
Dumfries and Galloway Council

Annual Report to Members and the
Controller of Audit for the year
ended 31 March 2013

September 2013

Final



PwC
141 Bothwell Street
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Members and the Controller of Audit
Dumfries and Galloway Council
Council Headquarters
Council Offices
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24 September 2013

Dear Members and the Controller of Audit

We are pleased to enclose our Report to the Members and the Controller of Audit in respect of our external audit for the year ended 31 March 2013. The primary purpose of this report is to communicate significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit and Risk Management Committee on 8 January 2013. We have subsequently updated our audit plan and have made two changes which we wish to bring to members attention.

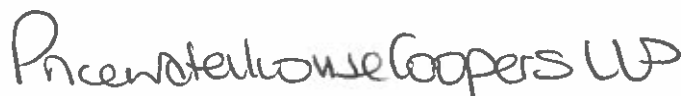
As required by auditing standards, there is a presumption that there is a risk of material misstatement due to fraud in revenue recognition and as a result we have recognised the risk of fraud in revenue recognition as an additional significant risk for the 2012/13 audit. This audit risk has been included in all of our public sector external audit plans for 2012/13 and is not specific to Dumfries and Galloway Council.

In addition, we have reduced our audit risk rating in relation to the liability concerning Equal Pay from elevated to normal as this is a historic provision that is common amongst all local authorities. Given that Dumfries and Galloway Council provide for this potential liability and disclose a contingent liability we see no reason why this should continue to be treated as a higher audit risk.

We have completed our audit work and will issue an **unqualified** audit opinion on the financial statements. We would like to take this opportunity to thank management and staff for their assistance and help during the audit process.

We look forward to discussing our Report with you at the Audit and Risk Management Committee on 24 September 2013.

Yours faithfully



PricewaterhouseCoopers LLP



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Code of Audit Practice and Statement of Responsibilities of Auditors and of Audited Bodies

In May 2011 Audit Scotland issued a revised Code of Audit Practice. The Code's purpose is to assist auditors and audited bodies by explaining where the responsibilities of auditors begin and end and what is to be expected of the audited body in certain areas. Our reports and management letters are prepared in the context of the Code. Reports and letters prepared by appointed auditors and addressed to Members and the Controller of Audit are prepared for the sole use of the audited body or the Controller of Audit and no responsibility is taken by auditors to any Member or officer in their individual capacity or to any third party not expressly stated.



Executive summary

Our overall responsibility as external auditor of Dumfries and Galloway Council (“the Council”) is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice (“the Code”), revised and published in May 2011. We have a dual reporting responsibility for the audit: to the Members of the Council and to the Controller of Audit.

Under the Auditing Practices Board’s International Standard on Auditing (UK and Ireland) “ISA (UK&I) 260 - Communication of audit matters with those charged with governance” we are required to report to those charged with governance on the significant findings from our audit before giving our audit opinion on the Council’s accounts.

This Annual Audit Report to Members and the Controller of Audit, together with previous reports in the year to the Audit and Risk Management Committee and Full Council, discharges the requirements of ISA (UK&I) 260. It contains the significant matters we wish to report to you arising from all aspects of our audit work.

Financial Statements - Section 1

We are pleased to report that our opinion on the financial statements for the year ended 31 March 2013 is **unqualified**.

We proposed a number of adjustments during the audit relating to disclosure matters in the 2012/13 financial statements. These have been processed by management in the final version of the financial statements. There are no unadjusted misstatements.

The audit process has improved significantly from last year and our thanks are offered to the Finance team.

Use of Resources - Section 2

The Council budgeted for a breakeven position in 2012/13 and returned an under spend. After required adjustments between the accounting basis and funding basis under regulations, the Council increased its General Fund balance by £3.794 million to £63.752 million, including specific amounts set aside to fund identified expenditure, compared with a balance of £59.958 as at 31 March 2012.

In total the Council had useable reserves of £72.067 million at 31 March 2013. This includes significant amounts required to address identified commitments including PFI/PPP contractual payments. Useable reserves also include the General Fund, capital funds, and other statutory funds. These reserves are designed to enable the Council to deal with unforeseen events and help manage for future periods of heightened uncertainty.

The Council’s budget for 2012/13 assumed that efficiency savings of £8.354 million (the equivalent to 2.2% of the total budgeted revenue expenditure) would be achieved. This savings target was met and services reported additional £0.723 million savings against budget. The most notable savings were achieved through reductions in staffing and procurement efficiencies.

Governance - Section 3

We have assessed the Council’s overall governance arrangements including a review of key Council and Committee structures and minutes, financial reporting to Committees, and the risk management framework. We consider that appropriately structured arrangements and reporting are in place.

The Code of Audit Practice requires us to review and report on the Council’s Annual Governance Statement. The Council has outlined the processes it employed to identify and evaluate risks. In addition, key elements of the Council’s control framework have been highlighted, along with a self evaluation of developments and areas for further improvement. Based on our normal audit procedures, we **do not disagree** with the disclosures contained in the Statement.

As was the case in 2011/12, business and financial management arrangements within Social Work continue to be an area of particular challenge for the Council.

Performance - Section 4

The Council reports on a range of mandatory Statutory Performance Indicators (SPIs) which are used by Audit Scotland to compare the performance of all authorities in Scotland. In addition to this, councils are encouraged to identify supplementary key performance measures in addition to the statutory measures to provide more tailored performance information. Based on our work performed, the Council was able to demonstrate the basis for the SPIs reported and operates a database for capturing all 227 of its key performance indicators.

Acknowledgement

We would like to formally extend our thanks to the Council's management and staff for the assistance they have given us during the audit process.

1. Financial Statements and Audit Opinion

Audit Opinion

We have completed the audit of the Council's accounts in line with current International Standards on Auditing (UK and Ireland) ("ISAs") and have given an **unqualified** opinion that the financial statements of the Council for 2012/13 give a true and fair view of the financial position and expenditure and income of the Council for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

Our opinion on those selected parts of the Remuneration Report which are subject to audit is also **unqualified**. Our audit opinion does not extend to any other part of the Remuneration Report.

