

The background of the slide features a large, light blue crest of the University of Victoria. The crest is a shield divided into four quadrants. The top-left quadrant shows a building with a cross on its roof. The top-right quadrant depicts a stag's head with large antlers. The bottom-left quadrant shows a three-masted sailing ship on the water. The bottom-right quadrant features an eagle with spread wings perched on a branch. Above the shield is a crown with four floral motifs. A banner at the bottom of the shield contains the motto "ANNE FOR A'".

## **Agenda Item 5**

# **External Audit Framework**

# Falkirk Council

2016 - 2021

External Audit Framework

December 2016



Building a better  
working world



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## About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Accounts Commission has appointed us as external auditor of Falkirk Council (the Council) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Local Government (Scotland) Act 1973 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the Council and is made available to the Accounts Commission, the Controller of Audit and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

In May 2016, the Accounts Commission appointed EY as your external auditor for the five year period 2016/17 to 2020/21 in accordance with the Local Government (Scotland) Act 1973. The appointment comes at a period of significant challenge and opportunity for local authorities across Scotland. Over the next five years, the public sector landscape in Scotland will continue to change. Greater powers and responsibilities are being devolved to the Scottish Parliament for taxation and social security. Locally, financial pressures and increasing demand for services represent significant challenge to authorities. The introduction of Integration Joint Boards is one of the new ways in which services are being delivered. To manage these challenges, it is essential that entities have a strong and effective system of financial control, accountability and transparency that supports the best use of public money in the public interest.

As auditor of Falkirk Council (“the Council”), we will provide independent assurance that public money is being appropriately used and that the Council is delivering value for money to the taxpayer. We provide insight and challenge to ensure the effective use of resources and how services are delivered.

Under the terms of the appointment, we are required to conduct our audit in accordance with Audit Scotland’s Code of Audit Practice (“the Code”). The Code was revised in May 2016 and now puts greater responsibility on auditors to consider and conclude on the four dimensions of the wider scope of public sector audit: **financial sustainability**; **financial management**; **governance and transparency**; and **value for money**. This builds upon our responsibilities to provide an opinion on the Council’s financial statements.

This document summarises the audit framework. It provides details of the evolving focus of public sector external audit, our approach over the term of our appointment and initial areas of focus for the Council. We will present our annual audit plan to the Audit Committee in February 2017 upon completion of our initial planning process.

The rest of this document sets out how we will take forward our audit appointment with the Council.

## Public sector audit framework

We provide an overview of the framework for public sector audit within which we operate.

## Audit strategy and approach

We provide a summary of our overall approach to delivering on our audit responsibilities over the five year term of our appointment.

## Financial statements

We detail our risk based audit approach and areas of initial audit focus as part of our statutory audit of the financial statements.

## Wider scope audit dimensions

We fulfil the requirements of the Code in respect of the four wider scope dimensions applicable to public sector audit.

## Other responsibilities

As your appointed auditor, we undertake and participate in a broad range of intelligence gathering, information returns and grant claim certification as part of our responsibilities under the Code.

# **1. Public sector audit framework**

# 1. Public Sector Audit Framework



In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as your external auditor for the five year period 2016/17 to 2020/21. We will undertake our audit in accordance with Audit Scotland's Code of Audit Practice (May 2016) and the requirements of International Standards on Auditing (UK and Ireland) (ISA). The Code outlines the principles and standards to be followed by auditors and their responsibilities. Our responsibilities extend beyond the statutory audit of the financial statements. We have responsibilities to review, conclude and report on the four wider scope dimensions of public sector audit as well as other responsibilities under the terms of our appointment.

## Financial statements audit

We are responsible for conducting an audit of the financial statements of the Council. Our audit work will be planned and undertaken in accordance with International Standards on Auditing (UK and Ireland). Our responsibilities in relation to the audit of the financial statements are defined within the Code and statute. We will provide an opinion on the financial statements as to:

- whether they give a true and fair view of the financial position of audited bodies and their expenditure and income; and
- whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

## Wider scope audit dimensions

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide conclusions on the four dimensions of wider-scope public audit: **financial sustainability; financial management; governance and transparency; and value for money.**

There is a requirement on appointed auditors to report and conclude on the arrangements across the Council. Our audit work over the four wider scope audit dimensions is aligned with and compliments our financial statements audit.

