Final report to the Members of the Council and the Controller of Audit on the 2014/15 audit

23 September 2015

Contents

Our final report

Appendices

A reminder of our audit plan:

- Materiality: £6,300k (2013/14: £5,700k).
- Performance materiality: £5,670k (2013/14: £4,674k).
- Threshold for reporting misstatements: £126k (2013/14: £114k).
- Significant risks over property, plant and equipment valuations; Council Tax bad debt provision; revenue recognition and management override of controls.
- In line with prior years and our audit plan, we have not placed any reliance on controls and our audit work was fully substantive.
- We have not identified any additional significant risk areas since our plan was issued.
- There have been no changes to our audit plan presented to you in February 2015.

Partner introduction

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Partner introduction

Financial statement audit

I have pleasure in presenting our final report for the 2014/15 audit. I would like to draw your attention to the key messages of this paper:

Conclusions from our testing	• The key judgements in the audit process related to:
	  • property, plant and equipment valuation;
	  • calculation of the Council Tax bad debt provision; and
	  • revenue recognition (being completeness of Council Tax and Housing Rent income).
	• A significant risk has also been identified in relation to management override in line with Auditing Standards.
	• Two material and two significant audit adjustments have been identified in relation to the treatment of depreciation and revaluations in the new Fixed Asset Register. These have been corrected in the final financial statements. We have also identified two uncorrected misstatements, one in relation to the under accrual of an invoice and the other being a reclassification error in relation to Business Rates income. Details of the corrected and uncorrected misstatements are included in **Appendix 1.** We will obtain written representations from the Council confirming that after considering all uncorrected items, in the context of the financial statements taken as a whole, no adjustments are required.
	• Based on the current status of our audit work, we anticipate issuing an unmodified audit opinion.

Insight	• We have raised a number of insights from our current year audit work which are discussed throughout the report and summarised in the action plan in **Appendix 2**. • We have also followed up our prior year action plan and noted that while progress has been made on some of the actions, a number are only partially implemented, as detailed in **Appendix 2**. Management should ensure that achievable timescales are agreed so that these actions are implemented timeously. • We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year and insights have been noted for management consideration to potentially help improve efficiencies in the finance team, including the number of journals with "error" in description and variations in the number of journals processed by different finance teams.

Status of the audit	• The audit is substantially complete subject to the completion of the following principal matters:
	  • Finalisation of quality control procedures;
	  • Receipt of updated financial statements;
	  • Receipt of signed management of representation letter; and
	  • Our review of events since 31 March 2015.

Audit quality is our number one priority. When planning our audit we set the following audit quality objectives for this audit:

A robust challenge of the key judgements taken in the preparation of the financial statements.

A strong understanding of your internal control environment.

A well planned and delivered audit that raises findings early with those charged with governance.

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Partner introduction (continued)

Public sector audit dimensions

We have commented below on the Audit Scotland impact dimensions with regard to Aberdeenshire Council.

Financial sustainability

Financial sustainability continues to be one of the most significant challenges and risks for Aberdeenshire Council.

Whilst 2015/16 shows a balanced position, significant shortfalls are projected in future years with a cumulative funding gap of £50.2 million up to 2019/20.

We recognise that work has been ongoing with both Officers and Members and an agreed timetable is now in place with high level proposals developed for consideration. However, the pace and scale of delivery is not yet sufficient to meet the Council's objectives and address the significant financial challenges and therefore must be increased over the coming months in advance of setting the budget in February 2016.

Financial Management

The final outturn position was an underspend of £9.996 million against an overall budget of £516.677 million. While variances were reported to Policy and Resources Committee during the year, the projected underspend increased from £5.333 million as at January 2015 (reported in April 2015) to this final reported position. A review is currently being undertaken by Internal Audit to review the robustness of the forecasting techniques in place.

A significant underspend of £29 million was also reported on the Capital Plan against a budget of £165 million as a result of delays in a number of school projects. The Council has an ambitious Capital Plan increasing by circa £50 million in comparison with previous years.

Best Value (BV)

There is evidence of transformation taking place at an operational level within the Council, including changes in the education services operational model and the integration of health and social care progressing. However progress in the last 12 months on the Councils Transformation Programme is disappointing and there is limited evidence of tangible "transformation" across the Council from these projects. They have now been built into the medium term financial strategy.

While all data for the NFI exercise was submitted on time, due to resourcing issues the Council has only recently started following up on the recommended matches.

We are satisfied that the Council has developed a clear understanding of the organisational impacts associated with welfare reform and has implemented appropriate mitigations.

Governance and Transparency

A number of changes in leadership have occurred during the year.

A review of the governance arrangements was agreed by Full Council in March 2015. It is important that the current review of the committee structure and other related reviews, including the review of Financial Regulations, are fully aligned to ensure that any changes are not made in isolation.

Internal Audit continue to report significant concerns around the lack of compliance with financial regulations. We note that no frauds have been identified as a result of these issues. The review of the Regulations has been planned for some time, but has been put on hold pending the wider governance review noted above. Whilst we agree that these reviews need to be fully aligned, the current level of breaches must be reviewed and action taken by ensuring that the current financial regulations are fit for purpose.

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Partner introduction (continued)

Significant risk dashboard

Presumed Fraud risk per Auditing Standards	Controls approach and findings	Consistency of judgements with Deloitte expectations	Comment
Property, Plant and Equipment (PPE) valuation			
✗	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	●	Revaluations of PPE based on methodology and assumptions adopted by the Council's internal valuer. We are satisfied that the correct guidance has been followed, with the exception of the observations on Modern Equivalent Asset (MEA) consideration noted on page 11. These issues do not have a material impact on the financial statements. A material misstatement of £10.439 million was noted in relation to the processing of the revaluation adjustments in the Fixed Asset Register, however, this has been corrected in the final financial statements.
Council Tax bad debt provision			
✗	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	●	We have confirmed that the Council undertook a review of the provision methodology during 2014/15. This has resulted in a release of £838k from the bad debt provision during the year. We have reviewed and challenged the new methodology and found it to be reasonable.
Revenue recognition			
✓	Evaluate design / implementation of key controls. No controls reliance. No significant observations.	●	We have noted no issues with the recognition of revenue from Council Tax and Housing Rents.
Management override of controls			
✓	Evaluate design / implementation of key controls. No controls reliance. No significant observations	●	We have noted no issues with journal entries and other adjustments made in the preparation of the financial statements. Our review of accounting estimates for bias that could result in material misstatement due to fraud noted no issues

Overly prudent, likely to lead to future credit ⊖ ⊖ ● ⊕ ⊕ Overly optimistic, likely to lead to future debit.

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Scope, nature and extent of audit

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Scope, nature and extent of audit

Our overall responsibility as external auditor of the Council is to undertake our audit in accordance with the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011.

The special accountabilities that attach to the conduct of public business, and the use of public money, means that public sector audits must be planned and undertaken from a wider perspective than in the private sector. This means providing assurance, not only on the financial statements and associated documents such as governance statements, but providing a view also, where appropriate, on matters such as regularity (or legality), propriety, performance and use of resources in accordance with the principles of Best Value and 'value for money'.

Our core audit work as defined by Audit Scotland comprises:

- Providing the Independent Auditor's Report on the financial statements of the local authority (including any assurance statement on whole of government accounts returns) and relevant registered charities;
- Providing the annual report on the audit addressed to the body and the Controller of Audit;
- Providing reports to management, as appropriate, in respect of the auditor's corporate governance responsibilities in the Code (including auditors' involvement in National Fraud Initiative (NFI));
- Submitting fraud returns, including nil returns, to Audit Scotland;
- Certifying all grant claims submitted by the Council that have been approved for certification by Audit Scotland;
- Discharging the auditor's responsibilities in connection with bodies' publication of SPIs in accordance with the Accounts Commission's annual Direction;
- Provide existing evidence and intelligence for, and participate in, the Shared Risk Assessment (SRA) process leading to the preparation of a 3-year rolling Assurance Improvement Plan (AIP) and national scrutiny plan; and
- Report on the results of follow-up on Councils progress in implementing existing BV improvement plans.

In addition to this annual report, we have completed and reported the following matters to those charged with governance (the Scrutiny and Audit Committee) of the Council:

- Planning Report; and
- The Deloitte Finance Benchmarking Survey 2015.

The key issues from these outputs are summarised in this report.

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Significant risks

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Property, Plant and Equipment Revaluations

Risk Identified

Changes in the property market and economic environment can drive significant movements in valuation. There is a risk of material misstatement of the property, plant and equipment on the balance sheet.

IFRS requires assessment with significant regularity to ensure no significant divergence between carrying value and fair value of assets. Aberdeenshire Council carry out a 5-year rolling programme of revaluations of its assets. The current year includes revaluation of the school portfolio.

Net Book Value of Property, plant & equipment at 31 March 2015: £2,101 million (31 March 2014: £2,015 million)

Key judgements

- We reviewed the internal revaluations performed in the year and assessed whether they have been performed in a reasonable manner, on a timely basis and by suitably qualified independent individuals;
- We challenged the inputs made by management to the valuations;
- We tested a sample of revalued assets and re-performed the calculation assessing whether the movement has been recorded through the correct line of the financial statements;
- We considered assets classified as surplus or held for sale to assess whether these have been valued and disclosed in line with IFRS 5; and
- We involved the use of our internal property specialists to review and challenge the assumptions and methodology adopted by the internal valuer.

Deloitte response

We are satisfied that the correct guidance has been followed and the correct valuation bases are being adopted. The valuer is independent, appropriately qualified and appears to have the requisite experience to undertake the valuations. From our audit procedures, we can also conclude that the net book value is not materially misstated. We have, however, made some observations in relation to the methodology adopted by the valuer which are detailed on page 11.

The Council implemented a new fixed asset register during 2014/15. From our testing of the movements through the financial statements, we identified a material error of £10.439 million in relation to the gain processed for two specific assets. This has arisen due to incorrect dates being entered into the register for the additions made in the year resulting in an element of double counting. This error has been corrected in the final financial statements, reducing the property, plant and equipment assets and revaluation reserve by this amount.

A related error was also identified in relation to the treatment of depreciation within the new register, resulting in a material error of £6.211 million being identified. This has arisen due to the system not being correctly populated with the remaining useful life of assets, resulting in the annual depreciation charge being understated. This error has been corrected in the final financial statements, reducing the property, plant and equipment assets by this amount.

In view of these material errors arising from the new fixed asset register, we would recommend that finance staff should incorporate a review process into their procedures to ensure that the data being produced by the system is in line with expectations. **Appendix – Action Plan**

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Property, Plant and Equipment Revaluations (continued)

Deloitte response (continued)

There has been a downward revaluation of £100.842 million (£86.123 million charge to the Revaluation Reserve and £14.719 to the CIES). These decreases are primarily as a result of the school portfolio being revalued in the year and reflect decreases in property and land value since the last valuation as well as changes being made to the schemes of valuation used. The significant movements in the year can be summarised as:

- Primary Schools – downward revaluation of £79.288 million.
- Other assets (community centre/offices/housing) – downward revaluation of £5.604 million.

An impairment of £23.563 million has also been recognised during the year (2013/14: £11.399 million). This is mainly as a result of the immediate 51% impairment applied to all Council House additions. This represents the difference between the market rents and social housing rent as these assets are valued on the basis of existing use value for social housing. We reviewed the basis of the 51% as part of our review of the full valuation performed in 2012 and the valuer has confirmed that this will be revisited as part of the next full revaluation of the housing stock in 2017.

Observation 1 - Modern Equivalent Asset (MEA)

Whilst the valuer has confirmed that the MEA has been assessed in relation to assets valued on the Depreciated Replacement Cost (DRC) basis, this is largely restricted to the adoption of modern replacement build costs and functional obsolescence issues. It would appear that the valuer's MEA considerations do not extend to the consideration of buildings or site sizes or location or there is no evidence that these issues have been considered. This may impact on asset valuation. However, if it can be argued that the site of the MEA would ultimately be the same size as the current site and that the majority of the Council assets have to be located within a certain geographical locale, then there would not be an impact on value.

