



Aberdeen City Council

Annual audit report to the Members of Aberdeen City Council and the Controller of Audit for the year ended
31 March 2018

28 September 2018

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Aberdeen City Council ("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.

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Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Andy Shaw, who is the engagement leader for our services to the Council, telephone 0131 527 6673, email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or email to 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.

Introduction

Purpose, scope and approach

Purpose of this report

The Accounts Commission 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.

This annual audit report presents our conclusions in respect of the wider scope matters of Audit Scotland’s Code of Audit Practice (“the Code”). It is addressed to both those charged with governance at Aberdeen City Council and the Controller of Audit. The areas of wider scope focus were set out in our audit strategy document which was presented to the Audit, Risk and Scrutiny Committee (“ARSC”) at the outset of our audit.

The Code sets out the wider dimensions of public sector audit which involves consideration of the following audit dimensions: financial management; financial sustainability; governance and transparency; and value for money.

It is the Council’s responsibility to ensure that it has proper arrangements across each of the audit dimensions. These arrangements should be appropriate to the nature of the Council and the services and functions that it has been created to deliver.

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. 2017-18 represents year two of the Best Value plan for the Council during which we considered Leadership, Scrutiny and Governance, and Improvement.

We issued an ISA 260: *Audit report to those charged with governance* report to the June 2018 meeting of the ARSC, summarising the findings and conclusions from the financial statements audit. The ISA 260 report and this report discharge our year end reporting responsibilities under the Code.

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.

Scope and approach

We come to a conclusion on the audit dimensions, having considered the arrangements that the Council has put in place. Our work to consider these wider scope aspects of the Code was not designed to identify all matters that may be relevant to those charged with governance.




We performed a range of procedures to inform our work:

- interviews with senior officers, including the Chief Executive, and with the co-leaders of the Council;
- 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 also considered the Accounts Commission’s five Strategic Audit Priorities when considering the audit dimensions:

- the clarity of Council priorities and quality of long-term planning to achieve these;
- the effectiveness of councils in evaluating and implementing options for significant changes in delivering services;
- how effectively councils are ensuring that members and officers have the right knowledge, skills and time to lead and manage delivery of council priorities;
- how effectively councils are involving citizens in decisions about services; and
- the quality of council public performance reporting to help citizens gauge improvements.



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

Key:  Best practice  Area of ongoing development  Case study

Audit dimensions

Financial context

Our report to those charged with governance, dated 27 July 2018, provided our conclusions in respect of our external audit of the annual accounts. By way of context, we set out below a summary of financial outturn for 2017-18 and the financial position as at 31 March 2018.

<p>Total long term borrowing £891 million 2016-17 £901 million</p>	<p>Capital investment (2017-18) £217.5 million 2016-17 £221.7 million</p>	<p>The Council has developed additional forms of commercial income and previously raised funds by issuing bonds on the London Stock Exchange. The proceeds of the £370 million bonds are being invested in the Council's capital plan with a view to furthering economic prosperity within Aberdeen and the region.</p>
<p>Capital financing requirement £744 million 2016-17 £621 million</p>	<p>Total reserves £1,384 million 2016-17 £1,493 million</p>	<p>The significance of the Council's bond debt and capital investment plans increases the importance of effective financial management arrangements (page five), focus on financial sustainability (page eight) and governance (page 11). The Council has worked hard to continue to enhance each of these areas with significant changes and ongoing development during 2017-18. Management's actions are wide ranging, ambitious, enacted at a relatively high pace and delivering the results intended to date. The extent of change brings inherently higher risk but is being closely managed and subject to a high degree of scrutiny. </p>
<p>Deficit on provision of services £73 million 2016-17 £58 million</p>	<p>Surplus on general fund £4.5 million 2016-17 £3.5 million</p>	<p>For 2017-18, service saving options of £31.9 million were presented to members in setting the budget, and a total of £21.8 million of savings proposals were approved. The Council delivered the savings required in 2017-18 and the core outturn was a surplus of £5 million against a balanced budget (being £4.5 million on the General Fund and £0.5 million on the Housing Revenue Account).</p>
<p>Finance lease liabilities £58.8 million 2016-17 £-</p>	<p>Investment property valuation £148.6 million 2016-17 £85.3 million</p>	<p>There remain significant identified savings to be achieved. The Council transformation to the Target Operating Model ("TOM") is designed to deliver the required savings while enabling continued service delivery and achievement of outcomes. The approach to budget setting includes early identification and approval of savings options through the Strategic Transformation Committee ('STC'). </p> <p>Following completion of the Marischal Square development in 2017-18 it was subject to valuation and the value of investment property increased by £63.3 million and associated finance lease liabilities also increased by £58.8 million.</p>
<p>Cash and short term investments £154.9 million 2016-17 £322.4 million</p>	<p>Net defined benefit liability £310 million 2016-17 £249.8 million</p>	<p>The Council's cash and short term investment balance decreased, associated with ongoing capital investment and use of reserves to support delivery of the transition to the TOM.</p> <p>The net defined benefit pension liability increased and we concluded in our report on the financial statements that the underlying assumptions adopted by the Council are reasonably balanced.</p>


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 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.

