REPORT TO: SCRUTINY COMMITTEE – 11 FEBRUARY 2015

REPORT ON: KPMG EXTERNAL AUDIT STRATEGY REVIEW AND PLAN FOR THE YEAR ENDED 31 MARCH 2015

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 67-2015

1 PURPOSE OF REPORT

To submit to elected members the above report that describes how KPMG will deliver the audit of Dundee City Council for the year ending 31 March 2015. This includes the opinions on the financial statements in accordance with relevant legal and accounting requirements.

2 RECOMMENDATIONS

It is recommended that elected members note the information included in the attached report.

3 FINANCIAL IMPLICATIONS

Provision for the proposed external audit fee has already been made in the Corporate Services department's 2015/16 revenue budget. There are no further direct financial implications arising from this report.

4 MAIN TEXT

4.1 The Accounts Commission for Scotland has appointed KPMG LLP as auditors of Dundee City Council under the Local Government (Scotland) Act 1973. The period of appointment is 2011-12 to 2015-16, inclusive. This strategy review and plan details their responsibilities as external auditors for the year ended 31 March 2015 and specifies the objectives of their audit.

4.2 The report is divided into the following sections:

<u>Executive summary</u>
This section sets out a high level summary of their audit approach and outlines the key risk areas, together with details of the main items they will report on in their findings. The section also summarises the key responsibilities of both the external auditor and management, a detailed list of these responsibilities is included in Appendix 2.

<u>Audit strategy and planning</u>
This section provides contextual information in terms of the Council's current financial position and outlines the key risk areas external audit have identified together with their planned audit approach in response to these specific risks. This section also provides details of the mandatory communications they are required to undertake and sets out their consideration for determining audit materiality levels.

<u>Other audit areas</u>
The section provides details of the other areas their audit will cover including governance and scrutiny arrangements, national fraud initiative and performance management. This section also sets out the arrangements for liaising with the Council's internal audit function in order to minimise any potential duplication of work.

Delivery of the audit
This final section outlines the resources the external auditor will employ to carry out their audit and details of their proposed fee arrangements. An audit timeline and details for their communication arrangements with management is also included. It is noted that whilst the overall timetable is largely unchanged from previous years the timetable should be regarded as indicative and will be subject to refinement through discussions with management during the course of the audit. The section details the key audit outputs and the dates they plan to report to management on each of these areas.

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 CONSULTATION

The Chief Executive and Head of Democratic and Legal Services.

7 BACKGROUND PAPERS

None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES **02 FEBRUARY 2015**

KPMG

cutting through complexity

Dundee City Council

Audit strategy review and plan

Year ending 31 March 2015

27 January 2015

For scrutiny committee consideration on 11 February 2014

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 ("Council") and is made available to Audit Scotland and the 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 audit strategy and planning 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 (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Beneficiary's Publication Scheme or otherwise) 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.

Complaints

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie who is the engagement leader for our services to Dundee City Council, telephone 0131 527 6682 email: hugh.harvie@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

KPMG

Executive summary

Planning for our audit takes into account the broad risk profile of the Council and includes consideration of other areas of assurance such as the shared risk assessment.

Audit background

Our audit is undertaken in accordance with appointment terms made by the Accounts Commission, Audit Scotland's *Code of Audit Practice* and International Standards on Auditing (UK & Ireland).

Our approach to the Council's audit is risk-based, focussing on our understanding of the Council and the wider environment in which it operates, while also reflecting the expectations of the Accounts Commission.

Significant risks and other matters

From our initial risk assessment procedures, we have identified two significant risks for the 2014-15 audit, in relation to:

- the Council's financial position, including revenue, capital, the impact of borrowing and achievement of efficiency savings; and
- the assumed risk of management override of controls as prescribed by the International Standards of Auditing (UK & Ireland).

We will provide an updated list of significant risks in our annual audit report which will be reported to the scrutiny committee in September 2015.

Shared risk assessment

The audit approach is informed through our participation in the annual shared risk assessment process, which is part of a simplified and coherent approach to delivering local government scrutiny. Scrutiny bodies that engage with local government establish a shared assessment of the risks in each council and have developed a range of proportionate approaches in response to the risk assessment. The shared risk assessment process results in each council receiving a local scrutiny plan, previously the assurance and improvement plan.

We have considered the finalised 2014-17 assurance and improvement plan as part of planning this years audit. It concluded that no additional risk based scrutiny was required for the Council. We will take account of the outcome of the 2015-16 risk assessment process, which is due to be finalised in March 2015.

Even where no risk based scrutiny is identified, the SRA process ensures knowledge sharing and identification of audit focus areas.

Best Value

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act.

Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

Reporting

In addition to reporting on matters identified during our audit, as part of our audit appointment, we are also required to consider the Council's arrangements in a number of other areas and report our findings. These include:

- arrangements with respect to the National Fraud Initiative;
- the Council's response to specific national studies;
- review and reporting on various grant claims made by the Council;
- follow-up on the response to specific performance audits; and
- arrangements for reporting statutory performance indicators.

We will summarise our findings in each of these areas in our annual audit report

Introduction and responsibilities

Our audit work is undertaken in accordance with the Code of Audit Practice and guidance issued by Audit Scotland. The Code specifies a number of objectives for our audit.

The Accounts Commission has appointed KPMG LLP as auditor of the Council under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

KPMG's planned audit work in 2014-15 will include:

- an audit of the financial statements and provision of an opinion on whether:
  - they give a true and fair view of the state of affairs of the Council;
  - the accounts have been prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014-15, the requirements of the Local Government (Scotland) act 1973 and the Local Government Scotland Act 2003.
- a review and assessment of the Council's governance arrangements including: a review of the adequacy of internal audit and review of the governance statement;
- a review of National Fraud Initiative arrangements; and
- a review of arrangements for preparing and publishing statutory performance information.

