ITEM No …11………..

REPORT TO: **SCRUTINY COMMITTEE – 26 JUNE 2019**

REPORT ON: **AUDIT SCOTLAND MANAGEMENT REPORT – INTERIM AUDIT 2018/19**

REPORT BY: **EXECUTIVE DIRECTOR OF CORPORATE SERVICES**

REPORT NO: **248-2019**

1   PURPOSE OF REPORT

To submit to Members of the Scrutiny Committee the Management Report – Interim Audit 2018/19, prepared by the Council's External Auditor, Audit Scotland.

2   RECOMMENDATIONS

Members of the Committee are asked to note Audit Scotland's report and to approve the management response to Audit Scotland's key findings.

3   FINANCIAL IMPLICATIONS

There are no direct financial implications arising from this report. Any costs associated with implementing the management response will be contained within existing budgets.

4   MAIN TEXT

4.1   The report summarises the findings from Audit Scotland's interim audit of the Council for the financial year 2018/19. These findings have been discussed with management and an action plan is included at Exhibit 1, starting on page 3 of the report. The implementation of the agreed management actions will be monitored by both the Council and by Audit Scotland, with progress being reported to elected members in due course.

4.2   The External Auditor will prepare a final report to members for 2018/19, following the audit of the financial statements. This report will be considered at the Scrutiny Committee meeting on 25 September 2019.

5   POLICY IMPLICATIONS

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

6   CONSULTATIONS

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

7   BACKGROUND PAPERS

None.

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EXECUTIVE DIRECTOR OF CORPORATE SERVICES   **17 JUNE 2019**

Dundee City Council

Management report 2018/19

AUDIT SCOTLAND

Audit findings

Introduction

1. This report contains a summary of the key issues identified during the interim audit work carried out at Dundee City Council (the council). This work included testing of key controls within financial systems to gain assurance over the processes and systems used in preparing the annual accounts. We will consider the results of this testing when determining our approach to the audit of the 2018/19 annual accounts.

2. Our responsibilities under the *Code of Audit Practice* require us to assess the system of internal control put in place by management. We seek to gain assurance that the audited body:

- has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements

- has systems of internal control which provide an adequate means of preventing and detecting error, fraud or corruption

- complies with established policies, procedures, laws and regulations.

3. We also carried out work on the wider audit dimensions as required by the *Code of Audit Practice*. This focussed on financial management, financial sustainability, governance and transparency and value for money.

Conclusion

4. No significant key control weaknesses were identified from our interim audit work, although we did identify some areas where there is scope for improvement as set out in Exhibit 1. In general, appropriate and effective arrangements were in place for general ledger, budgetary control, purchase ledger, sales ledger, payroll, non-domestic rates, council tax, housing rents, housing benefits and banking. Our findings enable us to take assurance for our audit of the 2018/19 annual accounts, subject to additional testing on journals (see paragraphs 14-16).

Work summary

5. Our 2018/19 testing covered key controls in a number of areas including bank reconciliations, payroll validation and exception reporting, authorisation of journals, change of supplier bank details and IT access controls. Additionally, we tested controls in the following areas: budget monitoring and control; feeder system reconciliations and controls for preventing and detecting fraud in areas such as taxation receipts, welfare benefits, grants and other claims.

Bank reconciliations   **Payroll controls**   **IT access**   **Budgets**

6. In accordance with *ISA 330: the auditor's response to assessed risk*, our audit judgements are based on current year testing of controls and where appropriate prior year results. Our risk-based audit approach allows us to take a three-year cyclical approach to controls testing. This approach enables us to place reliance on previous years' audit work where controls remain unchanged and no significant weaknesses had been identified. Also, where possible we place reliance on the work of internal audit to avoid duplication of effort.

7. The contents of this report have been discussed with relevant officers to confirm factual accuracy. The co-operation and assistance we received during the course of our audit is gratefully acknowledged.

Risks identified

8. The key control and wider dimension risks identified during the interim audit are detailed in Exhibit 1. These findings will inform our approach to the financial statements audit, where relevant.

9. Any weaknesses identified represent those that have come to our attention during the course of normal audit work and therefore are not necessarily all the weaknesses that may exist. It is the responsibility of management to decide on the extent of the internal control system appropriate to the council.

