected by management, however, this is simply a disclosure misstatement and the income has been correctly recognised in the Comprehensive Income and Expenditure Statement (CIES).
Significant risks (continued)

Risk 2 - Management override of controls

Risk identified
In accordance with ISA 240 (UK) management override of controls is a significant risk. This risk area includes the potential for management to use their judgement to influence the financial statements as well as the potential to override the Council’s controls for specific transactions.

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

• The Council’s results throughout the year were projecting overspends in the year, specifically in the Health and Social Care Partnership (HSCP). This was closely monitored and whilst projecting overspends, the underlying reasons were well understood; and

• Senior management’s remuneration is not tied to particular financial results.

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

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

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

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

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

Accounting estimates (see next page)
We have performed design and implementation testing of the controls over key accounting estimates and judgements.

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

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

Deloitte view
We have not identified any significant bias in the key judgements made by management.

We have not identified any instances of management override of controls in relation to the specific transactions tested based on work performed.
Significant risks (continued)
Risk 2 - Management override of controls (continued)

Key judgements
The key judgements in the financial statements are those which we have selected to be the significant audit risks around the recognition of grant income (page 9). In addition, while not considered to be a significant audit risk, we have considered the assumptions used to calculate the pension liability (page 12) and the valuation methodology for property valuations. These are inherently the areas in which management has the potential to use their judgment to influence the financial statements.

As part of our work on this risk, we reviewed and challenge management’s key estimates and judgements including:

<table>
<thead>
<tr>
<th>Estimate / judgement</th>
<th>Details of management’s position</th>
<th>Deloitte Challenge and conclusions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Property Valuation</td>
<td>The value of property is based on valuations provided by a professional valuer. The Council has a rolling programme of revaluations to ensure all assets are revalued over a 5 year period. An annual review is performed to assess for any material changes in the year.</td>
<td>We have assessed the competency, capability and objectivity of the Council’s valuer. We reviewed and challenged the assumptions and methodology used to value the property. We considered management assessment of impairment or material changes in value for those assets not part of the current year valuation programme, corroborating to changes in build cost indices and overall market movements. We concluded that the management estimates were reasonable and in line with our expected range.</td>
</tr>
<tr>
<td>Provisions</td>
<td>The total provisions held within the Council’s balance is immaterial, at £2.580m. This comprises provisions in respect of a number of employee related potential claims outstanding at 31 March 2019 and the Council’s share of the former Strathclyde Regional Council’s insurance claims and other potential insurance claims against the Council.</td>
<td>We examined the rationale for each provision, including a retrospective review of amounts provided in 2017/18. We have also challenged the completeness of the provisions made through discussion with the Council’s legal advisors and benchmarked with our industry knowledge. We concluded that the provisions made were reasonable.</td>
</tr>
</tbody>
</table>
Other matters
Defined benefits pension scheme

Background
The Council participates in two defined benefits schemes:
• Scottish Teachers’ Superannuation Scheme, administered by the Scottish Government; and
• The Strathclyde Pension Fund, administered by Glasgow City Council.

After taking into account the adjustments noted on the following page in relation to the McCloud judgement and GMP indexation, the net pension liability has increased from £84.143m in 2017/18 to £155.657m in 2018/19. The increase is as a result in changes in assumptions, specifically the discount rate has reduced and salary increase rate has increased, together with the impact of McCloud and GMP indexation.