Auditors and audited bodies' responsibilities are set out in Audit Scotland's Code of Audit Practice ("the Code"). This Code states the responsibilities in relation to:

- the financial statements;
- corporate governance and systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- arrangements for preparing and publishing statutory performance information;
- financial position; and
- Best Value, uses of resources and performance.

The responsibilities of the auditor and management are summarised below; appendix two sets out the detailed responsibilities.

Responsibilities of the appointed auditor

We carry out our audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the wider responsibilities embodied in the Code.

We have set out opposite the key elements of our audit work for 2014-15 on the financial statements and corporate governance arrangements. While auditors are not responsible for preventing or detecting fraud or irregularity and do not substitute for audited bodies own responsibilities, we will review and report on these arrangements. We will review and report whether the Council has adequate arrangements in place to maintain and promote proper standards of financial conduct and to prevent and detect bribery and corruption. We will also report on whether management has established adequate arrangements to manage performance, regularity, use of resources and performance information.

Responsibilities of the accountable officer

The audit of the financial statements does not relieve management or the audit and governance committee of their responsibilities. The Council is responsible for financial statements which show a true and fair view of the Council's affairs, and for making available to us all the information and explanations we require for the purposes of our audit.

The Council is responsible for establishing arrangements for ensuring the proper conduct of its affairs and developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. These systems should include arrangements to prevent and detect fraud and other irregularity. Management is responsible for implementing proper arrangements to ensure that their financial position is soundly based.

Financial context

Our initial risk assessment is undertaken through building on our understanding of the Council and its environment.

In order to update our understanding of the financial environment in which the Council operates, we have discussed current financial performance with management and reviewed the 2014-15 revenue and capital budgets.

Audit Scotland's report *An overview of local government in Scotland 2014* highlighted the challenges of reducing budgets and increasing demands on local authorities. This is coupled with further expected budget reductions, the public's expectation of service delivery and demographics becoming more biased towards older people, who typically need more public services. The Council should also meet the requirements of the Single Outcome Agreement.

The Council is therefore operating in a challenging economic and operating environment, including funding reductions and increasing expenditure pressures, Welfare Reform and the requirement to integrate Health and Social Care. In response, management regularly analyse areas of public reform, which should support achievement of strategic priorities in a changing environment.

In setting its annual budgets, senior management considers the financial risks facing the Council and on this basis make recommendations to members on the level of reserves it is appropriate to hold. However, the Council continues to have a low level of useable reserves relative to other Scottish local authorities.

Financial position – revenue

The 2014-15 revenue budget was approved by the policy and resources committee on 13 February 2014. The revenue budget forecast expenditure, in respect of general fund departments of £334 million funded via general grant funding, non-domestic rates income and council tax income, with no budgeted use of reserves.

As part of our planning for this year's audit, we have obtained an understanding of the reported financial position to date. The revenue monitoring report presented to the policy and resources committee on 10 November 2014, for the period to 30 September 2014, forecast a break-even position against the adjusted budget. The adjusted budget has been updated to include £2.3 million use of reserves and increased funding of £1.9 million which was not included in the original revenue budget. This has allowed for a breakeven position to be forecast despite an additional £4.2 million of expenditure across various departments.

Financial position – capital: general services

The approved capital budget for 2014-15 was £39.05 million. This has been revised to £43.6 million.

Actual spend in the six months to 30 September 2014 was behind budget at £12.08 million, representing 28% of the revised capital budget. The capital expenditure monitoring report to the policy and resources committee on 10 November 2014, for the period to 30 September 2014, shows a projected outturn of £43.6 million, which represents a nil variance against the revised budget.

Financial position – capital: housing revenue account

The housing revenue capital budget for 2014-15 is £19.3 million. Actual spend to 30 September 2014, was also behind budget at £5.2 million, representing 28% of the annual budget. The projected outturn as reported to the policy and resources committee on 10 November 2014 of £19.0 million, which represents a projected underspend of £0.3 million. This is mainly due to a decrease in lift replacements and external insulation costs.

We will consider and challenge management's capital monitoring reports; we will provide commentary on the achievement of the capital budget and any impact on the capital limits and associated borrowing during the year, in the annual audit report.

Significant risks

International Standard on Auditing (UK and Ireland) 315 requires us to determine whether any of the risks identified through our risk assessment processes are significant.

We have identified two significant risks in our initial risk assessment for 2014-15. Our risk assessment procedures are ongoing and we provide updates on any emerging risks as they become apparent.

Risk classification
Significant risk
Other focus area

Audit approach

Our audit approach is based on an understanding of the characteristics, responsibilities, principal activities, risks and governance arrangements of the Council. We also consider the key audit risks and challenges in the local government sector generally.

Significant risks

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of risk assessment are significant risks and therefore requiring specific audit consideration. In determining whether a risk is significant, judgement is applied in respect of the whether, for example, the risk is associated with the complexity of transactions, the degree of subjectivity involved in the measurement of financial information, whether the associated transactions are outside the normal course of business, or whether there is an associated risk of fraud.

We include two significant risks below which are pervasive across the financial statements.

