

# **Dundee City Council**

## **Report on the 2003-04 Audit**

**6 December 2004**

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## Executive summary

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### Introduction

This report summarises my main responsibilities as auditor, the scope of the work undertaken and the issues arising from the audit of Dundee City Council for the year to 31 March 2004. My responsibilities and duties derive from the Local Government (Scotland) Act 1973 and are summarised in the Code of Audit Practice, which sets out my objectives as being to assess:

- ❑ whether the statement of accounts presents fairly the Council's financial position;
- ❑ the adequacy of the main financial systems and the arrangements in place for the prevention and detection of fraud and corruption;
- ❑ the performance of particular services and the effectiveness of overall management arrangements.

### Audit findings and conclusions

The Council submitted the accounts for audit within the prescribed deadline. My overall conclusion is that the financial stewardship of Dundee City Council in 2003-04 was of a satisfactory standard, in particular there were no qualifications to my opinion in my auditor's report and I have concluded that the financial statements '*present fairly*', the Council's financial position.

My audit report does, however, draw attention to a failure to comply with a statutory requirement. The Council made payments of £6.1 million between 1 October 2003 to 31 March 2004 on housing support services. Under the Regulation of Care (Scotland) Act 2001, all service providers were required to apply to be registered by the Care Commission by 1 October 2003. All Scottish councils and other service providers were unable to meet this deadline due to circumstances outwith their control.

The Council achieved its overall financial target for General Fund revenue expenditure with a favourable underspend against budget, which increased the General Fund balance from £6.4 million brought forward at 1 April 2003, to £8.6 million carried forward to 2003-04, of which approximately £4.3 million was uncommitted as at 31 March 2004.

I am pleased to report that the Council has complied with the reporting requirements for pension costs and I note that the net pension liability attributable to the Council from the Pension Fund has been calculated at £75.3 million as at 31 March 2004 representing a significant decrease in the pension liabilities of the Council from the previous year.

Except for three performance indicators classed as '*unreliable*' and one indicator classed as '*failed to report*', the other sixty statutory Performance Indicators provided by the Council have been assessed as '*reliable*' for the 2003-04 financial year.

DERL was financially restructured during 2003-04 and at 31 March 2004, the Council's investment totalled £5.3 million in the form of deferred shares. In addition, the Council acquired the plant and leased it back to DERL at a commercial rate. In 2004-05, the Council has provided a £2.3 million interest bearing loan facility, for working capital over the period of time whilst plant improvements are effected. Members should continue to monitor DERL's financial and operational performance.

The Council has many aspects of a sound corporate governance framework in place. Internal audit has been assessed as being within performance band 1 – almost fully complying with the Code of Practice for Internal Audit in Local Government.

I would like to record my thanks to those officers and members of the Council with whom my staff and I have had contact during the audit for their courteous and helpful co-operation.



Peter Tait, Chief Auditor



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## Introduction

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- 1.1 I was appointed as the external auditor for Dundee City Council from 1 April 2001. This Report to Members on the 2003-04 Audit will be my last report to Members in the current round of appointments and the Accounts Commission will appoint my successor for the 2004-05 audit.
- 1.2 I would like to introduce this report by summarising my main responsibilities and duties and the way in which I approach the conduct of the audit. My responsibilities and duties derive from the Local Government (Scotland) Act 1973 and are summarised in Audit Scotland's Code of Audit Practice and Statement of Responsibilities, which sets out the auditor's objectives as being to review and report on:
- ❑ the Council's financial statements;
  - ❑ the Council's corporate governance arrangements as they relate to:
    - the system of internal control,
    - the prevention and detection of fraud and irregularity,
    - standards of conduct and the prevention and detection of corruption,
    - the Council's financial position; and
  - ❑ aspects of the Council's arrangements to manage its performance and secure economy, efficiency and effectiveness in the use of resources, including compliance with requirements in relation to Best Value and the publication of specified performance information.
- 1.3 The Local Government Scotland Act 2003 introduced new statutory requirements for Scottish local authorities, including duties relating to Best Value and Community Planning. The Accounts Commission holds councils to account in relation to these duties and Audit Scotland conducts the audit of Best Value on the Commission's behalf.
- 1.4 The audit of Best Value is conducted by a centrally directed specialist team with full support from the external auditor. This ensures consistency and the inclusion of local knowledge and experience. A full audit of best value and community planning is expected in 2006.
- 1.5 I have, therefore, significantly wider responsibilities than would be expected of external auditors in the private sector. This report on the 2003-04 audit is a summary of audit activity for the year, and reflects those wider responsibilities.
- 1.6 This report requires to be considered in the context of the stewardship responsibilities of the management of the Council. As the Audit Scotland Code of Audit Practice makes clear:
- "The prime responsibility for ensuring both that public business is conducted in accordance with the law and proper standards and that public money is handled with absolute integrity and spent appropriately rests with the elected members and officials. To discharge this accountability, public bodies and those responsible for the conduct of their affairs require to establish and maintain proper arrangements for the governance of their affairs and the stewardship of resources at their disposal."*
- 1.7 The key issues arising from the audit, which require action by the Council, are set out in the Action Plan included as an appendix to this report.

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## Financial statements and related matters

- Auditor's report
  - Financial position
  - Issues arising
  - Legality
  - Statutory objections
  - The Local Government in Scotland Act 2003
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### Auditor's report

- 2.1 My audit report concludes that the financial statements '*present fairly*' the financial position of the Council as at 31 March 2004 and its income and expenditure for the year then ended.
- 2.2 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. The regulation of housing support services under the Regulation of Care (Scotland) Act 2001 commenced on 1 April 2003. I would draw Members attention to the fact that all Local Authorities in Scotland have been affected by this matter due to circumstances outwith their control. The relevant section of my report is shown as follows.

#### ***Failure to comply with statutory requirement***

It has not been necessary to qualify my opinion in respect of the following matter.

- ❑ Supporting people grant of £11.389 million has been used by the Council in 2003-04 to fund expenditure on housing support services, both directly and by making payments to other providers. Housing support services as defined in the Regulation of Care (Scotland) Act 2001 require to be registered with the Care Commission. An Order made under that Act required applications to register to be made before 1 October 2003.
- ❑ However, due to the fact that multiple and complex services were being provided, it took some time for the Care Commission and individual providers to agree on the number of applications required and no valid applications were made before 1 October 2003. As a result, expenditure funded by supporting people grant since 1 October 2003 in respect of services that required to be registered is not in compliance with the statutory requirement. The Council estimates that the sum involved for the period from 1 October 2003 to 31 March 2004 is in the region of £6.129 million.

### Financial position

- 2.3 The Council's net revenue expenditure amounted to £260.065 million in 2003-04 and was met from government grants and local taxation of £262.279 million, resulting in a surplus for the year of £2.214 million.
- 2.4 In his Foreword to the financial statements, the Depute Chief Executive (Finance) summarises performance against budget in 2003-04. A net underspend of £6.086 million on revenue expenditure was achieved against the approved 2003-04 revenue budget (a deficit of £3.872 million). The main elements included a general underspend of departmental budgets and savings in debt charges.