Conclusion

We concluded that this issue did not have a material impact on the current year valuation. However, with regard to MEA considerations for land, rather than adopting current site areas and valuing on the basis that assets will be located in same geographical area, the valuer should consider MEA issues and where possible determine the land value reflecting an appropriate site size for a MEA facility and if possible determine a site value reflecting least cost to replace basis. **Appendix – Action Plan.**

Observation 2 - Complex 'schemes of valuation'

This year the scheme of valuation for determining the build costs for the schools portfolio is particularly complex and has resulted in a large variation in build costs which are then applied to the schools dependent upon their specific profile. Whilst the schemes can be followed, the development of such schemes is unnecessary and can often result in inconsistencies in the valuation/componentisation of specific assets as the asset will be valued in accordance with the overarching scheme as opposed to the valuer reflecting the specific characteristics of the asset when applying for example build costs or component percentages.

Conclusion

We concluded that this issue did not have a material impact on the current year valuation, however, in future we recommend that these schemes are simplified and that the valuer seeks further input from senior management and their external consultants prior to devising such schemes and that these are critically reviewed prior to adoption. **Appendix – Action Plan.**

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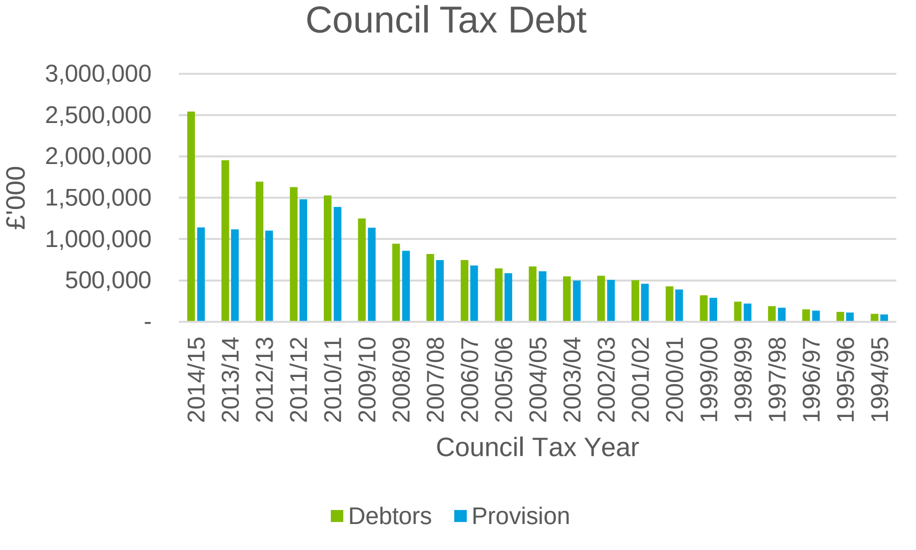
Bad Debt Provision: Council Tax

Nature of the risk

There is significant judgement and complexity around debtor provision calculations. There is a risk that the valuation of provisions is not appropriate and assumptions underpinning calculations are not accurate. Particularly given the changes being implemented from welfare reform, assumptions on recoverability of amounts may not be reasonable. The risk has been pinpointed to the Council Tax provision given its level of materiality. We concluded in our 2013/14 final report that while the provision for Council Tax was not materially misstated, providing 100% on all debts over 4 years old (total provision of £10.3 million) is towards the higher end of prudent given there is evidence that the Council is still continuing to collect on these old debts.

Key judgements



We have performed the following:

- Verified the gross debtor on which the provision is based to the Council Tax system;
- Reviewed and challenged the methodology applied by the Council for the bad debt provision calculation;
- Reviewed and challenged management's judgements and assumptions included within the calculations; and
- Compared the provisions made with historical data on cash collection.

Deloitte response

The Council undertook a review of the council tax bad debt provision during the year, including benchmarking against other councils and reviewing historic bad debt collection rates. This exercise showed that on average 9% of debts older than 4 years old were collected after the balance sheet date. As a result of this exercise the Council has updated their method of provisioning to provide for 91% of debts older than 4 years old instead of 100% as in prior years. This has resulted in a release of £838k from the bad debt provision during the year. We have reviewed and challenged the new methodology and found it to be reasonable.

From our audit procedures, we are satisfied that the provision and associated debtor are not materially misstated.

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Revenue Recognition: Completeness of income

Risk Identified

ISA 240 states that when identifying and assessing the risks of material misstatement due to fraud, the auditor shall, based on a presumption that there are risks of fraud in revenue recognition, evaluate which types of revenue, revenue transactions or assertions give rise to such risks.

The risk is pinpointed to completeness of council tax and housing rent income given the significance to the organisation. Other main components of income are government grants and business rates which are directed by the Scottish Government are not considered a significant risk as the process for receipt of this income is not complex and can be verified 100%.

Key judgements

We have performed the following:

- tested the council tax and housing rents reconciliations performed by the Council at 31 March 2015 to confirm all income correctly recorded in ledger;
- compared income recorded with expectations, based on Council Tax and rent levels agreed as part of budget process and number of properties;
- corroborated property numbers to independent record held by the valuer (Council Houses) and the Assessor (Council Tax properties); and
- confirm that the reconciliations performed during 2014/15 have been reviewed on a regular basis.

Deloitte response

- No issues noted from our testing of the treatment of income in the year.

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Management override of controls

Risk Identified

International Standards on Auditing require auditors to identify a presumed risk of management override of control. This presumed risk cannot be rebutted by the auditor.

This recognises that management may be able to override controls that are in place to present inaccurate or fraudulent financial reporting.

Key judgements

Our audit work is designed to test for instances of management override of controls.

We have summarised on pages 10 to 13, our work on key estimates around revenue recognition, bad debt provisions and valuation of property, plant and equipment. Other estimates which have are not considered significant risks including the pension liability, provisions and accruals have also been tested with no issues noted.

Deloitte response

- No issues noted around journal entries and other adjustments made in the preparation of the financial statements.
- Our review of accounting estimates for bias that could result in material misstatement due to fraud noted no issues.
- Retrospective review of management's judgements and assumptions relating to significant estimates reflected in last year's financial statements completed with no issues noted.
- We have utilised Spotlight, Deloitte's patented analytics tool, to perform analytics on the journal entries posted in the year and insights have been noted on pages 15 and 16.

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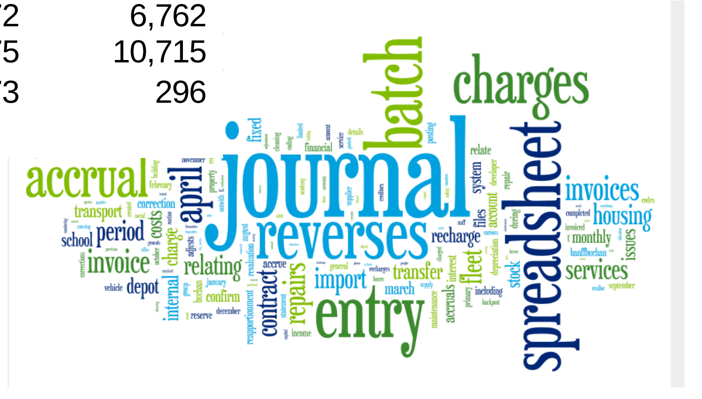
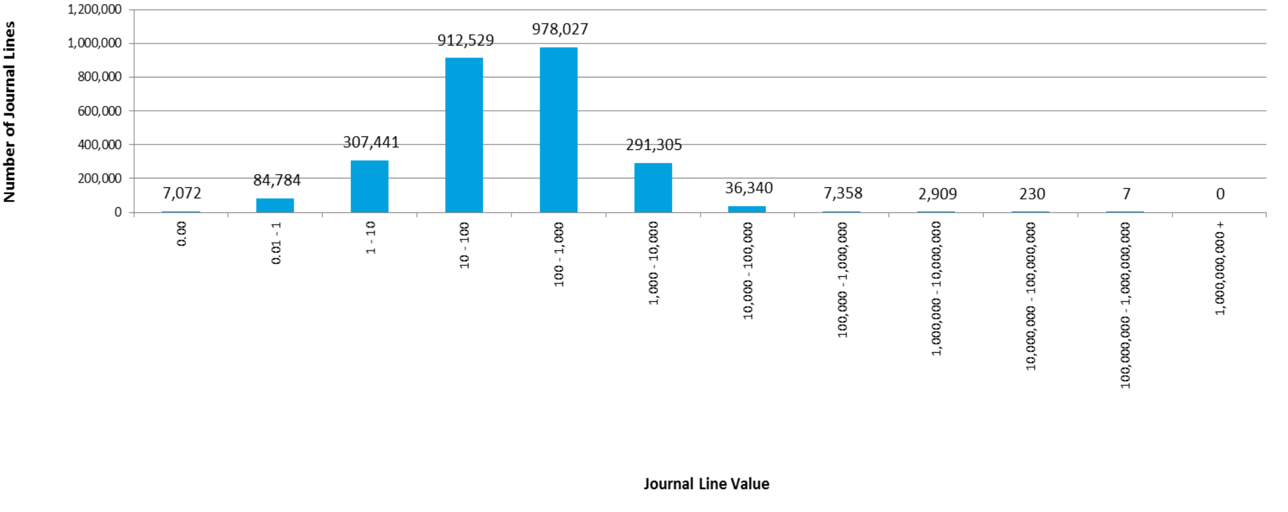
Insights from Journal entry testing

We have utilised **Spotlight** to perform analytics on all of the journal entries processed during the year. The data was extracted from the Council's general ledger and represents all transactions processed in the year. We have highlighted some key themes arising from this work for your consideration.

Key Metrics	2014/15	2013/14
Total number of journal lines	2,628,002	2,705,235
Journal lines with zero value	7,072	6,762
Total number of journals	10,075	10,715
Total number of journals with 'error' or 'correction'	873	296





Commentary from finance team:

- **Journal lines with zero values** – excel templates are used in populating common journals, as such, this can result in a template being uploaded with a number of lines with a value of zero, the templates help to save on efficiencies by reducing the need to prepare a journal each time a similar format is required.
- The number of journals with '**error' or 'correction**', while still relatively low, has increased in comparison with prior year. As part of the 2013/14 audit it was identified that journal descriptions were not detailed enough. Increase in the number of corrections being identified could be due to more detailed descriptions being used when preparing the journal. No specific problem has been identified which has resulted in an increase in coding errors. The current subjective rationalisation should reduce the number of corrections going forward as the codes available will be much more restricted (although an initial increase is expected).
- No unusual/ unexpected words included in journal entries.

