Dumfries and Galloway Council

Annual report to Those Charged with Governance and the Controller of Audit

Year ended 31 March 2016

September 2016

The Audit and Risk Committee
Dumfries and Galloway Council
Council Offices
English Street
Dumfries
DG1 2DD

22nd September 2016

Ladies and Gentleman,

We are pleased to enclose our report to the Audit and Risk Committee in respect of our audit for the year ended 31 March 2016. The primary purpose of this report is to communicate the significant findings arising from our audit that we believe are relevant to those charged with governance.

The scope and proposed focus of our audit work was summarised in our audit plan, which we presented to the Audit and Risk Committee in January 2016. We have reviewed the results of our risk assessment procedures and on the basis of that review, we have made two amendments to our original risk assessment. Details of these amendments are set out in Section 2.

We have completed our audit work and expect to be able to issue an unqualified audit opinion on the financial statements on 22 September 2016. At the time of writing, the key outstanding matters, where our work has commenced but is not yet finalised, are audit completion procedures and subsequent events review. We will provide an oral update on these matters at the meeting on 22 September 2016.

We look forward to discussing our report with you on 22 September. Attending the meeting from PwC will be Margaret Kerr and Jennifer McKillop.

Yours faithfully

PricewaterhouseCoopers LLP

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Section 1. Executive summary

Introduction

This report sets out the significant findings from our audit of Dumfries and Galloway Council ("the Council") for the year ended 31 March 2016. We set out our proposed audit approach in the audit plan that was submitted to the Audit and Risk Committee in January 2016. We have reconsidered our risk assessment procedures and as a result we have made two amendments to the original risk assessment as follows: as a result of a change in PwC guidance we have increased the risk rating on property valuation from elevated to significant; and, following discussion with management, we have identified an additional audit risk relating to the presentation and disclosure of a significant receipt during the year. Further details of these amendments are set out in Section 2.

Framework for Our Audit

Our audit is conducted in accordance with Auditing Standards (International Standards on Auditing ('ISAs') (UK and Ireland)) and the Code of Audit Practice ('the Code').

The Code explains how external auditors should carry out their functions under the Local Government (Scotland) Act 1973. Given the fact that the audit of financial statements is covered by engagement and ethical standards issued by the UK Auditing Practices Board (APB), the Code focuses more on the wider functions and duties of public sector auditors.

Audit Summary

We have completed the majority of our audit work and expect to be able to issue an unqualified audit opinion on the financial statements on 22 September 2016. However, our opinion will report that the Roads Statutory Trading Operation did not achieve its statutory financial target to break even over a three year period. This is a matter we are required to report on by exception under the Code.

The key outstanding matters, where our work has commenced but is not yet finalised, are:

- Final review of financial statements and disclosures;
- Subsequent events review; and
- Approval of the financial statements and receipt of management letter of representation.

Financial Statements

As a result of our work, we proposed a number of disclosure adjustments and one financial adjustment to the draft financial statements. There are no unadjusted misstatements at the conclusion of our audit, as these have been resolved and accepted by management.

We found that the draft financial statements and accompanying working papers were of a good standard and accounting records were appropriately maintained.

Management responsibility

It is the responsibility of the Council and the Responsible Financial Officer to prepare the financial statements in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003. This means:

- selecting suitable accounting policies and applying them consistently;
- making reasonable and prudent judgements and estimates;
- maintaining proper accounting records; and

- preparing financial statements timeously which give a true and fair view of the financial position of the Council and its expenditure and income for the year ending 31 March 2016 and which comply with the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the UK 2015/16 (the Code).

Auditors' responsibilities

Our statutory responsibilities require us to provide you with an audit report stating whether, in our opinion the financial statements and the part of the remuneration report to be audited:

- give a true and fair view of the financial position of the Council and its expenditure and income for the year;
- were prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements; and
- the information which comprises the management commentary included with the financial statements is consistent with the financial statements.

We are also required to review and report as necessary on other information published with the financial statements, including the annual governance statement and the remuneration report.

Financial performance

The Council's operational budget for services in 2015/16 was £334.3 million and the Council achieved actual net expenditure of £334.1 million, resulting in an underspend of £0.2 million against budget.

The Council achieved savings in services of £7.6m against a target of £8.3m. Service areas which incurred overspends against budget were Social Work, delivering an overspend of £164,000, and Planning and Environment Services which reached an overspend of £73,000. The overspends were offset by underspends in other service areas.

The amount held in overall General Fund balance as at 31 March 2016 was £55.5 million (2014/15: £57.8 million). The General Fund balance includes an amount held in the unallocated fund of £6.8 million (2014/15: £6.8 million). This meets the Council's agreed policy to seek to retain unallocated General Fund balances at a minimum 2% of annual planned expenditure.

During the year a total of £15.6m was transferred into the General Fund and £17.9m transferred out which resulted in a net reduction of £2.3m. Key uses of the fund balance in the year relate to the investment required to meet the treatment, recycling and recovery requirements of the Waste (Scotland) Regulations 2012, which required £3m to be utilised from the Waste PFI Sinking Fund in 2015/16. In addition £4m was utilised in the year from the Corporate Change Fund to support Early Retirement/Voluntary Redundancy schemes ongoing within the Council as part of the longer term transformation programme.

Acknowledgements

We would like to thank the management and staff of the Council for their co-operation and assistance during the course of our work. We believe that we had a good working relationship with the Council which resulted in an efficient and effective audit process.

Section 2: Significant audit and accounting matters

Audit Opinion

We have completed our audit, subject to the following outstanding matters:

- Final review of financial statements and disclosures;
- Subsequent events review; and
- Approval of the financial statements and receipt of management letter of representation.

Subject to the finalisation of the above we expect to issue an unqualified audit opinion. However, our opinion will be modified to report on the fact that the Council's Road's Statutory Trading Operation did not achieve its statutory financial target to break even.

Key matters arising from the audit

Our approach to the audit of the financial statements was set out in our Audit Plan presented to you in January 2016.

Our audit approach is risk based, informed by a sound understanding of the operations of the Council and an assessment of the risks associated with the financial statements. We have reviewed the results of our original risk assessment procedures and have identified the following changes to the overall approach outlined in our Audit Plan:

1. Our External Audit Plan identified the audit risk in relation to property valuation as elevated. Following new PwC guidance we have elected to raise this audit risk to significant given the significance of this value on the Council's balance sheet and the judgements that must be applied in the valuation process. Raising this risk to significant ensures that we gather audit evidence which is proportionate to the size and complexity of this balance. This change in our risk assessment does not mean that we believe that the risk profile within the Council has changed; rather it is reflective of a change in our audit methodology.

2. Following discussions with management, we have added an additional elevated risk in relation to disclosure of settlement receipts in accordance with accounting standards. This was raised as an audit risk due to the high profile and material value of a settlement receipt received in the year. Further details on the settlement receipt are included later in this section.

We have set out in this section the significant matters arising from our audit.

Matters identified in our audit plan

Set out below is a summary of our response to matters classified as having either a significant or an elevated risk profile:

Risk	Categorisation	Results of work performed
Management override of controls ISA (UK&I) 240 requires that we plan our audit work to consider the risk of fraud, which is presumed to be a significant risk in any audit. In every organisation, management may be in a position to override the routine day to day financial controls. Accordingly, for all of our audits, we consider this risk and adapt our audit procedures accordingly.	Significant risk	We performed the following procedures: • Tested the appropriateness of journal entries using Computer Assisted Audit Techniques; • Reviewed accounting estimates for bias and evaluated whether circumstances producing any bias represented a risk of material misstatement due to fraud; • Evaluated the business rationale underlying significant transactions; and • Performed 'unpredictable' procedures over the completeness of the properties listed on the Oasis system for Council tax and Non-domestic rates. **We have noted no matters to bring to your attention as a result of our work.**
Fraud in revenue and expenditure recognition Under ISA (UK&I) 240 there is a presumption that there are risks of fraud in revenue recognition. We consider the risk of fraud in revenue recognition to apply to all income streams other than Council tax and Non-domestic rates. We extend this presumption to the recognition of expenditure in local government, as there is arguably greater risk associated with the recognition of expenditure. There is a risk that the Council could adopt accounting policies or treat expenditure transactions in such a way to lead to material misstatement in the reported expenditure position to ensure budgets are achieved. We consider the risk of fraud in expenditure recognition to apply to all expenditure streams other than financing expenditure and staff costs.	Significant risk	We obtained an understanding of key revenue and expenditure controls. We have tested the appropriateness of significant income and expenditure journals applying a risk based sampling technique. We evaluated and tested the accounting policies for income and expenditure recognition to ensure that they are consistent with the requirements of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the UK 2015/16 (the Code). We performed substantive testing on a sample of revenue and expenditure transactions and confirmed with reference to supporting documentation that each was recorded at the correct value, in the correct accounting period and was posted correctly within the accounts. We also tested transactions recorded after the year end to ensure that these had been accounted for in the correct period. We reviewed significant accounting estimates and judgements for indicators of management bias. These included accounting estimates relating to expenditure accruals, early retirement and doubtful debt provisions. **We have noted no matters to bring to your attention as a result of our work.**

