

**REPORT TO: FINANCE COMMITTEE - 17 MAY 2004**

**REPORT ON: RESPONSE TO EXTERNAL AUDITOR'S REPORT TO MEMBERS ON THE  
AUDIT OF DUNDEE CITY COUNCIL FOR THE YEAR TO 31 MARCH 2003**

**REPORT BY: DEPUTE CHIEF EXECUTIVE (FINANCE)**

**REPORT NO: 399-2004**

**1 PURPOSE OF REPORT**

This report is a response to the report prepared by the Council's External Auditor on the audit of Dundee City Council for the year to 31 March 2003. A copy of the External Auditor's report is included on the Finance Committee agenda as a separate item (Report No 398-2004). The 2002/03 Audited Statement of Accounts for the City Council (and its DLO and DSOs) were presented to the Finance Committee on 19 April 2004.

**2 RECOMMENDATIONS**

It is recommended that the Committee:

- i endorses this report as the Council's formal response to the External Auditor's report.
- ii agrees the completed Action Plan appended to this report.

**3 FINANCIAL IMPLICATIONS**

There are no financial implications arising directly from this report, or from the External Auditor's report.

**4 LOCAL AGENDA 21 IMPLICATIONS**

There are no direct Local Agenda 21 implications.

**5 EQUAL OPPORTUNITIES IMPLICATIONS**

There are no direct equal opportunities implications.

**6 BACKGROUND**

The external audit of Dundee City Council for the financial year 2002/03 was carried out by Mr Peter Tait CPFA, Chief Auditor (East Region), Audit Scotland. Local authority external auditors are appointed for a five year period and the financial year 2002/03 marked the second year of Mr Tait's appointment at the City Council.

**7 EXTERNAL AUDITOR'S REPORT**

- 7.1 The External Auditor's report outlines his main responsibilities as auditor and describes the scope of audit work undertaken during 2002/03 and the issues arising from that work. The report is divided into three key areas of the Council's activities:

Financial Statements and Related Matters (Section 2)  
 Corporate Governance (Section 3)  
 Performance Management (Section 4)

- 7.2 As part of the 2002/03 external audit, eight detailed reports have already been issued to management on matters related to the key areas outlined above. (A further three reports are currently in draft form). All of the reports issued have included an action plan agreed by management to address the key issues arising from the auditor's findings. Where appropriate, summarised versions of the reports will be submitted to the Audit and Risk Management Sub-Committee in due course.
- 7.3 In addition to the Elected Members of Dundee City Council, the External Auditor's report is also addressed to the Controller of Audit at the Accounts Commission for Scotland. Given this wider audience, and the extent of the External Auditor's responsibilities and scope of work, his report is by necessity both fulsome and extensive. It contains much information that has already been reported to the relevant Committees of Dundee City Council. Further, as outlined above, the External Auditor's detailed reports already include agreed management action plans and will be the subject of separate scrutiny by the Audit and Risk Management Sub-Committee. Accordingly, it is not the intention in this report to provide a detailed response or commentary on all of the External Auditor's findings. Rather, this response will focus on the main issues arising within each of the three key areas outlined above.

## **8 FINANCIAL STATEMENTS AND RELATED MATTER**

- 8.1 The External Auditor's overall conclusion is that the financial stewardship of the Council during 2002/03 was of a satisfactory standard.
- 8.2 The Council's draft 2002/03 Accounts were presented to the Finance Committee on 30 June 2003 and submitted for audit in line with the statutory deadline of 30 June 2003. The audit itself was formally concluded by the target date of 30 September 2003, with the issuing of the Auditor's Report on the Statement of Accounts. It is encouraging to note that the External Auditor has commented favourably on the standard of the Council's accounts preparation procedures and working papers.
- 8.3 There are no qualifications to the auditors report on the 2002/2003 Statement of Accounts and he has concluded that the accounts "present fairly" the Council's financial position. This effectively means that the Council's accounts have again been given a "clean bill of health".
- 8.4 The External Auditor has reported that the DLO and DSO's operated by the Council during 2002/03 had again successfully achieved the financial objectives set by Scottish Ministers.
- 8.5 The net outturn on the 2002/03 Consolidated Revenue Account showed a surplus of income over expenditure of £2.833m, representing an underspend of £3.870m against the budgeted deficit of £1.037m (the amount agreed to be met from accumulated balances in setting the 2002/03 Council Tax). The underspend confirms that the established systems for monitoring and controlling revenue expenditure were operating successfully during 2002/03.
- 8.6 The Council's General Fund balance stood at £6.431m as at 31 March 2003. There were, however, estimated commitments of £4.235m against this balance (including £1.5m used in setting the 2003/04 Council Tax). This left an uncommitted General Fund balance of £2.196m at 31 March 2003. Elected Members will be aware that the level of General Fund balances held by Scottish local authorities has been the subject of much comment recently, including criticism that excessive balances are being held. It is pleasing to report that Dundee City Council is very much at the lower end of the scale and operates with a relatively

low General Fund balance. Further, as part of the Council's overall Corporate Governance framework, the Policy & Resources Committee recently agreed a protocol for the operation of reserves and balances.

