**REPORT TO:** **SCRUTINY COMMITTEE – 12 FEBRUARY 2014**

**REPORT ON:** **EXTERNAL AUDIT REPORT - KPMG EXTERNAL AUDIT STRATEGY OVERVIEW AND PLAN FOR THE YEAR ENDED 31 MARCH 2014**

**REPORT BY:** **DIRECTOR OF CORPORATE SERVICES**

**REPORT NO:** **89-2014**

## 1 PURPOSE OF REPORT

To submit to elected members the above report that describes how KPMG will deliver the audit of Dundee City Council for the year ending 31 March 2014. This includes the opinions on the financial statements in accordance with relevant legal and accounting requirements.

## 2 RECOMMENDATIONS

It is recommended that elected members note the information included in the attached report.

## 3 FINANCIAL IMPLICATIONS

None.

## 4 MAIN TEXT

4.1 The Accounts Commission for Scotland has appointed KPMG LLP as auditors of the Council under the Local Government (Scotland) Act 1973. The period of appointment is 2011-12 to 2015-16, inclusive. This document summarises their responsibilities as external auditors for the year ended 31 March 2014 and specifies the objectives of their audit.

4.2 The report sets out the timeline for working during the audit and arrangements for communication and reporting with both management and those charged with governance together with a summary of their planned audit outputs. The audit approach focuses on the key issues and risks facing the Council and the areas most likely to lead to material misstatement in the Council's financial statements. The auditors have performed an initial risk assessment to identify focus areas for the 2013-14 audit and whilst there were no significant risks identified, areas where specific audit work is planned this year include valuation of property, plant and equipment and accounting treatment for retirement benefits.

4.3 The document also includes various other information relating to the audit process including a summary of the key changes to the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14, details of their procedures for working with internal audit, consideration of audit materiality levels, performance management and governance and scrutiny arrangements.

## 5 POLICY IMPLICATIONS

This report has been screened for any policy implications in respect of Sustainability, Strategic Environmental Assessment, Anti-Poverty, Equality Impact Assessment and Risk Management.

There are no major issues.

## 6 CONSULTATION

The Chief Executive and Head of Democratic and Legal Services.

## 7 BACKGROUND PAPERS

None.

**MARJORY M STEWART**
**DIRECTOR OF CORPORATE SERVICES** **04 FEBRUARY 2014**

KPMG

*cutting through complexity*

# Dundee City Council

Audit strategy review and plan

Year ending 31 March 2014

3 February 2014

For scrutiny committee consideration on 12 February 2014

# Contents


**The contacts at KPMG in connection with this report are:**

**Stephen Reid**
*Director, KPMG LLP*

Tel: 0131 527 6795
Fax: 0131 527 6666
stephen.reid@kpmg.co.uk

**Keith Macpherson**
*Senior Manager, KPMG LLP*

Tel: 0141 300 5806
Fax: 0141 204 1584
keith.macpherson@kpmg.co.uk

**Natalie Dyce**
*Audit Assistant, KPMG LLP*

Tel: 0141 300 5746
Fax: 0141 204 1584
natalie.dyce@kpmg.co.uk




**About this report**

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

This report is for the benefit of Dundee City Council ("Council") and is made available to Audit Scotland and the Accounts Commission (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

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

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

**Complaints**

If at any time you would like to discuss with us how our services can be improved or if you have a complaint about them, you are invited to contact Stephen Reid who is the engagement leader for our services to Dundee City Council, telephone 0131 527 6795 email: stphen.reid@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Alex Sanderson, our Head of Audit in Scotland, either by writing to him at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 527 6720 or email to alex.sanderson@kpmg.co.uk. We will investigate any complaint promptly and do what we can to resolve the difficulties. After this, if you are still dissatisfied with how your complaint has been handled you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 110 George Street, Edinburgh, EH2 4LH.

# Overview

**This document describes for the Council's scrutiny committee how we will deliver our audit of Dundee City Council for the year ending 31 March 2014.**

**The audit strategy and plan has been developed from using our knowledge of the Council from earlier years and in accordance with the requirements of Audit Scotland.**

## Experience

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Your senior audit team provides continuity from 2012-13, and builds upon our established understanding of the Council's aims, objectives and delivery strategies.

We will update our understanding of your systems and objectives and will hold regular meetings with senior management.

## Independence

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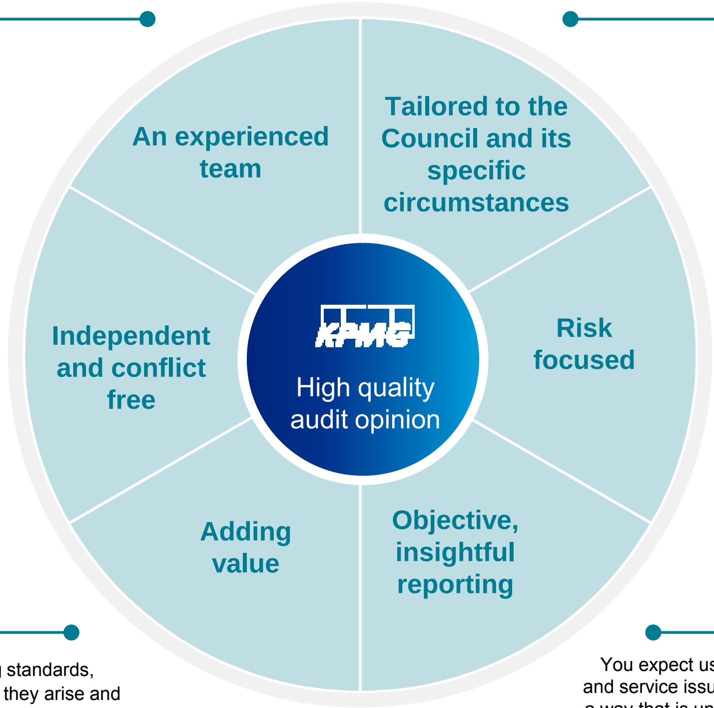
Independence and quality are at the foundation of our approach. We have systems and processes to ensure our ongoing independence and will report formally on this, together with any non-audit services undertaken. We are satisfied that we are independent.

