Dundee City Council

Report to those charged with governance

Audit: Year ended 31 March 2012

20 September 2012

REPORT NO: 383-2012

Contents

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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 ("the Council") and is made available to Audit Scotland and Accounts Commission (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.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code"). This specifies a number of objectives for our audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance*, this report summarises our work in relation to the financial statements.

We wish to record our appreciation of the continued co-operation and assistance extended to us by your staff during the course of our work.

Accounting	
Accounting policies are appropriate for the underlying operations, although we have suggested areas of enhancement from our experience with other government bodies and understanding of the Code.	Page 3
Our audit approach reflected our assessment of financial statement level risks and included consideration of technical accounting matters. Our conclusion on the key risks are set out on pages three to eight, being: ▪ Dundee Energy Recycling Limited ("DERL"); and ▪ accounting for other group entities. We also set out our consideration of other matters, which are important, albeit with a lower risk of material misstatement. These matters are financial instruments disclosure and financial statement disclosures.	Pages 3 – 8
Financial statements	
Draft financial statements were prepared by management prior to the 30 June 2012 deadline and it is anticipated that the final financial statements will be signed in line with the agreed timetable. Notwithstanding this, a significant delay was experienced during the audit as a result of information outstanding until the planned clearance date. The two key areas of delay were in respect of understanding bank account reconciliations and suspense account operations, as well as being provided with evidence to support the accounting treatment of capital grants.	Page 9
Audit conclusions	
We anticipate issuing an unqualified audit opinion.	-
Mandatory communications	
We have one significant matter to communicate in respect of an audit difference. We have no significant matters to communicate in respect of management representation letter content. We confirm our independence to act as the Council's auditors	Appendices one, two and four
Action plan	
We identified several control recommendations during the interim and final audits, primarily related to the lack of formality and regularity of control account reconciliations, lack of authorisation of reconciliations and journal review. We set out an action plan with eight recommendations, one of which is in respect of a "high" risk observation.	Appendix three

Accounting policies; technical accounting matters

There is one development in accounting policies, in respect of heritage assets, which has been appropriately adopted.

The Code of Practice on Local Authority Accounting in the United Kingdom 2011-12 ("the Code") included a number of amendments. These have been correctly implemented in the financial statements.

Other accounting policies have been applied consistently.

Accounting policies	The 2011-12 financial statements have been prepared in accordance with the *Code of practice on Local Authority Accounting in the United Kingdom 2011-12 ("the Code")* which is based upon International Financial Reporting Standards ("IFRS"). The 2011-12 Code introduced the requirement for the Council to apply FRS 30 *Heritage Assets* for the first time. We discussed with management the requirements of FRS 30 during the interim audit and have considered the treatment within the draft financial statements. The implementation of the new accounting policy resulted in £8.1 million of heritage assets being capitalised. This value is predominately based on the insurance valuation of the Council's museums collections. Management has provided us with their 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. On this basis, the adoption of the accounting policy and the required disclosures have been appropriately applied in the financial statements.
Code of practice on Local Authority Accounting in the United Kingdom 2011-12 ("the Code")	The 2011-12 Code has a number of amendments from the 2010-11 version and management considered the reporting requirements for the financial statements. The amendments included: ■ applicability of FRS 30 *Heritage Assets (as above);* ■ additional guidance in respect of leases; ■ additional disclosure requirements in respect of exit packages; and ■ a requirement for a specific statement in the annual governance statement / statement on the system of internal financial control on whether financial management arrangements conform with the governance requirements of the statement on "the role of the chief financial officer in local government." We discussed the changes to the Code with management and considered that they have been appropriately reflected in the financial statements. Overall, the number of presentational or disclosure changes required to the unaudited financial statements in order to comply with the Code was low. In considering a number of the key technical accounting matters which formed part of our audit, we requested management prepare supporting technical analysis to outline the Council's proposed accounting treatment against the requirements of the Code. Going forward, more timely preparation and retention of this analysis will ensure that the Council has a record of the key judgements made in preparing the financial statements; ensure there is greater ownership of decisions; and lead to efficiencies in the process by helping to ensure that there is early consideration and liaison with external audit over potentially material audit and accounting matters. ***Recommendation one***

Accounting policies; technical accounting matters (continued)

The Council continues to support Dundee Energy Recycling Limited ("DERL"), as the company plays a key role in the Council's waste management strategy.

