



# Aberdeen City Council

**Interim management report and audit status summary**

For the year ended 31 March 2018

For Audit, Risk and Scrutiny Committee consideration on 8 May 2018

13 April 2018

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# Introduction

## **Purpose of document**

In line with our audit strategy we have completed an interim audit. Key activities performed were the testing of a selection of system controls and holding discussions with management to update our understanding and our assessment of the key risks and audit focus areas.

This report provides the Audit, Risk and Scrutiny Committee with an update on:

- 1) Significant risks and other focus areas (pages four and five);
- 2) The results of the control testing, encompassing overarching governance and systems controls (pages six to eight).
- 3) Best Value approach (page nine).

## **Significant risks and other focus areas in relation to the audit of the financial statements as identified in our audit strategy document dated 9 February 2018:**

The significant risks identified were:

- fraud risk from management override of controls;
- fraud risk from income revenue recognition;
- revaluation of property, plant and equipment;
- retirement benefits; and
- capital expenditure.

The other focus areas identified were:

- Faster accounts close.

## **Acknowledgements**

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

# Significant risks and other focus areas

## Update: significant risks

We outline below the significant risks and other focus areas included within the audit strategy document, together with an update following the interim audit. We will conclude on these areas in the ISA 260 report.

Significant risk	Update from strategy
<p><b>Fraud risk from management override of controls</b></p> <p>This is an assumed risk from ISA 240 'the auditor's responsibilities relating to fraud in an audit of financial statements' on which we are required to report.</p>	<p>We performed controls testing over expenditure, bank reconciliations, budget monitoring and journals. In addition, we tested a sample of procurement arrangements for compliance with the relevant Council controls. The results of the testing are set out on pages six to eight. We did not identify instances where management override of control had occurred.</p> <p>Substantive procedures will be performed during the year end audit, including testing journal entries processed throughout the year, assessing accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.</p>
<p><b>Fraud risk from income revenue recognition</b></p> <p>This is an assumed risk from ISA 240. We consider the fraud risk from other income such as charges or service income to be significant.</p> <p>We rebutted the assumed fraud risk in respect of government grants, local taxes and regulated rental income. We consider only the fraud risk from recognition of 'other income' to be significant.</p>	<p>We discussed sources of other income with officers across different services to develop our understanding of the service income which is received and developed our knowledge of the composition of 'other income' in the financial statements. Testing over controls are set out on page six, with no exceptions identified.</p> <p>Substantive procedures will be performed during the year end audit. The potential for other income to be incorrectly recognised will be addressed through further substantive procedures. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details (including agreeing sample rental income to rent agreements).</p>
<p><b>Revaluation of property, plant and equipment</b></p> <p>In order to comply with the 2017-18 Code and IFRS accounting requirements, Council assets are subject to rolling valuations, with a tranche of 'other land and buildings' being subject to valuation in 2017-18.</p> <p>The Council also holds £85 million of investment property, which must be revalued on an annual basis.</p> <p>In both cases, there is a level of judgement involved associated with valuation assumptions which gives rise to a risk of misstatement.</p>	<p>We met with the valuations team and discussed the areas being revalued in 2017-18 as well as reviewing the five year rolling programme. To support the faster accounts close, the 2017-18 valuations are being prepared as at 30 November 2017.</p> <p>As part of our year end audit KPMG's in-house valuer will review the assumptions and valuation methodology used to confirm they are reasonable and in line with Code of Practice on Local Authority Accounting ('the Code'). A sample of revaluations will then be considered in more detail, including any potential impact on the valuation between 30 November 2017 and 31 March 2018.</p> <p>We will verify that the revaluation has been correctly disclosed in the accounts and that the accounting entries are correct.</p>