- 2.5 The General Fund balance increased to £8.645 million as at 31 March 2004. In his Foreword to the financial statements, the Depute Chief Executive (Finance) estimated that there were expenditure commitments amounting to £2.280 million outstanding at 31 March 2004 due to underspends in 2003-04, which will be carried forward and fully utilised in 2004-05.
- 2.6 When setting the Council Tax for 2004-05, the Council decided to utilise £1.646 million of the General Fund balance. After allowing for balances in respect of the Devolved School Management scheme, the Depute Chief Executive (Finance) estimated that approximately £4.257 million of the General Fund balance was uncommitted as at 31 March 2004.
- 2.7 The balance of £0.237 million on the Dundee Contract Services Reserve as at 31 March 2003 was transferred to the General Fund on 1 April 2003. This transfer was made to comply with the requirements of the Local Government in Scotland Act 2003 and was reported to Committee in February 2004.
- 2.8 In September 2003 the Policy & Resources Committee agreed to the establishment of a Capital Fund to facilitate the resourcing of new office accommodation. During the financial year, capital receipts totalling £2.840 million were transferred into the Capital Fund.
- 2.9 As at 31 March 2004, the Council had a total balance of £17.027 million as summarised below.

**Dundee City Council: Useable Funds as at 31 March 2004**

Balance at 31/3/03	Description	Balance at 31/3/04
£m		£m
6.431	General Fund	8.645
4.352	Renewal & Repair Fund	4.627
-	Capital Fund	2.840
0.721	Car Park Reserve	0.627
0.399	Insurance Fund	0.288
0.237	Dundee Contract Services Reserve	-
<b>12.140</b>	<b>Total</b>	<b>17.027</b>

- 2.10 On the 9 February 2004, the Policy & Resources Committee agreed a protocol covering the purpose, utilisation, management, control and review of the Council's reserves and balances in line with the Local Authority Accounting Panel guidance issued by CIPFA.
- 2.11 Capital expenditure totalled £47.652 million and was funded by borrowing of £17.990 million, capital receipts of £11.589 million, grants and contributions of £10.117 million, revenue contributions to capital of £4.901 million and other receipts of £3.055 million.
- 2.12 The year ended 31 March 2004, was the last year of the Scottish Executive's capital control regime which relied on the consent of Scottish Ministers (S94 consent). Each year returns have to be prepared by the Council and submitted for audit. The returns show that spending was within the available Section 94 consent or the acceptable anticipation limit.

## Issues arising

- 2.13 Under the Local Authority Accounts (Scotland) Regulations 1985, the Council's financial statements required to be submitted to the Controller of Audit not later than 30 June 2004. The Accounts Commission for Scotland set a target date of 30 September for the issue of the Auditor's report on the Statement of Accounts.
- 2.14 I am pleased to be able to advise members that, due to the considerable efforts of Council staff, the accounts were submitted for audit by the due date and the audit of the financial statements was concluded within the tight timescales set by the Accounts Commission for Scotland.
- 2.15 Final accounts preparation procedures and working papers were very good and this enabled the audit to progress smoothly. Some presentational and disclosure adjustments have been made to the accounts presented for audit to comply more fully with the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom 2003 (ACOP).

### **Statement of Auditing Standard 610**

- 2.16 Statement of Auditing Standard 610 (SAS 610) *Communication of audit matters to those charged with governance* was revised by the Auditing Practices Council in June 2001 and came into effect for accounting periods starting on or after 23 December 2001. The main requirements of the SAS centre on the need for auditors to communicate matters relating to the audit of financial statements to those charged with governance of a body in sufficient time to enable appropriate action. SAS 610 requires me to highlight:
- ☐ the nature and scope of the audit, including any limitations, and the form of reports expected to be made;
  - ☐ expected modifications to the audit report;
  - ☐ unadjusted misstatements (other than those which are clearly trifling);
  - ☐ material weaknesses in the accounting and internal control systems identified during the audit;
  - ☐ views about the qualitative aspects of accounting practices and financial reporting;
  - ☐ matters specifically required by other auditing standards to be communicated and any other matter relevant to the audit.
- 2.17 The following matters were brought to the attention of the Depute Chief Executive (Finance) but did not result in a requirement for an adjustment to the 2003-04 financial statements. The Depute Chief Executive (Finance) has undertaken to review these issues during the 2004-05 financial year:
- ☐ Council Services – within the first section of the Consolidated Revenue Account (CRA) the service expenditure analysis should be in accordance with the Best Value Accounting Code of Practice (BVACOP). The Council has instead continued to reflect its Departmental structure in the CRA and has disclosed the required information at Note 15 to the CRA. Only in exceptional circumstances should authorities diverge from the service expenditure analysis prescribed in BVACOP.

- ❑ Revenue and capital expenditure – ACOP requires that all expenditure on repairs and maintenance relating to fixed assets should be charged to the appropriate service revenue account. All expenditure on the acquisition, creation or enhancement of fixed assets should be capitalised on an accruals basis. The Finance Committee on 12 January 2004 instructed the Depute Chief Executive (Finance), in the medium to long term, to move towards implementing the definition of capital expenditure as contained in ACOP by liaising with Chief Officers to review future Capital Plans.
- ❑ Depreciation – ACOP states that depreciation should be provided for on all fixed assets with a finite useful life. Depreciation has not been provided for on a number of assets, in particular, schools and the City Square Complex.

### **Superannuation fund accounts**

- 2.18 The principal scheme for Council employees is the Local Government Pension Scheme (Scotland), which is a funded, defined benefit, multi-employer scheme. The Council is one of eleven councils in Scotland that administer pension (superannuation) funds under the local government pension scheme. The Tayside Superannuation Fund has 43 organisations participating in the fund with a membership of more than 17,400 employees and with 9,629 pensioners on the roll as at 31 March 2004.
- 2.19 The Council is responsible for the management and administration of two superannuation funds – the Tayside Superannuation Fund and the Tayside Transport Superannuation Fund. The monies belonging to the Superannuation Funds are entirely separate from any of the employing bodies but the Councils' Statement of Accounts includes details of the Tayside Superannuation Fund Accounts and the Tayside Transport Superannuation Fund Accounts, both of which are subject to audit as part of the overall audit of the Council.
- 2.20 The investment assets for both funds are under the management of external fund managers and over the recent past the net investment assets have fluctuated attributable in the main to movements in the equity market.

### **Market value of investments managed externally**

	31/3/02	31/3/03	31/3/04
	£m	£m	£m
Tayside Superannuation Fund	913.0	729.7	942.2
Tayside Transport Superannuation Fund	35.6	29.1	32.9

- 2.21 I note that the Council has now completed the revised arrangements for the management of the Tayside Superannuation Fund's investments. During 2002-03 it was decided to alter the portfolio allocation to a more specialised structure in July 2003 utilising five fund managers. The Superannuation Investment Sub-Committee will now consider the structure of the fund at least every three years, following the results of the triennial valuation becoming available. The following table illustrates the scale of the changes in 2003-04.