A fire at the DERL plant subsequent to the year end required management to consider the effect on the carrying value of assets leased by the Council to DERL, as well as the recoverability of loan and debtor balances.

We are satisfied that the analysis provided by management appropriately takes account of the requirements of IAS 10 *Events after the reporting period*.

This issue will, however, require further detailed consideration by management during 2012-13.

Dundee Energy Recycling Limited ("DERL")	DERL is a private limited company with ordinary and deferred (preference) shares. The Council holds 40% of the ordinary shares which have voting rights. The DERL board comprises six directors of which two are Council representatives. The Council previously accounted for its interest in DERL as a joint venture. During 2011-12, in response to our queries, management updated their consideration and concluded that it is more appropriate that the company be accounted for as an associate in the group financial statements. 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. The disclosure in the group financial statements has been updated to this effect; there was no other material impact on the group financial statements. In March 2004 the Council loaned DERL £2.3 million and in April 2010 a further loan was advanced of £1 million, both of which were funded internally by advances from the loan fund. A further loan of £0.6 million was made in 2011-12. All loans are secured by floating charges over all of DERL's assets. Repayment of the first loan was due by instalments, commencing in 2006. This loan has been rescheduled several times and full repayment is now due in 2020. 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. We requested that management prepare a paper considering the occurrence of the fire, and whether there were any additional disclosures or adjustments required under IAS 10 *Events after the reporting period*. In respect of the property, plant and equipment which DERL leases from the Council, IAS 10 identifies that an event such as the fire would be a non-adjusting event in the 2011-12 financial statements, however, disclosure of the event and any quantification of the impact is appropriate. The Council has updated its post balance sheet event note to provide this disclosure. Management has also confirmed that they had undertaken an impairment review in respect of these assets as at 31 March 2012, and concluded that the valuation was appropriate. Prior to the fire, DERL had made losses for the previous four years, resulting in cumulative net liabilities of £4.2 million at 31 December 2011. The financial statements of DERL are prepared on a going concern basis due to the continued assurances of support from the Council. As a result of this, as part of our audit planning, we asked management to consider the recoverability of both the outstanding loan balances, and any shorter-term trading debtors. In light of the fire, it was appropriate to reconsider whether this provided new information on the recoverability of the outstanding balances, and management updated their analysis accordingly. While the full loan balances remain to be repaid by 2020, management has considered that a provision of £1.95 million, representing 50% of outstanding loan balances, was appropriate in respect of the outstanding balances. However, as the Council has already repaid £2.4 million of the capital financing costs on the loans, we have accepted the position that no further charge to the general fund was required in 2011-12. We are satisfied with management's view over the appropriateness of the level of this provision.

Accounting policies; technical accounting matters (continued)

Tayside Contracts Joint Committee does not technically meet the definition of `an entity' for group financial statement reporting purposes.

Appropriate disclosures explaining the basis on which the Council's single-entity financial statements, and group financial statements have been prepared, has been included.