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

<table>
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<tr>
<th></th>
<th>Council</th>
<th>Benchmark</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount rate (% p.a.)</td>
<td>2.4</td>
<td>2.39</td>
<td>Reasonable, slightly optimistic</td>
</tr>
<tr>
<td>Consumer Price Index (CPI) Inflation rate (% p.a.)</td>
<td>2.50</td>
<td>2.23</td>
<td>Prudent</td>
</tr>
<tr>
<td>Salary increase (% p.a.) (over CPI inflation)</td>
<td>1%</td>
<td>Council specific</td>
<td>Prudent</td>
</tr>
<tr>
<td>Pension increase in payment (% p.a.)</td>
<td>2.5</td>
<td>2.28</td>
<td>Prudent</td>
</tr>
<tr>
<td>Pension increase in deferment (% p.a.)</td>
<td>2.40</td>
<td>2.23</td>
<td>Prudent</td>
</tr>
<tr>
<td>Mortality - Life expectancy of a male pensioner from age 65 (currently aged 65)</td>
<td>23.40</td>
<td>21.20</td>
<td>Reasonable</td>
</tr>
<tr>
<td>Mortality - Life expectancy of a male pensioner from age 65 (currently aged 45)</td>
<td>25.80</td>
<td>23.00</td>
<td>Reasonable</td>
</tr>
</tbody>
</table>
Other matters (continued)
Defined benefits pension scheme (continued)

Impact of McCloud ruling

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

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

The Council’s actuary has provided an updated results schedule which included an allowance for the additional liability potentially arising as a result of the McCloud ruling. This has resulted in an audit adjustment of £9.315m for past service costs (c.1.8%) arising from this post balance sheet event.

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

Impact of Guaranteed Minimum Pension (GMP) indexation

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

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

Details of any permanent solution are still unknown.

The Council’s actuary has provided an updated results schedule including an allowance for the estimated additional liability arising as a result of GMP indexation. An amount of £2.183m has been identified as the additional liability for paying all GMP increases for members reaching SPA from 6 April 2016.

The allowance equates to c. 0.3% of the total defined benefit obligations. Typically, we would expect to see an allowance of between 0% and 0.4% of total defined benefit obligations, therefore the allowance made is within this range.

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

The allowances made for the McCloud ruling and GMP are reasonable and within the expected range.
Other matters (continued)

Charitable trusts

Risk identified
From 2013/14, all Scottish Councils who act as sole trustees for any registered charities have to fully comply with the Charities Accounts Regulations. This requires Charities SORP compliant accounts to be prepared for each charity, and a separate audit of each. South Ayrshire Council administers three such registered charities – South Ayrshire Charitable Trust, South Ayrshire Council Charitable Trusts and the McKechnie Library Trust.

As the gross income of each of the Trust is less than £100,000, the Council has opted to prepare the charitable trust accounts on a receipts and payments basis in accordance with The Charities Accounts (Scotland) Regulation 2006. Fully compliant Charities SORP accounts are therefore not required and disclosure is limited to that specified in the Regulations.

Deloitte response

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

A summary is provided in the table adjacent. We are pleased to note that the Council is actively using the charitable funds in accordance with the charitable purposes of each charity, with £103,580 of payments made in the year from the £528,168 carried forward from 2017/18.

Deloitte view

No issues noted from our testing of the South Ayrshire Charitable Trust, South Ayrshire Council Charitable Trusts and the McKechnie Library Trust accounts in the year, which were found to be correctly accounted for in accordance with the Regulations.
Other matters (continued)
Implementation of IFRS 9 and IFRS 15

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

Deloitte view
Officers conclusion that the new accounting standards do not have a material impact for the Council is consistent with the conclusion of other local authorities and the absence of unusual transactions or income streams which may require a different accounting treatment.
Other significant findings
Internal control and risk management

During the course of our audit we have identified a number of internal control findings, which we have included below for information.

