REPORT TO: SCRUTINY COMMITTEE – 13 JUNE 2012

REPORT ON: INTERIM MANAGEMENT REPORT - YEAR ENDED 31 MARCH 2012

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 245-2012

1 PURPOSE OF REPORT

1.1 To submit to Members of the Scrutiny Committee the Interim Management Report for the year ended 31 March 2012 prepared by the Council's External Auditor, KPMG.

2 RECOMMENDATIONS

2.1 Members of the Committee are asked to note KPMG's report and to approve the agreed management actions in response to KPMG's recommendations.

3 FINANCIAL IMPLICATIONS

3.1 There are no direct financial implications arising from this report. Any costs associated with implementing KPMG's recommendations will be contained within existing budgets.

4 MAIN TEXT

4.1 The report summarises the findings from KPMG's interim management review of the Council for the year ended 31 March 2012. These findings have been discussed with management and an agreed action plan in respect of the 12 recommendations made by KPMG is included as an appendix to the report. The implementation of the agreed management actions will be monitored by both the Council and by KPMG, with progress being reported to elected members in due course.

4.2 The External Auditor will prepare a final report to members for the year ended 31 March 2012, following the audit of the financial statements. This report will be submitted to elected members later in 2012.

5 POLICY IMPLICATIONS

5.1 This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6 CONSULTATIONS

6.1 The Chief Executive and Head of Democratic and Legal Services have been consulted on the content of this report.

7 BACKGROUND PAPERS

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **31 MAY 2012**

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Dundee City Council

Interim management report

Year ended 31 March 2012

31 May 2012

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This interim management report is presented under the terms of our appointment by the Accounts Commission for Scotland.

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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 Dundee City Council and is made available to the Accounts Commission for Scotland and Audit Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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 scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Service overview

The financial and operating environment in which Dundee City Council ("the Council") operates continues to change, with developing priorities and emerging financial and non-financial risks.

The council plan sets out the Council's vision, priorities and how these will be achieved, including supporting targets. The council plan is currently being updated, taking into consideration the Council's draft assurance and improvement plan, and will be approved following the May 2012 local government elections.

The changing for the future board oversees and guides the changing for the future programme. Membership includes: the chief executive (chair), director of corporate services, and the leaders of the administration and opposition parties. The board meets monthly for consideration of changing for the future proposals, and other strategic budget proposals. Any policy proposals are subsequently presented to committee for approval by members.

The members of the Council's strategic management team are assigned sponsorship roles for programmes, sub-programmes and projects and the team collectively assists with the management of the changing for the future programme.

The changing for the future programme is split into four sub-programme areas:

1) *service prioritisation* - assessing each service to determine to what degree it is core or non-core to the priorities of the Council and what services to provide in the medium term;

2) *reshaping the service delivery model* - ensuring the service delivery model for the Council and each of the services is redesigned to provide services in the most productive and effective way;

3) *assets* - development of a corporate-wide asset and infrastructure strategy that includes the optimum organisation of all Council staff whose focus is on assets of any type; and

4) *enabling the change* – corporate-wide changes that will support the new service delivery models identified through the *reshaping the service delivery model* sub-programme.

Linked to the reshaping of the service delivery model, the Council has implemented significant changes to reduce the size of its senior management team from ten chief officers and departments to six. The revised operating structure was approved by the policy and resources committee in March 2011 and has been implemented progressively throughout 2011-12.

The Scottish Housing Regulator ("SHR") carried out scrutiny work around the Council's housing management and asset management and property maintenance functions in November 2011, publishing their inspection report in March 2012. SHR found that the Council has improved its approach to meeting the Scottish Housing Quality Standard by 2015 and that it is working to mitigate the financial risks and other challenges it faces, but that this remains an area of significant risk. SHR will continue to monitor progress towards meeting this standard.

Financial position

Revenue budget

The Council set a breakeven revenue budget for 2011-12. The January 2012 revenue outturn monitoring report shows a projected surplus of £125,000. Significant movements from the original budget are summarised in the table below.

Movements from original budget		
	£'000	**£'000**
Original budgeted outturn		**-**
Budget adjustments		
Increase in expenditure	852	
Use of general reserves	(760)	
Use of repairs and renewals fund	(92)	-
Variances from budget		
Increase in social work costs	(2,153)	
Reduction in capital financing costs	950	
Increase in council tax income	800	
Reduction in finance revenues expenditure	300	
Other movements	228	125
Forecast surplus at January 2012		**125**

Source: *KPMG's analysis of information provided by management.*

Throughout the revenue monitoring reports for the year the Council has consistently reported constant variances with little fluctuation in the forecast surplus or deficit for the year. Significant adverse variances have been consistently reported for the social work department which is forecasting an overspend of around £2.2 million. Management has advised that this is due to increases in placement costs for children requiring permanent substitute care (£1.5 million) and cost pressures in adult social care (£0.9 million), combined with some other favourable variances.

As part of the 2012-13 budget, additional funding of £2 million has been proposed specifically in response to these areas, which have been pressure points in the Council's budget over more than one year.

Financial position

Capital budget

The Council approved a general services capital budget of £66.5 million for 2011-12. The capital monitoring report to 31 January 2012 showed that the budget had been reduced by £12.1 million. While £8.7 million of funding has been brought forward from the prior year, £20.8 million will be deferred into future financial years. The projected outturn is forecast to be £3,000 higher than the adjusted budget. The graph illustrates the reported budget adjustments and variances during 2011-12.

Movements from capital budget	General services	Housing Revenue Account
	£'000	**£'000**
Original budgeted outturn	**66,566**	**29,440**
Budget adjustments	(12,057)	(720)
Revised budget	54,509	28,720
Reported variances	3	(4,938)
Forecast outturn at January 2012	**54,512**	**23,782**

