Perth and Kinross Council

Annual Audit Report to the Members of Perth and Kinross Council
and the Controller of Audit for the year ended 31 March 2017

29 September 2017

Contents

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 Perth and Kinross 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 section 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 alex.sanderson@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

Audit conclusions	We have issued unqualified audit opinions on the financial statements of Perth and Kinross Council and Perth and Kinross Council Charitable Trusts. We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in the audit strategy document. The annual accounts, statement of responsibilities, governance statement and remuneration report were received at the start of the audit fieldwork. The annual accounts were of high quality, as were supporting working papers. We did not identify any audit misstatements. This demonstrates good financial management. We have no matters to highlight in respect of independence.
Financial position	The 2016-17 surplus on the provision of services of £9.0 million is £3.7 million lower than the surplus reported in 2015-16. The underlying surplus was £7.0 million greater than budgeted. As in prior years, the surplus was achieved through strong financial discipline, underspends and achieved savings. Approved underspends can be carried forward as part of the budget flexibility scheme. The Council maintains a strong financial position, with £15.5 million uncommitted general fund balance, representing 4.6% of the 2017-18 revenue budget. The HRA account outturn was in line with budget.. Net assets decreased by £37.9 million to £400.2 million, primarily as a result of the movement in pension liability (page 17).
Financial management and financial sustainability	We observed strong financial management, in respect of monitoring of costs, forward planning and reporting to elected members. The Council prepares a two year revenue budget which is considered good practice, with a proposal being put forward to move to a three year revenue budget. There is an estimated savings requirement of £17.4 million in 2017-18, subject to underlying assumptions. Savings are partly managed through the transformation programme 2015-20. The Council has a robust reserves policy which aims to keep reserves at an adequate level to maintain resources and support financial sustainability.

Executive summary (continued)

Key messages (continued)

Governance and transparency	The Council has an effective governance structure through committee meetings, the scheme of delegation and standing orders. The Council demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee reporting reviewed. A new risk management strategy was implemented in 2016-17, which shows a commitment to continuous improvement. The Council's arrangements in relation to the prevention and detection of fraud are satisfactory, including its participation in the National Fraud Initiative. Systems of internal control operated effectively throughout the year, with only minor control recommendations identified during the audit.
Value for money	We consider that 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 are developed to support key decisions and are appropriately scrutinised. From our testing planned advantages and justifications are being realised or plans are in place to do so.
Outlook	Budgets have been set for the next two years with a medium term financial plan setting out the direction of the Council for the next five years. This represents good practice. The Council faces financial challenges and opportunities associated with reducing settlements and new ways of working such as the partnership with NHS Tayside and the integration joint board. We are content that the going concern assumption is appropriate for the Council. The Scottish Government financial settlement for local authorities for 2017-18 has been communicated, and two year budgets show adequate resource to deliver planned services.

Introduction
Scope and responsibilities

Purpose of this report

The Accounts Commission has appointed KPMG LLP as auditor of Perth and Kinross 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 Perth and Kinross 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 Committee 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 areas such as financial performance and corporate governance.

Accountable officer responsibilities

The Code sets out Perth and Kinross 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 one 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 the Audit Committee, together with previous reports to the Audit Committee throughout the year, discharges the requirements of ISA 260.

Financial position

Overview

The Council recognised an underlying underspend relative to budget of £7.0 million. This is against a backdrop of a challenging environment for all local authorities, with growing demand on service delivery, funding cuts and uncertainty in the current economic climate.

As highlighted in the Audit Scotland report, *Local Government in Scotland; Performance and challenges 2017*, local authorities total revenue funding from the Scottish Government decreased overall by 9.2% in real terms since 2010-11. For Perth and Kinross Council the reduction was 7.0%.

Whilst one year funding settlements from Scottish Government makes long term financial planning difficult, the Council prepares a two year revenue budget using assumptions on future levels of income and expenditure. There is a five year medium term financial plan. This demonstrates good practice in financial planning. A proposal is being put forward to members to approve preparing a three year revenue budget.

Perth and Kinross is an area with a changing demographic and a rising population. An increase in the demographic of older people brings challenges in service provision in health and social care.

The Tay Cities deal was approved, with notice of the final award anticipated in early 2018. This is expected to bring 15,000 new jobs and around £1.8 billion of funding to the Tay region over a ten year period. The area has one of the lowest rates of unemployment at 3.2% in 2016-17, compared with 4.5% for Scotland.

The Transformation Programme 2015-20 continues to support the Council's objectives and support changing service delivery in the challenging period ahead. The Council engages in a range of partnership working with Dundee City Council and Angus Council to realise efficiencies of joined working.

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

Surplus on provision of services

£9.0 million

2015-16 £12.7 million

Net underspend

£7.0 million (£5.4 million approved through budget flexibility)

2015-16 £16.0 million (£5.3 million approved through budget flexibility).

Total useable and unusable reserves

£400.2 million

2015-16 £438.1 million

Uncommitted general fund balance

£15.5 million

2015-16 £13.4 million

Pension liability

£249.9 million

2015-16 £161.8 million

Capital financing requirement

£455.2 million

2015-16 £411.1 million

Financial position (continued)

Comprehensive income and expenditure statement

There are changes to the format of the annual accounts' comprehensive income and expenditure statement (''CIES'') as a result of the Chartered Institute of Public Finance and Accountancy (''CIPFA'') disclosure requirements on 'telling the story', (see page 19).

Net cost of services reduced compared to the prior year, due to a range of savings achieved across services including procurement reform review, appraising repairs and maintenance options on council houses and maximising the efficiencies in the school estate.

Net underspends of £7.0 million relative to budget are reported for 2016-17. The main areas of underspend are:

- Education and Children's Services (£2.9 million), due to staff vacancies, reduced supplies and services costs and additional income.
- Environment (£1.7 million), due to lower fuel and energy costs, additional income and reduced staff costs.
- Health and social care (£2.9 million), due to staff slippage and additional income in older people services from residential homes, and £0.9 million from learning disability services and mental health provision. The Council earmarked £0.6 million in its own reserves for future health and social care transformation.
- Culture (£0.8 million), due to re-phasing of Perth theatre expenditure into 2017-18.

The above underspends were achieved through additional income and use of the budget flexibility scheme. Approved underspends can be carried forward as part of this scheme (see page 27).

Through monitoring performance indicators (see page 31) and ongoing consultation with service users, the Council demonstrates that underspends have not impacted service delivery in a significant way, and the services which were set out to be delivered in the budget were provided.

The following table shows a comparison of current year to prior year income and expenditure;

Comprehensive income and expenditure statement

	2016-17 £000	2015-16 £000	Variance £000
Net cost of services	303,237	322,391	(19,154)
Other operating expenditure	(635)	644	(1,279)
Financing and investment income and expenditure	22,945	21,878	1,067
Taxation and non specific grant income	(334,579)	(357,653)	(23,074)
(Surplus) on the provision of services	**(9,032)**	**(12,740)**	**(3,708)**
Other comprehensive income and expenditure	46,966	(52,034)	99,000
Total comprehensive income and expenditure	**37,934**	**(64,774)**	**102,708**

Source 2016-17 draft financial statements

The movement in other operating expenditure relates to the disposal of non current assets. In 2015-16 a loss was incurred on disposal compared to a gain in 2016-17.

Taxation and non specific grant income decreased due to capital grants reducing by £13.9 million to £20.8 million which is in line with the capital programme. The High Street office upgrade has finished and work is commencing on a number of projects, leading to an anticipated higher spend in 2017-18. The revenue grant from Scottish Government also decreased.

Other comprehensive income and expenditure moved significantly due to re-measurement of the pension liability. Movements in gilt rates caused a material increase in the liability, (see page 17).

Financial position (continued)

Balance Sheet			
	2016-17 £000	**2015-16 £000**	**Variance £000**
Long term assets	1,040,482	942,043	98,439
Current assets	79,139	85,114	(5,975)
Current liabilities	(73,818)	(69,335)	(4,483)
Long term liabilities	(645,550)	(519,635)	(125,915)
Net assets	**400,253**	**438,187**	**37,934**
Useable reserves	80,357	85,835	5,478
Unusable reserves	319,896	352,352	32,456
Total reserves	**400,253**	**438,187**	**37,934**

Source; 2016-17 draft financial statements

Fixed assets increased significantly compared to 31 March 2016 due to additions of £94.0 million, partly offset by £7.3 million of disposals. Additions are in line with the major capital investment programme being undertaken, and include works to the A9/A85 road junction and upgrades to the High Street Council offices. Major capital works in 2017-18 will include the next phases of the A9/A85 road improvements and construction starting on the new secondary school at Bertha Park. There were revaluations in the year as part of the five year rolling programme (see page 16).

Current assets reduced partly due to the timing of trade receivables payments and the cash balance. Short term investments decreased by £20.1 million whilst cash and cash equivalents increased by £16.1 million. The Council is holding more funds in short term deposit facilities due to preferable interest rates and liquidity requirements.

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The current liabilities increase relates to a new provision for dilapidations on the Blackfriars offices which the Council has now exited, and timing of trade payables payments.

Long term liabilities increased significantly due to movements in the pensions liability of £88.1 million and borrowing to fund capital expenditure (see page 27).