## Adding value

We will discuss the implications of new accounting standards, regulatory requirements and accounting issues as they arise and are applicable for the current or future reporting years.

We will report on identified material control weaknesses and other performance improvement observations as well as unadjusted audit differences.




## Tailored approach

Pages 3 to 13

We invest the time to understand the key risks, challenges and drivers affecting the Council's operations. Our audit approach is carefully designed to align with these.

## Risk-based approach

Pages 3 to 13

We work closely with management to inform our understanding of the Council and its challenges to ensure our audit responds accordingly

Our audit plan outlines the specific areas of focus for the year to 31 March 2014.

## Insightful reporting

You expect us to form independent views on the key accounting and service issues. We will express these clearly and concisely in a way that is understandable to accountants and non-accountants alike.

Our audit gives us an independent view on your key results drivers. We use this knowledge to challenge the key messages delivered by your internal reporting systems.

We will discuss these areas with the scrutiny committee.

# Executive summary

**Planning for our audit takes into account the broad risk profile of the Council and includes consideration of other areas of assurance such as the shared risk assessment.**

## Context

Our audit is undertaken in accordance with appointment terms made by the Accounts Commission, Audit Scotland's *Code of Audit Practice* and International Standards on Auditing (UK & Ireland).

Our approach to the Council's audit is risk-based, focussing on our understanding of the Council and the wider environment in which it operates, while also reflecting the expectations of Audit Scotland.

## Significant risks

In accordance with International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment,* we have identified and assessed the risk of material misstatement at both the financial statement level, as well as at the assertion level for classes of transaction, account balances and disclosures.

From our initial risk assessment procedures, we have not identified any significant risks for the 2013-14 audit which would require specific audit consideration. We will provide an updated list of significant risks in our annual audit report which will be reported to the scrutiny committee in September 2014.

## Shared risk assessment

The approach is informed through participation in the local area network ("LAN") of local audit and inspection representatives and the annual shared risk assessment process which is part of a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies. Scrutiny bodies that engage with local government established a shared assessment of the risks in each council and developed a range of proportionate approaches in response to the risk assessment.

The shared risk assessment process results in each council receiving an assurance and improvement plan ("AIP") each year. The shared risk assessment process for 2013-14 has been finalised and we have considered this as part of our planning for this year's audit. We will take account of the outcome of the 2014-15 risk assessment process, which is due to be finalised in February / March 2014.

## Best Value

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors also have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act. Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

## Overall reporting

In addition to reporting on matters identified during our audit, as part of our audit appointment, we are also required to consider the Council's arrangements in a number of other areas and report our findings. These include:

- arrangements with respect to the National Fraud Initiative;
- the Council's response to specific national studies;
- review and reporting on various grant claims made by the Council;
- follow-up on the response to specific performance audits; and
- arrangements for reporting statutory performance indicators.

We will summarise our findings in each of these areas in our annual audit report.

# Introduction

**Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practice*. This specifies a number of objectives for our audit.**

The Accounts Commission has appointed KPMG LLP as auditors of the Council under the Local Government (Scotland) Act 1973 ("the Act"). The period of appointment is 2011-12 to 2015-16, inclusive. This document summarises our responsibilities as external auditors for the year ending 31 March 2014 and our intended approach to issues impacting the Council's activities in that year.

We carry out our audit in accordance with our statutory responsibilities under the Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board ("APB") and the wider responsibilities embodied in Audit Scotland's *Code of Audit Practice*. Under this, auditors address and comment upon a number of objectives, together with complying with a number of obligations. The *Code of Audit Practice* also places a number of obligations on the Council.

Auditors' objectives in relation to the *Code of Audit Practice* are to:

- audit the financial statements and place a certificate on the statements stating that the audit has been conducted in accordance with Part VII of the Act;
- satisfy ourselves that:
  - the financial statements have been prepared in accordance with all applicable statutory requirements;
  - proper accounting practices have been observed in the preparation of the financial statements;
  - the body has made proper arrangements for securing Best Value and is complying with its community duties; and
  - the local authority has made adequate arrangements for collecting, recording and publishing prescribed performance information;
- hear any objection to the financial statements lodged by an interested person.

We conduct our audit of the financial statements in line with International Standards on Auditing (UK and Ireland). We have a professional responsibility to report if the Council's financial statements do not comply, in any material respect, with the IFRS-based Code of Practice on Local Authority Accounting in the United Kingdom 2013-14 ("the Code"), taking account of the international financial reporting standards issued by the International Accounting Standards Board and relevant guidance issued by the Chartered Institute of Public Finance and Accountability ("CIPFA") / Local Authorities (Scotland) Accounts Advisory Board ("LASAAC").

