Aberdeen City Council

Annual audit report to the Members of Aberdeen City Council and the Controller of Audit for the year ended 31 March 2019

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

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

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

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 Andy Shaw, who is the engagement leader for our services to the Council, telephone 0131 527 6673, email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or email to hugh.harvie@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Fiona Kordiak, Director of Audit Services, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Executive summary

Significant risks

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Open control recommendations

Appendix four

	Number
Significant control recommendations (IT controls)	2
Other control recommendations (IT and general controls)	2
Other control recommendations	1

Audit opinion

We have issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2019, and of the deficit for the year then ended.

There were no matters identified on which we are required to report by exception.

Uncorrected audit misstatements

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Understatement/(overstatement)

	£m	%
Deficit on provision of services	(1.8)	(1.7)
Net assets	(1.8)	(0.1)

Corrected audit misstatements

Page 42

Understatement/(overstatement)

	£m	%
Deficit on provision of services	(11.5)	(11.1)
Net assets	-	-

Accounting judgements related to estimates

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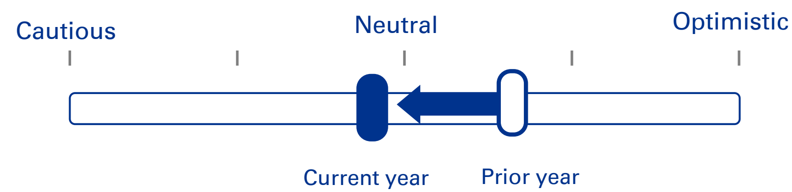


Overall we are satisfied with the key accounting judgments taken and that discussion of these matters in the section of the accounting policies appropriately addresses the matters we have communicated to you.

Scope and responsibilities

Purpose of this report

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

Our annual audit report is designed to summarise our opinions and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at the Council and the Controller of Audit. The scope and nature of our audit are set out in our audit strategy document which was presented to the Audit, Risk and Scrutiny Committee (ARSC) on 14 February 2019.

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 wider scope areas. The reports incorporates both aspects of the Code.

Accountable officer responsibilities

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

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

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK) issued by the Financial Reporting Council and the Code. Appendix seven 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 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 report to those charged with governance and our presentation to ARSC, together with previous reports to ARSC throughout the year, discharges the requirements of ISA 260.

Limitations on work performed

This Report is separate from our audit report in the annual accounts and does not provide an additional opinion on the Council's annual accounts nor does it add to or extend or alter our duties and responsibilities as auditors in accordance with the Code.

We have not designed or performed procedures outside those required of us as auditors for the purpose of identifying or communicating any of the matters covered by this Report.

The Council will need to consider whether to give public notice in respect of this report under the Market Abuse Regulation as well as the Disclosure and Transparency Rules. We draw attention to the section, "About this report" on the contents page.

Audit conclusions

Audit opinion

Following approval of the annual accounts by the ARSC we have issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2019, and of the deficit for the year then ended. We have also issued unqualified opinions on the truth and fairness of the state of the Aberdeen City Council Charitable Trusts' affairs as at 31 March 2019. The long form audit opinion, prepared as a requirement of the Council's status as an EU Public Interest Entity, in accordance with ISA 700, is included in the annual accounts. There were no matters identified on which we are required to report by exception.

Financial reporting framework, legislation and other reporting requirements

The Council is required to prepare its annual accounts in accordance with International Financial Reporting Standards, as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2018-19 ("the CIPFA Code"), and in accordance with the Local Authority Accounts (Scotland) Regulations 2014. Our audit confirmed that the annual accounts have been prepared in accordance with the CIPFA Code and relevant legislation.

The Aberdeen City Council Charitable Trust's financial statements are prepared in accordance with the Charities SORP (FRS 102), the Charities and Trustee Investment (Scotland) Act 2005 and regulation 8 of the Charities Accounts (Scotland) Regulations 2006 (as amended). Our audits confirmed that the annual accounts have been prepared in accordance with the relevant charity accounting legislation.

Annual accounts preparation and audit readiness

The Council further accelerated its financial reporting and external audit timetable for 2018-19, with complete draft accounts approved on 30 April 2019. The statutory deadlines are 30 June 2019 for unaudited accounts and 30 September 2019 for audited accounts. The Council's finance team continued to perform well in its delivery of high quality annual accounts and in its readiness for audit, effectively responding to our queries during the audit. There remain opportunities to improve in respect of accounting for property transactions and revaluations.

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

Three audit misstatements were identified during the audit, of which one was adjusted. There are two unadjusted audit misstatements.

Written representations

Our representation letter did not include any additional representations to those that are standard as required for our audit.

Materiality and summary of risk areas

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 £8.7 million for the Council's standalone financial statements, and £9.21 million for the Group financial statements. This equates to 1% of cost of services expenditure, adjusted for revaluation decreases recognised in the year. We designed our procedures to detect errors in specific accounts at a lower level of precision than our materiality. For the standalone accounts our performance materiality was £5.5 million. For the Group accounts it was £6 million. We report all identified misstatements greater than £250,000.

Forming our opinions and conclusions

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

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

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

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

Significant risks:

- Management override of controls fraud risk;
- Expenditure recognition fraud risk;
- Retirement benefits*; and
- Revaluation of council dwellings, other land and buildings, surplus assets and investment properties*.

In accordance with paragraph 19A of ISA 700, we are required to describe those assessed risks of material misstatement which had the greatest effect on: the overall audit strategy; the allocation of resources in the audit; and directing the efforts of the engagement team, in our audit opinion. The * matters shown above have had 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 report on these areas in our financial statements annual audit opinion.

We also previously identified an audit focus area in respect of Capital Expenditure.

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

Significant risks

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Management override of controls fraud risk 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. This is an assumed risk per ISA 240 *The Auditor's responsibilities related to fraud in the audit of financial statements*.	Our audit methodology incorporates the risk of management override as a default significant risk. We did not identify 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. Our audit procedures included: — controls testing and substantive procedures, including over journal entries and accounting estimates (such as over property revaluations and pensions); and — review of significant transactions that are outside the Council's normal course of business, or are otherwise unusual. In 2018-19 this included voluntary severance and accounting for Lochside Academy on its initial recognition.	*We did not identify any indicators of management bias or management fraud.* Our testing of journal entries was satisfactory and we have obtained sufficient audit evidence as a result of the planned procedures. No issues were identified.

Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Expenditure recognition fraud risk Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. We do not consider that there is a significant risk in relation to improper income recognition, given the nature of the Council's income; being primarily statutory, solely related to the financial year, readily supported by third party evidence and therefore has a limited risk of manipulation. We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs, financing and investment expenditure, and depreciation. These costs are routine in nature and have limited risk of manipulation. As other operating expenditure is unlikely to be material, we also rebut the assumed risk in respect of this account. We have not rebutted the assumed risk in respect of the remaining expenditure accounts (£562 million) within the £1,017 million (in 2018-19) gross expenditure.	We performed the following testing: — Comparison of the outturn with the in year budget monitoring, considering variances from budgeted reserves utilisation to actual utilisation. — Testing of controls specific to capital versus revenue allocation. — Testing of expenditure cut-off including a search for unrecorded liabilities. — Detailed testing of transactions focusing on the areas of greatest risk, including creditors, accruals and provisions to challenge completeness of these balances. — Review and challenge of management in respect of estimates for evidence of bias. — Testing of journal entries in relation to expenditure for evidence of management bias.	*We have concluded that that expenditure is appropriately recognised.* We obtained sufficient, appropriate evidence for variances from budgeted reserves utilisation to actual utilisation. No exceptions were identified in respect of the specific controls testing, expenditure testing and testing of high risk expenditure journals. Having closed the finance ledger to routine transactions on 15 March, the Council undertook an exercise to require officers to consider all invoices between 15 March and 30 April and consider whether they had been or should be accrued. Our testing of this exercise did not identify errors in expenditure cut-off. No indications of management bias were identified.

Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Revaluation of council dwellings, other land and buildings, surplus assets and investment properties The CIPFA Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate current value at that date. The Council has adopted a rolling revaluation model which sees certain land and buildings revalued over a five year cycle. In 2018-19 the following assets were revalued, totalling £321 million: — Libraries. — Waste disposal sites. — Travellers sites. — Secondary schools (including academies). — Depots The Council also holds £146 million of investment property, held at fair value, which is subject to annual revaluation. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of council dwellings, other land and buildings, surplus assets and investment properties has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for annual accounts as a whole, and possibly many times that amount. This represents a Key Audit Matter in the audit opinion.	Our procedures included: **Control design:** — Understanding the extent of the Council's involvement in the valuation process to assess if appropriate oversight occurred. — Assessing the approach that the Council has adopted to evaluate the risk that the carrying value of assets not subject to valuation is materially misstated and consider the robustness of that approach. — Assessing 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, critically assessing the independence, professional qualifications, competence and experience of the Council valuer. **Assessing methodology choice and benchmarking assumptions:** — Utilising our internal specialist to critically assess the methodology used by the Council's valuer by considering if the valuations are in accordance with the RICS Valuation Professional Standards 'the Red Book' and accounting standards. — Challenging the key assumptions upon which the valuations were based for a sample of properties, by making a comparison to our own assumption ranges derived from market data. — Meeting with the Council's valuer to understand the assumptions and methodologies used in valuing the assets revalued during 2019 and the market evidence used to support the assumptions. — Challenging the Council's assessment of why it considers that the land and buildings not revalued in 2019 are not materially misstated, by reference to market evidence relevant to the assets. **Input assessment** — Assessing the observable inputs used in the valuations by reference to supporting evidence. **Our sector expertise** — Assessing, in light of our knowledge of the Group's assets and changes in market conditions, the assumptions used compared to our own expectations.	*We found the resulting valuation of council dwellings, other land and buildings, surplus assets and investment properties to be acceptable on an appropriate basis.* We concluded that the Council's valuer is appropriately qualified, competent and experienced to prepare the Council's valuations. Our internal valuation specialist challenged the Council's valuer in terms of assumptions and comparable evidence as set out opposite. Support for the assumptions used was provided, for each of the assets selected for testing. The ready availability of support represents an improvement on last year's audit. The Council documented the basis for its assertion that the land and buildings not revalued in 2019 are not materially misstated, we concur with the conclusion. For each of the assets sampled, management supported the key inputs to the asset valuation. *Unadjusted audit difference (see page 43)* We identified an error in respect of Harlaw Academy where the valuer used an incorrect land area to calculate the valuation as at 31 March 2019. The overstatement to the land carrying value is £1.8 million.

Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Retirement benefits The net pension liability (£322.1 million as at 31 March 2019), including assets of £1.36 billion) represents a material element of the Council's balance sheet. The Council is an admitted body of North East Scotland Pension Fund, which had its last triennial valuation completed as at 31 March 2017. Small changes in the assumptions and estimates relating to discount rate, inflation rate, mortality/life expectancy and rate of increase in pensionable salaries which are used to value the pension obligation (before deducting scheme assets) would have a significant effect on the pension liability. The effect of these matters is that, as part of our risk assessment, we determined that the valuation of the pension benefit obligation has a high degree of estimation uncertainty, with a potential range of reasonable outcomes greater than our materiality for the annual accounts as a whole, and possibly many times that amount. This represents a Key Audit Matter in the audit opinion.	Our audit approach included: **Control design:** — Testing the design and operating effectiveness of controls over the provision of membership information to the actuary to calculate the pension obligation. **Benchmarking assumptions:** — Challenging, with the support of our own actuarial specialists, the key assumptions used by the actuary (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 the assumptions used by the actuary.	*We are satisfied that the retirement benefit obligation:* — *is correctly recognised on the balance sheet as at 31 March 2019;* — *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 a range which we consider to be acceptable.* Results of testing of controls in respect of provision of information to the actuary were satisfactory. The disclosures in the annual accounts are in line with the Code's requirements, including relevant sensitivity analysis. Guaranteed minimum pensions ('GMP') equalisation Following a UK High Court judgement on 26 October 2018, gender equalisation of GMP is required to remediate the unequal benefits and retirement ages for men and women from 1990. — The UK Government consultation on GMP ended in December 2018 and extended the interim solution already in place for GMP equalisation from 2016 for the period 2018-2021. A review of the process in respect of normalising this arrangement is ongoing. — The Council's actuaries do not include the full effect of the interim indexation solution in the calculation of scheme liabilities (the actuaries have only recognised the effect for those reaching state pension age up to April 2021). This is on the basis of materiality and we concur with this judgement.

