

REPORT TO: SCRUTINY COMMITTEE - 26 OCTOBER 2011

REPORT ON: EXTERNAL AUDIT REPORT- CORPORATE GOVERNANCE ARRANGEMENTS

REPORT BY: ALASDAIR CRAIK, SENIOR AUDIT MANAGER

REPORT NO: 485-2011

1 PURPOSE OF REPORT

- 1.1 To submit to Members of the Scrutiny Committee the External Audit Report on 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 The report summarises the findings from the external audit reviews 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.
- 3.2 Overall we were satisfied that the level of internal control was good and we were able to place reliance on them for final accounts purposes.
- 3.3 The report also summarises the council's progress in addressing the findings of Audit Scotland's national report "Improving public sector procurement", and the arrangements for the creation of a new data centre in Dundee House. Overall we were satisfied by the arrangements in place in both areas.
- 3.4 Where we have felt that risk remains we have advised management of the risks and their responses are included as part of the action plan.
- 3.5 External audit have recently concluded the audit of the council's statement of accounts which was completed by the target date of 30 September. The final report to members is expected to be submitted by the target date of 31 October.

Alasdair Craik
Senior Audit Manager
10 October 2011

Dundee City Council

Corporate Governance

September 2011



 AUDIT SCOTLAND



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Corporate governance

Introduction

1. Our 2010/11 Annual Audit Plan highlighted that we would undertake a review of the council's corporate governance arrangements in a number of key areas. This report summarises the findings from our 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.

Internal control systems

2. Internal control systems are the means by which management manages the risks inherent in key financial systems. Our responsibilities under the Code of Audit Practice require us to identify the council's key financial systems and assess the systems of internal control. The key systems that we seek to place reliance on for the 2010/11 financial statements are set out below.

Key System	Reliance on Internal Audit	Review by External Audit
Accounts payable	partial	yes
Payroll	-	yes
General ledger	-	yes
Accounts receivable	-	yes
Cash management	-	yes
Capital accounting	-	yes
Non-domestic rates billing and collection	-	yes
Council tax billing and collection	-	yes
Housing rents billing and collection	-	yes
Treasury management	-	yes
Housing benefit/council Tax benefit	-	yes

3. Auditing standards require internal and external auditors to work closely together to make optimal use of available audit resources. We seek to rely on the work of internal audit wherever possible. However, in recent years, the council's internal audit section, in common with internal audit sections of other Scottish local authorities, has moved to a wider risk based approach that considers areas other than financial risk. A consequence of this has been a reduction in the level of work undertaken on key financial systems. This has resulted in external auditors taking less assurance from internal audit work, and increased the risk that internal audit may not be able to provide comprehensive assurances over the adequacy and effectiveness of the council's internal financial control systems.

Key risk area 1



Other internal control systems

Dundee Contract Services ledger

4. A separate ledger has been operated for Dundee Contract Services (DCS) for some time. This system tries to perform some of the reporting functions of main ledger, such as calculating balances with customers and suppliers. Configuring it to stay up to date with changes to codes is time-consuming and results in regular postings to various suspense accounts. The system objective for DCS of keeping a parallel ledger leads to inefficiencies and should be reviewed.

Key risk area 2

Architects fees

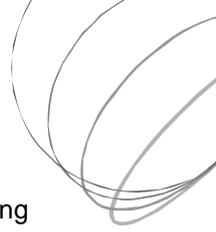
5. The future of the Architects Fees system is being reviewed. One of the options is terminating the system. This would mean that instead of billing fees according to time recorded fees would be billed at a percentage rate. For architects, it will mean less time-recording. It is also expected to lead to an efficiency gain, with posts removed from the establishment. Although termination could lead to greater efficiencies, it is not without risk.

Key risk area 3

6. In general we found a good level of control to be in place although some lower level risks were noted. Consideration should also be given to addressing the areas highlighted in Appendix B to further improve the control environment. These areas relate to checks and authorisations not performed or evidenced as performed, lack of reconciliations, weaknesses in procedural documentation and a variety of matters arising over payroll, non-domestic rates and tangible assets.

Procurement

7. The joint Accounts Commission / Auditor General for Scotland report *.Improving public sector purchasing.* (July 2009) examined the progress and impact of the Public Procurement Reform Programme introduced in 2006. In brief, the report found:
 - the public sector in Scotland was improving its purchasing and making some savings. However some expected savings had been delayed and there was uncertainty about how future savings would be made, measured and reported.
 - more widely, the procurement reform programme had improved cross-sector working and helped purchasing activity on a number of levels – from promoting and developing purchasing skills and awareness to increasing the use of electronic purchasing. The scale of improvement however was



difficult to quantify and there was wide variation across public bodies in the quality of purchasing data, practice and skill levels.

