

**REPORT TO: FINANCE COMMITTEE - 17 JANUARY 2005**

**REPORT ON: RESPONSE TO EXTERNAL AUDITOR'S REPORT TO MEMBERS ON THE  
AUDIT OF DUNDEE CITY COUNCIL FOR THE YEAR TO 31 MARCH 2004**

**REPORT BY: DEPUTE CHIEF EXECUTIVE (FINANCE)**

**REPORT NO: 52-2005**

## **1 PURPOSE OF REPORT**

This report is a response to the report prepared by the Council's External Auditor on the audit of Dundee City Council for the year to 31 March 2004. The External Auditor's report is included on the Finance Committee agenda as a separate item (Report No 51-2005). The 2003/04 Audited Statement of Accounts for the City Council is also included on the agenda (Report No 50-2005).

## **2 RECOMMENDATIONS**

It is recommended that the Committee:

- i endorses this report as the Council's formal response to the External Auditor's report.
- ii notes the completed Action Plan appended to this report.

## **3 FINANCIAL IMPLICATIONS**

There are no financial implications arising directly from this report, or from the External Auditor's report.

## **4 LOCAL AGENDA 21 IMPLICATIONS**

There are no direct Local Agenda 21 implications.

## **5 EQUAL OPPORTUNITIES IMPLICATIONS**

There are no direct equal opportunities implications.

## **6 BACKGROUND**

External audit is one of the key methods by which the activities and performance of local government are independently scrutinised and reported upon. The external audit of Dundee City Council for the financial year 2003/04 was carried out by Mr Peter Tait CPFA, Chief Auditor (East Region), Audit Scotland. Local authority external auditors are appointed for a five year period and the financial year 2003/04 marked the third year of Mr Tait's appointment at the City Council. Mr Tait has recently taken up a new post within Audit Scotland and Mrs Fiona Kordiak is now the Council's appointed auditor for 2004/05 and 2005/06.

## **7 EXTERNAL AUDITOR'S REPORT**

- 7.1 The External Auditor's report outlines his main responsibilities as auditor and describes the scope of audit work undertaken during 2003/04 and the issues arising from that work. The report is divided into three key areas of the Council's activities:

Financial Statements and Related Matters (Section 2)  
 Corporate Governance (Section 3)  
 Performance Management (Section 4)

- 7.2 As part of the 2003/04 external audit, eight detailed reports have already been issued to management on matters related to the key areas outlined above. (A further five reports are currently in draft form). All of the reports issued have included an action plan agreed by management to address the key issues arising from the auditor's findings. Where appropriate, summarised versions of the reports are submitted to the Audit and Risk Management Sub-Committee for further scrutiny.
- 7.3 In addition to the Elected Members of Dundee City Council, the External Auditor's report is also addressed to the Controller of Audit at the Accounts Commission for Scotland. Given this wider audience, and the extent of the External Auditor's responsibilities and scope of work, his report is by necessity both fulsome and extensive. It contains much information that has already been reported to the relevant Committees of Dundee City Council. Further, as outlined above, the External Auditor's detailed reports already include agreed management action plans and are the subject of separate scrutiny by the Audit and Risk Management Sub-Committee. Accordingly, it is not the intention in this report to provide a detailed response or commentary on all of the External Auditor's findings. Rather, this response will focus on the main issues arising within each of the three key areas outlined above.

