

**REPORT TO: FINANCE COMMITTEE - 12 DECEMBER 2005**

**REPORT ON: RESPONSE TO EXTERNAL AUDITOR'S REPORT TO MEMBERS ON THE  
AUDIT OF DUNDEE CITY COUNCIL FOR THE YEAR TO 31 MARCH 2005**

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

**REPORT NO: 691-2005**

## **1 PURPOSE OF REPORT**

This report is a response to the report prepared by the Council's External Auditor on the audit of Dundee City Council for the year to 31 March 2005. The External Auditor's report is included on the Finance Committee agenda as a separate item (Report No 692-2005). The 2004/05 Audited Statement of Accounts for the City Council is also included on the agenda (Report No 693-2005).

## **2 RECOMMENDATIONS**

It is recommended that the Committee:

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

## **3 FINANCIAL IMPLICATIONS**

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

## **4 LOCAL AGENDA 21 IMPLICATIONS**

There are no direct Local Agenda 21 implications.

## **5 EQUAL OPPORTUNITIES IMPLICATIONS**

There are no direct equal opportunities implications.

## **6 BACKGROUND**

External audit is one of the key methods by which the activities and performance of local government are independently scrutinised and reported upon. The external audit of Dundee City Council for the financial year 2004/05 was carried out by Ms Fiona Kordiak CPFA, Assistant Director - Audit Services, Audit Scotland. Local authority external auditors are appointed for a five year period and the financial year 2004/05 marked the fourth year of Audit Scotland's appointment at the City Council.

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

- 7.1 The External Auditor's report outlines her main responsibilities as auditor and describes the scope of audit work undertaken during 2004/05 and the issues arising from that work. The report is divided into three key areas of the Council's activities:
- Financial Statements
  - Corporate Governance
  - Performance Management
- 7.2 Paragraph 1 of the report details the External Auditor's conclusions on key aspects of the Council's performance, based on the audit work undertaken during the year. For the first time, performance is assessed on a rating of very good, good, fair and unsatisfactory. For Financial Statements, Financial Position, Corporate Governance, Financial Strategy, Anti Fraud and Corruption Arrangements and Internal Control an assessment of good was given. In addition, for Performance Management a rating of fair was received. The table included in the report following paragraph 1, provides further details of the External Auditor's conclusions.
- 7.3 As part of the 2004/05 external audit, nine detailed reports have already been issued to management on matters related to the key areas outlined above. These reports have included an action plan agreed by management to address the key issues arising from the auditor's findings. Where appropriate, summarised versions of the reports are submitted to the Audit and Risk Management Sub-Committee for further scrutiny.
- 7.4 In addition to the Elected Members of Dundee City Council, the External Auditor's report is also addressed to the Controller of Audit at the Accounts Commission for Scotland. Given this wider audience, and the extent of the External Auditor's responsibilities and scope of work, her report is by necessity both fulsome and extensive. It contains much information that has already been reported to the relevant Committees of Dundee City Council. Further, as outlined above, the External Auditor's detailed reports already include agreed management action plans and are the subject of separate scrutiny by the Audit and Risk Management Sub-Committee. Accordingly, it is not the intention in this report to provide a detailed response or commentary on all of the External Auditor's findings. Rather, this response will focus on the main issues arising within each of the three key areas outlined above.

## **8 FINANCIAL STATEMENTS**

- 8.1 The External Auditor's overall conclusion is that the financial stewardship of the Council during 2004/05 was of a satisfactory standard.
- 8.2 The Council's draft 2004/05 Accounts were presented to the Finance Committee on 27 June 2005 and submitted for audit in line with the statutory deadline of 30 June 2005. The audit itself was formally concluded by the target date of 30 September 2005, with the issuing of the Auditor's Report on the Statement of Accounts (see page 53 of the accounts). It is encouraging to note that the External Auditor has again commented favourably on the standard of the Council's accounts preparation procedures and working papers.
- 8.3 There are no qualifications to the auditors report on the 2004/05 Statement of Accounts and she has concluded that the accounts "present fairly" the Council's financial position. This effectively means that the Council's accounts have again been given a "clean bill of health".