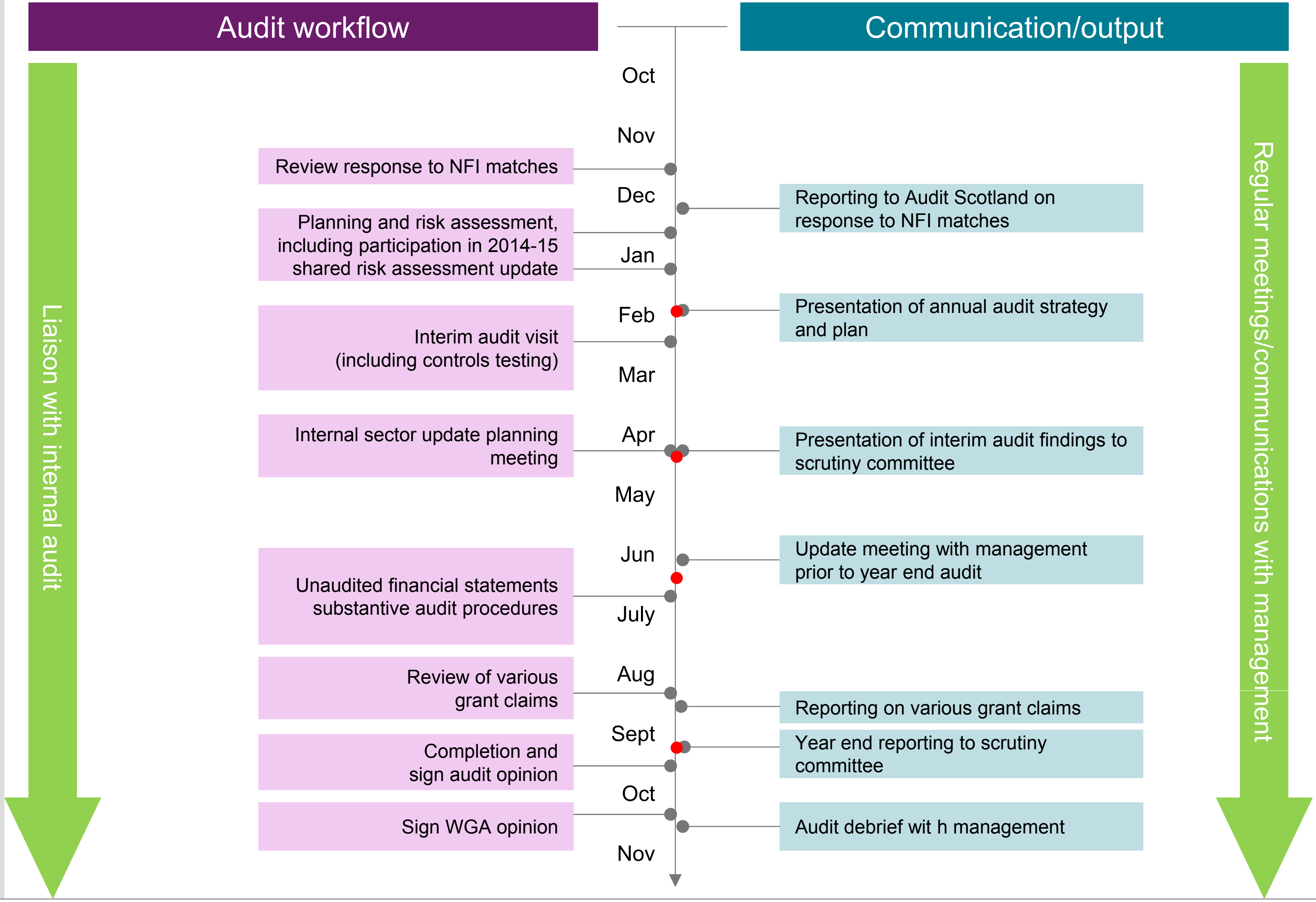
As part of our audit we also review the financial information contained in the foreword to ensure that it is consistent with the financial statements. We also review the annual governance statement to ensure it has been prepared in accordance with the Code and other relevant guidance, taking account of the financial statements and other information gained by us as auditors.

International Standard on Auditing (UK and Ireland) 240: *The auditor's responsibility to consider fraud in an audit of financial statements* applies to our work. In particular, this Standard requires us to consider directly the possibility that management may choose to override the system of internal controls that otherwise may appear to be operating effectively. The Standard requires the auditor to maintain an attitude of professional scepticism, recognising the possibility that a material misstatement due to fraud could exist – notwithstanding the auditor's experience with regard to the honesty and integrity of management and those charged with governance.

In accordance with International Standard on Auditing (UK and Ireland) 260: *Communication with those charged with governance* we will report to you all non-material, non-trivial errors, which have not been adjusted.

# 2013-14 audit timeline

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




● scrutiny committee meetings

# Audit outputs

**Our audit process will result in reporting on a number of outputs to the Council; these are listed in the table on the right.**

| Output | Description | Report date |
|---|---|---|
| **Audit strategy** | ■ Our strategy for the external audit for the year. | ■ By 28 February 2014 |
| **Update NFI report** | ■ We report on the Council's actions to investigate and follow-up NFI matches. | ■ By 31 December 2013 |
| **Interim management report** | ■ We report our findings from our interim audit visit where we will update our planning for the year end and perform controls testing. | ■ By 30 May 2014 |
| **Statutory performance indicators** | ■ We will report on arrangements for preparation of the Council's statutory performance indicators; this will be included in our annual audit report. | ■ By 30 September 2014 |
| **Independent auditor's report** | ■ Our opinion on the Council's financial statements. | ■ By 30 September 2014 |
| **Annual audit report to the Council and the Controller of Audit** | ■ We summarise our findings from our work during the year. | ■ By 30 September 2014 |
| **Whole of Government Accounts** | ■ We report on the pack prepared for consolidation and preparation of the Whole of Government Accounts. | ■ By 31 October 2014 |
| **Audit reports on grant claims and other returns** | ■ We will report on the following returns:<br>- Housing Benefit Count return;<br>- Non Domestics Rate return;<br>- Education Maintenance Allowance return; and<br>- Criminal Justice Social Work Srvices return. | ■ In line with Audit Scotland's reporting timetable |

# Financial context

**Our initial risk assessment is undertaken through building on our understanding of the Council and its environment.**

**In order to update our understanding of the financial environment in which the Council operates, we have discussed current financial performance with management based on the 2013-14 revenue and capital budgets for the Council.**

Audit Scotland's report *Responding to challenges and change: An overview of local government in Scotland* highlighted a number of service challenges for councils, with demand and resource pressures continuing to build, against a backdrop of reform in public services. The report highlights a large number of issues which councils face, the majority of which are applicable to the Council. The Council must also comply with the requirements for a Single Outcome Agreement ("SOA") which is a mechanism for aligning public sector activity to national priorities.