- 8.7 In paragraphs 2.23 and 2.24 of his report, the External Auditor has highlighted the significant reductions in the value of the investments held by the Tayside Superannuation Fund. These reductions were due to the sharp downturn in share prices during the year to 31 March 2003. Since that date, however, the market has picked up significantly and by 31 March 2004 the Fund had more than recovered the previous reductions in value. The stock market reductions during 2002/03 also had an adverse effect on the Council's estimated net pension liability, as measured under Financial Reporting Standard 17. The figures are included in paragraph 3.32 of the External Auditor's report and show an increase in the liability from £12.204m to £117.360m. Again, however, the position has been affected positively by the stock market recovery and the net pension liability had reduced to £75.3m at 31 March 2004. It must be stressed, however, that this figure is based on a "snap-shot" on a single day and the calculation is particularly sensitive to the vagaries of the stock market. The pension liability is only notional and does not impact on the Council's General Fund balance or budgetary requirements. Through the normal course of events, any projected net liability on the Superannuation Fund is recouped by increased employers' contributions. In this connection, the employers' contribution rate was increased with effect from 1 April 2003 following the last triennial revaluation undertaken by the Fund's actuary.
- 8.8 In paragraphs 2.46 and 2.47 of his report, the External Auditor makes reference to the impact of consolidating DERL's financial results into the Council's 2002/03 Group Accounts. For the avoidance of doubt, it is stressed that the Council's financial liability in respect of DERL was limited to the value of its shareholding at 31 March 2003, ie £40. (This is the normal position of any shareholder in a limited liability company). In this respect, the Group Accounts can be somewhat misleading although they have been properly prepared in accordance with the relevant account guidance.
- 8.9 The External Auditor outlines the background to the backlog of work in the Revenues Division, in paragraphs 2.59 to 2.64 of his report. He notes that the backlog was effectively cleared by February 2004.
- 8.10 The External Auditor has also detailed developments on the Council's Schools PPP Project and on the Benefit Fraud Inspectorate follow-up inspection in 2003. The relevant Committees of the Council have been kept fully apprised on both of these matters.
- 8.11 The External Auditor has various and wide ranging responsibilities with regard to examining the legality of the Council's transactions and activities. It is therefore pleasing to note that the External auditor has no matters to report in this area arising from his audit work in 2002/03.
- 8.12 A number of issues arising from the Local Government in Scotland Act 2003 are identified by the External Auditor in paragraph 2.76 of his report. The Council is already well advanced in its arrangements to address the various challenges and opportunities presented by the Act. These arrangements will be the subject of close scrutiny by the External Auditor as part of his 2003/04 audit.

## 9 CORPORATE GOVERNANCE

- 9.1 The External Auditor has undertaken a review of the Council's corporate governance arrangements and has concluded that the Council has many aspects of a sound corporate governance framework in place. His review covered five key areas of the Council's corporate governance arrangements:

- Corporate Governance Overview (paragraphs 3.3 to 3.9)
- Fraud and Corruption Arrangements (paragraphs 3.10 to 3.12)
- Internal Audit (paragraphs 3.13 to 3.18)
- Systems of Internal Control (paragraphs 3.19 to 3.43)
- ICT Arrangements (paragraphs 3.44 to 3.61)

The following paragraphs provide a brief commentary on the External Auditor's findings in each of these areas.

- 9.2 Under "Corporate Governance Overview", it is noted that good progress has been made in developing a corporate governance framework. Examples of specific initiatives undertaken by the Council during 2002/03 are shown in paragraph 3.6. The inclusion of a "Statement of Internal Financial Control" in the 2002/03 is also commended. It is noted that no significant weakness or failures in internal control systems required to be disclosed in this statement and the Chief Internal Auditor's independent reporting structures are also noted.
- 9.3 Under "Fraud and Corruption Arrangements", the External Auditor has commented favourably upon the Council's Anti-Fraud and Corruption Strategy, which was agreed and implemented during 2002/03.
- 9.4 Under "Internal Audit", a significant improvement in the performance of the Council's Internal Audit function is noted. This enabled the External Auditor to place a greater degree of reliance on the assignments undertaken by Internal Audit, thereby reducing his required input in these areas and avoiding unnecessary duplication of audit effort.
- 9.5 Under "Systems of Internal Control", the External Auditor reports on the following reviews that he undertook during 2002/03:

Dundee Contract Services Payroll System  
 Payment of Creditors  
 Non-Domestic Rates  
 Tayside Superannuation Fund  
 Housing and Council Tax Benefit

The outcome of each review is communicated in a detailed report to management on the key issues identified. Each report also contains an action plan, agreed by management, to rectify the weaknesses identified. These reports will be the subject of separate scrutiny by the Audit and Risk Management Sub-Committee in due course. The External auditor has also conducted a follow-up review of a few areas that were reviewed in previous years (Members Services, Superannuation Investments, Housing Income Collection and Dundee Contract Services Major Contracts). Where necessary, action is now being taken to address any outstanding recommendations.

