

City Chambers  
DUNDEE  
DD1 3BY

6th December, 2011

**Membership**

Councillor Kevin Keenan  
Councillor Richard McCready  
Bailie Derek Scott  
Councillor Fraser Macpherson  
Councillor Bob Duncan  
Bailie Willie Sawers  
Councillor Craig Melville  
Councillor Stewart Hunter

**All other Members**

Agenda and papers for information

Dear Sir or Madam

**SCRUTINY COMMITTEE**

Please attend the **SCRUTINY COMMITTEE** to be held in Committee Room No 1, 14 City Square, Dundee on Wednesday, 14th December, 2011 at 2.00 pm. Substitute members are allowed.

Yours faithfully

DAVID K DORWARD

Chief Executive

Members are reminded that, in terms of The Councillors Code, it is their responsibility to make decisions about whether to declare an interest in any item on this agenda and whether to take part in any discussions or voting.

This will include all interests, whether or not entered on your Register of Interests, which might be perceived as influencing your opinion/vote on any matter.

**1 INTERNAL AUDIT REPORTS**

(Report No 548-2011 enclosed).

**2 EXTERNAL AUDIT REPORT - TAYSIDE SUPERANNUATION FUNDS - CORPORATE GOVERNANCE ARRANGEMENTS**

(Report No 540-2011 enclosed).

**3        EXTERNAL AUDIT REPORT - VOLUNTARY EARLY RETIREMENT AND REDUNDANCY  
          SCHEMES**

(Report No 541-2011 enclosed).

**The Committee may resolve under Section 50(A)(4) of the Local Government (Scotland) Act 1973 that the press and public be excluded from the meeting for the undernoted item of business on the grounds that it involves the likely disclosure of exempt information as defined in paragraph 8 of Part I of Schedule 7A of the Act.**

**4        INTERNAL AUDIT REPORT**

**REPORT TO: SCRUTINY COMMITTEE – 14 DECEMBER 2011**

**REPORT ON: INTERNAL AUDIT REPORTS**

**REPORT BY: CHIEF INTERNAL AUDITOR**

**REPORT NO: 548-2011**

## **1.0 PURPOSE OF REPORT**

To submit to Members of the Scrutiny Committee a summary of the Internal Audit Reports finalised since the last Scrutiny Committee.

## **2.0 RECOMMENDATIONS**

Members of the Committee are asked to note the information contained within this report.

## **3.0 FINANCIAL IMPLICATIONS**

None

## **4.0 MAIN TEXT**

**4.1.** The day-to-day activity of the Internal Audit Service is primarily driven by the reviews included within the Internal Audit Plan. Broadly, on the completion of a specific review, a report which details the audit findings and recommendations is prepared and issued to Management for a formal response and submission of Management's proposed action plan to take the recommendations forward. Any follow-up work subsequently undertaken will examine the implementation of the action plan submitted by Management.

**4.2.** Executive Summaries for the reviews which have been finalised in terms of paragraph 4.1 above are provided at Appendix A. Within each Executive Summary the prime aim is to provide both Members and Management with key information which includes the reason for undertaking the review, summary financial data and statistics, the areas encompassed within the review and specific areas which were excluded, the principal audit objectives, an audit opinion on the adequacy of the systems and control framework of the area reviewed, the key conclusions based on the audit findings and recommendations and a summary of Management's response to the audit report. The full reports are available to Members on request.

## **5.0 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.

## **6.0 CONSULTATIONS**

The Chief Executive, Depute Chief Executive and Director of Finance have been consulted on the content of this report.

## **7.0 BACKGROUND PAPERS**

None

Sallie Dailly, Chief Internal Auditor

DATE: 29 November 2011

## i) INTERNAL AUDIT REPORT 2011/04

|                |   |
|----------------|---|
| <b>Client</b>  | <b>Environment</b>  |
| <b>Subject</b> | <b>Debit and Credit Card Refunds - Brown Street Kennels</b> |

**Introduction**

A review of the procedures operated in respect of credit and debit card refunds was part of the planned internal audit work.

In addition to payments made for council tax, non-domestic rates and rent customers may make payments to the Council for a variety of services provided. These include the purchase of stray or abandoned dogs. Payment for this may be made by cash, cheque, debit card or credit card. Debit and credit card payments to the Council are facilitated by Streamline, a company which provides merchant accounts to businesses to facilitate the processing of such payments.

There may be occasions when a refund is requested by the customer. In order to ensure that refunds are properly controlled such transactions should be appropriately authorised and there should be a clear audit trail which includes the reason, authorising officer, amount and date on which the refund was made.

**Scope and Objectives**

The overall objective of this review was to assess procedures operated by staff in respect of credit and debit card refunds at locations which do not use the corporate cash receipting system. This includes the Brown Street Kennels.

**Conclusion**

*The principal conclusion drawn from this review is that whilst there is basically a sound system of control there are some areas where it is viewed improvements can be made.*

The main areas commented upon in the report are as follows:

- To improve controls over the processing of debit and credit card payments, staff should be instructed to annotate the log of card payments with payment declined where appropriate. In addition, the system for retaining documentation supporting refunds should be formalised.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Director of Environment and appropriate action agreed to address the matters raised.

## ii) INTERNAL AUDIT REPORT 2011/13

|                |   |
|----------------|---|
| <b>Client</b>  | <b>Finance Revenues</b>   |
| <b>Subject</b> | <b>Performance Indicator - Current Year Income from Council Tax</b> |

**Introduction**

A review of the above performance indicator was undertaken as part of the planned internal audit work.