Significant risk and implications	Our planned audit approach
Pervasive risk: fraud risk from management override of controls Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.	We have not identified any specific additional risks of management override relating to this audit. Our audit methodology incorporates the risk of management override as a significant risk. This includes testing of journals at the year end and throughout the year, review of unusual transactions in the year, enquiries with employees outside the finance department, tests of unpredictability and controls testing, including higher level controls.
Pervasive risk: Financial position With higher demand for services coupled with budget reductions and public reform, financial position is of key importance to local authorities. In 2013-14 the Council recorded an accounting deficit of £42.2 million in the comprehensive income and expenditure account. The net movement on the useable funds balance was a decrease of £2.9 million, while uncommitted general fund balances remained at £5.0 million. The Council reported an overall underspend against budget for services of £1.1 million. In benchmarking undertaken by Audit Scotland from analysis of the 2013-14 unaudited financial statements of Scotland's 32 local authorities, the Council's uncommitted reserves as a percentage of net revenue spend continues to be the lowest.	We will update our understanding of the Council's financial position and year end outturn position through review of quarterly reports and other management information. We will assess management's progress with implementation of efficiency savings. Commentary and analysis on these areas will be provided within the annual audit report. We will consider management's capital monitoring reports and provide commentary on the achievement of the capital budget and impact on the capital limits and associated borrowing during the year. We will perform controls testing over the budgeting process including the monitoring of budgets throughout the year. We will perform substantive procedures, including substantive analytical procedures, over income and expenditure comparing the final position to budget.

Financial statements – comprehensive income and expenditure statement

In addition to significant risks, we consider audit focus areas. We set this out in relation to the comprehensive income and expenditure statement and the balance sheet.

We have used our experience gained during previous years' audits to refine our understanding of the risks in the financial statements. For those balances not linked to a significant risk or other focus area, we will perform analytical reviews and specific item testing over material balances to consider material errors or disclosure errors.

Caption	2013-14 balance (£'000)
Gross income	(187,901)
Gross expenditure	552,345
Other operating expenditure	1,897
Financing and investment income and expenditure	39,613
Taxation and non-specific grant income	(363,797)
Other comprehensive income and expenditure	29,391

Key risk or other matter and implications	Our planned audit approach
Fraud risk from income recognition Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk.	Part of the Council's income is received from non ring-fenced government grants. As government grants are agreed in advance of the year, with adjustments requiring Government approval, we do not regard the risk of fraud from this revenue recognition as significant. The other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing revenues). These revenues are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as revenue. This minimises the level of judgement required in revenue recognition by management and we do not regard the risk of fraud from this revenue recognition as significant. Sales income is recognised at point of sale, with an invoice raised when the service is delivered, minimising the judgement necessary and we do not regard the risk of fraud from this revenue recognition as significant. The potential for revenue to be incorrectly recognised will be addressed through controls testing and substantive procedures. We will consider each source of income and analyse results against budgets and forecasts, performing substantive analytical procedures and tests of details.

Risk classification
Significant risk
Other focus area

Financial statements – balance sheet

We have used our experience gained during previous years' audits to refine our understanding of the risks in the financial statements. For those balances not linked to a significant risk or other focus area, we will perform analytical reviews and specific item testing over material balances to determine if there are material errors or disclosure errors.

Caption	2013-14 balance (£'000)
Property, plant and equipment	1,363,832
Other long term assets	35,445
Short term debtors	40,835
Cash and cash equivalents	5,366
Other current assets	4,067
Short term borrowing	(62,908)
Short term creditors	(70,915)
Provisions	(4,283)
Long term liabilities	(472,533)
Pension asset/ liability	(409,199)
Useable reserves	(22,640)
Unusable reserves	(407,067)

Key risk or other matter and implications	Our planned audit approach
Property, plant and equipment ("PPE") Under the Code, PPE is required to be held at fair value. In order to comply with the accounting requirement, Council assets are subject to rolling valuations on an asset type basis. Valuation of PPE across the Council's portfolio of assets remains a focus area. In 2014-15, the classes of assets to be revalued include industrial units/shops, off-street car parks, charity assets, investment properties, assets held for sale and surplus assets. It is expected that the 2016-17 Code will adopt requirements of the *Code of practice on transport infrastructure assets* ("the transport code"), which requires measurement of assets (such as roads) on a depreciated replacement cost basis. This represents a change in accounting policy from 1 April 2016 and require full retrospective restatement. Local authorities are advised to develop a project plan to during 2014-15 to help achieve successful implementation.	We will consider the valuations in detail, incorporating the use of KPMG valuation specialists to challenge the valuation assumptions. We will review the accounting treatment of the valuations to ensure appropriate recognition and disclosure in the financial statements. We will consider the Council's plan for the requirements of the transport code, including assessing the robustness of the plan. We will evaluate the extent to which the Council is prepared for the change in accounting policy.
Provisions (landfill sites and holiday pay) Whilst the Council does not operate landfill sites or coal mines, Tayside Contracts Joint Committee operates quarries which carry obligations for rectification. Management should review whether appropriate provisions are held for this required expenditure. Following a European Court of Justice ruling in May 2014, employers are required to pay holiday pay to staff at a rate commensurate with any commission or over time that they regularly earn, instead of at their basic pay level. In common with all impacted employers, the Council is required to consider if there is a contingent liability that requires disclosure as at 31 March 2015.	Under IAS 37 a provision should be recognised when: ▪ an entity has a present obligation as a result of a past event; ▪ it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and ▪ a reliable estimate can be made of the amount of the obligation. We will remain alert to legislative changes and consider the Council's position in relation to the criteria. We will challenge and assess the judgements applied as at the year end and review recognition of any provisions, or disclosures of contingent liabilities.

Risk classification	
Significant risk	
Other focus area	

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Financial statements – balance sheet (continued)

Caption	2013-14 balance (£'000)
Property, plant and equipment	1,363,832
Other long term assets	35,445
Short term debtors	40,836
Cash and cash equivalents	5,366
Other current assets	4,067
Short term borrowing	(62,988)
Short term creditors	(70,915)
Provisions	(4,283)
Long term liabilities	(472,533)
Pension asset/ liability	(409,199)
Useable reserves	(22,640)
Unusable reserves	(407,067)

Key risk or other matter and implications
Retirement benefits The Council accounts for its participation in the Tayside Pension Fund in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants. The Council's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The calculation of the pension liability is inherently judgemental.

