cutting through complexity

Dundee City Council

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

Audit: year ended 31 March 2014

30 September 2014

Contents

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About this report

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

This report is for the benefit of Dundee City Council and is made available to Audit Scotland and the Accounts Commission (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. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the beneficiaries alone.

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 limited circumstances set out in the scope and objectives section of this report.

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Headlines

This annual audit report summarises our findings in relation to the audit for the year ended 31 March 2014. Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice* ("the Code").

This report also sets out those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the year ended 31 March 2014.

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

Area	Summary observations	Analysis
Strategic overview and use of resources		
Key issues and challenges	Public sector reforms have created a number of service challenges which have been accentuated by competing demands and resource pressures. Management undertake regular analysis of the key areas of public reform, in order to support achievement of strategic priorities in this changing environment.	Pages 6-8
Financial position	The Council recorded an accounting deficit of £42.2 million in the comprehensive income and expenditure account, £4.3 million less than originally budgeted. This resulted in a £1.6 million decrease in the general fund balances. Audit Scotland's analysis of the 32 local authorities continues to show that the Council has the lowest level of uncommitted general reserves as a proportion of revenue spend of all Scottish local authorities, representing a continuing challenge for financial management during difficult economic conditions. Total capital expenditure in 2013-14 was £86.2 million, below the approved capital plan budget of £92.0 million.	Pages 9-12
Financial planning	The 2014-15 budget forecasts a breakeven position, with no utilisation of reserves. Total savings of £3.7 million were required to balance the budget. Additional resources of £4.5 million have been allocated to the social work budget, based on previous experience and modelling of the demographic changes anticipated.	Pages 13-14
Financial statements and accounting		
Audit conclusions	We have issued an unqualified audit opinion on the 2013-14 financial statements. There were no adjusted audit differences or unadjusted audit differences.	Page 16
Significant risks and audit focus areas	We have considered inherent significant risks that the ISAs would require us to raise with you covering risks in relation to revenue recognition and management override of controls and have satisfactorily concluded our work in these areas. Other significant risks and other areas of audit focus have been considered and satisfactorily concluded. These included valuation of property, plant and equipment; accounting for employee benefits and accounting for the consolidation of Dundee Energy Recycling Limited.	Pages 17-19
Accounting policies	The Council adopted IAS 19 (revised), relating to accounting for employee benefits, in the financial statements and we agreed with management's decision to restate prior year comparatives due to the material nature of the adjustment. There was no overall impact on the prior year net assets position as a result of this adjustment. No newly effective accounting standards are expected to have a material impact on next year's financial statements. The financial statements have been appropriately prepared on a going concern basis.	Page 20

Headlines (continued)

Financial statements and accounting (continued)		
Control observations	Our testing of the design and operation of financial controls over significant risk points confirms that generally, controls relating to financial systems and procedures are designed appropriately and operating effectively. In our interim management report we noted opportunities for management to further strength the control environment in relation to financial reconciliations and the senior officer's register of interests.	Page 27
Governance and narrative reporting		
Governance and narrative reporting	Over-arching and supporting corporate governance arrangements provide a framework for organisational decision-making. The annual governance statement identifies no major weaknesses in governance or internal control arrangements.	Pages 24-27
Performance management arrangements		
Performance management	Our work has identified that the Council's Best Value and performance management arrangements are now well established. The Council's Changing for the Future programme continues to be the mechanism for identifying corporate improvement and achieving efficiencies to deliver balanced budgets. The arrangements for scrutiny of performance are considered to be maturing, demonstrating a commitment to continuous improvement. The Council monitors statutory performance indicators throughout the year and completes the Local Government Benchmarking Framework exercise. We have considered the Council's arrangements in responding to Audit Scotland national study *Health Inequalities in Scotland.* Our work identified that despite this report not being formally considered by the Council, the issues in relation to health inequalities had been considered as part of the single outcome agreement. We completed our work on the follow up of Audit Scotland's *Major Capital Investment in Councils* report (stage one) and found that the Council has satisfactory control in place surrounding major capital investment. We also completed our work on the follow up of Audit Scotland's *Arms Length External Organisations: Are you getting it right?* Report. We identified some areas of improvement in relation to this report, however, overall found that the Council had achieved 'basic and better' practice. We have substantially completed our review of *Major Capital Investment in Councils* (stage 2) and will report our findings in due course.	Pages 29-31

Scope and responsibilities

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit of the Council's financial statements for 2013-14. It is addressed to both those charged with governance at the 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.

The context of our audit is one of an overall reduced level of risk, based on the shared risk assessment of the Council's arrangements.

Responsibilities

Audit Scotland's *Code of Audit Practice* ('the Code') sets out the Council's responsibilities in respect of preparation of financial statements, 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.

The Code sets out the wider dimensions of public sector audit which involved not only the audit of the financial statements, but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is undertaken in accordance with legislation and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code, but 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 audit work in accordance with the Code, and may not be all that exist. Communication 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 or 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.

Context of the audit

The Scottish Government's response to the Crerar report in 2007 was to simplify the approach to delivering local government scrutiny. As a result, scrutiny bodies that engage with local government established a shared assessment of the risks in each Council and developed a range of proportionate approaches in response to the risk assessment. A local area network ("LAN") of local audit and inspection representatives undertakes a shared risk assessment for each local authority in Scotland, to identify targeted, risk-based scrutiny. Following a review of the shared risk assessment process in 2013, there has been a shift in focus to identifying the Council's position in implementing the Scottish Government's reform agenda.

This results in each council receiving an annual Assurance and Improvement Plan ("AIP"). The Council's AIP for 2013-16 reported that the overall level of risk for the Council had continued to reduce. There were no specific risk based scrutiny areas identified for the Council in 2013-14.

The work and enterprise outcome area was identified as an area of uncertainty in the 2012-15 AIP; Audit Scotland carried out some targeted audit work in this area during 2013-14 and concluded that no further scrutiny is required in this area.

The 2013-16 AIP identified two areas where further information was required; governance and accountability and risk management. This was addressed as part of the external audit process for year ended 31 March 2013.

During 2013-14, a refresh of the Council's AIP was undertaken for the period 2014-17, which was subsequently published in June 2014. No risk based scrutiny areas were identified for 2014-15. The change in focus from the review of the shared risk assessment process is reflected in the structure of the AIP.

Strategic overview and use of resources

Our perspective on the Council's approach to key issues affecting the local government sector, and its use of resources

Key issues

Audit Scotland's analysis of local authorities continues to show that the Council has the lowest level of uncommitted general reserves as a proportion of revenue spend of all Scottish local authorities, representing a continuing challenge for financial management during difficult economic conditions.

The Council is continuing to monitor and take appropriate action to respond to a range of external developments.