Audit Approach

- 1.01 Our audit approach was set out in our Annual Audit Plan as presented to the Audit and Risk Management Committee on 8 January 2013. We have subsequently updated our audit plan and have made two changes which we wish to bring to members attention.
- 1.02 As required by auditing standards, there is a presumption that there is a risk of material misstatement due to fraud in revenue recognition and as a result we have recognised the risk of fraud in revenue recognition as an additional significant risk for the 2012/13 audit.
- 1.03 In addition we have reduced our audit risk rating in relation to the liability concerning Equal Pay from elevated to normal as this is a historic provision that is common amongst all local authorities. Given that Dumfries and Galloway Council provide for this potential liability and disclose a contingent liability we see no reason why this should continue to be treated as a higher audit risk.

Audit Process

- 1.04 The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The working papers provided were of a high standard and reflected the deliverables listing we issued to management in advance of the audit. Overall we believe an efficient audit process was achieved and an effective working relationship has been developed between us and your officers. This is a significant improvement on last year and our thanks are offered to the Finance team.

Basis of Preparation

- 1.05 The financial statements were prepared in accordance with the accounting requirements contained in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom and the Service Reporting Code of Practice 2012/13, supported by International Financial Reporting Standards (IFRS).

Misstatements and significant audit adjustments

- 1.06 We are required to report to you all unadjusted misstatements (matters we have identified but which officers have chosen not to adjust) which we have identified during the course of our audit, other than those of a trivial nature. In the context of the Council we consider that amounts of a value less than 2.5% of materiality (£270,000) are of a trivial nature. This has increased from the forecast amount reported in the Audit Plan reported to the Audit and Risk Management Committee on 8 January 2013 of £200,000, which at the time was based on prior year balances.

- 1.07 A number of adjustments to the format and disclosure within the Financial Statements have been discussed during the course of our audit and have been processed by management in the final version of the 2012/13 financial statements. No financial adjustments have been raised through our audit work and hence there are no unadjusted misstatements.
- 1.08 In the previous year, we received an objection to the accounts from Loreburn Community Council on the basis that the assets disclosed in the Dumfries Common Good Fund have been misstated. We received further communication in July 2013 from Loreburn Community Council that they were not satisfied that any progress has been made during 2012/13. It is our view that any potential misstatement is not material to our true and fair view on the financial statements and as such has not impacted our audit opinion.

Action 1

Areas of Audit Focus and Significant Accounting Issues Identified

- 1.09 Our response to areas of audit focus per our audit plan and other significant accounting issues identified is detailed below:

Area of Focus	Response
<p><i>Risk of Fraud in Revenue Recognition</i></p> <p>As required by auditing standards, there is a rebuttable presumption that there is a risk of material misstatement due to fraud relating to revenue recognition.</p>	<p>As the majority of revenue within public sector bodies comes from government grants and assistance, this may not necessarily be a significant risk for Dumfries and Galloway Council; however our work has been planned to ensure the auditing standard requirements have been addressed.</p> <p>We performed audit testing on a sample of transactions across the service level and other income and confirmed, with reference to supporting documentation, that it was recorded at the correct value and in the correct period. We have also performed substantive testing over government funding.</p> <p>In addition, we identified higher audit risk manual journals posted to revenue accounts and identified the rationale for these transactions.</p> <p>Our work did not identify any errors that required adjustment to the financial statements.</p>

Area of Focus	Response
<p><i>Risk of Fraud in Expenditure Recognition</i></p> <p>As the Council has financial targets to meet, the risk of fraud in expenditure recognition has also been considered as part of the audit process.</p>	<p>We performed substantive testing on a sample of transactions from each material category of expenditure to confirm, with reference to supporting documentation, that it was recorded at the correct value and in the correct period. This also included audit testing over the year-end payables and accruals balances as well as unpredictability testing over Members expenses claimed in the year.</p> <p>We identified higher audit risk manual journals posted to expenditure accounts and identified the rationale for these transactions.</p> <p>Our work did not identify any errors that required adjustment to the financial statements.</p> <p>It had been our intention to rely on controls put in place by the Council surrounding accounts payable through reliance on the work of Internal Audit; however due to a high level of exceptions found in this testing it was concluded that controls reliance could not be taken. It is recommended that a full review of accounts payable controls is conducted by Internal Audit in 2013/14 to further investigate these issues.</p>
Action 2	
<p><i>Management override of controls</i></p> <p>In any organisation, management may be in a position to override the financial controls. A control breach of this nature may result in a material misstatement of your financial position. For all of our audits, ISAs require us to consider this as a significant risk and adapt our audit procedures accordingly.</p>	<p>Manual journals are a key way in which the financial statements of an organisation can be misstated. To test this we utilised computer assisted audit techniques (CAATs) to review the entire population of journals to identify those which would be regarded as unusual or higher risk. These journals were then tested to ensure they were authorised and appropriate.</p> <p>For unpredictability testing, we tested a sample of Members' expenses claimed in the year.</p> <p>There were no misstatements identified as a result of the work on journals. However; we were unable to perform complete testing to verify that the persons processing journals were appropriate due to limitations in the current reporting functionality of the Integra system, which meant that the listing of journals provided did not contain an automatic name stamp showing who posted each journal.</p>
Action 3	
<p><i>Introduction of Integra FMIS</i></p> <p>The Council introduced the Integra Financial Management Information System in 2012.</p>	<p>In conjunction with Internal Audit we have performed testing over the migration of data from the previous financial ledger (Powersolve) to Integra.</p> <p>We have also evaluated and tested relevant IT general controls to gain assurance over the proper and consistent operation of the key automated procedures that depend on them.</p> <p>Our work did not identify any errors that required adjustment to the financial statements.</p>

2. Use of Resources

2012/13 Financial Performance

The Council reported a deficit of £27.786 million on the provision of services in 2012/13, compared to a deficit of £18.378 million in 2011/12. It is important to recognise that this largely reflects the impact of accounting adjustments and a more informative indication of the Council's performance in the year is reflected in the movement in the General Fund.