Exhibit 1
Key findings and action plan 2018/19

Issue identified	Management response	Responsible officer and target date
Audit findings		
1. Accounts payable - sundry creditors The accounts payable team maintain a sundry creditors system, whereby payments can be made for invoices received for a supplier that is not set up in the system. This system is designed for one off payments (e.g. severance packages, pension fund payments), however a significant number of invoices are paid through this system (approximately 4,000 invoices with a value of £4.8 million that were not pension related up to February 2019). Therefore, invoices are being paid without having to go through the process of setting up a supplier on the system. These invoices do require to be authorised within the service (confirmed through audit work), however there is no due diligence on the supplier's details (e.g. bank account details). **This increases the risk that payments could be fraudulently diverted.**	Work has been ongoing to replace the Sundry Payments system with integrated Civica Payment Request module which will mean all payment requests will be routed to central payments team for approval. In the interim a review of access to sundry payments is being undertaken and only essential users, eg Pensions will have access remaining. Any other requests for payment will require to be forwarded to the central payments team for approval and processing in appropriate manner.	Corporate Procurement Manager 30th June 2019

Issue identified	Management response	Responsible officer and target date
2. Accounts payables – change of suppliers' bank details When a supplier requests a change to their bank details, the accounts payable team are required to phone the supplier and sign and date the request, to confirm the change is authentic. From a sample of 32 bank details changes during 2018/19, there were 3 cases where there was no supporting documentation for the change and 2 others where there was no evidence of the authenticity check on the notification from the supplier. Daily exceptions reports are produced which highlight changes in suppliers standing data, however the absence of evidence to support these changes were not identified through officers' reviews of the exception reports. **There is a risk that supplier's bank details could be changed erroneously.**	Documentation for all changes is recorded against the creditor notes in Civica, and BACS changes currently held in email format will also be added. Daily verification against this will continue to be undertaken by Corporate Procurement Manager ensuring full scrutiny of each change.	Corporate Procurement Manager 31st May 2019

Wider audit dimensions

Issue identified	Management response	Responsible officer and target date
3. Long term financial planning The Accounts Commission's March 2019 *Local government in Scotland: Performance and challenges* report encourages all councils to continue to develop and refine their medium and long-term planning and the use of scenario planning to support both. The council introduced a medium-term financial plan (covering three years) in 2017/18, however there is scope to further improve financial planning by developing long-term financial plans (typically 5 to 10 years), aligned to the Council's priorities, to demonstrate how the council will address future budget challenges. **Without a longer-term strategy future funding gaps may not be addressed timeously, and the council's objectives may not be achieved.**	10-year revenue budget projections and an updated financial strategy will be presented to the Policy & Resources Committee on 19th August 2019.	Executive Director of Corporate Services 19th August 2019
4. Service planning The *City Plan 2017-2026* sets out the Dundee Partnership's shared vision for the city. The plan sets out one, three and ten year targets on a range of	Service Plans are currently being developed as appropriate.	Executive Directors of Service 31st December 2019

Issue identified	Management response	Responsible officer and target date
outcome measures across the partnership's priority themes. The *Council Plan 2017-22* sets out the part the council will play in achieving the city's vision as well as the council's own priorities. This plan details the Council's priority outcomes supported by key measures and targets. Sevice plans were not in place in 2018/19 but the council is currently developing its service planning arrangements to link to the performance management framework approved in August 2018. This includes the development of digital dashboards to ensure that the council is clear on the extent to which the council plan objectives are embedded within services. **There is a risk that the focus of services may not be working directly towards achieving the council-wide objectives.**		
5. Workforce planning The Accounts Commission's March 2019 *Local government in Scotland: Performance and challenges* report highlighted that workforce reductions have changed how councils are structured and the skills available, but the quality of workforce planning is inconsistent. The Commission believes that integrated workforce planning is essential for robust medium and long-term planning and effective transformation. The council's *Our People Strategy* and annual updates demonstrates the council's commitment to workforce planning, however, the council currently does not have an overarching plan which includes an analysis of what workforce requirements the council will need in the future, where the gaps lie and how to address them. **There is a risk that the council will not be able to ensure that it has the right capacity, skills and leadership in its workforce.**	The Council has made significant steps in developing our strategic approach to workforce planning. A revised Our People Strategy which will include the Council's approach to strategic workforce planning will be completed by September 2019.	Head of Human Resources and Business Support 30th September 2019
6. Performance management Our 2017/18 Annual Audit Report highlighted that a new performance management framework was approved	The first in-year six month progress report (April to September 2019) is scheduled to be submitted to Committee in November 2019.	Head of Chief Executive's Services