Member 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.

 The STC has all-party representation and approved measures on 9 February 2018 to reduce third party spending and staff costs, through a voluntary severance scheme associated with the interim transformation structure, aimed at saving £16.4 million in 2018-19. These were assumed to be included in the baseline budget proposals subsequently considered at the Council budget meeting. The original indicative forecast savings required for 2018-19, as presented in last year’s annual audit report, was £37.4 million and the reduction demonstrates the progress made to date.


The 2018-19 budget proposed by the administration was considered together with proposals by SNP and Liberal Democrats. Following a vote, the administration budget was adopted.


On 6 March 2018 the Council approved a detailed balanced revenue budget for 2018-19 and a five year high-level budget to 2022-23. The Council also approved a five year capital budget (2018-19 to 2022-23) of £578.9 million, in addition to a revised housing investment program over the same period of £166 million.

The budget approved by Council was aligned to the new interim organisational structure and in light of the new chief officers appointed, the budget was formally delegated to the new chief officers by the interim head of finance in order to ensure clarity of budget responsibilities.


Participatory budgeting


The Aberdeen City Voice is the citizen’s panel run by the Community Planning Partnership (‘CPP’). It exhibits a number of aspects of good practice including clear link to outcomes but faces challenges in demonstrating appropriate demographic representation, like many localities.

Key strengths include: any citizen can join the panel; the questions are informed by the LOIP themes; responses are accepted online or in paper form; and the results are published in full and heads of service responses and plans to address comments are regularly included. 

There are some development areas as response rates are generally falling (most recently 56.5% of panellists), however we note that the number of panellists is increasing resulting in more responses overall. The youngest age group (16 – 34) also represents the majority of the population in Aberdeen (33%) but the minority of responses (4.4%). 

UDECIDE is a participatory budgeting process in which community groups in four priority areas can bid for a share of £250,000 funding. This is good practice although represents a small amount of the Council’s overall budget. It is management’s intention to scale up the use of such budgets as evidence demonstrates their effectiveness in delivering improvement.

The Council made available £1.6 million to the Fairer Aberdeen Fund which has a majority community board, combining individuals, organisations and councillors. It awarded funds ranging from £2,000 to £155,000 to 44 bodies in 2017-18 in support of work in regeneration areas with vulnerable groups and individuals. Recipients are required to monitor and report the impact and benefit of funding. While the Fairer Aberdeen Fund does not encourage citizen voting on projects, it provides an opportunity for broader community participation and partnership working. 

Overall, a wide variety of consultation is undertaken in a modern, technologically enabled way through the ‘consultation hub’, the community planning partnership, Aberdeen City Voice and UDECIDE. However, the Council does not formally consult citizens in respect of the annual budget. **(Recommendation one).** 

Audit dimensions

Financial management (continued)

Financial capacity

As the Council transitioned to the new organisational structure, the existing head of Finance was promoted to the position of Director of Resources and an interim Head of Finance was appointed internally. The Director of Resources retained the Section 95 responsibilities during this period, as is appropriate

✓ Financial capacity has been demonstrated through:

- embedding quarterly financial reporting (as opposite);
- successfully accelerating production of the annual accounts by three months;
- providing members with regular financial information and input;
- providing professional support as required to deliver the TOM, such as budget analysis and monitoring reports.

Financial reporting

The Council continues to forecast significant savings requirements which are anticipated to be delivered through transition to the TOM. Financial performance is regularly monitored.

✓ During 2017-18, quarterly financial reporting was embedded. It comprises of a full set of financial statements with management commentary and additional notes to explain the financial position. This is in recognition of good governance in view of the listed debt, and is leading practice in a local authority context as noted opposite.

Workforce planning

There is ongoing voluntary severance associated with transition to the interim TOM of up to 260 FTE posts, including disestablishment of 140 FTE posts approved in respect of 2018-19. This is a significant undertaking and management undertook consultation with unions as part of the proposals and is closely monitoring the process.

Annual accounts – faster accounts closure

Management significantly accelerated the timetable for the production (and audit) of the annual accounts for the year ended 31 March 2018. This timetable is ahead of local authorities in Scotland, and in the UK more widely. ✓

Draft annual accounts were provided on 3 May 2018, being complete and including the narrative statements. High quality working papers were also provided at the start of the audit fieldwork. Management made good arrangements in advance of the planned timetable acceleration including: ✓

- implementing quarterly close down comprising a full set of financial statements with management commentary and notes to explain the financial position, this is leading practice in a local authority context;
- making the unaudited accounts available for public inspection as required by the Local Authority Accounts (Scotland) Regulations 2014, earlier than in previous years;
- issuing instructions to components of the Council's group to ensure that their accounts and audits were appropriately advanced; and
- reviewing detailed transactional information following the early close of the financial ledger on 19 March 2018, to consider the appropriate cut-off in recognition of expenditure.

