REPORT TO: **SCRUTINY COMMITTEE - 25 JUNE 2013**

REPORT ON: **KPMG INTERIM MANAGEMENT REPORT - YEAR ENDED 31 MARCH 2013**

REPORT BY: **DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **287-2013**

1 PURPOSE OF REPORT

To submit to Members of the Scrutiny Committee the Interim Management Report for the year ended 31 March 2013 prepared by the Council's External Auditor, KPMG.

2 RECOMMENDATIONS

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

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 2013. These findings have been discussed with management and an agreed action plan in respect of the 6 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 2013, following the audit of the financial statements. This report will be submitted to elected members later in 2013.

5 POLICY IMPLICATIONS

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

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 **07 JUNE 2013**

cutting through complexity

Dundee City Council

Interim management report

Audit: Year ended 31 March 2013

31 May 2013

Contents

This interim management report and audit status summary is presented in connection with our audit for the tear ending 31 March 2013 under the terms of our appointment by the Accounts Commission for Scotland.

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	Page
Service overview	2
Financial statements audit	5
Financial statements	8
Other audit areas	13
Delivery of the audit	20
Appendices	21

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.

Financial position and governance framework

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.

Following the 2012 local government elections, the Council's SNP majority administration has been working with officers to establish strategic priorities and embed them within the updated council plan and single outcome agreement ("SOA").

The changing for the future ("CFTF") program has seen significant development since its initial implementation. Originally it was formed as a change management tool which focussed on the four key areas:

- service prioritisation;
- reshaping the service delivery model;
- assets; and
- enabling the change.

The program has evolved from this starting point and is now a multi-phase tool for continuous improvement. There has also been a drive to increase the reliability of information provided on projects, such as the expected delivery dates, and the level of participation by the CFTF board.

Management continue to monitor welfare reforms. These are taking place during the sixth consecutive year of council tax rate freezes by the 32 Scottish local authorities. Changes to the council tax benefit scheme from 1 April 2013 have been incorporated in the 2013-14 council tax proposals. Detailed reporting on these changes and the evaluated impact of the Scottish welfare fund and discretionary housing payments have been reported to Council.

The Council continues to face significant cost pressures, particularly in social work which has seen further overspend compared to budget in the current financial year. The Council has a history of managing its overall result close to budget through realisation of cost reductions in other departments to offset the rise in social work costs. Current forecasts for 2012-13 show an overspend of around £90,000.

During 2012-13 there was considerable investment made in increasing the energy efficiency of housing throughout the city with over £10 million spent on heating, kitchens and bathrooms and over £6 million on external insulation.

Financial position and governance framework (continued)

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.

Revenue budget

The Council set a breakeven revenue budget for 2012-13. The revenue outturn monitoring report as at 28 February 2013 shows a projected deficit of £0.09 million. 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	4,625	
Additional Scottish Government grant	(1,403)	
Use of committed balances	(3,222)	-
Variances from budget		
Increase in social work costs	2,039	
Increase in city development and chief executive costs	1,087	
Decrease in environment, education and corporate services costs	(1,130)	
Decrease in interest on revenue balances, and draw on contingency for energy costs	(896)	
Projected refund for share of Tayside Joint Police Board and Tayside Fire and Rescue Board reserves	(1,010)	90
Forecast outturn deficit at 28 February 2013		**90**

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

The forecast position after 11 months of the financial year represents a significant improvement on the forecast deficit outturn of £1.07 million as at 31 January 2013. The primary reason for this has been the inclusion of the projected refunds for the share in the accumulated reserves and balances of Tayside Joint Police Board and Tayside Fire and Rescue Board.

Significant adverse variances have been consistently reported for social work throughout the year, due to continued cost pressures.

As in the prior year, cost pressures in both adults services and children services were significantly greater than budgeted. The 2011-12 social work budget had an overspend of £2.2 million. In response, the 2012-13 final revenue budget increased year-on-year social work expenditure by £5.1 million. The forecast overspend in social work for 2012-13 highlights the ongoing increase in cost pressures faced by this service.

Our annual audit report for 2011-12 recommended that the budget setting process for 2013-14 should include indicative budget information for subsequent years, to provide members with a more strategic overview of the revenue budget position.

The 2013-14 revenue budget is set on a model providing considerations for the 2013-14 financial period with limited information on expected departmental savings in 2014-15. Continued development of the budget setting process to provide information for an increased number of future periods will enable members to receive a longer term strategic overview of the financial position.

Recommendation one

We also recommended in our 2011-12 annual report that the Council should review the protocol on reserves in light of expected funding challenges. In a report to the policy and resources committee dated 14 February 2013 the director of corporate services provided a detailed review of the protocol on reserves and emphasised that a minimum uncommitted balance of £4.75 million should be maintained. This is equivalent to around 1.4% of budgeted net expenditure. Comparison with Audit Scotland's local government overview report for 2011-12 indicates that this level is within the lowest quartile of the percentage general fund reserves held across all Scottish local authorities.

