Perth and Kinross Council

Report to the Audit Committee

(Report No. 20/35)

Audit strategy

Year ending 31 March 2020

—

For Audit Committee consideration on 5 February 2020 (DRAFT)

Introduction

About this report

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

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

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

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

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

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Michael Wilkie, who is the engagement leader for our services to Perth and Kinross Council, telephone 0141 300 5890 or email to michael.wilkie@kpmg.co.uk, who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or by emailing hugh.harvie@kpmg.co.uk.

We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Diane McGiffen, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Introduction (continued)

To the Audit Committee of Perth and Kinross Council

2019-20 is the fourth year of our external audit appointment to Perth and Kinross Council (“the Council”) and its group (“the Group”), having been appointed by the Accounts Commission as auditor of the Council under the Local Government (Scotland) Act 1973 (“the Act”). The period of appointment is 2016-17 to 2020-21, inclusive. Our appointment includes the audit of the Perth and Kinross Council Charitable Trusts.

Our planned work in 2019-20 will include:

— an audit of the financial statements and provision of an opinion on whether the financial statements:

  — give a true and fair view in accordance with the applicable law and the Code of Practice on Local Council Accounting in the United Kingdom (“the 2019-20 Code”) of the state of the affairs of the Council as at 31 March 2020 and of the income and expenditure of the Council for the year then ended; and

  — have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the European Union, as interpreted and adapted by the 2019-20 Code, the requirements of the Local Government (Scotland) Act 1973, The Local Council Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003;

— participation in the shared risk assessment as part of the local area network;

— completion of returns to Audit Scotland and grant claims;

— a review and assessment of the Council’s governance arrangements and review of the governance statement;

— a review of National Fraud Initiative arrangements;

— a review of arrangements for preparing and publishing statutory performance information; and

— contributing to the audit of wider scope and Best Value through performance of risk assessed work, and the follow up of recommendations made in the Best Value Assurance Report in respect of the Council.

How we deliver audit quality

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.

We define ‘audit quality’ as being the outcome when audits are:

— **executed consistently**, in line with the requirements and intent of **applicable professional standards** within a **strong system of quality controls**; and

— all of our related activities are undertaken in an environment of the outmost level of **objectivity**, **independence**, **ethics** and **integrity**.

Adding value

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

— our experience, which brings insight and challenge;

— our tools and approach, which contribute to a world class audit; and

— transparency and efficiency, which improves value for money.

Introduction (continued)

Our team

The team has significant experience in the audit of local authorities, and is supported by specialists, all of whom work with a variety of local government and public sector bodies. All members of the team are part of our wider local government network. Senior members of the audit team and their relevant contact details are provided on the back page of this report. The senior team involved in the external audit benefits from continuity with Michael Wilkie continuing as the engagement leader, and Christopher Windeatt taking up the role of engagement manager.

Our work will be completed in four phases from December 2019 to September 2020. Our key deliverables are this audit strategy document, an interim report and an annual audit report.

Acknowledgements

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

Headlines

Materiality

Group materiality for planning purposes is based on last year's gross expenditure and is set at £9.8 million, which equates to 2% of gross expenditure. We will review gross expenditure on receipt of draft accounts for 2019-20, and assess whether we are required to updated this calculated group materiality.

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

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Audit risks

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

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

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

— retirement benefits obligations; and

— valuation of property and investment property.

The risk with less likelihood of giving rise to a material error, but which is nevertheless worthy of audit understanding, relates to capital expenditure, which is included as an other focus area. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions. We also consider that any large capital project inherently brings a fraud risk to an entity, which we consider appropriate for the Council.

Pages eight - 13

Financial statement audit

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

Wider scope

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

— financial sustainability;

— financial management;

— governance and transparency; and

— value for money.

We test wider scope areas where there are identified risks. We consider that there are wider scope risks in respect of demand pressures and the transformation programme. As part of our year four Best Value work, we will consider Performance & Outcomes, and Partnership workings & empowering communities topics. While the above risks are a common theme across local authorities, we will focus on the specific circumstances of Perth and Kinross which includes a follow up of the Best Value Assurance Report ("BVAR") recommendations. We have not identified wider scope financial statement level risks.