## **8 FINANCIAL STATEMENTS AND RELATED MATTERS**

- 8.1 The External Auditor's overall conclusion is that the financial stewardship of the Council during 2003/04 was of a satisfactory standard.
- 8.2 The Council's draft 2003/04 Accounts were presented to the Finance Committee on 28 June 2004 and submitted for audit in line with the statutory deadline of 30 June 2004. The audit itself was formally concluded by the target date of 30 September 2004, with the issuing of the Auditor's Report on the Statement of Accounts (see page 51 of the accounts). It is encouraging to note that the External Auditor has again commented very favourably on the standard of the Council's accounts preparation procedures and working papers.
- 8.3 There are no qualifications to the auditors report on the 2003/2004 Statement of Accounts and he has concluded that the accounts "present fairly" the Council's financial position. This effectively means that the Council's accounts have again been given a "clean bill of health". There is, however, an explanatory paragraph in the auditor's report regarding a failure to comply with a statutory requirement. This relates to expenditure incurred on housing support services that were not properly registered by the Care Commission in accordance with the timescale set out in the relevant legislation. It is emphasised that this situation affected all 32 Councils in Scotland and was due entirely to circumstances outwith their control. The Care Commission have recently confirmed that all local housing support services have now been registered, as required.
- 8.4 The net outturn on the 2003/04 Consolidated Revenue Account showed a surplus of income over expenditure of £2.214m, representing an underspend of £6.086m against the budgeted deficit of £3.872m (being mainly expenditure commitments brought forward from 2002/03 and the amount agreed to be met from accumulated balances in setting the 2003/04 Council Tax). The underspend confirms that the established systems for monitoring and controlling revenue expenditure were operating successfully during 2003/04.
- 8.5 The Council's General Fund balance stood at £8.645m as at 31 March 2004. There were, however, estimated commitments of £4.388m against this balance (including £1.646m used

in setting the 2004/05 Council Tax). This left an uncommitted General Fund balance of £4.257m at 31 March 2004. The various reserves and balances held by the Council at 31 March 2004 are detailed in paragraph 2.9 of the External Auditor's report. In line with the relevant professional guidance, the Council now has an agreed protocol covering the purpose, utilisation, management, control and review of these reserves and balances.

- 8.6 In paragraph 2.20 of his report, the External Auditor has highlighted the significant fluctuations in recent years in the value of the investments held by the Tayside Superannuation Fund. These fluctuations were due to movements in share prices, with a marked upturn during 2003/04, following the "low-point" at March 2003. The general recovery in share prices has continued through 2004/05 and the market value of investments held by the Fund has increased by around a further 10% since March 2004.
- 8.7 The stock market recovery during 2003/04 also had a positive effect on the Council's estimated net pension liability, as measured under Financial Reporting Standard 17. (The External Auditor notes that the Council complied with the revised reporting requirements of FRS17). The figures are included in paragraph 2.27 of the External Auditor's report and show a reduction in the liability from £117.360m to £75.303m. It must be stressed that these figures are based on a "snap-shot" on a single day and the calculation is particularly sensitive to the vagaries of the stock market, as evidenced by the significant fluctuations in the liability figure in recent years. The pension liability is only notional and does not impact on the Council's General Fund balance or budgetary requirements. Through the normal course of events, any projected net liability on the Superannuation Fund is recouped by increased employers' contributions. In this connection, the External Auditor has noted that the Council is implementing the increases in the contribution rate over the period 2003-2006 that were recommended by the Fund's actuary following the 2002 triennial valuation. The next actuarial valuation will take place in 2005 and will likely recommend further increases over the period 2006-2009. Allowance for these increases will be made in the Council's Provisional 2005-2008 Revenue Budget.
- 8.8 In paragraphs 2.32 to 2.48 of his report, the External Auditor outlines the financial restructuring of DERL that took place during 2003/04 and details the impact of consolidating the company's latest financial results into the Council's 2003/04 Group Accounts. For the avoidance of doubt, it is stressed that the Council's investment in DERL has already been fully funded by charges to the Consolidated Revenue Account in previous years and no further unfunded liability exists. In this respect, the Council's Group Accounts are somewhat misleading although they have been properly prepared in accordance with the relevant accounting guidance.
- 8.9 The External Auditor has detailed recent developments on the Council's Schools PPP Project. The PPP Project Board and Education Committee have been kept fully appraised on all relevant matters.
- 8.10 The External Auditor has various and wide ranging responsibilities with regard to examining the legality of the Council's transactions and activities. It is therefore pleasing to note that the External Auditor has no matters to report in this area arising from his audit work in 2003/04. Further, there were no formal objections to the 2003/04 accounts from members of the public.
- 8.11 The various new duties and arrangements arising from the Local Government in Scotland Act 2003 are detailed by the External Auditor in paragraph 2.59 of his report. The External Auditor then describes the Council's progress in addressing two of the key areas of the Act : Prudential Borrowing Framework and Statutory Trading Accounts. It is encouraging to note that there is no adverse comment on the Council's arrangements in these areas. The

Council will continue to respond positively to the various challenges and opportunities presented by the Act.