## Best Value

Under the Local Government (Scotland) Act 1973, councils have a statutory responsibility to make arrangements to secure best value through the continuous improving in the performance of their functions. With considerable pressures on available finances, difficult choices are being faced by councils both in respect of scope of local services and delivery of those services.

As part of our annual audit we will consider the Council's Best Value arrangements through our wider scope audit work. Over a five year cyclical period, the Council will receive at least one report on Best Value concluding on its performance relating to Best Value characteristics and improvements. Our annual work around the wider-scope audit dimensions will help inform and develop our assessment of the Council's Best Value arrangements. We will work in partnership with Audit Scotland Performance Audit and Best Value staff in delivering this work, in line with the Accounts Commission's new model for Best Value audits.

## Other responsibilities

Under the terms of our appointment, our role and responsibilities extend beyond the audit of the financial statements. There a number of further areas of audit activity that we will cover over the term of our appointment. These include our responsibilities in relation to following the public pound, statutory performance information and audit activity across the National Fraud Initiative and grant claims.

## Adding value

In line with the general principles outlined in The Code, we aim to add value through our audit work by providing clear judgements and conclusions from our audit work and providing constructive, appropriate and proportionate recommendations for improvement where significant risks are identified.

# 1. Public Sector Audit Framework

We review the adequacy of governance arrangements. In particular, we consider and report on; whether these are appropriate and operating effectively and that there is effective scrutiny, challenge and transparency on decision-making.



We consider the medium and longer term outlook to determine if planning is effective to support service delivery. This will focus on the arrangements to develop viable and sustainable financial plans.

We conclude on the effectiveness of financial management arrangements. This includes considering whether there is sufficient financial capacity and resources, sound budgetary processes and whether the control environment and internal controls are operating effectively.

We consider whether value for money can be demonstrated in the use of resources. This includes the extent to which there is an alignment between spend, outputs and outcomes delivered and that there is a clear focus on improvement.



## **2. Audit strategy and approach**

## 2. Audit strategy and approach

We perform our audit in accordance with International Standards on Auditing (UK and Ireland), the International Standard on Quality Control (UK and Ireland), ethical standards and applicable Practice Notes and other guidance issued by the Auditing Practice Board.

Our audit strategy and planning follows a risk based approach. This reflects our overall assessment of the relevant risks that apply to the Council. This ensures that our audit focuses on the highest areas of risk.

### Planning methodology

Our detailed audit plan will be presented to the Audit committee in February 2017, following finalisation of the Audit Scotland planning guidance and completion of our audit planning processes. We adopt a risk based planning approach, analysing the risks inherent in your external influences, the key strategic, operational and financial risks for the Council and our knowledge of other factors that may impact the financial statements. Our planning considers the following key areas:

- Review of Audit Scotland planning and technical guidance.
- Review of the Council's corporate strategies and plans.
- Review of the Council's risk register.
- Consideration of recent reviews including external audit reports and self assessments.
- Engagement with internal audit.
- Discussion with senior officers.
- Engagement with Audit Scotland.
- Participation in the Shared Risk Assessment process.
- Consideration of the work of other inspection bodies.
- Detailed understanding of the Council's key financial systems and processes and control environment.

### Wider scope audit assurance

Our audit planning process extends our risk assessment beyond the standard scope of an audit of the financial statements.

Under the requirements of the Code, our planning process will consider the four dimensions of **financial sustainability; financial management; governance and transparency; and value for money** when undertaking our annual risk assessment and audit planning.

This will enable us to develop a rounded, risk based audit plan to allow us to both identify, assess and report on the Council's Best Value arrangements.

