



Aberdeen City Council

Audit strategy

Year ending 31 March 2018

For audit, risk and scrutiny committee consideration on 22 February 2018

9 February 2018

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About this report

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

This report is for the benefit of 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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Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Andy Shaw, who is the engagement leader for our services to Aberdeen City Council, telephone 0131 527 6673 email: andrew.shaw@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Hugh Harvie, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6682 or email to hugh.harvie@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Fiona Kordiak, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN.

Introduction

2017-18 is the second year of our external audit appointment to Aberdeen City Council (“the Council”), having been appointed by the Accounts Commission as auditor of the Council under the Local Government (Scotland) Act 1973 (“the Act”). The period of appointment is 2016-17 to 2020-21, inclusive. Our appointment includes the audit of the Aberdeen City Council Charitable Trusts.

Our planned work in 2017-18 will include:

- an audit of the financial statements and provision of an opinion on whether the financial statements:
 - give a true and fair view in accordance with the applicable law and the Code of Practice on Local Authority Accounting in the United Kingdom (“the 2017-18 Code”) of the state of the affairs of the Council as at 31 March 2018 and of the income and expenditure of the Council for the year then ended; and
 - have been prepared in accordance with IFRS as adopted by the European Union, as interpreted and adapted by the 2017-18 Code, the requirements of the Local Government (Scotland) Act 1973, the Local Authority Accounts (Scotland) Regulations 2014 and the Local Government in Scotland Act 2003.
- participation in the shared risk assessment as part of the local area network;
- completion of returns to Audit Scotland and grant claims;
- a review and assessment of the Council’s governance arrangements and review of the governance statement;
- a review of National Fraud Initiative arrangements;
- a review of arrangements for preparing and publishing statutory performance information; and
- contributing to the audit of wider scope and Best Value through performance of risk assessed work.

Adding value

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

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

Our team

The senior team involved in the external audit benefits from continuity in engagement leader and has significant experience in the audit of local authorities. The team is supported by specialists, all of whom work with a variety of local government and public sector bodies. All members of the team are part of our wider local government network. The senior members of the audit team are set out below and relevant contact details are provided on the back page of this report. Due to the Council’s status as an EU Public Interest Entity (“EU-PIE”), we are also required to include an engagement quality control reviewer.



Andy Shaw
Engagement leader – Audit director



Michael Wilkie
Senior Manager

Our work will be completed in four phases from December 2017 to September 2018. Our key deliverables are this audit strategy document, an interim report, ISA 260 report and annual audit report.

Acknowledgements

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

Headlines



Materiality

Group materiality for planning purposes is based on last year's expenditure and is set at £8.78 million, which equates to 1% of gross cost of services expenditure. We will review the level of materiality on receipt of draft accounts for 2017-18.

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

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Audit risks

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

- management override of controls fraud risk (assumed risk per ISA 240);
- fraud risk from revenue recognition (assumed risk per ISA 240);
- retirement benefits;
- revaluation of property, plant and equipment; and
- capital expenditure.

The last two items are those we consider to have the greatest effect on the overall audit strategy, the allocation of resources in the audit and on directing the efforts of the engagement team. We anticipate reporting on these areas in our financial statements annual audit opinion.

The risks with less likelihood of giving rise to a material error but which is nevertheless worthy of audit understanding relate to "faster accounts close".

Pages seven to 12



£ Financial statement audit

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



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



Wider scope

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

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

We test wider scope areas where there are identified risks. We consider that there are wider scope risks in respect of the implementation of the Target Operating Model and implementation of the changes arising from the governance review. We have not identified wider scope financial statement level risks, although have included "faster accounts close" as an audit focus area as noted opposite.

Pages 15 to 21

Headlines (continued)

Best Value

In June 2016, the Accounts Commission formally agreed the overall framework for the approach to auditing Best Value in councils. The framework introduced a five year approach to Best Value. 2017-18 represents year two of the Best Value plan for the Council during which we will consider Improvement and Leadership.

Pages 15 to 21 provide more detail on our work over Best Value and wider scope areas.

Subsidiaries

In addition to the Council we deem the following subsidiaries and associates to be significant in the context of the group audit:

- Aberdeen City Council Common Good and Trust Fund;
- Aberdeen City Health and Social Care Partnership;
- Bon Accord Care Limited; and
- Bon Accord Support Services Limited.

