



# Aberdeen City Council

Audit strategy

Year ending 31 March 2019

For audit, risk and scrutiny committee consideration on 14 February 2019

1 February 2019

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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 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 scoping and purpose section of this report.

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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 Aberdeen City Council, telephone 0131 527 6673 email: [andrew.shaw@kpmg.co.uk](mailto: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](mailto: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 Fiona Kordiak, Audit Scotland, 4<sup>th</sup> Floor, 102 West Port, Edinburgh, EH3 9DN.

# Introduction

2018-19 is the third year of our external audit appointment to Aberdeen City Council (“the Council”), having been appointed by the Accounts Commission as auditor of the Council under the Local Government (Scotland) Act 1973 (“the Act”). The period of appointment is 2016-17 to 2020-21, inclusive. This five year period is also the maximum permitted for an engagement leader for an EU Public Interest Entity (“EU-PIE”). Our appointment includes the audit of the Aberdeen City Council Charitable Trusts.

## Our planned work in 2018-19 will include:

- an audit of the financial statements and provision of an opinion on whether the financial statements:
  - give a true and fair view in accordance with the applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom (“the 2018-19 Code”) of the state of the affairs of the Council as at 31 March 2019 and of the income and expenditure of the Council for the year then ended; and
  - have been prepared in accordance with IFRS as adopted by the European Union, as interpreted and adapted by the 2018-19 Code, the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003.
- participation in the shared risk assessment as part of the local area network;
- completion of returns to Audit Scotland and grant claims;
- a review and assessment of the Council’s governance arrangements and review of the governance statement;
- a review of National Fraud Initiative arrangements;
- a review of arrangements for preparing and publishing statutory performance information; and
- contributing to the audit of wider scope and Best Value through performance of risk assessed work.

## Adding value

Throughout the audit, we will consider opportunities to add value and will conclude on this in our annual audit report. We add value through:

- our experience, which brings insight and challenge;
- our tools and approach, which contribute to audit quality; and
- transparency and efficiency, which improves value for money.

## Our team

The senior team involved in the external audit benefits from continuity in engagement leader and has significant experience in the audit of local authorities. The team is supported by specialists, all of whom work with a variety of local government and public sector bodies. All members of the team are part of our wider local government network. The senior members of the audit team are set out below and relevant contact details are provided on the back page of this report. Due to the Council’s status as an EU-PIE, we are also required to include an engagement quality control reviewer.



**Andy Shaw**  
Engagement leader – Audit director



**Matthew Moore**  
Manager

Our work will be completed in four phases from December 2018 to September 2019. Our key deliverables are this audit strategy document, an interim report, ISA 260 report and annual audit report.

## Acknowledgements

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

# Headlines



## Materiality

Group materiality for planning purposes is based on last year's expenditure and is set at £9.2 million, which equates to 1% of gross cost of services expenditure. We will review the level of materiality on receipt of draft accounts for 2018-19.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. In line with the Code of Audit Practice this is £0.25 million.

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## Audit risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- management override of controls fraud risk (assumed risk per ISA 240);
- fraud risk over expenditure recognition (assumed risk per ISA 240 and Practice Note 10);
- retirement benefits; and
- revaluation of property, plant and equipment.

We also include an other focus area in respect of capital expenditure.

We consider that revaluation of property, plant and equipment and retirement benefits to have the greatest effect on the overall audit strategy, the allocation of resources in the audit and on directing the efforts of the engagement team. We anticipate reporting on these areas in our financial statements annual audit opinion.

Pages seven to 12



## £ Financial statement audit

Our financial statements audit work follows a four stage audit process which is identified below. **Appendix three** provides more detail on the activities that this includes. This report concentrates on the audit planning stage of the financial statements audit.



There are no significant changes to the Code of Practice on Local Council Accounting ("the Code") in 2018-19, which means for this year there is consistency in terms of accounting standards the Council needs to comply.



## Wider scope

Auditors are required to assess and provide conclusions in the annual audit report in respect of four wider scope dimensions:

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

We test wider scope areas where there are identified risks. We consider that there are wider scope risks in respect of the continued embedding of the Target Operating Model and in respect of large capital projects. We have not identified any wider scope financial statement level significant risks.

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# Headlines (continued)

## Best Value

In June 2016, the Accounts Commission formally agreed the overall framework for the approach to auditing Best Value in councils. The framework introduced a five year approach to Best Value. 2018-19 represents year three of the Best Value plan for the Council during which we will consider Performance and Outcomes.

**Pages 15 to 21** provide more detail on our work over Best Value and wider scope areas.

## Subsidiaries

In addition to the Council we deem the following subsidiaries and associates to be significant in the context of the group audit:

- Aberdeen City Integration Joint Board;
- Bon Accord Care Limited; and
- Bon Accord Support Services Limited.

To support our audit work on the Council's group accounts, we seek to place reliance on the work of firm which is the auditor to the Bon Accord entities. We will liaise with it in order to confirm that its programme of work is adequate for our purposes and they satisfy professional requirements. KPMG is auditor to the Aberdeen City Integration Joint Board.

## Appendix seven

## Independence

In accordance with International Standards on Auditing (UK) ('ISA') 260 'Communication of audit matters with those charged with governance' and the APB Ethical Standards, we are required to communicate to you all relationships between KPMG and the Group that may be reasonably thought to have bearing on our independence both:

- at the planning stage; and
- whenever significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place.



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**Appendix two** contains our confirmation of independence and any other matters relevant to our independence.

Total fees charged by us for the period ended 31 March 2018 were communicated in our Annual Audit Report issued in September 2018. Total fees for 2018-19 will be presented in our Annual Audit Report issued on completion of the audit. The proposed audit fee for 2018-19 is £424,210 will be discussed with management.

## Quality

International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

Our Audit Quality Framework and KPMG Audit Manual comply with ISQC1. Our UK Senior Partner has ultimate responsibility for quality control. Operational responsibility is delegated to our Head of Quality & Risk who sets overall risk management and quality control policies. These are cascaded through our Head of Audit in Scotland and ultimately to Andy Shaw as the Director leading delivery of services to the Council.

The nature of our services is such that we are subject to internal and external quality reviews. KPMG's annual financial statements include our transparency report which summarises the results of various quality reviews conducted over the course of each year.

We also provide Audit Scotland with details of how we comply with ISQC1 and an annual summary of our achievement of KPIs and quality results.

We welcome your comments or feedback related to this strategy and our service overall.

# Financial statements audit planning

## Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the users of the financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

Materiality for planning purposes has been set at £8.7 million for the Council's standalone accounts, and at £9.2 million for the group accounts, which in both cases equates to 1% percent of gross expenditure. We adjust gross expenditure for plant and property impairments, as these fluctuate significantly year-on-year. We take a five year rolling average of revaluation movements into our materiality calculations. We also remove the Integration Joint Board expenditure from the calculation, as income and expenditure is grossed up for presentational purposes within the consolidated income and expenditure account.

We design our procedures to detect errors in specific accounts at a lower level of precision; performance materiality is £6.0 million.

### Reporting to the audit, risk and scrutiny committee

Under ISA 260 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the Council, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £0.25 million.