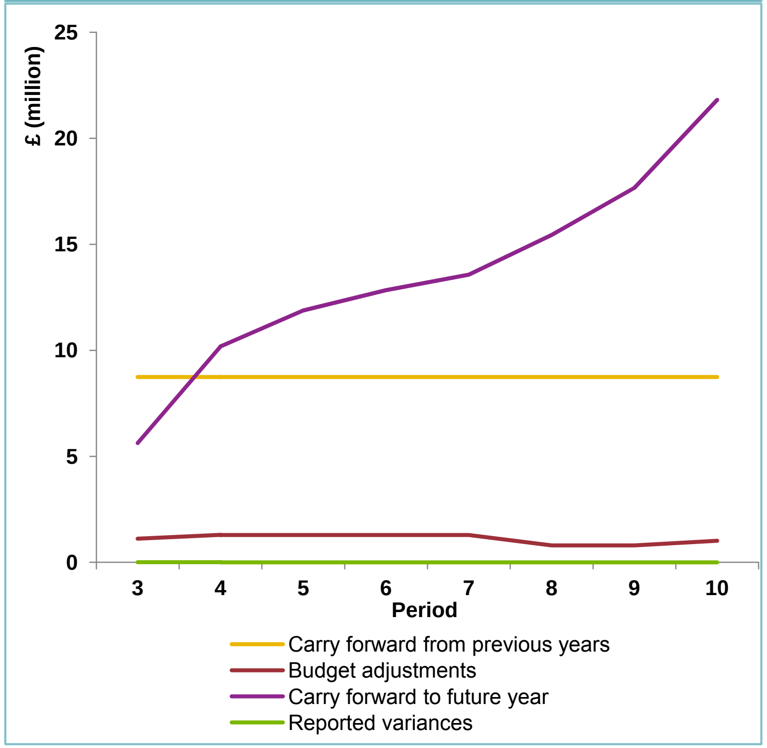
Source: *KPMG's analysis of information provided by management.*

The adjustments and variances reporting throughout the year are illustrated in the following graph. This highlights the significant amounts of capital expenditure that are identified for deferral into future years, even from period three within the financial year.

There is a risk that, within the continued revisions and budget adjustments which results in the forecast outturn tracking the revised budget, that any savings made, or overspends incurred, on individual capital projects within the overall programme are less obviously identifiable for members scrutinising the reports.

Significant capital projects in the year include the Allan Street swimming pool (£11.2 million) and car park (£3.5 million), in addition to £18.2 million expenditure within the education department.

General services capital budget movements



Audit focus areas

During the planning process we identified a number of key risks for specific consideration during the audit.

We have updated our understanding of the factors impacting on each of these risks to further inform our year end procedures.

We have developed our understanding of your key audit risk areas based on our initial risk assessment procedures, including discussions with management. Key areas identified are detailed below.

Issue	Key risk and implications	Update
Opening balances	International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* requires us as auditors to obtain sufficient appropriate audit evidence about whether opening balances contain misstatements that materially affect the current period's financial statements; and appropriate accounting policies reflected in the opening balances have been consistently applied in the current period's financial statements.	We have: ▪ held discussions with your previous external auditors in respect of previous significant audit issues, corporate governance and general risk assessment; and ▪ reviewed prior year financial statements, annual audit reports and other reports issued by your previous external auditors. As a result of this work we have identified a number of areas for further enquiry and review across the accounts and associated notes. We have discussed these areas with finance staff and requested further information to support the Council's application of specific accounting policies. Discussion of the group accounting and accounting for balances relating to the operation of Dundee Energy Recycling Limited has been considered in more detail later in this report. In addition, we have discussed with management our initial consideration of the accounting policies adopted by the Council, and the disclosures made in prior year financial statements. We will complete our work in this area as part of our financial statements audit fieldwork, commencing in July.

Audit focus areas (continued)

Issue	Key risk and implications	Update
Organisational restructuring	During 2011-12, as part of the changing for the future programme, the Council has continued with organisational restructuring. The Council previously had the highest number of chief officers / departments of any Scottish local authority. The restructuring has rationalised the structure with the aim of producing a more efficient operating model.	The restructuring has been ongoing during 2011-12, including the consolidation of support services and creation of Leisure and Culture Dundee which included the transfer of leisure and community services. The new operating structure was fully implemented with effect from 1 April 2012. The 2010-11 accounts include disclosures of income and expenditure by operating segment on the basis of information provided to the 'chief decision maker'. Management considers this to reflect the financial information provided to the policy and resources committee. The changes to departmental structures will require to be reflected in the 2011-12 accounts. We have discussed this matter with the Council's 'final accounts working group' and agreed a process for management to reconcile data provided from the previous departmental structure to the new structure. Management will also need to ensure that the 2011-12 accounts clearly narrate changes in operating structure, as appropriate. In addition, management has agreed voluntary redundancy packages for some senior officers. The remuneration report within the accounts requires details of exit packages and amounts paid to senior employees. We have agreed with management that we will review the proposed disclosures prior to issue of the unaudited accounts.

Audit focus areas (continued)

Issue	Key risk and implications	Update
Valuation of property, plant and equipment	In compliance with IAS 16 *Property, plant and equipment,* as interpreted by the Code, property, plant and equipment is valued by the internal valuer. During 2011-12 the property, plant and equipment of the social work, support services and chief executive's departments will be valued. In addition, other elements of property, plant and equipment, where management consider there to be indicators of impairment will also be subject to valuation.	We have met with the internal valuers and capital accountants to discuss the valuation process. In accordance with auditing standards, this has included an evaluation of the valuers competence, capabilities and objectivity. Properties are valued on a five yearly rolling basis by department. Accounting standards require that, for consistency, if an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs should be revalued. Currently, property, plant and equipment are valued by department and as a result similar classes of asset are being valued during different years. The Code allows classes of assets to be valued in different years provided that this is within a short space of time and valuations are kept up to date. We have discussed this with management and are satisfied with management's assessment that this would not have a material impact on the current financial year. Management has agreed that the application of this accounting policy will be subject to revision for subsequent years. We will review the accounting treatment and disclosure of valuation movements during our final audit fieldwork, including consideration of management's interpretation of the valuation report and processes to update underlying accounting records.
Heritage assets	The Code includes the requirement to account for heritage assets in line with FRS 30 (as interpreted by the Code). Implementation of this new accounting policy may require a prior year adjustment if the impact on the 2010-11 comparatives meets set criteria.	Management correctly identified the need to consider heritage assets, and the impact of the new accounting policy, early in the 2011-12 financial year. Finance staff have been conducting analysis for the accounts and we have held meetings with staff to provide advice on their approach and disclosures required. Management estimated that the likely impact of the implementation of this new accounting policy will result in around £7.2 million of heritage assets being capitalised. This estimate is predominately based on the insurance valuation of the museums collection. Management has provided us with their updated analysis which confirms heritage assets matching this value have been identified. We concur with management's view that this amount is not sufficiently material to require a prior year adjustment.

