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Tayside Contracts Joint Committee

Annual audit report to the members of Tayside Contracts Joint Committee and the Controller of Audit

Audit: year ended 31 March 2015

30 September 2015

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 the Tayside Contracts Joint Committee and is made available to Audit Scotland and the Accounts Commission for Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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

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

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

Headlines

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

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

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

Area	Summary observations	Analysis
Strategic overview		
Key issues and update	The year to 31 March 2015 was the first year of the new business plan covering the period from 2014 to 2017, with the theme of "Adapting for Success". Within the business plan, actions are included in relation to the expected reduction in budgets for local authorities over the next three to five years which will likely impact on Tayside Contracts Joint Committee (the "Joint Committee"). During the year the janitorial and school crossing guard services were transferred to the Joint Committee's facilities division from Angus Council and Dundee City Council.	Page 6
Financial position	In 2014-15 the Joint Committee achieved a trading surplus before IAS 19 adjustments of £1.03 million for the combined divisions, compared to a budget of £0.841 million. The result for the year incorporates a charge of £0.403 million in relation to redundancy and pension costs arising from phase one of the restructuring plan. The surplus returned to the three Constituent Councils exceeded budget. After IAS 19 entries the total comprehensive income was £21.612 million, primarily reflecting a £22.28 million actuarial gain. The two trading divisions; facilities and constructions, did not achieve the prescribed financial objective of attaining a breakeven position over a three year rolling period, due to the impact of recognising IAS 19 entries within each division.	Page 6-8
Financial statements and accounting		
Audit conclusions	We have issued an unqualified audit opinion on the 2014-15 financial statements, following their approval by the Proper Officer on 24 August 2015. The financial statements, directors' report, governance statement and remuneration report were received by the start of audit fieldwork and were supported by high quality working papers.	Page 10
Going concern	The accounts have been prepared on a going concern basis, as management considers that future charges to constituent councils are sufficient to ensure that the Joint Committee is able to meet debts as they fall due. The financial statements show net liabilities of £29.56 million, incorporating the £31.83 million retirement benefit obligation. As this obligation does not fall due within one year, it is not considered to impact on the going concern assumption.	Page 13

Headlines (continued)

Area	Summary observations	Analysis
Financial statements and accounting		
Significant risks and audit focus areas	The areas highlighted below are the specific audit focus areas identified within our audit strategy: ■ management override of controls fraud risk;and ■ fraudulent revenue recognition. and other focus areas of: ■ provisions; and ■ pension liability. Audit work has been completed to satisfy the requirements of ISA 330 'The auditor's procedures in response to assessed risks', including tests of key financial controls. In respect of each matter, we are content with management's judgements and accounting treatment.	Page 12
Accounting policies	There have been no changes to accounting policies applied by the Joint Committee in 2014-15. No newly effective accounting standards are expected to have a material impact on the 2015-16 financial statements.	Page 13
Governance and narrative reporting		
Governance	Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.	Page 16-18
Internal controls	Testing of the design and operation of financial controls over significant risk points was undertaken as part of our testing. Our work concluded that controls relating to financial systems and procedures are designed appropriately. Within the action plan we include a recommendation in relation to internal controls, in respect of journal authorisation.	Page 17
Performance Management		
Performance management	Our work has confirmed that the Joint Committee's performance management arrangements remain appropriate.	Page 20

Scope and responsibilities

Purpose of this report

The Accounts Commission for Scotland has appointed KPMG LLP as auditor of Tayside Contracts Joint Committee ("the Joint Committee") under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive.

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

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

Proper Officer responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out Joint Committee's responsibilities in respect:

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

Auditor responsibilities

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

Scope

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

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

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

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

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

Strategic overview

Our perspective on key business issues and financial position

Financial position

2014-15 represents the first year of the three year business plan.

The plan included an objective to return a surplus of £750,000 to the constituent councils in respect of 2014-15; the actual returned surplus was £1.03 million.

