KPMG

Aberdeen City Council

Annual audit report to the Members of Aberdeen City Council and the Controller of Audit for the year ended 31 March 2017

15 September 2017

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

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

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the introduction and responsibilities sections of this report.

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Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Andy Shaw, who is the engagement leader for our services to the Council, telephone 0131 527 6673, email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or email to hugh.harvie@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied 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.

Executive summary

Key messages

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Audit conclusions	We intend to issue unqualified audit opinions on the financial statements of Aberdeen City Council and Aberdeen City Council Charitable Trusts following agreement of the outstanding technical matters and completion of audit work. We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy plan and document. The annual accounts, statement of responsibilities, governance statement and remuneration report were received at the start of the audit fieldwork and were supported by high quality audit work papers. We identified ten audit differences, of which all have been adjusted by management. We have no matters to highlight in respect of independence.
Financial position	The 2016-17 deficit on the provision of services of £58.6 million is £11.7 million lower than the deficit reported in 2015-16. Following statutory adjustments between the accounting basis and funding basis of £46.0 million, and transfers to earmarked reserves of £0.1 million, there was a decrease in usable reserves of £12.5 million including an increase of £0.5 million to the Housing Revenue Account ("HRA"). Long term liabilities and cash increased by £315 million compared to the prior year primarily as a result of the bond issuance. Capital expenditure in 2016-17 amounted to £223 million, with significant progress made against th billion capital plan.
Financial management and financial sustainability	The Council has a strong financial position with £11.3 million uncommitted general fund balance and an additional £8.3 million financial risk fund within earmarked reserves. During budget setting there is ongoing consultation with members, service users and other key stakeholders. This results in an open and transparent budget setting process and supports effective financial management. The Council has an estimated savings requirement of £125 million over the next five years, with £22.4 million to be delivered in 2017-18 subject to underlying assumptions. Savings are anticipated to be delivered through the transformation project's service redesign and the voluntary redundancy programme.

Executive summary (continued)

Key messages

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Governance and transparency	The Council has an effective governance structure through supporting committees meetings, the scheme of delegation and standing orders. On the whole it demonstrated effective scrutiny, challenge and transparency on decision making through the various levels of committee reporting reviewed. A governance review is being undertaken to enhance these arrangements and this demonstrates a commitment to improvement. Systems of internal control operated effectively throughout the year.
Value for money	We consider the Council demonstrates a commitment to achieving value for money and has appropriate arrangements for complying with the following the public pound code. Options appraisals and business cases processes have developed over the year, with value for money considerations being evident. There are a number of areas of partnership working with other public sector entities and clear evidence of a commitment from management for continuous improvement.
Outlook	The Council approved a balanced budget for 2017-18 on 22 February 2017, with a reduction of £13 million in funding from Scottish Government and savings of £22.4 million. The budget supports the Council's Strategic Business Plan for 2017-18 which is aligned to Aberdeen City's Community Planning Partnership's Local Outcome Improvement Plan ("LOIP"). As well as the statutory obligation to set a balanced budget, the Council must maintain the credit rating obtained from Moody's Investor Service and ensure compliance with the London Stock Exchange listing rules. Compliance is controlled effectively by the bond governance working group and has been rolled out across the local authority.

Introduction
Scope and responsibilities

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Purpose of this report

The Accounts Commission has appointed KPMG LLP as auditor of Aberdeen City Council (the Council) under part VII of the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2016-17 to 2021-22, inclusive.

Our annual audit report is designed to summarise our opinions and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Aberdeen City Council and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit, risk and scrutiny committee ("ARSC") at the outset of our audit.

Audit Scotland's Code of Audit Practice ("the Code") sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of the following wider scope areas:

- financial management;
- financial sustainability;
- governance and transparency; and
- value for money

Accountable officer responsibilities

The Code sets out Aberdeen City Council's responsibilities in respect of:

- corporate governance;
- financial statements and related reports;
- standards of conduct for prevention and detection of fraud and error
- financial position; and
- Best Value

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code. Appendix two sets out how we have met each of the responsibilities set out in the Code.

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to ARSC, together with previous reports to ARSC throughout the year, discharges the requirements of ISA 260.

Financial position

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Overview

The Council delivered a surplus of £2.5 million on the general fund, before bond effective interest rate charges of £3.8 million. This underlying surplus was delivered despite the challenges that face local authorities, with growing demand on service delivery, real time funding settlement reductions and uncertainty in the current economic climate. This was achieved while taking the ambitious step of obtaining a credit rating and issuing the public bond. The Council demonstrates pace and depth in measures to secure financial sustainability.

As highlighted in the Audit Scotland report, *Local Government in Scotland; Performance and challenges 2017*, total revenue funding from the Scottish Government has decreased overall by 9.2% in real terms since 2010-11. The Council's real term funding cut is 6%.

In November 2016 the Council became the first local authority in Scotland to issue a public bond, with £370 million listed on the London Stock Exchange. The finance raised is being used to deliver the Council's transformational capital and infrastructure programme.

Significant capital expenditure of £223 million was delivered in 2016-17, with progress made against the city centre masterplan and the Aberdeen Exhibition Conference Centre, an increase of 70% on the prior year's capital expenditure.

The new 'Target Operating Model' was approved in August 2017 and the Strategic Transformation Committee created to direct the planned £125 million of savings over the next five years. The Council has set aside an earmarked reserve of £6 million to fund this in 2017-18.

The headline financial position figures are shown opposite. Further details are provided in the following pages.

Deficit on provision of services

£58 million

2015-16 £70 million

Surplus on general fund

£3.5 million*

2015-16 £5.3 million

Total reserves

£1,493 million

2015-16 £1,525 million

Total long term borrowing

£901 million

2015-16 £465 million

Net defined benefit liability

£250 million

2015-6 £251 million

Capital financing requirement

£621 million

2015-16 £499 million

* Surplus of £3.5 million before bond indexation and effective interest rate adjustments of £3.8 million to give a deficit of £0.3 million.

Financial position (continued)

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Comprehensive income and expenditure statement

There are changes to the format of the comprehensive income and expenditure statement ("CIES") as a result of the Chartered Institute of Public Financial Accountants ("CIPFA'') disclosure requirements on 'telling the story'. This enables the reader of the accounts to better understand the reconciliation from reported budget performance to statutory position, through the inclusion of the Expenditure and Funding Analysis ("EFA"). The table below summarises the amounts presented in the CIES under the new format.

Comprehensive income and expenditure statement

	2016-17 £000	2015-16 £000	Variance £000
Cost of services	509,163	525,661	(16,498)
Other operating expenditure	(2,831)	(3,264)	(433)
Financing and investment income and expenditure	32,657	26,575	6,082
Taxation and non specific grant income	(480,392)	(478,633)	(1,759)
Deficit on the provision of services	**58,597**	**70,339**	**(11,742)**
Other comprehensive income and expenditure	(26,827)	(403,960)	(377,133)
Total comprehensive income and expenditure	**31,770**	**(333,621)**	**(301,851)**

The key movements in the CIES relate to:

- Cost of services reduced in part due to a range of savings achieved across services including procurement reform review, digital transformation and using flexible working to create efficiencies.
- Financing and investment income increased by £6.1 million, primarily due to the bond interest charges of £3.8 million. This was offset by a £1.7 million increase in taxation and non specific grant income as a result of recognition of £3.4 million non-domestic rate income relating to 2015-16, which was notified as being eligible to be retained.
- Other comprehensive income and expenditure included a surplus on revaluation of £14.6 million, in comparison to a surplus of £352 million in 2015-16. An actuarial gain of £12.6 million was also included (2015-16: £52.5 million). Together the differences in these amounts explain the significant movement in other comprehensive income and expenditure.

Performance against budget

The Council set a balanced budget for 2016-17, excluding the use of earmarked reserves and statutory adjustments. During the year, it was identified that there were emerging areas of overspend. Management took swift action and issued instructions on managing the budget for the final three months of the year. This resulted in year end position of a surplus of £3 million. The main areas of under or over spend against budget during the year were:

- Within communities, housing and infrastructure there were a number of vacancies not filled, resulting in a £4.7 million underspend. However this was offset by an increase in agency costs. The bus lane enforcement fund was approved for use against staff costs and road maintenance to reduce costs against budget of £1.2 million.
- Underspend in corporate governance due to lower than expected staff costs (£1.5 million) were partly offset by the impact of increasing legal provisions (£0.7 million).
- Out of authority placements for teachers and social workers resulted in a £3.4 million overspend in educations and children's service.
- The business rate incentivisation scheme provided additional income of £2.7 million.

Financial position (continued)

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Balance sheet

	2016-17 £m	2015-16 £m	Variance £m
Long term assets	2,522	2,436	86
Current assets	408	125	283
Current liabilities	(185)	(216)	(31)
Long term liabilities	(1,252)	(821)	431
Net assets	**1,492**	**1,525**	**(33)**
Useable reserves	87	100	(13)
Unusable reserves	1,405	1,425	(20)
Total reserves	**1,492**	**1,525**	**(33)**

The key movements on the Council's balance sheet from the prior year, as identified in the table above are:

- Fixed assets increased significantly due to capital investment of £223 million, offset by £14 million of disposals and downward revaluations of £43 million (see page 15).
- Current assets were significantly higher as a result of the bond issuance. A large portion placed in short term investments, an increase of £110 million from prior year, with the rest held in the Council's bank accounts.
- Debtors increased by £9 million, primarily due to a debtor due from NHS Grampian in relation to the integration joint board ("IJB") in respect of change funds not yet spent.
- Long term borrowings increased due to recognition of the bond and premium, with short term borrowing decreasing by £31 million, in line with the Council's treasury management policy.

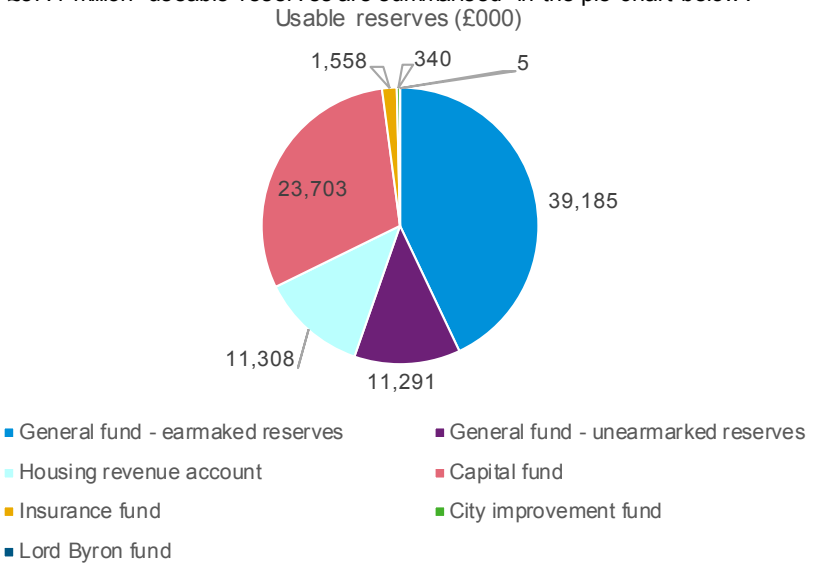
Reserves

The general fund balance decreased by £8.4 million in 2016-17 to £50.5 million. This included changes in earmarked reserves; comprising of the creation of a £6 million change fund, £3.8 million transferred from the capital fund in relation to bond interest charges and a number of other transfers. Movements out of earmarked funds were for spend on investment strategy, welfare reform and devolved management of school funds. No change was made to the £8.4 million risk fund for future uncertainties.

The uncommitted general fund balance as at 31 March 2017 was £11.3 million and there is no intention to draw on this in future years. Elected member approval is required to earmark these funds.

The Council's other statutory funds (capital, insurance, city improvement and Lord Byron) decreased by £0.7 million to £29.4 million.

£87.4 million useable reserves are summarised in the pie chart below.



Financial position (continued)

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Capital programme

Capital monitoring is managed and monitored by the newly appointed Strategic Asset and Capital Plan Board and at the year end the Council noted the following projects progress with the major capital investment programme being undertaken.

- Aberdeen Western Peripheral Route (2016-17 spend £7.19 million): due for first stage completion as planned, however some delays with a third party have meant the budgeted expenditure for 2017-18 has transferred later into the timeline and has decreased by £5 million.
- 3rd Don Crossing (2016-17 spend £5.25 million): on track for budget completion in 2017-18.
- A96 Park and Choose/Dyce Drive Link Road 2016-17 spend £5.53 million): additional £1 million expenditure allocated for 2017-18.
- AECC development (2016-17 spend £70.48 million) is in the major construction stage and the remaining budgeted expenditure is £288 million over the course of three years.

Although the Marischal Square development is not yet on the balance sheet due to the finance lease arrangements, the Council continues to monitor the progress and uptake on rental areas. There have been minor delays and the project is due to complete in late 2017.

