358-2015

Dundee City Council

Annual audit report to the Members of Dundee City Council and the Controller of Audit

Audit: year ended 31 March 2015

Report No 358-2015

DRAFT: 22 September 2015

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About this report

This report has been prepared in accordance with the responsibilities set out in Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Dundee City Council ("the Council") and is made available to Audit Scotland and the Controller of Audit (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the circumstances set out in the executive summary: scope and responsibilities.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

Headlines

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Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code"). This specifies a number of objectives for the audit.

In accordance with ISA (UK and Ireland) 260: *Communication with those charged with governance,* this report summarises our work in relation to the annual accounts for the year ended 31 March 2015.

We wish to record our appreciation of the continued co-operation and assistance extended to us during the course of our work.

Area	Summary observations	Analysis
Strategic overview		
Key issues and update	The challenges faced by the Council to deliver services with less resources over the past five years have required careful management and monitoring. Public sector reform continues to gather pace against a backdrop of continuing financial pressures. The introduction of integrated health and social care partnerships, coupled with welfare reforms, will require effective leadership and governance. We consider that the Council has so far progressed well in managing these changes.	Page 6
Financial position	The Council reported a deficit of the provision of services of £36.4 million in 2014-15 (2013-14: £42.2 million). This gave rise to an increase in general fund reserves of £5.0 million, a decrease of £5.5 million in the capital grants unapplied account and an increase in other reserve balances of £2.0 million.	Pages 9 - 14
Financial statements and accounting		
Audit conclusions	We intend to issue an unqualified audit opinion on the 2014-15 annual accounts, following their approval by the scrutiny committee in September 2015. The annual accounts, statement of responsibilities, governance statement and remuneration report were received by the start of audit fieldwork and were supported by high quality working papers.	Page 16
Significant risks and audit focus areas	The areas highlighted below are the specific audit focus areas identified within our audit strategy document: ■ fraud risk from management override of controls; ■ fraud risk from revenue recognition; ■ the Council's financial position; ■ accounting for provisions; ■ the valuation of property, plant and equipment and preparation for the requirements of the 2016-17 Code; and ■ retirement benefit obligations. Audit work was completed to satisfy the requirements of ISA 330 *The auditor's responses to assessed risks*, including tests of key financial controls. In respect of each matter, we are content with management's judgements and accounting treatment.	Pages 17-20

Headlines (continued)

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Area	Summary observations	Analysis
Financial statements and accounting (continued)		
Going concern	The annual accounts have been prepared on a going concern basis, as the revenue support grant has been approved for 2015-16 and forms the basis of a budget which is considered to be manageable within existing facilities. The Council added to the general fund reserve in 2014-15, and had net assets of £563.2 million at the balance sheet date.	Page 22
Accounting policies	There have been no changes to accounting policies applied by the Council in 2014-15. No newly effective accounting standards are expected to have a material impact on the 2015-16 annual accounts. The requirements of the *Code of practice on transport infrastructure assets* ("the transport code"), will apply from 2016-17.	Page 21
Governance and narrative reporting		
Governance	Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.	Page 26 - 27
Internal controls	Testing of the design and operation of financial controls over significant risk points was undertaken as part of our audit. Our work concluded that controls relating to financial systems and procedures are designed appropriately and operating effectively. Since the finalisation of our interim report there have been no changes to the operation of the controls subject to review.	Page 28
Performance management		
Performance management	Our work has identified that the Council's performance management arrangements are generally robust, however, a number of areas for improvement were identified in relation to statutory performance indicators ("SPIs") by Audit Scotland. Internal audit reviews, conducted as part of the internal audit plan, provide assurance over performance reporting and Best Value considerations.	Page 35

Scope and responsibilities

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Purpose of this report

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

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit. It is addressed to both those charged with governance at Dundee City Council and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the scrutiny committee at the outset of our audit.

Audit Scotland's Code of Audit Practice ("the Code") sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements but also consideration of areas such as financial performance and corporate governance.

Accountable officer responsibilities

The Code sets out Dundee City Council's responsibilities in respect of:

- preparation of financial statements that show a true and fair view;
- systems of internal control;
- prevention and detection of fraud and irregularities;
- standards of conduct and arrangements for the prevention and detection of bribery and corruption;
- financial position; and
- Best Value.

Auditor responsibilities

This report reflects our overall responsibility to carry out an audit in accordance with our statutory responsibilities under the Act and in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code.

Scope

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance.

Weaknesses or risks identified are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist.

Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity.

This annual audit report to members and our presentation to the scrutiny committee, together with previous reports to the scrutiny committee throughout the year, discharges the requirements of ISA 260.

Strategic overview

Our perspective on key business issues and financial position

Key business issues

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Public sector reform and financial pressures have caused challenges for local authorities in delivering services with reduced resources.

Sector overview

Local authorities have faced challenges over the past five years as a result of public sector reform and the UK's continued financial pressures. Councils are faced with real term funding decreases, combined with increasing demand for services resulting in challenging decisions to achieve a balanced budget. The integration of health and social care presents additional challenges. Councils are aware of the need to deliver services efficiently and effectively, with fewer resources.

These challenges are highlighted in Audit Scotland's report "An overview of local government in Scotland 2015", which highlights that the real-terms reduction in council's funding from the Scottish Government between 2011-12 and 2013-14 was 8.5%.

The report recommends that councillors ensure that council officers provide high-quality financial and performance information to support effective scrutiny and decision-making. Management has reviewed this report and completed the self assessment tool to assess current performance and identify areas for improvement. With the exception of the workforce strategy, where management action to develop it by March 2016 is required, all other recommendations from the report were "in place" or "in place but needing further improvement". Areas the Council noted for improvement included capital and revenue budget monitoring.

We set out our views on the Council's progress with key public sector reforms over the following pages and provide commentary on its financial position from page eight.

Local area network / shared risk assessment

Local area networks ("LANs"), comprising representatives from scrutiny bodies perform an annual shared risk assessment and plan shared scrutiny activity. The 2014-15 local scrutiny plan, (formally the assurance and improvement plan), noted that the Council continues to make improvements and as such no specific areas were identified as 'scrutiny required' or 'further information required' beyond that already planned by participants (outlined below).

2015-16 included a change in the process of shared risk assessments ("SRAs") and how the LANs work with local authorities. The 2015-16 local scrutiny plan highlights the Council's continued progress with the significant transformation programme 'Changing for the Future' and maintained or improved performance in a number of areas. The SRA process is intended to support local authorities in performance improvement, and the 2015-16 SRA identified planned scrutiny as:

- joint inspection of services for children and young people led by the Care Inspectorate;
- a planned Joint Thematic Review of Multi-Agency Public Protection Arrangements (MAPPA) in Scotland during 2014 to 2015;
- Scottish Housing Regulator (SHR) planned programme of thematic inquiries into housing services; and
- validated self-evaluation (VSE) of educational psychology services with Education Scotland over a two-year period beginning in 2015-16.
- KPMG's scrutiny activity, as part of the external audit is:

"monitoring of the Council's progress with the development of a medium-term financial strategy."

"monitoring of the progress with, and outcomes of the McClelland Review of the Victoria and Albert (V&A) museum in Dundee project."

Key business issues (continued)

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Service and management structures

The policy and resources committee approved proposed service and management structures which realign Council services to better reflect policy priorities. There are three main elements to the new structure:

- streamlining departmental structures;
- introducing a single pay model for all employees; and
- providing additional career development opportunities for young people.

It is anticipated that the new departmental structures will result in cost savings of £400,000 per annum; achieved through a planned approach to voluntary early retirement and voluntary redundancy. This has led to a reduction from seven directors and 24 heads of service to six directors and 14 to 15 heads of service.

Welfare changes

As a result of the Welfare Reform Act 2012, a number of significant changes in how councils deliver benefit services were implemented on 1 April 2013. The most significant change is the introduction of ‘universal credits’, which is an integrated working age benefit which will replace existing benefits, including housing benefit. Universal credits will be administered by the Department of Work and Pensions (“DWP”).

The Council Plan for 2012-17 anticipates that welfare reform will have a significant impact on the city’s population, as 22.3% are in receipt of benefits. While the full financial impact for the City has not yet been quantified, members have been provided with the Scottish Government’s report of 11 April 2013 which estimated that the impact on Dundee’s economy would be an annual loss of £58 million.

In response, a corporate welfare reform group has been formed to address the potential impact of welfare reform on the city’s population. Regular updates from management on the impact of welfare reform have been provided to members for consideration via the policy and resources committee.

The Council has been proactive in its approach to welfare reform and mitigating the effects on the local population. Additional external grant funding has enabled the Council to fund community teams to help local people in hardship to access available advice and resources.

Integrated health and social care

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Parliament. This requires all councils and NHS boards to formally and legally establish integration of health and social care by April 2016. In response the Council set up a joint board with NHS Tayside to meet the requirements of the Act. The chief officer post has been filled and the chief finance officer post is being recruited.

The partnership will integrate adult and elderly services; children’s services will not be transferred to the new partnership, however, the Council has a strategy for children’s services which requires joint working. We consider the joint board’s arrangements in more detail at pages 31 - 33.