We made some low graded recommendations to further enhance the efficiency of the process in our report on the financial statements.

We consider that management performed creditably in its approach and delivery of a faster accounts closure which is ahead of the other Scottish local authorities despite the relatively high level of complexity inherent in the Council's annual accounts.

Audit adjustments

As summarised in our report on the financial statements, 11 misstatements were identified during the 2017-18 audit. The adjustments generally related to complex/non-routine transactions and management is making progress on associated audit recommendations. ✓

Audit dimensions

Financial management (continued)

Capital plan

The Council has committed to significant capital projects, some with unique funding arrangements. The total gross capital resource over the next five years (2018-19 to 2022-23) is £578.9 million, in addition to a revised housing investment programme over the same period of £166 million, approved in March 2018.

The focus of capital investment is on ensuring that Aberdeen has empowered, resilient and sustainable communities. Supporting this commitment, the capital plan includes major infrastructure projects such as the Aberdeen Western Peripheral Route ('AWPR') and £25 million is also earmarked for investment and renewal of other roads over the next five years.

The City Centre Masterplan funding 2018-19 is concentrated on the redevelopment of Union Terrace Gardens, completing Broad Street works and the restoration of Provost Skene's House. Aspects of these works are funded from proceeds associated with the Marischal Square development; representing a good degree of management foresight when it was initially planned.

The Council has developed its capital project management, governance and reporting processes over the last two years. We consider that the arrangements are robust and facilitate member and officer scrutiny of individual project progress.

Aberdeen Western Peripheral Route

The construction of the AWPR is approaching completion, with the unitary charge mechanism in place for the sections which have reached "permitted for use" stage. The Council's contribution to this scheme is capped at £75 million and is not impacted by the collapse of Carillion, which was one of three companies which constituted the main contractor for the scheme. This is because the other contractors are jointly and severable liable for completion.

The 2017-18 budget was £12.56 million but in year spend was £4 million and completion delayed by around six months. The variance between budgeted and actual spend is primarily due to variation in the cost of land; with many land owners compensated through compulsory purchase orders. The £12.56 million budget reflected the expected purchase cost.

Aberdeen Exhibition and Conference Centre ("AECC")

The AECC project is advanced, and is expected to be completed by the due date of June 2019. The project management company prepares detailed reports on the project status, which are submitted to the Council on a monthly basis. It is anticipated that ACC will need to fund a relatively small variation in the overall cost, which reflects nature of the construction agreement, being primarily fixed cost.

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

Major projects are closely monitored and where exceptions within developments or project management weaknesses arise, improvement actions are identified and reported to members. The Council incorporated clauses into underlying contractor and partner agreements, associated with major capital projects, designed to reduce the financial risk to the Council and incentivise other parties to deliver projects well. This represents good practice but it increases the underlying complexity of arrangements which require careful management.

Audit dimensions

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.

Annual budget presentation

As a result of the bond issuance and subsequent annual credit re-assessment, the Council developed its approach to medium and long term capital and revenue financial planning alongside the statutory requirement for an annual budget setting exercise. To support this, the annual budget report to Council includes the balance sheet, long term and medium term outlook and annual budget statement.

Medium term financial plan and benefits realisation

Long term assumptions around borrowing are used to inform prudential indicators that are presented as part of the final budget report and ensure that investment and borrowing proposals are affordable.

The medium term financial plan is refreshed at the start of the budget setting process, being informed by long term plans and Service Cost Models developed to estimate the impact of demand pressures and assumptions on current budgets. These are approved by the CMT before being presented to Council annually.

Deficits are forecast for each of the next five years, before further savings plans (as shown below).

General fund revenue budget	2018-19 £'000	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Gross expenditure	443,637	463,297	479,368	496,125	525,324
Gross income	(438,752)	(432,357)	(426,572)	(423,935)	(424,431)
Deficit	4,883	30,940	52,796	72,190	100,893

At the budget meeting in March 2018, members instructed the Chief Executive to continue to progress the transformation programme, reporting transformation options and associated financial benefits through the approved transformation governance process in order to address the future years' funding gap.

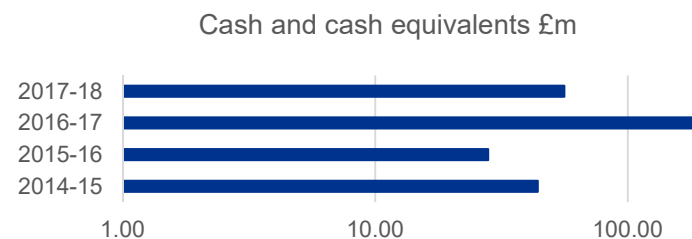
Representing best practice, the transformation portfolio budget (£15 million of reallocated existing earmarked reserves) and associated benefits realisation are included on the agenda of each meeting of the STC. Monitoring against benefits is by the responsible delivery board, following business case approval by the STC and its remit includes monitoring overall delivery.