The Accounts Commission's 2008 Direction signalled a major change in the approach to performance measures and significantly reduced the range of specified indicators upon which Councils have to report. No amendments have subsequently been made to the 2008 Direction and therefore this formed the basis of the specified performance indicators to be reported for the 2010/11 financial year.

One of the specified performance indicators which Councils are required to compile is the current year income from Council Tax which is viewed as a measure of the effectiveness of the council in collecting current council tax due to it. In terms of income due this is defined as the amount of Council Tax payable for the year and excludes all water charges as well as any outstanding Council Tax or Community Charge from previous years. In order to determine the amount of water charges the "ABCD" formula allocation has traditionally been used. This essentially allocates the total cash received on a pro-rata basis between the Council and Scottish Water. However in practice this methodology results in an element of Council Tax charges being passed across to Scottish Water.

The "ABCD" methodology has also been traditionally used to compile the performance indicator. However an alternative methodology which is based on the raw data being analysed on an individual account basis and provides a more accurate calculation has been adopted by at least one other Scottish Council. This methodology was also adopted by the City Council to calculate the 2010/11 performance measure. This change was agreed in principle by the City Council's external auditor subject to internal audit undertaking a more detailed review to provide the necessary assurances.

**Scope and Objectives**

The objective of this review was to confirm the robustness of the new methodology and obtain assurance that properties are correctly treated in the calculation of the performance indicator being reported.

**Conclusion**

*On the basis of examining the procedures and data used, and obtaining explanations and carrying out such tests as deemed necessary, it is considered that appropriate systems are in place to ensure that the Statutory Performance Indicator(s) can be compiled in line with the guidance issued by the Accounts Commission.*

## iii) INTERNAL AUDIT REPORT 2011/14

|                |                               |
|----------------|-------------------------------|
| <b>Client</b>  | <b>Corporate</b>              |
| <b>Subject</b> | <b>Performance Indicators</b> |

**Introduction**

A review of the compilation of performance indicators for 2010/11 was part of the planned internal audit work. As part of this exercise, the Council's external auditor, Audit Scotland requested internal audit examine the robustness of the variance statements provided by departments.

The Accounts Commission's 2008 Direction signalled a major change in the approach to performance measures and significantly reduced the range of specified indicators upon which Councils have to report. No amendments have subsequently been made to the 2008 Direction and therefore this forms the basis of the specified performance indicators to be reported for the 2010/11 financial year. Under the new regime the Commission has aligned the arrangements for specified indicators with the responsibility that authorities have under best value for selecting and using information to drive continuous improvement in services and for reporting on those aspects of performance that are of most importance to local communities, service users and citizens. Consequently, the various departments of the Council have compiled a list of performance indicators which complements the indicators specified in the 2008 Direction.

Many of the indicators, both specified and non-specified are reported quarterly to the Scrutiny Committee in the Corporate Performance Self Assessment. In this report the Council's priorities as laid down in the Council Plan namely A Working City; Quality of Life and Social Inclusion; Healthy, Safe Communities; Getting It Right for Every Child and Corporate Change and Improvement are used as the basis on which performance is reported. For each of the key themes the report details the indicators to be reported upon and whether performance has improved, been maintained or deteriorated. Additional commentary is provided for those where there has been deterioration.

**Scope and Objectives**

The objective of this review was to confirm the accuracy of a sample of performance indicators being reported for 2010/11, assess the robustness of the variance statements and obtain sufficient documentation to support the explanations provided.

**Conclusion**

*The principal conclusion drawn from this review is that whilst there is basically a sound system of control there are some areas where it is viewed improvements can be made.*

The main areas commented upon in the report are as follows:

- To improve the current arrangements detailed definitions and the methodology to calculate the performance indicators should be prepared by the relevant personnel for all of the non-specified indicators and the figure submitted the previous year should be used as the base figure for calculating the variance for all performance measures. In addition, whilst it is acknowledged that performance indicators should be reviewed regularly to confirm their relevance and this may result in amendments being made there should be a formal record of such changes which includes the reason and date from which the change is effective.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Director of Finance and appropriate action agreed to address the matters raised.

## iv) INTERNAL AUDIT REPORT 2011/20

|                |  |
|----------------|--|
| <b>Client</b>  | <b>Environment</b>                             |
| <b>Subject</b> | <b>Procurement and Management of Materials</b> |

**Introduction**

A review of the procurement and management of materials within the Construction Division of the Environment Department was part of the planned internal audit work.

The Division provides quality building services utilising all building craft trades including joiners, electricians, plumbers, blacksmiths and tile-layers. Work undertaken includes new build works, repairs, upgrades and modernisation for buildings of any type and use. The turnover of the Division for 2010/11 was of the order of £26m.

For routine maintenance work the Division carries a range of materials in its store to enable staff to carry out work allocated although specialist items may need to be purchased on an ad hoc basis. Routine items are automatically re-ordered when stock reaches a pre-determined level. For major contracts the Division compiles a bill of quantities which is used as the basis for pricing contracts. The vast majority of larger items needed for completion of the contract are ordered via the formal ordering procedure and delivered to the site. Additional materials required urgently are picked up from local suppliers.

It is essential that management can be reasonably assured that all materials ordered for a particular contract are used in the delivery of that contract as this information is input to the costing system and may be used in the pricing of subsequent tenders for future work. It is also important that any wastage is tracked and monitored so that faulty materials can be returned or improvements can be made to working practices.

**Scope and Objectives**

The overall object of the review was to examine the systems operated in respect of the procurement and management of materials for major contracts within the Construction Division.