Tayside Contracts Joint Committee	In our interim management report (31 May 2012), we reported on our discussions with management in respect of the appropriate accounting treatment for Tayside Contracts Joint Committee. We agreed with management's assessment that Tayside Contracts Joint Committee did not technically meet the definition of `an entity' for group financial statement reporting purposes. As a result, the Code requires that the Council's share of activities of Tayside Contracts Joint Committee are reflected in the single entity financial statements, rather than the group financial statements. Management has confirmed that they agree that this is the most appropriate accounting treatment. Management proposed that for 2011-12, a revised disclosure would be included such that the impact of Tayside Contracts Joint Committee would be reflected as an adjustment to the Council 'single-entity' financial statements. This ensures that appropriate information was provided, but reduced the need for management to process changes to a large number of notes to the financial statements. We have reviewed the proposed disclosure and are content that these are reasonable in respect of the 2011-12 financial statements. It is important that for 2012-13 the full presentational adjustments required are reflected in line with the Code. We will work with management in early 2012-13 to ensure that this matter is addressed on a timely basis.
Leisure and Culture Dundee	Leisure and Culture Dundee was established as a Scottish Charitable Incorporated Organisation ("SCIO") in 2011-12, being operational from 1 July 2011. The purpose of the SCIO was to manage the leisure and cultural facilities owned by the Council, replacing Dundee Leisure Limited which previously managed only the leisure facilities. The activities of Dundee Leisure Limited were consolidated into the Council's group accounts up until 31 July 2011, when it transferred its activities to the SCIO. The SCIO has also been consolidated into the group financial statements, on an associate basis based on the membership composition of the Board. The Code requires that authorities should prepare group financial statements in accordance with SIC 12 *consolidation – special purpose entities and other standards.* 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 requested prior to the interim audit fieldwork that management conduct an analysis of Leisure and Culture Dundee with respect to the accounting standards and the specific tests within both the CIPFA *group accounts in local authorities practitioners workbook (2011)* and SIC 12. This was not provided by management until after the year end audit clearance meeting. We received management's analysis in late September. This concluded that under the CIPFA guidance for group financial statements, Leisure and Culture Dundee should be accounted for as an associate. In respect of the further SIC 12 analysis, the judgement was more complex. Management has, however, concluded that there is insufficient evidence that the SCIO met the SIC 12 definition of a special purpose vehicle, which would consequently require full consolidation in the group financial statements. We consider this to be a judgemental area, and based on the level of judgement involved in the analysis, combined with the overall materiality of the SCIO to the group financial statements, we are satisfied that the treatment as an associate is appropriate in 2011-12.

Accounting policies; technical accounting matters (continued)

A short narrative disclosure in the financial statements to explain the rationale for the non-consolidation of the Tay Road Bridge Joint Board has been included.

The Council's accounting policy in respect of the valuation of property, plant and equipment will be subject to revision from 2012-13.

During 2011-12, the Council moved into Dundee House, having incurred capital expenditure of around £38 million on its construction. The property was valued at £17.8 million, resulting in an impairment charge of £20.2 million.

Tay Road Bridge Joint Board	During 2011-12 we requested that management review the basis on which the Council was accounting for the Tay Road Bridge Joint Board, taking into account the revised Code. Management's analysis concluded that the Tay Road Bridge Joint Board should not be included in the Council's group financial statements on the basis of the lack of interest, financial or otherwise, in the Tay Road Bridge Joint Board's activities. We agree with management's view in this respect. To improve the transparency of the Council's financial statements, and specifically how the Tay Road Bridge Joint Board is accounted, for we suggested that a short narrative disclosure should be included in the Council's financial statements. We have read the revised disclosure and consider this to be appropriate.
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 Council's internal valuer. Properties are valued on a five yearly rolling basis by department. During 2011-12 property, plant and equipment in respect of social work, support services and chief executive's departments was subject to valuation. In addition, other elements of property, plant and equipment where management considered there to be indicators of impairment was also subject to valuation. Accounting standards require that, for consistency, where 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. As a result of the Council's current policy, in some instances, primarily office buildings, similar classes of asset are being valued during different years. We have discussed this with management and are satisfied with management's assessment that this does not have a material financial impact on the 2011-12 financial statements. Management has agreed that the application of this accounting policy will be subject to further review from 2012-13 in order to comply with best practice. During 2011-12, the Council moved into Dundee House having incurred capital expenditure of around £38 million on its construction and fit - out. As a significant project completed in the year, the internal valuer completed a valuation of the property in the year. The Council's internal valuer has indicated that due to the nature of the building (a large city centre office building), that it would not be appropriate to value on a depreciated replacement cost basis. Consequently, it has been valued on an income stream method, with the market value being derived based on current market rents for similar property. The resulting valuation for accounting purposes was £17.8 million, resulting in an impairment of £20.2 million being charged to the comprehensive income and expenditure account. Having consulted further with the Council's valuation team, the significant reduction in accounting value, compared to construction and fit-out cost, has arisen from a combination of factors including the current office rental market conditions in Dundee resulting from the current economic climate. More significantly, is the difference between the actual cost of providing a property to the Council's required specification and the market value of the property constructed and fitted out to that specification. Where similar large scale projects are undertaken in the future, it is recommended that management engage early with the internal valuer to identify while the project is in progress, whether there is any expenditure which should be impaired as incurred . This will mitigate the risk of any significant impairment charge only being identified and recognised on completion of a project. ***Recommendation two***

