



# Aberdeen City Council

**Interim management report and audit status summary**

For the year ended 31 March 2017

For audit, risk and scrutiny committee consideration on 22 June 2017

5 June 2017

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# Introduction

## Purpose of document

In line with our audit strategy we have completed an interim audit. Key activities performed were the testing of a selection of system controls and holding discussions with management to update our understanding and our assessment of the key risks and audit focus areas.

This report provides the Audit, Risk and Scrutiny Committee with an update on:

- 1) Significant risks and other focus areas (pages four and five);
- 2) The results of the control testing, encompassing overarching governance and systems controls (pages six to nine).
- 3) Best Value approach for years one and two (page 10).

## Significant risks and other focus areas in relation to the audit of the financial statements as identified in our audit strategy document dated 13 February 2017:

The significant risks identified were:

- fraud risk from management override of controls;
- revenue recognition fraud risk;
- revaluation of property, heritage assets, plant and equipment;
- accounting for the bond issuance;
- retirement benefits; and
- capital expenditure;

The other focus areas identified were:

- presentation of financial statements ‘telling the story’;
- highway network assets readiness; and
- consolidation of integration Joint Board.

Due to a change in requirements, the highway networking assets readiness focus area is no longer relevant.

## Acknowledgements

We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout the audit work.

# Significant risks and other focus areas

## Update: significant risks

We outline below the significant risks and other focus areas included within the audit strategy document, together with an update following the interim audit. We will conclude on these areas in the annual audit report.

Significant risk	Update from strategy
<p><b>Fraud risk from management override of controls</b></p> <p>This is an assumed risk from ISA 240 'the auditor's responsibilities relating to fraud in an audit of financial statements' on which we are required to report.</p>	<p>We performed controls testing over expenditure, bank reconciliations, budget monitoring and journals. The results of the testing are set out on pages seven and eight. We did not identify instances where management override of control had occurred.</p> <p>Substantive procedures will be performed during the year end audit, including testing journal entries throughout the year, assessing accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.</p>
<p><b>Fraud risk from income recognition</b></p> <p>This is an assumed risk from ISA 240. We consider the fraud risk from other income such as charges or service income to be significant.</p> <p>We rebutted the assumed fraud risk in respect of government grants, local taxes and regulated rental income.</p>	<p>Testing over controls are set out on page eight, with no exceptions identified. We discussed sources of other income with officers across different services to develop our understanding of the service income which is received.</p> <p>Substantive procedures will be performed during the year end audit. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details.</p>
<p><b>Revaluation of property, plant and equipment</b></p> <p>In order to comply with the 2016-17 Code and IFRS accounting requirements, Council assets are subject to rolling valuations, with a tranche of other land and buildings being subject to valuation in 2016-17.</p> <p>The Council holds £86 million of investment property, which must be revalued on an annual basis.</p>	<p>We met with the valuations team and discussed the areas being revalued in 2016-17 as well as reviewing the five year rolling programme.</p> <p>As part of our year end audit KPMG's in-house valuer will review the assumptions and valuation methodology used to confirm they are reasonable and in line with Code of Practice on Local Authority Accounting ('the Code'). A sample of revaluations will then be considered in more detail, including the roll forward to 31 March 2017, where all assets need to be held in line with the Code valuation requirement. We will also consider the 31 March 2016 carrying values, as required for our audit of opening balances. We will verify that the revaluation has been correctly disclosed in the accounts and that the accounting entries are correct.</p>
<p><b>Accounting for the bond issuance</b></p> <p>The accounting for the bond issue is complex, involving the calculation of the effective interest rate, which is based on future cash flows and this is the first year the Council is preparing these accounting entries.</p>	<p>We reviewed bond documentation to obtain evidence for the details used in the bond calculations.</p> <p>We will assess the accounting treatment proposed by the finance team during the final audit. We will consider the approach used against accounting standards based on the assumptions presented and provide challenge where appropriate. The disclosure requirements will also be reviewed against the listing rules regulations and guidance.</p>