Pages 16 - 22

Headlines (continued)

Best Value

In June 2016, the Accounts Commission formally agreed the overall framework for the approach to auditing Best Value in councils. The framework introduced a five year approach to Best Value. 2019-20 represents year four of the Best Value plan for the Council during which we shall complete a follow up of the Best Value Assurance Report ("BVAR") recommendations and will consider Performance & Outcomes and Partnership workings & empowering communities topics as part of phased consideration over the term of appointment.

Pages 16 - 22 provide more detail on our work over Best Value and wider scope areas.

Group audit

In addition to the Council, we deem the Perth and Kinross Integration Joint Board (''IJB'') to be significant in the context of the group audit. KPMG is the auditor of the IJB. Further details regarding our approach can be found at page 15.

Page 15 and Appendix six

Independence

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

— at the planning stage; and

— whenever significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place.

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

Total fees charged by us for the period ended 31 March 2019 were communicated in our Annual Audit Report issued in September 2019. Total fees for 2019-20 will be presented in our Annual Audit Report issued on completion of the audit. The proposed audit fee for 2019-20 is £284k (inc VAT) as explained in **Appendix five**.

Quality

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

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

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

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

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

Financial statements audit planning

Materiality

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

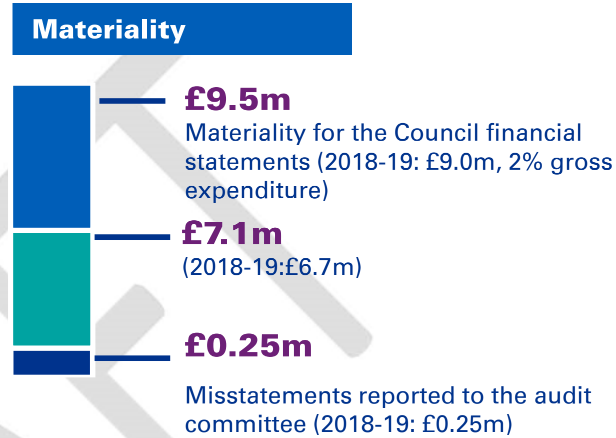
Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

In respect of the Council's standalone accounts, materiality for planning purposes has been set at £9.5 million, and at £9.8 million for the group accounts, which in both cases equates to 2% percent of an adjusted 2018-19 gross expenditure. We adjusted gross expenditure for plant and property revaluations, to 'smooth' the impact of these movements by taking a five year rolling average of revaluation movements in line with the Council's five year revaluation policy. In addition, expenditure relating to the IJB is removed from our calculation, as income and expenditure is grossed up for presentational purposes within the consolidated income and expenditure account.

We design our procedures to detect errors in specific accounts at a lower level of precision, which is set at 75% of materiality. For the group, this equates to £7.35 million, and £7.1 million for the Council.

Charitable funds Materiality

In respect of the Charitable funds, materiality for planning purposes has been set at £47,000 (2018-19: £157,000), performance materiality set at £35,000 (2018-19: £117,750) and reporting threshold was set at £2,300 (2018-19: £7,500). The reduction in materiality is as a result of changes to KPMG's internal acceptable ranges, and not as a result of the statutory audit in 2018-19.



Reporting to the audit committee

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

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

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

Significant risks

Significant risks and other focus areas

Risk assessment: Our planning work takes place during December 2019 to February 2020. This involves: risk assessment; determining the materiality level; and issuing this audit plan to communicate our audit strategy. We use our knowledge of the Council, discussions with management and review of Council papers to identify areas of risk and audit focus categorised into financial risks and wider dimension risks as set out in the Code.

Significant audit risk

The risk

Fraud risk from management override of controls

Why

A presumed risk we are required to consider covers fraud risk from management override of control.

Management is typically in a position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk.

This is a presumed risk per ISA 240.

Audit approach

- Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to the audit of the Council.
- We will consider the level of oversight of finances by management which provides additional review of potential material errors caused by management override of controls.
- In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.

Significant risks (continued)

Significant audit risk

The risk

Fraud risk from income recognition and expenditure

Why

Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by PN10, issued by the FRC, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

Income

We consider that the Council's significant income streams, which include taxation and non-specific grant income are free of management judgement or estimation. We do not consider recognition of the remaining income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised, and these are not likely to be materially inappropriate. We did not identify any such errors or manipulation in the prior year. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area beyond our standard fraud procedures.

Expenditure

We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs, financing and investment expenditure, or depreciation. These costs are routine in nature and not at risk of manipulation. This relates to a significant proportion of council expenditure. As other operating expenditure is unlikely to be material, we also rebut the assumed risk in respect of this account.