Significant risks (continued)

SIGNIFICANT RISK	OUR RESPONSE	AUDIT CONCLUSION
Retirement benefits (continued) See previous page	See previous page	Continued… — No liability is recognised in respect of the effect of GMP post 2021 on the basis that a ‘trigger event’ has not occurred, i.e. the UK Government consultation on any potential future scheme amendment is ongoing. We concur with this on grounds of materiality. — We consider that appropriate disclosure of the above is made in the pensions note of the annual accounts. McCloud judgement On 20 December 2018 the Court of Appeal ruled that transitional arrangements offered to some public sector pension scheme members amounted to unlawful discrimination. This related to new schemes set up in 2015 which typically meant older workers could stay in the existing, more generous schemes, while younger workers had to transfer to the new schemes. — This ruling potentially gives rise to additional liabilities for local government pension schemes. It is an ongoing development and the assessment of the potential impact on all local government pension schemes is ongoing. — The Council’s actuary has not made any allowance for the ruling because of uncertainty in the amount which would be recognised. — We concur with this approach and consider that appropriate disclosure is made in the contingent liabilities note of the annual accounts.

Other areas of audit focus

Other area of audit focus	OUR RESPONSE	AUDIT CONCLUSION
Capital expenditure The Council has a five year £1 billion capital plan which is focused around the city centre masterplan. Key projects in progress in 2018-19 include The Event Complex Aberdeen ('TECA') and the Aberdeen Western Peripheral Route ('AWPR'). During the year Lochside Academy was also recognised on the balance sheet, being a Public Private Partnership ('PPP') asset. Due to the significance of this capital investment programme and complexity of some of the projects, we consider it to be an area of audit focus. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions.	Our procedures included: **Control design:** — Testing the design and operating effectiveness of controls over the capital projects. — Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and revenue 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 revenue accounting classification by reference to supporting documentation. — Assessing a sample of items allocated to revenue expenditure to determine whether they are correctly classified. — Review and corroboration of manual journals. — Considering the accounting for Lochside Academy, being the initial recognition of the asset in accordance with the CIPFA code and subsequent measurement. This included agreeing the key facts to the underlying agreement.	The controls tested were found to be effective. Other than for Lochside Academy, no exceptions were identified in the tests of detail, with supporting documentation available for each item sampled. The statistical sample of capital additions included items ranging from £2,436 to £13.14 million. *We have concluded that the treatment of capital expenditure is satisfactory, after the adjustment included below.* *Adjusted audit difference (see page 42):* Lochside Academy is a PPP asset funded substantially by Scottish Government. The construction cost, to be repaid over the life of the PPP agreement, was £45.6 million. The asset was revalued as at 31 March 2019 on a Depreciated Replacement Cost basis, being the appropriate valuation basis, and valued at £34.1 million (this asset is included in the PPE assets revalued at the year end, see page nine). The Council recognised the capital addition at £34.1 million although the CIPFA Code requires the initial recognition to be at the value of the "portion of payments paid for the asset", being £45.6 million. An audit adjustment was therefore agreed with the Council, to increase the capital addition by £11.5 million, and recognising an impairment charge of £11.5 million. This has no impact on net assets as at 31 March 2019.

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 CIPFA Code. We considered the level of prudence within key judgments in the 2018-19 financial statements and accounting estimates. We set out our view below:

Subjective areas	2017-18	2018-19	Commentary
Bad debt provisions (excluding Council tax) *£23.8 million*	4	3	In the 2016-17 annual audit report we recommended that the Council reviews the bad debt provision methodology, and this was implemented in the subsequent year (2017-18). For 2018-19 the Council has further refined the methodology with a range of provision rates ranging from around 10% (for debts between 30 days and 365 days old) to around 90% for debts up to five years old. This is in part in recognition of new requirements of IFRS 9. Debtor provisions (excluding council tax) increased by £4.8 million. We concur with the provisioning approach and we note that this is not a material area of judgement.
Council tax bad debt provisions *£33 million*	2	3	The council tax provisioning methodology has also been revised in the current year, adopting a less complex calculation. There was a £2.6 million decrease in the council tax bad debt provision from £35.6 million in the prior year. Collection rates have remained stable year-on-year and we note that the change in methodology relates to a previous recommendation from our external audit (see page 52). We concur with the provisioning approach and we note that this is not a material area of judgement.
Pension assumptions Net liability*:* *£322.1 million*	4	3	For defined benefit obligations, the estimate is calculated under IAS 19 (as calculated by the Council's actuary, Mercers, using agreed financial assumptions). We found the assumptions and accounting for pensions to be appropriate. We consider that the discount rate used (2.4%) to be balanced, the CPI inflation assumption (RPI less 1.2%) to be optimistic, and mortality – future improvements (CMI 2015 projections model, 1.75%/ 1.5% long-term trend rate for males/females) to be cautious. Salary inflation assumptions are in line with Council expectations. We consider that the return on pension assets assumptions to be appropriate.
Council dwellings, other land and buildings, surplus assets, and investment property revaluations: *£2,584.7 million*	3	3	Our findings over the valuation of Council dwellings, other land and buildings, surplus assets, and investment properties are discussed on page nine. We did not identify any indications of management bias and consider that the valuations are balanced in the round.
RPI assumptions built in to effective interest rate on the bond *3.5% RPI assumption*	2	2	Management has chosen an RPI assumption of 3.5% to include within the bond effective interest rate calculation, which is in line with other similar RPI assumptions included in estimates within the financial statements, for example, within the pension assumptions. RPI of 3.5% is broadly in line with publically available forecasts albeit cautious.

Level of prudence

0	1	2	3	4	5	6
Audit difference	Cautious		Balanced		Optimistic	Audit difference

Going concern

Going concern

Going concern means the ability of the Council to remain solvent for the twelve month period from the accounts being signed.

The Council had net assets of £1.29 billion (2017-18 £1.4 billion) as at the balance sheet date. Net assets decreased on 2017-18 by £94.9 million, reflecting the total comprehensive expenditure for the year.

During 2018-19, the Council set a net revenue expenditure budget of £526 million (being £439 million on the General Fund and £87 million on the Housing Revenue Account). The core outturn is a surplus of £8.3 million (being £0.5 million on the General Fund and £7.8 million on the Housing Revenue Account).

Management considers it appropriate to continue to adopt the going concern assumption for the preparation of the annual accounts. The Council is in a net asset position, and it considers that the confirmed general revenue grant (which includes non-domestic rates income) of £342.3 million is sufficient to meet debts as they fall due. The Council also has reasonable certainty over income sources, such as Council Tax income. Financial assets were £115.7 million as at 31 March 2019. This is lower than as at 31 March 2018 (£154.9 million), reflecting the planned capital expenditure for the year.

Over the past few years there has been managed reduction in the overall cost base and further efficiency savings are incorporated into budgets. The Council approved savings for 2019-20 of £41.2 million, across a wide range of the activities of the Council, in order to achieve a balanced budget. Delivery against the savings is being monitored on a regular basis and the Council has demonstrated the ability to deliver on savings targets in prior years.

Conclusion

The Council has a strong net assets position and a significant value of available financial assets. It has put in place savings plans and prepared short, medium and long term financial forecasts. These are inherently dependant on a number of assumptions out with the Council's control although the Council is currently performing broadly in line with budget. Management has demonstrated strong leadership in taking action on overspends to ensure tight budgetary control

In light of the financial position, the short-term and medium-term forecasts, the confirmation of general revenue grant and the reasonable certainty over other significant income streams, we are content that the going concern assumption is appropriate.

Management reporting in financial statements

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Management commentary	The Local Authority Accounts (Scotland) Regulations 2014 require the inclusion of a management commentary within the annual accounts, similar to the Companies Act requirements for listed entity financial statements. The requirements are outlined in the Local Government finance circular 5/2015. We are required to read the management commentary and express an opinion as to whether it is consistent with the information provided in the annual accounts. We also review the contents of the management commentary against the guidance contained in the local government finance circular 5/2015.	We are satisfied that the information contained within the management commentary is consistent with the annual accounts. We reviewed the contents of the management commentary against the guidance contained in the local government finance circular 5/2015 and, following some suggested enhancements are content with the proposed report.
Our view of Alternative Performance Measure (“APM”) presentation	As an EU Public Interest Entity (“EU-PIE”), we are required to provide a view on the APMs that the Council uses in its management commentary. APMs are those amounts presented which do not directly appear in the financial statements themselves. The local government finance circular 5/2015 provides clear guidance to councils on the type of information to be included within the management commentary. Furthermore, the CIPFA Code requires an expenditure and financing analysis is presented within the financial statements, providing a reconciliation from the Council’s internal management reporting to the statutory position. The key performance measure which users of the accounts consider is the achievement of over or under spends against budget. An appropriate reconciliation from the £8.3 million underspend against budget (including HRA) to the statutory position presented in the comprehensive income and expenditure account is provided in the management commentary. This reconciliation does not give undue prominence to an adjusted measure.	We consider the presentation of alternative performance measures in the management commentary to be appropriate in the context of the Council’s accounts.

Management reporting in financial statements (continued)

REPORT	SUMMARY OBSERVATIONS	AUDIT CONCLUSION
Remuneration report	The remuneration report was included within the unaudited annual accounts and supporting reports and working papers were provided.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the annual accounts and all required disclosures have been made. Our independent auditor's report confirms that the part of the remuneration report subject to audit has been properly prepared.
Annual governance statement	The statement for 2018-19 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 reviewed a draft of the proposed statement in April 2019, and provided the Assurance Manager with suggestions to support its development.	We consider the governance framework and annual governance statement to be appropriate for the Council and that it is in accordance with guidance and reflects our understanding of the Council.

Group financial statements

Our audit appointment of the Council extends to the audit of the Aberdeen City Council Charitable Trusts and Aberdeen City Integration Joint Board. Appendix seven sets out the group structure. The table below sets out the key audit findings from these entities and also significant matters discussed with the component auditor. There are no findings to report in relation to other group entities.

ENTITY	WORK PERFORMED	AUDIT CONCLUSION
Charitable Trusts	We assessed materiality based on our knowledge and understanding of the charities' risk profile and annual accounts balances. Materiality was determined at 2.5% of total assets. We considered and confirm our independence as auditor and our quality procedures, together with the objectivity of the audit director and audit staff.	We issued an unqualified audit opinion on the charitable trusts.
Common Good	Aberdeen City Council Common Good does not prepare separate financial statements, and is incorporated as disclosure notes within the Council's financial statements. Common Good holds investment properties as well as other assets.	The Common Good amounts are included within the Group financial statements, for which we issued an unqualified opinion.
Integration Joint Board ('IJB')	A separate annual audit report was presented to the Audit and Performance Systems committee of the Aberdeen City Integration Joint Board on 28 May 2019. No significant exceptions were identified during the audit.	We issued an unqualified audit opinion for the IJB on 19 June 2019.
Bon Accord Care Limited	As set out in our audit strategy document, we provided group audit instructions to the component auditor of Bon Accord Care Limited, a significant component in view of its material retirement benefit obligations. Formal reporting from the component auditor has been provided and no audit adjustments were raised. We reviewed the component auditor's audit files in relation to retirement benefits and discussed the key judgements with the engagement director. There were no significant findings that we would be required to report.	The component auditor issued an unqualified audit opinion Bon Accord Care Limited. There are no matters to report which would impact the group accounts.

New accounting standards

New accounting standards for 2018-19

The CIPFA code was revised for 2018-19 to take into account IFRS 15 *Revenue from Contracts with Customers* and IFRS 9 *Financial Instruments.*

IFRS 15 introduces a five-step process for recognising revenue based on the transfer of control rather than the previous transfer of risk and reward. Given the nature of the Council's income, which is typically a fee in exchange for a service and/or related only to the Council's financial year, there is no material impact on the Council's accounting for income.

IFRS 9 includes a single classification approach for financial assets which is driven by cash flow characteristics and how an instrument is managed, and a forward looking "expected loss" model for impairment. The implementation of this standard does not have a material impact on the annual accounts.

IFRS 9 does, however, change several aspects of accounting for financial instruments and debtor provisioning. The most notable change being the removal of the Available For Sale Financial Instruments Reserve and reclassification of certain of the Council's equity investments from "amortised cost" to "fair value through profit and loss".

We consider that the Council's disclosures for the transition to IFRS 9 to be appropriate.

Future accounting and audit developments

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

The Council is conducting an exercise to consider the impact on the 2019-20 annual accounts.

Wider scope 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. The dimensions are: financial management; financial sustainability; 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 work carried out by internal audit and other scrutiny bodies to ensure our work meets the proportionate and integrated principles contained within the Code.

All appointed auditors are also required to consider areas of focus identified by Audit Scotland, we include our view on each area as within the relevant wider scope section.

