Agenda Item 6(b)

APPENDIX 1

Falkirk Council

Year ended 31 March 2017

Annual Audit Report

Audit Committee – 28 September 2017

DRAFT

Building a better working world

Contents

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.

Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Executive summary – overview

Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of Falkirk Council (the Council) for the five year period 2016/17 to 2020/21. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Auditing Practices Board; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both the members of the Council and the Controller of Audit, and presented to both Council management and those charged with governance, identified at the Council as being the Audit Committee. It will be published on Audit Scotland's website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the Council. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Scope and responsibilities

The Code sets out the responsibilities of both the Council and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Audit Committee on 13 March 2017. We summarise the responsibilities of the Council in Appendix A.

Our Annual Audit Plan also provided you with an overview of how we intended to carry out our responsibilities as your auditor. We carried out our audit in accordance with this plan.

We planned our procedures using a materiality of £9 million and a Tolerable Error of £4.5 million. We reassessed this using the actual year-end figures, to confirm that the materiality remained appropriate for the audit. No adjustment was made to materiality amounts communicated in our Annual Audit Plan. The threshold for reporting audit differences is £250,000, in accordance with the Code.

Status of the audit

We have substantially completed our audit of the Council's financial statements for the year ended 31 March 2017. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Council's financial statements. However until work is complete, further amendments may arise:

- Review of the final version of the financial statements.
- Completion of subsequent events review and receipt of signed management representation letter.

Upon completion of these outstanding items and following final approval of the audited financial statements by the Council we will update and finalise this Annual Audit Report.

Key contacts

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Acknowledgement

We would like to thank all members of the Council's management and staff who have been involved in our work for their co-operation and assistance during our audit work.

Accounting and audit matters – our reporting on the Council's financial statements

Preparation of financial statements

- The unaudited financial statements were prepared to a satisfactory standard. There were some delays experienced in obtaining key information. There is scope to improve and streamline the financial statements, together with the financial reporting process.
- We identified one error in the prior year financial statements which management corrected. There was no impact on the net assets as at 31 March 2016, however the deficit on provision of services was increased by £4.4 million. Adjustments in the current year reduced the surplus on provision of services by £7.7 million and reduced net assets by £1.8 million. One unadjusted difference of £0.70 million was identified.

Significant risks

Risk of fraud in income and / or expenditure recognition

- We have not identified any material weaknesses in the design and implementation of controls tested as part of our audit, or evidence of fraud in income and expenditure recognition during the financial year.

Management override of controls

- We are have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.
- We consider that management made appropriate disclosure on the accounting judgements and estimates made, with some scope for further enhancement.
- Provisions should be reviewed at the balance sheet date to ensure these are appropriately recorded.

Other inherent risks

Valuation of property, plant and equipment

- An adjustment was required to the prior period financial statements to reflect a material impairment of council dwellings which had been charged incorrectly to the revaluation reserve and not cost of services in 2015/16. A similar adjustment was required in 2016/17. There was no impact on the general fund.
- We are satisfied that other property, plant and equipment was supported by appropriate valuations.

Retirement benefits

- Defined benefit pension scheme liabilities have been estimated using actuarial assumptions which we consider to be reasonable. The required disclosures are provided in the financial statements, including those providing details of the sensitivity of the valuation to changes in the assumptions.
- We have undertaken appropriate testing of underlying data to support the calculation of the liability.

Other matters and reporting requirements

- The new Expenditure and Funding Analysis has been presented in accordance with the Accounting Code of Practice and the Movement in Reserves Statement and Comprehensive Income and Expenditure Statement restated accordingly. We consider the disclosures provided to be appropriate to the Council's internal reporting during the year.
- We obtained reasonable and appropriate audit evidence over the Council's group financial statements. Based on our group scoping we did not need to undertake detailed testing at any group components. We are the appointed auditor to Falkirk Integration Joint Board. In obtaining support for the Council's investment in one of its subsidiaries there is a requirement to clarify the loan relationship.
- The Council's statutory trading operation for Building Maintenance met its 3-year break even requirement.
- We undertook the audit of the Falkirk Temperance Trust. We have provided an unqualified audit opinion on the financial statements of the Trust.
- We concluded that the Council complied with the requirements of the Local Authority Accounts (Scotland) Regulations 2014. In respect of our 'Opinions on other prescribed matters', including the management commentary, the auditable part of the remuneration report, and the annual governance statement, our opinion is unqualified. We have identified no matters on which we are required to report by exception.

Wider scope audit dimensions – our judgements and conclusions on the Council's arrangements

Financial management – area of audit focus

- We have concluded, based on the evidence in 2016/17, that the Council maintained good financial management over income and expenditure, ensuring that the budget was achieved and savings required were delivered. The budgeted utilisation of reserves was not required in the year.
- In line with other support services, the finance function has undergone further restructuring in the year, with a number of individuals leaving the Council. This has left one senior post unfilled. Without a full complement of appropriately experienced finance professionals, there is increased risk to the Council.

We have made one recommendation in the action plan (point 6) in respect of the Council's arrangements.

Financial sustainability – area of audit focus

- We have concluded that the Council's financial position as at 31 March 2017 is satisfactory. While they have maintained a number of reserves within the target range, the overall financial position of the Council has weakened significantly due to an increase in pension liabilities.
- Only a one-year budget was approved for 2017/18, although information on longer-term budget gaps was provided to members as part of the budget setting process. These have been updated and formulated into a medium-term financial plan. The analysis makes it clear that the Council has to clearly identify its priorities as well as transform the way the Council operates and delivers its services.

We have made four recommendations (points 7 to 10) , two of which are graded one, in respect of the Council's arrangements.

Governance and transparency – area of audit focus

- The Council has now established a comprehensive framework of governance arrangements which provides a clear commitment to the core principles of independent scrutiny. Internal audit is well respected, however, we have made recommendations for consideration to enhance the arrangements.
- The Council is in the process of agreeing its new Corporate Plan and supporting enabling strategies. While these are being finalised, there is a need to establish clear milestones to demonstrate the timelines for delivery of multi-year projects, to enhance accountability and enable the required pace of change.

We have made six recommendations (points 11 to 16), two of which are graded one, in respect of the Council's arrangements.

Value for Money

- The Council is in transition in setting out its new Corporate Plan and the underlying service plans and targeted priorities. In order to be able to demonstrate the commitment to continuous improvement, it is important that appropriate measures and targets are in place to assess performance over the five year period of the Corporate Plan.
- LGBF data shows that the Council performs reasonably well compared to the national average in a number of areas. There has been an improvement in performance generally over time.

We have made one recommendation in respect of the Council's arrangements, at grade one (point 17).

Appendices

We set out in the appendices a number of required communications we provide in accordance with auditing and ethical standards. In particular, we have confirmed our continuing independence to act as auditor of the Council.

We also provide a short accounting and regulatory update highlighting forthcoming changes and their potential impact on the Council.

1. Financial statements and accounting

1. Financial statements and accounting

The Council's Annual Accounts enables the Council to demonstrate accountability for, and its performance in the use of its resources. They are prepared in accordance with proper accounting practice, which is represented by the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom.

Audit opinion

In respect of the financial statements, we expect to issue an unqualified opinion on the truth and fairness of the state of affairs of the Council and its group at 31 March 2017 and of the deficit on provision of services for the year then ended, in accordance with applicable law and the 2016/17 Code of Practice

The detailed form and content of our audit report, plus the requirements underpinning the report are contained in the Audit Scotland guidance at: http://www.audit-scotland.gov.uk/uploads/docs/um/tgn_2017_5_local_authorities.pdf.

We have not identified any circumstances to notify the Controller of Audit that a statutory report may be required under the Local Government (Scotland) Act 1973.

Financial statements preparation

As part of your oversight of the Council's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit.

We experienced delays in the provision of certain key information, notably data in respect of payroll information. Overall we believe there is scope to improve the financial reporting process further, and to streamline the format of financial statements. We will work with the finance team as part of our annual debrief meeting to ensure we support improvements to both the financial reporting and audit processes.

Action plan point - 1

Materiality

We planned our procedures using a materiality of £9 million. We reassessed this using the actual year-end figures, to ensure that our level of materiality remained appropriate. We did not change our assessment of materiality as a result. Our audit Tolerable Error for the audit was £4.5 million and the threshold for reporting audit differences is £250,000.

We also identified areas where misstatement at a lower level than materiality might influence the reader and developed a specific audit strategy for them. They include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits - we applied a materiality of £1,000 based on the potential sensitivity of these disclosures.
- Related party transactions - we considered the nature of these disclosures individually.

Audit differences

We identified one audit difference in the draft financial statements which management has chosen not to adjust. We ask that the Audit Committee and Council note this and that these will be included in the Letter of Representation. The aggregated impact of unadjusted audit differences is £0.7 million. We agree with management's assessment that the impact is not material.

There were a number of audit differences identified which were adjusted by management. These reduced the surplus on provision of services by £7.7 million and reduced net assets by £1.8 million.

Included within these was an error identified in the opening balance sheet information which resulted in management correcting the prior year comparative figures. There was no impact on the net assets as at 31 March 2016, however the deficit on provision of services was increased by £4.4 million.

Our Audit Plan identified key areas of focus for our audit of the Council's financial statements, including significant risks. This report sets out the results of our audit procedures plus relevant observations, including our views on areas which might be conservative, and where there may be potential risk and/or exposure.

Significant risk – risk of fraud in income and expenditure recognition

What is the risk?

Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We rebutted the risk of improper recognition of revenue in respect of core grant funding from the Scottish Government, as well as in respect of council tax and non-domestic rate income.

Results of audit procedures

In relation to income, predominantly fees and charges, and other operating expenses where we had identified a significant risk of material misstatement, we:

- Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias.
- Reviewed transaction listings for individually material transactions as well as unusual items (debits to income, credits to expenditure etc.) to agree to supporting documentation and third party evidence.
- Tested a representative sample of transactions across the remaining untested income and expenditure population to ensure coverage of testing across all balances.
- Reviewed and tested revenue cut-off around the year end through reviewing manual journals posted to revenue and reviewing material credit notes raised after year end.
- Performed a search for material receipts received after year end and ensured these had been accounted for in the correct period.

Where we are performing procedures to address significant risks to the financial statements we do so to a lower level of materiality than for standard accounts. All procedures outlined above were completed with no material reported audit differences or other matters noted.

Other income and expenditure areas

The most significant area of revenues was taxation and non-specific grant income of £360.8 million. £236.4 million of this related to government grant income which we substantively tested to grant confirmation letters. The remainder is made up of £69.1 million of NDR redistributions and £55.3 million of Council Tax income. These were agreed either to funding correspondence, and / or through establishing detailed expectations of income and expenditure, agreeing underlying assumptions to supporting evidence, and comparison to actual income and expenditure recorded by the Council in the year.

For expenditure, £227.3 million relates to payroll costs. These have been subject to detailed analytical procedures and reconciliation to underlying payroll information. We have agreed PPP transaction costs to PFI contract and finance models. Depreciation and impairment charges have been subject to detailed audit testing, including reconciliation to the fixed asset register.