Accounting policies; technical accounting matters (continued)

We undertook specific audit work in respect of capital grants received in advance, to ensure that these had been properly deferred due to conditions which restricted their initial recognition. One adjustment was made to the financial statements, being recognition of a grant for £13.6 million, which was transferred to the capital grants unapplied account.

Disclosures of the fair value of financial instruments have been reviewed and found to comply with the requirements of the Code

Recognition of grants and contributions	Since 2010-11, the Code requires that grants and contributions shall not be recognised until there is reasonable assurance that (i) an authority will comply with conditions attached to the grants or contributions, and (ii) that the grants or contributions will be received. Notwithstanding this, the Code states that grants and contributions will be 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. Capital grants received and recognised, but not applied to capital assets, should be credited to the capital grants unapplied account. The Council carries a zero balance in this account, however, it had £14.6 million within capital grants received in advance. We undertook specific audit work to understand the specific conditions which existed in respect of these grants which prevented their recognition on receipt. This balance included one material grant received in respect of the Waterfront project. Management has re-considered the treatment in line with the Code and processed an adjustment to recognise the grant, and transfer it to capital grants unapplied at the balance sheet date. It is recommended that finance prepare updated guidance for circulation to all staff involved in the receipt, recording and monitoring of grants and contributions, to ensure the consistent treatment in accordance with the updated requirements of the Code. ***Recommendation three***
Financial instruments	Borrowings held by the Council are accounted for as financial liabilities in accordance with the Code, and are held at amortised cost. There is also a requirement for the Council to disclose the fair value of the financial liabilities within a note to the financial statements. Sector, an independent treasury management consultant, prepared a fair value valuation report of the Council's Public Works Loan Board ("PWLB") loans, giving a fair value of £396 million. This value is different to the valuation obtained from the PWLB's own website (£462 million). Following discussions with management, we understand that this is due to a different discount rate being used; the early repayment rate is used by PWLB and Sector apply the rate available for new borrowing. Audit Scotland's notes for guidance identify that there is a preference for the early repayment rate, although either method is acceptable, combined with disclosure within the financial statements of the methodology used and the reason. The Council has used the Sector valuation, which is consistent with the prior year, and the financial statements include the appropriate disclose of the interest rate used and why management deem this to be appropriate.

Efficiency of underlying process

Draft financial statements were provided on 29 June 2012, in line with the agreed timetable.

There were some delays in the audit, specifically arising from the adjustment identified in respect of the main bank reconciliation and receipt of evidence to support the treatment of capital grants.

Recommendations are included in the action plan in appendix three.