We have not rebutted the assumed risk in respect of the remaining expenditure of £210 million.

Audit approach

In respect of material income:

— non-ringfenced government grants are agreed in advance of the year, with any changes requiring government approval. There is no estimation or judgement in recognising this stream of income and we do not regard the risk of fraud to be significant. We will agree significant grants to supporting documentation.

— the other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing incomes). These incomes are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as income. We will perform tests of detail and substantive analytical procedures in our audit of these sources of income.

We will include procedures to:

— compare the outturn with the in year budget monitoring, considering variances;

— test controls specific to confirm correct capital vs revenue allocation;

— test expenditure cut-off including a search for unrecorded liabilities;

— test transactions focusing on the areas of greatest risk, including debtors, creditors, accruals, prepayments and provisions to challenge completeness and existence of these balances; and

— review and challenge of management in respect of estimates for evidence of bias.

Significant risks (continued)

Significant audit risk

The risk

Valuation of property and investment property

Why

Assets revalued in the year:

The 2019-20 Code requires that where assets are subject to revaluation, their year-end carrying value should reflect the appropriate fair value at that date. In common with other councils, the Council has adopted a five year rolling revaluation model where all land and buildings are revalued. In 2019-20 council dwellings, industrial and business investment properties, shops, common good properties, other miscellaneous non–operational properties, and assets with significant capital investment will be subject to revaluation and we expect movements to be material.

The Council uses a valuation date of 1 April 2019 for the 31 March 2020 year end, and 1 August 2019 for all investment properties. We consider there to be a risk of material movement between these dates.

Given the quantum of the asset carrying values and the inherent use of assumptions in their valuation, we consider there to be a significant risk of misstatement.

Assets not revalued in the year:

The 2019-20 Code also requires consideration that the carrying amount of assets do not differ materially from the current value at the end of the reporting period. Therefore, we consider there to be a risk in relation to the assets not revalued in the year, as their current value at year end may be materially different.

Audit approach

Assets revalued in the year:

A number of the Council's assets are revalued on an annual basis, including investment properties. In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations. We will test the accounting treatment for assets revalued to challenge whether the accounting treatment is appropriate and consider valuation inputs and assumptions using the approach below.

We will also assess the risk of the valuation changing materially during the year, or between the date of valuation and the year end.

Assessing methodology choice and benchmarking assumptions:

We will review management's assessment of impairment indicators and assess for completeness.

We will utilise our internal specialist to assess the methodology used including testing the underlying data inputs and assessing the assumptions used in comparison to available market information.

We will select a representative sample of revalued assets to agree calculation inputs to supporting evidence, consider in detail the revaluation calculations and challenge the underlying assumptions.

Assets not revalued in the year:

We will review the approach that the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach, including any indicators of impairment.

Significant risks (continued)

Significant audit risk

The risk

Retirement benefit obligations

Why

The net pension liability (£118.5 million as at 31 March 2019, including assets of £787 million) represents a material element of the Council's Balance Sheet. The Council is an admitted body of Tayside Pension Fund, which has its next triennial valuation due 31 March 2020. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.

There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions should be derived on a consistent basis year to year, or updated to reflect any changes.

There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.

Audit approach

Our planned audit approach includes:

Control design:

Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with management's review of assumptions, to calculate the pension obligation.

Benchmarking assumptions:

Challenging, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data.

Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations.

Assessing transparency:

Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions.

Assessing if the disclosures within the financial statements are in accordance with the 2019-20 Code's requirements.

Significant risks (continued)

Significant audit risk	Why	Audit approach
The risk Retirement benefit obligations (continued)	**Guaranteed minimum pensions ("GMP") equalisation** Following a UK High Court judgement on 26 October 2018, the Government published the outcome to its Indexation and equalisation of GMP in public service pension schemes consultation, concluding that the requirement for public service pension schemes to fully price protect the GMP element of individuals' public service pension would be extended to those individuals reaching State Pension Age ("SPA") before 6 April 2021.	We will discuss with management any updates regarding this matter, and how these will impact the audit.

Other focus area

Other focus area

The focus area

Capital expenditure

Why

The Council has a revised ten year £633 million net capital plan, which includes the Cross Tay Link Road, A9/A85 road junction improvement project and Perth City Hall upgrade. The expected net expenditure in 2019-20 is £68.2 million based on the most recent revised budget approved in November 2019.