Risk of fraud in income and expenditure recognition – what have we concluded?

- We have not identified any material weaknesses in the design and implementation of controls tested as part of our audit, or evidence of fraud in income and expenditure recognition during the financial year.

Significant risk – management override
What is the risk?
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.
Audit procedures performed and what did we find?
Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements We obtained a full list of journals posted to the general ledger during the year, and used our bespoke data analysers to identify any unusual journal types or amounts based on our identified risk areas for the audit. We then tested a sample of these journals, understood their purpose and agreed and corroborated them to supporting documentation.
Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates. We identified and considered the existence of any accounting estimates and their susceptibility to bias. Management has disclosed their consideration of the critical accounting judgements and key estimates in the financial statements. We have reviewed these and agree with the detail of the assessment performed. We considered all material provisions made in the financial statements in 2016/17. In one instance we identified a provision in relation to statutory employee costs where management had understated the accounting for the provision by £1.8 million based on the most recently available information. In our view this adjustment is the result of an oversight in the fundamental accounting treatment rather than an attempt to manipulate the Council's financial position, as the quantum of provision needed at year end was well established and recognised. Management has corrected the difference, with an impact of reducing the surplus on provision of services by £1.8 million, which has subsequently reversed out of the general fund through the movement in reserves statement to a statutory employee costs reserve. ***Action plan point - 2***
Evaluate the business rationale for any significant unusual transactions. We did not identify any significant unusual transactions outside the normal course of business.
Review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. We reviewed expenditure on property, plant and equipment to ensure that expenditure items were not being inappropriately capitalised to defer costs to future years. Likewise we performed analytical procedures and transaction testing of HRA expenditure to ensure that HRA reserves were not being utilised to meet general fund transactions. No issues were identified through our testing.

Risk of management override – what have we concluded?

- We are have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.
- We consider that management made appropriate disclosure on the accounting judgements and estimates made, with some scope for further enhancement.
- Provisions should be reviewed at the balance sheet date to ensure these are appropriately recorded.

Other inherent risk – valuation of property, plant and equipment
What is the risk?
The Council's property portfolio totalled £987 million as at 31 March 2016, with the major elements of this being in respect of Council Dwellings, Other Land and Buildings and Infrastructure assets. Given the size of this balance and the fact that a number of assumptions are made in the valuation, we assigned a higher inherent risk to the valuation of property, plant and equipment.
Audit procedures performed and what did we find
In response to our identified risk around property valuations, we performed the following procedures: ► Through analysis of the source data and through enquiries of management, the appropriateness as to the procedures used by management's specialist valuer to establish whether the source date is complete. ► Assessment of the reasonableness of the assumptions and methods used in the valuation of land and buildings, including their compliance with the Accounting Code of Practice. ► Considered the appropriateness of the timing of when the specialist carried out the work. ► Confirmation that the substance of the specialist's findings were properly reflected in the financial statements, and that these took account of the Council's ongoing strategic property review. In respect of housing capital additions, management had identified that these do not add full value due to the interaction of valuation for existing value for social housing. In charging the impairment of £5.9 million, we identified that this had incorrectly been charged to the revaluation reserve and not as impairment below cost to the income and expenditure statement. This treatment had also been adopted in the prior year, where £4.4 million was charged to the revaluation reserve. As this represented a material misstatement, management corrected both the current year and the prior year comparatives accordingly. We identified approximately £0.7 million in assets that were disposed of with no proceeds. On further investigation we identified that these were leased assets which had been incorrectly added to the fixed asset register. The disposal of the assets corrected the position at the year-end. However, since these were not Council assets this represents an error in accounting. We have raised this an audit adjustment and note that management has chosen not to adjust on the basis of materiality. We consider this to be a reasonable approach. The error in respect of these assets was identified through the Council's annual rolling valuation exercise. As the exercise did not cover all fixed assets on the register there is a risk that further incorrectly held assets exist. In addition, while management has established a process whereby significant capital additions in the year are used to consider whether there may be any material changes in asset valuation, there is no formal process to determine movements based on market prices in general. While we are satisfied that the Council's valuations have been appropriately reflected within the financial statements, we recommend that management enhance the existing valuation process to ensure that there is a robust process for ensuring that asset valuations do not materially differ from current value over the rolling cycle of valuations. ***Action plan point - 3***

Inherent risk, valuation of property, plant and equipment – what have we concluded?
• An adjustment was required to the prior period financial statements to reflect a material impairment of council dwellings which had been charged incorrectly to the revaluation reserve and not cost of services in 2015/16. A similar adjustment was required in 2016/17. There was no impact on the general fund. • We are satisfied that other property, plant and equipment was supported by appropriate valuations.

Other inherent risk – retirement benefits
What is the risk?
The Code and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS). Accounting for the pension fund assets and liabilities involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.
Results of audit procedures
In planning our audit, we identified that pension liabilities at 31 March 2016 were £303 million. Following the result of the EU Referendum in June 2016, we saw significant changes in certain economic assumptions used in the valuation of pension liabilities leading to significant increases in reported net pension liabilities by entities with accounting year-ends after the June 2016. At 31 March 2017, the Council's net pension liability had increased to £461.7 million, primarily as a result of changes in the discount rate used to value the pension obligations. Our audit procedures included: ► Analysis of the payroll and pensions source data and made inquiries as to the procedures used by management's specialist to establish whether the source date was relevant and reliable. ► Utilisation of EY pension specialists to challenge the appropriateness of the assumptions used in deriving the liabilities at 31 March 2017. As part of this work, our specialists considered the work undertaken by PWC on behalf of the public audit agencies to provide assurance over the major actuarial firms involved in preparing IAS 19 valuation reports. Assumptions used by the actuary and adopted by the Council are considered to be within our acceptable range. ► Testing of the journal entries for the pension transactions to ensure that they have been accurately processed and agreed the required disclosures in the financial statements to relevant information provided by the actuary.

Inherent risk, retirement benefits – what have we concluded?

- Defined benefit pension scheme liabilities have been estimated using actuarial assumptions which we consider to be reasonable and the required disclosures have been provided in the financial statements, including those providing details of the sensitivity of the valuation to changes in the assumptions.
- We have undertaken appropriate testing of underlying data to support the calculation of the liability.

1. Financial statements and accounting

Our Audit Plan identified other audit matters and aspects of our work which arise either in accordance with International Standards on Auditing (UK & Ireland) or in accordance with the Code. These are set out below.

Other audit matters

Expenditure and funding analysis

In 2016/17 there were amendments to the Accounting Code of Practice as a result of the 'Telling the Story' review of the presentation of local authority financial statements. The Accounting Code of Practice no longer requires statements or notes to be prepared in accordance with SeRCOP. Instead it requires that the service analysis is based on the organisational structure under which the authority operates, reflecting internal financial reporting structures.

This change impacted the Consolidated Income and Expenditure Statement (CIES), the Movement in Reserves Statement (MiRS) and introduced the new expenditure and funding analysis (EFA), with full retrospective restatement of the CIES and MiRS. Our audit approach has focused on:

- Reviewing the expenditure and funding analysis, CIES and new notes to ensure disclosures are in line with the Accounting Code of Practice. Management initially presented the EFA apparently as the first statement within the financial statements. Since it does not form one of the four primary statements, we asked management to make the narrative clear that the EFA, while it can be displayed prominently, is a note to the financial statements.
- Reviewing the analysis of how these figures are derived, the re-mapping of the ledger system to reflect the Council's organisational structure and how overheads are apportioned across the service areas reported.
- Agreement of restated comparative figures back to the Council's segmental analysis and supporting working papers.

Opening balances

International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* requires auditors to obtain sufficient, appropriate audit evidence that opening balances do not contain misstatements that materially affect the financial statements. The standard also requires auditors to verify that appropriate accounting policies are reflected in the opening balances and that they have been consistently applied in the current period's financial statements.

In response, we have:

- Held discussions with the former external auditor in respect of previous significant audit issues, corporate governance and general risk assessment.
- Reviewed prior year financial statements, annual audit reports and other reports issued by the former s external auditors.
- Substantively tested opening balances to ensure that they agree both to the prior year audited financial statements and closing trial balance.
- Undertaken a mix of testing on balances during 2016/17 which provide assurance on the judgements and estimates made as at 31 March 2016.

We have reported elsewhere on the requirement to undertake restatement of the prior period to correct errors identified. There are no other matters to raise with you as a result of our work.

Other audit matters – what have we concluded?

- The EFA has been presented in accordance with the Accounting Code of Practice and the MiRS and CIES restated accordingly. We consider the disclosures provided to be appropriate to the internal reporting of the Council during the year.
- We concluded our work on the opening balances as part of the requirements for initial audit engagements. As reported elsewhere, a number of adjustments to prior period figures were required.

1. Financial statements and accounting

The Council's Annual Accounts enables the Council to demonstrate accountability for, and its performance in the use of its resources. They are prepared in accordance with proper accounting practice, which is represented by the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom.

Audit opinion

In respect of the financial statements, we expect to issue an unqualified opinion on the truth and fairness of the state of affairs of the Council and its group at 31 March 2017 and of the deficit on provision of services for the year then ended, in accordance with applicable law and the 2016/17 Code of Practice

The detailed form and content of our audit report, plus the requirements underpinning the report are contained in the Audit Scotland guidance at: http://www.audit-scotland.gov.uk/uploads/docs/um/tgn_2017_5_local_authorities.pdf.

We have not identified any circumstances to notify the Controller of Audit that a statutory report may be required under the Local Government (Scotland) Act 1973.

Financial statements preparation

As part of your oversight of the Council's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit.

We experienced delays in the provision of certain key information, notably data in respect of payroll information. Overall we believe there is scope to improve the financial reporting process further, and to streamline the format of financial statements. We will work with the finance team as part of our annual debrief meeting to ensure we support improvements to both the financial reporting and audit processes.

Action plan point - 1

Materiality

We planned our procedures using a materiality of £9 million. We reassessed this using the actual year-end figures, to ensure that our level of materiality remained appropriate. We did not change our assessment of materiality as a result. Our audit Tolerable Error for the audit was £4.5 million and the threshold for reporting audit differences is £250,000.

We also identified areas where misstatement at a lower level than materiality might influence the reader and developed a specific audit strategy for them. They include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits - we applied a materiality of £1,000 based on the potential sensitivity of these disclosures.
- Related party transactions - we considered the nature of these disclosures individually.

Audit differences

We identified one audit difference in the draft financial statements which management has chosen not to adjust. We ask that the Audit Committee and Council note this and that these will be included in the Letter of Representation. The aggregated impact of unadjusted audit differences is £0.7 million. We agree with management's assessment that the impact is not material.

There were a number of audit differences identified which were adjusted by management. These reduced the surplus on provision of services by £7.7 million and reduced net assets by £1.8 million.

Included within these was an error identified in the opening balance sheet information which resulted in management correcting the prior year comparative figures. There was no impact on the net assets as at 31 March 2016, however the deficit on provision of services was increased by £4.4 million.