Risk	Categorisation	Results of work performed
Risk of error in land and property valuations Given the significant value of property held on the balance sheet, there is an increased risk of material misstatement through the valuations cycle, impairment reviews or other accounting entries which impact the net book value of assets.	Significant risk	In response to the risk of error in land and property valuations: • We have engaged internal valuations specialists to review the valuation methodology utilised and the underlying assumptions applied in that methodology; • We have tested the accounting treatment for a sample of revaluations in the period and ensured this has been done correctly; • We have agreed key valuation inputs from properties sampled to supporting documentation such as original floor plans and title deeds; • We have reviewed management's procedures to identify any indicators of impairment to the value of its properties for appropriateness; and • We have performed substantive testing of a sample of fixed asset additions and depreciation calculations. **We have noted two control deficiencies in relation to this work. These are discussed later in this section. Our work resulted in one financial adjustment which was agreed and amended by management.**
Financial sustainability risk PwC has classed the budgetary pressures experienced by Local Authorities across Scotland at present as an elevated risk. This risk is pervasive, impacting the financial statements, the ability of the council to achieve sustainable financial balance and continue to meet current levels of service provision.	Elevated risk	In response to the elevated risk in relation to financial sustainability: • We have inspected the revenue and capital outturn reports to consider performance against budget for the year ended 31st March 2016; • We have enquired with management to understand the process by which budgets and savings targets set; • We have reviewed future budgets and longer term financial plans; • We have assessed key assumptions used by management in setting its budgets; and • We have considered how this budget aligns with the Council's strategy. **The Council has determined that 2016/17 and beyond will present a number of challenges, largely due to the reduction of the Local Government Settlement. Whilst a series of actions have taken place to achieve savings, there remains a risk that these will be insufficient to achieve financial balance.** **Our full commentary in relation to financial sustainability of the Council is set out in Section 3.**

Risk	Categorisation	Results of work performed
Health & Social Care – Integration Joint Board accounting arrangements The Council entered into an Integration Joint Board with NHS Dumfries & Galloway for the delivery of the Health and Social Care Integration legislation. These new legal structures and governance arrangements came into place during 2015-16 for the first time, and will therefore be required to be accounted for accurately.	Elevated risk	We have considered the financial position of the Integration Joint Board for 2015/16. We have reviewed management's decision not to consolidate the entity on an equity basis due to materiality. **We have noted no matters to bring to your attention as a result of our work.**
Disclosure of settlement agreement During the course of the year the Council entered into a settlement agreement which resulted in a receipt of £9.5m. Given the value of the receipt and the high profile nature of the settlement, we deemed this to be an elevated audit risk.	Elevated risk	We have considered the accounting treatment of the settlement receipt received in the year in accordance with the requirements of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the UK 2015/16 (the Code) and the International Financial Reporting Standards (IFRS). As a consequence of a confidentiality agreement, and pending the receipt of final advice from PwC, management were advised not to disclose the value and nature of the item separately within the draft financial statements. We have subsequently concluded that the settlement receipt requires separate disclosure within the notes to the financial statements. This was an adjustment subsequently processed by management during the course of the audit. **Our commentary in relation to disclosure of the settlement agreement is set out later in this section.**

Materiality

Materiality is set to direct the overall audit strategy and to assess the impact of any adjustments identified. Overall materiality was set at 2% of total expenditure for the year. This was calculated as gross expenditure plus other operating expenditure.

ISA (UK&I) 450 (revised) requires that we record all misstatements identified except those which are "clearly trivial" i.e. those which we do expect not to have a material effect on the financial statements even if accumulated. We have applied a de-minimus level of £250,000 which we have assessed as clearly trivial. This was agreed with the Audit and Risk Committee upon submission of our annual audit plan. The materiality levels to which we worked are set out below:

	£
Overall materiality – This is the amount we have applied in assessing the overall impact on the group financial statements of potential adjustments	**£9,684,400**
Performance materiality - We have applied this to direct the amount of work performed over each financial statement line item – for example in calculating sample sizes	**£7,263,300**
De-minimus posting level - Under ISA (UK & I) 450, we are required to report to the Audit Committee on all unadjusted misstatements in excess of a 'de-minimus' or 'clearly trifling' amount	**£250,000**

Accounting issues

We identified the following accounting matters during the course of our work that we wish to draw to your attention.

Disclosure of settlement receipt

During the year a settlement agreement was reached between the Council and another party in respect of a dispute regarding Council property, resulting in a receipt of £9.5m.

We understand that, as part of the agreement, the Council signed up to a confidentiality clause prohibiting disclosure of the terms of the agreement other than in certain specified circumstances. As a consequence of the confidentiality agreement, and pending the receipt of final advice from PwC, management were advised not to disclose the value and nature of the item separately within the 2015/16 draft financial statements.

We have considered the requirements of section 12 of the Local Government in Scotland Act 2003 and the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the UK 2015/16 which states the following in relation to disclosure of material items:

- S.3.4.2.25: "When items of income or expense are material, an authority shall disclose their nature and amount separately"; and
- S.3.4.2.53: "A local authority shall present separately each material class of similar items. A local authority shall present separately items of a dissimilar nature or function unless they are immaterial".

For the purposes of the external audit PwC has deemed the settlement as material in both value and nature. Therefore our conclusion is that, in order to comply with the Code, and present a true and fair view, the Council is required to disclose the nature and value of the settlement separately within its financial statements.

This disclosure adjustment is now reflected within the 2015/16 audited financial statements.

Significant Trading Operations

Local authorities have a duty, under section 10 of the Local Government in Scotland Act 2003, to conduct each of their Significant Trading Operations to ensure that income is not less than expenditure over a rolling three year period.

The Council has put in place criteria for determining which of its trading units should be classified as Significant Trading Operations (STOs). The Roads Maintenance Service and the Building Maintenance Service met all of the criteria for 2015/16 and therefore require separate disclosure in the financial statements.

The Building Maintenance Service has delivered a deficit in the current year of £56,000 (2014/15 surplus: £94,000). This deficit represents the first over the past three years and the service has a cumulative surplus position over this period of £199,000.

The in-year deficit was wholly in relation to the statutory accounting IAS19 pension adjustments and, excluding this accounting adjustment, a surplus of £42,000 would have been achieved.

The Roads Maintenance Service has delivered a deficit in the current year of £676,000 (2014/15: £405,000). The service has delivered a three year cumulative deficit of £1.18m. An analysis of its three year cumulative position is set out below:

Table 1: Roads Maintenance Service financial performance 2013/14 – 2015/16

	2013/14 (£'000)	2014/15 (£'000)	2015/16 (£'000)	Cumulative 3 Year Position (£'000)
Income	(25,507)	(23,765)	(21,809)	(71,081)
Expenditure	25,602	24,170	22,485	72,257
Net (Surplus)/Deficit	95	405	676	1,176

As detailed above, the Council's Roads Maintenance STO has not achieved a surplus over a three year period, with a cumulative deficit of £1.18 million. As a result the Council has not met the statutory financial target in relation to its STO.

We have noted the key causes of the cumulative deficit as follows:

- Pensions charges total £590,000 over the past three years, which reflects the reduction in the discount rate applied to future pension liabilities. This discount rate and the associated pension charges are largely out with management control.
- A £368,000 allowance for doubtful debts was also charged to the service in the current year. This allowance related to a specific provision for a single debtor which was outstanding for over 12 months at year end. Management consider that this position is one-off and will not recur in future years.

The trading performance of the Roads Maintenance Service over the prior three years excluding accounting adjustments relating to pensions and bad debt provision is set out below, highlighting a significant improvement in performance over the last year.

Table 2: Roads Maintenance Service financial performance 2013/14 – 2015/16 (excluding accounting adjustments)

	2013/14 (£'000)	2014/15 (£'000)	2015/16 (£'000)	Cumulative 3 Year Position (£'000)
Income	(25,507)	(23,765)	(21,809)	(71,081)
Expenditure	25,503	23,983	21,815	71,301
Net (Surplus)/Deficit	(4)	218	6	220

Management is taking action to address the financial position of the Roads Maintenance Service by looking at other areas where profitability can be improved to ensure an improvement in the trading performance going forward. A local action plan to address the recurring deficit was implemented in 2014/15 and work continues in that regard.

Auditors are required by the Code of Audit Practice to report by exception where there has been a failure to achieve a prescribed financial objective. The statutory requirement for a Significant Trading Operation to break even over a three year period (2013/14 to 2015/16) is a prescribed financial objective. As such this has been included within our Audit Opinion as a matter to report by exception.

Disclosure of Related Party Transactions

In accordance with the Section 3.9 of the CIPFA / LASAAC Code of Practice on Local Authority Accounting in the UK 2015/and IAS 24 *Related Party Disclosures,* the Council is required to identify related party relationships and transactions and disclose these appropriately.

Our audit testing identified that the original disclosure within the unaudited accounts omitted two related party transactions which are required to be disclosed under the Code and IAS 24. Whilst management had undertaken a process and identified these related parties and transactions, they were excluded on the basis that the transactions were not material to the Council. However, it is a requirement of the CIPFA Code that the authority considers whether the transactions are material to the other party. Where this is the case, the disclosure criteria must be met.

Upon further review of the transactions in the context of the related parties it was agreed that these would be material to the recipient. Management has processed a disclosure adjustment to include these transactions within the related parties note to the accounts.

Whilst we are comfortable that material related party disclosures are now accounted for correctly, the Council should enhance its process for ensuring that all relevant related party transactions are captured and disclosed as necessary.

This matter has been identified as an audit finding within our action plan set out at Appendix 1.

Compliance with procurement standing orders

For the two undisclosed related party transactions identified during the audit, we undertook procedures to assess compliance with the Council's procurement standing orders. For one of these transactions we noted that the requirements of the standing orders had not been adhered to.

In this instance the contract value for these services was not determined in advance. However, the Council's standing orders for contracts without a set duration or scope require that an estimate of the total value be calculated and used as the basis to determine what procurement procedures should be followed. Using the methodology set out within the Council's standing orders, we calculated the indicative contract value to be £32,520 based on invoices raised in 2015/16. For contracts of value between £20,001 - £50,000 there is a requirement to use the Public Contracts Scotland Quick Quote Service to invite a minimum of five suppliers to quote. In the event that five suppliers with relevant experience are not known, advice should be taken from procurement on appropriate advertising that will allow adequate competition.

