REPORT TO: SCRUTINY COMMITTEE – 24 JUNE 2015

REPORT ON: KPMG INTERIM MANAGEMENT REPORT – FOR YEAR ENDED 31 MARCH 2015

REPORT BY: DIRECTOR OF CORPORATE SERVICES

REPORT NO: 252-2015

1   **PURPOSE OF REPORT**

         To submit to Members of the Scrutiny Committee the Interim Management Report for the year ended 31 March 2015 prepared by the Council's External Auditor, KPMG.

2   **RECOMMENDATIONS**

         Members of the Committee are asked to note KPMG's report and to approve the agreed management actions in response to KPMG's recommendations.

3   **FINANCIAL IMPLICATIONS**

         There are no direct financial implications arising from this report. Any costs associated with implementing KPMG's recommendations will be contained within existing budgets.

4   **MAIN TEXT**

4.1   The report summarises the findings from KPMG's interim management review of the Council for the year ended 31 March 2015. These findings have been discussed with management and an agreed action plan in respect of recommendations made by KPMG is included as an appendix to the report. The implementation of the agreed management actions will be monitored by both the Council and by KPMG, with progress being reported to elected members in due course.

4.2   The External Auditor will prepare a final report to members for the year ended 31 March 2015, following the audit of the financial statements. This report will be submitted to elected members later in 2015.

5   **POLICY IMPLICATIONS**

         This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management. There are no major issues.

6   **CONSULTATIONS**

         The Chief Executive and Head of Democratic and Legal Services have been consulted on the content of this report.

7   **BACKGROUND PAPERS**

         None.

MARJORY M STEWART
DIRECTOR OF CORPORATE SERVICES   **15 JUNE 2015**

Dundee City Council

Contents

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About this report

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

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

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

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out within our audit strategy.

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If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Hugh Harvie, who is the engagement leader for our services to Dundee City Council, telephone 0131 527 6682 email: hugh.harvie@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

Significant risks and other matters update

Introduction

We have completed the interim audit where we tested a selection of entity wide, process level and general IT controls and held discussions with management to update our understanding of the key business and audit focus areas.

This report provides the scrutiny committee with an update on:

■ significant risks and other matters (pages two to four); and

■ the results of our control framework testing, encompassing overarching governance and systems controls (pages five to ten).

Significant risks

In the audit strategy and plan document, we identified management override of controls and financial position (revenue and capital) as significant risks. Our audit procedures are inherently designed to consider the risk of management override of controls. The interim testing did not identify instances where management override of controls had occurred and controls tested were found to be operating effectively.

As outlined in our audit strategy, the Council is operating in a challenging economic environment, with funding reductions and increasing expenditure pressure together with a low level of useable reserves and therefore this requires specific audit consideration. We have reviewed the Council's performance in these areas at the time of our interim audit work and provide a status update on the following pages.

We will provide an updated list of, and our conclusions on, significant risks and other matters in our annual audit report, which will be reported to the scrutiny committee in September 2015.

Financial position – capital

The Council approved the general services capital plan 2014-2018 in February 2014, incorporating £39.054 million of planned capital expenditure for 2014-15. The capital monitoring report presented to the policy and resources committee on 9 March 2015 shows a projected outturn for capital expenditure of £28.312 million.

Movements from general services capital budget	
	£'000
Original budgeted outturn	**39,054**
Education	(647)
Social work	(1,284)
City development	(5,899)
Leisure & culture	(527)
Environment	(433)
Council-wide property upgrades	(197)
Open space	(157)
Roads infrastructure	(1,493)
Other smaller projects	38
Information & communications technology	(250)
Total budget adjustments	(10,849)
Revised budget	28,205
Reported variances	107
Forecast outturn at 31 January 2015	**28,312**

Source: report no 88-2015 to the policy and resources committee

As a result of budget adjustments, variances, and an increase in general capital grant of £1.3 million, the projected outturn for capital borrowings is approximately £12 million less than the budget.

The housing revenue account budget from 2014-15 to 2018-19 set out projected capital spend for 2014-15 of £19.3 million including slippage. The most recent housing revenue account capital monitoring report shows a projected outturn of £18.3 million.

We provide an update on the significant risks and other audit focus areas identified in our audit strategy document.