In order to maintain the minimum uncommitted balance of £4.75 million, as part of the budget approval process for 2013-14, the Council identified budget savings totalling £6.45 million.

Financial position and governance framework (continued)

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.

Capital budget

The Council approved a general services capital budget of £58.1 million for 2012-13. This has been subject to budget adjustments throughout the year, with the capital monitoring report to 30 November 2012 showing an increase in the budget of £2.6 million. The adjusted budget for the year has since reduced, with the latest position for 28 February 2013 showing an overall budget adjustment downwards of £2.5 million, to a projected outturn of £55.6 million. £6.4 million of funding has been brought forward from the prior year to apply to the 2012-13 budgeted expenditure.

The projected outturn is forecast to be in line with the adjusted budget. The table illustrates the reported budget adjustments and variances during 2012-13.

Movements from capital budget	General services	Housing Revenue Account
	£'000	**£'000**
Original budgeted outturn	**58,094**	**24,032**
Budget adjustments	(2,481)	-
Revised budget	55,613	24,032
Reported variances	-	(682)
Forecast outturn at 28 February 2013	**55,613**	**23,350**

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

In the prior year we noted that significant amounts of capital expenditure were identified for deferral into future years from period three within the financial year. At January 2012 the amount identified for deferral was £21.8 million. By 31 March 2012 this had been substantially reduced, with £6.4 million of funding carried forward to 2012-13.

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 activity.

Significant capital projects in the year include the Allan Street swimming pool (£11.3 million) and car park (£3.1 million). The waterfront development, including the V&A, central waterfront and Dundee Railway Station concourse works, has an in-year expenditure profile of £7.5 million, of which £6.3 million will be externally funded. Expenditure of £16 million within the education department includes development of the Balgarthno and West End primary schools (£6.3 million and £3.3 million respectively).

Significant housing revenue account capital projects in the year include the energy efficiency expenditure (£18.2 million) and demolition activity in relation to the overall strategic programme for the supply of the required level of council housing (£1.8 million).

Audit focus areas

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

Areas of audit focus are:

- **financial position;**
- **capital grants;**
- **capital programme;**
- **valuation of property, plant and equipment; and**
- **Dundee Energy Recycling Limited.**

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
Financial position	The key risks and implications are detailed in the previous financial position slides. These are: ▪ the adjusted 2012-13 budget forecasts a breakeven position; ▪ the recent budget monitoring position forecasts an overspend of £0.09 million for the year; and ▪ social work continues to face strong cost pressures, leading to a £2.05 million overspend in the current year.	We have: ▪ updated our understanding of the 2012-13 budget setting process through discussions with key members of staff at both departmental and senior management levels; ▪ considered the key budget pressures, and the action taken by management to address these; and ▪ inspected a sample of budget monitoring reports. We will compare the final audited financial position to the forecast figures from February 2013 to determine the accuracy of budget monitoring during the year.
Capital grants	The Code requires that grants and contributions are recognised immediately in the comprehensive income and expenditure statement except to the extent that grant or contribution has a condition relating to initial recognition that has not been satisfied. During 2011-12, our audit focussed on the Council's accounting for capital grants received, and a significant audit adjustment was identified as a result of our procedures, to ensure compliance with the Code.	We recommended that management provide updated guidance on the accounting for capital grants received. As part of our interim audit procedures, we have reviewed the action taken by management, together with considering actual capital grants received during the year to date. We have attended meetings of the Council's final accounts working group and confirmed updates to accounting for capital grants appears reasonable. We will to continue to discuss this area with the Council in order to further reduce the risk of audit adjustments being required at a late stage.

Audit focus areas (continued)

Issue	Key risk and implications	Update
Capital programme	Following a £2.5 million decrease to the capital budget for 2012-13, the revised budget for general services capital expenditure in the year is £55.6 million. The housing revenue account ("HRA") capital budget is currently unchanged at £24 million for the year. As at 28 February 2013, expenditure incurred to date represents 73% and 80% of the general services and HRA budget. The Council continues to progress several major capital projects, including the Waterfront project, as well as a current review of its schools estate.	We have: ▪ monitored the achievement of the capital programme for the year to date; ▪ updated our understanding of the future capital plans of the Council, including the incorporation of plans for the schools estate and the progress of the waterfront development; and ▪ considered the risks associated with the funding of the capital programme.
Valuation of property, plant and equipment	Valuation of property, plant and equipment across the Council's substantial portfolio of assets remains a key risk area. 2012-13 represents the fourth year of the current revaluation programme cycle. In addition, decisions made by the Council in approving elements of the future capital programme need to be considered as to whether there is any associated impairment of the current carrying value of existing assets on the balance sheet.	We have discussed with management the proposed amendments to the Council's componentisation policy and impairment of assets policy. This has allowed us to consider any adjustments necessary, which can be processed in advance of the preparation of the Council's unaudited financial statements. The proposed componentisation policy would see an increased depreciation charge in 2012-13 of £0.6 million. The draft analysis on the impairment of assets, prepared by the Council, recognises significantly increased annual depreciation charges arising from greatly reduced useful economic lives. The total revised 2012-13 depreciation charge for assets identified for replacement would be £13.3 million. In response, we have requested management work closely with property valuation experts within the estates team to calculate the carrying values and potential impairments of assets identified for replacement as at March 2013. This will determine the element of impairment charge versus accelerated depreciation to be charged for the year. We will continue to discuss the impairment policy with management to ensure it provides a true and fair view of the value of the assets in the final financial statements.