**Conclusion**

*The principal conclusion drawn from this review is that there are weaknesses in the system which should be addressed.*

The main areas commented upon in the report are as follows:

- To reduce time spent travelling to suppliers, minimise travel costs and improve the audit trail the pick-up system should be reviewed as a matter of urgency. In particular, the feasibility of providing consumables for major contracts from the store at Clepington Road should be explored.
- To improve controls over procurement of materials, the list of staff authorised to use the electronic requisitioning system should be updated and thereafter amended when necessary to reflect starters or leavers. In addition, consideration should be given to introducing a system for monitoring damaged and surplus materials.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Director of Environment and appropriate action agreed to address the matters raised.

## v) INTERNAL AUDIT REPORT 2011/26

|                |   |
|----------------|---|
| <b>Client</b>  | <b>Support Services</b>                           |
| <b>Subject</b> | <b>Debit and Credit Card Refunds - Registrars</b> |

**Introduction**

A review of the procedures operated in respect of debit and credit card refunds was part of the planned internal audit work.

For the Registrar charges are levied for the registration of births, deaths, civil partnerships and marriages and searches for family history information. Payments due in respect of these services may be made by cash, cheque, debit card or credit card.

There may be occasions, such as the cancellation of a wedding, when a refund requires to be processed. To ensure that such transactions are adequately controlled there should be a clear audit trail which details key information including the reason, amount, processing date and the officer who has authorised the refund. In addition, refunds for any payments initially made by debit or credit card should preferably be processed through Streamline to the source card which was used for the original payment.

**Scope and Objectives**

The overall objective of this review was to assess procedures operated by staff in respect of debit and credit card refunds at Council locations which do not use the corporate cash receipting system. This includes the Registrars and also the Family History Unit which is based in the Central Library.

**Conclusion**

*The principal conclusion drawn from this review is that whilst there is basically a sound system of control there are some areas where it is viewed improvements can be made.*

The main areas commented upon in the report are as follows:

- To improve monitoring and reconciliation procedures, the income spreadsheet maintained by the Registrars staff should be submitted to Support Services administration staff along with corresponding till receipts, Streamline receipts and Streamline reconciliation reports. These records should be reconciled to the Streamline statements and any anomalies satisfactorily resolved.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Depute Chief Executive (Support Services) and appropriate action agreed to address the matters raised.

## vi) INTERNAL AUDIT REPORT 2011/27

|                |  |
|----------------|--|
| <b>Client</b>  | <b>Chief Executive</b>   |
| <b>Subject</b> | <b>Debit and Credit Card Refunds - Ancrum Outdoor Education Centre</b> |

**Introduction**

A review of the procedures operated in respect of debit and credit card refunds was part of the planned internal audit work.

For the Ancrum Outdoor Education Centre charges are levied for courses and the hire of equipment. Payment due in respect of these may be made by cash, cheque, debit card or credit card.

There may be occasions, such as the cancellation of a course, when a refund requires to be processed. To ensure that such transactions are adequately controlled there should be a clear audit trail which details key information including the reason, amount, processing date and the officer who has authorised the refund. In addition, refunds for any payments initially made by debit or credit card should preferably be processed through Streamline to the source card which was used for the original payment.

**Scope and Objectives**

The overall objective of this review was to assess procedures operated by staff in respect of debit and credit card refunds at Council locations which do not use the corporate cash receipting system. This includes the Ancrum Outdoor Education Centre.

**Conclusion**

*The principal conclusion drawn from this review is that there are weaknesses in the system which should be addressed.*

The main areas commented upon in the report are as follows:

- To improve controls over debit or credit cards refunds, the current guidance should be amended to cover this area. In addition, reconciliation procedures should be tightened up and staff advised that any differences between the Centre's records and Streamline statements must be fully resolved at the time when they occur.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Head of Communities and appropriate action agreed to address the matters raised.

## vii) INTERNAL AUDIT REPORT 2011/28

|                |   |
|----------------|---|
| <b>Client</b>  | <b>City Development</b>                                     |
| <b>Subject</b> | <b>Carbon Reduction Commitment Energy Efficiency Scheme</b> |

**Introduction**

A review of the Council's submissions under the Carbon Reduction Commitment (CRC) Energy Efficiency Scheme was part of the planned internal audit work.

The Climate Change Act 2008 introduced legally binding targets for the UK to achieve significant reductions in greenhouse gas emissions by 2050. The Scottish targets, contained within the Climate Change (Scotland) Act 2009, are a reduction in carbon emissions of at least 80% by 2050, with an interim target of 42% by 2020. Included within the primary legislation are powers to introduce domestic emissions trading schemes more quickly and easily through secondary legislation. Use of this provision resulted in a UK-wide CRC Energy Efficiency Scheme coming into force in April 2010. Essentially this is a mandatory carbon emissions reporting and pricing scheme to cover all organisations using more than 6,000 megawatt hour per year of electricity during the 2008 calendar year. Dundee City Council is registered as a participant of the CRC scheme.

For administrative purposes the CRC scheme is divided into pre-determined phases. The key components of the first phase include a qualification period, a registration period and a series of compliance years, the first of which is also the footprint year. The footprint year and the first compliance year mirrored the 2010/11 financial year.

For 2010/11 participating organisations were required to measure and report their carbon emissions on the basis of a specific set of measurement rules and to submit a footprint report and an annual report to the Scottish Environmental Protection Agency (SEPA) by the last working day in July 2011. The footprint report outlined the total energy supply and emissions and electricity credits for the period and the annual report detailed the organisation's emissions for the financial year. These reports are underpinned by an evidence pack compiled by the organisation.

**Scope and Objectives**

The overall objective of this review was to the procedures operated in the compilation of the footprint and annual reports and confirm that they cover all relevant areas.