Cash and cash equivalents

There was a significant reduction in cash and short term investments of £167.5 million from 31 March 2017 to 31 March 2018, as planned and in connection with ongoing capital investment in major projects.

The Council's Treasury Management Strategy states that the 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 overall trend is of decreasing current assets (associated with planned investment) and the Council's current asset ratio is 1.3:1.



Audit dimensions

Financial sustainability (continued)

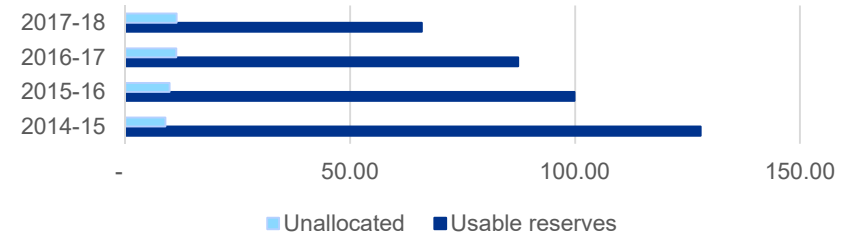
Use of reserves

The Council's useable reserves have decreased in recent years as planned, primarily due to major capital investment. The General Fund Balance decreased by £9.8 million to £40.7 million during 2017-18.

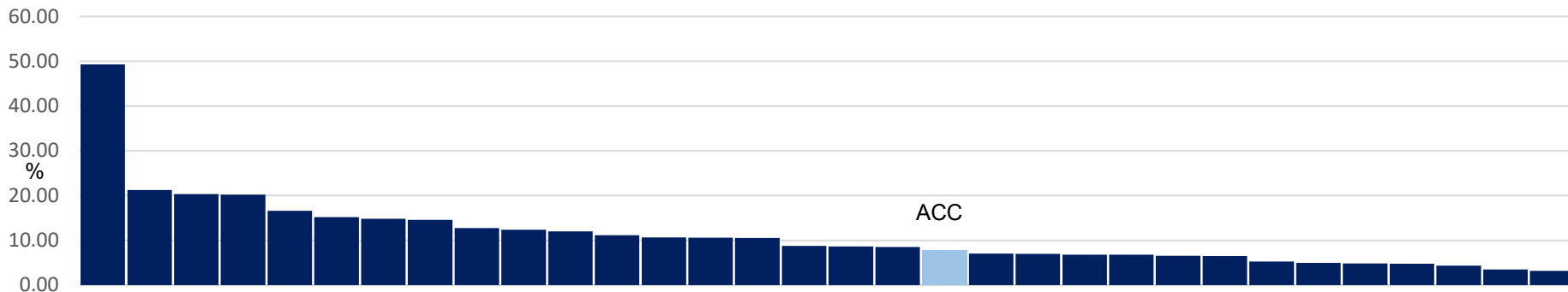
The unusable general fund balance as at 31 March 2018 was £1,318 million compared to overall useable reserves balance of £66 million. Earmarked reserves as at 31 March 2018 were £29.3 million and uncommitted reserves were £11.4 million, a £0.1 million increase compared with 2016-17 and member approval is required to utilise these funds. The majority of earmarked reserves relate to the transformation fund (£11.2 million) and funding set aside for affordable housing (£8.3 million).

As indicated below, the ratio of the Council's general fund reserves as a proportion of annual expenditure is broadly in the middle of all Scottish local authorities. In view of the planned utilisation of reserves and actions underway to reduce the funding gap, the level of general fund balance is reasonable.

Useable reserves £m



Usable general fund balance as a proportion of net cost of services



Audit dimensions

Financial sustainability (continued)

In line with Audit Scotland guidance, we have specifically considered the following areas related to financial sustainability. The Council has limited or no control in each of these areas.

EU withdrawal

A paper on EU funding implications post-Brexit was considered by the Communities, Housing and Infrastructure Committee on 1 December 2016. This was also considered as part of a wider 'Leaving the EU' report that went to Council on 14 December 2016. The Council has continued to consider the potential impacts from EU withdrawal through its routine risk management monitoring.

We note that the Council's credit rating was downgraded from Aa2 to Aa3 on 26 September 2017, together with 53 other UK sub-sovereign issuers and in line with the UK sovereign downgrading. The Council's credit rating relative to the UK sovereign credit rating is an important measure; there has been no change to this relationship.

In explaining the downgrading, Moody's noted that it considers that the UK government's decision to leave the EU Single Market and customs union will be negative for the country's medium-term economic growth prospects. The Council's credit rating was adjusted to Aa3 stable outlook from Aa2 negative outlook in September 2017 and further affirmed after the Council's annual reassessment in November 2017.