Dumfries and Galloway Council increased its General Fund balance by £3.794 million during 2012/13 against a breakeven budget. This increase was due to a number of factors, including the collection of old debt and council tax (£0.858 million) and increases to the Corporate Change Fund to support the delivery of change, savings and efficiencies (£1.133 million).

2.01 The Council's General Fund financial performance for 2012/13 is summarised in the table below.

Provision of Services and General Fund	2012/13 actual £000	2011/12 actual £000
Net Cost of Services	(368,238)	(365,243)
Taxation and non-specific grant income	383,859	385,547
Other operating (expenditure)/income	(611)	259
Financing and investment income/(expenditure)	(42,796)	(38,941)
Deficit on Provision of Services	(27,786)	(18,378)
General Fund		
Deficit on Provision of Services	(27,786)	(18,378)
Adjustments between accounting basis and funding basis under regulations.	29,936	25,142
Transfers from Reserves	1,644	1,473
General Fund increase in the year	3,794	8,237
General Fund Opening Balance	59,958	51,721
General Fund Closing Balance	63,752	59,958

2.02 The Council's service departments achieved an under spend of £0.723 million against an operational budget of £406.720 million. Key variations from the budget were as follows:

- **Education Services** reported an under spend of £0.545 million, achieved due to a reduction in supply teaching costs, reflecting an improvement in teacher absence rates, and efficiencies accrued through more in house delivery of school college links, therefore reducing transport and college fees.
- **Police** reported an under spend of £0.506 million due to recovery of mutual aid costs in relation to the London 2012 Olympics and additional funding was secured for officers deployed locally in partnership with the NHS.
- **Social Work** reported a net over spend of £0.653 million in the 2012/13 financial year due to increased Homecare costs, particularly within Older People and Learning Disability.
- **DGFirst** - Due to the extreme and prolonged winter weather, additional costs of £0.958 million were incurred which were offset by a combination of the use of the Severe Weather Emergency Fund (£0.500

million) and additional cost reductions within other areas of DGFirst’s activities (£0.348 million) which resulted in a net overspend against budget of £0.110 million.

- 2.03 It should be noted that the operational budget and actual outturn (see 2.02) are calculated on a Service basis which reflects the Council’s management structure; whereas the figures reported in the Comprehensive Income and Expenditure Statement (see 2.01) are calculated based on that prescribed by the Service Reporting Code of Practice (SeRCOP) and therefore the two are not directly comparable.

Capital Expenditure

- 2.04 The Capital Investment Strategy Group is responsible for assessing improvements to project planning and delivery to ensure that approved capital allocations are appropriate and that the level of slippage incurred on individual projects is reduced.
- 2.05 The Council had a general fund capital programme budget for 2012/13 of £38.774 million (2011/12: £29.600 million). The 2012/13 actual expenditure was £38.310 million. The total capital expenditure was funded through capital grants, receipts from the sale of assets and other contributions totalling £20.7 million leaving £17.6 million to be funded through borrowing.

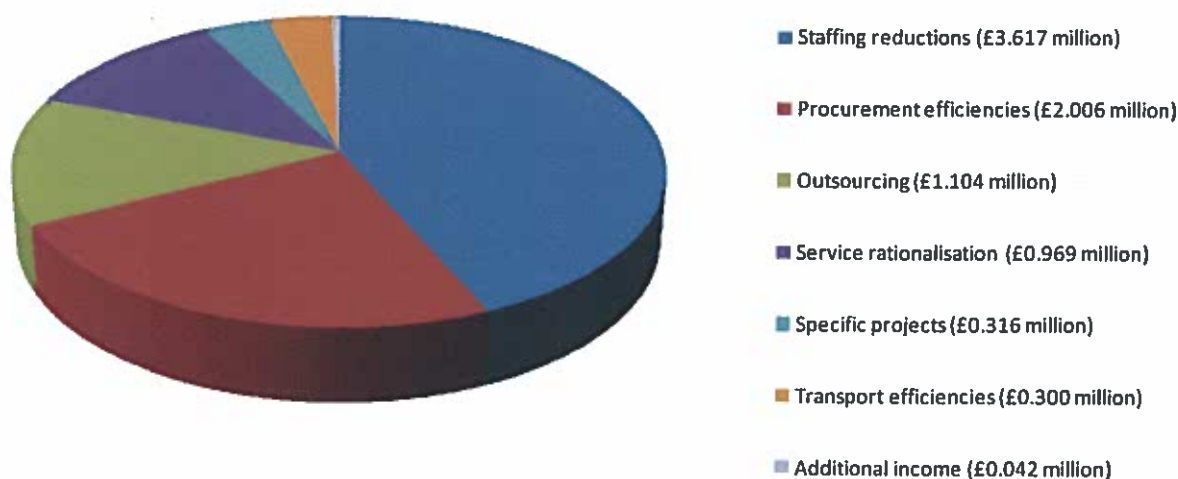
Trading Operations

- 2.06 Management carried out a review of all services to determine the significant Trading Operations in 2012/13. One service (Roads Maintenance) met all the criteria of a significant Trading Operation and is included in a separate note in the 2012/13 financial statements.
- 2.07 The trading operation achieved its statutory performance target of ‘break-even’, over a three year period. The total net surplus on trading services in 2012/13 was £0.098 million, with a cumulative surplus of £0.465 million achieved over the three year period since 2010/11.

Designing Better Services

- 2.08 The Council’s Corporate Management Team recognises that significant savings, beyond operational efficiencies, are required to be identified to balance the Council’s budget over the upcoming period. The savings target for the Council in 2012/13 was £8.354 million. This savings target was met and services reported a further £0.723 million of net savings against budget.