**Conclusion**

*The principal conclusion drawn from this review is that whilst there is basically a sound system of control there are some areas where it is viewed improvements can be made.*

The main areas commented upon in the report are as follows:

- Given Carbon Counter is the Council's key database for its CRC evidence pack the outstanding documentation should be uploaded to the system as soon as possible. In addition, the outstanding exclusion lists along with written procedures should be compiled and thereafter input into Carbon Counter.

**Management Response to the Audit Report**

The audit findings and recommendations were formally reported to the Director of City Development and appropriate action agreed to address the matters raised.

## viii) INTERNAL AUDIT REPORT 2011/41

|                |  |
|----------------|--|
| <b>Client</b>  | <b>Environment</b>                                     |
| <b>Subject</b> | <b>Debit and Credit Card Refunds- Marchbanks Depot</b> |

**Introduction**

A review of the procedures operated in respect of credit and debit card refunds was part of the planned internal audit work.

In addition to payments made for council tax, non-domestic rates and rent customers may make payments to the Council for a variety of services provided. These include the hire of skips and special collections and payment for such services may be made by cash, cheque, debit card or credit card. Debit and credit card payments to the Council are facilitated by Streamline, a company which provides merchant accounts to businesses for the processing of such payments.

There may be occasions when a refund is requested by the customer. In order to ensure that refunds are properly controlled such transactions should be appropriately authorised and there should be a clear audit trail which includes the reason, authorising officer, amount and date on which the refund was made.

**Scope and Objectives**

The overall objective of this review was to assess procedures operated by staff in respect of credit and debit card refunds at locations which do not use the corporate cash receipting system. This includes the Marchbanks Depot.

**Conclusion**

*The principal conclusion drawn from this review is that there is a sound system of control designed to achieve the system objectives and that the controls are being consistently applied.*

**REPORT TO: SCRUTINY COMMITTEE - 14 DECEMBER 2011**

**REPORT ON: EXTERNAL AUDIT REPORT- TAYSIDE SUPERANNUATION FUNDS CORPORATE GOVERNANCE ARRANGEMENTS**

**REPORT BY: ALASDAIR CRAIK, SENIOR AUDIT MANAGER**

**REPORT NO: 540-2011**

## **1 PURPOSE OF REPORT**

- 1.1 To submit to Members of the Scrutiny Committee the External Audit Report on Tayside Superannuation Funds Corporate Governance Arrangements

## **2 RECOMMENDATIONS**

- 2.1 Members of the Committee are asked to consider the report and to note the agreed action plan.

## **3 BACKGROUND**

- 3.1 Dundee City Council administers the Tayside Superannuation and Tayside Transport Superannuation Funds on behalf of employees and employers. Jointly the funds cover approximately 39,000 members and, as at 31 March 2010 had combined net assets of £1.8 billion.
- 3.2 An amendment to the Local Government Pension Scheme (Administration) (Scotland) Regulations 2008 required the administering authority to publish a pension fund annual report from 2010/11 and consequently, auditors are required to provide a separate audit opinion on the financial statements within the annual report. As part of this work we have conducted a review of the Council's corporate governance arrangements as the administering authority. The report summarises the findings from that review.
- 3.2 The report identifies that the Council has many of elements of good practice in place. Particularly through the existence of a dedicated sub-committee to scrutinise investments, and the use of external fund managers with appropriate expertise to manage investments.
- 3.3 The report also highlights the findings of our review of internal controls in operation over the key financial systems used in the administration of the funds noting that we found a good level of control to be in place.

**Alasdair Craik**  
**Senior Audit Manager**

**29 November 2011**

# Tayside Superannuation Funds

Corporate Governance 2010/11

August 2011



 AUDIT SCOTLAND

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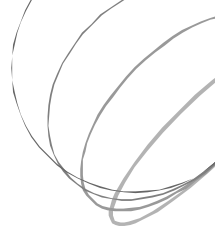
# Corporate governance

## Introduction

1. The Local Government Pension Scheme (LGPS) is a common scheme throughout Scotland, administered by 11 individual pension funds. Between these funds manage assets of around £20bn on behalf of members of the scheme in Scotland
2. Dundee City Council administers the Tayside Superannuation Fund on behalf of its own employees and some 47 other admitted and scheduled bodies. The council also administers the Tayside Transport Superannuation Fund on behalf of the employees of the former Tayside Public Transport Company. Local government pension schemes are administered by local authorities but adhere to the nationally determined regulations of the LGPS. Jointly the funds cover approximately 39,000 members with c18,500 contributing members and c11,650 pensioners and as at 31 March 2010 had combined net assets of £1.791 billion.
3. Although those entrusted to make statutory decisions under the LGPS are, in many ways, required to act in the same way as trustees in terms of their duty of care, they are subject to a different legal framework, which derives from public law. In particular, members of LGPS pension committees are subject to all the normal duties and responsibilities that come with their office. However, they are not trustees in the strict legal sense of that word.
4. The LGPS also differs from most private sector schemes in terms of the management of risk to members' accrued benefits. In private sector schemes, accrued benefits payable to members are always subject to risk of fund/scheme under-performance or even failure meaning that a degree of risk of underperformance is shared with scheme members. By contrast, the accrued benefits paid by local authorities are established and payable by statute and underpinned from local authority revenue. In effect, the pension fund exists to defray the pension costs incurred by the local authority. Therefore, it is the local authority itself and, ultimately, the council tax payers who bear the financial and investment risks, rather than scheme members.,
5. Our 2010/11 Annual Audit Plan highlighted that we would undertake a review of the funds' governance arrangements in a number of key areas. This report summarises our findings from the review of corporate governance arrangements and from the testing of high level controls upon which we plan to place reliance for our audit of the financial statements.

