Aberdeenshire Council

2016/17 Annual Audit Report

AUDIT SCOTLAND

For Members of Aberdeenshire Council and the Controller of Audit

28 September 2017

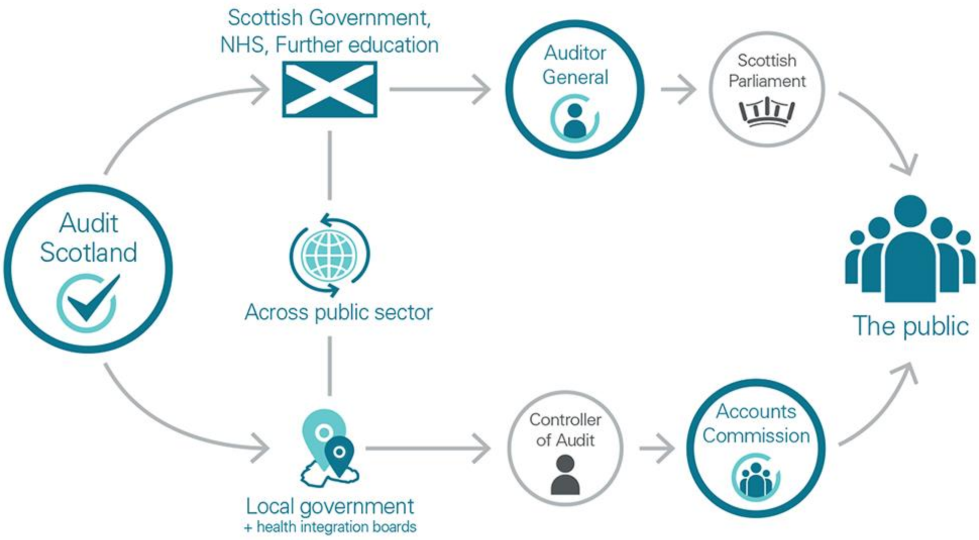
Who we are

The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Key messages

Audit of the 2016/17 annual accounts

1 Our audit opinions were all unqualified. These covered the financial statements, management commentary, remuneration report and the annual governance statement.

Financial management

2 The council reported an overspend of £1.7m after transferring £10.0m from uncommitted reserves to support in-year expenditure. The use of reserves is a non-recurring way of supporting budget pressures and there is a risk that underlying challenges are not being addressed.

3 Throughout 2016/17 the council reported overspends due to increased costs in respect of staff costs and less income than expected.

4 The level of borrowing has been increased to support the capital programme. The council has a significant 15 year capital programme with £200m planned investment in the school estate.

Financial sustainability

5 The 2017/18 revenue budget process identified a 5 year cumulative deficit of £41m. While potential savings have been identified, the council does not routinely measure delivery of those savings plans but focuses on delivery of the overall budget.

6 With a reduction in its working balance, the council has less overall resources to safeguard against further budget pressures.

Governance and transparency

7 A significant review of governance was undertaken during the year and a new decision making and scrutiny structure implemented. While it is too early to assess the impact, the framework shares the responsibility for scrutiny across all policy committees.

8 A comprehensive programme of member induction was provided following the council election in May 2017 to support new members in discharging their role.

Value for money

9 Overall service performance has improved in recent years.

10 The council reports robust performance information to elected members and the public.

Introduction

1. This report is a summary of the findings arising from the 2016/17 audit of Aberdeenshire Council.

2. The scope of the audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Audit Committee. This report comprises:

- the outcome from our audit of the annual accounts
- consideration of the four dimensions that frame the wider scope of public sector audit requirements as shown in Exhibit 1.

Exhibit 1
Audit dimensions

Source: Code of Audit Practice 2016

3. The main elements of our audit work in 2016/17 have been the council's

- main financial systems and governance arrangements
- financial planning and resource management arrangements
- 2016/17 annual accounts.

4. Aberdeenshire Council is responsible for preparing the annual accounts that show a true and fair view in accordance with the Local Authority Accounts (Scotland) Regulations 2014. It is also responsible for establishing effective governance arrangements and ensuring financial management is effective.

5. Our responsibilities as independent auditor are established by the Local Government in Scotland Act 1973 and Audit Scotland's *Code of Audit Practice 2016* guided by the auditing profession's ethical guidance.

6. As public sector auditors we provide an independent auditor's report on the annual report and accounts. We also review and report on the arrangements within Aberdeenshire Council to manage its performance and use of resources such as money, staff and assets. Additionally, we report on the council's best value arrangements. In doing this, we aim to support improvement and accountability.

7. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016*.

8. This report raises matters from the audit of the annual accounts, risks or control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

9. Our annual audit report contains an action plan at Appendix 1. It sets out specific recommendations, responsible officers and dates for implementation.

10. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

11. This report is addressed to both the Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

12. We would like to thank all management and staff who have been involved in our work for their co-operation and assistance during the audit.

Part 1

Audit of 2016/17 annual accounts

Main judgements

We provided unqualified audit opinions on the council's annual accounts and the accounts of the charitable trusts administered by the council.

Good quality accounts were submitted for audit supported by satisfactory working papers.

Unqualified audit opinions

The council's annual accounts are the principal means of accounting for the stewardship of resources and reporting on performance in the use of resources.

13. The annual accounts for the year ended 31 March 2017 were approved by the Audit Committee on 21 September 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- unqualified opinions on the management commentary, remuneration report and annual governance statement.

14. Additionally, we have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

Audit of charitable trusts administered by Aberdeenshire Council

15. Due to the interaction of the Local Government (Scotland) Act 1973 with the charities legislation, a full and separate audit and auditor's report is required for each registered charity where members of Aberdeenshire Council are sole trustees, irrespective of the size of the charity. For Aberdeenshire Council the applicable charities are:

- Aberdeenshire Charities Trust (known as ACT2)
- Aberdeenshire Educational Trust
- Anderson & Woodman Library Trust
- Andrew Cooper History Prize Fund
- Mcdonald Public Park Endowment

16. Our duties as auditors of the charitable trusts administered by Aberdeenshire Council are to:

- express an opinion on whether each charity's financial statements properly present the charitable trust's financial position and is properly prepared in accordance with charities legislation

- read the trustees' annual report and express an opinion as to whether it is consistent with the financial statements
- report on other matters by exception to the trustees and to the Office of the Scottish Charity Regulator.

Submission of the council's annual accounts for audit

17. We received the unaudited annual accounts on 19 June 2017, in line with the audit timetable set out in our 2016/17 Annual Audit Plan. In 2016/17, the council prepared group accounts which included the financial results of Aberdeenshire Integration Joint Board and Trusts and Endowments for which the council is sole Trustee.

18. The working papers provided with the unaudited accounts were of a good standard and finance staff provided good support to the audit team. This helped ensure that the final accounts process ran smoothly.

Materiality

19. Materiality defines the maximum error that we are prepared to accept and still conclude that our audit objective has been achieved (i.e. true and fair view). The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

20. Our initial assessment of materiality for the annual accounts was reported in our Annual Audit Plan. On receipt of the draft accounts we reviewed our materiality calculations and concluded that they required to be updated to reflect the significant increase in the council's cost of services as a result of the revaluation of its council dwellings. The materiality levels are summarised in Exhibit 2.

Exhibit 2
Materiality values

Materiality level	Per Annual Audit Plan	Actual Used
Overall materiality – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. It was set at 1% of gross expenditure for the year ended 31 March 2017.	£8.6m	£9.9m
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 70% of overall materiality.	£6.0m	£6.9m
Reporting threshold (i.e. clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality, rounded up to £100,000.	£100k	£100k

Source: Audit Scotland

Risk of material misstatement

21. Appendix 2 provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team. Also included within the appendix are wider audit dimension risks, how we addressed these and conclusions.

How we evaluate misstatements

22. All misstatements identified during the audit, which exceeded our materiality threshold, have been amended in the financial statements. The impact of these is to increase Total Comprehensive Expenditure by £12.4m, with a corresponding decrease in Net Assets and Total Reserves. The key items were as follows:

- additions to housing stock during the year were overstated by £8.9m as the discount factor had not been applied in the first instance. This is discussed in Exhibit 3 (item 3)
- potential receipts of £3.5m had been incorrectly recognised from a developer. While there is agreement that the developer will provide funding to the council, recognition of the income is dependent on the developer selling units of housing. As construction has not yet commenced, in our view it is too early to recognise the income

23. On the balance sheet, deposits of £20m were incorrectly classified as short term investments instead of cash and cash equivalents and debtors and creditors were overstated by £2.7m. Items affecting group accounts are discussed in Exhibit 3, item 6. In addition, we identified a number of presentational issues which were discussed with relevant officers and these were adjusted in the audited accounts.

24. A number of monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed not to adjust as the amounts were not considered material in the context of the financial statements. Appendix 3 sets out the misstatements. Had they been adjusted, the net impact would have been to decrease the council's Net Cost of Services by £3.2m, with a corresponding increase in Net Assets and the General Fund. We agree with management's decision.

Significant findings

25. International Standard on Auditing 260 (UK & Ireland) requires us to communicate to you significant findings from the audit. These are summarised in Exhibit 3 (where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included).

Exhibit 3

Significant findings from the audit of Aberdeenshire Council's 2016/17 annual accounts

Issue
1. Revaluation of council dwellings As part of the council's rolling 5 year valuation programme for property, the council's dwelling stock was revalued during the year. The net book value at 31 March 2017 was £410.7m, a decrease of 16.4% on the value of £491.3m at 31 March 2016. In accordance with the Code of Practice on Local Authority Accounting, the basis of the valuation was Existing Use Value for Social Housing (EUV-SH). In line with recommended practice, a Beacon approach was adopted by the council's internal valuers as the basis for the valuation process.

Issue

To calculate the discount to be applied to EUV to reflect Social Housing values, the council compared the potential rental yields if under public or private ownership using a methodology suggested by the District Valuer (DV) and based on guidance issued in England by the Department for Communities and Local Government.

Information on suggested yield and discount parameters was obtained from the Royal Institution of Chartered Surveyors (RICS) and the DV, and private rental values were derived from the applicable Local Housing Allowance. The calculation identified a discount factor of 71.45% leaving the social housing element as 28.55% of the valuation.

We reviewed the entries made to update the Asset Register and were satisfied that the revised valuations were correctly accounted for.

The council received advice from the DV during the process as part of an informal peer review process.