The Council is therefore operating in a challenging economic environment, with funding reductions and increasing expenditure pressures. These include Welfare Reform and the integration of Health and Social Care. In response, management undertake regular analysis of the key areas of public reform, which should support achievement of strategic priorities in a changing environment.

The Council continues to have a low level of useable reserves in relation to other Scottish local authorities. In setting its annual budgets, however, senior management make consideration of the financial risks facing the Council and on this basis make recommendations to members on the level of reserves it is appropriate to hold.

### Financial position – revenue

As part of our planning for this year's audit, we have obtained an understanding of the reported financial position to date. The revenue monitoring report to the policy and resources committee on 13 January 2014, for the period to 30 November 2013, forecasts a breakeven position against the adjusted budget. This has been achieved as a £350,000 underspend in relation to capital financing costs offset overspends totalling £350,000. These overspends include a £200,000 overspend in relation to the city development department as a result of lower than expected property rental and car parking income. A further £150,000 overspend is forecast in relation to the environment department due to a shortfall in trade refuse income.

A breakeven position is currently forecast for the social work department. However, there continues to be underlying cost pressures. A number of overspends, mainly in relation to older people care, have been offset by a number of additional income streams resulting from a reduction in residential and care placements and underspends on purchases from external social care providers.

In setting the 2013-14 budget, a number of efficiency savings were identified for delivery in the year. Financial performance to date indicates that these savings are being delivered on target.

### Financial position – capital: general services

Capital expenditure in 2012-13 was £60.7 million which included a £3 million increase on 2011-12. The 2013-14 budgeted capital expenditure is £ 55.1 million, which represents a 9% (£5.6 million) decrease over 2012-13 levels.

The capital expenditure monitoring report to the policy and resources committee on 13 January 2014, for the period to 30 November 2013, shows a forecasted overspend of £55,000 against budget if further savings are not made.

### Financial position – capital: housing revenue account

Forecasted HRA capital expenditure is currently £664,000 over the revised capital budget, the main reason for this overspend is the lower level of owners receipts received. This is as a result of collecting a number of owners receipts early, at the end of 2012-13, instead of these being received in the 2013-14 financial year.

We will read management's capital monitoring reports and provide commentary on the achievement of the capital budget and any impact on the capital limits and associated borrowing during the year.

# Financial statements audit focus areas

**Our audit approach is risk-based, and focuses on the areas most likely to lead to material misstatement in the Council's financial statements.**

**Through meetings with management, we have performed initial risk assessment procedures to identify focus areas for the 2013-14 audit.**

We have developed an understanding of your key audit risk areas based on our initial risk assessment procedures, including discussions with management. Our risk assessment procedures are ongoing throughout the audit, and we will update you in respect of any emerging risks as we become aware of them.

## Significant risks

International Standard on Auditing (UK and Ireland) 315: *Identifying and assessing risks of material misstatement through understanding the entity and its environment* requires the auditor to determine whether any of the risks identified as part of our risk assessment are significant risks and therefore requiring specific audit consideration. In determining whether a risk is significant, judgement is applied in respect of the whether, for example, the risk is associated with the complexity of transactions, the degree of subjectivity involved in the measurement of financial information, whether the associated transactions are outside the normal course of business, or whether there is an associated risk of fraud.

With the exception of the required two fraud risks identified in International Standard on Auditing (UK and Ireland) 240, which are set out further below, we have not identified any significant risks of material misstatement as a result of our planning and risk assessment.

We will provide an updated list of significant risks in our annual audit report which will be reported to the scrutiny committee in September 2014.

## Fraud risk from management override of controls

Professional standards require us to communicate the fraud risk from management override of controls as significant. Management is typically in a unique position to perpetrate fraud because of its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We have not identified any specific additional risks of management override relating to this audit. Our audit methodology incorporates the risk of management override as a significant risk.

## Fraud risk from income recognition

Professional standards require us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. However, part of the Council's income is received from non ring-fenced government grants. As government grants are agreed in advance of the year, with adjustments requiring Government approval, we do not regard the risk of fraud from this revenue recognition as significant.

The other major sources of income are from annual local taxes and rental income (council tax, non-domestic rates and housing revenues). These revenues are prescribed by law and other specific regulations, which prescribe the period in which annual local taxes and rental income is recognised as revenue. This minimises the level of judgement required in revenue recognition by management and we do not regard the risk of fraud from this revenue recognition as significant.

Service income is generally recognised at 'point of sale', with an invoice raised when the service is delivered, minimising the judgement necessary. The potential for revenue to be incorrectly recognised will be addressed through appropriate substantive procedures.

# Financial statements audit focus areas (continued)

### Other areas of judgement

Notwithstanding the reported results of our risk assessment, we have identified two areas where management will apply accounting judgement in the preparation of the Council's financial statements.

### Property, plant and equipment

Under the Code and IFRS, property, plant and equipment ("PPE") is required to be held on the balance sheet at fair value which for specialised assets is assumed to be depreciated replacement cost and for other PPE is open market value. In order to comply with these accounting requirements, Council assets are subject to rolling valuations on a asset type basis.

Valuation of property, plant and equipment across the Council's substantial portfolio of assets remains a key risk area. In 2013-14, the classes of assets to be revalued include council dwellings, sports, cultural and neighbourhood facilities, investment properties, assets held for sale and surplus assets. In addition, the Council is looking to introduce appropriate component accounting for its council dwellings, as part of the valuation exercise.

We will review the valuations in detail, liaising with our internal experts to consider the Council's general approach. We will also consider the accounting implications of the valuations to ensure these are appropriately reflected in the financial statements.