Audit focus areas (continued)

Issue	Key risk and implications	Update
Dundee Energy Recycling Limited ("DERL")	On 16 May 2012 there was a fire at the plant operated by DERL. Since this date the plant has been non-operational, and management from both the Council and DERL have been involved in discussions in respect of the impact of this event on DERL's operations. The Council has continued to support DERL through this period, providing short-term working capital support before the business continuity insurance payments were approved. In addition, the Council has committed additional support totalling £7.9 million to enable improvement works to be undertaken during the reinstatement process. These additional capital works are aimed at improving the overall efficiency and long-term viability of the plant. This investment is due to be repaid by DERL over five years, in line with DERL's updated business plan. We understand from management that DERL has affected a change to its accounting reference date, which may mean that audited financial statements are not available to consolidate into the Council's group accounts. There is an increased risk that financial information used for consolidation purposes is not therefore accurate.	We have continued to hold regular discussions with management in respect of the impact on the operations of the plant, and the steps being taken to secure its future. As part of our final audit work for 2012-13, we will: ▪ consider the additional investment made by the Council into DERL, and ensure that this has been accounted for appropriately; ▪ review for appropriateness any provisions made by management for non-recovery in respect of any existing balances owed by DERL; ▪ update our understanding in respect to the source of financial information on which the Council intends to consolidate the results of DERL into its group financial statements; and ▪ liaise as appropriate with DERL's auditors, as part of our inclusion of DERL within our scope for the audit of the Council's group financial statements (more details are provided later in respect to our approach to this area).

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 financial statements.

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
Financial management	■ Financial analysis ■ 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 expenditure 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 financial ledger and, as such, variances are not reported against expected expenditure 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. ■ In our 2011-12 interim audit report we noted that 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 activity. ***Recommendation two***
Organisation-wide policies	■ Standing orders and scheme of delegation ■ Code of conduct ■ Employee handbook ■ Whistle blowing policy ■ Counter fraud policy	■ Organisation-wide policies are important as they set the tone of the Council, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. ■ The majority of these policies have recently been updated to reflect new requirements and are available to all staff on the intranet.

Governance framework (continued)

Audit area	Key areas considered	Findings
Related parties	■ Elected members' register of interest ■ Chief officers' 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, the agenda requests compensates for any gaps.
Risk management	■ Risk management strategy ■ Corporate risk register ■ Strategic department risk register ■ Operational risk register ■ Risk monitoring	■ The Council's risk management strategic plan (2007–2011) details the Council's risk management framework. Management is currently in the process of updating the plan and expect to have a revised version by the summer of 2013. ■ 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 the 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. ■ An internal audit review identified weaknesses in the current risk register and recommended management make improvements to the current process. This was scheduled for March 2013 and we will review the updated risk register during our financial statement audit.

Governance framework (continued)

Audit area	Key areas considered	Findings
Internal audit	■ Annual internal audit plan ■ Sample sizes ■ Reliance on individual internal audit reviews	■ The internal audit plan is developed 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. ■ Internal audit reports are provided to management with an executive summary provided to the scrutiny committee. ■ In our audit plan, we reported that we planned to place reliance on internal audit's work on: - payroll - overtime; - procurement; - corporate governance framework; and - performance measures. We have evaluated this work and used it to modify the level of planned testing and to increase our understanding of the risk environment of the Council. ■ We have provided assistance to the chief internal auditor in respect of two specialised IT reviews contained within the internal audit plan. ■ The IASAB produced a common set of public sector internal audit standards ("PSIAS"), which require to be applied to the public sector from 1 April 2013. CIPFA has prepared an application note for the application of these standards in local government and we recommend that internal audit perform a self assessment against the updated requirements.

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.

A number of key financial controls are automated or rely on computer or systems based controls; we will carry out work on general IT controls and the overarching IT environment.