The following issues were considered:

I. The number of properties physically inspected as part of the valuation process was low.

The council has approximately 12,800 council dwellings from which 536 beacons were identified, of which 16 were inspected as part of the valuation process. Council officers had not planned to undertake physical inspections but following DV advice, 16 were visited i.e. 2 from each of the 8 areas identified by the valuers. While the DV confirmed that 536 was an excessive number of beacons, they suggested a range between 115 and 280 beacons as more reasonable for the authority.

II. EUV – Social housing discount factor

Before discount, the value of the council's stock had increased as a result of the valuation process. The reason for the significant reduction in the value included in the accounts is the discount factor used in the process. At the last valuation, the social housing element represented 49% of the value. As a result of the methodology used on this occasion, the social housing element used was 28.55%. Our recent experiences in neighbouring councils would indicate social housing elements of around 35%. The DV's experience from a range of councils they advise, suggested an average range of between 30 and 46%.

Resolution:

The Code provides for valuation activity at least every five years. In our view, the number of properties visited was low and especially so, given the scale of the geographical area within the council's boundary.

Council stock valuation is dependent on the professional judgement of valuers in accordance with the standards and guidelines set by RICS. ISA 500: reliance on an expert, permits us to take assurance from professional opinions of experts such as valuers. It is helpful that the DV was involved in some peer review activity, albeit on an informal basis. Due to the scale of the impact of the revaluation, a reduction of £80.6m in the net book value of council dwellings, we have also sought management representation on this matter.

We acknowledge that a valuation methodology was selected and followed by experts and that the results have been properly reflected within the council's annual accounts. However, there should have been a more robust process to challenge the results of the valuation process, to confirm that the results were appropriate for the area and that there was an element of benchmarking to confirm the reasonableness of the methodology adopted.

In light of the apparent low level of physical inspection activity carried out, we would recommend that a programme of inspections is scheduled to ensure that beacons are inspected within a 5 year period. To compensate for the fact that inspections are not currently up to date, beacons could be inspected as part of the council's rolling programme. We would also suggest that valuations are kept up to date by reflecting the results of inspection activity on an ongoing basis.

Recommendation 1

Issue

2. Valuation of land and buildings (other than council dwellings)

The council values land and buildings on a rolling 5 year programme. In 2016/17, approximately 300 buildings were revalued representing 7% of the gross value of other land and buildings at 31 March 2017. All valuations were carried out as desktop exercises and did not involve any physical inspection. As explained in relation to council houses above, valuation activity should include physical inspection at least on a sample basis to ensure that the valuation is based on the actual condition of properties.

Resolution:

In accordance with auditing standards, we have taken assurance from the work of the valuer as a professional expert we are permitted to rely on. We have also taken management assurances around the robustness of the council's desk based valuation activity.

Recommendation 1

---

3. New build affordable housing

During the year, affordable housing projects costing £20.2m were transferred from assets under construction to operational assets. It is standard practice for assets to be transferred at cost and for any adjustment to be recognised when the assets are next formally valued. However, where housing stock is concerned, we would expect the social use discount factor to be applied in the first instance and the adjusted amount included as operational assets. We found that the discount had not been applied to all projects transferred and consequently, Total Comprehensive Income and Expenditure, Net Assets and Total Reserves were overstated by £8.9m.

Resolution:

The revised accounts have been amended to reflect this adjustment.

---

4. Equal pay provision

During the year the council opted to reduce its provision for equal pay claims by £1.1m (23%) from £4.8m to £3.7m. This was the first significant movement in the provision for several years and followed a review of outstanding claims to remove time barred and duplicate cases. Consequently, the number of outstanding claims that the council considers to be valid fell from 898 in 2015/16 to 550 in the current year. Following advice from its legal advisors, the council developed a methodology for estimating settlement payments to claimants and negotiations based on the new methodology are currently ongoing with claimants' legal representatives.

The level of provision required at the year end was calculated with reference to the average value of previous settlements and the proposed settlement methodology.

While we were satisfied with the overall methodology followed, specific management representations have been sought and provided to support the change in approach.

Resolution:

We are satisfied with the adequacy of the provision at 31 March 2017 and the approach adopted by the council in respect of equal pay claims.

---

5. Provision for decommissioning of council owned assets

The council owns several landfill sites, quarries, waste transfer sites and household waste recycling centres. As required by accounting standards, the council has made provision for the future capital costs associated in decommissioning these assets. At 31 March 2017, the provision amounted to £6.7m

We reviewed calculation estimates provided by relevant technical officers within the council and confirmed that the accounting treatment is in accordance with relevant accounting guidance.

Resolution:

We are satisfied with the adequacy of the provision at 31 March 2017 and the approach adopted by the council in respect of decommissioning of council owned assets.

Issue

6. Group accounts

Issue 1 - The council has prepared Group Accounts for the first time since 2012/13 to reflect its interest in Aberdeenshire Integration Joint Board (IJB) and the Trusts and Endowments for which the council is sole trustee. The joint board is regarded as a joint venture and the Trusts are regarded as a subsidiary for the purposes of group accounts. The council has opted not to include a group cash flow statement as it would effectively be the same as its single entity cash flow statement.

Resolution

On the basis that Aberdeenshire IJB transactions are processed through its partner bodies, it does not hold cash or cash equivalents and while the Trusts have material balances, there were minimal transactions during the year. We have therefore accepted the council's approach but requested the inclusion of a note confirming why it has adopted an alternative approach from the Code. A footnote to this effect has been added to the Cash-Flow Statement in the revised accounts.

Issue 2 - We reviewed the basis for consolidation for both components and confirmed that this was appropriate in each case. However, on testing the consolidation adjustments, we identified the 'intra-group trading' had not been properly reflected in the draft accounts.

Resolution:

The revised accounts have been amended to remove the impact of intra-group trading. This has reduced group net assets and total reserves by £2.7m.

---

7. Provision for non-collection

The council has provided a total of £22.5m for possible losses at 31 March 2017 if its outstanding debts are not fully collected. This amount is split between council tax £14.8m, sundry debtors £4.8m and rent arrears £2.9m. In response to the 2016/17 forecast overspend, officers undertook a review of the estimation processes adopted by the council including its provision for non-collection of debts.

In relation to Council Tax, we noted the level of provision was reduced in the year by £0.8m. Whilst collection rates remain at similar levels to previous years, the total percentage of outstanding income provided for has fallen from 68% to 62%. The main change has been the council's decision not to include the current year's council tax debt in the calculation.

Resolution:

In overall terms, while the total percentage of outstanding debt provided for has fallen from 68% to 62%, the council continues to have good council tax collection rates and the trend in cash collection remains stable. In itself, the change in the provision is not a material movement and can be accepted. Overall, we are satisfied with the adequacy of the provision at 31 March 2017. However, given the change in the council's estimation process, we have sought management assurances and will continue to keep this matter under review.

---

8. Aberdeenshire IJB

The IJB became operational from 1 April 2016 with delegated budgets of around £300m of which £105m was provided by Aberdeenshire Council. The Scottish Government's Integrated Resources Advisory Group (IRAG) issued guidance for IJB accounting which requires that the primary transactions with the council and the payments in support of the directions made by the IJB to the council be accounted for as distinct and separate transactions. In effect, there should have been a 'doubling up' within the accounts so that the council's gross income and expenditure both increase by approximately £100m.

While the council's share of the IJB was correctly included in the council's group accounts, the IRAG requirements were not reflected in the council's single entity accounts,

Resolution: This has been amended in the revised accounts.

Issue
9. Manual authorisation of invoices for payment In our interim report, we highlighted the manual approval of invoices to be an area of audit risk. The majority of the council's purchase orders are raised through the iProcurement system which requires users to have approved access to the system. In addition, the council has a number of legacy systems from which orders for goods and services are also initiated and in these cases, the associated invoices require to be manually approved for payment. While the council has a list of approved signatories, it is unlikely to be up-to-date due to the effort involved in maintaining and checking such a list. In order to gather the necessary assurances to confirm the validity of the related expenditure within the financial statements, our testing strategy included an increased sample size in respect of such purchases (not initiated through the iProcurement system). **Resolution:** The results of extended audit testing confirmed the validity of the expenditure in respect of the financial statements. The results also identified further internal control issues around the payment authorisation for such invoices. For example, officers approving invoices were approving amounts above their authorised limits. **Recommendation 2**

Source: Audit Scotland

Management commentary, remuneration report and annual governance statement

26. The *Code of Audit Practice 2016* requires councils to prepare and publish, along with their financial statements, an annual governance statement, management commentary and a remuneration report that are consistent with the disclosures made in the financial statements. The management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.

27. The content of the Management Commentary and the Annual Governance Statement were discussed with management and some amendments were made. In particular, the governance statement now includes a wider range of actions to be addressed by the council including the need to revise its local code of corporate governance.

Recommendation 3

Objections

28. The Local Authority Accounts (Scotland) Regulations 2014 require a local authority to publish a public notice on its website that includes details of the period the unaudited accounts are available for public inspection and the process for making an objection to the accounts. The notice must remain on the website throughout the statutory 3 week inspection period. We can confirm that the council complied with the regulations for public inspection and that there were no objections lodged during this period.

Part 2
Financial management

Main judgements

The council reported an overspend of £1.7m after transferring £10.0m during the year from uncommitted reserves to support in-year expenditure. The use of reserves is a non-recurring way of supporting budget pressures and there is a risk that the underlying challenges are not being addressed.

The council has appropriate internal controls within main financial systems which operated effectively during the year.

Arrangements for the prevention and detection of fraud and corruption need to be refreshed and promoted across the council.

Financial performance in 2016/17

29. On a statutory basis, the council reported a deficit of £211.2m on the provision of services in 2016/17. Adjusting this balance to remove the accounting entries required by the Code of Practice for Local Authority Accounting, the council's usable reserves decreased by £11.2m. This decrease reflects a year end deficit of £1.7m and use of reserves of £10.0m.