Fund Manager	March 2003 % of investments	March 2004 % of investments
A	30.9	-
B	30.2	25.1
C	29.1	29.8
D	9.8	9.4
E	-	10.7
F	-	25.0

### ***Pension liabilities***

- 2.22 Accounting for the costs of pensions and similar benefits in the accounts of employer organisations presents one of the most difficult challenges in the field of financial reporting. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty which have to be made the subject of assumptions; in addition the actuarial mechanisms used for matching the costs to years of employment are complicated and their selection open to debate.
- 2.23 The Council participates in two pension schemes covering general council staff and teachers. Each scheme has its own rules, funding and audit arrangements. The teachers' pension scheme is notionally funded and administered by the Scottish Public Pensions Agency, which is subject to public audit under separate arrangements by the Auditor General for Scotland.
- 2.24 The management, funding and payment of pensions are long-term activities that require periodic reassessment of assumptions, investment performance and contributions rates necessary to sustain pension commitments. Professional independent actuaries advise on these and recommend contribution rates to maintain the appropriate level of funding to provide adequate funds to meet future pension liabilities. Actuaries provide each participating employer with an estimate of their share of the assets and liabilities of the scheme on a consistent and reasonable basis.
- 2.25 Traditionally, actuaries have reported pension scheme funding levels using valuation methods that smoothed the volatility of investment markets. However, accounting for pensions is now subject to Financial Reporting Standard (FRS)17, which was introduced in stages from 2001 to 2004. This new standard introduces a market-based approach to the valuation of pension funds rather than actuarial valuation, which is in line with international standards. The objectives of the standard are as follows:
- ☐ financial statements reflect at fair value the assets and liabilities arising from an employer's retirement benefit obligations and related funding;
  - ☐ the operating costs of providing retirement benefits to employees are recognised in the accounting period(s) in which the benefits are earned;
  - ☐ the financial statements contain adequate disclosure of the cost of providing retirement benefits and the related gains, losses, assets and liabilities.

- 2.26 Applying market based asset valuations and applying market related discount rates for liabilities means that significant shifts in the investment markets between accounting dates may result in sharp swings in pension funding levels between accounting dates.
- 2.27 Dundee City Council complied with the reporting requirements for FRS17 in their 2003-04 accounts. Note 16 to the Consolidated Revenue Account details pension costs and Note 18 to the Consolidated Balance Sheet shows pension assets and liabilities. I would draw to your attention the following movements in assets and liabilities since 31 March 2002.

**Net pension liability attributable to Dundee City Council**

	<b>31 March 2002 £m</b>	<b>31 March 2003 £m</b>	<b>31 March 2004 £m</b>
Share of assets in Tayside Supn. Fund	394.956	326.010	400.489
Estimated liabilities in Tayside Supn. Fund	(384.715)	(426.790)	(456.484)
Net assets/(liabilities) in Tayside Supn. Fund	10.241	(100.780)	(55.995)
Present value of unfunded liabilities	(22.445)	(16.580)	(19.308)
<b>Net pension liability</b>	<b>(12.204)</b>	<b>(117.360)</b>	<b>(75.303)</b>

- 2.28 The net pension liability attributable to Dundee City Council from the Tayside Superannuation Fund has been calculated at £75.303 million as at 31 March 2004 representing a significant decrease in the pension liabilities of the Council from the previous year.
- 2.29 Superannuation Fund assets are primarily investments, the market value of which can go up as well as down and the net pension liability, therefore, represents the position at 31 March 2004 only. Continued sustained improvement in the investment market is necessary for the deficit to be removed.
- 2.30 Pension liabilities are funded over the long term in line with contribution rates set by the Fund's actuary. The Fund's actuary completed his normal three-year review of funding requirements and reported in March 2003 on the recommended rate of employers' contributions to enable the Fund to remain in balance. Employee contributions are currently fixed under the local authority pension scheme rules and, therefore, the Council will bear the majority of the funding burden. Contribution rates for all councils have increased significantly over the past ten years.
- 2.31 I note the Council is implementing the Actuary's recommended increases in the contribution rate from 250% of the employee contribution rate in 2003-04, to 275% in 2005-06. The next triennial review will be due to take effect from 1 April 2006. The Council are in the same position as other local authorities in reviewing the adequacy of its pension fund and my successor will monitor this situation closely in the coming year.

**Group Accounts - Dundee Energy Recycling Limited (DERL)**

- 2.32 In my previous Reports on the 2001-02 and 2002-03 Audits, I described the background to DERL and the difficulties that had been experienced since March 2000. DERL is a special purpose company, originally formed under a Private Finance Initiative, to develop, own and operate the waste to energy plant.

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- 2.33 The original Council investment in DERL amounted to 40% of the equity. As at 31 March 2003 the Council also had invested £5.063 million in DERL, in the form of an interest free loan, repayable in 17 year's time.
- 2.34 During 2003-04, DERL was financially restructured. Apart from the 40% of the equity, the Council's investment in DERL was increased to £5.362 million, but it is now in the form of Deferred Shares rather than an interest free loan.
- 2.35 As part of the restructuring the Council also entered into a purchase and leaseback arrangement with DERL, which involved the Council acquiring the plant and leasing it back to DERL at a commercial rate. The contractual terms for the treatment of the Council's waste were also amended.
- 2.36 In 2004-05, the Council has provided a £2.3 million interest bearing loan facility, for working capital over the period of time whilst plant improvements are effected. Members should continue to monitor DERL's financial and operational performance.
- 2.37 I have monitored the Council's involvement with DERL as part of the 2003-04 audit and have considered the impact on the Council's Group Accounts.
- 2.38 The Code of Practice on Local Authority Accounting (ACOP) requires local authorities with material interests in subsidiary and associated companies and joint ventures, to prepare summarised Group Accounts as supplementary information. The Council's interest in DERL is deemed to be material and the company is a joint venture, which together with the Council and along with two associated companies form the 'Group'.
- 2.39 The Council's accounting policy is to prepare the Group Accounts using the 'equity' method of consolidation, which involves the recognition of the Council's share of the joint venture and associated companies' profits and losses in the Group Revenue Account. Also the recognition of the Council's share of the joint venture and associated companies' assets and liabilities in the Group Balance Sheet. The Group Accounts are shown at pages 36 to 39 of the Statement of Accounts.
- 2.40 DERL's normal accounting period is for the year ending 31 December. Figures from DERL's management accounts to 31 March 2002 were used for the purposes of disclosure in the Council's 2001-02 Group Accounts. The consolidation of DERL's accounts could not be carried out in 2002-03 due to up to date financial information not being available.
- 2.41 For the purpose of disclosure in the Council's 2003-04 Group Accounts, figures from DERL's unaudited statutory accounts to 31 December 2003 have been used. DERL's unaudited loss for the financial year 2003 was £5.343 million and the unaudited net liabilities at 31 December were £25.635 million. The change in the accounting period used for consolidation, from 31 March in previous years to 31 December in 2003-04 resulted in the restatement of the comparative figures for 2002-03.