Due to the significance of this capital investment programme and complexity of some of the projects, we consider there to be a risk of misstatement. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions.

We also consider that any large capital project inherently brings a fraud risk to an entity, which we consider appropriate for the Council.

Audit approach

Our audit approach includes:

Control design:

— Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and income projects.

Control re-performance:

— Comparing the total capital expenditure reported in the financial statements with that reported in reports to those charged with governance.

Tests of detail:

— Use of substantive sampling methods to evaluate the appropriateness of capital or income accounting classification by reference to supporting documentation.

— Assessing a sample of items allocated to income or expenditure to determine whether they are correctly classified.

Other matters

Accounting framework update

The Code of Practice on Local Authority Accounting in the United Kingdom is revised each year, incorporating selected changes to the underlying IFRSs, and key accounting changes include:

- Updates to reflect 2018 IASB Conceptual Framework and provides details of improvements and updates;
- Guidance on the Code's adoption of the amendments to IFRS 9 Financial Instruments relating to prepayment features with negative compensation;
- Updates to reflect the Code clarifications relating to contracts with lender option borrower option clauses;
- New guidance on the group accounts scope clarification for the disclosure requirements with respect to interests in entities within the scope of IFRS 5 Non-current Assets Held for Sale and Discontinued Operations (introduced by the Annual Improvements to IFRSs 2014 to 2016 Cycle);
- Explanation of the Code approach to drafting amendments;
- Removal of references to Carbon Reduction Commitment Scheme following the Scheme closure;
- A new section has been added on the accounting treatment for the apprenticeship levy; and
- Updates for the new voluntary transfers presentation (for Scottish local authorities only) in the movement in reserves statement and expenditure and funding analysis. This includes the treatment within the reserves.

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

These changes are significant, and where the 2019-20 balances will form the comparatives in future accounts, we will consider the Council’s arrangements for complying with the forthcoming changes.

Revision to the Going Concern Standard

In September 2019 the FRC published a revised UK auditing standard for Going Concern ISA UK 570. This responds to recent enforcement cases and well-publicised corporate failures where the most recent auditor's report had not included a material uncertainty on going concern. The revised standard is applicable for periods commencing on or after 15 December 2019, including short periods.

Given the funding, nature and legislation in respect of the Council, we do not anticipate significant changes to the approach of management regarding going concern.

Controls testing

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

In 2018-19 we identified two recommendations in relation to the control environment, and two relating to financial statement audit findings. We will follow-up progress in implementing these recommendations and report any new recommendations arising from our work and report our view of progress. **Appendix three** details our approach across each phase of the audit.

Other matters (continued)

Internal audit

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

— consider the activities of internal audit and any impact on our audit;

— obtain an understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;

— perform a preliminary assessment of the internal audit function when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and

— evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

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

Group audit considerations

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

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

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

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

We also consider that the Council is responsible for approximately 97% of the group’s activities, for which we are responsible for providing an opinion.

Wider scope and Best Value

Approach

We are required to assess and provide conclusions in the Annual Audit Report in respect of four wider scope dimensions: financial sustainability; financial management; governance and transparency; and value for money. We set out below an overview of our approach to wider scope and Best Value requirements of our annual audit. We provide on pages 18 - 22 our risk assessment in respect of these areas. We will provide narrative on these and other areas in the Annual Audit Report where relevant.

Risk assessment

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

In doing so we consider:

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

The LAN brings together local scrutiny representatives in a systematic way to agree a shared risk assessment. Michael Wilkie from KPMG is the LAN lead for the shared risk assessment process for the Council. For 2019-20 there is no additional scrutiny required by external audit.

The shared risk assessment process across Scotland has changed for 2020-21 and no local scrutiny plans are prepared. We use the shared risk assessment process to consider if there are wider scope risks relevant to the Annual Audit Report.

