KPMG

Perth and Kinross Council

Audit strategy

Year ending 31 March 2019

—

For Audit Committee consideration on 27 March 2019

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

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

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

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the Beneficiaries) for any purpose or in any context. Any party other than the Beneficiaries that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Beneficiaries.

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 Michael Wilkie, who is the engagement leader for our services to Perth and Kinross Council, telephone 0141 300 5890 or email to michael.wilkie@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 by emailing hugh.harvie@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Fiona Kordiak, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Introduction

2018-19 is the third year of our external audit appointment to Perth and Kinross Council (''the Council'') and its group ("the Group"), having been appointed by the Accounts Commission as auditor of the Council under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2016-17 to 2020-21, inclusive. Our appointment includes the audit of the Perth and Kinross Council Charitable Trusts.

Our planned work in 2018-19 will include:

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

Adding value

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

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

Our team

The senior team involved in the external audit benefits from continuity in the engagement in-charge, and the recent involvement of the engagement director with the Council. The team has significant experience in the audit of local authorities, and is supported by specialists, all of whom work with a variety of local government and public sector bodies. All members of the team are part of our wider local government network. Senior members of the audit team and their relevant contact details are provided on the back page of this report. Michael Wilkie is the engagement leader, and Claire Connor is the engagement manager.

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

Acknowledgements

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

Headlines

Materiality

Group materiality for planning purposes is based on last year's gross expenditure and is set at £9.3 million, which equates to 2% of gross expenditure. We will review gross expenditure on receipt of draft accounts for 2018-19, and assess whether we are required to updated this calculated group materiality.

In line with the Code of Audit Practice, we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at £0.25 million.

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Audit risks

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

– management override of controls fraud risk (assumed risk per International Standards of Auditing ("ISA") 240 *The auditor's responsibilities relating to fraud in an audit of financial statements*);

– fraud risk over expenditure recognition (assumed risk per ISA 240 and Practice Note 10 ("PN10"));

– retirement benefits obligations; and

– revaluation of property, plant and equipment.

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

The risk with less likelihood of giving rise to a material error, but which is nevertheless worthy of audit understanding, relates to capital expenditure, which is included as another focus area.

Pages seven to 11

Financial statement audit

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

Wider scope

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

– financial sustainability;

– financial management;

– governance and transparency; and

– value for money.

We test wider scope areas where there are identified risks. We consider that there are wider scope risks in respect of demand pressures and the transformation programme. While the above risks are a common theme across local authorities, we will focus on the specific circumstances of Perth and Kinross. We have not identified wider scope financial statement level risks.

Pages 14 to 21

Headlines (continued)

Best Value

In June 2016, the Accounts Commission formally agreed the overall framework for the approach to auditing Best Value in councils. The framework introduced a five year approach to Best Value. 2018-19 represents year three of the Best Value plan for the Council during which we, working together with Audit Scotland, will prepare a full Best Value Assurance Report ("BVAR").

Pages 14 to 21 provide more detail on our work over Best Value and wider scope areas.

Group audit

In addition to the Council, we deem the Perth and Kinross Integration Joint Board (''IJB'') to be significant in the context of the group audit. KPMG is the auditor of the IJB. Further details regarding our approach can be found at page 13.

See page 13 and Appendix six

Independence

In accordance with ISA 260 *Communication of audit matters with those charged with governance* and the Financial Reporting Council's ("FRC") Ethical Standards, we are required to communicate to you all relationships between KPMG and the Group that may be reasonably thought to have bearing on our independence both:

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

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

Total fees charged by us for the period ended 31 March 2018 were communicated in our Annual Audit Report issued in September 2018. Total fees for 2018-19 will be presented in our Annual Audit Report issued on completion of the audit. The proposed audit fee for 2018-19 is £161,830 (inc VAT) as explained in **Appendix five**.

Quality

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

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

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

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

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

Financial statements audit planning

Materiality

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

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

In respect of the Council's standalone accounts, materiality for planning purposes has been set at £9.0 million, and at £9.3 million for the group accounts, which in both cases equates to 2% percent of an adjusted 2017-18 gross expenditure. We adjusted gross expenditure for plant and property revaluations, to 'smooth' the impact of these movements by taking a five year rolling average of revaluation movements in line with the Council's five year revaluation policy. In addition, expenditure relating to the IJB is removed from our calculation, as income and expenditure is grossed up for presentational purposes within the consolidated income and expenditure account.

We design our procedures to detect errors in specific accounts at a lower level of precision.