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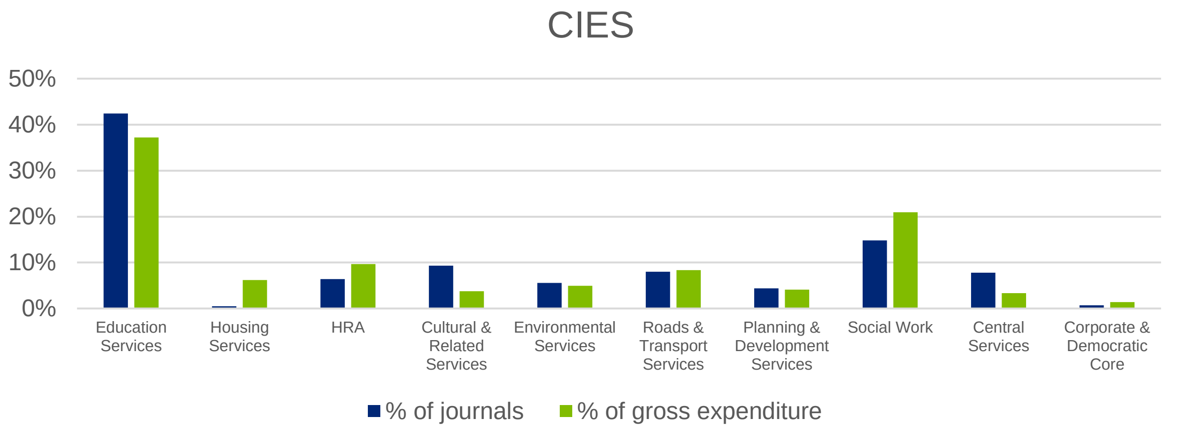
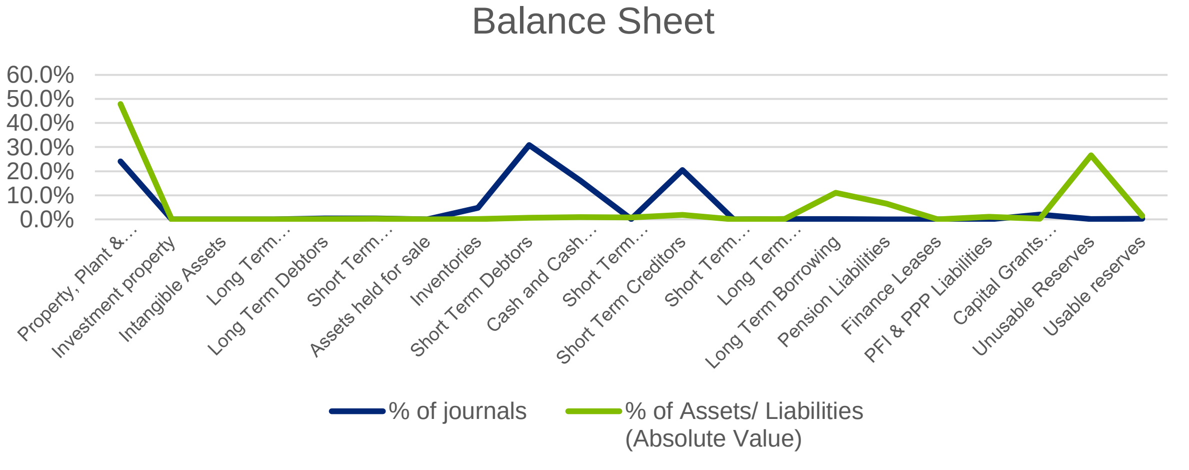
Insights from Journal entry testing (continued)





Points for management consideration:

- While the overall number of journals with “error” in the description is low, the underlying reasons should be investigated to reduce the need for correcting journals. The increase in ‘error’ journals in the year is significant in percentage terms, the reason for this should be investigated. The number of error journals posted in the period have increased by 577 (194%).
- Education Services processes the highest percentage of CIES journals but also incurs the highest proportion of gross expenditure. However, Social Work and Housing Services process less journals in proportion to their gross expenditure. The underlying reason for these variances should be investigated to identify if potentially more efficient processes can be shared across the Services.
- Some Balance Sheet items, such as PPE, Borrowings and Pension Liability have a low level of transactions in comparison with the Balance Sheet value, whereas Inventories, Debtors, Cash and Creditors have a high level of transactions. This analysis could help the Council review its process and focus on streamlining processes in the financial statements preparation timetable.

Appendix – Action Plan

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Other matters

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Defined benefits pension scheme

Background

The Council participates in two defined benefits schemes:

- Scottish Teachers' Pension Scheme, administered by the Scottish Government; and
- The Local Government Pension Scheme.

Audit work performed

We have:

- obtained a copy of the actuarial report produced by Mercer, the scheme actuary, and agreed in the disclosures to notes in the accounts;
- reviewed and challenged the assumptions made by Mercer;
- independently confirmed the total assets of the scheme with the audited Pension Fund financial statement;
- agreed Aberdeenshire's share of scheme assets to Mercer reports and challenged the basis of allocation;
- reviewed the disclosures within the accounts against the Code; and
- assessed the independence and expertise of the actuary supporting the basis of reliance upon their work.

No issues noted.

Deloitte response

We have considered the work carried out by PwC on behalf of Audit Scotland which assessed the competence and objectivity of, and assumptions and approach adopted by, actuaries producing IAS 19 figures in respect of the LGPS schemes as at 31 March 2015. We concur that the assumptions used appear reasonable and in line with those being used by other organisations with a March 2015 year end.

We have reviewed the assumptions and, on the whole, the set of assumptions is reasonable and lies towards the middle of the reasonable range of assumptions when compared with the Deloitte benchmarks. The assumptions have been set in accordance with generally accepted actuarial principles and are compliant with the accounting standard requirements of IAS19.

	Council	Benchmark	Comments
Discount rate - LGPS	3.20%	3.15%	Reasonable
Discount rate – Teachers	3.10%	2.90%	Reasonable
Consumer Price Index (CPI) Inflation rate – LGPS	2.0%	1.95%	Reasonable, slightly prudent
CPI Inflation rate - Teachers	2.0%	1.80%	Reasonable, slightly prudent
Salary increase (over CPI inflation)	1.50%	Council specific	Consistent with previous year-end
Pension increase – LGPS	2.0%	1.95%	Reasonable, consistent with prior year end
Pension increase - Teachers	2.0%	1.80%	Reasonable, consistent with prior year end
Current mortality	107% (97%) of standard mortality table for males (females)	Council specific	Consistent with the 2013 funding valuation of the Fund. Reasonable.
Mortality – future improvements (CMI – Continuous Mortality Investigation)	CMI13 with a 1.5% p.a. long-term rate	CMI14 with a 1.25% p.a. long-term rate	Reasonable, though slightly prudent

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Charitable Trusts

Risk identified

From 2013/14, all Scottish Councils who act as sole trustees for any registered charities have to fully comply with the Charities Accounts Regulations. This requires Charities SORP compliant accounts to be prepared for each Charity, and a separate audit of each. Aberdeenshire Council administers 39 such registered charities. The Charities Accounts (Scotland) Regulation 2006 permits connected charities to prepare a single set of accounts. Aberdeenshire Council has taken the view that those registered charities with common trustees are connected, which has reduced the number of separate sets of accounts to 13.

Key judgements

International Standards on Auditing require us to identify and assess the risk of material misstatement and to identify areas of risk that will require focussed consideration. The following are identified significant risks for the charitable trusts:

- Carrying value of investments
- Presumed risk over revenue recognition, specifically focused on allocation between restricted and unrestricted funds
- Presumed risk of management override of controls

Deloitte response

No issues were noted from our testing of the charitable trusts accounts in the year, which were found to be correctly accounted for in accordance with the Charities SORP.

Following our recommendations made in previous years, we note that the Council is progressing with the re-organisation of its current charities into one (Aberdeenshire Charities Trust) and this was approved by OSCR on 9 April 2015. A final set of accounts is required to be submitted to OSCR before the current charities can be transferred to the new one. The Council should progress this at the earliest opportunity to ensure that the administrative burden of these is minimised. Recognition should also be made to the new Charities SORP which will need to be applied to the 2015/16 charities accounts.

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Best value, use of resources and financial performance

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Financial performance and outlook

Value for money

In 2014/15, Aberdeenshire Council budgeted to use £3.703 million of working balances in order to achieve a balanced budget. The final outturn was an in-year surplus of £6.293 million, resulting in an overall underspend of £9.996 million.

The Comprehensive Income and Expenditure Statement reported a deficit on the provision of services of £62.383 million for the year. After adjusting for the difference between accounting basis and funding basis under regulation and transfers from statutory reserves, the Council reported an decrease in the General Fund balance of £5.893 million.

Overall financial and quality performance

The table below illustrates how the Council's performance compares to budget:

	2014/15 Budget £'000	2014/15 Actual £'000	**2014/15 Variance £'000**
Gross Expenditure	526,835	521,726	(5,109)
Income	(523,132)	(528,019)	(4,887)
Deficit/ (Surplus)	**3,703**	**(6,293)**	**(9,996)**
Use of Earmarked Reserves	N/A	12,186	N/A
Use of Statutory Reserves	N/A	8,882	N/A
Adjustments between accounting basis and funding basis	N/A	47,608	N/A
Deficit on the Provision of Services	**N/A**	**62,383**	**N/A**

Variances were reported to the Policy and Resources Committee throughout the year, with a final report to the full Council meeting in June 2015 and Scrutiny and Audit Committee in July 2015. We note, however, that the net projected variances increased from a £5 million underspend as at January 2015 (reported in April 2015) to the final outturn at March 2015 (reported in June 2015) of £10 million. We note that the Chief Executive has commissioned a review to be undertaken to review the forecasting techniques to establish whether they were appropriate and if the correct degree of risk was accepted when producing them. In addition to this review, we recommend that the finance team looks to achieve a faster, more efficient, financial close to enable more real time reporting and also embrace more effective finance business partnering with the rest of the Council so that such variances are identified at an earlier stage. **Appendix – Action Plan.**

The overall variance is a combination of under and overspends on expenditure and variances on income streams, which are discussed more fully on the following pages.

In terms of **capital expenditure,** housing reported a final outturn of £41.121 million against a budget of £43.757 million. The **non-housing capital expenditure** reported a significant underspend of £29 million (18%) against a budget of £165 million. The key drivers for this underspend are delays on significant projects, including £8 million underspend on Kintore Primary School due to problems in securing land, £4 million underspend on Drumoak Primary School due to delays associated with steel delivery and water connection and £8 million underspend on site acquisitions due to negotiations for acquiring sites for new schools not progressing as quickly as anticipated.

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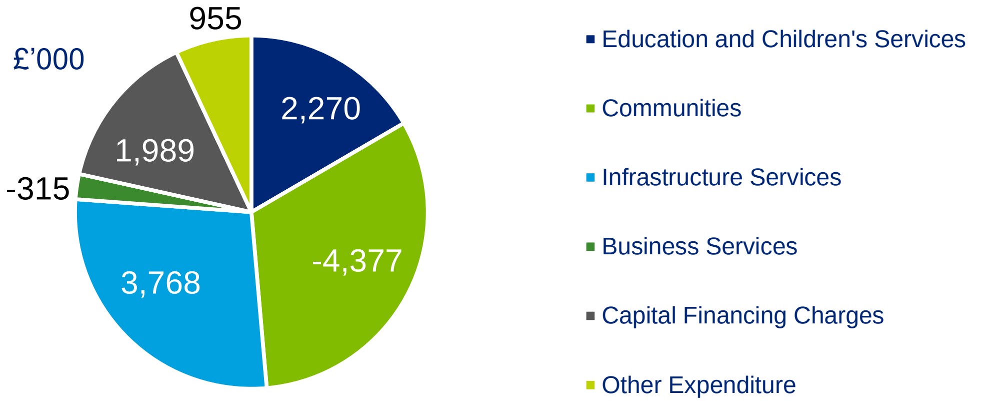
Financial performance and outlook

Overall financial and quality performance (continued)

Expenditure Variances - £5.107 million underspend



- **Education and Children's Services** reported an underspend of £2.270 million due to a number of factors, the main being: £873k underspend in Nursery Education (Children and Young People Act) due to a lower number of eligible 2 year olds using the service than originally anticipated, services to 3 and 4 year old pupils are also evolving to meet the needs of parents/ carers and at the same time there have been recruitment difficulties with teachers. Other factors include vacancies in both teaching and non-teaching staff and restructuring of staff .

- **Communities** reported an overspend of £4.377 million which is largely attributed to Older People Care Management which reported an overspend of £3.621 million. This has arisen due to costs of care at home, residential care, direct payments and self-directed support payments increasing.

- **Infrastructure Services** reported an underspend of £3.768 million (a movement of £2.816 million from the January 2015 forecast) due to a number of factors, including: £1 million underspend in Waste Disposal due to the change in process of collection, which the Council has noted will take time for the budget requirements to settle during the transitional period; £514k underspend in Refuse Collection due to grant income from Zero Waste Scotland towards to the new co-mingled waste service not being included within the budget; and £482k underspend in roads maintenance principally because of three specific network management projects not progressing as planned.

- **Capital Financing Charges** underspent by £1.989 million due to a reduction in interest costs as a result of new borrowing in 2014/15 being deferred until later than budgeted as a result of market conditions, the level of cash backed reserves and a review of the Council's underlying cash needs.