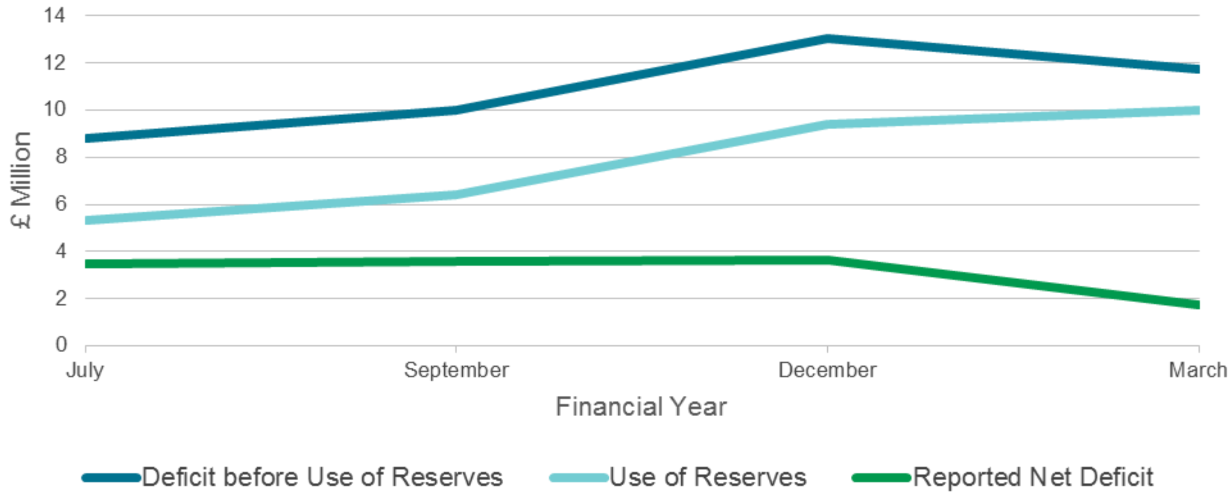
30. In recent years, the council achieved year end surplus positions but throughout 2016/17 budget monitoring reports were forecasting a year end deficit. The first 2016/17 budget monitoring report to elected members covering the 4 months to 31 July 2016 indicated a deficit of £8.8m. Allowing for the use of reserves of £5.3m, there was a net forecast deficit for the year of £3.5m. Exhibit 4 sets out the forecast positions reported during 2016/17.

Financial management is about financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

31. Throughout the year, key reasons reported for the deficit included:

- an increase in the number of primary pupils resulting in an increase in the number of teachers required. In addition, the budget continued to be based on a pay award of 1% when teachers had received 1.5% in 2015/16
- an increase in the number of packages agreed for Out of Authority Placements
- less Building Standards and Development Management income than expected due to the downturn in the local economy
- a reduction in income from council property commercial rentals and ongoing repairs following the 'Storm Frank' floods
- less council tax was received than expected in respect of properties empty more than one year. Following the council's decision to increase council tax by 100% on such properties, a number of properties were brought back into use and therefore the higher council tax charge no longer applied.

Exhibit 4
Forecast year end positon



Source: Budget Monitoring Reports, Aberdeenshire Council

32. In order to address the forecast deficit position, the council's Strategic Leadership Team (SLT) requested further information from services and received monthly updates to enable timely monitoring of actions being taken to rebalance the forecast position. A number of specific measures were implemented to return the budget to a breakeven position. These included vacancy management, reducing overtime, reducing routine expenditure to essential spend only and capitalising expenditure of a capital nature which had been funded from revenue. In addition, SLT sanctioned greater use of reserves (Exhibit 4) and reviewed the underlying assumptions in the provisions for non-collection of council tax and equal pay to minimise the impact on its overspend position. These matters were discussed in Exhibit 3.

33. The outturn position was reported to full council in June 2017. This stated that overall, the council was over budget by £1.7m. This included an underspend of £0.5m against revised budgeted expenditure of £545.5m and the main reason for the overspend was reported as being that the council received £2.2m less council tax and government grant than expected. These amounts are reflected in Exhibit 5.

Exhibit 5
2016/17 Revenue outturn

	Revised budget - £m	Actual- £m	Diff - £m
Expenditure	545.510	545.026	0.484
Income	(535.496)	(533.287)	(2.209)
Use of Reserves	**10.014**	**11.739**	**(1.725)**

Source: Revenue Budget 2016/17, Budget Monitoring Reports, Aberdeenshire

34. As a consequence of the 2016/17 outturn position, the council's level of uncommitted general fund reserves has fallen to £8.5m which is below the new limit of £9.0m approved in February 2017. Using non-recurring income such as use of reserves to support budget pressures is a one-off opportunity and is not a viable long term strategy. There is a risk that the underlying reasons for the overspend are not being addressed.

Housing Revenue Account (HRA)

35. The council is required by legislation to maintain a separate HRA and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year.

36. Total net HRA income of £13.3m was down £3.1m from budget, largely as a result of increases in expenditure on repairs and maintenance. The council's policy is to use net income as Capital Funded from Current Revenue (CFCR). Despite the drop in CFCR, total capital expenditure was £1.6m greater than budgeted. This was funded through borrowing and increased levels of grant received in relation to new build properties. Overall, the council maintained its uncommitted HRA working balance of £2.0m.

Capital programme

37. In February 2016, the council approved a total capital budget for 2016/17 of £135.6m. Of this total, £108.3m related to general services and £27.4m to the HRA. The council has developed a 15 year Capital Plan which will provide capital investment of £873.0m over the period to 2031.

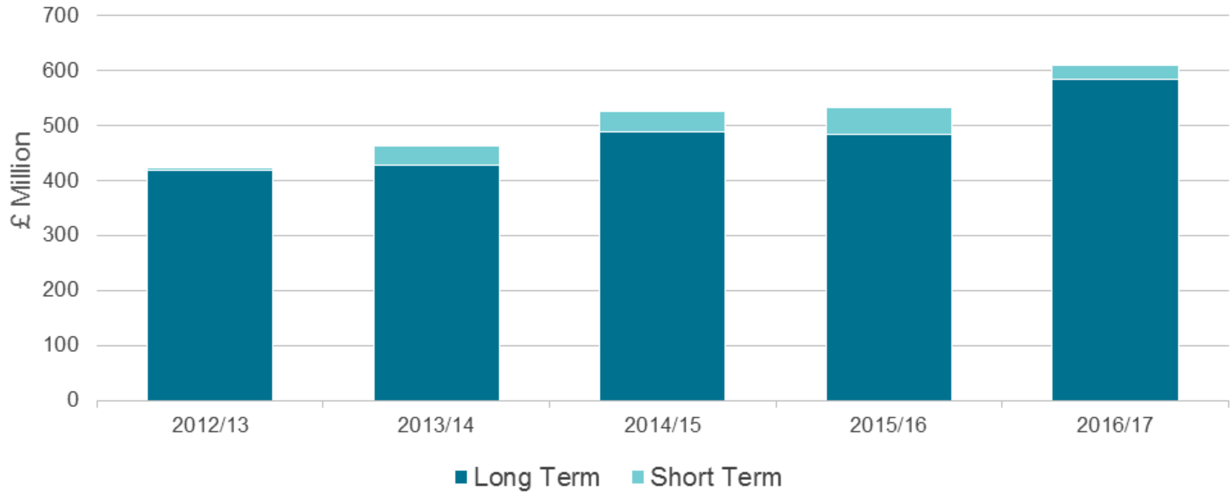
38. In 2016/17, total capital spend was £131.3m which was £4.3m (3.2%) below budget. This comprised an underspend of £5.9m (5.5%) on general fund and an overspend of £1.6m (5.8%) on the HRA. Whilst there was slippage on a number of projects in 2016/17, conversely greater progress was achieved in others. For example, spend on the Aberdeen Western Peripheral Route (AWPR) was less than expected in the final quarter of the year, however the mild winter weather allowed faster than anticipated progress at Markethill and Uryside Primary Schools. We comment on the council's procedures for monitoring capital expenditure at paragraphs 71 to 73.

39. The HRA capital programme for 2016/17 totalling £27.4m was approved by the Housing & Social Work Committee in September 2016. Total expenditure for the year was £29.0m, £1.6m (5.8%) greater than budget. This was largely as a result of increased expenditure on the New Build programme, matched by increased grant received from the Scottish Government. During the year the council concluded Phase 5 of its new build programme that delivered a total of 169 new build affordable homes across 8 sites in Aberdeenshire.

Borrowing in 2016/17

40. The council's outstanding loans at 31st March 2017 were £609.3m, an increase of £75.4m on the previous year. Exhibit 6 shows an increase in the council's level of borrowing over the last 5 years to support the delivery of its 15 year Capital Plan.

Exhibit 6
Total borrowing 2012/13 – 2016/17

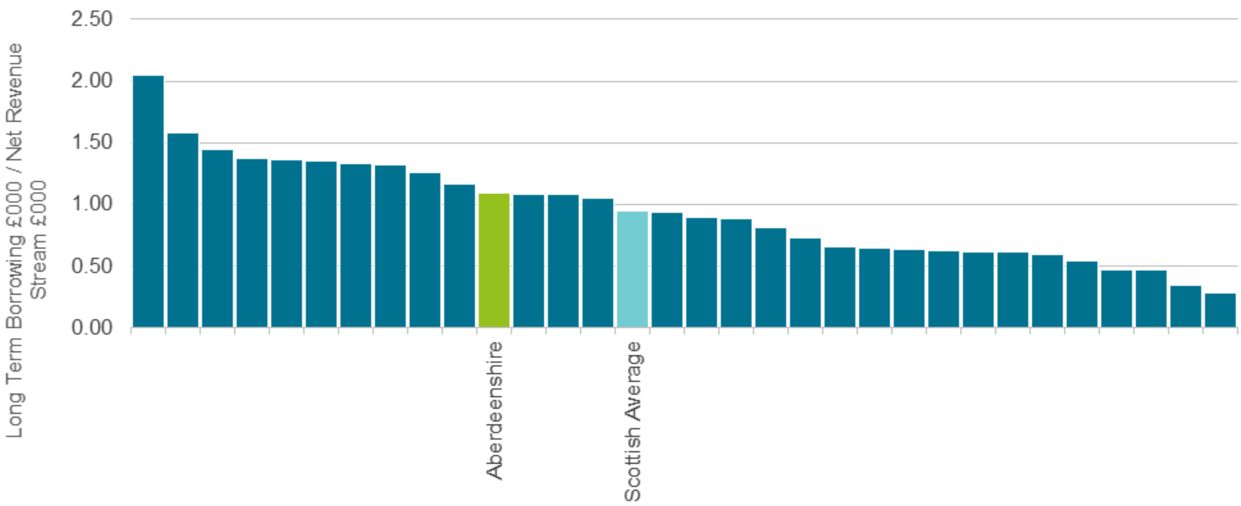


Source: Aberdeenshire Council

41. Of the total long term borrowing of £584.8m at 31 March 2016, £95.6m (16.3%) related to 'Lender Option Borrower Option' (LOBO) loans. These loans, popular in the 1980s, provide an option that allows the lender to increase the interest charge at specified dates, and the borrower has an option to repay the loan or accept the increased rate. In total, the council has eleven such loans with an average interest rate of 4.9%. All such loans held by the council are now beyond the option period and therefore there is no risk to the council of increased interest rates.