<table>
<thead>
<tr>
<th>Area</th>
<th>Observation</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Preparation for IFRS 16</td>
<td>The implementation of IFRS 16, Leases, for 2020/21 is expected to have a greater and more complex impact upon most Councils than the adoption of IFRS 9 and 15. The scope and potential complexity of work required, which may require system or process changes to underpin correct accounting under the standard, will require work to be completed at a significantly earlier stage than has been the case for IFRS 9 and 15 to allow for financial reporting timetables to be met. As reported in our “Sector developments paper” presented to the Audit and Governance Panel in March 2019, the changes introduced by the standard will have substantial practical implications for Councils that currently have material leases, and also likely to have an effect on the capital financing arrangements of the authority. CIPFA/ LASAAC included a readiness assessment questionnaire in the consultation document which will help Councils consider their own preparedness. We recommend the Council targets completion of its IFRS 16 impact analysis during 2019/20, and to calculate an adjusted opening balance sheet position for audit following the 31 March 2020 audit. We recommend early consideration following the impact analysis of actions required to embed IFRS 16 accounting in the Council’s underlying accounting systems. We understand that management have plans in place to prepare for this change.</td>
<td>Medium Priority</td>
</tr>
<tr>
<td>Fixed Asset Register</td>
<td>As noted in the Appendix on page 25, we identified an audit adjustment of £1.289m in relation to the property revaluations. This is as a result of a weakness within the fixed asset legacy system where individual asset values are allocated over a number of asset codes in the system. As a result, there is a risk that individual lines are missed when calculating the revaluation adjustment. We understand that management are reviewing the set up of the system to ensure that similar errors do not occur in the future.</td>
<td>Low Priority</td>
</tr>
</tbody>
</table>

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

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

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

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

While the Council is faced with financial sustainability issues (as discussed on page 21), it achieved a balanced budget in 2018/19 and has set a balanced budget for 2019/20. There is also a general assumption set out in Practice Note 10 (Audit of financial statements of public sector bodies in the United Kingdom) public bodies will continue in operation, therefore it is appropriate to continue as a going concern.

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

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

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

Our opinion on matters prescribed by the Controller of Audit are discussed further on page 18.
**Your annual report**

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

<table>
<thead>
<tr>
<th>Requirement</th>
<th>Deloitte response</th>
</tr>
</thead>
</table>
| Management Commentary | The Management Commentary comments on financial performance, strategy and performance review and targets. The commentary included both financial and non financial KPIs and made good use of graphs and diagrams. The Council also focusses on the strategic planning context.  
We have assessed whether the Management Commentary has been prepared in accordance with the statutory guidance.  
We have also read the Management Commentary and confirmed that, following amendments to points identified through the audit process, the information contained within is materially correct and consistent with our knowledge acquired during the course of performing the audit, and is not otherwise misleading. |
| Remuneration Report | The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior councillors and Senior Employees of the council.  
We have audited the disclosures of remuneration and pension benefits, pay bands, and exit packages and apart from a small number of minor disclosure misstatements which were subsequently corrected by management, we can confirm that they have been properly prepared in accordance with the regulations. |
| Annual Governance Statement | The Annual Governance Statement reports that South Ayrshire Council governance arrangements provide assurance, are adequate and are operating effectively.  
We have assessed whether the information given in the Annual Governance Statement is consistent with the financial statements and has been prepared in accordance with the accounts direction. No exceptions noted. |
Audit dimensions
Audit dimensions

Overview

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

Audit Dimensions

Strategic Audit Priorities
As set out in our Annual Audit Plan, the Accounts Commission sets out five Strategic Audit Priorities that are built into audit expectations, as follows:
- Having clear priorities with a focus on outcomes, supported by effective long term planning
- Demonstrating the effective appraisal of options for changing how services are delivered in line with their priorities
- Ensuring that members and officers have the right knowledge, skills and support to design, develop and deliver effective services in the future
- Empowering local communities and involving them in the design and delivery of local services and planning for their local area
- Reporting the council’s performance in a way that enhances accountability to citizens and communities, helping them contribute better to the delivery of improved outcomes.

Best Value (BV)
The BV framework follows a five year approach to auditing BV. 2018/19 represents year three of the BV audit plan. The Best Value Assurance Report (BVAR) report for South Ayrshire Council is planned for year five in the five-year programme (i.e. 2020/21). The BV audit work in 2018/19 was integrated into our audit approach, including our work on the audit dimension.

