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West Dunbartonshire Council Report to those charged with governance

Year ended 31 March 2011

16 September 2011

Contents

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

This report is for the benefit of West Dunbartonshire Council and is made available to the Accounts Commission and Audit Scotland (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 Grant Macrae, who is the engagement leader for our services to the Council, telephone 0131 527 6611, email grant.macrae@kpmg.co.uk who will try to resolve your complaint. If your problem is not resolved, you should contact Lorraine Bennett, partner, either by writing to her at Saltire Court, 20 Castle Terrace, Edinburgh, EH1 2EG or by telephoning 0131 222 2000 or email to lorraine.bennett@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.

Headlines

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

In accordance with ISA (UK and Ireland) 260 *Communication with those charged with governance*, this report summarises our work in relation to the financial statements.

We wish to record our appreciation of the continued co-operation and assistance extended to us by your staff during the course of our work.

Accounting		
✓	Accounting policies are appropriate for the underlying operations	Page 3
✓	A number of technical accounting matters were considered during the audit process	Page 3
✓	Our audit approach was updated to reflect our assessment of financial statement level risks	Pages 4 to 6
Systems and controls		
	Control environment	
✓	■ Uncommitted reserves have increased from £3.4 million (2009-10) to £4.7 million (2010-11). This represents an increase from 82% (2009-10) to 120% (2010-11) of the Council's prudential reserve target.	Page 7
✓/✗	■ We are satisfied that there are appropriate procedures for preparation and monitoring of financial information. There was however, a significant increase in the actual outturn from the probable outturn reported at period 11.	Page 7
✓/✗	■ The finance department continues to make improvements in the financial statements preparation process. Supporting documentation available to support the audit was to a higher standard than previous years. We have, however, noted areas for continuous improvement in respect of the efficiency of the underlying process.	Page 8
Audit conclusions		
✓	We anticipate issuing unqualified audit opinions	-
Mandatory communications		
✓	No significant matters in respect of: 1. Audit differences 2. Auditor independence and non-audit fees 3. Management representation letter content	Appendices 1 to 3
Action plan		
✓	This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork. We have not repeated recommendations raised in reports issued during our earlier work in respect of our 2010-11 audit.	Appendix 4

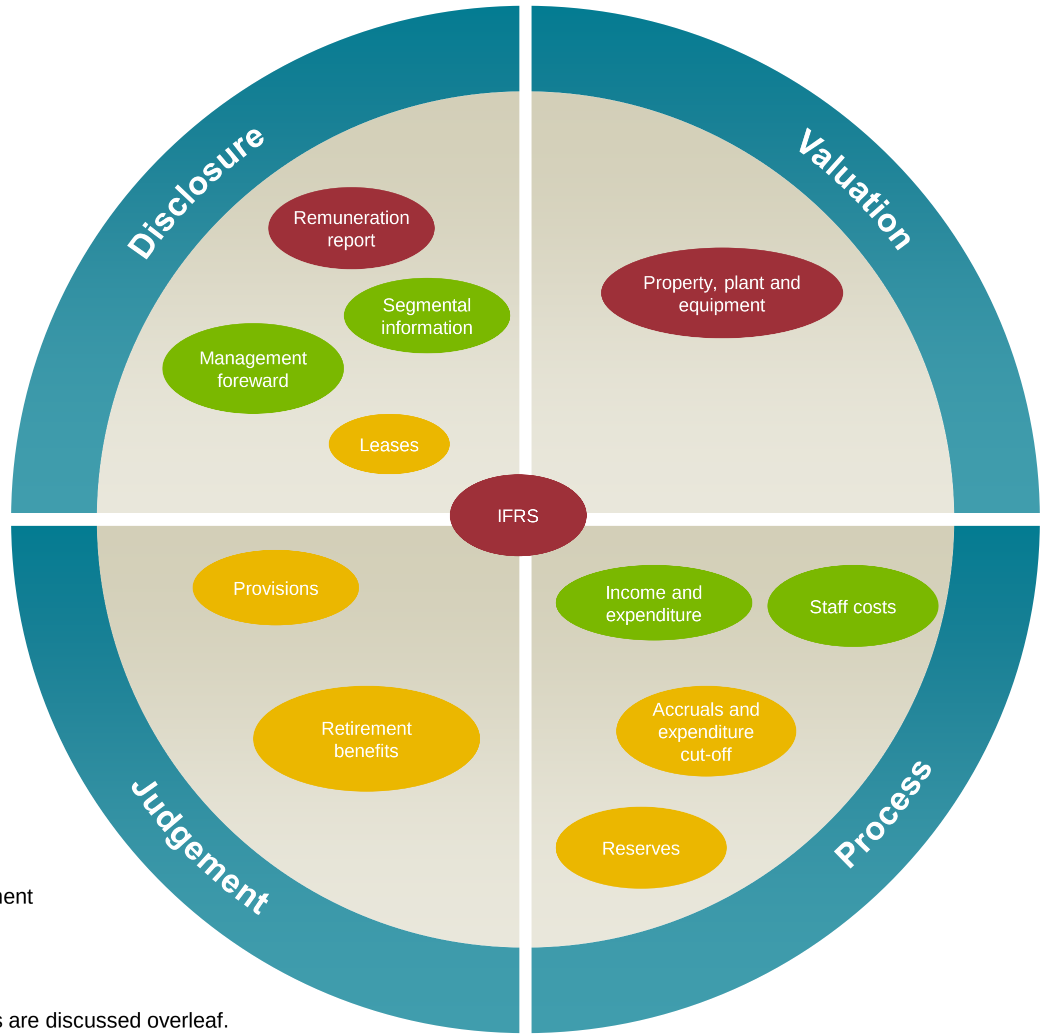
Accounting policies; technical accounting matters

