

# Perth and Kinross Council

Audit strategy

Year ending 31 March 2018

For Audit Committee consideration on 28 March 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 Perth and Kinross Council and is made available to Audit Scotland and the Controller of Audit (together "the Beneficiaries"). This report has not been designed to be of benefit to anyone except the Beneficiaries. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the Beneficiaries alone. Nothing in this report constitutes an opinion on a valuation or legal advice.

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

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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 Perth and Kinross Council, telephone 0131 527 6673 email: [andrew.shaw@kpmg.co.uk](mailto: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](mailto:hugh.harvie@kpmg.co.uk). We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Fiona Kordiak, Audit Scotland, 4<sup>th</sup> Floor, 102 West Port, Edinburgh, EH3 9DN.

# Introduction

2017-18 is the second year of our external audit appointment to Perth and Kinross Council ("the Council"), 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 2017-18 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 2017-18 Code") of the state of the affairs of the Council as at 31 March 2018 and of the income and expenditure of the Council for the year then ended; and
  - have been prepared in accordance with IFRS as adopted by the European Union, as interpreted and adapted by the 2017-18 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.

## Adding value

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

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

## Our team

The senior team involved in the external audit benefits from continuity in engagement leader and engagement manager. The team has significant experience in the audit of local authorities. It 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 are set out below and relevant contact details are provided on the back page of this report.



**Andy Shaw**

Engagement leader – Audit director

**Fiona Bennett**

Engagement Manager



**Chris Windeatt**

Engagement In-charge

Our work will be completed in four phases from December 2017 to September 2018. 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 expenditure and is set at £9.0 million, which equates to 2% of gross cost of services expenditure. We will review the level of materiality on receipt of draft accounts for 2017-18.

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 ISA 240);
- fraud risk from revenue recognition (assumed risk per ISA 240);
- pension liability; and
- revaluation of property, plant and equipment.

We will report on each of these areas in our annual audit report.

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

Pages seven to 11



## Financial statement audit

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



There are no significant changes to the Code of Practice on Local Council Accounting ("the Code") in 2017-18, which means for this year there is consistency in terms of accounting standards the Council needs to comply.



## Wider scope

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

- financial sustainability;
- financial management;
- governance and transparency; and
- value for money.

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

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# 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. 2017-18 represents year two of the Best Value plan for the Council during which we will consider Improvement and Leadership.

**Pages 13 to 19** 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 Health Integration Joint Board ("IJB") to be significant in the context of the group audit. KPMG is the auditor of the IJB.

## Appendix six

## Independence

In accordance with ISA 260 'Communication of audit matters with those charged with governance' and the APB 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 2017 were communicated in our Annual Audit Report issued in September 2017. Total fees for 2017-18 will be presented in our Annual Audit Report issued on completion of the audit. The proposed audit fee for 2017-18 is £158,240 (inc VAT).

## 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 Andy Shaw 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 KPIs and quality results.

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

## Regularity

We consider the presumed risk of fraud and error over income and expenditure recognition for all public sector bodies, in line with *Practice Note 10 Audit of financial statements of public sector bodies in the United Kingdom*. As such, we consider there to be a significant risk over fees and charges income, see **page eight**. We do not consider there to be any specific risks over expenditure recognition, and perform controls and substantive testing to support our opinion.

# 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.

For the Council, materiality for planning purposes has been set at £8.7 million for the Council's standalone accounts, and at £9.0 million for the group accounts, which in both cases equates to 2% percent of gross expenditure. We adjust 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 addition, the Integration Joint Board expenditure is removed from our calculation, as income and expenditure is grossed up for presentational purposes within the consolidated income and expenditure account.

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

### Reporting to the audit committee

Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) 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, 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.



# Financial statements audit planning (continued)



## Significant risks and other focus areas

**Risk assessment:** Our planning work takes place during December 2017 to February 2018. 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 risk	Why	Audit approach
<b>Financial statement risk</b>		
Fraud risk from management override of controls	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.	<ul style="list-style-type: none"> <li>— 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.</li> <li>— Strong oversight of finances by management provides additional review of potential material errors caused by management override of controls.</li> <li>— 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.</li> </ul>

