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Aberdeen City Council

Audit status update

For Audit, Risk and Scrutiny Committee

30 June 2022

Purpose of the report and background

Purpose of this report

- To provide an update to members of the Audit, Risk and Scrutiny Committee of the current status of the external audit.
- Highlight **draft** conclusions and matters arising to date.

Background

In prior years Aberdeen City Council ("the Council") worked towards early preparation, inspection and audit of the financial statements, largely complete by 30 June. As a consequence of the complexity of the Council's financial statements and inherent judgements together with Council and Audit teams working remotely and in increasingly challenging environments, achieving this deadline has remained challenging.

Taken together with changes in the Committee timetable and elections in 2022, we agreed that unaudited financial statements would continue to be provided for audit by early May in order to provide opportunity to progress significant work by 30 June but with completion of the audit and reporting reverting to autumn.

We appreciate that production of the financial statements by this early timetable is / remains ambitious. Due to some staff absences and competing requirements, we received unaudited accounts and commenced our audit on 16 May. This remains significantly ahead of statutory deadlines but is later than in previous years.

Our audit is progressed in line with the revised timetable and this report summarises the current status in respect of the significant risks and other audit areas identified in the audit strategy. Our audit testing is ongoing and therefore draft findings are subject to change.

We have not commenced testing in respect of consolidation or completed internal review which may give rise to further audit challenge, change in draft findings or identification of new matters.

Status update

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IFRS16 Transition *(for future periods)*	No update to date

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Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Fraud risk from management override of controls	Management is typically in a position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. This is an assumed risk per ISA 240. Strong oversight of finances by management, and reporting to those charged with governance, provides additional review of potential material misstatements caused by management override of controls. Our audit methodology incorporates the risk of management override as a default significant risk. We have not identified any specific additional risks of management override relating to the audit of the Council.	Our audit work is ongoing and below is the current position of the work: — We have evaluated the design and implementation and tested the operating effectiveness of the controls in place for the approval of manual journals posted to the general ledger to ensure that they are appropriate – ***no issues identified.*** — We will analyse all journals through the year using data and analytics and are in the process of analysing the data so we can concentrate our testing on those with a higher risk, such as journals impacting expenditure recognition, and significant risk areas. — We will evaluate the appropriateness of changes compared to the prior year to the methods and underlying assumptions used to prepare accounting estimates this work is ongoing — We will review the appropriateness of the accounting for significant transactions that are outside the Council's normal course of business, or are otherwise unusual, this work is ongoing. — We have evaluated the design and implementation of the controls in place for the identification of related party relationships and there are ***no issues identified***. We will test the completeness of the related parties identified and related disclosure. ***To the extent tested, controls are designed, implemented and operating effectively.*** ***Audit work is ongoing in respect of the selection and testing of journals and non routine transactions.***

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Fraud risk over expenditure recognition	Under ISA 240 there is a presumed risk that income may be misstated due to improper recognition of income. This requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. We consider that there is not a risk of improper recognition of expenditure in respect of payroll costs, financing and investment expenditure, and depreciation. These costs are routine in nature and have limited risk of manipulation. As other operating expenditure is unlikely to be material, we also rebut the assumed risk in respect of this account. We have not rebutted the assumed risk in respect of the remaining expenditure accounts (£523 million) within the £1,148 million (in 2020-21) gross expenditure. The Council is currently projecting an overspend in year, funded by the use of the Covid19 reserves transfers created in 2020-21, providing a break even position to the general fund. The risk is for the expenditure in the months following month 9 reporting, including the year end processes and cut off. (The risk is the completeness, accuracy and existence of the expenditure).	Our work is ongoing and the current position is detailed below: — We are have selected the samples and received supporting documentation for most items which is currently being considered. Our tests of expenditure cut-off and search for unrecorded liabilities are ongoing. — We have selected a number of expenditure samples focusing on the areas of greatest risk, including creditors, accruals and provisions. We have received supporting documentation for most items and are considering it, challenging the Council evidence as appropriate. — We will challenge management in respect of cut-off arrangements and use of any de-minimis levels; and — We will test journal entries in relation to expenditure for evidence of management bias. **Our work is not significantly progressed in this area but we have selected the majority of samples for which management have already provided supporting documentation in most cases. Samples in respect of cut-off testing have yet to be selected.**

Income recognition fraud risk

As above, ISA 240 requires us to consider if the fraud risk from revenue recognition is significant.