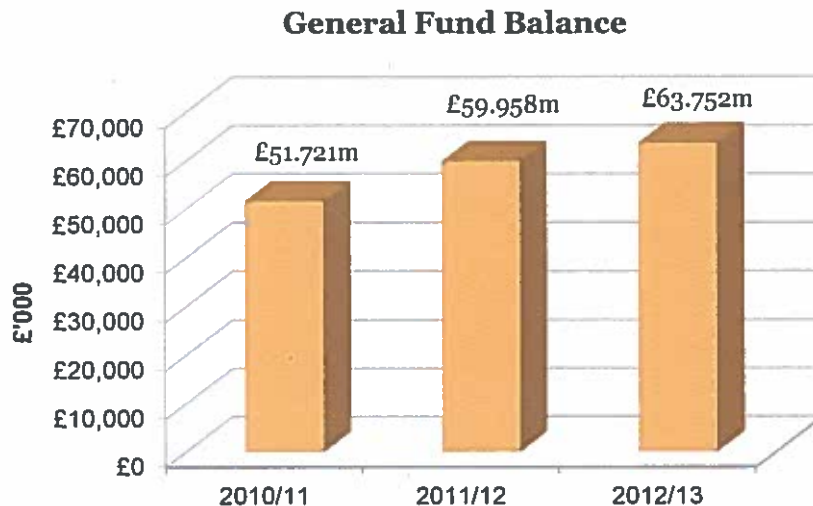
Identified Savings 2012/13



- 2.09 The most notable savings were achieved through reductions in staffing and procurement efficiencies. This savings trend is expected to continue into 2013/14.

Reserves

- 2.10 The Council had a General Fund balance of £63.752 million (including specific amounts set aside for identified expenditure) as at 31 March 2013, an increase of £3.794 million from the prior year. As can be seen from the graph below, general fund balances have been rising year on year, albeit the rate of growth has slowed.



- 2.11 The most notable additions to this increase in 2012/13 were in relation to the creation of the following funds within the General Fund:
- Creation of a Social Work Support Fund (£1.000 million) – a shortfall was identified in the 2013/14 Social Work budget and so measures have been put in place to achieve savings within this service going forward. A corporate fund has been set up to help implement these measures and to support Social Work in the short term. To ensure there is appropriate control over the use of these funds, amounts will only be released for specific purposes as approved by the Policy & Resources Committee.
 - Creation of a Policy Development Fund (£1.488 million) – includes funding for policy development to help achieve the priorities set out in the Single Outcome Agreement, such as the Modern Apprenticeship Scheme and the High Street Facelift Scheme.
 - Corporate Change Fund (£1.216 million) – includes funds allocated for early retirement and voluntary severance payments during 2013/14.
- 2.12 It is the Council's agreed policy to retain an unallocated General Fund balance at a minimum of 2% of annual planned expenditure, equivalent to £7.625 million for 2012/13, resulting in a committed General Fund balance at 31 March 2013 of £56.127 million.
- 2.13 In addition to the Funds noted at 2.11, the allocated/committed elements of the General Fund balance include the following amounts:
- £15.542 million held in a sinking fund for the Smarter Schools PPP Fund and a further £16.342 million held in a sinking fund to meet the future payments of the Waste Management PFI, to support the affordability over the lifetime of the associated contracts. The Scottish Government funding for both projects is not index linked and so this General Fund allocation is required to meet relevant contract charge increases.
 - £2.377 million funding for affordable housing projects, which is ring-fenced per the Scottish Government Statutory Instrument.

Revenue budget 2013/14

- 2.14 The Council approved its 2013/14 revenue budget of £340.977 million (2012/13 budget £376.685 million) in February 2013, which provided for a break-even position. This is calculated on a Service basis, reflecting the Council's management structure. The primary change was to exclude the Police and Fire budgets of £36.060 million which transferred to the new Scottish Police Authority and the Scottish Fire and Rescue Service on 1 April 2013.
- 2.15 The budget model for 2013/14 includes increased costs of £3.000 million to address budget pressures as follows:

Budget Pressures	2013/14 £000	2014/15 £000	2015/16 £000
Non Domestic Rates (2.6% for 2013/14 and 3% thereafter)	170	370	560
Increase in Energy Costs (7% gas; 5% electricity; 10% oil for 2013/14)	553	1,056	1,588
SWAN Vanguard Broadband Project (migration to new contract)	300	800	800
Welfare Reform	1,195	1,195	1,195
General Inflation	250	500	750
Further cost pressures	532	2,079	4,087
Cumulative Budget Pressures	3,000	6,000	9,000

- 2.16 The Council will need to generate £7.226 million of savings to balance the 2013/14 budget. Planned savings over the three year period to 2015/16 total £26.406 million as per the funding gap identified by the Council:

	2013/14 £000	2014/15 £000	2015/16 £000
Cumulative budget deficit/savings required	7,226	17,191	26,406
Annual savings required	7,226	9,965	9,215

The Council's agreed budget development process outlines the approach to be taken for the identification of savings over the upcoming period.

- 2.17 In addition, the Council will continue to support civic pride initiatives and in the run-up to the 2014 Commonwealth Games, has made provisions to recognise and support sporting excellence.

Welfare Reform

- 2.18 In February 2011, the Westminster Government published the Welfare Reform Bill which set out plans to fundamentally overhaul the benefits system. The stated overarching objectives of the Bill were to simplify the benefits system, achieve savings and increase incentives for unemployed people to work. The Welfare Reform Act was given Royal Assent on 8 March 2012. The Council should ensure that it puts in place specific arrangements to address the implications of the Act.
- 2.19 Elected Members have been briefed on Welfare Reform and arrangements are in place for regular up-dates. In addition, Members of the Social Work Services Committee have received a specific briefing on the anticipated impact of the changes upon that service. The impact on people as a result of Welfare Reform has been added to the corporate risk register for 2013/14, with updates to the Audit and Risk Management Committee planned throughout 2013/14.
- 2.20 The Council's Policy and Resources Committee agreed a policy statement on Welfare Reform including the establishment of a Sub Committee to make recommendations to the Policy and Resources Committee on further policy initiatives required. The Sub-Committee first met in April 2013 with subsequent meetings in June and July 2013, with a further three meetings scheduled before the end of the calendar year.