Audit area	Key controls	Findings
Reconciliations	■ Reconciliation controls should exist in the majority of financial systems and should be performed periodically, from daily to annually.	■ Through our testing we identified that several daily, weekly and monthly reconciliations were either not performed regularly or not documented appropriately. In addition, several reconciliations were not subject to evidenced of independent review. These matters formed the basis of recommendations in our 2011-12 interim audit report; there is limited evidence to support that appropriate progress has been made on addressing these matters. ***Recommendation three*** ■ It was noted that there were mitigating controls as annual reconciliations will be performed. We will review reconciliations performed at year-end as part of our financial statement audit to ensure they have been prepared effectively. ■ Where reconciliations are only performed on an annual basis, there is a risk that fraud or errors are not detected and resolved on a timely basis during the financial year. ■ We identified that progress has been made with regards to the bank reconciliation process, with increased accountability placed on individuals responsible for their preparation and review. There are still improvements to be made, as certain reconciliations were identified as being incomplete or submitted several months late. ■ Appendix two reflects updated details of the identified weaknesses and associated risks. ■ As the Council continues towards a paperless office, we noted the use of electronic signatures remained underutilised. Management should ensure that there is adequate arrangements for electronic signatures in order that the operation of important controls are appropriately documented.

Key financial controls (continued)

Audit area	Key controls	Findings
Income and Debtors	■ Authorisation of NDR reliefs ■ Budget monitoring	■ The key controls tested have been designed appropriately, implemented and are operating effectively.
Expenditure and Creditors	■ New supplier authorisation and amendments ■ Budget monitoring	■ The key controls tested have been designed appropriately, implemented and are operating effectively.
Staff Costs	■ Review of payroll system exception messages ■ Budget monitoring ■ Staff in post check	■ The key controls tested have been designed appropriately, implemented and are operating effectively. ■ The staff in post check is a new control to be introduced from March 2013 in response to an internal audit recommendation. We will review this as part of our final audit visit to ensure it has been effectively implemented.
Property, plant and equipment	■ Capital monitoring	■ The key controls tested have been designed appropriately, implemented and are operating effectively.
Journals	■ Automated journal controls ■ Authorisation of journals	■ We recommended as part of our 2011-12 interim audit report that there should be a system of authorisation and review of journal entries. Management plan to introduce quarterly testing of a statistical sample of journals. We identified that there is still no such process in place. It is also unclear as to how much detail the planned check will include. ■ Individual operators are able to post and authorise the same journal leading to a lack of key segregation of duties. ■ There is a risk that journals are processed in error without appropriate authorisation. Best practice would have all manual journals subject to independent authorisation and review prior to posting to the financial ledger, however as a minimum, quarterly testing should be introduced as a matter of priority. ***Recommendation four***

Performance management

Our audit strategy and plan set out a number of performance management audits that we are required to carry out.

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. As external auditor, our responsibilities extend to understanding arrangements and systems that the Council uses to generate performance results and consequent reports. Our work will include consideration of internal audit's role in testing SPIs and reporting the results.	We made a recommendation in our 2011-12 audit report that management select and test a sample of SPIs to ensure arrangements are in place to collect the required data and the SPIs reported are complete and accurate. This was agreed by management. Our work will review the progress made by management in addressing this recommendation. We will complete work in this area in July 2013 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 received matched data for the 2012-13 process. The corporate services department are building time into their 2013-14 plan to review these matches. We will select a sample of resolved matches to test during our final audit and ensure they have been appropriately reviewed and any follow up carried out.
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 Council LAN has completed the process of updating the AIP for the period 2013-14. Along with the National Scrutiny Plan, the AIPs for all 32 local authorities were published on the Audit Scotland website on 25 April 2013.

Performance management (continued)

Audit area	Overview	Findings
Local response to national studies	Audit Scotland and the Accounts Commission for Scotland 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, the Accounts Commission and its appointed auditors, auditors will 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 report: ■ Commissioning Social Care We have prepared a short return to Audit Scotland for this report. Management has considered the report and will discuss it further at the joint management meetings to identify appropriate action to be taken. We note that national study reports are not always considered by the scrutiny committee. There is a risk that, as formal consideration by the scrutiny committee of the national studies reports does not take place, the full benefits for the Council are not derived. ***Recommendation five***
Changing for the future	The changing for the future board oversees and guides the changing for the future programme. The board meets regularly 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 changing for the future programme is split into four sub-programme areas: ■ service prioritisation; ■ reshaping the service delivery model; ■ assets; and ■ enabling the change.	The CFTF program has evolved from the original change management model into a tool for continuous improvement. The program is currently in phase two, with plans to move to phase three within 2013. Our testing identified that the CFTF board has developed their monitoring and operations from prior year, providing a detailed picture of the projects and the expected savings arising from these. We recommended in 2012 that the board continue providing the regular updates to members in respect to progress of the projects, and this has been evidenced through our testing. While it is accepted that delays to certain projects are inevitable and the board display good monitoring and reactionary activity, we consider that it may be useful to provide greater details of such delays in the update document and to consider a revised end date for the affected projects. ***Recommendation six***

Performance management (continued)

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified Scotland's public finances: Addressing the challenges for follow-up in 2012-13.

We carried out follow-up work to consider the Council's response to the report.

Although management reviews and utilises performance information management recognises that this is still an area for development.