Reporting to the audit committee

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

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

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

Council materiality
£9.0 million
2% gross expenditure

Reporting threshold
£0.25 million

Financial statements audit planning (continued)

Significant risks and other focus areas

Risk assessment: Our planning work took place during December 2018 to February 2019. This involved: risk assessment; determining the materiality level; and issuing this audit plan to communicate our audit strategy. We use our knowledge of the Council, discussions with management and review of Council papers to identify areas of risk and audit focus categorised into financial risks and wider dimension risks as set out in the Code.

Significant Risk	Why	Audit Approach
Financial statement risk		
Fraud risk from management override of controls	A presumed risk we are required to consider covers fraud risk from management override of control. Management is typically in a position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. This is a presumed risk per ISA 240.	– 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. – There is strong oversight of finances by management which provides additional review of potential material errors caused by management override of controls. – In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.

Financial statements audit planning (continued)

Significant risks (continued)

Significant Risk	Why	Audit Approach
Financial statement risk		
Fraud risk from income recognition and expenditure	Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by PN10, issued by the FRC, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. **Income** We consider that the Council's significant income streams, which include taxation and non-specific grant income are free of management judgement or estimation. We do not consider recognition of the remaining income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised, and these are not likely to be materially inappropriate. We did not identify any such errors or manipulation in the prior year. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area beyond our standard fraud procedures. **Expenditure** We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs, financing and investment expenditure, or depreciation. These costs are routine in nature and not at risk of manipulation. This relates to a significant proportion of council expenditure. As other operating expenditure is unlikely to be material, we also rebut the assumed risk in respect of this account. We have not rebutted the assumed risk in respect of the remaining expenditure of £210.5 million.	In respect of material income: – non-ringfenced government grants are agreed in advance of the year, with any changes requiring government approval. There is no estimation or judgement in recognising this stream of income and we do not regard the risk of fraud to be significant. We will agree significant grants to supporting documentation. – the other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing incomes). These incomes are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as income. We will perform tests of detail and substantive analytical procedures in our audit of these sources of income. We will include procedures to: – compare the outturn with the in year budget monitoring, considering variances; – test controls specific to confirm correct capital vs revenue allocation; – test expenditure cut-off including a search for unrecorded liabilities; – test transactions focusing on the areas of greatest risk, including debtors, creditors, accruals, prepayments and provisions to challenge completeness and existence of these balances; – review and challenge of management in respect of estimates for evidence of bias; and – test journal entries in relation to expenditure for evidence of management bias.

Financial statements audit planning (continued)

Significant risks (continued)

Significant Risk	Why	Audit Approach
Financial statement risk		
Revaluation of property, plant and equipment	The 2018-19 Code requires that where assets are subject to revaluation, their year-end carrying value should reflect the appropriate fair value at that date. In common with other councils, the Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. In 2018-19 community centres, day care centres, halls and town halls, hostels, libraries, public toilets, residential homes, miscellaneous operational properties, investment properties, and shops will be subject to revaluation and we expect the movement to be material. The revaluation model also includes revaluation of assets with significant capital investment, and consideration of impairment indicators for all Council assets. The Council uses a valuation date of the 1 April 2018 for the 31 March 2019 year end in respective of all properties except those classed as investment properties which has a valuation date of 1 August 2018. Therefore we consider there to be a risk of a material movement in valuation between these dates. Given the quantum of the asset carrying values and the inherent use of assumptions in their valuation, we consider there to be a significant risk of misstatement.	Our procedures will include: **Control design:** We will review the approach that the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach, including any indicators of impairment. We will also assess the risk of the valuation changing materially during the year, or between the date of valuation and the year end. **Assessing valuer's credentials:** In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations. **Assessing methodology choice and benchmarking assumptions:** We will review management's assessment of impairment indicators and assess for completeness. We will utilise our internal specialist to assess the methodology used including testing the underlying data inputs and assessing the assumptions used in comparison to available market information. We will select a representative sample of assets to agree calculation inputs to supporting evidence, consider in detail the revaluation calculations and challenge the underlying assumptions. **Other land and buildings** A number of the Council's assets are revalued on an annual basis, including investment properties and assets held for sale. We will test the accounting treatment for assets revalued to challenge whether the accounting treatment is appropriate and consider valuation inputs and assumptions using the approach above.

Financial statements audit planning (continued)

Significant risks (continued)

Significant Risk	Why	Audit Approach
Financial statement risk		
Retirement benefit obligations	The net pension liability (£98.4 million as at 31 March 2018, including assets of £756.1 million) represents a material element of the Council's Balance Sheet. The Council is an admitted body of Tayside Pension Fund, which had its last triennial valuation completed as at 31 March 2017. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions should be derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.	Our planned audit approach includes: **Control design:** – Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with management's review of assumptions, to calculate the pension obligation. **Benchmarking assumptions:** – Challenging, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data. – Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations. **Assessing transparency:** – Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions. – Assessing if the disclosures within the financial statements are in accordance with the Code's requirements.