PwC confirmed for this contract the quick quote service was not used and no alternative procurement process was followed to award the work. Enquiries were also made with procurement to obtain evidence of advice being provided on how best to allow adequate competition; however, while it was indicated that advice had been sought, this had not been documented.

In considering the related party transaction we found no evidence to demonstrate that the transaction had not taken place at arms-length. However, the absence of adherence to the procurement process has resulted in a lack of transparency over the transaction.

The Council's procurement process provides a control framework to minimise the risk of fraud and failing to achieve best value. However, for this transaction the process has not been followed. The Council should take action to ensure that procurement standing orders are operating effectively in the future.

This matter has been identified as an audit finding within our action plan set out at Appendix 1.

Accounting for asset combinations

During the year the Council elected to combine multiple assets in order to capture land and buildings at a site level. The limitations of the fixed asset register are such that in order to combine assets, a series of transactions must take place. These include transferring the assets that will be removed to assets held for sale and subsequently revaluing them down to zero, and revaluing the remaining asset upwards to capture the additions. We found that these transactions were also being processed as accounting entries in the general ledger.

Whilst it is appreciated that these transactions may be the only means by which management can combine assets on the register, the journals being processed in the general ledger result in the notes to the accounts conveying a series of movements and revaluations which in substance have not genuinely taken place.

Our audit found that there were three instances in the year in which incorrect journals had been processed as a consequence of asset combinations on the fixed asset register. Whilst the impact on the net book value of PPE remained unchanged, movements and revaluations in the notes to the accounts were found to be incorrect. An audit adjustment was therefore proposed to correct this which was accepted by management and processed in the final accounts.

Management should ensure, going forward, that automated entries to the general ledger which are driven by fixed asset register transactions are reviewed to ensure these are correct.

This matter has been identified as an audit finding within our action plan set out at Appendix 1.

Impairment review process

Within the 2014/15 annual report to those charged with governance we recommended that the Council improves its process for assessing whether there were any indicators of impairment in relation to the value of its fixed asset portfolio. This followed an audit adjustment required in the prior year to account for impairment to the DG One leisure centre.

We have followed up with Management on the progress made against this recommendation. Whilst a formal process has not been operating for the current year end, we have noted that some progress has been made towards implementing a formal process.

A pilot exercise is underway which aims to record the status of all operational built assets on a single web-based database. The database will be populated using information gathered following building inspections conducted by the Council's building maintenance and safety team. The information gathered from these inspections will rate identified repair/maintenance requirements between priority 1 and 4. Whilst the primary use for the database will be to ensure that Council properties are maintained to an appropriate standard, this will also be used as a tool to consider whether there is an indication of the need for an impairment. Whilst progress has been made, the current planned timescale for full operation of the database is 18 months.

In the current year we have assessed the process followed by management to consider impairment and note that it continues to be dependent on the rolling revaluation exercise. However, discussions with estates personnel confirmed that there is also an informal process whereby known changes to property conditions (such as improvement works, damage or unresolved repairs) are considered and where these are identified the asset is accelerated in the revaluation programme. This was evidenced in the current year through the acceleration of Loreburn Hall in the revaluation programme due to expansion works that had taken place in the year. The property was revalued in both 2014/15 and in the current year. The current year revaluation resulted in an upwards revaluation of £402,000 following completion of a programme of investment.

Whilst we accept that some progress has been made towards implementation of the recommendation, this has been retained as an open prior year finding. Details of prior year findings and status is set out at Appendix 2.

Misstatements and significant audit adjustments

We report to you all misstatements that we have found during the course of our audit, other than those of a trivial nature, which have not been corrected by management in the financial statements. We noted a number of disclosure adjustments and one financial adjustment during our audit, all of which have been corrected by Management.

Significant accounting principles and policies

Significant accounting principles and policies are disclosed in the notes to the financial statements. We will ask Management to represent to us that the selection of, or changes in, significant accounting policies and practices that have, or could have, a material effect on the financial statements have been considered.

Judgments and accounting estimates

The Council is required to prepare its financial statements in accordance with the CIPFA Code of Practice for Local Authority Accounting. Nevertheless, there are still many areas where management need to apply judgement to the recognition and measurement of items in the financial statements. The following significant judgements and accounting estimates were used in the preparation of the financial statements:

Pension assumptions

Employees of the Council participate in the Dumfries and Galloway Council Pension Fund which is a local authority defined benefit pension scheme. In order to ascertain the value of scheme assets and liabilities attributable to the Council, an actuarial valuation is conducted on an annual basis by independent firm of actuaries Hymans Robertson. In financial year 2015/16 the Council recognised a pension liability of £305m (2014/15:£362.7m).

The pension liability held by the Council is based on a number of assumptions made by the actuary. We have outlined the principal assumptions applied in arriving at this estimate along with PwC's expected ranges in the table below:

Table 3: Pension assumptions

Pension assumption	Actuary assumptions	PwC expected range
Pension increase rate	2.20% (1.0% below RPI inflation)	0.80% - 1.20% below RPI (i.e. 2.00% - 2.40%)
Salary increase rate	4.20% The salary increase assumption has been set to be consistent with the most recent formal valuation. As at 31 March 2015, the long term pay growth assumption is RPI plus 1.0% p.a. An additional allowance has also been made for promotional salary increases.	This is an entity specific assumption but general expectation is between CPI plus 0.5% and RPI plus 1.5%. This is in line with our actuarial assumptions. .
Discount rate	3.50%	3.35% - 3.70%
Retail price index	3.20%	2.80% - 3.25%

Based on our work performed we have concluded that the assumptions applied are reasonable.

Allowance for Doubtful Accounts – Council Tax

The Council has an allowance for doubtful debt for council tax receivables of £12.5m as at 31 March 2016 (2014/15: £12.1m). We carried out procedures to consider the adequacy of the allowance for doubtful accounts, including the application of the Council's bad debt policy.

In order to capture recoverability of the year-end council tax receivables balance, the Council performs an analysis of historic recoverability of income in prior years. This percentage is then applied to the receivables balance to arrive at a provision value. The Council adopts this approach as opposed to providing for the receivables balance on an aging basis, as is its process for trade debtors. The Council's systems cannot produce a report containing council tax debtors by age and the application of historic recoverability rates has been deemed a reasonable basis to apply.

We have considered the methodology applied and agree with management's assessment that this is a reasonable approach. We have also analysed historic collection rates and actual amounts recovered relative to the allowance made and have no issues to report.

Valuation of property, plant and equipment

The Council's property portfolio is subject to a 5 year rolling revaluation programme which is undertaken by the Property and Architectural Services Department. Through this programme all assets are formally revalued on a five yearly basis.

The revaluation exercise in 2015/16 has resulted in a net upwards revaluation of £21m in the current year relating to land and buildings. We have selected a sample of revaluations performed in the year and engaged our internal valuations experts to consider the methodology and assumptions applied in reaching the valuation. We have also tested the accuracy of the inputs into the each revaluation exercise. We have noted no issues in relation to the work performed.

Charitable Funds audit

We are required as appointed auditors to provide an audit opinion on charitable trusts registered with the Office of the Scottish Charities Regulator (OSCR) where the Council, or some members of the Council, act as sole Trustee.

Regulation 7 of The Charities Accounts (Scotland) Regulations permits charities that have a common purpose or shared management to prepare a single set of 'connected charities' accounts. In line with this guidance, and with the approval of OSCR, management has prepared sets of connected charities accounts.

In the current year the Wigtownshire Connected Trusts and Dumfries and Galloway Educational Endowments were de-registered. Wigtownshire Connected Trusts had a net assets balance of zero as at 31 March 2015 and therefore ceased to conduct activities in 2015/16. The funds of Dumfries and Galloway Educational Endowments were transferred in full to Dumfriesshire Educational Trust, which exists for the same charitable purpose of providing prize funds for local schools. This was considered and approved by elected members on 21 January 2016 and OSCR was also consulted on the transfer.

The Council confirmed with OSCR that following de-registration there is no requirement for these connected trusts to prepare annual accounts. As such no audit is required. We have performed audit procedures in relation to the remaining active connected trusts: Stewartry Connected Trusts and Nithsdale Connected Trusts.

Audit Scotland published a position report on Section 106 charities in April 2016. The report highlighted the following key matters:

1. There has been progress made by Local Authorities in reducing the number of registered charities in recent years but there remains considerable scope for reductions;
2. A number of Local Authorities are not utilising the connected charities provision for the purpose of preparing accounts; and
3. Auditors should report on whether governing documents are available for charities.

Dumfries and Galloway Council is making progress towards the reduction of the number of registered charities and as such have de-registered two in the current year. Efforts continue to identify possible options for transferring funds to other related trusts or to utilise existing funds.

Dumfries and Galloway has utilised the connected charities provision and as such has prepared two sets of accounts representing a number of individual connected trusts.

In respect of Stewartry Connected Trusts we found that of the 11 component trusts we were able to obtain original governing documents for only one. However, the trust which is supported by governing documents was the only trust in the year to award grants and therefore we were able to confirm that grants had been made in accordance with the charitable purpose.

Our review of governing documents for Nithsdale Connected Trusts noted that of 17 trusts we were able to obtain governing documents for one. During the year grants were made by only two trusts, one of which had governing documents.

Whilst the Council does not hold governing documents for the majority of the connected trusts, it does maintain a record of the charitable purpose. In addition, for the majority of grant expenditure incurred in the year we have been able to agree that the expenditure is suitable in the context of the original governing documents. For these reasons the lack of governing documents has had no impact on our audit opinion for 2015/16.