- 2.42 The following table compares the Council's 2002-03 Statement of Accounts in respect of DERL with that which is included in the Council's 2003-04 Statement of Accounts.

	<b>2002-03 Accounts</b>	<b>2003-04 Accounts</b>	
		<b>2002-03 (Restated)</b>	<b>2003-04</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Group Revenue Account:</b>			
Share of deficit	-	5.149	2.137
<b>Group Balance Sheet:</b>			
Share of gross assets	15.131	12.116	7.771
Share of gross liabilities	(19.113)	(20.233)	(18.025)
Share of net liabilities	<b>(3.982)</b>	<b>(8.117)</b>	<b>(10.254)</b>

- 2.43 DERL's audited accounts for the year ended 31 December 2003 were completed on 29 October 2004. I note that DERL's accounts for the four years to December 2003 record the following losses:

<b>DERL (surplus)/loss</b>	<b>Losses reported</b>
<b>Year to 31 December</b>	<b>in DERL's</b>
	<b>audited</b>
	<b>accounts</b>
	<b>£m</b>
2000	2.541
2001	5.178
2002	12.873
2003	13.343
<b>Cumulative Losses to 31 December 2003</b>	<b>33.935</b>

- 2.44 DERL's loss for the financial year 2003 of £13.343 million and the net liabilities as at 31 December 2003 of £33.635 million are both £8 million greater than the figures used for the purpose of disclosure in the Council's 2003-04 Group Accounts as per paragraph 2.42 above. The Council's 40% share of £8 million equates to £3.2 million.
- 2.45 The following table compares what the Council has included in its Group Accounts to 31 March 2004 with what it would have included if the information contained in DERL's audited accounts to 31 December 2003 had been available to the Council.

	Data from audited 2003-04 Group Accounts	Revised data Using DERL's Audited Accounts to 31 Dec 2003
	£m	£m
<b>Group Revenue Account:</b>		
Group (surplus)/ deficit	(0.040)	3.160
<b>Group Balance Sheet:</b>		
Joint venture and associate companies Profit & Loss Account	(10.408)	(13.608)

2.46 The first impact would have been a material change from a net surplus £0.040 million to a net deficit of £3.160 million shown on the Group Revenue Account. The cumulative position on the Group Balance Sheet would have been to increase the reported deficit on the '*Joint Venture and Associate Companies Profit and Loss Account*' from £10.408 million to £13.608 million.

2.47 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 and, in my view, preparations should commence as soon as possible.

2.48 The situation shall continue to be closely monitored in the coming year.

### ***Schools PPP project***

2.49 In my Report on the 2002-03 Audit, I described the background to the major programme of school replacement and refurbishment works to be carried out under a Public Private Partnership (PPP) arrangement.

2.50 The Education Committee was advised in March 2004 that the Scottish Executive had approved the project and had also agreed that variant bids may be sought in respect of a joint venture arrangement and the use of Tayside Contracts as a sub-contractor for school cleaning.

2.51 The Education Committee was also advised of the project timetable which included:

Issue tender documents	Late July 2004
Submissions returned by	Late November 2004
Contract award	August 2005
First schools ready	August 2006



- 2.52 The Education Committee was also advised that the timetable is exacting and its achievement will be dependent on all parties meeting a range of tight deadlines and on approval processes being streamlined wherever possible. The Committee delegated the responsibility for progressing the project, up to and selecting the preferred bidder to be recommended to the Education and Policy & Resources Committees, to the Chief Executive, in consultation with the Project Board.
- 2.53 Tender documents were issued to the two bidders on 16 July 2004 with the tenders due for return by Friday 26 November 2004.
- 2.54 In March 2003 I provided the Depute Chief Executive (Finance) with my comments on his "initial view" for the proposed accounting treatment of the variant Schools PPP project. The proposed project is a major development for the Council and progress will continue to be monitored as part of the audit process.

## Legality

- 2.55 All auditors plan and perform their audit recognising that non-compliance with statute or regulations may materially affect the financial statements. Public sector auditors also have wider responsibilities relating to the legality of transactions and activities to ensure that funds are expended for duly authorised purposes.
- 2.56 I fulfil my duties with regard to legality by the:
- ☐ inclusion of all significant legal requirements in audit programmes and checklists used in the conduct of the audit;
  - ☐ deployment of staff who have substantial experience of the public sector's legal framework;
  - ☐ assessment of the arrangements the Council has in place to ensure compliance with, and obtain advice on, legal matters;
  - ☐ consideration of the impact of new legislation and guidance when planning the audit;
  - ☐ review of Council minutes, making further enquiries where necessary;
  - ☐ provision of written confirmation from the Depute Chief Executive (Finance) that the financial transactions of the Council are in accordance with the relevant legislation and regulations governing its activities.
- 2.57 The Depute Chief Executive (Finance) confirmed on 29 June 2004: "*the financial transactions of Dundee City Council are in accordance with the relevant legislation and regulations governing its activities.*" I am pleased to report that, apart from the failure to comply with a statutory requirement referred to previously, there were no other issues of legality arising from the audit work in 2003-04.

## **Statutory objections**

- 2.58 Section 101 of the Local Government (Scotland) Act 1973 covers the right of an interested person to inspect and object to a local authority's accounts. I am pleased to report that no formal objection to the Council's 2003-04 accounts was received.

## **The Local Government in Scotland Act 2003**

- 2.59 The Local Government in Scotland Act 2003 has introduced a number of significant duties and changes in arrangements for local government in Scotland. In particular:
- ❑ a statutory duty to make arrangements to secure Best Value (defined as continuous improvement in performance, balancing quality and cost and taking account of efficiency, effectiveness and economy and the need to meet equal opportunity requirements);
  - ❑ a statutory duty to maintain and disclose trading accounts for significant operations from 2003-04, and for them to break-even over a rolling three year period;
  - ❑ relaxation of rules concerning award of contracts and the supply of goods and services;
  - ❑ changes in the rules for disposal of land for less than full value (although regulations have yet to be produced in this area);
  - ❑ a statutory duty to report to the public on performance;
  - ❑ a duty to initiate and to maintain and facilitate a community planning process;
  - ❑ a general power to advance well being; and
  - ❑ from 2004-05, replacement of formal controls on the level of borrowing with a prudential framework based on affordability.
- 2.60 The Act represents significant challenges and opportunities for local authorities in Scotland and the Council should have in place appropriate arrangements to meet these new requirements and take advantage of the new opportunities presented.

## **Prudential code**

- 2.61 The system of centrally based controls over local authority capital expenditure was replaced from 1 April 2004 by a prudential regime based largely on self-regulation by local authorities. The basic principle of the new system is that local authorities will be free to invest so long as their capital spending plans are affordable, prudent and sustainable.
- 2.62 'The Prudential Code for Capital Finance in Local Authorities' has been prepared by CIPFA to underpin the new system. Local authorities are required by Regulation, from 1 April 2004, to comply with the Prudential Code under Part 7 of the Local Government in Scotland Act 2003.
- 2.63 The Prudential Code requires the Depute Chief Executive (Finance) to prepare a set of indicators which demonstrates that the Council's Capital Plan is affordable, prudent and sustainable.