To support our audit work on the Council's group accounts, we seek to place reliance on the work of firm which is the auditor to the Bon Accord entities. We will liaise with it in order to confirm that its programme of work is adequate for our purposes and they satisfy professional requirements. KPMG is auditor to Aberdeen City Council Common Good Fund and Aberdeen City Health and Social Care Partnership.

Appendix seven

Independence

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

- at the planning stage; and

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

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

Total fees charged by us for the period ended 31 March 2017 were communicated in our Annual Audit Report issued in September 2017. Total fees for 2017-18 will be presented in our Annual Audit Report issued on completion of the audit. The proposed audit fee for 2017-18 will be discussed with management.

Quality

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

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

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

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

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



Financial statements audit planning

Materiality

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

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

For the Council, materiality for planning purposes has been set at £8.78 million for the Council's standalone accounts, and at £8.99 million for the group accounts, which in both cases equates to 1% percent of gross expenditure. We adjust gross expenditure for plant and property impairments, to 'smooth' the impact of these movements. We take a five year rolling average of revaluation movements into our materiality calculations. We also remove the Integration Joint Board expenditure from the calculation, as income and expenditure is grossed up for presentational purposes within the consolidated income and expenditure account.

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

Reporting to the audit, risk and scrutiny committee

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

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

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

Group audit

We will report the following matters in the annual audit report:

- deficiencies in the system of internal controls or instances of fraud which the subsidiary auditors identify;
- limitations on the group audit, for example, where the access to information may have been restricted; and
- instances where our evaluation of the work of the subsidiary auditors gives rise to concern about the quality of that auditor's work.



Financial statements audit planning (continued)



Significant risks and other focus areas

In accordance with paragraph 19A of ISA 700, we are required to describe in our financial statements audit opinion those assessed risks of material misstatement which have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team. We have identified the revaluation of property, plant and equipment and capital expenditure as the two areas which we consider, at the planning stage of our audit, to have the greatest effect on our approach and on which we will report in our opinion in the financial statements. We will update this assessment in our ISA 260 report.

Significant risk	Why	Audit approach
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. Our audit methodology incorporates the risk of management override as a default significant risk.	<ul style="list-style-type: none"> — 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. — 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. — In line with our methodology, we will carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the Council's normal course of business, or are otherwise unusual.

Financial statements audit planning (continued)



Significant risks (continued)

Significant risk	Why	Audit approach
Financial statement risk		
Fraud risk from revenue recognition	<p>International Standards on Auditing require us to consider if the fraud risk from revenue recognition is significant. We consider only the fraud risk from recognition of 'other income' to be significant. Other income relates to charges or service income from various streams where we consider there to be judgement in recognition. In particular we consider investment property revenue recognition to represent a significant risk.</p> <p>We do not consider recognition of the remaining income sources to represent a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk (other than for "other income") and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.</p>	<ul style="list-style-type: none"> — Non-ringfenced government grants are agreed in advance of the year, with any changes requiring government approval. There is no estimation or judgement in recognising this stream of income and we do not regard the risk of fraud to be significant. We will agree significant grants to supporting documentation. — The other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing revenues). These revenues are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as revenue. We will perform tests of detail and substantive analytical procedures in our audit of these sources of income. — The potential for other income to be incorrectly recognised will be addressed through controls testing and substantive procedures. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details (including agreeing sample rental income to rent agreements).

Financial statements audit planning (continued)



Significant risks (continued)

Significant risk	Why	Audit approach
Financial statement risk		
Revaluation of property, plant and equipment	<p>The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Council has adopted a rolling revaluation model which sees all land and buildings revalued over a five year cycle. In 2017-18 “other land and buildings” will be subject to revaluation and we expect the movement to be material.</p> <p>Given the quantum of the asset carrying values and the inherent use of assumptions in their valuation, we consider there to be a significant risk of misstatement.</p> <p>The Council also holds £85 million of investment property which is subject to annual revaluation and similarly we consider there to be a risk of misstatement arising from the use of assumptions in the valuations.</p>	<p>Our procedures include:</p> <p>Control design:</p> <ul style="list-style-type: none"> — We will review the approach that the Council has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach. — We will also assess the risk of the valuation changing materially during the year, or between the date of valuation and the year end. <p>Assessing valuer’s credentials:</p> <ul style="list-style-type: none"> — In relation to those assets which have been revalued during the year we will assess the valuer’s qualifications, objectivity and independence to carry out such valuations. <p>Assessing methodology choice and benchmarking assumptions:</p> <ul style="list-style-type: none"> — We will utilise our internal specialist to assess the methodology used including testing the underlying data inputs and assessing the assumptions used in comparison to available market information.