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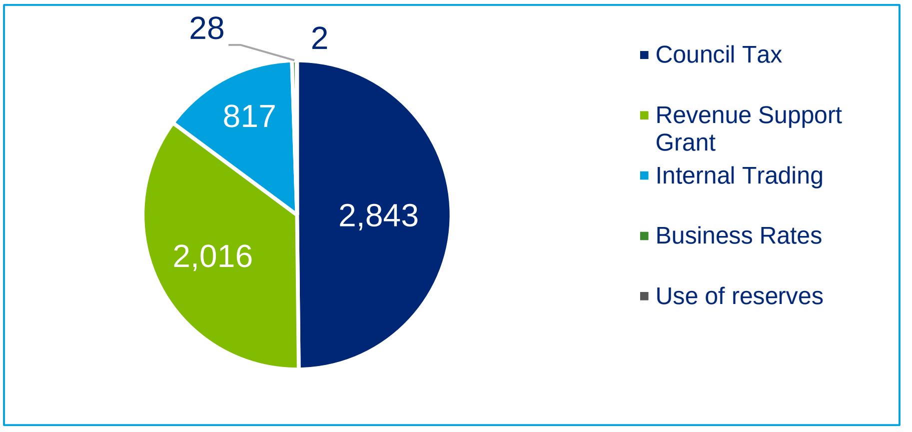
Financial performance and outlook

Overall financial and quality performance (continued)

Income Variances - £4.887 million additional income compared to budget



- **Council Tax achieved £2.843 million additional income** in comparison to budget due to an increase in the number of properties and a reduction in the bad debt provision.

- **Revenue Support Grant was higher than budget by £2.016 million** due to additional funding received from the Scottish Government late in the financial year, where the associated expenditure was met by existing budgets.

Conclusion

While a number of the variances noted above have arisen as a result of changes which would be unforeseen at the time of setting the budget, there are areas where the Council should consider whether the budget process and forecasting is adequately robust. As noted previously, the Chief Executive has commissioned a review of the forecasting techniques given significant late movements in forecasting. We welcome this review.

With the move to an integrated health and social care partnership from 1 April 2016, the pressures noted within Communities will impact on the new partnership going forward. It is important therefore that the Council fully understands the underlying causes of these overspends. With the ever increasing demand on services, the Council and its partner should work to identify how best to target its work on interventions and to deliver better outcomes. A suggested approach based on a case study in England is discussed further on page 33.

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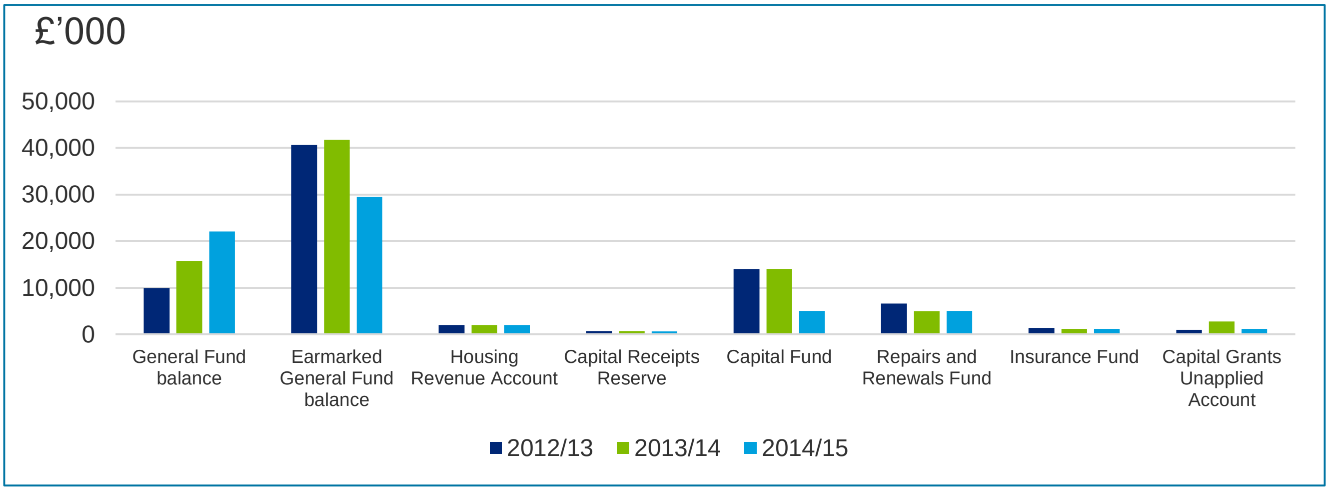
Financial performance and outlook

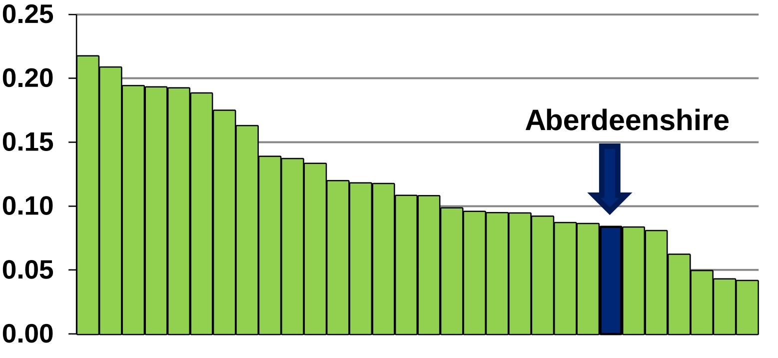
Reserves

The Council's **Usable Reserves** balance has decreased by £16.323 million in the year to £66.764 million at 31 March 2015. This has been achieved mainly as a result of the significant underspends against budget in the previous three years, offset by expenditure of previous earmarked amounts including £12 million on Broadband, £4.486 million on 'Six Key Areas for Development; and £3.664 million towards Innovation.



The Council's policy is to hold minimum working balances of £10 million (2% of budget) for the General Fund and £2 million (5% of budget) for the HRA. The level of reserves at 31 March 2015 is in line within this policy, although significantly above this at £22 million. The Council must ensure that it has an appropriate strategy in place to manage reserves to bring these working balances back in line with the reserves policy, which at the same time demonstrating a clear linkage with the current earmarked balances as set out below.

The chart to the right shows how Aberdeenshire Council compares to the other 32 Councils across Scotland, comparing the usable reserves balance with gross expenditure within the draft 2014/15 accounts.



A total of £29.536 million is being held as "Earmarked General Fund reserves" at 31 March 2015, a reduction of £12.186 million in the year which is largely as a result of the expenditure noted above and new transfers in of £16.399 million. These reserves are to provide financing for future expenditure, including: £7.577 million on Business Transformation, £4.382 million to Devolved Education Management, £2.654 million to Infrastructure Projects, £2.990 million to "Six Key Areas for Development" and £3.229 million to Innovation.

Capital reserves of £6.918 million at 31 March 2015, a reduction of £10.538 million in the year, has been set aside to fund future capital expenditure and to prevent the need for additional borrowing. The reduction is due to funding transfer for the Aberdeen Western Peripheral Route.

Regular reports are provided to Members on the progress of expenditure on these earmarked funds.

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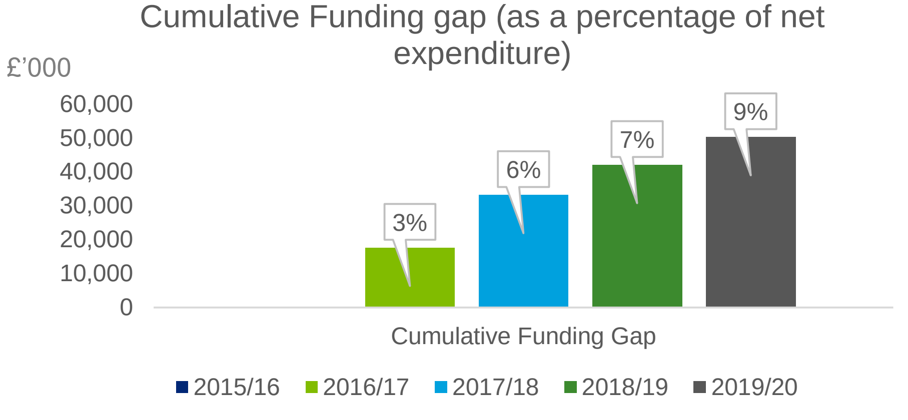
Financial performance and outlook (continued)

Financial outlook

The **2015/16 revenue budget** was approved by the Council on 12 February 2015. This budgeted net expenditure of £532,128 million incorporated £3.665 million budget reductions to meet the budget gap. A number of risks have been identified by the Council when compiling the budget. Some of these are as a result of policy changes such as Welfare Reform, Integration of Health and Social Care and Self Directed Support, whereas others are local risks specific to Aberdeenshire, including staff recruitment issues, particularly difficulties in recruiting teachers, capacity to deliver savings from 2016/17 and demographic changes across Aberdeenshire.

Draft budgets have been prepared on the assumption of a flat cash settlement for all years of the five year budget. The Council has noted that this may be optimistic given the anticipated financial restraints across the public sector over the next 5-year period which could impact on future grant settlement. Whilst 2015/16 shows a balanced position, significant shortfalls are projected in future years as noted below, with a cumulative funding gap of £50.2 million up to 2019/20. A recent report to the Accounts Commission (14 May 2015) noted that 16 of the 32 Councils in Scotland are reporting that they will have a cumulative funding gap in 2017/18, which equates to 2.5% of Councils' budgets across Scotland. While each Council records this slightly differently, comparisons should be treated with caution, the gap in each Council ranges from 1.8% to 14.1%. Aberdeenshire therefore sits within the upper quartile.



From our review of the Council's overall approach to budgeting and its transformation programmes on pages 27, while some progress is being made, the scale and pace of progress needs to be improved.

To date, we have seen limited evidence that robust benefits realisation plans are in place to give assurance that this gap will be filled. These plans also need to be clearly linked to the reserves policy discussed earlier. **Appendix – Action Plan**

From our discussion with Officers, there appears to be a high degree of confidence that these savings can be achieved taking into account factors such as local demographics, the local tax base, the historic level of reserves, the history of underspends (without significant adverse impact on service provision) and a perception amongst officers that there are a number of "quick wins" from inefficiencies and simplifications. Whilst use of reserves may be considered as an option in the short term, we would strongly caution against an over reliance on this at the expense of tackling difficult decisions and properly planning for the medium to longer term.

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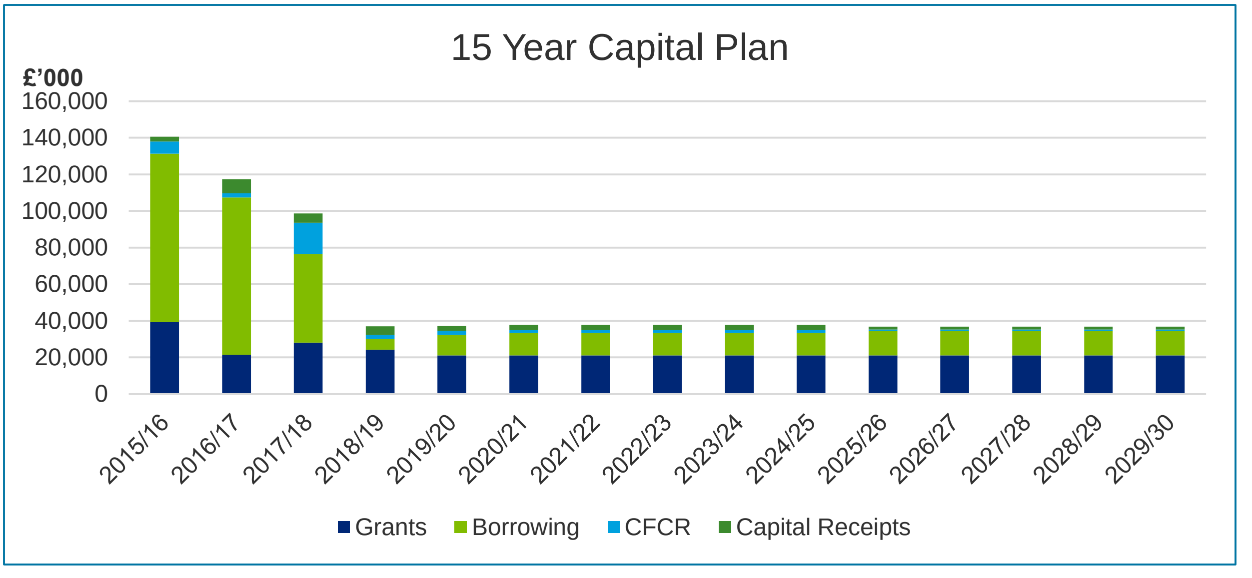
Financial performance and outlook (continued)

Financial outlook (continued)

The 15 year **capital plan** was also approved by the Council at its meeting on 12 February 2015 and was balanced by reflecting an increase in borrowing, which created a corresponding pressure on the revenue budget. To support the balancing of the 2015/16 revenue budget, £22 million of projects were deferred until 2016/17, including £5.8 million planned expenditure on workspaces in the Inverurie Office, £4.9 million planned expenditure on depots and £5.48 million development of industrial portfolios and factory units.