Consideration of management information and the Council's arrangements for its compilation and monitoring has not identified any additional audit risks; the Council's financial performance appears to be broadly in line with expectations.

Financial position - revenue

Budget monitoring is performed on a monthly basis, with monthly reports submitted to the policy and resources committee from period three to ten. As part of the interim audit we considered the budget setting and monitoring process from the department level to the policy and resources committee reporting level. We consider this process to be robust and did not identify additional risks.

The Council set a break-even revenue budget for 2014-15, with no budgeted use of reserves. The revenue outturn monitoring report as at 31 January 2015 (as reported to the policy and resources committee on 9 March 2015) shows a projected surplus of £0.6 million. Variances against adjusted budget are summarised in the table opposite.

Budget overspends in the city development and environment departments are principally due to reductions in external rental income and lower than expected income from the sale of recyclable materials respectively.

The social work outturn is below budget, principally in respect of third party payments (£575,000). This is due to delay in fully implementing service developments and a decrease in the number of residential and secure care placements. Costs in relation to children and families and older people have increased compared to budget.

The education underspend is as a result of a decrease in the number of children being looked after by the family placement service (£150,000); staff vacancies following employee turnover (£150,000); and savings in energy costs (£200,000). These savings are offset by a forecast overspend in relation to special schools transport (£400,000) as a result of the number of children needing support.

Capital financing costs are forecast to be £500,000 less than expected due to lower than anticipated interest rates and slippage within the 2014-15 capital plan.

Projected revenue outturn against adjusted budget			
	Adjusted budget	Forecast	Variance
	£'000	£'000	£'000
General fund departments			
City development	22,245	22,985	740
Environment	18,689	18,809	120
Chief executive	18,603	18,603	-
Corporate services	22,404	22,404	-
Education	119,924	119,824	(100)
Social work	96,725	95,850	(875)
Other	15,974	15,974	-
General fund departments total	314,564	314,449	(115)
Capital financing costs / IORB	26,508	26,008	(500)
Contingencies	(88)	(88)	-
Miscellaneous income	(3,166)	(3,166)	-
Discretionary NDR relief	147	147	-
Supplementary superannuation costs	2,925	2,925	-
Tayside Valuation Joint Board	953	953	-
Forecast outturn at 31 January 2015	**341,843**	**341,228**	**(615)**

Source: *KPMG's analysis of information provided by management.*

We provide an update on the significant risks and other audit focus areas identified in our audit strategy document.

Other matters noted in the audit strategy document were in respect of the accounting for:

- **property, plant and equipment;**
- **provisions; and**
- **retirement benefits.**

Other matters

Property, plant and equipment

Under the Council's rolling basis of revaluations, the following assets will be subject to valuation in 2014-15:

- depots and workshops;
- off street car parks;
- industrial units and shops; and
- land – car parks.

A valuation report will be produced as at 31 March 2015 by City Development. We will liaise with our internal valuation experts to review the methodology and assumptions used. As part of our year end procedures we will review the accounting treatment of the valuations to ensure appropriate recognition and disclosure in the financial statements.

It is expected that the requirements of the *Code of practice on transport infrastructure assets* ("the transport code") will be applicable to local authorities from 1 April 2016.

Management has developed a working group and a project plan in order to prepare for the implementation of the transport code. Systems in both the highways and finance departments have been assessed; management considers the highways department systems to be able to incorporate the transport code requirements. We will update our understanding of management's progress in preparation for the transport code during year end procedures.

In line with the agreed Local Scrutiny Plan, developed by the Local Area Network we will continue to monitor the progress with, and outcomes of the McClelland Review of the Victoria and Albert museum project and consider costs in respect of the project to the extent they are incurred and material to our audit.

Provisions

We have updated our understanding of provisions and continue to liaise with management regarding holiday pay. Based on our previous year's audit work and our current understanding, we are not expecting that this area will have a material impact on the financial statements. We will remain alert to any legislative changes and consider the Council's position in detail as part of our year end procedures.

Retirement benefits

The Council accounts for its participation in the Tayside Pension Funds in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants, Barnett Waddingham.

During our year end audit procedures we will:

- review the financial assumptions underlying the actuaries' calculations and comparison to our central benchmarks;
- test the level of contributions used by the actuary to those actually paid during the year; and
- test membership data used by the actuary to data from the pension fund.