42. Analysing long term borrowing as a proportion of net revenue stream gives an indication of the relative indebtedness of the council. Exhibit 7 shows long term borrowing at 31 March 2017 as a proportion of net revenue stream for all councils in Scotland. This shows that the council is slightly above the Scottish Average when borrowing as a proportion of net funding stream is compared.

Exhibit 7
Scottish councils' long term borrowing as a proportion of net revenue streams



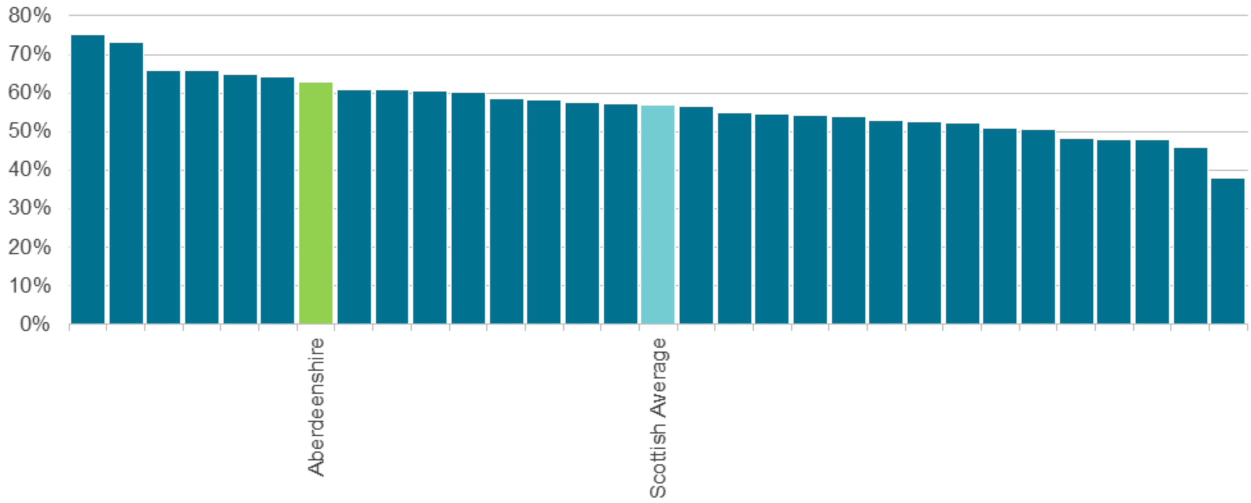
Source: Scottish councils' unaudited accounts 2016/17 (excluding Orkney Islands Council)

Pension Liability

43. During the year, the council's net pension liability increased by £159.3m (62.73%) to £413.2m. This movement is attributable to a decrease in the discount rate used by the scheme's actuary. The pension liability represents the difference between the expected future pension payments and the underlying value of pension fund assets available to meet this cost. Exhibit 8 shows that significant increases in pension liabilities were experienced throughout Scotland.

Exhibit 8

Scottish councils' percentage increase in Pension Liability 2015/16 – 2016/17



Source: Scottish councils' unaudited accounts 2016/17 (excluding Aberdeen City and Orkney Islands councils)

Budgetary monitoring and control

44. The *Local Government in Scotland: Financial overview 2015/16* (November 2016) highlighted that the need for budgets and forecasts to reflect actual spending becomes increasingly important for councils with decreasing or low levels of usable reserves. In setting the budget, there is scope for Aberdeenshire's underlying assumptions to be updated to reflect actual situations. (For example, at paragraph 31 we note that the budget reflects an annual pay award of 1% when teachers' actually received 1.50% in 2015/16).

45. In line with the council's new governance arrangements, scrutiny of Aberdeenshire's overall financial performance has been undertaken by the council from January 2017. It therefore receives regular revenue and capital monitoring reports. Detailed revenue monitoring reports for each of the council's directorates continue to be provided to the relevant service committee.

46. From our review of these reports, we concluded that they provided an overall picture of the budget position at council and service level. The forecast out-turn position was included with good commentary on significant variances against budget. In our view, however, key messages could be clearer and the impact of movements in earmarked balances explained. It would also be helpful if in-year virements could be reported separately from planned virements so that elected members receive a better understanding of the financial pressures during the year.

Recommendation 4

Prevention and detection of fraud

47. We have responsibility for reviewing the arrangements put in place by management for the prevention and detection of fraud. We reviewed the council's arrangements including policies and codes of conduct for staff and elected members, whistleblowing and the fraud prevention/response plan.

48. We reported our findings in our Interim Report recommending that the fraud strategy, which currently dates from 2012, should be refreshed to reflect current good practice. Once updated, the strategy should be re-issued, widely promoted and included within the remit of the audit committee.

National Fraud Initiative

49. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

50. The latest position on NFI investigations by the council is summarised in Exhibit 9.

Exhibit 9
National Fraud Initiative

Total number of matches	Number recommended for investigation	Completed/closed investigations
13,968	1,896	1,317

Source: NFI website

51. We were generally satisfied with the council's planning for the exercise, with meetings having been held with the relevant service contacts at an early stage and again when matches were released in January 2017. However there is little in the way of reporting of outcomes to management or committee and there is scope for commitment to the exercise to be more visible throughout the council.

52. At 31 August 2017, the council had completed 9.4% (1,317) of the total 13,968 identified matches. Within its total matches, the council has 1,896 recommended matches of which 32.5% (616) has been completed confirming that the council has correctly concentrated on high risk recommended matches. To date, one error of just over £10,000 has been identified in respect of a duplicate payment which the council will recover.

53. Overall, the council's response to the NFI matches is inconsistent, good progress has been made in some areas with little progress in others. For example, all recommended matches have been investigated for creditors but so far, only 1% of Blue Badge recommended matches have been completed.

Part 3

Financial sustainability

Main judgements

The Revenue Budget 2017/18 identified a 5 year cumulative deficit of £41m. While potential savings have been identified, the council does not routinely monitor savings achieved to measure whether plans are realistic.

The level of the council's uncommitted reserves has fallen below the agreed minimum balance and is one of the lowest balances in Scotland. It will be increasingly difficult for the council to use reserves to help fund expenditure in the future.

Good quality information is provided to members to allow for scrutiny of progress against the Capital Plan.

Financial planning

54. In the period prior to 2016/17, the council enjoyed relative financial stability. It was able to set a balanced revenue budget without a requirement to deliver a significant level of savings and it reported underspends against budget at the year end, enabling the council to increase its usable reserves. In common with other councils, financial pressures are increasing. In preparing the 2016/17 revenue budget, the council identified an indicative funding gap of £45.5m by 2020/21.

55. In order to address growing financial pressures, the council developed a Medium Term Financial Strategy (MTFS) as part of the revenue budget process for 2016/17. The purpose of the strategy is to ensure *'a structured approach to financial planning across Services and presents a complete view of the Revenue Budget, Capital Plan and Council Reserves allowing the Council to consider and plan the full financial impact of decisions taken now on next year's budget and an indication of the impact on future years'*. The MTFS is best described as an overarching set of principles to be followed in the budget setting process rather than a clearly documented strategy.

56. Budgets are prepared with full involvement of members and consultation with wider stakeholders. Regular meetings were held with elected members during the process providing opportunities to discuss the political priorities to be reflected in budgets and areas for potential savings.

57. A budget engagement exercise was carried out in December 2015 to help inform the 2016/17 budget setting process. The aim of this exercise was to seek the views of Aberdeenshire communities and employees around various budget proposals. The survey was widely promoted through local and regional press, and online through social media. A total of 1,318 responses were recorded, 57% from residents and 41% from employees. The responses were used to provide information on the views and attitudes of residents and employees towards a range of proposals informing the council's future budget considerations.

Financial sustainability looks forward to the medium and longer term to consider whether the council is planning effectively with regard to future service delivery.

58. The council prepares detailed indicative 5 year revenue budgets, which are approved along with the annual budget in February each year. This provides a clear indication of the forecast financial position over the period. Future years are based on the best estimate of financial uplifts and funding settlements available. Although budgets do not consider the impact of different scenarios on the assumptions made (for example the impact of pay inflation being greater than expected), they do provide a clear discussion of the risks that impact on these assumptions.

Five Year Funding position

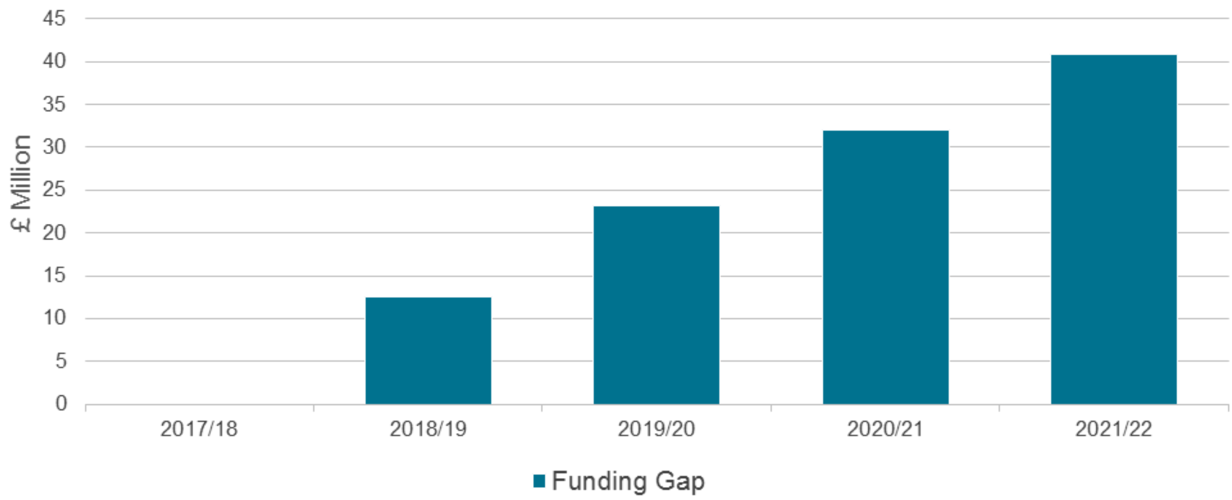
59. The council is facing a number of challenges in maintaining a sustainable financial position in future. These include rising demands for services, increasing costs of services and reductions in central government funding.

60. The 2017/18 revenue budget was approved in February 2017, again following stakeholder consultation and discussions with elected members. To ensure a balanced budget, the council was required to meet a funding gap of £24.2m which it did through a combination of savings of £21.1m, and a decision to increase council tax by 2.5% to produce expected additional revenue of £3.1m. A total of 49 savings areas were identified of which 8 are in excess of £1.0m.