# Financial statements audit planning (continued)



## Significant risks (continued)

Significant risk	Why	Audit approach
<b>Financial statement risk</b>		
Fraud risk from income revenue recognition	<p>International Standards on Auditing require us to consider if the fraud risk from income recognition is significant. We consider only the fraud risk from recognition of 'fees and charges' to be significant. Fees and charges income relates to service income from various streams where we consider there to be judgement in recognition.</p> <p>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. We therefore rebut this risk (other than for "fees and charges income") and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.</p>	<ul style="list-style-type: none"> <li>— 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.</li> <li>— The other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing revenues). These revenues are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as revenue. We will perform tests of detail and substantive analytical procedures in our audit of these sources of income. We will perform data analytics work over housing rents, which is a focus area due to collection levels being behind budget.</li> <li>— The potential for fees and charges income to be incorrectly recognised will be addressed through controls testing and substantive procedures. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details.</li> </ul>

# Financial statements audit planning (continued)



## Significant risks (continued)

Significant risk	Why	Audit approach
<b>Financial statement risk</b>		
Revaluation of property, plant and equipment	<p>The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. In 2017-18 operational depots, car parks, tips, investment properties and shops will be subject to revaluation and we expect the movement to be material.</p> <p>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.</p> <p>The Council uses a valuation date of the 1 April 2017 for the 31 March 2018 year end, therefore we consider there to be a risk of a material movement in valuation between this time.</p>	<p>Our procedures include:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>— 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.</li> <li>— We will also assess the risk of the valuation changing materially during the year, or between the date of valuation and the year end.</li> </ul> <p><b>Assessing valuer's credentials:</b></p> <ul style="list-style-type: none"> <li>— 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.</li> </ul> <p><b>Assessing methodology choice and benchmarking assumptions:</b></p> <ul style="list-style-type: none"> <li>— 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.</li> <li>— We will select a representative sample of assets to agree to supporting evidence and consider in detail the revaluation calculations.</li> </ul>

# Financial statements audit planning (continued)



## Significant risks (continued)

Significant risk	Why	Audit approach
<b>Financial statement risk</b>		
Pension liability	<p>The net pension liability (£250 million as at 31 March 2017, including assets of £716 million) represents a material element of the Council's balance sheet. The Council is an admitted body of Tayside Pension Fund, which had its last triennial valuation completed as at 31 March 2017. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.</p> <p>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 is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>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.</p>	<p>Our audit approach includes:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation.</li> </ul> <p><b>Benchmarking assumptions:</b></p> <ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul> <p><b>Assessing transparency:</b></p> <ul style="list-style-type: none"> <li>Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions.</li> <li>Testing the assets recorded and disclosed, using our actuarial team.</li> <li>Assessing if the disclosures within the financial statements are in accordance with the Code's requirements.</li> </ul>

# Financial statements audit planning (continued)



## Other focus area

Other focus area	Why	Audit approach
<b>Financial statement focus area</b>		
Capital expenditure	<p>The Council has a six year £500 million capital plan, which includes the Cross Tay Link Road, A9/A85 road junction improvement project and Perth City Hall upgrade. The expected spend in 2017-18 is £101 million.</p> <p>Due to the significance of this capital investment programme and complexity of some of the projects, we consider there to be a risk of misstatement. 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.</p> <p>We also consider that any large capital project inherently brings a fraud risk to an entity, which we consider appropriate for the Council.</p> <p>As at February 2018, the capital expenditure for both the Housing Investment Programme and Capital Programme is expected to reach 100% of the most recent budget. The projected capital outturns represent 105% and 120% of the budget revised in April 2017.</p>	<p>Our audit approach includes:</p> <p><b>Control design:</b></p> <ul style="list-style-type: none"> <li>Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and revenue projects.</li> </ul> <p><b>Control re-performance:</b></p> <ul style="list-style-type: none"> <li>Comparing the total capital expenditure reported in the financial statements with that reported in reports to those charged with governance.</li> </ul> <p><b>Tests of detail:</b></p> <ul style="list-style-type: none"> <li>Use of substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation.</li> <li>Assessing a sample of items allocated to revenue expenditure to determine whether they are correctly classified.</li> <li>Review and corroboration of manual journals.</li> <li>There has been ongoing development in the implementation of Gateway reviews, this will be considered as part of our wider scope and Best Value work.</li> </ul>

# Other matters

## Accounting framework update

There are no significant changes to the 2017-18 Code compared to the previous Code.