Capital programme

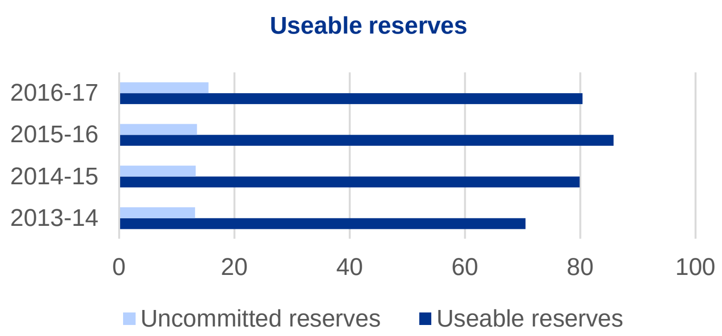
Capital monitoring is reported to the Strategic Policy and Resource Committee four times a year in line with Committee timetable. The following major capital investment programmes are being undertaken:

- A9/A85 road junction improvement project. This is being completed over several phases with phase one currently in progress.
- Kinross primary school and Tulloch primary school upgrades; both projects are progressing ahead of budget and expenditure has been phased in to 2016-17 from 2017-18.
- Bertha park development: including new housing and a secondary school which is scheduled to open in August 2019.
- Perth City Hall upgrade: the City Hall is being transformed into a cultural attraction after the proposal was passed by Council. This is currently in design phase. This is part of a £20 million commitment to capital expenditure on culture.

Financial position (continued)

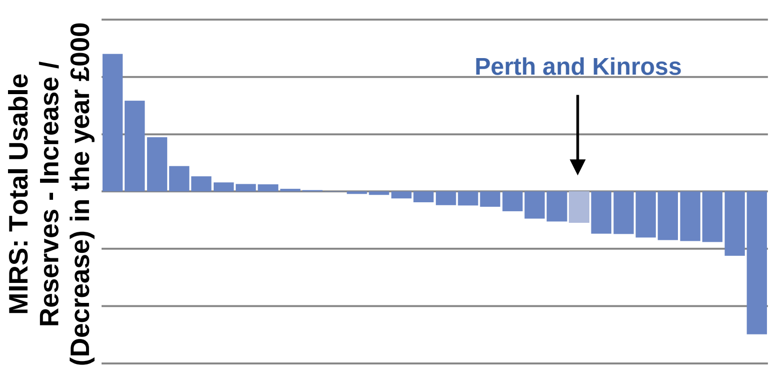
Reserves

The uncommitted general fund balance was £15.5 million as at 31 March 2017 which represents 4.6% of the 2017-18 revenue budget. The reserves policy is to retain uncommitted reserves of between 2-4%, however with reserves expected to reduce, management considered it prudent to remain at 4.6% for 2016-17.



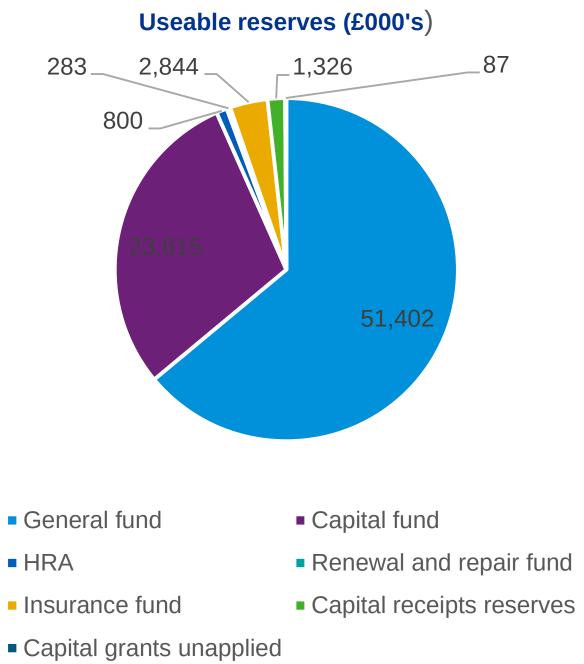
Source; prior year audited accounts and current year unaudited accounts

The decrease in useable reserves is in line with other local authorities;



Source: Audit Scotland benchmarking 2017

The useable reserves are split between different funds, with a section of the general fund being uncommitted (£15.5 million) with the rest being earmarked for future projects. Useable reserves are summarised in the pie chart below:



Financial position (continued)

Financial plans 2017-18

Budgets are set for the next two years, recognising a need for financial constraint. A balanced budget is forecast each year, which relies on savings being achieved and income levels being as budgeted. The key assumptions used in setting the 2017-18 and 2018-19 budgets include:

- Scottish Government funding provided beyond 2017-18.
- Transformation projects forecast to generate savings; there is inherent uncertainty around how successfully these projects can be implemented and the savings they can deliver.
- Band D properties continuing to increase, therefore generating additional council tax income. If the council tax base does not increase revenue would be lower than budgeted.
- Pay award agreements may change and result in a variance from budget. Currently 1% has been agreed by COSLA for 2017-18 and is in line with national pay expectations in the public sector.
- Inflation may exceed or not meet budgeted provisions, and this is heightened by the impact of Brexit on the value of the Sterling.
- The current economic climate provides risk 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.

Management has carried out some sensitivity analysis to understand the impact on the budget if different levels of income are received.

Results for the first quarter do not show a significant variance to budget, indicating that savings assumptions to date are being realised.

The 2017-18 and 2018-19 provisional revenue budgets are summarised below.

	Provisional revenue budget 2017-18 £000's	Assumed 2018-19 budget £000's
Service expenditure	308,286	298.886
Corporate expenditure	25,460	28,079
Total budget expenditure	**333,746**	**326,965**
Scottish Government Funding	243,516	241,414
Council tax income	82,240	85,119
Other income	7,990	431
Total budgeted income	**332,746**	**326,965**

Source; revenue budget 2017-18 & 2018-19

Going concern

The Council had net assets of £400.3 million (2015-16: £438.1 million) as at 31 March 2017. Although this decreased from 2015-16 by £37.8 million, it is primarily in relation to the increase in the pension liability (£88.1 million) which is a long term liability.

Management considers it appropriate to continue to adopt the going concern assumption for the preparation of the annual accounts. It considers that the confirmed revenue support grant of £238.0 million for 2017-18 and the savings proposals are sufficient to ensure the Council can meet debts as they fall due.

Continued...

Financial position (continued)

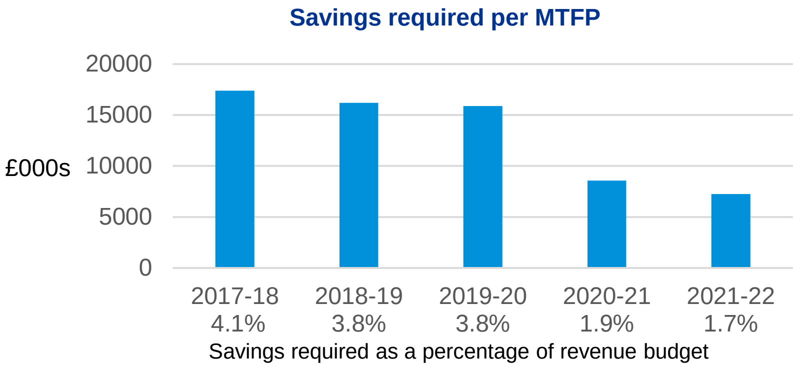
Going concern (continued)

The Council recognised a surplus on the provision of services in the year and is forecast to deliver a balanced budget going forward. Over the past few years there has been a reduction in the overall cost base and further efficiency savings are incorporated in budgets.

The Scottish Government financial settlement for local authorities for 2017-18 is confirmed, covering the 12 month period to 31 March 2018. Amounts for funding periods after 2017-18 are currently unknown, however a reasonable expectation is a 1.3% reduction and is incorporated into the forecasts which are regularly reviewed.

The Council has identified expenditure pressures and estimated required savings to be achieved through the transformation programme. This is considered in the wider scope section, page 26-28.

The table shows savings required over the next five years, totalling £65.3 million:



Source; medium term financial plan 2017-22

Savings are required to proactively respond to a range of areas such as decreasing revenue funding, inflation, welfare reform, apprenticeship levy and demographic changes. There is a rising number of older people within Perth and Kinross, as well as a rising number of young people, with each growing demographic providing unique challenges.

Identified savings in the transformation programme come from:

- procurement reform review; closer management of suppliers and collaborative working;
- corporate digital service review; moving more services online;
- a range of social care reforms to provide care at home for longer and reviewing day care services; and
- voluntary severance schemes.

Conclusion

The Council has prepared short and medium term financial forecasts which are dependant on a number of assumptions out with the Council's control.

A surplus was achieved in the year and a net asset position was maintained.

We are content that the going concern assumption is appropriate given the financial plans prepared, the progress with savings options to date, the brought forward reserves position, the expectation of continued government funding and the Council's sound financial management

Financial statements and accounting
Audit conclusions

Audit opinion
Following approval of the annual accounts by the Audit Committee we issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2017, and of the surplus for the year then ended. We also issued unqualified opinions on the truth and fairness of the state of the Perth and Kinross Council Charitable Funds' 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 financial statements 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 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 Code and relevant legislation. The Perth and Kinross Council Charitable Funds financial statements are prepared in accordance with the Charities SORP (FRS 102). Our audit confirmed that the financial statements 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
There have been no audit misstatements identified during the audit.
Written representations
We request standard representations from those charged with governance prior to issuing our opinions.