61. In Part 2 of the report, we highlighted that the council were forecasting an overspend for 2016/17 from early in the year. The revenue budget for 2017/18 notes the MTFS approach to ensure the full financial impact of decisions taken now are reflected in the next year's budget.

62. The council's indicative 5 year budgets for the period 2017/18 – 2021/22 highlight a total cumulative funding gap of £40.8m by 2021/22 as shown in Exhibit 10. This is an improvement on the position reported in February 2016 when the cumulative 5 year deficit was forecast at £45.5m.

Exhibit 10
Cumulative funding gaps 2017/18 – 2021/22



Source: Aberdeenshire Council Revenue Budget 2017/18

63. The indicative 5 year budget is based on officers' assumptions of the likely changes to income and expenditure in the period. In particular, the lack of clarity over future funding levels from the Scottish Government increases the level of assumptions made. The council has committed to further detailed work on future years' budgets to re-examine assumptions and priorities. This will continue to be part of the MTFS discussions in preparation for the draft 2018/19 budget proposals expected to be reported to the council in the autumn.

Underlying assumptions

64. The council was required to make savings in excess of £28m to deliver a balanced budget in 2016/17. In Part 2 of this report, we commented on the year end outturn position including the use of reserves. The council does not specifically report on progress against agreed savings but focuses on the achievement of a balanced bottom line position. Consequently, it is difficult to demonstrate if planned savings were achieved and therefore if plans were robust or if compensating factors produced the required outcome.

65. Savings of £21m were agreed in delivering a balanced budget for 2017/18 and Exhibit 10 shows the cumulative funding gaps ahead. The 2017/18 Revenue Budget stated that *'the level of savings identified within the MTFS process have not been applied to future years' budgets'*. This suggests that the council has identified savings which have not yet been applied to future budgets. It is not therefore clear what level of savings the council still needs to identify.

66. The need for budgets and forecasts to reflect actual spending becomes increasingly important for councils with decreasing levels of usable reserves to draw on. The council cannot continue to rely on underspends in certain services offsetting overspending elsewhere. Given the 2016/17 deficit position and the low level of uncommitted reserves, it is important that the council redesigns budgets, reviews underlying assumptions in light of actual spending and develops its use of scenario planning.

Recommendation 4

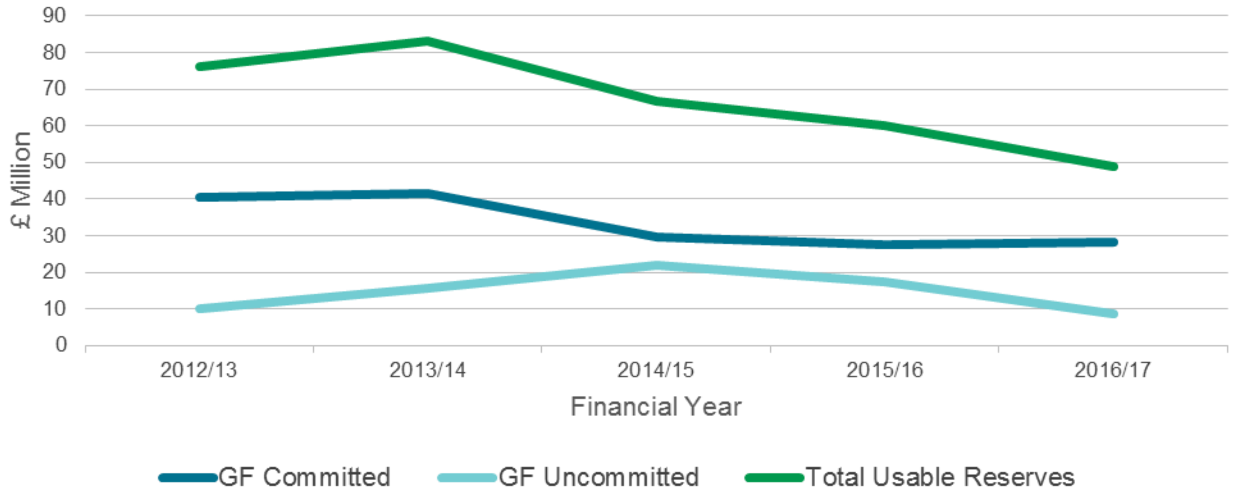
Reserves

67. One of the key measures of the financial health of a local authority is the level of reserves held. The level of usable reserves held by the council decreased by £11.2m from £60.0m in 2015/16 to £48.8m in 2016/17 as illustrated in Exhibit 11. In the 5 year period since 2012/13, total usable reserves have fallen by £27.4m or 36.0%. Whilst this reflects planned use of both revenue and capital reserves during the year, it also includes the use of uncommitted reserves to support the revenue budget overspend for the year as previously noted at paragraph 29.

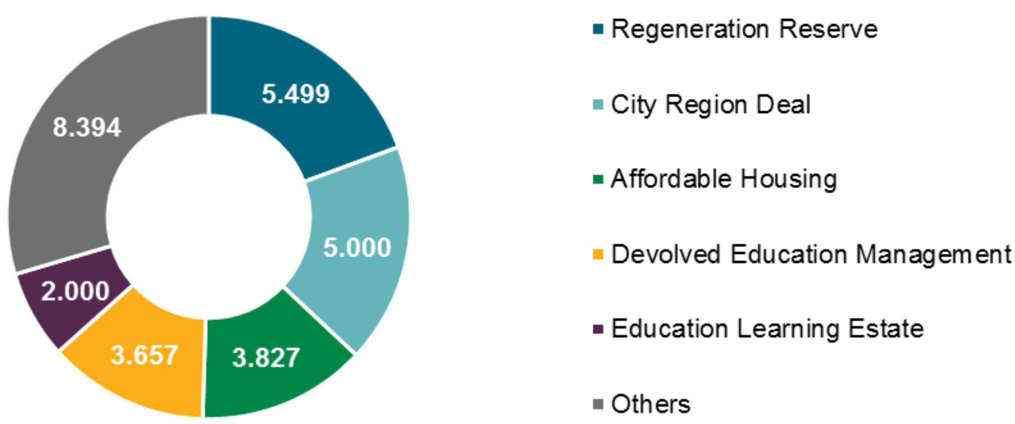
68. The level of committed reserves has increased slightly in the year by £0.7m (2.6%) to £28.4m. This reflects use of previous earmarked balances for Business Transformation and Innovation and creation of new balances for Education Learning Estate, Regeneration and City Region Deal.

69. The council reviews the level of its uncommitted reserves when setting the budget each year and in February 2017 agreed a revised balance of £9.0m to be held as a contingency fund to meet unexpected expenditure. As highlighted at paragraph 34, the council's uncommitted reserves at 31 March 2017 were below the agreed minimum balance. There is therefore a growing risk should any unforeseen event arise, that the council may not have sufficient reserves available and may need to reduce services.

Exhibit 11
Total Usable Reserves, General Fund Committed and Uncommitted balances



Committed balances - £ Million



Source: Aberdeenshire Council

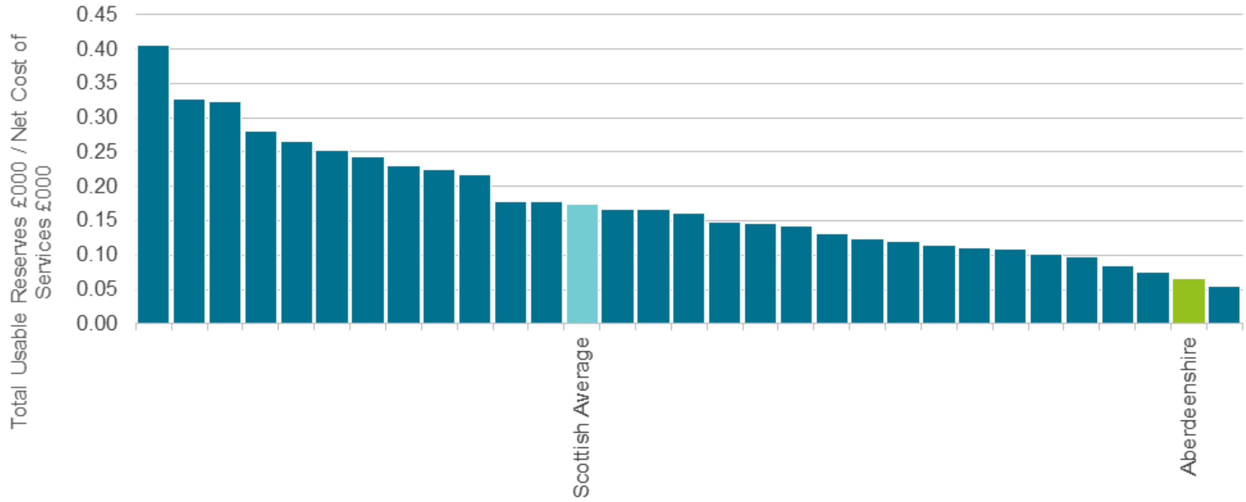
70. Exhibit 12 presents the council's usable reserves position in relation to the net cost of services for the year in comparison to other Scottish councils for 2016/17 and comparison against the Scottish average since 2011/12. This shows that the council has low levels of reserves in comparison to other Scottish councils, and is falling against the Scottish average. This further highlights that the council will not be able to rely on its reserves to support revenue expenditure in the future.

Asset management

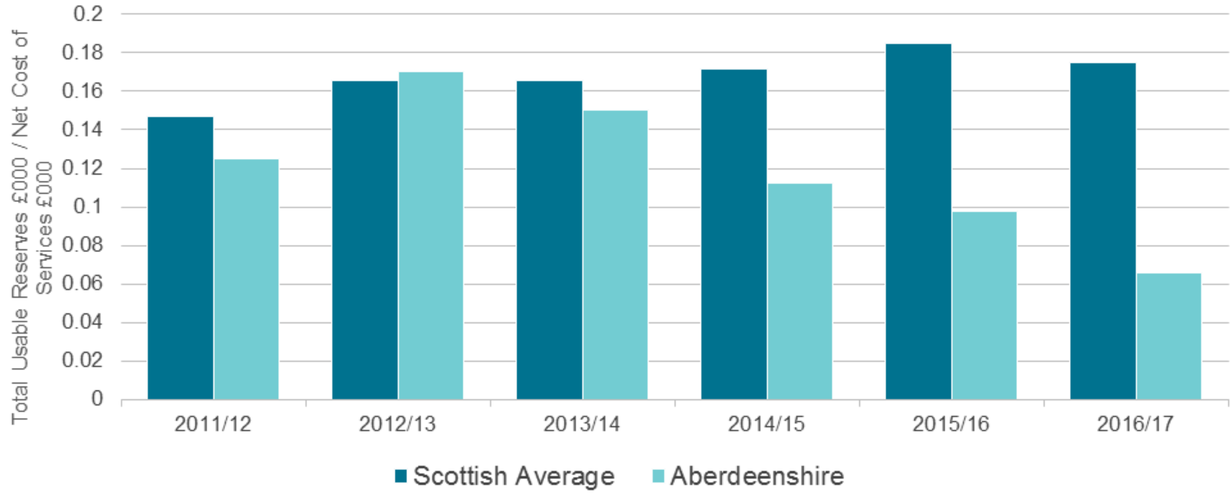
71. In February 2016, the council approved a 15 year capital programme totalling £873m. Total expenditure in the 5 year period 2016/21 is £385m or 44% of the total plan. The programme contains a range of projects which are grouped under each of the council's Four Core Objectives.