2014-15 outturn

2014-15 was the first year of the Joint Committee's three year business plan 2014 – 2017. The plan includes five key business objectives:

- deliver on our financial targets;
- provide quality services which meet clients' expectations;
- protect the environment;
- effectively manage and develop our people; and
- ensure the safety and welfare of our people and the public.

The 2014-15 budget assumed a surplus within the trading accounts of £0.841 million. The actual outturn, prior to transfers, was £1.03 million. A summary by division is presented on the following pages, and the result for the Joint Committee as a whole is shown below. The table does not include IAS 19 and other adjustments, to provide a clear view of the construction and facilities divisions.

	Budget £'000	Actual £'000	Variance £'000
Income	64,348	68,549	4,201
Expenditure	63,507	67,519	(4,012)
Surplus	**841**	**1,030**	**189**

In 2014-15 external income was £68.6 million, compared to £66.8 million in 2013-14. Charges to constituent local authorities (Angus, Dundee City and Perth and Kinross) rose £2.2 million from £61.9 million to £64.1 million. This reflects changed work patterns, including greater winter maintenance activity and the transfer of janitorial and school crossing guard services from Angus Council and Dundee City Council.

The increase in income was partially offset by a rise in costs compared to 2013-14, with expenditure increasing £3.1 million to £70.6 million. The increase was primarily due to greater direct labour and supervision costs associated with the increase in staff numbers and pay increase in the year. The living wage commitment made by the Joint Committee is a key factor of increasing staff costs, with a pay rise of 2.4% applied to the lower paid employees.

Significant trading operations

The Local Government in Scotland Act 2003 prescribes that the Joint Committee's trading operations should achieve a break-even position over a rolling three year period.

The rolling three year deficit for the Construction Division was £1.46 million and for the Facilities Services Division it was £1.709 million. It should be noted that these figures include IAS 19 adjustments made under accounting requirements and that without these figures the three year rolling surpluses would be £1.621 million and £1.662 million respectively.

As a result of the failure to deliver a three year surplus, the audit opinion notes a "failure to achieve a prescribed objective".

2015-16 budget

The Joint Committee's budget for 2015-16 has been approved. The budget details an anticipated income for the year ended 31 March 2016 of £71.311 million and expenditure of £70.437 million. The trading account surpluses are forecast as £0.119 million and £0.3 million for the construction and facilities divisions respectively. The Joint Committee has budgeted a total return to the constituent councils of £0.75 million.

Financial position (continued)

The construction division exceeded expectations in 2014-15, partly due to the higher level of winter maintenance required. The facilities services division also performed ahead of budget in the current year.

Construction services division – trading account

The construction division exceeded expectations in 2014-15. This was partly due to the higher level of winter maintenance required, as seen by the year on year comparatives of activity. This higher level of activity also led to an increase in direct purchases of £0.574 million, primarily as a result of a need to purchase additional stocks of salt and other winter maintenance materials.

Sub-contractors are engaged dependent on factors such as the level of work ongoing and the complexity and specialised skill required. Two large projects, namely Dock Street and Dundee City Square, ended in 2013-14, thereby reducing the need for sub-contractor assistance in 2014-15.

Construction services division

£'000	2014-15	2013-14	Movement
Charges to constituent councils	38,996	39,072	(76)
Charges to internal users	161	158	3
Other income	2,560	3,189	(629)
Income	**41,717**	**42,419**	**(702)**
Direct labour	10,068	9,912	156
Direct purchases	13,980	13,406	574
Sub-contractors	4,333	6,122	(1,789)
Transport and plant hire	2,329	2,092	237
Overheads	9,561	9,086	475
Depreciation	1,750	1,656	94
Depot rental charges	396	437	(41)
Interest payable	288	317	(29)
Expenditure	**42,705**	**43,028**	**(323)**
Net surplus/(deficit) including IAS19 adjustments	**(988)**	**(609)**	**(379)**

Source: draft 2014-15 financial statements

Facilities services division – trading account

The facilities services reported a deficit of £1.391 million for the year ended 31 March 2015 including the IAS 19 adjustments. There were strong performances in both the catering and cleaning units in the year compared to budget and prior year. There was continued focus on enhancing efficiencies whilst maintaining and improving service standards. The catering unit showed an increase of 4% in the number of meals provided throughout Tayside in the year, with numbers for 2014-15 at 4.84 million. The cleaning unit experienced positive growth in its business with income increasing by 16.5% against prior year. The facilities division also saw the transfer of janitorial and school crossing guard services from Angus Council and Dundee City Council.