Financial statements and accounting
Audit conclusions (continued)

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 £8.4 million for the Council's standalone financial statements, and £8.5 million for the Group financial statements. This equates to 2% of cost of services expenditure, adjusted for revaluation decreases recognised in the cost of services expenditure. We designed our procedures to detect errors in specific accounts at a lower level of precision than our materiality. For the standalone and group accounts our performance materiality was £6.3 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 Chief Internal Auditor and reviewed internal audit reports as issued to the Audit Committee 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 Audit Committee meetings to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Financial statements preparation

High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 26 June 2017. This included the management commentary and annual governance statement.

In advance of our audit fieldwork we issued a 'prepared by client' request setting out 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 division.

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; and
- retirement benefits.

Other focus areas:

- presentation of the financial statements;
- consolidation of the IJB; and
- capital expenditure.

Financial statements and accounting

Significant risks

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Fraud risk from management override of controls Professional standards require us to communicate the fraud risk from management override of controls as a significant risk; as the standards consider management to typically be in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	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. Strong oversight of finances by management provides additional review of potential material errors caused by management override of controls. In line with our methodology, we carried 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.	There were no specific circumstances identified which would indicate additional risk of management override of controls. No overrides were identified.

Financial statements and accounting
Significant risks (continued)

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.	We considered the fraud risk from revenue recognition for the Council for each of its significant revenue streams and include a significant risk over 'other income', relating primarily to fees and charges income across different services. We consider there to be judgement in recognising this income. Our work consisted of: — agreeing non-ring fenced government grants (£187.1 million) to correspondence from the Scottish Government; — sample checking capital grants to third party award letters; — sample testing non domestic rates (''NDR'') reliefs and council tax discounts to verify the relief / discounts were awarded at the correct rate and are appropriate. Substantive analytical procedures over gross council tax collected and gross NDR levied. We also completed the audit of the NDR grant claim; — substantive analytical procedures over housing rents income using the full list of properties and rental charge to develop expected charge; — analytical review over other income (£79.1 million) at service level compared to budget and prior year; — journals testing of fees and charges income; — test of detail over services with material other income amounts not already tested; and — cut-off testing over other income to verify it is recorded in the correct financial year.	We found controls around income to be operating effectively. We are satisfied that income is recognised appropriately, in the correct financial year and in line with the Code. From our journals testing, two journals were identified where back up had not been kept. ***Recommendation one***

Financial statements and accounting
Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Revaluation of property, plant and equipment Under the 2016-17 Code and IFRS, property, plant and equipment ("PPE") is required to be held at fair value. In order to comply with these accounting requirements, Council assets are subject to rolling valuations; with nursery, primary and secondary schools, outdoor centres, tips (former landfill sites) and investment properties being subject to valuation in 2016-17. The total value of PPE as at 31 March 2016 was £896 million, therefore the related revaluation is significant. Furthermore, the Council holds £18 million of investment property, which must be revalued on an annual basis. As with any local authority which performs valuations, this is an inherently judgemental area and is therefore an area of financial statement risk.	Our work consisted of: — review of the in-house valuation team, considering their objectivity, independence, experience and integrity; — review by KPMG valuer of valuation methodology, comparative sales, supporting evidence of rent or land values and yield applied in valuation calculations. This was also carried out for 2015-16 to gain comfort over opening balances; — selecting a representative sample of assets to agree to supporting evidence and re-perform the revaluation calculations. Our sample included schools, a car park, shopping centre and the Council head offices; — regular meetings and communication with estates team to discuss valuations and understand approach, including treatment of VAT, valuation date and valuation methodology used. The valuation date of 1 April was challenged at our interim audit to verify there was no material movement between 1 April 2016 and 31 March 2017; — review of impairment indicators for those items that have been revalued; and — testing the allocation of revaluation movements between revaluation reserve and income and expenditure for sample of revalued assets.	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; — valuations are appropriately recognised and disclosed in the financial statements. Having considered a paper prepared by the Council that demonstrated there was no material movement between valuation date and year end, we are satisfied the 1 April is an acceptable valuation date. We note the yield in the calculation of St Johns shopping centre is at the lower end of an accepted range, however does not cause a material difference. For the Council's head office at 2 High Street, the depreciated replacement cost model (''DRC'') is used. This is generally only applied to buildings of a specialised nature e.g. schools, and we expect to use market value for an office building. Having challenged the Council's valuers, we accept the DRC method, as there is a lack of an identifiable market and in light of the specific features of the building.

Financial statements and accounting
Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Retirement benefits The Council accounts for its participation in the Tayside 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 calculations based on market conditions at the year end, including a discount rate to derive the 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 for all local authorities and represents an area of financial statement risk.	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 are satisfied that the retirement benefit obligation: — is correctly stated in 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 page 50. The net liability in the balance sheet increased by £88.1 million compared to 31 March 2016, driven by an decrease in discount rate (1%), and increases in pension rates (0.3%).

Financial statements and accounting

Other focus areas (continued)

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Capital expenditure The Council has a capital budget of £464 million over the next five years. This is split between £386 million for the composite budget and £78 million for the housing investment programme. The expected spend in 2016-17 was £82 million with £59 million for the composite budget and £23 million for the housing investment programme. Due to the significance of this capital investment programme and inherent risk of delivering it in line with budget, we consider this to be an other focus area for our audit work to ensure the classification of costs between operating and capital expenditure is appropriate.	Our audit work consisted of: — review of the capital plan and discussing the monitoring arrangements by teams across the Council; — understanding the processes to verify the appropriate recording of capital and other expenses in the financial records and that authorisation by appropriate individuals occurred; — selecting a sample of capital item additions to agree to invoice to verify appropriateness of classification of items between expenditure and capital expenditure; — selecting a sample of expense items to agree to invoice to verify appropriateness of items expense allocation and clarification; — testing of reallocation of assets under the course of construction to fixed asset categories at the period end to verify appropriate categorisation; and — review accounting treatment of developer contributions to significant capital projects.	Controls were tested over capital monitoring as reported in our interim highlights memorandum. Controls were found to be operating effectively. No issues were identified when testing capital additions, nor were any items found to be expensed of a capital nature. No exceptions were identified and we conclude that capital expenditure is appropriately stated in the financial statements.

Highway network assets were identified as an other focus area in our strategy document. An announcement was made on 8 March 2017 by the CIPFA/LASAAC Code Board that the introduction of the Highway Network Asset Code into the financial reporting requirements for local authorities would no longer occur. We therefore no longer consider highways network assets to be an area of audit focus.

Financial statements and accounting

Other focus areas (continued)

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 important material disclosure change in this year's financial statements, worthy of audit understanding.	Our audit work consisted of: — assessing how the Council actioned the revised disclosure requirements for the CIES, MIRS and the new Expenditure and Funding Analysis (''EFA'') as required by the Code; — checking the restated numbers and associated disclosures for accuracy and compliance with applicable Accounting Standards and Code guidance; and — ongoing discussion on the position of the EFA within the financial statements with the finance team.	The EFA had been presented in line with the code and is included as a note to the primary financial statements. The restated numbers for 2015-16 and current year 2016-17 figures were found to be accurate.

Financial statements and accounting

Other focus areas (continued)

OTHER FOCUS AREA	OUR RESPONSE	AUDIT CONCLUSION
Consolidation of the IJB The IJB was established in 2015-16, and took on full delegated functions from 1 April 2016. The consolidation of this new entity has a material impact on the Council's 2016-17 financial statements. There are a number of intra group transactions to be recognised. The Council has shared risk over the IJB with NHS Tayside, as well as obligations for delivery of services as requested by the IJB. Strong monitoring and reporting is required within the Council to ensure all statutory requirements are met and risk is managed at an appropriate level.	Our audit work consisted of: — review of the group consolidation instructions; — agreeing the intra group transactions and consolidated amounts to those of the IJB financial statements; — discussion with management the overall reporting and monitoring arrangements in place within the Council to meet its obligations to the IJB; — confirmation that the accounting treatment is appropriate with a particular focus on the treatment of reserves. We considered the arrangements in respect of any balance of unspent or overspent funds at the year end; and — review of the joint internal audit work completed by the NHS Tayside internal auditors over the IJB.	The IJB has been correctly consolidated into the group accounts. The IJB presents gross income and expenditure from the Council. We confirmed this is the correct accounting treatment in grossing up the charges to and from the IJB in the CIES. Reserves are held on behalf of the IJB where an underspend occurs, which is first subject to Council approval. For 2016-17 a creditor is recognised in the Council's accounts of £1.4 million which is effectively the reserves of the IJB. The IJB was assessed as a joint venture and is accounted for using the equity method of accounting, see page 47 for group accounting considerations. We consider this to be the correct accounting treatment.