- **It is closely monitoring developments in welfare reform policy in order to mitigate associated risks.**
- **Active consideration is being given to preparing for the implementation of the Public Bodies (Joint Working) (Scotland) Act.**

Sector overview

Audit Scotland's report *An overview of local government in Scotland 2014* highlighted the challenges of reducing budgets and increasing demands. This is coupled with further expected budget reductions, the public's rising expectation of services and increasing numbers of older people, who typically need more public services.

The Council continues to have the lowest level of usable revenue reserves as a proportion of its net revenue spend based on benchmarking conducted by Audit Scotland on the 2013-14 unaudited financial statements. The Council is one of only five councils to have usable reserves of less than £10 million. Therefore, strong financial management continues to be essential to address the challenges which the Council faces.

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. Detailed legislation and broader statutory guidance is being devised. Two sets of regulations have been released for consultation and management are compiling responses.

The Council has agreed, in conjunction with NHS Tayside, to adopt a body corporate model of integration and has established a shadow board with the wider partnership to see through the process of implementation. The interim chief officer post will be shared by the general manager of Dundee Community Health Partnership and head of service, strategy, integration, performance and support services, until a permanent post is filled.

The interim chief officers will lead the transition arrangements for the integration of health and social care ahead of the introduction of the Health and Social Care Partnership which will be formed by April 2015. In order to ensure a smooth transition to the partnership, the shadow board will encourage those currently involved in providing health and social care to work closely and share information locally in order to provide co-ordinated services to local communities.

The partnership will integrate adult and elderly services; children's services will not be transferred to the new partnership, however, the Council has in place a strategy for children's services which requires joint working.

Finance officer representation is achieved on the shadow board through the involvement of the Council's director of corporate services, which will help to strengthen the governance arrangement in place.

Joint arrangements / Partnership working

The Council has demonstrated a strong commitment to partnership working in the past, including through the long standing joint committee arrangement (Tayside Contracts) with Perth and Kinross Council and Angus Council.

In addition to the statutory requirement for joint working in relation to health and social care, the Council works with the Dundee Partnership to promote joint working at the community level. The Dundee Partnership incorporates the key players in the local community, including the Council, Tayside Police, NHS Tayside and Scottish Enterprise as well as representatives from business, education and voluntary sectors.

The Dundee Partnership is involved in developing the Single Outcome Agreement, which sets out the Partnership's top strategic priorities, a delivery plan and local community plans to ensure that the joint goals of the partnership are achieved.

Key issues (continued)

The Council also works with NHS Tayside on a number of projects which involve joint resourcing. For example, the Whitfield Community Project, which opened in April 2014, was completed in partnership with NHS Tayside and has been designed as a ‘one stop shop for the local community. The project involves sharing resources between the Council and the NHS services provided in the development. The development includes GP services and pharmacy services, in addition to Council services.

Welfare reform

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 welfare reform group has six distinct project responses, covering universal credit, council tax reduction scheme, Scottish welfare fund, housing services, supporting initiatives and employability and learning. The Council has participated in Scottish Government pilot schemes relating to universal credit ahead of implementation in 2016, and has received a positive response from the Department for Work and Pensions in relation to welfare reform arrangements.

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

The Scottish Government’s council tax reduction scheme came into force from 1 April 2013. There is little or no change financially to recipients and therefore this has had a low financial impact on the Council. Funding will remain the same in 2014-15, however there is greater financial risk due to the an increase in the number of properties in the Council boundaries as the funding is a fixed sum instead of being demand led.

The housing benefit under occupancy supplement was introduced on 1 April 2013, although mitigated by the payment of discretionary housing payments. The welfare cap was implemented from 15 July 2013, with the Council identifying that 18 households were affected. Continued monitoring of the welfare reform changes will ensure that the Council is able to respond in an agile manner and ensure it continues to support its most vulnerable service users.

Management therefore consider that they are well prepared for the changes, however, they acknowledge that there remain significant uncertainties and challenges ahead.

Key issues (continued)

Police and fire reform

The Police and Fire & Rescue Reform (Scotland) Act 2012 created a national police force and a national fire and rescue service from 1 April 2013. It replaced local authorities' role as police authorities and fire and rescue authorities through the creation of Police Scotland, the Scottish Police Authority ("SPA") and the Scottish Fire & Rescue Service ("SFRS"). The Act includes a framework for the delivery of local scrutiny and engagement arrangements.

The Council's policy and resources committee meets to perform the scrutiny function of police, fire and community safety. The committee receives quarterly performance updates from Police Scotland and the Scottish Fire and Rescue Service.

Employee claims

Following a European Court of Justice ruling in May 2014, employers may be required to pay holiday pay to staff at a rate commensurate with any commission or overtime that they regularly earn, instead of at their basic pay level. Following legal advice, management have opted to take no action at this stage until further information on the impact of this ruling is available. We agree with management's treatment of this issue in the financial statements, i.e. inclusion within the contingent liabilities note.

Financial position

The Council recorded an accounting deficit of £42.2 million in the comprehensive income and expenditure account which. Whilst there was a £1.6 million decrease in the general fund balance, the uncommitted element of the general fund remained unchanged at £5 million.

Management should continue to develop the Council's medium term financial strategy to be approved by members.

Financial position

For the year ended 31 March 2014 the Council generated an accounting deficit of £42.2 million in the comprehensive income and expenditure account (*2012-13:* deficit of £70.8 million). After the required statutory adjustments relating to differences in the accounting and funding basis, the net movement on the usable funds balance was a decrease of £2.9 million (*2012-13*: decrease of £6.1 million). This is summarised below.

Comprehensive income and expenditure statement	Usable reserves £million	Unusable reserves £million	Total £million
Deficit on the provision of services	42.2	-	42.2
Other comprehensive income and expenditure	-	29.4	29.4
Total comprehensive income and expenditure	42.2	29.4	71.6
Adjustment between accounting basis and funding basis	(39.3)	39.3	-
Decrease for the year	2.9	68.7	71.6
Reserves brought forward	(25.5)	(475.8)	(501.3)
Reserves carried forward	**(22.6)**	**(407.1)**	**(429.7)**

Source: financial statements 2013-14

Usable reserves

The movement in usable reserves can be broken down across the Council's cash backed reserves as follows:

	2013-14 £million	2012-13 £million	Movement £million
General fund balance	8.1	9.7	(1.6)
Housing revenue account	-	-	-
Capital grants unapplied account	6.9	7.3	(0.4)
Capital fund	0.7	2.2	(1.5)
Repairs and renewals fund	6.2	5.8	0.4
Insurance fund	0.7	0.5	0.3
Total	22.6	25.5	(2.9)

Source: financial statements 2013-14

In setting the 2013-14 budget, the Council approved a recommendation from the director of corporate services that £4.75 million (around 1.4% of budgeted net expenditure) was the minimum level of uncommitted balances which should be retained for the year.

Within the general fund balance of £8 million, the Council has uncommitted balances of £5.0 million. This represents a slight increase in the uncommitted balance as a percentage of annual budgeted net expenditure from 1.34% in 2012-13 to 1.52% in 2013-14. The year-end uncommitted balance has therefore exceeded the initial target level.