Bringing together staff from NHS Tayside and the Council, under one single management structure in the integration joint board is a significant challenge for the Council. It requires a scheme of delegation to be agreed which sets out the services which will be transferred from the Council to the integration joint board. This scheme has been substantially agreed by Council but will require ongoing management and operational staff time and resources to manage through the transition period and continued liaison and negotiation with the integration joint board in respect of outcomes and resources available to support their delivery.

Key business issues (continued)

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The V&A at Dundee will be the first ever purpose-built design museum in the UK outside of London.

Work began on the building in March 2015, with no funding provided by the Council as at 31 March 2015.

The review of the combination project for the V&A, written by John McClelland CBE, was issued on 27 July 2015.

V&A at Dundee

The V&A museum is the largest single item of expenditure included in the 2016-21 capital plan. The phasing of planned expenditure and associated funding is summarised below:

	Expenditure	External funding	Council funding
Actual prior to 31 March 2015	6.2	(6.2)	-
2015-16	22.4	(18.3)	4.1
2016-17	27.2	(24.0)	3.2
2017-18	21.9	(15.0)	6.9
2018-19	2.4	-	2.4
Total	**80.1**	**(63.5)**	**16.6**
Original budget per 2014-18 capital plan	**49.0**	**(49.0)**	**-**
Variance	**31.1**	**14.5**	**16.6**

Source: Capital Plan 2016-21 and 2014-18, P&R Committee 279-2015 and 59-2014

Following the increase in estimated cost of the V&A, the Council appointed John McClelland CBE to conduct an independent review of the project. The key focus of the review was to examine the reasons for the increase in the estimated construction costs. This review was reported to the policy and resources ("P&R") committee on 24 August 2015 and included eight recommendations. In summary, the report found that the main reason for the variance in budget was underestimates in the original budget (£18.1 million, 58.2%), programme delays (£5.4 million, 17.4%) and cost increases and design changes (£7.6 million, 24.4%). The P&R committee accepted the recommendations of the report. We will consider implementation in respect of the ongoing and other capital projects in our 2015-16 audit. We have substantively audited the £1.8 million grant funded V&A expenditure incurred during 2014-15.

Design Dundee Limited ("DDL")

The company is a partnership between the Council, University of Dundee, Abertay University and the Victoria and Albert Museum. DDL was set up with the aim of organising the development and delivery of the V&A Dundee. Its objectives include:

- advancement of the arts, heritage, culture and science, education and research, citizenship and community development; and
- to advance such similar charitable purposes as the directors may consider appropriate from time to time.

The McClelland review notes that there was a lack of clarity in the governance arrangements between DDL and the Council, following the decision to transfer responsibility for construction of the V&A from DDL to the Council. While the V&A building is in the construction phase most activity undertaken by DDL is in promoting the V&A and securing private investment. Most of its expenditure is staff costs and are met by revenue grant funding; the Council does not currently fund DDL.

Once the V&A museum is operational, DDL will be responsible for running the museum and the Council will own the asset. DDL will pay the Council a 'peppercorn rent' for its use and the Council will make revenue contributions to DDL in respect of running costs. Responsibility for total revenue funding will be shared with the other partners in DDL. The Council should finalise the development, lease and management agreements with DDL as soon as possible.

Recommendation one

DDL has nine directors, one of whom is a representative of the Council. As such the Council does not consider that it exercises 'joint control' or 'significant influence' by being DDL's sole funder and does not consider DDL a subsidiary, associate or joint venture and as such does not require to be consolidated in the Council's group accounts. This position must be considered as the relationship develops.

Recommendation two

Financial position

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The Council recorded a deficit on the provision of services of £36.4 million in 2014-15. This resulted in a transfer to the general reserve of £5.0 million.

Financial position

The 2014-15 deficit on the provision of services of £36.4 million compares to the 2013-14 deficit of £42.2 million.

A total of £1.6 million was transferred to usable reserves in 2014-15, compared to a transfer from reserves of £2.9 million in 2013-14. Of the transfer, £5.0 million relates to an increase in general fund balances and £1.8 million relates to an increase to the renewal and repair fund. There was a decrease of £5.4 million to the capital grants unapplied account. The composition of the Council's reserves is shown below:

Reserve	31 March 2015	31 March 2014	Variance
General fund balance	13,027	8,070	4,957
Housing revenue account	-	-	-
Capital grants unapplied account	1,493	6,944	(5,451)
Capital fund	676	673	3
Repairs and renewals fund	8,070	6,253	1,817
Insurance fund	926	700	226
Total usable reserves	**24,192**	**22,640**	**1,552**
Unusable reserves	539,056	407,067	131,989
Total reserves	**563,248**	**429,707**	**133,541**

Source: KPMG analysis of Dundee City Council's annual accounts 2014-15.

The Council aims to maintain uncommitted reserves at a minimum level of £5 million (around 1.5% of budgeted net expenditure). As a result no amounts were taken from uncommitted reserves in setting the 2014-15 budget. The level of uncommitted general reserves at 31 March 2015 was £5.1 million (2013-14: £5.0 million).

Comprehensive income and expenditure statement

	2014-15 £'000	2013-14 £'000	Variance £'000
Cost of services	(193,931)	(187,901)	(6,030)
Taxation and non specific grant income	(384,127)	(363,797)	(20,330)
Net income from investment properties	(53)	(389)	336
Changes in the fair value of investment properties	1,113	2,339	(1,226)
Share of Tayside Contracts surplus	(397)	(367)	(30)
Interest receivable	(466)	(848)	382
Total income	(577,861)	(550,963)	(26,898)
Cost of services	569,405	552,345	17,060
Other operating expenditure	1,140	1,897	(757)
Interest payable and similar charges	25,479	25,743	(264)
Net interest on the net defined benefit liability (asset)	18,257	13,135	5,122
Total expenditure	614,281	593,120	21,161
Deficit on the provision of services	**36,420**	**42,157**	(5,757)
Surplus on revaluation of non current assets	(6,200)	(65,340)	59,140
Surplus or (deficit) on revaluation of available for sale financial assets	(157)	357	(514)
Remeasurements of the net defined benefit	(163,604)	94,374	(257,978)
Total comprehensive income and expenditure	**(135,541)**	**71,548**	(205,089)

Source: KPMG analysis of Dundee City Council's annual accounts 2014-15.

Financial position (continued)

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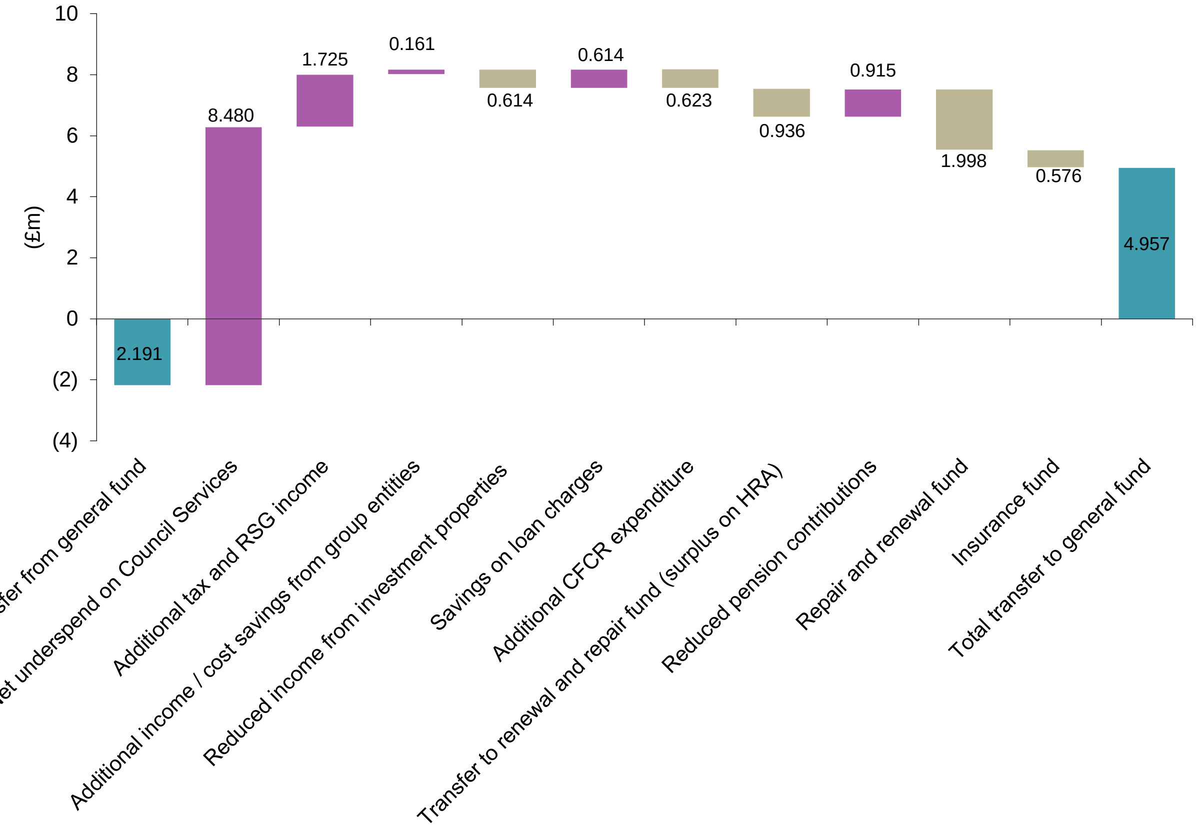
The budgeted outturn was for a transfer from general fund reserves of £2.2 million. The Council achieved a transfer to the general fund reserve of £5.0 million in 2014-15.