Other audit matters (continued)
Group financial statements
The Council consolidates its interest in FCSL (Holdings) Ltd and Falkirk Community Stadium Ltd (FCSL) as subsidiaries. The principal activity of the companies is the operation of the stadium at Westfield. FCSL has two directors who are employees of the Council. In requesting supporting documentation for the consolidation spreadsheets, the information provided in respect of FCSL was inconsistent with that contained in the subsidiary company financial statements. In particular, the subsidiary financial statements still showed the existence of a loan payable to the Council. We were advised that from the Council's side, this loan was no longer payable and had been cancelled when the Council had taken security over the assets within FCSL. We have obtained sufficient and appropriate evidence to support the carrying value of the investment in FCSL on the Council's balance sheet, however, it is necessary that the Council review this relationship and ensure that there is a consistent position recognised by both parties. ***Action plan point - 4*** In scoping our audit work over the group, only the Falkirk Integration Joint Board (the FIJB) was scoped into our audit procedures on the grounds of materiality. We are the appointed auditor to the FIJB and report separately on our audit of that entity. The accounting for the FIJB was new in 2016/17. The relationship as a joint venture meant that in the Council CIES, a gross-up of expenditure funding made to FIJB plus the expenditure on social care services was shown, offset by the income receivable from FIJB as part of its delegation of resources. The overall impact of preparing group financial statements was to reduce total reserves by £8.7 million (*2015/16: £7.6 million*).
Qualitative aspects of the financial statements
With the exception of the matters discussed specifically elsewhere in this report: ► We have reviewed the significant accounting policies, which are disclosed in the annual financial statements, and we consider these to be appropriate to the Council. ► There was no disagreement during the course of the audit over any accounting treatment or disclosure. ► There were no significant difficulties encountered in the audit.
Significant trading operations
Under the Local Government in Scotland Act 2003, the Council has to maintain statutory trading accounts for any 'significant trading operations' (STOs). The 2003 Act also prescribes that STOs have to break even over a three year rolling period. The Council reports one significant trading operation for Building Maintenance. The cumulative three-year result is a surplus of £0.38 million. Consequently the Council met the statutory objective placed in it.

Other audit matters (continued) – what have we concluded?

- We obtained reasonable and appropriate audit evidence over the Council's group financial statements. Based on our group scoping we did not need to undertake detailed testing at any group components. We are the appointed auditor to Falkirk Integration Joint Board. In obtaining support for the Council's investment in one of its subsidiaries there is a requirement to clarify the loan relationship.
- The Council's statutory trading operation for Building Maintenance met its 3-year break even requirement.

Other audit matters (continued)
Falkirk Temperance Trust
The Council acts as sole trustee for the Falkirk Temperance Trust. The Charities Accounts (Scotland) Regulations 2006 outline the accounting and auditing requirements for charitable bodies. The Regulations require an auditor to prepare a report to the charity trustees where an audit is required by any other enactment. The Falkirk Temperance Trust is covered by the requirements of section 106 of the Local Government (Scotland) Act 1973 and consequently requires a full audit. In summary: ► We have provided an unqualified audit opinion on the charitable trust fund's financial statements, in accordance with applicable law and the relevant financial reporting framework. ► There were no audit adjustments impacting on the net assets or income and expenditure reported for the year. ► No numerical adjustments were required to the financial statements prepared for audit. A number of presentational adjustments were suggested and made in order to ensure compliance with the disclosure requirements outlined in the above legislation. ► We considered and confirmed our independence to act as auditor of the charitable trust, in line with the procedures set out in Appendix C for the Council audit, together with the objectivity of the audit partner and staff. ► Materiality for the audit was set in accordance with our audit methodology, at 2% of total assets. ► We encountered no significant difficulties in undertaking our work and have no other significant matters to report to you.

Other audit matters (continued) – what have we concluded?

- We undertook the audit of the Falkirk Temperance Trust. We have provided an unqualified audit opinion on the financial statements of the trust.

The Local Authority Accounts (Scotland) Regulations 2014 set out the statements which should be included in the Annual Report and Accounts in addition to the financial statements. These items are covered by our independent auditor's report as *Other prescribed matters*, in accordance with the requirements of the Code.

Other reporting requirements

The Local Authority Accounts (Scotland) Regulations 2014 (the Regulations)

Regulations 8 to 10 set out the statutory requirements on the Council in respect to the Annual Accounts, their availability for public inspection and the consideration and signing by the Council or a committee with an audit or governance remit. As required, we received the unaudited Annual Accounts by the 30 June. The Audit Committee considered the unaudited Annual Accounts on 21 August 2017, in advance of the 31 August deadline. No statutory objections were received on the unaudited financial statements.

Management Commentary

The requirement for the Council to include a management commentary is included in Regulation 8(2)(a). Audit Scotland requires us to read the management commentary and express an opinion on whether the information given is consistent with the financial statements and whether it has been prepared in accordance with the Scottish Government's statutory guidance within Local Government Finance Circular 5/2015.

We considered whether the management commentary provided a fair and balanced review of the Council's business; a description of the principal risks and uncertainties; financial and non-financial key performance indicators; a description of the Council's strategy and business model and the main trends and factors likely to affect future developments; performance and position of the Council's business and explanation of the amounts in the financial statements.

We were satisfied that the management commentary provided a detailed explanation of the financial performance for the year, along with other required information. No key performance indicators were initially included. We requested management update the commentary to include key performance indicators. In addition we suggested adjustments to improve the clarity of the narrative. Management updated the commentary appropriately to reflect the key elements of our review.

Action plan point - 5

Remuneration Report

Auditors are required by the Code to audit the disclosures of remuneration and pension benefit, pay bands, and exit packages and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the Regulations.

No amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentation in accordance with the statutory requirements. The Council has disclosed appropriately exit packages provided to 93 staff totalling £2.2 million (*2015/16: 179 staff totalling £3.8 million*).

Annual Governance Statement

Audit Scotland requires us to read the information in the annual governance statement and express an opinion on whether the information given in the annual governance statements is consistent with the financial statements and whether the statement has been prepared in accordance with *Delivering good governance in local government: framework 2016*.

We set out the work undertaken in respect of the Council's annual governance statement as part of the Wider Scope – Governance & Transparency section of this Report.

Other reporting requirements – what have we concluded?

- We have concluded that the Council has complied with the requirements of the Regulations.
- In respect of our 'Opinions on other prescribed matters', which includes the management commentary, the auditable part of the remuneration report, and the annual governance statement, our opinion is unqualified.
- We have not identified any other matters on which we are required to report by exception.

2. Wider scope audit

Together the Accounts Commission and the Auditor General for Scotland agreed the four dimensions set out in the Code which comprise the wider scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money.

Wider scope audit

Our wider scope audit work, and the judgements and conclusions reached in these areas, contribute to the overall assessment and assurance on the achievement of Best Value. As your external auditor we participate in the Local Area Network (LAN), and were appointed as the LAN-lead for the Council. The LAN brings together representatives from across different scrutiny bodies to agree a Shared Risk Assessment (SRA) for each local authority. The SRA informs the local scrutiny plan (LSP) ensuring that for any risks identified there is an appropriate scrutiny response.

The 2016/17 LSP focussed on the Best Value follow-up work planned, as well as the risk of financial sustainability. The 2017/18 LSP reported the LAN's conclusion that no new scrutiny risks had been identified which require specific scrutiny work during 2017/18. The LSP noted the findings of the Accounts Commission in the Best Value follow-up report published on 1 December 2016 and the requirement for a further follow-up report by the end of 2017.

Best Value auditing

Under the new approach to Best Value auditing in local government, the Controller of Audit will provide a Best Value Assurance Report (BVAR) for each council at least once in a five year period. The requirement for a Best Value follow-up report means that specific work this year has focussed on those aspects reported by the Accounts Commission in 2016. Timing of a BVAR is unconfirmed at this time.

The annual audit continues to focus on aspects of Best Value over our five year appointment. We have identified an indicative five year Best Value Plan in the table below. This will be subject to ongoing revision as priorities change or emerging risks arise, and the timing of a BVAR is confirmed.

The Accounts Commission has announced its strategic audit priorities and these are mapped across, at a high level, to the Best Value audit work planned as shown below.

A. The clarity of council priorities and quality of long-term planning to achieve these.
B. How effectively councils evaluate and implement options for significant changes in delivering services.
C. How effectively councils are ensuring members and officers have the right knowledge, skills and time to lead and manage delivery of the council priorities.
D. How effectively councils are involving citizens in decisions about services.
E. The quality of council public performance reporting to help citizens gauge improvement.

Indicative five year Best Value plan	2016/17	2017/18	2018/19	2019/20	2020/21	Mapping to Strategic Audit Priority
Planned BVAR			tbc	tbc	tbc	
Follow up Best Value work	X					
Audit coverage:						
Performance and outcomes		X				B
Improvement		X			X	-
Leadership, Governance and Scrutiny	X				X	A
Equal Opportunities			X			E
Partnership Working and Empowering Communities				X		C, D
Financial and service planning	X		X			A, C
Financial governance and resource management	X			X		-

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

Financial management

In undertaking our work on this audit dimension, at a high level we consider the following aspects:

- Is financial management effective?
- Are the budget setting and monitoring processes operating effectively?
- Is there sufficient financial capacity?

Area of audit focus

We set out in our annual audit plan that aspects of financial management were a key audit focus area. This was specifically as a result of the Accounts Commission Best Value follow-up report recommendations which indicated that the Council needed to:

- Review the process for preparing the budget to ensure all costs and income are more accurately anticipated.

Overview of 2016/17 financial statements

We provide an overview of key financial statements movements and balances in the table below, including our commentary on whether we consider these to represent a potential risk to the Council. Our detailed analysis over financial management and financial sustainability provides context to these assessments.

Focus on financial statements results	2016/17 £000	Restated 2015/16 £000	Commentary	RAG rating
(Surplus) / deficit on provision of services	**(1,220)**	18,938	A change to an accounting surplus was reported due to the timing of capital grants received, gains on disposals of fixed assets and other adjustments between the funding and accounting basis.	G
(Surplus) / deficit on General Fund and HRA in year	**119**	262	No significant change. In general this result reflects on good in-year financial management and budgetary control	G
Uncommitted general fund	**11,530**	8,562	Uncommitted reserves were in excess of the £6.6 - £10 million range set in the Council's reserves strategy. £3.3 million of reserves were committed in the 2017/18 budget.	A
Earmarked reserves	**8,451**	10,037	Earmarked reserves reduced mainly due to spend being incurred against the earmarked purpose.	A
Net current liabilities	**(43,956)**	(43,575)	Net current liabilities can reflect a potential inability to meet liabilities as they fall due. In practice, good cash flow management will ensure that this is not a risk, but the Council should monitor this position.	A
Total Usable Reserves	**42,278**	42,706	No major change in the overall level of usable reserves	G
Total Unusable Reserves	**133,933**	281,716	Significant increase in the pension fund liability means that the overall net assets of the Council, which equate to total usable and unusable reserves have decreased substantially.	R
Net increase / (decrease) in cash	**(10,798)**	22,530	The decrease in cash reflects outflows due to financing and borrowing arrangements, and working capital movements.	A

2016/17 financial outcomes

The 2016/17 Comprehensive Income and Expenditure Statement (CIES) shows that the Council incurred gross expenditure on the provision of services of £593 million (*2015/16: £551.8 million*), and incurred an accounting surplus of £8.9 million (*2015/16: deficit of £14.5 million*) on those services.