Financial statements audit planning (continued)

Other focus area

Other focus area	Why	Audit Approach
Financial statement focus area		
Capital expenditure	The Council has a ten year £576 million capital plan, which includes the Cross Tay Link Road, A9/A85 road junction improvement project and Perth City Hall upgrade. The expected spend in 2018-19 is £70.8 million. Due to the significance of this capital investment programme and complexity of some of the projects, we consider there to be a risk of misstatement. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions. We also consider that any large capital project inherently brings a fraud risk to an entity, which we consider appropriate for the Council.	Our audit approach includes: **Control design:** – Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and income projects. **Control re-performance:** – Comparing the total capital expenditure reported in the financial statements with that reported in reports to those charged with governance. **Tests of detail:** – Use of substantive sampling methods to evaluate the appropriateness of capital or income accounting classification by reference to supporting documentation. – Assessing a sample of items allocated to income expenditure to determine whether they are correctly classified. – Review and corroboration of manual journals. – There has been ongoing development in the implementation of Gateway reviews. This will be considered as part of our wider scope and Best Value work.

Other matters

Accounting framework update

The 2018-19 Code is revised each year, incorporating selected changes to the underlying IFRSs, and key accounting changes include:

- revenue from Contracts with Service Recipients following the adoption of IFRS 15 *Revenue from Contracts with Customers*.
- amendments to Presentation of Financial Statements to reflect the disclosure requirements under International Accounting Standard ("IAS") 7 *Statement of Cash Flows* (Disclosure Initiative);
- clarification to the segmental reporting arrangements under the 2018-19 Code;
- amendments to Property, Plant and Equipment to reflect changes as a result of The Item 8 Credit and Item 8 Debit (General) Determination from 1 April 2017;
- amendments to the Code to introduce the incurred loss model for the impairment of non-contractual debts including relevant disclosure requirements as a consequence of the expected credit loss model for impairment being introduced by the adoption of IFRS 9 *Financial Instruments*;
- amendments to Debtors and Creditors sections to remove the requirement to disclose the analysis of debtors across public sector bodies; and
- a new Financial Instruments section to reflect the Code's adoption of IFRS 9.

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

These changes are significant and the Council should consider preparation in advance, particularly where the 2018-19 balances will form the comparatives in future accounts. We will consider the Council's arrangements for complying with the forthcoming changes.

Controls testing

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

In 2017-18 we identified three recommendations in relation to the control environment, and three relating to financial statement audit findings. We will follow-up progress in implementing these recommendations and report any new recommendations arising from our work and report our view of progress. **Appendix three** details our approach across each phase of the audit.

Internal audit

ISA 610 *Considering the work of internal audit* requires us to:

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

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

Other matters (continued)

Group audit considerations

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

Perth and Kinross Council, Tactran and the IJB are audited by the same audit team within KPMG. Both the Council and the IJB are consolidated into the group accounts. Tactran is not consolidated on the grounds of materiality.

Perth and Kinross Council Charitable Funds are also audited by KPMG from the same office. Andy Shaw continues to be the engagement leader in their respect. We do not intend to issue group instructions in respect of the Charitable Funds.

We reviewed the remaining components within the group structure, and did not deem any other component significant. We therefore do not intend to issue group audit instructions to any component.

Wider scope and Best Value

Approach

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

Risk assessment

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

In doing so we consider:

- The Council's own assessment of the risks it faces, and its arrangements to manage and address its risks.
- Evidence gained from previous audit work, including the response to that work.
- The work of other inspectorates and review agencies, through the Local Area Network ("LAN") which is established for each council.
- Discussion with Audit Scotland and the LAN over the scope of the BVAR on Perth and Kinross Council.

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

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

Linkages with other audit work

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

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

Wider scope and Best Value (continued)

Approach (continued)

Identification of significant risks

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

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

– Considering the results of work by the Council, inspectorates and other review agencies.

– Carrying out local risk-based work to form a view on the adequacy of the Council’s arrangements for securing economy, efficiency and effectiveness in its use of resources.

Concluding on wider scope and Best Value

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

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

In 2018-19, Audit Scotland, in conjunction with KPMG, will undertake a Best Value audit of Perth and Kinross Council. Planning for this audit commenced in January 2019, with reporting due no later than September 2019. This audit will build on work already completed by KPMG in previous years, and planned to be completed in 2018-19, to produce a single report outlining the assessment of the Council in relation to Best Value.