From 2018-19, IFRS 9 replaces IAS 39 *Financial instruments: recognition and measurement*, and includes:

- a single classification approach for financial assets driven by cash flow characteristics and how an instrument is managed;
- a forward looking 'expected loss' model for impairment rather than the 'incurred loss' model under IAS 39; and
- new provisions on hedge accounting.

From 2018-19, IFRS 15 replaces IAS 18 *Revenue* and IAS 11 *Construction contracts* and their associated interpretations. The core principle in IFRS 15 for local authorities is that they should recognise revenue to depict the transfer of promised goods or services to the service recipient or customer in an amount that reflects the consideration to which the authority expects to be entitled in exchange for those goods or services.

Expected from 2019-20, IFRS 16 *Leases* supersedes IAS 17 *Leases*. IFRS 16 introduces a single lessee accounting model. Public body lessees will be more likely to account for operating leases in a similar way to the current IAS 17 treatment for finance leases.

These changes are significant and the Council will need to prepare in advance, particularly where the 2017-18 balances will form the comparatives in future accounts. As part of the 2017-18 audit, we will consider the Council's arrangements for complying with the forthcoming changes.

## Controls testing

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

In 2016-17 we identified five recommendations in relation to the control environment. We will follow-up progress in implementing these recommendations and report any new recommendations arising from our work in 2017-18 and report our view of progress. Appendix three summarises our approach across each phase of the audit.

## Internal audit

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

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

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

# 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 15 to 19 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.

The LAN brings together local scrutiny representatives in a systematic way to agree a shared risk assessment. Antony Clark from Audit Scotland is the LAN lead for the shared risk assessment process for the Council. For 2017-18 there is no additional scrutiny required by external audit.

The 2018-19 shared risk assessment has begun, and a local scrutiny plan will be agreed with management by 31 March 2018, followed by publication in Spring 2018.



### 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, as noted on the next page. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

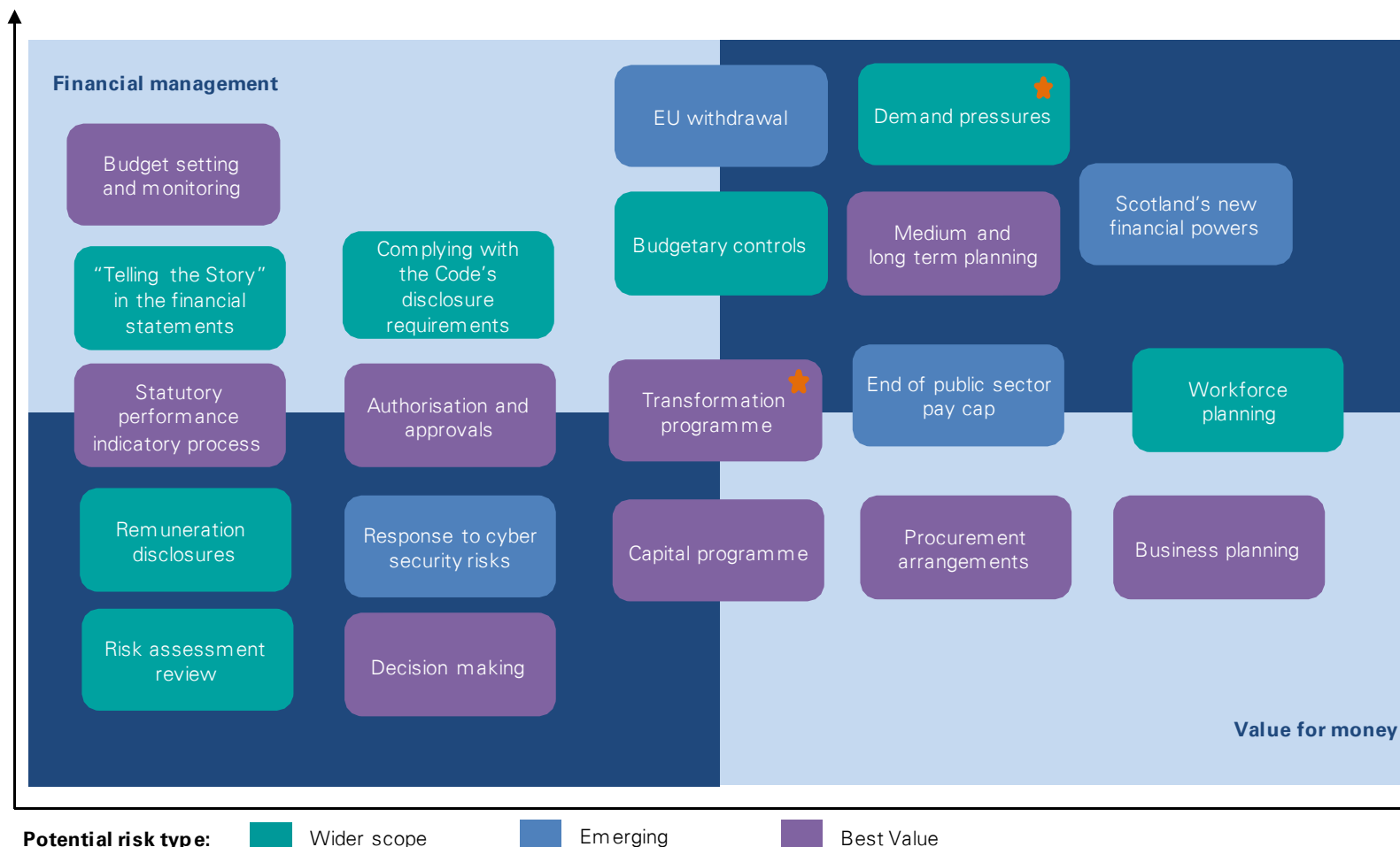
We will report on the results of the wider scope and Best Value audit through our Annual Audit Report. This will summarise any specific matters arising, and the basis for our overall conclusion.