Financial statements audit planning (continued)



Significant risks (continued)

Significant risk	Why	Audit approach
Financial statement risk		
Retirement benefits	<p>The net pension liability (£250 million as at 31 March 2017, including assets of £1.2 billion) 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 2014. The next triennial valuation (as at 31 March 2017) is expected to be completed in March 2018.</p> <p>The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Council's overall valuation.</p> <p>There are financial assumptions and demographic assumptions used in the calculation of the Council's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Council's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes.</p> <p>There is a risk that the assumptions and methodology used in the valuation of the Council's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements.</p>	<p>Our audit approach includes:</p> <p>Control design:</p> <ul style="list-style-type: none"> — Testing the design and operating effectiveness of controls over the provision of membership information to the actuary who uses it, together with the assumptions, to calculate the pension obligation. <p>Benchmarking assumptions:</p> <ul style="list-style-type: none"> — Challenging, with the support of our own actuarial specialists, the key assumptions applied, being: the discount rate; inflation rate; and mortality/life expectancy against externally derived data. — Challenging the rate of increase in pensionable salaries assumption, by comparing it to other evidence such as business and transformation plans and our understanding of Government and staff expectations. <p>Assessing transparency:</p> <ul style="list-style-type: none"> — Considering the adequacy of the disclosures in respect of the sensitivity of the deficit to these assumptions. — Testing the assets recorded and disclosed, using our actuarial team. — Assessing if the disclosures within the financial statements are in accordance with the Code's requirements.

Financial statements audit planning (continued)



Significant risks (continued)

Significant risk	Why	Audit approach
Financial statement risk		
Capital expenditure	<p>The Council has a five year £1 billion capital plan which is focused around the city centre masterplan.</p> <p>The Council is utilising some innovative methods of delivery of capital projects. This includes the use of a 'development strip lease' basis for Marischal Square (completed in 2017-18) and further PPP agreements for the Aberdeen Western Peripheral Route. These can give rise to more complex accounting arrangements.</p> <p>Due to the significance of this capital investment programme and complexity of some of the projects, we consider there to be a significant risk of misstatement. This is in respect of ensuring that the classification of costs between operating and capital expenditure is appropriate and in respect of capturing all relevant costs and contributions.</p> <p>We also consider that large capital projects inherently bring a fraud risk.</p>	<p>Our audit approach includes:</p> <p>Control design:</p> <ul style="list-style-type: none"> — Testing the design and operating effectiveness of controls over the capital projects. — Testing the design and operating effectiveness of controls in respect of the review of costs allocated to capital and revenue projects. <p>Control re-performance:</p> <ul style="list-style-type: none"> — Comparing the total capital expenditure reported in the financial statements with that reported in reports to those charged with governance. <p>Tests of detail:</p> <ul style="list-style-type: none"> — Use of substantive sampling methods to evaluate the appropriateness of capital or revenue accounting classification by reference to supporting documentation. — Assessing a sample of items allocated to revenue expenditure to determine whether they are correctly classified. — Review and corroboration of manual journals. <p>We will specifically consider the following major projects overall, which may include more complex accounting treatments, including wider scope and Best Value aspects:</p> <ul style="list-style-type: none"> — Marischal Square; — Aberdeen Art Gallery redevelopment; and — Aberdeen Exhibition and Conference Centre.

Financial statements audit planning (continued)



Other focus area

Other focus area	Why	Audit approach
<p>Faster accounts close</p>	<p>The Council intends to accelerate the timetable for production and audit of the financial statements by three months. The financial statements are anticipated to be finalised and subject to audit from 1 May and concluded by end June.</p> <p>Acceleration of the timetable increases the risk of error, notwithstanding the Council's detailed planning for the new timetable.</p> <p>In 2016-17 the Council become the first Scottish local authority to issue a £370 million bond for capital financing, listed on the London Stock Exchange.</p> <p>Consequently, the Council is subject to the continuing obligations set out in the Listing Rules and the Disclosure Rules and Transparency Rules.</p> <p>Members of the public have a right to inspect and object to local authority accounts under the Local Government (Scotland) Act 1973. The Local Authority Accounts (Scotland) Regulations 2014 require the Council to:</p> <ul style="list-style-type: none"> — give public notice of the inspection period by 17 June; — have an inspection period of at least 15 working days; and — commence the inspection period at least 14 days after publication of the notice. <p>The inspection period will extend to the audit fieldwork period.</p>	<p>Our audit approach includes:</p> <ul style="list-style-type: none"> — reviewing and challenging the suitability of the Council's arrangements for faster accounts close; — understanding the revised accounts preparation and audit timetable and revising our approach accordingly; — assessing management's arrangements to comply with the public inspection rules; — conducting a substantive audit of finalised financial statement numbers to the end of quarter three, in February 2018; and — testing the roll forward of balances from 31 December 2017 to 31 March 2018, with specific reference to areas of judgement (pensions valuation/plan and property valuation).