Our planned audit approach
Through the deployment of KPMG actuarial specialist and through the testing of the core audit team, we will: - review and challenge the financial assumptions underlying the actuaries' calculations and comparison to our central benchmarks; - test of the level of contributions used by the actuary to those actually paid during the year; and - verify membership data used by the actuary to data from the pension fund. We will agree the disclosures within the financial statements to the report prepared by the Council's actuary.

Risk classification
Significant risk
Other focus area

KPMG

Presentation of financial statements

The Council is required to prepare financial statements in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2014-15* ("the Code").

While there are some changes in the content of the Code for 2014-15, the financial statements and underlying accounting policies are expected to remain substantially consistent with the previous year.

KPMG remains committed to working with management to enhance the clarity and impact of the financial statements, including the implications of the revisions to the Code.

Code of practice on Local Authority Accounting in the United Kingdom 2014-15 ("the Code")	The 2014-15 financial statements will be prepared in accordance with the *Code of practice on local authority accounting in the United Kingdom 2014-15* ("the Code") which is based on International Financial Reporting Standards ("IFRS"). The 2014-15 Code has a number of amendments from the 2013-14 version and management should consider if these changes will impact the financial statements. The amendments include: ■ adoption of the new group accounting standards IFRS 10, IFRS 11, IFRS 12 and IAS 28; ■ amendments in respect of the restated opening balance sheet; and ■ changes to the requirements for accounting for combinations of bodies and transfer of functions. We consider that the adoption of the new group accounting standards may have an impact on the Council's financial statements. Audit Scotland has also provided enhanced guidance in respect of a number of technical topics, which will be considered during the audit.

Changes to Local Authority Accounts (Scotland) Regulations

The Local Authority Accounts (Scotland) Regulations 2014 came into force on 10 October 2014, replacing the 1985 regulations. The new regulations include a number of changes designed to help strengthen corporate governance processes. These amendments include:

- clarification of the composition of the annual accounts, requiring the inclusion of a management commentary, a statement of responsibilities, an annual governance statement and a remuneration report;
- changes to the process for approving the unaudited accounts, including a requirement for the scrutiny committee to consider the unaudited accounts by 31 August;
- changes to the process for approval of the audited annual accounts, with a deadline of 30 September; and
- changes to the requirements for the publication of the audited annual accounts.

Group financial statements

IFRS and the Code require the Council to prepare group financial statements. The Council has a number of subsidiaries and associates to be included in the group financial statements.

ISA (UK and Ireland) 600 *Special considerations- audits of group financial statements* requires the auditor to obtain an understanding of the group, its components, and any related risks.

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

The Code requires the following statements to be prepared, together with appropriate notes:

- movement in reserves - this statement summarises all movements in reserves;
- group comprehensive income and expenditure - this statement summarises the group's income and expenditure for the year;
- group balance sheet - this statement sets out the overall financial position of the group at the year end; and
- group cash flow - the group cash flow statement includes the cash flows of the Council and the Common Good Funds and Trusts. Cash receipts and payments that flow to and from the Council and its subsidiaries only (full group members) must be included. Cash flows to and from the Council to its associates are included within the cash flow statement of the Council.

Subsidiaries

These are entities in which the Council either:

- controls the majority of equity capital or equivalent voting rights;
- appoints the majority of the governing body; or
- exercises (or has the right to exercise) influence (i.e. give direction which must be complied with) over the entity's operating and financial policies.

The Council considers that the following are subsidiaries:

- Dundee Energy Recycling Limited ("DERL");
- Fleming Trust; and
- Common Good Funds.

We will continue to review the Council's assessment of its group boundary and confirm our agreement with the Council's view.

Associates

These are entities in which the Council can exercise a significant influence without support form other participants. The Council has concluded that the following require to be treated as associates:

- Tayside Valuation Joint Board;
- Dundee City Developments Limited; and
- Leisure & Culture Dundee.

We will perform a statutory audit of the Tayside Valuation Joint Board.

Other relationships – Tayside Contracts Joint Committee

Following detailed consideration of the above relationship, in conjunction with the partner local authorities involved in the Joint Committee, the Council accounts for its participation as a jointly controlled entity.

The council will need to consider if this treatment remains appropriate following the changes to the Code. The treatment of this entity by the Council should be consistent with Angus and Perth councils to ensure that the entity is fully consolidated. We will review the Council's assessment of this relationship.

Mandatory communications

Mandatory communications with those charged with governance as required by International Auditing Standards are set out opposite.

These cover:

- **fraud;**
- **related party transactions; and**
- **independence.**

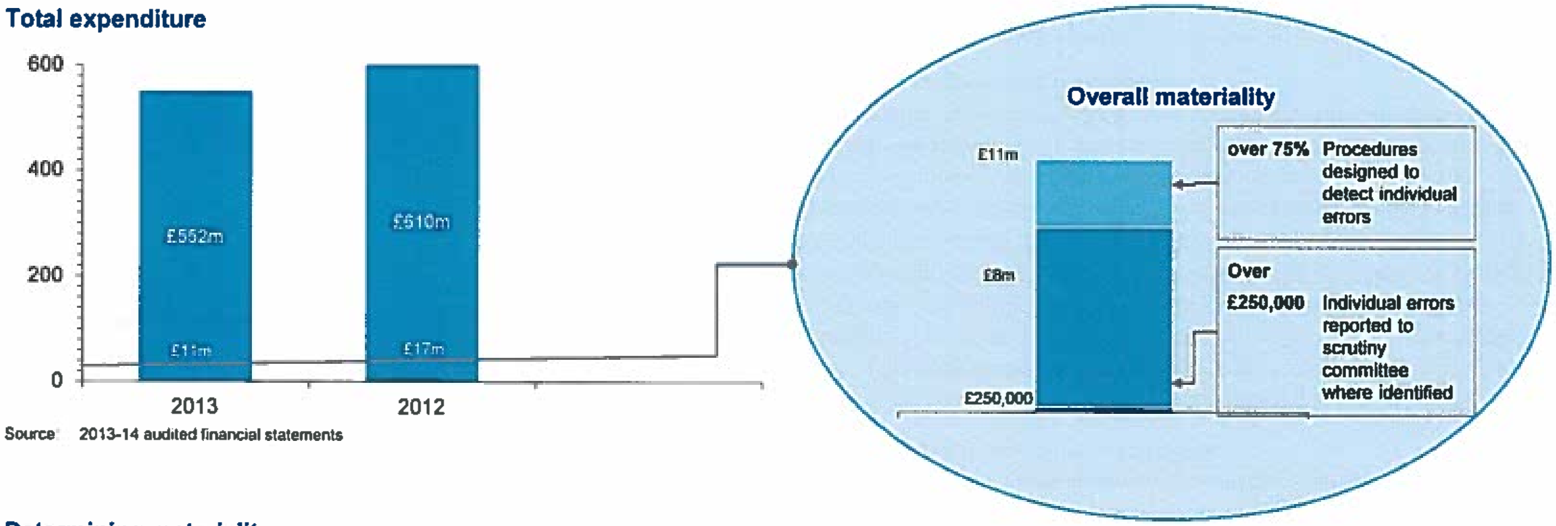
Area	Management responsibility/ action	KPMG response
Fraud risks	▪ It is the responsibility of management to implement accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements caused by fraud or error. ▪ Those charged with governance must ensure, through oversight of management, the integrity of these systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with laws. This is in the context of preparing financial statements that give a true and fair view and that do not contain material misstatements arising from fraudulent reporting (intentional misstatements/ omissions to deceive the financial statement user) or from the misappropriation of assets.	▪ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error. The audit team will review and discuss fraud related risks and controls with internal audit, the chief financial officer and senior management. ▪ Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud.
Related party transactions	▪ Management has processes in place to identify related party transactions and a number were disclosed in the 2013-14 financial statements. All material related party transactions must be disclosed in the financial statements.	▪ We will ensure that there continues to be appropriate processes in place as part of the financial statements preparation process to identify any related party transactions.
Independence	▪ Auditing Standards require us to consider our independence and related matters in our dealings with the Council.	▪ We have provided our formal independence communication in appendix one. In respect of non-audit services provided to the Council we have completed internal conflict checks to confirm that the services may be provided with no threat to our audit independence.

Mandatory communications: audit materiality

Our audit work is planned to detect errors that are material to the financial statements as a whole.

Our materiality is based on total expenditure and takes into account the low risk nature of the Council.

We are required by Auditing Standards to report to the scrutiny committee unadjusted audit differences other than non-trivial items.



Source: 2013-14 audited financial statements

Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

We have reassessed our level of materiality this year based on our knowledge and understanding of the Council's risk profile and, therefore, financial statements. Materiality has been set at £11 million which is approximately 2% of total expenditure in 2013-14. This will be revised once draft financial statements for 2014-15 are received.

We design our procedures to detect errors at a lower level of precision, i.e. £8 million.

In accordance with instructions from Audit Scotland to all appointed auditors, we will report identified errors greater than £250,000 to the scrutiny committee.

Reporting to scrutiny committee

To comply with Auditing Standards, the following three types of audit differences will be reported to the scrutiny committee:

- material adjusted audit differences;
- unadjusted audit differences; and
- disclosure differences (adjusted and unadjusted).

Governance and scrutiny arrangements

We review governance and scrutiny arrangements in light of the shared risk assessment, Best Value, Single Outcome Agreement and the integration of health and social care.

The shared risk assessment process for 2014-15 did not identify any significant areas where the Council was not making progress.

Shared risk assessment

Local area networks ("LANs") are established for each council. These bring together local scrutiny representatives in a systematic way with the common aims of joint scrutiny scheduling and planning, sharing risk assessment and the delivery of a single corporate assessment through the Best Value 2 audit process. As external auditor, we are a key member of the shared risk assessment process for the Council.

The role of the shared risk assessment process is to ensure that relevant data collected from councils and other sources by their organisation is analysed and brought to the LAN for discussion. All LAN members discuss and agree a shared risk assessment ("SRA") and identify a proportionate scrutiny response.

A national scrutiny plan sets out how Scotland's scrutiny agencies coordinate their work and focus on the key issues at each council. This plan is underpinned by a local scrutiny plan, previously an assurance and improvement plan, for individual councils.

The SRA process for 2014-15 identified that there are no areas of 'scrutiny required' identified in the assurance and improvement plan, compared to two in 2013-14.

Best Value and continuous improvement

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act. Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

The timing, nature and extent of these is determined as part of the SRA process. A key component of the SRA will be the extent to which implementation of the existing Best Value improvement plan has had the anticipated impact. As your external auditor, we are responsible for conducting follow-up reviews to assess the Council's progress against its agreed improvement priorities.

The Council put in place a Council plan covering the period 2012 to 2017. This recognises the challenge of year on year budget reductions facing the Council and identifies the following strategic priorities: jobs, social inclusion and quality of life. Annual progress against these objectives and related outcomes from the Single Outcome Agreement is monitored through: the Council's Annual report to the Policy & Resources Committee, quarterly Performance Review reports to the Council's Scrutiny Committee, six monthly update reports for the Strategic Management Team and Policy & Resources Committee, self assessments using the Public Sector Improvement Framework, and community engagement processes.