Financial statements and accounting
Management reporting in financial statements

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Management commentary	There is a new requirement for auditors to provide an opinion on whether the management commentary had been prepared in accordance with statutory guidance, this is included within our independent auditors report. *Regulation 8(2) The Local Authority Accounts (Scotland) Regulations 2014* requires the inclusion of a management commentary within the annual accounts, similar to the Companies Act requirements for listed entity financial statements.	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. We provided management with some relatively minor suggestions relating to how the management commentary could be enhanced and where additional information disclosures should be made.
Remuneration report	The remuneration report was included within the unaudited annual accounts and supporting reports and working papers were provided. Amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentational changes to ensure that it complied with the Local Authority Accounts (Scotland) Regulations 2014. In the course of testing it was identified that the incorrect report had been used to prepare the 'Remuneration of Employees by Pay Band' table. The report returned gross pensionable pay, rather than gross pay. This was subsequently addressed by management, and the table was restated, as well as the prior year figures.	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. Some minor presentational adjustments were made as part of the audit. We recommended that the gross pay report is used, this has been implemented by management. Our independent auditor's report confirms that the part of the remuneration report subject to audit has been properly prepared.

Financial statements and accounting
Management reporting in financial statements

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
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 that the annual governance statement is appropriate for the Council.

Financial statements and accounting

Qualitative aspects and future developments

Qualitative aspects

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 Code.

Significant accounting estimates relate to the present value of defined benefit obligations and valuation of non current assets. For defined benefit obligations, the estimate is calculated under IAS 19 (as calculated by the Council's actuary, Barnett Waddingham using agreed financial assumptions). We found the assumptions and accounting for pensions to be appropriate (page 46). Non current asset impairment is considered by the Council's valuation team. We used our internal valuation specialists to assess the assumptions used in these reports. We did not identify indications of management bias.

Financial statement disclosures were considered against requirements of the Code, relevant legislation and IFRS. No departures from these requirements were identified.

Future accounting and audit developments

CIPFA / LASAAC consulted on amendments to the 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,* will be issued as a companion publication to the Code setting out the approach to these two standards.

Other changes to the 2017 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.

Wider scope and Best Value
Introduction

Audit dimensions introduction

The Code sets out four audit dimensions which, alongside Best Value, 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 makes 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 is assessed over the five year audit appointment, as part of the annual audit work. There are seven areas considered over the five years. 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 within the audit dimensions on pages 25-38.

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 scope work over the 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, Head of Culture and Public Service Reform and 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

Financial sustainability

The Council has identified savings requirements over the next five years in order to continue to deliver services.

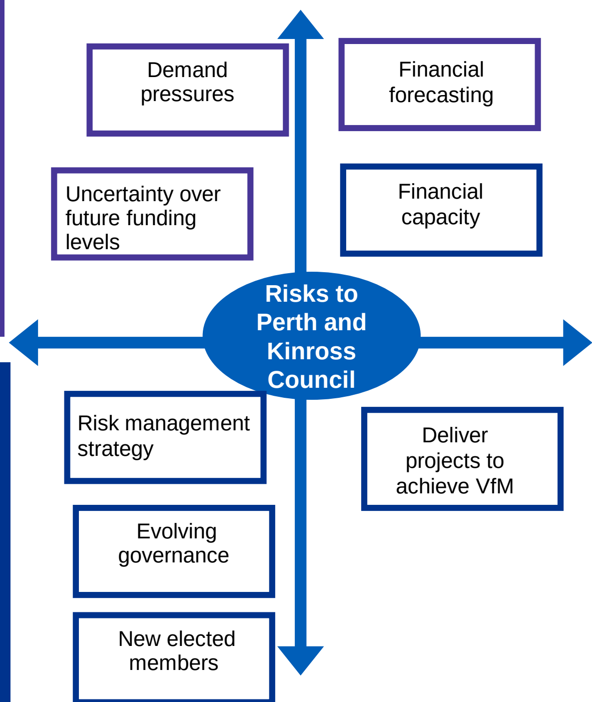
The transformation programme supports achievement of these savings through redesigning the way services are delivered to maximise efficiencies and support change.

We consider that the Council has effective measures to address financial sustainability.

Financial management

The Council has a sound process in place to manage its finances and resources which aids effective financial planning and budget setting.

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



Governance and transparency

We consider the Council to have high standards of governance and accountability. This is provided through an effective governance framework of committees, internal audit, and internal controls. Transparency is achieved through the committee structure and open nature of discussions.

Value for money

We consider that the Council has appropriate arrangements for achieving value for money.

Options appraisals and business cases are developed to support key decisions and are appropriately scrutinised.

Partnership working such as Tayside Procurement Consortium provides economies of scale which we consider good practice.

Capital programme management is an area which is evolving and would benefit from further development (see page 37).

Wider scope and Best Value

Financial sustainability

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.

Medium to long term financial strategy

The Medium Term Financial Plan (''MTFP'') was approved on 5 October 2016 at Council and covers five years from 2017-22 with a two year revenue budget, 2017-19. This sets out the key variables which are likely to have significant impact on results, e.g. the local government finance settlement, pay awards, inflation and pension fund contributions. The plan identifies projected savings targets for the next five financial years.

The MTFP links to each of the five objectives in the Council's corporate plan 2013-18:

- giving every child the best start in life;
- developing educated, responsible and informed citizens;
- promoting a prosperous, inclusive and sustainable economy;
- supporting people to lead independent, healthy and active lives; and
- creating a safe and sustainable place for future generations.

By linking financial plans to the Council's objectives, it demonstrates strong commitment to achieving the objectives and embeds the priorities of the Council into the financial planning process.

Forming the two year revenue budget – *good practice*

The Council set a two year revenue budget for 2017-18 and 2018-19 on 11 February 2016, as well as the budget for 2016-17, which we consider to be good practice. A number of assumptions and risks to delivery are set out within the budget, with expected impacts and mitigations. A proposal is being put forward to prepare a three year revenue budget going forward.

The budget setting process is ongoing throughout the year. Members of the finance team consult with services using last year's budget as a starting point. Adjustments are made based on known service demands and looking at areas of under / over spend from the previous year's budget.

Meetings take place with the administration and with opposition parties to explain the budget and give a platform for discussion on what options could be taken to achieve required savings. This is a transparent process and allows appropriate challenge and scrutiny of budgeted options.

We consider it good practice for the Council to set a medium term budget, which is supported by the five year MTFP. The Council's other long term strategies such as the Single Outcome Agreement (''SOA'') and transformation programme clearly link to the budget, with regular reporting allowing budgets to be considered and revised in real time.

Wider scope and Best Value

Financial sustainability

Reserves

The Council reserves policy was approved at Council on 22 February 2017. Proposals were put forward to earmark reserves for areas such as the transformation programme, delivering affordable housing and bridge feasibility studies for assessment of the Queens Bridge. There are sufficient reserves to support future operations. We provide further commentary on the financial position on pages six to 13.

Budget flexibility – *good practice*

The Council has an approved revenue budget flexibility scheme which allows certain service under and over spends to be carried forward to future financial years. Revenue budget flexibility proposals are reviewed annually. This allows services to re-phase work where required and have flexibility in how they deliver services. We consider that the budget flexibility is a positive part of the Council's approach to managing financial challenges and discourages short term thinking.

The Council faces financial constraints which impact on its ability to raise future levels of reserves. Constraints include a tight budgetary environment and due to the budget flexibility programme there is limited opportunities to raise uncommitted reserves from service underspends. Target levels of uncommitted reserves are between 2-4% of net revenue expenditure. For 2016-17 the uncommitted reserve balance is 4.6%. As it is expected that reserves will begin to deplete in the future, the Council considers it prudent to hold reserves at this position going forward. This provides the Council with a sound basis from which to address transformation needs and plans.

Treasury management and investment

The Treasury and Investment Strategy covers 2016-17 to 2020-21. The projected borrowing requirement over this period is £131.6 million. This represents approved capital expenditure and refinancing of mature debt. The Council has considered and uses different financing options such as Public Private Partnerships and tax incremental financing.

An annual investment strategy is set in line with Local Government Investment (Scotland) Regulations 2010. Levels of acceptable risk are documented and the Council takes a 'risk aware' approach to investments.

The Council has an appropriate policy for treasury management and investment decisions, this is scrutinised at Council meetings and we do not consider the level of borrowing required to pose a financial sustainably risk.

Asset management plans

The Council has a number of policies and reports which contribute to the asset management programme. There is a central site where documents are linked, split by service area. The Council uses guidance on good practice such as Account Commission reports and Scottish Government consultations. Capital monitoring reports are linked as well as specific proposals, such as the future of Perth City Hall and the consultations on Bertha Park.

There are separate asset management plans for key areas such as fleet and mechanical equipment, ICT and service assets in schools, which all link into the capital plan. The capital plan links into MTFP, showing there is a connection through from asset management plans to financial planning process.

We consider the Council follows good practice by having detailed asset management plans.

Wider scope and Best Value

Financial sustainability (continued)

Service redesign

The Council has a five year transformation programme 2015-20. The programme provides a framework for innovation, creativity, flexibility and greater entrepreneurship to meet future challenges. Some key themes include:

- Leadership: elected members will have a broader role, overseeing a range of service delivery models and leading on issues such as tackling inequalities and health and social care. More flexible leadership arrangements are coming into place which will enable new models of service to be developed.
- People: focus on commercial and business skills and working across organisational boundaries as more services are delivered on a collaborative basis.
- Communities: understand what needs communities have in order to use resources efficiently and effectively.
- Financial Planning: maintaining a balanced budget with the planned used of reserves against anticipated tough financial settlements over the short to medium term.
- Capacity: focus use of physical assets to ensure diminishing resources are targeted at priorities.
- Governance: governance arrangements will be reviewed as part of the change process. Need to consider developing power whilst still maintaining strong controls.