Scotland's public finances: Addressing the challenges

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified the *Scotland's public finances: Addressing the challenges* for follow-up by local auditors in 2012-13. The aim of the follow-up work is to assess how public bodies are responding to the challenges of public sector budget constraints and their efforts to achieve financial stability. Set out below are our findings from our follow up work.

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction?	
Does the organisation have a balanced financial plan for 2012-13 which sets out: ▪ Assumptions about sources of income and cost pressures? ▪ What cost reductions and other efficiency savings will need to be made, and how they are to be delivered? ▪ Risks to service delivery as a consequence of the need to reduce costs and deliver identified efficiency savings?	The 2013-14 budget was approved by the Council on 14 February 2013. We have considered this latest process for the purpose of this review rather than the 2012-13 budget. The provisional budget is created with a consideration of cost pressures and cost savings, and an understanding of the Local Government finance settlement ("LGFS") for the year. The LGFS figures were announced for the 2012-15 period in December 2011 and have subsequently been updated. The grant figure as at 27 November 2012 was confirmed by LGF circular 5/2012 and is the figure used for total distributable revenue support in the budget. Each budget change and efficiency measure or saving is identified in the budget proposals, with a brief explanation. Key strategic, operational and financial risks facing the Council over the period are covered at a high level in the budget and monitored through the course of the financial year.

Performance management (continued)

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction? (continued)	
Does the organisation have a clear budget-setting process which: ▪ Demonstrates a clear understanding of its costs and how costs vary with activity? ▪ Takes into account previous years' service delivery performance and where improvements need to be made? ▪ Takes into account the body's track record on delivering against budgets and analysis of the reasons for previous years' under/over spends? ▪ Allocates resources according to a clear understanding of its priorities, including which services or activities are expected to contribute most and least to the achievement of the organisation's outcomes?	The 2013-14 budget is created using the 2012-13 final revenue budget as a base, anticipating any inflationary pressures, including pay awards. Any cost pressures and savings identified through the 2012-13 budget are incorporated in the 2013-14 budget, along with any new pressures which are expected to emerge in 2013-14. The Council closely monitors delivery of the budget. This is aided by regular adjustments arising from budget monitoring processes. Analysis of variances from the budget are included in budget monitoring reports. In 2011-12 we requested that management perform a review of late underspends which came through in March 2012. We have been informed this is being addressed as part of the 2012-13 close-down process. Management are looking at service prioritisation and alignment as projects are finalised in 2012-13. This is intended to identify savings going forward in order to maintain or increase the level of savings achieved in prior years. The Council's strategic management team lead on priority alignment. This will involve adapting the current year financial information for future budgets. Management recognise the challenges involved in this process and the increased attention required on it in the future. They expect to have substantially completed this by September 2013 so as to feed into the 2014-15 budget.

Performance management (continued)

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction? (continued)	
Is there a clear evidence base to cost reduction plans (CRPs)? If yes: ■ Does the organisation undertake a programme of service reviews designed to identify the scope to reduce costs? ■ Do cost reduction plans provide adequate detail on how savings are to be made and over what timeframe? ■ Do cost reduction plans state who within the organisation is accountable for their delivery? ■ Do cost reduction plans give adequate consideration to the impact of reduced expenditure/ changes to service delivery arrangements on service performance and outcomes? ■ Are clear baselines established against which efficiency savings can be measured?	Management has stated that increased work is required on CRPs. Currently there is a combination of changing for the future projects, best value and service reviews all undertaken. In the annual budget, departmental savings required or expected in the year are identified. These are supported by more detailed reports from each department on cost reductions. More consideration could be given to the impact of reduced expenditure on service performance and outcomes. The majority of the CRPs result in changes to delivered services and cost reductions. Management plan to increase the impact of CRPs through communication of papers on benefit realisation to departments. Through the changing for the future program we identified several departments where costs versus benefits are regularly measured against targets.
Does the organisation regularly use benchmarking to compare its costs and performance with other organisations, including public bodies in other sectors and other non-public sector bodies? Can the organisation demonstrate real and measurable benefits from its benchmarking activities in terms of cost and/or quality improvements?	Management has made initial evaluations of the use of benchmarking against other organisations. Limited indirect comparisons have been made previously to other authorities, notably in areas of council tax and benefits administration. The Council recognises the benefits that arise from benchmarking, in particular the comparisons to other authorities. It is intending to increase the use of benchmarking going forward by utilising the SOLACE project.

Performance management (continued)

1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction? (continued)	
Does the organisation have a longer term financial strategy which: ■ Takes into account planned changes to service delivery arrangements and anticipated changes in demand for services? ■ Sets out how financial resources will be matched to strategic goals? ■ Demonstrates that current cost reductions and efficiency savings are in line with longer term strategic objectives?	There is currently a high-level longer term financial strategy. It was noted that there was minimal detailed information relating to future revenue. Individual work on the longer term financial strategy has been performed at a departmental level over demographics in social work, where reports have been fed into high level plans. This work has arisen from the recognition of longer term issues which exist in these departments where continued funding will be required. Other departments do not appear to be considered in detail as part of the longer term financial strategy. The policy and resources committee considers monthly reports detailing the factors behind any variances from budget.