Management representations

The final draft of the representation letter that we ask management to sign is attached in Appendix 3.

Annual Governance Statement

The CIPFA Code of Practice on Local Authority Accounting states the following in relation to Scottish Local Authorities and the preparation of an annual governance statement:

"Scottish local authorities, which are not required by legislation to conduct a review at least once in a year of the effectiveness of its system of internal control, shall consider doing so voluntarily and preparing an Annual Governance Statement. Authorities that do not voluntarily choose to do this shall include a statement on the system of internal financial control with their Statement of Accounts."

The Council has chosen to voluntarily conduct a review during the year of the effectiveness of its system of internal control and has prepared an Annual Governance Statement within the 2015/16 annual accounts. We have reviewed the Annual Governance Statement to consider whether it is consistent with the requirements set out in the Code, and whether it is misleading or inconsistent with other information known to us from our audit work. We found no areas of concern to report in this context.

Whole of Government Accounts

As part of our work on the financial statements we will also report on the Whole of Government Accounts Return submitted to the National Audit Office. This work will be submitted in accordance with the deadline of 30 September 2016.

Section 3. Financial standing

2015/16 Financial Performance

The Council returned a deficit of £19.1 million on the Provision of Services in 2015/16, compared to a deficit of £21.3 million in 2014/15. This deficit reflects the impact of a number of technical accounting adjustments and a more informative indication of the Council's performance in the year is reflected in the movement in the General Fund.

The Council's financial performance for the General Fund for 2015/16 is summarised in the table below.

Table 4: Financial performance 2015/16

	2015/16 £000	2014/15 £000
Net Cost of Services	**368,193**	**356,960**
Taxation and Non-Specific Grant Income	(379,967)	(368,070)
Other operating expenditure	(20)	48
Other Income and Expenditure (Financing and Investment)	30,868	32,330
Deficit/(Surplus) on Provision of Services	**19,074**	**21,268**
	General Fund	**General Fund**
Deficit/(Surplus) on Provision of Services	**19,074**	**21,268**
Adjustments between accounting basis and funding basis under regulations.	(16,113)	(20,170)
Net Decrease before Transfers to Reserves	**2,961**	**558**
Transfers (from)/to Reserves	(630)	74
Decrease in Year	**2,331**	**632**
Opening Balance	**(57,792)**	**(58,424)**
Closing Balance	**(55,461)**	**(57,792)**

The General Fund balance reduced from £57.8 million at 31 March 2015 to £55.5 million at 31 March 2016 and follows a similar decrease in the prior year. This decrease can be attributed to a number of areas, some of which were not offset by transfers into the fund. During the year a total of £15.6m was transferred into the General Fund and £17.9m transferred out which resulted in a net reduction of £2.3m in the General Fund balance. Significant uses of General Fund balances include the following:

- The need to provide funding to meet the treatment, recycling and recovery requirements of the Waste (Scotland) Regulations 2012 (agreed by the Planning, Housing & Environment Committee in November 2012). This required funding of £3 million from the Waste PFI Sinking Fund.
- £4 million was transferred from the General Fund to fund exit packages offered to staff under the Early Retirement/Voluntary Severance scheme. Other transfers from reserves are mainly attributed to the funding of capital investment and other necessary repairs and maintenance costs.

Performance against budget

The 2015/16 operational budget and actual comparison is set out in the table below:

Table 5: 2015/16 performance against operational budgets

Description	2015/16 Budget £000	2015/16 Actual £000	Variance £000
Education	134,554	134,382	172
Social Work	81,181	81,345	(164)
Planning and Environment	31,229	31,302	(73)
DG First	33,501	33,494	116
Community and Customer Services	32,065	31,949	116
Chief Executive Services	21,763	21,618	145
Total	**334,293**	**334,090**	**203**

The following over spends were noted in the year:

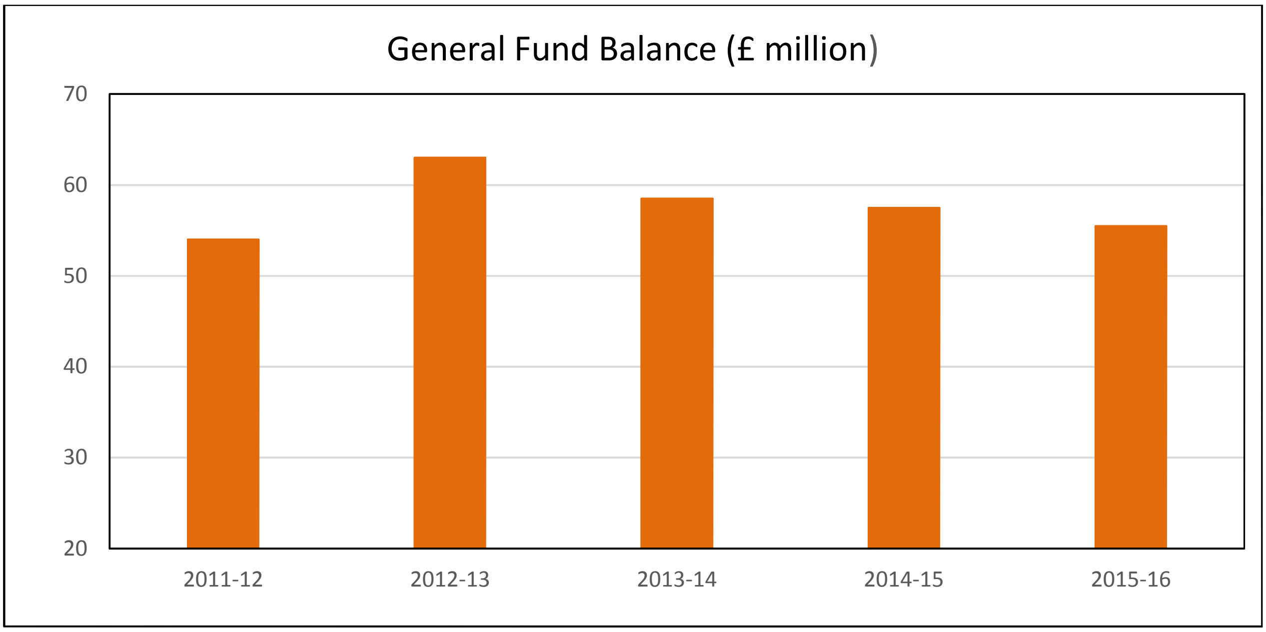
Social work – the overspend returned in the year is largely attributable to pressures with Adult Services involving increased residential placement costs. Also within this service there has been a general delay in the achievement of planned efficiency savings.

Planning and environment –The overspend returned in year was as a consequence of cost pressures in fleet management. Whilst Management identified these pressures during the year, cost control measures were not sufficient to deliver a break even position.

Reserves

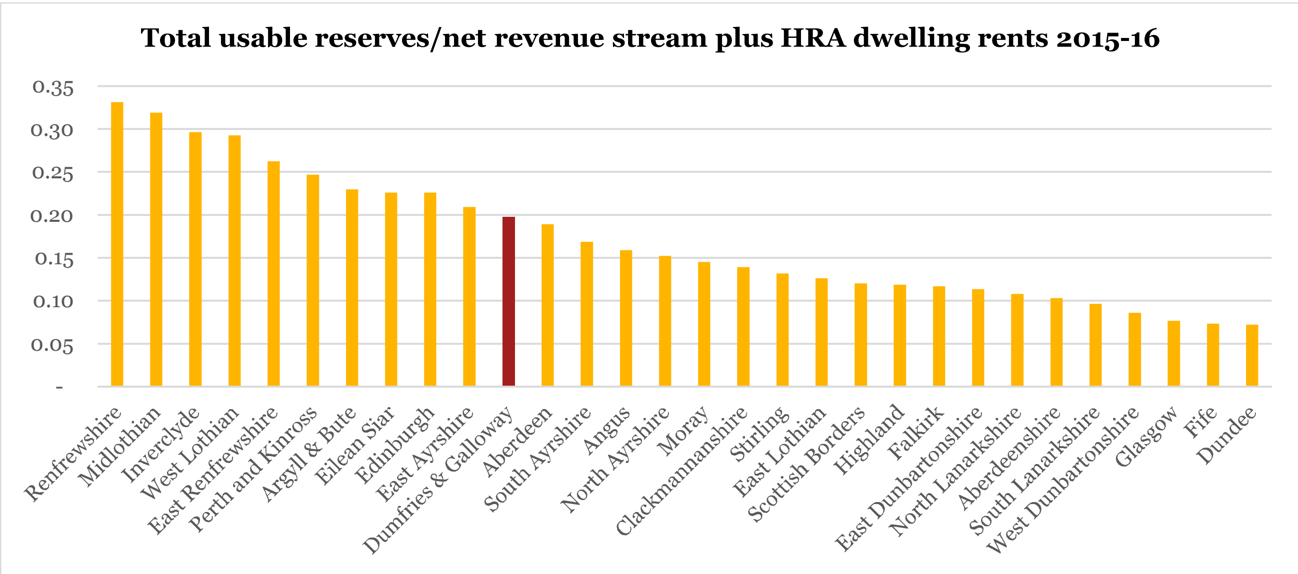
The Council's general fund balance has fallen by £2.3 in the current year. See table below showing movements in the general fund over the last five years.

Table 6: General fund balance 2011/12 – 2015/16



Overall the Council's level of general reserves relative to its size appears reasonable and is in line with the Council's policy. See table below which outlines how Dumfries and Galloway Council compares to other Scottish local authorities.

Table 7: General fund balances relative to Council size (excluding Orkney and Shetland Islands Council due to their unique reserves position)



Note: Dumfries & Galloway Council does not have a Housing Revenue Account and as such does not receive dwelling rents.