The Council has an ambitious capital plan in place for the next three years, and while the 15 year plan is balanced, there are significant pressures on the plan for new projects coming forward for inclusion. From the most recent review of Service Strategies, £322 million of additional pressures have been noted and a prioritisation process, linking to strategic priorities, has been agreed which will be used to re-score the potential new projects highlighted by services.

The following significant projects are included in the next three years:

- New care home - £8 million
- Aberdeen Western Peripheral Route - £65 million
- Garioch Academy - £25 million
- Kinnellar Primary School - £12 million
- Uryside Primary School - £13 million
- Portlethen/ Hillside Primary School - £11 million
- Community Sports Facility, Hill of Banchory - £8 million

In addition, the housing capital programme, totalling £26.295 million for 2015/16 was approved. This includes £3.471 million of expenditure against new builds, which increases to £11.8 million and £13.5 million in the following two years.

It is important that the Council has robust project management in place to manage this ambitious plan. As noted on page 27, we note that a shared Programme Management Office (PMO) with Aberdeen City Council has been agreed which should incorporate these projects.

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Financial performance and outlook (continued)

Approach to outcome-based budgeting

In our planning paper, we noted that we would undertake a review of the Council's overall approach to its budget process taking into account the planned outcome-based review to assess the arrangements in place for achieving the longer-term savings required to balance its budget.

Following the approval of the 2014/15 budget in February 2014, Members agreed for Officers and Councillors to begin work to balance future years of the revenue budget. In approving the 2015/16 budget, future years budgets from 2016/17 continue to show a shortfall, as noted on page 25.

Officers have been working with Members to develop detailed savings plans to achieve financial balance in future years. These are expected to be presented to Full Council in November 2015, with consultation on proposed options thereafter. To date, we have seen little evidence that robust benefits realisation plans are in place, clearly linking to outcomes. High level proposals have been developed for consideration by the Administration, but further work is required to detail how these will be achieved. We are therefore concerned that the pace and scale of delivery is not yet sufficient to meet the Council's objectives and to address the Council's significant financial challenges.

As we have reported previously, it is essential that a robust benefits realisation delivery process is established with sufficient resource in both capacity and capability, to ensure that these savings plans are achieved. The Strategic Leadership Team has recently considered a paper on the implementation of a shared Programme Management Office (PMO) with Aberdeen City Council, which can then be used to drive significant savings projects by both performing a direct role on large programmes and helping the Council build capacity so that there is clear ownership of responsibilities. This must be progressed with a degree of urgency to ensure that savings are achieved without impacting on outcomes. **Appendix – Action Plan**

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Financial performance and outlook (continued)

Transformation projects

In our planning paper, we noted that we would continue to review the arrangements in place to monitor and implement the **transformation projects** currently ongoing, which are being driven by the need to make significant savings over the next few years.

We recognise that there is evidence of transformation taking place at an operational level within the Council, including changes in the education services operational model and the integration of health and social care progressing. However, the progress with the Councils Transformation Programme in the last 12 months is disappointing and there is limited evidence of tangible "transformation" across the Council. This is acknowledged by Officers and work is being undertaken to relaunch some of the key underlying initiatives. From our experience, Councils, who successfully deliver transformation, place a strong emphasis on communications, stakeholder engagement, leadership alignment, organisation alignment and benefits realisation. The Council should ensure going forward that transformation work streams are introduced which specifically address these requirements. We would be happy to discuss and to provide further detail of potential work stream activities.

The strategic responsibility for all projects now sits with the Senior Leadership Team and existing projects are being reviewed in conjunction with the budget review noted above, which we expect to then fall under the remit of the PMO when set up. Initially, the PMO is expected to help govern, co-ordinate and deliver the joint Procurement Achievement Customer Excellence (PACE) transformation programme and any other joint programmes going forward, as well as provide the Council with a cohesive approach to strategic planning and the delivery of service priorities, investment and transformational change. It is expected to give visibility of all transformational and efficiency programmes at the appropriate level and consider all interdependencies and resource requirements. We welcome the establishment of the shared PMO and encourage a free flow of shared experiences.

One of the key projects that is still ongoing is the new ERM HR and payroll system, which has seen considerable delay from the original timetable. Parallel running to test the system has taken place in July and August and is expected to go live from 1 September for some staff, with the system expected to be fully live for all employees by the end of November.

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Statutory performance indicators

Statutory duties and responsibilities

The **Local Government Act 1992** lays a duty upon each council to ensure that it has in place such arrangements for collecting, recording and publishing performance information that will allow it to comply with a Direction from the Commission.

The appointed auditor's statutory duty in relation to the performance information is set out in the **Local Government (Scotland) Act 1973.** The auditor's duty is to be satisfied that the council "*has made adequate arrangements for collecting and recording information, and for publishing it as required for the performance of their duties".*

The 2012 Accounts Commission Direction and guidance on auditing SPIs was issued in March 2013 and sets out the following approach:

The audit of SPI 1, 2 and 3 is a two stage process:
- Stage 1: Initial stage appraising the arrangements – see below for outcome of this work
- Stage 2: Assessing the quality of Public Performance Reporting (PPR). This will be reported by the Accounts Commission in April/ May 2016.

In July 2015, Audit Scotland reported the findings of its review of PPR across Scottish local authorities for 2013/14. While the SPI Direction sets a flexible approach, it does define corporate management themes and service performance areas that should be included in PPR. Audit Scotland's approach to evaluating the quality of performance reports is based on these themes and the Council's approach to presenting and explaining its performance information.

The Council was reported as being fully compliant in 22 SPI areas (85%) and 4 areas were identified for improvement (15%). The areas for improvement covered both SPI 1: Corporate Management and overall aspects of the reporting. The results of this work have been discussed with the Council and are being taken forward in developing PPR for future years. This is an improved position in comparison with prior year, where only 24% were fully compliant, 71% partially compliant ans 5% not compliant.

The Direction 2014 was issued in December 2014 and sets out the range of the range of performance information for the 2015/16 financial year that the Accounts Commission requires Council to collect and report in public.

Deloitte response

Deloitte has considered the Council's arrangement for collecting, recording and publishing accurate and complete information in relation to the Public Performance Reporting (SPI 1 Corporate Management and SPI 2 Service Performance). We have gained assurance that the Council's process of verifying the SPI data and have controls tested a sample of SPIs for completeness and accuracy. No significant issues were identified within Stage 1 of the process.

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Whole of Government Accounts

Background

Whole of government accounts (WGA) is the consolidated financial statements for all components of government in the UK. Most public bodies are required to provide information for the preparation of the WGA. External auditors are required to review and provide assurance on WGA returns over a prescribed threshold.

Purpose

The WGA provides the most complete picture available of government finances and is a set of accounts for the whole UK public sector (over 5,500 bodies in 2013/14). The WGA is being used in a number of ways:

- Treasury are using as part of their spending team's work;
- Treasury are using to assess the impact of policy changes on long term financial position;
- Ministry of Justice and Department of Health working together to examine reducing the cost of clinical negligence;
- Treasury and Cabinet Office have formed a joint fraud, error and debt task force to tackle the level of losses; and
- Cabinet Office have drawn on WGA in their work on validating the Government estate.

Aberdeenshire perspective

Deadline of 24 July for draft return met

Management review checklist completed and signed by Chief Accountant as evidence of quality review.

No inconsistencies noted between WGA and financial statements

No material counter-party data omitted from return

On schedule to complete audit work by 30 September deadline

Conclusions

Aberdeenshire Council has appropriate arrangements in place for completion of the WGA return. However, the Treasury have committed to faster delivery in future years, which is likely to have a knock-on effect to Council deadlines. We therefore continue to recommend that the Council considers standardising, streamlining and simplifying the close down process, taking into account all the information that is currently produced, including Local Financial Returns (LFRs), Outturn Reports, Financial Statements and the WGA to ensure that they are produced in the most efficient manner. **Appendix – Action Plan**

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Grant claim work

As part of our audit procedures, we have completed our review of the following grant claims / returns by the audit deadlines set by Audit Scotland:

Grant	Deadline	Status	Issues
Safety Camera Partnership Grant	31 July 2015	**Completed**	**None**
Education maintenance allowance	31 July 2015	**Completed**	**None**
Criminal justice social work services grant claim	31 August 2015	**Completed**	**None**
Non-domestic rates income return	9 October 2015	**On Target**	**None to date**
Housing benefit subsidy	30 November 2015	**On Target**	**None to date**

We are on target to complete all grant claim work in line with Audit Scotland deadlines.

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Integration of adult health and social care

Background

We have undertaken a review of the current arrangements and plans in place to develop the Health and Social Care Partnerships with NHS Grampian.

Status

The Integration Scheme has been agreed by partners at the end of March 2015 following extensive consultation and is now with the Scottish Government for approval. There has been close liaison with the Scottish Government during its drafting and it was expected to be signed off in August 2015, at which time the entity will be formally established in legal terms.

Work is now underway to draft the Strategic Plan and is currently out for consultation, with all functions formally being delegated from 1 April 2016. This plan describes the ambitions of the Partnership against the nine national outcomes.

The principle in the Public Bodies (Scotland) Act is that all services included in the legislation should be delegated but those hospital based services that are embedded within larger hospitals, e.g. Aberdeen Royal Infirmary, will remain directly managed by NHS Grampian. The Integrated Joint Board (IJB) will, however, be responsible for the strategic planning of those services and for the whole pathway of care. In relation to the delegated services provided across Aberdeenshire, a condition of the delegation is the requirement for a memorandum of understanding agreed by the IJB and NHS Grampian to ensure that all parties are satisfied with the management and coordination arrangements that will be put in place. This was considered at the North East Partnership Steering Group in February and there was a consensus on this way forward. These arrangements will be developed by the Strategic Change Management Group and North East Partnership Steering Group for approval by the parent organisations and the shadow IJB. This is expected to be completed early in 2015/16.

The development of the budgets associated with the delegation of services continues during 2015 and a process of due diligence will be agreed to ensure that the final budget allocations are fair and reasonable for all parties.

Conclusion

Overall, work is progressing and regular reports are provided to the Council on status.