Other matters

Accounting framework update

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

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

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

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

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

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

Controls testing

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

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

Internal audit

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

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

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

Other matters (continued)

Bond accounting

We considered the accounting for the £370 million bond to be a significant risk in the 2016-17 audit, being the year of issuance. For 2017-18 management will update factual RPI movements to the 28 February 2018 measurement date (which determines the bond principal outstanding and interest payable) and will accrue for the month of March 2018 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.

Whilst the accounting for the bond is complex, the treatment was established in 2016-17 and an accounting model was constructed, and audited by KPMG. We therefore have determined that bond accounting is not a significant risk to the financial statements, or an area of audit focus.

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. At the date of this report, the Council's credit rating is one notch below that of UK sovereign debt and is rated as "stable". We would consider the impact to any revisions to credit rating relative to UK sovereign debt should they occur.

Group audit considerations

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

We conduct our audit of the Group in accordance with International Standard on Auditing 600 ("ISA 600") *Using the work of another auditor*. Consequently, we will issue group audit instructions to the auditor of Bon Accord Care Limited and Bon Accord Support Services Limited. We will meet with the external auditor at the outset of the audit, to discuss its risk assessment and proposed audit approach and review the reporting provided in response to group instructions.

We have reviewed the group accounts preparation timetable which management issued to bodies consolidated or those providing information required to prepare the Group accounts.

Wider scope and Best Value

Approach

We are required to assess and provide conclusions in the Annual Audit Report in respect of four wider scope dimensions: financial sustainability; financial management; governance and transparency; and value for money. We set out below an overview of our approach to wider scope and Best Value requirements of our annual audit. We provide on pages 17 to 21 our risk assessment in respect of these areas. We will provide narrative on these and other areas in the Annual Audit Report where relevant.

Risk assessment

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

In doing so we consider:

- The Council's own assessment of the risks it faces, and its arrangements to manage and address its risks.
- Evidence gained from previous audit work, including the response to that work.
- The work of other inspectorates and review agencies, through the Local Area Network ('LAN') which is established for each Council.

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

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



Linkages with other audit work

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

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



Wider scope and Best Value (continued)

Approach (continued)

Identification of significant risks

The Code identifies a matter as significant *'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'*

If we identify significant wider scope and Best Value risks, we will highlight the risk to the Council and consider the most appropriate audit response in each case, including:

- Considering the results of work by the Council, inspectorates and other review agencies.
- Carrying out local risk-based work to form a view on the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources.



Concluding on wider scope and Best Value

At the conclusion of the wider scope and Best Value audit we will consider the results of the work undertaken and assess the assurance obtained against each of the wider scope audit dimensions and Best Value, regarding the adequacy of the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources.

If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our wider scope and Best Value conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.



Reporting

We have completed our initial wider scope and Best Value risk assessment and have not identified any significant risks, as noted on the next page. We will update our assessment throughout the year and should any issues present themselves we will report them in our Annual Audit Report.

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



Wider scope and Best Value (continued)

Risk assessment

We have not identified any financial statement significant risks in relation to wider scope and Best Value, although we have identified “Faster Accounts Close” as a financial statements other focus area. ★ relates to an identified Wider Scope risk to be specifically addressed through audit procedures, as further explained on the next page.