Financial position (continued)

The Council's outturn for the year against the revised budget was an underspend of £1.1 million against final budgeted expenditure of £365.5 million.

Usable reserves (continued)

In setting the 2014-15 revenue budget, and following the updated assessment of the Council's needs, a revised recommendation was approved setting a minimum uncommitted balances level at £5 million (around 1.5% of budgeted net expenditure) for the year. This took into account the identified financial risks facing the Council in the year.

Monthly revenue performance monitoring reports are scrutinised by the policy and resources committee. Throughout the year the revenue budget is adjusted for any unforeseen items which require to be built into the budget. Both the budget setting process and the revenue monitoring process demonstrate good financial control, with an underspend on services of £1.1 million achieved against budget in 2013-14.

Performance against budget

The Council's budget for services was approved by members in February 2013 at £365.6 million after various adjustments throughout the year, to be financed by income from council services, revenue support grant including national non-domestic rate income, and council tax and transfer from general fund balances.

Per the table shown below, the Council has reported an overall underspend against budget of £1.1 million. Unlike in previous years where additional resources have been added to the social work budget, the underspend was largely as a result of larger than anticipated under spend in social work. The Council's move away from residential children's care to longer term care options in the local community helped to achieve this underspend.

In setting budgets, management identified and included provision for contingencies totalling £2.4 million, to be used for increasing energy costs, the council tax reduction scheme and general contingency.

£million	Budget 2013-14	Actual 2013-14	Under / (over)
Education services	145.8	144.4	1.4
Social work	107.0	104.4	2.6
General fund housing	15.9	16.3	(0.4)
Housing revenue account	13.6	13.9	(0.3)
Cultural and related services	25.9	25.7	0.2
Environmental services	17.0	18.4	(1.4)
Roads and transport services	15.1	14.7	0.4
Planning and development services	9.5	10.5	(1.0)
Central services to the public	8.8	8.7	0.1
Valuation services	1.0	1.0	-
Other	6.0	6.4	(0.4)
Total	**365.6**	**364.4**	**1.2**

Source: financial statements 2013-14

Financial position (continued)

Financial management is considered to be strong, with a continual focus on the anticipated outturn forecast.

There is scope to enhance this through longer term financial planning.

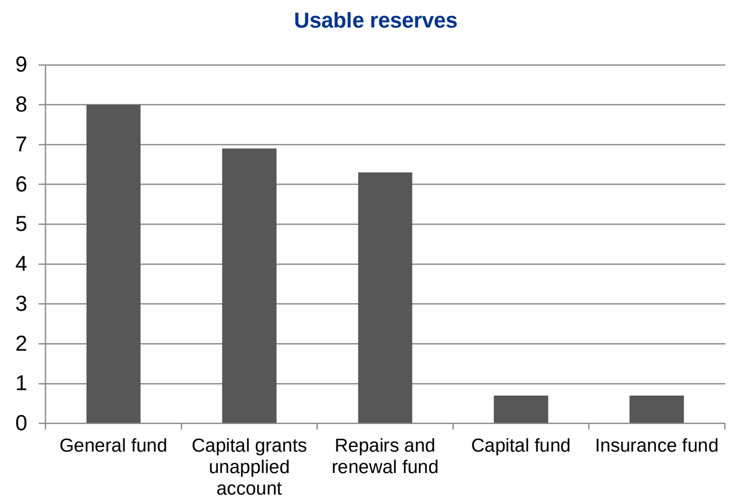
Housing revenue account

The net costs of housing revenue account services included in the comprehensive income and expenditure statement is £13.9 million. After the application of additional charges to the HRA income and expenditure account, and the adjustments between the accounting basis and funding basis under statute, the HRA reported a surplus of £664,000 before transfers to reserves.

The Council's policy is to transfer all surpluses to the renewal and repairs fund, hence the carry forward balance on the HRA is £nil.

Composition of reserves

As at 31 March 2014, the Council had usable reserves of £22.6 million. These consisted of the general fund (£8 million), the capital grants unapplied account (£6.9 million), the capital fund (£0.7 million), the repairs and renewal fund (£6.3 million) and the insurance fund (£0.7 million). The funds are illustrated in the diagram below.



Source : financial statements 2013-14

In benchmarking undertaken by Audit Scotland from analysis of the 2013-14 unaudited financial statements of Scotland's 32 local authorities, the Council's uncommitted reserves as a percentage of net revenue spend continues to be the lowest.

The Council reviews the adequacy of their minimum target for uncommitted reserves when setting the budget each year. In addition, management advised the policy and resources committee against taking funds from the general fund when setting the council tax for 2013-14, due to the likelihood of the Council's financial position deteriorating further in future as Scottish Government funding continues to fall in real terms.

The key elements of a medium-term financial strategy have previously been included in a report the policy and resources committee. In our view, management should to seek to further develop this financial strategy for approval by members. This should include identification of a longer term target level of reserves to be held which is fixed in relation to the level of expenditure incurred by the Council annually on services. While we accept that there is uncertainty in future years' financial settlements, and that in the current economic environment, elements of the strategy may be aspirational, many other local authorities have now set five year financial strategies even with these uncertainties.

Recommendation one

Financial position (continued)

Total capital expenditure in 2013-14 was £86.2 million, below the approved capital plan budget of £92.0 million.

Capital programme

Total budgeted capital expenditure for 2013-14 was £92.0 million, including an allowance for slippage in the housing capital budget. Actual capital expenditure for the year was £86.2 million, £5.8 million below the original capital plan budget.

The table below provides analysis across general services and the housing revenue account, comparing actual capital expenditure to budget and the prior year.

Year	Total £m
2013-14 budget	92.0
2013-14 actual spend	86.2
Underspend	(5.8)
Capital grants and receipts	47.8
Borrowing	37.3
Direct revenue contributions	1.1
Total	86.2

Source: financial statements 2013-14

The original capital budget included provision for 'slippage' of £2.5 million. This was to allow for the fact that there was expected to be some projects which were delayed. The effective underspend in terms of the capital funding identified for the year was £3.3 million.

We considered the Councils approach to capital budgeting during our review of Audit Scotland *Major Capital Investment in Councils* report (stage 1). We found that overall the Council has satisfactory controls in place surrounding major capital investment.

The Council oversees a large capital plan including major infrastructure projects, despite this the Council has delivered the capital plan under budget whilst also minimising slippage. Members are provided with monthly capital monitoring reports through via the policy and resources committee. There is scope to improve this process by considering the inclusion of performance against timescales and achievement of intended scope and benefits to the capital monitoring reports.