- 2.64 The Finance Committee approved the Prudential Indicators for 2004-05 on 12 January 2004. One of the key indicators is the level of capital expenditure to be met from borrowing. The level of capital expenditure to be met from borrowing has been estimated as follows.

	<b>2004-05 Estimate £m</b>	<b>2005-06 Estimate £m</b>	<b>2006-07 Estimate £m</b>
General Services	18.477	18.062	16.100
Housing Revenue Account	11.346	11.436	8.436
<b>Total</b>	<b>29.823</b>	<b>29.498</b>	<b>24.536</b>

- 2.65 The estimated levels of borrowing represent a significant increase on the actual levels of borrowing in 2001-02 to 2003-04.

	<b>2001-02 Actual £m</b>	<b>2002-03 Actual £m</b>	<b>2003-04 Actual £m</b>
General Services	13.758	9.208	10.706
Housing Revenue Account	6.358	5.635	7.284
<b>Total</b>	<b>20.116</b>	<b>14.843</b>	<b>17.990</b>

- 2.66 Monitoring reports on capital expenditure are regularly submitted to the Finance Committee. The report to the Finance Committee on 8 November 2004 showed that the General Services expenditure to be funded from borrowing in 2004-05 was projected to increase to £20.746 million.
- 2.67 The Depute Chief Executive (Finance) has reported to the Finance Committee that the projected levels of borrowing under the Prudential Code would have a nil incremental impact on Council Tax payers and Housing Rents.

### **Statutory trading accounts**

- 2.68 The Local Government in Scotland Act 2003 repealed CCT legislation and introduced a new requirement for the Council to maintain and disclose Trading Accounts for significant trading operations from 2003-04, and for them to break even over a rolling three year period. The 2002-03 Statement of Accounts included the following in respect of Direct Labour and Direct Service Organisations:

	<b>Income £000</b>	<b>Surplus £000</b>
Building maintenance/construction	18,396	796
Grounds maintenance	6,208	249
Refuse collection/other cleaning	6,796	18
Leisure management	3,703	0
Cleaning of buildings	206	14
	<b>35,309</b>	<b>1,077</b>

- 2.69 The Finance Committee was advised on 12 January 2004 that the Council's Best Value Officers Group had considered the new legislation together with the guidance available from CIPFA in the context of the Council's Final Revenue Budget 2003-04 including existing DLO/DSO services.
- 2.70 In addition to the work undertaken by the DLO/DSOs and Tayside Contracts some twenty-two additional activities were considered for significant trading operations status including residential homes for older people, off-street car parking, the letting of industrial units and the airport.
- 2.71 Only building maintenance/construction and grounds maintenance were deemed to meet the criteria to be determined as significant trading operations. These activities are undertaken by Dundee Contract Services.
- 2.72 The Council has established a single Statutory Trading Account. Note 18 to the Consolidated Revenue Account shows that a surplus of £1.223m was generated in 2003-04. There was no internal reappropriation of the surplus in 2003-04.
- 2.73 The Depute Chief Executive (Finance) is to carry out an annual evaluation beyond financial year 2003-04 to demonstrate the Council's assessment of the need to prepare Statutory Trading Accounts against CIPFA guidance reflecting any new operational and service delivery arrangements.
- 2.74 The above issues will fall to be considered as part of the 2004-05 audit.

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## Corporate governance

- Background
  - Corporate governance overview
  - Fraud and corruption arrangements
  - Internal audit
  - Systems of internal control
  - Information, communication and technology (ICT) arrangements
- 

### Background

- 3.1 Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The Council has a responsibility to put in place arrangements for the conduct of its affairs, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice.
- 3.2 As auditor, I have a responsibility to review and report on the Council's corporate governance arrangements. This section of the report highlights, for the interest and attention of members, the main findings from the principal areas examined in 2003-04.

### Corporate governance overview

- 3.3 Corporate governance is the system by which local authorities direct and control their functions and relate to their communities, and incorporates the way in which a Council manages its business, determines strategy and objectives and goes about achieving those objectives. It is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles of corporate governance apply equally to all public sector bodies - openness, integrity and accountability.
- 3.4 In conjunction with the Society of Local Authority Chief Executives and Senior Managers (SOLACE), the Chartered Institute of Public Finance and Accountancy (CIPFA) has developed a framework of the principles of corporate governance for adoption by local government. The new framework '*Corporate Governance in Local Government – A Keystone for Community Governance*' was launched in May 2001. In January 2002 a working group set up by Local Authority Directors of Finance in Scotland produced a template for the development of a local corporate governance code by Councils.
- 3.5 In my Report on the 2002-03 Audit I referred to the good progress the Council had made in developing its corporate governance framework. As part of the 2003-04 audit, I have therefore continued to monitor the progress being made in developing the Council's corporate governance.
- 3.6 Developments during 2003-04 included:
- ❑ the adoption of a Code of Conduct and the issue of a Guidance Note to all Councillors under the terms of the Ethical Standards in Public Life etc. (Scotland) Act 2000;

- ❑ modernising the management structure to facilitate better decision making;
- ❑ the revision of Standing Orders and Financial Regulations;
- ❑ the ongoing development of risk management and internal control arrangements;
- ❑ the development of performance reporting.

3.7 The Council has developed arrangements to support the inclusion of a 'Statement on the System of Internal Financial Control' in its financial statements for 2003-04. The Depute Chief Executive (Finance) concluded that reasonable assurance can be placed upon the Council's internal control system. The Statement defines the system of internal financial control as including:

- ❑ comprehensive revenue and capital budgeting systems covering a three-year period;
- ❑ setting targets to measure financial and other performance;
- ❑ the preparation of monthly financial monitoring reports which indicate actual and projected expenditure against budget;
- ❑ annual financial reports which indicate actual financial performance against budget;
- ❑ clearly defined Standing Orders and Schemes of Administration covering Financial Regulations, Tender Procedures and Delegation of Powers;
- ❑ approved Anti-Fraud & Corruption Strategies, including 'whistle blowing' arrangements under the Public Interest Disclosure Act 1998;
- ❑ clearly defined capital expenditure guidelines;
- ❑ formal project appraisal techniques and project management disciplines.

3.8 One of the key components in the arrangements that support the Statement is the work of the Council's internal audit service. I note that the Chief Internal Auditor reports on internal audit matters to the Audit and Risk Management Sub-Committee chaired by the Finance Convener and also reports to the Depute Chief Executive (Finance) and has open access to the Chief Executive.

3.9 The Council's corporate governance arrangements will continue to be monitored as part of future audits.

### **Fraud and corruption arrangements**

3.10 All public sector bodies have a responsibility to establish arrangements to prevent and detect fraud and corruption. In previous years I was able to conclude that the Council had a satisfactory series of guidelines aimed at the prevention and detection of fraud and corruption.

3.11 The 2003-04 audit included a review of the Council's progress in developing its arrangements to prevent and detect fraud. Developments during 2003-04 included:

- ❑ the adoption of a revised Anti Fraud & Anti Corruption Policy in respect of Housing Benefit and Council Tax Benefit;

- ❑ the introduction of the Verification Framework on 1 February 2004;
- ❑ the production of a Counter-Fraud report for 2003-04 and the adoption of a procedure of quarterly reporting in future years.