The Council's accounting policies have been updated to take account of the transition to IFRS

Accounting policies	The 2010-11 financial statements have been prepared in accordance with the *Code of practice on Local Authority Accounting in the United Kingdom 2010 ("the Code")* which is based upon International Financial Reporting Standards (IFRS). As part of the transition to IFRS, there was a requirement for the Council to restate the 2009-10 financial statements to provide prior year comparatives on an IFRS basis. The accounting regulations (*IFRS First Time Adoption of IFRS*) require that the comparative amounts are restated to reflect the new accounting policies and that the date of transition to IFRS is the earliest comparative financial period reported in the Financial Statement. For the Council this means that the date of transition to IFRS is 1 April 2009. Required disclosures include material reclassification adjustments between presentation under SORP 2009 and the IFRS based code with regards to the balance sheet as at 1 April 2009 and as at 31 March 2010 and the comprehensive income and expenditure statement for the year ended 31 March 2010. We reviewed management's proposed accounting policies and, as reported in our IFRS report issued 15 April 2011, made a number of recommendations for enhancement which management adopted.	
Retirement benefit assumptions	The government announced on 8 July 2010 that they would in future use the consumer prices index ("CPI") in place of the retail prices index ("RPI") as the index for determining pension increases for public sector pension schemes. This will affect minimum required increases, applying to both current and future pension payments. CPI is generally expected to be lower than RPI in the long term and this should lead to lower pension increases. In addition, the cost of benefit accrual will also be correspondingly lower.	CIPFA's Local Authority Accounting Panel ("LAAP") issued a bulletin (number 89), considering the Accounting Standard Board's Urgent Issue Task Force ("ASB UITF") Abstract 48 which set out the technical basis for considering whether a body has a constructive obligation to pay benefits in line with RPI. CIPFA's LAAP concluded that there was a presumption that the change in inflation measure from RPI to CPI is likely to be accounted for as a change in benefit with respect to local government schemes. We are satisfied with management's assessment that scheme members expected inflationary increases to be in line with RPI and therefore that the change be accounted for as a change in benefits in the comprehensive income and expenditure statement.
	■ Accounts disclosures in this respect are complete and in accordance with IFRS requirements. ■ The statement of comprehensive income includes a credit of £53.8 million in respect of the change in pension benefits from RPI to CPI. This was the major contributory element to the reduction of £101.3 million in the Council's net pension liability as at 31 March 2011.	

Financial statement level risks

Our audit focused on high risks in respect of management judgment and the finance team's process of preparing the remuneration report and the valuation of property, plant and equipment.



Note: Risk assessment

- High.
- Medium.
- Low.

The high risk issues are discussed overleaf.

Financial statement level risks (continued)

Management anticipated risks around property, plant and equipment; no audit adjustments were required and matters were concluded in a timely manner.

Recommendations are included in the action plan in appendix four.