Audit focus areas (continued)

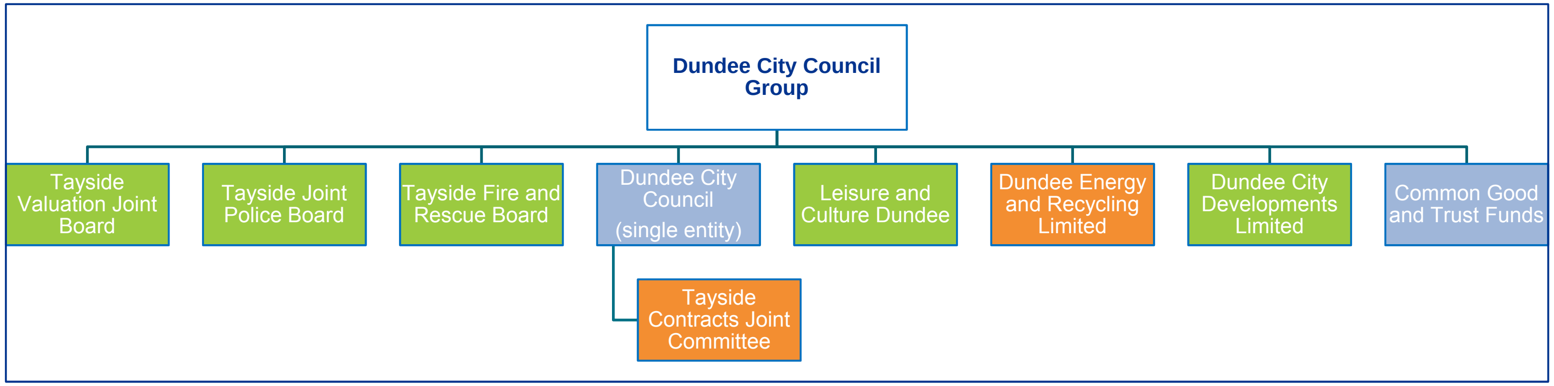
Issue	Background	Findings
DERL leased assets	Dundee Energy Recycling Limited ("DERL") was established to construct and operate a waste to energy plant. As part of a restructuring of DERL the Council purchased the plant and equipment of the company and leases it back to DERL. The previous external auditors reported in their 2010-11 report to those charged with governance that there is a divergence of accounting policy regarding plant, property and equipment which results in assets being accounted for by both the Council and DERL. They concluded that their discussions with management were without resolution.	We obtained management's analysis of the leases to allow us to consider if the leases with DERL have been correctly classified and accounted for in accordance with IAS 17 *leases.* The lease evaluation carried out by management was inconclusive, and was dependent on more information being available specifically in respect of the currently assessed useful economic lives of the assets. We discussed these findings with management and have requested that they consolidate all available information in preparation of a detailed consideration of the nature of the leases and the tests outlined by IAS 17. We will review management's updated analysis and supporting evidence as part of our final audit work for the year.
DERL loans	In March 2004 the Council loaned DERL £2.3 million and in April 2010 the Council loaned a further £1 million. Both loans are secured by floating charges over all of DERL's assets. A further loan facility of £0.6 million has been approved. Repayment of the first loan was due by instalments, commencing in 2006. This loan has been rescheduled several times and the first repayment is now due in 2020.	DERL has made losses for the last four years, resulting in cumulative losses of £2.5 million. Net assets at 31 December 2010 were £1.4 million. While the Council has been repaying the capital financing costs on the loans, the full debtor balance of £3.3 million due from DERL is still held in the Council's balance sheet. Given the recent financial performance of DERL and the cumulative losses of £2.5 million and net asset position of £1.4 million, we have raised the matter of the recoverability of this debtor with management. We have requested that management provide us with their assessment in respect of the recoverability of the loans previously made to DERL.

Audit focus areas (continued)

The Council uses a range of service delivery vehicles to facilitate the discharge of its functions which, whilst technically independent, are effectively under either the Council's influence or control. The Council is required under the Code to prepare group financial statements which include the Council's interest in subsidiaries, associates and joint ventures, where these are considered material to the group.

Given this is the first year of our appointment as the Council's external auditors, we have considered the completeness and appropriateness of entities included / excluded from the Council's group accounts. The following pages include details of our findings.

Consolidated entities – per 2010-11 group financial statements



Non-consolidated entities

Audit focus areas (continued)

Entity	Background	Findings
Tayside Contracts Joint Committee	Tayside Contracts is comprised equally of six members from each of the three constituent authorities. In the group accounts it is accounted for as a 'joint arrangement'. In the *single entity income and expenditure account* for 2010-11 the Council's share of the profit of Tayside Contracts has been recognised. In the *group balance sheet* the Council's share of all assets and liabilities are consolidated on a line by line basis.	As part of our first year audit work, we asked management to confirm the rationale for the accounting treatment for the Joint Committee, in accordance with the Code and relevant group accounts guidance published by CIPFA. The crucial test from which to determine the accounting treatment was in respect of the definition of an `entity' for group accounts purposes under the Code. While the Joint Committee carries on a trade and business of the constituent local authorities, this does not make it an entity which is capable of, amongst other things: ▪ the ability to employ staff directly; ▪ to take control over its assets, and raise finance against them; and ▪ the ability to enter into contracts purely in its own name. From discussion between ourselves and management, including consultation with the Council's previous external auditors, we are of the view that the Joint Committee is not an entity for group accounts purposes. As a result, the Code requires that the Council's share of activities of the Joint Committee are reflected in the single entity accounts, rather than the group accounts. Management has confirmed that they recognise that this is the most appropriate accounting treatment for the Joint Committee, in terms of the definitions in the Code. While the Council's group accounts would not be changed as a result of this decision, the Council's share of the assets and liabilities of the Joint Committee would now be included in the Council single entity accounts, rather than brought in on consolidation. We will agree with management the nature and extent of disclosure in respect of this change in due course.

Audit focus areas (continued)

Entity	Background	Findings
Leisure and Culture Dundee	This is a Scottish Charitable Incorporated Organisation (SCIO) established in July 2011. It includes the activities of Dundee Leisure Limited and activities of the Council's leisure and communities service.	We have considered the nature of the entity and enquired of management's proposed accounting treatment as part of the group. Local authorities are responsible for leisure trusts and trust funds, and they are required to include them in the group accounts where they control them. The Code requires that authorities should prepare group accounts in accordance with SIC 12 *consolidation – special purpose entities* and other standards. SICs are the official interpretations of international accounting standards that were developed by the IASB's predecessor body and its interpretative committee. SIC 12 applies where it is not possible to discern who has control of an entity by first applying the normal control provisions of IAS 27 *consolidated and separate financial statements*. We have discussed this with management and have requested that they conduct an analysis of Leisure and Culture Dundee with respect to the group accounting standards and the specific tests within both the CIPFA group accounts in local authorities practitioners workbook (2011) and SIC 12. At the time of finalisation of this report, this analysis has not yet been completed.