Within the General Fund the Council has created a Corporate Change Fund with a balance of £8.2m at 31 March 2016 (2014/15: £2.7m). This fund will be used to support the delivery of change, savings and efficiencies going forward and is a key mechanism which will support the delivery of the Council's overall transformation programme. Movements within the Corporate Change Fund in the year are set out in the table below:

Table 8: Movement in Corporate Change Fund 2015/16

Balance brought forward	**£2.653m**
Release of other Reserves	£4.393m
Early Retirement/Voluntary Severance Funding	£1.622m
Utilised during the year	(£4.176)
Corporate positive budget variances transferred at year end	£3.688m
Balance carried forward	**£8.170m**

Amounts utilised during the year represent amounts used to cover the cost of Early Retirement and Voluntary Redundancy packages.

Members agreed the need to increase the level of the Corporate Change Fund at the Policy and Resources Committee in January 2016, with a target level of £7.5m, in recognition of the increased investment likely to be required to support the delivery of 2016/17 agreed savings.

The General Fund balance of £55.5 million also includes the following other key allocated/committed amounts:

- £15.3 million being held in a Sinking Fund in order to be used for the Smarter Schools PPP Project;
- £4.3 million being held in a Sinking Fund to be used to meet future payments on the Waste Management/Recycling PFI project;
- £2.7 million being held to fund affordable housing projects.

There is also an unallocated balance of £6.8 million, which, as noted above, is in line with the Council's plan to maintain an unallocated balance of 2% of annual planned expenditure.

Capital Expenditure

The Council had a capital expenditure budget for 2015/16 of £32.440m, against which £32.382m of expenditure was incurred. Capital expenditure was made in relation to the following key projects:

Table 9: 2015/16 capital projects

Project	Capital Expenditure £'000
Priority projects:	
Dalbeattie Learning Campus*	(177)
Dumfries Learning Town	2,626
Next Generation Broadband	6,000
Whitesands Flood Protection and Public Realm	98
Kirkudbright Charter	268
Asset classes:	
Property/buildings (Schools)	5,023
Property/buildings (non-schools)	2,831

Infrastructure	9,082
Economic development	1,727
Land	813
ICT/business systems	1,037
Vehicles/fleets	660
SWestrans	1,035
CFCR	1,359
Total	**32,382**

*This project received repayment fees earlier than anticipated which resulted in the funding being carried forward to 2016/17.

Capital expenditure in year was funded through the following key sources:

Table 10: 2015/16 sources of capital funding

Source	Funding £'000
General capital grant	22,181
Corporate borrowing	8,142
Net CFCR	1,359
Corporate receipts	362
Ring-fenced capital receipts	200
Funded from revenue	138
Total	**32,382**

Efficiency savings

The Council is required to contribute annual savings towards the Scottish Government's Efficiency Targets. The table below provides an overview of the final savings reported to each Service Committee for 2015/16, showing a comparison between the savings target applied to the original budget and the savings achieved.

Table 11: Efficiency savings 2015/16

Source	Savings target £ million	Savings actual £ million	% of gross expenditure
Social work	1.855	1.357	1.69
Education	1.557	1.557	1.16
Planning and environment	1.122	0.956	4.11
DG First	2.004	1.944	5.8
Community and customer services	944	944	2.94
Chief Executive services	858	858	2.32
Total	**8.340**	**7.616**	**2.27**

2016/17 Budget

The 2016/17 budget was presented to the Council and agreed in February 2016. The budget sets out planned expenditure before savings of £356.7m (2015/16: £353.4m). The Council's original three year financial plan to 2017/18 had assumed savings of £12.6m would be required in 2016/17. However, the outcome of the 2016/17 Local Government Finance Settlement has resulted in a savings requirement of £21.2m in 2016/17.

In response to the requirement to find an additional £8.6m of savings over and above what was planned, the Council has had to set challenging savings plans at a service level. Accountability for delivery of these plans has been assigned to Heads of Service. Progress against these plans is being monitored by the Corporate Management Team, the Policy and Resources Committee and individual service committees.

Whilst the Council has responded to the need for increased savings it is acknowledged that there is heightened risk around the delivery of the savings plans. Going forward the Council has identified reductions in Scottish Government funding as a key financial risk.

2017/18 Budget

In 2015/16 the council agreed a 3 year budget, meaning that an indicative budget for 2017/18 had also been agreed. However, following the 2016/17 Local Government Settlement, the 2016/17 budget was revised and no further budgets have yet been devised. This is largely due to the fact that the present Local Government Settlement does not look beyond 2016/17. The Council has deemed that, should the levels per the 2016/17 settlement continue for future years, there will need to be service cuts which should not be made without public consultation.

For this reason the Council will not prepare a longer term budget until it has undertaken public consultation and agreed on the service impact of future settlement reductions.

Financial standing

The Council has determined that 2016/17 will be a challenging financial year, largely due to the impact of the Local Government Finance Settlement. Despite detailed plans and actions being in place, supported by regular monitoring and reporting systems, there remains a risk that the Council will not achieve planned savings.

The Council has acknowledged that its current operational structure will not promote financial sustainability going forward and therefore initiated a reshaping programme in 2014/15 with a view to transforming operations to make them more efficient and sustainable in the longer term. The Council continues to make progress in its reshaping programme which was approved by the Council in December 2014. Work has been completed in relation to the senior management structure review, securing £575,000 of recurring savings. Reductions in the Council staffing provision have been agreed and are being progressed through the Pensions Panel. Each Service area has completed a review of management structures and new structures have been agreed and presented to full Council.

The service review element of the programme is ongoing. To date 12 of 18 service reviews have reported savings options to elected members and action is ongoing to implement approved options. It is expected that service reviews will result in £6.1m of savings for 2016/17 and £12.2m 2017/18.

Future levels of funding through Scottish Government Grants and the power to vary local taxes are at present uncertain. As such, there will be a need for further savings and efficiencies to be identified. Doing so will be critical to the financial sustainability of Dumfries and Galloway Council and the provision of key local services in a way that is sustainable over the longer term.

Section 5. Best value and performance

Performance management

The Council's Policy and Resources Committee determines how and when the Council officers will report performance as part of the Business Planning process by setting a Performance Reporting Timetable. Scrutiny and Performance Committee reviews and scrutinises the effectiveness of services and reports on its assessment and recommendations to Full Council.

Each Service area must set out an annual business plan, against which its performance is assessed at the end of the year. Business plans and end of year performance reports are presented to the relevant Service Committees for review. End of year performance reports also include details of performance against agreed performance indicators.

The Council also participates in the Local Government Benchmarking Framework which is clearly signposted on its website to allow stakeholders to benchmark performance.

On an annual basis the Council reviews progress made against its four strategic priorities:

4. Build the local economy
5. Provide the best start in life for all our children
6. Protect our most vulnerable people
7. Be an inclusive Council.

Progress on priorities is reported both internally and published on the Council website. The Council has also included a summary of actions being taken to meet these priorities within the annual accounts for 2015/16.

Statutory performance indicators

The Accounts Commission has a statutory responsibility to define the performance information that councils must publish in the following financial year. As part of continuing improvements being made to the SPI regime by the Accounts Commission since 2008, the Accounts Commission has considered how the SPI process could be made more effectively aligned with their new integrated approach to auditing Best Value.

The Accounts Commission has therefore adopted a new SPI strategy which incorporates longer-term performance information, reflecting the increasing maturity of the Commission's ongoing support and integrating councils' assessments of performance management approaches. This will first apply for the financial year 2016/17.

In terms of our responsibilities as your appointed auditor, we were not required to formally audit the SPI return for 2015/16 submitted by the Council. We however were required to comment on the arrangements in place for collecting, recording and publishing performance data in accordance with the direction as set by the Accounts Commission.

We did not identify any issues in relation to the arrangements in place for gathering and reporting performance data.

Complaints management

The Council has in place defined processes to support the receipt and management of complaints from the public. On an annual basis the Council produces an Annual Complaints Monitoring Report which is available publicly both in hard copy and on the Council website.

During the year the Scottish Public Services Ombudsman (SPSO) contacted the Council regarding complaints referred to them during the year. Of these five complaints four were not upheld and one was partially upheld. The complaint that was partially upheld related to poor record keeping in relation to a decision for the payment of school transport. The SPSO therefore recommended that the Council considers how it could better communicate with parents on school transport.

Best Value: Stranraer Slipway

In our role as external auditors to Dumfries and Galloway Council, we were commissioned by Audit Scotland in January 2016 to undertake a review of the Stranraer Slipway capital project which has been the subject of concerns raised by two elected members of the Council. Our review sought to understand the project management and governance arrangements of the project and consider any impact on best value.

Whilst we did not find evidence to conclude that there was a failure to secure best value on this project, we did identify a number of areas where the project management arrangements could have been better. These included matters such as the need for improved stakeholder management, improvements to business case considerations and the need for a post project evaluation to take place.

We have included full details of the work undertaken and outcomes in a separate report to the Audit and Risk Committee and Audit Scotland.

Exit packages

The Council has incurred costs of £4.5m (2014/15: £2.5m) in 2015/16 in relation to exit packages agreed in respect of Early Retirement/Voluntary Redundancy (ERVS) scheme. See table below which sets out the number and value of packages agreed:

Table 12: Exit packages

Exit package cost band (including special payments)	Total number of exit packages by cost band		Total cash value of exit packages in each band	
	2015/16	2014/15	2015/16	2014/15
£0 – £20,000	72	26	675,470	273,173
£20,001 - £40,000	48	25	1,355,816	1,355,816
£40,001 - £60,000	21	10	975,679	511,952
£60,001 - £80,000	8	6	579,010	390,834
£80,001 - £100,000	1	5	89,350	448,150
£100,001 - £150,000	4	0	458,887	0
>£150,000	2	1	375,883	189,111
Total	156	73	4,510,095	2,494,664

Included in the above is £1.3m (2014/15: £1.1m) of packages which have been agreed in the year but not yet paid. A provision is included in the accounts to reflect this commitment.