### Joined up assurance planning

As your external auditor we participate in the Local Area Network (LAN). LAN's bring together representatives from across local government scrutiny bodies to agree a Shared Risk Assessment (SRA). The SRA informs the local scrutiny plan ensuring that for risks identified there is sufficient scrutiny activity.

Our audit planning activity will both inform and build upon the SRA ensuring that there is a co-ordinated approach to assurance activity. We also work in partnership with Audit Scotland to develop a joined up approach to Best Value audit.

### **3. Financial statements audit**

# 3. Financial statements audit

Financial statements are an essential part of demonstrating stewardship of public resources and the financial performance in the use of those resources. A core element of our role as your external auditor is undertaking a robust audit to allow us to express an opinion on the Council and group financial statements. We perform our audit in accordance with International Standards on Auditing (UK and Ireland), the International Standard on Quality Control (UK and Ireland), ethical standards and applicable Practice Notes and other guidance issued by the Auditing Practice Board. Our audit strategy and planning follows a risk based approach. This reflects our overall assessment of the relevant risks that apply to the Council.

## Financial statements audit

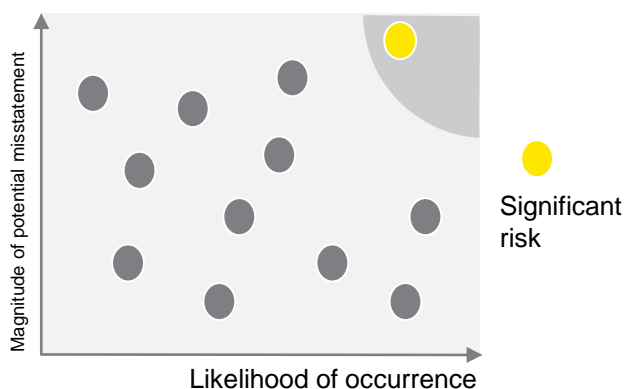
Our responsibilities in relation to the audit of the financial statements are defined within the Code and statute. We provide an opinion on the financial statements as to whether they:

- give a true and fair view in accordance with applicable law and the Code of Practice on Local authority Accounting of the state of the affairs of the council and its group as at 31 March and of the income and expenditure of the council and its group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the Code of Practice, and have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003.

We are also required to provide an opinion on other prescribed matters, in particular, whether the part of the Annual Remuneration Report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014 and the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements.

## Significant risks

Auditing standards require us to consider whether any of the risks identified are 'significant' risks to our audit of the Council and the group. Financial statement significant risks are defined as those with a higher likelihood of occurrence and, if they were to occur, could result in a material misstatement of the consolidated financial statements, as set out in the graphic below:



We are required to identify financial statements significant risks in the audit, and perform specific procedures over those risks, including identification and testing of the design and implementation of key controls designed to address the risks.

We are required to specifically highlight these significant risks to 'those charged with governance' i.e. the Audit Committee.

The outcome from our risk assessment will be included in our annual audit plan.

## Controls based approach and coordinated assurance

We work with management and internal audit to develop our understanding of the Council's control environment to reduce the level of reliance on substantive procedures.

We will look to work with internal audit and other assurance providers to ensure a co-ordinated assurance approach. In our first year we will undertake a detailed review of the work performed by internal audit to satisfy ourselves that this meets relevant guidance and standards and to determine the extent of reliance we can place on work performed.

## Value through use of our analytical tools

We utilise our data analytics tools to provide enhanced assurance over key transaction data sets. This enables us to assess complete account balances and reduce the use of sample testing of transactions to gain assurance.

## **4. Wider scope audit dimensions**

## 4. Wider scope audit dimensions



### Governance and transparency

Members and officers are responsible for establishing robust governance arrangements. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations. Crucial to this is ensuring that there is sufficient monitoring and review of corporate governance arrangements to ensure that these remain fit for purpose.

### Our responsibilities

In response to the changing economic pressures and demands, local authorities are undergoing a significant period of change, as service function and delivery is updated and aligned with available funding.

It is increasingly important that the Council's governance arrangements are sufficiently robust to ensure that these challenges and opportunities are effectively managed and delivered.