## Governance arrangements

6. Governance is about how local government bodies ensure that they do the right things, in the right way, for the right people, in a timely, inclusive, open, honest and accountable manner. It comprises the systems and processes, culture and values by which local government bodies are directed and



controlled and through which they account to, engage with and, where appropriate, lead their community.

7. Elected members have legal responsibilities for the prudent and effective stewardship of LGPS funds and in more general terms, have a clear fiduciary duty in the performance of their functions. However, the scheme beneficiaries have an interest in the beneficial title to the assets and the legal right to require that assets are held and managed on their behalf in accordance with the LGPS regulations. In this regard elected members have a duty of care that goes beyond the strict fiduciary duty to employers and tax payers.
8. The Council exercises its responsibility for the administration of the funds through powers delegated to the Superannuation Investment Sub-Committee (the sub-committee). The sub-committee comprises of six elected members from Dundee City Council with provision made for 3 employee representatives to attend as observers.
9. The remit of the sub-committee and the governance framework are detailed in the Governance Compliance Statement approved by the sub-committee in May 2009. We note, however, that the remit is mainly concerned with pension investment arrangements and is silent on fund income and expenditure and administration. In particular, no mention is made of transactions with members, such as payments made to members and contributions received from members and participating employers. It is unclear where the responsibility for governance of these areas lies within the current framework.

**Key risk area 1**

10. CIPFA's report *Delivering good governance in local government funds* (2009) highlights that LGPS funds have many stakeholders including beneficiaries (pensioners), contributors (employees) employers and council tax payers. It is therefore essential that there are appropriate arrangements for ensuring that the legitimate interests of all stakeholders are properly represented within the structures chosen for the management of funds.
11. Under section 57 of the Local Government (Scotland) Act 1973, it is for the appointing council to decide upon the number of members of a committee and their terms of office. They may include committee members who are not members of the appointing council. Such members may be given voting rights by virtue of section 14 of the Local Government and Housing Act 1989. On this basis it is open to pension committees to include representatives from employing authorities, scheme members and other lay member representatives, with or without voting rights, provided that they are eligible to be committee members.
12. At present the sub-committee membership is comprised of 6 elected members of Dundee City Council with rights. Provision is made for three observer employee representatives who do not have voting rights.. Pensioners and employers are not directly represented.



**Key risk area 2**

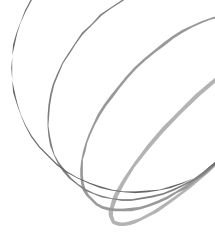
13. The council communicates with active members through annual statements and newsletters and holds regular meetings and training events with participating employers. However, we understand that there is no regular communication with pensioners on cost grounds.
14. Pension scheme rules and investments are complex. Effective oversight of pension funds requires a robust understanding of complicated rules, investment types and transactions. Although provision is made for regular training of sub-committee members, attendance at these training events is voluntary and there has been no formal assessment of specific pension related training needs for relevant elected members.

**Key risk area 3**

15. At its meeting on 21 February 2011, the sub-committee approved the first risk register for the funds. Sub-committee members should ensure that they are satisfied with risk assessments and current risk control measures and should obtain assurances that sound controls are in place and operating effectively. We welcome this development and will keep a watching brief to ensure that risk management is embedded in the operation of the funds.
16. Internal audit is an appraisal activity established by or provided as a service to the entity. The objectives of the internal audit function are determined by management and, where applicable, those charged with governance. Its functions include, amongst other things, examining, evaluating and monitoring the adequacy and effectiveness of internal control.
17. The funds' Governance Policy Statement records that Dundee City Council provides an internal audit service which covers pension investment and administration at regular intervals. However, the council's internal audit service has not reviewed pension scheme-related systems and controls for some time and no pension fund work was undertaken in 2010/11.
18. We also note that there is no formal agreement between the council and the pension funds as to the provision of an internal audit service and that the sub-committee does not approve an annual programme of work or consider reports, including a year end statement of assurance on the effectiveness of the system of internal control.
19. This increases the risk that assurances over the adequacy and effectiveness of internal controls are not available to underpin effective governance and support the governance compliance statement.

**Key risk area 4**

20. The funds use 6 investment managers and a custodian to provide professional fund management services for their £1.8 billion investment portfolio. SAS70 reports (Service Organisations – replaced by ISA 402 for accounting periods ending on or after 15 June 2011) are issued annually by reporting



accountants who are independent to investment managers and custodian. These reports provide assurances to those charged with governance that controls in operation at investment managers operate satisfactorily. As well as an overall opinion, they give details of tests performed and weaknesses identified. However, we understand that these reports are not subject to formal review and that available assurance or weaknesses identified are not reported to members.

#### ***Key risk area 5***

21. Given the magnitude of funds under management and the importance of exerting adequate control over the operations of outsourced services, it is essential that robust and up-to-date contracts are in place with firms providing outsourced services. However, we found weaknesses in the funds' contracts arrangements. Generally, there is a need for the Sub-Committee to ensure that it has up-to-date agreements for all outsourced professional services. We found one investment manager for whom no contract was in place. Two contracts were extended during 2010/11, however, member approval for these extensions was only obtained after the event.