The Westminster Government and Scottish Government announced a guarantee that all 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 existing projects, and any agreed ahead of the official leave date.

Scotland's New Financial Powers

The Council does not obtain any new financial powers directly as a result of those obtained by the Scottish Government but may be impacted indirectly by subsequent delegated powers or changes in the external economic environment.

The Scottish Government's Local Government Finance (Scotland) Settlement 2018-19 includes the continued flexibility to increase Council Tax by up to 3%. The Council has used this flexibility.

Public sector pay policy

The 2018-19 budget assumes a pay award in line with the Scottish Government Public Sector Pay Policy and in the event of national negotiations exceeding this assumption, to instruct the Chief Officer - Finance to report back to the Finance, Policy and Resources Committee on options to finance potential additional costs.

Negotiations are ongoing between trade unions and negotiating bodies on the 2018-19 pay award which could impact upon the approved budget.

Our view – financial sustainability

A clear assessment of the future savings need has been identified and reported to Council on a consistent basis and decisive action taken, in approving the transformation programme designed to deliver the required savings.

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 2023. Cash and cash equivalents have decreased significantly, associated with ongoing major capital projects but the Council closely monitors project performance and has included good examples of mechanisms to reduce financial risk and encourage cost effective completion of projects.

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.



Audit dimensions

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.

Target Operating Model

The TOM was approved by the Council on 23 August 2017 and represents a significant redesign in the operating model of the Council. The TOM was designed in recognition of the need for financial restraint, growing demand pressures and changing customer expectations. The TOM puts delivery of the outcomes within the LOIP at its core.

There are four phases to the transition to the new model, each broadly aligned to a financial year. Phase one (2017-18) includes 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.

The key functions of the Council and First Tier structure are:

- Customer (Director of Customer)
- Commissioning (Director of Commissioning)
- Operations (Chief Operating Officer)
- Resource management (Director of Resources)

All four directors have been appointed.

The Transformational Portfolio is set to achieve three objectives; namely delivering up to £125 million benefit realisation (savings) over five years from 2018-19 to 2022-23, delivering the Council's digital strategy and delivering the TOM by 2020-21.

Having agreed the interim functional structure, phase two (2018-19) is primarily related to further developing the structure, embedding new governance arrangements and progressing the digital transformation.

Best Value focus area: leadership, governance and scrutiny

Governance

Transformation to the TOM is being overseen by the STC, supported by control boards and delivery boards.

The Council continued its wide ranging governance review during 2017-18, as detailed in our 2016-17 Annual Audit report. The review so far has delivered:

- refreshed constitutional documents brought together under one Scheme of Governance to provide consistency and clarity;
- a Policy on the Appointment of Elected Members to Outside Bodies following a review of such appointments, to support any such appointments being consistent with the Council's objectives;
- a new ALEO Assurance Framework. The Account Commission reviewed these arrangements and considered them to be appropriate;
- new arrangements to support the bond issuance and credit rating, summarised by a Bond Governance Protocol. A report by Internal Audit concluded that the protocol is "comprehensive and clear" as well as raising recommendations for improvement. Officers report that the recommendations have been addressed and that the bond governance arrangements will be monitored annually through the credit rating reassessments.
- a Risk Management Framework to provide clarity to members and officers on the Council's risk management arrangements. This will be further developed, to keep pace with the Council's move to a new operating model.

The revised Scheme of Governance, approved by Council on 5 March 2018 includes provision for:

- a Commissioning Committee to which procurement workplans will be submitted at the start of the financial year;
- a City Growth and Resources Committee, which will have oversight of short, medium and long term financial strategies linked to outcomes: and

Governance and transparency (continued)

Best Value focus area: leadership, governance and scrutiny (continued)

- a Public Protection Committee to scrutinise the Council's statutory regulatory activities.

We note that there was a reported governance failing in respect of 2016-17, reported during 2017-18, in respect of Wellington Brae. Management reported to Council committees in respect of the matter together with intended improvement actions.

Scrutiny



There is a high degree of scrutiny and challenge exercised by officers and members. In particular, the political constitution of Council leads to robust scrutiny of proposals and reports, as further set out on page 14.

Key aspects of financial and project management are subject to regular oversight and appropriate level. Performance against the LOIP and other plans and objectives are also publicly reported.

Stakeholder engagement

At its meeting in August 2017, the Council noted that a programme of engagement with stakeholders, both within and outwith the Council, including trade unions, ALEOs and other partners would be undertaken as the detail of the TOM is developed.



57 staff engagement sessions were held in the next few months and attended by over 3,000 employees. This took total engagement sessions to 108 and 4,505 attendees, including statutory consultation sessions in respect of voluntary severance.

Feedback from engagement resulted in the following changes:

- the customer function including early intervention and community empowerment clusters;
- inclusion of place planning and city growth to the overall model, reflecting stakeholder emphasis on the importance of Place
- trade unions being invited to participate in any governance / control boards; and
- elevation of the Chief Social Work Officer status and reporting lines.