Audit focus areas (continued)

Entity	Background	Findings
Dundee Energy Recycling Limited	DERL is a private limited company with ordinary and deferred (preference) shares. The Council holds 40% of the ordinary shares which have voting rights and the DERL board comprises six directors of which two are the Council's representative. In the Council's group accounts DERL has been considered to be a joint venture and has been consolidated using the `gross equity' method. This involves recognising the Council's share of the profits and the assets and liabilities of the company.	We have considered the nature of the entity and its relationship with the Council. Specifically we also requested that management consider whether the Council's interest in the company continued to meet the definition of a joint venture, as defined in the Code. Management have undertaken this further analysis, and concluded that it is more appropriate that the company be accounted for as an associate in the group accounts. This is based primarily on the share ownership of the company, plus the absence of a binding agreement committing the three shareholders to joint decision-making. We are in agreement with management's updated assessment of the group relationship with DERL. This change in treatment will not, however, have any material impact on the Council 's group accounts, although the associated narrative disclosures will be require to be updated.

Audit focus areas (continued)

Entity	Background	Findings
Tay Road Bridge Joint Board	The Joint Board is comprised of 12 members, of which six are members of the Council. This entity is not consolidated by the Council and is not mentioned in it's group accounts.	As part of our first year audit work, we requested management provide their rationale for non-consolidation of the Tay Road Bridge Joint Board. We challenged the initial documentation provided, as this excluded the Joint Board on the basis of lack of influence, which was potentially contradicted by the level of representation of Council members on the Joint Board. Management has refined their analysis against the group accounts guidance produced by CIPFA in respect of the Code. Based on this, management has concluded that the Joint Board fails the criteria for inclusion in the Council group accounts under the test `does the authority have an interest in the entity'? This is based on the conclusion that the Council has no financial interest in the Joint Board, as it provides no direct funding, nor has it entitlement to residual reserves or assets of the Joint Board. Furthermore, there are no other direct benefits arising to the Council from the operations of the Joint Board. We are satisfied that the approach now proposed by management is consistent with the requirements of the Code, although we have asked management to include a short narrative disclosure in the group accounts to explain the rationale for non-consolidation. Our consultations with the Council's previous external auditors, undertaken as part of Audit Scotland's handover protocol, have confirmed this approach remains consistent with audit judgements made previously.

Governance framework

Organisation-wide controls often have a pervasive impact on control activities, and therefore on our assessment of the risk of significant misstatement within the Council's accounts.

Our interim audit fieldwork was based on gaining an understanding of the strategic and operating culture and framework in which services are delivered. Audit procedures performed to gain an understanding about the design and implementation of relevant controls include inquiring of senior personnel, observing the application of specific controls and inspecting documents and reports.

Audit area	Key areas considered	Findings	Reliance on internal audit	Overall findings
Organisation-wide policies	■ standing orders of council and scheme of delegation ■ code of conduct ■ employee handbook	■ Organisation-wide policies are important as they set the tone, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. ■ An anti-fraud and anti-corruption policy was approved in September 2010. The Bribery Act 2010 came into force in 2011. The Council has considered this legislation and assessed that the current policies cover the requirements of this legislation. ■ Management should ensure that as case law arises in this area, any impact on their existing policies is considered.	n/a	●
Related parties	■ elected member register of interest ■ chief officer register of interest	■ Separate registers of interest exist for chief officers and elected members. Our testing confirmed that both registers were up to date. ■ All Council and committee meeting agendas require attendees to declare interests relevant to specific items. While the register of interests should be maintained and complete, this approach supports the overall process.	n/a	●

Key:
- ● Significant weakness in key controls exists
- ● Weaknesses in the control process were identified
- ● No areas for improvement were identified

Source: KPMG observations during the audit.

Governance framework (continued)

Audit area	Key areas considered	Findings	Reliance on internal audit	Overall findings
Financial management	■ financial regulations ■ budget setting process ■ financial reporting	■ The financial regulations set out the requirements for budget setting, monitoring and reporting. ■ Formal revenue budget monitoring is completed on a monthly basis for period three to 11. Departmental accountants meet with departmental staff to gain an understanding of the financial position of the service, including the actual spend to date. The accountants conduct their own analysis to identify and quantify variances and the forecast outturn to the year end. Budgets are not phased in the ledger and, as such, variances are not reported against expected spend throughout the year. Explanations are provided for variances; these are included in the revenue monitoring report provided to the policy and resources committee. This approach is viewed by management as forward looking and provides a holistic overview of the Council's financial performance. ■ As part of the budget setting process management and members agree budget savings to close the budget gap. These savings are incorporated into the annual budget which is monitored. However, no specific monitoring has been conducted to date in respect of benefit realisation for efficiency and savings projects. ■ The format of reporting for capital expenditure means that there is a risk that, within the continued revisions and budget adjustments which result in the forecast outturn tracking the revised budget, that any savings made, or overspends incurred, on individual capital projects within the overall programme are less obviously identifiable for members scrutinising the reports. ***Recommendation one***	n/a	

Governance framework (continued)

Audit area	Key areas considered	Findings	Reliance on internal audit	Overall findings
Risk management	■ risk management strategy ■ corporate risk register ■ directorate risk registers ■ risk monitoring	■ The Council's risk management strategic plan (2007–2011) details the Council's risk management framework which is currently under review. ■ The Council's strategic management of risk is included within the remit of the risk and business continuity manager. The scrutiny committee has responsibility to consider and monitor the strategy, plan and performance of Council's risk management arrangements and seek assurances that action is being taken on risk related issues. ■ A corporate risk register is in place supported by directorate risk registers. There is a Council-wide risk management group with responsibility for supporting the operational risk management arrangements. ■ Internal audit highlighted weakness in the risk management process. They identified key areas that require to be strengthened and developed including governance, the risk management strategic plan, roles and responsibilities, the corporate risk register and departmental risk registers. Management has agreed with these findings and are implementing changes during 2012. We have not re-raised these findings within our own report.	✓	●

Internal audit

In compliance with International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* we have completed our evaluation of internal audit.

We did not identify any material weaknesses. As a result, we have concluded that we can rely on the work of internal audit.