The number of packages agreed has increased significantly in the current year. This is attributable to the Council's ongoing plans to achieve sustainable savings going forward.

We have performed sample testing over the exit packages in 2015/16 and can confirm that packages were approved in accordance with the Council's policies and procedures.

The Scottish Government issued statutory guidance which provides local authorities with financial flexibility to assist with meeting the costs associated with equal pay and severance (Finance circular 4/2015 Equal pay and severance) which permits authorities to:

- delay the financial impact of equal pay and severance until a cash payment is made
- use capital receipts to fund equal pay back pay settlements and severance payments.

The statutory guidance, which is not mandatory but gives authorities flexibility, applies from 1 April 2014 and will expire on 1 April 2018. Dumfries and Galloway Council have elected not to utilise the financial flexibility provided by the circular and instead have funded the ERVS packages through their Corporate Change Fund which is an allocated fund within General Reserves.

Workforce planning in Councils

In November 2013 Audit Scotland published its report "*Scotland's Public Sector Workforce*" which made recommendations in relation to workforce planning. In particular, organisations should:

- Develop and use organisation-wide workforce plans, informed by a series of service or departmental plans that are consistent in their structure and content and which are scrutinised and monitored by senior managers and boards or elected members;
- Assess the impact of different terms and conditions on the likely costs and uptake of their early retirement/voluntary redundancy schemes before they put a scheme in place;
- Collect information on the costs and net savings from their workforce programmes and report these details to boards and elected members;
- Forecast expected staff numbers, skill needs and costs on a rolling three year basis, using scenario planning where necessary; and
- Make better use of existing mechanisms, such as community planning partnerships, to identify opportunities to share resources, including workforces.

In accordance with our responsibilities as your appointed auditor, we have completed the follow-up questionnaire and submitted this by the June 2016 deadline.

Key points noted from our follow up procedures include the following:

- The Council approved a workforce strategy for the period 2015 – 2020 in April 2015. The strategy is centred around improving the longer term deployment and retraining of the Council workforce.
- The Council is undergoing a transformation programme which is supported by the Business Transformation Steering Group. As part of this the workforce impact of service redesign has been considered.
- The Council has incurred costs of £4.5m in the current year associated with early departure schemes. A formal process is in place to regulate the scheme and the cost of release of all employees is formally assessed by the Council's Pension's Panel considering both long term sustainability and immediate cost.

Community Empowerment Act

The Community Empowerment (Scotland) Act 2015 was passed by the Scottish Government in June 2015 and it is expected the majority of the provisions will come into effect by late summer 2016. The overall objective of the legislation is to empower local communities by improving their level of involvement in local decisions and strengthening the statutory provisions for community involvement.

The new legislation places duties on Community Planning Partnerships (CPPs) in relation to planning and delivery of local outcomes. Tackling inequalities has also been identified as an area of required focus for CPPs. Dumfries and Galloway Council has led the development of the Local Outcomes Improvement Plan which has been signed up to by all local partners. The plan establishes a set of six overarching objectives all of which can be linked back to the Council's four priority areas.

Other key provisions that will impact local authorities include the following:

- Increased ability of community bodies to participate in improving outcomes for the local community;
- Extension of the Land Reform (Scotland) Act 2003 to extend the rights of the community to buy land;
- Provides community bodies with the right to request to buy land belonging to local authorities;
- Introduction of a statutory duty to establish and maintain a register of all property held by them for the common good;
- Simplification of the process for selling allotments; and
- Provision of a new power for local authorities to create and fund their own localised business rates relief scheme.

Health and social care integration

The Public Bodies (Joint Working) (Scotland) Act 2014 was passed in April 2014 as part of the Scottish Government's agenda to drive improvement in the provision of health and social care services. The Act details the integration models available to Health Boards and Local Authorities in developing their integration strategy as well as required documentation and timescales for delivery of integration schemes.

Following the approval of the Board's Integration Scheme by Scottish Ministers on 3rd October 2015 the IJB has operated as a shadow board with services not formally delegated until 1st April 2016. During the shadow period a number of governance and operating arrangements were developed to prepare for the entity becoming full operational in 2016/17. These include the following:

- Appointment of IJB members consisting of five Local Authority Members and five Health Board Non-Executive Directors and a number of non-voting members;
- Appointment of a Chief Officer and Chief Financial Officer;
- Development of the organisational structure of the IJB, consisting of six operational directorates;
- Agreement of the Board's governance structure as supported by three sub-committees;
- Approval of a financial plan for 2016/17; and
- Development of four locality plans and underpinning local performance indicators for each.

The IJB has prepared financial statements for the 2015/16 financial year. Transactions included within the statements were limited to the costs of Chief Officer and the external audit fee for the year. Total expenditure for the year was £29,000.

Section 4. Governance and internal control

Governance arrangements

Dumfries and Galloway Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded and accounted for properly. In discharging this overall responsibility the Council is responsible for putting in place proper arrangements for the governance of its affairs and facilitating the effective exercise of its functions. The Council's governance arrangements are consistent with CIPFA/SOLACE good practice guidance and the following Committees are part of its overall governance structure:

- Policy and Resources Committee;
- Community and Customer Services Committee;
- Education Committee;
- Social Work Services Committee;
- Environment, Economy & Infrastructure Committee;
- Scrutiny and Performance Committee; and
- Audit and Risk Management Committee.

Based on our planning procedures, our assessment of the overall control environment, review of minutes and consistency of arrangements with CIPFA good practice guidance, we consider that the governance arrangements in place are appropriate.

Accounting systems and systems of internal control

Management is responsible for developing and implementing systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. We review these arrangements for the purposes of our audit of the financial statements and for our review of the annual governance statement and report to you any significant deficiencies in internal control that we find during our audit.

As a result, the weaknesses or risks identified in this report are only those which have come to our attention during the normal audit work in accordance with the Code, and may not be all that exist. Communication of such 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.

Control deficiencies

We have identified three control deficiencies during the course of the audit, which are noted in Section 2 and set out in detail at Appendix 1. Whilst we have elected to report these deficiencies we do not consider any of these to be significant.

We have also performed procedures to follow up recommendations raised in the prior year. This work has concluded that all findings remain open. We have provided a status update and revised timescale in Appendix 2.

Based on our work performed we consider the systems of internal control to be appropriate.

Risk management

The Council's Corporate Risk register sets out the strategic-level risks identified by the Council's most senior managers and is formally updated annually. The Corporate Risk register is developed by the Heads of Services and Directors and endorsed by the Corporate Management Team. It is reported to Corporate Management Team on a quarterly basis with related actions followed up as necessary. It is also considered by the Audit and Risk Management Committee as part of its role to oversee the Council's risk management arrangements. At an operational level, risk registers are prepared and considered by the Council at a committee level for each of the business plans that are approved.

Internal Audit

The internal audit team within the Council operates to a plan agreed at the beginning of each financial year.

We have liaised with Internal Audit during out interim visit and final year-end audit to review its programme of work for the current financial year and to establish progress against the Internal Audit plan. We have also reviewed the reports to determine the main issues being reported to ensure that our audit takes account of any specific risks identified. In addition, we have relied on the work of Internal Audit in relation to our grant claim certification work in the year.

Based on audit work performed we consider the Internal Audit function to be appropriate for the needs of the Council.

We would like to take this opportunity to thank the Chief Internal Auditor and his team for their assistance throughout the year.

Section 5. Fraud

International Standards on Auditing (UK&I) state that we, as auditors, are responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. The respective responsibilities of auditors, management and those charged with governance are summarised below:

Auditors' responsibility

Our objectives are:

- to identify and assess the risks of material misstatement of the financial statements due to fraud;
- to obtain sufficient appropriate audit evidence regarding the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and
- to respond appropriately to fraud or suspected fraud identified during the audit.

Management's responsibility

Management's responsibilities in relation to fraud are:

- to design and implement programmes and controls to prevent, deter and detect fraud;
- to ensure that the entity's culture and environment promote ethical behaviour; and
- to perform a risk assessment that specifically includes the risk of fraud addressing incentives and pressures, opportunities, and attitudes and rationalisation.

Responsibility of the Audit and Risk Committee

Your responsibility as part of your governance role is:

- to evaluate management's identification of fraud risk, implementation of anti-fraud measures and creation of appropriate "tone at the top"; and
- to investigate any alleged or suspected instances of fraud brought to your attention.

Standards of conduct and prevention and detection of fraud and corruption

The Council has in place a number of arrangements in order to maintain standards of conduct, prevent and detect fraud and corruption. These include the following:

- The Council has a Code of Conduct for both employees and elected members. The Code sets out the expected behaviours and principles in conducting Council business.
- The Council has financial procedures which set out the reporting requirements for any actual or suspected frauds.
- Investigation of actual or suspected fraud is managed by the in-house internal audit team who are independent from Council services.
- The Council has a whistleblowing policy which includes access to a confidential helpline through which staff can report concerns.

The Council participates in the National Fraud Initiative (NFI). The Council participated in 2014/15 NFI exercise which was reported on as part of our 2014/15 audit. In accordance with our responsibilities as your appointed auditor, we have completed the follow-up NFI questionnaire which was submitted by February 2016.