Recommendation two

Summary of key capital projects – expenditure incurred during 2013-14	Expenditure £m
Central Waterfront	15.4
Whitfield Life Services building	5.5
Dundee Energy Recycling Limited refurbishment	5.2
Harris Academy	4.6
Kirk Street eco project	4.2
New swimming pool and car park at Allan Street	3.2
Dundee railway station concourse	2.6
Controlled door entry in council housing	2.6
Balgarthno Primary School	1.6
Demolition of Derby Street multi storeys	1.1

Source: financial statements 2013-14

Financial planning

Given the low level of reserves held by the Council, the 2013-14 budget anticipates a breakeven position and does not require funding from the Council's reserves.

Revenue budget 2014-15

Local government finance settlements have been agreed for 2014-15 and 2015-16. This gives management some certainty over future income from the Scottish Government which will be used in the development of the medium-term financial strategy.

The revenue budget was agreed at the policy and resources committee on 13 February 2014.

	2014-15 £m	2013-14 £m	Variance £m
Education	135.7	140.7	(5.0)
Social Work	105.9	101.4	4.5
City Development	21.3	20.5	0.8
Environment	26.2	24.9	1.3
Chief Executive	27.4	29.9	(2.5)
Corporate services	6.8	7.2	(0.4)
Other housing	2.8	3.1	(0.3)
Supporting people	11.6	11.8	(0.2)
Capital financing costs	26.6	24.9	1.7
Other, including Welfare Reform	14.9	14.8	0.1
Total net revenue budget	**379.2**	**379.2**	-

Source: final revenue budget volume 2014-15

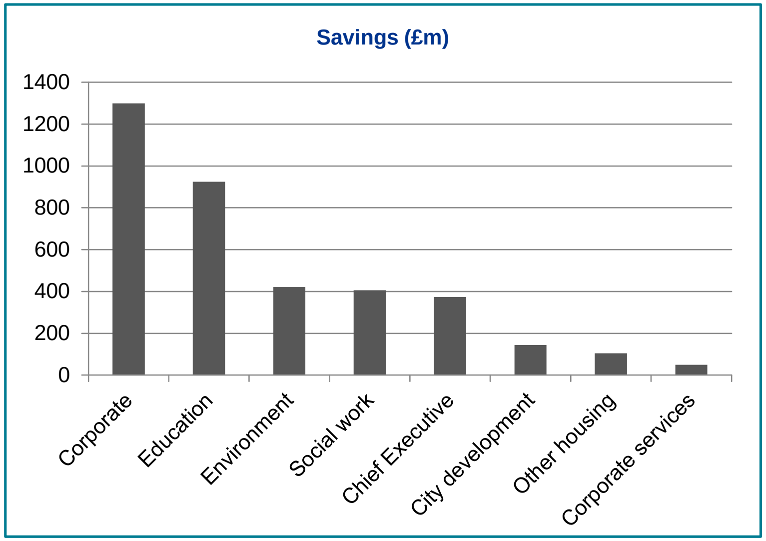
The key assumptions underlying the setting of the budget included:

- council tax continues to remain frozen; and
- allowance for 1% pay award for all staff, plus allowance for the National Living wage of £7.65 per hour.

Savings of £3.7 million were required to enable a council tax freeze in 2014-15. It is estimated that in order to achieve a council tax freeze in 2015-16 further budget savings of around £7.8 million will need to be identified.

As in previous years, the 2014-15 social work budget has been significantly increased by £4.5 million from the budget originally set for 2013-14 to recognise the recurring pressures. This increase is after budget savings of £0.7 million.

Savings totalling £3.7 million were identified and approved as part of the budget setting process as follows:



Source: final revenue budget volume 2014-15

Financial planning (continued)

The Council has approved a general services capital plan covering 2014-18, and a housing revenue account capital plan for 2014-19. In 2014-15 the Council plans to spend a total of £58.4 million on capital projects.

Capital plan

The Council has formulated a general services capital plan for 2014-18, updating the existing 2013-17 plan to reflect the latest known phasing of expenditure. The plan takes account of the Council's property asset management process, which identifies six main areas of asset ownership: buildings and property, open space, roads infrastructure, vehicle fleet, information and communications technology, and council housing (which is dealt with in the housing revenue account capital plan). The CIPFA Prudential Code principles are used to develop the capital financial plan.

The total projected capital resource for 2014-15 to 2017-18 is shown below, which has been fully matched to planned expenditure projects.

Funding source – general fund services	2014-15 £m	2015-16 £m	2016-17 £m	2017-18 £m	Total £m
Borrowing	20.9	40.4	32.1	19.7	**113.1**
General capital grant	17.2	18.4	17.0	17.0	**69.6**
Capital receipts	1.0	1.0	1.0	1.0	**4.0**
Total projected capital resources	**39.1**	**59.8**	**50.1**	**37.7**	**186.7**

Source: Capital Plan 2014-18 – General services, Policy & Resources Committee 59-2014

Key projects 2014-18	Amount £m
National housing trust (phase 1 and 2)	11.0
Central waterfront (net Council contribution)	9.6
Menzieshill Primary, Nursery and community provision	15.0
Harris Academy rebuild (net Council contribution)	12.0
Coldside Primary and community facilities	12.0
Strathmartine campus (primary and secondary)	18.1

Source: Capital Plan 2014-18 – General services, Policy & Resources Committee 59-2014

The table excludes the £45 million funding for the Victoria & Albert at Dundee, which is fully funded by external funding and forms part of the general investment in the central Waterfront area of Dundee.

Expenditure on the housing services capital plan is summarised as follows:

Funding source – housing services	2014-15 £m	2015-16 £m	2016-17 £m	2017-18 £m	2018-19 £m
Borrowing	13.6	11.8	11.0	11.0	11.0
Capital receipts	3.9	3.9	3.8	2.6	2.9
Slippage	1.8	-	-	-	-
Total projected capital resources	**19.3**	**15.7**	**14.8**	**13.6**	**13.9**

Source: Five year housing capital budget from 2014-15 to 2018-19, Policy and Resources Committee 27 January 2014

Key elements of the programme are in meeting the Scottish Housing Quality Standard, with expenditure on external insulation and cavity fill, plus renewal of heating, kitchens and bathrooms together representing 50% of the total expenditure.

In line with good practice under the Prudential Code, the capital plans for general fund services and housing services provided members with details of the prudential indicators for the periods of the plans as part of the approval process.

The investment in general services capital increases the ratio of financing costs to the net revenue stream from 7.6% currently to 8.1% at the end of 2016/17.

In respect of the HRA, the percentage increases from the current level of 42.7% to a peak of 43.2% before reducing back to a forecast 41.3% by 2017-18.

Financial statements and accounting

Our perspective on the preparation of the financial statements and key accounting judgements made by management

Audit conclusions and materiality

We have issued an unqualified audit opinion on the financial statements. Our work was based on a revised approach to materiality related to the Council's expenditure for the year.