Evaluation areas	Finding	Overall findings
Evaluation of objectivity, technical competence, and due professional care	■ We did not identify any matters to report to management or the scrutiny committee.	
Annual internal audit plan	■ The internal audit plan is completed prior to the start of each financial year. In developing the plan the chief internal auditor informs this plan from: ■ discussions with departmental heads to identify risk and areas of concern; ■ risk assessment using CIPFA indicators; and ■ consultation with the risk manager and review of risk registers. ■ The internal audit plan provides a detailed and comprehensive overview of the Council's activities and risks. It is delivered through a mixed approach with audits performed internally and specialist audit work conducted by contractors.	
Sample sizes	■ The number of items tested by internal audit varies across individual reviews and is not determined by reference to a defined methodology. The Council's internal audit manual includes details on the types of sampling methods that could be employed, but does not provide details on the method to be used. Internal audit staff should develop a methodology to determine sample sizes, this should reflect the risk associated with individual controls and the frequency of the control, e.g. daily, weekly, monthly or annually. This will ensure that the rationale for selecting a sample is both justified and consistent. ■ We have provided details of our sample sizes to allow internal audit reviews to cover the minimum number of tests required to ensure that we maximise reliance, where appropriate, on tests performed by internal audit.	
Reporting	■ Internal audit reports are provided to management with an executive summary provided to the scrutiny committee.	
Reliance on individual internal audit reviews	■ In our audit plan, we reported that we planned to place reliance on internal audit's work on: ■ debtors and debt management ; ■ amendments to creditors standing data; and ■ payroll leavers. We have evaluated this work and placed reliance on specific tests.	n/a

Key financial controls

Our testing of the design and operation of controls over significant risk points confirms that, with the exception of weaknesses reported, controls are designed appropriately and operating effectively.

We will assess the impact of control weaknesses on our audit approach and increase our substantive audit testing, where required.

Our audit plan identified the classes of transactions, disclosure and account balances that are significant to the financial statements. Where the audit objective has a controls approach, we have obtained an understanding of accounting and reporting activities over each significant account and identified and tested key financial controls. We have evaluated the design and implementation of these controls and, where appropriate, tested the operating effectiveness.

Audit area	Key controls	Findings	Reliance on internal audit	Overall findings
Income	■ sales invoice requests ■ cash receipting ■ debtors reports ■ bad debt provisions and write-offs	■ Each department is responsible for raising their own invoices and, as part of this responsibility, are required to keep back-up for any invoice raised. There is, however, no formal authorisation process relating to sales invoices although the system will record the individual details of the user responsible for raising the invoice. While we understand that there is pre-population by the system in respect of many standard fees and charges, there is a risk that sales invoices are raised without appropriate authorisation. ***Recommendation two*** ■ The Council has no in-built control to prevent customers with significant outstanding debts from receiving additional services. As far as appropriate, management should ensure that as part of their credit control arrangements, customers with overdue debts should have arrangements for repayment of debts in place before further services are provided. ***Recommendation three*** ■ The Council has a pro-forma document for raising and authorising credit notes which is not utilised across all departments. While the results of our testing concluded that appropriate authorisation was given, not all credit notes were raised using the pro-forma. We recommend that this is utilised consistently across all departments. ***Recommendation four***	✓	●
Council tax and non-domestic rates	■ reconciliation to assessors role ■ authorisation of exemptions and reliefs ■ reconciliation to cash receipting system, benefits system and the general ledger	■ The key controls tested have been designed appropriately, implemented and are operating effectively. This testing will be used to inform our completion of the Council's non-domestic rates grant claim.	n/a	●

Key financial controls (continued)

Audit area	Key controls	Findings	Reliance on internal audit	Overall findings
Expenditure	■ new supplier authorisation and amendments ■ purchase order, goods received and invoice authorisation ■ payment run processing	■ Staff enter invoices received into the creditors system. If the system identifies a potential duplicate invoice, for example where an invoice reference has been used twice, it will warn the user to check this. However, this warning can be ignored and accepted by any staff member. Most invoices are matched from the purchases system which helps mitigate against duplicate invoices being recorded, however, this matching process is not required in advance of payment. There is a risk that duplicate invoices could be paid. Management should consider the level of authorisation required to 'override' this system warning to mitigate the risk of duplicate invoices being processed for payment. ***Recommendation five*** ■ The Council does not have a standard approach to determine the appropriate levels of delegated authority for individual staff members across the Council. Management should agree a scheme of delegated authority and apply this to the creditors system. All invoices require to be approved electronically in the creditors system by a member of staff with defined delegated authority. In practice invoices are approved manually by the officer with the appropriate delegated authority, before being uploaded to the creditors system for authorisation by administrative finance staff. This is possible as, within the creditors system, there are ten members of administrative finance staff with delegated authority to approve invoices over £250,000. It is recommended that senior officers should approve invoices in the creditors system directly, both to avoid duplication of the work but also to enable the appropriate delegated authority levels to be set-up on the creditors system. ***Recommendation six*** ■ Supplier statement reconciliations can be an important control which requests details from suppliers of all transactions with them. These details are then reconciled with the Council's system to identify any differences. The Council does not currently undertake supplier statement reconciliations. Management should consider arrangements for undertaking supplier statement reconciliations, for example focusing particularly on suppliers which are considered significant in terms of value and / or number of transactions. ***Recommendation seven***	✓	

Key financial controls (continued)

Audit area	Key controls considered	Findings	Reliance on internal audit	Overall findings
Payroll	■ starters, leavers and amendments forms ■ timesheets ■ exceptions reports	■ Timesheets are completed weekly by applicable staff. These are initialled by a supervising individual as authorisation, and forwarded to the payroll department to process. We recommend that timesheet forms are revised to clearly require the authorisation of the member of staff and approving line manager. ***Recommendation eight*** ■ The Council has a standard form for new start employees, however, this is not used by the education department. An alternative form used is not authorised by the department or member of staff. Management should ensure that the standard process is used in the education department, including obtaining and documenting the required authorisations. ***Recommendation nine***	✓	
Treasury management	■ bank reconciliations ■ cash forecasting ■ reconciliation of investments system to general ledger ■ prudential indicators reporting	■ The key controls tested have been designed appropriately, implemented and are operating effectively.	n/a	
Housing revenue account	■ addition / deletion of properties ■ rent uprating ■ reconciliations between rent system to cash receipting system, benefits system and the general ledger	■ The key controls tested have been designed appropriately, implemented and are operating effectively.	n/a	

Key financial controls (continued)

Audit area	Key controls considered	Findings	Reliance on internal audit	Overall findings
Journals	■ authorisation of journal entries ■ ledger system controls	■ Supporting documentation for manual journals posted is scanned and included in the `notes' section within the financial ledger. There is, however, no authorisation procedure for posting journals. Transfer journals i.e. those between departments, should be authorised, however, these can currently be self-authorised by the same person inputting the journal. ■ There is a risk that journals are processed in error without appropriate authorisation. Management should require that all journals are subject to independent authorisation and review prior to posting to the financial ledger. ***Recommendation ten***	n/a	●
Reconciliations	■ Reconciliation controls should exist in the majority of financial systems and should be performed periodically, from daily to annually. ■ Reconciliations include a combination of internal financial and non-financial systems and external data, such as bank statements.	■ The majority of reconciliations undertaken are not documented to provide evidence that appropriate action has been taken in respect of reconciling items. In addition, the majority of reconciliations are not subject to evidenced independent review. Where there is evidence of specific reconciliations being performed, there is inconsistent evidence of who prepared the reconciliation and very limited evidence of independent review. Evidence of preparation and independent review is required to demonstrate segregation of duties. For example, if a reconciliation of two systems is performed by a member of staff with access to both systems, there is a potential risk of manipulation of the underlying data. The overall lack of audit trail means that management cannot determine the nature of action taken in respect of reconciling items; or gain assurance that underlying financial records are free from fraud and error. ***Recommendation eleven*** ■ The Council is focused on reducing the volume of paper and is continuing to move towards electronic records. Management should ensure that there is adequate arrangements for electronic signatures in order that the operation of important controls are appropriately documented.	n/a	●

Performance management

Our audit strategy and plan set out a number of national studies that we are required to follow-up to consider the local response to the findings made within these studies.