# Significant risks and other focus areas (continued)

Update: significant risks (continued) and other focus areas

Significant risk	Update from strategy
<p><b>Retirement benefits</b></p> <p>The Council is a member of the North East Scotland Pension Fund and recognises a net defined benefit liability on its balance sheet being £250 million as at 31 March 2017. This comprises assets of £1.22 billion offset by liabilities of £1.47 billion. The determination of the net deficit is inherently judgemental and is based on a number of assumptions.</p>	<p>Our controls testing over the transfer of pension data to the pension administrators is set out on page eight, with no exceptions noted.</p> <p>The remaining procedures will be performed during the year end audit, including review of relevant assumptions and testing them against our understanding of the Council. Prior to the fieldwork beginning in May, we will request the agreed assumptions for 2017-18 from management to facilitate this consideration and benchmarking by our internal actuary.</p> <p>We will also review the disclosures made in the financial statements against the requirements of the Code.</p>
<p><b>Capital expenditure</b></p> <p>The Council has a five year £1 billion capital plan which is focused around the city centre masterplan and includes some innovative methods of delivery. These can give rise to more complex accounting arrangements.</p> <p>Due to the significance of this capital investment programme and complexity of some of the projects, we consider there to be a risk of misstatement. We also consider that large capital projects inherently bring increased risk.</p>	<p>We tested controls over capital monitoring and procurement of capital projects. The results are set out on page six, with no exceptions noted.</p> <p>We met with management to discuss the progress of the key capital projects below, as well as beginning to consider the legal documentation associated with those developments, which may give rise to accounting implications.</p> <p>We have reviewed the capital budget and plan for both 2017-18 and future years and we will perform substantive procedures over capital spend at the final audit. This will include substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation, review of manual journals, testing additions and specifically considering the following major projects overall, which may include more complex accounting treatments:</p> <ul style="list-style-type: none"> <li>▪ Marischal Square;</li> <li>▪ Aberdeen Art Gallery redevelopment; and</li> <li>▪ Aberdeen Exhibition and Conference Centre.</li> </ul>
Other focus area	
<p><b>Faster accounts close</b></p> <p>The Council intends to accelerate the timetable for the production and audit of the financial statements by three months. This acceleration increases the risk of error.</p>	<p>We performed enquiries to gain a better understanding of the Council's revised accounts preparation and audit timetable and assessed management's arrangements to comply with the public inspection rules.</p> <p>We also conducted a substantive audit of those financial statement numbers which had been finalised to the end of quarter three. Further procedures will be undertaken at year end.</p>

# Control framework

## System controls

In accordance with ISA 330; “the auditor’s response to assessed risks”, we have designed and performed tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls over the main financial systems. Audit testing took place during February and March 2018. Overall we concluded that the control environment is effective.

Test	Description	Results
<b>Bank reconciliations</b>	<p>Bank reconciliations are prepared weekly or monthly by the income team and reviewed by a more senior officer.</p> <p>We test a sample of 40 bank reconciliations across all bank accounts to verify they had been authorised and completed on a timely basis. This sample extends beyond the date of our interim fieldwork.</p>	<p>Testing is ongoing and we will conclude during our final audit. No deficiencies have been identified in the testing conducted to date.</p> <p><b>Conclusion to be reported in the ISA 260 report in June</b></p>
<b>Budget monitoring</b>	<p>The Council has a robust budget setting process, with involvement of key members of staff. Performance against budget is monitored on a regular basis and formally reported to the relevant committees via the budget monitoring reports.</p> <p>Three quarters’ reports were considered to confirm that a sufficient level of detail was presented to and considered by the committees and that a level of precision is used to determine which variances require further analysis and discussion.</p>	<p>Testing confirmed that budget monitoring arrangements are designed, implemented and operating effectively.</p> <p><b>Satisfactory</b></p>
<b>Procurement testing</b>	<p>The Council has well defined processes for the awarding of contracts, with written procedures to be followed for each contract type and value.</p> <p>Procurement testing covered a sample of 25 contracts awarded in the year, split between those which had gone through the quotation process and those which required to be tendered. We confirmed that they had followed the correct procurement route based on value and reviewed the evidence of the tender evaluation process.</p>	<p>Testing confirmed that the selected contracts had followed the correct procurement route based on value.</p> <p><b>Satisfactory</b></p>
<b>Journals authorisation</b>	<p>A sample of 40 journals were selected and checks carried out to confirm segregation of duties exist between who raises and who authorises journal entries.</p> <p>We also considered the back up available for each journal to verify the authoriser could carry out an appropriate review and conclude the journal is correct.</p>	<p>All journals selected were raised and approved by a different officer, as appropriate. Each journal was supported with back up detail available to the authoriser.</p> <p><b>Satisfactory</b></p>

# Control framework (continued)

## System controls (continued)

Test	Description	Results
<b>Payroll</b>	<p>In order to obtain comfort over payroll processes, we tested controls related to employee standing data, when joining, leaving and making changes.</p> <p>This included testing five starters, seven leavers and 13 amendments to employee standing data for appropriate authorisation and evidence of segregation of duties.</p> <p>As a final control, a member of the Council's HR team completes a checklist to ensure that all appropriate and necessary documentation was included in the employee's file. We also tested this step of the process as part of our controls testing.</p>	<p>All changes to the payroll system followed the established process, with appropriate authorisation and segregation of duties.</p> <p>Several employees were missing the final checklists on their file. We consider that evidence is available to support segregation of duties in making changes is sufficient, however management may want to consider ensuring the checklist is used in all cases.</p> <p><b>Satisfactory</b></p>
<b>Cost of services (non-payroll expenditure)</b>	<p>A sample of 25 purchase orders were tested by agreeing to invoice and goods received note, to verify appropriate authorisation.</p>	<p>All purchase orders could be matched through the purchase cycle, with appropriate authorisation.</p> <p><b>Satisfactory</b></p>
<b>Capital expenditure review</b>	<p>Capital expenditure is subject to monthly and quarterly review to ensure that the split between revenue and capital expenditure is correct and appropriate.</p> <p>We tested three monthly reviews of capital expenditure to verify that only items above the threshold of £6,000 were capitalised and see evidence of review.</p> <p>We also tested two quarterly reviews to confirm they had taken place and appropriate cross-referencing to the fixed asset register had taken place.</p>	<p>Review of revenue and capital expenditure is operating effectively.</p> <p><b>Satisfactory</b></p>