Control framework: governance arrangements

Organisation-wide controls often have a pervasive impact on control activities, and therefore on our assessment of the risk of significant misstatement within the Council's financial statements.

Our interim audit fieldwork was based on gaining an understanding of the strategic and operating culture and framework in which services are delivered. Audit procedures performed to gain an understanding about the design and implementation of relevant controls include inquiring of senior personnel, observing the application of specific controls and inspecting documents and reports.

Test	Description	Results
Risk management	A corporate risk register is in place supported by department risk registers. Following an internal audit review which identified weaknesses in the risk management process, the scrutiny committee now receives frequent updates on risk management. This includes review of the corporate risk register.	Satisfactory
Organisation-wide policies	Organisation-wide policies are important as they set the tone of the Council, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. Up-to-date policies are available to all staff on the intranet.	Satisfactory
Related parties	Separate registers of interest exist for elected members and senior officers. The elected members' register of interests is updated every six months and the declaration of members' interests is the first item on the agenda for all Council and committee meetings. Senior officers are expected to inform the Head of Democratic and Legal Services of any changes in-between updates of the senior officers register of interests. Should a senior officer have an interest to declare in an item of business coming before the Council or a committee they are required to declare this interest at the meeting and leave the room while the item is being considered. Council and committee meeting agendas require attendees to declare interests relevant to specific items. The requirement to declare relevant interests applies whether or not the register of interests has been updated accordingly.	Satisfactory
Internal audit	We reviewed the reports of internal audit as presented to the scrutiny committee to consider if there are further risk risks associated with key business processes. We have reviewed a number of internal audit reports completed during 2014-15 including: corporate capital monitoring; corporate grant funding; anti-virus software; and various grant claim reports.	Satisfactory. No additional risk areas identified through review.

Test	Description	Results
Financial analysis and financial reporting	The financial regulations set out the requirements for budget setting, monitoring and reporting. As part of the budget setting process, management and members agree budget savings to close the budget gap. These savings are incorporated into the annual budget which is monitored. The level of savings required over the two-year period 2016-2018 were also identified in the medium term financial outlook and strategy section of the revenue budget and council tax report approved by the policy and resources committee in February 2015. Linked to the Council's Local Scrutiny Plan, we considered the Council's progress with the development of a medium-term financial strategy. We consider the medium-term financial outlook to be progressing towards the development of a medium-term financial strategy, however, further improvements can be made. We recommended in the annual audit report 2013-14 that management should consider the scope for developing a medium-term financial strategy for approval by members. This was to be progressed by management in the 12 months following our report. Formal revenue budget monitoring is completed on a monthly basis for periods three to ten. Department accountants meet with departmental staff to gain an understanding of the financial position of the service, including the actual expenditure to date. The accountants conduct analysis to identify and quantify variances and the forecast outturn to the year end. Explanations are provided for variances; these are included in the revenue monitoring report provided to the policy and resources committee. This approach is viewed by management as forward looking and provides a holistic overview of the Council's financial performance.	We note the progress made in stating the Council's medium-term outlook as part of the budget setting process. However, this should contribute to an approved medium term financial strategy in line with our previous recommendations.
National fraud initiative (NFI)	In December 2014, we performed a review of the Council's progress in the investigation of data matches in relation to the 2013-14 council tax to electoral register exercise and also considered wider aspects such as management attitude to the exercise. We found that the datasets for this NFI exercise had not yet been submitted due to staffing shortages. We submitted a return to Audit Scotland setting out the Council's position. We followed up on the progress towards this NFI exercise and found that the datasets had still not been submitted at the time of our interim audit. It was noted that the intention is to submit the dataset, however, staffing shortages have not allowed this to happen. We are due to submit a further return to Audit Scotland by 30 June 2015.	The 2013-14 council tax to electoral register exercise has not been completed. ***Recommendation one***

Integrated health and social care

In March 2014 the Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Government. This requires all Councils and NHS Boards to formally and legally establish integration of health and social care by April 2016. The Council has agreed that in conjunction with NHS Tayside, the body corporate model should be adopted and the scheme of integration should be based on this model.

Integration schemes must be submitted to Scottish Ministers for approval by 1 April 2015.

We reviewed the draft integration plan submitted to the policy and resources committee on 9 March 2015. This document sets out the functions that will be delegated by the Council and NHS Tayside to the Integrated Joint Board. There are no plans to transfer staff to the Integrated Joint Board.