Areas of HIGH audit risk			
	Value (£'000)		
Area	2010	2011	KPMG comment
Property, plant and equipment	714,945	738,288	Management obtained a valuation of properties on a rolling basis in addition to newly acquired assets and assets where there was an indication of a change in value. We met with management and the internal valuer to discuss the valuation process, methodology and significant changes in the valuation of specific properties in conjunction with input from Audit Scotland and KPMG's internal valuation experts. Revaluation of operational properties resulted in a net upward revaluation of £14 million. There were also impairments identified by management of £9.6 million. *Operational land and buildings* The Code now specifics that assets valued on a depreciated historic cost basis should use the *instant build methodology* providing for the replacement of a *modern equivalent asset*. We considered the internal valuer's application of the "*modern equivalent asset*" principle in relation to newly operational schools. While the valuation methodology did not fully adopt the modern equivalent asset approach, the valuation did take cognisance of the principal through an alternative approach which in particular used the Scottish Assessors' Association guidance to consider any spare capacity of buildings. We were therefore satisfied with the valuation basis adopted within the financial statements. We recommend, however, that as part of the future rolling valuation programme that estates and finance staff continue to take account of the changing requirements of the Code when preparing valuations, to ensure that these remain appropriate. ***Recommendation one*** *Surplus assets* The Council has £13.1 million of surplus assets at the year end. These are defined by the Code as assets that are surplus to service needs but are not being held for investment purposes or held for sale. We considered the classification of these assets through discussions with finance and estates staff in addition to the valuation basis of these properties and are satisfied with their classification and valuation.

Financial statement level risks (continued)

Management anticipated risks around the IFRS restatement process and the remuneration report; audit adjustments were required and matters were concluded in a timely manner.

Areas of HIGH audit risk			
	Value (£'000)		
Area	**2010**	**2011**	**KPMG comment**
Property, plant and equipment *(continued)*			*Accounting for changes in value* In the draft financial statements, the affects of revaluations and impairments on the land and buildings elements of individual properties had been accounted for single transaction. The Code requires that that assets are now accounted for according to their separate components. This required management to treat individual movement separately. We identified that management had not separately accounted for valuation movements of separate components of assets which required adjustments to the financial statements. ■ Adjustments were made that increased the revaluation reserve by £1.1 million and recognised additional impairment to the statement of comprehensive income of £1.2 million. There was no impact on the general fund balance.
IFRS restatement	n/a	n/a	The transition to the IFRS based Code required a number of changes as described in note five to the financial statements. We carried out a specific audit of the restatement process and reported our findings to the audit and performance review committee as part of our IFRS report issued on 15 April 2011.
Remuneration report	n/a	n/a	The Local Authority Accounts (Scotland) Amendment Regulations 2011 introduced the requirement for authorities to prepare a remuneration report for the first time. We considered the requirements of the regulations in addition to guidance provided by LAAP bulletin (number 88). We discussed enhancement to the presentation of the report in addition to the inclusion of details on exit packages provided and the inclusion of remuneration for positions held at Joint Boards. We are satisfied that the contents of the remuneration report meet the Regulations' requirements.

Preparation of financial information

The reported surplus is higher than the forecast outturn.

Recommendations are included in the action plan in appendix four.

In January 2010 the Council approved its revenue budget with a planned surplus of £250,000. The actual general services surplus achieved was £6.5 million. Uncommitted reserves have increased from £3.4 million (2009-10) to £4.7 million (2010-11). This represents an increase from 82% (2009-10) to 120% (2010-11) of the Council's prudential reserve target.

Overall the result for the year demonstrates strong management action to control expenditure and maintain the financial position of the Council. The graph below shows the reported general services outturn against budget throughout the year. The reported surplus shows a significant increase from the original budget , as well as a significant increase between period seven to eight and period 11 to 12.

The significant change between period seven and eight is explained by the fact that management started reporting against probable outturn from period eight. Prior to this reporting is against the phased budget to maintain financial control.

This increase from the previous estimates was primarily due in part to the anticipated full year effect of: savings from the spending freeze (£0.6 million); lower staff pay award compared to the budgeted assumption (£0.3 million) and additional Council savings options approved (£0.4 million).

The increase between period 11 and 12 relates primarily to favourable variances in housing, environment and economic development (£1.1 million) and educational services (£0.7 million). Favourable variances include a £0.5 million increase in the trading operations surplus due to additional and unanticipated work completed by the housing maintenance trading operation.