Area	Comments
Overall process	■ KPMG was appointed as auditor of the Council during 2012 and several introductory and planning meetings were held prior to the commencement of the interim audit. To facilitate an efficient audit, a prepared by client ("PBC") list was discussed and agreed with management, in advance of the final audit fieldwork, together with the timetable for delivery. ■ During the planning and interim fieldwork a number of technical matters were identified and discussed with management, the key matters being the valuation of property, plant and equipment; accounting treatment of DERL loans and assets; accounting treatment of Tayside Joint Contracts Committee, Tay Road Bridge Joint Board and Leisure and Culture Dundee. We also highlighted, as part of our interim audit the lack of formality and timeliness in respect of control account reconciliations; where evidence of preparation and separate review was not available for a number of significant ledger accounts. ■ Management provided the draft financial statements on 29 June 2012, in line with the agreed timetable, and a PBC audit file was made available at the start of the final audit fieldwork. It was evident that management had spent time considering the content of the PBC list and ensuring that appropriate and relevant documentation was available within the shared drive to ensure ease of access to electronic documentation. In some cases there were minor difficulties encountered where the supporting documentation did not agree to the financial statements. While, overall the quality of working papers was good, opportunities exist for continued improvement by ensuring that working papers include clear explanations and fully reconcile to the financial statements prepared for audit. ***Recommendation four*** ■ In two specific areas, where additional information was requested from management we experienced delays resulting in matters not being resolved promptly. The key matters were in respect of: ▪ resolving an error in respect of the main bank account reconciliation, and the operation of related suspense accounts; and ▪ obtaining detailed information to support the accounting treatment of various capital grants, as this information was held by a number of officers across the Council. ■ In respect of the error in the main bank account reconciliation, this was identified in the first week of the audit, with a reconciling item of £4.3 million queried with Council staff. A revised bank reconciliation, complete with details of an adjustment of £4.3 million to cash balances was not provided until 17 August. In the course of this process, management identified a further error in the operation of suspense account transfers, where the sales ledger account was approximately £650,000 overdrawn, in error. Management are continuing to investigate how this discrepancy has arisen. Overall, this issue represented the main significant delay in the conduct of the audit and gave rise to a risk of unidentified errors in other financial ledger accounts, requiring more detailed audit work to mitigate the risk. ***Recommendation five***

Efficiency of underlying process (continued)

Area	Comments
Overall process	■ As part of the year end audit, we attempted to reconcile the financial ledger as at 31 March 2012 to the financial statements. Management undertake an exercise to reconcile the final balance sheet to the financial ledger, however they do not conduct the same type of exercise for the comprehensive income and expenditure account. On request, management identified the appropriate reports to run from the system and provided this to us, which provided us with the assurance required. In order to gain assurance over the completeness of the financial statements and the financial ledger management should undertake a full reconciliation of the financial statements to the financial ledger on an annual basis. ***Recommendation six*** ■ We undertook detailed audit work in respect of the level of provisions against specific debtor balances e.g. housing revenue account arrears, council tax and national non-domestic rates debtors. No audit adjustments arose from this work. To improve the transparency of the process, we recommend that management consider documenting how certain levels of provision are determined, in reference to approved policies where these are in place. ***Recommendation seven*** ■ Management send information to the actuaries on an annual basis to allow the actuaries to prepare IAS 19 disclosures. This data is not subject to independent review for completeness nor accuracy. While our audit work did not identify any errors in the data submitted, without a control to review the completeness and accuracy of the data there is a risk that the IAS 19 disclosure is prepared using erroneous data and that these errors are not identified on a timely basis. ***Recommendation eight***

Update on key financial controls

Our interim management report identified some areas for improvement in respect of key financial controls.

No further key financial control observations have been identified as part of our final audit work.

Recommendations are included in the action plan in appendix three.

Audit area	Key controls	Findings	Raised at interim	Overall findings
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. ■ 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.	✓	●
Update	■ No further key financial control observations have been identified as a result of our audit.			

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Appendices

Audit differences

A small number of audit and other presentational adjustments were identified during the audit process.

The net impact of adjustments on the general fund balance is nil.

There are no unadjusted audit differences to report.

Adjusted caption	Nature of difference	£'000
Cash and cash equivalents	Error in consolidated bank reconciliation, whereby an amount was double-counted into the cash balances. The adjusting entry processed was split between short-term debtors and creditor balances.	(4,257)
Short-term debtors		4,309
Short-term creditors		(52)
Capital grants receipts in advance	Adjustment in respect of capital grant received in respect of the Waterfront project which has been transferred to the capital grants unapplied account, as the expenditure has not yet been incurred.	13,572
Capital grants unapplied account		(13,572)
Short-term Creditors	Error in bank reconciliation	(52)
Total		-
We discussed the content and layout of the foreword with management, in respect of good practice, and the forthcoming requirements of the International Public Sector Accounting Standards Board ED 47 *financial statement discussion and analysis*.		
The disclosures in the remuneration report were amended to provide best practice disclosure with the requirements of the statutory regulations.		
A number of minor presentational amendments were made to a number of disclosures throughout the financial statements.		