Performance management (continued)

2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?	
Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans: ▪ Are high level financial targets and the overall financial position of the organisation discussed regularly at board level meetings? ▪ In setting financial plans, do members adequately consider the impact of budget reductions on service quality and outcomes?	Minutes for meetings in 2012-13 showed that those charged with governance regularly considered the financial position of the Council. Specific responsibility for this lies with the policy and resources committee, which receives monitoring reports on general fund, capital and housing spend regularly throughout the year. During the budget setting process, the finance division work with members to identify and evaluate budget proposals. Members are informed of the impact their proposed budget reductions would have on service quality and outcomes.
Do senior officials, elected members and non-executive directors provide: ▪ Sufficient focus on strategy and performance? ▪ Adequate challenge on longer-term financial plans? ▪ Regular consideration of financial risks? ▪ Adequate monitoring of the achievement of efficiency targets?	The strategic management team provide sufficient and regular challenge in these areas. Senior officials actively input to council governance and priority alignment. The scrutiny committee and individual management both consider performance reports on a regular basis. The policy and resources committee is actively involved in developing budget plans and considering financial risks. The Council produces an annual efficiency statement to monitor the level of efficiencies achieved.
Is there appropriate transparency and accountability of decisions about cost reduction measures and future organisational plans: ▪ Is there appropriate consultation with the public and other stakeholders over cost reduction plans which identify various options and their impact on service delivery and outcomes? ▪ Do financial and corporate plans adequately spell out the consequences of reduced budgets on the organisation's ability to deliver services and outcomes?	Management review any proposed cost reductions to consider the longer term impact on quality and savings against short term gains. There is currently no formal public budget consultation exercise performed by the Council before the cost reductions are agreed. Savings proposals to be considered by members when setting the budget are published in advance which allows press and public feedback before decisions are taken. There is evidence that some proposals have been changed as a result of feedback from the public, such as the proposed withdrawal of a free bus service for those with limited mobility. Feedback from the trade unions was used to influence the plans to reduce mileage rates available to individuals earning above a certain limit.

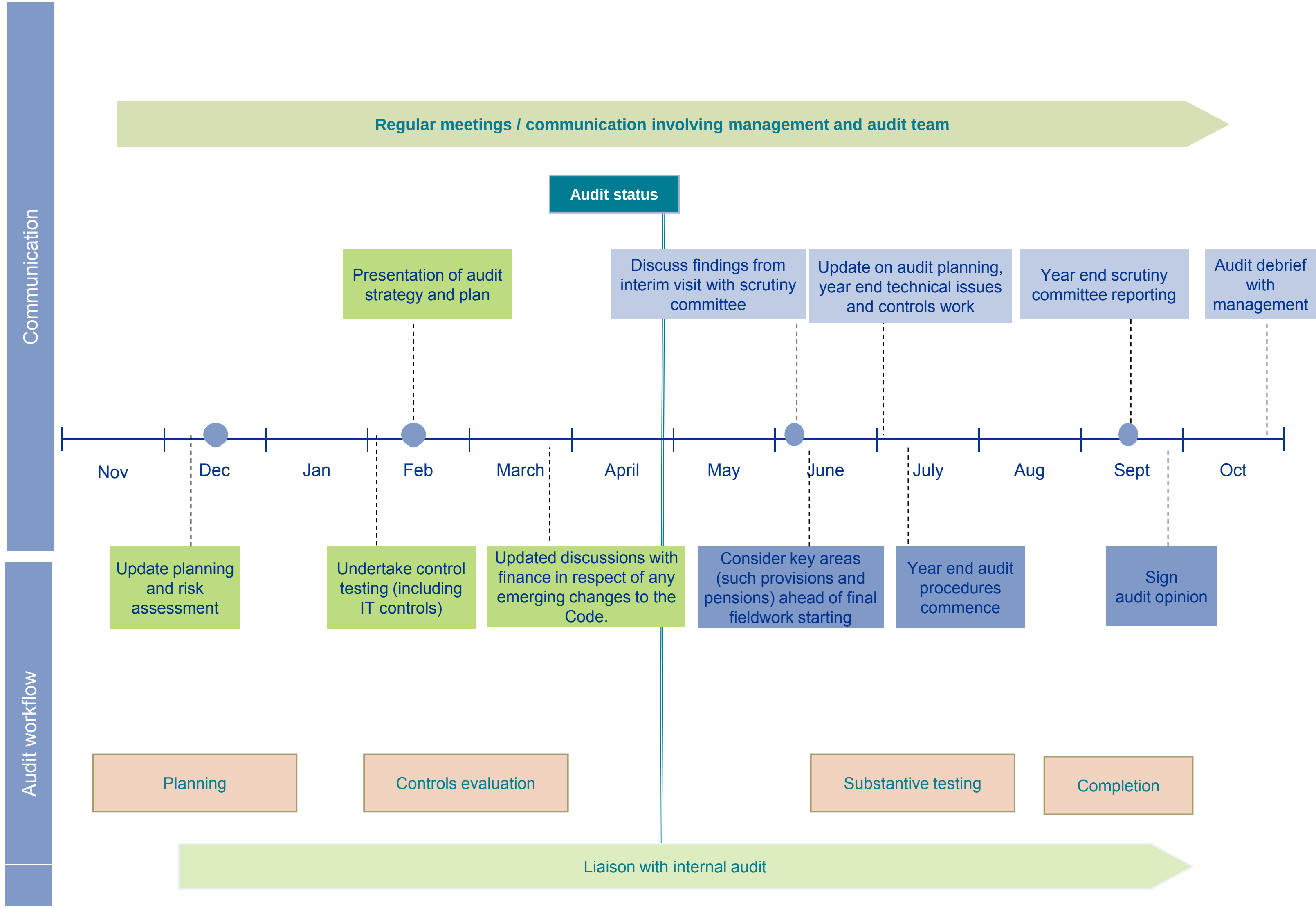
Performance management (continued)