3.12 The Council's arrangements will continue to be monitored during future audits.

### **Internal audit**

- 3.13 The authority has a dedicated internal audit function. The main duty of internal audit is to provide an assurance to management on the accounting and internal control systems within the Council. The procedures used to provide that assurance are broadly similar to those used by external audit. As a result, I attempt to place as much reliance as possible on internal audit both to reduce my input and avoid unnecessary duplication of audit effort.
- 3.14 A performance audit review of the effectiveness of internal audit was carried out during 2003-04. The outcome of this exercise is included within Section 4 of this report.
- 3.15 During August 2003 change to the organisational structure of the internal audit service was authorised, in order to fulfil the increasing demands for professional services being placed upon the section. Two additional posts of internal auditor were established.
- 3.16 In addition to the work planned on behalf of the Council, the 2003-04 internal audit plan included provision for services to the Tay Road Bridge Joint Board and the Tayside Valuation Joint Board.
- 3.17 Due to a combination of recruitment difficulties and long term sickness some 12 exercises, accounting for 26% of the planned productive input for the Council, did not proceed as planned in 2003-04. In addition, no internal audit work was undertaken for the Joint Boards.
- 3.18 To address the shortfall in resources alternative options are being considered in consultation with senior management. The Finance Department has contracted with two local accounting firms to provide internal audit services in 2004-05 to the Tay Road Bridge Joint Board and the Tayside Valuation Joint Board.
- 3.19 In overall terms, I am broadly satisfied with the adequacy of the Council's internal audit function in terms of their quality of work, coverage, independence and effectiveness.

### **Systems of internal control**

- 3.20 The Council has a responsibility to develop and implement systems of internal control, including systems of financial, operational and compliance controls and risk management. This involves undertaking a proper assessment of the risks facing the Council and implementing systems and procedures to address those risks. During the course of this year's audit I have reviewed 'matters from previous years' and the following internal control systems.
- ❑ Borrowing, loans and deposits;

- 
- ☐ Council Tax billing and collection.

***Matters from previous years***

- 3.21 The 2003-04 audit included a review of the Council's progress in implementing agreed recommendations arising from our previous audits of:
- ☐ ISIS payroll system;
  - ☐ payment of creditors;
  - ☐ non-domestic rates billing and collection arrangements.
- 3.22 As part of our 2001-02 audit a review of the ISIS Payroll System was carried out. The 2001-02 report contained eleven recommendations. I am pleased to report that good progress has been made.
- 3.23 Two of the recommendations were dependent upon the implementation of a "link" between the ISIS Payroll System and the ISIS Personnel System and one other was to be incorporated in the specification for the new payroll/ personnel product planned for implementation in 2007. Only one other recommendation had not been implemented.
- 3.24 The Policy and Resources Committee on 10 March 2003 authorised the purchase of the integrated payroll and personnel 'Resourcelink' package which is being phased in over the medium term.
- 3.25 Audit testing of the current system revealed a small number of control deficiencies. Recommendations to remedy them have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.
- 3.26 The follow-up reviews of the payment of creditors and non-domestic rates billing and collection arrangements are on-going and reports will be issued in due course.

***Council tax billing and collection***

- 3.27 The system for the billing and collection of council tax represents one of the key financial systems operated by Dundee City Council. In the financial year 2003-04 the amount to be met from government grants and local taxpayers was £260 million, with income from council tax for the year representing £49million (19%) of this.
- 3.28 As part of our 2003-04 audit we have conducted a review of the procedures in place for managing council tax billing and collection. Our review focused on the controls in place to ensure that:
- ☐ all relevant data from the valuation list is promptly and correctly transferred to the billing system;
  - ☐ bills are correctly calculated (including discounts, reliefs etc) for all relevant properties;
  - ☐ only valid amendments can be made to the billing system;



- ☐ payments received are promptly processed and correctly posted to taxpayers' accounts;
- ☐ write-offs, cancellations and refunds are properly controlled;
- ☐ arrears follow-up procedures are properly controlled.

3.29 In broad terms, the system operated properly in that bills were raised and council tax was collected. However, a number of issues have been identified which give cause for concern. Of particular importance are that:

- ☐ there is no automated interface between the valuation list held by Tayside Valuation Joint Board and the council tax billing and collection system. All additions, deletions and updates of council tax accounts are therefore manually input, based on information passed via weekly interface reports received from Tayside Valuation Joint Board;
- ☐ weekly interface reports, advising the Council of amendments to the valuation list, had been processed without any formal accompanying letter from Tayside Valuation Joint Board;
- ☐ there is no independent, secondary check of the amendments made to the council tax billing and collection system, based on information contained in the weekly interface reports, to verify that all data has been accurately input;
- ☐ there is no rolling programme of reviews of exemptions and discounts to ensure that only valid awards are continuing to be made.

3.30 Recommendations to remedy the above weaknesses have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

### ***Borrowing, loans and deposits***

3.31 The treasury management operations within the Finance Department are significant and accounted for some £285 million of borrowings and £13 million investments as at 31 March 2003. During 2002-03, £38 million of new loans were raised and £43 million of loans were repaid; £497 million of short-term advances were made and £484 million were repaid; and interest paid during the year amounted to £18 million, with interest received of £0.5 million.

3.32 As part of our 2003-04 audit we have, therefore, conducted a review of the procedures in place for managing borrowing, loans and deposits transactions. Our review focused on the controls in place to ensure that:

- ☐ borrowing and lending transactions are in accordance with statutory powers and approved policy and strategy;
- ☐ annual borrowing requirements and daily balances are properly estimated;
- ☐ borrowing and lending transactions are properly controlled;
- ☐ loan repayments and interest are paid on the due dates and in respect of valid loans;
- ☐ deposits and interest are recalled/repaid on the due dates;
- ☐ borrowing and lending transactions are correctly recorded in bank accounts, the financial ledger, and other subsidiary records.

3.33 I am pleased to report that the Council comply with the CIPFA code in the operation of their treasury management function and that they have adopted the Prudential Code's main treasury management indicators. The internal control framework associated with the Council's treasury management system and the procedures in place to follow CIPFA's guidance notes are generally satisfactory, however, some internal control weaknesses were identified, including:

- ☐ no written instructions detailing daily operational procedures were in use;
- ☐ the frequency of a Logotech password change has only been agreed verbally as six monthly;
- ☐ reconciliations are not signed/initialled nor dated by the preparer and they are not reviewed by a senior officer.

3.34 Recommendations to remedy the above weaknesses have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

### **Information, communication and technology (ICT) arrangements**

3.35 The use of Information, Communications and Technology is essential to the efficient and effective operation and management of Dundee City Council. As part of the 2003-04 audit therefore, we reviewed the Council's ICT arrangements in the following areas:

- ☐ Computer services review – follow-up;
- ☐ Computer network services review – follow-up;
- ☐ Data protection, freedom of information & information management review;
- ☐ Modernising government – project management review.