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

Specific risks
As set out in our Annual Audit Plan, Audit Scotland had identified a number of specific risks faced by the public sector which we have considered as part of our work on the four audit dimensions.
- EU Withdrawal
- Changing landscape for public financial management
- Care income, financial assessments and financial guardianship
- Dependency on key suppliers
- Openness and transparency

Our conclusions on the above were reported in our Interim Report to the Audit and Governance Panel in June 2019.

Since June, the Council is continuing to prepare for the impact of EU withdrawal, and has a member/ officer working group in place. In line with our conclusions in our Interim Report, we are satisfied that the Council is sufficiently prepared for the impact of EU withdrawal.
Audit dimensions (continued)

Financial sustainability and financial management

**Financial sustainability** looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

**Key facts:**

**2018/19 financial position**
- A net decrease in the general fund of £9.232m, comprising an in year underspend of £5.974m offset by a draw on reserves of £15.208m. The draw on reserves included £6.091m from 2017/18 earmarked spend and £3.280m temporary funding to the HSCP to fund its in year overspend.

**2019/20 financial position**
- £6.45m new savings required
- £1.82m use of reserves

**Overall conclusions**

The Council has achieved short-term financial balance and has set a balanced budget for 2019/20, which includes £1.82m use of reserves and £6.45m of new savings. The current reserves held is at an acceptable level and the planned use of reserves is sustainable in the short-term, however, the Council should consider if this is sufficient from a risk-based perspective, and should consider whether the Reserves Strategy needs to be amended to increase the minimum reserve level. Savings targets are ambitious, however, the Council has a robust planning and monitoring process in place for achieving savings and, historically, has achieved the majority of savings targets in place.

The Council is currently developing its next stage of transformation. It is important that detailed plans are developed, which are clearly linked to the savings targets required so that the Council has a clear understanding of what transformation is required in order to achieve savings targets. Given the financial challenges the Council faces, we recommend that a formalised transformation programme be put in place as a matter of urgency.

The Council does not have a long term financial strategy in place covering the next 5 to 10 years. We note that the Capital Investment Programme takes a longer term view, which looks at the next 10 years to 2028/28 and we recommend that a similar exercise be carried out for the revenue budget which should also consider the Scottish Government’s Medium Term Financial Strategy. Management has confirmed that this work is in progress, with a view to presenting an updated Financial Plan to the Leadership Panel in October 2019.

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

**Key facts:**

**2018/19 budget**
- Original budgeted expenditure of £256.41m.
- Savings of £3.56m achieved, against budgeted savings of £3.68m
- Overspends reported during the year on HSCP.
- Regular reporting to CLT and Leadership Panel.

**Overall conclusions**

The Council has strong financial management arrangements which are robust enough to sufficiently manage financial activity and capture and address any challenges to the achievement of financial targets. The Council has a Budget Working Group where various savings options are presented and then decided on what approach to take based on the Council Plan and priorities. The Council links budgets into these key priorities to ensure that savings targets are met and funding is directed to the areas that need it most.

From review of the Council’s budget monitoring reports to the Leadership Panel throughout the year, it is clear that underlying financial performance including in-year changes to funding is transparently presented. The reports identify all variances in budgets are highlighted and fully explained.

As reported in our return to Audit Scotland in June, the Council is fully engaged in the NFI exercise. The Council has continued to investigate and process matches, with all outcomes recorded in the system.
Audit dimensions (continued)
Governance and transparency and value for money

**Key facts:**

- A restructuring of the organisation was completed in 2018/19 to align the management structure with the Council Plan.

**Overall conclusions**

A restructuring of the Council’s management structure was completed in 2018/19 to align with the Council Plan. This has also allowed the Council to flatten and simplify the management structure and to release currently untapped capacity. Whilst we have not identified any specific issues, the Council should continue to ensure that the change in structure will not have an adverse impact on capacity to deliver services.