Linkages with other audit work

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

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

Wider scope and Best Value (continued)

Approach (continued)

Identification of significant risks The Code identifies a matter as significant 'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.' If we identify significant wider scope and Best Value risks, we will highlight the risk to the Council and consider the most appropriate audit response in each case, including: Considering the results of work by the Council, inspectorates and other review agencies. Carrying out local risk-based work to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.
Concluding on wider scope and Best Value At the conclusion of the wider scope and Best Value audit we will consider the results of the work undertaken and assess the assurance obtained against each of the wider scope audit dimensions and Best Value, regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources. If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our wider scope and Best Value conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.
Reporting We have completed our initial wider scope and Best Value risk assessment and have not identified any significant risks. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report. We will report on the results of the wider scope and Best Value audit through our Annual Audit Report. This will summarise any specific matters arising, and the basis for our overall conclusion.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
Financial sustainability	**Financial sustainability** looks forward to the medium and longer term to consider whether the Council is planning effectively to continue to deliver its services or the way in which they should be delivered. **Specific identified focus area:** ***Demand pressures*** The Council faces growing demand pressures, both from the increasing elderly population and increasing number of young people living in Perth and Kinross. Each subset brings unique challenges to services, for healthcare, social care and education. This comes at a time when the workforce is decreasing, which adds pressure to ongoing workforce planning. There are a number of "hard to fill" posts for teachers in rural areas and social care workers, which add to the pressure on the growing demand for service provision. We consider there to be a resultant risk to the sustainability of delivering services with increasing demand and a decreasing workforce.	— We will consider the Council's long term financial plans and its ability to adapt to the changing landscape in local government funding. This will involve consideration of the 2020-21 budget and longer term financial plans from 2021-22 and beyond. — We will monitor the Council's key performance indicators and performance reporting, to identify any movements requiring further investigation. We will consider any overspends against budget where demand has caused a significant strain on funding, as well as underspends against budget due to staff slippages where roles have been hard to fill.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
Financial management	Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively. **Specific identified focus area:** ***Medium and long term planning*** The Council has historically considered the medium-term financial plan in October for the proceeding five financial years. The uncertainty generated by Brexit and the General Election will result in the MTFP being presented as part of the Council's budget in late February. Owing to the wide range in the estimated savings requirements identified in the previous year's MTFP, we consider this to be continue to be an area of focus. ***Transformation programme*** The Council has an ambitious five year transformation programme from 2015-20. The programme provides a framework for innovation, creativity, flexibility and greater entrepreneurship to meet future challenges. The transformation programme supports identifying savings through redesigning service delivery to maximise efficiencies and support change We consider there to be a risk around delivering the level of planned savings over the next five years, and what impact this may have on service delivery.	— We will consider how the Council's transformation programme is progressing and any potential impact on financial and service planning. — We will review the financial results to 31 March 2020 compared to budget to consider if there are indications that savings are not being delivered as planned. — We will consider the Council's approach to setting a balanced budget for 2020-21, and considering implications and delivery of the budget in our Annual Audit Report.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
Financial management (continued)	**Specific identified focus area (continued):** Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies. ***EU withdrawal*** The Bill covering the UK's withdrawal from the European Union was passed in January 2020, effective 31 January 2020. There is now a transition period in place until 31 December 20202 which will require management to consider the impact on Council operations. ***Partnership working and empowering communities*** As part of our year four Best Value work, we will consider Partnership working and empowering communities.	— We will consider how the Council reports its funding arrangements, responsibilities and performance through the audit of its management commentary and financial statements. — We will remain alert to the impact of the EU withdrawal on the Council's operations and the environment within which it operates as part of our risk assessment procedures and wider scope responsibilities. — We will consider the appropriateness of management's risk assessment and planning for both matters with reference to guidance provided by Audit Scotland. — We will consider how the Council works with other bodies and local communities to effectively manage its finances.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area

Governance and transparency

Why

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

Specific identified focus area:

Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies.

Fraud and corruption in procurement

Illicit rebates, kickbacks and false invoicing are potential risks across the public sector. For all bodies other than those where the full wider scope is not judged to be appropriate, auditors should assess the risk of fraud and corruption in the procurement function.

Audit approach

- We will consider the effectiveness of scrutiny and governance arrangements, by evaluating the challenge and transparency of the reporting of financial and performance information.
- We will update our understanding of the controls and processes around capturing officers' and members' interests.
- We will obtain and review minutes of meetings of the various committees to assess the level of transparency, and consider the Council's plan for enhancing transparency.
- We will assess whether the risk of procurement fraud is acknowledged on the body's risk register, and whether reasonable policies are in place and enforced to prevent unacceptable instances taking place as well as systems to ensure all acceptable instances are recorded in a register.
- We will assess whether there are controls around the procurement process, including segregation of duties, and if these are adequate, followed and enforced.
- We will assess whether staff involved in procurement-related decisions are adequately trained and that the Council has arrangements in place to encourage and protect whistle-blowers.
- Ensure that internal audit coverage of procurement systems is adequate and proportionate to the risks faced by the body.