We provide a summary of the movements from original budget to outturn position in the graph.

2014-15 budgeted deficit to outturn



Key under spends in the year included:
- lower payments to third sector bodies in relation to adult services (£3.85 million);
- savings in staff costs (£3.85 million);
- lower level of residential and secure placements for children (£1.122 million); and
- higher than anticipated housing rental income and lower cost rents (£0.999 million).

Key over spends in the year included:
- additional nursing and residential placements for older people and a continuing increase in demand for free personal care placements (£0.4 million);
- income shortfall in commercial property rentals (£0.5 million);
- income shortfall in car parking (£0.3 million); and
- income shortfall in environmental protection services for the sale of recyclable materials (£0.2 million).

Financial position (continued)

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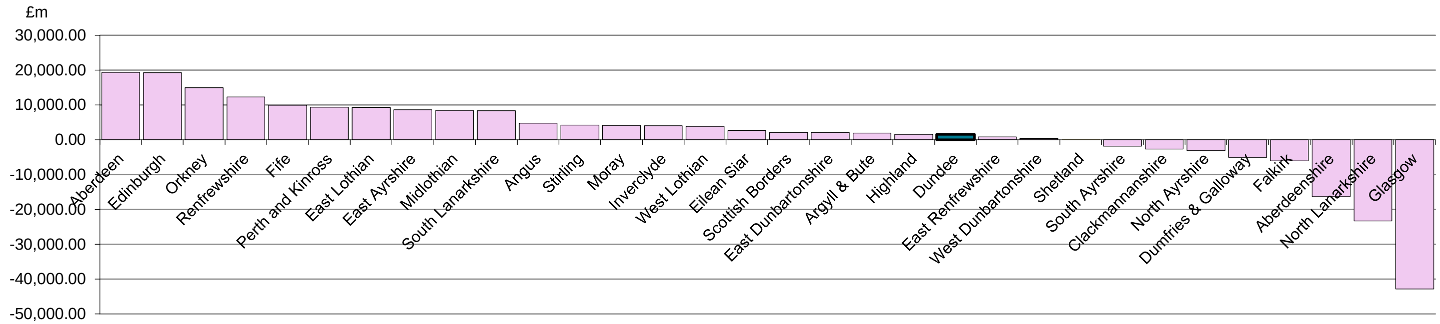
Audit Scotland performs benchmarking on various financial indicators across the 32 local authorities, drawn from the unaudited financial statements.

In benchmarking undertaken by Audit Scotland from analysis of the 2014-15 unaudited financial statements of Scotland's 32 local authorities, Dundee City Council had a movement in total useable reserves just above the average movement. The carried forward usable revenue reserves as a proportion of revenue were the third lowest in Scotland.

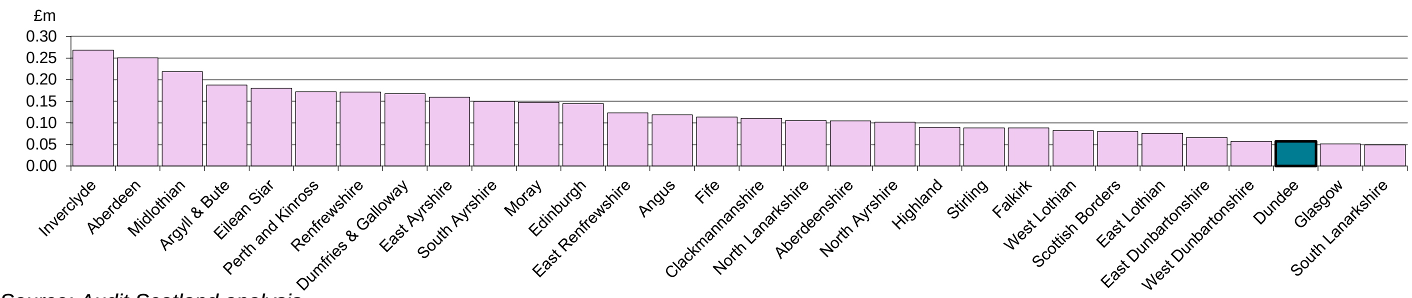
The Council's uncommitted reserves as a percentage of net revenue spend continues to be low. The Council reviews the adequacy of its minimum target for uncommitted reserves when setting the budget each year.

In setting the 2014-15 revenue budget, management advised the policy and resources committee that the target level of reserves should remain at £5m (around 1.5% of budgeted expenditure). To achieve this it was recommended that funds should not be taken from the general fund when setting the council tax for 2014-15. The same approach has been taken for 2015-16.

2014-15 increase in usable reserves – 32 Scottish local authorities



2014-15 carried forward usable revenue reserves as a proportion of revenue – 32 Scottish local authorities



Source: Audit Scotland analysis

Financial position (continued)

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The Council's total capital spend in 2014-15 was £73.1 million, £19.3 million below budget. Capital grants provided the primary source of capital funding in 2014-15, however a large proportion of capital expenditure continues to be funded through borrowing.

Borrowing

The Council's capital expenditure is primarily funded through capital grants and borrowing, in line with the capital plan approved by the policy and resources committee.

The capital expenditure programme gives rise to greater borrowings and management incorporates the debt service costs into budgets. In Audit Scotland's 2014-15 benchmarking, the Council has the fifth highest level of net external debt when taken as a proportion of revenue expenditure. The Council also has the fifth highest external debt per head of population at £3,655 per head (2013-14: £3,647). We recognise that this benchmarking does not differentiate between demographic differences or the split between general services and housing related borrowing.

Capital programme

Total capital expenditure in 2014-15 was £73.1 million, below the original budget of £92.4 million. £58.6 million related to general services capital spend and £14.5 million to the housing revenue account. This represents a 15% decrease from the 2013-14 spend of £86.2 million.

The largest underspend in 2014-15 related to the National Housing Trust (phase 1 and 2) with £4.8 million being rephased into the 2016-17 capital plan.

£13.9 million of the capital underspend relates to general services capital expenditure. The majority of this underspend will be re-phased into future years capital budgets.

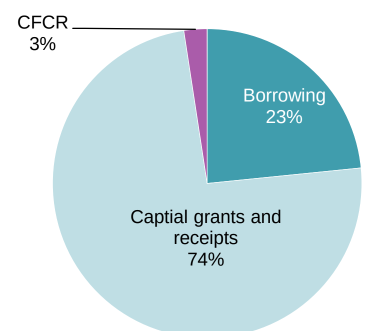
The remaining £5.4 million relates to underspends and re-phasing of other housing projects.

Key capital expenditure incurred in 2014-15 related to:

- £13.3 million on Harris Academy;
- £9.2 million on Central Waterfront;
- £8.9 million on heating, kitchens and bathrooms in council housing;
- £2.6 million on external insulation and cavity fill in council housing;
- £2.4 million on Seabraes Pedestrian Bridge;
- £2.2 million on road reconstructions;
- £1.9 million on Barnhill Primary School;
- £1.9 million on street lighting renewal;
- £1.8 million on the V&A at Dundee; and
- £1.5 million on Dundee Railway Station concourse.

The majority of capital expenditure (£54.2 million; 74%) has been funded by capital grants applied in year. Capital expenditure compared to budget and the sources of capital finance are shown below.

Capital expenditure funding



Source: KPMG analysis of Dundee City Council's annual accounts and year end report 2014-15.

Financial position (continued)

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The 2015-16 budget incorporates budget savings of £6.9 million which were required in order to freeze council tax without utilising reserve balances.

Financial plans 2015-16

The budget has been set on the assumption that council tax will remain frozen in 2015-16; the Scottish Government has confirmed its support for this policy in 2015-16.

	2015-16 £m	2014-15 £m	Variance £m
Education	141.9	135.7	6.2
Social Work	105.0	105.9	(0.9)
City Development	22.1	21.3	0.8
Environment	23.7	26.2	(2.5)
Chief Executive	30.9	27.4	3.5
Corporate services	7.6	6.8	0.8
Other housing	2.6	2.8	(0.2)
Supporting people	11.6	11.6	-
Capital financing costs	26.7	26.6	0.1
Other, including Welfare Reform	18.9	14.9	4.0
Subtotal	**391.0**	**379.2**	**11.8**
Less: capital charges	(38.6)	(34.7)	(3.9)
Total net revenue budget	**352.4**	**344.6**	**7.8**

Increases in costs across departments includes a 1.5% allowance for estimated pay awards in 2015-16 for all categories of staff. Allowance has also been made for the increased National Living Wage of £7.85 per hour.

As part of the budget setting process the Council re-stated its medium term financial outlook. The key elements of this outlook are as follows:

- Local Government in Scotland will experience funding cuts (in both cash and real terms) for the remainder of this decade;
- the Council will continue to experience pressure on demand-led services in key areas such as Education and Social Work, due to demographic factors;
- pay and prices inflation will require to be provided for and the updating of grant distribution factors will likely continue to work against the Council; and
- the Westminster Government's intention to withdraw the contracting-out rebate on employers national insurance contributions will add around £4.0 million to the Council's annual pay bill, from 2016-17 onwards.