The new Expenditure and Funding Analysis (EFA) note to the financial statements provides an explanation of how this expenditure is used and funded by the Council. This is different from the accounting position shown in the CIES in accordance with the Accounting Code of Practice and, together with the Movement in Reserves Statement, demonstrates how the Council's statutory reserves, including the General Fund, have changed in the year.

As shown in the EFA, the outturn for the financial year against the Council's general fund was a deficit of £0.12 million (*2015/16: £0.26 million*). In February 2016, the Council approved a one-year revenue budget for 2016/17. Included within the budget for 2016/17 were savings of £25 million to deliver a balanced budget. This represented a significant element of savings required, however, the outturn for the year demonstrated that these were delivered.

2016/17 budget monitoring and outturn

The 2016/17 budget was based on a total spend of £329.6 and assumed a draw on uncommitted reserves of £1.45 million and earmarked reserves of £0.75 million. The majority of the £25 million savings came from budget rebasing and service level savings. The projected outturn against budget was reported regularly to the Council Executive during the year. The outturn report in June 2017 which supported the preparation of the unaudited annual financial statements is summarised in the table.

Service area	Budget £000	Outturn £000	Over / (under) £000
Children's Services	181,533	180,679	(854)
Social Work – Adult Services	5,865	5,332	(533)
Development Services	28,758	28,690	(68)
Corporate & Housing Services	26,485	25,444	(1,041)
Falkirk Community Trust	11,934	11,934	-
Valuation Joint Board	1,022	1,022	-
Integrated Joint Board	59,521	59,521	-
Other	960	890	(70)
Capital Financing Costs and Capital Charges	17,328	17,289	(39)
Service Expenditure - Total	**333,406**	**330,579**	**(2,827)**
Net Income	329,703	330,091	(388)
Surplus / (deficit)	**(3,703)**	**488**	**(3,215)**
Transfers to / (from) earmarked or other reserves	(1,503)	(3,455)	1,952
(Increase)/Decrease in Uncommitted General Fund Reserve	**2,200**	**(2,976)**	5,167

In-year budget monitoring reports were provided to the Council Executive on four occasion during the year, which included forecast outturn. The forecast outturn showed an increasingly positive outturn against budget as the year progressed. Delivery of the required financial savings targeted workforce reductions of 231 Full Time Equivalent (FTE) staff in the year, through not filling vacancies and management of temporary and agency staffing. By March 2017, there had been severance of 137 posts in the year, and the FTE numbers have reduced by 107. The projected net savings arising from the severances over five years is £13.3 million.

Housing Revenue Account

The HRA delivered a contribution to the reserve of £0.31 million, increasing the reserve balance to £5.1 million as at 31 March 2017. The average weekly rent increased by 3.7% resulting in increase rental income for the year.

There were no significant movements in any of rent arrears, losses on void properties or the bad debt provision from the prior year.

2016/17 financial outcomes – capital expenditure

Capital expenditure	Budget £000	Outturn £000	Over / (under) £000
General services capital programme	**34,736**	**30,826**	**(3,910)**
The Council under-delivered on the programme by approximately 11%, principally due to an underspend in relation to commercial property and environmental projects. The programme reports also on seven major stand-alone projects, of which in 2016/17 £12 million spend on the new Carrongrange High School was a key element of spend. The longer term Grangemouth flood prevention scheme is the single largest project, totalling forecast spend of £111 million.			
Housing capital programme	**27,060**	**31,136**	**4,076**
The housing programme over-delivered against the original plan, but was in line with the revised budget of £31.3 million which included carry-forward from 2015/16. There was approximately £3 million slippage on the new build budget of £7 million but other programme works were accelerated to off-set this.			

Overall financing of the capital programme was supported by £12.4 million of borrowing, £27 million of Scottish Government grants across both general fund and housing services, £8.8 million from capital receipts (primarily council house sales) and £10.5 million of capital expenditure funded by revenue.

The actual borrowing for capital expenditure was significantly lower than originally forecast and this was reported to members in the year end treasury management review. This borrowing was undertaken short-term, due to the relatively low interest rates available. Two market loans totalling £13 million held with Barclays were converted to fixed rate loans in the year after the bank waived their right to change the applicable interest rate of the two loans.

Capacity of finance and standing in the organisation

The Council's section 95 officer is the chief finance officer. We considered the role and status of the section 95 officer in respect of the principles laid out within CIPFA's *Statement on the role of the Chief Financial Officer in Local Government*, taking account of the recommendation raised in the 2015/16 annual audit report by the former auditor.

From our attendance at relevant meetings, and discussion with senior officers, we are satisfied that while the Chief Finance Officer does not directly report to the Chief Executive, the CFO is involved in the development and implementation of financial strategy to support the Council's strategic objectives.

To support this role, the CIPFA statement makes it clear that the CFO must lead and direct a finance function that is resourced to be fit for purpose. In line with other support services, the finance team at the Council has reduced in size in the year. In addition, the 2017/18 budget formally approved that the two chief officer Depute Chief Finance officer posts would be deleted and removed from the structure, as both were now vacant.

A new Grade O in the staffing structure was introduced to allow appointment to roles that would be deputes for statutory officer posts, including the depute to the Chief Finance Officer. This post has yet to be filled.

Action plan point - 6

We have reviewed the Council's financial regulations and are satisfied that these are comprehensive, subject to regular update and made available through the Council's website.

Internal control

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Our first year audit has been predominantly substantive in nature, and therefore we have not tested the operation of key controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We have not identified any such matters to report to you.

Financial management – what have we concluded?

- We have concluded, based on the evidence in 2016/17, that the Council maintained good financial management over income and expenditure, ensuring that the budget was achieved and savings required were delivered. The budgeted utilisation of reserves was not required in the year.
- In line with other support services, the finance function has undergone further restructuring in the year, with a number of individuals leaving the Council. This has left one senior post unfilled. Without a full complement of appropriately experienced finance professionals, there is increased risk to the Council.

Financial sustainability interprets auditors' requirements under ISA 570 *Going concern* and looks forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Financial sustainability

The Accounts Commission's overview report on Local Government in Scotland: Performance and Challenges 2017 sets out the increasingly demanding environment facing local authorities. In particular an overall reduction of 9.2% in Scottish Government total revenue funding since 2010/11 and demographic changes in particular in respect of aging populations. Additionally, there are a broad range of legislative and policy changes, including for example integration of health and social care, community empowerment provision and education reform.

Scottish Government funding is distributed to councils using a formula based on factors such as population, deprivation and rurality. This means that not all councils have experienced the same level of reductions in funding. Audit Scotland figures show that the Council's reduction in funding overall has been the seventh lowest of all councils, at about 6-7%. This is in the context, however, of a demographic which also shows that the Council is expected to experience the 12th most significant increase in population over 75 years old, by around 90% in the period 2014 to 2039.

Education and social work increasingly make up a greater majority of expenditure in local government. Within the Council's Expenditure and Funding Analysis, in terms of the amount chargeable to the general fund and HRA, 77% of spend was in respect of these areas, near the top end of the national range of 60 – 80%.

Area of audit focus

We set out in our annual audit plan that financial sustainability was a key audit focus area. This was specifically in response to the Accounts Commission Best Value follow-up report recommendations which indicated that the Council needed to:

- Review the process for preparing the budget to ensure all costs and income are more accurately anticipated.
- Develop its approach to medium and longer-term financial planning which takes into account uncertainties around future funding and income and includes scenario planning for a range of options.

Level of reserves

The table below sets out over time the various usable reserves held by the Council, either revenue or capital, with comparison of the revenue reserves against the level of expenditure incurred on services.

Analysis of reserves	2012/13 £000	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000	%age change
Earmarked general fund	15,680	13,448	10,565	10,037	8,451	(45)
Uncommitted general fund	14,117	12,309	8,368	8,562	11,530	(18)
HRA fund	7,631	5,093	5,093	4,781	5,093	(33)
Other funds	7,629	8,940	9,570	9,202	7,351	(4)
Total Usable Revenue Reserves	**45,057**	**39,790**	**33,596**	**32,582**	**32,425**	**(28)**
As a % of net expenditure on cost of services	**12.6%**	**10.9%**	**9.4%**	**9.6%**	**10.1%**	
Capital receipts reserve	4,428	5,055	5,778	6,498	8,031	81
Capital Grants Unapplied Accounts	5,501	4,373	3,869	3,626	1,822	(67)
Total Usable Reserves	**54,986**	**49,218**	**43,243**	**42,706**	**42,278**	**(23)**

The Council's level of usable revenue reserves as a percentage of net expenditure on cost of services has decreased over the last five years. While the overall level of usable revenue reserves has reduced by 28%, the reduction in Council expenditure over the same period has meant that the available reserves still represent approximately 10% of net annual expenditure on services.

The Council has maintained an uncommitted general fund balance in line with its reserves strategy. However, as noted earlier £3.3 million of the closing balance as at 31 March 2017 was committed as part of the 2017/18 budget. This has happened on a number of occasions in recent years and while in 2016/17, underspends on budget meant that the draw on reserves was not required, there is a risk that utilisation of these reserves will in future restrict the Councils flexibility.

Action plan point - 7

Forward financial planning

The Accounts Commission has stressed the need for long-term financial strategies, supported by medium-term financial planning, to provide councils with the ability to respond to the acknowledged demographic and fiscal pressures.

The Council introduced a three year budget framework in February 2015 covering 2015/16 to 2017/18, however, the subsequent budget approvals in February 2016 and February 2017 reverted to one year budget setting. The reason provided for this was due to late adjustments and uncertainty in the Local Government settlement figures.

While the 2017/18 budget setting approved only a one-year budget, the budget paper built on other reports provided to Council during 2016/17 outlining the need for medium-term financial planning in the face of the likely financial challenges facing the Council.

In June 2017, the Chief Finance Officer presented an updated outline medium-term financial paper (MTFP) to Council. It was noted that this represented the first part of the strategy, in quantifying the financial position and impact of demographic changes on the Council.

Forecast budget gaps	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m	Total £m
2017/18 budget setting	18.0	18.0	16.0	15.0	-	67.0
June 2017 update	22.4	16.4	15.8	11.1	11.8	77.5

The main change in the forecasts from the budget paper to the updated June 2017 paper was the increased budget gap for 2018/19, which arose primarily as a result of the decision by members to apply the additional £3.3 million of non-recurring spend into the 2017/18 budget.

A further year was also added to the proposals to provide a five-year overview.