If management has corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the audit, risk and scrutiny committee to assist it in fulfilling its governance responsibilities.

### Group audit

We will report the following matters in the annual audit report:

- deficiencies in the system of internal controls or instances of fraud which the subsidiary auditors identify;
- limitations on the group audit, for example, where the access to information may have been restricted; and
- instances where our evaluation of the work of the subsidiary auditors gives rise to concern about the quality of that auditor's work.



# Financial statements audit planning (continued)



## Significant risks and other focus areas

In accordance with paragraph 19A of ISA 700, we are required to describe in our financial statements audit opinion those assessed risks of material misstatement which have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team. We have identified the revaluation of property, plant and equipment and retirement benefits as the areas which we consider, at the planning stage of our audit, to have the greatest effect on our approach and on which we will report in our opinion in the financial statements. We will update this assessment in our ISA 260 report.

| Significant risk                                | Why  | Audit approach   |
|---|--|--|
| <b>Financial statement risk</b>                 |  |  |
| Fraud risk from management override of controls | <p>Management is typically in a position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.</p> <p>This is an assumed risk per ISA 240.</p> | <ul style="list-style-type: none"> <li>— Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to the audit of the Council.</li> <li>— Strong oversight of finances by management, and reporting to those charged with governance, provides additional review of potential material misstatements caused by management override of controls.</li> <li>— In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.</li> </ul> |

# Financial statements audit planning (continued)



## Significant risks and other focus areas (continued)

| Significant risk                        | Why   | Audit approach   |
|---|---|--|
| <b>Financial statement risk</b>         |   |  |
| Fraud risk over expenditure recognition | <p>Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.</p> <p>We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs, financing and investment expenditure, and depreciation. These costs are routine in nature and have limited risk of manipulation. As other operating expenditure is unlikely to be material, we also rebut the assumed risk in respect of this account.</p> <p>We have not rebutted the assumed risk in respect of the remaining expenditure accounts (£670 million) within the £909 million (in 2017-18) gross expenditure.</p> | <ul style="list-style-type: none"> <li>— Comparison of the the outturn with the in year budget monitoring, considering variances from budgeted reserves utilisation to actual utilisation.</li> <li>— Testing of controls specific to capital vs revenue allocation.</li> <li>— Testing of expenditure cut-off including a search for unrecorded liabilities.</li> <li>— Detailed testing of transactions focusing on the areas of greatest risk, including creditors, accruals and provisions to challenge completeness of these balances.</li> <li>— Review and challenge of management in respect of estimates for evidence of bias.</li> <li>— Testing of journal entries in relation to expenditure for evidence of management bias.</li> </ul> |

### Income recognition fraud risk

As above, ISA 240 requires us to consider if the fraud risk from revenue recognition is significant.

We do not consider recognition of the income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised. Income of a commercial or non-standard nature (“other income”), where the risk of manipulation is inherently greater, is not likely to be materially inappropriate. We therefore rebut the revenue recognition fraud risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures. In the prior year audit strategy we did not rebut the risk in respect of other income. Having considered the results of the prior year testing we have rebutted the assumed risk for 2018-19.



# Financial statements audit planning (continued)



## Significant risks and other focus areas (continued)

| Significant risk                                    | Why  | Audit approach  |
|---|--|---|
| <b>Financial statement risk</b>                     |  |   |
| <p>Revaluation of property, plant and equipment</p> | <p>The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. In 2018-19 the following category of assets will be subject to revaluation and we expect the movement to be material:</p> <ul style="list-style-type: none"> <li>— Libraries.</li> <li>— Waste disposal sites.</li> <li>— Travellers sites.</li> <li>— Secondary schools.</li> <li>— Depots</li> </ul> <p>Given the quantum of the carrying values and the inherent use of assumptions in their valuation, we consider there to be significant risk of misstatement.</p> <p>In addition to those assets revalued in year, the Council will have to evidence how it satisfies itself that the other assets not revalued in 2018-19 are not materially misstated.</p> <p>During the year construction of the Lochside Academy was completed. The Academy is funded by a Private Finance Initiative and there are specific accounting entries (and disclosures) that are required to recognise the asset initially, and subsequently value the asset on an ongoing basis. These two values may be materially different.</p> | <p>Our procedures include:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>— We will obtain an understanding of management’s involvement in the valuation process to assess if appropriate oversight has occurred.</li> <li>— We will review the approach that the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach.</li> <li>— We will assess the risk of the valuation changing materially during the year, or between the date of valuation and the year end.</li> </ul> <p><b>Assessing valuer’s credentials:</b></p> <ul style="list-style-type: none"> <li>— We will critically assess the independence, professional qualifications, competence and experience of the Council valuer.</li> </ul> <p><b>Assessing methodology choice and benchmarking assumptions:</b></p> <ul style="list-style-type: none"> <li>— We will utilise our internal specialist to critically assess the methodology used by the valuer by considering whether the valuations are in accordance with the RICS Valuation Professional Standards ‘the Red Book’ and relevant accounting standards.</li> <li>— We will challenge the key assumptions upon which the valuations were based for a sample of properties, by making a comparison to our own assumption ranges derived from market data.</li> <li>— We will meet with the Council valuer to understand the assumptions and methodologies used in valuing the various assets revalued during 2018-19 and the market evidence used to support the assumptions.</li> </ul> |
| Continued.....                                      |  | Continued...  |

# Financial statements audit planning (continued)



## Significant risks and other focus areas (continued)

| Significant risk  | Why   | Audit approach   |
|---|---|--|
| <b>Financial statement risk</b>                             |   |  |
| Revaluation of property, plant and equipment<br>(continued) | <p>Continued.....</p> <p>The Council also holds £148 million of investment property which is subject to annual revaluation and similarly we consider there to be a risk of misstatement arising from the use of assumptions in the valuations.</p> <p>The Marischal Square development was valued for the first time in 2017-18 and new leases have been signed with tenants in 2018-19, giving rise to potential change in the carrying value of this investment property (£64 million as at 31 March 2018).</p> | <p>Continued.....</p> <ul style="list-style-type: none"> <li>— We will challenge management’s assessment of why it considers that the land and buildings not revalued in 2018-19 are not materially misstated.</li> <li>— In respect of new PFI assets, we will agree the accounting entries to the underlying contract and PFI model. We will test the PFI model for appropriateness and arithmetical accuracy.</li> <li>— In respect of new PFI assets we will consider the appropriateness of disclosures in the financial statements.</li> </ul> <p><b>Input assessment</b></p> <ul style="list-style-type: none"> <li>— We will agree observable inputs used in the valuations, such as land size, floor space, rental income etc.</li> </ul> <p><b>Disclosure assessment</b></p> <ul style="list-style-type: none"> <li>— We will critically assess the adequacy of the Council’s disclosures in relation to the judgement in relation to valuing properties.</li> </ul> |