Financial position (continued)

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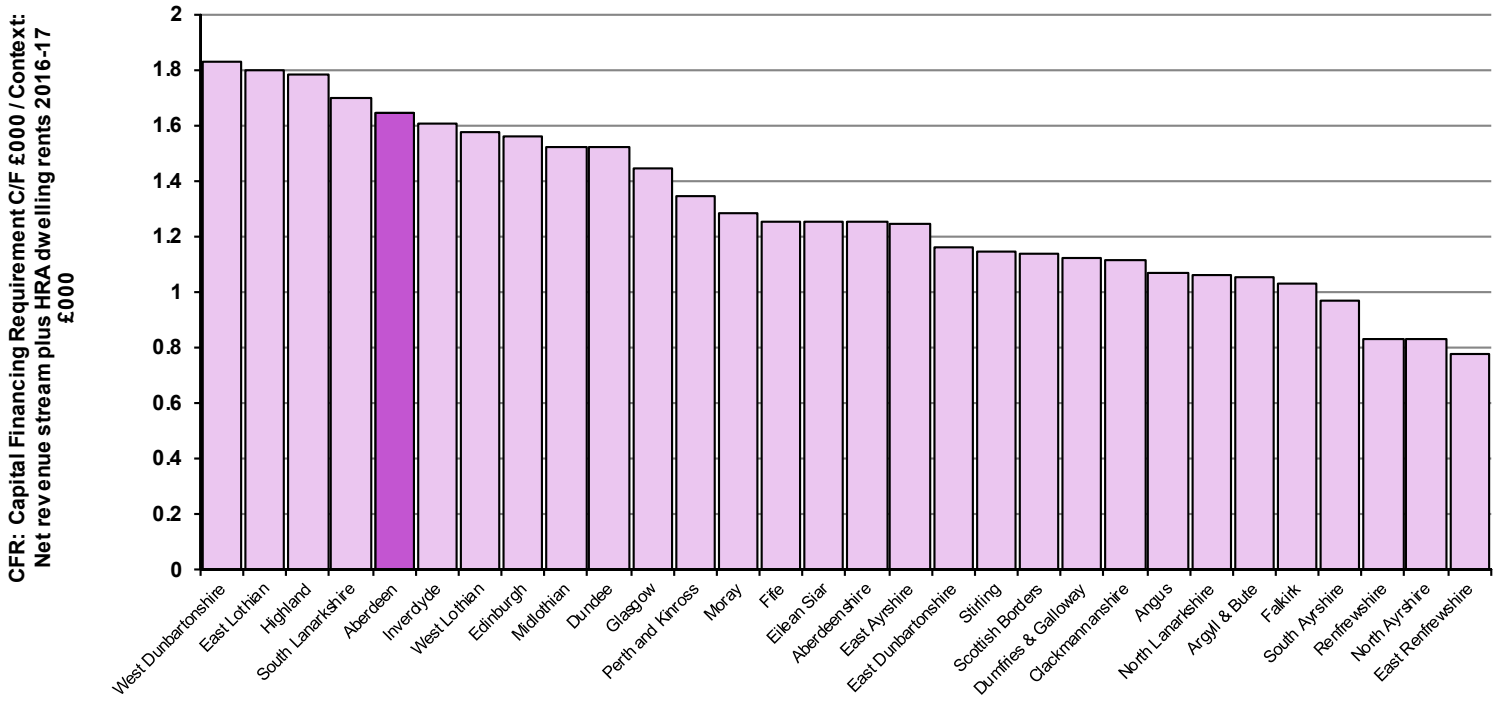
In a benchmarking study carried out by Audit Scotland, Aberdeen City Council has the fifth largest capital finance requirement in the context of the net revenue stream plus Housing Revenue Account ("HRA") dwelling rates. This shows Aberdeen is making significant capital investment in comparison to the majority of Scottish authorities. The requirement supports the city centre development to improve Aberdeen City, and the Council performed appropriate due diligence to obtain finance and ensure enough resource is available to finance the debt.



Financial position (continued)

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Financial plans 2017-18 and beyond

The budget for 2017-18 was approved by Council on 22 February 2017, and takes into account likely cost pressures and assumes a decrease in grant funding from Scottish Government. The extent of reductions will be influenced by the wider economic climate and government polices.

The Council operates on a five year cyclical basis in terms of its strategic and financial planning, albeit detailed budgets are only approved on an annual basis once the funding settlement has been confirmed by Scottish Government.

The key assumptions used in setting the 2017-18 budget include;

- transformation projects forecast to generate savings, however with inherent uncertainty around how successfully these projects can be implemented and the savings delivered;
- the Council's credit rating is maintained;
- inflation may exceed budgeted provisions; this is heightened by the impact of Brexit on the value of the Sterling and the effect this has on the indexation of the bond; and
- 1% has been agreed for staff costs increase by COSLA and is in line with national pay expectations in the public sector, this is included in all five years.

There are additional risks that the current economic climate creates over income levels in areas such as commercial rent income and council tax collection levels. Similarly there is a risk over increased expenditure due to the ageing populations and welfare reform.

In setting the 2017-18 budget, management calculated a deficit of £17.2 million. Service options totalling £31.9 million were presented to members in setting the budget, and a total of £22.4 million of savings proposals were approved. The revised surplus was £5.2 million, with the intention that this would be used to fund new initiatives and the change fund during the year.

A similar methodology has been used in setting the five year budget to 2021-22, as shown in the table below. Cumulative savings proposals of £129 million were approved, however further cumulative savings of £162 million will be required over the five year period to breakeven.

Some of the initiatives to provide efficiencies and raise other sources of funding include:

- smarter procurement, £3 million each year;
- building service apprentice scheme, £0.4 million each year;
- remove staffing vacancies, £5.7 million each year;
- applying a 3% council tax increase, £45 million in total; and
- increase building services income by £1 million per year.

	2017-18 £000	2018-19 £000	2019-20 £000	2020-21 £000	2021-22 £000
Gross service costs	666,339	683,653	699,324	714,513	728,595
Gross income	(649,095)	(648,213)	(639,220)	(633,608)	(631,076)
Net deficit	**17,244**	**35,440**	**60,104**	**80,905**	**97,519**
Savings proposals approved	(22,406)	(26,728)	(26,753)	(26,778)	(26,803)
Potential (surplus) / deficit	**(5,162)**	**8,712**	**33,351**	**54,127**	**70,716**

As part of the implementation of the 'target operating model', management reviewed the overall scale of savings required by the Council over the five year period. It has been agreed that in 2018-19 £7 million of reserves will be utilised as a transformation investment, and a further £8 million in 2019-20.

Financial position (continued)

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Going concern

The Council had net assets of £1.5 billion (2015-16 £1.5 billion) as at the balance sheet date. Net assets decreased on 2015-16 by £32 million, reflecting the total comprehensive expenditure for the year.

Management considers it appropriate to continue to adopt the going concern assumption for the preparation of the annual accounts. The Council is in a net asset position, and it considers that the confirmed revenue support grant (which includes non-domestic rates income) of £313 million is sufficient to meet debts as they fall due. With the significant increase in long term debt, the level of interest to finance this debt will increase, potentially putting further pressure on the Council's finances.

The Council recognised a surplus on the provision of services in the year, providing further comfort over the Council's financial position. Over the past few years there has been a reduction in the overall cost base and further efficiency savings are incorporated into budgets.

Whilst the budget for 2017-18 is breakeven, a decision to utilise £7 million of reserves in 2018-19 could present additional financial risks in future years. Management is aware of the significant financial pressures and is taking appropriate action to balance budgets. From a statutory going concern position (i.e the ability of the Council to remain a going concern for the twelve month period from the accounts being signed), the budgets set and plans in place do not give rise to a going concern risk.

Conclusion

The Council has a strong net assets position supported with £11.3 million uncommitted reserves and a positive cash flow position forecast for 2017-18.

The Council has prepared short, medium and long term financial forecasts which are inherently dependant on a number of assumptions out with the Councils control. Management has identified potential savings and has demonstrated strong leadership in taking action on overspends to ensure tight budgetary control.

We are content that the going concern assumption is appropriate for the Council in light of the above.

Financial statements and accounting

Audit conclusions

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Audit opinion
Our audit work is substantially complete with the exception of the WGA and CJA grant claim (see page 52). Following approval of the annual accounts by the ARSC we intend to issue an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2017, and of the deficit for the year then ended. We also intend to issue unqualified opinions on the truth and fairness of the state of the Aberdeen City Council Charitable Trusts' affairs as at 31 March 2017. There are no matters identified on which we are required to report by exception.
Financial reporting framework, legislation and other reporting requirements
The Council is required to prepare its annual accounts in accordance with International Financial Reporting Standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016-17 ("the CIPFA Code"), and in accordance with the Local Authority Accounts (Scotland) Regulations 2014. Our audit confirmed that the financial statements have been prepared in accordance with the CIPFA Code and relevant legislation. The Aberdeen City Council Charitable Trust's financial statements are prepared in accordance with the Charities SORP (FRS 102), the Charities and Trustee Investment (Scotland) Act 2005 and regulation 8 of the Charities Accounts (Scotland) Regulations 2006 (as amended). Our audits confirmed that the annual accounts have been prepared in accordance with the relevant charity accounting legislation.
Statutory reports
We have not identified any circumstances to notify the Controller of Audit that indicate a statutory report may be required.
Other communications
We did not encounter any significant difficulties during the audit. There were no other significant matters arising from the audit that were discussed, or subject to correspondence with management that have not been included within this report. There are no other matters arising from the audit, that, in our professional judgement, are significant to the oversight of the financial reporting process.
Audit misstatements
Ten audit misstatements were identified during the audit, of which all have been adjusted. There are no unadjusted audit misstatements.
Written representations
Our representation letter will not include any additional representations to those that are standard as required for our audit.

Financial statements and accounting
Audit conclusions (continued)

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Materiality

We summarised our approach to materiality in our audit strategy document. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that the level of materiality set at planning was still relevant.

We used a materiality of £7.75 million for the Council's standalone financial statements, and £7.85 million for the Group financial statements. This equates to 1% of cost of services expenditure, adjusted for revaluation decreases recognised in the year. We designed our procedures to detect errors in specific accounts at a lower level of precision than our materiality. For the standalone accounts our performance materiality was £5 million. For the Group accounts it was £5.1 million. We report all misstatements greater than £250,000.

Forming our opinions and conclusions

In gathering the evidence for the above opinions and conclusions we:

- performed controls testing and substantive procedures to ensure that key risks to the annual accounts have been covered;
- communicated with the head of internal audit and reviewed internal audit reports as issued to ARSC to ensure all key risk areas which may be viewed to have an impact on the annual accounts had been considered;
- reviewed estimates and accounting judgments made by management and considered these for appropriateness;
- considered the potential effect of fraud on the annual accounts through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to the prevention and detection of fraud; and
- attended ARSC meetings to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Significant risks and other focus areas in relation to the audit of the financial statements

We summarise below the risks of material misstatement as reported within the audit strategy document.

Significant risks:

- Management override of controls fraud risk;
- Fraudulent revenue recognition;
- Revaluation of property, heritage assets, plant and equipment;
- Accounting for the bond issuance;
- Retirement benefits; and
- Capital expenditure.

Other focus areas:

- Presentation of the financial statements; and
- Consolidation of the IJB.

No further significant risks or other matters were identified during our audit work.

We have no changes to the risk or our approach to addressing the assumed ISA risk of fraud in management override of controls and we do not have findings to bring to your attention in relation to these matters. No control overrides were identified.

Financial statements and accounting
Audit conclusions (continued)

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Financial statements preparation

Draft financial statements and high quality working papers were provided at the start of the audit fieldwork on 12 June 2017. This included the management commentary and annual governance statement. This is earlier than other councils we have worked with in Scotland, and demonstrates the strength of the finance team's skills and understanding of the day-to-day operations of the Council. Accounting for the bond issuance had not been completed at the time of the draft accounts being published and therefore included disclosure to this effect. With more complex financial transactions expected in future years, management is intending to work with the finance team to support faster accounts close.

A second version of the financial statements was provided on 17 August. Whilst these addressed most audit comments on presentational matters, accounting for the bond issuance had not been finalised and therefore was not included. A final draft of the financial statements, including accounting for the bond issuance were received on 7 September.

The audit team provided some initial comments to enhance the management commentary and governance statement prior to the draft financial statements being published.

Whilst the Council does not have a premium listing on the London Stock Exchange requiring it to apply the rules regarding preliminary announcements, the bond is listed debt and the publication of unaudited accounts for the 30 June deadline was in effect a market announcement. The unaudited accounts were updated prior to publication to include disclosure that the audited accounts may change following the external audit.

The Council intends for the 2017-18 external audit to be concluded by 30 June 2018 in part to resolve this. Management will consider the requirements of the Local Authority Accounts (Scotland) Regulations 2014 in respect of maintaining compliance with this legislation. We will work with management to assess the impact on the accounts preparation timetable and our audit timetable for future years.

In advance of our audit fieldwork we issued a 'prepared by client' request, a list of required analyses and supporting documentation. The standard of the documentation was good and there was evidence of accountability and ownership of working papers across the finance department. Responses to audit queries were answered effectively and on a timely basis on the whole, although there were some delays when the query extended beyond the finance team.

From a number of our audit tests over judgemental areas, or balances requiring estimates, we identified that documentation could be enhanced to better set out management's judgements and calculations.

Recommendation one

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Fraudulent income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from revenue recognition is a significant risk. As set out in our audit strategy document, the only income stream we considered to have a significant risk attached is other income. Other income relates primarily to charges or service income from varying different streams and therefore we consider there to be judgement in recognising this income. There was no change to the planned audit work over income streams which did not contain a significant risk.	As set out in our audit strategy document we considered each source of other income and analysed the potential revenue recognition risk against each of these as follows: — Investment property income: we did not rebut the revenue recognition risk as leases may have incentives, ratchets, rent free periods or discounts which could impact the revenue recognition, and may give rise to recognising income in different periods to those it was received. — Other trading operation income: these are non-complex services, such as car parking charges, and therefore income is recognised at the point of provision of service. There is limited judgement required in identifying the period in which income should be recognised and we rebutted the significant risk. — Other services income: services are recharged between directorates and also arms length external organisations. This includes internal reallocations and external charges. Similar to the above, income is recognised at point of service delivery, with limited judgement required over recognition. Therefore the significant risk is rebutted. Following these considerations, the income stream where there is a significant revenue recognition risk is investment property rental income. We performed the following work over this income stream: — Proof in total of investment property income based on the number of properties. — Test of detail over a sample of leases to assess whether there are complex clauses/conditions which could impact recognition of revenue. — Journals testing over investment property income. *Continued….*	We did not identify exceptions from our testing over investment property rental income. Whilst we did not identify any leases with complex clauses or conditions, we understand that new leases will be entered in to in future years as a result of the completion of Marischal Square, and we will reassess the significant risk over this income stream. We identified an error in how some year-end earmarked reserve transfers were recognised in the comprehensive income and expenditure statement, which resulted in an overstatement of gross income and expenditure of £7.87 million. This error did not have an impact on the net cost of services, and was adjusted. We have recommended enhancements to year-end processes to avoid similar matters in the future. ***Recommendation two*** We are satisfied that income is recognised appropriately, in the correct financial year and in line with the CIPFA Code.