- 2.21 Budget pressure funding of £1.195 million was identified within the 2013/14 budget to support the development of the Welfare Reform agenda, this is made up as follows:
- Council Tax Benefit Replacement Scheme (£0.421 million) - From April 2013 Council Tax Benefit will be abolished and replaced by a local scheme. The funding being made available under the revised arrangements will be 10% less than that available to support the existing Council Tax Benefit Scheme and indications are that this will result in a funding shortfall of £40 million across Scotland. The Scottish Government will fund £23 million of that shortfall with the remaining £17 million to be met by Local Authorities.
 - Reduction in the Department of Works and Pensions (DWP) Administration Grant (£0.159 million) - the Administration Grant received from the DWP will be reduced in 2013/14.
 - Loss of Benefit Overpayment Recovery (£0.115 million) – Where benefit overpayments (due to claimant error) are recovered the level of DWP subsidy received on the initial overpayment does not require to be repaid provided that the overall error rate is below a threshold level. Due to the Council's very low error rate, this has allowed subsidies to be retained but this will no longer be possible under the new arrangements.
 - Impact on Services (£0.500 million) – In addition to the above specific pressures, it is also anticipated that the Welfare Reform Bill will have a direct impact on the level of Council services that will need to be provided to residents and partner organisations.
- 2.22 In addition Policy Development Funding of £0.477 million has been set aside for enhanced advisory services and discretionary housing payments.
- 2.23 Four posts are currently dedicated to Welfare Reform preparation within the Council: a planning officer funded from the Change Fund and three officers funded by a grant from the DWP. Three additional posts have also been recruited within the DG Direct call centre in order to meet additional customer demand.
- 2.24 Joint partnership events were held in April 2013 involving the Council, Dumfries and Galloway Health Board and voluntary sector representatives to identify key issues. This forum aims to raise awareness about Welfare Reform within local communities through talks and media campaigns, collaboration and shared information, the facilitation of the development of Credit Unions within Dumfries and Galloway and the mapping of impacts on specific communities to identify any improvements that can be made.

Action 4

Equal Pay

- 2.25 As at 1 August 2013, the Council had received 358 equal pay claims. Where it is difficult to quantify values in terms of likelihood of success and value of final claims, the claims have been disclosed as a contingent liability. Claims where the liability is more certain have been included as a provision. The equal pay provision included in the 2012/13 financial statements is £7.985 million (2011/12: £7.985 million).
- 2.26 The equal pay claims are classed by the Council as "rated as equivalent". The majority (251) relate to "appellants" who are classroom assistants, learning assistants and nursery nurses employed during school term-time in Dumfries and Galloway's schools under terms contained in a national collective agreement known as the 'Blue Book'. The appellants wish to compare their terms and conditions with those enjoyed by a variety of full time manual workers employed by Dumfries and Galloway Council, such as grounds staff, refuse collectors, refuse drivers and leisure attendants ('the comparators'), under a different collective agreement known as the 'Green Book'. The comparators were entitled to substantial supplements on top of their basic pay, whereas the appellants were not.
- 2.27 In 2005 an employment tribunal allowed for the claim to proceed but an appeal overturned that decision saying there was no real possibility of the male workers doing these jobs in schools. The Court of Session supported the Council's claim that the women's case was unjustified. The Local Authority workers union, Unison, took the appeal to the Supreme Court in June 2013 which ruled that the women do have a valid case for discrimination and reversed the earlier rulings. The case has been referred back to an employment tribunal which will decide whether to find in favour or otherwise.

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- 2.28 We have considered the provision and contingent liability against the criteria set out in the International Accounting Standard (IAS) 37 – “Provisions, Contingent Liabilities and Contingent Assets” and the Code of Audit Practice on Local Authority Accounting and we are satisfied with management’s accounting treatment for these equal pay claims.

Action 5

Landfill sites

- 2.29 Through the Council’s waste management/recycling PFI contract, Shanks Dumfries and Galloway operate two landfill sites under Pollution, Prevention, and Control Permits. This is to ensure that the sites are properly managed according to standards set by the Scottish Environment Protection Agency (SEPA). Shanks are also responsible for the restoration and continuing aftercare of a further five closed landfill sites through the contract. As these operations are fully covered and implemented through the PFI contract, the Council has not provided for the cost of decommissioning these sites in the 2012/13 financial statements.
- 2.30 A primary concern for the Council is to maintain an effective service in relation to waste, and so management should continue to monitor this to ensure service quality is maintained.

Action 6

3. Governance

- 3.01 In accordance with the Code of Audit Practice's requirements for the auditor's consideration of corporate governance arrangements, we have considered the following matters:
1. Corporate governance and systems of internal control, including risk management and internal audit.
 2. Prevention and detection of fraud and irregularity.
 3. Standards of conduct and arrangements for the prevention and detection of corruption.

Overall Governance Arrangements

- 3.02 Dumfries and Galloway Council has a well established committee structure that continues to be reviewed on an annual basis by the full Council in order to ensure that it reflects the activities of the Council. In addition there are Standing Orders, and a Scheme of Delegation in place which sets out the governance and accountability arrangements. These documents are available to staff within the organisation and are reviewed on an annual basis.
- 3.03 The Council has a target of providing Members with reports and committee papers seven days prior to the committee. All Council reports are prepared using a standard template which is designed to ensure that Members can become familiar with the structure of the reports even if the content is on an unfamiliar subject.
- 3.04 There have been no significant changes to the overall governance arrangements operating at the Council during 2012/13 and overall governance structures and activities are as expected.
- 3.05 The Council has appointed a Sub-Committee which is restructuring its Standing Orders and Schemes of Delegation but does not have plans to materially change these governance structures in the run up to the Independence Referendum in 2014. The usual governance arrangements before an election (i.e. members are prohibited from speaking on behalf of the Council on party political issues) will be implemented.