# Wider scope and Best Value (continued)

## Risk assessment

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



# Wider scope and Best Value (continued)

## Risk assessment (continued)

Wider scope area	Why	Audit approach
<b>Financial sustainability</b>	<p><b>Financial sustainability</b> 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.</p> <p><b><i>Specific identified focus area:</i></b></p> <p><u>Demand pressures</u></p> <p>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.</p> <p>This comes at a time when the overall Council workforce is decreasing, and adds pressure to 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.</p> <p>We consider there to be a resultant risk to the sustainability of delivering services with increasing demand and a decreasing workforce.</p>	<ul style="list-style-type: none"> <li>— 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 2018-19 budget and longer term financial plans from 2019-20 and beyond.</li> <li>— 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.</li> </ul>

# Wider scope and Best Value (continued)

## Risk assessment (continued)

Wider scope area	Why	Audit approach
Financial Management	<p><b>Specific identified focus areas (continued):</b></p> <p><b>Financial management</b> is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p> <p>The Council has approved the preparation of a three year revenue budget, which will aid longer term financial management and workforce planning.</p> <p><b>Specific identified focus area:</b></p> <p><u>Transformation programme</u></p> <p>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.</p> <p>In October 2017, the Council reported estimated savings requirements ranging between £22 million and £103 million, with the 'mid-range' estimate of £54.5 million over the next five years, and the transformation programme supports this through redesigning service delivery to maximise efficiencies and support change.</p> <p>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.</p>	<ul style="list-style-type: none"> <li>— We will consider how the Council's transformation programme is progressing and any potential impact on financial and service planning.</li> <li>— We will consider innovative ideas the Council is piloting, such as the £2 million redesigned family supportive service, which will be the first of its kind in the country, and how this aids more effective service delivery.</li> <li>— We will review the financial results to 31 March 2018 compared to budget to consider if there are indications that savings are not being delivered as planned.</li> </ul>

# Wider scope and Best Value (continued)

## Risk assessment (continued)

Wider scope area	Why	Audit approach
<b>Financial sustainability and financial management</b> (continued)	<p><b>Specific identified focus areas (continued):</b></p> <p>Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies.</p> <p><b>Scotland's new financial powers</b></p> <p>The Fiscal Framework agreement arising as part of the 2012 and 2016 Scotland Acts provides the Scottish Parliament with new powers and changes Scottish public finance.</p> <p>There is a risk that the Council's funding, responsibilities or performance objectives are altered, together with changes to the environment in which it operates which may impact on day to day activities.</p> <p><b>EU withdrawal</b></p> <p>The nature and impact of withdrawal from the EU continues to be uncertain and changing.</p> <p>There is a risk that Council fails to prepare for, or is impacted by changes to employees, citizens, funding or regulations.</p> <p><b>End of public sector pay cap</b></p> <p>The Scottish Government has stated its intention for the 1% public sector pay cap which has applied for seven years is being lifted. It is not clear when increases will take effect or how they will be funded.</p> <p>There is an uncertainty risk which needs to be considered as part of the Council's forward financial planning.</p>	<ul style="list-style-type: none"> <li>— We will remain alert to the impact of new financial powers and EU withdrawal on the Council's operations and the environment within which it operates. We will consider the appropriateness of management's risk assessment and planning for both matters.</li> <li>— We will consider how the Council is planning for the end of the public sector pay cap, for example, within future budget modelling, sensitivity and funding analysis.</li> </ul>