Financial statements and accounting
Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Fraudulent income recognition	*Continued….* Our audit work over the remaining other income streams included: — Analytical reviews of other income at service level compared to prior year and budget. — Test of detail over services other income amounts not already tested. — Cut off testing over all income streams to verify it is recorded in the correct financial year.	See above

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Revaluation of property, heritage assets, plant and equipment Under the CIPFA Code, and IFRS, property, heritage assets, plant and equipment ("PPE") is required to be held on the balance sheet at current value (market value or depreciated replacement cost). In order to comply with these accounting requirements, Council assets are subject to rolling valuations, with a tranche of other land and buildings being subject to valuation in 2016-17. Furthermore, the Council holds £86 million of investment property, which must be revalued on an annual basis. The Council carries out a rolling programme that ensures that all PPE required to be measured at fair value is revalued at least every five years by internal valuers.	Our overall approach to auditing valuations of non-current assets was in line with that set out in the audit strategy document: — in respect of PPE, review of the in-house valuation team and of the use of other experts; considering their objectivity, independence, experience and integrity; — in respect of heritage assets, discussion of valuation methodology with the curator, sample testing of opening balance valuations to agree to supporting evidence, and research of similar asset values. There was no significant revaluation during the year requiring audit; — consideration of the impairment review undertaken by management and of impairment indicators for the Council's estate; and — review of material manual journals posted to both the fixed asset and revaluation accounts. In addition, a KPMG valuation expert reviewed the valuation methodology for other land and buildings and investment properties, comparative sales, supporting evidence of rent or land values and yield applied in valuation calculations, including discussion with the estates team to discuss and challenge the methodology. Specific considerations for different categories of assets revalued are set out below. *Impairment review* The impairment review is carried out by the Head of Land and Property Assets. Although the Council officers are comfortable there have been no indicators of impairment and our audit work has not identified issues in this regard, there is limited supporting evidence to document that a complete assessment has taken place. *Continued…..*	We consider that the revaluation of property, plant and equipment is materially appropriate. We consider that: — the methodologies and approach taken by the internal valuers are appropriate and in line with KPMG expectations; and — Valuations are appropriately recognised and disclosed in the financial statements. Overall, we identified that the documentation of valuations and impairment reviews could be enhanced to better set out the work undertaken, the evidence considered, the assumptions made and the final conclusions. ***Recommendation one*** Specific considerations in relation to different categories of assets are set out below. *Impairment review* The impairment review did not identify any assets which should be impaired. We concur with management's assessment. *Continued…..*

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Revaluation of property, heritage assets, plant and equipment	*Continued….* *Other land and buildings* A number of assets were valued using the depreciated replacement cost model ("DRC") method, usually applied as an alternative when no market use value is available. We challenged the application of the DRC method for a number of assets (including Marischal College, His Majesty's Theatre and the Townhouse). Within DRC we reviewed the assessment of obsolesce, deprecation and modern equivalent area (the area that would be required to replace the use of space in a modern equivalent building) and it's application to the valuation. *Investment property (including Common Good assets)* Our approach to investment property valuations was similar to that of other land and buildings, and no significant matters arose. Within Common Good, the development at Pinewood is being sold in tranches over a multi-year period. We discussed this specific development with management to understand the accounting treatment and progress. From this work we identified that the sale of tranches of Pinewood had been accounted for as a downwards revaluation instead of a disposal. *Heritage assets* In accordance with the CIPFA Code the Council's internal curator applies valuations of the artwork collection in order to ensure they are appropriate and relevant. We considered with management the approach to previous valuations of heritage assets and viewed the insurance documents for heritage assets, including on loan in Europe, to support the values recognised.	*Other land and buildings* We consider that the DRC method was appropriate to use for specific assets due to their specialised nature and appropriate considerations had been included within the calculation of the DRC value. *Investment properties (including Common Good assets)* Audit adjustments were raised to recognise the revaluation and subsequent sale of the Common Good assets at Pinewood in the correct account balances. *Heritage assets* There were no significant revaluations in the year. Whilst we are content that the previous valuation approach adopted meets the requirements of the CIPFA Code, given the significant value attached to certain pieces of artwork we recommend that management engages an external specialist art valuation expert to further support valuation of its heritage assets. ***Recommendation three***

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Accounting for the bond issuance 2016 saw the Council become the first Scottish local authority to issue a bond for capital financing. The £370 million bond attracted a premium of £41 million. The accounting for the bond issuance is complex, involving the calculation of the effective interest rate, which is based on future cash flows. This is the first year the Council has prepared the relevant accounting entries. Interest accrues on the principal amount at 0.1% from the date of issuance. However there is a three year repayment holiday, whereby no principal amounts need to be repaid until February 2020. The bond is index linked to RPI, therefore the principal amount increases in line with inflation at each repayment date, which in turn impacts the interest payable. The £41 million premium is deferred on the balance sheet of the Council, to be released to income over the 38 year life of the bond.	The unaudited amounts made available by management on 12 June 2017 did not include all elements of the required accounting treatment for the bond. Since receiving initial calculations from them in May 2017 we have worked with management to finalise the appropriate accounting and disclosure in the accounts which were provided on 7 September 2017. Our audit approach, included: — selecting a sample of transactions and agreeing the cash received and documents issued; — selecting a sample of related issuance expenditure and agreeing to supporting documentation to ensure it was appropriate to include as a transaction cost; — considering the accounting treatment and disclosures against the IFRS 9 and IAS 39 requirements, including accounting for the premium; — reviewing the Council's current credit rating and any impact on the bond repayment schedule; and — performing sensitivity analysis to assess what impact a change in the variable factors (for example RPI used to calculate the effective interest rate) could have on the credit rating and bond value. The key elements where we provided challenge to management are: — Bond issuance transaction costs were initially capitalised within PPE. Per IAS 39, transaction costs which are directly attributable to the origination of a financial liability (i.e. those which would not have been incurred if the bond had not been issued) are deducted from the amount of the liability initially recognised. Prior to the draft financial statements being published, management made an adjustment to remove the transactions costs from property, plant and equipment and deduct from the bond liability. We reviewed the costs included in transaction costs and agreed with management's conclusion that all were eligible transaction costs. *Continued….*	We consider that the recognition of the bond and premium on the balance sheet as at 31 March 2017 is materially correct, based on the underlying principal amount and effective interest charged to date. We consider that using 3.5% as the forecast RPI for calculating the effective interest rate is within an acceptable range and results in a materially appropriate interest charge for 2016-17. Audit adjustments were raised to correctly account for the effective interest rate and premium amortisation. For future complex financial transactions we recommend that management considers the accounting implications prior to the transaction taking place, and provide an accounting paper before the year end, to ensure these transactions can be agreed and incorporated into the draft financial statements. ***Recommendation four***

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Accounting for the bond issuance *Continued….* IFRS requires that interest payments are charged to the comprehensive income and expenditure account on a consistent basis over the life of the bond, rather than in line with the actual cash payments. An effective interest rate has to be calculated, which takes into account of the initial capital repayment holiday. The calculation of the effective interest rate is further complicated by the requirement to make an assumption of RPI to calculate the expected indexation on the principal and therefore the impact on the interest payments.	*Continued….* — The effective interest rate calculation involves a detailed understanding of the terms and conditions of the bond trust deed, in particular around the calculation of interest and principal instalment payments which are based on a limited indexation factor and limited index ratio. The calculation also includes the amortisation of the premium. No effective interest rate calculation had been completed at the date the unaudited accounts were made available and an audit adjustment was identified to correctly recognise the in-year effective interest and premium amortisation. The in-year charge is £3.8 million which is significantly greater than the cash cost. For 2017-18, the charge is forecast to be £11.3 million; management should include a pro-rata of these charges within the quarterly reports. — The limited indexation factor is the forecast RPI movement for each instalment date. Management chose to use 3.5% on the basis of known movements to date and consideration of other RPI assumptions, for example the RPI assumption of 3.4% used within the pension liability calculation. — The CIPFA Code permits management a choice over whether to expense borrowing costs in respect of qualifying assets. The Council is not permitted to borrow for specific assets and therefore has elected to expense borrowing costs. For 2016-17 management elected to transfer funds from the capital reserve to the general fund to offset the effective interest rate charge. Management is considering the impact of the effective interest rate charge in future years. *Continued...*	See above

Financial statements and accounting

Significant risks (continued)

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SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Accounting for the bond issuance	*Continued….* — In February 2017, the first instalment of interest was payable. Also that was the first point in time when indexation of the bond would occur. Indexation of £2.1 million was recognised. Management deducted the indexation from the bond premium, however IFRS requires such indexation to be charged to the comprehensive income and expenditure statement. An audit adjustment was raised to appropriately account for this transaction, coupled with the adjustments required to recognise the correct effective interest rate charge. — The fair value of the bond and premium is disclosed within the accounts. The fair value is provided by Capita.	See above

Financial statements and accounting

Significant risks (continued)

DRAFT

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Retirement benefits The Council accounts for its participation in the North East Scotland Pension Fund and in accordance with IAS 19 *Retirement benefits*, using information obtained in a valuation report prepared by actuarial consultants. Actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The calculation of the pension liability is inherently judgemental. The Council also accounts for the discretionary post retirement benefits on early retirement in the Scottish Teachers Superannuation Scheme as a defined benefit scheme. Liabilities are recognised when awards are made and there are no plan assets.	As set out in our audit strategy document, our work consisted of: — review by KPMG specialists of the financial assumptions underlying actuarial calculations and comparison to our central benchmarks; — review by KPMG specialists of the roll forward of scheme assets and liabilities and the impact on the value of assets of different calculation methodologies; — testing of the level of contributions used by the actuary to those actually paid during the year; — agreement of membership data used by the actuary to data from the Council; and — agreeing actuarial reports to financial statement disclosures. We noted that management chose to use a bespoke assumption for salary growth instead of using the generic assumption provided by the actuary. We considered the assumption with management, and agree with its assertion that it better reflects current public sector pay restraint as it has a level of local influence on pay decisions. A bespoke assumption for salary growth was not used for STSS. Management considers this to be appropriate because teacher salaries are set at a national level with limited local influence. The audit team consulted with KPMG actuarial specialists, and agreed that management's assumptions for both pension schemes are appropriate.	We are satisfied that the retirement benefit obligation: — is correctly recognised on the balance sheet as at 31 March 2017; — has been accounted for and disclosed correctly in line with IAS19 Retirement benefits; and — assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range. We set out further information in respect of the defined benefit obligation on pages 53 and 54. The net liability in the balance sheet decreased by £1.3 million compared to 31 March 2016, driven by an decrease in the North East Scotland Pension Fund of £3 million and a increase in the Scottish Teachers Superannuation Scheme of £1.6 million.

Financial statements and accounting

Significant risks (continued)

DRAFT

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Capital expenditure The Council has a £1 billion capital plan for the next five years, which is focused around the city centre masterplan. The Council is utilising some innovative methods of delivery of capital projects, including the use of a 'development strip lease' basis for Marischal Square and further PPP agreements for the Aberdeen Western Peripheral Route. These can lead to various accounting treatments in the financial statements. Due to the significance of this capital investment programme and inherent risk of delivering it in line with budget, we consider this to be a significant risk for our audit work to ensure the classification of costs between operating and capital expenditure is appropriate. We also consider that large capital projects inherently bring a fraud risk.	As set out in our audit strategy document, we completed the following work: — reviewed the capital plan and discussed its monitoring by teams across the Council; — understood the processes to ensure the appropriate recording of capital and other expenditure in the financial records and that authorisation by appropriate individuals has occurred; — selected a sample of capital item additions to agree to invoice to verify appropriateness of classification of items between revenue expenditure and capital expenditure; — tested reallocation of assets under the course of construction to fixed asset categories at the period end to confirm appropriate categorisation; — through our expenditure testing, agreed a sample of invoice to verify the appropriateness of the items as expenditure; — reviewed material manual journals posted to both the fixed asset and expense accounts; and — reviewed project approvals through procurement testing and inspecting CMT minutes. From our understanding of the capital plan, the innovative methods of delivery referred to have not yet begun, and therefore no further detailed testing was completed. These are expected to impact the financial statements from 2017-18. Specific consideration was given to the accounting treatment for the Aberdeen Western Peripheral Route, whereby the first section had achieved 'permitted for use' status. As this section of the road is considered a trunk road, it falls under the responsibility of Transport Scotland. It was therefore appropriate that this section of road continued to be held as an asset under construction; following detrunking in April 2017, the asset will be moved to operational assets.	Our testing found capital expenditure to be accurate and appropriately classified. We note that there are a number of large ongoing capital projects at the Council, of which there is a range of different types of expenditure. We identified that it was not always easy to reconcile the amounts capitalised to the records held, and record keeping can be improved. Whilst management is aware of the complexities of capital project management, we recommend that reconciliation and record keeping is enhanced. ***Recommendation one***

Financial statements and accounting

Other focus areas

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OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Presentation of the financial statements – 'telling the story' New disclosure requirements and restatement requires compliance with relevant guidance and correct application of applicable Accounting Standards. Though less likely to give rise to a material error in the financial statements, this is an material disclosure change in this year's financial statements, worthy of audit understanding.	Our audit work consisted of; — assessing how the Council has actioned the revised disclosure requirements for the CIES, MIRS and the new Expenditure and Funding Analysis ("EFA") as required by the CIPFA Code; and — checking the restated numbers and associated disclosures for accuracy, correct presentation and compliance with applicable Accounting Standards and Code guidance.	The presentation of the CIES is in line with the Council's internal reporting structures, as required by the CIPFA Code. The restated 2015-16 numbers agreed to the underlying accounting records and had been appropriately disclosed. The EFA had been presented in line with the CIPFA Code and was included as a primary financial statement. We are satisfied that the CIES and EFA are appropriately presented.
Consolidation of the IJB The IJB was established in 2015-16, and assumed full delegated functions from 1 April 2016. The consolidation of this entity will have a material impact on the 2016-17 financial statements. There will be a number of intra group transactions to be recognised. The Council will also have shared risk over the IJB with NHS Grampian, as well as obligations for delivery of services as directed by the IJB. Strong monitoring and reporting will be required within the Council to ensure all statutory requirements are met and risk is managed at an appropriate level.	Our audit work involved consideration of the appropriate accounting for the treatment of transactions with the IJB in the Council-only accounts and the way in which the IJB is consolidated into the group accounts.	An audit adjustment was identified over the accounting treatment for the IJB on the Council's balance sheet. Management had initially recognised a long term investment equivalent to the Council's share of the net assets of the IJB as at 31 March 2017. As the Council has not invested cash into the IJB, it is not appropriate to recognise an investment. It was identified that transactions with the IJB had not been correctly recorded in line with LASAAC guidance on accounting for IJBs, which resulted in gross expenditure and income being understated on the CIES. This had no impact on the net cost of services. Both of these errors were amended by the Council. We are satisfied that the IJB has been correctly accounted for in the group accounts.