Unadjusted caption	Nature of difference	£'000
n/a	-	-
Total		-

Management representation letter

You are required to provide us with representations on specific matters such as your financial standing, application of accounting policies, and whether the transactions within the financial statements are legal and unaffected by fraud.

In the management representation letter, we are requesting specific confirmation that:

- except as disclosed in the financial statements or notes to the financial statements, there are no exit packages that have not been properly recorded in the accounting records underlying the financial statements;
- all non-current fixed assets are appropriately classified and valued in accordance with IAS 16 Property, Plant and Equipment and IAS 40 Investment Property. In particular, all assets have been subject to appropriate impairment testing undertaken in accordance with IAS 36 *Impairment of Assets* where there was any indication of impairment as at the reporting date;
- In respect of Dundee Energy Recycling Limited, it is considered that appropriate provision has been made in respect of outstanding loans and short-term debtors, and that all disclosures required under IAS 10 `Events after the reporting period' have been made; and
- The group financial statements appropriately account for and disclose the Council's interests in other entities and organisations, in accordance with the Code and other applicable guidance issued by CIPFA/LASAAC.

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 organisation 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 Technical analysis and ownership		**Grade two**
During 2011-12 we enquired of management in respect of the Council's adopted treatment in respect of a number of technical accounting matters. In each case we requested consideration of the circumstances of the issue against the requirements of the Code, and other relevant guidance or statute.	Going forward, more timely preparation and retention of this analysis will ensure that the Council has a record of the key judgements made in preparing the financial statements; ensure there is greater ownership of decisions; and lead to efficiencies in the process by helping to ensure that there is early consideration and liaison with external audit over potentially material audit and accounting matters.	Various actions will be implemented to ensure continuous improvement in the accounts closure process and thereby address the External Auditor's recommendations. **Responsible officer:** Head of Corporate Finance **Implementation date:** 30 June 2013

Action plan

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Impairment of assets		**Grade two**
In undertaking large scale capital projects, there is a risk that not all of the capital expenditure required to complete the project will add capital value to the asset. This can lead to a significant impairment charge being required when the asset is transferred from assets under construction into operational assets.	Where similar large scale projects are undertaken in the future, it is recommended that management engage early with the internal valuer to identify while the project is in progress, any aspects of expenditure which may not add accounting value to existing assets. This will mitigate the risk of any significant impairment charge being required on completion of the project.	Work-in-progress on large scale capital projects will be assessed on an annual basis to identify impairment and any such impairment will be accounted for on an on-going basis. **Responsible officer:** Finance Manager)Corporate) / Valuation Staff (City Development) **Implementation date:** 30 June 2013
3 Recognition of capital grants		**Grade two**
The 2010-11 Code brought changes to the approach to the recognition of capital grants, increasing the presumption that grants should be recognised on an accruals basis, unless there are clear initial conditions preventing the recognition of the grant income. The Council does not carry any balances within its `capital grants unapplied' reserve, however, it has deferred £14.6 million on the balance sheet.	It is recommended that finance prepare updated guidance for circulation to all staff involved in the receipt, recording and monitoring of grants and contributions, to ensure the consistent treatment in accordance with the updated requirements of the Code.	The existing guidance underpinning the receipt, recording and monitoring of capital grants will be reviewed and strengthened as required. **Responsible officer:** Head of Corporate Finance **Implementation date:** 31 December 2012