Robust governance arrangements are built upon the key areas shown in the diagram. Effective governance enables management and councillors to make clear strategic decisions through transparent management information.

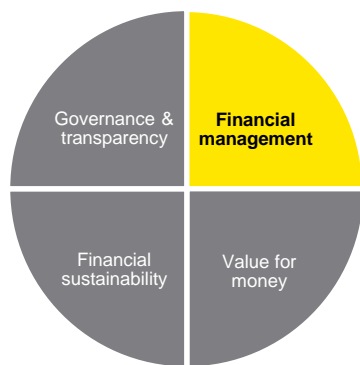


### Our strategy

We will evaluate and report on the Council's corporate governance arrangements. This will consider the:

- systems of internal control, including its reporting arrangements;
- arrangements for maintaining standards of conduct and the prevention and detection of corruption;
- arrangements for prevention and detection of fraud and irregularity; and
- the arrangements for the monitoring and review of corporate governance arrangements.

## 4. Wider scope audit dimensions



### Financial Management

With the significant financial challenges facing public sector bodies, it is essential that the Council has robust financial management arrangements to ensure that it can continue to deliver services to the local population. Effective financial management requires good financial planning, budgetary control and financial reporting arrangements.

### Our responsibilities

Financial management is concerned with financial capacity and robust financial planning processes. This includes sound budgetary processes and whether the control environment and internal controls are operating effectively. While the Council has delivered recent required financial savings targets, delivery of further efficiency savings is likely to require more fundamental decisions around services offered and service delivery.

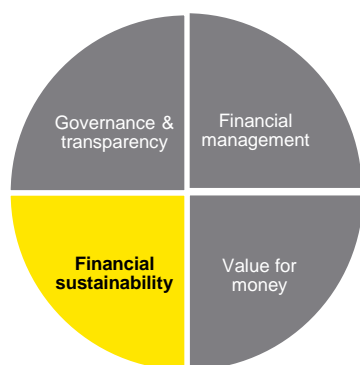
The Council faces significant financial pressures including reductions in government funding and social and demographic factors increasing the level of demand on available resources. Therefore, it is increasingly important that the Council has robust financial management arrangements to effectively manage these pressures.

### Our strategy

Over the course of our audit planning and execution we will look to develop a comprehensive understanding of the Council's financial management arrangements. Our audit work will include assessing and reporting on areas including:

- the Council's arrangements to ensure systems of internal control are operating effectively;
- whether the Council can demonstrate the effectiveness of the budgetary control system in communicating accurate and timely financial performance;
- how the Council has assured itself that its financial capacity and skills are appropriate; and
- whether the body has established appropriate and effective arrangements for the prevention and detection of fraud and corruption.

## 4. Wider scope audit dimensions



### Financial sustainability

Financial sustainability is focused on the medium to longer term financial viability. A key challenge for authorities is ensuring that in implementing shorter term financial and operational targets, the Council does not adversely impact on the delivery of its strategic objectives and medium to longer term financial sustainability.

### Our responsibilities

As part of the annual audit of the financial statements, ISA 570 requires auditors to consider the appropriateness of the use of the going concern assumption in the preparation of the financial statements. This requires auditors to consider that an entity will continue in operational for a period of at least 12 months from the date of signing the financial statements. The Code requires auditors to consider the financial sustainability of an entity for the medium to longer term, which covers a period of two to five years.

Some of the challenges facing the Council over this timescale include:

- Government grant levels which have not kept pace with inflation and service demand;
- Continuing demographic pressures with rising school rolls at one end of the spectrum and a higher number of elderly people requiring care at the other end;
- Other events, including equal pay settlements and changes to national insurance for defined benefit pension schemes.

### Our strategy

Our audit work in respect of financial sustainability will include assessing and reporting on areas including:

- The effectiveness of the financial planning systems and identifying and addressing risks to financial sustainability across shorter and longer terms;
- Whether the Council can demonstrate the affordability and effectiveness of funding and investment decisions that it has made; and
- The appropriateness of the arrangements put in place to address identified funding gaps and whether the body can demonstrate that these arrangements are working.