Reporting

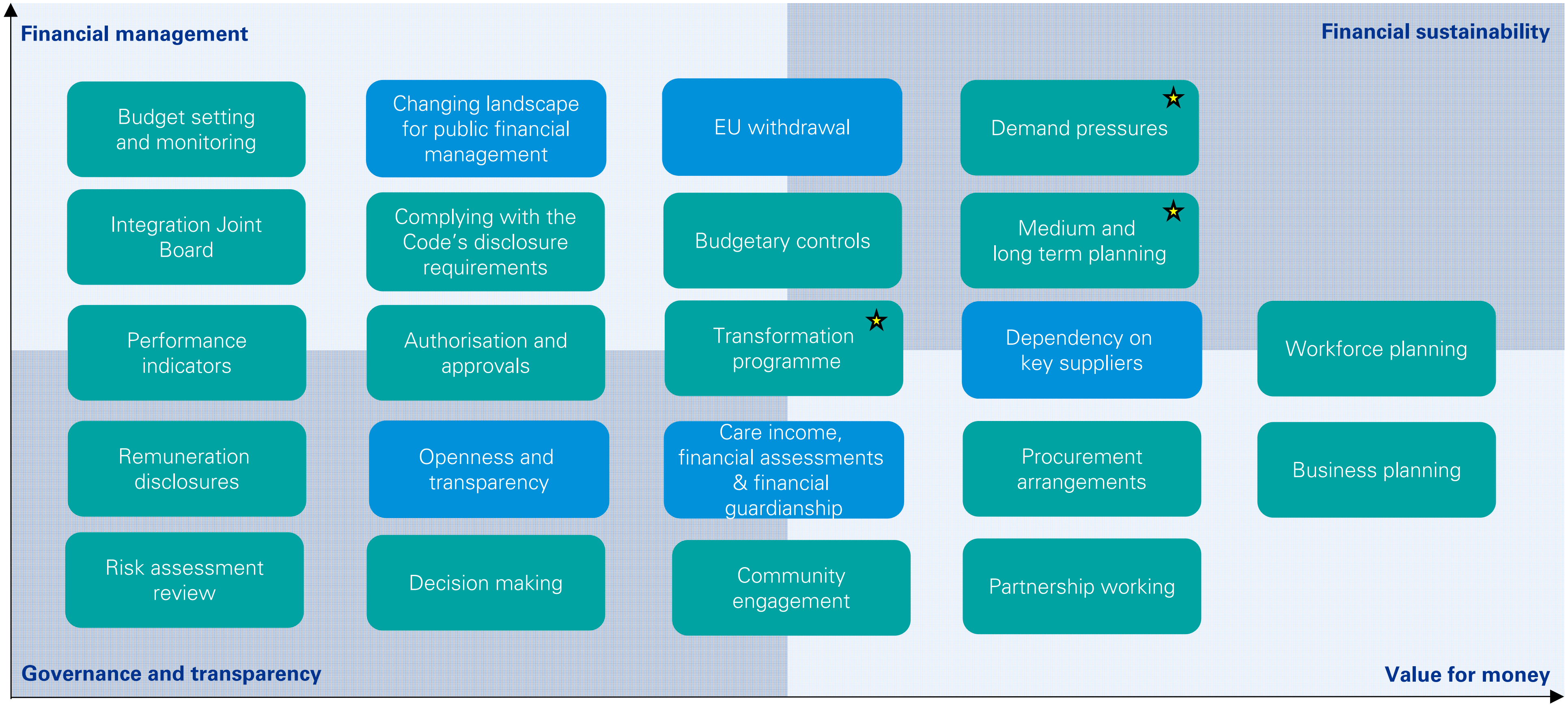
We have completed our initial wider scope and Best Value risk assessment and have not identified any significant risks, as noted on the next page. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

We will report on the results of the wider scope and Best Value audit through our Annual Audit Report. This will summarise any specific matters arising, and the basis for our overall conclusion. In addition, the BVAR will be issued by September 2019.

Wider scope and Best Value (continued)

Risk assessment

We have not identified any financial statement significant risks in relation to wider scope and Best Value. ★relates to an identified wider scope focus areas to be specifically addressed through audit procedures, as further explained on the next page.