#### ***Key risk area 6***

## **Internal control systems**

22. Internal control systems are the means by which management manages the risks inherent in key financial systems. In the period to April 2011, we carried out audit testing focussing on the high level controls in place within key internal control systems relevant to the funds, namely:
  - Investments
  - Pensions administration
  - Payroll
  - Cash management
23. In general, we found a good level of control to be in place although some risks were noted.
24. Sub-committee members receive quarterly reports on investment market values, transactions and performance. We have reviewed the underlying data used to report to members and have a number of observations, mainly in relation to derivatives (futures) and the benchmarks used for performance measurement.
25. We understand that some of the funds' investment managers use derivatives in the management of their portfolios. For example, we found that one manager's exposure to derivatives was around 50% of the value of its portfolio. However, the funds' exposure to derivatives and offsetting cash holdings are not reported to members. It is essential that members appreciate the financial techniques used by their appointed investment managers and the risks associated with financial instruments.



**Key risk area 7**

26. Performance benchmarks set vary between investment managers and may even vary for the same type of asset. However, benchmarks reported to members do not always take this into account, occasionally resulting in incorrect performance assessment. In some cases, benchmarks are not reported, which may make performance data less meaningful..

**Key risk area 8**

27. Admitted and scheduled bodies are responsible for the collection and timeous transfer to the fund of contributions from both employer and employees. If the sums due to be transferred are incorrectly calculated there is a risk that pension benefits will be incorrectly. We noted a lack of controls to ensure that employers contributions received are complete and accurate. While steps are taken to monitor the levels of employee contributions by employer month by month, this does not extend to confirming the employers' contributions.

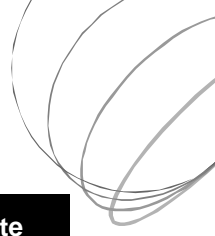
**Key risk area 9**

28. Consideration should also be given to addressing the findings highlighted in Appendix B to further improve the control environment.
29. The issues identified in preparing this report are only those which have come to our attention during the course of the review and are not necessarily, therefore, all the risk areas that may exist. It remains the responsibility of management to determine the extent of the internal control system appropriate to Dundee City Council. We would stress, however, that an effective system of internal control is an essential part of the efficient management of any organisation.
30. The assistance and co-operation we received during the course of our work is gratefully acknowledged.

# Appendix A – Risk summary and action plan

| No                             | Risk   | Responsible officer        | Response and agreed action  | Target date |
|--------------------------------|--|----------------------------|---|-------------|
| <b>Governance arrangements</b> |  |                            |   |             |
| 1.                             | <p>The remit of the sub-committee and the governance framework are detailed in the Governance Compliance Statement approved by the sub-committee in May 2009. We note, however, that the remit is mainly concerned with pension investment arrangements and is silent on fund income and expenditure and administration. In particular, no mention is made of transactions with members, such as payments made to members and contributions received from members and participating employers. It is unclear where the responsibility for the governance of these areas lies in the current framework.</p> <p><b><i>Risk: governance arrangements in relation to the administration of the funds and their transactions with stakeholders are weak and do not represent good practice.</i></b></p> | Exchequer Officer          | <p>Revised compliance statement is being prepared for August Sub-committee</p> <p>The remit of Sub-Committee will continue to focus on investments.</p> <p>Financial Regulation 24.5 confirms the Director of Finance's responsibility for income and expenditure and there is delegated authority for administering the Local Government Pension Scheme.</p> | August 2011 |
| 2.                             | <p>Representatives of participating LGPS employers, admitted bodies and scheme members (including pensioners) should be represented on the committee established to govern the fund. At present the sub-committee membership is comprised of 6 elected members of Dundee City Council who hold all the voting rights. Provision is made for 3 observer employee representatives. Pensioners and employers are not directly represented.</p> <p><b><i>Risk: the views of key stakeholders may not be adequately represented in the management of the funds.</i></b></p>   | Head of Financial Services | <p>Legal position needs to be clarified at a national level.</p> <p>Representatives are consulted and included in communications regularly.</p>   | March 2012  |

| No | Risk   | Responsible officer        | Response and agreed action  | Target date |
|----|--|----------------------------|---|-------------|
| 3. | <p>Pension scheme rules and investments are complex. Effective oversight of pension funds requires a robust understanding of complex rules and investment types and transactions. Although provision is made for regular training of Sub-Committee members, attendance at these training events is voluntary and there has been no formal assessment of specific pension – related training needs for Sub-Committee members.</p> <p><b>Risk: Sub-committee members may have unidentified training needs and may lack the knowledge and skills to fulfil their roles effectively.</b></p>   | Head of Financial Services | <p>Training of current members will be reviewed but preparation will also be made for potential change in membership next year.</p> <p>This will include discussions with other Scottish Local Authority Funds regarding delivering nationwide training.</p>  | May 2012    |
| 4. | <p>The funds' Governance Policy Statement records that Dundee City Council provides an internal audit service which covers pension investment and administration at regular intervals. However, the council's internal audit service has not reviewed pension scheme-related systems and controls for some time and no pension fund work was undertaken in 2010/11.</p> <p>We also note that there is no formal agreement between the council and the pension funds as to the provision of an internal audit service and that the sub-committee does not approve an annual programme of work or consider reports, including a year end statement of assurance on the effectiveness of the system of internal control.</p> <p><b>Risks: assurances over the adequacy and effectiveness over the system of internal controls are not available to underpin effective governance and support the governance compliance statement.</b></p> | Head of Financial Services | <p>Please note that the reference to Internal Audit originates from the Fund's risk register.</p> <p>As Dundee City Council administers the Pension Fund any planned audit work and subsequent reports will be taken to the Scrutiny Committee.</p> <p>An item is included in the 2011/12 Audit Plan.</p> | N/A         |