## 4. Wider scope audit dimensions



### Value for money

Value for money is focused on how the Council effectively utilises its resources and the arrangements in place to continually improve services.

### Our responsibilities

The Council has a responsibility to achieve value for money and demonstrate this through transparent reporting to the public, demonstrating how efficiently and effectively these are being delivered. Local authorities use various mechanisms to determine the efficiency of services, including a range of performance measures and indicators. They should also look to benchmark performance against other authorities to demonstrate value for money.

A key challenge for councils is ensuring that pressures to deliver short term financial and operational targets do not hinder the achievement of medium to longer efficiency improvements. Furthermore, there is a risk that the delivery of these is not at a sufficient pace to maximise the benefits.

Under the Code we are required to consider the extent to which the Council is delivering value for money and that there is clear focus on delivering services as efficiently as possible. Two key areas of focus are:

#### Option appraisal process

The Council's decision making process and the extent to which it is underpinned by critical appraisal of potential options to secure the best value to the Council.

#### Focus on continuous improvement

The Council's arrangements for monitoring the delivery of planned efficiencies. The extent to which planned efficiencies or improvements are tracked by the organisation and achievement of these, including pace of delivery, are challenged.

### Our strategy

In accordance with the Code, our audit work will include reviewing:

- The extent to which the Council can demonstrate that there is a clear link between money spent, outputs and outcomes delivered;
- Whether the Council can demonstrate that outcomes are improving;
- The extent to which there is a sufficient focus on improvement and the pace in which it is delivered; and
- The extent to which the Council can evidence that it is demonstrating value for money in the use of resources.

## **5. Other audit responsibilities**

## 5. Other audit responsibilities

Under the terms of our appointment, our role and responsibilities extend beyond the audit of the financial statements and the wider scope audit dimensions. There a number of further areas of audit activity that we will cover over the term of our appointment. These include our responsibilities in relation to following the public pound, statutory performance information and audit activity across the National Fraud Initiative and grant claims. Below we provide a summary of these areas which will be further detailed in our audit plan.

### **Following the public pound**

Local Authorities have a statutory responsibility to comply with the Accounts Commission / COSLA Code of Guidance on Funding External Bodies and Following the Public Pound (FPP Code). The principles of the FPP Code are embedded into the new approach to auditing Best Value. As part of our risk based planning approach we will consider the Council's arrangements to comply with the FPP Code. Over our five year appointment, Audit Scotland undertake performance audits across authorities for which we will be required to provide supporting information. During 2017, Audit Scotland will be undertaking a performance audit relating to Arms Length Organisations (ALEOs).

### **Statutory performance information**

Local authorities have a responsibility, under their Best Value duty, to report performance to the public. One of the Accounts Commission's Strategic Audit priorities is 'the quality of council public performance reporting to help citizens gauge improvement'. Consequently, over the term of our appointment, we will focus on the Council's performance reporting arrangements and integrate this with our wider planning activity.

### **National Fraud Initiative and fraud returns**

All local authorities are required to participate in the National Fraud Initiative (NFI). NFI involves the collection of data from various entities including authorities to identify potential irregularities for investigation. Authorities are required to participate through both initial data submission and investigation of identified matches. We are required to monitor and report on the Council's participation in NFI. We are also required to report on any frauds identified at the Council.

### **Other assurance activity**

Under the terms of our appointment we are required to undertake a number of other areas of audit activity. These include certifying authorities Whole of Government Accounts returns as well as certifying any applicable grant claims and returns such as the non-domestic rates return and housing benefits subsidy claim.

## **Appendix A - Implementation timeline**

# Appendix A - Implementation timeline

We will develop our detailed audit plan over the coming months and report our planned audit approach. Over the term of our appointment we will develop our knowledge and understanding of the Council to help develop and inform our conclusions on the Council's Best Value arrangements. The diagram below summarises our annual audit cycle for 2016/17, as well as the longer term strategic planning.



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