- 9.6 Under "ICT Arrangements", the External Auditor reports on two detailed reviews that he undertook during 2002/03: Axis Pension Management System and Computer Network Services. Again, these reviews have been the subject of detailed reports to management and action plans, agreed by management, to rectify the weaknesses identified. They will also be the subject of separate scrutiny by the Audit and Risk Management Sub-Committee in due course. The External Auditor also undertook a review of the Council's preparations for e-Government and has commented favourably on some aspects of the Council's arrangements.

## 10 PERFORMANCE MANAGEMENT

- 10.1 During 2002/03, the External Auditor reviewed the Council's arrangements to secure value for money from the use of its resources. This review covered three key areas of the Council's arrangements:

- The Performance Management and Planning process (paragraphs 4.3 to 4.14)
- Performance Indicators (paragraphs 4.15 to 4.30)
- Centrally Directed Studies of performance in selected service areas (paragraphs 4.31 to 4.46)

The following paragraphs provide a brief commentary on the External Auditor's findings in each of these areas.

- 10.2 Under "Performance Management and Planning", it is noted that the Council has made good progress in implementing the corporate level improvement actions previously agreed in 2001/02. The External Auditor has commended the Council's 2002/03 Performance Report and intends to recommend it as an example of good practice to other Councils. Good progress has also been made in implementing previously agreed improvement actions at service level, although some outstanding issues are identified. The External Auditor's overall conclusion is that the Council has made good progress on Best Value in recent years and that the Council's PMP framework has assisted in the delivery of continuous improvement. PMP audit work will now be replaced by the new Best Value audit, which will operate on a cyclical basis. The City Council has been selected for inclusion in the first year of the new audit approach and preparations are at an advanced stage to meet this new challenge.
- 10.3 Under "Performance Indicators", it is noted that 61 of the Council's 65 statutory performance indicators were classed as "reliable" in 2002/03. The systems for collecting and recording this information are under continual review by the Council and attempts will be made to rectify identified weaknesses, where possible. The External Auditor has also highlighted four areas where performance is improving or declining and is at variance with average performance.
- 10.4 Under "Centrally Directed Studies", the External Auditor reports on his review of four areas of the Council's operations: Community Equipment and Adaptations, Commissioning Community Care Services for Older People, Early Retirement and Youth Justice. His findings in these areas are generally favourable, although some improvements have been identified and remedial action agreed with management. It is also noted that the HMIE follow-up inspection in 2003 found that the Council had made considerable progress in implementing the previously agreed action points. The Council had already been rated as "good" or "very good" in the original inspection report that was issued in 2001.

## 11 ACTION PLAN

The External Auditor has identified only one key issue arising from his 2002/03 audit that requires action by the Council at a corporate level. This relates to securing up-to-date information for DERL, for consolidation in the Council's Group Accounts. The External Auditor's recommendation is set out in the form of an Action Plan which is appended to his report. This matter has been considered carefully by the Depute Chief Executive (Finance) and the completed Action Plan, incorporating the "Management Response", is appended to this report.

## 12 CONCLUSIONS

During 2002/03, the External Auditor examined a number of areas covering a wide range of the City Council's activities. Whilst some areas for improvement have been identified, it is encouraging to note that the auditor's overall findings and conclusions have been satisfactory. The process has culminated in the issuing of an unqualified (or "clean") audit certificate and there is only one issue that requires action by the Council at a corporate level.

**13 BACKGROUND PAPERS**

No background papers, as defined by Section 50D of the Local Government (Scotland) Act 1973 (other than any containing confidential or exempt information) were relied on to any material extent in preparing the above Report.

**DAVID K DORWARD**  
**DEPUTE CHIEF EXECUTIVE (FINANCE)**

**10 MAY 2004**

Report Section	Issue and Audit Recommendation	Responsible Officer	Agreed	Management Response	Completion Date
Section 2 (paragraphs 2.37 – 2.49)	<p><b>Group Accounts - DERL</b></p> <p>The consolidation of DERL's accounts could not be carried out in 2002-03 due to up to date financial information not being available.</p> <p>The Council should consider the requirements of the '<i>Code of Guidance on Funding External Bodies and Following the Public Pound</i>', which includes the need for appropriate access to the records and the need to provide the Council with reports on financial matters.</p>	Depute Chief Executive (Finance)	Yes	For the purposes of preparing the Council's 2003/04 Group Accounts, financial information from DERL's statutory audited accounts to 31 December 2003 will be used. If these accounts are not available, then the Council will seek to secure unaudited information from DERL relating to their financial results to 31 December 2003.	30 September 2004