Potential risk type: Wider scope and Best Value | Emerging

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit Approach
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. **Specific identified focus area:** **Demand pressures** The Council faces growing demand pressures, both from the increasing elderly population and increasing number of young people living in Perth and Kinross. Each subset brings unique challenges to services, for healthcare, social care and education. This comes at a time when the workforce is decreasing, which adds pressure to ongoing workforce planning. There are a number of “hard to fill” posts for teachers in rural areas and social care workers, which add to the pressure on the growing demand for service provision. We consider there to be a resultant risk to the sustainability of delivering services with increasing demand and a decreasing workforce.	– We will consider the Council’s long term financial plans and its ability to adapt to the changing landscape in local government funding. This will involve consideration of the 2019-20 budget and longer term financial plans from 2020-21 and beyond. – We will monitor the Council’s key performance indicators and performance reporting, to identify any movements requiring further investigation. We will consider any overspends against budget where demand has caused a significant strain on funding, as well as underspends against budget due to staff slippages where roles have been hard to fill.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit Approach
Financial management	**Financial management** is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. **Specific identified focus area:** **Medium and long term planning** In October 2018, the Council reported estimated savings requirements ranging between £9.6 million and £106.8 million, with the 'mid-range' estimate of £52.3 million over the next five years. This plan reported a mid-range forecast highlighting budget pressures of £16.5 million in relation to 2019-20. As part of the budgetary process, the Council approved a three year revenue budget on 20 February 2019, which aids longer term financial management and workforce planning. There is a risk Council are unable to achieve the approved budget. **Transformation programme** The Council has an ambitious five year transformation programme from 2015-20. The programme provides a framework for innovation, creativity, flexibility and greater entrepreneurship to meet future challenges. The transformation programme supports identifying savings through redesigning service delivery to maximise efficiencies and support change We consider there to be a risk around delivering the level of planned savings over the next five years, and what impact this may have on service delivery.	– We will consider how the Council's transformation programme is progressing and any potential impact on financial and service planning. – We will review the financial results to 31 March 2019 compared to budget to consider if there are indications that savings are not being delivered as planned. – We will consider the Council's approach to setting a balanced budget for 2019-20, and considering implications and delivery of the budget in our Annual Audit Report.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit Approach
Financial sustainability and financial management (continued)	**Specific identified focus area (continued):** Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies. Changing landscape for public financial management Scottish public finances are fundamentally changing, with significant tax-raising powers, new powers over borrowing and reserves, and responsibility for 11 social security benefits. The Scottish Government published an initial five-year Medium Term Financial Strategy in May 2018. The Council needs to consider the impact of the new powers on its operations and future budgets. EU withdrawal The nature and impact of withdrawal from the EU continues to be uncertain and changing. There is a risk that the Council fails to prepare for, or is impacted by changes to employees, citizens, funding or regulations. Dependency on key suppliers This has brought into focus the risk of key supplier failure and the risk of underperformance in suppliers that are experiencing difficult trading conditions. The risk exists where individual public sector bodies are dependent on key suppliers; and the Scottish public sector as a whole is subject to significant systemic risk. There is a risk that entities are overly dependent on a small number of key suppliers to provide services.	— We will consider how the Council reports its funding arrangements, responsibilities and performance through the audit of its management commentary and financial statements. — We will remain alert to the impact of the EU withdrawal on the Council's operations and the environment within which it operates as part of our risk assessment procedures and wider scope responsibilities. We will consider the appropriateness of management's risk assessment and planning for both matters with reference to guidance provided by Audit Scotland. — We will consider how the Council manages the risk of dependency on key suppliers, and seek further understanding on the use of suppliers through procurement.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit Approach
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. **Specific identified focus area:** Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies. Openness and transparency There are signals of changing and more challenging expectations for openness and transparency in public business. This is an area the Council is expected to keep under review and consider where there is scope to enhance transparency.	– We will consider the effectiveness of scrutiny and governance arrangements, by evaluating the challenge and transparency of the reporting of financial and performance information. – We will update our understanding of the controls and processes around capturing officers' and members' interests. – We will obtain and review minutes of meetings of the various committees to assess the level of transparency, and consider the Council's plan for enhancing transparency.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit Approach
Value for money	**Value for money** is concerned with how effectively resources are used to provide services. **Specific identified focus area:** Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies. Care income, financial assessments and financial guardianship In some councils, responsibility for financial assessments on those receiving care has transferred from social care to finance, and this has revealed issues with backlogs of financial assessment and under-recovery of care charges over long periods of time (more than five years). Audit Scotland identified that officers within some councils may be operating as financial guardians for individuals with a lack of capacity to act in their own interests. This may give rise to a potential conflict of interest when finance officers are in a senior position and the council is issuing invoices to a person for their care.	— We will specifically consider statutory performance indicators, performance reporting and arrangements to provide for continuous improvement. — We will undertake a review of the arrangements for financial assessment of those requiring care and assess whether these are subject to delays, and how this is reported. — We will complete a questionnaire return to Audit Scotland providing intelligence on the extent to which officers undertake financial guardianship roles and the reasons for this.