In addition, decisions made by the Council in approving elements of the future capital programme need to be considered as to whether there is any associated impairment of the current carrying value of existing assets on the balance sheet.

### Retirement benefits

The Council accounts for its participation in the Tayside pension fund in accordance with IAS 19 *Retirement benefits*, using a valuation report prepared by actuarial consultants. The Council's actuaries use membership data and a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases.

IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities.

Our audit approach to IAS 19 includes:

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

# Presentation of financial statements

**The Council is required to prepare financial statements in accordance with the *Code of Practice on Local Authority Accounting in the United Kingdom 2013-14* ("the Code").**

**While there are some changes in the content of the Code for 2013-14, the financial statements and underlying accounting policies are expected to remain substantially consistent with the previous year.**

**KPMG remains committed to working with management to enhance the clarity and impact of the financial statements, including the implications of the revisions to the Code.**

| | |
|---|---|
| **Code of practice on Local Authority Accounting in the United Kingdom 2013-14 ("the Code")** | The 2013-14 financial statements will be prepared in accordance with the *Code of practice on local authority accounting in the United Kingdom 2013-14 (*"the Code"*)* which is based on International Financial Reporting Standards ("IFRS").<br>The 2013-14 Code has a number of amendments from the 2012-13 version and management should reflect these changes to the reporting requirements in the draft financial statements. The amendments include:<br>■ accounting for allowances in respect of the Carbon Reduction Commitment Energy Efficiency Scheme;<br>■ amendments to the Comprehensive Income and Expenditure Statement as a result of changes to IFRS;<br>■ clarification of the treatment of overdrafts or the balance sheet and cashflow statement;<br>■ augmentation to pensions on service concession arrangements;<br>■ amendments to the accounting for retirement benefits; and following amendments to IAS19 *Retirement benefits*; and<br>■ a number of clarifications and augmentations as a result of the CIPFA/LASAAC post implementation review. |

### Changes to Local Authority Accounts (Scotland) Regulations

The Scottish Government has commenced a consultation period to amend the Local Authority Accounts (Scotland) Regulations. The consultation period closed on 4 October 2013, but at the time of compilation of this plan, the outcome of that consultation is unknown. The proposed draft regulations include a number of changes designed to help strengthen corporate governance processes. It is unclear at the current time whether the proposed regulations will be applicable in full to 2013-14 onwards, however, we have discussed with management that consideration should be given to the implications for the Council's reporting arrangements arising from the content of the consultation draft and of course from the finalised Regulations once these are known.

### Financial reporting for charitable trusts

The Council has 30 registered charitable trust funds. From 2013-14, all charitable trust funds registered with the Office of the Scottish Charity Regulator ("OSCR") will require an audit. The audit of these charitable trust funds may result in additional administrative and financial costs to the Council. The council is considering a rationalisation process which will involve reducing the number of registered trust funds significantly. This rationalisation process will require committee approval and authorisation from OSCR thereafter. Many other councils are seeking to follow a similar process and hence this will result in significant additional work for OSCR. Management have advised that this rationalisation process will not be completed by 31 March 2014, therefore, arrangements for the audit of these charities will be required. Detailed arrangements for the audit of the charitable trusts will be discussed and agreed with management in due course.

# Group financial statements

**IFRS and the Code require the Council to prepare group financial statements.**

The Council uses a range of service delivery vehicles to facilitate the discharge of its functions which, whilst technically independent, are effectively under the Council's influence or control. The Council is required under IFRS and the Code to prepare group financial statements which include the Council's interest in subsidiaries, associates and joint ventures.

The Code requires the following statements to be prepared, together with appropriate notes:

- movement in reserves – this statement summarises all movements in reserves;
- group comprehensive income and expenditure – t his statement summarises the group's income and expenditure for the year;
- group balance sheet – this statement sets out the overall financial position of the group at the year end; and
- group cash flow - the group cash flow statement includes the cash flows of the Council and the Common Good Funds and Trusts. Cash receipts and payments that flow to and from the Council and its subsidiaries only (full group members) must be included. Cash flows to and from the Council to its associates are included within the cash flow statement of the Council.

## Subsidiaries

These are entities in which the Council either:

- controls the majority of equity capital or equivalent voting rights;
- appoints the majority of the governing body; or
- exercises (or has the right to exercise) influence (i.e. give direction which must be complied with) over the entity's operating and financial policies.

Following the Council's acquisition of the remaining shares in Dundee Energy Recycling Limited ("DERL"), management has recognised that this entity is now a 100% subsidiary of the Council.

From previous assessment of its relationships with other entities, the Council has also concluded that Trust Funds and Common Good Funds, in respect of which the Council is sole trustee, fall to be treated as subsidiaries. We continue to review the Council's assessment of its group boundary and confirm our agreement with the Council's view.

## Associates

These are entities in which the Council can exercise a significant influence without support form other participants. The reassessment of relationships with other entities in 2011-12 concluded that the following required to be treated as associates:

- Tayside Valuation Joint Board;
- Dundee City Developments Limited; and
- Leisure & Culture Dundee.

In prior years, the Council also accounted for interests in Tayside Joint Police Board and Tayside Fire & Rescue Board as associates. In 2012-13, the consolidation of these two entities had the effect of decreasing the net assets and reserves in the group balance sheet by £410.2 million when compared with the Council balance sheet. Following the dissolution of those boards from 1 April 2013, the differences between the group and Council financial statements will be lesser as they will no longer be treated as group entities.

## Other relationships – Tayside Contracts Joint Committee

Following detailed consideration of the above relationship, in conjunction with the partner local authorities involved in the Joint Committee, the Council accounts for its participation as a jointly controlled entity.