# Financial statements audit planning (continued)



## Significant risks and other focus areas (continued)

| Significant risk                | Why   | Audit approach   |
|---------------------------------|---|--|
| <b>Financial statement risk</b> |   |  |
| Retirement benefits             | <p>The net pension liability (£310 million as at 31 March 2018, including assets of £1.265 billion) represents a material element of the Council's balance sheet. The Council is an admitted body of North East Scotland Pension Fund, which had its last triennial valuation completed as at 31 March 2017.</p> <p>The calculation of the Local Government Pension Scheme liability requires the use of an actuarial methodology, the result of which is dependent upon a number of assumptions. These include both financial and demographic assumptions, such as the discount rate, inflation rates, mortality rates etc. These assumptions should reflect the profile of the Council's employees, and be based on appropriate data. The basis of the assumptions should also be derived on a consistent basis year to year.</p> <p>There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact on the net pension liability accounted for in the financial statements.</p> | <p>Our audit approach includes:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>— Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation.</li> </ul> <p><b>Benchmarking assumptions:</b></p> <ul style="list-style-type: none"> <li>— Challenging, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data.</li> <li>— Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations.</li> </ul> <p><b>Assessing transparency:</b></p> <ul style="list-style-type: none"> <li>— Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions.</li> <li>— Testing the assets recorded and disclosed, using our actuarial team.</li> <li>— Assessing if the disclosures within the financial statements are in accordance with the Code's requirements.</li> </ul> |

# Financial statements audit planning (continued)



## Significant risks and other focus areas (continued)

| Other focus area                            | Why   | Audit approach  |
|---|---|---|
| <b>Financial statement other focus area</b> |   |   |
| <p>Capital expenditure</p>                  | <p>The Council has a five year £1 billion capital plan which is focused around the city centre masterplan. Key projects in progress in 2018-19 include the Aberdeen Exhibition and Conference Centre and the Aberdeen Western Peripheral Route.</p> <p>Due to the significance of this capital investment programme and complexity of some of the projects, we consider it to be an area of audit focus. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions.</p> <p>In the 2017-18 audit strategy we included this area as a significant risk. We have reduced the classification to an other focus area for 2018-19 having considered the results of the testing in the prior year. This is in view of the specific nature of the underlying contracts, whereby financial overrun risks for large projects substantially rests with the building contractors. The impact of this is primarily in respect of the quantum of the additions samples tested. The nature of the audit work is unchanged.</p> | <p>Our audit approach includes:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>— Testing the design and operating effectiveness of controls over the capital projects.</li> <li>— Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and revenue projects.</li> </ul> <p><b>Control re-performance:</b></p> <ul style="list-style-type: none"> <li>— Comparing the total capital expenditure reported in the financial statements with that reported in reports to those charged with governance.</li> </ul> <p><b>Tests of detail:</b></p> <ul style="list-style-type: none"> <li>— Use of substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation.</li> <li>— Assessing a sample of items allocated to revenue expenditure to determine whether they are correctly classified.</li> <li>— Review and corroboration of manual journals.</li> </ul> <p>We will specifically consider the following major project overall, which may include more complex accounting treatments, including wider scope and Best Value aspects:</p> <ul style="list-style-type: none"> <li>— Aberdeen Exhibition and Conference Centre.</li> </ul> |

# Other matters

## Accounting framework update

The Code is revised each year, incorporating selected changes to the underlying International Financial Reporting Standards ('IFRS').

The key accounting changes in the 2018-19 edition of the Code include:

- Revenue from Contracts with Service Recipients following the adoption of IFRS 15 *Revenue from Contracts with Customers*.
- amendments to Presentation of Financial Statements to reflect the disclosure requirements under IAS 7 *Statement of Cash Flows (Disclosure Initiative)*;
- clarification to the segmental reporting arrangements under the Code;
- amendments to Property, Plant and Equipment to reflect changes as a result of The Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017;
- amendments to the Code to introduce the incurred loss model for the impairment of non-contractual debts including relevant disclosure requirements as a consequence of the expected credit loss model for impairment being introduced by the adoption of IFRS 9;
- amendments to Debtors and Creditors sections to remove the requirement to disclose the analysis of debtors across public sector bodies; and
- a new Financial Instruments section to reflect the Code's adoption of IFRS 9 *Financial Instruments*.

Expected from 2020-21, IFRS 16 *Leases* supersedes IAS 17 *Leases*. IFRS 16 introduces a single lessee accounting model. The Council will be more likely to account for operating leases in a similar way to the current IAS 17 treatment for finance leases. A significant volume of leases which are currently accounted for as operating leases will become financial leases and will be recognised within the Council's balance sheet.

These changes are significant and the Council has started to prepare in advance, particularly where the 2018-19 balances will form the comparatives in future accounts. As part of the 2018-19 audit, we will consider the Council's arrangements for complying with the forthcoming changes.

## Controls testing

In respect of the financial statements, we identify the constituent account balances and significant classes of transactions and focus our work on identified risks. Determining the most effective balance of internal controls and substantive audit testing enables us to ensure the audit process runs smoothly and with the minimum disruption to the Council's finance team.

In 2017-18 we made recommendations for enhancing the control environment, particularly in respect of certain general IT controls, revaluation accounting and complex transactions accounting. During the 2018-19 audit we will follow-up on management's progress in implementing the agreed recommendations. We will also report any new findings arising from our work in 2018-19.

# Other matters (continued)

## Bond accounting

We considered the accounting for the £370 million bond to be a significant risk in the 2016-17 audit, being the year of issuance. In 2018-19 we do not consider it to be a significant risk, consistent with 2017-18. For 2018-19 management will update factual RPI movements to the 28 February 2019 measurement date (which determines the bond principal outstanding and interest payable) and will accrue for the month of March 2019 using factual RPI movements, which will be available when the accounts are prepared.

Management will also estimate future RPI movements in order to complete accounts disclosures and to facilitate long-term budgeting.

Whilst the accounting for the bond is complex, the treatment was established in 2016-17 and an accounting model was constructed, and audited by KPMG. We therefore have determined that bond accounting is not a significant risk to the financial statements, or an area of audit focus.

The Council must comply with the conditions of the Bond Trust Deed, which are not unusual for such financial instruments. We will obtain management's support for the compliance during the final audit.

The bondholders could seek repayment of the bond principal in certain circumstances. One such circumstance is if the Council's credit rating (as assessed by Moody's) is downgraded such that it is three notches or more below that of UK sovereign debt. At the date of this report, the Council's credit rating is one notch below that of UK sovereign debt and is rated as "stable". We would consider the impact to any revisions to credit rating relative to UK sovereign debt should they occur.

## Brexit uncertainty

A combination of the challenges facing the economy, rapidly changing risks to business models in some sectors and Brexit means that the level of uncertainty facing all bodies is unprecedented, at a time when they will be approving annual reports and accounts. That in turn means that our audits need to respond to the changing landscape and our approach will inevitably need to react as events unfold.

In all long form audit opinions (relevant to EU PIEs) we consider whether Brexit is a Key Audit Matter requiring specific consideration and emphasis. We will assess the position in June 2019, taking account of Westminster decisions made in relation to EU withdrawal.

## Internal audit

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect, if any, on external audit procedures;
- obtain an understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;
- perform a preliminary assessment of the internal audit function when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and
- evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

We will continue liaison with internal audit and update our understanding of its approach and conclusions where relevant. The general programme of work will be reviewed for significant issues to support our work in assessing the statement of internal control.