The Council estimates it will need to identify further budget savings of around £22.7m over the two year period 2016-2018 in order to maintain a Council Tax freeze. It has set out the key aspects of a medium term financial strategy, however, this could be enhanced with the inclusion of financial budgeting. A three year budget based on current year budget and updated for known changes to income and expenditure would help management to identify and manage future cost pressures. It is normal for such a budget to be appropriately informed by reference to savings plans and changes in operations.

Recommendation three

Financial position (continued)

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Total projected capital resources of £390.7 million are included within the 2016-21 capital plan.

Capital plan

The capital plan 2016-21 includes both general services and housing revenue account capital expenditure. This plan updates the 2015-18 capital plan which was approved in February 2015. The CIPFA Prudential Code principles are used to develop the capital plan.

The total projected capital resource for 2015-16 to 2020-21 is shown below, which has been matched to planned expenditure projects.

Funding source	15-16 £m	16-17 £m	17-18 £m	18-19 £m	19-20 £m	20-21 £m	Total £m
Borrowing	54.6	64.4	75.5	25.9	18.2	24.4	**263.0**
Capital grants	51.5	48.9	47.8	20.0	20.0	17.8	**206.0**
Capital receipts	5.2	6.1	3.8	4.1	4.2	4.0	**27.4**
Slippage	8.2	3.1	2.5	0.0	0.0	0.0	**13.8**
Total projected capital resources	**119.5**	**122.5**	**129.6**	**50.1**	**42.4**	**46.2**	**510.2**

Source: Capital Plan 2016-21, Policy & Resources Committee 279-2015

Key projects	Amount £m
General services:	
Road reconstructions/recycling (net Council contribution)	30.6
Primary school investment	23.0
Menzieshill Primary, Nursery and community provision (net Council contribution)	20.9
Purchase computer equipment	19.6
Vehicle fleet purchases (net Council contribution)	19.3
Road schemes/minor schemes (net Council contribution)	18.0
V&A at Dundee (net Council contribution)	16.6
Longhaugh - St Lukes & St Matthews and St Vincents - Replacement	16.0
Coldside Primary and community facilities	14.7
Structural improvements & property upgrades	14.0
Street lighting renewal (net Council contribution)	13.2
Victorian / Edwardian schools	13.0
Coastal protection works (net Council contribution)	12.4
Regional Performance Centre for Sport (net Council contribution)	12.0
Harris Academy refurbishment (net Council contribution)	12.0
Housing revenue account:	
Energy efficient: heating replacement	21.8
External insulation and cavity fill (net Council contribution)	20.8
SHQA capital: roof	13.1
Increased supply of Council housing	10.2

Financial statements and accounting

Our perspective on the preparation of the annual accounts and key accounting judgements made by management

Audit conclusions

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We intend to issue an unqualified audit opinion.

The annual accounts, including the governance statement, were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Our audit work is complete subject to receipt of management representations and update of subsequent events. Following approval of the annual accounts by the scrutiny committee we intend to issue an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2015, and of the Council's deficit for the year then ended. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed controls testing and substantive procedures to ensure that key risks to the annual accounts have been covered;
- communicated with internal audit and reviewed its reports as issued to the scrutiny committee to ensure all key risk areas which may be viewed to have an impact on the annual accounts have been considered;
- reviewed estimates and accounting judgements made by management and considered these for appropriateness;
- considered the potential effect of fraud on the annual accounts through discussions with senior management and internal audit to gain a better understanding of the work performed in relation to prevention and detection of fraud; and
- attended scrutiny committees to communicate our findings to those charged with governance, and to update our understanding of the key governance processes.

Annual accounts preparation

- High quality working papers and draft accounts were provided at the start of the audit fieldwork on 6 July 2015, including a statement of responsibilities, remuneration report, governance statement and management commentary.
- In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. Reflective of the long standing working relationship with the Council the standard of documentation was very good and management quickly responded to queries.
- Throughout the course of the year we had regular discussion with the Council's finance team to ensure that disclosure within the annual accounts was consistent with the requirements of the Code. We provided feedback to management on the content of the annual accounts, management commentary, governance statement and remuneration report and we are pleased to report that these were prepared appropriately.
- There is one audit adjustment set out at appendix two. There are no significant matters in respect of auditor independence and non-audit fees; and management representation letter content, as reported in appendix one.
- We consider that management has maintained a robust control environment throughout 2014-15.

Significant risks and audit focus areas

DRAFT

The significant areas of risk identified in our audit strategy were in respect of:

- **management override of controls fraud risk; and**
- **the Council's financial position;**

and other focus areas of:

- **fraudulent revenue recognition;**
- **accounting for provisions;**
- **valuation of property, plant and equipment and preparation for the 2015-16 Code; and**
- **retirement benefits.**

We summarise below the risks of material misstatement as reported within the audit strategy. We set out the key audit procedures to address those risks and our findings from those procedures, in order that the scrutiny committee may better understand the process by which we arrived at our audit opinion.

We have no changes to the risk or our approach to addressing the assumed ISA risks of fraud in management override of controls and risks of fraudulent revenue recognition. We do not have findings to bring to your attention in relation to these matters. No control overrides were identified.

Significant risk	Our response	Audit findings
Financial position In 2014-15 the Council recorded an accounting deficit of £36.4 million in the comprehensive income and expenditure account (2013-14: £42.2 million) The net movement on the useable funds balance was an increase of £1.5 million (2013-14: decrease £2.9 million), while uncommitted general fund balances remained at £5.0 million. The Council reported an overall underspend against budget for services of £8.4 million. In benchmarking undertaken by Audit Scotland from analysis of the 2014-15 unaudited financial statements of Scotland's 32 local authorities, the Council's uncommitted reserves as a percentage of net revenue spend continued to be one of the lowest.	We have updated our understanding of the Council's financial position and year end outturn position through review of quarterly reports and other management information. We have commented on this on pages 9 to 14. We performed controls testing over the budgeting process including the monitoring of budgets throughout the year. We performed substantive procedures, including substantive analytical procedures, over income and expenditure comparing the final position to budget and investigating significant variances.	We found that management is adequately monitoring the financial position through regular internal reporting. This is communicated to members on a regular basis. Management has applied the going concern assumption in preparing the annual accounts. We have considered this assumption on page 20 and concluded that this is appropriate. The McClelland review (page 32) includes a recommendation that the Council "should fully adopt and integrate the V&A project into its existing structures for dealing with construction projects and fully allocate accountability and responsibility across appropriate Council functions and departments". The Council has integrated all V&A capital expenditure into its 2016-21 capital plan and will prepare capital budget monitoring reports to include whole project costs, not just the Council share.

Significant risks and audit focus areas

DRAFT

Focus area	Our response	Audit findings
Accounting for provisions (holiday pay and landfill sites) ▪ Following a European Court of Justice ruling in May 2014, employers are required to pay holiday pay to staff at a rate commensurate with any commission or over time that they regularly earn. Management has updated its process for holiday pay going forward following consultation with trade unions. Management considered whether there was a provision or contingent liability that required disclosure as at 31 March 2015. ▪ Whilst the Council does not operate landfill sites, coal mines or other sites which carry significant obligations for rectification, Tayside Contracts Joint Committee operates quarries which carry obligations for rectification. We reported in our audit strategy that further analysis was required by management to identify whether appropriate provisions are held for this required expenditure.	Under IAS 37 a provision should be recognised when: ▪ an entity has a present obligation as a result of a past event; ▪ it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and ▪ a reliable estimate can be made of the amount of the obligation. We monitored legislative changes on holiday pay and considered the Council's position in relation to the above criteria. We updated our understanding of Tayside Contract's provisions and reviewed the calculation and application of provisions associated with quarry reinstatement and environmental legislation, taking into account future intentions for use. We challenged management's year end judgements and assessed the provision values. We also discussed other risk areas in respect of provisions, such as equal pay, to verify no further provisions are required.	We found that: ▪ management has implemented actions to mitigate the impact of the legislation in relation to holiday pay by adding 8.3% on eligible hours paid one year in arrears. The estimated annual cost is £0.1 million. There are 263 open cases which the Council aim to settle with the trade unions. Management consider it to be unlikely that there would be a material settlement in respect of this. ▪ We concur with management's assessment that a provision is not required as at 31 March 2015. ▪ A provision is held by Tayside Contracts in respect of reinstatement costs and remedial works. Our testing as auditors of Tayside Contracts concluded that the provisions balance is appropriately stated and the estimate is free from management bias.