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 Best Value audit work integrated into our audit in 2018-19 focused on one of the seven areas: Performance, Improvement and Outcomes. The findings of this work are reported on pages 33 to 35.

Strategic Audit Priorities

The Accounts Commission agreed five strategic audit priorities:

- the clarity of Council priorities and quality of long-term planning to achieve these;
- how effectively councils are 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:

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

We use icons to highlight specific matters of note throughout this report.

Key: Best practice Area of ongoing development

Financial management

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

2018-19 financial performance

The Comprehensive Income and Expenditure Statement shows a deficit on the provision of services of £103.9 million for the year to 31 March 2019, of which £81.3 million relates to the General Fund. The deficit includes various accounting adjustments as required by the CIPFA code, such as in respect of actuarial movements and revaluation of property, plant and equipment. Excluding these adjustments, the Council reported a surplus of £8.3 million, being £0.5 million in respect of the General Fund and £7.8 million in respect of the Housing Revenue Account.

General Fund

A balanced budget was approved at the start of the year, incorporating a final saving requirement of £4.9 million. The £0.5 million General Fund underspend represents around 0.1% of the net services expenditure, although it is the net result of overspends and underspends within the Council's functions as well as re-profiling of Loans Fund charges. The largest value overspends were:

- Foster care costs (£2.8 million), as a result of foster carer vacancies and the resultant use of external agencies.
- Out of authority placements (£2.1 million), reflecting the rising costs and the placement decisions.
- Building Services income shortfalls (£3 million), due to tradespeople shortfalls and the impact on completion of works.

The largest element of underspend is in relation to the Council's review of Loans Fund charges as permitted by the Local Authority (Capital Financing and Accounting) (Scotland) Regulations 2016. The Council changed the profiling of Loans Fund charges for the repayment of its outstanding debt liability for debts issued after 1 April 2016. This gave rise to a £4.3 million gain relative to the budget.

The 2018-19 budget also included contingencies, in recognition of the uncertain nature of needs and pressures within any local authority, and these enabled the Council to deliver a broadly balanced outturn overall.

Financial headlines

Deficit on provision of services

£104 million

2017-18: £73 million

Deficit on general fund

£81 million

2017-18: £59 million

Total reserves

£1,289 million

2017-18: £1,384 million

General fund reserve

£35 million

2017-18: £41 million

Reported underlying underspend

£8.3 million

2017-18 £5 million

Capital financing requirement

£1,117 million

2017-18 £971 million

(Source: audited annual accounts)

Financial management (continued)

2018-19 financial performance (continued)

Housing Revenue Account ('HRA')

The Council is required by legislation to maintain a separate HRA and to ensure that rents are set to cover the costs of its social housing provision. Rent levels are set in order to achieve a breakeven position based on forecast expenditure.

The £7.8 million underspend on the provision of services reported for 2018-1, reflects a £3.5 million surplus from Loans Fund charges profiling (see page 20) and a surplus from the extension of useful economic lives of housing assets.

The HRA acquired four properties from the General Fund at a value of £7.7 million, resulting in an increase in the General Fund reserve and a reduction in the HRA reserve. Closing HRA reserves were £12.3 million for use in future years.

Financial reporting

Quarterly financial reporting is provided to the City Growth and Resources Committee ('CGRC'), comprising a full set of financial statements with management commentary and additional notes to explain the financial position. Further detailed analysis of the results are provided in appendices, including in respect of HRA, Common Good Fund and the Capital budget. This is good governance in view of the listed debt, and remains leading practice in a local authority context.

The forecast out outturn for the 2018-19 £438 million general fund budget as per the quarterly financial reporting is set out below, with the full year forecast as reported at each quarter presented to show the changes in expectations over the year.

Forecast outturn (£000)	Q1	Q2	Q3	Q4
(Underspend) / overspend	(75)	826	2,680	(562)

Over the course of 2018-19 a growing overspend was identified, and the pressures behind that overspend were set out for members within the reporting. The greatest uncertainty was in respect of the pay settlement which was not within the Council's control.

In view of the need to deliver a balanced budget, in Q2 members approved the officer recommendation at the CGRC to *"instruct the Corporate Management Team to stop and reduce net expenditure wherever possible with immediate effect".* The delivery of a small surplus demonstrates the strong management of the Council's finances, noting that Loans Fund charge reprofiling supported the outturn.

Capital budget

There was a significant shortfall in capital expenditure relative to the £350 million budget, with £222 million invested in capital projects. The largest spend being in respect of TECA, where £135.6 million was incurred. The shortfall is in part due to reprofiling in respect of four proposed new primary schools, delays with the Union Terrace Gardens project and known delays in settling land claims for the AWPR.

In respect of TECA, a programme board provides scrutiny and oversight of the project. We reviewed the TECA cost monitoring processes and performed capital additions testing, noting that financial oversight of the project is strong, as is expected given the scale of the project.

Scrutiny and monitoring of the overall capital plan delivery is the responsibility of the Capital Programme Committee.

2019-20 budget proposals

The Council sets five budgets on an annual basis: General Fund; HRA; Capital; Common Good; and Pension Fund. Throughout July to November there is an iterative process of budget development, of transformation proposals and reporting through Corporate Management Team ("CMT") and Extended CMT ("ECMT"), concluding in November.

Officer proposals are submitted during that iterative process, for costing or consideration. Alternative proposals are then submitted by members or political groups, for consideration in advance of the meeting.

On 5 March 2019 the Council approved a detailed balanced revenue budget for 2019-20 and a five year high-level budget to 2023-24. The Council also approved a five year capital budget of £503 million, in addition to a housing investment program over the same period of £154 million.

We consider that the budgeting process is robust, and is supported by regular monitoring as noted opposite.

Financial management (continued)

Accounts and audit process

2018-19 was the second year of the accelerated accounts timetable, with draft annual accounts issued to the ARSC on 30 April 2019, and the audit commenced on the same day. In order to approve the annual accounts by the end of June 2019, the subsidiary and associate entities also delivered to an accelerated timetable. The statutory deadline for signed annual accounts is 30 September 2019.

High quality working papers were provided at the start of the audit fieldwork and management responded effectively to our queries. No significant issues arose during the audit and a low number of audit misstatements were identified. In the prior year there were misstatements related to the accounting for property revaluations and the audit of the revaluations themselves was not straightforward. Management's processes showed significant improvement in 2018-19, with evidence being readily available to support revaluations and the accounting treatment being appropriate.

The pension scheme actuaries prepared disclosures based on estimated assumptions for the unaudited annual accounts. These assumptions were updated during the audit to reflect subsequent evidence, and significant changes were required to the annual accounts. This could occur in future years where there is market volatility in March, given that unaudited accounts are prepared in April and prior to March market data being available.

The ARSC meeting at which the unaudited annual accounts were considered was on 30 April 2019, compared to 8 May 2018 for the 2017-18 annual accounts. This year's timetable resulted in less time for the finance team to prepare the annual accounts, and some minor notes required amendment after the ARSC April meeting.

One key area of improvement was identified, as in prior years, being the robustness of considering significant contracts and their treatment in the annual accounts. As in the prior year an audit misstatement was identified in respect of a new contract, being the Lochside Academy initial recognition for 2018-19.

Notwithstanding this matter, we consider that the Council performed very well to achieve the June 2019 audit annual accounts timetable. We set out opposite our qualitative assessment of the readiness for the audit.

Readiness overview	2017-18	2018-19
Preparation and planning	H	H
Production of accounts	M	H
Oversight and review	M	M
Significant judgements	M	M
Supporting information	H	H

KPMG qualitative assessment:
H/M/L – High/medium/low level of preparation, accuracy and detail

Financial management (continued)

Internal control

We consider that the Council has a generally robust control environment. We tested the operating effective controls within certain financial processes, where reliance upon them enabled an efficient testing approach. No exceptions were identified from the testing and the controls tested were:

- Budget monitoring.
- Bank reconciliations.
- Procurement: contract awards.
- Capitalisation of expenditure.
- Loans ledger reconciliation.
- HRA stock reconciliation.
- Council tax assessor report reconciliation
- Council tax banding rate reconciliation.

We noted in the prior year audit that although the Council demonstrates a good level of control through general IT controls, we were unable to place reliance on these controls in the audit. The primary reason for this was a lack of system logging and monitoring in place for IT privileged users. We did not plan to rely on these controls for the 2018-19 audit, given the work ongoing to implement the prior year recommendations.

In 2017-18 we made a total of eight recommendations and a summary of their status is below. The action plan is shown on page 44 onwards.

Status	Grade one	Grade two	Grade three
Implemented	-	1	3
In-progress/overdue	2	2	-
	2	**3**	**3**

Our view – financial management

We consider that the approach to financial management, including budget setting and monitoring is appropriate with clear supporting governance arrangements. The Council demonstrates advanced practice, in a local authority context, through quarterly financial reporting

The controls tested for the purposes of forming an opinion on the annual accounts were found to be effective.

Financial sustainability

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

Audit Scotland's *Local Government in Scotland: Financial Overview 2017-18* report highlighted that councils face an increasingly complex range of challenges and continuing pressure on finances. Funding gaps across councils in 2018-19 totalled £0.3 billion, with Scottish Government revenue funding increasing by only 0.2% in real terms and demand growing. Funding gaps are expected to increase over subsequent years and most councils have a transformation programme underway.

The Council's Target Operating Model ("TOM") was designed in recognition of the need for financial restraint, as well as the growing demand pressures and changing customer expectations.

Target Operating Model

The TOM was approved by the Council on 23 August 2017 and represented a significant redesign in the operating model of the Council. It puts delivery of the outcomes within the Local Outcome Improvement Plan ('LOIP') at its core.

There are four phases to the transition to the model, each broadly aligned to a financial year. Phase one (2017-18) included the approval of the TOM design principles, organisational structure, transformation portfolio and supporting governance framework, engagement with a digital partner and realignment of staff roles within the approved First Tier structure.

Phase two (2018-19) was primarily related to further developing the structure, embedding new governance arrangements and progressing the digital transformation. Phase two was completed with key programmes being primarily on target.

Phase three (2019-20) is to continue to deliver the Council's digital strategy enabling the delivery of £125 million benefit realisation (savings) over five years from 2018-19 to 2022-23, and delivering the TOM by 2020-21. The medium term gap between income and expenditure is annually reviewed to take account of actual experience, current funding and operating conditions.

Implementation of the effective redesign of services and a move to a commissioning-led approach, including the digital strategy, is key in the delivery of the required savings needed to maintain financial sustainability over the short to medium term.

Annual budget presentation

The annual budget was approved by Council on 5 March 2019. The budget report set out the general fund revenue and capital budgets for 2019-20, together with the general fund revenue budget for 2020-21 to 2023-24. The revenue budget showed the need to make savings in 2019-20 of £41.2 million. The savings were identified within the report, being a combination of income raising, cost saving and service redesign.

General Fund revenue budget and benefits realisation

The prior year (March 2018) General Fund revenue budget identified the need to deliver savings of £4.9 million in 2018-19 and the medium term outlook (2019-20 to 2022-23) demonstrated the ongoing need to deliver recurring savings across the Council. By 2022-23 the value of recurring savings required was forecast as £100.9 million. The Council reports a 2018-19 general fund surplus of £0.5 million, having delivered on the saving requirements.

When preparing the March 2019 budget report, the Council identified increasing service demands, (including costs of out of authority placement for children, fostering and kinship care allowances), pay settlements and uncertainty in respect of Local Government grant settlements. Together with the 2019-20 savings need of £41.2 million, the medium term financial outlook described in the report was consistent with previous years, that a significant level of recurring savings will continue to be needed. The total value required to 2023-24 is forecast as £133.2 million. If no action were taken by the Council then useable reserves of £405 million would be required to support current services.

Deficits are forecast for each of the next five years, before further savings plans:

General Fund revenue budget	2019-20 £000	2020-21 £000	2021-22 £000	2022-23 £000	2023-24 £000
Gross expenditure	477,260	498,335	522,161	543,345	566,173
Gross income	(436,040)	(431,234)	(429,654)	(431,237)	(432,931)
Cumulative deficit	**41,220**	**67,101**	**92,507**	**112,108**	**133,242**

(Source: 5 March 2019 – Council report)

Financial sustainability (continued)

At the time of the budget setting report there was no national pay agreement and therefore assumptions were made for the 2019-20 and 2020-21 budgets. These were a pay award of 3% in 2019-20 and 2020-21, then 2.5% for 2021-2022. The 3% pay assumption was in line with the offer made by Local Government employers to trade unions on which agreement was eventually reached.

Teacher pay negotiations were concluded in April 2019 and additional funding from Scottish Government is being distributed to support a higher pay award. Both negotiations were for a three year period from 2018-19 to 2020-21.