## Group audit considerations

Appendix six sets out our understanding of the Group structure and nature of each associated entity.

We conduct our audit of the Group in accordance with International Standard on Auditing 600 ("ISA 600") *Using the work of another auditor*. We will issue group audit instructions to the auditor of Bon Accord Care Limited. We will meet with the external auditor at the outset of the audit, to discuss its risk assessment and proposed audit approach and review the reporting provided in response to group instructions. We will also request that we review its audit work in respect of the pension liability as that is an area of significant risk for the Council's group accounts.

# Wider scope and Best Value

## Approach

We are required to assess and provide conclusions in the Annual Audit Report in respect of four wider scope dimensions: financial sustainability; financial management; governance and transparency; and value for money. We set out below an overview of our approach to wider scope and Best Value requirements of our annual audit. We provide on pages 17 to 21 our risk assessment in respect of these areas. We will provide narrative on these and other areas in the Annual Audit Report where relevant.

### Risk assessment

We consider the relevance and significance of the potential business risks faced by local authorities, and other risks that apply specifically to the Council. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice*.

In doing so we consider:

- The Council's own assessment of the risks it faces, and its arrangements to manage and address its risks.
- Evidence gained from previous audit work, including the response to that work.
- The work of other inspectorates and review agencies, through the Local Area Network ('LAN') which is established for each Council.

The LAN brings together local scrutiny representatives in a systematic way to agree a shared risk assessment. Andy Shaw is the LAN lead for the shared risk assessment process for the Council. For 2018-19 there is no additional scrutiny required by external audit.

The shared risk assessment process across Scotland has changed for 2019-20 and no local scrutiny plans are prepared. We use the shared risk assessment process to consider if there are wider scope risks relevant to the Annual Audit Report.



### Linkages with other audit work

There is a degree of overlap between the work we do as part of the wider scope and Best Value audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Council's organisational control environment, many aspects of which are relevant to our wider scope and Best Value audit responsibilities.

We have always sought to avoid duplication of audit effort by integrating our financial statements and wider scope and Best Value work, and this will continue. We consider information gathered through the shared risk assessment and the Audit Commission's five strategic priorities when planning and conducting our work.



# Wider scope and Best Value (continued)

## Approach (continued)

### Identification of significant risks

The Code identifies a matter as significant *'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'*

If we identify significant wider scope and Best Value risks, we will highlight the risk to the Council and consider the most appropriate audit response in each case, including:

- Considering the results of work by the Council, inspectorates and other review agencies.
- Carrying out local risk-based work to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.



### Concluding on wider scope and Best Value

At the conclusion of the wider scope and Best Value audit we will consider the results of the work undertaken and assess the assurance obtained against each of the wider scope audit dimensions and Best Value, regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources.

If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our wider scope and Best Value conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.



### Reporting

We have completed our initial wider scope and Best Value risk assessment and have not identified any significant risks, as noted on the next page. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

We will report on the results of the wider scope and Best Value audit through our Annual Audit Report. This will summarise any specific matters arising, and the basis for our overall conclusion.





# Wider scope and Best Value (continued)

## Risk assessment

We have not identified wider scope significant risks relevant to the Council. We include in the following tables areas of focus and their impact on the audit approach. In summary we consider that the following are key areas of focus:

- Delivery of transformation, income generation and efficiencies to meet the financial sustainability challenges within the local authority environment. The continued embedding of the Target Operating Model ('TOM') is a key part of the Council's plans to deliver these objectives.
- Progress of significant capital projects. The Aberdeen Exhibition and Conference Centre ('AECC') in particular is a critical part of the Council's city development and its successful delivery is important to support future debt service costs.

Audit Scotland highlighted five areas which may represent significant risks to all bodies and we reference these in the relevant wider scope sections: EU withdrawal; changing landscape for public financial management; dependency on key suppliers; care income, financial assessments and financial guardianship; and openness and transparency.

| Wider scope area  | Why  | Audit approach         |
|---|--|------------------------|
| <p><b>Financial sustainability and financial management</b></p> | <p>Financial sustainability looks forward to the medium and longer term to consider whether the Council is planning effectively to continue to deliver its services or the way in which they should be delivered.</p> <p>Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p> <p><b>Areas of focus:</b></p> <p><i>Delivery of transformation, income generation and efficiencies</i></p> <p>In May 2018 the Scottish Government published its five year medium term financial strategy. This highlighted that the funding reductions for local government will likely continue in medium term. This contributed to further savings to be identified by the Council. Management has also identified needs-led pressures in services for 2019-20 and beyond.</p> <p>In addition to the Council identified potential risks to future budgets from future teacher pay settlement and the costs that might be needed to implement any findings from the Scottish Child Abuse inquiry. The Council has restricted non-essential spend to help alleviate these pressures.</p> <p style="text-align: right;">Continued.....</p> | <p>— See next page</p> |

# Wider scope and Best Value (continued)

## Risk assessment (continued)

| Wider scope area  | Why   | Audit approach  |
|---|---|---|
| <p><b>Financial sustainability and financial management</b><br/>(continued)</p> | <p>In recognition of this environment and the need for change, in 2017-18 the Council started the implementation of the TOM.</p> <p>The Transformational Portfolio is set to achieve three objectives; namely delivering up to £125 million benefit realisation (savings) over five years from 2018-19 to 2022-23, delivering the Council's digital strategy and delivering the TOM by 2020-21.</p> <p>Phase one (2017-18) represented the design principles, organisational structure, transformation portfolio and supporting governance framework, engagement with a digital partner and realignment of staff roles within the approved First Tier structure.</p> <p>Having agreed the interim functional structure, phase two (2018-19) is primarily related to further developing the structure, embedding new governance arrangements and progressing the digital transformation.</p> <p>We consider that there are inherent risks arising from the significant capital investment, organisational and cultural change associated with the Target Operating Model which also brings risk to achievement of savings and achievement of outcomes for citizens.</p> <p>There is also a risk associated with the timely completion of capital investment programmes which are supported by the bond financing, in the context of the capital repayments commencing in 2019-20 and being index linked.</p> <p>We understand that the Council is looking to use new legislation to review and amend the statutory repayment of the loans fund. This enables Councils to provide for a prudent repayment schedule.</p> <p>We reported in the 2017-18 annual audit report that the Council had an appropriate governance and monitoring structure associated with transformation.</p> | <ul style="list-style-type: none"> <li>— We will consider the Council's long term financial plans and its ability to adapt to the changing landscape in local government funding. This will involve consideration of the 2019-20 budget and longer term financial plans from 2020-21 and beyond, including sensitivity analysis and bond repayment/RPI assumptions.</li> <li>— We will consider how the Council's move to the TOM is progressing and any potential impact on financial and service planning.</li> <li>— We will review the progress of key capital programmes, the largest of which being the AECC.</li> <li>— We will review the Council's proposed prudent loans fund repayment schedule, assessing if it is in accordance with legislation.</li> <li>— We will review the progress of the digital transformation.</li> </ul> |