Significant risks and audit focus areas

DRAFT

Focus area	Our response	Audit findings
Property, plant and equipment In order to comply with the requirements of the Code, Council assets are subject to rolling valuations; the assets valued in 2014-15 were: ▪ depots and workshops; ▪ off street car parks (and associated land); and ▪ industrial units and shops. The revaluations were carried out by City Development and resulted in a gain of £6.2 million recognised in the revaluation reserve in 2014-15. It is expected that the 2016-17 Code will adopt requirements of the *Code of practice on transport infrastructure assets* ("the transport code"), which requires measurement of these assets on a depreciated replacement cost basis. This will represent a change in accounting policy from 1 April 2016 and require full retrospective restatement. Local authorities are advised to develop a project plan to during 2014-15 to help achieve successful implementation.	Our audit work consisted of: ▪ engaging KPMG valuation specialists to challenge the valuation assumptions used by the valuer; and ▪ agreeing the values posted in the financial statements to those provided by the external valuer. We also considered the Council's plan for the requirements of the transport code, including reviewing the project plan and whole of government accounts ("WGA") submission. We evaluated the extent to which the Council is prepared for the change in accounting policy. We reviewed all transactions in relation to the V&A museum during 2014-15 including income and expenditure.	From the work of our valuation specialists, which included direct contact and challenge of the valuer, we consider that the revaluation is materially appropriate with the exception of the Wellgate Centre revaluation (appendix two). We also consider that: ▪ the methodology and approach taken by the external valuer is appropriate and in line with KPMG expectations; ▪ the valuation is appropriately recognised and disclosed in the annual accounts. An audit adjustment was agreed with management in respect of the downwards revaluation of the Wellgate Centre. In respect of readiness for the 2016-17 Code, we consider the Council to be generally well prepared with a detailed project plan supported by a cross departmental working group. The Council received the transport infrastructure valuations in time for the WGA submission but had queries on this data which remain outstanding. Management anticipates that this will be completed prior to the final WGA submission in October 2015. Recommendation four

Significant risks and audit focus areas

DRAFT

Focus area	Our response	Audit findings
Retirement benefit obligations The Council accounts for its participation in the Tayside Pension Fund in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants. The Council's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The calculation of the pension liability is inherently judgemental.	Our work consisted of: ■ KPMG specialists reviewing the financial assumptions underlying actuarial calculations and comparison to our central benchmarks, the results of which are outlined on page 40; ■ testing of scheme assets and rolled-forward liabilities; ■ testing of the level of contributions used by the actuary to those actually paid during the year; ■ testing of membership data used by the actuary to data from the Council; and ■ agreeing actuarial reports to financial statement disclosures.	We are satisfied that the retirement benefit obligation: ■ is correctly stated in the balance sheet as at 31 March 2015; ■ has been accounted for and disclosed correctly in line with IAS19 *Retirement benefits*; and ■ assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range. We set out further information in respect of the defined benefit obligation on pages 37 and 38. The net defined benefit obligation decreased by £131.9 million compared to 31 March 2014, driven by experience re-measurements of £141.5 million; reflecting the trueing up of the IAS 19 deficit to the 2014 actuarial valuation.

Accounting policies

DRAFT

The Council prepares annual accounts in accordance with the 2014-15 Code. There have been no changes to accounting policies in the year, however the requirements of the transport code will represent a change in accounting policy from 2016-17.

Accounting framework and application of accounting policies		
Area	**Summary observations**	**Audit findings**
Accounting policies	■ There have been no changes to adopted accounting policies in the year. ■ Critical accounting judgements continue to relate to the valuation of property, plant and equipment as well as the valuation the present value of defined benefit obligations under IAS 19 (as calculated by the Council's actuary, Barnett Waddingham) using agreed financial assumptions. ■ The requirements of the transport code will apply from 2016-17, and represent a change in accounting policy. This will require a retrospective restatement for the Council's 2015-16 balance sheet.	We are satisfied that the accounting policies and estimates adopted remain appropriate to the Council. We have not identified any indications of management bias.
Financial reporting framework	Dundee City Council prepares annual accounts in accordance with the Code of Practice of Local Authority Accounting in the United Kingdom ("the 2014-15 Code") which is based upon International Financial Reporting Standards ("IFRS"). The 2014-15 Code has a number of amendments from the 2013-14 version. The amendments include: ■ adoption of the new group accounting standards IFRS 10, IFRS 11, IFRS 12 and IAS 28; ■ amendments in respect of the restated opening balance sheet; and ■ changes to the requirements for accounting for combinations of bodies and transfer of functions. We have considered the adoption of the new group accounting standards on page 24. We do not consider these changes to have a material impact on the Council's annual accounts. There was no requirement for a restated opening balance sheet and no combinations or transfer of funds.	We are satisfied that the accounting policies adopted remain appropriate to the Council and have been correctly applied.

Accounting policies

DRAFT

The annual accounts have been appropriately prepared on a going concern basis, having due consideration of the agreement of revenue support grant in respect of 2015-16.

Accounting framework and application of accounting policies		
Area	**Summary observations**	**Audit findings**
Going concern	■ The Council had net assets of £563.2 million (2013-14 £429.7 million) at the balance sheet date. Although this has increased from 2013-14 by £133.5 million, this is primarily in relation to the decrease in the pension liability (£131.9 million). ■ Management considers it appropriate to continue to adopt the going concern assumption for the preparation of the annual accounts. It considers that the confirmed revenue support grant of £297 million is sufficient to meet debts as they fall due. ■ The Council recognised a deficit in the year, however, £5.0 million was transferred to the general fund, providing further comfort over the Council's financial position. Over the past few years there has been a reduction in the overall cost base and further efficiency savings are incorporated in budgets.	We concur with management's view that the going concern assumption remains appropriate for the reasons noted.

Management reporting in financial statements

DRAFT

Our testing of the design and operation of financial controls over the production of the annual report and remuneration report are consistent with the annual accounts.

Area	Summary observations	Audit findings
Management commentary	The Local Authority Accounts (Scotland) Regulations 2014 requires the inclusion of a management commentary within the annual accounts, similar to the Companies Act requirements for listed entity financial statements. The requirement notification was issued relatively late in the accounts preparation process, however management commentary was included within the unaudited annual accounts received on 26 June 2015. We reviewed the contents of the management commentary against the guidance contained in the local government finance circular 5/2015 and are content with the proposed report. We provided management with some relatively minor suggestions relating to how the management commentary could be enhanced and where additional information disclosures should be made.	We are required to consider the management commentary and provide our opinion on the consistency of it with the annual accounts. We are satisfied that the information contained within the management commentary is consistent with the annual accounts.
Remuneration report	The remuneration report was included within the unaudited annual accounts and supporting reports and working papers were provided. Amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentational changes to ensure that it complied with the Local Authority Accounts (Scotland) Regulations 2014.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the annual accounts.

Subsidiaries and associates

DRAFT

We have considered the Council's subsidiaries and associates against the requirements of group accounting standards.

We have considered the Council's arrangements in respect of following the public pound and arms-length external organisations.

Requirements	Summary observations	Audit findings
Group accounts The 2014-15 Code includes a requirement for the adoption of the new group accounting standards IFRS 10, IFRS 11, IFRS 12 and IAS 28. As part of adopting the new standards, management was required to identify interests in other entities and determine whether these were classified as subsidiaries, joint ventures or associates and ensure appropriate disclosure in the annual accounts.	We compared management's disclosure of group entities against the requirements of the Code, incorporating the new group accounting standards. Subsidiaries are entities over which the Council can exercise control. Control occurs if the Council has: ■ power over the investee; ■ exposure, or rights, to variable returns from its involvement with the investee; and ■ the ability to use its power over the investee to affect the amount of the investor's returns. The Council considers that the Common Good Fund, Fleming Trust, and Dundee Energy Recycling Limited are subsidiaries. Associates are entities in which the Council can exercise a significant influence without support from other participants. The Council considers that the Tayside Valuation Joint Board, Dundee City Developments Limited and Leisure and Culture Dundee are associates. The Council considers Tayside Contracts Joint Committee to be a joint venture following re-classification required to comply with IFRS 10. Management attempted to facilitate early discussion with the other council members of the Joint Committee to ensure a consistent approach was applied by all councils. We consider the Joint Committee to be an associate rather than a joint venture; this is a disclosure issue only as the consolidation method is the same regardless of the classification. This has been updated in the audited annual accounts.	We agree with management's classification of subsidiaries and associates in line with the requirements of group accounting standards, however we consider Tayside Contracts Joint Committee to be an associate rather than a joint venture. The subsidiaries are consolidated within the annual accounts, none of them are material for audit purposes. We agree with management's view that DDL is not part of the Dundee City Council group (page eight).
Following the public pound Auditors are required to consider the Council's arrangements for compliance with the Code of Guidance on Funding External Bodies and Following the Public Pound ("the FtPP Code").	We have considered management's processes to comply with the FtPP Code. Funding provided to external organisations is considered on an annual basis by the policy and resources committee. We prepared a report to management in 2013-14 in relation to the Council's arrangements in respect of arms-length external organisations ("ALEOs"). Our report did not include any significant recommendations, however we highlighted areas where the Council's arrangements could be improved.	No significant recommendations have been made to the Council in respect of weaknesses in compliance with the FtPP Code.