We reported the need for improvements in the NFI process in our 2014/15 annual report to those charged with governance. We have noted that an NFI Programme Board has been established and that this will govern the NFI process and ensure that requirements are met, timescales adhered to and adequate reporting takes place. It is expected that this will support the completion of the NFI process going forward. However during our follow up in February 2016 we noted that there remained limited progress in investigation of 2014/15 matches. Of the 355 matches, only 77 (23%) of these had been investigated with resulted uploaded on to the NFI system.

Whilst we have noted that progress has been made in setting up the programme board, we note that matches remain open. This has therefore been recorded as an open prior year finding in Appendix 2.

Based on audit work performed we consider that the controls in place to prevent and detect fraud or corruption to be suitable for the operations of the Council. However, we did identify an instance of non-compliance with the Council's procurement arrangements, a key control in protecting the Council against fraud.

Section 6. Independence

Independence and objectivity

We are required to follow both the International Standard on Auditing (UK and Ireland) 260 (Revised) “Communication with those charged with governance”, UK Ethical Standard 1 (Revised) “Integrity, objectivity and independence” and UK Ethical Standard 5 (Revised) “Non-audit services provided to audited entities” issued by the UK Auditing Practices Board.

Together these require that we tell you at least annually about all relationships between PricewaterhouseCoopers LLP in the UK and other PricewaterhouseCoopers’ firms and associated entities (“PwC”) and the Authority that, in our professional judgement, may reasonably be thought to bear on our independence and objectivity.

For the purposes of this engagement we have made enquiries of all PricewaterhouseCoopers’ teams and note no matters which may impact our independence.

Conclusion

We hereby confirm that in our professional judgement, as at the date of this document:

- we comply with UK regulatory and professional requirements, including the Ethical Standards issued by the Auditing Practices Board; and
- our objectivity is not compromised.

We would ask the Audit and Risk Committee to consider the matters in this document and to confirm that they agree with our conclusion on our independence and objectivity.

Appendix 1: Action plan

Finding	Management response
1. Related parties process **Audit finding:** We identified two disclosure adjustments arising from the omission of related party transactions from the related party transactions note to the accounts. These transactions, although identified by management, had not been disclosed as materiality was considered only in the context of the Council. **Recommendation:** The Council should enhance procedures to ensure that related party transactions are disclosed in accordance with accounting standards. This should include the following: • Clear definitions of related parties in the context of the Council such as, , for example which staff groups represent "key management personnel" under the Code; • A value to be used in the assessment of transactions as material to the Council; • The requirement to consider all transactions in the context of materiality to the other party and document the rationale for inclusion/exclusion in the notes to the accounts.	The current procedure note for Related Parties will be reviewed and additional clarification added around what is considered material to the Council and highlight that consideration of materiality to the related party must also be considered. The revised guidance note will be used in the preparation of the 2016/17 annual accounts. **Target date:** March 2017

2. Compliance with procurement standing orders

Audit finding:

We performed testing over the two undisclosed related party transactions to assess whether the Council's procurement standing orders had been complied with. For one of these transactions we found that the required process had not been followed.

Recommendation:

Management should seek to understand the underlying cause for the failure to adhere to procurement policy in this instance and assess whether any further procedures require to be undertaken in the context of this contract.

Management should follow-up with procurement to assess the need for further monitoring controls to prevent deviations from standing orders going forward.

A review of compliance will be undertaken and any process gaps identified.

A communication will be sent out to departments reminding them of the requirement to adhere to procurement standing orders. Procurement team will continue to support services in ensuring that compliance is adhered to.

Target date: March 2017

3. Accounting for asset combinations

Audit finding:

We noted that transactions processed on the asset register to account for asset combinations result in inaccurate journals being posted to the general ledger. Whilst these do not impact the net book value of PPE, they do result in the notes to the accounts presenting inaccurate reclassification and revaluation movements.

Recommendation:

Management should implement a monthly review of automated journals posted to the general ledger as a consequence of fixed asset register transactions to ensure that these are correct.

An additional step will be added into the fixed asset register closedown process to review any asset combinations during the year and ensure that relevant postings are carried out in the general ledger to avoid any inaccurate revaluation movements.

Target date: April 2017

Appendix 2: Follow up of prior year recommendations

Finding	2015/16 updated position
1. Consideration of asset impairment **Audit finding:** The Council, at the request of PwC, carried out an assessment of the carrying value of the DG One facility. This review concluded that an impairment was required to reflect the additional remedial costs identified as part of the current DG One closure. **Recommendation:** Going forward the Council should review the controls it has in place to ensure that all asset impairment triggers are identified by the Council's Estates and Finance department (i.e. not just those assets being formally revalued as part of its annual rolling revaluation exercise to ensure that the value of the Council's assets have not been overstated in the financial statements at the year end.	A pilot is currently ongoing with a view to developing a web based database of planned maintenance and scheduled repair works. This shall include preventative, scheduled and restorative works. This will also provide management information which will assist in the identification of impairment indicators beyond the rolling valuation exercise. The pilot remains excel based, and the process of building the web based solution has not yet started. It is estimated that gathering sufficient information to populate this database in full will take around 18 months. **In progress** **Revised target date:** June 2018

2. Borrowing and treasury management in councils

Audit finding:

In March 2015 Audit Scotland published its report "Borrowing and Treasury Management in Councils", which made recommendations in the area of Treasury Management. This report has not yet been considered by the Council.

Recommendation:

We recommend that the Council consider the "Borrowing and Treasury Management in Councils" report and assess its controls against the recommendations raised within it.

During the year a report has been prepared by Dumfries & Galloway Council Internal Audit Team to assess the extent to which Council processes and controls were in line with good practice as advised by Audit Scotland.

An action plan was prepared following this review to ensure that the council are following the recommendations made within the guidance. These actions are currently in progress.

In progress

Revised target date:

January 2017

3. Management of the National Fraud Initiative

Audit Finding:

We noted a number of areas where action is required in relation to the NFI exercise including the following:

- The self-appraisal checklist included in the 2014 NFI Report was not presented to the Audit & Risk Management Committee as a means of monitoring the body's planning and progress with the 2014/15 NFI exercise;
- There is a lack of dedicated resource to investigate non housing benefit or corporate fraud.
- Not all required data sets had been submitted by the Council in time with the NFI deadlines; and
- No formal reporting on NFI progress has been made within the Council.

Recommendation:

We recommend that the Council reviews the procedures and resources it has put in place to deal with NFI to ensure that the issues identified above are resolved.

We have confirmed that the NFI programme board was re-established and leads identified for each work stream.

Records have been set up on the covalent performance management system in order to ensure that agreed actions are monitored and progress on tasks can be tracked.

However there remains matches not investigated for the 2014/15 period. Timelines have been established with a view to beginning to investigate matches by January 2017.

In progress

Revised target date:

January 2017

Appendix 3: Letter of representation

PricewaterhouseCoopers LLP
141 Bothwell Street
Glasgow
G2 7EQ

Dear Sirs

Representation letter – audit of Dumfries and Galloway Council's (the Authority) Statement of Accounts for the year ended 31 March 2016

Your audit is conducted for the purpose of expressing an opinion as to whether the Statement of Accounts of the Authority give a true and fair view of the affairs of the Authority as at 31 March 2016 and of its surplus and cash flows for the year then ended and have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 supported by the Service Reporting Code of Practice 2015/16.

I acknowledge my responsibilities as Head of Finance and Procurement for preparing the Statement of Accounts as set out in the Statement of Responsibilities for the Statement of Accounts. I also acknowledge my responsibility for the administration of the financial affairs of the authority and that I am responsible for making accurate representations to you.

I confirm that the following representations are made on the basis of enquiries of other chief officers and members of the Authority with relevant knowledge and experience and, where appropriate, of inspection of supporting documentation sufficient to satisfy myself that I can properly make each of the following representations to you.

I confirm, to the best of my knowledge and belief, and having made the appropriate enquiries, the following representations:

Statement of Accounts

- I have fulfilled my responsibilities for the preparation of the Statement of Accounts in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 supported by the Service Reporting Code of Practice 2015/16; in particular the Statement of Accounts give a true and fair view in accordance therewith.
- All transactions have been recorded in the accounting records and are reflected in the Statement of Accounts.
- Significant assumptions used by the Authority in making accounting estimates, including those surrounding measurement at fair value, are reasonable.
- All events subsequent to the date of the Statement of Accounts for which the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16 requires adjustment or disclosure have been adjusted or disclosed.

- The Statement of Accounts disclose all matters of which we are aware that are relevant to the Authority's ability to continue as a going concern, including all significant conditions and events, mitigating factors and the Authority's plans. The Authority also has the intent and ability to take actions necessary to continue as a going concern.

Information Provided

- I have taken all the steps that I ought to have taken in order to make myself aware of any relevant audit information and to establish that you, the authority's auditors, are aware of that information.
- I have provided you with:
  - access to all information of which I am aware that is relevant to the preparation of the Statement of Accounts such as records, documentation and other matters, including minutes of the Authority and its committees, and relevant management meetings;
  - additional information that you have requested from us for the purpose of the audit; and
  - unrestricted access to persons within the Authority from whom you determined it necessary to obtain audit evidence.
- I have communicated to you all deficiencies in internal control of which I am aware.
- So far as I am aware, there is no relevant audit information of which you are unaware.

Accounting policies

I confirm that I have reviewed the Authority's accounting policies and estimation techniques and, having regard to the possible alternative policies and techniques, the accounting policies and estimation techniques selected for use in the preparation of Statement of Accounts are appropriate to give a true and fair view for the authority's particular circumstances.

Fraud and non-compliance with laws and regulations

I acknowledge responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud.