# Wider scope and Best Value (continued)

## Risk assessment (continued)

Wider scope area	Why	Audit approach
<b>Governance and transparency</b>	<p><b>Governance and transparency</b> is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision making, and transparent reporting of financial and performance information.</p> <p>With the retirement of the Depute Chief Executive, there will be a change to the senior officer structure. Changes were proposed to ensure capacity is placed in the correct areas and a paper was presented to and approved by the Strategic Policy and Resource Committee in February.</p> <p><b>Specific identified focus area:</b></p> <p>Audit Scotland planning guidance requires us to consider the following matters which are potential risks to all Public Sector bodies.</p> <p><b>Openness and transparency</b></p> <p>There are signals of changing and more challenging expectations for openness and transparency in public business. This is an area the Council are expected to keep under review and consider where there is scope to enhance transparency.</p> <p><b>Response to cyber security</b></p> <p>The Scottish Government published the Public Sector Action Plan for cyber resilience in November 2017. It aims to ensure that Scotland's public bodies work towards becoming exemplars of cyber resilience.</p> <p>The EU General Data Protection Regulation ("GDPR") will come into effect from 25 May 2018.</p> <p>The Council will need to understand its baseline cyber resilience position and demonstrate commitment to achieving good practice. It will also need to comply GDPR.</p>	<ul style="list-style-type: none"> <li>— We will consider the effectiveness of scrutiny and governance arrangements, by evaluating the challenge and transparency of the reporting of financial and performance information.</li> <li>— We will update our understanding of the controls and processes around capturing officers' interests.</li> <li>— We will obtain and review minutes of meetings of the various committees to assess the level of transparency.</li> <li>— We will use guidance provided by Audit Scotland to consider the Council's approach to cyber resilience and readiness for GDPR.</li> </ul>

# Wider scope and Best Value (continued)

## Risk assessment (continued)

Wider scope area	Why	Audit approach
<b>Value for money</b>	<p><b>Value for money</b> is concerned with how effectively resources are used to provide services.</p> <p>We have not identified specific value for money focus areas.</p>	<ul style="list-style-type: none"> <li>— We will specifically consider statutory performance indicators, performance reporting and arrangements to provide for continuous improvement.</li> <li>— In the context of the Council's capital plan and procurement procedures, we will consider the arrangements to provide for value for money.</li> <li>— Our year two Best Value work will consider Improvement and Leadership and we will provide narrative on both in the Annual Audit Report.</li> </ul>



# Appendices

# Mandated communications with the Audit Committee

Matters to be communicated	Link to Audit Committee papers
Independence and our quality procedures ISA 260 (UK and Ireland).	■ See next page
The general approach and overall scope of the audit, including levels of materiality, fraud and engagement letter ISA 260 (UK and Ireland).	■ 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)	

# Auditor independence

## Assessment of our objectivity and independence as auditor of Perth and Kinross Council

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

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

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

## General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent.

As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

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

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

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

We have considered the fees charged by us to the Council and its affiliates for professional services provided by us during the reporting period. Total fees charged by us for the period ended 31 March 2017 and planned for 2017-18 are as follows:

Services provided to the Council and its group in respect of:	2017-18 continuing (excl VAT) £	2016-17 (excl VAT) £
Audit of the financial statements	131,867	129,326
Other audit related services	-	27,000
<b>Total</b>	<b>131,867</b>	<b>156,236</b>

There are no non-audit fees for 2017-18. Under the FRC's Revised Ethical Standard and in accordance with Audit Scotland requirements, no new tax contingent fees for listed entities can be entered into after 17 June 2016. We confirm that no new contingent fees for tax services have been entered into for Perth and Kinross Council since that date.

All non-audit services require audit committee or equivalent approval. We will seek approval in advance of any such services being proposed

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

# Auditor independence (continued)

### Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgement, 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.