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Integration of adult health and social care (continued)

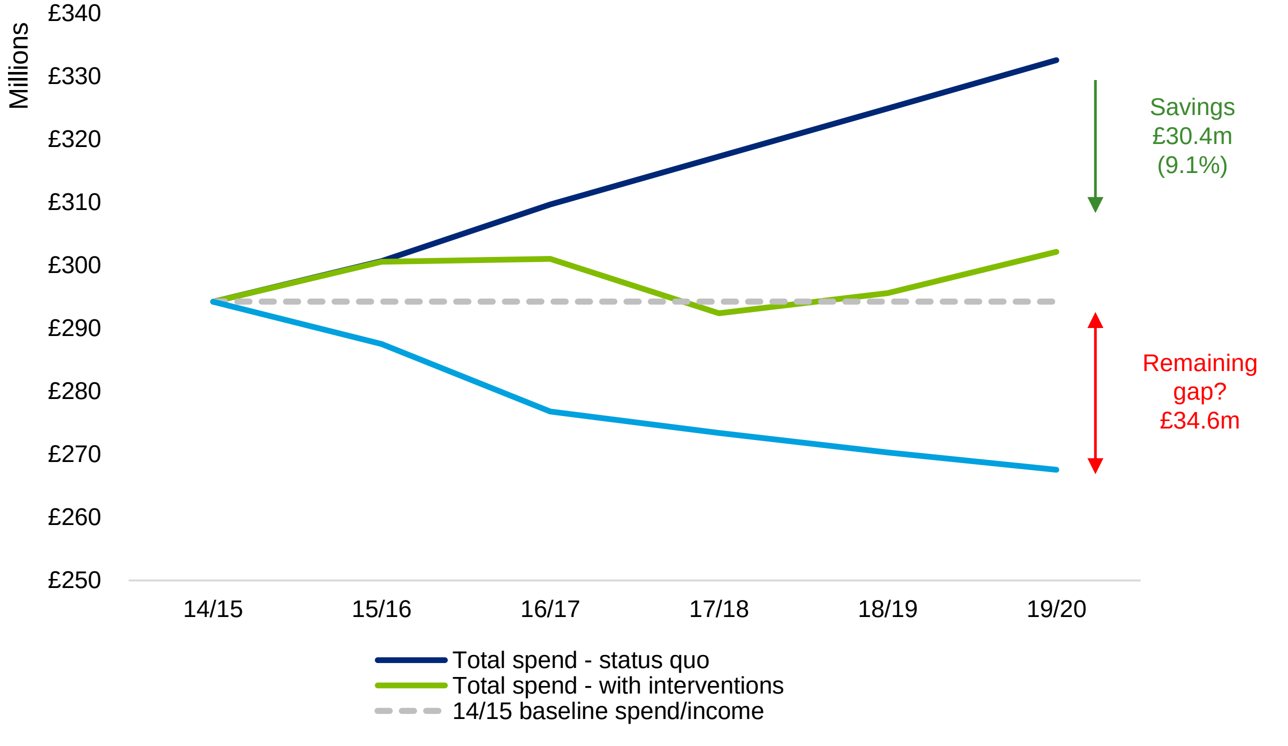
Insight

As both the health and local government sectors continue to be under huge financial pressure it is important that the new Integrated Joint Board (IJB) use the integration of adult health and social care to make transformational changes.

Case Study – Early Intervention

Deloitte has been involved in work in England and carried out a case study on an organisation which had an early intervention programme and assisted living service within local communities due to go live in 2015/16. We estimated the benefits that might be possible from the programme, looking forward at the financial position on a "do nothing" baseline and then applying assumptions around reductions in activity based on best practice evidence available. We were then able to advise on the make up of the programme and make recommendations on the best approach to delivering the projects and on the governance structures and resourcing required to enable the programme to achieve its ambitions.

From this work we estimated that the programme could deliver £30m in savings as illustrated in the following diagram, which should at the same time improve outcomes.



Recommendation

We recommend that the Transitional Leadership Group and IJB consider applying a similar analysis to help identify how best to target its work on interventions and to deliver better outcomes from the new pooled budgets. **Appendix – Action Plan**

Welfare Reform

The 2012 Welfare Reform Act brought fundamental changes to the UK Benefits System. With a phased introduction from 1 April 2013, the changes outlined within the Act affected the majority of existing types of benefit resulting in a significant impact on a large percentage of people in receipt of benefits.

Housing benefits awards may be affected by Local Housing Allowance, the financial circumstances of applicants, any other benefits they receive and also the effects of the Spare Room Subsidy introduced in the aforementioned Act. It is therefore important that each case is calculated accurately based on all available information. Staff training and actively engaging with key stakeholders are key to assessing and managing the impact of, and risks associated with, these changes.

In Aberdeenshire, Universal Credit is now available to single claimants living in north Aberdeenshire. The new benefit, which will be available in all Jobcentres across the UK by next spring, has been introduced to Jobcentres in Banff, Fraserburgh and Peterhead from 26th May 2015. The Council has reported that the Council, Jobcentre Plus, social landlords and other partners and stakeholders have been working together to co-ordinate their response so that they support those residents affected. This includes the provision of on-line supported access, personal budgeting support and data sharing arrangements.

On the basis of our review, we are satisfied that the Council has developed a clear understanding of the organisational impacts associated with welfare reform and has implemented appropriate mitigations.

Reducing the cost of welfare benefits continues to be a government focus. In the 8 July 2015 Budget Announcement, the Chancellor advised that a further £12 billion in savings to be made from welfare benefits had been identified, including:

- Freezing the uprating of working age benefits, tax credits and Local Housing Allowance for the next 4 years;
- Reduction in housing support benefits, and
- Capping of total benefits paid to a household at £20,000 (£23,000 in London).

As a result of this announcement and the inevitable changes to benefits administration that it will bring, maintaining an effective change management strategy and clear communication plan will remain key requirements of the Council's approach moving forward if the associated impact on financial sustainability and Council service delivery are to be managed.

We will continue to monitor the impact of the reform during the period of our appointment.

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Local Area Network

Council's responsibilities

Deloitte continues to actively participate in the Local Area Network (LAN) and make positive contributions to the Local Scrutiny Plan. The LAN met in December 2014 to update the shared risk assessment, and met with the Chief Executive and the Council's Management Team in February 2015. The Local Scrutiny Plan 2015/16 was published by Audit Scotland in March 2015 and was presented to the Full Council meeting on 18 June 2015.

Conclusions

No specific risks were identified in the shared risk assessment this year. However, the LAN identified a number of areas which form part of the on-going oversight and monitoring work carried out by scrutiny partners. This work includes the following issues:

- **Leadership and management –** We have provided commentary on the changes in senior management and administration on page 39 of this report.
- **Future year funding gap –** We have provided commentary on this risk on page 25 of this report.
- **Health and social care –** The Care Inspectorate link inspector will monitor progress made in relation to the resultant action plan from the pilot joint inspection of services for older people. We have also made comment on the preparatory work being done for the new health and social care partnership (see page 32).
- **Housing and homelessness –** The Scottish Housing Regulator will continue to monitor the percentage of Council housing stock that meets the Scottish Housing Quality Standard.
- **Education Scotland –** Recruitment and retention of teaching staff continue to be a major challenge. Education Scotland will continue to provide related support and challenge through its ongoing engagement with the Council.

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National Fraud Initiative

Council's responsibilities

As part of the 2014/15 NFI exercise, local authorities were required to submit data in October 2014. Matches for investigation were then communicated to all at the start of 2015. All bodies should investigate the recommended matches plus further matches based on findings and the risk of error or fraud. Match investigation work should be largely completed by 30 September 2015 and the results recorded on the NFI system. Some investigations may continue beyond this date.

Auditor responsibilities

We are required to monitor the Council's participation and progress during 2014/15 and into 2015/16 as part of our consideration of the arrangements for the prevention and detection of fraud. As part of this, two completed questionnaires have been submitted to Audit Scotland during the year reflecting the activity undertaken by Aberdeenshire Council following receipt of the matches for investigation.

Status

Council Tax to Electoral Register matches

- This NFI match is very simple in that it matches council tax records to the electoral register and identifies cases where single person discount (SPD) has been awarded when the electoral register indicates that another countable adult is living at the same address.

- Aberdeenshire Council submitted both datasets for the NFI 2013/14 Council Tax to Electoral Register matching exercise. It hasn't, however, used the Flexible Matching Service as it was in the process of a review exercise using Northgate and Experian. This exercise resulted in discount being cancelled in 795 cases (out of a total of 32,224), worth an estimated £243k in additional council tax income. This exercise cost £30k, therefore net benefit to Council was £213k to date, with further claims still being reviewed.

NFI Exercise 2014/15

- While a report was presented to the Scrutiny and Audit Committee setting out the outcomes of the 2013/14 exercise, no self appraisal checklist was completed (as recommended in the Audit Scotland 2014 NFI Report) as a means of monitoring the Council's planning and progress with the 2014/15 exercise.

- Following the transfer of staff to the Single Fraud Investigation Service (SFIS), the Council no longer has any dedicated fraud staff to deal with non-housing benefit or corporate frauds. There area also currently no procedures in place to determine action required if SFIS don't take on the referrals from the Council.

- All mandatory data sets were submitted on time. However, due to resourcing issues, the Council has only recently started following up on the recommended matches, with the Payroll matches still to be started.

Conclusions

The Council must review its arrangements for following up NFI data matches as a priority to ensure that any potential frauds or errors are identified and followed up timeously. The self appraisal checklist from the Audit Scotland 2014 report should be used to assist with planning and monitoring progress. **Appendix - Action Plan**

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Governance and accountability

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Governance and Transparency

Governance arrangements are operating effectively

In accordance with the Code of Audit Practice, we are required to consider and formally report in relation to the following key matters:

Appropriate systems of internal control are in place	Arrangement for the prevention and detection of fraud and other irregularities are satisfactory
Arrangements for maintaining standards of conduct and the prevention and detection of corruption are satisfactory	Committees of the Council are effective in overseeing governance and performance monitoring

We confirm that we have reviewed the arrangements in each of the four areas and have identified no issues in this regard. Further commentary on internal audit and the wider governance arrangements is noted on the following pages.

We are comfortable with the fraud arrangements in place and confirm there have been no financially significant frauds of which management have made us aware.

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Governance and Transparency (continued)

Governance arrangements are operating effectively

Leadership

A number of changes in **leadership** have been noted during the year as noted below:

Chief Executive

- Colin Mackenzie retired as Chief Executive in Feb 2015
- Jim Savege was appointed as new Chief Executive in Feb 2015

Directors

- Changes to the portfolio of the four Directors during 2014.
- Director of Business Services resigned and has since left Council in May 2015.
- Further changes to portfolio of Directors planned from October 2015, reducing to three Directors.

Political Leadership

- A series of political changes took place following a Special Council meeting in June 2015
- The Council is now led by an administration, 'The Partnership' comprising 28-member SNP group, and the four 'Progressive Alliance' between Scottish Labour and Progressive Independent Councillors.

The Full Council agreed at its meeting in March 2015 to review all aspects of the decision-making structure of the Council so as to be responsive to the changes facing local government in the short, medium and longer term. We understand that this review will incorporate a review of the Scrutiny and Audit Committee. We welcome this ongoing review. A 14 member working group was established, however due to the change in administration in June 2015, the original timescale has slipped and the first meeting of this group did not meet until 27 August 2015. An Officer Review Group has also been established to review all governance documentation to ensure that it is comprehensive and covers all relevant matters. We would recommend that these reviews, including the decision-making structure, committee structure and review of Financial Regulations, are fully aligned to ensure that any changes are not made in isolation. **Appendix – Action Plan**

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Governance and Transparency (continued)

Governance arrangements are operating effectively

Internal Audit

From 1 April 2015, Aberdeenshire Council's Internal Audit team has been providing internal audit services to Aberdeen City Council through a shared service agreement. In view of this and the impending changes around integration of health and social care, a one year plan (rather than a 3-year rolling plan) was approved by the Scrutiny and Audit Committee in April 2015.

From our review of the internal audit reports issued during 2014/15, we have noted a number of "major" graded recommendations, in particular issues identified from internal audit's review of year-end payments which raised some significant concerns around lack of compliance with financial regulations. This has been a recurring theme and highlighted by the Scrutiny and Audit Committee. We note that no frauds have been identified as a result of these issues

The planned review and update of the Financial Regulations has been put on hold pending the wider governance review noted previously. Whilst we agree that these reviews do need to be fully aligned, the current level of lack of compliance needs to be investigated and action taken by ensuring that the current financial regulations are fit for purpose.

We note that this has been highlighted in the governance statement where the Chief Internal Auditor has raised concerns that the training has had little impact to date and more action is required and that the Senior Leadership Team will be receiving regular updates on the progress being made. We will continue to monitor the impact of this during the 2015/16 audit.

Shared Services

We note that good progress has been made in the year in identifying areas where there can be greater synergies and efficiencies from working together with Aberdeen City Council, including the shared Internal Audit service (as noted above) and the proposed shared PMO (see page 27). The Central Procurement Unit has also been in place for a number of years.

The focus at this time has been on shared contracting as opposed to shared services and there have been a number of good examples of this. We would encourage this momentum and recommend that in due course full shared services should be fully considered for certain support functions.

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Governance and Transparency (continued)

Governance arrangements are operating effectively

Following the Public Pound

The statutory requirements to comply with the Following the Public Pound Code, in conjunction with the wider statutory duty to ensure Best Value, means that Councils should have appropriate arrangements to approve, monitor and hold third parties accountable for public funding provided to them.