Appendices

Appendix one

Mandated communications with the Audit Committee

Matters to be communicated	Link to Audit Committee papers
Independence and our quality procedures ISA 260.	See page 25.
The general approach and overall scope of the audit, including levels of materiality, fraud 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, and their resolution (AU 380).	In the event of such matters of significance we would expect to communicate with the Audit Committee throughout the year. Formal reporting will be included in our ISA 260 report for the Audit Committee meeting, which focuses on the financial statements.
Significant difficulties we encountered during the audit.	
Significant matters discussed, or subject to correspondence, with management (ISA 260).	
Our views about the qualitative aspects of the entity's accounting and financial reporting. The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements (ISA 260 and ISA 540).	
Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on its financial statements. We will request you to correct uncorrected misstatements (including disclosure misstatements) (ISA 450).	
The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements (ISA 570).	
Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570).	
Expected modifications to the auditor's report (ISA 705).	
Related party transactions that are not appropriately disclosed (ISA 550)	

Appendix one

Mandated communications with the Audit Committee (continued)

Matters to be communicated	Details
Management's responsibilities (and, where appropriate, those charged with governance)	Prepare financial statements in accordance with the applicable financial reporting framework that are free from material misstatement, whether due to fraud or error. Provide the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.
Auditor's responsibilities	Our engagement letter communicates our responsibilities to form and express an opinion on the financial statements that have been prepared by management with the oversight of those charged with governance. The audit of the financial statements does not relieve management or those charged with governance of their responsibilities.
Auditor's responsibilities – Fraud	This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit. See also **Appendix eight**.
Auditor's responsibilities – Other information	Our engagement letter communicates our responsibilities with respect to other information in documents containing audited financial statements. We will report to you on material inconsistencies and misstatements in other information.
Independence	Our independence confirmation letter (**Appendix two**) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff. We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Director and audit staff is not impaired.

Appendix two

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 planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP’s objectivity and independence, the threats to KPMG LLP’s independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP’s objectivity and independence to be assessed.

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

We have considered the fees charged by us to the council and its affiliates for professional services provided by us during the reporting period.

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 and should not be used for any other purposes.

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

Yours faithfully

KPMG LLP

Appendix three

Timeline

Communication

2018 2019

January
Best value planning and scoping

February
Interim onsite audit work, business update and controls testing

March/April
Best value desktop review and fieldwork

May
Presentation of Interim Audit Report

June
Presentation and discussion of draft Best value report with management

Statutory inspection period

September
Submission of WGA

Dec | Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sept

Audit workflow

December
Audit planning meeting

March
Presentation of Audit Strategy

June
Final audit fieldwork commences

September
Best value report presented to Accounts Commission

September
Financial statements signed by the Council and KPMG, and presentation of Annual Audit Report

- Perform risk assessment procedures and identify risks
- Determine audit strategy
- Determine planned audit approach

- Understand accounting and reporting activities
- Evaluate design and implementation of selected controls
- Test operating effectiveness of selected controls
- Assess control risk and risk of the accounts being misstated

- Plan substantive procedures
- Perform substantive procedures
- Consider if audit evidence is sufficient and appropriate

- Form audit opinion
- Review wider scope objectives and areas
- Perform grant and other audit testing
- Perform completion procedures

Appendix four

Audit outputs

Output	Description	Report date
Audit strategy	Our strategy for the external audit of the Council and its group, including significant risk and audit focus areas.	By 29 March 2019
Interim audit report	We summarise our findings from our interim audit work.	By 31 May 2019
Independent auditor's report	Our opinion on the Council's financial statements.	By 30 September 2019
Annual audit report	We summarise our findings from our work during the year.	By 1 October 2019
NFI report	We report on the Council's actions to investigate and follow-up NFI matches.	By 28 June 2019
Whole of Government Accounts	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 30 September 2019
Audit reports on other returns	We will report on the following returns:	
	– Current issues return.	January, March, July and October 2019
	– Technical database.	5 July 2019
	– Fraud returns.	February, May, and August 2019
Grant claim audits	We provide an opinion on:	To submit by:
	– Education maintenance allowance, housing benefit, and non domestic rates	July 2019, November 2019 and August 2019

Appendix five

Fees

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

– Auditor remuneration

– Pooled costs

– Contribution to Audit Scotland's Performance Audit and Best Value ("PABV") team