Transformation qualities

Audit Scotland's report *Local Government in Scotland: Challenges and Performance 2018* stated that for transformation be successful councils should:

- set priorities - councils cannot transform everything at once;
- conduct robust option appraisals - councils should consider a wide range of options;
- have a clear strategy and a realistic savings target which is properly monitored;
- have proportionate governance structures; and
- assess the impact on equality of access and opportunity and whether change may have a disproportionate impact on more vulnerable or poorer communities or individuals.

It further noted that transformation needs effective leadership from councillors and senior management.

With these qualities in mind, we consider that the Council has a robust and proportionate approach to transitioning to the TOM and its objectives.



Our view – Target Operating Model

It is clear that local authorities need to make fundamental changes in order to meet today's funding challenges as well as meeting the customer demands of the future. We consider that the TOM is bold, forward looking and wide ranging. By 'anchoring' the TOM around LOIP delivery the Council is focussed on better outcomes for the City, but has designed a model which is intended to be more efficient, more customer focussed and with better visibility of information which can be used to improve outcomes.

The change is significant but we consider that it is being managed methodically and with appropriate governance including through the STC. The governance arrangements require to be kept under review as TOM is implemented. A phased approach to implementation is also welcome. The governance review was thorough and robust, with a positive evolution of the Council's overall governance framework.

Audit dimensions

Governance and transparency (continued)

Transparency



Transparency is an important aspect of good governance and increasingly 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 have observed instances of robust debate over any suggestion to 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.

The Council also demonstrates transparency by:

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

Fraud risk management

The fraud, bribery and corruption policy was updated during the year, in particular to ensure that a balanced, case by case approach is taken in respect of potential Council Tax benefit investigations which may arise but not be the fault of the tenant. We reported positively to Audit Scotland on the Council’s participation in the National Fraud Initiative, which is a key part of the Council’s response to fraud risk.

Internal controls and risk management

In our previous reports to those charged with governance during 2017-18 we have reported broadly satisfactory conclusions in respect of those key internal controls which were tested.

We highlighted four recommendations related to general IT controls to enhance arrangements in respect of super-user access in particular. We also recommended enhanced arrangements in respect of the complex and innovative arrangements the Council has entered into.

An update on the risk and assurance improvement project was presented to the ARSC in November 2017 and includes relevant actions.

Local Scrutiny Plan

The Local Scrutiny Plan (‘LSP’) sets out the planned scrutiny activity at the Council during 2017-18. The plan is based on a shared risk assessment undertaken by the Local Area Network (‘LAN’), comprising representatives from scrutiny bodies which engage with the Council. The shared risk assessment process draws on a range of evidence with the aim of determining the scrutiny activity required.

For 2017-18 there was no additional scrutiny required by external audit. Whilst there were positive views of the Health and Social Care Partnership and the progress being made, scrutiny partners continued to monitor progress against the issued action plans.

The 2018-19 LSP was presented to the June 2018 ARSC.




Governance and transparency (continued)


Approach to Cyber Resilience and GDPR compliance

In line with Audit Scotland guidance, we have specifically considered this area, being a key focus for all organisations given the May 2018 effective date of the new General Data Protection Regulations (“GDPR”).

We note that the Council developed a Data Governance Standard in support of compliance with GDPR.

A new information security team has been established, comprising eight staff members. Cyber risk is recorded on the corporate risk register together with relevant controls and monitoring arrangements.

 In a positive development, the Council has achieved Cyber Essentials Plus compliance and also reviews CIS Critical Security Controls for Effective Cyber Defence to consider and report on current cyber capability. This is good practice and uncommon in the sector.

 Control monitoring is generally assumption based rather than informed by specific testing. We concur with development areas identified by management, specifically in respect of progress to be made on data handling, classification and loss prevention as well as the opportunity to prepare an update report to the ARSC and enable a “deep dive” into risk areas.

Best Value focus area: leadership, governance and scrutiny

Leadership

We consider that Aberdeen City Council exhibits strong member and officer leadership. The Labour and Conservative Alliance Group forms the administration and set out its collective vision and priorities in a Policy Document in August 2017. This, together with CPP working and stakeholder involvement, informed the LOIP objectives which are the basis of the Council's strategy. In response, officers proposed transition to the TOM, which is designed to achieve sufficient savings to enable delivery of the LOIP.

The Council administration has an effective majority of one, which gives rise to a high degree of challenge and scrutiny within all aspects of Council business. While the proposed TOM was supported by the administration and approved in line with the working majority, we can see that members have now accepted the model as the approved structure of the Council. It remains the subject of ongoing scrutiny by all members regardless of political affiliation.

Both members and officers have a clear focus on delivery of the LOIP, economic development and on ‘Place’.