Facilities services division

£'000	2014-15	2013-14	Movement
Charges to constituent councils	25,069	22,835	2,234
Charges to internal users	182	175	7
Other income	1,924	1,772	152
Income	**27,175**	**24,782**	**2,393**
Direct labour	18,426	16,150	2,276
Direct purchases	4,581	4,407	174
Overheads	5,501	4,551	950
Depreciation	33	24	9
Depot rental charges	25	28	(3)
Expenditure	**28,566**	**25,160**	**3,406**
Net surplus/(deficit) including IAS19 adjustments	**(1,391)**	**(378)**	**(1,013)**

Source: draft 2014-15 financial statements

Financial position (continued)

The Joint Committee was in a net liability position as at 31 March 2015.

The net liability decreased from £46.738 million as at 31 March 2014 to £29.56 million as at 31 March 2015, driven by actuarial gains in respect of the pension scheme.

Balance Sheet

The Joint Committee had net liabilities as at 31 March 2015 of £29.560 million, compared to £47.738 million as at 31 March 2014. The key elements of the movement are set out below.

Assets

Property, plant and equipment increased by £0.278 million in 2014-15, representing additions of £2.103 million less disposals of £0.042 million and depreciation of £1.783 million.

Short term debtors decreased by £0.483 million compared to the prior year, primarily relating to timing differences in payments.

Liabilities

The bank overdraft balance was reduced by £1.81 million in the year, as a result of the depreciation adjusted surplus for the year. Long term borrowings remained broadly consistent with the prior year.

The main factor of the reduction in the net liability was the decrease in the pension liability. The assets of the fund performed strongly, with an increase of £15.969 million in the present value of the scheme assets partially offset by a £1.096 million decrease in the present value of the scheme liabilities, notwithstanding the reduced discount factor, further details are included on pages 24 and 25.

Balance Sheet	2015 £'000	2014 £'000
Property, Plant and Equipment	9,487	9,209
Non-Current Assets	**9,487**	**9,209**
Inventories	2,362	2,581
Short Term Debtors	11,610	12,093
Cash and Cash Equivalents	6	5
Current Assets	13,978	14,679
Bank Overdraft	(618)	(2,431)
Short Term Borrowing	(1,226)	(1,115)
Short Term Creditors	(12,698)	(11,789)
Short Term Provisions	(868)	(586)
Current Liabilities	**(15,410)**	**(15,921)**
Long Term Creditors	-	(121)
Long Term Provisions	(286)	(272)
Long Term Borrowing	(5,501)	(5,419)
Other Long Term Liabilities	(31,828)	(48,893)
Long Term Liabilities	**(37,615)**	**(54,705)**
Net liabilities	**(29,560)**	**(46,738)**
Usable Reserves	500	500
Unusable Reserves	(30,060)	(47,238)
Total reserves	**(29,560)**	**(47,738)**

Source: draft 2014-15 financial statements

Financial statements and accounting

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

Audit conclusions

We have issued an unqualified audit opinion on the financial statements.

The financial statements, including the governance statement and managing director's report, were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Following approval of the financial statements by the Joint Committee we have issued an unqualified opinion on the truth and fairness of the state of Joint Committee's affairs as at 31 March 2015, and of Joint Committee's deficit for the year then ended. A "failure to achieve a prescribed objective" paragraph has been included within the audit opinion detailing the failure of the significant trading operations to achieve a break-even position over a three year rolling period.