#### ***Computer services review – follow-up***

3.36 As part of the 2001-02 audit, a review was carried out of Dundee City Council's Information, Technology and Communications (ICT) provisions. This highlighted scope for improvement in a number of areas and appropriate recommendations were made. Council officers agreed to take action on these recommendations within a set timescale. The initial review covered:

- |  |   |
|--|---|
| <input type="checkbox"/> Strategy                | <input type="checkbox"/> Security of ICT assets |
| <input type="checkbox"/> Structure               | <input type="checkbox"/> Contingency planning   |
| <input type="checkbox"/> Installation management | <input type="checkbox"/> Networking             |
| <input type="checkbox"/> Service delivery        |   |

3.37 As part of the 2003-04 audit these areas have been revisited to determine whether the agreed recommendations had been implemented and improvements introduced.

3.38 The Council had made considerable progress in implementing the recommendations made as a result of the initial review. Ten recommendations have been fully implemented, amongst which:

- 
- ❑ a Security Officer has been appointed;
  - ❑ planning has been improved through the issue of an IT Service Plan and the preparation of an annual implementation plan;
  - ❑ a new computer room has been built on the 1st floor of Tayside House with smart card access controls and environmental monitoring equipment;
  - ❑ illegal access attempts to the Council Network are monitored.
- 3.39 Although progress has been made on the above mentioned issues, a number of issues had still to be addressed, including:
- ❑ Business Continuity and Disaster Recovery Planning are still to be developed and tested, which could result in serious risks with regard to continuity of services within the Council;
  - ❑ although there is a 5-year replacement policy for hardware and software in place for the schools network, such a policy is still to be implemented for the Council as a whole. A replacement policy would greatly enhance the planning of equipment replacement and serve as a budget tool for both the IT Division and the Council.
- 3.40 Recommendations to remedy the above weaknesses found have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

#### **Computer network services review**

- 3.41 Dundee City Council has developed an extensive computer network that is now used by most of its office based staff, providing access to its own applications, email, and the Internet. The developing use of this technology provides opportunities to improve the effectiveness and efficiencies of the services provided by the Council. However, it also introduces new security threats.
- 3.42 As part of the 2002-03 audit we carried out a high level review of the controls within the Council over its computer network and access to the Internet. This looked at the security measures established to deter hackers from accessing data or placing files on the network. In addition to recognising the good practice already in operation, we highlighted a number of areas where improvements could be introduced.
- 3.43 As part of the 2003-04 audit these areas have been revisited to determine whether the agreed recommendations had been implemented and improvements introduced. The Council has made limited progress on a number of the original recommendations.
- 3.44 The following recommendations have been fully implemented:
- ❑ a Data Networking Strategy was prepared and has been approved by the Committee;
  - ❑ a software application has been purchased that helps managing the Network and desktop security patches.

- 3.45 Although progress had been made on the above mentioned issues, a number of recommendations had still to be addressed. In order to implement these recommendations the Council felt that it had to increase the number of staff in the IT Division's Networking section. Whilst this staffing increase was agreed by Council and staff were appointed, the Council encountered delays in filling these positions, which has led to delays in implementing the recommendations.
- 3.46 Recommendations to remedy the above weaknesses have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

***Data protection, freedom of information & information management review***

- 3.47 The Data Protection Act 1998 and the Freedom of Information (Scotland) Act 2002 set out requirements for dealing with information of both personal and public nature with which Local Authorities are required to comply. Also, as a result of both Acts, but specifically in light of Section 61 (Records Management) of the Freedom of Information (Scotland) Act 2002, demands are made upon Local Authorities' information management processes.
- 3.48 As part of our 2003-04 audit of Dundee City Council therefore, we asked that a short questionnaire be completed to establish the level of compliance with the requirements of the Acts and also to establish whether provisions for controlling information within the Council have been made.
- 3.49 The Council has appointed a Data Protection Officer for the day-to-day handling of Data Protection issues. The Depute Chief Executive (Support Services) is the named officer responsible for Freedom of Information while the City Archivist is the contact officer for any enquiries under the Act.
- 3.50 I was pleased to find that:
- ☐ the Council had developed policies for Data Protection and Records Management and a Freedom of Information Policy was under development;
  - ☐ an Information Security Project Team had helped identify the Council's information assets in light of the Freedom of Information (Scotland) Act 2002;
  - ☐ a Records Management Group has been set up, under the direction of the Depute Chief Executive (Support Services) that seeks to apply best practice in records management;
  - ☐ the Council has provided extensive guidance for Data Protection issues for staff and there are also data sharing protocols available.
- 3.51 There are, however, opportunities to improve current practice in some areas including:
- ☐ The Records Management Policy appeared to date from before 1999 and should be reviewed in light of the changing environment and legal requirements;
  - ☐ A procedure should be considered for periodic review of the Information Asset Inventory.
- 3.52 Recommendations to remedy the above weaknesses have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

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**Modernising government – project management review**

- 3.53 As part of our 2002-03 audit of Dundee City Council a review was held in order to establish the level of on-going preparedness towards achieving the Government's commitment on "information age government", and to gauge the level of provision made for controlling the introduction of new electronic services.
- 3.54 It was established that the Council had secured Modernising Government Funding (MGF) for the local development of four projects:
- ❑ Dundee Discovery Card, a smartcard which would be used in schools (cashless kitchens and attendance registration) and for concessionary transport;
  - ❑ Master Address Database integrated with other Council applications;
  - ❑ Dialogue Youth, a partnership between Young Scot, COSLA, the Scottish Executive and all local authorities to create and provide training to local Dialogue Youth Units;
  - ❑ ScotXed, the exchange of education data with the Scottish Executive Education Department.
- 3.55 Besides these four projects, the Council is also systematically working towards an agreed list of services aimed at improved transaction capability on the Council's website under the caption Electronic Service Delivery (ESD).
- 3.56 As part of the 2003-04 audit, we revisited the four projects as well as the progress with the ESD target.
- 3.57 Although a number of the projects had not been run on a formal project management basis, there were elements of good practice evident. There are, however, opportunities to improve the current practice.
- 3.58 Recommendations have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

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## Performance management

- Background
  - Best value
  - Internal audit
  - Performance indicators
- 

### Background

- 4.1 My review of the Council's arrangements to secure value for money from the use of resources includes three main activities:
- ☐ appraisal of the Council's performance management and planning processes;
  - ☐ undertaking local fieldwork on topics which form part of Audit Scotland's Performance Audit Group's centrally directed studies programme;
  - ☐ reviewing arrangements for collecting, recording and publishing directed performance information.
- 4.2 This section of the report highlights, for the interest and attention of members, the main findings from the principal areas examined in 2003-04.