Financial statements and accounting

Management reporting in financial statements

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REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Management commentary	The Local Authority Accounts (Scotland) Regulations 2014 require the inclusion of a management commentary within the annual accounts, similar to the Companies Act requirements for listed entity financial statements. The requirements are outlined in the Local Government finance circular 5/2015. We are required to read the management commentary and express an opinion as to whether it is consistent with the information provided in the annual accounts. We also review the contents of the management commentary against the guidance contained in the local government finance circular 5/2015.	We are satisfied that the information contained within the management commentary is consistent with the annual accounts. We reviewed the contents of the management commentary against the guidance contained in the local government finance circular 5/2015 and are content with the proposed report.
Our view of Alternative Performance Measure ("APM") presentation	As an EU Public Interest Entity ("PIE"), we are required to provide a view on the APMs that the Council uses in it's management commentary. APMs are those amounts presented which do not directly appear in the financial statements themselves. The local government finance circular 5/2015 provides clear guidance to Councils on the type of information to be included within the management commentary. Furthermore, the changes to the CIPFA Code to include an expenditure and financing analysis, provides a requirement for a reconciliation from the Council's internal management reporting to the statutory position. The key performance measure which users of the accounts consider is the achievement of over or under spends against budget. An appropriate reconciliation from the £3 million underspend against budget to the statutory position presented in the comprehensive income and expenditure account is provided in the management commentary. This reconciliation does not give undue prominence to an adjusted measure. Following the bond issuance, the Council will now have additional users of the accounts, for example investors. Management will need to consider whether to enhance the content of its management commentary to provide additional financial performance measures that will inform investors of its financial position relative to their interest in the Council's bond.	We consider the presentation of alternative performance measures in the management commentary to be appropriate in the context of the Council's accounts.

Financial statements and accounting

Management reporting in financial statements

DRAFT

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Remuneration report	The remuneration report was included within the unaudited annual accounts and supporting reports and working papers were provided. We challenged management on the disclosure of two persons who held senior positions at the Council and received remuneration through an agency appointment. For greater transparency, management was content to enhance the disclosure. Amendments were also required to the disclosure of the remuneration senior staff of the Council's subsidiary bodies. It was identified that a number of Councillors had incurred high levels of expenses as a result of overseas trips. Whilst all trips and expenditure had been approved by a committee and were appropriately reported, we understand that in autumn 2017 management will implement a requirement for greater benefit reporting for overseas trips.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the annual accounts and all required disclosures have been made. Our independent auditor's report confirms that the part of the remuneration report subject to audit has been properly prepared.
Annual governance statement	The statement for 2016-17 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on the Council's governance framework, review of effectiveness, continuous improvement agenda and group entities and analyses the efficiency and effectiveness of these elements of the framework.	We consider the governance framework and annual governance statement to be appropriate for the Council and that it is in accordance with guidance and reflects our understanding of the Council.

Financial statements and accounting

Group financial statements

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Our audit appointment of the Council extends to the audit of the Aberdeen City Council Charitable Trusts and Aberdeen City Integration Joint Board. Appendix nine sets out the group structure. The table below sets out the key audit findings from these entities and also significant matters discussed with the component auditor. There are no findings to report in relation to other group entities. We note that the Council has created a new partnership with Places for People, Shaping Aberdeen Housing LLP, to deliver 1,000 affordable homes. There were no transactions in 2016-17, however management will need to consider the accounting and audit implications for this new entity in future years.

ENTITY	WORK PERFORMED	AUDIT CONCLUSION
Charitable Trusts	We assessed materiality based on our knowledge and understanding of the charities' risk profile and annual accounts balances. Materiality was determined at 2% of total assets. There were no audit adjustments required to the draft accounts which impacted on the net assets and income and expenditure for the year. We considered and confirm our independence as auditor and our quality procedures, together with the objectivity of the audit director and audit staff. The Office of the Scottish Charity Register approved an application to reorganise the Bridge of Dee Trust. In 2017-18 the assets of this Trust will be transferred to the Bridge of Don Trust and used for the advancement of heritage. The Education Endowment Investment Fund is made up of 60 smaller trusts and the ultimate aim is to have these trusts amalgamated into two trusts that specialise in educational bursaries and disabilities in the community, this will be carried out over the next few years.	We anticipate issuing an unqualified audit opinion on the charitable trusts.
Common Good	Aberdeen City Council Common Good does not prepare separate financial statements, and is incorporated as disclosure notes within the Council's financial statements. Common Good holds investment properties as well as other assets. Our findings in relation to the valuation of investment properties across the Council and Common Good are reported on pages 18 and 19.	The Common Good amounts are included within the Group financial statements, for which we intend to issue an unqualified opinion.
IJB	A separate annual audit report is presented to the audit and performance systems committee of the Aberdeen City Integration Joint Board. No significant exceptions were identified during the audit	We issued an unqualified audit opinion on the IJB on 12 September 2017.
Bon Accord entities	As set out in our audit strategy document, we provided group audit instructions to the component auditor of Bon Accord Care Limited and Bon Accord Support Services Limited (together the Bon Accord entities). Formal reporting from the component auditor has been provided and [...no] audit adjustments were raised. There were no significant findings that we would be required to report.	Component auditors intend to issue an unqualified audit opinion on the Bon Accord entities. There are no matters to report which would impact the group accounts.

Financial statements and accounting

Qualitative aspects

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ISA 260 requires us to report to those charged with governance our views about significant qualitative aspects of the Council's accounting practices, including accounting policies, accounting estimates and financial statement disclosures. We consider the accounting policies adopted by the Council to be appropriate. There are no significant accounting practices which depart from what is acceptable under IFRS or the CIPFA Code. We considered the level of prudence within key judgements in your 2016-17 financial statements and accounting estimates. We set out our view below:

Subjective areas	2016-17	Commentary
Bad debt provisions (excluding Council tax) *£20.4 million*	6	For debtor balances greater than 120 days overdue, but under 10 years overdue, a bad debt provision of 40% is recognised. We consider that this is at the optimistic end of an acceptable range as it is unlikely that significant debts over a year old will be collected and recommend that management reviews its debtor provisioning levels. Following discussions with management, the bad debt provisioning was amended to provide for a larger proportion of older debts. An audit adjustment was raised to increase the bad debt provision by £3.0 million. This was corrected by management and we agree that the updated provisioning is more balanced. ***See recommendation five.***
Council tax bad debt provisions *£34.6 million*	3	Whilst we consider the methodology for calculating the council tax bad debt provision is overly complex, we do not consider it leads to an overly cautious or optimistic estimate. There was a £1.5 million increase in the council tax bad debt provision from previous years, and collection rates have remained stable. ***See recommendation five.***
Other provisions and contingent liabilities *£4.9 million*	4	The Council recognises a number of specific provisions and contingent liabilities, relating to matters such as holiday pay, equal pay and ongoing legal matters. Individually, and in aggregate, these provisions are not considered material, although management tends to take an optimistic approach to calculating these provisions. Legal letters support management's estimates.
Pension assumptions *Liability: £250 million*	4	For defined benefit obligations, the estimate is calculated under IAS 19 (as calculated by the Council's actuary, Mercers, using agreed financial assumptions). We found the assumptions and accounting for pensions to be appropriate, as discussed on page 23.
Property, plant and equipment revaluations *£43 million decrease*	3	Our findings over the valuation of PPE is discussed on pages 18 and 19. We did not identify any indications of management bias and consider that the valuations are balanced in the round.
RPI assumptions built in to effective interest rate on the bond *3.5% RPI assumption*	2	Management has chosen an RPI assumption of 3.5% to include within the bond effective interest rate calculation, which is in line with other similar RPI assumptions included in estimates within the financial statements, for example, within the pension assumptions. RPI of 3.5% is in line with publically available forecasts.

Level of prudence

Financial statements and accounting
Future developments

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Future accounting and audit developments

CIPFA / LASAAC consulted on amendments to the CIPFA Code for IFRS 9 *Financial instruments* and IFRS 15 *Revenue from contracts with customers*. A separate publication *Forthcoming Provisions for IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers in the Code of Local Practice on Local Authority Accounting in the United Kingdom 2018-19,* has been issued as a companion publication to the CIPFA Code setting out the approach to these two standards.

Other changes to the 2017 CIPFA Code include an amendment to section 3.1 (Narrative Reporting) to introduce key reporting principles for the narrative report, and updates to section 3.4 (Presentation of Financial Statements) to clarify the reporting requirements for accounting polices and going concern reporting.

IFRS 16 *Leases* will bring a significant number of operating leases onto the balance sheet unless they are low value or have less than a year to run. CIPFA/LASAAC will revisit accounting for PFI liabilities which are currently under finance lease accounting rules of IAS 17, which is being replaced by the new standard. It is expected that this standard will be incorporated in to the 2019-20 CIPFA Code.

Wider scope and Best Value
Introduction

DRAFT

Audit dimensions introduction

The Code of Audit Practice sets out four audit dimensions which, alongside Best Value in the local government sector, set a common framework for all the audit work conducted for the Controller of Audit and for the Accounts Commission: financial sustainability; financial management; governance and transparency; and value for money.

It remains the responsibility of the audited body to ensure that it has proper arrangements across each of these audit dimensions. These arrangements should be appropriate to the nature of the audited body and the services and functions that it has been created to deliver. We review and come to a conclusion on these arrangements.

During our work on the audit dimensions we considered the work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

Best Value

The Accounts Commission agreed the overall framework for a new approach to auditing Best Value in June 2016. Best Value will be assessed over the five year audit appointment, as part of the annual audit work. In addition a Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in the five year period. The BVAR report for the Council is planned for later in the five year programme.

The Best Value audit work integrated into our audit in 2016-17 focused on two of the seven areas: financial and service planning and financial governance and resource management. The findings of this work are reported on pages 32-44.

Strategic Audit Priorities

The Accounts Commission agreed five Strategic Audit Priorities:

- the clarity of Council priorities and quality long-term planning to achieve these;
- the effectiveness of councils in evaluating and implementing options for significant changes in delivering services;
- how effectively councils are ensuring that members and officers have the right knowledge, skills and time to lead and manage delivery of council priorities;
- how effectively councils are involving citizens in decisions about services; and
- the quality of council public performance reporting to help citizens gauge improvements.

We consider the strategic audit priorities when performing the wider audit dimension work over our five year appointment.

Our approach

We performed a range of procedures to inform our work over best value;

- interviews with senior officers including the Chief Executive, the Policy, Performance and Parliamentary Liaison Manager and the Head of Finance;
- review of various committee papers and reports;
- attending committee meetings
- discussion with officers throughout the Council; and
- consideration of Audit Scotland guidance to draw conclusions on good practice.

Wider scope and Best Value

Audit dimensions conclusions

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Financial sustainability

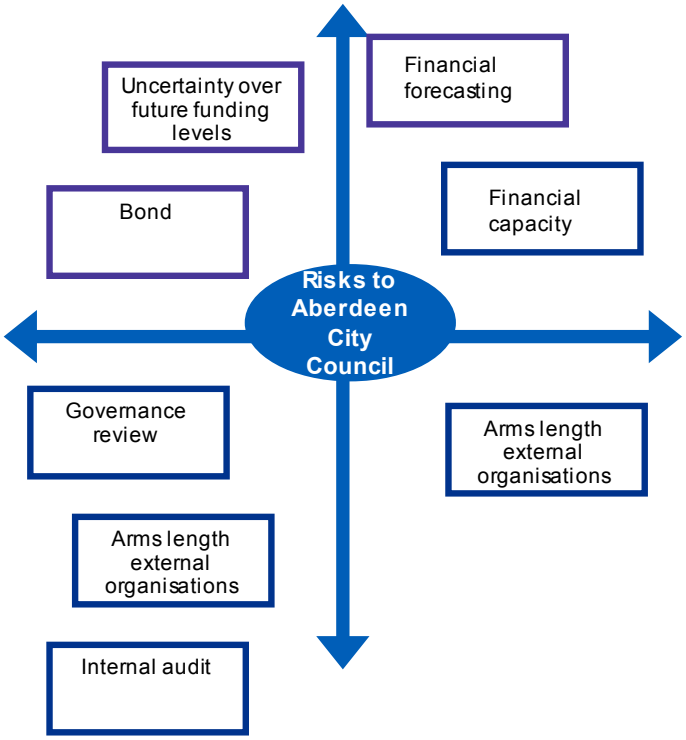
The Council approved savings proposals (£129 million) over the next five years in order to continue to provide services which meet demand (page 11).

In addition the transformation programme will support achievement of these savings and strengthen the Council's capital management through redesigning the way services are delivered to maximise efficiencies and support change.