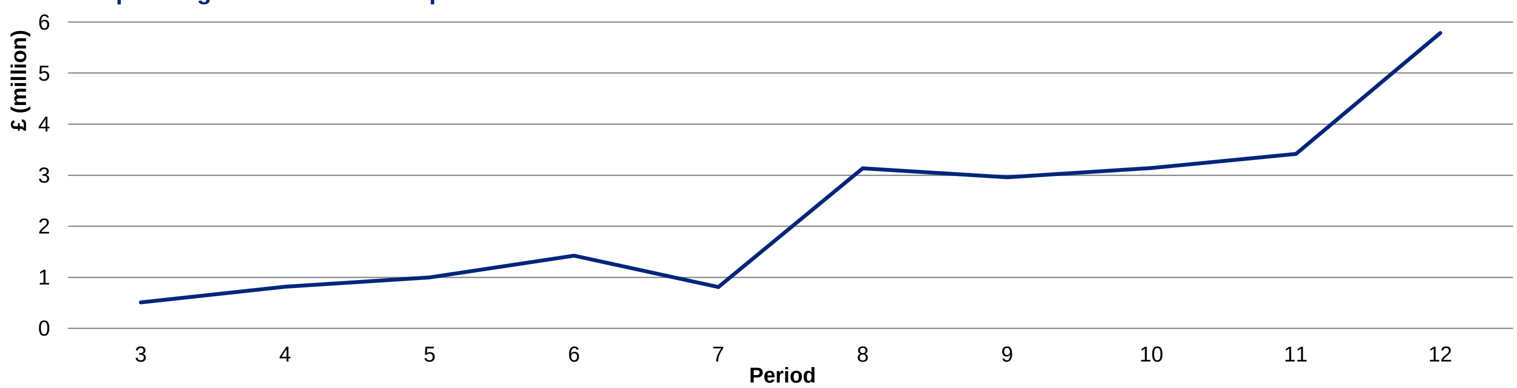
The Council reports against probable outturn from period eight onwards and these movements are indicative that the actual outturn was not as accurately predicted as may have been desirable. We recommend that management review the reasons for the significant increase in actual year end surplus to identify whether these should have been anticipated and reported on earlier.

Recommendation two

In addition we note that the impact on the year end general fund balance as a result of budget variances is not reported as part the Council's budgetary control reporting.

Recommendation three

Reported general services surplus



Efficiency of underlying processes

Unaudited financial statements were completed by the statutory deadline of 30 June 2011, with most supporting documentation provided along with the unaudited financial statements for audit on 1 July 2011. This was in line with the agreed timetable.

Overall, management's approach to preparing the financial statements is efficient, but improvements could still be made in respect of reconciling working papers to the financial statements and consideration of technical bulletins.

Recommendations are included in the action plan in appendix four.

Area	Comments	Recommendation
Income and expenditure	Supporting documentation was provided, in a timely manner, in respect of a number of income and expenditure categories. Our prepared by client list, requested explanations for significant variances in addition to variance analysis. This information was of a higher standard than previous years but improvements could still be made to provide all information requested in advance of the audit. As in previous years, there were some problems with reconciling the evidence provided to the financial statements.	2
Property, plant and equipment	We were provided with the requested information in a timely manner and finance / estates staff responded to all queries quickly and efficiently. We previously requested that management revise the format of this note to comply with the requirement of the IFRS based Code, however, the draft financial statements had not been updated. We worked closely with management to resolve the matter however this led to some delays in the process.	1
Investments and borrowing	Management prepared all information requested which was of a high standard and clearly reconciled to the financial statements and supporting evidence. This ensured that this work was completed efficiently and with minimal additional input from finance staff.	3
Pensions	The pension note was completed within the draft financial statements but recommended narrative, outlined in a recent LAAP89 bulletin, was omitted. We recommend that management ensure that appropriate guidance is considered and reflected, as appropriate, in the financial statements.	2
Debtors and creditors	We received information requested at the start of the audit, however, working papers had been prepared on the basis of the previous years format and not on an IFRS basis. We encountered problems reconciling the evidence provided to the notes to the financial statements.	1
Remuneration report	The remuneration report was also available at the start of the audit fieldwork, but we made further recommendations to ensure its accuracy and completeness of disclosures which were accepted by management.	2

Note: 1 Resulted in delays 2 Scope for improvement 3 Efficient

Appendices

Appendix one – audit differences

A number of differences were identified by management and the audit process:

The net impact of adjustments increased general fund balances by £1.8 million.

We are required by ISA 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences in respect of our audit.