# Mandatory communications

**Mandatory communications with those charged with governance as required by Auditing Standards are set out opposite.**

**These cover:**

- **fraud;**
- **related party transactions; and**
- **independence.**

| Area | Issue | KPMG response |
|---|---|---|
| **Fraud risks** | ■ It is the responsibility of management to implement accounting and internal control systems which are designed to prevent and detect fraud and error. Such systems reduce but do not eliminate the risk of misstatements caused by fraud or error.<br>■ Those charged with governance must ensure, through oversight of management, the integrity of these systems and that appropriate controls are in place, including those for monitoring risk, financial control and compliance with laws. This is in the context of preparing financial statements that give a true and fair view and that do not contain material misstatements arising from fraudulent reporting (intentional misstatements/ omissions to deceive the financial statement user) or from the misappropriation of assets. | ■ Our audit procedures are designed to have a reasonable chance of detecting misstatements as a result of fraud or error. The audit team will review and discuss fraud related risks and controls with internal audit, the director of corporate services and senior management.<br>■ Our risk assessment procedures will include a number of interviews with senior personnel concerning processes to identify and respond to risks of fraud. |
| **Related party transactions** | ■ Management has processes in place to identify related party transactions and a number were disclosed in the 2012-13 financial statements. All material related party transactions must be disclosed in the financial statements. | ■ We will ensure that there continues to be appropriate processes in place as part of the financial statements preparation process to identify any related party transactions. |
| **Independence** | ■ Auditing Standards require us to consider our independence and related matters in our dealings with the Council. | ■ We have provided our formal independence communication in appendix one. In respect of non-audit services provided to the Council we have completed internal conflict checks to confirm that the services may be provided with no threat to our audit independence. |

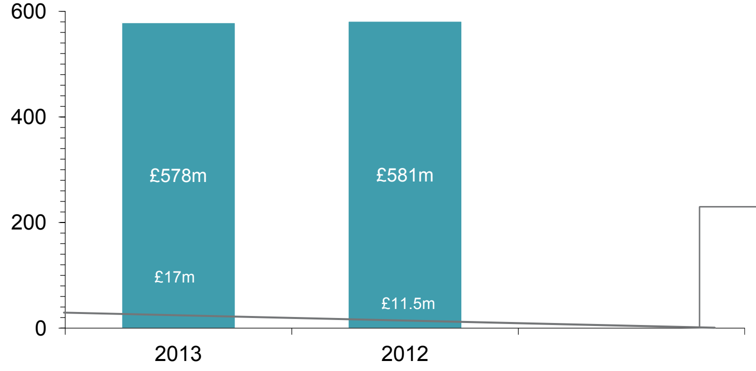
# Mandatory communications: audit materiality

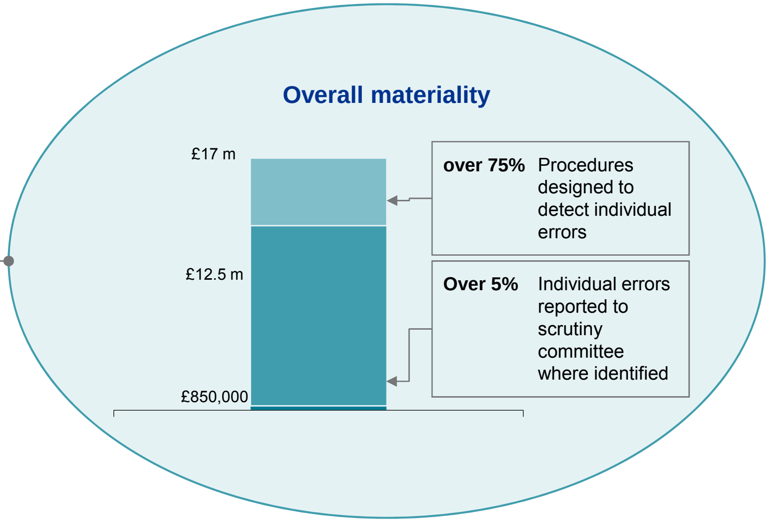
**Our audit work is planned to detect errors that are material to the financial statements as a whole.**

**Our materiality is based on total income and takes into account the low risk nature of the Council.**

**We are required by Auditing Standards to report to the scrutiny committee unadjusted audit differences other than non-trivial items.**

**Total income**




Source: 2012-13 financial statements

## Determining materiality

We consider quantitative and qualitative factors in setting materiality and in designing our audit procedures.

We have reassessed our level of materiality this year based on our knowledge and understanding of the Council's risk profile and, therefore, financial statements. Materiality has been set at £17 million which is approximately 3% of total income in 2012-13. This will be revised once draft financial statements for 2013-14 are known.

We design our procedures to detect errors at a lower level of precision, i.e. £12.5 million.

We will report identified errors greater than £850,000 to the scrutiny committee.

## Reporting to scrutiny committee

To comply with Auditing Standards, the following three types of audit differences will be reported to the scrutiny committee:

- material adjusted audit differences;
- unadjusted audit differences; and
- disclosure differences (adjusted and unadjusted).

# Governance and scrutiny arrangements

**We review governance and scrutiny arrangements in light of the shared risk assessment, Best Value and Single Outcome Agreement.**

**The shared risk assessment process for 2013-14, while identifying a number of areas for further consideration, did not identify any significant areas where the Council was not making progress.**

## Shared risk assessment

Following the publication of the Crerar report in September 2007, the Scottish Government's response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies.

Local area networks ("LANs") have been established for each council. These bring together local scrutiny representatives in a systematic way with the common aims of joint scrutiny scheduling and planning, sharing risk assessment and the delivery of a single corporate assessment through the Best Value 2 audit process. As your external auditor, we are a key member of the shared risk assessment process for the Council.

The role of the shared risk assessment process is to ensure that relevant data collected from councils and other sources by their organisation is analysed and bought to the LAN for discussion. All LAN members discuss and agree a shared risk assessment ("SRA") and identify a proportionate scrutiny response, with Audit Scotland acting as lead in the co-ordination process.