Audit conclusions

Our audit work is complete and we have issued an unqualified opinion on the truth and fairness of the state of the Group's affairs as at 31 March 2014, and of the Group's deficit for the year then ended. The financial statements have been properly prepared in accordance with the 2013-14 Code of Practice, and prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government Scotland Act 2003. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks and audit focus areas;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to the prevention and detection of fraud with the potential to impact on the financial statements;
- attended the scrutiny committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

Materiality

Planning materiality was provided in the audit strategy and plan 2013-14 dated 3 February 2014. We revised materiality prior to the commencement of the final audit, following consideration of updated internal sector guidance and receipt of the draft financial statements.

Materiality has been re-set at £10 million (previously £17 million) which is approximately 2% of total expenditure in 2013-14 and we revised our approach to reflect this materiality level. We have designed our procedures to detect errors at a lower level of precision, i.e. £7.5 million. We reported identified errors greater than £500,000 to the scrutiny committee.

Significant risks and audit focus areas

The main audit focus areas are discussed on the following pages.

These were identified in the audit strategy and plan and are significant risks in respect of:

- **management override of controls;**
- **revenue recognition fraud risk; and**
- **valuation of property, plant and equipment;**

and other focus areas of:

- **employee benefits; and**
- **Dundee Energy Recycling Ltd.**

Significant risks that ISAs require us to raise in all cases

Professional standards require us to consider two specific risks for all organisations:

- management override of controls; and
- fraudulent revenue recognition.

Our audit approach to address these was set out in our audit plan and strategy. We did not consider fraudulent revenue recognition to be a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised given the nature of the Council's income sources. We therefore rebutted this risk and did not incorporate additional, specific work into our audit plan in this area over and above our standard fraud procedures. Although we did not consider the presumed risk of fraud from revenue recognition to be applicable, we remained alert to indications of fraud during the course of the audit.

As part of our work to address the significant risk of management override of controls we performed the following tests:

- testing of journals at the year end and during the year;
- review of unusual transactions in the year;
- enquiries with employees outside the corporate finance division; and
- controls testing, including higher level controls.

We do not have any findings to bring to your attention in relation to these matters. No control overrides were identified.

Other significant risks

Valuation of property, plant and equipment

Under the Code of Practice and IFRS, property, plant and equipment ("PPE") is required to be held on the balance sheet at fair value which for specialised assets is assumed to be depreciated replacement cost and for other PPE is open market value. In order to comply with these accounting requirements, Council assets are subject to rolling valuations. In between formal valuation periods, PPE is considered for any indications of impairment and where these are identified, formal valuations are performed and reflected in the financial statements. Valuations were undertaken by the estates valuer in the City Development department.

2013-14 represented the second year of the revised revaluation programme now being followed, where revaluations are carried out on an asset classification basis. This ensures that all assets of the same class are revalued in the same financial year.

Our audit of the accounting for the revaluation includes evaluation of the valuer as a third party expert and consideration of the data underlying the valuation report.

Significant risks and audit focus areas (continued)

We have considered key accounting issues, in relation to valuation of property, plant and equipment, accounting for Dundee Energy Recycling Limited and employee benefits.

We concur with management's judgements regarding valuation of property, plant and equipment and employee benefits.

Other areas of audit focus (continued)

Valuation of property, plant and equipment (continued)

We found that the estates valuer was appropriately professionally qualified and had sufficient experience and expertise to provide the information for use by the Council. Our testing included review of actual data against that used in the valuation report. No issues were identified.

The valuer uses a number of assumptions in his calculations based on market conditions at the year end. Using our own valuation specialists, we considered the methodology applied by the estates valuer and concluded that it had been applied satisfactorily in accordance with guidance issued by the Royal Institution of Chartered Surveyors. We did note, however, that the valuer comments that not all of the assets have been inspected. There is potential for carrying out more detailed valuations, however, the estates valuer has sufficiently detailed knowledge of the properties, gained through regular estate management inspections, to carry out valuations in this way.

Dundee Energy Recycling Limited

Dundee Energy Recycling Limited ("DERL") is a private limited company with ordinary and deferred (preference) shares. The Council previously held 40% of the ordinary shares which have voting rights.

DERL operates a waste-to-energy plant. The plant was non-operational during 2012-13 as a result of a fire. As the plant was in decline before the fire, the closure of the plant due to the fire was used as an opportunity to undertake improvement works. The policy and resources committee approved an investment of £7.9 million to carry out the improvement works. This work was completed in July 2013 when the plant became operational.

During 2013-14, as a result of acquiring shares from other shareholders, the Council's shareholding in DERL has increased to 100%. Consequently, from 21 October 2013 DERL became a subsidiary of the Council. DERL has been consolidated into the group accounts as an associate from 1 April 2013 to 20 October 2013, and as a subsidiary from 21 October 2013 to 29 December 2013.

DERL prepared financial statements for the 18 month period to 30 June 2013, and will then prepare financial statements for the six month period to 31 December 2013 which will become DERL's accounting reference date. Management used DERL's management accounts in order to include DERL in the group accounts.

We identified that this is an audit focus area in 2013-14 due to the different methods of consolidation available. We performed audit testing over the consolidation, with specific consideration on whether the management accounts used by the Council for consolidation were materially consistent with the audited financial statements for DERL to 31 December 2013. We confirmed with DERL management that there were no consequences of subsequent trading which would affect the results being reported.

Significant risks and audit focus areas (continued)

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.

Other areas of audit focus (continued)

Employee benefits valuation

The Council accounts for post employment benefits arising from participation its in the Tayside Pension Fund in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants covering the Council's share of the assets in the fund and measurement of liabilities. Our audit of the accounting for employee benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the year, the financial assumptions and membership data provided to the actuary by the Council, and estimates of the Council's share of the pension fund assets.

We found that the actuarial consultant as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the Council. The level of contributions made by the Council in the year is estimated based on data prior to the year end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the year end. Our testing included review of actual data against that used in the actuarial calculations. No issues were identified.

The actuaries use 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. Using our own actuarial specialists, we reviewed the assumptions and concluded that the overall assumptions proposed represented a balanced position for the net deficit within our expected range.

The Council adopted IAS 19 (Revised) in 2013-14. Under IAS 19, interest cost on the defined benefit obligation and an expected return on plan assets were recognised in the statement of comprehensive net expenditure within interest payable. Under IAS 19 (Revised), these two amounts have been replaced by a single measure called 'net interest' calculated on the net defined benefit liability.

We found that the Council has appropriately applied IAS 19 (Revised) in its financial statements by restating the prior year comparative information given in 2013-14 financial statements. There was no impact on the previously reported net asset position.

Accounting policies

There have been no substantive changes to the financial reporting framework as set out in the *Code of Practice on Local Authority Accounting in the United Kingdom 2013-14* ("the Code of Practice").

There have been no changes to accounting policies in 2013-14. All accounting policies have been applied consistently.

Disclosure has been included in respect of the impact of revisions to IAS 19 *Employee benefits.*

The financial statements have been prepared on a going concern basis.