Annual Governance Statement

- 3.06 The Council is required to produce an Annual Governance Statement, which is consistent with guidance issued by CIPFA / SOLACE: 'Delivering Good Governance in Local Government'.
- 3.07 We reviewed the Statement to consider whether it complied with the CIPFA / SOLACE framework and whether it was misleading or inconsistent with other information known to us from our audit work. The main disclosures include the effectiveness of governance and committee frameworks, the work of internal audit and significant governance issues, including health and social care integration, police and fire reform and welfare reform. Based on our normal audit procedures, we **do not disagree** with the disclosures contained in the Statement.

Accounting Systems and Systems of Internal Control

- 3.08 It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. As auditors, we review these arrangements for the purposes of our audit of the financial statements and our review of the Annual Governance Statement.
- 3.09 The results of our work on systems of internal financial control were communicated to the Audit and Risk Committee in April 2013 in our Interim Management Letter. We identified no new control issues during our interim work.
- 3.10 During our final audit visit we had intended to rely on the work of Internal Audit surrounding accounts payable controls; however due to the number of exceptions in control arrangements identified by Internal Audit we opted to take a fully substantive approach.

- 3.11 The control recommendations identified have been reported in a separate Internal Controls Management Letter dated 6 September 2013. In total five control weaknesses were reported: one low, three medium and one high risk rated finding. The high risk rated finding is in relation to amendments to supplier data where it was found that controls surrounding the verification of supplier amendments and the approval of these were not operating effectively. The most common type of fraud witnessed in the public sector in recent years has been procurement fraud, specifically changes made to supplier bank details and the creation of fictitious suppliers. Without appropriate controls around the creation and amendment of supplier details there could be a risk of procurement fraud to the Council.
- 3.12 The three medium risk findings related to segregation of duties in the order process, authorisation of payments and incomplete audit trails being kept in relation to BACS payments. Management has provided a response to these recommendations within our Internal Controls Management Letter and Internal Audit intend to perform a view of accounts payable controls in 2013/14.

Follow up of outstanding recommendations

- 3.13 Good progress has been made by the Council on the nine recommendations outstanding from previous audit reports. At August 2013, only two remained in progress:

Status	Number of outstanding recommendations as at February 2013	Update at August 2013	
		Closed	Overdue/ In progress
Audit Scotland Annual Report 2010/11	1	1	-
Interim Management Letter 2011/12	3	3	-
Annual Report 2011/12	5	3	2
Total	9	7	2

- 3.14 The outstanding recommendations are as follows:

- Management of Social Work Services - Social Work Services management prepared an action plan to address the weaknesses in the business and financial management arrangements which was presented to the Council's Social Work Services Committee on 21 February 2013. The action plan showed an ambitious target for management to achieve a large number of short term actions between November 2012 and March 2013. As at 31 March 2013 Social Work Services had overspent against budget by £0.653 million. A Social Work Support Fund of £1.000 million has been allocated from the General Fund to support the service in 2013/14. Close monitoring and scrutiny over financial and business management within the service is therefore required during 2013/14.
- Action 7**
- Objection to the accounts – In the previous year, we received an objection to the accounts from Loreburn Community Council on the basis that the assets disclosed in the Dumfries Common Good Fund had been misstated. We received further correspondence during July 2013 from the Loreburn Community Council questioning the progress that has been made against this. Due to the transfer of the police and fire services during 2012/13 the Council was unable to allocate the intended resource to resolve this issue and so the Council should work with the Loreburn Community Council during 2013/14 to ensure that this matter is fully resolved (see Action 1).

Prevention of Fraud and Corruption arrangements

- 3.15 Our responsibilities as auditors in relation to fraud are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
 - to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement of the financial statements due to fraud, through designing and implementing appropriate responses; and
 - to respond appropriately to fraud or suspected fraud identified during our normal audit procedures.
- 3.16 The National Fraud Initiative (NFI) brings together data from health bodies, councils, police and fire rescue bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud.
- 3.17 The Council must complete the next NFI exercise by February 2014, investigating and concluding on its matches. The Council continues to demonstrate a commitment to the NFI process and has taken steps to review its NFI arrangements.

Internal Audit

- 3.18 We have liaised with Internal Audit during our interim and final audit visits to review their programme of work for the current financial year to establish progress against the internal audit plan and review a summary of their completed reports to determine the main issues being reported.
- 3.19 International Standard on Auditing (UK and Ireland) 610: “The auditor’s consideration of the internal audit function” requires us to perform the following:
- Consider the activities of Internal Audit and the extent that their work can be relied upon for external audit procedures;
 - Obtain sufficient understanding of internal audit activities and the effectiveness of the function to enable us to identify areas of risk and develop an effective and targeted audit approach; and
 - Evaluate and test the quality and timeliness of internal audit work, where we seek to rely on the findings, in order to confirm its adequacy for our purposes.
- 3.20 Our audit fee was agreed based on an expectation that we are able to rely on Internal Audit work for key financial systems of control, certification of grant claims, and follow up of Audit Scotland national reports. We are happy to report that we have been able to rely on the work of Internal Audit in the following areas:
- Bus Service Operators grant claim;
 - Education Maintenance Allowance grant claim;
 - Safety Camera Partnership grant claim;
 - Follow up of Audit Scotland report “Scotland’s Public Finances – Addressing the challenges”; and
 - Detailed testing on Accounts Payable controls.
- 3.21 We also intend to rely on the work of Internal Audit to complete the work on the following grant claims:
- Criminal Justice Social Work Services grant claim;
 - Non Domestic Rates Income grant claim; and
 - Housing and Council Tax Benefit Subsidy.
- 3.22 We would like to take this opportunity to thank the Head of Internal Audit and the team for their assistance during the current financial year.