- Best Practice Indicators (BPIs) to help improve purchasing had been agreed but many public bodies were still in the process of completing and using them.
 - overall there was potential for the public sector to buy goods and services more efficiently and deliver more significant savings through increased collaboration and better management.
8. In July 2009, the Scottish Government introduced a new assessment tool, the procurement capability assessment (PCA), to monitor how far public bodies adopt good purchasing practice and as a basis for sharing best practice and promoting continuous improvement across the public sector. In summary, the PCA process is an annual evidence-based assessment to drive continual improvement in purchasing practice.
 9. The Scottish Government reported the outcome of the first round of PCA assessments to the Public Procurement Reform Board in June 2010. In summary, while the results indicated instances of best practice throughout the Scottish public sector, they also confirmed a real need for improvement in practice in many bodies. Consequently, public bodies have developed high-level procurement improvement targets at sector level and (where required) individual improvement plans. The aim is to ensure all bodies can be assessed as at least “conformant” (i.e. operate essential good purchasing practice and control) by the next round of assessments.
 10. As well as savings, good purchasing practice is important to ensure that resources are used effectively, that spending is well directed and controlled and that overall public bodies secure value for money. Given the level of spending by public bodies there may be a broader expectation that auditors satisfy themselves that public bodies are effectively controlling purchasing activity.
 11. As part of our 2010/11 audit work we have undertaken a follow-up study to assess the council’s progress in addressing the findings of the national report.
 12. Overall, we found that progress has been made from the position we reported in 2009/10, with e-procurement being embedded across the council. A report detailing the progress of the procurement programme was presented to the Policy and Resources Committee in August 2010. We note that:
 - the council’s PCA score has improved from 23% (non-compliant) in 2009 to 33% (conformant) in 2010. The council’s target for 2011 is a PCA score of 50% (improved performance). This demonstrates the council’s commitment to delivering continuous improvement in procurement and securing value for money.
 - the council aims to cascade PCA objectives down into the personal development plans for officers in the procurement team.
 - the council has historically followed a devolved approach to procurement, operating a central procurement team with procurement officers in departments. Steps are being taken to centralise



control over procurement, e.g. strengthening the links between departments and the council's procurement section, to improve accountability to the Head of Procurement.

- the council plays an active part in "Tayside Procurement Collaborative Opportunities", a local scheme to take advantage of cross-sectoral procurement opportunities in collaboration with other public sector bodies in Tayside

13. In some areas, however, there is further scope to improve processes and support the delivery of efficiencies through improved procurement practices.

14. Identified procurement savings opportunities for 2009/10 and 2010/11 were reported to the Policy and Resources Committee. From 2011/12 onwards, budgets will be reduced (by £387,000 for 2011/12) to take account of identified procurement savings opportunities. However, systems have not been developed to monitor and report actual savings achieved and compare these with planned procurement savings.

Key risk area 4

15. A corporate approach to procurement improvement has been adopted, with the procurement project forming part of the Changing for the Future project and project management arrangements. However we note there is no formal monitoring of actual timescales against planned timescales for procurement projects.

Key risk area 5

16. The council participates in the Tayside Procurement Consortium (TPC), in partnership with Perth & Kinross and Angus Councils and Tayside Contracts. We noted that the draft TPC strategy for 2011-2014 has clear objectives aligned with the PCA criteria. However, there is no documented action plan to facilitate the delivery of the TPC procurement strategy in Dundee City Council, thereby also formally addressing the findings of the PCA process locally.

Key risk area 6

New data centre

17. As part of our audit work we conducted an overview of the council's arrangements for the creation of its new data centre in Dundee House. Our work included a review of the project documentation, a visit to the new data centre and a meeting with key project staff. At the time of our visit on 5 May 2011, the data centre had yet to be handed over to the council.

18. The new data centre is a core element of the council's long term plan to increase the resilience and efficiency of its information systems. The completion of a second modern data centre should greatly reduce the risk that physical damage disrupts core information systems, representing a strategic asset



for the council. The data centre project is an independent component of the Dundee House programme, was on track at the time of our audit and was professionally managed by the council with an appropriate level of outside support. We would draw attention to two risks

19. Although council officers are experienced in project management, the project team were unable to provide us with a comprehensive document setting out the scope, objectives, methodology and timings of the data centre project. Furthermore, no written memorandum of the objectives and procedures for testing was available during the audit. While we recognise that preparing documentation takes time, the council needs to consider the benefits of having robust, well-maintained documentation in place. For example:

- using checklists to ensure that all hardware tests are complete helps to ensure consistency of approach and demonstrate work done to management
- developing and reviewing test plans can improve testing by ensuring appropriate test coverage
- written test plans and the recording of test results can assist the correction of any faults encountered
- detailing the planned infrastructure set-up within the data centre could, in the long term, save time in locating software or cables.