Accounting framework and application of accounting policies	
Area	**KPMG comment**
Code of Practice on Local Authority Accounting in the United Kingdom 2013-14 ("the Code")	■ The 2013-14 financial statements have been prepared in accordance with the Code of Practice which is based upon International Financial Reporting Standards ("IFRS"). ■ During the year there have been no substantive changes in the Code's financial reporting requirements, and consequently there are no material changes to the Council's accounting policies. ■ We are satisfied that the accounting policies adopted remain appropriate to the business, and have been applied consistently.
Impact of revised accounting standards	■ Disclosure has been included in the financial statements on revisions to IAS 19 *Employee benefits.* The restatement to 2012-13 figures resulted in a estimated change to the amount charged to the Comprehensive Income and Expenditure statement of £11 million. ■ No other newly effective accounting standards are considered to have a material impact on the Council's financial statements.
Going concern	■ The Council has net assets of £430 million at the balance sheet date. While current liabilities exceed current assets, through treasury management monitoring, the Council has access to borrowing as required to meet the liabilities as they fall due. Management has considered the funding available to the Council, which is approved for 2014-15, combined with longer term funding indications, and the fact that the net liability obligations do not fall due within one year. Management considers it appropriate to adopt a going concern basis for the preparation of these financial statements. ■ The group balance sheet has net assets of £405 million, with the removal of the significant pensions liabilities in respect of Police and Fire services the principal reason for the significant increase in group net assets compared to the position at 31 March 2013. ■ We confirm that the going concern basis of preparation of the financial statements is appropriate.

Financial statements preparation

The unaudited financial statements were made available on a timely basis. Improvements from 2012-13 in the preparation of the financial statements were observed.

Financial statements preparation

- High quality working papers and complete unaudited financial statements were provided by the statutory deadline of 30 June 2014. This included the explanatory foreword, remuneration report and annual governance statement. A prepared by audit client file was made available at the start of the audit fieldwork on 7 July 2014. Supporting documentation was received in a timely basis and queries were answered promptly.
- We provided feedback to management on the content of the financial statements, annual governance statement and explanatory foreword and management subsequently amended the financial statements.
- In 2011-12, we recommended that management review the manner in which both the comprehensive income and expenditure account and the balance sheet are reconciled to the underlying financial ledger. Management has now completed an exercise to increase the automation of the financial statements from the underlying records. This has operated well in 2013-14 and should continue to make the preparation of future years' financial statements more efficient.
- There is further opportunity for continuous improvement in the financial statements preparation, including further reduction of the financial statements preparation time. Management indicated their desire to achieve a faster close of financial statements going forward. We will proactively engage with management to support an improvement in the financial statements close process.
- There are no non-trifling unadjusted audit differences, and there were no adjusted audit differences.
- No objections were received to the unaudited financial statements during the prescribed statutory public inspection period.
- The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014, replacing regulations which have applied since 1985. The regulations contain provisions for the unaudited annual financial statements as submitted to the auditor to be considered by the scrutiny committee no later than 31 August, and the audited financial statements to be presented to the scrutiny committee for consideration and approval prior to auditor signature before 30 September. Management should review the new regulations and assess any impact and make any necessary changes to the financial statements preparation and reporting processes.

Recommendation three

Financial statements preparation (continued)

Revised financial reporting and audit arrangements were applicable to the Council's charitable trusts for 2013-14.

We have satisfactorily concluded our audit work on these financial statements.

Charity accounts

- The preparation and audit of financial statements prepared by registered charities is regulated by the Charities and Trustee Investment (Scotland) Act 2005 and The Charities Accounts (Scotland) Regulations 2006. The 2006 regulations require charities to prepare a statement of account, and require an accompanying auditor's report where any legislation requires an audit. Section 106 of the Local Government (Scotland) Act 1973 applies the accounting and audit requirements of the Act to any trust fund where an authority, or some members of the authority, are the sole trustees. As section 106 requires an audit, the appointments of local authority auditors have been extended from 2013-14 to include the provision of an auditor's report for charitable funds covered by that section.
- The draft trustees' report and omnibus financial statements for Dundee City Council Charitable Trusts were received before the statutory date of 30 June 2014.
- The draft trustees' report and financial statements for Lord Provost of Dundee Charity Fund were received for audit slightly beyond the statutory date of 30 June 2014.
- Our audit work on these statements is complete and we have issued unqualified opinions. There were no matters to be brought to your attention by exception.
- Management intend to commence a re-organisation process to reduce the number of registered trusts significantly. Subject to committee approval, it is likely that a new charity will be created as a part of this process which will absorb the majority of the 29 current trusts with the remainder of the funds being absorbed by other local charitable bodies. This may represent significant work both for the Council and OSCR. To ensure that OSCR has time to complete this work, management should ensure that this process is progressed so that the re-organisation is completed by 31 March 2015.

Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Corporate governance arrangements

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

An updated risk management strategic plan has been approved by the policy and resources committee and scrutiny committee.

Corporate governance	The Council has effective overarching and supporting governance arrangements which provide an appropriate framework for organisational decision-making. The Council operates a committee based structure, comprising service committees as well as the policy and resources committee, with most of its business delegated to those committees. With the exception of the licensing and scrutiny committees, which have eight members, all members sit on all other committees. The scrutiny committee is chaired by a member of the opposition. The Council has a local code of corporate governance which is subject to annual review by a working group of senior officers and reported to the policy and resources committee. A 31-point checklist is completed which covers four areas: service planning and performance management; internal control environment; budgeting, accounting and financial control; and risk management and business continuity. This process has previously indicated a high level of compliance, however, it is also effective in highlighting areas of improvement, for example, this process resulted in the development of a new corporate risk register and counter-fraud policy during 2013-14. The Council's corporate governance arrangements are also supported by the work of internal audit. Internal audit's annual opinion for 2013-14 on the system of internal financial control was "reasonable assurance can be placed upon the adequacy and effectiveness of the Council's framework of governance, risk management and control for the year to 31 March 2014". An annual corporate performance self assessment exercise is carried out. The results of the 2014 self-assessment were reported to the scrutiny committee in June 2014. This report noted that performance levels in 2013-14 were generally maintained, showing some improvement. As set out in our audit plan and strategy, we have evaluated the work of internal audit. The content of the internal audit plan is in line with our expectations. We considered internal audit reports completed throughout the year to help inform our audit, however, we did not place reliance on any specific internal audit reports completed in 2013-14. In particular we considered the following reports in order to inform our audit approach: ▪ Tax governance; ▪ Performance measures; and ▪ Risk management arrangements. Internal audit reported that "reasonable assurance can be placed upon the adequacy and effectiveness of the Council's framework of governance, risk management and control for the year to 31 March 2014". This opinion was based on the internal audit work for the year, the assessment of risk completed during the preparation of the internal audit plan, knowledge of the Council's governance, risk management and performance management arrangements, as well as formal assurances received from the Council's directors / heads of service in the form of a self-assessment checklist.