Auditors are required to consider the Council's progress in the integration of health and social care, and report our findings in the annual audit report. We will continue to monitor progress including the development by the Integration Joint Board of the Strategic Plan.

Control framework: systems controls

Where an audit objective has a controls approach, we have updated our understanding of accounting and reporting activities over each significant account and identified and tested key financial controls as well as reviewing higher level organisational controls.

We have evaluated the design and implementation of these controls and, where appropriate, tested the operating effectiveness.

Our audit does not seek to test all transactions or controls established by management. Testing of the design and operation of key financial controls for the purposes of our financial statements audit, however, confirms that, with the exception of some weaknesses reported, those controls are designed appropriately and operating effectively.

Test	Description	Result
Budget monitoring	The Council has a robust budget setting process, with involvement from various key members of staff. Performance against budget is monitored on a regular basis and formally reported to the policy and resources committee via the budget monitoring reports.	Satisfactory – control designed and operating effectively.
Bank reconciliations	Reconciliations for key bank accounts are carried out weekly or monthly depending on the level of transactions. Our testing during found that some reconciliations were not prepared in a timely manner, with August 2014 bank statements being reconciled in October 2014.	Bank reconciliations are not consistently prepared in a timely manner. *Recommendation two*
Automated journal controls Journals authorisation	Management perform a review of a statistical sample of journals each quarter. A sample of journals posted in the quarter are selected and emailed to all staff members who are able to post journal entries. Staff must then produce supporting documentation and explanations for the journals selected so that this can be reviewed for appropriateness. The quarter one and two control reviews have not been fully completed, as some items of supporting information are still outstanding. Automated journal controls ensure that one-sided journals, out of balance journals, and journals to a closed period cannot be posted. Our testing found that these controls were operating effectively.	This is a good anti-fraud control, however, it has not been completed in a timely manner. *Recommendation three*
Payroll exception reports	Exception reports are run following initial payroll processing. Some of the key exceptions reported include: starters to the payroll; leavers from the payroll; gross pay exceeds threshold of £6,500; net pay exceeds threshold of £5,000; pay processed after projected post end date; and pay processed after end date. The exception report is reviewed and necessary changes made to the payroll. A second exception report is then produced and reviewed again to ensure no further changes to the payroll are required before payment.	Satisfactory - control designed and operating effectively.

Our audit approach for 2014-15 involves testing the design, implementation and operating effectiveness of the Council's general IT controls for the ledger system (Civica Financials) and the payroll system (Resource Link Aurora).