We will update our understanding of continuing progress and maturing arrangements during our final audit visit.

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Governance and scrutiny arrangements (continued)

Governance statement

The Council is required to prepare and disclose a governance statement to detail the purpose of the framework of internal control, along with an analysis of its effectiveness. It should describe sources of assurance for members and senior officers and identifies areas for improvements to be focussed on in the future. We are required to review the governance statement against disclosure requirements and consider its content against our knowledge and understanding of the Council. We will report on findings in the annual audit report.

Single outcome agreement

The SOA is an agreement between the Dundee Partnership and the Scottish Government, setting out how each party will work to improve outcomes and reduce inequalities for the people of Dundee. The Single Outcome Agreement for 2013-2017, re-affirms the following as the top strategic deliverables for Dundee: jobs and employability, social inequalities, children and young people and physical and mental wellbeing. Successful delivery of the SOA will depend on the degree to which it is supported by effective planning, budgeting and performance management arrangements at service-level, within the Council and across partner agencies.

During the audit cycle, we will update our understanding on the approach the Council and its partners are taking in respect of the SOA. This will include consideration of whether the SOA is supported by robust planning arrangements, governance arrangements and performance management. We will also consider the links between SOA outcomes and more detailed service outcomes, as well as the quality and frequency of reporting progress towards outcomes.

We will include a summary of findings in the annual audit report.

Integration of health and social care

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all councils and NHS Boards to formally and legally establish integration of health and social care by April 2016.

The new Health and Social Care Partnership (HSCP) will be jointly run by the Council and NHS Tayside, replacing the current Community Health Partnership (CHP). The partnership model agreed by the Council and NHS Tayside is the Body Corporate. The Dundee Health & Social Care Integration Joint Shadow Board has been in operation since November 2013. Preparation for the production of the Integration Scheme is being taken forward through two local bodies (the Tayside Integration Joint Issues Group and the Dundee Integration Support Team), and through local consultation. The Council has completed a consultative draft of the Integration Scheme, and this was presented to the policy and resources committee in August.

Auditors are required to consider the Council's progress in the integration of health and social care, and report our findings in the annual audit report. Specifically, we will consider the date that the integrated joint boards will be operational, review short and medium term financial plans and comment on progress towards establishing effective governance arrangements for the new partnerships.

National Fraud Initiative, performance management

The National Fraud Initiative is a data matching exercise used to prevent and detect fraud. We prepared a short return to Audit Scotland in December 2014.

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies on behalf of the Accounts Commission.

We will review the Council's response to these and will report our findings to Audit Scotland.

National Fraud Initiative

The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use. 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.

Management is responsible for investigating data matches from the latest round and we are required by Audit Scotland to review the Council's progress and engagement with the NFI process. We will report management's progress to the scrutiny committee during the year.

Local response to national studies

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies on behalf of the Accounts Commission. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at individual organisation level, as appropriate.

We may be required to make returns to Audit Scotland that performance reports have been considered by the Council and that action has been planned in response.

Targeted follow up of performance audit

Audit Scotland identifies a small number of reports each year as part of its targeted approach to following-up of performance audits. This will involve looking at what action has been taken by the Council and what difference this has made. We will include commentary in the annual audit report and may provide supplementary reports, where necessary.

Statutory performance indicators and benchmarking

The statutory deadline for publication by the Council of statutory performance indicators ("SPIs") is 30 September 2015. The specified indicators have been replaced by the Scottish Local Government Benchmarking Framework, which compares performance across councils using a standard set of indicators. The results of this benchmarking are analysed in 'family groups' to ensure comparison is between authorities with similar characteristics.

Auditors must assess the adequacy of arrangements for collecting and publishing information in relation to SPIs. We will complete a pro-forma schedule to reflect the audit work on SPIs for submission to Audit Scotland, and the annual audit report for 2014-15 will include a summary of this appraisal, the duties and responsibilities of the Council and us as auditor and any recommendations for improvement.

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Internal audit

We will liaise with your internal auditors to minimise duplication of effort.

Internal audit arrangements

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

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

We will continue liaison with the head of internal audit and maintain an understanding of their approach to ensure duplication of effort is minimised. We will review the internal audit work proposed or completed during our interim audit visit to determine the extent of assurance that can be taken from the work performed.

The general programme of work will be reviewed for significant issues to support our general work in assessing the Council's annual governance statement.

We will read the reports and consider the results of all internal audit work, and consider areas where we can place reliance in order to avoid duplication of effort.

KPMG team, reporting and fee arrangements

The team benefits from strong local authority experience

Team member
Hugh Harvie; *Partner* Hugh has overall authority and responsibility for the audit engagements, including reporting on the financial statements, and will review key conclusions reached by the engagement team on significant risk areas.
Andy Shaw; *Director* Andy will oversee the delivery of the audits and review the conclusions reached by the engagement team on core accounting and auditing matters.
Michael Wilkie; *Senior Manager* Michael serves as the day-to-day audit liaison between management and KPMG and a first point of contact. He also provides technical accounting, regulatory and other advice in the first instance.
Natalie Dyce; *Audit In-Charge* Natalie continues to coordinate the onsite audit fieldwork, liaising directly with the key finance staff in respect of the preparation for, and conduct of the financial statements audit work.

Fee arrangements

Audit Scotland requires that the fee for our work is set within an indicative range, depending on the assessment of risk and other factors facing the Council. The indicative fee range is calculated using a number of inputs:

- a central estimate of the number of days need to do the audit;
- the average remuneration rate for the audit team;
- the contribution to travel and expenses within the sector;
- the contribution towards performance audits, where relevant; and
- the contribution towards other central costs not met by the Scottish Consolidated Fund.