A national scrutiny plan sets out how Scotland's scrutiny agencies coordinate their work and focus on the key issues at each council. This plan is underpinned by an assurance and improvement plan ("AIP") for individual councils.

The SRA process for 2013-14 identified no specific scrutiny required. Governance and accountability, and risk management were identified as areas for further information, but which would be covered by the responsibilities of the annual audit process.

## Best Value and continuous improvement

Under the Local Government in Scotland Act 2003 ("the 2003 Act"), auditors have a duty to be satisfied that councils have made proper arrangements to secure best value. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and community planning under section 52 of the 2003 Act. Currently, Best Value audits are carried out by central teams within Audit Scotland's best value scrutiny improvement group in partnership with local auditors.

The timing, nature and extent of these is now determined as part of the SRA process. A key component of the SRA will be the extent to which implementation of the existing Best Value improvement plan has had the anticipated impact. As your external auditor, we are responsible for conducting follow-up reviews to assess the Council's progress against its agreed improvement priorities.

## Governance statement

The Council is required to prepare and disclose a governance statement to detail the purpose of the framework of internal control, along with an analysis of its effectiveness. It should describe sources of assurance for members and senior officers and identifies areas for improvements to be focussed on in the future. We are required to review the governance statement against disclosure requirements and consider its content against our knowledge and understanding of Council. We will then report on our findings in our annual audit report.

# Governance and scrutiny arrangements (continued)

## Single outcome agreement

Single outcome agreements ("SOAs") are a mechanism for aligning public sector activity to national priorities and the Accounts Commission has no immediate plans to audit their delivery. Best Value 2 will draw upon evidence contained within a council's SOA in order to consider outcomes more widely, as planning for, and managing the delivery of, outcomes should be central to all aspects of a local authority's activity. Successful delivery of SOAs will depend on the degree to which they are supported by effective planning, budgeting and performance management arrangements at service-level, within councils and across partner agencies.

During the audit cycle, our responsibilities extend to updating our understanding on the approach the Council and its partners are taking to:

- developing governance and accountability arrangements to support the SOA in line with Scottish Government advice;
- ensuring explicit links are made between high-level SOA outcomes and more detailed service-level outcomes, outputs and activities – both within a council and across community planning partners;
- ensuring the SOA is supported by robust resource planning arrangements at a service-level within the Council and jointly with community planning partners;
- ensuring the SOA is supported by robust performance management and reporting:
  - corporately
  - at service level
  - jointly with partners;
- reporting progress towards SOA outcomes to the Scottish Government, in line with guidance on annual reporting; and
- undertaking Public Performance Reporting ("PPR") on progress towards SOA outcomes, including linking SOA outcomes and indicators with other forms of PPR such as SPIs (specified and unspecified), other local performance indicators and community planning partners' public performance reporting – all in accordance with statutory guidance on PPR issued in 2003.

We will include a summary of our findings in our 2013-14 annual audit report to members and the controller of audit.

## National Fraud Initiative

The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use. NFI helps participating bodies to identify possible cases of fraud, and to detect and correct any under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud.

Management is responsible for investigating data matches from the latest round and we are required by Audit Scotland to review the Council's progress and engagement with the NFI process. We prepared a short return to Audit Scotland in December 2013 and we will report management's progress to the scrutiny committee during the year.

## Fraud returns

Audit Scotland's *Code of Audit Practice* requires auditors to make submissions of instances of fraud and irregularity. We will liaise with your internal auditors and relevant finance staff in advance of completing these submissions.

# Internal audit

**We will liaise with your internal auditors to minimise duplication of effort.**

## Internal audit arrangements

International Standard on Auditing (UK and Ireland) 610: *Considering the work of internal audit* requires us to:

- consider the activities of internal audit and their effect, if any, on external audit procedures;
- obtain a sufficient understanding of internal audit activities to assist in planning the audit and developing an effective audit approach;
- perform a preliminary assessment of internal audit when it appears that internal audit is relevant to our audit of the financial statements in specific audit areas; and
- evaluate and test the work of internal audit, where use is made of that work, in order to confirm its adequacy for our purposes.

We will continue liaison with your internal auditors and maintain an understanding of their approach to ensure duplication of effort is minimised. We will review the internal audit work proposed or completed during our interim audit visit to determine the extent of assurance that can be taken from the work performed.

The general programme of work will be reviewed for significant issues to support our general work in assessing the Council's annual governance statement.

## 2013-14 internal audit plan

We will read the reports and consider the results of all internal audit work, and intend to place specific reliance on some areas of work.

The table opposite highlights areas where we intend to place reliance and how this affects our planned audit approach (subject to a lack of significant risks being identified by internal audit).

| Internal audit area | Impact on our planned audit approach |
|---|---|
| **Governance reviews**<br>Community planning partnership; Partnerships; Performance information; Corporate governance; Information governance | We will review the findings from these reviews together and consider the impact on our audit work, in particular in respect of our work on the annual governance statement. |
| **Financial reviews**<br>Income collection; Invoice processing | We will review internal audit findings and consider any impact on our financial statements audit work for the year. |

# Performance management

**Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies on behalf of the Accounts Commission.**

**We will review the Council's response to these and will report our findings to Audit Scotland.**

## Local response to national studies

Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies on behalf of the Accounts Commission. While the recommendations from some of the studies may have a national application, elements of the recommendations are also capable of implementation at individual organisation level, as appropriate.

In order to ensure that added value is secured through the role of the Accounts Commission, Audit Scotland and its appointed auditors, will continue to ensure that audited bodies respond appropriately to reports from Audit Scotland's programme of national performance audits. We will therefore be required to make returns to Audit Scotland that performance reports have been considered by the Council and that action has been planned in response.

We will assess how the Council has responded to relevant national reports, preparing two returns to Audit Scotland.