Scenario planning

The MTFP outlined a range of base assumptions on which the strategy was based, along with a pessimistic and optimistic scenario plan around this. Certain key assumptions were:

- Pay award: Base 1.8%; optimistic 1.0%, pessimistic 3.0%
- Aggregate External Funding: Base (3.25%); optimistic 0.0%, pessimistic (4.9%)
- Council Tax: Base 3%; optimistic 3%, pessimistic 0%

The totality of key assumptions has a major impact on the forecast. A wholly pessimistic assumption would increase the 2018/19 gap to £34 million, while the optimistic extreme would be £10.5 million. In reality members were advised that the actual range would be narrower as not all assumptions would be outliers.

Closing the gap

The Corporate Management Team has been working through savings proposals to meet the forecast budget gaps. A Cross Party Budget Working Group was established in October 2015 and supported the preparation of budgets for both 2016/17 and also in 2017/18. Senior officers advised that this process worked well during 2016 in the lead up to the 2017/18 budget approval, as it was anticipated that there would be difficult decisions to be made in balancing the budget.

Following the May elections in 2017, the Cross Party Budget Working Group was reformed with total representation of six members, with equal representation of two from each of the main political parties. At the time of preparing our report, the Group has met once and is due to meet again in September and October in discussion proposals for consultation and engagement with the public in advance of budget approval.

The budget proposals will follow the approval of the Council's new Corporate Plan, which is also currently in development for approval in October 2017.

Action plan point - 8

Long-term capital programme

While only one-year revenue budgets have been approved in recent years, the Council has maintained approval of three year budgets for both general and housing capital investment.

General capital programme 2017/18 to 2019/20

The plan commits £87 million of investment over three years. The majority of the funding for the programme comes from Scottish Government grants, with £21.8 million of borrowing linked to the tax incremental financing scheme anticipated.

Key projects include the completion of the new high school during 2018/19 and ongoing works in relation to the long-term Grangemouth flood prevention scheme.

Housing capital programme 2017/18 to 2019/20

The Council is required to ensure its housing stock meets the Scottish Housing Quality Standard (SHQS). In accordance with the interpretation of the SHQS criteria, as at 31 March 2016 91% of the Council's properties met the SHQS. The remaining 9% is due to either abeyances or exemptions. The rolling three-year investment programme has been designed to improve the remaining properties while also ensuring the stock maintains the required standard. The impact of the Scottish Government's new Energy Efficiency Standard for Social Housing has been considered as part of identifying priority work within the Housing Investment Programme. Currently, the Council estimates that 79% of stock meets the new requirements, with the first milestone targets for compliance due at 31 December 2020.

Total investment of £104 million is phased over three years, split between housing improvement works and new build housing. The Council has set-aside £6 million per annum for property buy-backs to support making properties available to those requiring housing, while the new build programme is still in progress.

£64 million of the programme will be funded by new prudential borrowing, and a further £24.5 million capital funded from revenue. This is due to be supported by increased rental income through the housing revenue account.

Overall borrowing levels

The Accounts Commission's 2015/16 financial overview report provided comparison levels of borrowing across councils. This shows that, at seventh lowest, the Council has a relatively low level of overall borrowing compared to other local authorities in Scotland, although in terms of affordability of that debt it rises to 14th highest in terms of percentage of revenue income used to service debt, at approximately 12%.

We have concluded that while the Council's overall debt levels are not comparatively high, it remains important that the affordability of this debt continues to be monitored closely.

Action plan point - 9

Other long-term liabilities

Retirement benefits

We reported earlier on the significant increase in the liability assessed at the balance sheet in respect of the Council's obligations for pensions. Individual council obligations, and their corresponding affordability, reflects on a number of factors:

- performance of the pension funds of which they are members
- assumptions made by actuaries of the various funds
- the maturity of the council's membership (average age of pension scheme members)
- decisions made by councils to award discretionary benefits to staff retiring early.

In the Accounts Commission's 2015/16 financial overview report, the Council had the seventh highest ratio of pension liability to net revenue, at approximately 80%.

This ratio has increased substantially to closer to 130%. While similar movements will have affected all councils, the Council has one of the highest pension liability ratio in Scotland. The finalisation of the 2017 triennial valuation of the Falkirk Pension Fund will determine the impact on the Council's future pension contributions.

Action plan point - 10

PPP liabilities

The Council has two PPP contracts for schools. Class 98 commenced in August 2000 and is due to terminate in July 2026 and Falkirk Schools gateway, where payments commenced in January 2009, are due for termination in March 2040.

The outstanding finance lease repayment liability on these contracts totals £114.2 million at 31 March 2017. In line with other long-term leasing obligations, the Council also makes annual payments in respect of interest, lifecycle capital costs and operating costs.

Integration of Health and Social Care

The Public Bodies (Joint Working) (Scotland) Act 2014 established the legal framework for integrating health and social care in Scotland. The Falkirk Integration Joint Board (the FIJB) was legally established on 3 October 2015 and from 1 April 2016 took on the relevant functions and resources delegated to it from both the Council and NHS Forth Valley.

The Council committed £61.26 million of expenditure to the FIJB in 2016/17 and received direction from the FIJB in respect of use of these resources in the year. An underspend of £0.585 million was reported in the areas directed to the Council and so the FIJB has retained these resources for use in future years.

In the 2017/18 budget, the Council approved resource of £60.35 million to the FIJB.

Financial sustainability – what have we concluded?

- We have concluded that the Council's financial position as at 31 March 2017 is satisfactory. While they have maintained a number of reserves within the target range, the overall financial position of the Council has weakened significantly due to an increase in pension liabilities.
- Only a one-year budget was approved for 2017/18, although information on longer-term budget gaps was provided to members as part of the budget setting process. These have been updated and formulated into a medium term financial plan. The analysis makes it clear that the Council has to clearly identify its priorities as well as transform the way the Council operates and delivers its services.

2.4 Governance & transparency

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.

Governance arrangements

In accordance with the Code, we have reviewed the Council's overall governance arrangements. In line with responsibilities of the Council, this has considered the Council's arrangements as they relate to standards of conduct including for the prevention and detection of fraud and error.

Area of audit focus

We set out in our annual audit plan that governance and transparency was a key audit focus area. This took into consideration the Accounts Commission Best Value follow-up report recommendations which indicated that the Council needed to:

- Identify and clearly communicate its strategic priorities and ensure that all activity is aligned with these priorities.
- Ensure that workforce reductions are informed by detailed workforce plans and that budgets reflect any planned workforce changes.

Council

During 2016/17, the Council was led by a Labour – Conservative coalition. Following the May 2017 elections, which returned 12 Scottish National Party, nine Scottish Labour Party, seven Scottish Conservative and two non-aligned members of Council, the SNP formed a minority administration.

The full Council of 30 Members meets approximately eight times a year, with most of the Council's important decisions and policies made by the Council Executive or the Education Executive. Policy Development Panels may be established by the Executive to consider any policy areas, but with no decision making powers and non-committee status.

The Council has a set of Standing Orders which regulate the way it goes about its business, including the membership, powers and responsibilities for full council, all its committees, policy development panels and scrutiny panels. The Financial Regulations contain the Council's arrangements for the proper administration of its financial affairs.

In line with good practice, all documents are kept up to date to reflect any external or internal changes.

Following the elections, a series of induction training events were held. From discussion with senior officers, we understand that it is the intention to progress individual training plans for all members.

Focus on audit committee arrangements

The Council's audit committee supports the Council in its responsibilities for risk management, governance and control. The remit covers all aspects relating to internal and external audit, risk management, governance as well as consideration of the annual financial statements and recommendation for their approval.

The membership of the audit committee is seven, of which six are members of the Council with one lay member who is appointed as convenor of the meeting. This provides a mechanism for independence and insight for the committee.

The remit of the committee is quite extensive, although a number of items are cyclical. Senior officers asked us to support in an audit committee induction session in advance of the first meeting following the May 2017 elections. Internal audit and finance also provided input for the induction.

As part of managing the remit and business of the committee, introduction of a work plan mapped against the committee business will support the effectiveness of the committee.

Action plan point – 11

Focus on scrutiny arrangements

Scrutiny committee

Since 2015 the Council has operated two scrutiny committees, one for internal service delivery and the Scrutiny Committee (External) with a remit which specifically covers Following the Public Pound, and matters relating to other arms-length bodies or partners as appropriate. The composition of both committees is such that there is equal membership drawn from the administration and non-administration groupings, but with the Standing Orders providing that no member on the Council Executive can also sit on the Scrutiny Committees. Furthermore, the convenor of the committee will be from the largest opposition group.

In our judgement this provides a good basis for independent scrutiny of performance within the Council. The 2016 Best Value follow-up report noted that these revised scrutiny arrangements had improved the level of discussion, scrutiny and challenge taking place.

Due to the timing of the local elections and the establishment of the new committee, a scrutiny plan for 2017/18 was only approved in August 2017. This also confirmed the continuation of the performance panel as a standing scrutiny panel of the committee.

Focus on internal audit

The Council has an in-house internal audit function which is designed to provide members and management of the Council with independent assurance on risk management, internal control and corporate governance processes. As part of our first year audit appointment, we have considered various aspects of internal audit's performance with relevance to their compliance with Public Sector Internal Audit Standards (PSAIS).

Internal audit undertook their own self-assessment against PSIAS and advised the Audit Committee that an independent assessment would be performed in 2017/18 by South Ayrshire Council's Audit Services Manager.

Internal Audit provide reporting against key performance indicators. These provide a broad range of performance indicators through which the audit committee can assess the performance of the function, including:

- Completion of agreed audits.
- Acceptance of recommendations.
- Percentage of time on direct audit work.
- Issuance of draft reports within 3 weeks of completion of fieldwork.
- Completion of audits in budget.

In setting the internal audit plan for the year, however, we consider that there is scope for further enhancement of the reporting to members of the committee, including for example details of the linkage between assignments and the corporate risk register, an indicative number of days planned for individual assignments and the prioritisation of assignments in the audit plan. Further, when reporting on individual reviews, internal audit do not currently provide grading of recommendations.

Action plan point - 12

The 2017/18 internal audit plan set out that a joint working arrangement with Clackmannanshire Council was being entered into on the basis of a 12 month pilot. It was recognised that such an arrangement could bring benefit to both councils, but at the same time there are risks inherent in such an arrangement. In particular the days available for the 2017/18 audit plan have been reduced compared to the prior year.

It is important that both officers and members of the committee review the joint working arrangements to ensure that overall, the benefits to the Council outweigh any risk faced.

Action plan point - 13

Focus on Corporate Plan and Council of the Future
Development of the Corporate Plan

A revised Strategic Outcomes and Delivery Plan (SOLD) covering the period 2016-2020 was agreed by the Community Planning Leadership Board in June 2016. This provides the context for development of the Council's new Corporate Plan which requires refresh in 2017. Following the recommendations in the Best Value follow-up report, the Council entered into a process in early 2017 to prepare for the launch of the new Corporate Plan following the May elections.