Potential risk type: ■ Wider scope ■ Emerging ■ Best Value



Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
<p>Financial sustainability and financial management</p>	<p>Financial sustainability looks forward to the medium and longer term to consider whether the Council is planning effectively to continue to deliver its services or the way in which they should be delivered.</p> <p>Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.</p> <p>Specific identified risks:</p> <p>Target Operating Model</p> <p>The Council is delivering a transformation plan, to consider efficient delivery of services against a backdrop of continuing reductions in funding. The transformation is designed to support the Aberdeen City Local Outcome Improvement Plan 2016-2026. It includes:</p> <ul style="list-style-type: none"> — a new functional structure; — a revised approach to performance management (moving away from finance to outcomes), including new IT and business information systems investment; — development of a digital strategy; and — staff empowerment and engagement. <p>The transformation to the Target Operating Model underpins delivery of £125 million required savings over the next five years. Taken together, there is significant capital investment, organisational and cultural change associated with the Target Operating Model which brings risk to achievement of savings and achievement of outcomes for citizens.</p> <p>There is also a risk associated with the timely completion of capital investment programmes which are supported by the bond financing, in the context of the capital repayments commencing in 2019-20 and being index linked.</p>	<ul style="list-style-type: none"> — We will consider the Council's long term financial plans and its ability to adapt to the changing landscape in local government funding. This will involve consideration of the 2018-19 budget and longer term financial plans from 2019-20 and beyond, including sensitivity analysis and bond repayment/RPI assumptions. — We will consider how the Council's move to the Target Operating Model is progressing and any potential impact on financial and service planning. — We will review the progress of capital programmes which are underpinned by the bond financing.

Wider scope and Best Value (continued)

Risk assessment (continued)

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

Wider scope and Best Value (continued)

Risk assessment (continued)

Wider scope area	Why	Audit approach
<p>Governance and transparency</p>	<p>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.</p> <p>Specific identified risks:</p> <p>Governance review</p> <p>The Council is carrying out an extensive governance review as part of the transformation programme. This has led to a number of changes towards the end of 2016-17 including Standing Orders, ALEO governance, risk management and Council committee structures. These changes are positive and show depth of improvement in governance. There is a risk of control failure during transition to new arrangements.</p> <p>Audit Scotland planning guidance requires us to consider the following matter which is a potential risk to all Public Sector bodies.</p> <p>Response to cyber security</p> <p>The Scottish Government published the Public Sector Action Plan for cyber resilience in November 2017. It aims to ensure that Scotland's public bodies work towards becoming exemplars of cyber resilience.</p> <p>The EU General Data Protection Regulation ("GDPR") will come into effect from 25 May 2018.</p> <p>The Council will need to understand its baseline cyber resilience position and demonstrate commitment to achieving good practice. It will also need to comply GDPR.</p>	<ul style="list-style-type: none"> — We will consider the effectiveness of scrutiny and governance arrangements, by evaluating the challenge and transparency of the reporting of financial and performance information. — With regard to transformation and the move to the target operating model, we will consider the impact on existing governance and control arrangements. — We will update our understanding of the controls and processes around capturing officers' interests. — We will obtain and review minutes of meetings of the Governance Board which has responsibility for monitoring progress against agreed actions as part of the Council's governance review. — We will use guidance provided by Audit Scotland to consider the Council's approach to cyber resilience and readiness for GDPR.

Wider scope and Best Value (continued)

Risk assessment (continued)

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



Appendices

Mandated communications with the Audit, Risk and Scrutiny Committee

Matters to be communicated	Link to audit, risk and scrutiny committee papers
Independence and our quality procedures ISA 260 (UK and Ireland).	<ul style="list-style-type: none"> ■ See next page
The general approach and overall scope of the audit, including levels of materiality, fraud and engagement letter ISA 260 (UK and Ireland).	<ul style="list-style-type: none"> ■ Main body of this paper
<ul style="list-style-type: none"> ■ Disagreement with management about matters that, individually or in aggregate, could be significant to the entity's financial statements or the auditor's report, and their resolution (AU 380). 	<ul style="list-style-type: none"> ■ In the event of such matters of significance we would expect to communicate with the Audit Risk and Scrutiny Committee throughout the year. ■ Formal reporting will be included in our ISA 260 report for the Audit, Risk and Scrutiny Committee meeting, which focuses on the financial statements.
<ul style="list-style-type: none"> ■ Significant difficulties we encountered during the audit. ■ Significant matters discussed, or subject to correspondence, with management (ISA 260). 	
<ul style="list-style-type: none"> ■ Our views about the qualitative aspects of the entity's accounting and financial reporting. ■ The potential effect on the financial statements of any material risks and exposures, such as pending litigation, that are required to be disclosed in the financial statements (ISA 260 and ISA 540). 	
<ul style="list-style-type: none"> ■ Audit adjustments, whether or not recorded by the entity, that have, or could have, a material effect on its financial statements. We will request you to correct uncorrected misstatements (including disclosure misstatements) (ISA 450). 	
<ul style="list-style-type: none"> ■ The selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the entity's financial statements (ISA 570). 	
<ul style="list-style-type: none"> ■ Material uncertainties related to events and conditions that may cast significant doubt on the entity's ability to continue as a going concern (ISA 570). 	
<ul style="list-style-type: none"> ■ Expected modifications to the auditor's report (ISA 705). 	
<ul style="list-style-type: none"> ■ Related party transactions that are not appropriately disclosed (ISA 550) 	