In addition, formal review of plans and results can improve the quality of the work performed.

Key risk area 7

20. The business aim of the new data centre is to improve resilience. Regular updates to the council's computer service disaster recovery plan were suspended while project work was in progress, and with the completion of the new data centre, the current plan will become out-of-date. Documented plans are essential to respond appropriately to incidents, both at the high level of responsibility and management, and at the detailed level of technical counter-measures and procedures. Major changes to ICT infrastructure should always result in a review of affected business continuity plans.

Key risk area 8

Acknowledgements

21. 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.

22. The assistance and co-operation we received during the course of our work is gratefully acknowledged.



 **AUDIT SCOTLAND**

September 2011

Appendix A – Risk summary and action plan

No	Risk	Responsible officer	Response and agreed action	Target date
Internal control systems				
1.	<p>In recent years, the council's internal audit section, in common with internal audit sections of other Scottish local authorities, has moved to a wider risk based approach that considers areas other than financial risk. A consequence of this has been a reduction in the level of work undertaken on key financial systems.</p> <p><i>Risk: internal audit may not be able to provide comprehensive assurances over the adequacy and effectiveness of the council's internal financial control system.</i></p>	Chief Internal Auditor	The comments made by Audit Scotland are acknowledged. Cognisance will continue to be taken of the assessed risk in deciding the extent of inclusion of reviews on key financial systems in the planning of internal audit work.	Ongoing
Other internal control systems				
2.	<p>A separate ledger has been operated for Dundee Contract Services (DCS) for some time. This system tries to perform some of the reporting functions of main ledger, such as calculating balances with customers and suppliers. Configuring it to stay up to date with changes to codes is time-consuming and results in regular postings to various suspense accounts.</p> <p><i>Risk: financial or information loss due to unnecessary complexity and inefficiency.</i></p>	Head of Support Services (DCS) / Head of Information Technology / Head of Financial Services	A joint-review will be undertaken to identify whether a more suitable system is available.	30 June 2012



No	Risk	Responsible officer	Response and agreed action	Target date
3.	<p>The future of the Architects Fees system is being reviewed. One of the options is terminating the system. This would mean that instead of billing fees according to time recorded fees would be billed at a percentage rate. For architects, it will mean less time-recording. It is also expected to lead to an efficiency gain, with posts removed from the establishment. Although termination could lead to greater efficiencies, it is not without risk.</p> <p>Risks:</p> <ul style="list-style-type: none"> • <i>the basis for billing architects fees becomes more subjective and hence more prone to misstatement at the year end</i> • <i>the department fails to spot projects where it is not recovering its costs, resulting in budget over-runs.</i> 	City Architect	<p>Staff time will still be recorded against each capital project and charged on a quarterly basis.</p> <p>Projects will be assessed for their level of completion at the year-end to ensure accurate recording.</p> <p>Actual costs will be monitored against the percentage fee allocation on a quarterly and annual basis.</p>	<p>30 June 2012</p> <p>31 March 2013</p>
Procurement				
4.	<p>Identified procurement savings opportunities for 2009/10 and 2010/11 were reported to the Policy and Resources Committee. From 2011/12 onwards, budgets will be reduced (by £387,000 for 2011/12) to take account of identified procurement savings opportunities. However, systems have not been developed to monitor and report actual savings achieved and compare these with planned procurement savings.</p> <p>Risk: in the absence of an adequate monitoring process the council may fail to achieve the desired level of</p>	Corporate Procurement Manager	<p>Regular tracking report to be developed to monitor both planned and actual procurement savings achieved by each department. It is envisaged this new system will be deployed early next year.</p>	31 January 2012