Savings plans to deliver the 2019-20 balanced budget.

It is a statutory requirement to set an annual balanced budget. To achieve this a detailed savings plan was approved which identified £44.7 million of forecast savings. This included recurring items to be delivered through service redesign (£20.7 million), a reduction in in-year spending (£12.5 million), increases in fees and charges (£3.3 million), an increase in Council Tax (£5.6 million), a reduction in cost of assets (£1.4 million), and a reduction in cost of employees (£1.1 million). From these the Council decided on a range of options, totalling £41.2 million, to balance the budget.

The Council is transparent about the level of savings required in 2019-20 and over the medium term. Savings are required from transformation of the workforce and effective use of digital technology underpinned by services redesign. A Transformation Fund of £7.0 million is held as at 31 March 2019, to be utilised to make recurring savings through delivery of the Being Digital Strategy.

Progress against the delivery of the savings plan will be reported at the end of quarter one and work to assess and forecast the delivery of change, savings and / or income is in progress to meet the reporting deadlines set by the Council. We note that the Council has identified the individual elements of the £41.2 million and does not have a significant unidentified savings target.

Use of reserves

The Council continued to invest its reserves in the future of the organisation during 2018-19, including £4.2 million in respect of the earmarked Transformation Fund. The Council utilised a total of £5.9 million General Fund Reserves in delivering the 2018-19 financial outturn.

As at 31 March 2019 the Council had uncommitted general fund reserves of £10.1 million which equates to 1.9% of Net Cost of Services of £520 million (2.2% as at 31 March 2018). These reserves are to support the delivery of services in the case of unexpected issues, and a reserves strategy is in place.

We consider that this level of reserves is reasonable for a Council of the size of Aberdeen City Council, however the risk for the Council is the non-delivery of savings which would impact on these reserves.

General Fund Reserves	31 March 2018 £000	Increase /(utilisation) £000	31 March 2019 £000
Transformation Fund	11,232	(4,229)	7,003
Other Earmarked Reserves	18,081	(368)	17,713
Uncommitted General Fund Reserve	11,384	(1,270)	10,114
Total General Fund Reserves	**40,697**	**(5,867)**	**34,830**

Financial sustainability (continued)

Cash and Short Term Investments (Liquidity)

Liquidity	31 March 2018 £000	31 March 2019 £000	Movement £000
Cash and cash equivalents	56,202	70,520	14,318
Short term investments	98,705	45,213	(53,492)
Short term borrowing	(79,435)	(197,228)	(117,793)
Current liquidity	**75,472**	**(81,495)**	**(156,967)**

As at 31 March 2019 cash and short term investments were £39.2 million lower than as at 31 March 2018, including an investment of £106 million on behalf of the North East Scotland Pension Fund.

Current liquidity reduced by £157 million year on year. This reflects investment in capital projects and in transformation, as planned at the start of the year and in accordance with the Treasury Management Strategy. It is also due to the use of internal borrowing to support day-to-day cashflows, rather than using long term borrowing for this purpose.

The Treasury Management Strategy states that investment priorities are security of capital and the liquidity of investments. Liquidity is a key measure of the Council's ability to meet its liabilities as they fall due. The Council's current asset/liability ratio is now 0.7:1. (1.3:1 in 2017-18), similar to the level before the bond was issued for capital investment in the City.

Borrowing

Total borrowing as at 31 March 2019 was £122.7 million greater than as at 31 March 2020, with overall borrowing being £1,093 million. The increase in borrowing is primarily funding investment in capital and transformation as noted opposite. Investment in Capital in the City was £216 million in 2018-19.

In respect of the £81.5 million negative liquidity as at 31 March 2019, we note that the Council has cashflow forecasts that show an increase in the long term borrowing over the year which will bring the current liquidity to a positive position.

As the borrowing increases, the pressures on the revenue budget for capital financing costs increases, being 8.4% of income by 2023. The Council has identified that this level in not sustainable and increasing borrowing beyond the planning horizon would impact on services. The general fund revenue budget forecasts over the medium term show that borrowing is expected to peak in 2022-23 and fall in 2023-24.

The Council monitors its financial position on a routine basis and is borrowing in line with its financial plans. We note that the Council's credit rating was rated by Moody's as Aa3 and stable in November 2018, with recognition of the Council's financial management detailed within Moody's assessment.

Financial sustainability (continued)

Prudential Code

The key objectives of the Prudential Code are to ensure that the Council's capital programme is affordable, prudent and sustainable, and that treasury management decisions are taken in line with good professional practice.

Annually the Council has to set out it prudential indicators to provide a framework to work within to ensure that Council does not breach its prudential indicators as borrowing increases to fund capital investment.

The table below sets out the forecast prudential indicators over the medium term, showing the affordability gap narrowing over the medium term.

Prudential indicators	2018-19 £m	2019-20 £m	2020-21 £m	2021-22 £m	2022-23 £m	2023-24 £m
Capital Financing Requirement	1,216	1,338	1,482	1,494	1,473	1,448
Operational Boundary for External Debt	1,230	1,352	1,496	1,508	1,487	1,462
Gross Borrowing	870	1,051	1,175	1,322	1,338	1,321
Gap	**360**	**301**	**321**	**186**	**149**	**141**

Audit Scotland area of focus - Changing public landscape for 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. Scottish Government published an initial five year Medium term Financial Strategy in May 2018, which was refreshed in May 2019.

The Council does not obtain new financial powers directly as a result but may be impacted indirectly by subsequent delegated powers or changes in the external economic environment. The Local Government Finance (Scotland) Settlement 2018-19 includes the continued flexibility to increase Council Tax, with a cap of 4.79% for 2019-20. The Council has used this flexibility, increasing by 4.5% .

Other tax raising powers outlined in January 2019, (including tourist visitor levy, parking levy and non-domestic rates empty property relief) have not been reflected in the projected income in the General Fund revenue budget, however the Council will respond to Scottish Government consultation in respect of these and hopes to benefit from these over this period of the General Fund revenue budget.

Audit Scotland area of focus: EU withdrawal

The Council maintains a detailed and robust risk register of the risks that it considers could impact the Council and its services, as well as the wider economic environment of the City and surrounding area.

This risk register takes account of the following broad headings: workforce; capital projects: partner organisations; financial; operations; customer; place; governance; corporate landlord; and digital.

In addition to the internal risk assessment and mitigation work, the Council is a key participant in the Grampian Local Resilience Partnership, which maintains an EU Exit resilience checklist which incorporates the regional risks.

The UK Government announced a guarantee that UK projects that are approved before the UK officially leaves the EU will receive the funding to which they were awarded. No additional specific guarantees have been received, but the Council considers that this guarantee means there is limited additional financial risk attached to the EU funding for ongoing projects.

We consider that the Council has worked effectively alongside its partners and internally to understand the risks that the EU withdrawal creates and continues to engage fully. The Council has risk assessment and mitigate risks where possible, and is working across the area region. The Council was appropriately prepared for exit on 29 March 2019, being the original date of departure from the EU.

Financial sustainability (continued)

Audit Scotland focus area: Key supplier dependency

All bodies are potentially exposed to the failure of a key supplier, in an operational and infrastructure context. For ACC we identified the following as key suppliers during 2018-19 and over the next year: the building contractor for TECA, the Energy from Waste Contractor; Waste Disposal contractors; and digital partners.

Through established procurement arrangements the Council carries out financial due diligence on prospective partners and key suppliers. For the key suppliers identified, risk assessment had taken place with regards to accepting the suppliers and the ongoing risk of failure. Following risk assessment, the Council has mitigation plans in place should key suppliers fail.

Financial due diligence includes requesting up to date financial statements where considered necessary and using suppliers that are included on framework contracts where sustainability checks are already performed. The Council notes that the risk to the Council extends beyond loss of the key supplier, including the risk of the loss of Council services, or the loss of data. To mitigate this, legal officers are involved to ensure that legal recourse is in place to ensure continuity.

We consider that the Council has arrangements in place to manage the key supplier dependency risk.

Our view – financial sustainability

A clear assessment of the 2019-20 savings needs has been identified and reported to Council.

The Council will continue to utilise reserves associated with the transformation programme which is designed to realise benefits and savings required over the period to 2024.

There remains a residual risk that in the medium to long term, transformation does not deliver the benefits and savings expected, or does not deliver them at the pace required to deliver a balanced budget without impacting services. However we consider that the Council is financial sustainable in the short term, with well monitored plans to ensure longer time financial balance.

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 performance.

Governance

The Council continues to enhance and refine its governance arrangements, with the objective of being awarded the CIPFA Governance Mark of Excellence by 31 March 2021.

In 2017-18 the Council made substantial changes to its governance arrangements following a wide ranging governance review. The changes support the delivery of the four phases of the transformation and the key achievements noted in the prior year Annual Audit Report were the approval of: a Scheme of Governance; a Bond Governance Protocol; a Risk Management Framework; and an ALEO Assurance Framework.

The Scheme of Governance that brings together the Council's constitutional documents is reviewed annually. At the 4 March 2019 meeting of the Council the revised Scheme of Governance was approved, with the key changes being:

- the disestablishment of the Strategic Transformation Committee, in recognition that transformation has become 'Business As Usual" for the Council;
- revisions to Committee Terms of Reference, Powers Delegated to Officers, Standing Orders and Financial Regulations;
- changes to the Procurement Regulations, including measures to provide additional scrutiny by the Head of Commercial and Procurement Services to help ensure Value for Money.

During the year the Council also revised its Governance Function, which constitutes an Assurance Team, Democracy Team, Legal Team and the Programme Management Office. The objective of the function is to support the strengthening of the governance framework and reinforce accountability and ownership of governance across the Council.

Alongside these governance arrangement enhancements the Council has developed and approved Guiding Principles within its Behavioural Framework.

A focus on: The Guiding Principles

We care about our purpose, our city and our people

We take pride in what we do and work to make things better

One team, one council, one city

We trust each other and take responsibility

We value each other and recognise a job well done

Phases two to four of the transformation include the development of seven organisational capabilities, which are an evolution of the design principles of the TOM. The Council recognised that embedding these capabilities into the way that the Council operates requires a culture change, and it formed the Guiding Principles following engagement across the organisation.

The Guiding Principles are intended to: set out common understanding of what it means to work at and with Aberdeen City Council; guide how the Council interacts with customers, partners and each other; guides the approach to decision making, processes and policies; and ensure that all can challenge and support the way the Council operates.

To define the culture needed to deliver the organisational capabilities, officers engaged with over 800 individuals from across the Council, including members and trade union representatives. Options for principles and behaviours were formed and decided upon through an online survey, which generated over 1,000 responses.

Five Guiding Principles, including practical example behaviours, were formally approved on 4 March 2019.

Transformation can be ineffective when an organisation's culture does not change and respond a new way of working. Culture itself can be difficult to evolve if stakeholders cannot influence it. We consider that the Guiding Principles and the Behavioural Framework, together with the collaborative approach to their development, represent best practice will contribute significantly to the effectiveness of the required transformation.

Governance and transparency (continued)

Scrutiny

There is a high degree of scrutiny and challenge exercised by officers and members. This scrutiny is facilitated through the revisions to the committee structure and terms of reference.

The Council's monitoring and challenge of ALEOs continues to be embedded within the ALEO assurance hub. The May 2018 Audit Scotland report *Councils' use of arm's length organisations* commented that the ALEO Assurance Hub has a clear focus on risk management, financial management and governance.

Annual Governance Statement

The Annual Governance Statement within the Council's annual accounts sets out the Council's conclusion on the effectiveness of governance and the basis for that conclusion. It describes the sources of assurance to support the Council's compliance with the seven principles of the CIPFA/SOLACE framework *Delivering Good Governance in Local Government.* The Annual Governance Statement includes areas where there is future development in governance and where governance issues have been identified. It concludes that the Council's Code of Governance operates effectively.

We consider that the Annual Governance Statement shows an appropriate and accurate reflection of the Governance arrangements at the Council.

National Fraud Initiative (NFI)

The NFI in Scotland brings together data from local government, health boards and other public sector bodies. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud.

The Council submitted received matches for investigation during January 2019, to identify potential frauds or errors, with a deadline of 30 September 2019.

We completed a questionnaire considering the Council's participation in NFI for submission by 30 June 2019, with a generally positive conclusion.

Standards of conduct for prevention and detection of fraud and error

The Council has a range of procedures for preventing and detecting fraud and irregularity including: a whistleblowing policy; fraud, bribery and bribery policy; and codes of conduct for members and officers. We assessed these to confirm that they were appropriate, readily available to staff and are regularly reviewed to ensure they remain relevant and current.