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
Value for money	**Value for money** is concerned with how effectively resources are used to provide services. **Specific identified focus area:** **Performance and outcomes** As part of our year four Best value work, we will consider Performance and outcomes	— We will specifically consider statutory performance indicators, performance reporting and arrangements to provide for continuous improvement in respect of the Performance and outcomes audit programme.

Appendices

Mandated communications with the Audit Committee

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

Confirmation of independence

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

Professional ethical standards require us to provide to you at the 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 APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

— Instilling professional values

— Communications

— Internal accountability

— Internal accountability

— Risk management

— Independent reviews

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

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

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

Independence and objectivity considerations relating to other matters

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

Confirmation of audit independence

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

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

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

Yours faithfully

KPMG LLP

Appendix three

Timeline

2019 **2020**

Communication

January Audit planning meeting

February
Interim onsite audit work, business update and controls testing

May
Presentation of Interim Audit Report to the Audit Committee where we communicate significant control deficiencies

Statutory inspection period

August
Closing meeting with management to discuss auditors' report and any outstanding deliverables

September
Submission of WGA

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

Audit workflow

December
Planning work commences

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

February
Presentation of Audit strategy to the Audit Committee

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

June
Final audit fieldwork commences

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

September
Financial statements signed by the Council and KPMG, and presentation of Annual Audit Report to the Audit Committee, where we communicate audit misstatements

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

Audit outputs

Output	Description	Report date
Audit strategy	Our strategy for the external audit of the Council and its group, including significant risk and audit focus areas.	By 5 February 2020
Interim audit report	We summarise our findings from our interim audit work.	By 31 May 2020
Independent auditor's report	Our opinion on the Council's financial statements.	By 30 September 2020
Annual audit report	We summarise our findings from our work during the year.	By 1 October 2020
NFI report	We report on the Council's actions to investigate and follow-up NFI matches.	By 28 February 2020
Whole of Government Accounts	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 28 September 2020
Audit reports on other returns	We will report on the following returns: – Current issues return. – Technical database. – Fraud returns.	 January, March, July and October 2020 May and August 2020 December 2019, February, May, and August 2020
Grant claim audits	We provide an opinion on: – Education maintenance allowance, housing benefit, and non-domestic rates.	To submit by: July 2020, November 2020 and August 2020

Fees

Audit Scotland has completed a review of funding and fee setting arrangements for 2019-20. An expected fee is calculated by Audit Scotland to each entity within its remit. This expected fee is made up of four elements:

— Auditor remuneration

— Pooled costs

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

— Contribution to Audit Scotland costs

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

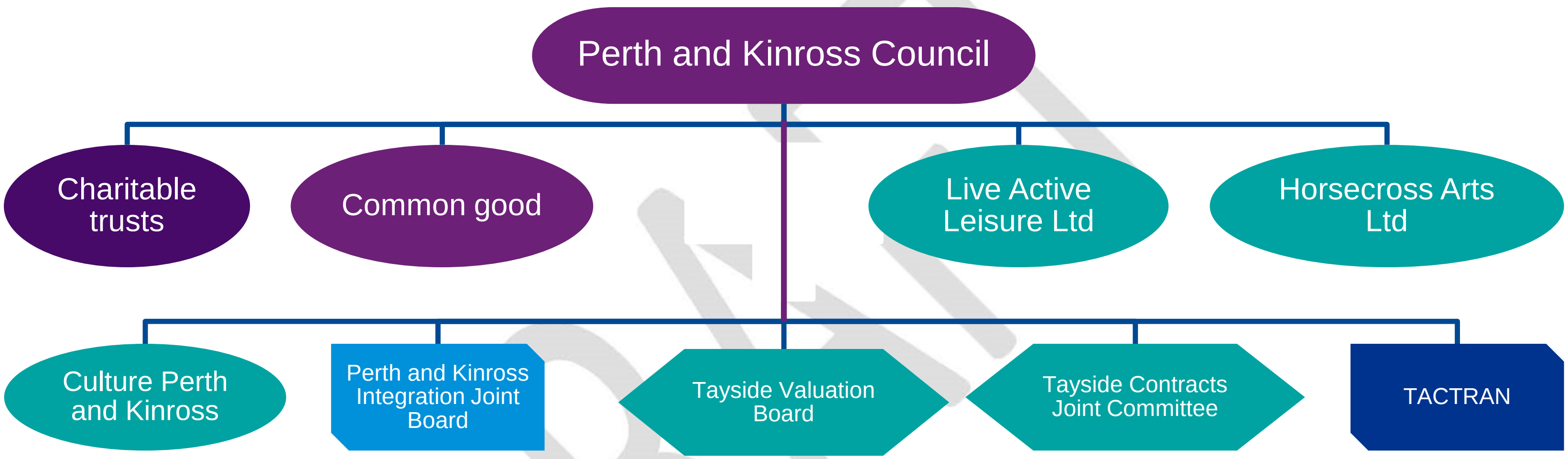
We are in discussions with management regarding the auditor remuneration for 2019-20. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