# Wider scope and Best Value (continued)

## Risk assessment (continued)

| Wider scope area  | Why  | Audit approach   |
|---|--|--|
| <p><b>Financial sustainability and financial management</b><br/>(continued)</p> | <p>Audit Scotland potential focus areas</p> <p><b>Key supplier failure</b></p> <p>Key supplier failure and the risk of underperformance of suppliers arising from difficult trading conditions is a potential focus area for all bodies. For example, the collapse of Carillion in 2018 had a significant impact across the public sector.</p> <p>The Council is inherently dependent on several key suppliers and it is important that there is an awareness of these relationships and the potential risks. These suppliers may support services or capital projects and could be impacted in the event of a “no deal” Brexit outcome.</p> <p>We have identified the contractors of the AECC and AWPR as key suppliers. The partner for digital services implementation is also critical to success of transformation.</p> <p><b>EU withdrawal</b></p> <p>The nature and impact of withdrawal from the EU continues to be uncertain and changing. The Council will need to react when it receives further clarity from Government as to what implications this may have to the activities and services provided by the Council.</p> <p><b>Changing landscape for public financial management</b></p> <p>Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits. Scottish Government published an initial five-year Medium Term Financial Strategy in May 2018. The Council has needed to consider the impact of the new powers on its operations and future budgets.</p> | <p>We will review</p> <ul style="list-style-type: none"> <li>— the arrangements the Council has in place for financial due diligence, performance and risk assessment for contracts and business continuity arrangements;</li> <li>— whether significant suppliers have identified risks and mitigating business continuity arrangements in the risk register;</li> <li>— whether significant suppliers are subject to ongoing financial performance and failure risk assessment; and</li> <li>— how the Council has responded to any issues with key suppliers that have arisen and reported them.</li> </ul> <hr/> <ul style="list-style-type: none"> <li>— We will remain alert to the impact of EU withdrawal on the Council’s operations and the environment within which it operates. We will consider the appropriateness of management’s risk assessment and planning for both matters.</li> <li>— We will review the arrangements that the Council put in place when more clarity is received as to the impact on the Council.</li> </ul> <hr/> <ul style="list-style-type: none"> <li>— We consider this area of focus within our overall consideration of the Council’s financial plans.</li> </ul> |

# Wider scope and Best Value (continued)

## Risk assessment (continued)

| Wider scope area                          | Why  | Audit approach   |
|---|--|--|
| <p><b>Governance and transparency</b></p> | <p>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.</p> <p>The Council has completed a wide-ranging review of governance over the last two years, giving rise to significant changes to committee structures, policies and procedures. The changes have been implemented in a methodical manner.</p> <p><b>Audit Scotland potential focus areas</b></p> <p>Care Income, financial assessments and financial guardianship</p> <p>The experience of a number of local government audits indicated there may be issues with the systems and processes for collecting care income, undertaking financial assessments on individuals receiving care and financial guardianship. In some cases where the responsibilities for financial assessments on those receiving care has transferred from social care to finance has revealed issues with backlogs of financial assessments and under-recovery of care charges over long years (more than five years).</p> <p>This is not a specific Aberdeen City Council risk.</p> <p>Openness and transparency</p> <p>There is an increasing focus on how public money is used and what is achieved. In that regard, openness and transparency supports understanding and scrutiny.</p> <p>We have commented in prior years that we consider Council business to be conducted in an open and transparent manner.</p> | <p>We will consider any further evolution of the Council's governance arrangements, their appropriateness and their robustness.</p> <hr/> <p>We will review:</p> <ul style="list-style-type: none"> <li>— the arrangements for financial assessment of those requiring care and assess whether these are subject to a significant backlog; and</li> <li>— the reporting of this within the Council.</li> </ul> <hr/> <p>We will remain alert to the need for openness and transparency, specifically considering:</p> <ul style="list-style-type: none"> <li>— the public availability of Council and committee papers; and</li> <li>— the appropriateness of business conducted in private, accepting that there are legislative reasons why some items must be private.</li> </ul> |

# Wider scope and Best Value (continued)

## Risk assessment (continued)

| Wider scope area              | Why  | Audit approach   |
|-------------------------------|--|--|
| <p><b>Value for money</b></p> | <p>Value for money is concerned with how effectively resources are used to provide services.</p> <p>We have not identified specific value for money risks.</p> | <ul style="list-style-type: none"> <li>— We will specifically consider statutory performance indicators, performance reporting and arrangements to provide for continuous improvement.</li> <li>— In the context of the Council's capital plan and procurement procedures, we will consider the arrangements to provide for value for money.</li> <li>— Our year three Best Value work will consider specifically <i>Performance and Outcomes</i> and we will provide narrative on both in the Annual Audit Report.</li> </ul> |



# Appendices

# Mandated communications with the Audit, Risk and Scrutiny Committee

| Matters to be communicated  | Link to audit, risk and scrutiny committee papers   |
|---|---|
| Independence and our quality procedures ISA 260.  | <ul style="list-style-type: none"> <li>■ See next page</li> </ul>   |
| The general approach and overall scope of the audit, including levels of materiality, fraud and engagement letter ISA 260.  | <ul style="list-style-type: none"> <li>■ Main body of this paper</li> </ul>   |
| <ul style="list-style-type: none"> <li>■ Disagreement with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report, and their resolution (AU 380).</li> </ul>  | <ul style="list-style-type: none"> <li>■ In the event of such matters of significance we would expect to communicate with the Audit Risk and Scrutiny Committee throughout the year.</li> <li>■ Formal reporting will be included in our ISA 260 report for the Audit, Risk and Scrutiny Committee meeting, which focuses on the financial statements.</li> </ul> |
| <ul style="list-style-type: none"> <li>■ Significant difficulties we encountered during the audit.</li> <li>■ Significant matters discussed, or subject to correspondence, with management (ISA 260).</li> </ul>  |   |
| <ul style="list-style-type: none"> <li>■ Our views about the qualitative aspects of the entity's accounting and financial reporting.</li> <li>■ 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 and ISA 540).</li> </ul> |   |
| <ul style="list-style-type: none"> <li>■ Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on its financial statements. We will request you to correct uncorrected misstatements (including disclosure misstatements) (ISA 450).</li> </ul>   |   |
| <ul style="list-style-type: none"> <li>■ 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 570).</li> </ul>  |   |
| <ul style="list-style-type: none"> <li>■ Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570).</li> </ul>   |   |
| <ul style="list-style-type: none"> <li>■ Expected modifications to the auditor's report (ISA 705).</li> </ul>   |   |
| <ul style="list-style-type: none"> <li>■ Related party transactions that are not appropriately disclosed (ISA 550)</li> </ul>   |   |

# Auditor independence

## Assessment of our objectivity and independence as auditor of Aberdeen City Council

Professional ethical standards require us to provide to you at the planning stage 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, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. 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
- Independent reviews.

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

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

We have considered the fees charged by us to the Council and its affiliates for professional services provided by us during the reporting period. Total fees charged by us for the period ended 31 March 2018 and planned for 2018-19 are as follows:

| Services provided to the Council and its group in respect of: | 2018-19 continuing (incl VAT) £ | 2017-18 (incl VAT) £ |
|---|---------------------------------|----------------------|
| Audit of the financial statements                             | 254,500                         | 250,920              |
| Audit of subsidiaries (Charitable Trusts)                     | 8,600                           | 8,500                |
| <b>Total audit services</b>                                   | <b>263,100</b>                  | <b>259,420</b>       |
| <b>Other non-audit services</b>                               |                                 |                      |
| Total non-audit services                                      | -                               | -                    |
| <b>Total</b>  | <b>263,100</b>                  | <b>259,420</b>       |

There are no non-audit fees for 2018-19. 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 Aberdeen City Council since that date.