We consider that the Council has appropriate arrangements for the prevention and detection of bribery and corruption.

Risk management

The Council's Risk Management Framework was updated and approved in March 2018, incorporating the Council's approach to risk management, monitoring, reporting and risk appetite. The framework is being refreshed during 2019-20.

The Corporate Risk Register is reviewed by the CMT on a monthly basis, with Cluster Risk Registers maintained to manage operational risks. The Council has commenced an assurance mapping programme, to identify control gaps or control duplication. With the revised governance structure in place, the programme should be taken to completion.

Local Area Network ('LAN')

A Local Scrutiny Plan ('LSP') was presented to the June 2018 ARSC and included no additional scrutiny by external audit in 2018-19. The LSP is based on a shared risk assessment undertaken by the LAN, comprising representatives from scrutiny bodies which engage with the Council.

The Accounts Commission, supported by Audit Scotland, chairs the Strategic Scrutiny Group ('SSG'). During 2018, the SSG reviewed the effectiveness of national scrutiny coordination and the Shared Risk Assessment process. As a result, a number of changes were made, the most notable being no requirement for LANs to produce LSPs. The new approach looks to embed a discussion about risks and responses between scrutiny bodies across the year, rather than a specific one-off approach..

Governance and transparency (continued)

Internal audit

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.

Every local authority internal audit function must be externally assessed against the PSIAS once every five years . In 2017 we reviewed the internal audit function, covering the PSIAS requirements as well as comparisons to best practice for an entity with debt listed on the London Stock Exchange. Where recommendations for improvement were identified and agreed, Internal Audit brought proposed changes for approval by ARSC members.

We reviewed internal audit reports and conclusions, and consider that they do not indicate additional risks and there was no impact on our audit approach. Internal audit's annual opinion confirmed, "that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's framework of governance, risk management and control in the year to 31 March 2019."

Internal audit reports are not graded, although the Health and Safety Audit was identified by officers as requiring specific focus to ensure that the agreed actions are implemented.

Open internal audit recommendations are monitored by officers and the remediation actions reviewed by Internal Audit prior to closure. Part way through 2018-19 several actions were overdue, although through CMT focus the outstanding actions as at 31 March 2019 were low in number, at 14 compared to 45 as at 31 March 2018.

Transparency

Transparency continues to be an important aspect of good governance and is expected by stakeholders. The Council makes committee meeting agendas and minutes available online and reports are publicly available in advance of meetings. Full Council meetings are also webcast.

Having attended various committee meetings, we observed appropriate debate over any proposed exempt specific items of business from publication. These examples demonstrated a commitment to conduct business as transparently as possible with senior officers providing legal guidance and their rationale for items to be taken in private business. We recognise that some reports should be considered in private to help ensure that the Council delivers Best Value and, in some cases, the Council must by law consider matters in private.

For 2018-19, the Council's committees prepared and noted annual committee effectiveness reports. Each committee's report sets out: delivery against the committee's terms of reference; officer and member attendance; a graphical summary of how committee reports align to LOIP categories; a summary of the number of committee decisions including those considered as exempt/confidential; civic engagement; and a section with a forward look to the next year's focus.

Committee effectiveness reports are good practice, but we note that the consideration of outcomes, transparency and the forward focus are best practice content.

The Council also demonstrates transparency by:

- participating in the Local Government Benchmarking Framework ("LGBF") and providing access via its website;
- publishing Statutory Performance Indicators ('SPIs'); and
- reporting regularly on delivery against the LOIP.

We consider that the Council conducts its business in an appropriately transparent manner.

Governance and transparency (continued)

Audit Scotland area of focus - Care income, financial assessments and financial guardianship

The experience of a number of local government audits indicates there may be issues with the systems and processes for collecting care income, undertaking financial assessments on individuals receiving care and financial guardianship. In some cases where the responsibilities for financial assessments on those receiving care has transferred from social care to finance has revealed issues with backlogs of financial assessments and under-recovery of care charges over many years.

The Council is responsible for collection of care income and processing financial assessments. Backlogs currently exist; as at 31 May 2019, 114 non-residential assessments were outstanding dating back to February 2019, and 563 residential assessments were in progress. The Council has allocated additional resource with the aim of clearing the backlog by 31 December 2019.

The Council/IJB approved two planned internal audits in the area, being in respect of financial assessments (February 2018) and Non-Residential Care Charging Policy (March 2019). Recommendations for improvement in processes were agreed in respect of both audits The Council and the IJB also commenced a lean Six Sigma continuous improvement project in February 2019 which seeks to simplify and shorten the financial assessments process.

The Council has an established process in respect of financial guardianship.

Leadership

We specifically considered the Best Value area of Leadership during 2017-18 and concluded that Aberdeen City Council exhibits strong member and officer leadership. We have concluded likewise for 2018-19.

During 2018-19 the vacant CMT positions were filled, and the Behavioural Framework was approved. In addition a Leadership Forum was formed, currently comprising 358 members; being “leaders” from across the Council. A Capability Framework is due for consideration and approval in 2019-20.

The Leadership Forum’s aims are to:

- Keep the Council’s leaders informed of key developments.
- Provide a space for them to get actively involved in what is happening and to involve their teams.
- Facilitate collaboration, sharing and problem solving for leaders across the Council.

The Leadership Forum is an everday network and also to date three events have been held, with up to 170 members attending. The events were an opportunity for members to engage and influence on topics such as: creating a culture to enable development of the organisational capabilities; budget update; the Guiding Principles; and the new approach to performance review and development.

We consider that the Leadership Forum is an excellent example of engaging senior staff members, to develop them and to make use of their skills to deliver transformational change at the Council.

Our view – governance and transparency

The Council has continued to enhance its governance framework and is working to secure the CIPFA Governance Mark of Excellence. It exhibits strong and effective governance and has engaged with stakeholders as it developed its Guiding Principles to support the culture change which is associated with transformation.

Members robustly challenge and scrutinise management with a clear focus on the communities and citizens they represent, in respect of governance, process and matters presented for decision.

We consider that the Council operates in an appropriately transparent manner.

Best Value and Value for Money

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

To consider how effectively the Council demonstrates Best Value in its delivery of services we consider the audit findings across the four audit dimensions. This section includes our conclusions relating to the audit dimension of Value for Money which contribute the delivery of Best Value.

Best Value is assessed over the five-year audit appointment as part of our annual audit work. A Best Value Assurance Report ('BVAR') for each council will be considered by the Accounts Commission at least once in this five year period. The BVAR report for Aberdeen City is planned for the last year of the five year programme (2020-21).

In 2018-19 our Best Value audit work focussed on the Council's arrangements for demonstrating Best Value in Performance, Improvement and Outcomes.

Best Value focus area: Performance, Improvement and Outcomes

Performance Management Framework

A revised Performance Management Framework ('PMF') was approved at the Strategic Commissioning Committee in March 2019. The PMF supports the seven operational capabilities as referred to on page 29, with performance reported against four elements of Customer, Processes, Finances and Controls, and Staff.

Performance is monitored and reported at a cluster level using performance scorecards. An aggregation of key performance statistics is provided to ECMT, the Staff Governance Committee, the City Growth and Resources Committee and the Operational Delivery Committee.

Through the digital and data investment that the Council has made, real-time interactive dashboards have been formed. These provide access to operational and financial data from across all aspects of the Council's activities and services. Officers provided External Audit with a demonstration of the data and reporting system, which uses the PowerBI platform. Whilst the system is being further developed during 2019-20, it is clear that it represents a step-change in the accessibility of data and in the ability to interrogate exceptions to drive change.

Through access to real-time information, the Council will move away from formal reporting of historical data for the purposes of operational management, with continuous monitoring by officers now taking place. Similarly the intention is that elected members will have real time information to inform decision making.

Public Performance Reporting

A key element of the PMF is in respect of Public Performance Reporting ('PPR'), being a statutory duty of every council. The PMF sets out the current PPR mechanisms and further notes that the "digital revolution" will provide customers and other stakeholders with real time data and information about services. It notes that the Council is developing its PPR by exploiting its new data analysis and reporting capabilities.

The Council's website includes a Strategy, Performance and Statistics section, through which users can access:

- the Aberdeen City Local Development Plan and the City Centre Masterplan;
- financial and procurement information;
- SPIs and a link to the LGBF;
- the Annual Complaints Report;
- extensive information about equalities and diversity; and
- statistical information.

The section also includes a link to the Community Planning Partnership ('CPP') website through which the LOIP and Annual Improvement Outcome Reports are available.

External Audit reviewed the Strategy, Performance and Statistics section and identified that performance information is up to date and relevant. The information is generally provided by annual reports and links to information sources, as is usual practice in Local Government, however the intended transformation of PPR through use of the interactive dashboard will greatly enhance the usability of the information and support in identifying trends.

Best Value and Value for Money (continued)

Best Value focus area: Performance, Improvement and Outcomes

SPIs

The Accounts Commission prescribed two SPIs for the financial years from 2016-17 to 2018-19:

- SPI 1: covering a range of information relating to areas of performance such as improving local public services, improving local outcomes, engaging with communities and achieving Best Value.
- SPI 2: reporting of performance information as required by the LGBF.

The Council publishes the information for both SPIs up to 2017-18, with the 2018-19 information being prepared at the date of this report and reflecting the earlier annual accounts timetable of the Council.

Outcomes

The LOIP 2016-26 sets out the CPP's vision for Aberdeen City and identifies 15 stretch outcomes across the areas of Economy, People and Place. Under the LOIP, the Council and the community planning partners have committed to delivering four outcomes for the people of Aberdeen; namely prosperous economy, prosperous people, prosperous place and enabling technology. Delivering these outcomes was the basis for the development of the TOM.

☑ The Council and the CPP developed their approach to supporting improved outcomes, including holding a Taking Stock Community Planning Conference in September 2018. The conference included participation from stakeholders across the City and provided a set of priorities for the CPP and refreshed LOIP. In preparation for the conference, a substantial document repository was provided to attendees, including evidence matrices, improvement project reports, locality annual reports and population needs assessment.

The current Council Delivery Plan was approved in March 2019 and establishes strategic commissioning intentions to support delivery of LOIP outcomes.

Improvement

The Council and the CPP adopted the Scottish Government Model for Improvement in order to support a systematic approach to identifying, planning and delivering improvements. A training and development programme, including regular workshop based 'bootcamps", support users in its implementation.

Where there is evidence of success the Council and the CPP seek to replicate and enhance the scale of improvement or stop activities which are not demonstrating improvement. There is a positive leadership culture which encourages decisions to stop activities without seeing this as failure.

Improvement reporting

Regular improvement tracking and monitoring happens throughout the year at an appropriate level. The Council's Service Improvement Plans include the LGBF measures and are routinely reported to members through the Council's established committee structures.

Each year an Annual Outcomes Improvement Report ('AOIR') and an Annual Public Performance Summary are published by the CPP.

As set out in last year's Annual Audit Report, the AOIR includes:

- clear improvement objectives, by year, with comparison to actual performance;
- red/amber/green status tracking in respect of each measureable indicator which underpins an improvement project objective;
- focus on outcome measures (rather than inputs);
- details of ongoing improvement projects;
- case studies; and
- priority next steps for the year ahead.

Where improvements are required, the Council seeks service responses in respect of relevant actions.

Best Value and Value for Money (continued)

Best Value focus area: Performance, Improvement and Outcomes

Progress in improving outcomes

The AOIR includes status indicators for the partnership outcome measures. The 2017-18 AOIR shows that for 56 improvement measures the outcome exceeds the Community Planning Aberdeen's ('CPA's) 2017-18 aim, demonstrating improvement on the 2015-16 baseline position. 12 improvement measures show that progress is nearly at the 2017-17 aim, with 18 reporting insufficient progress. Data was not available for the remaining 39 improvement measures.

Engagement with customers and stakeholders

In addition to Public Performance Reporting and the CPP engagement noted on the previous page, the Council engages with customers and stakeholders in a variety of ways:

- Citizens Space: online portal for consultations, through which c.14,000 responses were received in the 18 months to 31 May 2018.
- City Voice: the Citizens Panel managed by the Council on behalf of the CPP.
- The CPP's Civic Council: brining together Community Councils, Communities of Interest and other Community Groups.
- Community Council Forum: supporting community councils across Aberdeen.
- Community Engagement Group: bringing together several group from across the CPA partnership.

In January 2019 the Strategic Commissioning Committee considered a report which set out the findings of a review of the Council's approach to Customer and Community Engagement. Key developments which are being taken forward are: a better link between Service Delivery Plans and CPA engagement; monitoring of customer and community engagement through the new Performance Management Framework; and findings from the review are to be embedded into the Council's transformation project for civic leadership.