Savings required for 2017-18 appear to be on track to be delivered, and from evidence of actions taken in previous years, management demonstrates strong budgetary control and the ability to take effective action to address financial sustainability.

Governance and transparency

Management has demonstrated a commitment to achieving best practice in its governance arrangements. There is evidence of a good pace and depth of change since the implementation of the governance review, although we note not all actions have been able to be delivered on time. We consider that embedding the changes in to the Council will support management in achieving best practice, and we have seen a number of areas which already meet best practice.



Financial management

During budget setting there is ongoing consultation with members, service users and other key stakeholders. This results in an open and transparent budget setting process and supports effective financial management.

We consider that the Council has strong financial management.

Value for money

We consider that the Council has appropriate arrangements for complying with *"Following the public pound"*.

Options appraisals and business cases processes have developed over the year, with value for money considerations being evident.

There are a number of areas of partnership working with other public sector entities and there is clear evidence of a commitment from management for continuous improvement.

Wider scope and Best Value

Financial sustainability

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

Service redesign and transformation

The Council has a long term goal to become self-sufficient and has made significant progress such as by seeking alternative forms of commercial funding by issuing a bond on the London Stock Exchange. However, there are significant identified financial pressures of £125 million until 2023 as shown in the table below. The Council has launched its transformation programme to bridge this gap and specific plans have been reported to the Council through the target operational model proposal that is directing service redesign.

	2018-19 £'000	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Gross expenditure	683,653	699,324	714,513	728,595	741,741
Gross income	(226,754)	(227,321)	(227,887)	(228,454)	(229,020)
External funding	(421,459)	(411,899)	(405,721)	(402,622)	(402,400)
Net deficit	**35,440**	**60,104**	**80,905**	**97,519**	**110,321**
Transformation investment	7,000	8,000	-	-	15,000
Use of reserves	(7,000)	(8,000)	-	-	-
Potential deficit	**35,440**	**60,104**	**80,905**	**97,519**	**125,321**

The new 'Target Operating Model' was approved in August 2017 and the creation of the Strategic Transformation Committee will direct the planned £129 million of savings over the next five years. A part of this will be through the voluntary redundancy programme launched at the end of 2016-17 with savings of over £20 million expected.

There are five programmes of work that have been established regarding transformation. These programmes are overseen by a programme board, and during 2016-17 a Transformation Delivery Board was established as the key governance group overseeing the whole portfolio of transformation work. The five areas are:

- stewardship: focused with bond governance;
- governance review;
- operational excellence: "true transformation", considering service redesign include the large scale employee voluntary redundancy programme;
- Enterprise Council Board: commercial income, contract management, shared services and increasing economies of scale; and
- digital transformation.

At this stage it is too early to assess the projects involving redesign or services. The Transformation Delivery Board will monitor progress throughout the year and report back to Council.

For 2017-18 service options totalling £31.9 million were presented to members in setting the budget, and a total of £22.4 million of savings proposals were approved to address a £17.2 million deficit. As at June 2017 the Council was forecasting a £0.5 million deficit, however a working group is carrying out a strategic review to ensure this is balanced for year end.

Wider scope and Best Value
Financial sustainability (continued)

DRAFT

Financial planning

As part of obtaining a credit rating to be listed on the London Stock Exchange, the Council prepared a high level 35 year financial plan to aid forecasting and demonstrate the Council's ability to pay the debt finance.

This has been built into the budget setting and monitoring process in the short term demonstrates strong financial management. Members are involved in the budget-setting process from the first stage of service planning through to full budget approval. Management and members receive good quality revenue and capital monitoring reports and these receive appropriate scrutiny at the council management team and finance, policy and resources committee meetings.

The budgeting team has detailed financial projections for the five year period. These are built on a number of assumptions, including demographic projections for the city, pay awards, expected Scottish Government funding, income projections, Council Tax and NDR. All projections are approved by CMT and reviewed each year.

Treasury management and investment

The decision to use the bond issuance as capital financing was overseen and approved by the finance, policy and resources committee, and due to the significance of the transaction an options appraisal was carried out. This concluded that the bond financing offered the best value for money due to the initial cash injection whilst providing a three year repayment holiday before capital projects are complete and generate revenue to finance the debt on a suitable basis. The Council has an appropriate policy for treasury management and investment decisions, this is scrutinised at Council meetings and the policy gives Committee oversight of the temporary investments held to fund the capital programme.

With the issuance of the Bond, there has been additional scrutiny required of the Council's financial position. However, as noted, with the new financial reporting process and the ongoing bond governance project we do not consider the level of borrowing required to pose a financial sustainably.

Asset management

A number of ongoing capital projects had been highlighted by management as not having had the appropriate approvals or monitoring during their lifecycle; these included the Third Don Crossing, the Treasure Hub and Berryden Corridor.

Capital planning has therefore been an area of focus for the Council during 2016-17, with health-checks having been performed on key projects and a new governance framework for programme and project management having been approved by ARSC in June 2017.

New arrangements identified include:

- Formation of the Strategic Asset and Capital Board ("SACB").
- Implementing the capital governance review action plan.
- Formation of the members reference group for monthly review of the capital programme.
- programme boards will take responsibility for scrutiny and challenge of their own area projects, while the SACB will review projects on exception.

This is against the back drop of the £1 billion capital plan and recognising change to the current practices was required. We noted that a number of large projects have fallen behind partly due to developing programme management but we recognise the pace with which this is being rectified.

Wider scope and Best Value
Financial sustainability (continued)

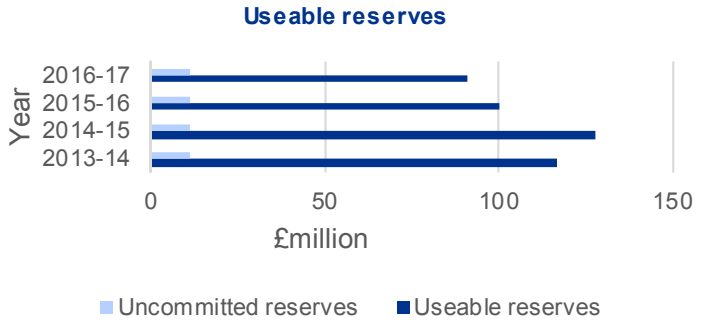
DRAFT

Reserves

The table below shows total useable reserves have decreased in recent years as planned, primarily due to major capital expenditure using capital funds, while unallocated reserves have remained constant at £11.3 million, demonstrating strong financial management. This has been aided by using earmarked reserves to reduce the impact of unforeseen financial pressures. Within earmarked reserves the Council has a risk fund of £8.4 million to mitigate any short term risks that may arise and impact operational funding.

However, the unallocated reserves accounts for 1% of annual expenditure and there is a risk that the Council does not have the reserves to cover the savings required for the next five years.

£22.4 million of savings proposals have been approved for 2017-18. Quarterly reporting for 2017-18 to date indicates that the Council is on track to meet its approved budget. However if there was a time lag in savings proposals being realised, uncommitted reserves would provide short term cover for up to 50% of these efficiencies. As noted, the Council is reactive to responding to budgeting pressures through the year and aim to action savings to achieve the budgeted year end position.



Conclusion

The Council has approved savings proposals (£129 million) over the next five years in order to continue to provide services to meet demand (page 11).

In addition the transformation programme will support achievement of these savings and strengthen the Council's capital management through redesigning the way services are delivered to maximise efficiencies and support change.

Savings required for 2017-18 appear to be on track to be delivered, and from evidence of actions taken in previous years, management demonstrates strong budgetary control and the ability to take effective action to address financial sustainability.

Wider scope and Best Value
Financial management

DRAFT

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

Financial capacity

The section 95 officer is appointed by the finance, policy and resources committee and is the Head of Finance. This position has appropriate status within the Council and access to the Chief Executive and the Council members. The finance function has decreased in size over the past few years, in line with the general reduction in the Council's scale.

We note that the finance team has been recognised by award of 'Finance Team of the Year', and the Head of Finance received 'Public Finance Professional of the Year' by CIPFA and also the 'Emerging Director of the Year' by the Scottish Accountancy and Finance Awards.

These awards demonstrate the Council's innovative culture and long term goal to become self sufficient. There are no concerns raised over the financial capacity to produce the annual accounts and the new CIPFA accounts production tool should help the team become more efficient.

Financial position and governance

The Council managed the 2016-17 outturn against budget during the year effectively, recognising efficiencies had to be found in the last quarter when presented with a forecast deficit. This resulted in £3 million surplus against budget for the year end position.

There are sufficient reserves to support future operations – reserves are discussed above. The Council has forecast a funding gap of £125 million over the next five years, but has identified saving opportunities to mitigate the gap. We provide further commentary on the financial position on pages six to 11.

As a result of the May 2017 elections new finance training for members was developed and is being delivered over the summer of 2017. This was recognised as an area of required improvement as previously no mandatory training was required or recorded. The training is facilitated by the Head of Finance and Finance Managers, demonstrating the Council's commitment to the importance of the sessions. The wider scope of budget setting includes consultations with third tier staff via a platform to encourage involvement from all aspects and inspire new proposals or identify efficiencies. Discussions with other councils are had to share budgeting ideas. The consultations process also highlights new or expected budget pressure points.

Budget consultation with members and services

All Councillors are informed of the budget proceedings as part of their induction. Procurement training was included within this and our testing found that all sampled capital projects were appropriately tendered for and approved by Committee.

Ownership of meeting budget shortfalls is with heads of service, not with finance. Directors are challenged to be more strategic, passing more responsibility for short-term financial planning to heads of service. This supports service redesign planning.

Consultation of service users in budget setting

The level of consultation in which the Council engages with the local population varies year-to-year, and is mainly carried out by members rather than officers. With local elections taking place in 2017 we understand that there was little consultation as part of the 2017-18 budget-setting cycle.

Wider scope and Best Value
Financial management (continued)

DRAFT

Increased consultation is a high priority for the Council, albeit recognising that there is a need for this to be effective.

The Council has an online consultation portal called Customer Space and also offers members of the public the chance to participate in the City Voice panel, which is consulted three times a year.

Workforce planning

Over the last five years the workforce of the Council has decreased. The Council has initiated a voluntary redundancy scheme in 2016-17 with 150 applications being received. Severance packages will be awarded in 2017-18 and this is planned to continue for 3 years.

Typically hard to fill posts are in relation to teachers, particularly in rural areas. The Council has developed a range of incentives such as relocation packages, providing affordable housing and retention incentives. Management recognise the challenges associated with attracting social care professionals to the city. Having heard innovative ideas from Councils in England, consideration is being given to a social work academy to train local residents. With the downturn in the oil and gas industry the Council has benefited from seeing a higher rise in applications for professional services type jobs, for example finance.

Sickness absence continues to be an issue for the Council, although developments in this area has seen the average days being reduced to just over 10, down from 14.8 days ten years ago. The maximising attendance policy is being reviewed by internal audit and there a number of measures implemented through workforce planning.

Quarterly reporting - continuous improvement

The Council is changing to quarterly reporting for 2017-18 to comply with bond governance and improve its financial reporting as well as reduce the administration burden on monthly reporting.

The first Q1 report went to Committee on 23 August 2017. This comprised of a full set of financial statements with management commentary and additional notes to explain the financial position. In addition there is a projection reported for rest of the year, including the Common Good, and a summary of ongoing capital works.

This also supports the faster close down period expected for 2017-18 year end, and the Council is piloting an automatic accounts production software purchased in alliance with CIPFA.

This meets the requirements for the Council to report its financial position on a quarterly basis to the London Stock Exchange and ensure monitoring of maintaining the credit rating is publically available. The Council should continue to seek assurances that reporting is appropriate and providing the relevant information in the first year of this process.

Conclusion

During budget setting there is ongoing consultation with members, service users and other key stakeholders. This results in an open and transparent budget setting process and supports effective financial management.

Wider scope and Best Value
Governance and transparency

DRAFT

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 structure

The Council is carrying out an extensive governance review which led on from a review of the existing governance arrangements and whether they were sufficient to ensure that the Council remains compliant with all matters pertaining to the bond issuance. During our audit we met with the Head of Legal and Democratic Services and the Governance Review Programme Manager to understand progress of the programme.

The enhancement of governance at committee level has been a focus area for the Council throughout 2016-17. A range of projects are being undertaken to enhance governance structures, the quality of committee reporting and the Council's risk management. We further explain in the box opposite.

While the Council largely demonstrates effective scrutiny, challenge and transparency on decision-making there have been two high profile governance weaknesses that were brought under scrutiny in 2016-17. These were in respect of the approval process of a cycle path repair in 2016-17 and the approval process for photovoltaic panels in a prior year. The former is subject to a Council investigation and the latter was reviewed by internal audit to, in part, identify lessons to learn.

These have demonstrated the need for attention in this area, but the scale and pace with which the Council has developed the governance review shows the Council's commitment to sound governance.

We consider that the governance arrangements in place during 2016-17 were appropriately formed, although welcome the far reaching review.

The Standing Orders are also going through a further refresh to take into account new co-leadership arrangements.

Governance review – continuous improvement

There were a number of drivers for the governance review including the bond issuance, the desire for further clarity in committee reporting and previous Best Value reports. The governance portfolio sits within the transformation programme since strong governance is necessary in the success of delivering transformation and ensuring the Council maintains its credit rating for the bond. One key aim is to ensure a 'golden thread' through all strategies and policy documents.

The Council sought external expertise to support its development, including the Good Governance Institute's review of risk management and CIPFA's interim assessment of governance arrangements prior to a full assessment against the Mark of Excellence.

A number of initiatives and changes were made. Below are examples and comments on their progress:

- *Officers' interests were not being appropriately captured under the Councils existing processes and a new process was determined in January 2017 to recognise the need for transparency in this area. The audit team noted that whilst this was actioned in May 2017, a number of responses are not yet complete which highlights delays in implementation.*
- *Standing Orders were refreshed in March 2017, and will now be updated to take account of the new co-leadership arrangements.*
- *A review of the effectiveness of internal audit has been completed.*
- *The review of ALEOs governance is complete and an options appraisal was presented to the ARSC in June 2017.*
- *The risk management framework being updated including risk register format and the completion of an assurance map to identify possible assurance gaps.*

The newly created Governance Board has responsibility for monitoring progress against the agreed actions.