Governance and narrative reporting

Our overall perspective on narrative reporting, including the annual governance statement

Update on controls findings from our audit

Corporate governance arrangements

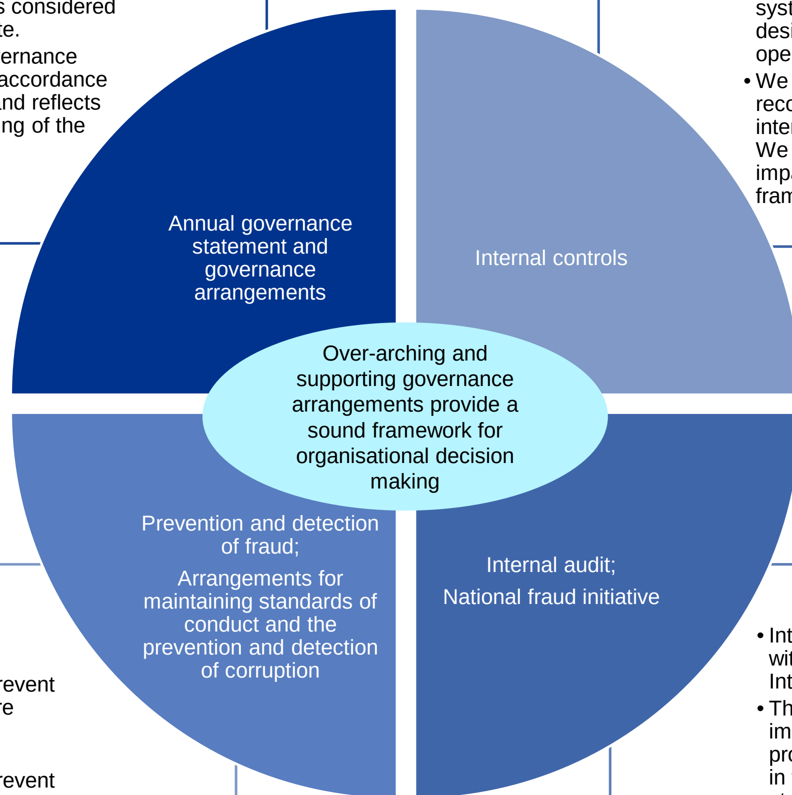
DRAFT

We considered the Council's corporate governance arrangements against a number of key areas which we consider to make up an effective governance framework.

Our audit findings against each key area are provided opposite.

- The governance framework of the Council is considered to be appropriate.
- The annual governance statement is in accordance with guidance and reflects our understanding of the organisation

- Controls relating to financial systems and procedures are designed appropriately and operating effectively.
- We raised minor recommendations in our interim management report. We do not consider these to impact the overall control framework.



- The Council's arrangements to prevent and detect fraud are appropriate.
- The Council's arrangements to prevent and detect conduct and corruption are appropriate

- Internal audit is compliant with the Public Sector Internal Audit Standards.
- The Council has implemented a new procedure for participation in the NFI. This will strengthen the overall control framework.

Corporate governance arrangements (continued)

DRAFT

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Annual governance statement

The Council includes an annual governance statement within its annual accounts. The following elements have been included.

Governance arrangements

The Council operates a committee structure, and has a scrutiny committee to ensure sound governance arrangements.

Compliance with the Code of Corporate Good Governance

The Councils’ local code of corporate governance reflects the requirements of the CIPFA/SOLACE ‘delivering good governance in local government’ framework. A working group of senior officers reviewed the guidance to assess the Council’s current compliance. Overall compliance was found to be good with a score of around 90% compliant. Where areas for improvement have been identified, these have been included in an action plan which will be reviewed during the next annual review of the Council’s arrangements.

Risk management

Management is continuing to review risk management arrangements to provide assurance to elected members over the mitigation of identified risks.

The Council’s risk management strategic plan was approved by the policy and resources committee in June 2013 and includes a broad description of the Council’s risk appetite.

The corporate risk register was updated and approved by the scrutiny committee in June 2014. Following this, the Council introduced the Covalent performance and risk management software. As part of the implementation of the new system, management has reviewed the risk register format which is in the process of being agreed. It is intended that frequent updates of the corporate risk register will be presented to the scrutiny committee once the new format has been agreed.

We have updated our understanding of the governance framework and documented this though our overall assessment of the Council’s risk and control environment. We consider the governance framework to be appropriate for the Council and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.

Corporate governance arrangements (continued)

DRAFT

We raised four recommendations in the interim audit report, in respect of bank reconciliations, journals authorisation, NFI data submission and new users to the Northgate system. We welcome the progress in implementing the recommendations.

Internal controls

Council officers are responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the annual accounts. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work.

As part of our interim audit report, we raised four recommendations in relation to control weaknesses. We provide an update on the progress of implementation of each of these recommendations below:

- timely completion of bank reconciliation – bank reconciliations were all completed for 2014-15, however the year end bank reconciliation was not prepared and reviewed until June 2015;
- journals authorisation – we confirmed during our year end testing that the quarter three control operated effectively, however the quarter four control was not completed at that time;
- NFI data submission – we completed a further return to Audit Scotland in June 2015 (page 29). The council tax to electoral register dataset remained outstanding in June 2015; and
- new users to Northgate system – management agreed our recommendation and set an implementation date of September 2015. We will follow up progress as part of our interim audit in 2015-16.

Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively.

Since the conclusion of our interim work, there has been positive action towards our recommendations, however opportunities remain to improve processes further.

Corporate governance arrangements (continued)

DRAFT

The Council has procedures in place for the prevention and detection of fraud and corruption.

The Council participates in the NFI exercise and has implemented new processes to address the weaknesses we highlighted in our June return to Audit Scotland.

Prevention and detection of fraud

No material fraud or other irregularities were identified during the year. The arrangements include policies and codes of conduct for staff and board members, supported by a fraud prevention policy and response plan. The Council participates in the national fraud initiative ("NFI") exercise, led by internal audit. We have discussed the Council's involvement in NFI opposite.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

The Council has arrangements including policies and codes of conduct for staff and elected members, supported by a whistleblowing policy. Management and members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise, to their work at the Council.

National fraud initiative ("NFI")

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

We completed a return to Audit Scotland in December 2014 in respect of the council tax single person discount to electoral roll NFI exercise, and our findings were reported in our interim management report.

We completed a further return in June 2015, where our review of the Council's NFI participation resulted in a red grading overall, indicating improvement is required. The Council did not submit the datasets by the required deadline and some datasets had not been opened or considered by relevant officers; as a result at least 70% of recommended matches had not been considered.

Our review also found that the efficiency of the NFI process could be improved by focussing on recommended matches from high quality data sets.

The scrutiny committee has not been provided with an update on the council's NFI progress in line with good practice.

We note that the council has introduced a new process for NFI from June 2015 whereby the chief internal auditor is now the line manager of the NFI key contact and is responsible for promoting the NFI process. This arrangement is expected to enhance the focus on NFI matches.

Recommendation five

We consider that the Council has appropriate arrangements to prevent and detect fraud.

We consider that the Council has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

The council has implemented new procedures from June 2015 to address the weaknesses highlighted in our NFI return to Audit Scotland.

Corporate governance arrangements (continued)

DRAFT

The Council's internal audit service supports management in maintaining sound corporate governance arrangements and internal controls. We have found internal audit to be compliant with the Public Sector Internal Audit Standards.

Internal audit

Internal audit is provided by the Council's internal audit department and supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action.

Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit. We also considered the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*.

From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Internal audit has completed its agreed plan for the year ended 31 March 2015 and the controls assurance statement states that reasonable assurance can be placed on the overall adequacy and effectiveness of Dundee City Council's framework of governance, risk management and control for the year to 31 March 2015. Internal audit's work during the year is summarised opposite.

Summary of internal audit work

- Agreed plan completed for the year.
- 25 reviews completed.
- Out of a total of 62 findings, none were categorised as 'critical' risk findings.
- Controls assurance statement provides reasonable assurance on the overall adequacy and effectiveness of the Council's governance framework, risk management and controls.

We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards.

We can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing.

Integration of health and social care

DRAFT

The integration joint board receives its delegated powers as of 1 April 2016.

We have considered the Council's progress against milestones to date and its preparedness for key milestones for activities from 1 April 2016.

We consider the Council's progress to be appropriate and in line with most local authorities.

Health and social care integration

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all Councils and NHS Boards to formally and legally establish integration of health and social care by April 2016. We have considered the Council's progress against milestones to its preparedness for activities from 1 April 2016. All statutory requirements have been met to date.

Milestone	Summary observations	Our view
Establishment of Shadow Board	The shadow board met throughout 2014-15. It revised its terms of reference in March 2015 to reflect the appointment of a chairperson and vice chairperson.	The shadow board has fulfilled its role and is strongly constituted and well attended by members, officers and stakeholders.
Approval of integration scheme and establishment of Integration Joint Board ("IJB")	The draft integration scheme was approved by the Council in March 2015 and subsequently submitted to the Scottish Government. The scheme continues to be updated, with ongoing discussions with the Scottish Government, primarily in respect of description of services and hosting arrangements in respect of some specialist services. The shadow IJB chairperson and vice-chairperson and Council chief executive have liaised in respect of changes, under the delegated authority from Council.	The Council met statutory requirements in relation to the draft integration scheme. The IJB will not be formally established until finalisation of the delegation scheme and standing orders. Good partnership working with Angus Council in particular has been noted in forming the draft scheme.
Governance and membership arrangements	The voting and non-voting members of the shadow IJB were formally appointed. The chief officer has dual responsibility, to the IJB for service delivery and to chief executives of the Council's and health board for operational services and use of resources. Consideration has been given by the shadow board to the clinical, care and professional governance framework of the IJB.	Progress is in line with expectations . Management is aware of the need to consider remits of committees and the Chief Social Work Officer within the Council to ensure they reflect the new responsibilities and maintain scrutiny of services. Summary papers have been prepared by Council officers to consider these arrangements going forward which is good practice.