Corporate governance arrangements (continued)

Corporate governance *(continued)*	The IASAB produced a common set of public sector internal audit standards ("PSIAS"), which require to be applied to the public sector from 1 April 2013. Internal audit submitted a report to the scrutiny committee which provided background to PSIAS and advised the committee that a review of existing internal audit working practice would be carried out to ensure compliance with PSIAS. This is considered to good practice, demonstrating the strength of the internal audit function.
Risk management	An internal audit review in 2011-12 highlighted a number of areas for consideration relating to risk management arrangements. Risk management was also highlighted in the Council's 2013-16 assurance and improvement plan as an `area of uncertainty', as management had not yet implemented their response to the internal audit findings. Internal audit had highlighted that the Council's previous risk management strategic plan was heavily focussed on insurance and business continuity risks, as opposed to strategic risks. The strategic management team were involved in a workshop session, facilitated by the Institute of Risk Management in Scotland which informed improvements to the risk management strategic plan. An updated strategic risk register was approved by the policy and resources committee and the scrutiny committee in June 2014. This ensures that the Council has an up to date register and that measures are in place to mitigate the likelihood and impact of significant risks. The Council's tolerance and appetite for risk are set out in the revised risk management strategic plan. The scrutiny committee has been given responsibility for reviewing the strategic and department risk registers, and for reviewing annual risk management performance. The Council has improved its risk management process and should continue to ensure that the risk management strategic plan and risk register are up to date in line with good practice.
Annual governance statement	The governance statement provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. It describes a number of sources of assurance for the accountable officer and identifies areas for improvements to be focussed on in the future. The statement also highlights the annual self-evaluation exercise carried out by the Council, which is based on the SOLACE/CIPFA good governance framework. Improvement points from this exercise are included within the statement and in the corporate improvement plan. We are satisfied that the content of the annual governance statement is in line with our understanding of the Council, and the relevant guidance.

Corporate governance arrangements (continued)

The annual governance statement identifies no major weaknesses in governance or internal control arrangements. A number of areas for continuous improvement are disclosed.

Remuneration report	We considered the contents of the remuneration report and reviewed against the requirements of the Local Authority Accounts (Scotland) Amendment Regulations 2011. We tested the disclosures in the remuneration report to supporting documents and therefore are able to confirm the accuracy of the content of the remuneration report.
Prevention and detection of fraud	A key mechanism in the allocation of authority, accountability and responsibility and the prevention and detection of fraud is the existence and maintenance of strategic and financial documentation. The Council has appropriate policies and codes of conduct for staff and councillors including a whistle blowing policy. Management has identified no significant fraud or irregularities, other than issues that were already brought to our attention by internal audit. The policy and resources committee receives reports from the director of corporate services on the performance in respect of housing and council tax benefit fraud of the counter-fraud section within the Council’s revenues division. During 2013-14, the Council introduced the “corporate fraud and corruption policy”. This policy was introduced in order to allow the Council’s counter-fraud team undertake pro-active counter-fraud activity in specific high risk areas, including pilot areas such as the council tax reduction scheme, housing tenancy and blue badge. This policy demonstrates good practice in the prevention and detection of fraud. Management and internal audit have confirmed that no significant fraud or irregularities have been identified during the year.
Maintaining standards of conduct and the prevention and detection of corruption	The Council has various organisational policies and procedures designed to prevent and detect corruption. Organisation-wide policies are important as they set the tone of the Council, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. There is also a specific members and officers code of conduct. The majority of these policies have recently been updated to reflect new requirements and are available to all staff on the intranet. This reinforcement of values will contribute to the effective prevention and detection of corruption at the Council. Separate registers of interest exist for chief officers and elected members. To ensure transparency in its arrangements, the register for members is available for inspection by the public.

Corporate governance arrangements (continued)

Our reporting through the year identified improvements in the governance and controls framework from the prior year. Management has demonstrated a commitment to continuous improvement, however a number of areas continue to require attention in respect of reconciliations and journal authorisation processes.

Systems of internal control	The early stages of our audit focussed on internal controls. We identified in our interim management report dated 2 April 2014 areas of the financial control framework that could be enhanced, including in respect of financial reconciliations and the senior officer's register of interests. As the financial and operating environment in which the Council operates continues to change, with developing priorities and new and emerging financial and non-financial risks, it is increasingly important that the Council plan, supporting service plans and other developments are underpinned by effective organisation-wide controls, robust financial management processes and effective key financial controls. We did not identity any further control weaknesses in the final stages of our audit work.
National fraud initiative	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. NFI helps participating bodies to identify possible cases of fraud and to detect and correct under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud. The Council has an established process for investigating cases of potential fraud highlighted by the NFI, falling largely under the control of benefits investigation officers as that is where the majority of cases fall. We prepared a short return to Audit Scotland in December 2013 assessing management's participation in the NFI exercise. Management's progress against a number of controls was graded on a traffic light basis. Twenty five of the 28 NFI questions were coded green with an overall green rating awarded. We found that the council had made good progress in processing matches demonstrating their commitment to the NFI process.

Performance management

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

Performance management

Our work has identified that the Council's Best Value and performance management arrangements are now well established.

The Council's Changing for the Future programme continues to be the mechanism for identifying corporate improvement and achieving efficiencies to deliver balanced budgets.

Best Value / performance management arrangements	In accordance with the principles of Best Value the Council seeks to pursue 'continuous improvement'. The corporate improvement team sit alongside the performance and improvement section, and the community planning team, each with individual responsibilities, within the chief executive's department. The Council has integrated many of the traditional Best Value focus areas into business as usual through the Council's improvement programme: Changing for the Future. This programme is the Council's policy programme for driving corporate improvement initiatives and for identifying how it intends to achieve the level of savings required to deliver balanced budgets. A new Single Outcome Agreement ("SOA") has been developed by the Council and related partners. The SOA is an agreement between the Dundee Partnership and the Scottish Government, setting out how each party will work to improve outcomes for the people of Dundee with a focus on jobs and the economy; social inclusion; and quality of life. The SOA for 2013-17 set out ten outcomes in order to achieve the SOA vision, which have been developed in line with the National Performance Framework for Scotland. Performance against each of these outcomes is monitored quarterly and annually by the scrutiny committee. The corporate performance self assessment for 2013-14 showed that 88% of the of the performance indicators had maintained or improved performance. Audit Scotland's Director of Performance and Best Value reported to the Accounts Commission on public performance reporting in June 2014, on whether councils reported on a range of information sufficient to demonstrate Best Value in a range of areas. The Council achieved a 'yes' score in 11 areas, a 'partial' score in ten areas and no 'no' scores. The report identified areas of good practice for the Council in effective use of customer satisfaction information in relation to the "we listened … we acted" webpage and good use of comparators specifically in relation to performance against other councils.

Performance management (continued)

Performance against statutory performance indicators and other local government bodies is measured by the Council and our responsibilities as external auditors extend to understanding the arrangements and systems.