2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval? (continued)	
Do finance/resource committees and other scrutiny committees play a suitably prominent role in the consideration of budget plans and risks to service delivery: ■ Are finance/resource and other scrutiny committees sufficiently involved in the consideration of budget plans, including: – the impact of budget reductions on service delivery – the organisation's track record of delivering against budgets? – reasons for previous years' under/over spends against budget? ■ Do finance/resource and other scrutiny committees undertake a regular programme of reviews of business areas to examine issues such as the achievement of value for money and service delivery? ■ Do finance/resource and other scrutiny committees regularly assess areas such as financial risks and efficiency savings? ■ Are reports from finance/resource and other scrutiny committees on budget plans and risks to service delivery given proper consideration by officials, with recommendations being promptly acted upon? ■ Do finance/resource and other scrutiny committees receive reports on the extent to which cost reductions and efficiency savings have impacted on service delivery?	The policy and resources committee consider budget plans and potential risks to service delivery. We confirmed that the committee appeared to: ■ be sufficiently involved in the consideration of budget plans; ■ undertake regular reviews of business areas to examine issues such as the achievement of value for money and service delivery; ■ regularly assess financial risks and efficiency savings; ■ receive reports on budget plans and risks from officials, which are considered and acted upon; and, ■ receive reports on the impact of cost reductions and efficiency savings on service delivery.

Audit timeline

The timetable is largely unchanged from the prior year, but is subject to refinement through discussions with management.

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



= Scrutiny committee meetings

Appendices

Action plan

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

We have identified one grade one ('significant') observations; we have identified four other recommendations.

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 Future years budget information		**Grade two**
In our 2011-12 final audit report we noted that the budget setting process contained only one years' budget information and recommended future years' budgets are included in the process. It was noted that the 2013-14 revenue budget contained limited consideration of 2014-15 and senior management should continue to develop this process to provide a longer term financial forecast.	It is recommended that as part of the budget setting process for 2014-15, increased details of future years' budgets are incorporated into this process to provide members with a more strategic overview of the revenue budget position.	As part of the 2013-14 Revenue Budget and Council Tax setting exercise, the Policy and Resources Committee was advised as to the estimated level of savings required in 2014-15 to deliver a Council Tax freeze in that year. As part of the 2014-15 Revenue Budget and Council Tax exercise, consideration will again be given to extending the planning timeframe and providing more detailed information for future years. It will appreciated, however, that the ability to provide robust and meaningful information beyond 2014-15 could be compromised by the uncertainties around government funding levels in the new Spending Review period (2015 – onwards). **Responsible officer(s):** Director of Corporate Services **Implementation date:** February 2014

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Financial management		**Grade two**
In our 2011-12 interim audit report we noted that 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.	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 where cost has exceeded the original approved budget.	The format and content of the capital budget monitoring report will be reviewed in light of the external auditor's comments and also taking on-board the recommendations in the recent Audit Scotland national study on Major Capital Investment in Councils. In particular, consideration will be given to incorporating information on total cost over the life-span of key capital projects. **Responsible officer(s):** Finance Manager (Corporate) **Implementation date:** 31 August 2013