Integration of health and social care (continued)

DRAFT

Health and social care integration (continued)

Milestone	Summary observations	Our view
Appointment of chief officer and chief finance officer	The chief officer has been appointed. In respect of the chief finance officer (section 95 officer), recruitment is ongoing.	A vacancy in the chief finance officer post is not unusual for IJBs at this stage.
Other key positions	A single management structure (across all partner organisations making staff resources available) has been prepared based on delegated functions. The Council has been considering alignment of staff roles and posts with similar staff appointed by the health board and proactively working to eliminate significant differences prior to implementation of the single management structure. The shadow board receives updates on organisational development.	Management is aware of the potential risk of inconsistency in staff terms and conditions between cohorts of staff employed by the Council or health board respectively. This will be more financially significant at senior levels and operationally significant at lower grades. This could lead to disputes or equal pay claims.
Development of strategic plan	Section 32 of the Public Bodies (Joint Working) (Scotland) Act places a duty on IJBs to establish a strategic planning group ("SPG") which is involved in all stages of developing and reviewing the strategic plan. It is anticipated that a strategic plan will begin to be developed to December 2015 in the context delivery targets and current resources (rolled forward from constituent parties). The initial focus is therefore on any shortfall in ability to deliver expected services within financial and operational constraints. A local deliver plan will follow.	We consider that progress with developing the strategic plan is on track and the statutory deadline for its approval will be 90 days from formal establishment of the IJB.
Due diligence	Detailed financial due-diligence was conducted at a half-day seminar and subsequently reported to the shadow board. It included consideration of past and future financial performance, risks and cost pressures together with medium-term financial forecasts.	We consider progress to be appropriate but further focus on other streams of non-financial due diligence could be considered.
Budgets	Annual accounts will be required for the joint board from 2016-17 onwards and it is anticipated that partners will include financial information regarding the joint board in annual accounts. The budget for 2016-17 will be formed drawing on existing functional budgets.	A budget for 2016-17 will need to be formed, and appointment of a chief finance office is a key step to enable this to happen. There is a dichotomy between a single service provision and separate partner financial requisition.

Integration of health and social care (continued)

DRAFT

Health and social care integration (continued)

Milestone	Summary observations	Our view
Communication	The Council keeps stakeholders informed of the progress of integration through the Council website. This has a section which includes the background of integration and progress. An integration scheme consultation and engagement plan has been approved by the shadow board and local events have been well and openly attended by a broad range of local stakeholders.	The website contains some information to inform stakeholders, but is less informative than some other websites which also make available minutes and details of key stakeholders. Local consultation and engagement is well focussed.

Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

Performance management

DRAFT

Our work has identified that the Council's Best Value and performance management arrangements are generally robust.

Performance management and Best Value

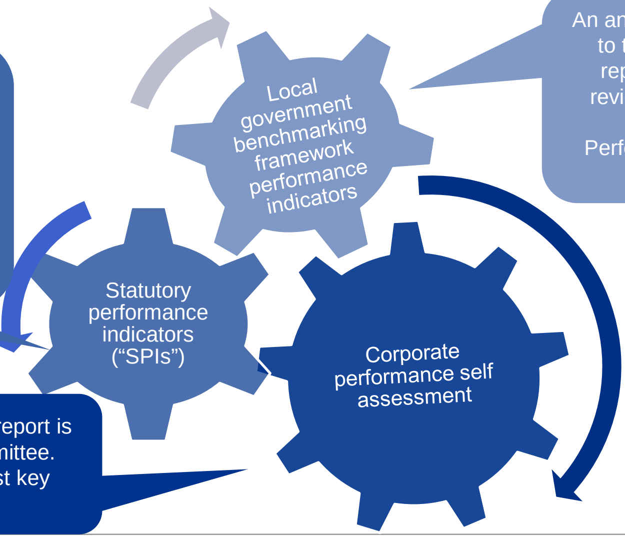
Scottish Government guidance on Best Value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on ito deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to priorities, operating environment, scale and nature of the body's business.

In June 2015 Audit Scotland presented a report to the Accounts Commission summarising a review of all Scottish councils' response to the Commission's Statutory Performance Information Direction (2012). The Council had 11 areas for improvement noted. Audit Scotland had originally noted 14 areas for improvement, however this was lowered to 11 following discussion with management. All SPI data is being loaded onto the Councils' website to ensure it is accessible by all stakeholders. It is anticipated that this will result in a more positive conclusion from Audit Scotland in their next review of SPIs.

Included within the internal audit plan each year is a review of the systems for preparation and reporting of performance indicators, to provide assurance over best value. Internal audit considers best value as part of the audit planning process to ensure that this is considered during all internal audit reviews.

Our consideration of the work of internal audit, as part of our extended control work, did not indicate high risk findings within these areas. We consider that the Council has adequate processes to ensure best value. However we recognise that there are a number of criteria to consider within best value and it is inherently judgemental.

Statutory performance indicator ("SPI") information is reported on the Council's website, and progress is reported to the policy and resources committee on a quarterly basis. We have prepared a report to Audit Scotland outlining the Council's process for collecting and reporting on SPIs.



An annual review of the Council's performance in relation to the local government benchmarking framework is reported to the P&R and scrutiny committees. This review compares the Council's performance to that of other councils within the same 'family group'. Performance highlights and areas for improvement are identified.

The Council's corporate self assessment report is presented quarterly to the scrutiny committee. This report sets out performance against key performance indicators.

We consider that the Council has appropriate arrangements to effectively manage performance and achieve best value in processes.

Performance management (continued)

DRAFT

The Council has established processes for the consideration of Audit Scotland's national performance audits.

We have prepared a return to Audit Scotland in 2014-15 in respect of our findings on financial capacity within the Council.

Local response to national studies

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies. To ensure that added value is secured through the role of Audit Scotland and its appointed auditors, auditors consider if audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits.

The Council has established processes for the consideration of national performance audits. All Audit Scotland performance audit reports are presented to the scrutiny committee which ensures members are aware of sector and national issues, and there is appropriate challenge for management in addressing any potential weaknesses.

Financial capacity in public bodies

Through the process of feedback through annual audit reports, current issues reports and sector meetings, Audit Scotland has identified that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance.

Audit Scotland has requested the collation of baseline data across the public sector to inform sector specific overview reports and may inform a follow-up to the joint report on the public sector workforce which was published in November 2013 or support the development of the future performance audit programme.

We have completed a return to Audit Scotland in respect of our findings. Our review in response to the request for data collection identified that there is appropriate financial capacity within the organisation to ensure effective management.

In our view the Council has adequate financial capacity and representation, however, it continues to face numerous financial challenges, complex projects and responsibilities associated with the integration of health and social care. Consequently there is increasing focus on appropriate delegation amongst corporate services team members.

We consider that the Council has appropriate arrangements to effectively respond to national studies.

We consider that the Council has sufficient financial capacity to effectively manage the organisation.

Appendices

Mandatory communications

DRAFT

There was one adjusted audit difference which resulted in a change to the unaudited core financial statements.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There was one audit adjustment required to the draft annual accounts which impacted on the net assets and financial and investment income and expenditure for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.	Appendix two
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences.	-
Confirmation of Independence Letter issued to the scrutiny Committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of the Audit Partner and audit staff.	Appendix three
Schedule of Fees Fees charged by KPMG for non-audit services	There were no non-audit fees in 2014-15.	Appendix four
Draft management representation letter Proposed draft of letter to be issued by the Council to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of Dundee City Council's risk profile and annual accounts balances. Materiality was determined at £11 million; approximately 2% of total expenditure, and is consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £8 million. We report identified errors greater than £250,000 to the scrutiny committee.	

Mandatory communications: charity accounts

DRAFT

The draft trustees' reports and financial statements for Dundee City Council Charitable Trusts and the Lord Provost of Dundee Charity Fund were received before the statutory date of 30 June 2015.

Our audit work on these statements is complete and we have issued unqualified opinions.

Area	Key content
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the draft accounts which impacted on the net assets and income and expenditure for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences.
Confirmation of Independence Letter issued to the scrutiny committee	We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of the Audit Partner and audit staff.
Schedule of Fees Fees charged by KPMG for non-audit services	There were no non-audit fees in 2014-15.
Draft management representation letter Proposed draft of letter to be issued by the Council to KPMG	There are no changes to the standard representations required for our audit from last year.
Materiality: Lord Provost of Dundee Charity Fund The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the charities' risk profiles and annual accounts balances. Materiality was determined at £4,800; approximately 10% of net assets. We designed our audit procedures to detect errors at a lower level of precision, i.e. £3,200, with errors greater than £200 reported to the scrutiny committee.
Materiality: Dundee City Council Charitable Trusts The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the charities' risk profiles and annual accounts balances. Materiality was determined at £110,000; approximately 10% of net assets. We designed our audit procedures to detect errors at a lower level of precision, i.e. £82,500, with errors greater than £5,500 reported to the scrutiny committee.