The Corporate Plan has been prepared in the context of the overall financial environment, preparing a vision for what the Council is going to be in five years, and what it aims to deliver over 5 years. The underpinning assumption is that potentially the Council will have up to one quarter less resources and so the Council needs to develop a vision that establishes its priorities within the SOLD.

Supporting the Corporate Plan will be three Service Plans, which will be designed to flow directly from the overall vision while setting out the more specific detail of priorities and deliverables at a service level. Key strategies also in development are:

- Medium term financial strategy
- Workforce strategy
- Digital / technology strategy
- Locality planning, including co-production on service design, empowerment of communities, asset management within localities and place shaping.

Members were briefed on the development of the Corporate Plan during the summer of 2017, and the document was considered by Council on 20 September 2017. The Council's priorities within the plan have been identified as People; Place; Partnership.

Council of the Future

The Council of the Future (COTF) was approved by the Council in December 2016, recognising a need to put in a place a new framework of change for the Council. A COTF Board was established to replace the existing Business Transformation Board, initially with membership comprising chief officers, the Leader of the Council and the Leader of the Opposition. Subsequent to the election, elected members have proposed that two members from each of the three main political groupings will sit on the Board.

A Programme Management Office was established centrally to support with the change programme, and the Council recruited in on a seconded position to support this structure.

In January 2017, the Council entered what it classed as Phase 1 – Readiness and Engagement of COTF, having previously identified the need for change and received approval for the overall programme. This engagement covered sessions with 380 people across chief officer, member, head-teachers, trades unions, service unit managers and staff.

Four common themes arose from these sessions and have been used to frame the programme.

Phase 1 is now considered to be complete. It is clear from speaking with members and officers that the vision has been articulated and there is a clear coherence to the main themes of COTF. This has the potential to drive improvement.

ONE COUNCIL	**ENABLED & EMPOWERED COMMUNITIES**
DATA	**MODERN & DIGITAL**

In order to drive the programme of change which is necessary, however, strong project management is required, with clear milestones for delivery of each stage of the multi-year projects identified.

Action plan point - 14

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. The Council's financial regulations contain a specific section on following the public pound. These emphasise that services must adhere to the Council's 'Funding at Falkirk' guidance for allocating funds to external organisations. The guidance applies where funding is provided, or transferred, to arms-length bodies such as companies, trusts and voluntary organisations. The Scrutiny Committee (External) provides a specific avenue for scrutiny of external and arms-length bodies which partner with the Council.

We noted that in its dealing with its subsidiary company, Falkirk Community Stadium Ltd (FCSL), Council officers also act as directors of the company. The Accounts Commission's *How councils work: Arm's-length external organisations (ALEOs): are you getting it right?* 2011 report highlights the risk of potential conflict of interests to arise in such situations. This risk could be heightened where officers are involved in either key decision-making posts or finance positions. We consider that there is scope for the Council to review its overall governance relationship with FCSL.

Action plan point - 15

Notwithstanding that one specific matter, we concluded overall that the Council has appropriate arrangements for ensuring compliance with the Code of Guidance on funding external bodies and following the public pound.

Fraud and irregularity

In line with our responsibilities under the Code, we have considered the Council's high level arrangements as they relate to the prevention and detection of fraud and error. Overall we consider the Council's arrangements to be appropriate.

National Fraud Initiative

The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. These exercises are undertaken every two years as part of the statutory audit of the participating bodies. Local authorities were required to submit datasets in autumn 2016 and matches for investigation and follow-up were released early in 2017.

We completed the NFI return provided by Audit Scotland through a balance of inquiries with the responsible officer, which for the Council is the internal audit manager, review of key documents and inspection of the Council's NFI account to understand progress in reviewing identified matches.

Overall we consider there was potential for the Council to demonstrate a greater emphasis on use of the NFI as a core element of its arrangements in relation to fraud and irregularity. In discussion with the NFI key contact, at the time our work was completed, the Council had not made significant progress in reviewing matches on the system. While we have been advised that a plan is in place, we recommend that management review their approach and provide the audit committee with the appropriate oversight of this both in advance, and through the exercise.

Action plan point - 16

Standards of conduct

Through consideration of the Council's financial regulations, standing orders and scheme of administration, supplemented by consideration of the Code of Conduct for elected members, we are satisfied that the Council has established appropriate arrangements.

Annual Governance Statement (AGS)

The AGS sets out the Council's governance framework. The Council supports its arrangements through its local code of corporate governance, and assessments are undertaken regularly of compliance against this. Other core support for the AGS is through the system of compliance statements which are obtained from key individuals in the Council's management team, relating to their areas of responsibility.

The annual report from the Internal Audit Manager is further source of support for the AGS. This report concluded "*On the basis of work undertaken, Internal Audit can provide substantial assurance in relation to the Council's arrangements for risk management, governance, and control for the year to 31 March 2017.*"

Governance and transparency – what have we concluded?

- The Council has now established a comprehensive framework of governance arrangements which provides a clear commitment to the core principles of independent scrutiny. Internal audit is well respected, however, we have made recommendations for consideration to enhance the arrangements.
- The Council is in the process of agreeing its new Corporate Plan and supporting enabling strategies. While these are being finalised, there is a need to establish clear milestones to demonstrate the timelines for delivery of multi-year projects, to enhance accountability and enable the required pace of change.

Value for money is concerned with using resources effectively and continually improving services. This includes consideration of whether resources are being used effectively; services are improving and the Council has appropriate arrangements to demonstrate Best Value.

Performance and improvement

Framework for improvement

The Council uses the Covalent performance management software as their central performance management system. Covalent supports management and reporting of performance and includes functionality for setting and reviewing targets and thresholds to trigger intervention or action from the service.

Under the new corporate planning framework, service plans are clearly aligned to the SOLD and Corporate Plan priorities. This enables the service to set-out how it will play its role in the achievement of priorities. The service plans set out recent performance assessment according to key indicators identified for that service. In addition target performance for 2017/18 is included. Driving performance improvement over the five year period of the Corporate Plan requires clear targets to be set for that period, against which services can set out how they will work towards achieving those targets over time.

Action plan point - 17

Statutory performance indicators

The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils to provide citizens with fair, balanced and engaging performance information reporting. The 2015 Direction set out a streamlined and more flexible set of performance information for the 2016/17 financial year that the Commission required councils to collect and report in public. Councils are required to publish the required information from the financial year ended 31 March 2017 each year through to the financial year ending 31 March 2019, according to the schedule below. The schedule within the 2015 Direction sets out the required information as:

Achievement of Best Value

SP 1: Each council will report a range of information setting out its performance in:

- improving local public services (including with partners)
- improving local outcomes (including with partners)
- engaging with communities and service users, and responding to their views and concerns
- achieving Best Value, including its use of performance benchmarking; options appraisal; and use of resources

Local Government Benchmarking Framework

SP 2: Each council will report its performance in accordance with the requirements of the Local Government Benchmarking Framework (LGBF)

Council performance in the LGBF

The Council reports annually to its Scrutiny Committee on comparative performance through the LGBF. The most recent report covered the 2015/16 performance year. Of the 80 indicators published, over the period from 2010/11 to 2015/16, the Council's performance improved in 38 indicators (47.5%), but decreased in 25 (31%).

In terms of relative performance, analysis by the Council of its performance in 2015/16 showed that its service indicator performance was above the national Scottish average in 57.5% of all indicators, with 38.8% performing below average. 20% of indicators were performing in the top quartile, while 12.5% were in the bottom quartile.

Audit Scotland national reports

Each year Audit Scotland produces a number of national performance audit reports. The Council has a clearly defined process for dealing with all such reports to ensure they are dealt with effectively. The Audit Committee is provided with a summary report providing an overview of this process. Key reports considered in the year included:

- Principles for a digital future – Scrutiny Committee
- Local Government in Scotland: Performance and challenges 2017 – provided to members as part of induction
- Local Government in Scotland: Financial overview 2015/16 – Council Executive
- How Councils work - Roles and working relationships in Councils: are you still getting it right? – circulated to members and included in induction materials
- Social work in Scotland – Audit Committee
- Maintaining Roads – Scrutiny Committee
- The National Fraud Initiative in Scotland – Audit Committee
- Changing models of Health & Social Care – reported through the IJB

We consider that this is an appropriate and effective arrangement for ensuring that members are provided with relevant information affecting the Council.

Procurement

During 2016/17, and as a result of the Procurement Reform (Scotland) Act and the Public Contracts (Scotland) Regulations 2015, the Council had a procurement assessment undertaken in accordance with the new assessment regime introduced as part of the new Procurement and Commercial Improvement Programme (PCIP).

The Council was assessed as being in the top band, of which there are twelve with a score of 70. The Scrutiny Committee has obtained reports from officers outlining the Council's approach to procurement under the new requirements. This demonstrates that the Council is committed to good practice in procurement.

Value for money – what have we concluded?

- The Council is in transition in setting out its new Corporate Plan and the underlying service plans and targeted priorities. In order to be able to demonstrate the commitment to continuous improvement, it is important that appropriate measures and targets are in place to assess performance over the five year period of the Corporate Plan.
- LGBF data shows that the Council performs reasonably well compared to the national average in a number of areas. There has been an improvement in performance generally over time.

3. Other audit deliverables

3. Other audit deliverables

Under the terms of our appointment, we provide other assurance activities such as the certification of certain grant claims and the Council's Whole of Government Accounts return, as well as information returns to Audit Scotland.

Other audit deliverables			
Aspect of work	**What we did and what we found**	**Expected completion / submission date**	**Completed / submitted on time**
Annual Audit Plan	Reported to audit committee on 13 March 2017.	31 March 2017	Yes
Audit Scotland Fraud Return submission	We submitted fraud returns summarising any reporting to audit committee during the year.	26 May 2017	Yes
Submit NFI return to Audit Scotland	Reviewed the Council's arrangements and completed an information return – see conclusion elsewhere in this report	30 June 2017	No – submitted July 2017 due to EY staff illness
Submit Audit Scotland EU Funding questionnaire return	The purpose of this questionnaire was to support the development of an understanding of Scotland's reliance on EU structural funding arrangements and in particular the extent to which public bodies have been preparing themselves for the consequences of not having access to EU funds in the future. We identified that the Council received £0.5 million of EU funds during 2016/17, with total funding due to 2018 of approximately £2.4 million.	30 June 2017	Yes
Submit certified Education Maintenance Allowance return	We have audited the Council's EMA return in line with the guidance set out by Audit Scotland with no matters or exceptions to report.	31 July 2017	Yes
Submit certified Criminal Justice Social Work claim	Audit work has been undertaken with no significant findings arising.	29 September 2017	On target
Whole of Government Accounts assurance statement to NAO	Audit work will be undertaken on updated WGA pack, following audit adjustments made to the financial statements.	29 September 2017	On target
Certify Annual Accounts and submit Annual Audit Report	Pending formal approval of the financial statements	30 September 2017	On target
Submit Best Value Data Return to Audit Scotland	Audit Scotland return summarising our work in respect of the wider scope audit.	2 October 2017	N/A
Submit certified Non-Domestic Rates return	Audit work has been undertaken with no significant findings arising.	6 October 2017	On target
Submit certified Housing benefit subsidies claim to DWP	Work is in progress and we will discuss findings with the relevant officers prior to submission of our certification report.	30 November 2017	On target

Appendices

A – The Council’s responsibilities

B – Required communications with the audit committee

C – Auditor independence

D – Accounting and regulatory update

E – Summary of audit differences

F – Action plan

A. The Council's responsibilities

The Code of Audit Practice (the Code) summarises the responsibilities on all audited bodies falling within the public sector audit framework. We summarise these on this page.