4. Performance

Performance Management

- 4.01 The Council's Service Business Plans 2012-2015 bring together the Council's commitments under the Single Outcome Agreement (SOA) and set out its strategies for achieving local and national priorities, which include a forward looking financial strategy, workforce plan and the prioritisation of projects.
- 4.02 Performance Management is now becoming more embedded within the organisation with corporate objectives and performance indicators used to evidence the success of the delivery of the Business Plans.
- 4.03 The Service Committees receive a performance report every six months detailing the Key Performance Indicators (KPIs) for their service in a traffic light format, with explanations when targets are not being met. In addition, Area Committees receive a performance report every six months, based on the performance across all services in their geographic location, which is in the same format as Service Committee Reports. In 2011/12 the Statutory Performance Indicators (SPIs) went to the Scrutiny and Performance Committee for the first time. This was repeated in 2012/13 with Members questioning Directors and Heads of Service on their departments' performance based on the SPIs.
- 4.04 The Council has a corporate-wide performance management system in place which acts as a database for capturing all 227 of its Key Performance Indicators that are used across the organisation. This allows corporate management to obtain up to date performance management information for the purposes of reporting to management and committees throughout the organisation. Further development of the Performance Management approach and performance information is a focus for the updated three year Business Plan.

Statutory Performance Indicators

- 4.05 The Accounts Commission has a statutory responsibility to specify information that all councils must publish about their performance in the form of statutory performance indicators. For 2012/13, the Accounts Commission stipulated the publication of 25 Statutory Performance Indicator (SPIs). 5 of these SPIs are not applicable to Dumfries and Galloway Council as they relate to housing stock.
- 4.06 Auditors are required to review those arrangements in place for collecting, recording and publishing performance data. Based on our work performed and review of the procedures the Council was able to demonstrate the basis for the SPIs reported.
- 4.07 Whilst we did not identify any issues in relation to the arrangements in place for gathering and reporting performance data, we did identify some minor errors in the calculation of some of the indicators which have subsequently been amended by management.

National Performance Audits

- 4.08 At the request of Audit Scotland, we were required to perform targeted follow up work on their National Performance Report: Scotland's Public Finances - Addressing the Challenges (published February 2011).
- 4.09 The findings from our work will be reported to members in a separate report dated August 2013. Overall, the Council was able to demonstrate it had considered the report at the appropriate level and had taken the original recommendations into account in its strategy and related actions.

Local Impact Returns – Commissioning Social Care

- 4.10 Local Impact Return questionnaires provide a template to assist auditors in making an assessment as to how the Council has responded to a range of National Performance Reports from Audit Scotland. During the current year, one Return in relation to *Commissioning Social Care* was submitted to Audit Scotland.

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- 3.23 The Strategic Planning, Commissioning and Performance division in Social Work Services used the report to assess the Council's position and identify the development path through which the recommendations could be addressed. In November 2012 the Council agreed a joint commissioning framework with its NHS partner for adult community health and social care to deliver a significant part of the report's objectives.

Local Area Network

- 4.11 An Assurance and Improvement Plan (AIP) for 2013-2016 was presented to the Audit and Risk Management Committee in June 2013. This is based on a shared risk assessment which is undertaken by a Local Area Network (LAN) made up of representatives of the main local government audit and inspection agencies. The aim of this process is to focus scrutiny activity where it is most needed.
- 4.12 The ongoing progress by the Council with its improvement agenda was reflected in further reductions in the scrutiny risk profile for 2013-2016. Scrutiny risks have reduced in ten of the assessment areas and one area was highlighted where further information was required (housing and homelessness). The only significant scrutiny risk identified by the LAN relates to management arrangements and financial controls within Social Work Services, as a result of PwC's report on this issue published in November 2012.

Appendices

Appendix 1 – Action Plan

	Paragraph Reference	Recommendation	Response
1	1.08	<p>Objection to Accounts</p> <p>The Council should work with Loreburn Community Council to ensure that all assets owned by the Council which were part of the Common Good of the former Royal Burgh of Dumfries are disclosed in the Accounts as being held under the Dumfries Common Good Fund, thereby seeking to resolve this matter fully.</p>	<p>Management Response:</p> <p>The Council is committed to increasing understanding and transparency on all aspects of Common Good. To this end, Property Services has prepared a list of Common Good heritable assets as known at this point in time. In addition, training is being organised for all Common Good Sub-Committee and Council Members which will, <i>inter alia</i>, cover the definition of Common Good assets thus assisting this work. A full review of all Dumfries title deeds would be a costly and resource-intensive exercise; accordingly, the Council is committed to agreeing a targeted approach with Loreburn Community Council to address concerns over specific assets aimed at resolving this matter.</p> <p>Responsible Officer: Head of Corporate Support</p> <p>Implementation Date: August 2014</p>
2	1.09	<p>Accounts Payable Controls</p> <p>A further review into accounts payable controls should be performed by Internal Audit to further investigate the extent of the control weaknesses identified in this review, as reported in our separate Internal Controls Management Letter.</p>	<p>Management Response:</p> <p>Measures to address identified issues are now being progressed and a further review into accounts payable controls will be performed by Internal Audit to ensure that revised control arrangements are effective.</p> <p>Responsible Officer: Chief Internal Auditor</p> <p>Implementation Date: June 2014</p>
3	1.09	<p>Manual Journal Processor Report</p> <p>Through discussions with Capita, management should ensure that the name/user ID of the persons processing journals can be extracted into a report for monitoring purposes.</p>	<p>Management Response:</p> <p>A report which extracts the required control information is now being developed.</p> <p>Responsible Officer: Head of Finance</p> <p>Implementation Date: 31 October 2013</p>
4	2.24	<p>Welfare Reform</p> <p>The Council should continue to put specific arrangements in place to ensure that Welfare Reform impacts can be planned, coordinated, monitored and</p>	<p>Management Response:</p> <p>The Council has established an Ad Hoc Welfare Reform Sub Committee and there is also an established Officers Working Group and Financial Inclusion Strategy Working group. These structures will allow the Council and its key partners to plan for, co-ordinate,</p>