Issue identified	Management response	Responsible officer and target date
in August 2018 and is in the process of being embedded within the council. Work is continuing in this area including populating the performance management system (Pentana) and reporting of performance to members (current expectations is that this will be 6 monthly). Currently, no regular reporting of in-year performance is reported to committee. Without more regular, up-to-date information then members will not have a clear picture of council's performance against corporate objectives, or a complete and balanced picture of performance. **There is a risk that the members cannot effectively scrutinise and take informed decisions on the allocation of resources and the prioritisation of improvement actions in services.**		30th November 2019

Source: Audit Scotland

10. Our work on the general ledger system highlighted that additions and changes to the ledger coding is restricted to the systems team, thereby providing segregation of duties in the maintenance of the ledger. However, there is no formal audit trail required for the requesting and approval of these changes. No change to the current process is proposed by management.

11. Management accept that the risk of error in changes to the ledger remains but are of the view that given the experience of the systems team, errors are likely to happen very infrequently. Management noted that it is highly unlikely that any error could lead to a material distortion of the ledger and that any error would be highlighted by the individual that requested the change.

Other audit work

Substantive verification testing

12. To obtain sufficient assurance for the 2018/19 financial statements audit over the occurrence, completeness, accuracy, recognition and classification of income and expenditure, we supplement our testing of controls with substantive verification of a sample of income and expenditure transactions.

13. To enable us to focus this testing on higher risk items, we have been provided with a download of all income and expenditure transactions posted to the ledger. We are currently working with our in-house data analytics team to further analyse this data and select a sample for testing. This will be completed as part of the financial statements audit.

14. In our 2017/18 management letter we highlighted that only journals making inter-departmental postings required to be independently authorised by a second staff member. For all other journal types, accountants were able to create, input and authorise their own journals. This position remained until January 2019 when

processes were implemented requiring all journals to be authorised. We have confirmed that the control is operating effectively since January 2019.

15. Our testing also highlighted 11 inter-departmental journals which did not comply with the requirement to be independently authorised and were input and authorised by the same individuals in the period up to January 2019.

16. As a result of the system weaknesses identified prior to January 2019, we will undertake focussed substantive testing of journal entries for the first 9 months of 2018/19.

Best value

17. The work planned in the council this year focusses on the arrangements for demonstrating effective vision & leadership and governance & accountability. The work in this area has commenced and initial findings will be incorporated into the 2018/19 Annual Audit Report.

18. We reported on Performance Management in 2017/18 and have carried out follow up work on progress in this area. The findings from this work are reported at item 6 in exhibit 1. Findings from further audit work planned in this area, including performance reported through the most recent Local Government Benchmarking Framework performance data (covering all 32 local authorities in Scotland) will be reported in our 2018/19 Annual Audit Report.

Local Area Network

19. The Accounts Commission chairs the Strategic Scrutiny Group which is made up of scrutiny bodies from across the public sector to make their work on local government more co-ordinated, better targeted and more proportionate to identified risks.

20. The arrangements for coordinating scrutiny at a local level include a Local Area Network (LAN) for each council. LANs are led by each council's appointed auditor. LANs bring together relevant scrutiny bodies, typically Audit Scotland, Care Inspectorate, Education Scotland and the Scottish Housing Regulator (SHR), to share information and intelligence on an ongoing basis.

21. The LAN discussions have highlighted a few areas in relation to performance including:

- the council is making the slowest progress in Scotland in improving attainment at secondary schools. Education Scotland highlighted that the council will need to move from incremental to transformational change to improve attainment

- the SHR is engaging with the council about its services for people who are homeless and the council's approach to gas safety, both of which have been highlighted by the SHR as poor performance areas in comparison to other councils.