Exhibit 12

Total Usable Reserves as proportion of Net Cost of Services 2016/17



Total Usable Reserves as proportion of Net Cost of Services 2011/12 – 2016/17



Source: Scottish councils' unaudited accounts 2016/17 (excluding Orkney and Shetland Islands councils)

72. The Capital Plan Group (CPG) is responsible for the development and monitoring of the capital programme. Directorates have responsibility for developing a business case to support a capital project to meet the needs of the Service Plan. The role of the CPG is to review submitted business cases against agreed criteria and confirm they fit with objectives. There is a methodology to determine the priority of each business case. From this process, a capital programme is developed each year and agreed by the SLT before final approval by elected members.

73. Regular capital monitoring reports are presented to the council which include a position against budget for each individual project included in the plan and narrative notes to explain any significant variances. Based on the capital monitoring reports reviewed, we would conclude that they provide members with a sufficient level of information to scrutinise progress against the Capital Plan.

Part 4

Governance and transparency

Main Judgements

A significant review of governance was undertaken during the year and a new decision making and scrutiny structure implemented. While it is too early to assess the impact, the framework shares responsibility for scrutiny across all policy committees.

The council is open and transparent in the way that it conducts its business, with public access to meetings, online availability to agenda papers and webcasting of council meetings now routinely carried out.

A comprehensive programme of member induction was provided following the council election in May 2017 to support new members in discharging their governance and scrutiny role.

Governance arrangements

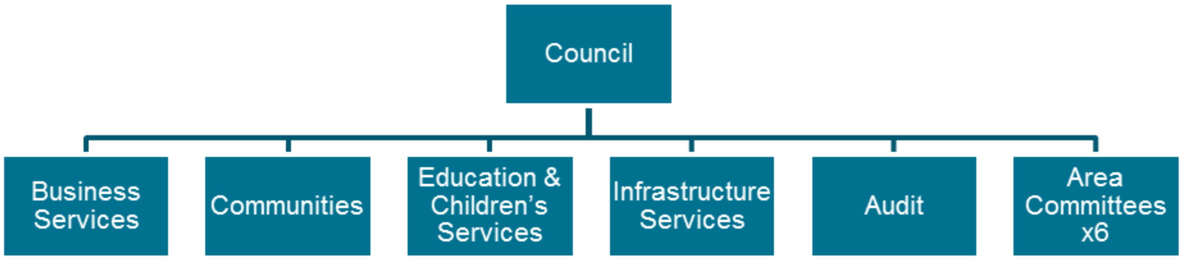
74. In March 2015, the council established a Future Governance Working Group to investigate, consider and make recommendations on all aspects of the decision making structure at the council so as to be responsive to the changes facing local government. The working group's recommendations were agreed in principle by the council in June 2016. A revised Scheme of Governance including updated Standing Orders and Financial Regulations was approved in November 2016, and the new governance arrangements were implemented from January 2017.

75. Key developments included:

- the existing committee structure for decision making continues to include four policy committees, six area committees and a revised bespoke audit committee as per Exhibit 13
- new vision statements and values for Area and Policy Committees, supported by more detailed remits for each committee have been developed
- the scrutiny role previously exercised by the Scrutiny and Audit Committee is shared amongst all policy and area committees based on respective remits (We consider this further in paragraph 76.)
- the new Audit Committee has been allocated responsibility for receiving and providing feedback on reports from the IJB Audit Committee
- full council has overall responsibility for financial planning and monitoring.

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

Exhibit 13
New Committee Structure



Source: Aberdeenshire Council

76. We reviewed the Scheme of Governance and confirmed that it is in accordance with best practice. While it is too early to assess the impact of the new governance arrangements on decision making and scrutiny, the new framework provides for wider involvement in scrutiny by sharing responsibility across four policy committees. In addition to routine scrutiny activities such as performance and finance monitoring, committees now have the option to initiate a committee review process which could entail a request for a report or lead to an investigation being carried out. Previously, investigations had been within the remit of the Scrutiny and Audit Committee.

Audit Committee

77. The new governance arrangements introduced an Audit Committee to replace the Scrutiny and Audit Committee which has delegated responsibility for financial management, managing all aspects of the council's relationship with internal and external audit and scrutiny of Aberdeenshire Integration Joint Board.

78. Transitional arrangements were put in place to complete outstanding work for the former Scrutiny and Audit Committee and the first proper business meeting of the new committee was held in June 2017.

79. Following the local government election in May 2017, and the change in the council administration, a new chair, previously the deputy chair, was appointed to the Audit Committee. The new chair is the only member of the new committee providing continuity from the previous committee.

80. In our 2016/17 Interim Report, presented to the Audit Committee in June 2017, we commented on our observations having attended three audit committees. In particular, we highlighted that officers called to update the committee were not always sufficiently briefed to respond to questions raised. This led to some matters being delayed to a subsequent meeting or handled via a written response. We concluded that this reduces the effectiveness of scrutiny as the committee is not able to fully consider the matter at the scheduled time. Steps have subsequently been taken by services to ensure the correct officers are reporting to committee. We will continue to monitor the level of service engagement as part of our overall involvement with the audit committee.

Internal audit

81. Internal audit provides senior management and elected members with independent assurance on the council's overall risk management, internal control and corporate governance processes.

82. The internal audit function is carried out by an in house team. We carried out a high level review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS). An external peer review of the Internal Audit function was carried out during the year and is expected to report in the autumn.

83. Following a detailed self-assessment against PSIAS carried out in 2015/16, Internal Audit prepared an action plan containing a number of improvements to address areas identified as general rather than full compliance. The action plan included the following areas for improvement which continue to be work in progress:

- improve understanding of systems and processes before planning testing required
- improve understanding and recording of risk when developing required testing.

84. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In line with our 2016/17 Annual Audit Plan, we placed formal reliance on internal audit's reviews of iProcurement and ledger, payroll, creditor and debtor systems, housing rents and budget control to support our opinion work on the financial statements.

Transparency

85. Transparency means that the public, in particular local residents, have access to understandable, relevant and timely information about how the council is taking decisions and how it is using resources such as money, people and assets.

86. There is evidence from a number of sources which demonstrate the council's commitment to transparency. From March 2017, all council meetings were webcast live with recordings available online. The public can attend meetings of full Council and committees and associated agenda papers and minutes of meetings are readily available on the council's website. Our review of minutes did not highlight that excessive numbers of items were held in private. Where items were in private, the reasons for doing so were clear.

87. The council's website allows the public to access a wide range of information including the register of members' interests, current consultations and surveys and the council's complaint process. A wide range of performance information is available on the website, including progress against Core Priorities, service performance, complaints data, customer satisfaction levels, benchmarking information and results from the Citizens Panel.

88. The council makes its annual accounts available on its website. These include a management commentary which provides details of performance against budget, information on the use of reserves and risks and uncertainties facing the council.

89. Overall, we concluded that the council conducts its business in an open and transparent manner.

Integration of health and social care

90. Legislation to implement health and social care integration, passed by the Scottish Parliament in February 2014, came into force on 1 April 2016. This brings together NHS and local council care services under one partnership arrangement for each area.

91. The Scottish Government's 2020 vision places greater emphasis on enabling people to stay in their homes, or another homely setting, where possible, sharing their lives with their family and friends and doing the things that give life meaning and value. The integration of health and social care is seen as a means of achieving this.

92. Aberdeenshire Integration Joint Board (IJB) is provided in partnership with NHS Grampian and Aberdeenshire Council and became fully operational on 1 April 2016. The financial transactions of the IJB are reflected in the council's accounts and consolidated into the council's group accounts.

93. There is a strong ethos of partnership working across the public sector in the north east of Scotland. The North East Scotland Partnership Steering Group provides the opportunity for NHS Grampian board members to meet with the chairs and chief officers of the three IJBs in the area. In addition, there are regular senior officer meetings involving NHS Grampian's chief executive and the council chief executive for the appropriate IJB area along with the relevant IJB chief officer and chief finance officer.

94. The IJB has sound governance arrangements in place that continue to develop as the board becomes more established. Workforce and locality planning are at an early stage of development but should demonstrate plans for integrated working in due course.

95. The 2017/18 break-even budget position was approved in March 2017 and requires delivery of identified budget savings of £3.5m. The benefit of longer term financial planning has been recognised with an agreement to develop a 5 year financial strategy.

96. A good practice community led initiative is the implementation of Virtual Community Wards. This has demonstrated early success in reducing the number of patients who would otherwise have required a hospital admission.

Local scrutiny plan

97. The 2017/18 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the council was considered by the council and the audit committee in May and June 2017 respectively. The LAN did not identify any new scrutiny risks in the year which would require specific work during 2017/18, however the council's financial position was highlighted as requiring continued monitoring and we have commented on this in Parts 2 and 3 of the report. The council will be subject to a range of nationally driven scrutiny activity as set out in the LSP.

Good practice points

98. Following the local government election, a total of 34 out of 70 members were newly elected to the council. This is a significant level of new members and therefore it was important that the council put arrangements in place to support them in being ready to promptly respond to the challenges ahead.

99. The council put robust arrangements in place for members' induction and provided a comprehensive programme of training in May and June which continued after the summer recess in August and September.

Part 5

Value for money

Main judgements

Overall performance has improved in recent years.

The council reports robust performance information to elected members and the public.

Recent inspection activity has generally been positive.

Best Value

100. The Accounts Commission agreed the overall framework for a new approach to auditing Best Value in June 2016. Best Value will be assessed over the five year audit appointment as part of the annual audit work. In addition, a Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five year period. The BVAR report for Aberdeenshire Council is planned for later in the five year programme.