The indicative fee ranges are based on the following assumptions to ensure an efficient audit process:

- draft report, financial statements and full electronic files of supporting work papers available at the start date of our on site visit agreed with officers preferably in electronic format;
- reliance on your internal controls;
- availability of key members of staff during the audit fieldwork; and
- completion within the agreed timetable.

Audit Scotland has notified us that the fee range for 2014-15 is £347,460 to £424,670, with a mid-point of £386,065 (including VAT). This represents a 1% increase from 2013-14. We have proposed a fee of £386,065.

Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arising, we will discuss with management the impact of this on our proposed fee.

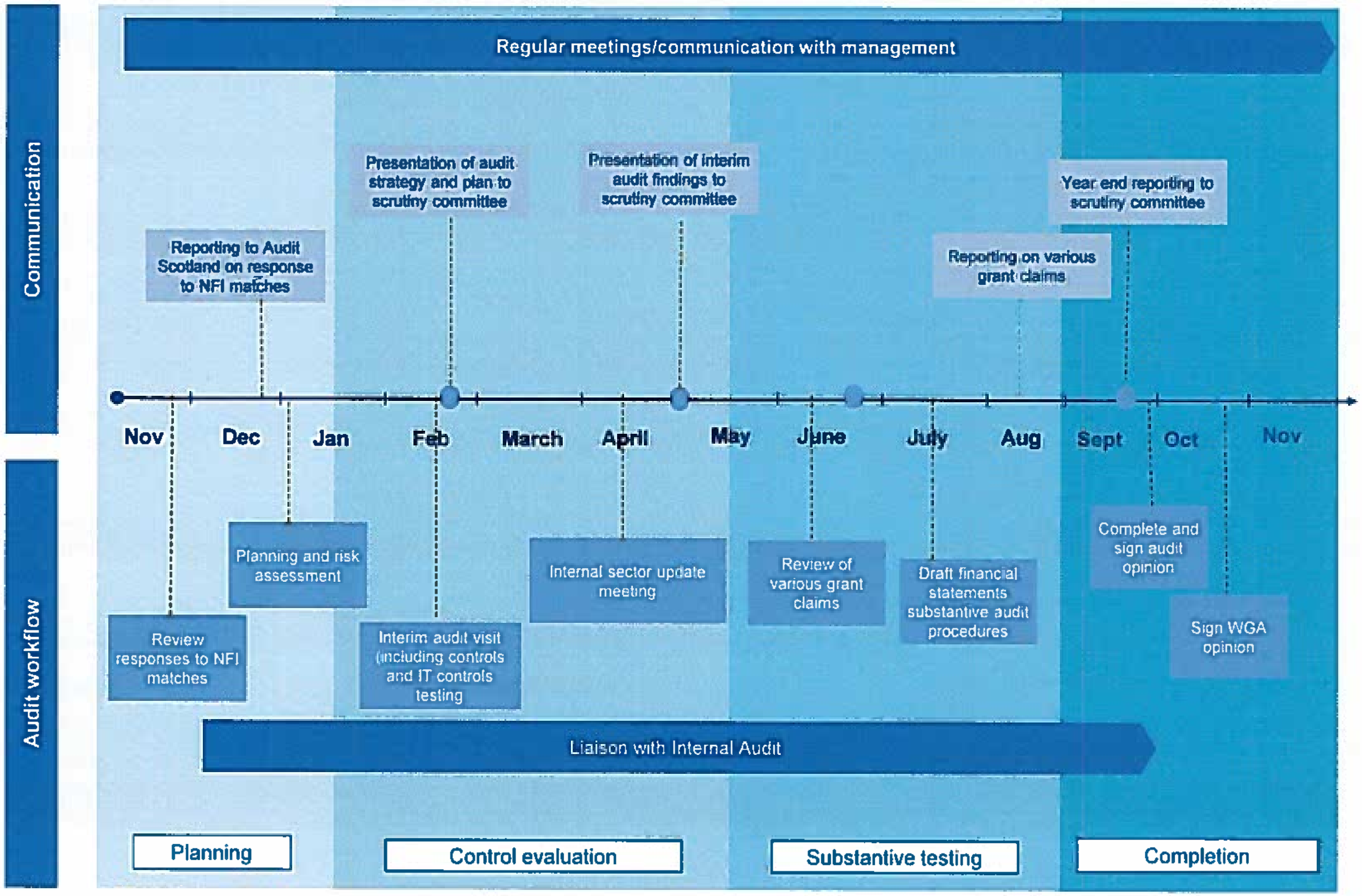
As in 2013-14, an element of this fee will be allocated for our work on the audit of the financial statements of the Council's Pension Fund and we will agree this with officers for the purposes of the re-charge to, and disclosure in, the Pension Fund's financial statements.

Charities

As in the prior year, we will audit Dundee City Council Charitable Trusts and Lord Provost of Dundee Charity Fund, charities administered by the Council. The fees for these audits are included within the Council audit fee.

Audit timeline and communications

Out timetable is largely unchanged from the prior year but will be subject to refinement through discussions with management.



Audit outputs

Our audit process will result in reporting on a number of outputs to the Council; these are listed in the table on the right.

Output	Description	Report date
Update NFI report	We report on the Council's actions to investigate and follow-up NFI matches.	By 31 December 2014
Audit strategy	Our strategy for the external audit for the year.	By 11 February 2015
Interim management report	We report our findings from our interim audit visit where we will update our planning for the year end and perform controls testing.	By 31 May 2015
Statutory performance indicators	We will report on arrangements for preparation of the Council's statutory performance indicators; this will be included in our annual audit report.	By 30 September 2015
Independent auditor's report	Our opinion on the Council's financial statements.	By 30 September 2015
Annual audit report to the Council and the Controller of Audit	We summarise our findings from our work during the year.	By 30 September 2015
Whole of Government Accounts	We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts.	By 31 October 2015
Audit reports on grant claims and other returns	We will report on the following returns: - Housing Benefit Count return; - Non Domestics Rate return; - Education Maintenance Allowance return; and - Criminal Justice Social Work Services return.	In line with Audit Scotland's reporting timetable

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Appendices

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Appendix one

Independence

Auditing Standards require us to communicate to the scrutiny committee in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent.