Our planning for the 2014-15 audit determined that we would test the design, implementation and operating effectiveness of a number of general IT controls to give us comfort over the information produced by the ledger and used as the basis of our audit work. Our testing gave us comfort over the controls in place for system access and program changes.
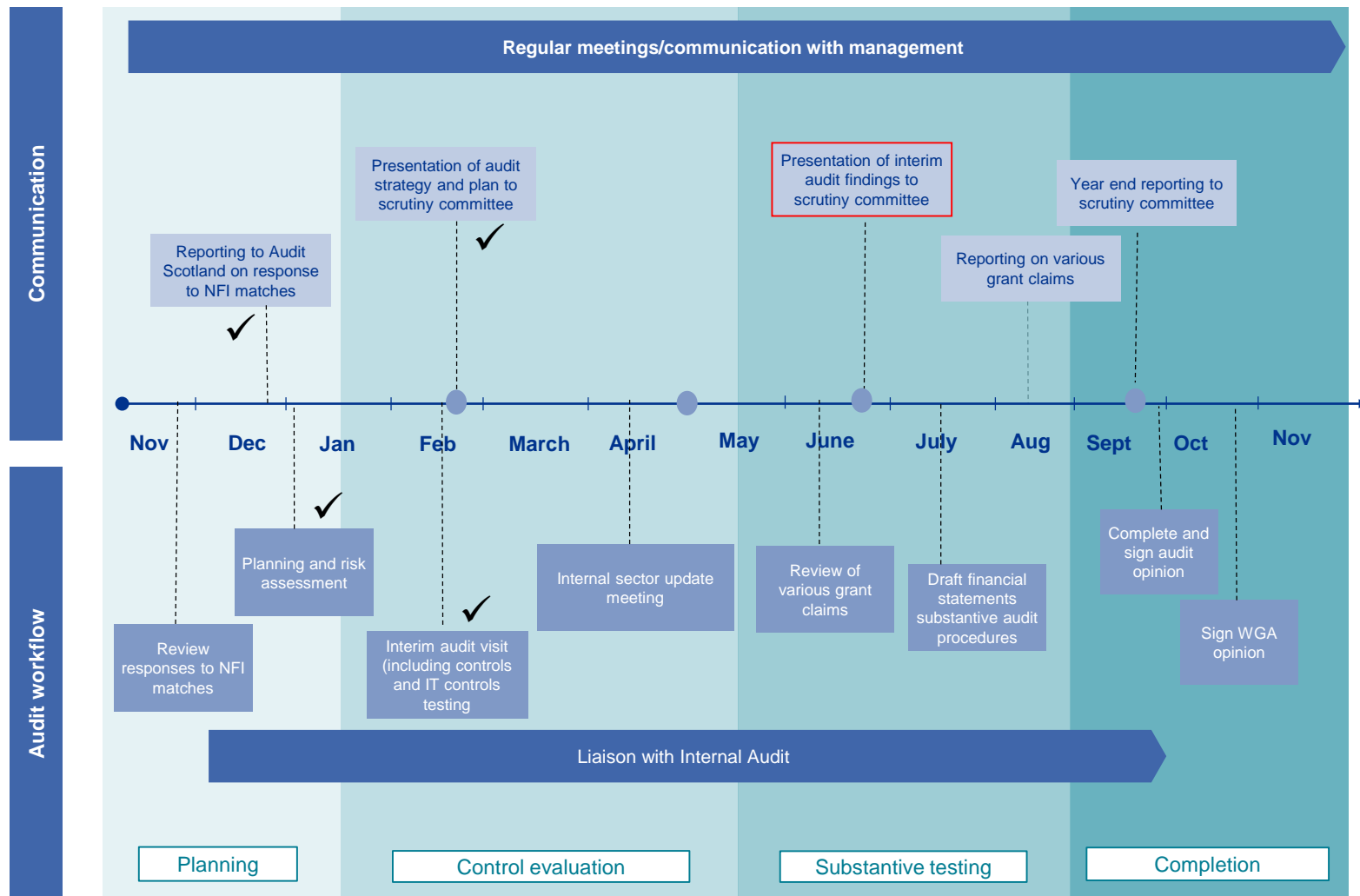
Test	Description	Result
Access controls	Starters, leavers and amendments were processed correctly and in line with procedures, with users added and removed from the system appropriately and in a timely manner. We also considered the appropriateness of users with 'super-user' access to both the Civica Financials and Resource Link Aurora. 'Super- user' access was considered to be appropriate to the user's responsibilities.	Satisfactory – no exceptions.
Program changes and IT policies	We considered the processes around program change requests for both the Civica Financials and Resource Link Aurora systems. We found that the controls for program changes are designed appropriately. We will complete our testing over program changes during the final audit fieldwork. The security policy was found to be up-to-date. We had planned to also test the Northgate V6 system. However, we were not able to obtain a reliable list of new starters to this system. As a result we cannot place reliance on the output of the Northgate V6 system without further testing.	Satisfactory – no exceptions. *Recommendation four*

Appendices

KPMG
cutting through complexity

Audit timeline and communications

Out timetable is largely unchanged from the prior year but will be subject to refinement through discussions with management.

Communication

Regular meetings/communication with management

Reporting to Audit Scotland on response to NFI matches ✔

Presentation of audit strategy and plan to scrutiny committee ✔

Presentation of interim audit findings to scrutiny committee

Year end reporting to scrutiny committee

Reporting on various grant claims

Nov | Dec | Jan | Feb | March | April | May | June | July | Aug | Sept | Oct | Nov