As part of transition to the TOM, newly appointed Directors are designing a Visible Leadership programme which includes staff and stakeholder engagement, a CMT blog which presents a united ‘tone from the top’ and ambition to use more flexible engagement methods.

A leadership strategy programme has been developed along with a training needs assessment for members and induction programme. The leadership capability framework assessment process has been developed to align the skills and knowledge of leaders with the Council's requirements. New Directors and Chief Officers have set objectives aligned to the delivery of the vision and priorities. Progress is captured via a single co-ordinated process.

The scale of change at the Council requires significant cultural shift, particularly in respect of digital innovation in service delivery and ways of working. Officers recognise this and are responding to this challenge appropriately.

Governance and transparency (continued)

Our view – governance and transparency

We attended a number of meetings of the ARSC and STC during 2017-18 at which we observed member / officer relations, scrutiny and challenge.

The Leadership has clear objectives, focussing on outcomes which are summarised in the LOIP. Service plans and other arrangements are designed to align with the LOIP, which is also based on stakeholder engagement – through the CPP and the administration’s Policy Document. Together this results in a clear strategic direction which is consistently pursued by members and officers.

Substantial changes have been made to the governance framework which underpins effective scrutiny. We consider that alignment to the transitional operating structure is best practice, together with the ongoing review. The governance review was thorough and robust.

It is evident that members have been closely involved in the design of the revised structure and influenced it in order to be satisfied that they are able to discharge their duties, as have staff and stakeholders.

The Council has a narrow administration majority and this inherently contributes to the level of scrutiny from all sides. We consider that this, while generally effective, has on occasions been detrimental to the efficient conduct of meetings and consideration of matters presented by officers. An example being high numbers of motions tabled on the day of meetings across agenda items.

Overall, 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. Member challenge is balanced by an appropriate degree of officer recognition.

The scale of changes associated with transition to the TOM is significant and has associated cultural challenges. We consider that officers are aware of and are responding to those challenges, although they remain a risk.

Value for Money

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

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 ALEOs.

This was updated during 2017-18 at the November 2017 meeting of the ARSC to include details in respect of assurance hubs, formed to monitor contracts and performance outcomes of ALEOs.

A report of the first meetings of the ALEO assurance hubs was also presented which included:

- details of the assurance hubs consideration and assessment in respect of selected ALEOs;
- details of individual ALEOs approach to financial management, governance, legal, risk and transparency matters; and
- an overall risk rating for each ALEO assessed.

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.

Major capital projects - Value for Money

Aberdeen Art Gallery

The Aberdeen Art Gallery was closed in 2015 for redevelopment works, expected to cost £30 million. The Art Gallery, Cowdray Hall and Memorial Hall are being transformed through significant investment in the fabric of the building, new exhibition and display galleries, and improved facilities for visitors.

The project was initially delayed by six weeks by the uncovering of a mediaeval cemetery from the 13th century. However, due to project management issues, it was further delayed in during the year. The redevelopment is currently experiencing cost overruns. We note that the reasons for the delay and the actions taken to progress the redevelopment were presented to the Finance, Policy and Resources committee on 6 December 2017 and publicly reported.

Officers identified improvement opportunities in management of the project and members instructed internal audit to include the Aberdeen Art Gallery within a planned audit of capital governance.

Marischal Square development

The significant project constructed in partnership with Muse and Aviva was completed in November 2017. On completion the Council entered into a 35 year head lease and arrangement for the sub-letting of office space. The development also includes a hotel, which is operated under a management agreement. This is a relatively innovative and complex arrangement which was subject to previous narrative from the appointed auditor in respect of the decision making process.

The hotel occupancy has been steadily improving since it opened and a number of office and commercial space tenants have entered into lease arrangements. Both aspects are monitored by management and have been subject to reporting to members.

In forming the underlying agreements, we consider that the Council took steps to mitigate project and financial risk by sharing risks and rewards with partners in a way that encourages Value for Money.

We recognised that the complexity of these arrangements led to adjustments in the financial statements and requires close ongoing management oversight. Our report to those charged with governance dated 22 June 2018 includes a recommendation in this respect.

Value for Money (continued)

Best Value focus area: improvement

Improvement

The Council identifies improvement needs by engaging with partners, including communities, and through strategic assessment by studying: past and current trends; emerging issues; and areas of concern arising from reports. Use of the Aberdeen City Voice also provides insight from stakeholders while members have a key role in representing their communities. These needs form the basis of the LOIP.

Three localities are identified, through community planning arrangements, as areas of focus and monitoring is in place to track actions and progress against both the LOIP and the three locality plans.

The Council has led the adoption, across the CPP of 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.

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 is the basis for the development of the TOM.

The Council's digital strategy is aimed at making it easier for employees to perform their responsibilities, give customers better choice in how they get information and use services, ensure that information is shared and to use data to make better decisions. It is therefore a key enabler to delivery of the LOIP and TOM.