No	Risk	Responsible officer	Response and agreed action	Target date
	savings.			
5.	<p>The council participates in the Tayside Procurement Consortium (TPC), in partnership with Perth & Kinross and Angus Councils and Tayside Contracts. We noted that the draft TPC strategy for 2011-2014 has clear objectives aligned with the PCA criteria. However, there is no documented action plan to facilitate the delivery of the TPC procurement strategy in Dundee City Council, thereby also formally addressing the findings of the PCA process locally.</p> <p>Risk: the delivery of the TPC procurement strategy within Dundee City Council is not adequately managed with a consequent reduction in the efficiencies achieved.</p>	Corporate Procurement Manager	<p>TPC Strategy 2011-2014 approved. Cascade of strategy and objectives to be made via Procurement Implementation Team. Decision to be taken on best approach following feedback on Procurement Organisation proposal meeting to be held in September 2011.</p>	31 December 2011
6.	<p>A corporate approach to procurement improvement has been adopted, with the procurement project forming part of the Changing for the Future project and project management arrangements. However we note there is no formal monitoring of actual timescales against planned timescales for procurement projects.</p> <p>Risk: procurement improvements are not delivered, or are not delivered timeously.</p>	Corporate Procurement Manager	Procurement project dates will be refreshed based on current resource capabilities.	30 September 2011
	ICT			
7.	<p>Test plans and checklists to ensure that hardware tests are sufficient and complete are still to be prepared. A more rigorous approach to documentation would assist problem resolution and controlled change, increase transparency, and reduce project risk. Documented plans increase the likelihood of a successful migration of data and systems to the new premises.</p> <p>Risk: gaps in the documentation of data centre configuration and testing may affect the success of the project.</p>	Head of Information Technology	<p>Project was completed on time with minimal unplanned downtime.</p> <p>Review of test plans and checklists for major projects will be undertaken.</p>	31 March 2012
8.	<p>The business aim of the new data centre is to improve resilience. Regular updates to the council's computer service disaster recovery plan were suspended while project work was in progress, and with the completion of the new data centre, the</p>	Head of Information Technology	When Tayside House data centre is fully decommissioned, suspension of updates will be removed.	31 March 2012



No	Risk	Responsible officer	Response and agreed action	Target date
	<p>current plan will become out-of-date. Major changes to ICT infrastructure should always result in a review of affected business continuity plans.</p> <p><i>Risk: a disaster recovery plan that is out-of-date may adversely affect business continuity should a risk event occur.</i></p>		Full update of Discovery Recovery plans to be completed.	

Appendix B

Findings from 2010/11 audit testing of internal control systems

Checks and authorisations not performed or evidenced as performed

These increase the risk of financial loss if input errors are not detected or incorrect financial information is reported to management and members:

1. Payroll: 30% of Education temporary variation forms (R12) tested lacked an approval/verification signature. As these forms are used to process temporary variations such as overtime and travel and subsistence payments this increases the risk of incorrect or unauthorised payments being made.

The responsibility for Education payroll has now been transferred to Finance Department. In future checks will be made to ensure all forms processed include appropriate approval / verification signatures.

2. Accounts receivable: only one department (Leisure and Communities) filled out an invoice request form which showed the invoice had been authorised by a second individual. The sales ledger requires a raised invoice to be authorised on the system, however, in most instances the authoriser is the same person who raised the invoice. From discussion with sales ledger staff it was noted that they used to require authorisation from a second individual but this led to delays in processing invoices and this practice was ceased.

We are satisfied that current authorisation procedures with regard to this item are adequate

3. Accounts receivable: only one department (Social Work) filled out an authorisation for credit note form which showed the credit note had been authorised by a second individual. The sales ledger requires a raised credit note to be authorised on the system, however, in most instances the authoriser is the same person who raised the credit note.

Development of system authorisation process for credit notes is currently being investigated by Sales Ledger Manager.

4. Cash management: in 5 out of 30 (16%) cases the daily cash book input sheet had not been initialled as agreeing to the Money Manager cash book.

This documentation is now stored electronically and authorisation check should always be completed.

Lack of reconciliations

These increase the risk that accounting errors are not timeously corrected, leading to incorrect financial information reported to management and members:

5. Non-domestic rates billing and collection: the weekly reconciliation between the Assessors systems and the DCC i-world system was not carried out throughout the year.

At annual billing, a reconciliation is undertaken between the two systems. The reconciliation is normally undertaken on a monthly basis but due to the move to Dundee House, this reconciliation did not occur on a regular basis. The move having been completed, the reconciliations will again be undertaken on a monthly basis.

6. Housing and council tax benefits: there is no reconciliation undertaken between the amounts posted in the benefits system and amounts shown in the financial ledger.

Whilst it is acknowledged that this was agreed as part of the year end procedures, it has not yet been possible to undertake a reconciliation of these items. The existing Council Tax and Housing Benefit system does not currently have the capacity to generate the reports that would allow us to reconcile

these amounts effectively. Northgate Public Services have committed to providing us with improvements to this function although to date no further progress has been made. Any further progress on the reconciliation will be delayed until these improvements are complete.