In gathering the evidence for our opinion we have:

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

Financial statements preparation

- High quality working papers and draft financial statements were provided at the start of the audit fieldwork on 15 June 2015. This included the directors' report, remuneration report and governance statement.
- Reflective of the long standing working relationship, the standard of documentation was very good and there was evidence of accountability and ownership of working papers across the finance department.
- There were no significant issues with respect to compliance with the Code. We provided feedback to management on the content of the financial statements, annual report, governance statement and remuneration report and we are pleased to report that these were prepared appropriately.
- There are no significant matters in respect of (i) audit differences; (ii) auditor independence and non-audit fees; and (iii) management representation letter content, as reported in appendix one.
- We consider that management has maintained a robust control environment.

Significant risks and audit focus areas

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

- **management override of controls fraud risk; and**
- **fraudulent revenue recognition.**

and other focus areas of:

- **provisions; and**
- **pension liability.**

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

We have no changes to the risk or our approach to addressing the assumed ISA risk of fraud in management override of controls. We do not have findings to bring to your attention in relation to this matter. No control overrides were identified.

Significant risks	Our response	Audit findings
Fraudulent revenue Recognition International Standard on Auditing (UK and Ireland) 240 requires us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk.	We compared income to budget and the prior year, and sought explanations and supporting documentation for unexpected movements. We developed an expectation of other income and compared to actual income recorded. We performed cut-off testing to verify that income and associated debtors were recorded in the correct accounting period. We verified a sample year-end associated debtors to supporting documentation.	No exceptions were noted from the testing performed. In respect of the income items noted, we are satisfied that income has been appropriately recognised in the financial statements.
Audit focus area	**Our response**	**Audit findings**
Provisions Provisions are recognised in respect of quarry reinstatement costs and remedial works and are inherently judgemental. Future plans for the operations of the Joint Committee's two quarries are under consideration.	Our audit work consisted of: ▪ updating our understanding of the basis of calculation of provisions and the processes in place to capture and record any warranty work required; and ▪ reviewed the calculation and application of provisions associated with quarry reinstatement and environmental legislation, taking into account future intentions for use.	We are satisfied that the provisions balance is: ▪ is correctly stated in the balance sheet as at 31 March 2015; ▪ as an estimate, is free from management bias.

Significant risks and audit focus areas

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

- **management override of controls fraud risk; and**
- **fraudulent revenue recognition.**

and other focus areas of:

- **provisions; and**
- **pension liability.**

Audit focus area	Our response	Audit findings
Pension liability The Joint Committee accounts for its participation in the Tayside Pension Fund in accordance with IAS 19 Retirement benefits, using a valuation report prepared by actuarial consultants. The Joint Committee's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. The determination of the retirement benefit obligation is inherently judgemental and there is a financial statement risk as a result.	Our audit work consisted of: ■ KPMG specialists reviewing the financial assumptions underlying actuarial calculations and comparison to our central benchmarks, the result of which are on page 25; ■ testing the scheme assets and rolled-forward liabilities; ■ testing the level of contributions used by the actuary to those actually paid during the year; and ■ agreeing actuarial reports to financial statement disclosures. We set out further information in respect of the pension liability on pages 24 and 25.	We are satisfied that the pension liability has been accounted for and disclosed correctly in line with IAS19 Retirement benefits; and assumptions used in calculating this estimate and management's judgements are appropriate and within the acceptable KPMG range. In 2014-15 around 215 employees were transferred to the Joint Committee from Dundee City Council ('DCC') and Angus Council ('AC'). The majority are members of the Tayside Pension Fund, although the change in employer was not reflected by the actuary for the purposes of calculating the Joint Committee's pension liability as at 31 March 2015. For employees transferred from AC the actuary calculated a £0.8 million increase in liability. No calculation has been prepared in respect of employees transferred from DCC, although it is expected to be broadly similar. The membership data also includes 11 employees who left the joint committee under severance arrangements towards the end 2014-15, correction of which would reduce the liability. It is not unusual for there to be changes in membership during the year which is not reflected in IAS 19 reports, although usually less significant. However the change in the liability is not considered to be material in total; we are content that the pension liability is appropriately stated.

Accounting policies

The financial statements have been appropriately prepared on a going concern basis, having due consideration of the net liability position.