Improvement plans

Service Improvement Plans have been developed during 2017-18 with performance subsequently reported to Committee. Both the Plans and the Performance reporting identifies specific change required in order to deliver improvement.

Scrutiny of the Annual Outcome Improvement Report and regular Improvement Tracker reports has led to new initiatives being started, for example projects around inclusive economic growth in localities.

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 2016-17 annual outcome improvement report was the first prepared since introduction of the current LOIP and the 2017-18 report is due to be published in September 2018. It includes a number of aspects of good practice, including:

- 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 objective;
- focus on outcome measures (rather than inputs);
- details of ongoing improvement projects;
- case studies; and
- priority next steps for the year ahead.

Statutory performance indicator reporting and the Council's participation in the LGBF also provide transparent opportunity for stakeholders to consider improvement.

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

The Council's Service Improvement Plans include the LGBF measures and are routinely reported to members through the Council's established committee structures.



Audit dimensions

Value for Money (continued)

Performance reporting



We consider that the Council has a transparent approach to reporting progress on LOIP objectives. In addition to the annual report, a new bulletin was recently published (July 2018) which summarises key recent activities and both positive results and areas which remain a challenge. This demonstrated a fair and balanced approach to reporting.

The Council makes the LGBF benchmarking available from a link on its website.

Statutory performance indicator performance is published together with details of targets and historical trend information where available. Detailed information is provided but there is no simple overview to highlight key trends or focus areas.

Our analysis of performance indicators indicates a general trend of improvement in the majority of cases, with some instances of declining performance (which are addressed by management commentary).

Our view – value for money and improvement

Building upon the clear vision and objectives which leadership have established in the LOIP, improvement actions, responsibility and monitoring arrangements are well established to support delivery.

There is a strong focus on partnership working, both to achieve value for money and also to contribute to delivery of improvement objectives.

Progress reporting is transparent and includes targets, trend analysis and is provided in full detail and summary level to enhance stakeholder engagement.

Given the nature of LOIP annual reporting and the Council's digital transformation ambition, there is some scope to enhance the way in which improvement objectives, actual performance and stakeholder feedback and priorities are considered. While this is currently transparent and not out of line with other local authorities, these aspects could be more interactive and encourage stakeholder participation by being provided in a more modern and technologically enabled way.

Overall, we consider that members and officers are committed to working collaboratively with partners in order to deliver value for money and improvement. There is transparent monitoring and reporting against objectives.



Appendices

Appendix one

Action plan

The action plan summarises specific recommendations arising from our work, together with related risks and management’s responses. We present the identified finding related to the four audit dimensions set out in this report.

Priority rating for recommendation

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.

Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation	Agreed management actions
<p>1. Citizen engagement in budget setting (page five)</p> <p><i>Audit dimensions: financial management and financial sustainability</i></p>		<p>Grade three</p>
<p>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.</p> <p>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.</p> <p>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.</p> <p>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.</p>	<p>At it’s 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.</p> <p>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:</p> <ul style="list-style-type: none"> - 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. <p>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).</p>	<p>Agreed.</p> <p>Implementation date: November 2018</p> <p>Responsible officer: Chief Officer (Business Intelligence and Performance Management)</p>

Appendix two

Grant claims and WGA return

We set out below the status of the “other reporting” responsibilities of our audit appointment. We will update this slide following completion of our procedures and issue a final version of this report.

RETURN	DESCRIPTION	CONCLUSION
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.	We provided an unqualified opinion on 28 September 2018.
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.	We have conducted testing in respect of the NDR return and will report our conclusions in advance of the reporting deadline of 6 October 2018.
Housing Benefits (“HB”)	The HB subsidy scheme is the means by which local authorities claim subsidy from the Department for Work and Pensions (“DWP”) towards the cost of paying HB in their local areas. Claimants benefits either by direct application to the authority or by applying simultaneously for income support/jobseekers allowance and HB to the DWP. Eligibility for, and the amount of, HB is determined in all cases solely by the local authority. Monthly instalments of subsidy are made by the DWP on the basis of authorities’ estimates in March and August. Final subsidy claims are made on claim form MPF720B which requires to be certified by the external auditor.	We have conducted testing in respect of the HB audit and will report our conclusions in advance of the reporting deadline of 30 November 2018.
Education Maintenance Allowance (“EMA”)	EMA is a means tested weekly allowance payable to young people from low income families to encourage them to remain in education beyond the compulsory school leaving age. Local authorities manage the delivery of the EMA programme in respect of schools, home education, and all other learning other than college provision. EMA payments comprise a weekly allowance of £30 and are made by local authorities to eligible young people. The Scottish Government reimburses the costs incurred by authorities through monthly payments of grant. An allowance for the costs of administering the programme is also paid by the Scottish Government.	We did not identify any exceptions in our testing and issued an unqualified opinion on the EMA return. We identified some cut-off errors in preparation of the draft return which were updated by management.



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