# Significant risks and other focus areas (continued)

## Update: significant risks (continued)

Significant risk	Update from strategy
<p><b>Retirement benefits</b></p> <p>The Council is a member of the North East Scotland Pension Fund and recognises a defined benefit liability on its balance sheet being £251million as at 31 March 2016. The determination of the net deficit is inherently judgemental given assumptions are used to derive the value.</p>	<p>For our assessment of opening balances, we performed a review of the 2015-16 assumptions provided within the actuaries' report. These are in line with the KPMG acceptable range of assumptions for 2015-16.</p> <p>Our controls testing over the transfer of pension data to the pension administrators is set out on page eight, with no exceptions noted. The remaining procedures will be performed during the year end audit. Prior to the field work beginning in June, we will request the agreed assumptions for 2016-17 from management to facilitate consideration and benchmarking by our internal actuary.</p>
<p><b>Capital expenditure</b></p> <p>Due to the significance of the £1billion capital investment programme and inherent risk of delivering it in line with budget, we consider this to be a significant risk to the classification of costs between operating and capital expenditure. We also consider that large capital projects inherently bring a fraud risk.</p>	<p>We tested controls over capital monitoring and procurement of capital projects. The results are set out on page seven, with no exceptions noted.</p> <p>We have reviewed the capital budget and plan for both 2016-17 and future years and we will perform substantive procedures over capital spend at the final audit. This will include assessing the Public Finance Investment Model used and confirming assets under construction balances have been correctly accounted for.</p>

# Significant risks and other focus areas (continued)

Update: other focus areas

Focus area	Update from strategy
<p><b>Presentation of the financial statements – ‘telling the story’</b></p> <p>CIPFA issued changes to the Code intended to make the financial statements more understandable and transparent to the reader.</p>	<p>We have started discussions with the finance team on the subject, and the Council provided us with its proposed pro forma Comprehensive Income and Expenditure Statement (“CIES”). We reviewed this for compliance with disclosure and restatement requirements of the Code, with no exceptions.</p> <p>We will review the presentational changes to confirm they reflect the objectives of the ‘telling the story’ project. We will review the Expenditure and Funding Analysis (“EFA”) and Movement in Reserves Statement (MIRS) for compliance with the Code and relevant accounting standards.</p>
<p><b>Highways network assets</b></p> <p>CIPFA planned to introduce a requirement in the Code to recognise all highway network assets owned by the Council on the balance sheet at depreciated replacement cost. This would result in a material increase in assets.</p>	<p>An announcement was made at the meeting at the 8 March CIPFA/LASAAC Code Board that the introduction of the Highway Network Asset Code into the financial reporting requirements for local authorities would no longer occur. We therefore no longer consider highways network assets to be an area of audit focus.</p>
<p><b>Consolidation of the Integration Joint Board (‘IJB’)</b></p> <p>The IJB took on full delegated functions from 1 April 2016. The consolidation of the new entity will have a material impact on the 2016-17 financial statements.</p>	<p>The Council’s share of the IJB’s results and balances will be included in the Council’s consolidated accounts. As this is the first year, we have held discussions with officers at any early stage about how the consolidation adjustments will be made and how the results will be treated in the Council’s financial statements</p> <p>We presented our audit strategy document to the IJB Audit Committee and have commenced planning work for the IJB audit.</p> <p>We will confirm the accounting treatment and disclosures in the unaudited financial statements are in line with guidance.</p>

# Control framework

## System controls

In accordance with ISA 330; “the auditor’s response to assessed risks”, we have designed and performed tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls over the main financial systems. Interim audit testing took place during February and March 2017. Overall we concluded that the control environment is effective.

Test	Description	Results
<b>Bank reconciliations</b>	<p>Bank reconciliations are prepared weekly or monthly by the income team and reviewed by a more senior officer.</p> <p>We tested a sample of 38 bank reconciliations across all bank accounts to verify they had been authorised and completed on a timely basis.</p>	<p>All reconciliations were completed and authorised as expected. We noted that evidence of the review of bank reconciliations was not always recorded. We have reported this back to management, however do not consider it impacts the overall operating effectiveness of the control and therefore do not raise a recommendation.</p> <p>We will review all year end bank reconciliations and confirm that the review has been appropriately documented.</p> <p><b>Satisfactory</b></p>
<b>Budget monitoring</b>	<p>The Council has a robust budget setting process, with involvement of key members of staff. Performance against budget is monitored on a regular basis and formally reported to the Finance, Policy and Resources Committee via the budget monitoring reports.</p> <p>Two months’ reports were considered to confirm a sufficient level of detail was presented to and considered by the Finance, Policy and Resources Committee.</p>	<p>Testing confirmed that budget monitoring arrangements are designed, implemented and operating effectively.</p> <p><b>Satisfactory</b></p>
<b>Procurement testing</b>	<p>The Council has well defined processes for the awarding of contracts, with written procedures to be followed for each contract type and value.</p> <p>Procurement testing covered a sample of 48 contracts awarded in the year, split evenly between those which had gone through the quotation process and those which went to tender. These were checked to verify they had followed the correct procurement route based on value. The tender evaluation was also considered.</p>	<p>Testing is ongoing with various teams across the Council. We will conclude during our final audit.</p> <p><b>Conclusion to be reported in the annual audit report.</b></p>
<b>Journals authorisation</b>	<p>A sample of 40 journals were selected and checks carried out to confirm segregation of duties exist between who raises and who authorises journal entries.</p> <p>We also considered the back up available for each journal to verify the authoriser could carry out an appropriate review and conclude the journal is correct.</p>	<p>All journals selected were raised and approved by a different officer, as appropriate. Each journal was supported with appropriate back up.</p> <p><b>Satisfactory</b></p>