Accounting framework and application of accounting policies

Area	Summary observations	Audit findings
Accounting policies	There have been no changes to accounting policy applied by the Joint Committee in 2014-15 The qualitative focus areas in relation to the accounting policies of the entity are IAS 19 accounting and the calculation of the provisions within the accounts.	We are satisfied that the accounting policies adopted remain appropriate to the Joint Committee.
Financial reporting framework	■ The Joint Committee prepared the financial statements in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2014-15 (“the Code”) which is based upon International Financial Reporting Standards (“IFRS”). ■ Changes to the Code in 2014-15 include changes in respect of the restated opening balance sheet, adopting new group accounting standards and changes to the requirements for accounting for combinations of bodies and transfer of functions. None of these changes are relevant to the Joint Committee.	We are satisfied that the Partnership has prepared the financial statements in accordance with the Code.
Going concern	The Joint Committee’s balance sheet as at 31 March 2015 shows a net liabilities position of £29.560 million, the majority of which relates to employee benefit liabilities of £31.828 million. The financial statements have been prepared on a going concern basis in view of forecast trading results and the fact that the pension scheme liability does not fall due within one year. The Joint Committee’s primary revenue source is in respect of charges from constituent councils and is considered sufficient to enable the Joint Committee to meet debts as they fall due.	We concur with management’s view that the going concern assumption remains appropriate for the reasons noted. We are satisfied that the going concern disclosure remains appropriate.

Management reporting in financial statements

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

Area	Summary observations	Audit findings
Annual report, including the managing director and directors' reports	The financial statements form part of the annual report of the Joint Committee for the year ended 31 March 2015. We reviewed the contents of the management commentary and directors' report against the disclosure requirements and are content with the proposed reports. We advised management on the need for a management commentary in line with the guidance received from the Scottish Government, and provided minor changes and suggestions to enhance the reports.	We are required to consider the explanatory foreword and governance statement, and provide our opinion on the consistency of it with the financial statements. We are satisfied that the information contained within the management commentary, governance statement and remuneration report is consistent with the financial statements.
Remuneration report	The remuneration report was included within the draft financial statements and supported by good quality information and working papers.	We are satisfied that the information contained within the remuneration report is consistent with the underlying records and the financial statements.

Governance and narrative reporting

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

Update on controls findings from our audit

Corporate governance arrangements

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

Area	Summary observations	Audit findings
Annual governance statement and governance arrangements	The statement for 2014-15 outlines the corporate governance and risk management arrangements in operation in the financial year. It provides detail on Joint Committee's governance framework, operated internal controls, the work of internal audit, internal financial controls and risk management arrangements and analyses the efficiency and effectiveness of these elements of the framework. The Joint Committee operates a local code of corporate governance, drawing on all aspects of its governance arrangements, to consolidate these into a framework which is in line with the principles of the CIPFA / SOLACE publication Delivering Good Governance in Local Government. The local code of corporate governance focuses on four key areas of Joint Committee activity, namely structures and governance; service delivery arrangements; internal control and risk management; and stakeholder focus. The revenue and capital budgets for the year are approved by the Joint Committee, which also receives regular monitoring reports to allow it to exercise and demonstrate stewardship and accountability for the use of its resources. Standing orders, scheme of delegation, financial regulations, fraud regulations and tender procedures are all approved, and have been made available on the Joint Committee's website to demonstrate openness and transparency of arrangements.	We consider the governance framework and annual governance statement to be appropriate for Joint Committee and that the governance statement is in accordance with guidance and reflects our understanding of the organisation.
Prevention and detection of fraud	No material fraud or other irregularities were identified during the year and we consider that the Joint Committee has appropriate arrangements to prevent and detect fraud. The arrangements include policies and codes of conduct for staff and Joint Committee members, supported by a fraud prevention policy and response plan.	We consider that Joint Committee has appropriate arrangements to prevent and detect fraud.
Arrangements for maintaining standards of conduct and the prevention and detection of corruption	The Joint Committee has arrangements including policies and codes of conduct for staff and Joint Committee members, supported by a whistleblowing policy. Joint Committee members are responsible for setting the 'tone at the top' and are responsible for abiding by the code of conduct and disclosing interests which may be of importance, material or otherwise, to their work at Tayside Contracts Joint Committee.	We consider that the Joint Committee has appropriate arrangements to prevent and detect inappropriate conduct and corruption.