The Council has agreed to fund the IJB’s £3.28m deficit on an interim basis, on the assumption that this will be repaid in future years. Whilst the IJB has agreed a balanced budget for 2019/20 incorporating a repayment plan for the £3.28m, the IJB accepted there are still high risks in the delivery of efficiencies. This therefore represents a recoverability risk to the Council.

We have considered the Council’s approach to openness and transparency, how good the Council’s information is; and its commitment to improving openness and transparency and we are satisfied that the Council is open and transparent with its residents and relevant stakeholders.

Through the South Ayrshire Community Planning Partnership, the Council is committed to engaging with local communities in order to work effectively in partnership to deliver sustained improvements to residents. We are satisfied that the Council is fully committed to engaging with local communities.

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**Governance and transparency** is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

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

**Key facts:**

- 66% of indicators in 2017/18 (2016/17: 67%) were either in the top quartile or second quartile, i.e. performing above the Scottish average.

- The year-on-year picture from 2016/17 to 2017/18 shows an increase in 36 indicators, decrease in 25 indicators and no change in 19 indicators.

- A number of issues have been highlighted by the Care Inspectorate in relation to Adult Services and Childrens’ Services. It is also monitoring progress on a number of issues highlighted in a recent Significant Case Review (SCR) published in April 2019.

**Overall conclusions**

There is a clear framework in place to ensure that council performance is monitored and reported. Performance reports and plans are available for the public to view on the Council website. We are satisfied the Council has an appropriate framework in place to ensure services are performing at the optimal level of efficiency and effectiveness, however, we recommend that the Council increase the frequency in which performance is reported to quarterly. Management has agreed to consider this by the end of December 2019 and an update was considered by the Audit and Governance Panel in August 2019.

In the 2017/18 Local Government Benchmarking Framework exercise Council service performance improved in 36 areas, declined in 25 areas, with no change identified in 19 areas. We are pleased to note that the council clearly reports on its contribution towards national outcomes by carrying out comprehensive analysis for each performance area and makes this available to the public. We conclude that the council is fully engaged with its contribution towards national outcomes, evidenced by carrying out comprehensive analysis on LGBF indicators.

The Care Inspectorate is closely monitoring a number of performance issues and a progress review was undertaken against a number of recommendations outlined in the SCR. The conclusions of the review have yet to be finalised but will be issued to the Council in due course. We will continue to maintain dialogue to assess progress and any further improvement required.
Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

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

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

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

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

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

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

Pat Kenny
for and on behalf of Deloitte LLP
Glasgow
18 September 2019
## Audit adjustments

### Summary of corrected and uncorrected misstatements and disclosure deficiencies

#### Corrected misstatements

<table>
<thead>
<tr>
<th>Misstatements identified in current year</th>
<th>Debit/ (credit) CIES £m</th>
<th>Debit/ (credit) MIRS £m</th>
<th>Debit/ (credit) in net assets £m</th>
<th>Debit/ (credit) reserves £m</th>
<th>If applicable, control deficiency identified</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pensions - GMP</td>
<td>[2] 2.183</td>
<td>(2.183)</td>
<td>(2.183)</td>
<td>2.183</td>
<td></td>
</tr>
<tr>
<td>Property – revaluations</td>
<td>[3] 0.806</td>
<td></td>
<td>(1.289)</td>
<td>0.483</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>12,304</strong></td>
<td><strong>11,498</strong></td>
<td><strong>12,787</strong></td>
<td><strong>11,981</strong></td>
<td></td>
</tr>
</tbody>
</table>

[1] As discussed on page 13 the McCloud judgment has been confirmed as final following the Supreme Court’s refusal of leave for the UK Government to appeal the ruling. This has resulted in the pension liability being adjusted to account for the impact of this judgment, with a corresponding increase in the pension reserve. The impact of this is a £9.315m increase in both the liability and the reserve. This has no impact on the General Fund.