| No | Risk  | Responsible officer | Response and agreed action  | Target date   |
|----|---|---------------------|---|---------------|
| 5. | <p>The funds use 6 investment managers and a custodian to provide professional fund management services for their £1.8 billion investment portfolio. SAS70 reports (Service Organisations – replaced by ISA 402 for accounting periods ending on or after 15 June 2011) are issued annually by reporting accountants who are independent to investment managers and custodian. These reports provide assurances to those charged with governance that controls in operation at investment managers operate satisfactorily. As well as an overall opinion, they give details of tests performed and weaknesses identified. However, we understand that these reports are not subject to formal review and that available assurance or weaknesses identified are not reported to members.</p> <p><b><i>Risk: the sub-committee does not have adequate assurance as to the effectiveness of controls in operation at outsourced service providers responsible for the management of significant fund assets.</i></b></p> | Exchequer Officer   | There have been no significant issues to report to committee but it is agreed it would be good practice to provide an annual report to the committee based on latest reports. | November 2011 |
| 6. | <p>Given the magnitude of funds under management and the importance of exerting adequate control over the operations of outsourced services, it is essential that robust and up-to-date contracts are in place with firms providing outsourced services. However, we found weaknesses in the funds' contracts arrangements. Generally, there is a need for the Sub-Committee to ensure that it has up-to-date agreements for all outsourced professional services. We found one investment manager for whom no contract was in place. Two contracts were extended during 2010/1, however member approval for these extensions was only obtained after the event.</p> <p><b><i>Risk: up-to-date agreements may not be in place for all outsourced service providers, leading to potential financial or reputational loss to the funds.</i></b></p>   | Exchequer Officer   | There have been no issues regarding contracts but a register will be maintained of latest versions and amendments.  | December 2011 |



| No                              | Risk   | Responsible officer        | Response and agreed action  | Target date |
|---------------------------------|--|----------------------------|---|-------------|
| <b>Internal control systems</b> |  |                            |   |             |
| 7.                              | <p>We understand that a couple of investment managers use derivatives (futures) in the management of their portfolios. For example, we found that one manager's exposure to derivatives was around 50% of the value of its portfolio. However, the funds' exposure to derivatives and offsetting cash holdings are not reported to members. It is essential that members appreciate the financial techniques used by their appointed investment managers and the risks associated with financial instruments.</p> <p><b>Risk: Sub-Committee members are unaware of exposure to derivatives and related risks to the funds.</b></p> | Head of Financial Services | Additional training will be provided for members and additional information will be provided on a quarterly basis.  | May 2012    |
| 8.                              | <p>Performance benchmarks set vary between investment managers and may even vary for the same type of asset. However, benchmarks reported to members do not always take this into account, occasionally resulting in incorrect performance assessment. In some cases, benchmarks are not reported, which may make performance data less meaningful.</p> <p><b>Risk: sub-committee members may be using incorrect or incomplete data when assessing investment performance.</b></p>   |                            | For practical purposes the summarised information presented to committee does not always fully differentiate between the individual benchmarks. However the Northern Trust reports which are considered every quarter cover the full detail of these. | N/A         |
| 9.                              | <p>We noted a lack of controls to ensure that employers contributions received are complete and accurate. While steps are taken to monitor the levels of employee contributions by employer month by month, this does not extend to employers' contributions.</p> <p><b>Risk: contributions received may be incomplete, inaccurate, or received late.</b></p>  | Exchequer Accountant       | The separate bank account and new coding structure make any discrepancies more obvious. A monthly checklist will be kept.   | August 2011 |

# Appendix B

## Findings from 20010/11 audit testing of internal control systems

### Investments

1. The Council appointed Northern Trust as custodian and also to monitor investment performance. However, we found that the investment performance reported to members did not originate from Northern Trust reports in all cases.
2. The Council uses Northern Trust reports for investment accounting and reporting. While officers agree most investment holdings between custodian and investment managers, derivatives and cash investments are not reconciled between custodian and investment managers' records.
3. It is not clear why the property portfolio (managed by Schroders) is reported separately and in so much detail. This portfolio makes up less than 10% of the total fund.

### Cash

4. The pension bank account is reconciled monthly between the bank balance and cashbook balance. However, officers do agree the cashbook balance per the bank reconciliation to the ledger. There is therefore a risk that ledger figures, which are used for reporting purposes, are incomplete and inaccurate.
5. We noted that recharges due to the funds from Dundee City Council amounted to around £3 million by 31 March 2011. We understand that this represents monies due to the fund from the council and which had accumulated over a number of months. This recharge would typically be for contributions payable by the Council to the pension fund, less amounts paid by the Council on behalf of the fund. The Council should ensure that monies due to the funds are promptly paid over. Contributions collected must be paid over to pension funds not later than the 19<sup>th</sup> of the month following deduction.

### Pension's administration

6. Membership reconciliations are not carried out by fund administrators. Members reconciliations provide comfort to trustees and auditors that movements in membership numbers (by category) can be fully explained and provides some assurance that the membership data is reliable. Robust membership data is essential as important actuarial decisions are based on this information.

**REPORT TO: SCRUTINY COMMITTEE**

**REPORT ON: EXTERNAL AUDIT REPORT- VOLUNTARY EARLY RETIREMENT AND REDUNDANCY SCHEMES**

**REPORT BY: ALASDAIR CRAIK, SENIOR AUDIT MANAGER**

**REPORT NO: 541-2011**

## **1 PURPOSE OF REPORT**

- 1.1 To submit to Members of the Scrutiny Committee the External Audit Report on Voluntary Early Retirement and Redundancy Schemes.

## **2 RECOMMENDATIONS**

- 2.1 Members of the Committee are asked to consider the report and to note the agreed action plan.