Action plan

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 Quality of supporting working papers		**Grade three**
The majority of supporting analysis provided was ledger prints or spreadsheets. In some cases there were minor difficulties encountered where the supporting documentation did not agree to the financial statements.	While, overall the quality of working papers was good, opportunities exist for continued improvement by ensuring that working papers include clear explanations and fully reconcile to the financial statements prepared for audit.	Appropriate opportunities for improving the quality of supporting working papers will be identified and implemented. **Responsible officer:** Finance Manager (Corporate) **Implementation date:** 30 June 2013
5 Bank reconciliation		**Grade one**
As part of our year end audit work we identified an error in the consolidated bank account reconciliation. This has not been identified by management despite the reconciliation having been completed and subject to independent review. As a result of the preparation of a revised bank reconciliation management identified a further error in the operation of suspense account transfers, where the sales ledger account was approximately £650,000 overdrawn, in error. As part of our audit we noted that a large number of staff were involved in the banking process and that there did not appear to be a 'process owner' who had oversight of the entire process. There is an increased risk of fraud or error not being identified on a timely basis with the current bank reconciliation process.	Management should take immediate action to review both the existing process, and the reasons why the errors arose and remained undetected. In addition, it is important that management complete the ongoing work to fully understand how the discrepancies with the sales ledger account arose. The overall bank reconciliation process should be subject to review to ensure staff are appropriately trained and there is a clear 'process owner' who has oversight of the entire process.	To improve the process going forward, a Sales Ledger Cash Book will be operated and account reconciliations will be done monthly. A daily 3-way check between Sales Ledger, General Ledger and bank Account will be instigated. Once this is fully functioning, attention will be focussed on the outstanding balance. **Responsible officer:** Business Support Manager **Implementation date:** 1 October 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
6 Reconciliation of financial ledger to financial statements		**Grade two**
Management undertake an exercise to reconcile the final balance sheet to the financial ledger, however they conduct no such exercise for the comprehensive income and expenditure account as part of the normal financial statements preparation process.	In order to gain assurance over the completeness of the financial statements and the financial ledger management should undertake a full reconciliation of the financial statements to the financial ledger on an annual basis.	The required reconciliation will now be prepared as part of the accounts closure process. **Responsible officer:** Finance Manager (Corporate) **Implementation date:** 30 June 2013
7 Bad debt provisioning		**Grade three**
We undertook detailed audit work in respect of the level of provisions against specific debtor balances e.g. housing revenue account arrears, council tax and national non-domestic rates debtors. While no audit adjustments arose from this work, it was not always clear from discussion with officers why certain levels of provision were made, with some analysis apparently being rolled forward from year to year.	In order to improve the transparency of the process, there is scope to review the process to ensure that there is a clear audit trail showing how provisions were assessed for adequacy by taking into consideration collection rates, or compared against the policy for provisions. Levels of provision against debtor balances should also be assessed against the Council's policy for setting bad debt provision levels in the respective areas.	The existing arrangements underpinning the calculation of the various bad debt provisions will be reviewed and strengthened as required. **Responsible officer:** Head of Corporate Finance **Implementation date:** 31 December 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
8 Pension data		**Grade two**
Management send information to the actuaries on an annual basis to allow the actuaries to prepare IAS 19 disclosures. This data is not subject to independent review for completeness nor accuracy. While our audit work did not identify any errors in the data submitted, without a control to review the completeness and accuracy of the data there is a risk that the IAS 19 disclosure is prepared using erroneous data and that these errors are not identified on a timely basis.	We recommend that management implement a control to provide independent review of the accuracy and completeness of data sent to the Council's actuaries.	The appropriate controls will be introduced so as to ensure the accuracy and completeness of data sent to the Council's actuaries for IAS19 purposes. **Responsible officer:** Business Support Manager **Implementation date:** 28 February 2013

Auditor's Independence

We are required by ethical standards to formally confirm our independence you.

There are no specific matters which have impinged on our independence.

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

We have considered the fees paid to us by the Council for professional services provided by us during the reporting period. There were no fees payable other than in respect of our audit.

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

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- communications;
- internal accountability;
- risk management;
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail. There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Joint Board.

Confirmation of audit independence

We confirm that as of 20 September 2012, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of Stephen Reid and audit staff is not impaired.

This report is intended solely for the information of the Council and should not be used for any other purposes.

Yours faithfully

KPMG LLP

KPMG

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