Corporate governance arrangements (continued)

Area	Summary observations	Audit findings
Internal controls	The Joint Committee is responsible for designing and implementing appropriate internal control systems to ensure a true and fair view of operations within the financial statements. Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls relating to financial systems and procedures are designed appropriately and operating effectively. The findings of our controls testing relate only to those matters identified during our normal audit work, in accordance with the Code, and there may still be weaknesses or risks within the control environment which have not been identified through this work. KPMG's identification of weaknesses, where applicable, does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control. A control observation was noted through our testing that the journal template did not have detail on the preparer of the journal. Therefore, there is no evidence of segregation of duties on the journals template, and a risk arises that a journal could be prepared and authorised by the same individual thus increasing the risk of error. Recommendation one	Our work concluded that that controls relating to financial systems and procedures are designed appropriately and operating effectively, with the exception of two control recommendations as set out in the action plan.

Corporate governance arrangements (continued)

Area	Summary observations	Audit findings
Internal audit	Internal audit is provided by Henderson Logie, an outsourced internal audit provider supports management in maintaining sound corporate governance and internal controls through the independent examination and evaluation of control systems and the reporting of any weaknesses to management for action. Audit Scotland's Code of Audit Practice sets out the wider dimension of public sector audit. It requires external auditors to perform an annual assessment of the adequacy of the internal audit function. We considered the activities of internal audit against the requirements of Public Sector Internal Audit Standards ('PSIAS'), focusing our review on the public sector requirements of the attribute and performance standards contained within PSIAS. This included a review of the internal audit charter, reporting lines, independence, objectivity and proficiency and the range of work carried out by internal audit. From this assessment, and considering the requirements of International Standard on Auditing 610 *(Considering the Work of Internal Audit)*, we can apply internal audit's work to inform our procedures, where relevant. The review of internal audit reports and conclusions did not indicate additional risks and there is no impact on our planned substantive testing. Internal audit has completed its agreed plan for the year ended 31 March 2015, and the annual report states that *"in our opinion the Organisation has adequate and effective arrangements for risk management, control and governance. Proper arrangements are in place to promote and secure Value for Money. This opinion has been arrived at taking into consideration the work we have undertaken during the current and previous financial years".*	We have concluded that the internal audit service operates in accordance with Public Sector Internal Audit Standards. Internal audit has concluded that the Joint Committee has a control framework which supports management of key risks.
National Fraud Initiative ("NFI")	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. Our review of Joint Committee' NFI participation resulted in an unsatisfactory grading. This was due to the Tayside Contracts data being submitted in partial form, out with Tayside Contracts management control, which led to a complete submission of data by Tayside Contracts occurring after the prescribed deadline. Once the issue was identified, management acted to rectify the situation and a full submission was provided to NFI. Recommendation two	We consider that the Joint Committee has not participated on a timely basis in the NFI process. A recommendation has been raised in relation to this matter in the action plan at appendix four.

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 Joint Committee's Best Value and performance management arrangements are generally robust.