Auditor independence

Assessment of our objectivity and independence as auditor of Aberdeen City Council

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

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

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

General procedures to safeguard independence and objectivity

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

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

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

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

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

Services provided to the Council and its group in respect of:	2017-18 continuing (excl VAT) £	2016-17 (excl VAT) £
Audit of the financial statements	193,103	194,431
Audit of subsidiaries (Charitable Trusts)	8,500	8,500
Total audit services	201,603	202,931
Other non-audit services		
- Capital financing advice	-	363,920
- Options appraisal and strategic review	-	50,000
- VAT claim advice	-	49,000
- Governance review	-	15,000
Total non-audit services	-	477,920
Total	201,603	680,851

There are no non-audit fees for 2017-18. Under the FRC's Revised Ethical Standard, no new tax contingent fees for listed entities can be entered into after 17 June 2016. We confirm that no new contingent fees for tax services have been entered into for Aberdeen City Council since that date.

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

We are appointed by the Accounts Commission via Audit Scotland as external auditor of Aberdeen City Council Charitable Trusts and Aberdeen City Health and Social Care Partnership.

We are also appointed as external auditor of Aberdeen Sports Village Limited, a subsidiary of the Council, this is not an appointment of the Accounts Commission.

Auditor independence (continued)

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the audit, risk and scrutiny committee.

Confirmation of audit independence

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

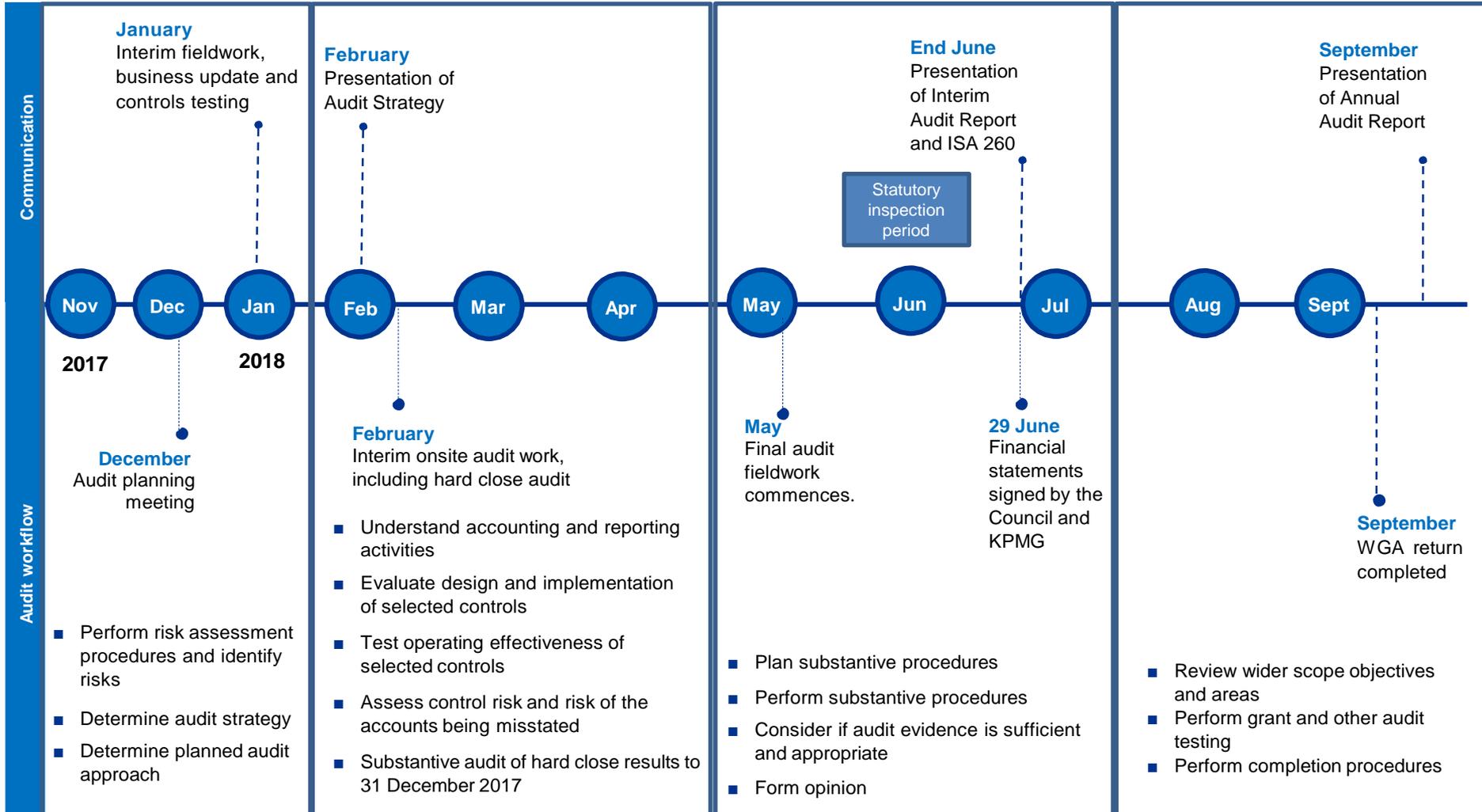
This report is intended solely for the information of the audit, risk and scrutiny committee and should not be used for any other purposes.