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

Financial statements audit

Significant risk	The risk	Response and findings
Financial statement risk		
Valuation of council dwellings, other land and buildings, surplus assets and investment properties **(KAM)**	The Accounting Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. There is a significant risk over the valuation assertion due to material estimates included within the valuation. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. In 2021-22 the following category of assets will be subject to revaluation and we expect the movement to be material: — Swimming pools and sport centres; — Golf courses; — Community and Community Education centres; — Museums and Theatres; — Crematorium; and — Council Offices. Given the quantum of the carrying values and the inherent use of assumptions in their valuation, we consider there to be significant risk of misstatement. In addition to those assets revalued in year, the Council will have to evidence how it satisfies itself that the other assets not revalued in 2021-22 are not materially misstated, especially with the current impact of the Covid19 pandemic and the economic impact of inflationary pressures within the construction industry.	**Our audit is ongoing in this area and below is a summary of the position of the work.** — We have obtained an understanding of management's involvement in the valuation process to assess if appropriate oversight has occurred. — We have evaluated the design and implementation of the controls relating to valuations. — We will critically assess the approach that the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach. ***We have requested that management provide us with their assessment of the basis of and valuation of a number of individually material assets and groups or assets. The current position is that we have been provided this for:*** ▪ ***Marschal Square investment properties*** ▪ ***Waste to Energy plant*** ▪ ***Most individually sampled properties*** ***We are still awaiting management's assessments in respect of:*** ▪ ***TECA investment properties (hotels, land);*** ▪ ***TECA (P&J Live)*** ▪ ***Energy Centre*** ▪ ***Bio Waste centre*** ▪ ***Former market (purchased in year and subject to demolition)*** ▪ ***Former policescotland site*** ▪ ***Assets not revalued in year*** *(continued…)*

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Valuation of council dwellings, other land and buildings, surplus assets and investment properties (continued)	Continued….. The Council also holds investment properties, which as at 31 March 2021 were valued at £192 million. These properties are subject to annual revaluation and similarly we consider there to be a risk of misstatement arising from the use of assumptions in the valuations. This includes significant assets such as Marischal Square development and the hotels and Energy centre at TECA site. The Covid19 pandemic has had a significant impact on the operation of P&J Live, hotels and interest in Marischal Square accommodation and may impact on investment and surplus asset valuations generally. P&J Live was classified as an operational asset (valued on the basis of depreciated cost), while the energy centre was classified as an investment property (valued at cost) in 2020-21, we have challenged management to continue to assess whether a market value can be determined. We understand that the Waste to Energy Plant will be completed in 2021-22 and management will need to document their judgements as to the classification of this asset, the basis of valuation, and the valuation itself.	For a sample of other assets to cover all the categories of Assets that have been valued in the rolling revaluation programme, at this stage the Council has provided us with its initial assessments and we are currently challenging the basis of the valuations ensuring they are in line with the CIPFA Code on Local Authority Accounting for 2021-22 and then we will challenge the key assumptions upon which the valuations were based for a sample of properties, by making a comparison to our own assumption ranges derived from market data. We will critically assess the independence, professional qualifications, competence and experience of the Council valuer. We are utilising our internal specialist to critically assess the methodology used by the valuer by considering whether the valuations are in accordance with the RICS Valuation Professional Standards 'the Red Book' and relevant accounting standards. We will for a sample of properties we will agree the observable inputs used in the valuations, such as land size and floor space to information held by the Estates Department. For the sample we will agree rental income to the amounts invoiced. We will critically assess the adequacy of the Council's disclosures in relation to the judgement in relation to valuing properties. ***Based on testing to date and discussions with management we expect that an updated valuation of schools will be required as a result of movement in construction costs – this may also apply to other categories of assets.*** ***Management have already reflected a revision to the valuation of Housing Revenue Account properties based on an external valuation. We have yet to consider this.*** ***We have challenged the Council in respect of a number of assets set out on the previous page and have yet to receive and consider judgements.***