## **3 BACKGROUND**

- 3.1 The report summarises the findings from the external audit review of the Council's voluntary early retirement and redundancy arrangements.
- 3.2 The Council had implemented two schemes, one for teachers and another for non-teaching staff. Overall we were satisfied that sound decision making framework had been established for both schemes. In terms of the non-teaching staff found a well documented audit trail supporting individual decisions. Whilst we understand a similar process was in place for teaching staff we found this to be less well documented.
- 3.3 The savings achieved from the voluntary early retirement and redundancy schemes will play a significant part in helping the Council to achieve the overall level of savings it needs to make over the next few years. It is important that the Council continues to monitor the planned savings to ensure that they are delivered and that service delivery is not impaired.

Alasdair Craik  
Senior Audit Manager  
29 November 2011

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Mr David Dorward  
Chief Executive  
Dundee City Council  
21 City Square  
DUNDEE  
DD1 3BD

27 October 2011

Dear Mr Dorward

### **2010/2011 Audit - Voluntary early retirement and redundancy schemes**

In our 2010/11 Annual Audit Plan, we highlighted risks in relation to reductions in the workforce and on-going costs. As part of the budget setting process the Council has sought to secure reductions in the workforce through voluntary arrangements for early retirement and redundancy to generate on-going savings in excess of £5.3 million per annum. These decisions need to be fully funded and demonstrate value for money. As well as the risks associated with the impact of such staff reductions on the continuation and quality of services, it is essential that the costs are properly accounted for and fully disclosed in the financial statements.

We have therefore undertaken a review of the Council's voluntary early retirement and redundancy schemes covering both non-teaching staff and teachers. The purpose of this letter is to report to you the findings from our work. Please refer to the enclosed risk summary for detail on the risks we have identified.

### **Process**

We are satisfied that a formal decision making framework was established for applications from non-teaching staff. This incorporated a robust appraisal and approval process which was approved by the Policy & Resources Committee. We note that although the Policy & Resources Committee approved the teachers' scheme and the criteria to be considered, no reference was made to the approval process to be followed.

As part of our review we examined a number of individual applications to ensure that the processes were followed and that each departure met the requirements of the scheme. In terms of non-teaching staff we found a well documented audit trail that clearly showed the process followed, the evidence considered and the outcomes achieved.

Whilst we understand that a similar process was in place for teaching staff, involving a group of senior officers from the Education Service and approval by the Director, we found that the process was less well documented and lacked a clear audit trail to evidence the process followed in individual cases. We would recommend that the department review the documentation process.

### **Scrutiny**

The council identified the Voluntary Early Retirement/ Voluntary Redundancy schemes to facilitate the rationalisation and restructuring of services to support the changing for the future programme. Members were not provided with projected numbers, costs and savings in advance of the schemes. Officers considered this impractical due to the voluntary nature of the scheme. Consequently no targets were set in terms of desired outcomes.

A report to the Policy and Resources Committee highlighted estimated savings of £6.633 million per annum from 2011/12 onwards in respect of non-teaching staff. A summary analysis provided by officers documents savings of £330,000 from the teaching scheme. However, this was 37% below the projected target leaving a shortfall of £190,000 for 2010/11.

We would recommend that members monitor the outcome of the schemes to ensure that anticipated savings are achieved and that there is no adverse impact on service delivery.

### **Impact on budget**

For the non-teachers voluntary early retirement/ redundancy scheme, costs and savings are reported to members as part of the revenue budget monitoring process. We note that the reported figures have been based on estimates from the pension section and departments pending finalisation of agreements. In respect of the teachers' scheme, information regarding savings was formally reported to elected members as part of the budget setting process.

### **Pension scheme accounting**


Unfunded pensions (the element of pensions funded by employers on an on-going basis, such as added years and strain on fund) are offset against recharges in a pension scheme control account. This means that the pension accounts show pensions net of unfunded pensions and contributions do not reflect employers' augmentation contributions (recharges to cover unfunded elements of pensions). Both pensions and contributions are therefore understated in the LGPS accounts by an amount equal to unfunded pensions.

We understand that mandatory and discretionary compensation in relation to teachers form part of the LGPS pension payroll and that a recharge from the council is made in respect of these elements of teachers' pensions. The council should ensure that any elements of pensions and recharges relating to teachers are excluded from the Tayside Superannuation Fund accounts.

The findings of our audit have been discussed with officers who have agreed to take the specific steps identified in the column headed "planned management action" in the attached action plan.

The co-operation and assistance of officers and staff during the review is gratefully acknowledged

Yours sincerely



Alasdair Craik  
Senior Audit Manager

cc: Mrs M Stewart, Director of Finance  
Mrs S Dailly, Chief Internal Auditor



| Risk No | Risk Exposure   | Planned Management Action   | Responsible Officer | Target Date |
|---------|---|---|---------------------|-------------|
|         | <p>on the accuracy of his valuation the LGPS accounts do not comply with the pensions SORP.</p>   |   |                     |             |
| 3.      | <p>Pension scheme accounting<br/> We understand that mandatory and discretionary compensation in relation to teachers form part of the LGPS pension payroll and that a recharge from the council is made in respect of these elements of teachers' pensions. The council should ensure that any elements of pensions and recharges relating to teachers are excluded from the Tayside Superannuation Fund accounts.</p> <p>Risk: LGPS scheme accounts may be misstated in respect of amounts relating to teachers pensions.</p> | <p>As noted at 3 above unfunded pensions and contributions have been excluded from the Pension Fund Accounts. This would continue for teaching staff.</p> | Exchequer Officer   | N/A         |