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

Yours faithfully

KPMG LLP

Timeline



Audit outputs

Output	Description	Report date
Audit strategy	Our strategy for the external audit of the Council and its group, including significant risk and audit focus areas.	By 22 February 2018
Interim audit report	We summarise our findings from our interim audit work.	By 31 May 2018
Independent auditor's report	Our opinion on the Council's financial statements.	By 29 June 2018
Annual audit report	We summarise our findings from our work during the year.	By 1 October 2018
NFI report	We report on the Council's actions to investigate and follow-up NFI matches.	By 2 February 2018
Whole of Government Accounts	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 28 September 2018
Audit reports on other returns	We will report on the following returns: <ul style="list-style-type: none"> - Current issues return. - Technical database. - Fraud returns. 	January, March, July and October 2018 27 July 2018 27 April 2018
Audit reports to support Audit Scotland's wider analysis	We will report on the following matters: <ul style="list-style-type: none"> - Health & social care integration progress. - City Deals - Digital 	July 2018 September 2018 September 2018
Grant claim audits	We provide an opinion on: <ul style="list-style-type: none"> - Education maintenance allowance, Housing Benefit, Non domestic rates and Criminal Justice social work 	To submit by: July 2017, November 2017 and August 2017

Fees

Audit Scotland has completed a review of funding and fee setting arrangements for 2017-18. An expected fee is calculated by Audit Scotland to each entity within its remit. This expected fee is made up of four elements:

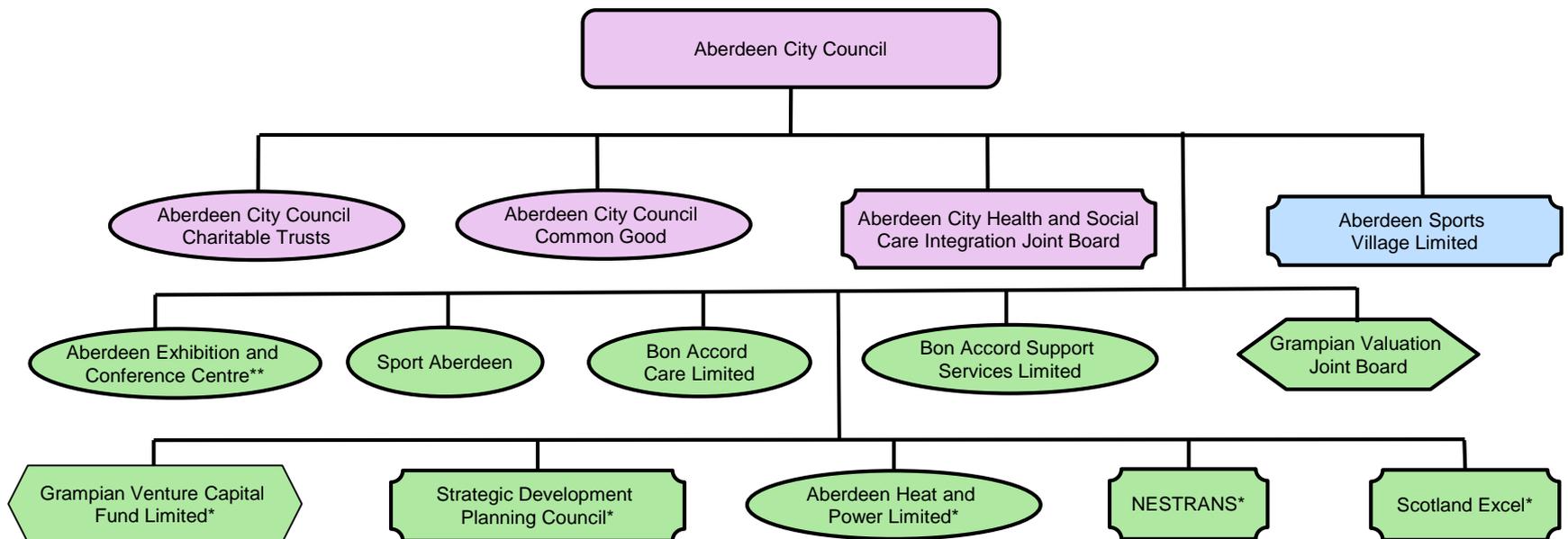
- Auditor remuneration
- Pooled costs
- Contribution to Audit Scotland's Performance Audit and Best Value team
- Contribution to Audit Scotland costs