Shared risk assessment	The scrutiny committee considered the updated assurance and improvement plan ("AIP") on 25 June 2014. The LAN recognises the Council's ongoing commitment to continuous improvement and self-evaluation. The detailed findings of the AIP were set out earlier.
Local response to national studies	Audit Scotland published *Health inequalities in Scotland* in December 2012 and as part of the audit for 2013-14 we considered the Council's response to it. We found that there had been no formal consideration of the report by the scrutiny committee or management as health inequalities discussions were already ongoing as part of the single outcome agreement development. We completed work on the follow up of Audit Scotland's *Major Capital Investment in Councils* and *Arms Length External Organisations: Are you getting it right?* reports. The Council's senior management team considered the March 2013 Audit Scotland report *Major Capital Investment in Council's* in May 2013. The scrutiny committee considered this report in June 2013. This provided background to the publication and although a formal action plan was not developed, the scrutiny committee remitted the report for action to the chief executive and director of corporate services. A review into the Council's capital investment arrangements was carried out as a result, which also included the director of city development. This review resulted in improvements being made to capital investment arrangements including the integration of capital investment teams. Auditors were required to complete a follow up review of this report in two stages. We prepared a short return to Audit Scotland on our findings from our stage 1 review in June 2014. We have substantially completed our stage 2 review and will prepare a report for Audit Scotland in due course. Audit Scotland require this report to be formally considered by the scrutiny committee. The Accounts Commission published a report in 2011, '*Arm's-Length External Organisations: Are you getting it right*?', as part of its 'How Councils Work' series of improvement reports. The aim of this was to provide the Accounts Commission a position statement on the Council's use of ALEOs. This report was presented to the scrutiny committee in 2011, however, no formal action plan was developed. Our findings did not identify any specific recommendations but did highlight areas for improvement.

Performance management (continued)

Performance against statutory performance indicators and other local government bodies is measured by the Council and our responsibilities as external auditors extend to understanding the arrangements and systems.

Statutory performance indicators	Local authorities have a statutory duty to ensure appropriate arrangements are in place for collecting, recording and publishing performance information. Auditors have a statutory duty to be satisfied that the Council has made adequate arrangements for collecting and recording information, and for publishing it, as are required for the performance of their duties. Consideration has been given to the Council's procedures for collecting and reporting information on SPIs, in line with Audit Scotland requirements. The audit of SPIs is a two stage process. Our results of the stage one assessment will be reported to Audit Scotland by 30 September 2014. The results of the second stage, assessing the quality of PPR, will be reported to the Accounts Commission by May 2015. In 2013-14, SPIs were not specified and were drafted by the Council based on categories provided by Audit Scotland. The specified indicators have been replaced by the Scottish Local Government Benchmarking Framework. The 2013-14 SPIs were developed in consultation with the policy and resources committee and are linked to the Audit Scotland categories as well as council plan and single outcome agreement objectives. The Council uses its own online performance monitoring system to input, manage, interrogate and present data. Each department is responsible for completing the current year figures based on the information they have gathered. This is performed by the compiler who is then required to calculate the percentage difference on the prior year. The compiler is then required to sign off this work and forward to the person responsible for checking the figures. On completion of the check, brief comments are attached to the result, with more detailed comments where variances are in excess of 5%. The final review is conducted by the head of service, before the performance indicators are subject to central collation. Management consider that there are adequate checks and controls to provide comfort over the completeness and accuracy of data. We are satisfied that this level of review is appropriate. Performance against the Council's performance indicators is reported in an annual performance report, including performance against the single outcome agreement.
Benchmarking	The Local Government Benchmarking Framework has been developed to help councils compare their performance using a standard set of indicators. The indicators in the framework replace the specified Statutory Performance Indicators ("SPI's") from 2013-14 onwards. Results are analysed in 'family groups' to ensure comparison is between authorities with similar characteristics. Management reviewed the available 2012-13 results, and reported these to the policy and resources committee in June 2013. The Council's performance was considered according to comparison with comparable local authorities across Scotland. Members approved recommendations that the indicators should be included in the Council's annual self-assessment report, as well being included in the department service plans to ensure continuous improvement is monitored each year. The policy and resources committee remitted to the scrutiny committee to review these comparisons in future years. We consider that this will support continuous improvement in performance reporting.

Appendices

Mandatory communications

There were no changes to the core financial statements, no adjusted audit differences and no unadjusted audit differences.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	There were no audit adjustments required to the unaudited financial statements which impacted on the net assets or the surplus and deficit for the year.	-
Unadjusted audit differences	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 by KPMG LLP to the scrutiny committee	We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff. There were no non-audit fees in the year.	Appendix 2
Draft management representation letter Proposed draft of letter to be issued by the Council to KPMG prior to audit sign-off	There are no changes to the representations required for our audit from last year.	-

Auditor independence and non-audit fees

Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the 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 the 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 members of the scrutiny committee.

Confirmation of audit independence

We confirm that as of 22 September 2014, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

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

Yours faithfully

KPMG LLP

Action plan

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

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 Medium term financial strategy		**Grade three**
There is scope for management to further develop the medium-term financial strategy for approval by members. This should include an identification of a target level of reserves in relation to the annual budgeted expenditure of the Council which is fixed as opposed to being re-set annually. Despite the uncertainty in future years' financial settlements, the development of such a strategy would enhance the Council's overall financial planning.	Management have considered the financial settlements recently published by the Scottish Government to 2015-16 and should now use this information to develop a medium term financial strategy.	The Council's medium term financial strategy will be developed further over the next 12 months. **Responsible officer:** Director of Corporate Services **Implementation date:** September 2015

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Capital budget monitoring		**Grade three**
We identified during our follow up of the Audit Scotland report *Major Capital Investment in Councils* that there is scope to improve the capital monitoring process. There is no consideration of how projects have performed against timescales set at the planning stage and no consideration of how projects have delivered in terms of meeting the anticipated benefits of the project.	Management should consider including analysis of performance against planned timescales and against the anticipated benefits of the project for large capital investments projects.	This matter will be considered as part of the on-going wider review of monitoring and governance arrangements around the capital programme. **Responsible officer:** Head of Corporate Finance **Implementation date:** December 2014
3 Local Authority Accounts (Scotland) Regulations 2014		**Grade three**
The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014, replacing regulations which have applied since 1985. The regulations contain provisions for the unaudited annual financial statements as submitted to the auditor to be considered by the audit committee no later than 31 August, and the audited financial statements to be presented to the audit committee for consideration and approval prior to auditor signature before 30 September.	It is recommended that management review the new regulations and assess any impact and make any necessary changes to the financial statements preparation processes and reporting.	The new regulations will be considered as part of the Final Accounts Working Group's preparations for the 2014/15 accounts. **Responsible officer:** Finance Manager (Corporate) **Implementation date:** 31 March 2015

cutting through complexity