101. The Best Value audit work carried out this year focussed on the council's arrangements for demonstrating Best Value in financial planning and governance as covered in with Parts 2 and 3 of the report. The effectiveness of the council's Best Value arrangements in other areas will be assessed and reported throughout our audit appointment.

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

Delivering the Council Plan

102. In March 2013, the council adopted the Council Plan 2013/17 which set out Four Core Outcomes – Lifelong Learning, Cared for Communities, Strong & Sustainable Communities and Public Sector Excellence. In 2015, midway through its period in office, the council administration changed following the resignation of a small number of councillors. It reverted back to its 2012 position following the local election in May 2017. Since May, a new Council Plan covering the period 2017/22 is currently being developed for approval in November 2017

103. Each service supports the Council Plan through their three year service plan which is monitored through six monthly performance reporting. These reports are considered by elected members and are available on the council’s website. A set of performance indicators was developed for each of the Four Core Outcomes, known as Aberdeenshire Performs, it can be accessed via the council’s website.

104. Under the stewardship of the Strategic Leadership Team, the following priority projects were progressed during the year:

- school estate – the council has an ambitious programme of ongoing investment in schools with a further £200m being spent over the 5 year period to 2021

- City Region Deal – the UK and Scottish Governments approved a £300m programme of investment in infrastructure and development projects in the north east. In respect of 2016/17, the spend was £2.7m but will increase in subsequent years

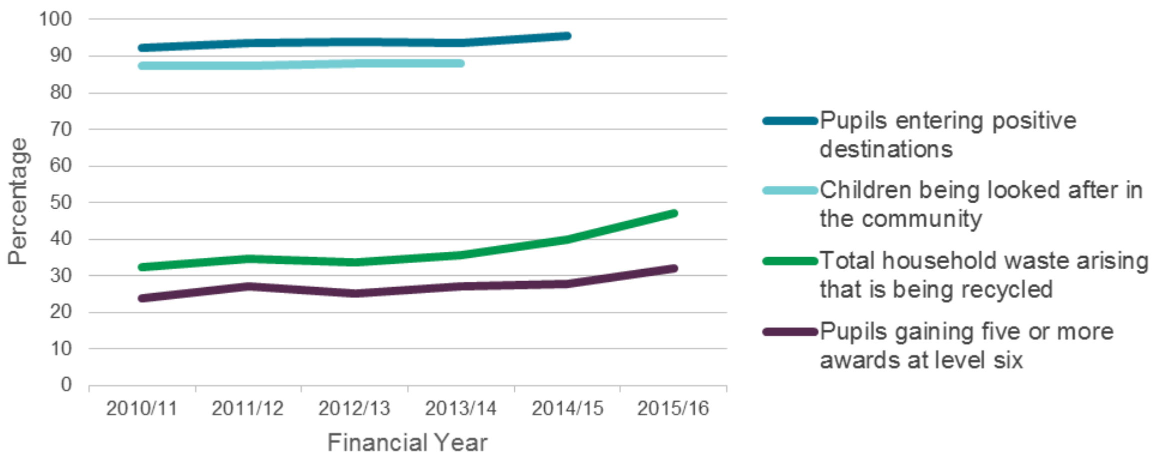
- property rationalisation and the new office strategy - A significant element of this project involves the transfer of the council's headquarters from Aberdeen to Inverurie. In preparation for increased flexible working, there is a programme of engagement with elected members and staff around associated changes in culture and the impact of agile working. In addition, the council is undergoing a significant depot rationalisation programme and has reduced the number of its offices from 98 to 53

- affordable housing – during 2016/17, the council built 169 units across 8 sites in Aberdeenshire bringing its total investment since 2010 to 332 units. Opportunities to extend the number of units continues to be sought.

105. The Local Government Benchmarking Framework allows councils to compare themselves to the Scottish average. It also groups councils with similar profiles into family groups based on factors such as population density and levels of deprivation. This allows similar councils to compare and benchmark performance.

106. Based on a number of measures that we believe give an indication of council performance in key service areas for the public, we found that the council's performance in the last five years has been maintained or improved as illustrated in Exhibit 14.

Exhibit 14 Aberdeenshire Council's performance against selected indicators 2010/11 to 2015/16



Source: Aberdeenshire Council

Performance management

107. In September 2016, the Performance and Resources Committee approved a Performance Management and Reporting Framework. The framework seeks to ensure that members and officers have the appropriate accountability, responsibility and ability to consider the performance of the council and make improvements to ensure service standards, targets or other benchmarks are achieved within the resources available. It outlines the governance and reporting arrangements for the council and the wider cycle for performance improvement.

108. There is regular reporting of performance to both service and area committees under the banner of Aberdeenshire Performs. Reports are in a standard format and provide information against target, trends and where appropriate some narrative is also provided. The information is presented in 'Red, Amber, Green' format, with arrows to showing direction of travel. This makes the reports easy to review and enables quick identification of areas where performance is not as expected.

109. A wide range of performance information is made available to the public via the 'Strategy & Performance' section of the council's website which is clearly signposted from the home page. Information includes performance against each of the 4 Core Outcomes, service performance, a 'Reputation Tracker', quarterly and annual complaints reports and links to external audit and inspection reviews. A link is also provided to the Local Government Benchmarking Forum, allowing users to compare Aberdeenshire against other councils.

110. Since 2013/14, the council has published an Annual Performance Report which aims to provide a balanced overview of progress towards delivery of core outcomes and priorities during the year. The report brings together a range of data including Statutory Performance Indicators and Local Government Benchmarking Framework data. The 2016/17 Annual Performance Report is scheduled to be considered by full council in September 2017.

111. Overall, the council's arrangements for monitoring and reporting performance are considered to be robust.

Statutory performance indicators (SPIs)

112. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report this information but expects them to provide the public with fair, balanced and engaging performance information.

113. For 2016/17, two SPIs were prescribed:

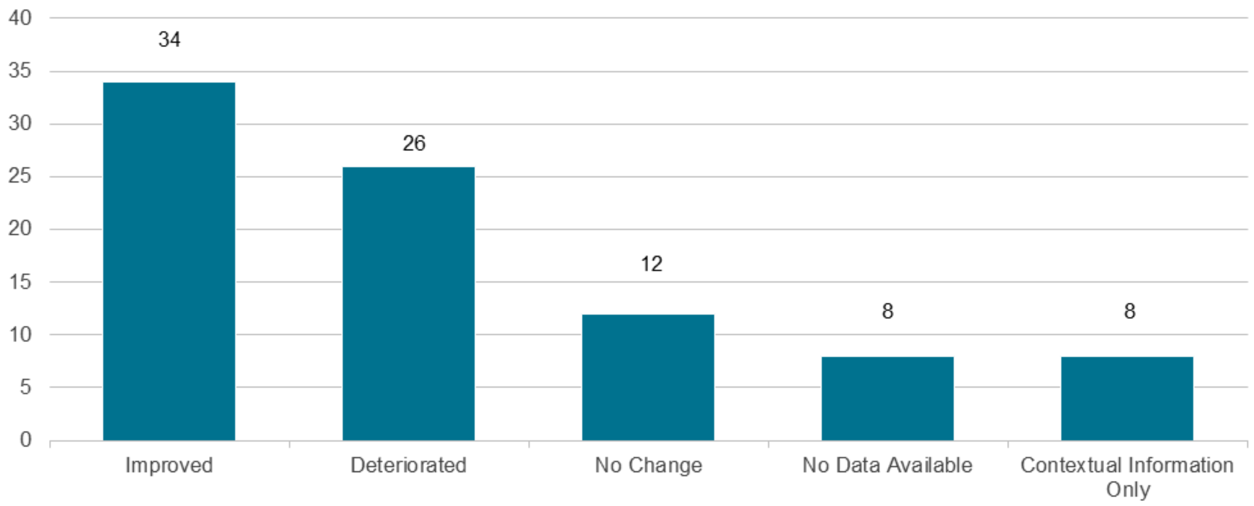
- SPI 1: covering a range of information relating to service performance and local outcomes
- SPI 2: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

114. Overall, we concluded that the council's arrangements for publication are satisfactory. For 2016/17, the council has produced a total of 88 indicators covering SPI's 1 and 2. A summary of the council's performance results compared with 2015/16 is set out in Exhibit 15 and overall, shows an improving position for the year.

115. The following examples were taken from the 34 indicators where performance improved during the year:

- percentage of trading standards high risk premises visited within the timescale – 94.29% (93.94% in 2015/16)
- percentage of school leavers achieving an award in Literacy and Numeracy at least SCQF Level 4 – 92.72% (90.10% in 2015/16)
- percentage of community care assessments completed within target timescales – 80.20% (73.40% in 2015/16)
- percentage of invoices sampled that were paid within 30 days – 86.31% (75.86% in 2015/16)

Exhibit 15 – Direction of Performance 2015/16 - 2016/17



Source: Audit analysis of council's SPIs

116. Among the 26 indicators showing a deterioration in performance compared with the previous year were the following:

- average time between time of noise complaint and attendance on site – 326.50hours (150.45 hours in 2015/16)
- percentage of schools inspected by Education Scotland with Meeting Learners Needs recorded as positive – 50% (75% in 2015/16)
- average re-let time of Council Dwellings in days – 40.7 (35.8 in 2015/16)
- average time taken to process new benefit claims from the date of receipt to the date of decision in days – 35 (29 in 2015/16).

Recent inspection activity

117. Education Scotland working in partnership with Aberdeenshire Council carried out a validated self-evaluation of Aberdeenshire Council's Educational Psychology Service. Concluded in February 2017, Education Scotland are confident that the service, working closely with the wider Education and Children's Services team, will build on their strengths and act on the learning from the validated self-assessment process to refine and review their strong psychological offer to stakeholders and children, young people and families in Aberdeenshire.

118. The strong leadership of the Principal Educational Psychologist and the distributive leadership evident across the service team has impacted positively on the quality of the service delivered to children, young people and their families. There is close synergy between the service's work and the educational priorities of the council, with a clear shared vision for improvement. Education and Children's Services now need to streamline planning to maximize the impact of the service's contribution to strategic developments, particularly in relation to national priorities.

119. The Care Inspectorate and Healthcare Improvement Scotland reported in October 2015 on the joint inspection of services for children and young people. This identified some key areas for development in Aberdeenshire. The Community Planning Partnership delegated the accountability and responsibility for addressing these key areas and developing the new plan for Children's Services to the Chief Officer Group for Children. The chief officers come together under the remit of their statutory responsibilities, working collaboratively to provide accountability for scrutiny and reassurance that services are being delivered in line with statutory responsibilities, and to ensure that action is taken to address any barriers. The new plan was effective from April 2017.