There are 27 reviews as part of the strategy which aim to develop new ways of working and support the development of efficient processes and systems to sustain high quality service delivery, while still deliveing savings and dealing with increasing service demand. An update on projects is presented at each Strategic Policy and Resources Committee using a dashboard system which shows the status of each project. Savings and spend are also reported on each project.

The transformation programme underpins the redesign of how the Council delivers services. Updates are reported to committee, showing transparency and appropriate scrutiny from members. The transformation programme is gathering pace at an appropriate level and has sufficient depth and detail to reach service levels as well as reshaping the aims of the Council.

Conclusion

The Council has identified savings requirements (£65.3 million) over the next five years in order to continue to provide services to meet demand. Results for the first quarter of 2017-18 are broadly in line with budget, which indicates that efficiencies are being delivered as planned.

The transformation programme supports achievement of savings through redesigning the way services are delivered to maximise efficiencies and support change, its remit and structure is appropriate.

We consider that the Council has effective measures to address financial sustainability.

Wider scope and Best Value

Financial management

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

Finance function capacity

The Section 95 officer is the Head of Finance, and a member of the Executive Officer Team (''EOT''), therefore 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 five years, in line with the general reduction in the Council's scale. We note the high quality of the annual accounts and regular reporting of financial position to elected members through the Strategic Policy and Resources Committee. The lack of audit adjustments identified through the external audit evidences the capabilities of the finance team. The finance function has sufficient capacity to deliver its objectives and ongoing training ensures adequate knowledge and performance.

The Council provides induction and ongoing training for elected members and staff. Elected members receive initial induction training, followed by an annual meeting to discuss and subsequently review their personal development/training plan. This took place in June 2017 for new elected members after the local government election. KPMG supported training on the financial statements, role of audit and the role of the Audit Committee. The Council will be rolling out the improvement service's continuous professional development framework to all elected members in 2018.

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Budget consultation with services

Services are consulted at the initial budget setting stage. The finance team meets with services to discuss the prior year budget as a benchmark, and consider areas they feel need more or less budget allocated in the year in line with allocations from the interim finance plan.

The EOT oversees the budget setting process, it is not a decentralised decision in each service. Work is ongoing in developing the process, with the Chief Accountant carrying out an exercise to ask services 'opinions' on the budget process and how this could be improved. This is highlighted as an area of good practice (page 26).

Consultation of service users in budget setting

A residents' survey is conducted every two years, with the latest in Spring 2017. Council consultations are advertised on the website, with events in 2016-17 being budget consultation, between December 2016 and January 2017, and rent restructure review, which is ongoing.

A number of participatory budget events are held in March and April each year to involve the community in deciding how the budget is spent. Participatory budgeting allows residents to engage with the Council and discuss their spending priorities. The Council recognises the importance of this being a repeated exercise rather than a one off scheme to allow the process to improve and refine.

There are five action partnerships in each locality within Perth and Kinross. Each partnership identifies areas where people experience higher levels of inequality. These areas are supported through locality action plans to improve outcomes and this feeds into the budget setting process.

Wider scope and Best Value

Financial management (continued)

Workforce planning

Over the last five years the workforce of the Council has decreased. The Council aims to have the right people with the right skills and abilities at the right time to perform duties. There is a drive to increase the range of recruitment measures for hard to fill posts, which are defined as a post vacant for six months or more. 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 using wider social media channels. Staff have also been funded to retrain as teachers to try and fill the resource gap. The Council has a programme of 'grow your own' which reviews the modern apprentice programme and aims to employ young people straight out of school.

Whilst we have not reviewed the programme in detail, we consider it to be an effective approach to addressing resource gaps. The programme enables efficiencies within certain service areas and reemployment to services with demand.

Sickness absence for teaching staff has traditionally been high within the Council, currently sickness absence days per teacher is 8.6 days. This has been heightened by more medium to long term absence. Proactive wellbeing measures are being taken to support employees and the council is investing time and resource into addressing this performance indicator.

Outturn versus budget

The Council generated a surplus on the provision of services of £9.0 million in 2016-17 and underspent £7.0 million against budget.

We note that underspends were delivered in the prior five years (£16.0 million in 2015-16) and the previous appointed auditor highlighted that the Council was working towards integrating service performance reporting and budget monitoring, (see appendix nine).

We considered the impact of service delivery from underspends and conclude there has been no clear negative impact on service delivery. This is evidenced through performance management information and the use of the budget flexibility scheme which allocates into 2017-18 with Council approval.

Conclusion

The Council has a sound process in place to manage its finances and resources which aids effective financial planning and budget setting.

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

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Wider scope and Best Value

Governance and transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.

Governance structure

There is a clear system of governance through the scheme of delegation and standing orders. The Council demonstrates effective scrutiny, challenge and transparency on decision making through various levels of committee reporting. The Council meetings are supported by: Strategic Policy and Resources Committee which is tasked with determining strategic policy objectives and priorities; Audit Committee to consider reports from internal and external audit and ensuring action is taken to improve internal controls; and the Scrutiny Committee for ensuring action is taken to monitor overall performance.

Members must declare any interest to the Council during committees. It was noted that non-financial interests are not collated for audit purposes.

Recommendation two

The Council reviews its Financial Regulations every two years, with the last review in December 2016. The main change was to accountable budget holders as a consequence of changes in structure.

The Local Code of Corporate Governance will be reviewed as a result of the May 2017 elections. A paper is going forward to Council in October 2017 for approval.

Transparency

Decisions are transparent as actions are documented within Council and committee minutes. There is a high level of transparency through the Council's website, which includes minutes and papers for all committee meetings. Committee membership is balanced between administration and opposition members to ensure adequate expertise, independence and challenge. Where areas for improvement are identified, they are included in an action plan which is reviewed during the next annual review of the Council's arrangements.

Performance management

The community plan and SOA link to the Corporate Plan which feeds into Business Management and Improvement Plans (''BMIP'') at a service level. BMIPs include a range of performance indicators relevant to the service and a review is carried out every six months at the Scrutiny Committee of progress against the indicators and against objectives.

The Council has developed a number of performance indicators ("PIs") with results reported on the Council's website in the Annual Performance Report (''APR'').The draft 2016-17 APR shows 48% of indicators have improved, 38% demonstrate consistent performance and 12% need further attention.

Statutory Performance Indicators (''SPIs'') as prescribed by the Accounts Commission are included within the Council's suite of PIs.

We considered the Councils process for gathering and reporting performance information including SPIs. We consider these arrangements to be appropriate with transparent reporting of results on the Council's website and through the APR.

Wider scope and Best Value

Governance and transparency (continued)

Leadership

The Council sets its objectives through the Corporate Plan, which feeds into BMIPs. Transformation projects at service level also support the Council objectives. Alongside this the MTFP and revenue budgets link directly to the Corporate Plan.

We consider this 'golden thread' approach to be good practice, whereby the high level Council objectives feed directly through to service plans, making officers accountable to Council objectives.

This whole Council involvement in delivering outcomes is evidenced through the employee engagement survey in September 2016. Staff were asked to answer ''agree'', ''disagree'' or ''neither'' on the statement *'I know how my job contributes to the Council objectives'*. 83% agreed with only 3.5% disagreeing.

There are a range of approaches the leadership team uses to share its vision across the Council, for example:

— business breakfasts: the chief executive and directors meet with services on a rotational basis to discuss emerging issues;

— elected member discussions: the chief executive meets with the leader of each party on a weekly basis to discuss Council performance and key issues; and

— future thinking sessions: staff are invited to share their thoughts and ideas on the future of the Council and what challenges and opportunities they face.

It is evident that the leadership team and senior management demonstrate a common ethos and motivation to make the Council succeed against its objectives.

NFI

The National Fraud Initiative ("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.

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

The NFI process should continue to be embedded with departments to ensure consistency in clearing matches and timeliness of returns.

Overall the arrangements were satisfactory and overall engagement with NFI is good, no exceptions were identified.

Fraud

No material fraud or other irregularities were identified during the year. The arrangements include policies and codes of conduct for staff and board members, supported by a fraud prevention policy and response plan. The Council participates in the NFI exercise, led by internal audit as above. We consider the Councils arrangement to prevent and detect fraud to be satisfactory.

Shared risk assessment (''SRA'')

The SRA process results in a Local Scrutiny Plan (''LSP'') for the Council, setting out scrutiny risks and the proposed scrutiny responses over the coming year. The 2017-18 LSP prepared by the Local Area Network of scrutiny partners was considered by the Council in June 2017. The Scottish Housing Regulator has identified risks in the Council approach to homelessness and housing. The Council is aware of these risks and is taking actions to address them.

Wider scope and Best Value

Governance and transparency (continued)

Arms Length External Organisations (''ALEOs'')

The Head of Culture and Public Service Reform is the strategic lead on governance of the ALEOs. ALEOs are monitored through monthly performance reports and quarterly meetings. Every six months the Chief Executives of the ALEOs attend the Strategic Policy and Resource Committee to discuss performance.

A collaborative approach is taken to consult with ALEOs on strategies and provide each body with an 'investment', rather than a subsidy. This allows ALEOs to be empowered to make decisions, while still under the policies and requirements as set out in the Service Level Agreements (''SLA''). The Council's management of the relationship with its ALEOs is defined within the SLAs.