In the 2017-18 Annual Audit Report we raised a "minor" graded recommendation in respect of monitoring the success of engagement, in a similar way to the Council's existing approach in respect of the Aberdeen City Voice. The January 2019 review report actions addresses the recommendation.

Following the Public Pound

Appointed 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 have previously considered management's processes to comply with the FtPP Code through its local code of practice which applies the FtPP Code in the local context of the Council's interactions with its Arm's Length External Organisations ('ALEOs').

Effective monitoring and scrutiny of ALEOs has continued to be enabled through the ALEO assurance hub, which provides officers and elected members with regular reporting of all ALEOs as set out on page 30.

Options appraisal

The Council has a business case template for use as part of the project management toolkit. This includes the requirement to undertake an options appraisal and all committee reports seeking decisions are submitted with the implications of recommended option. These implications include the impact of decisions on LOIP themes.

Four control boards operate to oversee and act as gateways for business cases and options appraisal. Having considered the terms of reference and business case templates, we consider that the arrangements for options appraisal are robust and appropriate.

With significant change underway at the Council, in the form of the Transformation Programme, there is significant focus on considering the benefit of change and the outcomes which will be delivered. For example, each project within the " transformation blueprint" is required to prepare a project canvas to set out the basis for the project and the options to be progressed. The projects are monitored and managed through the Transformation Management Group.

Best Value and Value for Money (continued)

Our view – value for money

Building upon the clear vision and objectives which the leadership has established in the LOIP, improvement actions, responsibility and monitoring arrangements are well established to support delivery. The Council has engaged stakeholders in its improvement journey, with a clear focus on outcomes.

There is a robust Performance Management Framework which ensures that Council performance is monitored and scrutinised. The investment in a data dashboard will greatly enhance the accessibility and usefulness of information; to enable members, officers and stakeholders to understand the Council's service delivery performance. Existing progress reporting is transparent and includes targets, trend analysis and is provided in full detail and summary level to enhance stakeholder engagement.

Public Performance Reporting is up to date and complete, although we welcome the planned interactive and real-time reporting which will be enabled by the Council's digital investment.

Appendices

Required communications with the Audit, Risk and Scrutiny Committee

Type		Response
Our draft management representation letter	OK	We have not requested any specific representations in addition to those areas normally covered by our standard representation letter for the year ended 31 March 2019.
Adjusted audit differences	OK	There was one adjusted audit differences with a deficit reduction impact of £11.55 million. See appendix three.
Unadjusted audit differences	OK	The aggregated deficit impact of unadjusted audit differences would be £1.76 million. In line with ISA 450 we request that you adjust for these items. However, they will have no effect on the opinion in the auditor's report, individually or in aggregate. See appendix four.
Related parties	OK	There were no significant matters that arose during the audit in connection with the entity's related parties.
Other matters warranting attention by the Audit, Risk and Scrutiny Committee	OK	There were no matters to report arising from the audit that, in our professional judgment, are significant to the oversight of the financial reporting process.
Control deficiencies	OK	We communicated to management in writing all deficiencies in internal control over financial reporting of a lesser magnitude than significant deficiencies identified during the audit that had not previously been communicated in writing.
Actual or suspected fraud, noncompliance with laws or regulations or illegal acts	OK	No actual or suspected fraud involving Group or Component management, employees with significant roles in Group-wide internal control, or where fraud results in a material misstatement in the financial statements were identified during the audit.

Type		Response
Significant difficulties	OK	No significant difficulties were encountered during the audit.
Modifications to auditor's report	OK	None.
Disagreements with management or scope limitations	OK	The engagement team had no disagreements with management and no scope limitations were imposed by management during the audit.
Other information	OK	No material inconsistencies were identified related to other information in the annual accounts. The Management Commentary is fair, balanced and comprehensive, and complies with the law.
Breaches of independence	OK	No matters to report. The engagement team and others in the firm, as appropriate, the firm and, when applicable, KPMG member firms have complied with relevant ethical requirements regarding independence.
Accounting practices	OK	Over the course of our audit, we have evaluated the appropriateness of the Group's accounting policies, accounting estimates and financial statement disclosures. In general, we believe these are appropriate.
Significant matters discussed or subject to correspond-dence with management	OK	The key audit matters (summarised on pages seven to 11) arising from the audit were discussed, or subject to correspondence, with management.

Additional report relating to EU Public Interest Entities

Type	Response
Our declaration of independence (OK)	No matters to report. The engagement team has complied with relevant ethical requirements regarding independence.
Key audit partner(s) (OK)	We have identified each key audit partner at page three in our Audit Strategy report dated 1 February 2019.
Independence of external experts engaged by KPMG and non-KPMG auditors (OK)	We have not engaged external experts or engaged non-KPMG auditors for the performance of aspects of our group audit.
Communications with audit committee and management (OK)	We have described the nature, frequency and extent of communication with the ARSC and management at pages 26 and 27 in our Audit Strategy report dated 1 February 2019.
Scope and timing of the audit (OK)	We have described the scope and timing of the audit at pages 26 and 29 in our Audit Strategy report dated 1 February 2019
Audit methodology (OK)	Our audit methodology is described at page six in this report.
Valuation methods (OK)	On page nine (and in the accounting policies of the annual accounts), we report the valuation methods applied to the items in the financial statements and the impact of any changes.
Going concern assessment (OK)	There are no significant matters affecting the entity's ability to continue as a going concern.
Requested explanations and documents (OK)	No matters to report. All requested explanations and documents were provided by management.

Type	Response
Materiality (OK)	Quantitative materiality applied to the audit of the financial statements as a whole and materiality for balances/disclosures affected by qualitative factors is set out at page six in our Audit Strategy report dated 1 February 2019
Non-compliance with laws and regulation or articles of association (OK)	No actual or suspected non-compliance with laws and regulation or articles of association were identified during the audit.
Significant deficiencies in internal control (OK)	There are no significant deficiencies to report in this report or our report dated 1 February 2019.
Significant difficulties (OK)	No significant difficulties were encountered during the audit. The significant matters (pages seven to 12) arising from the audit were discussed, or subject to correspondence, with management. In our professional judgment, no matters arose from the audit that were significant to the oversight of the financial reporting process.
Non-KPMG component auditors (OK)	We described the work of non-KPMG component auditors at pages, 5, 14 and 29 in our Audit Strategy report dated 1 February 2019.
Management's approach to consolidation (OK)	We report on management's approach to consolidation on page 18. It is consistent with the Code. The consolidated financial statements include all material subsidiaries.
Independence – Relationships and audit fees (OK)	No relationships have been identified between the firm, and the entity that, in our professional judgment, may reasonably be thought to bear on independence. We received £205,459 of fees during the period covered by the annual accounts for audit services provided by the firm and KPMG member firms to the entity and components controlled by the entity. There were no non-audit fees receivable.

Auditor independence

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

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

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

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

Summary of fees

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

Total fees charged by us for the period ended 31 March 2019 can be analysed as follows (there are no future services - contracted or with written proposal submitted, with the exception of continuing audit services).

Total fees charged by us for the period ending 31 March 2019 can be analysed as follows:	2018-19 continuing (exc VAT) £	2017-18 (exc VAT) £
Audit of the Council's financial statements	196,859	193,110
Audit of subsidiaries (Aberdeen City Council Charitable Trusts)	8,600	8,500
Total audit services	**205,459**	**201,610**
Non-audit services	-	-
Total	**205,459**	**201,610**

Auditor independence

The ratio of non-audit fees to audit fees for the year was 0 : 1. We do not consider that the total non-audit fees create a self-interest threat.

Joint ventures

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

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

Contingent fees

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

Supplier relationship

KPMG LLP paid £226,068 to the Council in the year ended 31 March 2019, in relation to rent, rates and services. This is not material to the Council or to KPMG LLP and we note that it is at a commercial "arm's-length" rate.

Independence and objectivity considerations relating to other matters

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

Confirmation of audit independence

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

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

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

Yours faithfully

KPMG LLP

Audit differences - adjusted

The table below lists the adjusted audit differences identified during the course of our 2018-19 audit procedures.

Nature of adjustment	Balance sheet £'000 DR	Balance sheet £'000 CR	Income and expenditure account £'000 DR	Income and expenditure account £'000 CR
1. Lochside Academy initial recognition (see page 12)				
Dr Impairment charge			11,550	
Cr PPP capital liability		11,550		
Being the Lochside Academy which is a PPP asset and valued at £34.1 million as at 31 March 2019 on a Depreciated Replacement Cost basis, as required by the RICS Red Book. The construction cost was £45.6 million and should be recorded as the PPP capital liability and the initial recognition of the asset. An impairment charge is therefore required to reflect the new valuation – this has no impact on usable reserves as it relates to a capital item.				

In addition to the audit adjustments, we identified disclosures within the annual accounts which required amendment. The most significant areas were in respect of: balances due to/from the Integration Joint Board, Classification of Trading Operations, and contingent liabilities in relation to pensions to reflect information available after the unaudited accounts were issued.

Audit differences - Unadjusted

The table below lists the unadjusted audit differences identified during the course of our 2018-19 audit procedures. These adjustments are not considered material.

	Balance sheet		Income and expenditure account	
Nature of unadjusted difference	**£'000 DR**	**£'000 CR**	**£'000 DR**	**£'000 CR**
1. Debit balance within creditors Dr Debtors Cr Creditors	 1,404 	 1,404		
Being a rent prepayment incorrectly recognised as a debit within creditors, reclassified.				
2. Harlow Academy revaluation (see page 9) Dr Impairment charge (CIES) Cr Land		 1,760	 1,760 	
Being an input error in respect of the area of land for Harlow Academy used to calculate its value for the year end revaluation.				
TOTAL	1,404	3,164	1,760	-

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 2017-18 and 2016-17 audits and their current status. We provide a status update below.

Year	Number of recommendations	Implemented	In progress	Not yet due
2017-18	8	4	4	-
2016-17	3	2	1	-

<table>
<tr><th>Finding(s) and risk(s)</th><th>Recommendation</th><th>Agreed management actions / update 2018-19</th></tr>
<tr><td colspan="2">1. Regular user access appropriateness review
Audit dimensions: governance and transparency</td><td>Grade one</td></tr>
<tr><td>There is no regular review performed of user access to determine if the access is appropriate for active business users on the AIRS and Infosmart application, database and operating system (including privileged user access).

User access is reviewed for the Oracle e-Financials and the Orbis Northgate applications, but the review does not establish if the user access assigned is appropriate for an individual’s current role.

Risk:

Where user access is not reviewed on a regular basis, the risk is increased that individuals may gain or retain unauthorised access rights that are not needed for their business role. This can lead to controls and segregation of duties being by-passed, leading to erroneous or fraudulent transactions being processed.</td><td>— Management should perform a periodic review of user access assigned to ensure that this is appropriate at the application, database and operating system level.

— This should include an assessment of user access across the production, development and test environments to ensure appropriate segregation of duties exist.

— Where inappropriate access is identified, this should be investigated and removed in a timely manner.

— The review should be formal, documented and retained as evidence for audit purposes.</td><td>Original response: Agreed. Digital and Technology will lead on the implementation of this action, in conjunction with system owners to ensure consistency across all systems.

Implementation date: 31 August 2018

Responsible officer: Incident & Problem Co-ordinator, in conjunction with System Owners.

Status update 2018-19: In progress.

Whilst an email was circulated to all system owners within the Council advising them to remove any users who no longer required access to the system, this did not constitute a formal, documented and evidenced review suitable for audit purposes. We further note that this review appeared to be a one-off exercise, as opposed to periodic business-as-usual activity (e.g. quarterly user recertification).

We note that the review did not consider the level of user access across environments to ensure appropriate segregation of duties between these environments.

As the review was not formal in nature, there was no evidence of inappropriate access being further investigated and removed in a timely manner.