Audit workflow

Planning and risk assessment ✔

Review responses to NFI matches

Interim audit visit (including controls and IT controls testing) ✔

Internal sector update meeting

Review of various grant claims

Draft financial statements substantive audit procedures

Complete and sign audit opinion

Sign WGA opinion

Liaison with Internal Audit

Planning | Control evaluation | Substantive testing | Completion

● Scrutiny committee meetings

Data analytics supplements existing control and substantive testing.
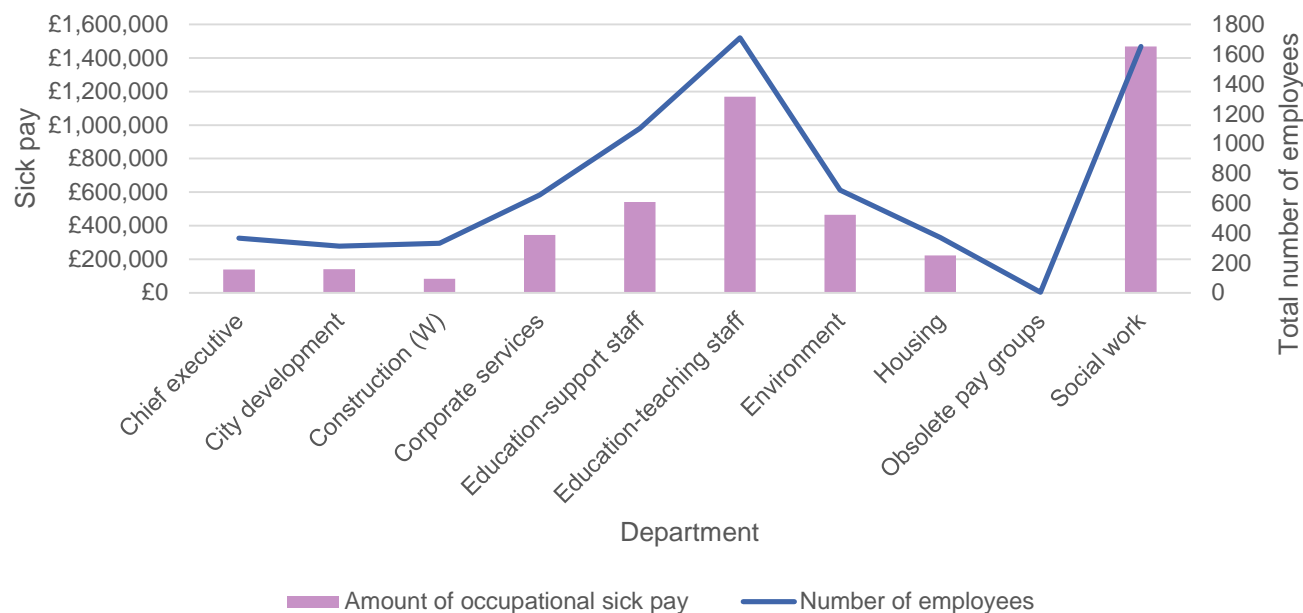
Data analytics takes mass data sets and analyses them to draw out potential control weaknesses or value for money concerns.

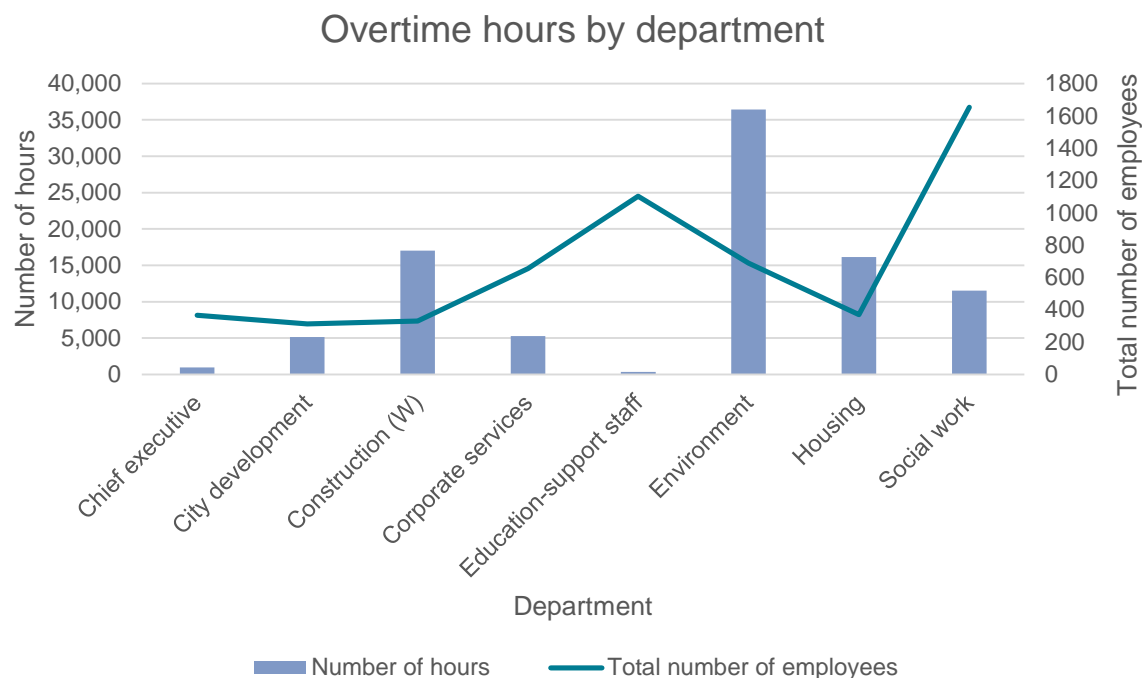**As part of our interim work, we have reviewed payroll information and journal entries.**