- 8.4 The net outturn on the 2004/05 Consolidated Revenue Account showed a surplus of expenditure over income of £0.388m, representing an underspend of £3.677m against the budgeted deficit of £4.065m (being mainly expenditure commitments brought forward from 2003/04 and the amount agreed to be met from accumulated balances in setting the 2004/05 Council Tax). The underspend confirms that the established systems for monitoring and controlling revenue expenditure were again operating successfully during 2004/05.
- 8.5 The Council's General Fund balance stood at £8.884m as at 31 March 2005. There were, however, estimated commitments of £5.725m against this balance (including £1.600m used in setting the 2005/06 Council Tax). This left an uncommitted General Fund balance of £3.159m at 31 March 2005. The various reserves and balances held by the Council at 31 March 2005 are detailed in paragraph 13 of the External Auditor's report. In line with the relevant professional guidance, the Council has an agreed protocol covering the purpose, utilisation, management, control and review of these reserves and balances.
- 8.6 The External Auditor has highlighted, in paragraph 19 of her report, the significant fluctuations in recent years in the value of the investments held by the Tayside Superannuation Fund. These fluctuations were due to movements in share prices. The position at 31 March 2005 reflects a significant improvement from a low point of two years earlier.
- 8.7 In paragraph 22 of her report, the External Auditor makes reference to the Council's increased pension liability as at 31 March 2005 and notes that this is largely due to a change in the financial assumptions used to calculate scheme liabilities. It has been estimated that the Council had a net pension liability of £191.023m as at 31 March 2005. The estimated net pension liability at 31 March 2004 was £75.303m. It must also be emphasised that these figures are based on a "snap-shot" on a single day and the calculation is particularly sensitive to the vagaries of the stock market, as evidenced by the significant fluctuations in the liability figure in recent years. Indeed, the continued upturn in share prices generally since 31 March 2005 will have reduced the liability somewhat. The pension liability is only notional and does not impact on the Council's General Fund balance or budgetary requirements. Through the normal course of events, any projected net liability on the Superannuation Fund is recouped by increased employers' contributions. In this connection, the External Auditor has noted that the Council is implementing the increases in the contribution rate over the period 2003-2006 that were recommended by the Fund's actuary following the 2002 triennial valuation. The next actuarial valuation is currently underway and will likely recommend further increases over the period 2006-2009. Allowance for these increases will be made in the Council's Provisional 2006-2009 Revenue Budget.
- 8.8 In paragraphs 25 and 26 of her report, the External Auditor outlines the financial restructuring of DERL that took place in 2004 and details the impact of consolidating the company's latest financial results into the Council's 2004/05 Group Accounts. The principal result of the financial restructure was the repayment and elimination of the companies outstanding debt and creation of new deferred shares. The resultant adjustment to the Group Accounts reduced liabilities and balances by £17.763m. The Council's share of the loss reported by DERL for the period to 2 January 2005 is £2.451m and this is included in the 2004/05 Group Revenue Account.
- 8.9 The External Auditor has various and wide ranging responsibilities with regard to examining the legality of the Council's transactions and activities. It is therefore pleasing to note that the External Auditor has no matters to report in this area arising from his audit work in 2004/05. Further, there were no formal objections to the 2004/05 accounts from members of the public.

- 8.10 In her report, the external auditor has also acknowledged the significant challenge ahead for the Council in the preparation of Group Accounts for 2005/06, following the modified arrangements introduced in the 2004 Code of Practice on Local Authority Accounting in the United Kingdom. The External Auditor carried out a review of the Council's preparations for the new requirements and it is encouraging to note that she reported a robust and structured approach has been applied and that the Council is well on target to achieving the 2005/06 deadline.
- 8.11 In paragraph 32 the External Auditor outlines the timetable for the introduction by HM Treasury of Whole of Government Accounts (WGA) and recommends that preparations for this process should begin as soon as possible. The Council has already made good progress for the first 'dry run' year of WGA with the 2004/05 submission being returned to the Scottish Executive by the due deadline. The Council has acknowledged that the task will be an evolutionary process and that systems and procedures will require to be fine tuned for future years as the deadline for full participation approaches.

## 9 CORPORATE GOVERNANCE

- 9.1 The External Auditor has a responsibility to review and report on the Council's corporate governance arrangements. In paragraphs 34 to 36 the report provides an overview of the progress made since last year. In addition, the overview provides details of Audit Scotland's national report published on the standards of internal audit in Scottish Councils and notes that overall, the Council was placed in the highest performance band. Her report includes references to four key areas of the Council's overall governance framework:

- Financial strategy (paragraphs 40 to 44)
- Anti-fraud and corruption arrangements (paragraphs 45 to 47)
- Systems of internal control (paragraphs 48 to 57)
- Following the public pound (paragraphs 58 to 62)

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

- 9.2 A detailed review of the Council's financial strategy was undertaken by the External Auditor that concluded sound budgetary control and treasury management procedures are in place that will enable the Council to build on and develop its financial strategy. A summary of the findings and recommendations of this wide ranging review are detailed in paragraphs 40 to 44.
- 9.3 Under "Anti-fraud and corruption arrangements", favourable comment had previously been made on the Council's arrangements to prevent and detect fraud and further developments were implemented in 2004/05. Examples of specific developments during 2004/05 are shown in paragraphs 46 to 47, including the introduction of the National Fraud Initiative in Scotland.
- 9.4 Under "Systems of internal control", the External Auditor reports on the following reviews that she undertook during 2004/05:
- Prudential Code and Asset Management (paragraphs 50 to 54)
  - Social Work debtors (paragraphs 55 to 56)
  - Information and communications technology (ICT) arrangements (paragraph 57)

The outcome of the above reviews has been communicated in detailed reports to management on the key issues identified. All reports also contained an action plan, agreed

by management, to rectify the weaknesses identified. These reports have also been the subject of separate scrutiny by the Audit and Risk Management Sub-Committee.