Status update

Significant risk	The risk	Response and findings
Financial statement risk		
Retirement benefits – Gross Liabilities **(KAM)**	The gross pension liability (£1.6 billion as at 31 March 2021), represents a material element of the Council's balance sheet. The Council is an admitted body of North East Scotland Pension Fund, which had its last triennial valuation completed as at 31 March 2020. The impact of the triennial valuation will be felt in the contributions paid in 2021/22, however it will help to form the valuation as at 31 March 2022 using the roll forward basis. The calculation of the Local Government Pension Scheme liability requires the use of an actuarial methodology, the result of which is dependent upon a number of assumptions. These include both financial and demographic assumptions, such as the discount rate, inflation rates, mortality rates etc. These assumptions should reflect the profile of the Council's employees, and be based on appropriate data. The basis of the assumptions should also be derived on a consistent basis year to year. The Gross Liabilities at 31 March 2022 should now include an assessment of the liability due to the legal rulings for McCloud / GMP and Seargent. There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact on the net pension liability accounted for in the financial statements.	***Our work on Retirement benefits – Gross liabilities is substantiallyprogressed and we have:*** • Assessed the design and implantation of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation. • Challenged, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data. • Challenged the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations. • Evaluated the competency, objectivity of the scheme actuaries to confirm the qualifications and the basis for their calculations. • Agreed the data provided by the council to the North East Scotland Pension Fund for use within the calculation of the scheme valuation. • Considered the adequacy of the disclosures in respect of the sensitivity of the liability to these assumptions. • Assessed if the disclosures within the financial statements are in accordance with the Accounting Code's requirements. ***An updated actuarial report was obtained by the Council which has resulted in amendment to the draft unaudited financial statements to reflect up to date market information. Based on our work to date, we expect to conclude that the assumptions are considered balanced overall and that disclosures are complete and accurate.*** ***Our work in respect of consolidation is not yet complete, including over the gross liabilities of combining entities where considered material.***

Status update

Other audit risk	Summary	Response and findings
Financial statement other audit risk		
Capital expenditure	The Council has a five year £1 billion capital plan which is focused around the city centre masterplan. This includes an initial budget of £214 million for 2021-22. The Pandemic has had an impact on the delivery of the planned capital program meaning a delay on some of the capital developments. Key projects in progress during 2021-22 include the Energy from Waste Plant construction, and affordable housing build. Due to the significance of this capital investment programme and complexity of some of the projects, we consider it to be an area of audit focus. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions.	Our work on capital expenditure is progressing: — We have tested the capital expenditure using a statistical substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation. — We plan to assess a sample of items allocated to revenue expenditure to determine whether they are correctly classified. We have yet to share this sample with the Council for them to supply the supporting evidence — We plan to review and corroborate to supporting audit evidence of manual journals. We have yet to share this sample to Council for them to produce the supporting evidence ***At this stage we have not identified any issues to bring to your attention, however there are still work to be completed.***

Status update

Other audit matter	Summary	Response and findings
Bond Accounting		
Bond Accounting Model	We considered the accounting for the £370 million bond to be a significant risk in the 2016-17 audit, being the year of issuance. In 2021-22 we do not consider it to be a significant risk, consistent with 2020-21. For 2021-22 management will update factual RPI movements to the 28 February 2022 measurement date (which determines the bond principal outstanding and interest payable) and will accrue for the month of March 2022 using factual RPI movements, which will be available when the accounts are prepared. Management will also estimate future RPI movements in order to complete accounts disclosures and to facilitate long-term budgeting. The Council must comply with the conditions of the Bond Trust Deed, which are not unusual for such financial instruments. We will obtain management's support for the compliance during the final audit. The bondholders could seek repayment of the bond principal in certain circumstances. One such circumstance is if the Council's credit rating (as assessed by Moody's) is downgraded such that it is three notches or more below that of UK sovereign debt. The Council's credit rating is is rated as "stable". We would consider the impact to any revisions to credit rating relative to UK sovereign debt.	We have reviewed the management Bond Accounting Model and have challenged the assumptions, estimates for the future RPI movements and reviewed the full model. ***Based on our testing to date we have no matters to report.***

About this report

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

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

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

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

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