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
3 Financial controls – Reconciliations		**Grade two**
Through our testing we identified that several daily, weekly and monthly reconciliations were either not performed regularly or not documented appropriately. In addition, several reconciliation were not subject to evidenced independent review. We note that there are a number of compensating controls in key risk areas, but there is scope to refine processes to further reduce the risks that: ■ fraud or error are not detected and resolved in a timely manner; ■ delays and infrequent performance of controls cause inefficiencies for finance staff, particularly when the majority of work is performed during the financial statements preparation process, in addition to the risk of material 'surprises' after the financial year end; and ■ the lack of audit trail means that management, the Council and those charged with governance have no or limited assurance that controls are being performed. The existence of a strong financial control framework acts itself as a deterrent for fraud and error.	Management needs to determine a framework in which reconciliations will be documented and reviewed on a regular basis during the year. 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.	A corporate exercise will be undertaken to document the key reconciliations that are undertaken around the various financial and non-financial systems operated by the Council. Information will also be recorded relating to the frequency of the reconciliations, who they are undertaken by, who they are checked / authorised by and how they are documented. In conjunction with Internal Audit, the sufficiency of each reconciliation will be reviewed and improvement action implemented where required. **Responsible officer(s):** Director of Corporate Services **Implementation date:** 30 September 2013

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 Financial controls – journal authorisation		**Grade one**
We recommended as part of our interim audit report for 2011-12 that there should be a system of authorisation and review of journal entries. We identified that there is still no such process in place. Management plan to introduce quarterly testing of a statistical sample of journals. It is currently unclear as to how much detail this check will include. Currently, individual operators are able to post and authorise the same journal leading to a lack of key segregation of duties. There is a risk that journals are processed in error without appropriate authorisation.	Management should require that journals are subject to independent authorisation and review prior to posting to the financial ledger, and introduce as a minimum the quarterly sample testing as a matter of priority.	Given the large volume of journals (c 12,000 per year) and the relatively low risk in most areas, it is neither necessary nor administratively feasible to check all of these. Accordingly, a risk-based approach will be adopted involving the checking of certain journal types on a sample basis. A report will be run each quarter to identify the non-feeder journals which have been posted and analyse these by journal type. A sample of each type (excluding transfer journals) will be selected and passed onto the appropriate staff for independent checking. Pending fuller implementation of electronic signatures, a printed summary sheet will be prepared for each quarter to allow the staff checking the journals to sign / initial and this will be scanned on completion and retained for audit purposes. **Responsible officer(s):** Accounting manager (Systems) **Implementation date:** 31 July 2013

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
5 Response to national studies		**Grade two**
Management has considered the Commissioning Social Care national studies report and will discuss it further at the joint management meetings to identify appropriate action to be taken. There is a risk that, as formal consideration by the scrutiny committee of national studies reports does not always take place, the full benefits for the Council are not derived.	Management should ensure that the content of all relevant national reports, and management's intended response, are considered by the scrutiny committee, including agreement of action plans, where appropriate.	National studies are considered by management and, where deemed appropriate, are also considered by the scrutiny committee, together with any recommendations for action. It is proposed that this arrangement should continue. **Responsible officer(s):** Director of Corporate Services **Implementation date:** n/a
6 Changing for the future		**Grade three**
While it is accepted that delays to certain projects are inevitable and the board display good monitoring and reactionary activity, it may be useful to provide greater details of such delays in the update report and to consider a revised end date for the affected project.	The changing for the future update report should be kept up to date for CFTF board meetings, and should include more detail in respect of delays in projects from original deadlines, reasons for these, and revised timetables.	Moving forward into future phases of the CFTF programme, we will incorporate information for the Board on deadline delays as well as highlighting when target dates are altered. The latter is currently agreed with the Chief Executive and project sponsors so can be updated to the Board in the future. **Responsible officer(s):** Corporate Improvement Manager **Implementation date:** 30 September 2013

Appendix two

Controls testing - reconciliations

The table below summarises reconciliation controls that should operate within key financial and non-financial systems, along with identified weaknesses in the design and operation of these controls. This table is not exhaustive and lists only those controls selected for testing during our interim audit.

Financial system	Reconciliation	Underlying risk	Frequency	Control documented	Control independently reviewed
Income	Cash receipting reconciliation	Theft or error may not be identified and resolved in a timely manner	Daily	✓	✓
			Monthly	✓	✓
Non-domestic rates	Reconciliation to assessor's roll	Incorrect bills raised against properties	Weekly	1	1
			Annually	2	2
	Non-domestic rate account reconciliation	Inappropriate recognition of non-domestic rates transactions	Annually	2	2
Cash and cash equivalents	Bank reconciliation	Incorrect recording of transactions	Monthly	3	3
Creditors	Creditor account reconciliation	Incorrect creditor balance recorded	Daily	✓	×
Staff costs	Payroll account reconciliation to general ledger	Incorrect recording of expenditure on staff costs	Weekly	✓	×
			Monthly	✓	×

1 – It was noted that weekly reconciliations were not always performed, therefore we will focus our testing on the annual reconciliation.

2 – We will review the appropriateness of these annual reconciliations during our financial statement audit.

3 – We reviewed the bank reconciliations performed in July and November 2012. For the sales account, no reconciliation had been completed, and for another account the reconciliation was not sent for independent review in a timely manner.

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cutting through complexity