Wider scope and Best Value
Governance and transparency (continued)

DRAFT

Risk management

The Council carried out a review of the system of risk management during 2016 and at its conclusion, agreed an action plan to take forward a number of actions to improve the system (which are incorporated within the governance review). Notable amongst these actions were improving the risk identification mechanisms, strengthening the level of assurance the Council's senior management can take in the effectiveness of risk controls and mitigation and the agreement of a risk appetite for the Council, to inform risk assessment and escalation between tiers of risk management.

Of the 14 actions, two had been completed by the end of June 2017, one was rated 'red', two 'amber' and nine 'green'. The 'red' rated action related to standardising the risk register, recording system and methodology across the Council.

In forming our views on risk management, we met with the Council's risk manager, inspected risk registers and reviewed progress against the action plan.

Whilst not all actions have yet been completed progress being made demonstrates the scale of change being implemented at a pace in line with that of the wider governance review being undertaken. Completion of the remaining actions and embedding the new risk management practises in to the Council should lead to best practice in this area. The updated risks registers presented to the ARSC are in line with best practice we see across the local government and other public sectors.

Fraud

No material frauds were identified during the year. Fraud arrangements include a separate corporate investigation team within the corporate governance directorate (from 2017-18 onwards), policies and codes of conduct for staff and board members, supported by a Policy and Strategic Response to Fraud, Bribery and Corruption.

Having met with the corporate investigation team to discuss ongoing investigations and reviewing related policies and code of conducts, we consider these to be appropriate for the Council.

National Fraud Initiative ("NFI")

The NFI is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. The Council's participation in the NFI is led by its corporate investigation team.

We submitted a return to Audit Scotland in June 2017, assessing management's participation in the NFI against Audit Scotland criteria.

The Council took part in CIPFA's NFI benchmarking exercise for the first time during 2016-17 and the results of this are being used by the Council to help shape its fraud response.

Overall the arrangements were satisfactory and overall engagement with NFI is good. We noted one area for improvement to achieve best practice in relation to reporting on the effectiveness of recovery efforts.

Recommendation six

Wider scope and Best Value
Governance and transparency (continued)

DRAFT

Leadership

There is evidence of strong leadership within the Council, although it is noted that there are changes in personnel in senior leadership positions. The target operating model should enable greater stability of such positions in future years.

Following the local elections in May 2017, a conservative/labour, independent coalition became the administration of the Council, with a majority of one giving rise to a finely balanced position in decision making. The Council has chosen to follow a co-leadership model, which is requiring the standing orders and a number of policy documents to be updated to allow such arrangements to work.

An administration councillor for the Rosemount and Midstocket ward is also a member of the Scottish Parliament.

We evidenced that due to a desire for paperless working, during committee meetings, amendments to proposed recommendations are circulated via email to Councillors and officers. There is a potential risk of diminished transparency as those without internet access or on the Council mailing lists do not receive these documents.

Local Area Network ("LAN") and local scrutiny plan ("LSP")

In forming our risk assessment for the wider scope areas and Best Value audit work, we considered the LSP and outcomes from the LAN.

The 2016-17 LSP did not identify any specific additional scrutiny, although scrutiny activity was undertaken as a consequence of national follow-up work or at the direction of Scottish Ministers and there was planned risk-based national driven scrutiny.

For 2017-18 there was no additional scrutiny required by external audit. Whilst there were positive views of the Health and Social Care Partnership and the progress being made, scrutiny partners will continue to monitor progress against the issued action plans. Thematic scrutiny will also be undertaken in relation to the accuracy of data on gas safety and homelessness.

Performance management

The Council has responsibility, under its Best Value duty, to report performance to the public. The Council participates in the Local Government Benchmarking Framework ("LGBF") and supported by Audit Scotland, they are using this to improve their approach to public performance reporting.

A revised performance management framework ("PMF"), incorporating a standard reporting template, was agreed by the corporate management team and subsequently implemented across services. The PMF will continue to be enhanced during 2017-18 through the performance, risk and improvement board which reports to the change delivery board.

As auditor we have integrated this into our risk assessment and will be addressed in more depth in the year of the Best Value Assurance Report.

Wider scope and Best Value
Governance and transparency (continued)

DRAFT

Internal controls

Council officers are responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual accounts. Our testing of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively. A review of the controls testing by KPMG as reported in our interim management report are shown opposite. We did not note requirements for improvements in controls tested.

The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work.

We note that there was a website homepage breach during 2016-17, however no confidential data was lost and an internal investigation was instigated immediately. We do not consider this impacts our work over IT systems and demonstrates the pace at which management is able to react to emerging issues.

Control tested	Effective
Bank reconciliations: three months bank reconciliations were tested for each bank account.	✓
Budget monitoring: three monthly reports were considered to confirm a sufficient level of detail was presented to and considered by the CMT.	✓
Payroll controls: starters, leavers and amendments tested to ensure changes to payroll data was appropriately authorised.	✓
Expenditure controls: A sample of 40 purchase orders were tested and agreed to invoice. Procurement testing covered a sample of 25 contracts. These were checked to verify they had followed the correct tender route based on value. The tender evaluation was also considered for Best Value. For capital expenditure we tested two monthly reviews to verify that only items over the threshold of £6,000 were capitalised.	✓
Journal authorisation: A sample of 40 journals were selected and checks carried out to confirm there is segregation of duties exist in who raises and who authorises journal entries.	✓

Arms length external organisations ("ALEOs") governance

The Council has a number of ALEOs that are subsidiaries and that deliver services on behalf of the Council. Refreshed governance arrangements were presented to the audit, risk and scrutiny committee in June 2017. The options appraisal, which was well laid out with supporting arguments and an appropriate level of detail for decision makers is considered to be good practice and demonstrated management's commitment to enhancing the governance arrangements.

The 'assurance hub model' was approved for adoption following a vote amongst elected members. Having read the options appraisal and listened to the debate, we consider these actions support an appropriate depth of change to the governance of ALEOs to a level that is commensurate with the Council's depth and breadth of ALEOs.

Audit Scotland is conducting a performance audit over ALEOs, with the Council having been picked as a case study. The audit includes a specific focus on new and emerging ALEO models such as those providing care services. The findings will be reported in early 2018.

Wider scope and Best Value
Governance and transparency (continued)

DRAFT

Internal audit

Internal audit is provided by Aberdeenshire Council's shared service internal audit department and supports management in maintaining corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action.

Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit.

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit),* we took the decision not to use internal audit's work to inform our procedures. We are working with internal audit to identify areas where we can place reliance on its work in future years.

Our review identified that the internal audit function generally conforms with PSIAS, although note that management would like the internal audit function to deliver to the same standards as those expected of an internal audit function in a listed commercial business. To this end we performed an effectiveness review on behalf of the Council in 2016-17, identifying improvement opportunities in respect of risk assessment, assignment scoping, specialist resource and performance measures. The recommendations are being considered as part of the governance review.

Due to the flexible nature of the internal audit plan, not all internal audit work was completed by 31 March 2017, with 73% of reviews complete by this date. This is an improvement from the prior year where 50% were complete. All audits from the prior year have now been completed.

The controls assurance statement states that "reasonable assurance can be placed on the adequacy and effectiveness of the Council's internal control system for 2016-17. This statement does contain caveats with regards significant concerns raised identified in the year in relation to recommendations graded as 'major' (in budget monitoring, compliance with procurement legislation, adult social work purchasing and creditors procedures and agency staff reviews) and the limitations of scope of planned internal audit work due to a lack of systems access and provision of requested information.

The review of internal audit reports and conclusions did not indicate additional significant risks not already identified and there is no impact on our planned substantive testing.

Conclusion

Management has demonstrated a commitment to achieving best practice in its governance arrangements. There is evidence of a good pace and depth of change since the implementation of the governance review, although we note not all actions have been able to be delivered on time. We consider that embedding the changes in to the Council will support management in achieving best practice, and we have seen a number of areas which already meet best practice.

Wider scope and Best Value
Value for money

DRAFT

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

Following the Public Pound

Auditors are required to consider the Council's arrangements for compliance with the Code of Guidance on Funding External Bodies and Following the Public Pound ("the FtPP Code"). We considered management's processes to comply with the FtPP Code. The Council has developed a local code of practice which applies the FtPP Code in the local context of the Council's interactions with its ALEOs. The local code sets out four tiers of external organisations based on level of annual funding provided by the Council. Based on these tiers a risk-based approach is taken regarding the assurance required by the Council on arrangements with ALEOs. Tier 1 organisations are those in receipt of over £7 million funding from the Council. Each service committee will oversee the funding of such ALEOs in its area as its Monitoring Body, and will receive an annual report from the budget holder.

Options appraisal

The Council reviewed its processes for options appraisal during the year, being an important area in light of the transformation programme and capital plan.

We have seen evidence of significant improvements to the Council's approach to options appraisal, in particular for the Aberdeen Exhibition and Conference Centre ("AECC") operator, the new ALEOs governance model and appraisal of options for financing the AECC construction. This is an area of focus for our year two Best Value work.

Value for money in key decisions

The Council has faced and will continue to face difficult decisions in how funding will be spent. The forecast funding gap of £143 million over the next five years necessitates value for money be achieved, effective options appraisal and governance around policy and resourcing. The transformation programme has a focus on VFM and emphasises the need to deliver existing services in a more cost efficient manner.

The Standing Orders help to ensure that decisions about spend are being made at the appropriate level and the Council will have to make an increased number of difficult decisions over the next five years. In February 2017 the Council approved a voluntary redundancy scheme. It is important that the right decisions are made about applications under this scheme to ensure that VFM is achieved through this process. Our testing of exit packages paid in 2016-17 identified that all had followed the appropriate policy.

Aberdeen Exhibition and Conference Centre – continuous improvement

With the development of the new Aberdeen Exhibition and Conference Centre (AECC), management undertook a procurement exercise to appoint a new operator and management of the AECC. Members were provided with detailed analysis of the procurement process and evaluation undertaken by officers. A number of criteria were considered in the evaluation, covering the financial offer, deliverability and legal and contractual.

The outcome of the procurement exercise was to appoint SMG Europe.

As the procurement was not solely financially driven, value for money considerations were evidenced to balance the need of appointing an operator with global reach and additional benefits with the overall cost to the Council.

Wider scope and Best Value
Value for money

DRAFT

Continuous improvement

Continuous improvement is evident in a range of ways at the Council. Management's response towards the findings of previous Best Value reports and other external reviews has demonstrated a commitment to achieving operational excellence.

Service improvement plans are being implemented with a starting position of stating the service improvement outcome. These are being linked to the local improvement plan. Management recognises there is further work to embed a continuous improvement mindset within the Council; the transformation programme now has a workstream on improvement.

Commissioning and procurement

The Council has a dedicated procurement function which it shares with Aberdeenshire and Highlands Councils, which allows the Council to realise VFM through greater buying power and economies of scale. This function also regularly receives high ratings in the PAC.

Partnership working

There is strong evidence of partnership working between the Council, Aberdeenshire Council and NHS Grampian. As well as the shared procurement function, internal audit function. The recent City Deal has brought joint governance arrangements between Aberdeen City and Aberdeenshire.

Previous other joint working arrangements had been in place for the section 95 officer and head of education. Whilst the Council undertakes it reorganisation to the 'target operating model' these arrangements are not in place. We do not consider that this impinges on the Council's desire to deliver effective services across the range of public sectors through partnership working.

Through discussions with senior Council staff we understand that further partnership working is being considered as part of the transformation project, with potential for services provided by the Council to be provided to other public sector organisations.

The largest area of partnership working is through the IJB. The IJB agreed payments to be made in advance of the start of the financial year. Going forward the IJB will present a budget, based on the strategic plan, to the partners for consideration as part of each partner's annual budget setting process. Payments to be made to the IJB will require to be formally advised by the 28 February each year in line with the Integration Scheme.

Alternative models of service delivery

This is an emerging area for the Council and one that could be a strength in future years. Due to the current financial climate and management's desire for depth of change in the Council, a number of alternative models of service delivery are being considered and this is an area that is high up on the Council management teams agenda. Some examples being considered include digitisation and robotics. Management has sought external advisors to support its analysis and review of such delivery models.

Conclusion

We consider that the Council has appropriate arrangements for complying with the FtPP Code.

Options appraisals and business cases processes have developed over the year, with value for money considerations being evident.

There are a number of areas of partnership working with other public sector
entities and there is clear evidence of a commitment from management for continuous improvement.

KPMG

Appendices

Appendix one

Mandated communications with the Audit, Risk and Scrutiny committee

DRAFT

MATTERS TO BE COMMUNICATED	LINK TO AUDIT, RISK AND SCRUTINY COMMITTEE REPORTS
Relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff (ISA 260 and Combined Code)	See appendix three.
The general approach and overall scope of the audit, including levels of materiality, fraud risks, business risks and audit responses and engagement letter (ISA 260)	Main body of this paper.
Disagreement with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report (ISA 260)	There were no such disagreements.
The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements (ISA 260)	There are no such matters to report.
Audit adjustments, whether or not recorded by the entity that have, or could have, a material effect on the entity's financial statements (ISA 260)	See appendix six.
The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements (ISA 260)	Accounting policies and practices selected by the Council are appropriate for the organisation and are in line with the requirements of the Local Authority Code of Practice (page 13).
The auditor's view on valuations and related disclosures (ISA 260)	See conclusion on page 18.
Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 260)	There are no such matters to report.
Expected modifications to the auditor's report (ISA 260)	There are no such matters to report.
Other matters warranting attention by those charged with governance, such as effectiveness of internal controls relevant to financial reporting, material weaknesses in internal control, questions regarding management integrity, and fraud involving management (ISA 260 and ISA 240)	There are no such matters to report.