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

We are in discussions with management regarding the auditor remuneration for 2017-18. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arise, we will discuss with management the impact of this on our proposed fee.

	2017-18 £ (incl VAT)
Auditor remuneration	250,920
Pooled costs	19,320
Contribution to PABV	124,780
Contribution to Audit Scotland costs	13,810
Total Council audit fee	408,830
Audit of Aberdeen City Council Charitable Trusts	8,500
Total fee	417,330

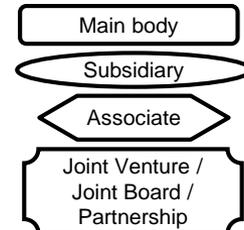
Group financial statements



Key

- Audited by KPMG "core team"
- Audited by KPMG – separate audit team
- Audited by component auditor – group audit instructions to be issued where considered significant components

* Entities not included in the group comprehensive income and expenditure account
 ** Aberdeen Exhibition and Conference Centre Limited was accounted for as a discontinued operation in 2016-17 and is expected to be wound up by 31 March 2018.



Responsibility in relation to fraud

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

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

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

Responsibilities of management

Financial statements

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

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

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

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

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.

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

Responsibilities of management
Corporate governance arrangements
Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including Audit Committees or equivalent) in monitoring these arrangements.
Financial position
Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: <ul style="list-style-type: none"> ■ such financial monitoring and reporting arrangements as may be specified; ■ compliance with any statutory financial requirements and achievement of financial targets; ■ balances and reserves, including strategies about levels and their future use; ■ how they plan to deal with uncertainty in the medium and longer term; and ■ the impact of planned future policies and foreseeable developments on their financial position.
Best Value, use of resources and performance
The Scottish Public Finance Manual sets out that accountable officers appointed by the Principal Accountable Officer for the Scottish Administration have a specific responsibility to ensure that arrangements have been made to secure best value.

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

Responsibilities of auditors

Appointed auditor responsibilities

Auditor responsibilities are derived from statute, this Code, International Standards on Auditing (UK and Ireland), professional requirements and best practice and cover their responsibilities when auditing financial statements and when discharging their wider scope responsibilities. These are to:

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

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

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

Responsibilities of auditors
General principles
This Code is designed such that adherence to it will result in an audit that exhibits these principles.
Independent
When undertaking audit work all auditors should be, and should be seen to be, independent. This means auditors should be objective, impartial and comply fully with the Financial Reporting Council's (FRC) ethical standards and any relevant professional or statutory guidance. Auditors will report in public and make recommendations on what they find without being influenced by fear or favour.
Proportionate and risk based
Audit work should be proportionate and risk based. Auditors need to exercise professional scepticism and demonstrate that they understand the environment in which public policy and services operate. Work undertaken should be tailored to the circumstances of the audit and the audit risks identified. Audit findings and judgements made must be supported by appropriate levels of evidence and explanations. Auditors will draw on public bodies' self-assessment and self-evaluation evidence when assessing and identifying audit risk.
Quality focused
Auditors should ensure that audits are conducted in a manner that will demonstrate that the relevant ethical and professional standards are complied with and that there are appropriate quality-control arrangements in place as required by statute and professional standards.

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

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



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