# Control framework (continued)

## System controls (continued)

Test	Description	Results
<b>Pension data</b>	<p>In order to determine the completeness and accuracy of the information that the actuary uses to produce the pension liability/asset estimation and actuarial gain/losses, we tested controls around the transfer of pension data from the pension team to the actuaries.</p> <p>We reviewed two monthly reconciliations to confirm that the pension data submitted to the actuary matched the data in the payroll system, and that the appropriate validation checks were completed for both months.</p>	<p>For the sample, complete and accurate data is sent from payroll to the pension fund, and subsequently to the actuary, and necessary documentation complete and on file.</p> <p><b>Satisfactory</b></p>
<b>Loan ledger reconciliation</b>	<p>We tested three monthly reconciliations to confirm that the loan ledger is appropriately reconciled and reviewed on a timely basis.</p> <p>This reconciliation is between the loan ledger fund on eFinancials and a spreadsheet of all Council loans maintained and updated by the finance team. The purpose of this reconciliation is to ensure the completeness and accuracy of the loan ledger fund on eFinancials.</p>	<p>Loan ledger reconciliation is operating effectively.</p> <p><b>Satisfactory</b></p>
<b>General IT controls</b>	<p>We intend to perform testing over key IT systems on which we will place reliance on as part of our audit. This includes ICON, eFinancials and Northgate:</p> <ul style="list-style-type: none"> <li>— programme changes</li> <li>— user access;</li> <li>— leavers; and</li> <li>— system administrators.</li> </ul>	<p>We met with management to understand the key systems and approach to controls in advance of testing by a specialist KPMG team. This testing will be performed in advance of the final audit.</p> <p><b>Conclusion to be reported in the ISA 260 report in June</b></p>

# Wider Scope and Best Value

The Code of Audit Practice sets out four audit dimensions which, alongside Best Value, set a common framework for all audit work conducted for the Accounts Commission. These areas are; governance and transparency, financial management, financial sustainability and value for money. During our interim audit we commenced our consideration these areas and will conclude our assessment in our Annual Audit Report. We provide an update below of work carried out so far on Best Value.

Area	Audit update
<p><b>Best Value</b></p>	<p>We held planning discussions with officers to obtain an understanding of the Council's approach to Best Value and how this is embedded within the Council's culture.</p> <p>In year one (2016-17), in line with guidance from the Accounts Commission, we reported on the areas of Financial Governance and Resource Management and Financial Planning. This year (2017-18) we are considering the areas of Leadership and Governance, and Improvement. Our conclusions will be included within the Annual Audit Report.</p> <p>We reviewed publically available evidence across the two Best Value areas and discussed with management further support and evidence required to enable us to perform the review. We will continue to gather information and meet with officers to build our knowledge of Best Value in order to conclude on the two focus areas in our Annual Audit Report in September.</p>
<p><b>Wider Scope</b></p>	<p>Specific risks in this area are set out in our audit strategy document and include the implementation of changes following the Council's governance review and effectiveness of transition to the Target Operating Model.</p> <p>As part of our audit work, we attended the Strategic Transformation Committee, reviewed the Council's update reports, key policies and staff updates. We also reviewed governance policies and procedures including elected members' registers of interest to confirm that they are up to date. We will audit the senior officers register as part of the year end procedures.</p> <p>We have reviewed the Council's revenue and capital budget to continue to consider long term financial sustainability and will complete testing during the final audit fieldwork.</p> <p>We submitted a return to Audit Scotland in February 2018, assessing the Council's participation in the NFI against Audit Scotland criteria. The results show that overall engagement with NFI is good, with only minor improvements identified.</p>



## Contacts

The contacts at KPMG in connection with this report are:

Andy Shaw

*Director*

Tel: 0131 527 6673

[andrew.shaw@kpmg.co.uk](mailto:andrew.shaw@kpmg.co.uk)

Michael Wilkie

*Senior Manager*

Tel: 0141 300 5890

[michael.wilkie@kpmg.co.uk](mailto:michael.wilkie@kpmg.co.uk)

Natalia Shamkina

*Assistant Manager*

Tel: 01224 416 887

[natalia.shamkina@kpmg.co.uk](mailto:natalia.shamkina@kpmg.co.uk)

Flavia Czika

*Audit Assistant*

Tel: 0131 527 6624

[flavia.czika@kpmg.co.uk](mailto:flavia.czika@kpmg.co.uk)

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