	Paragraph Reference	Recommendation	Response
		successfully addressed.	<p>monitor and deliver a range of measures in relation to welfare reform.</p> <p>A range of specific actions to plan for and mitigate the impact of welfare reform have been agreed through committee and are being taken forward.</p> <p>Additional budget provision has been allocated to support Welfare Reform initiatives and ongoing requirements will be reviewed as part of ongoing budget setting.</p> <p>Responsible Officer: Head of Strategic Housing, Welfare Reform and Revenues & Benefits</p> <p>Implementation Date: On-going as the roll out of the various statutory provisions continues to 2017.</p>
5	2.28	<p>Equal Pay</p> <p>Due to the potential risk to the Council, Management should continue to actively manage any developments in respect of equal pay claims. This should include regular briefings for Members.</p>	<p>Management Response:</p> <p>The Council will continue to review the status of current claims and monitor case law for any significant or emerging developments that might impact these. The Council's Corporate Management Team and Members will be briefed on a regular (quarterly) basis. Members are routinely updated as part of reports on budget development/ financial statements.</p> <p>Responsible Officer: Head of Organisational Development & HR</p> <p>Implementation Date: Continue with the system of briefings already started. Next briefing due in September 2013.</p>
6	2.30	<p>Landfill Sites</p> <p>The Council should continue to monitor waste management service contracts to ensure service quality is maintained.</p>	<p>Management Response:</p> <p>Management and monitoring of the waste management/recycling PFI contract is ongoing and will continue in accordance with the requirements of the contract for its remaining 18 year duration. Development of the contract will continue at a strategic/tactical level and monitoring of the contract will continue at a tactical/operational level with regular performance meetings ongoing in both cases.</p> <p>Responsible Officer: Head of Infrastructure & Commissioning</p> <p>Implementation Date: Immediate and ongoing</p>

	Paragraph Reference	Recommendation	Response
7	3.14	<p>Social Work Services</p> <p>Social Work Services management prepared an action plan to address the weaknesses in the business and financial management arrangements; this was presented to the Council's Social Work Services Committee on 21 February 2013. The action plan showed an ambitious target for management to achieve, with a large number of short term actions between November 2012 and March 2013. Close monitoring and scrutiny over financial management within the service is required during 2013/14.</p>	<p>Management Response:</p> <p>Both the Social Work <i>Way Forward Action Plan</i> and the Social Work Budget Monitoring position will be subject to ongoing, detailed management action and review and will be reported to each meeting of the Social Work Services Committee.</p> <p>Responsible Officer:</p> <p>Interim Chief Social Work Officer/Head of Finance</p> <p>Implementation Date:</p> <p>Immediate and ongoing</p>

Appendix 2 - Audit reports/outputs issued in 2012/13

Report Name	Report Date
Annual Audit Plan 2012/13	January 2013
Interim Management Letter 2012/13	March 2013
Local Impact Return – Commissioning Social Care	March 2013
Various Grant Claims	June 2013 – September 2013
Scotland's Public Finances: Addressing the Challenges – a follow up Report	August 2013
Annual Audit Opinion on Financial Statements	September 2013
Annual Report to Members and the Controller of Audit	September 2013
Internal Controls Management Letter 2012/13	September 2013

Appendix 3 – ISA 260 Communications to those charged with governance

Communication Required under ISA 260	Reference/Comment
Engagement Letters	<ul style="list-style-type: none"> Signed Engagement Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	<ul style="list-style-type: none"> We confirm that, in our professional judgement, as at the date of this document, we are independent auditors with respect to the Council and its related entities, within the meaning of UK regulatory and professional requirements and that the objectivity of the audit engagement leader and the audit staff is not impaired.
Audit Approach and Scope	<ul style="list-style-type: none"> This was set out within the Annual Audit Plan (reported to Audit and Risk Management Committee in January 2013). There were no significant changes to the audit approach set out within our audit plan, except for our changes to audit risk ratings (see covering letter to this Report) and the approach to expenditure and accounts payable (see page 5).
Materiality	<ul style="list-style-type: none"> Contained in our Annual Audit Plan (reported to Audit and Risk Management Committee in January 2013) and updated as noted in this Report.
Form and Timing of Communications	<ul style="list-style-type: none"> Annual Audit Plan (reported to Audit and Risk Management Committee in January 2013). Interim Management Letter reported to Audit and Risk Management Committee in March 2013). Annual Report to Members and Controller of the Audit (reported to Full Council in September 2013).
Accounting Policies/Estimates/Disclosures	<ul style="list-style-type: none"> Significant matters are included within this Report. Significant estimates have been used in relation to the Equal Pay liability; as discussed within this report we are satisfied with management's accounting treatment in the 2012/13 financial statements. Significant estimates have also been used in relation to the pension fund liability. We have reviewed the pension assumptions used and we are satisfied that these are within the ranges expected.
Correspondence with management on significant matters	<ul style="list-style-type: none"> Discussed and resolved matters arising with management throughout the audit process.
Letter of Representation	<ul style="list-style-type: none"> Signed by the Head of Financial Services on 24 September 2013.

Other matters significant to the oversight of financial reporting process and material uncertainties relating to Going Concern	<ul style="list-style-type: none">• None identified.
Related Parties	<ul style="list-style-type: none">• Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.
Fraud	<ul style="list-style-type: none">• Discussed fraud arrangements with the Audit and Risk Management Committee and management throughout audit process.
Material Weaknesses in Internal Controls	<ul style="list-style-type: none">• Internal controls findings reported separately in our 'Interim Management Letter 2012/13'.• Further control findings in relation to accounts payable and expenditure included in 'Internal Controls Management Letter 2012/13'.

In the event that, pursuant to a request which Dumfries and Galloway Council has received under the Freedom of Information (Scotland) Act 2002, it is required to disclose any information contained in this report, it will notify PwC promptly and consult with PwC prior to disclosing such report. Dumfries and Galloway Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and Dumfries and Galloway Council shall apply any relevant exemptions which may exist under the Act to such report. If, following consultation with PwC, Dumfries and Galloway Council discloses this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

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