Audit area	Overview	Findings
Local response to national studies	Audit Scotland and the Accounts Commission periodically undertake national studies on topics relevant to the performance of public sector bodies. To ensure that added value is secured through the role of Audit Scotland and the Accounts Commission and its appointed auditors, auditors are required to continue to ensure that audited bodies respond appropriately to reports from the programme of national performance audits.	We have considered the Council's response to the following national reports: ▪ Scotland's public finance's: responding to the challenge; ▪ transport for health; and ▪ community health partnerships. We have prepared a short return to Audit Scotland for each report. The Scotland's public finance's report has been formally considered by the scrutiny committee, however, neither of the other two reports have been subject to formal consideration by the Council or a committee of Council. In addition, for these reports, while we have been advised that the findings from the reports have been considered, there is no evidence that management has conducted a self-assessment against the reports findings. Management should ensure that the content of all relevant national reports are discussed by Council or a committee of Council, that self-assessments are performed and that appropriate action plans and timetables are agreed. ***Recommendation twelve*** We have suggested to management that, based on our experience elsewhere, one way of addressing this matter is for all national reports to be considered by the senior management team, including self-assessment and preparation of local action plans. These activities can be reported to the scrutiny committee, with further detailed updates on specific reports presented to the appropriate sub-committee, depending on the topic of reports.

Performance management (continued)

Audit area	Overview	Findings
Maintaining Scotland's roads: a follow up	As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified the *Maintaining Scotland's road – follow-up* report for follow-up by local auditors in 2011-12. The aim of the follow-up work is to assess the progress that councils have made in driving forward road maintenance activities, managing the performance of road maintenance activities, and maximising value for money in road maintenance services. We have considered the following four questions in response to this report. 1. How did the Council respond to the *Maintaining Scotland's roads: a follow-up* report following publication? 2. Does the Council have appropriate plans in place to drive road maintenance activities? 3. How does the Council manage performance of its road maintenance activities? 4. What is the council doing to maximise value for money in its road maintenance service?	Roads maintenance is delivered through a partnership with Tayside Contracts and is managed by the roads maintenance partnership board. The national report has been considered by the city development committee and the roads maintenance partnership board. The Council is currently developing its roads asset management plan in accordance with the Society of Chief Officers of Transportation in Scotland ("SCOTS") asset management project. It is expected that this plan will be completed by the end of April 2012 and it has been informed by the national report. The Council manages and monitors the performance of its road maintenance activities through internal performance indicators and SCOTS core performance indicators. These are formally reported annually to the city development committee as part of an annual report on the performance of the roads maintenance partnership. The Council continually seeks to maximise value from its roads maintenance services. This has included: ▪ cost and performance comparison with neighbouring councils through the maintenance strategy group; ▪ the Council agreeing with neighbouring authorities to rationalise material specification for surfacing products to maximise the efficiency of the Tayside Contracts in house quarry; ▪ utilising external farms to assist with winter maintenance; ▪ incorporating recycled material in carriageways and footways; and ▪ use of incinerated waste cyclone ash in base and binder materials which has generated financial benefits for the Council.

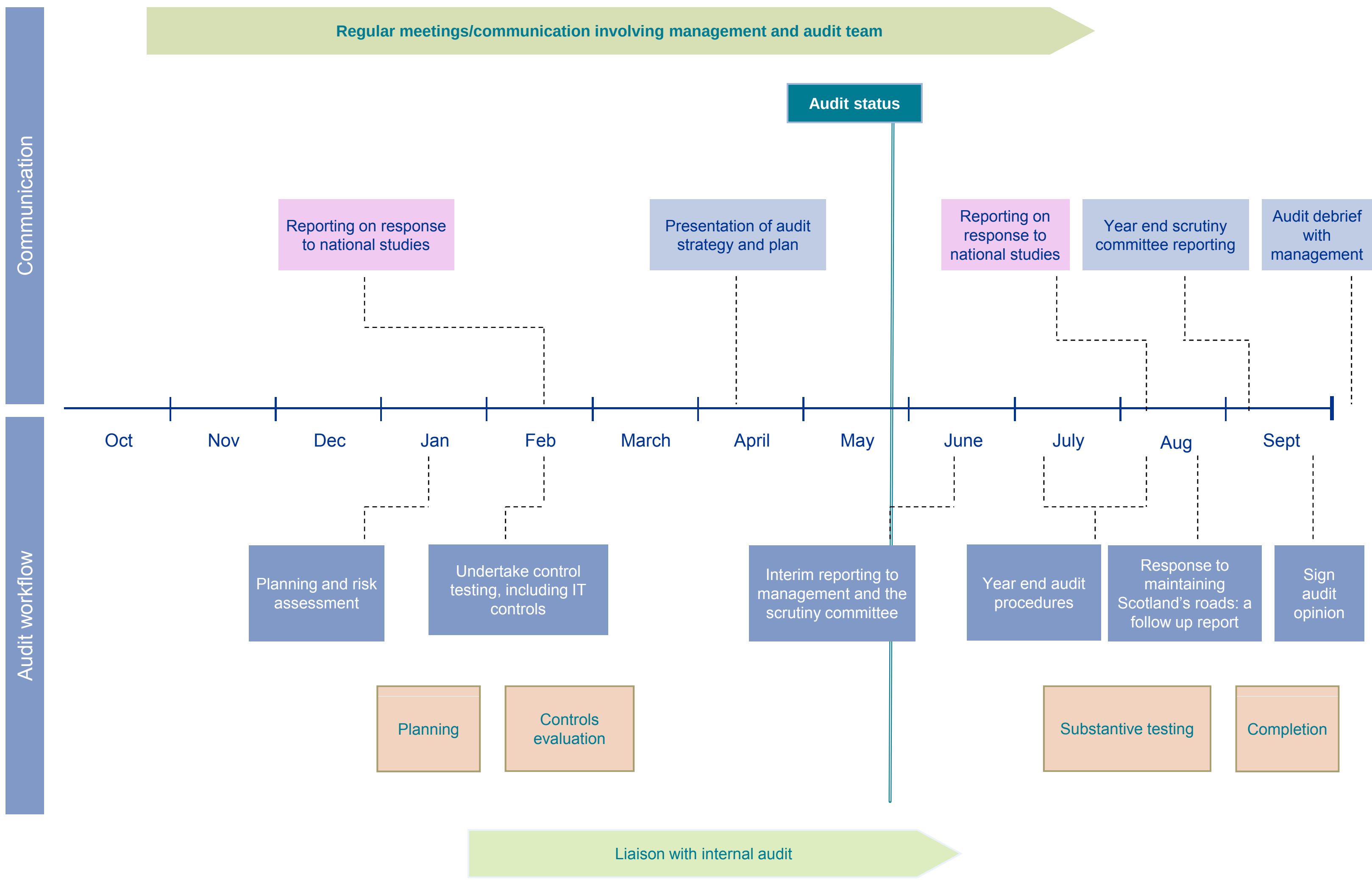
Performance management (continued)