Our results are set out on the following pages.

| D&A test	Description	Results	Management response
Occupational sick pay analysis	We obtained details of all payments made to employees from the payroll section. This allowed us to perform some analysis on the different types of payments made to employees.	We have summarised in the graph below all occupational sick payments paid in the year to date by department along with the size of the department defined by the number of pay numbers. Management may want to analyse this data further to identify and address problems in the departments with the highest cost of occupation sick pay. We did not have data on the reasons behind sick leave, however, management may want to investigate this to ensure they can appropriately support staff.	■ Across the Council, management will continue to closely monitor the levels of sickness absence and the associated costs.

Occupational sick pay by department

Legend: Amount of occupational sick pay ▬ Number of employees

D&A test	Description	Results	Management response
Overtime analysis	We obtained details of all payments made to employees from the payroll section. This allowed us to perform some analysis on the different types of payments made to employees.	We have summarised in the graph below all overtime payments paid in the year to date by department along with the size of the department defined by the number of pay numbers. Management may want to analyse this data further to identify capacity issues and consider the most efficient way of addressing these.	■ Across the Council, management will continue to closely monitor the levels of overtime working and the associated costs.

Overtime hours by department

D&A test	Description	Results	Management response
Journal entries	total and average value of journals processed	Analysis of the journals processed in the first ten periods of 2014-15 indicates that the highest value and number of journals are posted in period one (14,640 journal entries with a value of £3.9 billion). In the first ten periods of 2014-15, 18,413 journal entry lines were posted with values under £10 (16%); 55,517 journal entry lines were posted with values under £100 (20%). This appears to be inefficient; management should investigate whether journal entries can be reduced. Journal entry lines with values over £1 million totalled 140 (0.12%).	Agree that processing so many journal entry lines for such small values is inefficient. However, this requires to be balanced with the desire for accuracy and the fact that many journals are input by means of spreadsheets which is much more efficient than doing these manually.