22. We will monitor progress in these areas as part of the LAN arrangements.

Assessing public bodies' response to EU withdrawal

23. There remains significant uncertainty surrounding the terms of the UK's withdrawal from the European Union (EU). EU withdrawal will inevitably have implications for devolved government in Scotland and for audited bodies. In October 2018, Audit Scotland published a paper that presented Audit Scotland's view of the key issues that withdrawal from the EU presents to Scottish public bodies. The paper emphasised the importance of public sector bodies working to understand, assess and prepare for the impact on their business in three broad areas:

- Workforce – the extent to which potential changes to migration are likely to affect the availability of the people and skills needed to deliver services

- Funding – the extent to which potential changes to existing EU funding programmes are likely to affect the finances of public bodies and the activity that such funding supports

- Regulation – the extent to which potential changes to EU regulations are likely to affect the activities of some public bodies.

24. Audit Scotland produced guidance to support auditors in making judgements on preparedness for EU withdrawal as part of the 2018/19 audit work and this guidance has been shared with the council. This guidance sets out 14 criteria which illustrate what a public body that is under prepared, partly prepared or well prepared might look like and highlights that public bodies' preparation for EU withdrawal should be proportionate to the level of risk.

25. An assessment against this guidance has been undertaken with the council being well or partly prepared against all criteria (six well prepared and eight partly prepared).

26. The eight criteria where the council is considered to be partly prepared represent areas where:

- the risks are not considered significant by the council (e.g. impact on its long-term workforce planning)

- work is ongoing both at a national level (e.g. COSLA) or with the third sector and private organisations that provide services in partnership with the council (e.g. rules & regulations considerations; establishing the impact on other organisations).

27. Our overall conclusion is that the council has taken reasonable action in relation to the risks associated with EU withdrawal and should continue to liaise at a national level and with the third sector and private organisations that provide services in partnership with the council.

National Fraud Initiative (NFI)

28. The National Fraud Initiative (NFI) in Scotland brings together data from local government, health boards and other public sector bodies. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud. If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.

29. In our 2017/18 Annual Audit Report we concluded that the council has satisfactory arrangements in place for investigating and reporting data matches identified in the 2016/17 NFI. In 2018/19 we are reviewing the arrangements in place for the biennial matching exercise started during the year. The work in this area has commenced and initial findings will be incorporated into our 2018/19 Annual Audit Report.

Grant claim certification work

Education maintenance allowances claim

30. We have arranged to complete the sample testing for the 2018/19 education maintenance allowances claim in June 2019. The results of this testing will help inform our opinion on whether the claim is fairly stated and in accordance with the EMA guidance and processes issued by the Scottish Government which we are required to provide by the certification deadline of 31 July 2019.

Housing benefit subsidy claim testing

31. Each year, the Council makes a claim to the Department for Work and Pensions for subsidy in respect of housing benefit paid out by the Council (£59 million in 2018/19). As the Council's external auditors, we are required to certify that the claim is fairly stated and in accordance with specified terms and conditions.

32. As part of our work in support of our certification of the 2018/19 housing benefit subsidy claim, we undertake detailed testing on a sample of cases to confirm that benefit has been awarded in accordance with regulations, and that the correct level of subsidy has been claimed.

33. We have met with the Benefits and Revenues Adviser to select our sample of cases and testing is now underway. The results of this testing will help inform our opinion on whether the subsidy claim is fairly stated and in accordance with specified terms and conditions which we are required to provide by the certification deadline of 29 November 2019.

Audit queries

34. We continue to respond to client queries on an ongoing basis including giving an early opinion on the council's proposed treatment of transactions within the financial statements. Discussions ongoing this year have included:

- the proposed accounting treatment in 2018/19 of the waste management project and inclusion of an asset and liability in the council's financial statements for the service concession asset

- proposals in relation to the council's group accounts with the winding up of Dundee City Developments Limited and the proposals re the accounts and audit of Tay City Region Joint Committee

- changes in the Code and the impact on the accounts including: proposals for internal recharges disclosures; proposals for IFRS 9 financial instrument disclosures; proposals for IFRS 15 revenue from contracts with customers disclosures; and the preparation being undertaken for IFRS 16 leases

- the proposed accounting treatment in 2019/20 for the sale and lease back of Dundee House.

Publications

35. All our outputs and any matters of public interest will be published on our website: www.audit-scotland.gov.uk.

Dundee City Council
Management report 2018/19

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