The Council links governance of ALEOs to its community and corporate plans through a 'commissioning blueprint' which monitors the delivery of services from ALEOs. This enables the Council to set clear expectations and monitor ALEO performance against their own outcomes to assess if it is delivering the required service to meet Council objectives.

Since April 2016 the IJB has directed the provision of integrated health and social care services. The Council has developed new assurance frameworks for monitoring arrangements with the IJB and ALEOs which outline governance and reporting requirements to ensure a consistent approach.

ALEOs review – *good practice*

The Council completed an options appraisal exercise on the delivery of culture and sport to identify the best model for medium term delivery. This led to establishing Culture Perth and Kinross (''CPK'') with five different scenarios provided. For example keeping the services in house, merging Horsecross and/or Live Active Leisure. The final decision considered the financial benefit of NDR savings and increased income, and also impact on visitor numbers and customer experience, evidenced by improving PIs since its formation.

This is considered good practice, with the Council going through detailed options appraisal to ensure the right model was selected, for both service delivery and value for money.

Wider scope and Best Value
Governance and transparency (continued)

Risk management

The Council recently implemented a new risk management strategy, approved in February 2017, which aims to make the Council more risk aware, rather than risk averse. There is regular reporting of strategic and operational risks to the Strategic Policy and Resources Committee with monthly revenue and capital monitoring reports submitted which include discussion of risks and how these can be controlled / mitigated. The Chief Internal Auditor's reporting lines changed in the year, from the Head of Finance to the Head of Legal Services, giving more independence from the finance team.

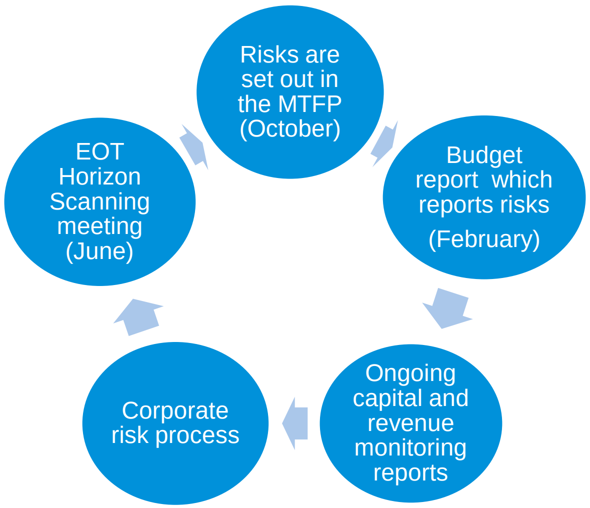
The need for a review of the risk strategy was identified and supported by Internal Audit's report presented on the 29 June 2016. The key drivers for review were an increase in partnership working and new operational models such as the IJB, which change the risk profile of the Council.

Key changes include:

- four risk documents: a risk management policy, risk management strategy to set out high level approach, risk management process guide aimed at service level operations and the risk management appetite which details the level of risk which will be tolerated in each area in order to achieve outcomes;
- definitions for terminology to ensure no ambiguity;
- being risk aware rather than risk adverse; and
- commentary on approach to managing risks within partnership arrangements.

The new risk management strategy demonstrates good practice, with high level outcomes being broken down to service level. This enables officers to take ownership and responsibility for risks, which enables risk management to be driven by all levels within the Council.

As shown below the risk management process is a continuous process throughout the year.



Wider scope and Best Value
Governance and transparency (continued)

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, combined with that of Internal Audit, 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.

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.

As part of our interim audit report, we raised five recommendations in relation to control weaknesses. Management accepted these responses and we will review the progress in our 2017-18 interim report. Notwithstanding the recommendations raised, we consider that the Council has a strong control environment.

Data analytics

The integrity of accounts payable data was tested using data analytics routines. The full life cycle of the purchase ledger was tested by reviewing purchase orders to invoices to goods received note. Tests included the three-way match, duplicate supplier information, duplicate bank details and unexpected date sequencing, e.g. goods received note is dated before purchase order. Key findings are summarised in appendix six.

Control tested	Effective
Bank reconciliations; three months bank reconciliations were tested for each bank account.	✓
BACS Authorisation; 15 weekly BACS runs were tested to verify they had been approved by an authorised signatory.	✓
Budget monitoring; Two monthly reports were considered to confirm a sufficient level of detail was presented to and considered by the Strategic Policy and Resources Committee.	✓
General IT controls; over key IT systems, Integra and Resource Link, placed reliance on this as part of our audit.	✓
Payroll controls; 16 exception reports were reviewed to confirm investigation and explanation of variances. The annual Service Establishment report was reviewed to confirm it has been signed off by each service.	Recommendation made
Council tax and NDR discounts and reliefs; a sample of 15 reliefs for each were reviewed to ensure appropriate authorisation took place before the relief was awarded.	✓
Capital monitoring reports; Two reports reviewed to confirm a sufficient level of scrutiny took place over variances and reasons were given for slippage and movements from budget.	✓
Expenditure controls; A sample of 25 purchase orders were tested and agreed to invoice. Procurement testing covered a sample of five contracts. These were checked to verify they had followed the correct tender route based on value. The tender evaluation was also considered.	✓
Journal authorisation; A sample of 25 journals were selected and checks carried out to confirm there is segregation of duties exist in who raises and who authorises journal entries.	Recommendation made
Financial reporting; two months service packs were tested to gain comfort over the accounts preparation process and authorisation of service packs.	Recommendation made

Wider scope and Best Value
Governance and transparency (continued)

Internal audit

Internal audit is provided by the Council's internal audit division which supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of 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. We also considered the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*.

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Internal audit's work during the year is summarised below:

- Agreed plan completed for the year with all approved reports finalised, as well as unplanned assignments as a result of investigations or additional requests from services.
- 36 internal audit reports completed.
- Out of a total of 188 agreed actions, none were categorised as 'critical' risk findings. 30 were classed as high risk.
- Controls assurance statement provides reasonable assurance on the overall adequacy and effectiveness of the Council's governance framework, risk management and controls.

We consider internal audit to operate effectively, covering a range of areas and delivering reports within agreed timescales. We note a six month plan for April 2017 to September 2017 was only approved in April 2017 by Audit Committee, with a further six month plan scheduled to be approved in September 2017.

Conclusions

We consider the Council to have high standards of governance and accountability. This is provided through an effective governance framework of committees, internal audit, and internal controls. Transparency is achieved through the committee structure and open nature of discussions.

Wider scope and Best Value
Value for money

Value for money (''VfM'') 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 presents annually to the Strategic Policy and Resource Committee to ensure value for money and best practice arrangements are in place in relation to the Council's use of companies, trusts and other arms length bodies.

Options appraisal

The Council carries out a range of option appraisals to assess the impact of key decisions and ensure the option selected represents best value and the best outcome for service users.

Business cases are used in areas such as exit packages where the payback period is estimated and savings of the redundancy are calculated. Our testing included consideration of the reasonableness of these savings and whether the decision demonstrates best value. In all cases our testing showed net savings within the next five years, some of which are beginning to be realised.

Capital projects appraisal is an area which is being developed by the Council, please see case study opposite.

Options appraisal links to the transformation programme by allowing services to consider how they provide services and assess if there is more efficient way to operate, thus achieving value for money.

Capital projects appraisal – *area of ongoing development*

The existing system for capital projects options appraisal is subject to ongoing development. There are regular member officer working groups (''MOWGs'') to scrutinise appraisals and discuss options. Project managers prepare business cases for capital projects. There is a set amount of funding and bids are entered. Each business case receives a technical appraisal with a weighted score and the highest rated projects are awarded funding. The HMRC five step model is used to create business cases which is considered good practice. An example of a capital project recently appraised is the A9/A85 link road which shows a balance of taking a risk and gaining a reward.

Gateway reviews are recommended for long term capital projects and historically this is an area the Council has not completed. It is recommended this is implemented as standard practice. By doing this at each milestone any overruns or changes to requirements can be identified and a decision made on the future direction of the project.

Recommendation three

We conclude the Council demonstrates good practice in the use of options appraisal, with the opportunity to further enhance this process particularly around large capital projects.

Wider scope and Best Value
Value for money

VfM in key decisions

The Council identified potential savings when forming the 2017-18 and 2018-19 budgets, although opted not to implement some due to extra grant funding and taxation income becoming available, however the decisions may have to be taken in future years. The ongoing transformation programme focuses on VfM through providing the same services in a more cost efficient way.

The Council considers and discusses difficult decisions such as school closures and teacher numbers as evidenced by committee meeting minutes. While these decisions have not had to be made in 2016-17 the Council is aware of possible tough decisions in the future.

However there is limited review of previous initiatives and the Council may be able to gain valuable insight from review of previous changes.

Commissioning and procurement

The Council has a dedicated procurement team which receives training and follows the Contract and Procurement Guidance. Contract rules are owned by the Head of Legal Services and officers are made aware of this guidance. We completed sample testing of five contracts to verify they followed the appropriate tender route.

We are aware a recent tender exercise was undertaken to transform City Hall and discussed arising press coverage concerning the tender process with management. No formal challenge has been made and the Council is content that the tender award process was robust.