Weaknesses in procedural documentation

These increase the risk of errors or non-performance of tasks when certain staff members are absent:

7. Payroll: although the payroll section has improved in recent years in relation to procedural manuals, a formal and structured approach to procedural manuals is not in place. There is no formal procedure manual covering all aspects of payroll operations. Document control should be improved (eg identifying the "owner" of the procedure, the date of issue and date for review, standardised format, and accessibility on the intranet). While a good selection of desk procedures has been drafted, there are risks that the present approach results in procedures not covering all processes, being up-dated and being available to all staff.

Now that the payroll team has been further centralised various procedural documents will be consolidated into a dedicated folder. Guidance will continue to be developed and reviewed as part of a wider training programme.

8. Cash management: although there are instructions for some parts of the cash process available, there is not a formal set of procedural instructions covering all cash processes to be followed. The risk is mitigated to some extent by staff rotation through the various processes but a formal system would lead to a better understanding by staff of the overall system.

Procedural guidance for Cash Management will continue to be developed and reviewed to reflect changes arising from move to the new Council headquarters at Dundee House.

9. Capital accounting: the council's fixed asset register is maintained by one staff member who is experienced in the AIRS system and the complexities of capital accounting. However, we noted that there are no formal procedures, specific to the council, showing how the fixed asset register is maintained and the procedural controls in place.

The complexities of capital accounting are understood by more than one person in the Finance department, whilst there is an on-going exercise to train someone else on the use of the AIRS system. AIRS is an "off-the-shelf" system and is operated in accordance with the systems manual. There is a robust series of checks and balances in place to ensure that the system is accurate.

10. Housing rents: there is a lack of formal desk instructions supporting the day to day procedures within rent accounting. Process flow charts and instructions should be formalised and be available to all staff by means of Plone.

Procedures are in place for the majority of key tasks within the rent accounting department. These have been developed over the past year whilst reviewing procedures for efficiencies and as part of the implementation of the CERDMS. These procedures are to be reviewed continually. Staff have access to these procedures through the public data server drive whilst the housing intranet site is being developed.

Payroll

11. Segregation of duties: there are 4 payroll staff who have access to the Human Resources module as well as the payroll module of Resourcelink. We understand that this arrangement is in place so that senior payroll staff can timeously amend and update personnel records. There is a risk of financial loss if staff have the ability to create posts, amend pay details and administer pay.

These 4 senior staff require this access for the efficient administration of the system. All posts created should be checked by a second member of Payroll staff.

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12. The council uses unique post numbers to ensure that every person paid forms part of the agreed staff establishment. However, generic post numbers are used within Education for supply teachers and within DCS for temporary workers. The use of generic post numbers increases the risk of bogus employees on the payroll.

It has been identified that some generic posts are required to reduce the administrative burden. Monthly lists of starters and leavers are provided to departments to verify changes.

13. We found no evidence that the payroll suspense account is regularly cleared. The balance as at 28/01/11 was £9.4m. This increases the risk that accounting errors are not timeously corrected, leading to incorrect financial information reported to management and members.

The balance noted above was prior to the month-end cash book entries being processed, which significantly reduced the unallocated amount. This amount has since been fully reconciled and is now been maintained on a monthly basis.

Non-domestic rates

14. We noted that the timetable for review of reliefs is not being met in certain areas, such as SBBS (25%,50% and 100%), sports clubs (100%) and disabled relief. There is an increased risk of financial loss if reliefs continue to be awarded after circumstances change.

Prior to the introduction of SBBS, a review was undertaken of all cases in receipt of SBBR and records amended in line with SBBS. Legislation states that the local authority should carry out a periodic review at their discretion. A review was due to be undertaken in early 2011 but due to other priorities, this was not possible. The review will now be undertaken in January 2012. Any changes in SBBS are being actioned and relief amended as necessary.

Sports clubs and disabled relief cases are reviewed every two years but any notified change of circumstances will be actioned and relief amended as necessary.

Tangible assets

15. There is no exercise undertaken to ensure assets on the asset register are still in existence. There is a risk that the asset register does not accurately reflect the assets which the council owns, leading to incorrect financial reports.

The asset register is not intended to represent a definitive list of the Council's assets - there are various systems in place across departments for this purpose. Nevertheless, there is robust series of checks and balances in place to ensure that AIRS is accurate including third party verification and reconciliations to other systems.