Auditors are required to provide the following information:

- Was the report discussed at any executive board or committee? If so, which committees and on which dates?
- Did the body carry out a self-assessment against the national report's findings?
- Did the body produce an action plan (a copy of which will be provided to Audit Scotland)?
- Are there plans to provide committee(s) with feedback on actions?

In particular, we will consider the Council's response to the recent report from the Accounts Commission *Health inequalities in Scotland.* We will report our findings to the scrutiny committee.

## Targeted follow up of performance audit

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified two reports for follow-up in 2013-14; *Arms length external organisation: are you getting it right?* and *Major capital investments in councils*. This will involve looking at what action has been taken and what difference this has made. We will include commentary in the annual audit report and may provide supplementary reports, where necessary.

## Statutory performance indicators

The statutory deadline for publication by the Council of statutory performance indicators ("SPIs") is 30 September 2014. In 2009-10 there was a significant shift in approach, reflecting the changing environment in which local authorities operate. There are further changes to the requirements for auditors for 2013-14.

Auditors must assess the adequacy of arrangements in place in local authorities for collecting and publishing information in relation to certain specific SPIs. We will complete a pro-forma schedule to reflect the audit work on SPIs and this will be submitted to Audit Scotland by 30 September 2014. Our annual audit report for 2013-14 will include a summary of this appraisal, the respective duties and responsibilities of the Council and us as auditor, any significant issues arising from the audit work and recommendations for improvement.

# KPMG team; reporting

**The team benefits from strong continuity at senior level, building on our engagement leaders' involvement in the audit of the Council, and other associate entities in previous years.**

| Team member | Role |
|---|---|
| **Stephen Reid**<br>*Engagement Director*<br>Tel: 0131 527 6795<br>Email: stephen.reid@kpmg.co.uk | Stephen has overall authority and responsibility for the audit engagements, including reporting on the financial statements, and will review key conclusions reached by the engagement team on all accounting and auditing matters. |
| **Keith Macpherson**<br>*Audit Senior Manager*<br>Tel: 0141 300 5806<br>Email: keith.macpherson@kpmg.co.uk | Keith serves as the day-to-day audit liaison between management and KPMG and a first point of contact. He also provides technical accounting, regulatory and other advice in the first instance. |
| **Natalie Dyce**<br>*Audit In-charge*<br>Tel: 0141 300 5746<br>Email: natalie.dyce@kpmg.co.uk | Natalie coordinates the onsite audit fieldwork, liaising directly with the key finance staff in respect of the preparation for, and conduct of the financial statements audit work. |

## Reporting

Through regular meetings at appropriate levels, there will be open and regular discussion between management, auditors and management. As a result, accounting and control issues can be identified and reported to allow you to manage them throughout the year.

Audit Scotland's *Code of Audit Practice* requires us to communicate to management findings arising as a result of the audit work completed. Reports to management will be submitted throughout the course of the year, with draft reports discussed and agreed with management and action plans developed to include the recommendations, target dates for implementation and the member of staff responsible for implementation.

We envisage submission of the following reports in respect of 2013-14:

- by 31 May 2014, interim management reporting based on the findings of our testing of financial, strategic and IT controls;
- by 31 October 2014, annual audit report to the Council and the Controller of Audit, encompassing our report to those charged with governance. This will include consideration of performance management arrangement and public performance reporting.

We will also submit information on the following areas to Audit Scotland during the year: NFI; fraud returns; Audit Scotland national reports; Best Value; grant claims; and statutory performance indicators.

# Fee arrangements

**Our audit fees are set according to the fee ranges set by Audit Scotland.**

## Fee arrangements

Audit Scotland requires that the fee for our work is set within an indicative range, depending on the assessment of risk and other factors facing the Council. The indicative fee range is calculated using a number of inputs:

- a central estimate of the number of days need to do the audit;
- the average remuneration rate for the audit team;
- the contribution to travel and expenses within the sector;
- the contribution towards performance audits, where relevant; and
- the contribution towards other central costs not met by the Scottish Consolidated Fund.

The indicative fee ranges are based on the following assumptions to ensure an efficient audit process:

- draft report, financial statements and full electronic files of supporting work papers available at the start date of our on site visit agreed with officers preferably in electronic format;
- reliance on your internal controls;
- availability of key members of staff during the audit fieldwork; and
- completion within the agreed timetable.

Audit Scotland has notified us that the fee range for 2013-14 is £344,020 to £420,460, with a mid-point of £382,244 (including VAT). This represents no increase from 2012-13. We have proposed a fee of £382,244, which represents the mid-point. Should we be required to undertake significant additional audit work in respect of any of the areas of audit focus or other matters arising, we will discuss with management the impact of this on our proposed fee.

As in 2012-13, an element of this fee will be allocated for our work on the audit of the financial statements of the Council's Pension Fund and we will agree this with officers for the purposes of the re-charge to, and disclosure in, the Pension Fund's financial statements.

# Appendices

# Independence

**Auditing Standards require us to communicate to the scrutiny committee in writing at least annually on any matters which may reasonably be thought to bear on our independence and set out the safeguards in place in relation to these matters and confirm that we are independent.**

Professional ethical standards require us to communicate to you as part of planning all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place that, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Audit Director and the audit team. This letter is intended to comply with this requirement although we will communicate any significant judgements made about threats to objectivity and independence and the appropriateness of safeguards put in place.

We are satisfied that our general procedures support our independence and objectivity, except for those detailed below where additional safeguards are in place.

### General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

### Confirmation of audit independence

We confirm that as of 17 January 2014, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the scrutiny committee and should not be used for any other purposes.

Yours faithfully

**KPMG LLP**

# Audit Scotland code of audit practice – responsibilities of Dundee City Council

### Financial statements

Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

### Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit or scrutiny committees.

### Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

### Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

# Audit Scotland code of audit practice – responsibilities of Dundee City Council (continued)

### Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

### Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

KPMG

*cutting through complexity*