## 9 CORPORATE GOVERNANCE

9.1 The External Auditor has undertaken a review of the Council's corporate governance arrangements and has concluded that the Council has many aspects of a sound corporate governance framework in place. His review covered five key areas of the Council's corporate governance arrangements:

- Corporate Governance Overview (paragraphs 3.3 to 3.9)
- Fraud and Corruption Arrangements (paragraphs 3.10 to 3.12)
- Internal Audit (paragraphs 3.13 to 3.19)
- Systems of Internal Control (paragraphs 3.20 to 3.34)
- ICT Arrangements (paragraphs 3.35 to 3.58)

The following paragraphs provide a brief commentary on the External Auditor's findings in each of these areas.

9.2 Under "Corporate Governance Overview", good progress in developing a corporate governance framework had previously been noted and further progress has been made in 2003/04. Examples of specific initiatives undertaken during 2003/04 are shown in paragraph 3.6. Also noted is the Statement on the System of Internal Financial Control (as included on page 49 of the accounts) and the Chief Internal Auditor's independent reporting structures.

9.3 Under "Fraud and Corruption Arrangements", favourable comment had previously been made on the Council's arrangements and further developments were implemented in 2003/04. Examples of specific developments during 2003/04 are shown in paragraph 3.11, including the introduction of the Verification Framework for Housing and Council Tax benefits.

9.4 Under "Internal Audit", a separate performance audit review was undertaken during 2003/04 (see paragraph 10.3 below). In addition, the External Auditor has noted the problems experienced in addressing the 2003/04 audit plan, due to a shortage of resources. Action has been taken to strengthen internal audit resources, including the appointment of two local accounting firms to provide internal audit services to the Valuation and Tay Road Bridge Joint Boards. Notwithstanding the problems experienced during 2003/04, it is pleasing to note that the External Auditor is broadly satisfied with the adequacy of the Council's internal audit function.

9.5 Under "Systems of Internal Control", the External Auditor reports on the following reviews that he undertook during 2003/04:

- Council Tax Billing and Collection
- Borrowing, Loans and Deposits

The outcome of both reviews has been communicated in a detailed report to management on the key issues identified. Both reports also contained an action plan, agreed by management, to rectify the weaknesses identified. These reports have also been the subject of separate scrutiny by the Audit and Risk Management Sub-Committee. The External Auditor has also conducted a follow-up review of three areas that were reviewed in previous years (ISIS Payroll System, Payment of Creditors and Non-Domestic Rates Billing and Collection Arrangements). Where necessary, action will be taken to address any outstanding recommendations.

9.6 Under "ICT Arrangements", the External Auditor reports on two detailed reviews that he undertook during 2003/04 :

- Data Protection, Freedom of Information & Information Management Review

- Modernising Government - Project Management Review

Again, these reviews have been the subject of detailed reports to management and action plans, agreed by management, to rectify the weaknesses identified. The first report has also been the subject of separate scrutiny by the Audit and Risk Management Sub Committee and the second report will be submitted to the Sub Committee for scrutiny in due course. The External Auditor has also conducted a follow-up review of two areas that were reviewed in previous years (Computer Services Review and Computer Network Services Review). Again, action will be taken where necessary to address any outstanding recommendations.

## 10 PERFORMANCE MANAGEMENT

- 10.1 The External Auditor has a duty to review and report on aspects of the Council's arrangements to manage its performance and secure economy, efficiency and effectiveness in the use of resources. Previously, this duty included a review of the Council's Performance Management and Planning Framework and the extent to which this contributed to the delivery of continuous improvement. The Local Government in Scotland Act 2003 introduced a statutory duty for Councils to make arrangements to secure Best Value. The Act also introduced new duties in relation to the audit of Best Value and the PMP audit has now effectively been replaced by a new Best Value audit. The new audit regime will operate on a cyclical basis using specialist audit teams, with each Council being subject to an in-depth review every 3 years. In paragraph 4.4 of his report, the External Auditor notes that the Council has been selected for inclusion in the first year of the new audit approach and work is about to get underway for this exercise. A detailed programme of arrangements for the audit was submitted to the Policy & Resources Committee on 10 January 2005. The External Auditor's final report on the outcome of the Best Value audit is expected by the end of June 2005. The External Auditor previously concluded that the Council had made good progress on Best Value in recent years and we can look forward to this new challenge with confidence.
- 10.2 During 2003/04, the External Auditor reviewed two key areas of the Council's arrangements to secure value for money in the use of its resources :
- Internal Audit (paragraphs 4.5 to 4.11)
  - Performance Indicators (paragraphs 4.12 to 4.19)

These reviews have been the subject of detailed reports to management and action plans, agreed by management, to rectify the weaknesses identified. The first report has also been the subject of separate scrutiny by the Audit and Risk Management Sub Committee and the second report will be submitted to the Sub Committee for scrutiny in due course. The following paragraphs provide a brief commentary on the External Auditor's findings in the above two areas.