Total value of journals processed

Average value of journals processed
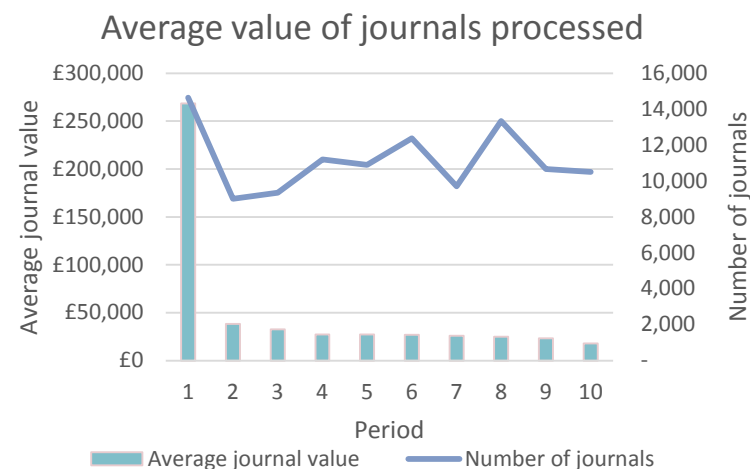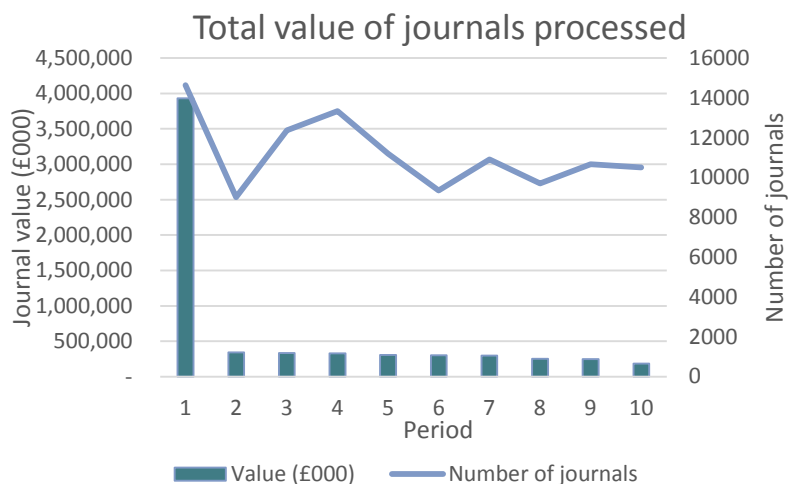
The action plan summarises specific recommendations, together with related risks and management's responses.

We have identified one grade two ('material') observation and three grade three (minor) recommendations.

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weaknesses may therefore give rise to loss or error.

Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1. NFI submission		**Grade two**
Management has not submitted the datasets necessary to take part in the 2013-14 council tax to electoral register exercise, due to staffing shortages. There is a risk that fraud matches are not identified resulting in financial loss to the Council.	Management should submit the required datasets in order to receive details of matches to be identified and investigated in order to minimise the risk to the Council.	Due to the length of time that has passed since the datasets were previously produced, new datasets will be run as a matter of urgency and thereafter uploaded on to the NFI system. **Responsible officer(s):** Systems & Training Manager **Implementation date:** Immediate
2. Bank reconciliations		**Grade three**
Our testing identified that some reconciliations were not prepared in a timely manner with some of the August bank statements being reconciled in October. Differences become harder to reconcile as more time passes, and fraud becomes harder to identify, therefore there is a risk that there will be differences which cannot be reconciled.	Management should ensure that all bank reconciliations are be completed in a timely manner and where necessary staff cover is arranged at busier times of the year.	Agreed. The number of accounts and staff resources is being reviewed to ensure this is not repeated. **Responsible officer(s):** Financial services and investment manager **Implementation date:** Immediate

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
3. Journals authorisation		**Grade Three**
The journals authorisation control should be carried out quarterly. This has not been possible to date due to sudden and unexpected staff absence. As a result the control for quarter one and quarter two has started but has not yet been completed. There is a risk that error or fraud is not identified in a timely manner as a result.	Management should ensure that the journals authorisation control is carried out in a timely manner and where necessary staff cover should be arranged to allow the control to take place.	Agreed. The difficulty caused by the sudden and unexpected staff absence was that the relevant reports had been created and saved in a personal area of the software (Business Objects). The solution is to copy these reports to the public area. **Responsible officer(s):** Accounting manager (systems) **Implementation date:** Immediate
4. Northgate revenues system new users		**Grade Three**
Staff from the systems team should only be able to add new users to the Northgate V6 revenues system, however, there are a number of additional users have access to create new users. Additionally, the control over new users is not designed effectively, as a manual spreadsheet is held to document the creation of a new user. There is a risk that new users are created without the knowledge of the systems team by unauthorised staff.	It is recommended that management: ■ reviews the access levels of system administrators on the Northgate V6 system, and reduce the access of users out with the systems department. This is to ensure that new users cannot be created by unauthorised staff; and ■ implements controls over new starters added to the Northgate V6 system.	Agreed. A review of the access to systems and the ability to create new users will be undertaken by the systems & training managers. A new procedure was implemented in 2014, which replaced the manual spreadsheet. A standard form now requires to be completed by the appropriate manager and forwarded to the systems team, who in turn make the necessary change. This amended procedure was implemented as a result of a recommendation in the previous year's review, undertaken by KPMG. **Responsible officer(s):** Head of revenues & customer services. **Implementation date:** 30 September 2015