Appendix two

Appointed auditor's responsibilities

DRAFT

AREA	APPOINTED AUDITOR'S RESPONSIBILTIES	HOW WE HAVE MET OUR RESPONSIBILITIES
Statutory duties	Undertake statutory duties, and comply with professional engagement and ethical standards.	Appendix three outlines our approach to independence.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions. Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page 13 summarises the opinions we have provided. Pages 26 and 27 report on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report. Page 52 summarises the grant claims and whole of government accounts we have reported on.
Financial statements and related reports	Notify the Auditor General or Controller of Audit when circumstances indicate that a statutory report may be required.	Reviewed and concluded on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.
Corporate governance	Participate in arrangements to cooperate and coordinate with other scrutiny bodies.	Page 42 sets out our conclusion on these arrangements.
Wider audit dimensions	Demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies': - Effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets; - Suitability and effectiveness of corporate governance arrangements; - Financial position and arrangements for securing financial sustainability; - Effectiveness of arrangements to achieve best value; - Suitability of arrangements for preparing and publishing statutory performance information	We set out our conclusions on wider scope and best value on pages 32 to 44.

Appendix three

Auditor independence

DRAFT

Assessment of our objectivity and independence as auditor of Aberdeen City Council ("the Council")

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values;
- Communications;
- Internal accountability;
- Risk management; and
- Independent reviews.

The conclusion of the audit engagement director as to our compliance with the FRC Ethical Standard in relation to this audit engagement and that the safeguards we have applied are appropriate and adequate is subject to review by an engagement quality control reviewer, who is a partner not otherwise involved in your affairs.

We are satisfied that our general procedures support our independence and objectivity.

Independence and objectivity considerations relating to the provision of non-audit services

Exiting of prohibited non-audit services

We have concluded our review of services performed in respect of the Council in the last three years. We confirm that we either completed or terminated any services that would not be permissible under the FRC's Revised Ethical Standard prior to 31 March 2017.

The following services were terminated:

- VAT claim advice: Support with two claims in respect of VAT, fee £49,000.

Summary of fees

We have considered the fees charged by us to the Council and its affiliates for professional services provided by us during the reporting period. We have detailed the fees charged by us to the Council and its related entities for significant professional services provided by us during the reporting period overleaf, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted.

Auditor independence (continued)

DRAFT

The ratio of non-audit fees to audit fees for the year was 2.36 : 1. We have considered the ratio of audit to non-audit fees. Prior to the appointment as the Council's external auditor we consulted with Audit Scotland and KPMG's Risk team with regards the non-audit services. The principal threat which arises from fees from non-audit services which are large in absolute terms of relative to the audit fee is the perception of self-interest. In this regard, we do not consider that the above ratio creates such a self-interest threat since the absolute level of non-audit fees is not significant to our firm as a whole and neither the audit director nor members of the audit team are incentivised on, or rewarded in respect of, the provision of non-audit services to you. We believe that the question of perception is best addressed through appropriate disclosure as to use of the auditor for the provision of non-audit services in the Council's financial statements. We do not consider that the total non-audit fees create a self-interest threat since the absolute level of fees is not significant to our firm as a whole.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out overleaf.

Contingent fees

Under the FRC's Revised Ethical Standard, no new tax contingent fees for listed entities can be entered into after 17 June 2016. We confirm that no new contingent fees for tax services have been entered into for the Council since that date.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit, Risk and Scrutiny Committee.

Confirmation of audit independence

We confirm that as of the date of this letter, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit, Risk and Scrutiny Committee and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

Yours faithfully

KPMG LLP

Appendix three

Auditor independence (continued)

DRAFT

Total fees charged by us for the period ending 31 March 2017 can be analysed as follows:	2016-17 (exc VAT) £
Audit of the Council's financial statements	194,431
Audit of subsidiaries (Aberdeen City Council Charitable Trusts)	8,500
Total audit services	**202,931**
Other non-audit services	
• Capital financing advice	363,920
• Options appraisal and strategic review	50,000
• VAT claim advice	49,000
• Governance review – internal audit effectiveness and assurance mapping support	15,000
Total non-audit services	**477,920**
Total	**680,851**

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the following table:

Disclosure	Description of scope of services	Principal threats to independence	Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2017 £	Value of services committed but not yet delivered £
Capital financing advice	Advice in respect of commercial structuring and financial structuring for the capital financing. Support in respect of obtaining external credit rating.	Self-review, self-interest, advocacy	Self-review – engagement delivered by a team separate from the external audit team and did not involve actions which directly impact on the financial statements. KPMG did not assume a management role. Self-interest – engagement concluded prior to external audit commencing, fees paid prior to external audit commencing. Fees are not material to KPMG or the Council. Advocacy – KPMG did not engage with debt providers or promote a client position.	Fixed	363,920	-

Appendix three

Auditor independence (continued)

DRAFT

Disclosure	Description of scope of services	Principal threats to independence	Safeguards applied	Basis of fee	Value of services delivered in the year ended 31 March 2017 £000	Value of services committed but not yet delivered £000
Options appraisal and strategic review	Options appraisal and strategic review relating to an associate entity of the Council.	Self-review, self interest	Self-review – engagement delivered by a team separate from the external audit team and does not involve actions which directly impact on the financial statements. KPMG did not assume a management role. Self-interest – engagement concluded prior to external audit commencing, fees paid prior to external audit commencing. Fees are not material to KPMG or the Council	Fixed	50,000	-
VAT claim advice	Support with two claims in respect of VAT. Originally agreed on a contingent fee basis in 2013.	Self-review	Self-review – engagement delivered by a team separate from the external audit team and does not involve actions which directly impact on the financial statements. KPMG did not assume a management role and the claims relate to the application of tax rules.	Fixed	49,000	-
Governance review support – internal audit effectiveness and assurance mapping	Review of internal audit effectiveness to support the overall governance review. Support with assurance mapping: provision of a template for assurance mapping and support with documenting the assurance for two selected risks from the risk register.	Self-review, management, advocacy	Scoping - engagements do not relate to the design of controls or processes. There is no assumption of a management role by KPMG. The management risk arises in the assurance mapping project but it is being led and delivered by the Council – KPMG's role is to guide the Council through how to form an assurance map for two risks on the risk register, for the Council to then plot the remaining risks and interpret the results. KPMG will not be acting on behalf of the Council or promoting a course of action.	Fixed	15,000	-

Appendix four

Grant claims and WGA return

DRAFT

RETURN	DESCRIPTION	CONCLUSION
Whole Government Accounts ("WGA")	WGA is the consolidated financial statements for all components of government in the UK. Most public bodies are required to provide information for the preparation of WGA. External auditors are required to review and provide assurance on WGA returns over a prescribed threshold.	Our audit work over the WGA is ongoing. We have not identified any errors or issues to report to date.
Non Domestic Rates ("NDR")	NDR in Scotland is collected by local authorities on an agency basis and notionally placed in a national 'pool', which is then redistributed among authorities based on each authority's estimated collection levels. In April each year, authorities submit an estimate of their expected NDR following the year end, authorities are required to submit their actual NDR yield, known as 'the notified amount' in a final return to the Scottish Government.	We did not identify any exceptions in our testing and expect to issue an unqualified opinion on the NDR return.
Housing Benefits ("HB")	The HB subsidy scheme is the means by which local authorities claim subsidy from the Department for Work and Pensions ("DWP") towards the cost of paying HB in their local areas. Claimants benefits either by direct application to the authority or by applying simultaneously for income support/jobseekers allowance and HB to the DWP. Eligibility for, and the amount of, HB is determined in all cases solely by the local authority. Monthly instalments of subsidy are made by the DWP on the basis of authorities' estimates in March and August. Final subsidy claims are made on claim form MPF720B which requires to be certified by the external auditor.	Our audit work over the HB return is ongoing. We have not identified any errors or issues to report to date.
Criminal Justice Authoriy ("CJA")	The delivery of social work services in the criminal justice system is the responsibility of the eight community justice authorities (CJAs) established under the Management of Offenders etc (Scotland) Act 2005. Funding is provided by Scottish Ministers and allocated to constituent authorities by CJAs. Constituent authorities are required to submit a financial return to their CJA detailing eligible expenditure incurred in the financial year to enable the CJA to produce a composite return to the Scottish Government.	Our audit work over the CJA return is ongoing. We have not identified any errors or issues to report to date.
Education Maintenance Allowance ("EMA")	EMA is a means tested weekly allowance payable to young people from low income families to encourage them to remain in education beyond the compulsory school leaving age. Local authorities manage the delivery of the EMA programme in respect of schools, home education, and all other learning other than college provision. EMA payments comprise a weekly allowance of £30 and are made by local authorities to eligible young people. The Scottish Government reimburses the costs incurred by authorities through monthly payments of grant. An allowance for the costs of administering the programme is also paid by the Scottish Government.	We did not identify any exceptions in our testing and issued an unqualified opinion on the EMA return.

Appendix five

Defined benefit obligations

In respect of employee benefits, each of the assumptions used to value the Council's net pension deficit in the North East Scotland Pension Fund ("NESPF") and Scottish Teachers Superannuation Scheme ("STSS") are within an acceptable range of KPMG's expectations. We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19. We set out below the assumptions in respect of defined benefit obligations.

DRAFT

North East Scotland Pension Fund

2017 £'000	2016 £'000	KPMG comment
218,746	221,749	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	Aberdeen City Council	KPMG Central	Comment
Discount rate (duration dependent)	2.50%	2.45%	The proposed discount rate is higher (lower liabilities) than KPMG's central rate as at 31 March 2017 but lies within a range we would normally consider to be acceptable for IAS19 purposes, albeit at the slightly less prudent end of that range.
CPI Inflation	2.20% RPI less 1.00%	2.40% RPI less 1.00%	KPMG's best estimate view is that the differential between RPI and CPI is 1% and we are seeing most organisations adopt an assumption of around 1% for this differential. The proposed assumption is therefore in line with KPMG central assumption. It could therefore be considered overly optimistic (lower liability). However, the assumption should not be considered in isolation
Salary growth	3.20% 1% above CPI inflation	Typically 1%-2.5% above CPI inflation	Assumed salary growth is set equal to CPI+1.0%, in line with the anticipated assumption for the 31 March 2017 valuation of the Fund. The Council set the salary growth assumption at 1.0% p.a. until 2020 to reflect short-term public sector pay restraints. From 2020 onwards, the proposed salary increase assumption has been set in line with 1.0% p.a. above CPI inflation. However, this can be considered reasonable provided the assumption is in line with management's best estimate view on future remuneration.

The overall assumptions applied by management are considered to be reasonably balanced. The closing deficit reduced by £3 million compared to 2015-16, primarily due to the decrease in the discount rate used (3.5% to 2.5%), offset with a decrease in salary increase (3.5% to 3.2%).

Defined benefit obligations (continued)

DRAFT

Scottish Teachers Superannuation Scheme

2017 £'000	2016 £'000	KPMG comment
31,021	29,369	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

Assumption	Aberdeen City Council	KPMG Central	Comment
Discount rate (duration dependent)	2.50%	2.45%	The proposed discount rate is higher (lower liabilities) than KPMG's central rate as at 31 March 2017 but lies within a range we would normally consider to be acceptable for IAS19 purposes, albeit at the slightly less prudent end of that range.
CPI Inflation	2.30% RPI less 1.00%	2.40% RPI less 1.00%	KPMG's best estimate view is that the differential between RPI and CPI is 1% and we are seeing most organisation adopt an assumption of around 1% for this differential. The proposed assumption is therefore in line with KPMG central assumption. It could therefore be considered less prudent (lower liability). However, the assumption should not be considered in isolation.
Salary growth	3.20% 1% above CPI inflation	Typically 1%-2.5% above CPI inflation	Assumed salary growth is set equal to CPI+1.0%, in line with the anticipated assumption for the 31 March 2017 valuation of the Fund. This assumption is lower than the previous year (RPI+0.9%) and is lower then what we generally see for participants in a number of other LGPS funds (typically around RPI+1%). However, this can be considered reasonable provided the assumption is in line with the management's best estimate view on future remuneration.

The overall assumptions applied by management are considered to be reasonably balanced. The closing deficit increased by £1.65 million compared to 2015-16, primarily due to the decrease in the discount rate used (3.4% to 2.5%.)

Appendix six

Audit differences

The table below lists the adjusted audit differences identified during the course of our 2016-17 audit procedures.

DRAFT

There are no unadjusted audit differences to report.

Nature of adjustment	Balance sheet		Income and expenditure account	
	£'000 DR	£'000 CR	£'000 DR	£'000 CR
Long term debtors reclassification				
Short term debtors	8,914			
Long term debtors		8,914		
Being the reclassification of St Nicolas House long term debtor to short term debtor as payable in 2017-18.				
Community charge debtor				
Short term debtors	2,498			
Bad debt provision		2,498		
Being the write off of community charges debtor due to the Council as this can no longer be recovered. The debtor related to the community charge had been fully provided.				
NDR debtor				
Non domestics rates income			976	
Short term debtors		976		
Write-off of prior year non domestics rates income which was not recoverable				
Investment in the Integration Joint Board				
Available for sale financial instruments reserve	5,209			
Long term investments		5,209		
Being the reversal of recognition of the investment in the Integrated Joint Board as does not meet the accounting definition of a financial asset.				
Integration Joint Board – CIES				
IJB expenditure			88,463	
IJB income				88,463
Gross income and expenditure within the CIES is understated and is required per legislation to be shown as grossed up.				