- 10.3 Under "Internal Audit", a review of the Council's arrangements was undertaken as part of a national follow-up to the previous review in 2001. The Internal Audit service was measured against six critical success factors and it is pleasing to note that our arrangements have been assessed as being within performance band 1 (ie almost fully complying with standards of good practice). This represents an improvement on the 2001 review when our arrangements were assessed as being within performance band 2 (ie generally complying with standards of good practice). Only 53% of Scottish Councils achieved the top performance band in the 2004 review.
- 10.4 Under "Performance Indicators", it is noted that 60 of the Councils 64 statutory performance indicators were classed as "reliable" in 2003/04. The systems for collecting and recording this information are under continual review by the Council and attempts will be made to

rectify identified weaknesses, where possible. The External Auditor also makes reference to the Council's 2003/04 Performance Report and notes that we are performing better than the other main City Councils in a large number of service areas.

## 11 **ACTION PLAN**

The External Auditor has identified two key issues arising from his 2003/04 audit that require action by the Council at a corporate level. These relate to the registration of housing support services with the Care Commission and the modified arrangements for the preparation of Group Accounts. The External Auditor's recommendations are set out in the form of an Action Plan. These matters have been considered carefully by the Depute Chief Executive (Finance) and the completed Action Plan, incorporating the "Management Response", is appended to both this report and to the External Auditor's report. As noted in paragraph 8.3 above, the issue relating to the registration of housing support services has already been successfully addressed. The modified arrangements for the preparation of Group Accounts will be addressed as part of the Council's established year-end accounts preparation procedures.

## 12 **CONCLUSIONS**

During 2003/04, the External Auditor examined a number of areas covering a wide range of the City Council's activities. Whilst some areas for improvement have been identified, it is pleasing to note that the auditor's overall findings and conclusions are satisfactory. In particular, the Council can take encouragement from the following findings :

- financial stewardship was of a satisfactory standard
- the accounts were submitted on time and there was no qualification to the auditor's opinion
- a favourable underspend against budget was achieved
- there was compliance with the revised reporting requirements for pension costs
- 94% of Statutory Performance Indicators were classed as "reliable"
- many aspects of a sound corporate governance framework are in place
- the Internal Audit service was assessed as being within the top performance band

## 13 **CONSULTATION**

The Chief Executive and Depute Chief Executive (Support Services) have been consulted on the content of this report.

## 14 **BACKGROUND PAPERS**

None.

**DAVID K DORWARD**  
**DEPUTE CHIEF EXECUTIVE (FINANCE)**

**7 JANUARY 2005**

## Action plan

Report Section	Issue and Audit Recommendation	Responsible Officer	Agreed	Management Response	Completion Date
Paragraph 2.2	<p><b>Failure to comply with statutory requirement</b></p> <p>The report includes an explanatory paragraph on a 'failure to comply with statutory requirement' concerning expenditure on housing support services which require to be registered by the Care Commission.</p> <p><i>The Council should monitor the progress of the registration of housing support services with the Care Commission.</i></p>	Director of Housing / Director of Social Work	Yes	The Care Commission have recently confirmed that all housing support services have been registered, as required.	31 October 2004
Paragraph 2.47	<p><b>Group Accounts</b></p> <p>The 2004 ACOP introduces modified arrangements for the preparation of group accounts. Councils are encouraged to adopt the new arrangements in 2004-05, but they are mandatory from 2005-06 (with the publication of comparative figures for the previous years). The new arrangements are likely to present a significant challenge to Councils.</p> <p><i>The Council should take early action to ensure compliance with the 2004 Code of Practice on Local Authority Accounting in the United Kingdom in the preparation of group accounts.</i></p>	Depute Chief Executive (Finance)	Yes	The requirements of the 2004 ACOP will be considered as part of the Council's established year-end accounts preparation procedures	28 February 2005