- 9.5 Under 'Following the public pound', Audit Scotland have carried out a follow up review of the Council's arrangements for the funding of arms length organisations to ensure that the Council comply with the COSLA and Audit Commission joint publication the 'Code of Guidance on funding external bodies and following the public pound'. Paragraphs 58 to 62 provide further details of the review undertaken.
- 9.6 Paragraph 63 summarises the main challenges that will Council will face in the coming years including the development of a robust Asset Management Planning process as part of the Prudential Code Framework. This issue, together with the others detailed in her report, and the controls implemented by management to address them are likely to be subject to ongoing review during the 2005/06 audit.

## 10 **PERFORMANCE MANAGEMENT**

- 10.1 The External Auditor has a duty to review and report on aspects of the Council's arrangements to manage it's performance and secure economy, efficiency and effectiveness in the use of resources. The Local Government in Scotland Act 2003 introduced a statutory duty for Council's to make arrangements to secure Best Value. In response, the Accounts Commission introduced new arrangements for the audit of Best Value based on a cyclical basis using specialist audit teams, with each Council being subject to an in-depth review every 3 years. The Council received its full Best Value audit this year, with the report being published in October 2005 and considered by the meeting of Dundee City Council on 24 October 2005. The main findings of the Best Value report are repeated in paragraphs 66 to 68.
- 10.2 During 2004/05, the External Auditor also reviewed the Council's arrangements for returning details of Statutory Performance Indicators. This review involves the External Auditor forming an opinion on their reliability to enable Audit Scotland headquarters to compile national reports on performance. It is noted that all of the Councils Statutory Performance Indicators were classed as "reliable" in 2004/05, although two indicators were not produced in relation to recoverable benefits overpayments and traffic lights repairs. The External Auditor has noted however, that there were weaknesses in the Council's arrangements to ensure the accuracy of the indicators. Consequently, the Council has agreed to undertake a cyclical review of the procedures and processes for preparing Statutory Performance Indicators. In addition, actual performance information will also be reviewed by Finance Department staff for accuracy, completeness and compliance with guidance prior to being submitted for audit.

## 11 **ACTION PLAN**

The External Auditor has identified two key issues arising from her 2004/05 audit that require action by the Council. These relate to the introduction by HM Treasury of Whole of Government Accounts (WGA) and arrangements for Statutory Performance Indicators. The External Auditor's recommendations are set out in the form of an Action Plan. These matters have been considered carefully by the Depute Chief Executive (Finance) and the completed Action Plan, incorporating the "Management Response", is appended to both this report and to the External Auditor's report. As noted in paragraph 8.11 above, good progress on the issue relating to WGA has already been made, the ongoing preparations will be co-ordinated through the Council's established year-end accounts preparation procedures. In addition, initial discussions have commenced within the department to review the procedures and processes for preparing Statutory Performance Indicators and actual performance information, prior to being submitted for audit.



## 12 **CONCLUSIONS**

During 2004/05, the External Auditor examined a number of areas covering a wide range of the City Council's activities. Whilst some areas for improvement have been identified, it is pleasing to note that the auditor's overall findings and conclusions are satisfactory. In particular, the Council can take encouragement from the following findings :

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

## 13 **CONSULTATION**

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

## 14 **BACKGROUND PAPERS**

None.

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

**1 DECEMBER 2005**

# Action plan

No.	Issue, risk & recommendation	Responsible officer	Response & agreed action	Action date
1. (para 33)	<p><b>Whole of Government Accounts (WGA)</b></p> <p>HM Treasury is in the process of introducing WGA covering the whole of the public sector and treating government as if it were a single entity by eliminating all significant transactions between public sector bodies. Local government is being included in this process in a phased manner, with the first 'dry run' this year.</p> <p><i>Risk: compliance with this high profile initiative places a significant burden on the Council's finance staff.</i></p> <p><b>Recommendation: preparations for the WGA process should begin as soon as possible.</b></p>	<b>Depute Chief Executive (Finance)</b>	The Council has made good progress on WGA, with the initial "dry run" submission for 2004/05 being returned to the Scottish Executive by the required date. It is acknowledged that WGA will be an evolutionary process and that systems and procedures will require to be fine-tuned as the deadline for full participation approaches. The Council's on-going preparations will be co-ordinated through the Final Accounts Working Group.	Ongoing
2. (para 70)	<p><b>Performance Indicators</b></p> <p>There are weaknesses in the Council's arrangements to ensure the accuracy of statutory performance indicators. Despite assurance sheets completed to confirm that quality control checks have been carried out, 7 indicators had to be amended after audit, casting doubt on the thoroughness of checks undertaken.</p> <p><i>Risk: inaccurate or incomplete PI information is submitted and published.</i></p> <p><b>Recommendation: PI information submitted to audit should be accurate, complete and compiled in line with current guidance.</b></p>	<b>Depute Chief Executive (Finance)</b>	The procedures and processes for preparing the Council's statutory performance indicators will be reviewed by Finance department staff in the current and future financial years. This review will be undertaken on a cyclical basis, using a risk-based approach. The actual performance information will also be reviewed by Finance department staff for accuracy, completeness and compliance with guidance, prior to being submitted for audit.	Ongoing