I have disclosed to you:

- the results of our assessment of the risk that the Statement of Accounts may be materially misstated as a result of fraud.
- all information in relation to fraud or suspected fraud that we are aware of and that affects the Authority and involves:
  – management;
  – employees who have significant roles in internal control; or
  – others where the fraud could have a material effect on the Statement of Accounts.
- all information in relation to allegations of fraud, or suspected fraud, affecting the Authority's Statement of Accounts communicated by employees, former employees, analysts, regulators or others.
- all known instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the Statement of Accounts.

I am not aware of any instances of actual or potential breaches of or non-compliance with laws and regulations which provide a legal framework within which the Authority conducts its business and which are central to the authority's ability to conduct its business or that could have a material effect on the Statement of Accounts.

I am not aware of any irregularities, or allegations of irregularities including fraud, involving members, management or employees who have a significant role in the accounting and internal control systems, or that could have a material effect on the Statement of Accounts.

Related party transactions

I confirm that the attached appendix to this letter is a complete list of the body's related parties, except for disclosing the names of elected members and their close family members. I confirm I am not aware of any related party transactions with close family members including transactions with companies which close family members have control of or directorships in. All transfer of resources, services or obligations between the Authority and these parties have been disclosed to you, regardless of whether a price is charged. We are unaware of any other related parties, or transactions between disclosed related parties.

Related party relationships and transactions have been appropriately accounted for and disclosed in accordance with the requirements of Section 3.9 of the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

I confirm that I have identified to you all senior officers, as defined by the Accounts and Audit Regulations 2011, and included their remuneration in the disclosures of senior officer remuneration.

Assets and liabilities

- The Authority has no plans or intentions that may materially alter the carrying value and where relevant the fair value measurements or classification of assets and liabilities reflected in the Statement of Accounts.
- In my opinion, on realisation in the ordinary course of the business the current assets in the balance sheet are expected to produce no less than the net book amounts at which they are stated.
- The Authority has no plans or intentions that will result in any excess or obsolete inventory, and no inventory is stated at an amount in excess of net realisable value.
- The Authority has satisfactory title to all assets and there are no liens or encumbrances on the Authority's assets, except for those that are disclosed in the Statement of Accounts.
- I confirm that we have carried out impairment reviews appropriately, including an assessment of when such reviews are required, where they are not mandatory. I confirm that we have used the appropriate assumptions with those reviews.
- Details of all financial instruments, including derivatives, entered into during the year have been made available to you. Any such instruments open at the year-end have been properly valued and that valuation incorporated into the statement of accounts. When appropriate, open positions in off-balance sheet financial instruments have also been properly disclosed in the Statement of Accounts.

Contractual arrangements/agreements

I confirm the following in relation to contractual agreements:

- All contractual arrangements (including side-letters to agreements) entered into by the Authority have been properly reflected in the accounting records or, where material (or potentially material) to the statement of accounts, have been disclosed to you.
- The Authority has complied with all aspects of contractual agreements that could have a material effect on the Statement of Accounts in the event of non-compliance. There has been no non-compliance with

requirements of regulatory authorities that could have a material effect on the Statement of Accounts in the event of non-compliance.

- I have disclosed all material agreements that have been undertaken by the Authority in carrying on its business.

Provisions

- Provisions for depreciation and diminution in value including obsolescence have been made against property, plant and equipment on the bases described in the statement of accounts and at rates calculated to reduce the net book amount of each asset to its estimated residual value by the end of its probable useful life in the authority's business. In this respect I am satisfied that the probable useful lives have been realistically estimated and that the residual values are expressed in current terms.

  Full provision has been made for all liabilities at the balance sheet date including guarantees, commitments (in particular in relation to redundancy plans) and contingencies where the items are expected to result in significant loss. Other such items, where in my opinion provision is unnecessary, have been appropriately disclosed in the statement of accounts as contingent liabilities.

Assessment of indication of impairment regarding DG One Leisure Centre

I confirm that we have conducted an appropriate assessment of whether or not there was any indication that DG One, would be further impaired. Our assessment did not reveal any impairment indicators.

Disclosures

Where appropriate, the following have been properly recorded and adequately disclosed in the statement of accounts:

- The identity of, and balances and transactions with, related parties.
- Material items of income and expenditure

I confirm that the Authority has recorded or disclosed, as appropriate, all formal or informal arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line of credit or similar arrangements.

I confirm that the Authority has recorded or disclosed, as appropriate, all liabilities, both actual and contingent, and has disclosed in the statement of accounts all guarantees that we have given to third parties, including oral guarantees made by the Authority on behalf of an affiliate, member, officer or any other third party.

Employee Benefits

I confirm that we have made you aware of all employee benefit schemes in which employees of the authority participate.

Litigation and claims

I have disclosed to you all known actual or possible litigation and claims whose effects should be considered when preparing the statement of accounts and such matters have been appropriately accounted for and disclosed in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Financial Instruments

- All embedded derivatives have been identified and appropriately accounted for under the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

  Where fair values have been assigned to financial instruments, I confirm that the valuation techniques, the inputs to those techniques and assumptions that have been made are appropriate and reflect market conditions at the balance sheet date, and are in line with the business environment in which we operate.

Taxation

I have complied with UK taxation requirements and have brought to account all liabilities for taxation due to the relevant tax authorities whether in respect of any direct tax or any indirect taxes. I am not aware of any non-compliance that would give rise to additional liabilities by way of penalty or interest and I have made full disclosure regarding any Revenue Authority queries or investigations that we are aware of or that are ongoing.

In particular:

- In connection with any tax accounting requirements, I am satisfied that our systems are capable of identifying all material tax liabilities and transactions subject to tax and have maintained all documents and records required to be kept by the relevant tax authorities in accordance with UK law or in accordance with any agreement reached with such authorities.
- I have submitted all returns and made all payments that were required to be made (within the relevant time limits) to the relevant tax authorities including any return requiring us to disclose any tax planning transactions that have been undertaken for the authority's benefit or any other party's benefit.
- I am not aware of any taxation, penalties or interest that are yet to be assessed relating to either the authority or any associated company for whose taxation liabilities the authority may be responsible.

Retirement benefits

- All retirement benefits that the Authority is committed to providing, including any arrangements that are statutory, contractual or implicit in the authority's actions, wherever they arise, whether funded or unfunded, approved or unapproved, have been identified and properly accounted for and/or disclosed.
- All settlements and curtailments in respect of retirement benefit schemes have been identified and properly accounted for.
- Actuarial assumptions underlying the valuation of retirement benefit scheme liabilities are consistent with my knowledge of the business and in my view would lead to the best estimate of the future cash flows that will arise under the scheme liabilities.
- The authority participates in the Teachers' Pension Scheme that is a defined benefit scheme. I confirm that the authority's share of the underlying assets and liabilities of this scheme cannot be identified and as a consequence the scheme has been accounted for as a defined contribution scheme.

Bank accounts

I confirm that I have disclosed all bank accounts to you including those that are maintained in respect of the pension fund.

Using the work of experts

I agree with the findings of Dumfries and Galloway Council's Property Services Department, which includes MRICS qualified valuers, experts in evaluating the Council's estate and have adequately considered the competence and capabilities of the experts in determining the amounts and disclosures used in the preparation of the Statement of Accounts and underlying accounting records. The Authority did not give or cause any instructions to be given to experts with respect to the values or amounts derived in an attempt to bias their work, and I am not otherwise aware of any matters that have had an impact on the objectivity of the experts.

I agree with the findings of Hymans Robertson LLP in evaluating the assets and liabilities of Dumfries and Galloway Council Pension Fund and have adequately considered the competence and capabilities of the experts in determining the amounts and disclosures used in the preparation of the Statement of Accounts and underlying accounting records. The Authority did not give or cause any instructions to be given to experts with respect to the values or amounts derived in an attempt to bias their work, and I am not otherwise aware of any matters that have had an impact on the objectivity of the experts.

PPP/PFI schemes

I confirm that the accounting models used to account for the PFI contract for waste management and recycling and the PPP contract for Smarter Schools are compliant with the requirements included within the 2015/16 Code and IFRIC 12. I confirm that the inputs into accounting models are consistent with the contractual financial model as agreed between the Authority and contractor and on this basis the associated liabilities has been accounted for accurately.

Items specific to local government

- The Authority does not have plans to enter into any further Private Finance Initiative schemes which might affect the Statement of Accounts for the year.
  I confirm that the provisions within the Statement of Accounts relating to the Early Retirement and Voluntary Severance Scheme have been appropriately disclosed and accounted for based on agreements entered into during 2015/16.

Subsequent events

There have been no circumstances or events subsequent to the period end which require adjustment of or disclosure in the statement of accounts or in the notes thereto.

As minuted by the Council at its meeting on 22 September 2016.

…………………………………

Head of Finance and Procurement

For and on behalf of Dumfries and Galloway Council

Date ……………………

Appendix 1 - Related parties

- NHS Dumfries & Galloway
- D&G Health & Social Care Integrated Joint Board
- Scottish Government
- Marchfield LLP
- Hub SW Dalbeattie DBFM CO Limited
- Nithsdale Amateur Rowing Club Ltd
- 7Stanes Mountain Biking Community Interest Company
- A.C. Designs (DFS) Limited
- Ice Hockey UK
- CMS Broadband Ltd
- Money Advice and Planning Ltd.
- AMD Contract Services Limited
- Culmore Industrial Development Company
- James Maitland & Associates
- Catherinefield Properties Limited
- Glenfirra of Langholm.
- GGN CONSULTING
- Peacock Developments Ltd
- Callisti Ltd
- Andrew S Wood and Partners
- South West Welding Services
- Hongmei Home Ltd (dormant company)
- Chicago Big Bite
- Town Dynamics Limited
- One Scotland Many Cultures
- Kellwood Engineering Ltd
- AWP contracting
- Solway Credit Union
- James B. Kerr Ltd
- Care Solutions Ltd
- People Smart Solutions