### Best value

- 4.3 The Local Government in Scotland Act 2003 has introduced a statutory duty for local authorities to make arrangements to secure Best Value and has introduced new responsibilities for the Accounts Commission in relation to the audit of BV. The key features of the new approach are:
- ☐ a focus on an individual council with more local context;
  - ☐ a three year cyclical basis, with on going progress checks between the in-depth audits;
  - ☐ a focus on results and future improvements and be risk based, targeted and proportionate;
  - ☐ it will use a specialist audit team with links to the work of other inspectorates;
  - ☐ a report to the Commission after every in-depth BV audit with clear conclusions on overall performance and improvement.
- 4.4 Dundee City Council was selected for inclusion in the first year of Best Value audits under the new audit approach and the work is expected to commence late in 2004.

## Internal audit

- 4.5 In August 2001, the Accounts Commission report *"A job worth doing – raising the standard of internal audit in Scottish councils"* examined the internal audit arrangements in Scottish councils. Council performance was assessed against the CIPFA Code of Practice for Internal Audit in Local Government (the Code). Councils were placed in one of four performance bands depending upon the extent to which they complied with the Code.

Band	
1	Almost fully comply
2	Generally comply
3	Partially comply
4	Generally did not comply

- 4.6 Since 2001 a number of developments have affected councils' arrangements for internal audit and the skills that internal auditors need to provide an effective service including:

- ☐ from 2002-03, the Accounting Code of Practice required local authorities to include within their accounts a statement on their system of internal financial control. Internal audit has a key role to play in producing evidence to support this statement;
- ☐ risk management has assumed a higher profile since the initial study and councils are increasingly expected to have effective audit committee arrangements;
- ☐ a new CIPFA Code of Practice for Internal Audit in Local Government was published in September 2003.

- 4.7 During 2003-04 external auditors conducted a follow-up study assessing the extent to which all 32 councils were complying with the new CIPFA Code. The following six critical success criteria were used to assess the extent to which each council's internal audit service met standards of good practice:

- ☐ setting clear and properly focused objectives;
- ☐ maintaining internal audit independence;
- ☐ planning and controlling the work of internal audit;
- ☐ resourcing the internal audit work programme;
- ☐ reporting and follow-up arrangements;
- ☐ holding internal audit to account for its performance.

- 4.8 The national follow-up report, which was published on 22 July 2004, highlighted that councils have improved in all aspects of internal audit, but there is room for further improvement. A local report, setting out the findings and recommendations arising from our review of the City Council's internal audit arrangements, was issued on 20 August 2004.

- 4.9 I am pleased to report that the City Council's internal audit arrangements in 2003-04 have been assessed as being within performance band 1. The arrangements almost fully comply with standards of good practice. This is an improvement on the 2001 review when the arrangements then were assessed as being within performance band 2.
- 4.10 A number of issues were identified which gave scope for improvement in the City Council's internal audit arrangements including:
- ☐ the strategic plan did not set out the resources required to meet the audit needs of the City Council, nor did it identify any mismatch between resource needs and resource availability;
  - ☐ there was no formal review of the annual internal audit plan during the year;
  - ☐ there was limited follow-up of agreed recommendations to ensure that they had been implemented by management.
- 4.11 Recommendations to remedy the above weaknesses have been discussed with management, and the agreed action plan will be followed up as part of the 2004-05 audit.

#### **Performance indicators**

- 4.12 The Council has a statutory duty under the Local Government Act 1992 to ensure that arrangements are in place for collecting, recording and publishing performance indicators and, so far as is practicable, that the information published is accurate and complete. The Accounts Commission issue a Direction each year detailing the performance indicators, which local authorities are required to publish. A Guide is also produced which provides further information to assist authorities in fulfilling their requirements under the 1992 Act.
- 4.13 The external auditor has a statutory duty to review the Council's arrangements to collect, record and publish the directed information. I am also required to return details of the performance indicators, and give an opinion on the reliability of the indicators, to Audit Scotland headquarters to enable compilation of national reports on performance.
- 4.14 As in previous years, I have not been able to assess all of the performance indicators provided by the Council for the 2003-04 financial year as 'reliable'. Sixty out of sixty-four were deemed to be reliable with four being assessed as follows:

##### ***Housing:***

- |   |            |
|---|------------|
| <input type="checkbox"/> Response repairs | Unreliable |
| <input type="checkbox"/> Re-letting times | Unreliable |

##### ***Benefits Administration:***

- |   |                  |
|---|------------------|
| <input type="checkbox"/> The time for processing applications   | Unreliable       |
| <input type="checkbox"/> Accuracy and security of processing - percentage of recoverable overpayments | Failed to report |

- 4.15 As part of the 2002-03 audit a number of recommendations were made to improve the Council's arrangements for the production of the performance indicators. Further improvement is required to ensure the reliability of all the performance information produced.



- 4.16 The review of performance indicator data has highlighted that the Council is making progress in some areas but demonstrates declining performance in others.
- 4.17 The Council's Performance Report 2003-04, in the section titled 'Measuring Our Performance', concludes that the Council is improving and is also performing better than the other main City Councils in a large number of service areas.
- 4.18 The Directors' Statements draw attention to those areas within each service where performance has improved. The Performance Report also highlights three areas where the Council 'Must Do Better':
- ☐ educational attainment;
  - ☐ council tax collection;
  - ☐ sickness levels.
- 4.19 New projects and initiatives already in place should help improve the Council's performance in these areas. The Council's performance across the range of statutory performance indicators shall be monitored as part of the 2004-05 audit.

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## Concluding remarks

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- 5.1 I am pleased to formally conclude the audit of Dundee City Council for 2003-04. My report on the 2003-04 audit has covered:
- ☐ whether the statement of accounts presents fairly the Council's financial position;
  - ☐ the adequacy of the main financial systems and the arrangements in place for the prevention and detection of fraud and corruption; and
  - ☐ the performance of particular services and the effectiveness of overall management arrangements.
- 5.2 I was able to issue my opinion on the Council's 2003-04 financial statements on 30 September 2004, which met the prescribed deadline and was due in part to the high standard of working papers and final accounts planning put in place by the Depute Chief Executive (Finance).
- 5.3 My overall conclusion is that that the financial stewardship of Dundee City Council in 2003-04 was of a satisfactory standard, in particular, there were no qualifications to my opinion in my auditor's report and I have concluded that the Annual Accounts present fairly, the Council's financial position.
- 5.4 My audit report does, however, draw attention to a failure to comply with a statutory requirement. The Council made payments of £6.1 million between 1 October 2003 to 31 March 2004 on housing support services which had not been registered with the Care Commission as required by the Regulation of Care (Scotland) Act 2001. The Council was unable to register these services due to circumstances outwith its control. All Scottish councils have been affected by this matter.
- 5.5 The Council has many aspects of a sound corporate governance framework in place. Internal audit has been assessed as being within performance band 1 – almost fully complying with the Code of Practice for Internal Audit in Local Government.
- 5.6 I would like to take the opportunity to record my thanks to those officers and members of the Council with whom my staff and I have had contact during the audit for their courteous and helpful co-operation.



Peter Tait, Chief Auditor

## Action plan

Report Section	Issue and <i>Audit Recommendation</i>	Responsible Officer	Agreed	Management Response	Completion Date
Paragraph 2.2	<p><b><i>Failure to comply with statutory requirement</i></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><i>Group Accounts</i></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