Area	Summary observations	Audit findings
Performance management and best value	Scottish Government guidance on Best Value in public services requires a systematic approach to self-evaluation and continuous improvement. The guidance identifies the themes an organisation needs to focus on in order to deliver the duty of Best Value, but notes that implementation should be appropriate and proportionate to the priorities, operating environment, scale and nature of the body's business. We note that in working towards achieving best value, the Joint Committee participates in the Tayside Procurement Consortium, as well as having access to a number of national procurement programmes in which Dundee City Council participates. The Joint Committee measures its performance through regular reporting of key performance indicators ('KPIs') and the generation of the annual performance report. Copies of the report are made available to the public through the Joint Committee's website. The KPIs are categorised as 'deliver on our financial targets', 'protect the environment', 'effectively manage and develop our people', and 'ensure the safety and welfare of our people and the public'.	We consider that Joint Committee has appropriate arrangements to effectively manage performance.
Financial capacity in public bodies	Through the process of feedback through annual audit reports, current issues reports and sector meetings, Audit Scotland has identified, that overall reductions in staff numbers in public bodies may be affecting the capacity of back-office functions and specifically finance. Audit Scotland has requested the collation of baseline data across the public sector to inform sector specific overview reports and may inform a follow-up to the joint report on the public sector workforce which was published in November 2013 or support the development of the future performance audit programme. We have completed the information for Audit Scotland and consider that the Joint Committee has an appropriate level of financial resource.	We consider that the Joint Committee has appropriate financial capacity to effectively manage the organisation.

Appendices

Mandatory communications

There were no changes to the core financial statement and there are 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 draft financial statements which impacted on the net assets or net operating cost for the year. A small number of minor numerical and presentational adjustments were required to some of the financial statement notes.	-
Unadjusted audit differences Audit differences identified that we do not consider material to our audit opinion	We are required by ISA (UK and Ireland) 260 to communicate uncorrected misstatements, other than those which are trivial. On page 12 we note that actuarial calculations were not updated for joiners and leavers in the last part of the year. The impact of the change is not considered to be material, considering the actuarial report in respect of the Angus Council transferees. We also note that a number of the assumptions on page 24 are more prudent than KPMG's central rates. The pension liabilities of Dundee City Council and Angus Council include the liabilities in respect of members who transferred to the Joint Committee during the year and the Joint Committee's pension liability does not. The treatment is consistent with the two local authorities and no adjustment is proposed.	-
Confirmation of Independence Letter issued to the Audit 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.	Appendix two
Schedule of Fees	No non audit fees charged in the year.	-
Draft management representation letter Proposed draft of letter to be issued by the Joint Committee to KPMG	There are no changes to the standard representations required for our audit from last year.	-
Materiality The materiality applied to audit testing.	We assessed materiality based on our knowledge and understanding of the Joint Committee's risk profile and financial statements balances. Materiality was determined at £1.5 million; approximately 2% of total expenditure, and is consistent with the materiality identified in our audit strategy. We designed our audit procedures to detect errors at a lower level of precision, i.e. £1.125 million. We report identified errors greater than £0.075 million to the Joint Committee.	-

Auditor independence

Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the Joint Committee.

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 Joint Committee and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

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

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

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

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

Confirmation of audit independence

We confirm that as of 30 September 2015, 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 letter is intended solely for the information of the audit committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

Defined benefit obligations

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

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

We set out below the assumptions in respect of employee benefits.

Defined benefit pension liability

2015 £'000	2014 £'000	KPMG comment
(31,828)	(48,893)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation. Details of key actuarial assumptions are included in the table, along with our commentary.

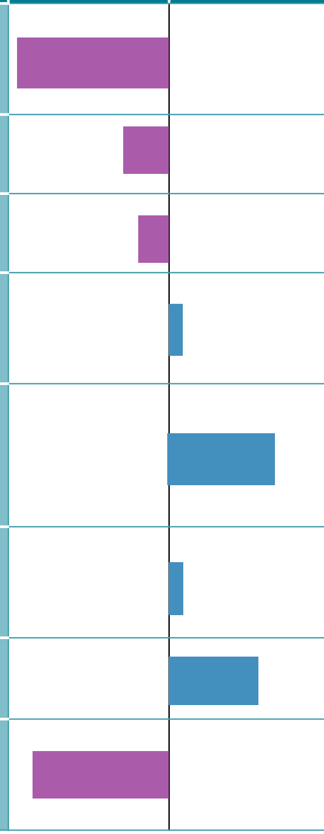
Assumption	Joint Committee	KPMG central	Comment
Discount rate (duration dependent)	3.30%	3.27%	The proposed discount rate is broadly in line with KPMG's central rate as at 31 March 2015. The proposed discount rate has been derived from the Merrill Lynch AA Corporate bond yield curve taking into account the employer's weighted average duration of the liabilities. This approach is acceptable for the purposes of IAS19 and is consistent with last year.
CPI inflation	RPI less 0.8% (2.40%)	RPI less 1.0% (2.23%)	The proposed CPI inflation rate is assumed to be the proposed RPI inflation rate less 0.8% which is consistent with last year.
Net discount rate (discount rate – CPI)	0.90%	1.04%	The proposed assumption is more prudent (higher liability) than KPMG's central rate. However, the proposed assumption is within an acceptable range of KPMG's central rate and therefore acceptable for IAS19 purposes.
Salary growth	4.20%	Typically 0%-1.5% above RPI	We note that the gap above RPI has reduced compared to last year, from 1.4% to 1%. Also, salaries are assumed to increase at a lower rate (in line with CPI) up to 31 March 2016, before reverting to the RPI + 1% long-term assumption.