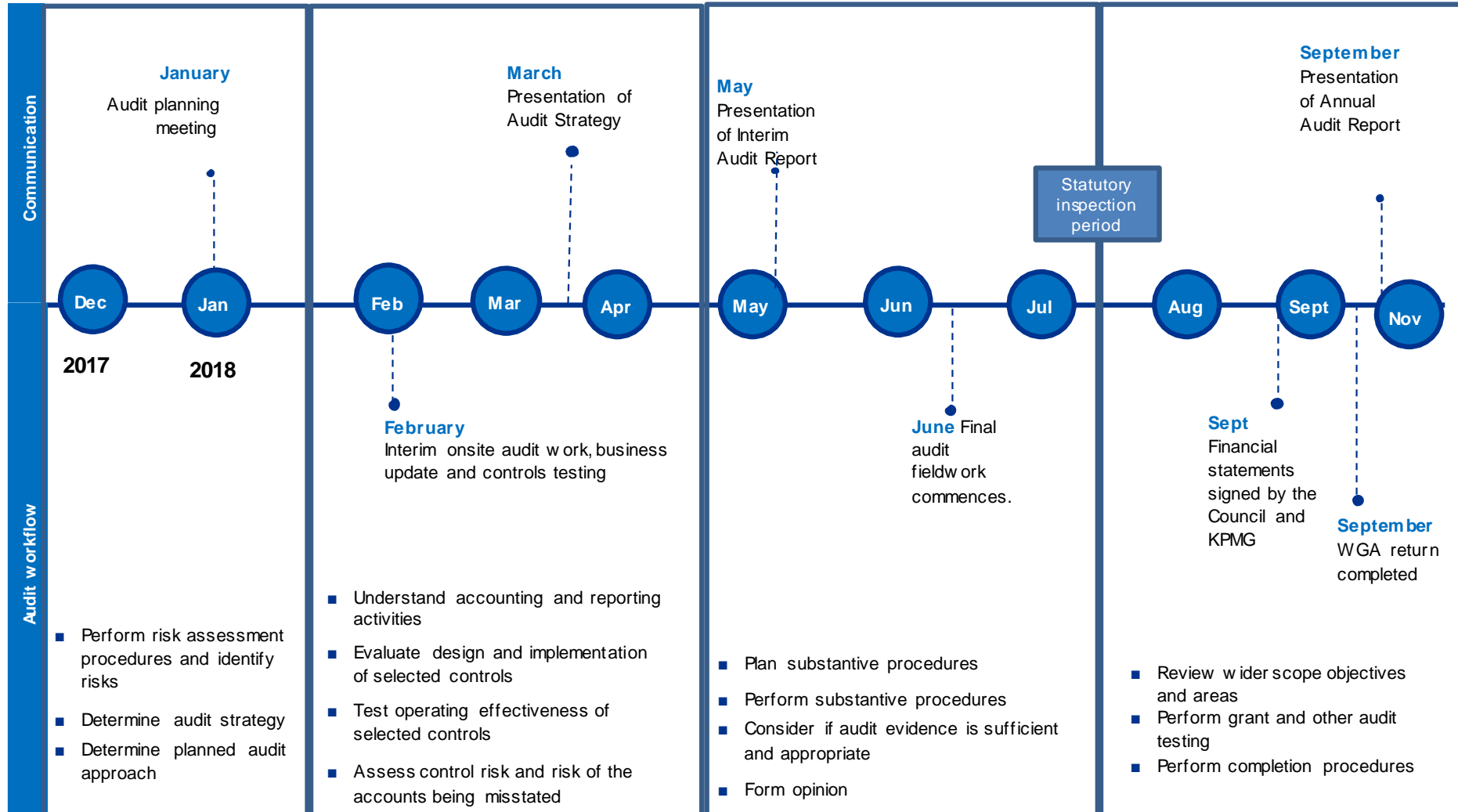
This report is intended solely for the information of the audit committee and should not be used for any other purposes.