Professional ethical standards require us to communicate to you as part of planning all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Audit Partner and the audit team. This letter is intended to comply with this requirement although we will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

We are satisfied that our general procedures support our independence and objectivity, except for those detailed below where additional safeguards are in place.

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 Audit 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 APB Ethical Standards. 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.

Confirmation of audit independence

We confirm that as of 20 January 2014, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

This letter is intended solely for the information of the scrutiny committee and should not be used for any other purposes.

Yours faithfully

KPMG LLP

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

Responsibilities of auditors	Responsibilities of management
Financial statements	
Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on: ■ whether they give a true and fair view of the financial position of audited bodies and their expenditure and income; and ■ whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements. Auditors should review and report on, as appropriate, other information published with the financial statements, including the management commentary, annual governance statement, statement on internal control or statement on internal financial control and the remuneration report. Where required, auditors should also review and report on the Whole of Government Accounts return.	Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for: ■ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority; ■ maintaining proper accounting records; ■ preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice); ■ preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and ■ preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.
Corporate governance arrangements	
Consistent with the wider scope of public audit, the Code gives auditors a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to: ■ bodies' reviews of corporate governance and systems of internal control, including their reporting arrangements ■ the prevention and detection of fraud and irregularity	Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

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Appendix two

Audit Scotland code of audit practice – responsibilities of auditors and management (continued)

Responsibilities of auditors	Responsibilities of management
Corporate governance arrangements (continued)	
▪ standards of conduct and arrangements for the prevention and detection of corruption; and ▪ the financial position of audited bodies.	
Systems of internal control	
Auditors are required to review and report on the compliance statements given by bodies under the relevant code or framework before their publication. This is discharged by reviewing and, where appropriate, examining evidence relevant to audited bodies' arrangements in accordance with any guidance issued by Audit Scotland. Auditors are not required to consider whether the statements cover all risks and controls, or form an opinion on the effectiveness of procedures, but report where compliance statements are not consistent with their knowledge of the body.	Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.
Prevention and detection of fraud and irregularities	
Auditors should review and report on these arrangements. While auditors do not substitute for audited bodies own responsibilities, and are not responsible for preventing or detecting fraud or irregularity, they should be alert to the potential for breaches of procedures, and of fraud and irregularity. Auditors examine evidence that is relevant to these arrangements, particularly aspects of internal financial control such as segregation of duties, authorisation and approval processes and reconciliation procedures.	Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes: ▪ developing, promoting and monitoring compliance with standing orders and financial instructions; ▪ developing and implementing strategies to prevent and detect fraud and other irregularity; ▪ receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and ▪ participating, when required, in data matching exercises carried out by Audit Scotland.

Audit Scotland code of audit practice – responsibilities of auditors and management (continued)

Responsibilities of auditors	Responsibilities of management
Standards of conduct and arrangements for the prevention and detection of bribery and corruption	
Auditors should consider whether bodies have adequate arrangements in place to maintain and promote proper standards of financial conduct and to prevent and detect bribery and corruption. Auditors review and, where appropriate, examine evidence that is relevant to these arrangements and reporting their findings. While auditors are not responsible for preventing or detecting failure to maintain an appropriate level of integrity and openness, they should be alert to the potential for corruption and breaches of standards of conduct in all aspects of their work. If weaknesses in arrangements are identified or notified, auditors should report them promptly to management or those charged with governance.	Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for: ▪ implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers; ▪ promoting appropriate values and standards; and ▪ developing, promoting and monitoring compliance with standing orders and financial instructions.
Financial position	
Auditors should consider whether audited bodies have established adequate arrangements to ensure that their financial position is soundly based, where appropriate, examining evidence that is relevant to the arrangements. Auditors should have regard to audited bodies': ▪ financial performance in the period under audit ▪ compliance with any statutory financial requirements and financial targets ▪ ability to meet known or contingent statutory and other financial obligations ▪ responses to developments which may have an impact on their financial position; and ▪ financial plans for future periods.	Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: ▪ such financial monitoring and reporting arrangements as may be specified; ▪ compliance with any statutory financial requirements and achievement of financial targets; ▪ balances and reserves, including strategies about levels and future use; and ▪ the impact of planned future policies and foreseeable developments on their financial position.

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Appendix two

Audit Scotland code of audit practice – responsibilities of auditors and management (continued)

Responsibilities of auditors	Responsibilities of management
Best Value, use of resources and performance	
The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission. Auditors should undertake appropriate work to satisfy themselves that bodies have put in place adequate arrangements for the collection, recording and publication of statutory performance information by reviewing and examining evidence that is relevant to these arrangements in accordance with any guidance issued by Audit Scotland.	Local authorities have a statutory duty to make arrangements to secure Best Value; defined as the continuous improvement in the performance of functions. In securing Best Value, local authorities must maintain a balance of quality and cost considerations and have regard, among other things, to economy, efficiency and effectiveness (or 'value for money') and the need to meet equal opportunity requirements and contribute to the achievement of sustainable development. Local authorities also have a duty for community planning, which is to initiate, maintain and facilitate consultation among and with public bodies, community bodies and others about the provision of services in the area of the local authority and the planning of that provision. Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily. The Local Government Act 1992 requires the Accounts Commission to specify information which local authorities must publish about their performance.

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