Management response 2018-19

See page 48.</td></tr>
</table>

Prior year recommendations (continued) 2017-18

Finding(s) and risk(s)	Recommendation	Agreed management actions / update 2018-19
2. Assignment of highly privileged access and monitoring of access *Audit dimensions: governance and transparency*		Grade one
Certain IT and business staff are assigned highly privileged access to the Council's IT systems (Oracle e-Financials, Orbis Northgate and Airs), required to perform user administration activities (e.g. assigning and changing user access rights), system development and configuration, and to ensure ongoing support and maintenance activities. We note that the Council does not monitor the activities performed by these accounts; security and event log auditing is either not enabled or not reviewed. For the purpose of relying on system generated reports for the external audit, we could not establish if the activities performed by these users were appropriate during the year . The weaknesses in the access assigned includes: — The privileged access assigned allows users within the business to perform activities that should be segregated and/or pro-actively logged and reviewed to ensure appropriate; and — The Oracle e-Financials and Orbis Northgate system administrators within the business can make direct changes to the data within the underlying database and bypass system controls (not logged); and — A shared system administrator account is used for Airs by two members of business staff (not logged). — Risk: - Where privileged user access is not robustly controlled the risk is increased that: — unauthorised access is gained to process erroneous or fraudulent transactions, make changes to data, and system settings; — unauthorised changes are not detected and appropriate action taken; — IT / operational system downtime is experienced; and — the system does not function as intended by management.	Management should ensure that: — A formal, documented and agreed policy is established that guides the Council's management of highly privileged access. — The sharing of the user accounts is investigated, risk assessed and the root cause is understood. — User accounts are only used by the approved and appropriate persons. — Each time the highly privileged accounts are used there should be a requirement that a supporting and approved incident ticket or change request is logged and retained. — The feasibility of implementing system audit logging for these highly privileged accounts is assessed, and if this is possible, a periodic review is performed over a sample of higher risk activity to ensure this was authorised and appropriate. — The logs are secured and retained in a segregated area that cannot be accessed by the users of the IT systems.	**Original response:** Agreed. Digital and Technology will lead on the implementation of this action, in conjunction with system owners to ensure consistency across all systems. **Implementation date:** 31 August 2018 **Responsible officer:** Incident & Problem Co-ordinator, in conjunction with System Owners **Status update 2018-19:** In progress. Whilst a formal policy has been established to manage the Council's use of highly privileged access (as part of the overarching ICT Access Control Policy), there is scope for improvement in the day-to-day management of how these accounts are used. We note that there is currently no requirement to raise an incident or change ticket for each use of a privileged account, and we were not provided with any evidence of root cause analysis or restriction of privileged account sharing for AIRS. We note that audit logging is enabled for Orbis Northgate, eFinancials and Infosmart and the logs are securely stored in a segregated area , but regular reviews of these logs are not currently carried out. **Management response 2018-19** See page 48.

Prior year recommendations (continued) 2017-18

Finding(s) and risk(s)	Recommendation	Agreed management actions / update 2018-19
3. Changes to IT systems *Audit dimensions: governance and transparency*		Grade two
There is no system generated log of changes to show the full population of changes to the Council's IT systems (Oracle e-Financials, Orbis Northgate and AIRS). for example changes to underlying system code or configuration. Management is therefore unable to review the changes made to the system to ensure these are appropriately approved and tested. It is also noted that the system administrators for Oracle e-Financials and Orbis Northgate have access to the production, test and development environments. Risk: Where a system generated log of changes is not available and reviewed, the risk is increased that changes are made to the IT systems that do not function as intended. The risk is further increased where: — user access is not reviewed on a periodic basis (as identified by internal audit in the Finance Systems review); — passwords to highly privileged user accounts are shared (finding 2); and — access to the production, test and development IT system environments are not segregated (this finding).	Management should ensure that: — Access to the production, test and development IT system environments are appropriately segregated, and any exception is risk assessed and approved. — The feasibility of implementing a system generated change log for the application, database, and operating system is considered. Further, a sample of higher risk changes should be reviewed by an independent person on a periodic basis to identify if changes have been approved and tested.	**Original response:** Agreed. Digital and Technology will lead on the implementation of this action, in conjunction with system owners to ensure consistency across all systems. **Implementation date:** 31 August 2018 **Responsible officer:** Incident & Problem Co-ordinator, in conjunction with System Owners **Status update 2018-19:** In progress. We note that there is no system generated changed log covering changes to key financial systems, and consequently no review of such changes being adequately approved and tested prior to release. Major changes to IT systems do come through the ACC Change Advisory Board, but cannot conclude that this covers all changes to IT systems. We were not made aware of risk assessment and / or approval relating to system administrators having access to multiple environments. **Management response 2018-19** See page 49.

Prior year recommendations (continued) 2017-18

Finding(s) and risk(s)	Recommendation	Agreed management actions / update 2018-19
4. Password parameters configuration *Audit dimensions: governance and transparency*		**Grade two**
The Council has established a range of information security policies and procedures which set out the minimum password parameters required. Our review identified the following which is not in line with the Council's information security policies and procedures: — The Infosmart application does not have any password parameters assigned for the system administrator's accounts (the Council specifies these should be enforced). — The Airs application system administrator password has never changed (the Council specify these should be changed). — The Northgate application minimum password length is six characters (the Council specify this should be eight characters). Risk: Where the passwords have weak configurations or are not compliant with the security policies approved by the Council, there is a risk that unauthorised users can have access to the applications. This could lead to system downtime, data not processed completely and accurately, or system changes that do not function as intended.	— Management should review the password parameters and ensure that they are appropriate at the application, database and operating system level. — Where password parameters can not be implemented in line with minimum requirements, this should be risk assessed on a periodic basis and formally approved by the business and IT (e.g. IT security function).	**Original response:** Agreed. Digital and Technology will lead on the implementation of this action, in conjunction with system owners to ensure consistency across all systems. **Implementation date:** 31 August 2018 **Responsible officer:** Incident & Problem Co-ordinator, in conjunction with System Owners **Status update 2018-19:** In progress. The minimum password length for the Orbis Northgate NDR application has been updated to meet the ACC Password Standard . We further note that the Infosmart application uses Single Sign On, and therefore does not meet the enhanced requirements for administrator accounts, and we have not been provided with evidence of risk assessment or approval of this by ACC. We were not provided with evidence to suggest that the AIRS system administrator password has been changed since last year's audit. **Management response 2018-19** See page 49.

Appendix four

Prior year recommendations (continued) 2017-18

The 2018-19 management response to the first four prior year recommendations are provided on this page and the next page.

1. Regular user access appropriateness review	Grade One
Proposed action: Services will implement a documented and evidenced review process against user access related to their systems with ICT assistance where appropriate. AIRS will not have this functionality. With continued development of our Identity and Access Management (IDAM) platform we would aim to bring in these systems into IDAM over time. EFinancials - To implement. Orbis - all users are required to confirm their ongoing need for access and levels of access required - including providing reason for access - on a rolling annual basis. Essentially, an Access database recording all users of Revenues and Benefits system (Orbis, Academy and URB) which incorporates a diary function prompting service to issue users with their annual system access review. A copy of the review form and screenshots of the database to illustrate functionality/control in place is provided to External Audit. Infosmart - Will implement a process similar to Orbis. User access to Development, Test and Live environments is segregated in that they are on different servers, different log on paths and use different usernames and passwords. These measures go towards mitigating potential risk. Many of the same users that use live environments also have to do testing and the test systems are also used to do training. We believe this segregation is adequate and meets the requirement. ***Responsible officer***: System Owners for D&T, EFinancials, Orbis, Infosmart. ***Implementation date:*** 31 August 2019	
2. Assignment of highly privileged access and monitoring of access	**Grade One**
Proposed action: It is impractical to raise a change each time an elevated account is used. The AIRS 'system' is an Access Database and can only have one password which is restricted to two users. For EFinancials, Orbis and Infosmart systems, ICT will, where possible, share activity logs with the service monthly so they can ratify admin access and activity against their own record of change. EFinancials - a record of changes made to the database and also any fixes applied to the application are being kept. These have been reviewed by the service. This record is provided to External Audit and we believe this meets the requirement. Orbis - already keeps an audited record of all log-ins, plus a specific additional level of audit to record all changes to Security Permissions however logs are not regularly reviewed. The Service concerned will introduce a review process. We believe this meets the requirement. Infosmart - Paperwork backs up any change and the service will implement quarterly spot check to validate requested amendments were processed appropriately. ***Responsible officer***: System Owners for D&T, EFinancials, Orbis, Infosmart. ***Implementation date***: 31 July 2019	

Prior year recommendations (continued) 2017-18

The 2018-19 management response to the first four prior year recommendations are provided on this page and the previous page.

3. Changes to IT systems	Grade Two
Proposed action: Low level changes would not come through the ACC ICT Change Board. Medium to high changes do, in line with ACCs Change Control Policy. The Digital and Technology service will investigate systems for use of automatic change logs. EFinancials - a record of changes made to the database and also any fixes applied to the application are being kept. These have been reviewed by the service. This record is provided to External Audit and we believe this meets the requirement. Orbis - will be implemented with immediate effect. Infosmart - will discuss with other service to establish what record they keep and a similar process will be put in place. ***Responsible officer***: System Owners for D&T, EFinancials, Orbis, Infosmart. ***Implementation date***: 31 July 2019	
4. Password parameters configuration	**Grade Two**
Proposed action: Infosmart is using single sign on which uses AD accounts which force password length and complexity for standard accounts. Admins log in directly using the complexity rules of the system. Digital and Technology will investigate the rules to see if they can force passwords to match the password policy. If it is not able to, all admin users will be pointed to the policy and asked to confirm their passwords meet the standard. AIRS password has been changed and with the system owner confirming this to IT by Email as evidence. The services consider that this action is met. ***Responsible officer***: Service System Owners in conjunction with IT ***Implementation date:*** 31 August 2019	

Prior year recommendations (continued) 2017-18

Finding(s) and risk(s)	Recommendation	Agreed management actions / audit update 2018-19
5. Managing complex legal agreements *Audit dimensions: financial management*		**Grade two**
The Council is required, by part of the legal agreements surrounding Marischal Square, to submit invoices in respect of estimated income due from the base void account within 10 days of each quarter end. This requirement had not been billed at the time of testing to support a material income accrual (£2.9 million). We understand that a process for regular claims in respect of the account is being developed. Risk: The Council may breach the terms of its agreements and be unable to collect money it is due, or suffer a loss of interest due to delays in receipt.	It is recommended that a suitably senior officer is assigned responsibility for managing Council, and monitoring third party compliance, with complex legal agreements including: - Marischal Square; and - Marriot Hotel. This should include use of calendar reminders to ensure compliance with key deadlines.	**Original response:** Agreed **Implementation date:** 31 August 2018 **Responsible officer:** Chief Officer - Finance **Status update 2018-19:** Complete. No exceptions identified from audit testing in 2018-19.
6. Faster accounts close – cut off review *Audit dimensions: financial management*		**Grade three**
Management undertook an exercise to require officers to consider all invoices between 19 March and 23 May and consider whether they had been or should be accrued. While good practice, more efficient methods are possible and the existing approach was not relied upon by us, due to difficulty in confirming completeness of the invoices considered by officers. A sample approach should be developed for 2018-19 and specific, material invoices subject to detailed review by management through to evidence of appropriate treatment in the general ledger. Risk: The Council may be inefficient in the use of resources, delay preparation of the annual accounts and impact adversely on officer capacity around the year end.	It is recommended a sample approach should be developed for 2018-19 and specific, material invoices subject to detailed review by management through to evidence of appropriate treatment in the general ledger.	**Original response:** In line with normal practice, a review and lessons learnt session will be held to consider improvement for future years. This recommendation will be considered through that process. **Implementation date:** 31 August 2018 **Responsible officer:** Finance Operations Manager **Status update 2018-19:** Complete We consider that the approach to expenditure cut-off to be appropriate.

Prior year recommendations (continued) 2017-18

Finding(s) and risk(s)	Recommendation	Agreed management actions / audit update 2018-19
7. Charity investments *Audit dimensions: financial management*		Grade three
Two investments, with a combined value as at 31 March 2017 of £104,755 were recorded as disposed during 2017-18, with no proceeds receivable. We understand that the Council was unable to obtain confirmation that these investments were still held, with records relating to their transfer to Barclays who have confirmed that the account was closed in 2012.	It is recommended that management continues to trace the balances recorded as disposals through discussion with Barclays.	**Original response:** Agreed **Implementation date:** 31 August 2018 **Responsible officer:** Finance Operations Manager **Status update 2018-19:** Complete**.** No exceptions identified in 2018-19.
8. Citizen engagement in budget setting *Audit dimensions: financial management and financial sustainability*		Grade three
A key principle for community planning is to ensure that people and communities are genuinely involved in the decisions made by public services which affect them. The Council's Engagement, Participation and Empowerment Strategy sets out an ambition to go significantly beyond the requirements of the Community Empowerment (Scotland) Act 2010. Broad stakeholder engagement in determining priorities is undertaken through the consultation hub, Aberdeen City Voice, UDECIDE participatory budgeting and community planning arrangements associated with the LOIP. This is good practice and informs budget setting which is aligned with the LOIP providing an integrated approach. Citizen engagement during budget setting is a key opportunity for engagement and participation. It also provides a basis for informed decision making by Councillors. However, the Council did not undertake citizen consultation during the budget setting process (when the relative value placed on services is important). This increases the risk that the Council's budget decisions are not aligned with stakeholder views and limits achievement of the aims of the Engagement, Participation and Empowerment Strategy.	At its June 2018 meeting, the Council's Strategic Commissioning Committee received a report on customer and citizen engagement and instructed that officers undertake an audit and review of existing methods and activity of engagement and report back to the Committee. It is recommended that, as part of that report, the Council considers best practice examples in respect of citizen consultation as part of the annual budget setting exercise. This should include: - Provision of information on budget challenges - A request for stakeholder input in respect of budget proposals; - A report, prepared for Council summarising feedback received in respect of the consultation. Best practice would include monitoring the success of engagement (in a similar way to the Council's existing approach in respect of the Aberdeen City Voice).	**Original response:** Agreed. **Implementation date:** November 2018 **Responsible officer:** Chief Officer (Business Intelligence and Performance Management**)** **Status update 2018-19:** Complete. In January 2019 the Strategic Commissioning Committee considered a report which set out the findings of a review of the Council's approach to Customer and Community Engagement, incorporating examples of effective citizen engagement.