National performance audit reports

120. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, a number of reports were issued which are of direct interest to the council. These included:

- The National Fraud Initiative in Scotland (June 2016)
- Maintaining Scotland's Roads: a follow up report (August 2016)
- Social Work in Scotland (September 2016)
- Scotland's new financial powers (September 2016)
- How councils work: roles and working relationships in councils (November 2016)
- Local Government in Scotland :Financial overview 2015/16 – November 2016
- Local Government in Scotland :Performance and challenges 2017 – March 2017

Good practice points

121. Alongside its 2017/18 Revenue Budget, the council agreed its first Carbon Budget, the first local authority in Scotland to do so. The Carbon Budget is intended to make services more accountable for reducing their own carbon emissions and enable the council to better manage how it works towards meeting its emission reduction targets.

122. Each directorate has been allocated an allowance of Carbon Dioxide Equivalent (CO_2e) emissions for the year which it will be required to operate within. The intention is to reduce the allowances each year and so reduce climate change emissions. This will also have financial benefits for the council.

Appendix 1

Action plan 2016/17

2016/17 recommendations for improvement

Page no.	Issue/risk	Recommendation	Agreed management action/timing
10/ Exhibit 3	1.Property valuations are not supported by sufficient physical inspections ***Risk: valuation calculations may not reflect the true condition of properties and the valuation process does not meet the requirement of RICS***.	A programme of inspections is scheduled to cover all beacon properties and a reasonable sample of other properties over a 5 year period.	An Action Plan will be prepared to address the recommended action. **31 October 2017**
13/ Exhibit 3	2.Manual approval of invoices (where the purchase order is outwith the iProcurement system) is not operating as expected. ***Risk: weaknesses in invoice authorisation may provide the opportunity for inappropriate/unauthorised expenditure to be incurred***.	Review authorisation limits for approved officers.	The increase of suppliers on to the iProcurement system will minimise the need for manual approvals. However, a review of limits and appropriate officers will be carried out. **31 December 2017**
13/27	3.The Local Code of Corporate Governance is out of date. ***Risk: the council is not operating in line with best practice and in the absence of robust self-assessment against the code, there is scope for standards to fall.***	Update the Local Code to reflect revised guidance and undertake an annual self-assessment exercise to demonstrate compliance as part of the assurance process for the Annual Governance Statement.	Agreed. The Code of Corporate Governance will be reviewed in early 2018 to take into account the CIPFA "Delivering Good Governance in Local Government: Framework (2016)" and the Council's priorities following the approval of the Council Plan 2017-2022. Annual self-assessments will continue to be undertaken through "How Good is Our Council?" **31 March 2018**

Page no.	Issue/risk	Recommendation	Agreed management action/timing
18/46 and 22/66	4.Budget monitoring reports do not separately identify virements made in-year in response to unplanned situations from virements planned as part of the budget process. Also, assumptions supporting budgets are not always updated to reflect actual spending. While the focus is rightly on achieving financial balance, it is difficult to follow the effect of specific action taken. ***Risk: if budgets do not fully reflect actual spending experience and the level of uncommitted reserves is low, budget monitoring will not be effective and plans to meet funding gaps may not be achievable.***	Review and improve the content of budget monitoring reports. For significant areas, assumptions should be revised to reflect the experiences of actual spending.	Budgets will only vary during the year as a result of approved virements. Variations between actual spending and the budget are expressed through reports and notes to Committee. The clarity of these notes will be reviewed to ensure up to date information is conveyed. **31 December 2017**

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

Audit risk		Assurance procedure	Results and conclusions
Risks of material misstatement in the financial statements			
1	**Risk of management override of controls** ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes consideration of the risk of management override of controls in order to change the position disclosed in the financial statements.	• Owing to the nature of this risk, assurances from management are not applicable.	• Journals - we found no evidence to suggest that management were overriding controls • Estimates - based on testing of debtors, creditors and provisions/contingencies, we found no evidence of bias in accounting estimates • Significant transactions - based on our work on the annual accounts, we did not find any evidence of transactions outwith the scope of the council • No fraud concerns identified in respect of management override of controls.
2	**Risk of fraud over income and expenditure** Aberdeenshire Council receives a significant amount of income in addition to Scottish Government funding. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud. Potential areas of concern include council tax, non-domestic rates and income from sundry debtors. The Code of Audit Practice expands the ISA assumption on fraud over income to aspects of expenditure. The council incurs significant expenditure in areas such as welfare benefits, social care payments and grants.	• Schemes of delegation • No history of significant fraud • Corporate fraud policy in place • Appropriate processes for the authorisation, separation of duties and workflow associated with income and expenditure • Compliance with procurement regulations • Budgetary control arrangements and regular financial monitoring by management and scrutiny by members through cycle of committee reporting • Regular review of financial systems and internal controls by internal audit • Debt recovery and bad debt arrangements.	• Key Controls - testing of key financial controls including reliance on internal audit did not highlight significant weaknesses. Concluded satisfactorily • Income Transactions – no concerns identified • Expenditure Transactions - no concerns identified • Year end income and expenditure - no concerns identified.

Audit risk	Assurance procedure	Results and conclusions
3 Group accounts Aberdeenshire IJB is a joint venture between the council and NHS Grampian and consequently, a share requires to be included in each partner's group accounts. There are risks that: • the council does not have proper arrangements in place to ensure the completeness and correct classification of IJB related transactions • balances between the council and the IJB are not agreed in sufficient time for preparation of the financial statements • budget overspends will directly impact on the council's budget and due to the demand led nature of a number of the budgets concerned, there is a risk of unexpected (i.e. unplanned) overspends.	• The financial ledger coding structure identifies all IJB transactions • Regular monitoring of financial information • Due diligence completed on the budget setting process • Early agreement of balances between council and IJB • Treatment of over- and underspends set out in the Integration Scheme • NHS Grampian chief executive and the council chief executive for IJB area meet with relevant IJB chief officer and s95 officer • IJB has an audit committee working alongside the council audit committee.	• We reviewed consolidation adjustments for the Group Accounts and confirmed these to the IJB Annual Accounts.
4 Council dwellings revaluation Council dwellings are revalued every 5 years. This is a significant undertaking by the council, requiring a number of complex judgements and calculations to be made. There is a risk that the value of council dwellings and consequently, the council's financial statements are materially misstated.	• Instructions to the valuer and valuation report/certificates.	• We considered the work of the council's internal Valuer and the District Valuer (who undertook a peer review) as management experts in accordance with ISA500 and concluded that reliance could be placed on both. • We reviewed the methodologies used by the council to determine the gross valuation and the adjustment required to reflect Social Housing. Findings in respect of the valuation are set out in Part 1 of the report, Exhibit 3 (item1).
5 Office Space Strategy The council has approved a strategy to reduce its offices from 98 to 53. In January 2017, the number was recorded as 63. A significant element of this project is options to transfer the council's headquarters from Aberdeen to Inverurie. In addition the council is undergoing a significant depot rationalisation	• Office Space Strategy and working group minutes • Involvement of Property experts • Internal audit review of fixed asset register.	• Confirmed that all surplus assets and assets held for sale were subject to revaluation in the year and included at Fair Value in the accounts.

	Audit risk	Assurance procedure	Results and conclusions
	programme. There are risks that surplus assets have not been correctly treated in terms of the Code with regard to valuation, asset lives and disclosure.		
6	**Estimation and judgements** There is a degree of subjectivity in the measurement and valuation of the material account areas of pensions, non-current assets (including council dwellings), accruals and provisions. This subjectivity represents an increased risk of misstatement in the financial statements.	• Use of clearly defined methodologies and procedures including experts, as appropriate, when making significant estimations and judgements • Management review by qualified finance staff.	• We reviewed the significant estimates and judgements made by the council relating to revaluation and depreciation of non-current assets, accruals, provisions, arrears and pension liabilities • Several of these items are discussed in Part 1 of the report (Exhibit 3). Overall, satisfactory conclusions reached.
7	**New Payroll System** In April 2016, the council went live with a new payroll system, i-Trent. Due to a number of issues during implementation which are not fully resolved, the council has had to increase the number of manual checks performed each month, and this has required additional resources through the appointment of temporary staff. There are risks that pay is incorrectly calculated / incorrect deductions are being made from gross pay by the system.	• Project board minutes and reports • Progress reports to management and elected members • Evidence and review of management checks and controls • Commissioned specialist consultancy Phase 3 for critical elements including year-end activities.	• We reviewed the additional controls put in place by the council to ensure payments were correctly made and concluded that these were satisfactory • We substantively tested a sample of 22 monthly payslips, across all payroll groups, and confirmed that these were all correctly calculated.

Appendix 3
Summary of unadjusted errors

We report all uncorrected misstatements that are individually greater than our reporting threshold of £100k.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in Exhibit 2. We are satisfied that these errors do not have a material impact on the financial statements.

No.	Account areas	Comprehensive income and expenditure statement		Balance sheet		Movement in Reserves Statement
		Dr £000	Cr £000	Dr £000	Cr £000	
1	DR Cost of Services	460				
	CR Debtors				460	
	Capital debtor re Ballater Outdoor Centre accrued in 2016/17 but income already posted in year					
2	Dr Creditors			414		
	Cr Cost of Services		414			
	Supplier invoices incorrectly posted to the wrong year					
3	Dr Intangible Assets			734		
	Cr Creditors				734	
	Intangible asset was not created in respect of carbon reduction commitment					
4	Dr Debtors			122		
	Cr Creditors				122	
	Credits in Debtors not removed					
5	Dr Property, Plant, Equipment			343		
	Cr Inventories				343	
	New vehicles included in stock at year end rather than non-current assets					

No.	Account areas	Comprehensive income and expenditure statement		Balance sheet		Movement in Reserves Statement
6	Dr Interest paid	225				
	Cr Interest received		225			
	Interest received in the year was incorrectly netted against interest paid					
7	Dr Cost of Services	721				
	Cr Creditors				721	
	Under/over statement of creditors re water charges and care invoices					
8	Dr Creditors			3,985		
	Cr Earmarked balances		3,985			
	Second home creditors					
	Totals	**1,406**	**4,624**	**5,598**	**2,380**	
Net impact			**3,218**	**3,218**		

Aberdeenshire Council

2016/17 Annual Audit Report

If you require this publication in an alternative format and/or language, please contact us to discuss your needs: 0131 625 1500 or **info@audit-scotland.gov.uk**

For the latest news, reports and updates, follow us on:

Audit Scotland, 4th Floor, 102 West Port, Edinburgh EH3 9DN
T: 0131 625 1500 E: **info@audit-scotland.gov.uk**
www.audit-scotland.gov.uk