Audit differences

DRAFT

There are no unadjusted audit differences and one adjusted audit difference to the financial statements.

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There is one adjusted audit difference and no unadjusted audit differences.

		Balance sheet		Income and expenditure account	
Caption	Nature of adjustment	£m DR	£m CR	£m DR	£m CR
Comprehensive income and expenditure account – financing and investment income and expenditure	The impairment of the Wellgate Centre driven by the reduced forecast rental stream.	-	-	2.285	-
Balance sheet – investment property		-	2.285	-	-

Auditor independence

DRAFT

Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with Dundee City Council.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by Dundee City Council and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular communications
- Internal accountability
- Risk management
- Independent reviews

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the board of directors.

Confirmation of audit independence

We confirm that as of 22 September 2015, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Partner and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

Defined benefit obligations

DRAFT

In respect of employee benefits, each of the assumptions used to value the Council's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19.

We set out below the assumptions in respect of defined benefit obligations.

Defined benefit pension liability

2015 £'000	2014 £'000	KPMG comment
(277,312)	(409,199)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary. (See assumptions table below.) The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of around 18 years. The closing deficit decreased by £131.9 million compared to 2013-14, primarily due to a higher return on assets than the discount rate used (14% return compared to 3.3% discount rate). A reconciliation from opening to closing deficit is included on the next page.

Assumption	Dundee City Council	KPMG central	Comment
Discount rate (duration dependent)	3.30%	3.25%	Acceptable. The proposed discount rate is slightly less prudent (lower liability) than KPMG's central rate as at 31 March 2015, but lies within an acceptable range for IAS 19 purposes
CPI inflation	RPI less 0.8%	RPI less 1.0%	Acceptable. KPMG's view is that the differential between RPI and CPI should be closer to 1%. The Council's assumptions could therefore be considered prudent (higher liability).
Net discount rate (discount rate – CPI)	0.9%	1.05%	Acceptable. The proposed assumptions are within the acceptable range of +/- 0.3% from the KPMG central range.
Salary growth	RPI + 1%	Typically 0% - 1.5% above inflation	Acceptable. The proposed assumptions are within the acceptable range.

Defined benefit obligations (continued)

DRAFT

The table opposite shows the reconciliation of the movement in the statement of financial position.

Increases to the pension scheme deficit in the year have been driven by changes in financial and demographic assumptions.

	£'000	Deficit / loss	Surplus / gain	Impact	Commentary
	Opening pension scheme deficit			**(409,199)**	The opening IAS 19 deficit for the Scheme at 1 April 2014 was £409.2 million, consisting of assets of £862.0 million and defined benefit obligation of £1,271.2 million.
I & E	Service cost			(34,264)	The scheme remains open to accrual. The employees' share of the cost of benefits accruing over the year is £34.3 million.
I & E	Past service cost			(2,353)	A past service cost of £2.4 million is recognised, relating to early retirement.
I & E	Net interest			(17,939)	This is the interest on the opening deficit of £1,271.2 million. This is made up of £38.6 million interest income on plan assets, and £56.6 million interest cost on obligations.
I & E	Administration expenses			(318)	The fund paid administrative expenses of £0.3 million from the scheme assets.
Cash	Contributions			22,650	The Council made contributions of £22.7 million, broadly in line with contributions made last year.
OCI	Actuarial gain/(loss) – demographic assumptions			38,745	There was an actuarial gain of £38.7 million.
OCI	Actuarial loss – financial assumptions			(123,089)	There was an actuarial loss of £123.1 million, driven by a 1.2% decrease in the discount rate assumption.
OCI	Other experience			141,494	Other experience re-measurements resulted in a gain of £141.5 million, as a result of trueing up the membership data to the 2014 actuarial valuation; as opposed to rolling forward the 2011 valuation results. This is usual practice although the size of the gain suggests greater accuracy is needed in future roll-forwards.
OCI	Other actuarial gains			23,802	There were other actuarial gains of £23.8 million.
OCI	Return on assets			83,159	The return on plan assets, excluding interest of £38.6 million, was £83.2 million.
	Closing pension scheme deficit			**(277,312)**	The closing IAS19 deficit on the scheme at 31 March 2015 is £277.3 million (consisting of assets of £999.9 million and defined benefit obligation of £1,277.3 million).

I&E – impacts on surplus /(deficit) within statement of comprehensive net expenditure

Cash – cash-flow impact

OCI – charged through other comprehensive income

Action plan

DRAFT

The action plan summarises specific recommendations arising from our work, together with related risks and management's responses.

We present the identified findings across four risk dimensions:

- **financial statements;**
- **business risks;**
- **governance risks; and**
- **performance reporting.**

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Design Dundee Limited (page 8) *Risk dimension: Governance*		**Grade two**
Once the V&A museum is operational, DDL will be responsible for running the museum and the Council will own the asset. DDL will pay the Council a peppercorn rent for its use and the Council will make revenue contributions to DDL in respect of running costs. We understand that while expected Council running cost and in-kind contributions have been approved, the management agreement, lease agreement and development agreement are currently in advanced draft form and should be agreed with partners shortly. There is a risk that agreements are not finalised in an appropriate timeframe or do meet the Council's needs.	The remaining draft agreements should be finalised, approved by relevant committee where appropriate and subsequently concluded with partners as soon as possible.	The draft agreements are currently being finalised and will be reported to the relevant committee at an early date. **Responsible officer:** Executive Director of Corporate Services **Implementation date:** 31 December 2015

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Design Dundee Limited (page 8) *Risk dimension: Governance*		**Grade three**
DDL has nine directors, one of which is a representative of the Council. The Council does not make a contribution to DDL. As such the Council does not consider that it exercises 'joint control' or 'significant influence' and does not consider DDL to be part of the group.	Although this is reflective of the current position, management should monitor this in advance of the preparation of the 2015-16 financial statements and regularly thereafter to determine whether DDL should be consolidated as part of the Council's group accounts.	The status of DDL will be considered again as part of the preparations for the 2015/16 accounts and monitored on an ongoing basis thereafter. **Responsible officer:** Executive Director of Corporate Services **Implementation date:** 31 March 2016
3 Financial planning (page 13) *Risk dimension: Business*		**Grade two**
The Council estimates it will need to identify further budget savings of around £22.7m over the two year period 2016-18 in order to maintain a Council Tax freeze. The key aspects of a medium term financial strategy have been set out, however, there is a risk that future cost pressures are not identified and understood by members in a timely manner as they are not presented with a longer term budget.	Management should consider presenting a three year budget based on current year budget and updated for known changes to income and expenditure to members.	The Council will continue to develop its budget projections and medium term financial strategy in response to the forthcoming spending review announcements by the UK and Scottish Governments. **Responsible officer:** Executive Director of Corporate Services **Implementation date:** February 2016

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 Whole of government accounts – transport infrastructure assets (page 19) *Risk dimension: financial statements*		**Grade three**
Management completed the whole of government accounts ("WGA") data collection tool ("DCT") slightly later than the deadline for submission to auditors on 24 July 2015. The DCT contains an optional tab for transport infrastructure assets to help local authorities prepare a depreciated replacement cost valuation in line with the transport code. The transport infrastructure assets tab was not completed on the unaudited DCT, however management plan to include this within the financial submission. There is a risk that management will not have the depreciated replacement cost figures for transport infrastructure assets as at 1 April 2015 to allow for a restatement of the 2015-16 balance sheet in line with the requirements of the Code.	Management should ensure the transport infrastructure assets tab of the DCT is completed prior to final submission. Going forward, this should be included in the first submission.	This data will be completed and returned in the final 2014/15 WGA submission. **Responsible officer**: Finance Manager (Corporate) **Implementation date:** 30 September 2015 Future arrangements will be considered through the Final Accounts Working Group and the interdepartmental working group that has been formed to implement the requirements of the CIPFA Transport Infrastructure Assets Code. **Responsible officer:** Finance Manager (Corporate) **Implementation date:** 31 March 2016

Action plan (continued)

DRAFT

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
5 National fraud initiative (page 28) *Risk dimension: Governance*		**Grade two**
We completed a return to Audit Scotland in June 2015 to review the Council's participation. This resulted in a red grading. The Council did not submit the datasets by the required deadline and some datasets had not been opened or considered by relevant officer; as a result at least 70% of recommended matches had not been considered. Council resources were not focussed on high quality recommended matches resulting in inefficient investigations. The scrutiny committee has not been provided with an update on the council's NFI progress.	We note that the council has introduced a new process for NFI from June 2015 whereby the chief internal auditor is now the line manager of the NFI key contact and is responsible for promoting the NFI process. As part of the new processes management should: ■ ensure all datasets are submitted by the required deadlines; ■ improve the efficiency of the NFI process by focussing on recommended matches from high quality data sets; and ■ update the scrutiny committee regularly on progress made in the NFI process.	To enhance the robustness of the NFI process the improvements contained in the recommendations are in the process of being progressed. As part of this exercise a reporting regime for the Scrutiny Committee in respect of NFI matters will be put in place. **Responsible officer:** Chief Internal Auditor **Implementation date:** 31 December 2016

cutting through complexity