Audit area	Overview	Findings
Statutory performance indicators	During the audit cycle, we will understand the arrangements and systems that the Council uses to generate performance results and consequent reports. Our testing may require sampling of data to test reliability, but the risk of ensuring accuracy and relevance of performance indicators lies with the Council. Our work will include consideration of internal audit's role in testing SPIs and reporting the results.	The Council uses an online performance management database developed in-house to monitor statutory performance indicators in addition to other performance targets. This information is available for all staff and members to review. We will complete work in this area as part of our final audit fieldwork visit and report our findings to management and the scrutiny committee.
National fraud initiative	NFI helps participating bodies to identify possible cases of fraud, and to detect and correct any under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud.	The Council has an established process in respect of NFI; we will update our understanding of these processes and discuss with management the preparations undertaken in advance of the 2012-13 NFI exercise.
Shared risk assessment, Best Value and the single outcome agreement	Local area networks ("LANs") have been established for each council to bring together local scrutiny representatives in a systematic way. The national scrutiny plan is underpinned by an assurance and improvement plan ("AIP") for individual councils.	As your external auditor, we are a key member of the LAN. We have met with members of the local area network, and will continue to participate and cooperate with other scrutiny bodies. The Dundee City Council LAN has updated the AIP for the period 2012-15 and we have reviewed the final versions for consistency with our understanding of the Council.

Audit timeline

We undertake our work on your financial statements in four key stages. We note our progress against these stages reported to you in our audit plan overview.

We have now substantially completed the planning and control evaluation phases of our audit.



Appendices

Action plan

The action plan summarises specific recommendations, together with related risks and management's responses.

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Financial management		**Grade two (material)**
■ As part of the budget setting process management and members agree budget savings to close the budget gap. These savings are incorporated into the annual budget which is monitored. However, no specific monitoring has been conducted to date in respect of benefit realisation for efficiency and savings projects. ■ The format of reporting for capital expenditure means that there is a risk that, within the continued revisions and budget adjustments which results in the forecast outturn tracking the revised budget, that any savings made, or overspends incurred, on individual capital projects within the overall programme are less obviously identifiable for members scrutinising the reports.	■ Management should consider how best to monitor benefit realisation in respect of specifically agreed savings, notably where these are not incorporated into the annual budget from the start of the year. This will enable the success of savings initiatives to be properly analysed. ■ Management should consider the format and content of capital budget monitoring reports to ensure that there is clarity and transparency in the achievement of savings, or on projects which have cost more than budgeted.	Guidance on benefits realisation management is being developed as part of the Corporate Improvement Programme and will be made available to staff once finalised. The recently agreed revision to the Council's Financial Regulations includes provision for the reporting of overspends on capital projects, within the regular capital budget monitoring reports. Further consideration will be given to this area to identify any further areas where reporting can be made more robust, in line with the recommendation. **Responsible officer(s):** Corporate Improvement Manager / Finance Manager (Corporate) **Implementation date:** 31 August 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Income – sales invoices		**Grade two (material)**
Each department is responsible for raising their own invoices and, as part of this responsibility, are required to keep back-up for any invoice raised. There is, however, no formal authorisation process relating to sales invoices although the system will record the individual details of the user responsible for raising the invoice. While we understand that there is pre-population by the system in respect of many standard fees and charges, there is a risk that sales invoices are raised without appropriate authorisation.	It is recommended that sales invoices are subject to appropriate authorisation prior to being raised.	Risk levels were considered when implementing the ledger system, and continue to be reviewed. The risk level was considered to be low where appropriate controls are present within the issuing department. Most departmental operators normally act on instruction from another member of staff (ie pro-forma / invoice request), so the authorisation is prior to reaching the ledger input stage. A high volume of invoices are interfaced from departmental systems therefore an authorisation process within the ledger is considered to be of no significant benefit. **Responsible officer(s):** n/a **Implementation date:** n/a
3 Income – credit control		**Grade two (material)**
The Council has no control to prevent customers with significant outstanding debts from being invoiced for further services. Previous attempts to introduce credit control processes at the invoicing stage found that many services had already been provided prior to a sales invoice being issued.	As far as appropriate, management should ensure that as part of their credit control arrangements, customers with overdue debts should have arrangements for repayment of debts in place before further services are provided.	Agreed, but the control is at the front-end of the process rather then within the financial system itself, but we will continue to promote good credit control practice in departments though the Sales Ledger User Group. **Responsible officer(s):** Sales Ledger Manager **Implementation date:** Ongoing
4 Income – credit notes		**Grade three (minor)**
The Council has a pro-forma document for raising and authorising credit notes which is not utilised across all departments. While the results of our testing concluded that appropriate authorisation was given, not all credit notes were raised using the pro-forma.	We would recommend that the standard pro-forma is utilised consistently across all departments.	Agreed that the authorisation varies in departments, however the plan during this financial year is not to use a pro-forma which would lead to duplication of data input, but to set up the authorisation process within the ledger itself where an operator may input the data and a manager has to complete the authorisation process providing a full audit trail within the sales ledger. **Responsible officer(s):** Sales Ledger Manager **Implementation date:** 31 October 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
5 Expenditure – duplicate invoices		**Grade two (material)**
Staff enter invoices received into the creditors system. If the system identifies a potential duplicate invoice, for example where an invoice reference has been used twice, it will warn the user to check this. However, this warning can be ignored and accepted by any staff member. Most invoices are matched from the purchases system which helps mitigate against duplicate invoices being recorded, however, this matching process is not required in advance of payment. There is a risk that duplicate invoices could be paid.	Management should consider the level of authorisation required to 'override' this system warning to mitigate the risk of duplicate invoices being processed for payment.	The processing of invoices is being removed from decentralised control within departments through the introduction of a central scanning process. The authority required to override the existing warning will be restricted. **Responsible officer(s):** Principal Accountant (Procurement) **Implementation date:** March 2013
6 Expenditure – authorisation		**Grade two (material)**
The Council does not have a standard approach to determine the appropriate levels of delegated authority for individual staff members across the Council. Management should agree a scheme of delegated authority and apply this to the creditors system. All invoices require to be approved electronically in the creditors system by a member of staff with defined delegated authority. In practice invoices are approved manually by the officer with the appropriate delegated authority, before being uploaded to the creditors system for authorisation by administrative finance staff. This is possible as, within the creditors system, there are ten members of administrative finance staff with delegated authority to approve invoices over £250,000.	Management should agree a delegated authority scheme and apply this to the creditors system. It is recommended that senior officers should approve invoices in the creditors system directly, both to avoid duplication of the work but also to enable the appropriate delegated authority levels to be set-up on the creditors system.	The delegated authority for individual members of staff will be identified. A corporate structure of delegated authority will be prepared as a guide for departments. The authorisation of payments to suppliers will be made in the system. **Responsible officer(s):** Principal Accountant (Procurement) **Implementation date:** March 2013
7 Expenditure – supplier statement reconciliations		**Grade two (material)**
Supplier statement reconciliations are an important control which requests details from suppliers of all transactions with them. These details are then reconciled with the Council's system to identify any differences. The Council does not currently undertake supplier statement reconciliations.	Management should consider arrangements for undertaking supplier statement reconciliations, for example focusing particularly on suppliers which are considered significant in terms of value and / or number of transactions.	Supplier statement reconciliations will be completed on a sample basis. **Responsible officer(s):** Principal Accountant (Procurement) **Implementation date:** March 2013