Responsibilities of audited bodies	
Corporate governance	Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.
Financial statements and related reports	Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: • preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation. • maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures. • ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority. • maintaining proper accounting records. • preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body. Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.
Standards of conduct / prevention and detection of fraud and error	Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Financial position	Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: • such financial monitoring and reporting arrangements as may be specified • compliance with any statutory financial requirements and achievement of financial targets • balances and reserves, including strategies about levels and their future use • how they plan to deal with uncertainty in the medium and longer term • the impact of planned future policies and foreseeable developments on their financial position.
Best Value	Local authority bodies have a statutory duty, under the Local Government (Scotland) Act 1973 and associated statutory guidance, to make arrangements to secure best value through the continuous improvement in the performance of their functions. Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

There are certain additional communications that we must provide to the Audit Committee, in accordance with ISA 260 and other auditing standards. These are set out below.

Required communication - what is reported?	Our reporting to you
Terms of engagement Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice
Planning and audit approach Communication of the planned scope and timing of the audit, including any limitations.	Annual Audit Plan – 13 March 2017
Significant findings from the audit • Our view of the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures • Any significant difficulties encountered during the audit • Any significant matters arising from the audit that were discussed with management • Written representations we have requested • Expected modifications to the audit report • Any other matters significant to overseeing the financial reporting process • Findings and issues around the opening balance on initial audits	This Annual Audit Report We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements.
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: • Whether the events or conditions constitute a material uncertainty • Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements • The adequacy of related disclosures in the financial statements	No conditions or events were identified, either individually or together to raise any doubt about the Council's ability to continue for the 12 months from the date of our report.
Misstatements • Uncorrected misstatements and their effect on our audit opinion • The effect of uncorrected misstatements related to prior periods • A request that any uncorrected misstatement be corrected • Significant corrected misstatements, in writing	This Annual Audit Report
Fraud • Asking the Audit Committee whether they have knowledge of any actual, suspected or alleged fraud affecting the Council • Unless all those charged with governance are involved in managing the entity, any fraud identified or information obtained indicating that a fraud may exist involving: (a) management; (b) employees with significant roles in internal control; or (c) others where the fraud results in a material misstatement in the financial statements. ► A discussion of any other matters related to fraud, relevant to Audit Committee responsibility.	This Annual Audit Report

Required communication - What is reported?	Our reporting to you
Significant deficiencies in internal controls identified during the audit • Significant deficiencies in internal controls identified during the audit.	This Annual Audit Report
Related parties Significant matters arising during the audit in connection with the Council's related parties including, where applicable: • Non-disclosure by management • Inappropriate authorisation and approval of transactions • Disagreement over disclosures • Non-compliance with laws and/or regulations • Difficulty in identifying the party that ultimately controls the entity	We have no matters to report.
Subsequent events • Where appropriate, asking the Audit Committee whether any subsequent events have occurred that might affect the financial statements.	We have asked management and those charged with governance. We have no matters to report.
Other information • Where material inconsistencies are identified in other information included in the document containing the financial statements, but management refuses to make the revision.	We have no matters to report.
External confirmations • Management's refusal for us to request confirmations • We were unable to obtain relevant and reliable audit evidence from other procedures.	We have received all requested confirmations.
Consideration of laws and / or regulations • Audit findings of non-compliance where it is material and believed to be intentional. This communication is subject to compliance with legislation on "tipping off" • Asking the Audit Committee about possible instances of non-compliance with laws and/or regulations that may have a material effect on the financial statements, and known to the Audit Committee.	We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.
Group Audits • An overview of the type of work to be performed on the financial information of the components • An overview of the group audit team's planned involvement in the component auditor's work on the financial information of significant components • Instances where the group audit team's evaluation of a component auditor's work of gave rise to a concern about its quality. Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted • Fraud or suspected fraud involving group or component management, employees with significant roles in group-wide controls, or others where the fraud resulted in a material misstatement of the group financial statements.	Annual Audit Plan – 13 March 2017 This Annual Audit Report
Independence • Communication of all significant facts and matters that have a bearing on EY's objectivity and independence.	This Annual Audit Report – Appendix C

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the Council.

What we are required to communicate

Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as:

- The principal threats.
- Safeguards adopted and their effectiveness.
- An overall assessment of threats and safeguards.
- Information on the firm's general policies and processes for maintaining objectivity and independence.
- Communications whenever significant judgments are made about threats to objectivity or independence and the appropriateness of safeguards.

Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated 13 March 2017.

We complied with the APB Ethical Standards and the requirements of Audit Scotland's Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your audit committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the audit committee on 25 September 2017.

Summary of fees

As part of our reporting on our independence, we set out below a summary of the fees initially agreed for the year ended 31 March 2017.

As reported in our Annual Audit Plan, we had provided £5,000 of non-audit services in respect of advice on the tax incremental financing scheme.

Additional auditor remuneration of £13,635 was agreed with management in March in respect of work for the year, plus £550 fee for the Falkirk Temperance Trust.

Auditor remuneration per Audit Scotland	£181,800
Audit Scotland central costs	£124,800
Total fee per Annual Audit Plan	**£306,600**
Additional auditor remuneration agreed	£14,185
Total audit fees	**£320,785**
Non-audit services	£5,000

There are a number of new accounting standards and interpretations which will impact on the local authority accounting code of practice in the next two or three years. The following table provides a high level summary of those that have the potential to have the most significant impact on you.

Area	Summary	Potential impact
IFRS 9 – Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year. This new standard will change: ► How financial assets are classified and measured ► How the impairment of financial assets are calculated ► Financial hedge accounting ► The disclosure requirements for financial assets. Transitional arrangements are included within the accounting standard, however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be and whether any accounting statutory overrides will be introduced to mitigate any impact.	Although some initial thoughts on the approach to adopting IFRS 9 have been issued by CIPFA, until the Code is issued and any statutory overrides are confirmed there remains uncertainty. The Council will, however, have to: ► Reclassify existing financial instrument assets ► Remeasure and recalculate potential impairments of those assets; and ► Prepare additional disclosure notes for material items
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ► Leases; ► Financial instruments; ► Insurance contracts; and ► for local authorities, Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. There are transitional arrangements within the standard, however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be.	Again CIPFA have issued initial thoughts on the approach to adopting IFRS 15, although uncertainty remains until the Code is issued. For all material income sources from customers the Council will have to: ► Disaggregate revenue into appropriate categories ► Identify relevant performance obligations and allocate income to each ► Summarise significant judgements
IFRS 16 Leases	IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard, IAS 17, for local authorities who lease in a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard, although as the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be or whether any statutory overrides will be introduced.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented.

E. Summary of Audit Differences

There were a number of significant adjustments processed to the unaudited financial statements as a result of our audit work. The impact of these is summarised below.

Summary of audit differences – prior year adjustments			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease**	**Balance sheet (Decrease) / Increase**
1	**Adjustment in respect of non-enhancing capital expenditure previously charged to revaluation reserve**		
	Net cost of services – CIES	£4.4 million	
	Revaluation reserve		£(4.4) million
	Movement in reserves adjustment	£(4.4) million	
	Capital adjustment account		£4.4 million
Summary of audit differences – current year adjustments			
2	**Adjustment in respect of non-enhancing capital expenditure charged to revaluation reserve**		
	Net cost of services – CIES	£5.9 million	
	Revaluation reserve		£(5.9) million
	Movement in reserves adjustment	£(5.9) million	
	Capital adjustment account		£5.9 million
3	**Increase to provisions**		
	Net cost of services	£1.8 million	
	Provisions		£1.8 million

There were a number of significant adjustments processed to the unaudited financial statements as a result of our audit work. One difference remains unadjusted as set out below.

Summary of audit differences – unadjusted differences			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease**	**Balance sheet (Decrease) / Increase**
1	**Disposal of property, plant and equipment assets incorrectly accounted for as fixed assets in prior periods (correction of accounting records, but an unadjusted difference in the current reporting period)**		
	Non-current assets – brought forward		£(0.7) million
	Loss on disposal of non-current asset	£0.7 million	

F. Action Plan

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report. We have graded these findings according to our consideration of their priority for the Council or management to action.

Classification of recommendations			
Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.		**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.
No.	**Findings and / or risk**	**Recommendation / grading**	**Management response / Implementation timeframe**
1	**Financial reporting process** We experienced delays in obtaining key audit evidence, including in particular payroll data to support our audit work in this area. In addition, we have raised a number of suggestions on the format and structure of the financial statements which we believe would help the clarity of presentation.	We will work with finance in a debrief of the financial reporting and audit process to ensure that there are no similar delays and inefficiencies in future years. Management should review the presentation of the financial statements to support their streamlining and simplification. *Grade 2*	Given this is EY's first year of auditing the Council's accounts there was inevitably going to be a few issues in terms of understanding and meeting expectations on both sides. As part of our normal debrief of the final accounts process in October/November we will reflect on the overall audit process and requirements and we will consider what improvements can be made going forward. We are always looking to simplify and streamline the annual accounts where possible and will take on board any suggestions and advice provided. Timeframe - March 2018
2	**Review of provisions** Audit adjustments arose in respect of liabilities not properly accounted for at the year end.	During the financial statements preparation process, all potential liabilities should be assessed and fully provided for. *Grade 2*	As the report notes we were aware of the potential liability but perhaps focused on ensuring there were adequate resources rather than the actual presentation in the final accounts. There was also still a degree of uncertainty surrounding the costs that was removed after the accounts were drafted. Timeframe – March 2018
3	**PPE Valuations** The Code of Practice on Local Authority Accounting requires that the Council carries assets on the balance sheet at fair value. While the Council considers material changes in asset valuations through consideration of significant capital additions in the year as well as discussions with in-house valuers around potential asset impairments, this process does not necessarily take account of movements in market prices underpinning valuations.	Management requires to consider and agree an appropriate process to ensure that valuations at 31 March each year are not materially different than fair value. This will required consideration of the impact of market movements on carrying values. *Grade 1*	All assets are valued as part of a 5 year Rolling Programme. In addition any significant impairment is adjusted for outwith the 5 year period. The Council does not believe that there is a material movement in the market prices underpinning valuations. However, the Capital Manager will liaise with the Council's Asset Management section throughout the financial year to seek assurances that there is no material market movement in the carrying values of the assets. The Council's Asset Management Section may have to liaise with professional valuers but the Council will have to have regard to any cost implications of such an exercise. Timeframe – Ongoing