– Contribution to Audit Scotland costs

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

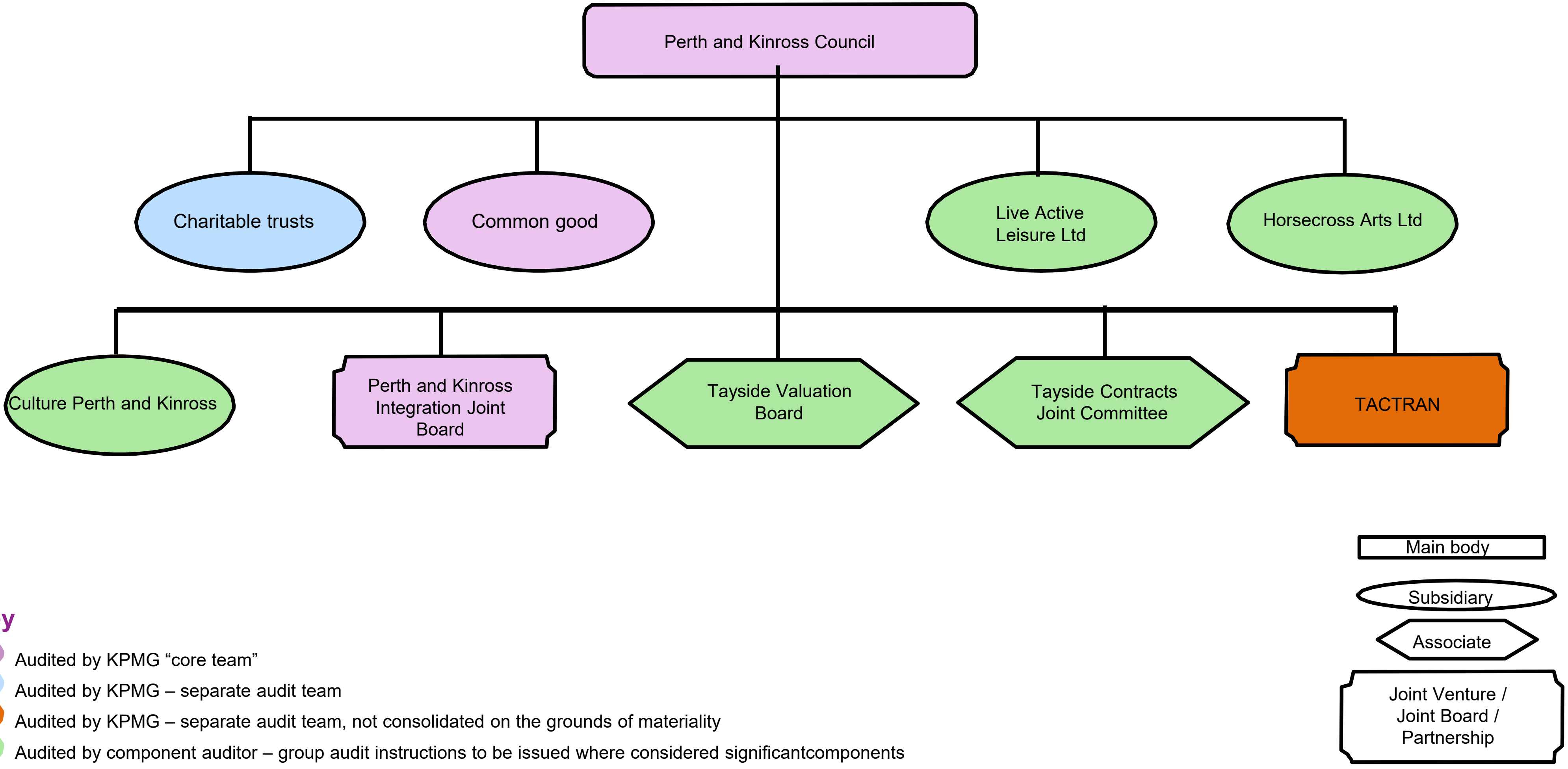
We are in discussions with management regarding the auditor remuneration for 2018-19. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

	2018-19 £ (incl VAT)
Auditor remuneration	161,830
Pooled costs	15,700
Contribution to PABV	85,710
Contribution to Audit Scotland costs	10,170
Total Council audit fee	273,410
Audit of Perth and Kinross Council Charitable Funds	3,100
Total fee	276,510

Appendix six

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 KPMG – separate audit team, not consolidated on the grounds of materiality
- Audited by component auditor – group audit instructions to be issued where considered significantcomponents

Responsibility in relation to fraud

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

Management responsibilities

- Adopt sound accounting policies
- With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.
- Establish proper tone, culture and ethics.
- Require periodic confirmation by employees of their responsibilities.
- Take appropriate action in response to actual, suspected or alleged fraud.
- Disclosure to audit committee and auditors:
  - Any significant deficiencies in internal control; and
  - Any fraud involving those with a significant role in internal controls.