Appendix six

Audit differences (continued)

DRAFT

Nature of adjustment	Balance sheet		Income and expenditure account	
	£'000 DR	£'000 CR	£'000 DR	£'000 CR
Revenue recognition and accounting treatment				
Service income			7,873	
Service expenditure				7,873
Being the reversal of earmarked funds incorrectly recognised as revenue. The release from earmarked funds is being recognised appropriately within corporate and miscellaneous service line.				
Bond accounting				
Financing and investment income and expenditure			4,336	
Short term creditors	32			
Long term borrowing: bond issuance		2,646		
Long term borrowing: bond premium		1,722		
Adjustments to take account of the appropriate calculation of the effective interest rate and adjust for previous journals posted for the bond indexation to date.				
Bad debt provision				
Service expenditure			3,014	
Bad debt provision		3,014		
Being the revision of the bad debt provision to ensure that all debts over 120 days to 40 years were prudently provided for.				
Homeless debtor				
Short term debtors	4,516			
Service income				4,516
Recognition of a debtor where a provision had been raised but the debtor and related income had not been recognised in the accounts.				
TOTAL	**21,169**	**24,979**	**104,662**	**100,852**

Appendix six

Audit differences (continued)

DRAFT

Nature of adjustment	Balance sheet		Income and expenditure account	
	£'000 DR	£'000 CR	£'000 DR	£'000 CR
Adjustments which impact on the additional financial statements				
Disposal of non current assets in Housing Revenue Account ("HRA")				
Gain on Sale of HRA Non Current Asset	4,127			
Adjustments between accounting and funding basis: HRA		4,127		
The gain on sale of HRA non current assets recognised in the HRA income and expenditure statement was identified as being the net book value of the assets disposed. Proceeds from the sale were £10.7 million, and the gain recognised should be £3.4 million.				

A number of presentational amendments were also identified, the most significant of which related to:

- amendments to the housing revenue account housing stock numbers;
- updates to the lease disclosures for specific leases which had been incorrectly categorised or future lease payments differed in lease agreements;
- removal of disclosures in relation to transactions which did not meet the definition of an agency relationship;
- updates to the capital commitments disclosure to include total costs less expenditure to date and ensure that all contracted commitments are disclosed, not just those entered into in 2016-17; and
- reallocation of specific debtors between different categories.

Appendix seven

Action plan

DRAFT

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

We present the identified findings across four audit dimensions:

- financial sustainability
- financial management
- governance and transparency
- value for money

Priority rating for recommendation		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Appendix seven

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation	Agreed management actions
1. Development of documentation *Audit dimension: financial management*		**Grade two**
There are a number of areas where supporting documentation for management's judgements or complex reconciliations could be enhanced. Without clear documentation of significant judgements, there is a risk of inappropriate accounting treatment particularly where staff change. Furthermore, there is a risk that balances recognised in the financial statements cannot be supported by appropriate evidence. — Internal revaluations of heritage assets are documented on the TMS system which is accessed by the Curator team. There is minimal documentation, narrative or evidence to justify and support the valuations. — The impairment review does not fully document the scope of the assessment carried out by management and there is a risk that the full scope of challenge to assess any indicators of impairment is not recorded. — There are a number of large capital projects which have complex reconciliations of different types of expenditure to support the value of additions. The audit trail of such reconciliations was limited and required additional time to support such capital additions.	It is recommended that: — sufficient supporting documentation and evidence be uploaded and held on the TMS system to support heritage asset valuations; — management strengthens the level of documentation produced in relation to the processes and challenge given to any indicators of impairment on properties within their remit; and — all relevant officers should be reminded of the importance of maintaining supporting documentation for capital additions and keeping appropriate records.	Finance will work with services to progress the recommendations made. **Implementation date:** 31/03/18 **Responsible officer:** Senior Accountant
2. Revenue recognition *Audit dimension: financial management*		**Grade two**
Our testing identified a number of transactions credited to revenue where earmarked reserves were used for expenditure in the year. This is not in line with the Code's accounting treatment of recognising revenue. There is a risk that revenue is incorrectly inflated and the CIES does not present a transparent representation of transactions.	We recommend that management reviews the approach to recording movements from earmarked reserves. This should not recognised revenue and movements should be appropriately highlighted within the financial statements.	Finance will review the approach to recording such movements and will implement a new procedure as part of the 2017-18 accounts preparation process. **Implementation date:** 31/04/2018 **Responsible officer:** Senior Accountant

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation	Agreed management actions
3. Heritage assets valuation *Audit dimension: financial management*		**Grade two**
Heritage assets are revalued internally by a team of Curators on an ad hoc basis. Whilst we agree that this in line with the requirements of the CIPFA Code, there is a risk that high value heritage assets are not being valued to precision where the insurable value is correct.	Management should review the process for valuing heritage assets and consider engaging an external art specialist valuer to value the highest value heritage assets on a rolling basis.	Finance will work with the service to progress this recommendation. **Implementation date:** 31/03/18 **Responsible officer:** Senior Accountant
4. Complex accounting treatments *Audit dimension: financial management*		**Grade two**
Accounting for the bond issuance is complex and involves the calculation of an effective interest rate based on future forecast cashflows. Transactions for the bond were not included in the draft accounts, and were not agreed until late in the process. The Council has a number of ongoing projects which will have similar complex accounting treatments. There is a potential risk that accounts may contain significant errors or be delayed if complex accounting treatments are not agreed early or adequately documented.	For future complex financial transactions we recommend that management considers the accounting implications prior to the transaction taking place, and provide an accounting paper before the year end, to ensure these transactions can be agreed and incorporated into the draft financial statements.	This will be put in place for future complex transactions. **Implementation date:** 31/03/18 **Responsible officer:** Senior Accountant

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation	Agreed management actions
5. Debtor provisioning *Audit dimension: financial management*		**Grade two**
For debtor balances greater than 120 days overdue, but under 10 years overdue, a bad debt provision of 40% is recognised. We consider that this is at the most optimistic end of an acceptable range as it is unlikely that significant debts over a year old will be collected and recommend that management review their debtor provisioning levels. Furthermore we consider the methodology for calculating the council tax bad debt provision is overly complex. There is a risk that debts unlikely to be recovered are not provided for and the Council has to write off significant balances in future years.	We recommend that management reviews: — its debtor provisioning methodology for council tax to ensure an efficiency of process whilst still providing for an appropriate level of potential bad debt; and — the level of bad debt provision for debts that are greater than 120 days old but less than 10 years old to adequately provide for those debts unlikely to be collected.	Finance will review the methodology around debtor provisions to improve process efficiency and ensure the appropriateness of the level of provision. **Implementation date:** 31/03/18 **Responsible officer:** Senior Accountant
6. National Fraud Inquiry ("NFI") *Audit dimension: governance and transparency*		**Grade three**
After the identification of frauds during the NFI process, the matching system does not allow the Council to monitor recovery. The Council does not have a mechanisms for monitoring the effectiveness of recovery between different services. There is a risk that current practices are ineffective or inefficient without oversight and monitoring.	It is recommended that the Council implements monitoring of the effectiveness of recovery from the NFI reports, to ensure resources are used efficiently.	The recovery process of losses to frauds in each service is different and is undertaken in accordance with relevant legislation. As such direct comparison of effectiveness in recovery is not possible. It is accepted that we do not gather the total losses to fraud and will , as part of our preparation for the NFI 2019 exercise, identify how this information can be collated and reported on. **Implementation date:** 31 January 2019 **Responsible officer:** Corporate Investigation Manager

Appendix eight

Prior year recommendations

DRAFT

We follow up prior-year audit recommendations to determine whether these have been addressed by management. The table below summarised the recommendations made during the 2015-16 audit and their current status. Note that the previous external auditor did not provide a grade against each recommendation.

Grade	Number recommendations raised	Implemented	In progress	Overdue
Interim	7	[...]	[...]	[...]
Final	3	-	3	-
Prior years	12	[...]	[...]	[...]

We have provided a summary of progress against in progress actions below, and their current progress.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
ALEOs			
In order to demonstrate best use in following the public pound, there should be agreed SLAs in place between the council and its ALEOs setting out measurable outcomes for the funding provided which can be effectively monitored by the governance hubs. *Risk*: council expectations around the funding it is providing are not delivered.	The ongoing review of SLAs is concluded and ensure that the council can meet its following the public pound code requirements. This is being progressed with legal colleagues. Arrangements around ALEOs are included within the council's governance review which will impact on future SLAs	This is being progressed with legal colleagues. Arrangements around ALEOs are included within the council's governance review which will impact on future SLAs.	In progress: management has estimated that subject to co-operation from the ALEOs new agreements will be in place in 12 months. Without co-operation from ALEOs, because there are fairly long notice periods on the existing funding and service provision agreements, it could be years in some cases until the Council could threaten to terminate, which would give it the leverage required to make changes.

Appendix eight

Prior year recommendations (continued)

DRAFT

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
Scrutiny			
The dashboard supporting the Strategic Infrastructure Plan provides an effective summary of overall progress for each project. Where there are delays, the supporting narrative for the reasons is not included within the dashboard monitoring. We also noted that lessons learnt messages are not collated for members' consideration. *Risk*: there is insufficient information or mixed messages around key priorities.	To further assist elected member scrutiny and increase transparency, progress reporting for capital projects should be reviewed to ensure cohesive information is provided and audit trails are complete.	Recommendations will be implemented as part of the review to be undertaken by the Strategic Asset and Capital Plan Board.	In progress: a capital programme governance review was carried out with findings and recommendations reported to ARSC on 22 June. This proposed a revision of the governance structure of the capital programme and the reporting mechanisms within it. Under the changes, all Strategic Infrastructure Plans and capital plan projects will be grouped together into programmes of work. Each programme will be governed by a programme board, have a Programme Sponsor and a Programme Manager. Project scrutiny and challenge will now take place at the programme boards, enabling the Strategic Asset and Capital Board to focus on its strategic role. The Board will receive highlight exception reports from each programme board, rather than the full dashboard giving an update on every project (if the Board wish to dive deeper into a project then this information will be available as necessary). All decisions required of the Board will be outlined in the highlight/exception report. *Continued...*

Prior year recommendations (continued)

DRAFT

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions	Status
Scrutiny (continued)			
			A monthly Members Reference Group for the Capital Programme is also being introduced with a membership of five Councillors, three nominated from the Administration and two nominated from the Opposition. Much of the detailed scrutiny of the capital programme will take place via this group. Once this group has been formed, discussions will take place about the type and level of monitoring information it requires to fulfil its role.
Public performance reporting			
The council is aware it needs to improve public performance reporting and has an agreed plan in place. *Risk:* Public performance reporting is not easily accessible for users	Ensure there are processes in place to support delivery of the plan.	A Public Performance Reporting Improvement Plan was approved by the Audit, Risk & Scrutiny Committee in April 2016. Its implementation is being managed through a corporate performance management project, which is part of the council's governance review.	In progress: Implementation of the PPR Improvement Plan is underway, with some short term actions having been completed. The ongoing development work to transform the main ACC website (due for 'launch' late September) will by default meet some of the aims of improved PPR, through more accessible provision of information about council services. Staff resources have been focused on this area of work in the last six to twelve months.

Appendix nine

Aberdeen City Council group structure

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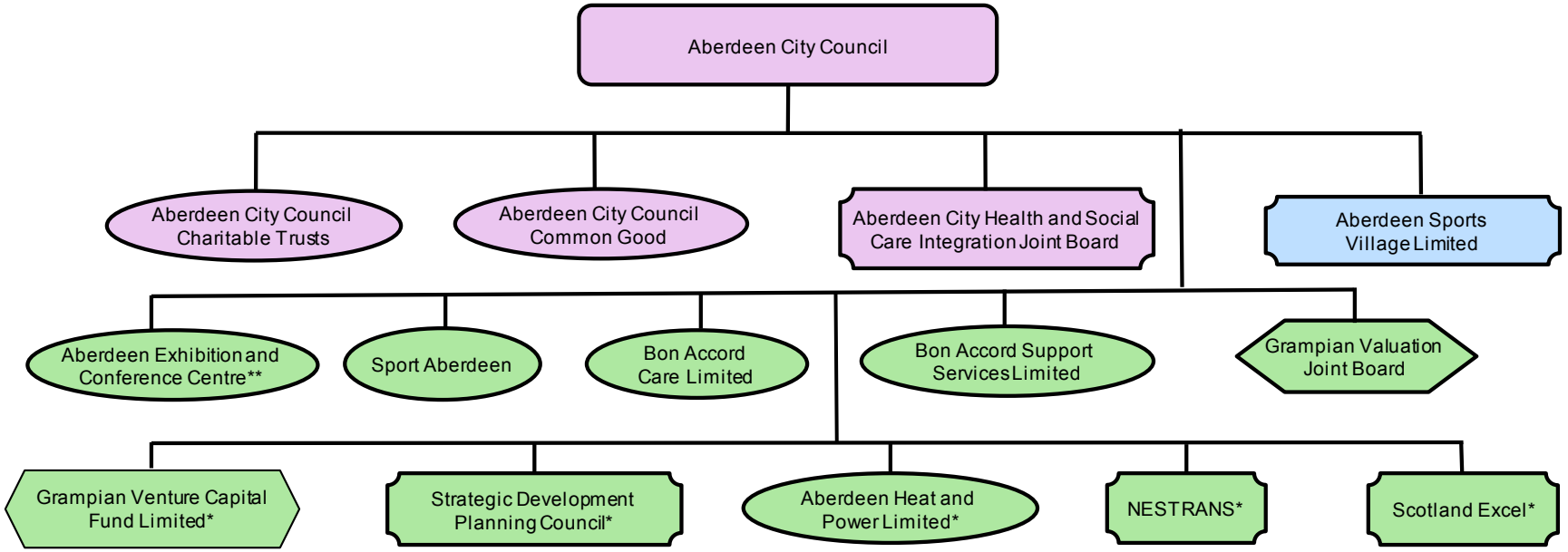

Key

- Audited by KPMG "core team"
- Audited by KPMG – separate audit team
- Audited by component auditor – group audit instructions to be issued where considered significant components

Main body

Subsidiary

Associate

Joint Venture / Joint Board / Partnership

* Entities not included in the group comprehensive income and expenditure account

** Aberdeen Exhibition and Conference Centre Limited ceased trading on 1 April 2017, and is classified as "held for sale" within the group financial statements

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