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
4	**Group financial statements** In requesting supporting documentation for the consolidation spreadsheets, as well as the carrying value of the Council's investment in Falkirk Community Stadium Limited, the information provided in respect was inconsistent with that contained in the subsidiary company financial statements. In particular, the subsidiary financial statements still showed the existence of a loan payable to the Council, which we were advised that from the Council's side, this loan was no longer payable and had been cancelled.	A review of the arrangements between the Council and the subsidiary company should be completed in order to confirm the legal position in respect of loans and security over assets. This will enable a consistent accounting treatment to be in place for both parent and subsidiary. *Grade 2*	Review of the treatment of the loans within FCSL's accounts is currently being actioned. Timeframe - March 2018
5	**Management commentary** Amendments were required to the management commentary to ensure it complied with the statutory guidance.	Management should ensure that key financial and non-financial performance indicators are considered for inclusion in the management commentary in 2017/18. *Grade 3*	The review of the Management Commentary will be considered in line with Recommendation 1 above. Timeframe - March 2018
6	**Capacity of finance** Following the loss of a number of experienced finance staff during the year, the Council has a current vacancy for the depute for the Chief Finance Officer. Given the financial challenges facing the Council, there is a risk that finance has insufficient capacity to support service transformation.	We understand that filling the finance vacancy remains a priority for senior officers and recommend that this is kept under review to ensure that this situation does not exist for longer than necessary. *Grade 2*	The capacity within Corporate Finance has significantly reduced over the last few years with a c40% reduction in staff numbers. This will inevitably bring challenges in managing workload and expectations. The overall staffing arrangements will be kept under review. Timeframe – Ongoing
7	**Commitment of reserves** While the 2016/17 budget outturn did not require the draw on reserves originally approved in the budget, the 2017/18 saw a further approval of £3.3 million reserves to use to provide non-recurring service expenditure. While the Council has maintained the level of uncommitted reserves in line with target, there is a risk that these are applied and utilised, leaving the Council exposed financially.	Reserves provide the Council with flexibility to invest in transforming and improving service delivery for its communities. Any use of these reserves however should only be applied in such a way as to ensure that future savings are clearly identifiable and that there is a short timescale over which the applied reserves will be recovered in full. *Grade 1*	Members are continually reminded of the Council's reserve position within ongoing financial monitoring and budget reports and are given cautionary and prudent advice in respect of using reserves to achieve a balanced budget. A report to the Council in June noted that using reserves to support services in the short term is not sustainable unless they are used to support service transformation and generate future savings Timeframe – Ongoing

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
8	**Approval of budgets** Good financial planning requires approval of multi-year budgets to ensure that savings for future years are already identified and in place well in advance of the start of the financial year.	The Member Budget Working Group provides a forum for building consensus on the budget in advance. We recommend that this is focussed on the principle of delivery on the Council's priorities from the bottom up, costing those priorities so that the budget process is aligned to the newly launched Corporate Plan. *Grade 1*	The report to Council in June noted that instrumental to achieving a balanced budget will be the Council's new five year Corporate Plan which would need to set clear priorities and that this was essential for driving long term planning. A further report to Members in October will give an updated position. Timescale – October 2017
9	**Borrowing levels** The Council has a relatively low level of overall borrowing compared to other local authorities in Scotland, although in terms of affordability of that debt it rises to 14th highest in terms of percentage of revenue income used to service debt, at approximately 12%.	While we have concluded that the Council's overall debt levels are not comparatively high, it remains important that the affordability of this debt continues to be monitored closely. *Grade 2*	The borrowing levels will undoubtedly vary across authorities and will depend on individual capital investment plans, capital receipts, grants and contributions to fund them. A comparison across authorities is therefore misleading. In terms of affordability of debt repayments this is calculated annually as part of the Revenue Budget process and reference to the Prudential Code and Indicators. Scenario planning is an integral part of the budget process. Scenarios look at variances in borrowing levels, repayment periods and current and projected interest rates for the next 5 year period which ties in with the Council's Medium Term Financial Plan. The Capital section works closely with the Council's treasury advisers to determine the best mix of repayment periods (i.e. long term or short term debt), and forecast interest rates, which will ultimately determine the estimated debt repayments and therefore affordability. This key control will continue to be a critical part of the budget process. Timescale – Ongoing
10	**Pension liabilities** The Council has one of the highest pension liabilities compared to net revenue of any local authorities in Scotland. This position significantly worsened at 31 March 2017.	It is recognised that the triennial review of the Pension Fund will determine the Council's future pension contributions. However, the long-term liabilities facing the Council need to be kept under regular review. *Grade 2*	Management will continue to have a close dialogue with the Pension Fund actuary and other advisers in order to understand and manage its pension liabilities effectively, recognising that the high value placed on liabilities currently is pre-dominantly a function of the low interest rate environment. Management notes that the Council has a legal obligation to operate the terms and conditions of the Local Government Pension Scheme and therefore has limited scope to control the costs and risks associated with the Scheme. One tangible area where the Council has been able to take steps in recent years to reduce pension liabilities is through its decision to no longer grant compensatory added years to retiring members. Timescale – Ongoing

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
11	**Audit committee work-plan** The audit committee has an important and extensive remit, with a number of standing items which will arise on a cyclical basis.	In order to assist with the effectiveness of the Committee's business, an annual work-plan indicating how and when it will discharge the elements of its remit will support members in their duties. *Grade 2*	The Terms of Reference agreed by Audit Committee in October 2012 included a 'Core Work Programme' setting out the business to be considered at each meeting. It is agreed that there would be value in reviewing and updating this. Timescale – March 2018
12	**Internal audit recommendations** In reviewing the Internal Audit function, we consider that there is scope for further enhancement of the reporting to members.	The audit plan should consider including linkage between assignments and the corporate risk register, an indicative number of days planned for individual assignments and the prioritisation of assignments in the audit plan. Further, when reporting on individual reviews, internal audit should introduce a grading framework for recommendations. *Grade 2*	The 2017/18 Internal Audit Plan was prepared taking account of the Corporate Risk Register, but it is accepted that this link could be made more explicit. The 2018/19 Plan, which will be presented to Committee in Spring 2018, will more clearly link planned assignments and corporate risks. The Internal Audit Manager will consider the points relating to indicative days for individual assignments and the prioritisation of assignments. The time spent on individual assignments is monitored and measured by the Internal Audit Manager on an ongoing basis, and one of the KPIs used by Internal Audit, and reported to Committee, is "Complete (to issue of final report) 75% of main audits within budget". Committee is, therefore, sighted on the team's performance in this regard. The point in relation to the introduction of a formal grading framework for recommendations is not accepted. For each assignment, Internal Audit provide an overall level of assurance, and for each recommendation Internal Audit agree a formal management response, responsible officer, and implementation date with the relevant Manager. This consultative and inclusive approach ensures that recommendations are addressed in a prioritised and pragmatic way, avoiding unnecessary discussion around the 'grading' rather than the recommendation itself. Timescale – March 2018 (where actions are agreed)
13	**Internal audit joint working** Internal audit has entered into a joint working arrangement with Clackmannanshire Council for 2017/18.	The arrangement should be kept under review to ensure that the benefits to the Council from joint working balance any risks from reduced resource to apply to reviewing the Council's internal control arrangements. *Grade 2*	The JWA with Clackmannanshire Council includes a commitment to undertake a mid-year review to evaluate the success of the pilot, and to intimate future intentions. The outcomes of this evaluation will be included in Internal Audit Progress Reports to Falkirk Council's Audit Committee and Clackmannanshire Council's Audit and Finance Committee. Timescale - November 2017

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
14	**Council of the Future** This is the Council's key transformational programme to underpin the delivery of the Corporate Plan over a period of extremely challenging financial constraints. There is a risk that any failure to deliver multi-year projects on time will lead to significant financial and operational difficulties for the Council.	Strong programme management should be in place around the Council of the Future, to enable for example: ▸ Dashboard reporting of the programme as a whole ▸ Clear deliverable milestones within individual projects ▸ Risk ratings against progress ▸ Timeline of savings / efficiencies expected over 5 years to meet budget gaps *Grade 1*	On 20 September 2017, Falkirk Council will review the Council of the Future Programme of Change. Falkirk Council will be asked to note the progress made with Council of the Future in developing the Council of the Future Vision and will be asked to ultimately approve the Council of the Future Programme of Change. This will include the review and ratification of the programme's timelines, initial phasing of project milestones and soft benefits of the programme. The financial benefits of the programme are tied in with the Council's budget planning process. The budget report will be submitted to the Executive in October and will include the proposed savings associated with the Council of the Future projects. Once the Council of the Future Programme of Change has been approved, the programme risk register will be completed and will be subject to the Council's risk management scrutiny processes. Appropriate project management training and support will also be put in place for those leading/expected to lead projects. All of this will enable full and transparent dashboard reporting of the programme as a whole in line with the Council of the Future governance arrangements. This will also include regular reporting to the Council of the Future Board and quarterly reporting to the Executive. Timescale – Ongoing
15	**Following the public pound** Officers of the Council act as directors of the Falkirk Community Stadium subsidiary company.	Management should review the governance arrangements around the subsidiary company, as where officers are also directors on a subsidiary, there are potential conflicts of interest which can arise. *Grade 1*	The current arrangements where senior officers have been appointed to the Falkirk Community Stadium Company as Directors has been in place since the first company was formed in 2003. Management has considered the arrangements to be appropriate for the Company during this period but will undertake a review in 2017/18 to re-consider and update arrangements as appropriate. Timescale – March 2018

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
16	**National Fraud Initiative** Overall we consider there was potential for the Council to demonstrate a greater emphasis on use of the NFI as a core element of its arrangements in relation to fraud and irregularity. In discussion with the NFI key contact, at the time our work was completed, the Council had not made significant progress in reviewing matches on the system.	While we have been advised that a plan is in place, we recommend that management review their approach and provide the audit committee with the appropriate oversight of this both in advance, and through the exercise. *Grade 2*	The Council's arrangements in relation to NFI are well established, and updates on progress are included within Internal Audit Progress Reports to Audit Committee. The time required to review and follow up on matches means that a pragmatic and evidence based approach is taken. This takes account of the findings arising from previous NFI exercises, with resource focused on those areas which yield material and proportionate results (for example on Council Tax Single Person Discount). In addition, the wider, and growing, role of the Corporate Fraud Team in relation to fraud prevention and detection compliments and builds upon the NFI process, and further strengthens the Council's counter fraud arrangements. The Internal audit Manager will review arrangements for reporting on counter fraud activity to Audit Committee. This will include NFI. Timescale - March 2018.
17	**Performance improvement** To support the service plans in place, while there are a number of performance indicators monitored annually, targets are included only for the one year of the service plan.	To drive continuous and ambitious transformation, longer term targets for key priorities should be set to assist in providing the framework for services to fully challenge how services are delivered, and what the key metrics and indicators are that matter to service users and communities. *Grade 1*	Consideration will be given to developing the performance indicators as the planning process develops. Timescale - Ongoing

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