The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of 19 years. A reconciliation from opening to closing deficit is included on the next page.

Defined benefit obligations

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

		Deficit / loss	Surplus / gain	Impact £000	Commentary
	Opening pension scheme deficit			**48,893**	The opening IAS19 deficit at 31 March 2014 for the Scheme was £48.9 million (consisting of assets of £105.5 million and defined benefit obligation of £154.4 million).
CIES	Service cost			6,919	The Scheme remains open to accrual. The employer's share of the cost of benefits accruing over the year is £6.9 million.
CIES	Net interest			2,166	This is the interest on the opening deficit of £49.9 million, adjusted for contributions paid during the period.
Cash	Contributions			(3,869)	The Joint Committee made cash contributions over the year of £3.9 million, which is broadly in line with contributions made last year, allowing for assumed salary increases.
CIES	Actuarial gain– financial assumptions			(11,284)	There was an actuarial gain on the financial assumptions of around £11.3 million. This is the changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions.
CIES	Actuarial gain – other adjustments			(770)	There was an actuarial gain of around £0.8 million, as a result of worse than expected experience between the 2011 and 2014 triennial valuations in respect of mortality, salary growth, and member movements.
CIES	Return on assets			(10,227)	The return on Plan assets, excluding interest of £4.8 million, was £10.2 million.
	Closing pension scheme deficit			**31,828**	The closing IAS19 deficit for the Scheme at 31 March 2015 is £31.8 million (consisting of assets of £121.4 million and defined benefit obligation of £153.2 million).



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

Cash – cash-flow impact

OCI – charged through other comprehensive income

Action plan

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 Journals authorisation (page 17)		**Grade two**
The first was noted through our testing that the journal authorisation form template did not have detail on the preparer of the journal. Therefore, there is no evidence of segregation of duties on the journals form. Segregation of duties within the journals control is a key aspect in providing mitigation of erroneous or fraudulent journals. This is particularly important where time is of the essence, and the risk of error increases. There is a risk that errors within journal postings are not detected and corrected in a timely manner.	Management should enhance the journals authorisation form to document the preparer of the journal thereby evidencing segregation of duties within the journals process.	Management will enhance the journal template and ensure that preparer and authoriser are different officers. **Responsible officer:** Financial Services Officer **Implementation date:** August 2015

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 NFI (page 18)		**Grade two**
The NFI exercise received an unsatisfactory rating overall. This was due to the Tayside Contracts data being submitted in partial form prior to being provided to management, leading to a complete submission of data occurring after the prescribed deadline. Once the issue was identified, management acted to rectify the situation and a full submission was provided to NFI. There is a risk that Tayside Contracts does not receive the full benefit of the NFI matching exercise.	Management should ensure that the NFI exercise is undertaken effectively to ensure that the data is of high quality, resulting in high quality matches. To coincide with the Council's submission, management should agree with Dundee City Council the process for the investigation and submission of data matches for future years.	Appropriate meetings have been arranged to ensure that this does not recur in the future. **Responsible officer:** Managing Director **Implementation date:** August 2015

cutting through complexity