We have considered the appropriateness of the Council's arrangements to meet their obligations to comply with the Code and note the following:

- Consideration of the arrangements in included within the Internal Audit plan. This was last reviewed in 2012/13 and is included in the plan for 2015/16.

- As a follow-up to the national report *Arm's length organisations: Are you getting it right?,* we reported in May 2014 that appropriate governance arrangements are in place where elected members are nominated to and involved with external bodies.

- We did recommend that as part of the ongoing budget strategy review, the Council should consider the benefits and risks of Arms Length Organisations (ALEOs) as laid out in the Commission's report in determining "How" any service proposed for an ALEO is to be delivered in the future. The Council's Scrutiny and Audit Committee has recently undertaken a review of the various Alternative Delivery Models (ADM) available to the Council in terms of the benefits and disadvantages of each; the experience of other Councils and the service deliveries in circumstances where ADMs exist; and the drivers for moving to an ADM for the delivery of any particular service. The Accounts Commission's report on ALEO's was considered as part of this review. The outcome of this review was as follows:

    - ADMs should not routinely be viewed as the only means to save money, or deliver services more efficiently;
    - Prior to determining that an ADM should be pursued, the outcomes sought should be clear, and the Council should have explored all possible avenues to optimise the service; and
    - Where a decision is made to pursue an ADM, subject to the above, the matters set out below should be taken into consideration by both Councillors and officers:

        1. Why is an ADM being considered?
        2. What services/ functions are being included/ excluded from consideration?
        3. How will the ADM be set up?
        4. Who should be involved in the process of determining the type of ADM to be utilised and its implementation?
        5. When should implementation take place?

The Committee concluded that by approaching the consideration and implementation of ADMs taking into account the above and utilising the toolkit developed should mitigate the risks which may be associated with such an approach.

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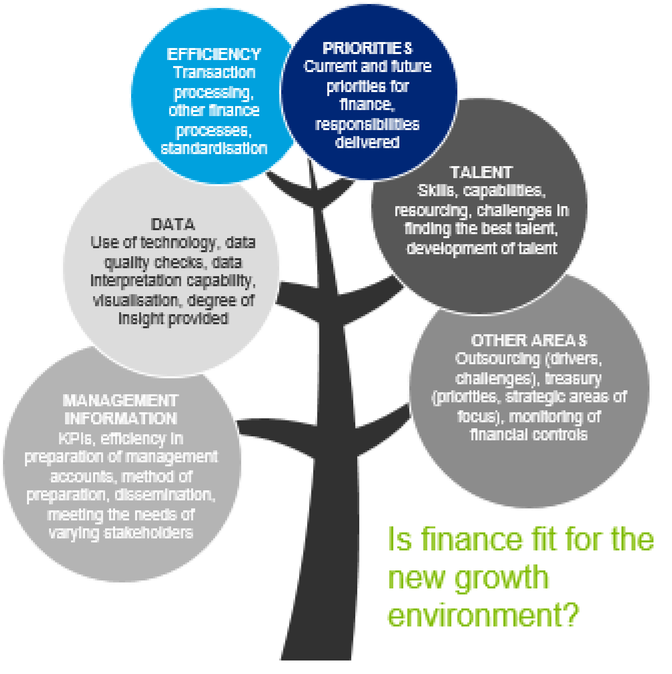
Governance and Transparency (continued)

Governance arrangements are operating effectively

Deloitte benchmarking survey

Aberdeenshire Council took part in Deloitte's second finance benchmarking survey, the results of which were reported to the Scrutiny and Audit Committee in May 2015.
Benchmarking was conducted across a range of finance-related topics.



From the analysis of Aberdeenshire Council's response to the survey in comparison with other respondents, the following key points were noted:

- Our benchmarking exercise has revealed that the Council performs well against its comparators in a number of areas, in particular, how most of the core services are provided, the balance of current time spent by finance across typical areas of responsibility and the technical capability of the finance function.

- Leading practice finance functions have tended to get more involved in driving strategic decision making and our results show that the Council is slightly behind this trend. Effective partnering between finance and the rest of the organisation is essential, particularly given the current financial climate and need to demonstrate and contribute to value for money. There is also scope to improve the analytical capabilities of the finance function to support this strategic decision making.

- The results of the survey also highlighted that there may be scope for efficiencies in transactional processing, month-end and year-end reporting timetables which could have the potential to free staff up to focus more on added value activities.

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Your Annual Report

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Our comments on your annual report

We welcome this opportunity to set out for the Scrutiny and Audit Committee our observations on the annual report. We are required to read the “front half” of your annual report to consider consistency with the financial statements and any apparent misstatements. Here we summarise our observations on your response to these areas:

	Deloitte response
Management Commentary	The 2014 Regulation introduced a requirement for the annual accounts to include a Management Commentary, which aligns the requirements to that of the Government Financial Reporting Manual and the Companies Act. The Management Commentary comments on financial performance, strategy and performance review and targets. Deloitte note that the Management Commentary has been prepared in line with issued guidance and includes a detailed review of the Councils performance. From benchmarking of other Council’s accounts, we have highlighted the following areas to be considered for future years to enhance to readers understanding: • The use of diagrams, charts and tables could be enhanced; • Use of signposting to notes in the accounts or other documentation for further details; • Benchmarking performance with other Councils; and • Balancing the level of detail of financial and non-financial information. **Appendix – Action Plan**
Remuneration Report	The remuneration report has been prepared in accordance with the 2014 Regulations, disclosing the remuneration and pension benefits of Senior Councillors and Senior Employees of the Council. Appropriate disclosure has been made following the retirement of the former Chief Executive. No redundancy payments, service enhancements or other compensation for loss of office were paid to him on his retirement.
Governance Statement	The Governance Statement reports that Aberdeenshire Council governance arrangements provide assurance, are adequate and are operating effectively. We have reviewed the systems in place to ensure that there is sufficient evidence available to the Chief Executive and Co-Leaders to sign the Governance Statement. Currently, assurance is largely taken from the work of Internal Audit. We have recommended that to further enhance these arrangements, best practice requires input from all Directors and Senior Councillors to ensure that all potential issues are captured **Appendix – Action Plan** The statement notes that some significant concerns relating to compliance with policies and procedures has been noted by Internal Audit. However, reasonable assurance can be placed upon the adequacy and effectiveness of the Council’s internal control environment. This is consistent with our knowledge based on evidence collected in the course of the audit. Appropriate disclosure has been made regarding the governance and financial assurance arrangements being put in place regarding the Integrated Joint Boards.

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Purpose of our report and responsibility statement

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Purpose of our report and responsibility statement

Our report is designed to help you meet your governance duties

What we report

Our report is designed to help the Scrutiny and Audit Committee and the Members of the Council discharge their governance duties. It also represents one way in which we fulfil our obligations under ISA 260 (UK and Ireland) to communicate with you regarding your oversight of the financial reporting process and your governance requirements. Our report includes:

- Results of our work on key audit judgements and our observations on the quality of your Annual Report.
- Other insights we have identified from our audit.

What we don't report

- As you will be aware, our audit was not designed to identify all matters that may be relevant to the Council.
- Also, there will be further information you need to discharge your governance responsibilities, such as matters reported on by management or by other specialist advisers.
- Finally, our views on internal controls and business risk assessment should not be taken as comprehensive or as an opinion on effectiveness since they have been based solely on the audit procedures performed in the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

The scope of our work

- Our observations are developed in the context of our audit of the financial statements.
- We described the scope of our work in our audit plan and the supplementary "briefing on audit matters" previously circulated to you.

We welcome the opportunity to discuss our report with you and receive your feedback.

Deloitte LLP

Deloitte LLP
Chartered Accountants
Edinburgh
11 September 2015

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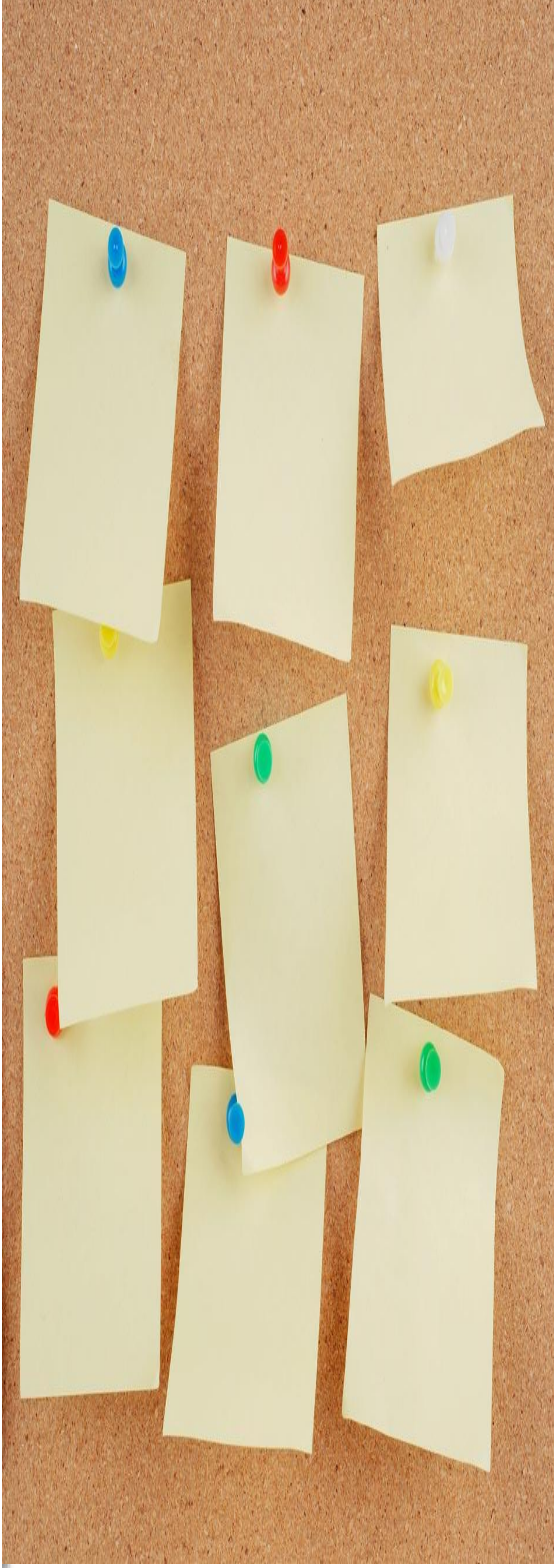
Appendices



Audit adjustments

Summary of uncorrected and corrected misstatements

Corrected misstatements

There were two material and two significant corrected misstatements noted during the process of our audit work.

Adjustment	Credit/ (charge) to current year CIES/ General Fund £'000	(Increase)/ decrease in net assets £'000	Increase/ (decrease) in reserves £'000
Dr Revaluation Reserve Cr PPE – Other Land and Buildings *Being the correction to the gain on revaluation*	- -	- 10,438	(10,438) -
Dr CIES Cr PPE – Infrastructure Services/ Vehicles, Plant & Equipment Dr Capital Adjustment Account Cr Movement in Reserves Statement *Being the correction of the depreciation on VPF&E and Infrastructure Assets*	(6,211) - - 6,211	- 6,211 - -	- - (6,211)
DR Revaluation Reserve CR Capital Adjustment Account *Being write down of housing revaluation gains journal omitted in error*	- -	- -	(3,988) 3,988
DR Revaluation Reserve Cr CIES DR Movement in Reserves Statement CR Capital Adjustment Account *Being the correction of depreciation adjustment on Mearns Academy revaluation*	- 327 (327) -	- - - -	(327) - - 327
Total	**Nil**	16,648	**(16,648)**

Uncorrected misstatements

There were two uncorrected misstatements noted during the process of our audit work, as summarised below:

- From our cut-off procedures, we identified one invoice relating to 2014/15 to the value of £66k which had not been accrued in error. As it is not possible to determine that this is an isolated error, we have extrapolated this error over the population of our testing (April 2015 payments) and calculated a judgemental misstatement of £621,000, being a potential understatement of accruals at the year-end. As this amount is not material, this has not been corrected by management

- The draft financial statements included both a debtor due from Scottish Government of £1.816m and a creditor due to Scottish Government of £2.095m in relation to Business Rates collected. As the Council collects these monies on a agency arrangement, these amounts should be netted off within the financial statements. The debtor of £1.816 million should therefore be reclassified and netted off against the creditor due.