Partnership working

The Council is a member of the Tayside Procurement Consortium (''TPC'') with Dundee City Council and Angus Council. By being an active member of the TPC, savings are generated showing sound procurement decisions being made by the Council. The Council will continue to be involved in improvement activities at national level to achieve savings and VFM through partnership working.

Resource will be shared with other Councils where there is opportunity to do so. This was recently evidenced with joint working with an officer in roads maintenance.

We consider the Council has used partnership working efficiently to achieve value for money.

Conclusions

We consider that the Council has appropriate arrangements for achieving value for money and complying with the FtPP Code.

Options appraisals and business cases are developed to support key decisions and these are appropriately scrutinised. From our testing planned advantages and justifications are being realised or plans are in place to do so.

Partnership working such as the TPC provides economies of scale which we consider good practice.

Capital programme management is an area which is evolving and would benefit from further development by implementing Gateway reviews and post project evaluations.

Appendices

Mandated communications with the Audit committee

MATTERS TO BE COMMUNICATED	LINK TO AUDIT 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 were 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)	There were no such matters to report
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 polices and practices selected by the Council are appropriate and in line with the Local Authority Code of Practice.
The auditor's view on valuations and related disclosures (ISA 260)	See page 16.
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)	We have reviewed management's assessment that the Council is a going concern and agree with this assessment.
Expected modifications to the auditor's report (ISA 260)	There are modifications to the auditor's 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.

Appointed auditors responsibilities

AREA	APPOINTED AUDITOR'S RESPONSIBILTIES	HOW WE'VE 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	Page 12 summarises the opinions we have provided
Financial statements and related reports	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 21 reports on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report. Page 45 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. Page 36 sets out our conclusion on these arrangements
Corporate governance	Participate in arrangements to cooperate and coordinate with other scrutiny bodies	Page 36 sets out our conclusion on these arrangements

Appointed auditors responsibilities

AREA	APPOINTED AUDITOR'S RESPONSIBILTIES	HOW WE'VE MET OUR RESPONSIBILITIES
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 page 25.

Auditor independence

Assessment of our objectivity and independence as auditor of the Perth and Kinross Council ("the Council")

Professional ethical standards require us to provide to you at the completion 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.

We will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

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 APB Ethical Standards. 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

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 in the table below, as well as the amounts of any future services which have been contracted or where a written proposal has been submitted. Total fees charged by us for the period ended 31 March 2017 can be analysed as follows:

Services provided to the Council and its group in respect of:	2016-17 (excl VAT)
Audit of the financial statements	129,326
Other audit related services	27,000
Total non-audit services	**27,000**
Total	**156,326**

The ratio of non-audit fees to audit fees for the year was 0.21: 1.

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.

Auditor independence (continued)

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 ending 31 March 2017	Value of Services committed but not yet delivered
VAT claim advice	Support with VAT claims in respect of sporting services. Originally agreed on a contingent fee basis, however amended to a fixed fee on appointment as external auditor in line with Ethical Standards.	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 fee	£27,000	-

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 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 Committee of Perth and Kinross Council 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

Grant claims and WGA return

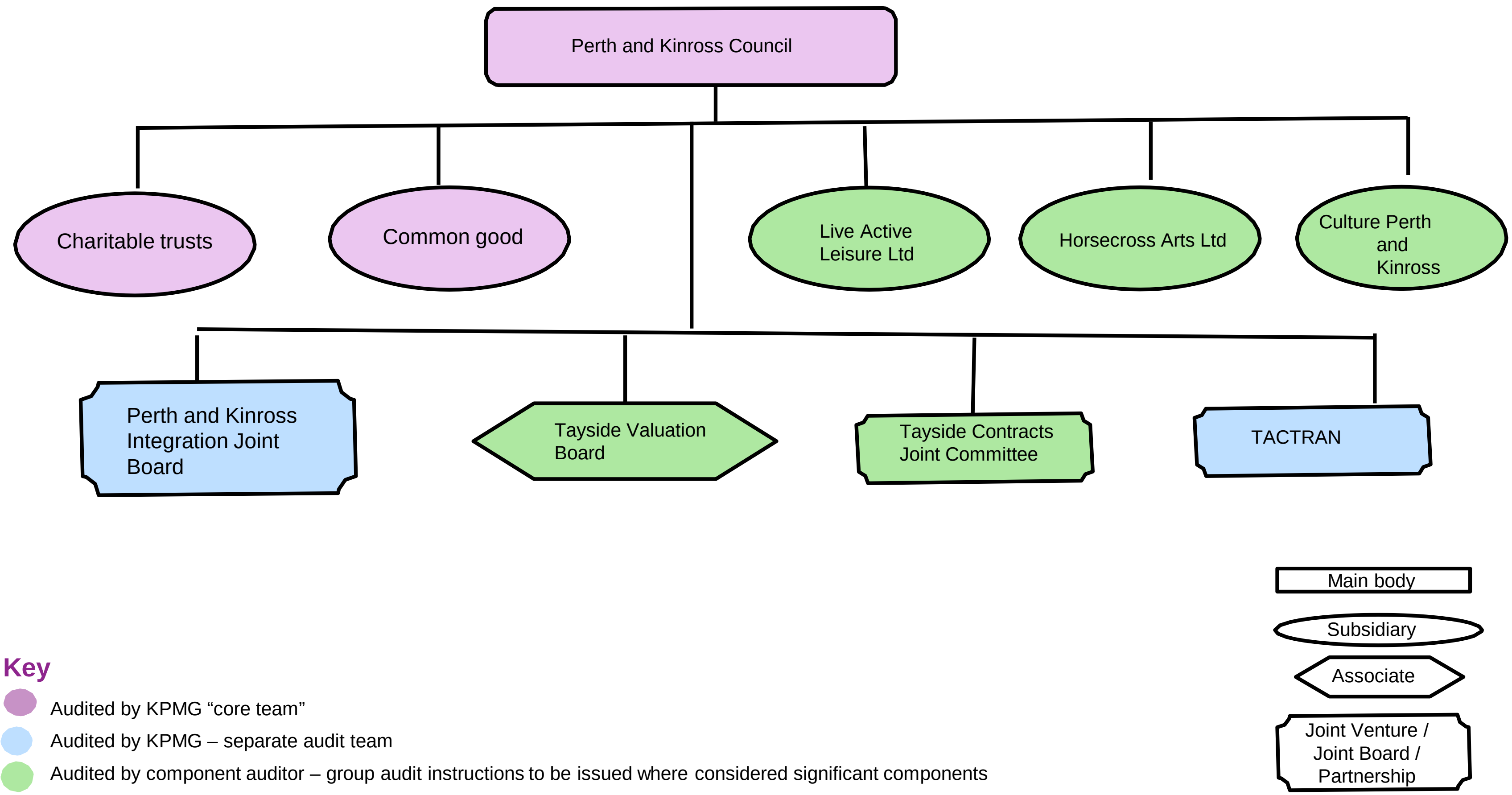
RETURN	DESCRIPTION	CONCLUSION
Whole of Government Accounts (''WGA'')	WGA is the consolidated financial statements for all components of government in the UK. Most public bodies are required to provide information for the preparation of WGA. External auditors are required to review and provide assurance on WGA returns over a prescribed threshold.	We did not identify any exceptions in our testing and issued an unqualified opinion on the WGA return.
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 NDRI 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 issued an unqualified opinion on the NDRI 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.	We did not identify any exceptions in our testing and issued an unqualified opinion on the HB return.

Grant claims and WGA return

RETURN	DESCRIPTION	CONCLUSION
Criminal Justice Authority (''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. Dundee City Council is the administering authority for the Tayside CJA. 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.	We did not identify any exceptions in our testing and issued an unqualified opinion on the CJA return.
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.

Group financial statements

The below diagram sets out our scoping of group entities in relation to the group financial statements, and related group audit instructions.



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

Group financial statements (continued)

ENTITY	WORK PERFORMED	AUDIT CONCLUSION
Charitable Trusts	The Council administers a number of charitable funds of varying sizes. As at 31 March 2016 there were 21 such charities, one of which is an umbrella charity (SC025085) formed by the amalgamation of 42 public trusts. The Council is in the process of reducing the number of charitable trusts by amalgamating those which share common charitable objectives with the Welfare Trust or Culture Perth and Kinross, or by divesting the trusts to other external charitable bodies, such as Tayside Mountain Rescue or the SSPCA. Since 31 March 2016 five charitable trusts have been amalgamated into the Perth and Kinross Welfare Trust, 17 have been transferred externally, and a further three are awaiting OSCR approval. As the trustees of the charities are appointed by the Council and they are registered with the Office of the Scottish Charity Regulator, an audit is required in line with the *Local Government (Scotland) Act 1973* (section 106 charities). We performed testing over investments held by the Charitable Trusts: agreeing amounts stated in the accounts to original third party documentation from the investment fund.	There were no audit adjustments required to the draft accounts which impacted on the net assets and income and expenditure for the year. We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of the Director and audit staff. We assessed materiality based on our knowledge and understanding of the charities' risk profiles and annual accounts balances. Materiality was determined at 10% of net assets. We have issued an unqualified opinion on the truth and fairness of the state of the Perth and Kinross Council Charitable Funds' affairs as at 31 March 2017.
Group	The group structure is shown on the previous page. We have completed the following procedures over the group financial statements; — review of the assessment of newly formed Culture Perth and Kinross and IJB to verify this is in line with the Code. — audit of consolidation adjustments; — disclosure checklist to verify disclosures are in line with the Code; — discussion of the treatment of pensions; and — agreeing inputs to consolidation back to component financial statements.	We did not identify any audit adjustments in the group financial statements. Minor presentational changes were suggested which have been accepted by management.