# Control framework (continued)

## System controls (continued)

Test	Description	Results
<b>Payroll</b>	In order to obtain comfort over payroll processes, we tested controls related to employee standing data, when joining, leaving and making changes. This included testing 11 starters, eight leavers and 21 amendments to employee standing data for appropriate authorisation and evidence of segregation of duties.	All changes to the payroll system followed the established process, with appropriate authorisation and segregation of duties.  <b>Satisfactory</b>
<b>Cost of services (non-payroll expenditure)</b>	A sample of 40 purchase orders were tested by agreeing to invoice and goods received note, to verify appropriate authorisation.	All purchase orders could be matched through the purchase cycle, with appropriate authorisation.  <b>Satisfactory</b>
<b>Capital expenditure review</b>	Capital expenditure is subject to monthly and quarterly review to ensure that the split between revenue and capital expenditure is correct and appropriate.  We tested two monthly reviews of capital expenditure to verify that only items above the threshold of £6,000 were capitalised and see evidence of review. We also tested two quarterly reviews to confirm they had taken place and appropriate cross-referencing to the fixed asset register had taken place.	Review of revenue and capital expenditure is operating effectively.  <b>Satisfactory</b>
<b>Policies and procedures</b>	Staff have access to a number of policies and procedures through the Council's intranet system, the Zone.  This includes HR policies, whistleblowing and general procedural documents.  We carried out a review of the key documents to ensure they covered all expected information and were updated within the prescribed timeframe.	All expected policies and procedures were available to staff via the Zone.  A number of key documents are under review via the ongoing governance project. We will continue to monitor this progress throughout the audit.  <b>Satisfactory</b>

# Control framework

## System controls (continued)

Test	Description	Results
<p><b>General ledger</b></p>	<p>In order to obtain comfort over the completeness and accuracy of the information contained in the general ledger and the financial statements, we reconciled trial balances from the opening and closing periods using the transactions posted in the year.</p>	<p>The Council has a unique approach to completing the financial statements from the general ledger. Several adjustments are made out with the general ledger through manual spreadsheets.</p> <p>In our experience with other local authorities, this is a less efficient way to manage the general ledger and the creation of financial statements.</p> <p>We note the Council is changing the approach for 2017-18 to reduce the manual input and to make the process more efficient.</p> <p><b>Satisfactory</b></p>

# Wider Scope and Best Value

The Code of Audit Practice sets out four audit dimensions which, alongside best value, set a common framework for all audit work conducted for the Accounts Commission. These areas are; governance and transparency, financial management, financial sustainability and value for money. During our interim audit we commenced our consideration these areas and will conclude our assessment in our Annual Audit Report. We provide an update below of work carried out so far on Best Value.

Area	Audit update
Best Value	<p>We held planning discussions with officers to obtain an understanding of the Council's approach to Best Value and how this is embedded within the Council's culture.</p> <p>In year one (2016-17), in line with guidance from the Accounts Commission, we will report on the areas of Financial Governance and Resource Management and Financial Planning. This will be included within the Annual Audit Report. We have reviewed publically available evidence across the two Best Value areas and discussed with management, requesting further support or explanation for us perform the review of Best Value. We will continue to gather information and meet with officers to build our knowledge of Best Value in order to conclude on the two year one areas in our annual audit report.</p> <p>In year two (2017-18) we will consider the Best Value areas or Leadership, Scrutiny and Governance and Improvement.</p> <p>The approach to Best Value is a maturing area and we are discussing and debating future year Best Value plans and approach with Audit Scotland.</p>



## Contacts

The contacts at KPMG in connection with this report are:

Andy Shaw

*Director*

Tel: 0131 527 6673

[andrew.shaw@kpmg.co.uk](mailto:andrew.shaw@kpmg.co.uk)

Sarah Burden

*Manager*

Tel: 0131 527 6611

[sarah.burden@kpmg.co.uk](mailto:sarah.burden@kpmg.co.uk)

Rachel Slaski

*Assistant Manager*

Tel: 0131 527 6831

[rachel.slaski@kpmg.co.uk](mailto:rachel.slaski@kpmg.co.uk)

Julie Robinson

*Assistant Manager*

Tel: 0141 300 5572

[julie.robinson@kpmg.co.uk](mailto:julie.robinson@kpmg.co.uk)



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