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*

# Timeline



# Audit outputs

Output	Description	Report date
<b>Audit strategy</b>	Our strategy for the external audit of the Council and its group, including significant risk and audit focus areas.	By 31 March 2018
<b>Interim audit report</b>	We summarise our findings from our interim audit work.	By 31 May 2018
<b>Independent auditor's report</b>	Our opinion on the Council's financial statements.	By 30 September 2018
<b>Annual audit report</b>	We summarise our findings from our work during the year.	By 1 October 2018
<b>NFI report</b>	We report on the Council's actions to investigate and follow-up NFI matches.	By 28 February 2018
<b>Whole of Government Accounts</b>	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 28 September 2018
<b>Audit reports on other returns</b>	We will report on the following returns: <ul style="list-style-type: none"> <li>- Current issues return.</li> <li>- Technical database.</li> <li>- Fraud returns.</li> </ul>	January, March, July and October 2018 27 July 2018 27 April 2018
<b>Audit reports to support Audit Scotland's wider analysis</b>	We will report on the following matters: <ul style="list-style-type: none"> <li>- Health &amp; social care integration progress.</li> <li>- City Deals</li> <li>- Digital</li> </ul>	July 2018 September 2018 September 2018
<b>Grant claim audits</b>	We provide an opinion on: <ul style="list-style-type: none"> <li>- Education maintenance allowance, Housing Benefit, Non domestic rates and Criminal Justice social work</li> </ul>	To submit by: July 2017, November 2017 and August 2017

# Fees

Audit Scotland has completed a review of funding and fee setting arrangements for 2017-18. 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 team
- Contribution to Audit Scotland costs

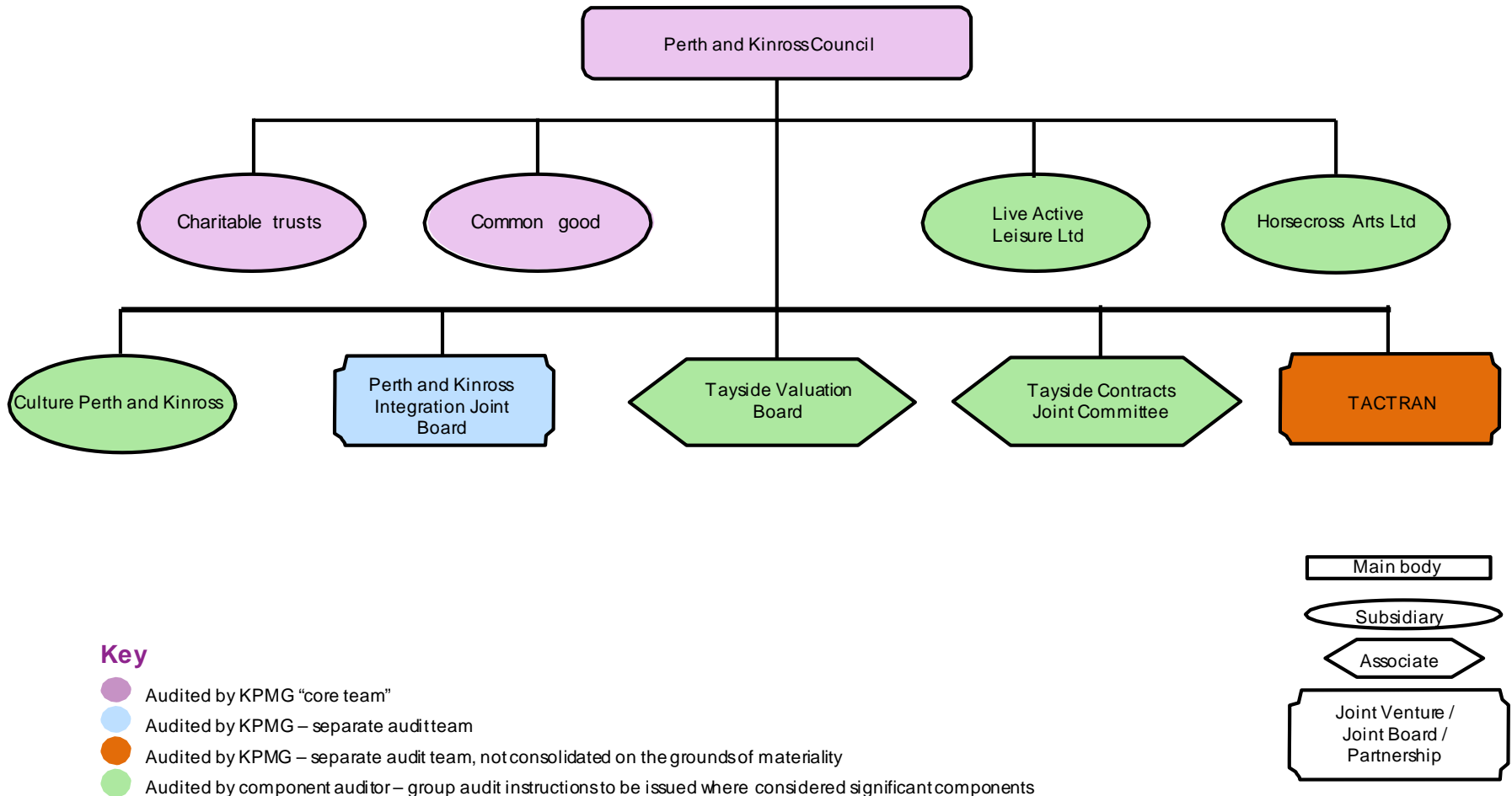
The expected fee for each body assumes that it has sound governance arrangements in place and operating effectively throughout the year, prepares comprehensive and accurate draft accounts and meets the agreed timetable for the audit.