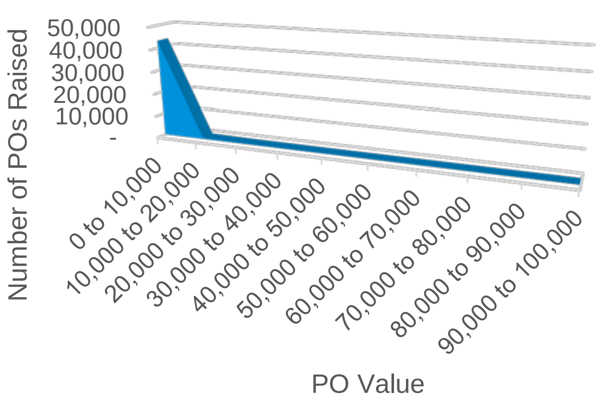
Data Analytics

This page summarises the work we have performed using data analytics over the accounts payable data as described on page 35.

Accounts payable data analytics – key findings

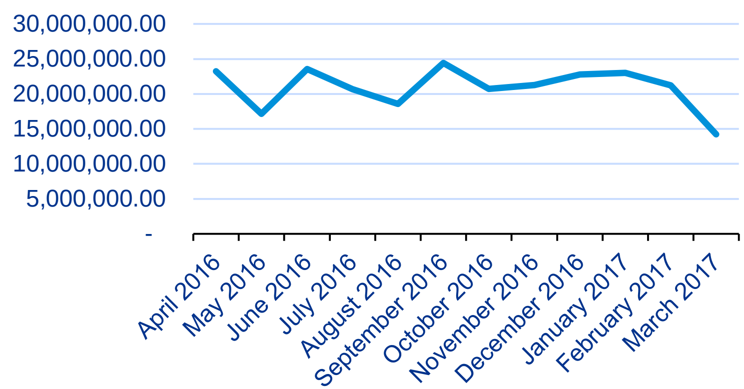
- There were 13,976 suppliers listed in the data, with a total of 103,735 invoices received in 2016-17. The largest value of invoices were received from Tayside Contracts totalling £24.1 million. This is consistent with our understanding of the Council's relationship with Tayside Contracts who provide a range of services to the Council.
- We stratified purchase order values between "£0-£100k", at 10 equal intervals of £10k. Education and children's services raised the highest number of POs, 45.9% of the total.
- Of the 45,872 POs included in the stratification, the largest volume of PO falls in the £0-10k band, with count 43,251 (94%) and a total value £18m (23%). This is in line with our expectations as we would not expect a large amount of high value POs to be raised.

Stratification of Purchase Orders



- The average number of days taken to pay an invoice was 27 days, which is within the standard 30 day terms for most suppliers.
- Invoice data was profiled by month, showing the value and volume of invoices during the period. The total invoices payable for the year ending March 2017 was 103,735 totaling £250 million. The highest number of invoices payable were in November 2016 (10,300 - 9.9% invoices totalling £20.9 million – 8.36%). The highest value of invoices payable was in September 2016 (£24.38 million – 9.75%). The pattern of invoices is relatively consistent across the year. There is no seasonality to take into account therefore we would expect invoices raised each month to be broadly consistent.

Invoice Value per Month



Overall we found the data within the accounts payable system to be of a good standard, with some anomalies which can be expected in any large data set. Our testing produced results we consider typical to a local authority.

Defined benefit obligations

In respect of employee benefits, each of the assumptions used to value the Council's net pension deficit 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.

Defined benefit pension liability

2017 £'000	2016 £'000	KPMG comment
249,939	161,821	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	Perth and Kinross Council	KPMG Central	Comment
Discount rate (duration dependent)	2.70%	2.49%	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 least prudent end of that range.
CPI Inflation	2.70% RPI less 0.90%	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 companies adopt an assumption of around 1% for this differential. The proposed assumption could therefore be considered overly prudent (higher liability). However, the assumption should not be considered in isolation.
Salary growth	3.70%	Typically 0%-1.5% above RPI 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 Directors' best estimate view on future remuneration.

The overall assumptions applied by management are considered to be reasonably balanced. The closing deficit increased by £88.1 million compared to 2015-16, primarily due to the decrease in the discount rate used (3.7% % to 2.7%.)

Action plan

This is the current year action plan based on the findings from our substantive testing. We set out the finding, risk and recommendation. We provide a priority grading for recommendations which is set out below;

Priority rating for recommendations

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 Council 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.

Finding and risk	Recommendation	Agreed management actions
1. Journals back up		**Grade three**
Two journals from our sample of 30 could not be agreed to back up as an audit trail had not been kept to agree the figures. There is a risk journals are posted with no clear audit trail kept to allow subsequent checking of the journal.	All officers should be reminded of the importance of maintaining back up for journals and keeping appropriate records	**Management response** Services will be reminded of the need to keep back up for journals by updating the guidance on inputting journals available on the Integra Information Zone. The issue will also be raised with Financial Controllers at their next meeting for cascade to their teams **Implementation date** 31 October 2017 **Responsible officer** Corporate Accounting Manager

Action plan

Finding and risk	Recommendation	Agreed management actions
2. Related parties		**Grade three**
Local authorities shall identify all related party relationships and transactions, including those relationships of close family members. Register of interests have an area for declaring non- financial interest. Currently the Council does not review this section for audit purposes There is a risk related party disclosures are not complete.	A log of members non financial interests should be kept and narrative added to the financial statements to explain that these types of relationship exist.	**Management response** Non-financial interests will be reviewed and collated as part of the Related Parties process within the Annual Accounts. The 2016/17 Financial Statements were updated to disclose that these relationships exist. **Implementation date** 30 June 2018 **Responsible officer** Corporate Accounting Manager
3. Project review		**Grade three**
Historically the Council has not conducted Gateway reviews at key milestones in a project, nor carried out post implementation reviews to learn from and improve on previous projects. There is a risk issues with previous projects are encountered again and review does note take place at key points in a project.	For long term capital projects it is recommended Gateway reviews are undertaken at each key milestone to identify any overruns and allow decisions to be made on the best route forward based on up to date facts. After a project has been completed a post implementation review should be carried out and lessons learned carried forward.	**Management response** The Capital Programme office will continue to consult with senior management to develop an appropriate Gateway Review process. Once formally agreed, this will be incorporated into the Capital Programme Governance framework and relevant training will be provide for all stakeholders. The Capital Programme Office will continue to develop a template benefits realisation report and agree the process and format for reporting which will be linked to the initial stages of future programmes. **Implementation date** 31 March 2018 **Responsible officer** Capital Programme Manager

Prior year recommendations

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.

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

Finding and risk	Original management actions	Status
1. Annual Governance Statement		
A new approach to compiling the Annual Governance Statement (AGS) was introduced for the 2015/16 financial statements. It was however difficult to evaluate how effective the new approach was as there was no audit trail to evidence the process applied. ***Risk*** *The AGS does not accurately reflect the governance arrangements within the council's group.* **Recommendation** Prior to members' consideration of the AGS all appropriate assurances should be received and considered.	Whilst verbal assurances had been received prior to consideration of the draft Governance Statement, written Certificates of each Service's assurance were available prior to submission of the Final Accounts. For the AGS 2016/17 we will ensure that written certificates are available prior to submission of the draft statement	**Implemented** We have received all signed assurance statements from officers. These were made available before members consideration of the AGS.

Prior year recommendations

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Finding and risk	Original management actions	Status
2. Budget setting process		
The council continues to underspend against budget (both revenue and capital). There is scope to better align budgets with services' actual spend. In addition, the monitoring reports presented to committee do not include information on service performance so members are unable to evaluate whether the underspends are having a detrimental impact on service delivery. ***Risk*** *There is an adverse impact on service delivery.* **Recommendation** The council should review its budget setting and monitoring procedures to ensure they remains fit for purpose. This review should consider the inclusion of performance information to provide a clearer basis for decision making.	The Council is aware of this position and has managed under spends and additional income effectively over the medium term. Significant sums were removed from the 2016/17 revenue budget when the final revenue budget was set in February 2016 to reflect historical spend. In addition the executive officer team has already met (06/09/16) to discuss the 2015/16 final outturns with a view to removing any recurring underspends from Service base budgets prior to setting the 2017/18 final revenue budget in February 2017. The revenue monitoring report has also been amended to remind members that reported underspends may be considered for use during the current financial year or as part of the revenue budget strategy for future years.	**Ongoing** We considered the revenue monitoring reports and note the inclusion of a statement on underspends being considered for future years. We note underspends may be partly achieved through the budget flexibility programme and additional income. We reviewed the Council's budget setting process and conclude it to be satisfactory. There is appropriate consultation with services and underspends are managed through budget flexibility and medium term financial planning. There is an ongoing process within the Council to review budget setting process. Performance information is reported through BMIPs which are at service level and reported to committee twice yearly.

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