KPMG's identification of fraud risk factors

- Review of accounting policies.
- Results of analytical procedures.
- Procedures to identify fraud risk factors.
- Discussion amongst engagement personnel.
- Enquiries of management, to audit committee and others.
- Evaluate broad programmes and controls that prevent, deter, and detect fraud.

KPMG's response to identified fraud risk factors

- Accounting policy assessment.
- Evaluate design of mitigating controls.
- Test effectiveness of controls
- Address management override of controls.
- Perform substantive audit procedures.
- Evaluate all audit evidence.
- Communicate to the audit committee and management

KPMG's response to identified fraud risk factors

Whilst we consider the risk of fraud at the financial statement level to be low for the Council, we will monitor the following areas throughout the year and adapt our audit approach accordingly:

- income recognition;
- Cash;
- Procurement;
- Management control override; and
- Assessment of the impact of identified fraud.

Audit Scotland code of audit practice - responsibility of auditors and management

Responsibilities of management
Financial Statements
Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: – preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation; – maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures; – ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council; – maintaining proper accounting records; and – preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body. Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.
Prevention and detection of fraud and irregularities
Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

Audit Scotland code of audit practice – responsibility of auditors and management (continued)

Responsibilities of management
Corporate governance arrangements
Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.
Financial position
Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: – such financial monitoring and reporting arrangements as may be specified; – compliance with any statutory financial requirements and achievement of financial targets; – balances and reserves, including strategies about levels and their future use; – how they plan to deal with uncertainty in the medium and longer term; and – the impact of planned future policies and foreseeable developments on their financial position.
Best Value, use of resources and performance
The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

Audit Scotland code of audit practice – responsibility of auditors and management (continued)

Responsibilities of auditors
Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:
– undertake statutory duties, and comply with professional engagement and ethical standards;
– provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
– review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant
– claims and whole of government returns;
– notify the Auditor General when circumstances indicate that a statutory report may be required;
– participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
– demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  – effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  – suitability and effectiveness of corporate governance arrangements; and
  – financial position and arrangements for securing financial sustainability.
Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Appendix eight

Audit Scotland code of audit practice - responsibility of auditors and management (continued)

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

Appendix eight

Audit Scotland code of audit practice – responsibility of auditors and management (continued)

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

Appendix nine

KPMG's audit quality framework

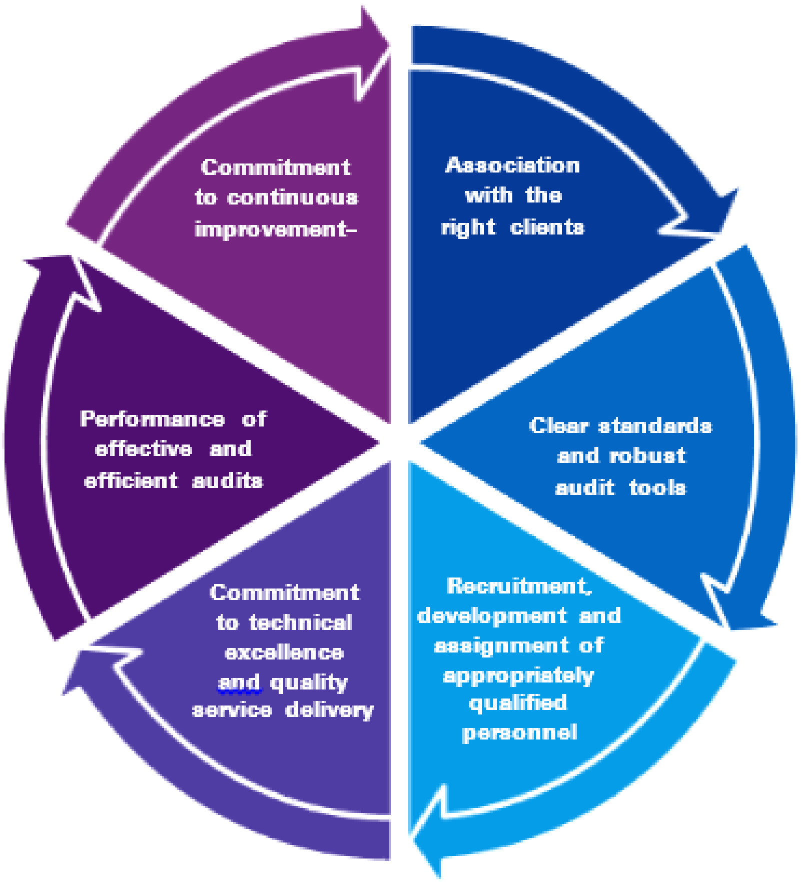
Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

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

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

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

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



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

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

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

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