We are in discussions with management regarding the auditor remuneration for 2017-18. 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.

	2017-18 £ (incl VAT)
Auditor remuneration	158,240
Pooled costs	14,060
Contribution to PABV	86,310
Contribution to Audit Scotland costs	10,050
<b>Total Council audit fee</b>	<b>268,660</b>
Audit of Perth and Kinross Council Charitable Trusts	3,000
<b>Total fee</b>	<b>271,660</b>

# 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.



# 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	KPMG's identification of fraud risk factors	KPMG's response to identified fraud risk factors	KPMG's identified fraud risk factors
<ul style="list-style-type: none"> <li>— Adopt sound accounting policies.</li> <li>— With oversight from those charged with governance, establish and maintain internal control, including controls to prevent, deter and detect fraud.</li> <li>— Establish proper tone/culture/ethics.</li> <li>— Require periodic confirmation by employees of their responsibilities.</li> <li>— Take appropriate action in response to actual, suspected or alleged fraud.</li> <li>— Disclose to audit committee and auditors:               <ul style="list-style-type: none"> <li>— any significant deficiencies in internal controls.</li> <li>— any fraud involving those with a significant role in internal controls.</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>— Review of accounting policies.</li> <li>— Results of analytical procedures.</li> <li>— Procedures to identify fraud risk factors.</li> <li>— Discussion amongst engagement personnel.</li> <li>— Enquiries of management, to audit committee and others.</li> <li>— Evaluate broad programmes and controls that prevent, deter, and detect fraud.</li> </ul>	<ul style="list-style-type: none"> <li>— Accounting policy assessment.</li> <li>— Evaluate design of mitigating controls.</li> <li>— Test effectiveness of controls.</li> <li>— Address management override of controls.</li> <li>— Perform substantive audit procedures.</li> <li>— Evaluate all audit evidence.</li> <li>— Communicate to audit committee and management.</li> </ul>	<p>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.</p> <ul style="list-style-type: none"> <li>— Revenue recognition</li> <li>— Cash</li> <li>— Procurement</li> <li>— Management control override</li> <li>— Assessment of the impact of identified fraud.</li> </ul>

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

Responsibilities of management
Financial statements
<p>Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:</p> <ul style="list-style-type: none"> <li>■ 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;</li> <li>■ 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;</li> <li>■ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate Council;</li> <li>■ maintaining proper accounting records; and</li> <li>■ 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.</li> </ul> <p>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.</p> <p>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.</p>
Prevention and detection of fraud and irregularities
<p>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.</p>

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

Responsibilities of management
<b>Corporate governance arrangements</b> <p>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.</p>
<b>Financial position</b> <p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>■ such financial monitoring and reporting arrangements as may be specified;</li> <li>■ compliance with any statutory financial requirements and achievement of financial targets;</li> <li>■ balances and reserves, including strategies about levels and their future use;</li> <li>■ how they plan to deal with uncertainty in the medium and longer term; and</li> <li>■ the impact of planned future policies and foreseeable developments on their financial position.</li> </ul>
<b>Best Value, use of resources and performance</b> <p>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.</p>

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

## Responsibilities of auditors

### Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, International Standards on Auditing (UK and Ireland), 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.

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

Responsibilities of auditors
<b>General principles</b>
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
<b>Independent</b>
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 Financial Reporting Council's (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.
<b>Proportionate and risk based</b>
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.
<b>Quality focused</b>
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

Responsibilities of auditors
<b>Coordinated and integrated</b>
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.
<b>Public focused</b>
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.
<b>Transparent</b>
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.
<b>Adds value</b>
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 where significant risks are identified.



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