All non-audit services require audit committee or equivalent approval. We will seek approval in advance of any such services being proposed.

We are appointed by the Accounts Commission via Audit Scotland as external auditor of Aberdeen City Council Charitable Trusts and Aberdeen City Integration Joint Board.

We are also appointed as external auditor of Aberdeen Sports Village Limited, a subsidiary of the Council, this is not an appointment of the Accounts Commission.



# Auditor independence (continued)

## **Independence and objectivity considerations relating to other matters**

There are no other matters that, in our professional judgement, 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 partner and audit staff is not impaired.

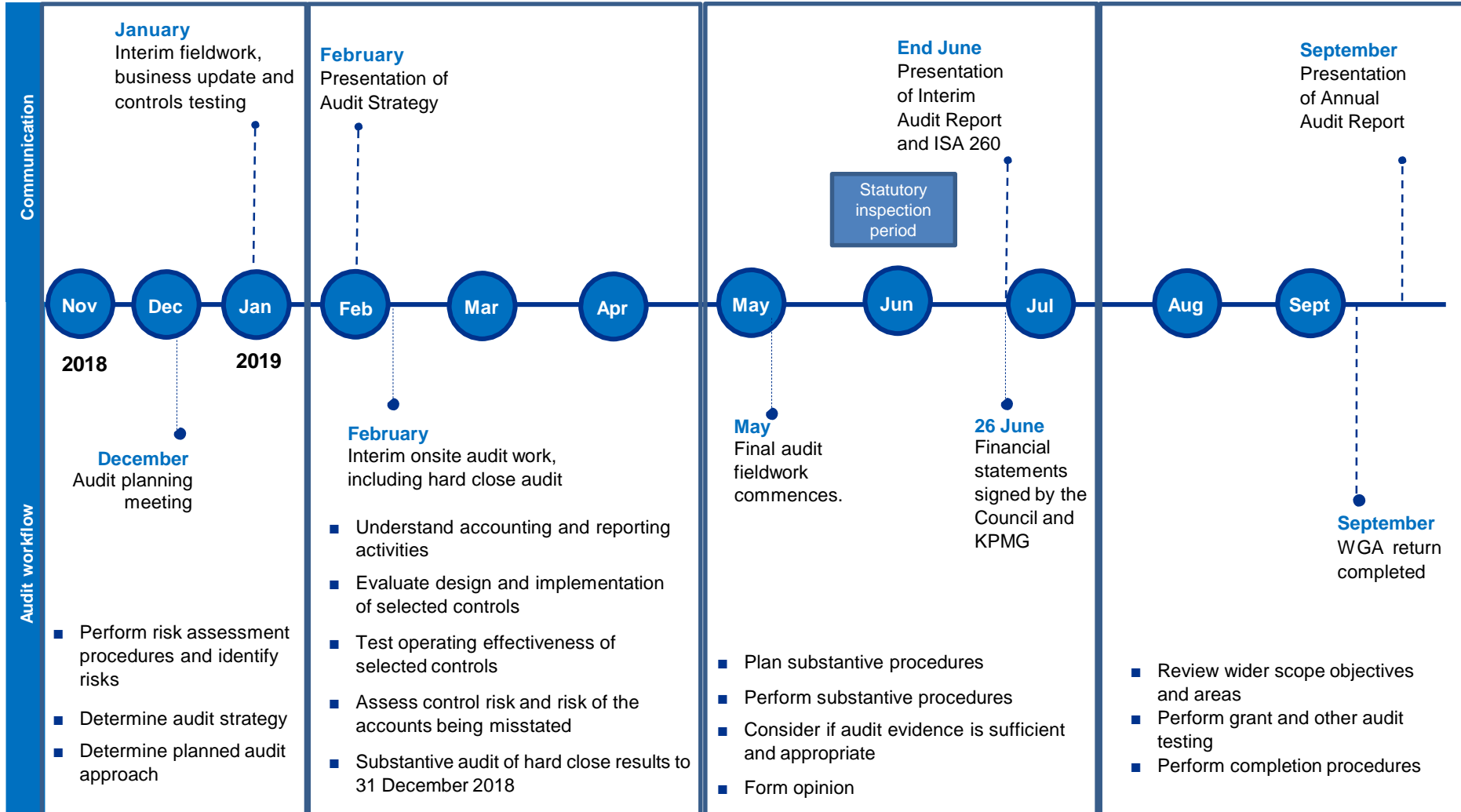
This report is intended solely for the information of the audit, risk and scrutiny committee and should not be used for any other purposes.

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*

# Timeline



## Audit outputs

| Output                                | Description  | Report date   |
|---------------------------------------|--|---|
| <b>Audit strategy</b>                 | Our strategy for the external audit of the Council and its group, including significant risk and audit focus areas.  | For 14 February 2019 AR&SC meeting  |
| <b>Interim audit report</b>           | We summarise our findings from our interim audit work.   | For 30 April 2019 AR&SC meeting   |
| <b>Independent auditor's report</b>   | Our opinion on the Council's financial statements.   | For 26 September 2019 AR&SC meeting   |
| <b>Annual audit report</b>            | We summarise our findings from our work during the year.   | By 30 September 2019  |
| <b>NFI report</b>                     | We report on the Council's actions to investigate and follow-up NFI matches.   | By 30 June 2019   |
| <b>Whole of Government Accounts</b>   | We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.  | By 28 September 2019  |
| <b>Audit reports on other returns</b> | We will report on the following returns: <ul style="list-style-type: none"> <li>- Current issues return.</li> <li>- Technical database.</li> <li>- Fraud returns.</li> </ul> | January, March, July and October 2019<br>6 July 2019<br>February, May and August 2019 |
| <b>Grant claim audits</b>             | We provide an opinion on: <ul style="list-style-type: none"> <li>- Education maintenance allowance, Housing Benefit, and Non domestic rates</li> </ul>                       | To submit by:<br>July 2019, November 2019 and October 2019                            |

# Fees

Audit Scotland has completed a review of funding and fee setting arrangements for 2018-19. An expected fee is calculated by Audit Scotland to each entity within its remit. This expected fee is made up of four elements:

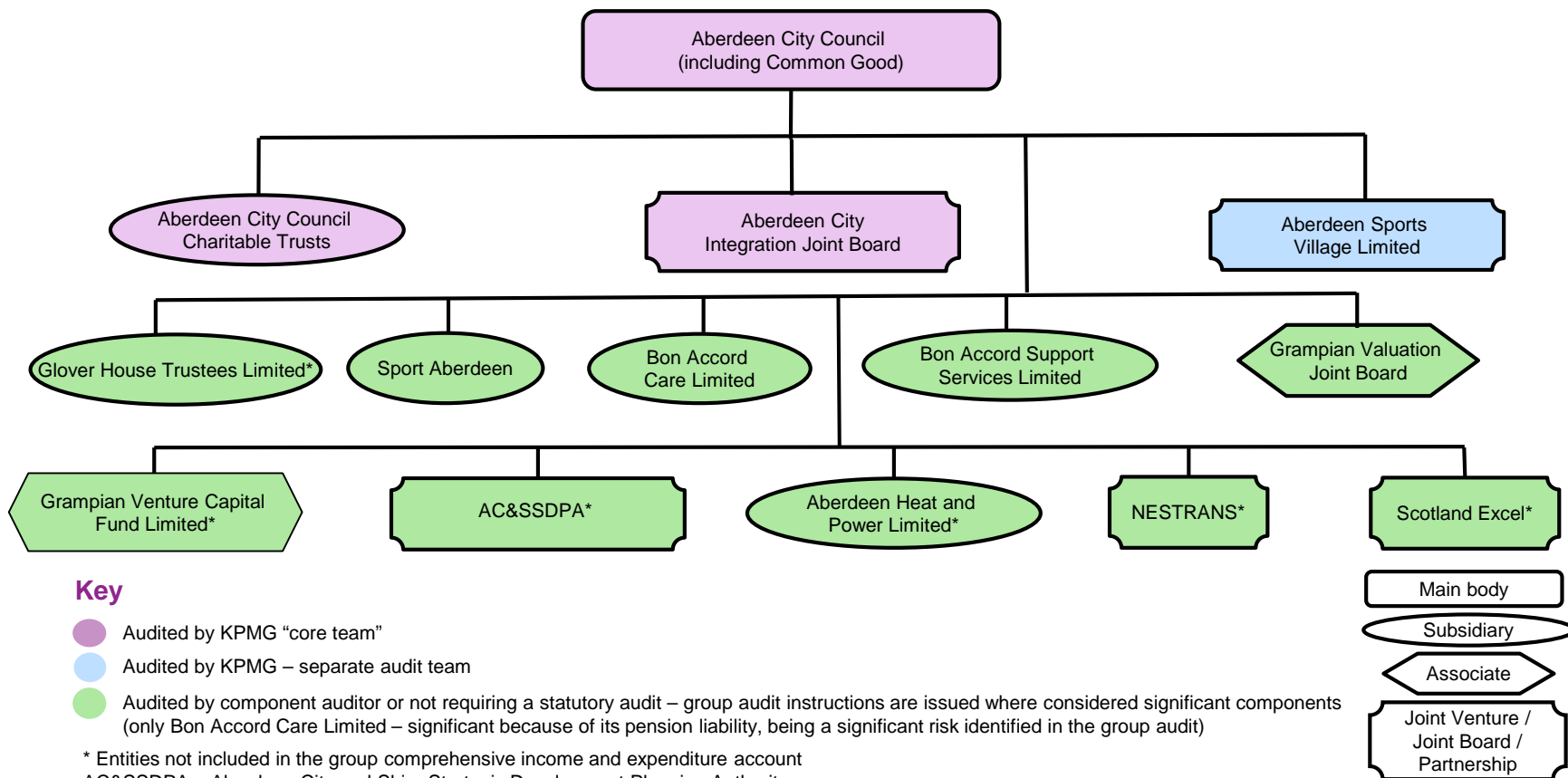
- Auditor remuneration
- Pooled costs
- Contribution to Audit Scotland's Performance Audit and Best Value team
- Contribution to Audit Scotland costs

The expected fee for each body assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for the audit.

We are in discussions with management regarding the auditor remuneration for 2018-19. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

|  | 2018-19 £ (incl VAT) | 2017-18 (incl VAT) |
|--|----------------------|--------------------|
| Auditor remuneration                             | 254,500              | 250,920            |
| Pooled costs                                     | 23,760               | 19,320             |
| Contribution to PABV                             | 130,570              | 124,780            |
| Contribution to Audit Scotland costs             | 15,380               | 13,810             |
| <b>Total Council audit fee</b>                   | <b>424,210</b>       | <b>408,830</b>     |
| Audit of Aberdeen City Council Charitable Trusts | 8,600                | 8,500              |
| <b>Total fee</b>                                 | <b>432,810</b>       | <b>417,330</b>     |

# Group financial statements



# Responsibility in relation to fraud

We are required to consider fraud and the impact that this has on our audit approach. We will update our risk assessment throughout the audit process and adapt our approach accordingly.

| Management responsibilities   | KPMG's identification of fraud risk factors   | KPMG's response to identified fraud risk factors   | KPMG's identified fraud risk factors   |
|---|---|--|--|
| <ul style="list-style-type: none"> <li>— Adopt sound accounting policies.</li> <li>— With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.</li> <li>— Establish proper tone/culture/ethics.</li> <li>— Require periodic confirmation by employees of their responsibilities.</li> <li>— Take appropriate action in response to actual, suspected or alleged fraud.</li> <li>— Disclose to audit, risk and scrutiny committee and auditors:                             <ul style="list-style-type: none"> <li>— any significant deficiencies in internal controls.</li> <li>— any fraud involving those with a significant role in internal controls.</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>— Review of accounting policies.</li> <li>— Results of analytical procedures.</li> <li>— Procedures to identify fraud risk factors.</li> <li>— Discussion amongst engagement personnel.</li> <li>— Enquiries of management, to audit, risk and scrutiny committee, and others.</li> <li>— Evaluate broad programmes and controls that prevent, deter, and detect fraud.</li> </ul> | <ul style="list-style-type: none"> <li>— Accounting policy assessment.</li> <li>— Evaluate design of mitigating controls.</li> <li>— Test effectiveness of controls.</li> <li>— Address management override of controls.</li> <li>— Perform substantive audit procedures.</li> <li>— Evaluate all audit evidence.</li> <li>— Communicate to to audit, risk and scrutiny committee and management.</li> </ul> | <p>Whilst we consider the risk of fraud at the financial statement level to be low for the Council, we will monitor the following areas throughout the year and adapt our audit approach accordingly.</p> <ul style="list-style-type: none"> <li>— Revenue recognition</li> <li>— Cash</li> <li>— Procurement</li> <li>— Management control override</li> <li>— Assessment of the impact of identified fraud.</li> </ul> |

# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of management

### Financial statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

# Audit Scotland code of audit practice – responsibility of auditors and management

|   |
|---|
| <b>Responsibilities of management</b>   |
| <b>Corporate governance arrangements</b>  |
| Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.  |
| <b>Financial position</b>   |
| <p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>■ such financial monitoring and reporting arrangements as may be specified;</li> <li>■ compliance with any statutory financial requirements and achievement of financial targets;</li> <li>■ balances and reserves, including strategies about levels and their future use;</li> <li>■ how they plan to deal with uncertainty in the medium and longer term; and</li> <li>■ the impact of planned future policies and foreseeable developments on their financial position.</li> </ul> |
| <b>Best Value, use of resources and performance</b>   |
| The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.  |



# Audit Scotland code of audit practice – responsibility of auditors and management

## Responsibilities of auditors

### Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, International Standards on Auditing (UK and Ireland), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- 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;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- 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; and
  - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their 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.