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
8 Payroll – timesheet authorisation		**Grade three (minor)**
Timesheets are completed weekly by applicable staff. These are initialled by a supervising individual as authorisation, and forwarded to the payroll department to process.	We recommend that timesheet forms are revised to clearly require the authorisation of the member of staff and approving line manager, to ensure a proper audit trail is in place for time worked.	Agree in principal that all timesheets must be authorised appropriately, before any payments are processed. **Responsible officer(s):** Assistant Payroll Manager **Implementation date:** Immediate
9 Payroll – new start employees		**Grade two (material)**
The Council has a standard form for new start employees, however, this is not used by the education department. An alternative form which is used within education is not authorised by the department or member of staff. There is a risk that new employees are added to the payroll without proper authorisation.	Management should ensure that the standard process is also used within the education department, to ensure that a consistent process of authorisation of new start employees is followed across the Council.	The Education Department currently use their own version of a New Start form and this is e-mailed, from a password protected DCC e-mail account. As a result the form has electronic initials of members of the Education Staffing Section authorising the form. This version of the form does not require an employee signature as the Staffing Section will hold a signed acceptance letter from the new employee. The intention is that when the CERDMS new start form is introduced corporately, Education will also adopt this procedure which will ensure a consistent approach across the Council. **Responsible officer(s):** Assistant Payroll Manager **Implementation date:** In conjunction with the implementation of the CERDMS new start form.
10 Journals		**Grade one (significant)**
Supporting documentation for manual journals posted is scanned and included in the `notes' section within the financial ledger. There is, however, no authorisation procedure for posting journals. Transfer journals i.e. those between departments, should be authorised, however, these can currently be self-authorised by the same person inputting the journal. There is a risk that journals are processed in error without appropriate authorisation.	Management should require that all journals are subject to independent authorisation and review prior to posting to the financial ledger, as this provides a key control over the processing of transactions within the financial ledger.	Given the number of journals (approx. 12,000 per year) it is not administratively feasible to check all of these. It is agreed, however, that journals should be checked on a sample basis to ensure their accuracy and authenticity. This sampling will be based on a risk assessment of all types of journal processed. **Responsible officer(s):** Accounting Manager (Systems) **Implementation date:** 31 August 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
11 Reconciliations		**Grade one (significant)**
The majority of reconciliations undertaken are not documented to provide evidence that appropriate action has been taken in respect of reconciling items. In addition, the majority of reconciliations are not subject to evidenced independent review. Where there is evidence of specific reconciliations being performed, there is inconsistent evidence of who prepared the reconciliation and very limited evidence of independent review. Evidence of preparation and independent review is required to demonstrate segregation of duties. For example, if a reconciliation of two systems is performed by a member of staff with access to both systems, there is a potential risk of manipulation of the underlying data. The overall lack of audit trail means that management cannot determine the nature of action taken in respect of reconciling items; or gain assurance that underlying financial records are free from fraud and error.	In respect of 2011-12, all key reconciliations should be documented, signed as prepared and signed as independently reviewed as part of the financial statements preparation process. Management needs to determine a framework in which reconciliations will be documented and reviewed on a regular basis during the year. The frequency of reconciliations will depend on the volume and materiality of transactions, but, in our view, it is unlikely that annual reconciliations provide sufficient assurance on the accuracy of underlying financial data. It is also important that the correct staff are identified to perform reconciliations, which means that staff involved in processing the source data should not subsequently be involved in reconciling this data. While we understand the focus of the Council on reducing the volume of paper , and moving towards electronic records, as part of the above review, management should therefore consider the need for electronic signatures in order to document evidence of controls where there is no physical paper trail.	Reconciliations will be categorised into a hierarchy of importance depending on whether they involve (a) an external source or (b) allocation of external transactions or (c) internal billing/costing, etc. Type (a) will be performed daily or weekly as appropriate, types (b) monthly and (c) quarterly (or monthly when possible). A form will be developed to manually record the performing and checking of each account reconciled (including signatures) and this will be scanned for electronic retention each month - until a method of recording signatures electronically is developed by the Council. **Responsible officer(s):** Accounting Manager (Systems) **Implementation date:** 31 August 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
12 Audit Scotland and Audit Commission national reports		**Grade two (material)**
National reports are sometimes considered by the scrutiny committee, but management has not performed a self-assessment of local arrangements against the recommendations in any of the three most recent reports.	Management should ensure that the content of all relevant national reports are discussed by the Council or a sub-committee, that self-assessments are performed and that appropriate action plans and timetables are agreed.	Recommendations will be implemented where national reports are deemed to be of sufficient relevance to the Council. **Responsible officer(s):** Director of Corporate Services **Implementation date:** Immediate

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