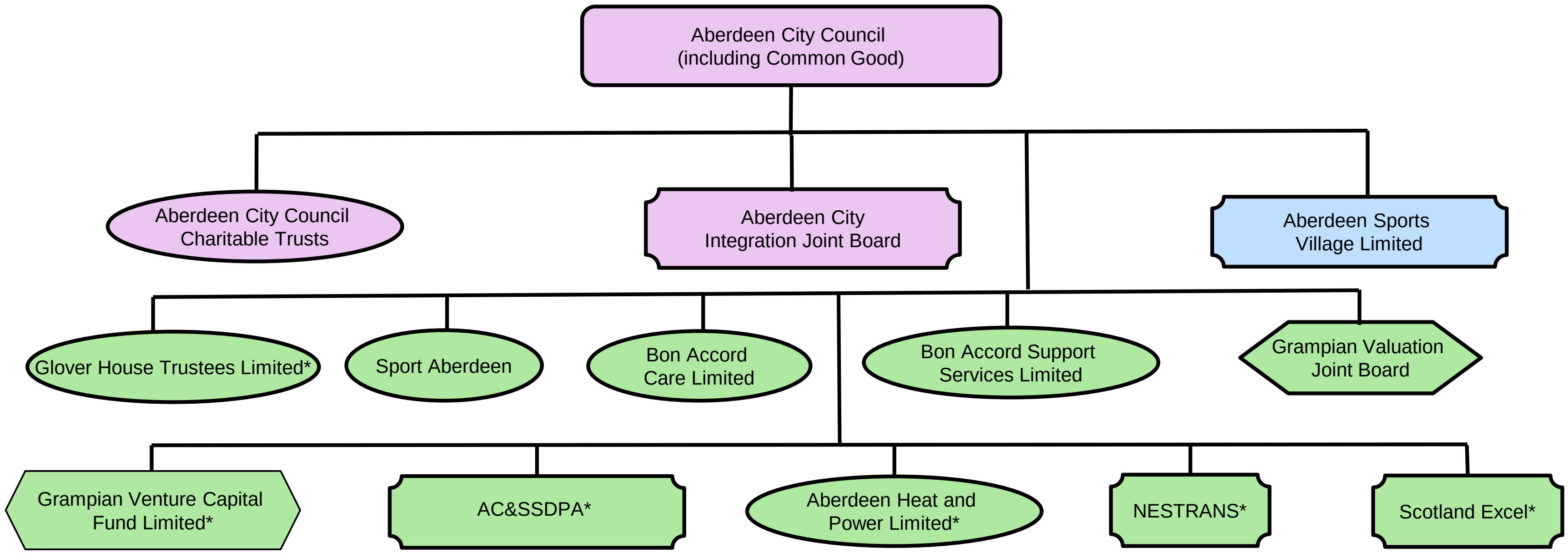
Prior year recommendations (continued) 2016-17

Finding(s) and risk(s)	Recommendation	Agreed management actions / audit update 2018-19
1. Complex accounting treatments *Audit dimensions: financial management*		Grade two
Accounting for the bond issuance is complex and involves the calculation of an effective interest rate based on future forecast cashflows. Transactions for the bond were not included in the draft accounts, and were not agreed until late in the process. The Council has a number of ongoing projects which will have similar complex accounting treatments. There is a potential risk that accounts may contain significant errors or be delayed if complex accounting treatments are not agreed early or adequately documented.	For future complex financial transactions we recommend that management considers the accounting implications prior to the transaction taking place, and provide an accounting paper before the year end, to ensure these transactions can be agreed and incorporated into the draft financial statements. **Status update 2017-18:** In progress. While documentation was enhanced in respect of some areas, including bond accounting and preparation of a technical analysis in respect of lease classification of Marischal Square, there is scope for further improvement.	**Responsible officer:** Senior Accountant. **Status update 2018-19:** In progress. There is evidence of review of complex areas of accounting, generally without exceptions being identified. However, a material misstatement was identified during the audit in respect of accounting for Lochside Academy. It is recommended that for material complex arrangements, an accounting paper is prepared by Finance and is subject to senior officer review.
2. Debtor provisioning *Audit dimensions: financial management*		Grade three
For debtor balances greater than 120 days overdue, but under 10 years overdue, a bad debt provision of 40% is recognised. We consider that this is at the most optimistic end of an acceptable range as it is unlikely that significant debts over a year old will be collected and recommend that management review their debtor provisioning levels. Furthermore we consider the methodology for calculating the council tax bad debt provision is overly complex. There is a risk that debts unlikely to be recovered are not provided for and the Council has to write off significant balances in future years.	We recommend that management reviews: — its debtor provisioning methodology for council tax to ensure an efficiency of process whilst still providing for an appropriate level of potential bad debt; and — the level of bad debt provision for debts that are greater than 120 days old but less than 10 years old to adequately provide for those debts unlikely to be collected. **Status update 2017-18:** In progress. Management implemented a revised approach to calculating the provision for general bad debts which is more sophisticated than in previous years. The approach to calculating the provision for council tax bad debts has yet to be revised.	**Responsible officer:** Senior Accountant. **Status update 2018-19:** Complete. The approach to calculating the council tax provision has been reviewed by the Council in the year and consequently simplified.

Prior year recommendations (continued) 2016-17

Finding(s) and risk(s)	Recommendation	Agreed management actions / audit update 2018-19
3. National Fraud Initiative ("NFI") *Audit dimensions: governance and transparency*		Grade three
After the identification of frauds during the NFI process, the matching system does not allow the Council to monitor recovery. The Council does not have a mechanisms for monitoring the effectiveness of recovery between different services. There is a risk that current practices are ineffective or inefficient without oversight and monitoring.	It is recommended that the Council implements monitoring of the effectiveness of recovery from the NFI reports, to ensure resources are used efficiently. **Status update 2017-18:** Not yet due	**Original response:** Agreed The recovery process of losses to frauds in each service is different and is undertaken in accordance with relevant legislation. As such direct comparison of effectiveness in recovery is not possible. It is accepted that we do not gather the total losses to fraud and will , as part of our preparation for the NFI 2019 exercise, identify how this information can be collated and reported on. **Implementation date:** 31 January 2019. **Responsible officer:** Corporate Investigation Manager **Status update 2018-19:** In progress. Academy (the benefits system) does not allow a marker to be recorded on cases where a NFI overpayment has been identified meaning a system report cannot be obtained. It was our aim to take this output and import this into the debt recovery system which would facilitate us being able to provide up to date recovery figures. Keeping manual records would be time consuming and not an effective use of resources. Representations will be made to our software provider to try to accommodate the creating of an additional field to allow this to be reviewed again, however, this will depend whether there is an additional charge.

Group financial statements



Key

- Audited by KPMG "core team"
- Audited by KPMG – separate audit team
- Audited by component auditor or not requiring a statutory audit – group audit instructions are issued where considered significant components (only Bon Accord Care Limited – significant because of its pension liability, being a significant risk identified in the group audit)

Main body
Subsidiary
Associate
Joint Venture / Joint Board / Partnership

* Entities not included in the group comprehensive income and expenditure account
AC&SSDPA = Aberdeen City and Shire Strategic Development Planning Authority

Grant claims and WGA return

We set out below the "other reporting" responsibilities of our audit appointment. We will update the ARSC at the September meeting should there be any exceptions arising from the testing.

RETURN	DESCRIPTION	STATUS
Whole Government Accounts ("WGA")	WGA is the consolidated financial statements for all components of government in the UK. Most public bodies are required to provide information for the preparation of WGA. External auditors are required to review and provide assurance on WGA returns over a prescribed threshold.	Report due 28 September 2019.
Non Domestic Rates ("NDR")	NDR in Scotland is collected by local authorities on an agency basis and notionally placed in a national 'pool', which is then redistributed among authorities based on each authority's estimated collection levels. In April each year, authorities submit an estimate of their expected NDR following the year end, authorities are required to submit their actual NDR yield, known as 'the notified amount' in a final return to the Scottish Government.	Report due 6 October 2019.
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.	Report due 29 November 2019.
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.	Report due 31 July 2019.

Appointed auditor's responsibilities

AREA	APPOINTED AUDITOR'S RESPONSIBILTIES	HOW WE HAVE MET OUR RESPONSIBILITIES
Statutory duties	Undertake statutory duties, and comply with professional engagement and ethical standards.	Appendix three outlines our approach to independence.
Financial statements and related reports	Provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions. Review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns.	Page five summarises the opinions we have provided. Pages 15 and 16 report on the other information contained in the financial statements, covering the annual governance statement, management commentary and remuneration report. We have not yet issued opinions in respect of grant claims and whole of government accounts.
Financial statements and related reports	Notify the Auditor General or Controller of Audit when circumstances indicate that a statutory report may be required.	Reviewed and concluded on the effectiveness and appropriateness of arrangements and systems of internal control, including risk management, internal audit, financial, operational and compliance controls.
Corporate governance	Participate in arrangements to cooperate and coordinate with other scrutiny bodies.	Page 30 includes arrangements to cooperate and coordinate with other scrutiny bodies.
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; and - Suitability of arrangements for preparing and publishing statutory performance information	We set out our conclusions on wider scope and best value in from page 19 onwards.

KPMG's Audit quality framework

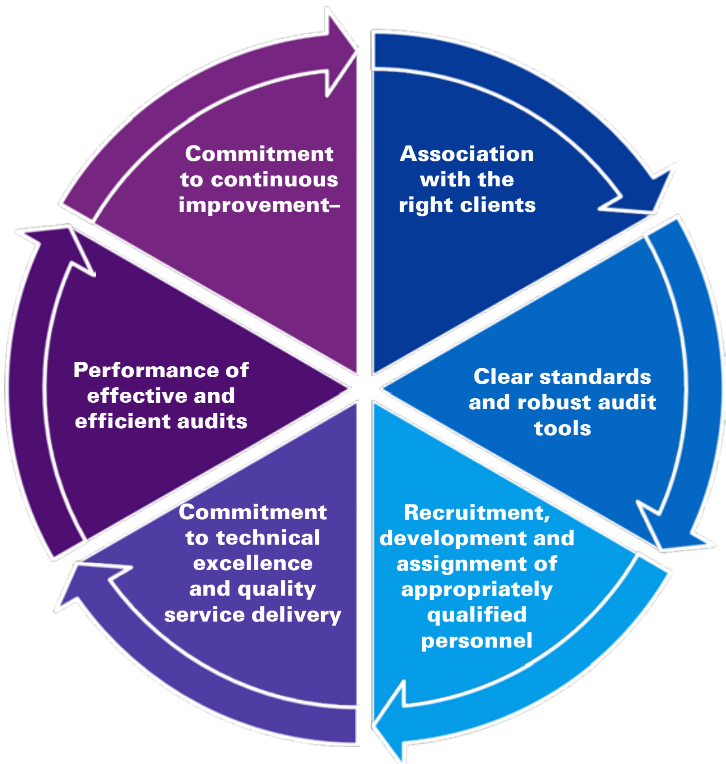
Audit quality is at the core of everything we do at KPMG and we believe that it is not just about reaching the right opinion, but how we reach that opinion.

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

The contacts at KPMG in connection with this report are:

Andy Shaw

Director

Tel: 0131 527 6673

andrew.shaw@kpmg.co.uk

Matthew Moore

Tel: 0131 231 3663

matthew.moore:@kpmg.co.uk

Leticia Barbosa

Assistant Manager

Tel: 01224 416 871

leticia.Barbosa@kpmg.co.uk