# Audit Scotland code of audit practice – responsibility of auditors and management







| <b>Responsibilities of auditors</b>   |
|---|
| <b>General principles</b>   |
| This Code is designed such that adherence to it will result in an audit that exhibits these principles.   |
| <b>Independent</b>  |
| When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the Financial Reporting Council's (FRC) ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.  |
| <b>Proportionate and risk based</b>   |
| Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self-evaluation evidence when assessing and identifying audit risk. |
| <b>Quality focused</b>  |
| Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.   |

# Audit Scotland code of audit practice – responsibility of auditors and management

| <b>Responsibilities of auditors</b>   |
|---|
| <b>Coordinated and integrated</b>   |
| It is important that auditors coordinate their work with internal audit, Audit Scotland, other external auditors and relevant scrutiny bodies to recognise the increasing integration of service delivery and partnership working within the public sector. This would help secure value for money by removing unnecessary duplication and also provide a clear programme of scrutiny activity for audited bodies.  |
| <b>Public focused</b>   |
| The work undertaken by external audit is carried out for the public, including their elected representatives, and in its interest. The use of public money means that public audit must be planned and undertaken from a wider perspective than in the private sector and include aspects of public stewardship and best value. It will also recognise that public bodies may operate and deliver services through partnerships, arm’s-length external organisations (ALEOs) or other forms of joint working with other public, private or third sector bodies.                     |
| <b>Transparent</b>  |
| Auditors, when planning and reporting their work, should be clear about what, why and how they audit. To support transparency the main audit outputs should be of relevance to the public and focus on the significant issues arising from the audit.   |
| <b>Adds value</b>   |
| It is important that auditors recognise the implications of their audit work, including their wider scope responsibilities, and that they clearly demonstrate that they add value or have an impact in the work that they do. This means that public audit should provide clear judgements and conclusions on how well the audited body has discharged its responsibilities and how well they have demonstrated the effectiveness of their arrangements. Auditors should make appropriate and proportionate recommendations for improvement where significant risks are identified. |

# Mandatory planning communications

| Type  | Response  |
|---|---|
| <b>Our declaration of independence</b>  |  No matters to report. The engagement team has complied with relevant ethical requirements regarding independence.             |
| <b>Key audit partner(s)</b>   |  We have identified the key audit partner at page 3 in our Audit Strategy.   |
| <b>Independence of external experts engaged by KPMG and non-KPMG auditors</b> |  We have not engaged external experts for the performance of aspects of our audit.   |
| <b>Communications with audit committee and management</b>                     |  We have described the nature, frequency and extent of communication with the audit committee and management at page 26 above. |
| <b>Scope and timing of the audit</b>  |  We have described the scope and timing of the audit within this report.   |
| <b>Audit methodology</b>  |  Our audit responses to identified risks are described from page 7 of this report.   |
| <b>Valuation methods</b>  |  We will report the valuation methods applied to the items in the financial statements and the impact of any changes.          |
| <b>Going concern assessment</b>   |  There are no significant matters affecting the entity's ability to continue as a going concern.                              |
| <b>Requested explanations and documents</b>                                   |  We will report on whether requested explanations and documents were provided by management.                                 |

| Type  | Response  |
|---|---|
| <b>Materiality</b>  |  Quantitative materiality applied to the audit of the financial statements as a whole and materiality for balances/disclosures affected by qualitative factors is set out at page 6 in our Audit Plan and Strategy report.   |
| <b>Non-compliance with laws and regulation or articles of association</b> |  We will report on whether actual or suspected non-compliance with laws and regulation or articles of association were identified during the audit.  |
| <b>Significant deficiencies in internal control</b>                       |  We will report on all significant deficiencies and whether they have been resolved by management.   |
| <b>Significant difficulties</b>   |  We will report on any significant difficulties encountered during the audit.<br><br>We will report on significant matters arising from the audit that were discussed, or subject to correspondence, with management.<br><br>We will report on matters that are significant to the oversight of the financial reporting process. |
| <b>Non-KPMG component auditors</b>  |  We described the work of non-KPMG component auditors at page 13 above.  |
| <b>Management's approach to consolidation</b>                             |  We will report on whether management's approach to consolidation is consistent with IFRS.   |

# KPMG's Audit quality framework

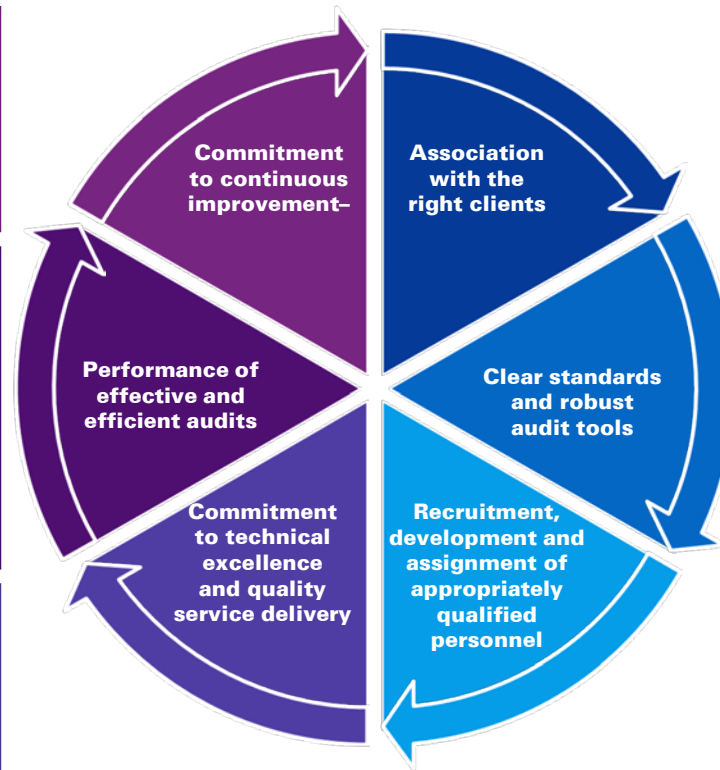
Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

To ensure that every partner and employee concentrates on the fundamental skills and behaviours required to deliver an appropriate and independent opinion, we have developed our global Audit Quality Framework.

- Comprehensive effective monitoring processes
- Proactive identification of emerging risks and opportunities to improve quality and provide insights
- Obtain feedback from key stakeholders
- Evaluate and appropriately respond to feedback and findings

- Professional judgement and scepticism
- Direction, supervision and review
- Ongoing mentoring and on the job coaching
- Critical assessment of audit evidence
- Appropriately supported and documented conclusions
- Relationships built on mutual respect
- Insightful, open and honest two way communications

- Technical training and support
- Accreditation and licensing
- Access to specialist networks
- Consultation processes
- Business understanding and industry knowledge
- Capacity to deliver valued insights



- Select clients within risk tolerance
- Manage audit responses to risk
- Robust client and engagement acceptance and continuance processes
- Client portfolio management

- KPMG Audit and Risk Management Manuals
- Audit technology tools, templates and guidance
- Independence policies

- Recruitment, promotion, retention
- Development of core competencies, skills and personal qualities
- Recognition and reward for quality work
- Capacity and resource management
- Assignment of team members and specialists



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