As part of our discussion with management, we highlighted the additional audit work to be carried out in relation to IFRS 16 and the Best value recommendations follow up. We will discuss any proposed changes to the fee when we plan to carry out our work.

	2019-20 £ (incl. VAT)
Auditor remuneration	167,700
Pooled costs	16,210
Contribution to PABV	86,660
Contribution to Audit Scotland costs	10,020
Total Council audit fee	280,590
Audit of Perth and Kinross Council Charitable Funds	3,500
Total fee	**284,090**

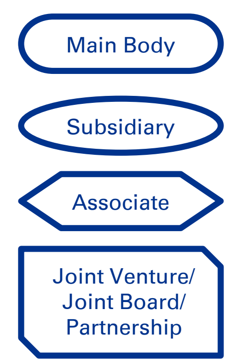
Group financial statements

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



Key

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



Responsibility in relation to fraud

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

Management responsibilities

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

KPMG's identification of fraud risk factors

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

KPMG's response to identified fraud risk factors

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

KPMG's response to identified fraud risk factors

- Whilst we consider the risk of fraud at the financial statement level to be low for the Council, we will monitor the following areas throughout the year and adapt our audit approach accordingly:
- Income recognition;
- Cash;
- Procurement;
- Management control override; and
- Assessment of the impact of identified fraud.

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

Responsibilities of management

Financial Statements

Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:

- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation;
- maintaining accounting records and working papers that have been prepared to an acceptable professional standard and that support their financial statements and related reports disclosures;
- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;
- maintaining proper accounting records; and
- preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer- term financial sustainability of the body.

Further, it is the responsibility of management of an audited body, with the oversight of those charged with governance, to communicate relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. The relevant information should be communicated clearly and concisely.

Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.

Audited bodies are responsible for providing the auditor with access to all information relevant to the preparation of the financial statements, additional information requested and unrestricted access to persons within the entity.

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

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

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

Responsibilities of auditors

Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, ISAs, professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

- undertake statutory duties, and comply with professional engagement and ethical standards;
- provide an opinion on audited bodies' financial statements and, where appropriate, the regularity of transactions;
- review and report on, as appropriate, other information such as annual governance statements, management commentaries, remuneration reports, grant claims and whole of government returns;
- notify the Auditor General when circumstances indicate that a statutory report may be required;
- participate in arrangements to cooperate and coordinate with other scrutiny bodies (local government sector only);
- demonstrate compliance with the wider public audit scope by reviewing and providing judgements and conclusions on the audited bodies:
  - effectiveness of performance management arrangements in driving economy, efficiency and effectiveness in the use of public money and assets;
  - suitability and effectiveness of corporate governance arrangements; and
  - financial position and arrangements for securing financial sustainability.

Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work in accordance with the Code, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

This report communicates how we plan to identify, assess and obtain sufficient appropriate evidence regarding the risks of material misstatement of the financial statements due to fraud and to implement appropriate responses to fraud or suspected fraud identified during the audit.

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

Responsibilities of auditors
General principles
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
Independent
When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the FRC ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour. Our independence confirmation letter (**Appendix two**) discloses matters relating to our independence and objectivity including any relationships that may bear on the firm's independence and the integrity and objectivity of the audit engagement partner and audit staff. We confirm that, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and that the objectivity of the Director and audit staff is not impaired.
Proportionate and risk based
Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self - evaluation evidence when assessing and identifying audit risk.
Quality focused
Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

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

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

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