[2] As discussed on page 13 the pension liability is also impacted by the Government’s ‘interim solution’ for funding inflationary increases for GMP. This has resulted in the pension liability being adjusted to account for the impact of this judgment, with a corresponding increase in the pension reserve. The impact of this is a £2.183m increase in both the liability and the reserve. This has no impact on the General Fund.

[3] This relates to the overstatement of the closing net book value of four assets. The correction is to reverse out the previous upwards revaluation which had been posted to the revaluation reserve, £0.483m, with the balance of the downwards movement, £0.806m, being posted to the CIES and subsequently the capital adjustment account (CAA).

#### Uncorrected misstatements

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

#### Disclosure misstatements

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

Recommendations for improvement

Our interim report, submitted to the Audit and Governance Panel in June 2019, we reported our detailed recommendations arising from our work on the wider audit dimensions as well as following up on our recommendations from our 2017/18 annual audit report in relation to the wider scope areas. We made a total of six recommendations which management have agreed to implement. We also noted that five of the eight recommendations from our 2017/18 report were fully implemented. We will follow up these recommendations and report to the Audit and Governance Panel on progress as part of our 2019/20 audit.

In the table below, we have followed up the one recommendation made in relation to the financial statements audit. This has not yet been implemented due to staffing changes within the finance team, therefore management have agreed a revised target date for this to be implemented during 2019/20.

<table>
<thead>
<tr>
<th>Area</th>
<th>Recommendation</th>
<th>Management Response</th>
<th>Responsible person</th>
<th>Target Date</th>
<th>Priority</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charitable Trusts – accounts</td>
<td>In our 2017/18 report, we noted the connected charity provisions in place under The Charities Accounts (Scotland) Regulations 2006 allow charities with common trustees to combine their annual accounts and as a result reduce the number of separate annual accounts to be published. We recommend the Council reviews this guidance and considers the option of combining the three trusts into one set of annual accounts going forward.</td>
<td>Consideration will be given to the merits of the suggested changes.</td>
<td>Head of Finance &amp; ICT and Head of Regulatory Services</td>
<td>Original target: March 2019, Revised target: March 2020</td>
<td>Low</td>
</tr>
</tbody>
</table>
Responsibilities:
The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Required representations:
We have asked the Council to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity or group.
We have also asked the Council to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

Audit work performed:
In our planning we identified the achievement of recognition of grant income and management override of controls as key audit risks for your organisation.
During course of our audit, we have had discussions with management and those charged with governance.
In addition, we have reviewed management’s own documented procedures regarding fraud and error in the financial statements.
We have reviewed the paper prepared by management for the Audit and Governance Panel on the process for identifying, evaluating and managing the system of internal financial control.

Concerns:
No concerns have been identified regarding fraud.
Independence and fees

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

<table>
<thead>
<tr>
<th>Independence confirmation</th>
<th>We confirm that we comply with FRC’s Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fees</td>
<td>The audit fee for 2018/19, in line with the fee range provided by Audit Scotland, is £271,770 as broken down below:</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>£</th>
</tr>
</thead>
<tbody>
<tr>
<td>Auditor remuneration</td>
</tr>
<tr>
<td>Audit Scotland fixed charges:</td>
</tr>
<tr>
<td>Pooled costs</td>
</tr>
<tr>
<td>Contribution to PABV</td>
</tr>
<tr>
<td>Audit support costs</td>
</tr>
<tr>
<td><strong>Total agreed fee</strong></td>
</tr>
</tbody>
</table>

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

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

<table>
<thead>
<tr>
<th>Non-audit services</th>
<th>In our opinion there are no inconsistencies between FRC Ethical Standards for Auditors and the company’s policy for the supply of non-audit services or any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relationships</td>
<td>We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence.</td>
</tr>
</tbody>
</table>

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