Disclosure misstatements

Auditing standards require us to highlight significant disclosure misstatements to enable audit committees to evaluate the impact of those matters on the financial statements. There were no disclosure misstatements noted in the course of our work.

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Action Plan

Our recommendations for improvement

We present a summary of observations on the Council's internal control and risk management processes:

Area	Observation	Management response	Priority
Property Plant and Equipment	We recommend that the valuer should consider MEA issues and where possible determine the land value reflecting an appropriate site size for a MEA facility and if possible determine a site value reflecting the least cost to replace basis.	We have addressed MEA issues, but have done so in a different manner to that suggested. Whereas we consider the method we adopted as appropriate, having had this approved by the District Valuer Service, we will adopt the suggested method in future valuations. **Responsible Officer:** Estates Manager **Target date:** 31 March 2016	
Property Plant and Equipment	We recommend that the 'schemes of valuation' are simplified and that the valuer seeks further input from senior management and their external consultants prior to devising such schemes and that these are critically reviewed prior to adoption.	The "schemes of valuation" referred to relate to the method of determining the building costs for schools. Whereas the method adopted is complex it is considered to be more accurate. Nevertheless, based on the recommendation we will adopt the method suggested for future valuations. For the avoidance of doubt the method adopted was approved internally and by the District Valuer Service before being implemented. **Responsible Officer:** Estates Manager **Target date:** 31 March 2016	
Infrastructure Assets	As recommended in prior year, the Council should establish information collection arrangements to allow them to apply full retrospective restatement. This will require changes to the way these assets are recorded within the fixed asset register.	A working group has been established and a project action plan devised in accordance with LAAP bulletin 100. The Infrastructure Assets have been prepared in accordance with the Transport Infrastructure Assets Code of Practice as at 31 March 2015 for the Whole of Government accounts. The working group will meet to validate these figures, identify any existing data gaps for producing the depreciated replacement cost position and aim to close this gap before finalising the 'dry-run' restatement of the 31 March 2015 position per the accounts. **Responsible Officer:** Corporate Finance Manager **Target date:** 31 December 2015	

Key:

High Priority   Medium Priority   Low Priority

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Action Plan (continued)

Our recommendations for improvement (continued)

Area	Observation	Management response	Priority
Journal Entries	Management should follow up the points raised as part of our journal insights, as detailed on page 16.	A review of the findings will be undertaking and an action plan produced. **Responsible Officer:** Chief Accountant **Target date:** 31 December 2015	
Financial close	We recommend that the finance team looks to achieve a faster, more efficient, financial close to enable more real time reporting and also embrace more effective finance business partnering with the rest of the Council so that such variances are identified at an earlier stage.	Discussions have taken place within Finance on the feasibility of achieving a faster financial close at each month end. This will be progressed with a view to implementing for the 2016/17 monitoring reports. **Responsible Officer:** Chief Accountant **Target date:** 31 July 2016	
Fixed Asset Register	While the new fixed asset register has been implemented, a number of classification issues were noted when the data was transferred. This has been manually corrected for the financial statements, however, we recommend that this is fully reconciled to allow full functionality of the new system in future years.	The data migration process when setting up the new asset register created additional time pressures at year end. We understand the new system's functionality can only be fully realised with the fixed asset register, ledger and annual accounts fully reconciled. We therefore aim to ensure opening balances as at 1 April 2015 are fully reconciled before the 15/16 year end begins. **Responsible Officer:** Corporate Finance Manager **Target date:** 31 December 2015	
Fixed Asset Register	In view of these material errors arising from the new fixed asset register, we would recommend that finance staff should incorporate a review process into their procedures to ensure that the data being produced by the system is in line with expectations.	Agreed – the year end procedures will incorporate a review process as recommended. **Responsible Officer:** Corporate Finance Manager **Target date:** 31 May 2016	

Key:

High Priority

Medium Priority

Low Priority

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Action Plan (continued)

Our recommendations for improvement (continued)

Area	Observation	Management response	Priority
Governance reviews	We would recommend that the ongoing governance reviews, including the decision-making structure, committee structure and review of Financial Regulations, are fully aligned to ensure that any changes are not made in isolation.	These reviews will be aligned. **Responsible Officer:** Director of Business Services **Target date:** 31 March 2016	Medium
Benefits realisation plans	As recommended previously, robust benefits realisation plans must be developed to give assurance that the funding gap will be filled. These plans also need to be clearly linked to the reserves policy.	Agreed – the Strategic Leadership Team are scheduled to receive a final proposal on PMO implementation at their meeting on 9 September 2015. Thereafter the communications and implementation plan, against agreed initial scope, will be worked up with engagement commencing with all Service Management Teams from 1 October 2015 onwards, and will take around twelve months to complete. The plans will be linked to the reserves policy. **Responsible Officer**: Head of Commercial and Procurement. **Target date:** 30 September 2016	High
Standardisation of reporting	As recommended previously, given the various levels of reporting now required by the Council, consideration should be given to standardising, streamlining and simplifying the close down process. This should include amending the ledger structure to allow more direct reporting from the ledger in the format required for the financial statements, with a reduced level of manual intervention.	The financial ledger coding structure has been reviewed and a number of codes have been closed down. Revised monitoring reports using this new structure will be run in parallel with the existing monitoring reports for monitoring from September to November with a view to full implementation for the December monitoring. The revised coding structure should also assist in reducing manual intervention at the year end. **Responsible Officer:** Chief Accountant **Target date:** 30 June 2016	Medium

Key:

High Priority

Medium Priority

Low Priority

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Action Plan (continued)

Our recommendations for improvement (continued)

Area	Observation	Management response	Priority
Health and Social Care Integration	We recommend that the IJBs consider applying a similar analysis to that noted on page 32 to help identify how best to target its work on interventions and to deliver better outcomes from the new pooled budgets.	We are aware of this work and are considering its value against the cost that a provider would charge us to undertake this work. **Responsible person:** Chief Officer (Health and Social Care) **Target date:** 31 October 2015	Medium Priority
NFI	The Council must review its arrangements for following up NFI data matches as a priority to ensure that any potential frauds or errors are identified and followed up timeously. The self appraisal checklist from the Audit Scotland 2014 report should be used to assist with planning and monitoring progress.	The lessons learned from the 2014 NFI exercise will be reviewed by 30 October 2015 and the self-appraisal checklist will be completed ahead of the 2016 NFI exercise. **Responsible person**: Corporate Finance Manager and Benefits Manager **Target date:** 30 September 2016	Medium Priority
Management Commentary	The Council should consider the following areas for future years to enhance to readers understanding: • The use of diagrams, charts and tables could be enhanced; • Use of signposting to notes in the accounts or other documentation for further details; • Benchmarking performance with other Council's; and • Balancing the level of detail of financial and non-financial information.	The format of the management commentary will be reviewed, taking account of the points raised by external audit. **Responsible person:** Chief Accountant **Target date:** 30 June 2016	Medium Priority
Annual Governance Statement	We recommended that a more formal process is agreed to obtain input from all Directors and Senior Councillors into the Annual Governance Statement to ensure that all potential issues are captured.	A formal process will be established. **Responsible person:** Head of Finance **Target date:** 30 April 2016	Medium Priority

Key:

High Priority

Medium Priority

Low Priority

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Action Plan (continued)

Follow up of prior year actions

We have followed up the recommendations included in our 2013/14 annual report and summarised below the progress made against each of these. While we have noted that progress has been made on some of the actions, a number are only partially implemented, as detailed below. Management should ensure that achievable timescales are agreed so that these actions are implemented timeously.

The more significant outstanding recommendations have been included again within out action plan on page 49-51 in relation to:

- Changes to the Code – Transport Infrastructure.
- Standardisation of reporting.
- Fixed Asset Register.
- Benefits realisation process.

Key Areas	Fully Implemented	Partially Implemented	Not Implemented	Not Implemented – Risk Accepted by Council	Not yet Due
Property, plant & equipment	2	1		1	
Provisions	1	1			
Charitable Trusts	1		1		2
Reporting	1				1
Statutory Performance Indicators	1				
Year-end working papers	1	2			1
Budget strategy review	1	1	1		
Follow-up Actions		1			
ICT			1	1	
Payroll		1			
Total	8 (33%)	7 (29%)	3 (13%)	**2 (8%)**	4 (17%)

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Fraud responsibilities and representations

Responsibilities explained

Responsibilities

The primary responsibility for the prevention and detection of fraud rests with management and those charged with governance, including establishing and maintaining internal controls over the reliability of financial reporting, effectiveness and efficiency of operations and compliance with applicable laws and regulations. As auditors, we obtain reasonable, but not absolute, assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error.

Required representations

We have asked the Council to confirm in writing that you have disclosed to us the results of your own assessment of the risk that the financial statements may be materially misstated as a result of fraud and that you are not aware of any fraud or suspected fraud that affects the entity.

We have also asked the Council to confirm in writing their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

Audit work performed

- In our planning we identified the risk of fraud in other income recognition and management override of controls as a key audit risk for the Council.
- During course of our audit, we have had discussions with management and those charged with governance.
- In addition, we have reviewed management's own documented procedures regarding the fraud and error in the financial statements.

Concerns

- As set out above we have identified the risk of fraud in revenue recognition and management override of controls as a key audit risk for your organisation.

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Independence and fees

There are no issues we wish to raise to you

As part of our obligations under International Standards on Auditing (UK & Ireland), we are required to report to you on the matters listed below:

Independence confirmation	We confirm that we comply with APB Ethical Standards for Auditors and that, in our professional judgement, we and, where applicable, all Deloitte network firms are independent and our objectivity is not compromised.
Fees	The audit fee for the year from 1 April 2014 to 31 March 2015 is £433,000 (inclusive of VAT and Audit Scotland fixed charge) and is within the indicative fee range set by Audit Scotland. There were no non-audit services for the period.
Non-audit services	In our opinion there are no inconsistencies between APB Ethical Standards for Auditors and the Board's policy for the supply of non-audit services or of any apparent breach of that policy. We continue to review our independence and ensure that appropriate safeguards are in place including, but not limited to, the rotation of senior partners and professional staff and the involvement of additional partners and professional staff to carry out reviews of the work performed and to otherwise advise as necessary.
Relationships	We are required to provide written details of all relationships (including the provision of non-audit services) between us and the organisation, its board and senior management and its affiliates, including all services provided by us and the DTTL network to the audited entity, its board and senior management and its affiliates, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our objectivity and independence. We are not aware of any relationships which are required to be disclosed.

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Future developments

Additional information on current and future technical developments

Transport infrastructure assets

The 2016/17 Code will adopt the measurement requirements of the Code of practice on transport infrastructure assets, and require highways to be measured on a Depreciated Replacement Cost basis.

CIPFA has issued **LAAP Bulletin 100: Project plan for implementation of the measurement requirements for transport infrastructure assets by 2016/17** and seeks to identify the key areas and milestones which bodies should take into consideration in developing their implementation plans.

It is essential that finance, asset management practitioners and engineering professionals work together to develop and action their project plan as soon as possible in order to achieve successful implementation, although it is likely that the finance professionals will take the lead on the accounting issues.

Councils should discuss their project plan with their external auditors and agree review timetable.

The Council should establish information collection arrangements to allow them to apply full retrospective restatement. This will require changes to the way these assets are recorded within the fixed asset register. **Appendix – Action Plan**

FRS 102 "The Financial Reporting Standard Applicable in the UK and Ireland" was published in March 2013 and replaces current UK GAAP. For periods beginning on or after 1 January 2015, charities will need to move to FRS 102.

A new Charities SORP will assist in interpretation of the new standard and a consultation draft was published July 2013 and the consultation closed on 4 November 2013. Early adoption of the SORP or FRS 102 will not be possible. The revised SORP is modular in approach and amongst other changes sets out a simplified SOFA, and place greater emphasis on the disclosures relating to risk management and going concern in the trustees report. Further details can be found in the charities alert July 2013.

(www.deloitte.co.uk/charitiesandnotforprofit)

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