Adjusted caption	Nature of difference	Value of adjustment £'000	Impact on general fund £'000
Adjustments to the prime financial statements:			
Net cost of service / reserves	The draft accounts included pension costs of £7.7 million within other comprehensive expenditure, which should instead have been included within the net cost of service. This was not an omission in the unaudited accounts, but just an adjustment to correct the presentation.	7,719	-
Provisions / reserves	Management included an amount in provisions for the increased staff costs resulting from successful single status appeals. This amount does not meet the criteria of IAS37 *'provisions, contingent liabilities and contingent assets',* as it reflects future costs payable for service still to be provided. This balance has been transferred to an earmarked reserve within the general fund.	1,625	1,625
Net cost of service / debtors	Adjustment to reflect amounts repayable to the Council from Strathclyde Partnership for Transport.	211	211
Debtors / creditors	£301,000 of credit balances included in trade debtors that should be reclassified to creditors.	301	-
Net cost of service / property, plant and equipment	Management capitalised £343,000 of fixtures and fitting as part of the buildings category of an asset. This decreases the value of the building and reduces the impairment on the building.	343	-
Property, plant and equipment / creditors	Under accrual in respect of final capital invoice, £500,000.	500	-
Net cost of service / revaluation reserve	The effect of movements in the valuation of land and buildings has been netted together. Under the Code movements in the valuation of land and buildings should be separately accounted for through the revaluation reserve and statement of comprehensive income. The impact of this combined with under accrual of the capital invoice (£500,000) and the reallocation of the fixtures and fittings (£343,000), resulted in an increase in the revaluation reserve of £1.1 million and an additional impairment charge to the statement of comprehensive income of £1.2 million.	2,300	-
Presentational adjustments:			
A number of presentational adjustments were proposed by us and processed by management including: • classification of creditors; • completeness of capital commitments; • presentation of movement in reserves statement; and • enhancements to various notes to comply with the new requirements of the IFRS based Code.			
Total		**12,999**	**1,836**

Appendix two – auditor independence and non-audit fees

We remain independent of the Council and there are no non-audit fees paid or payable at the date of this report.

Framework

Auditors appointed by Audit Scotland are required to comply with its *Code of Audit Practice* when carrying out audit work. The *Code* requires that … "Auditors should carry out their work with independence and objectivity. Their opinions, conclusions and recommendations should be, and should be seen to be, impartial. Auditors, or any associated firms, should not carry out any work for audited bodies if it would impair their independence or might lead to a reasonable perception that their independence could be impaired."

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code and the requirements of the Auditing Practices Board's Ethical Standard 1: *Integrity, Objectivity and Independence* ("Ethical Standards").

General procedures to safeguard independence

KPMG's reputation is built, in great part, upon the conduct of our professionals and their ability to deliver objective and independent advice and opinions. That integrity and objectivity underpins the work that KPMG performs and is important to the regulatory environments in which we operate. All partners, directors and staff have an obligation to maintain the relevant level of required independence and to identify and evaluate circumstances and relationships that may impair that independence.

Acting as an auditor places specific obligations on the firm, partners and staff in order to demonstrate the firm's required independence. KPMG's policies and procedures regarding independence matters are detailed in the Ethics and Independence Manual ("the Manual"). The Manual sets out the overriding principles and summarises the policies and regulations which all partners and staff must adhere to in the area of professional conduct and in dealings with clients and others.

All partners and staff must understand the personal and professional responsibilities they have towards complying with the policies set out in the Manual and follow them at all times. To acknowledge understanding of and adherence to the policies set out in the Manual, all partners and staff are required to submit an annual ethics and independence confirmation. Failure to follow these policies can result in disciplinary action.

Confirmation of independence

In relation to the audit of West Dunbartonshire Council for the financial year ended 31 March 2011, we confirm that there are no relationships between KPMG LLP and the Board, its directors and senior management that we consider may reasonably be thought to bear on the objectivity and independence of Grant Macrae and audit staff and which need to be disclosed to you. The audit fee for the financial year included our work in relation to corporate governance arrangements, use of resources and the financial statements audit. There were no fees payable for non-audit services during the year.

This report is intended solely for the information the audit and performance review committee and should not be used for any other purposes.

KPMG LLP

Appendix three – management representation letter

You are required to provide us with representations on specific matters such as your financial standing, application of accounting policies, and whether the transactions within the financial statements are legal and unaffected by fraud.

In the representation letter, in addition to standard representations required by auditing standards, we are requesting specific confirmation from the executive director of corporate services, as the Council's section 95 officer, that:

- the Council and the group have satisfactory title to all assets;
- non-current assets classified as held for sale are available for immediate sale in their present condition, subject only to terms that are usual and customary for sales of such assets, and their sale is highly probable as defined by IFRS *5 non-current assets held for sale and discontinued operations*;
- I have appropriately performed impairment testing in accordance with IAS 36 *Impairment of Assets* including at the reporting date, I have performed impairment testing for any asset or cash generating unit (CGU) for which there is an indication of a possible impairment at that date. In this regard, I confirms that I have as appropriately assessed, at the reporting date, whether there is any indication that an asset or CGU may be impaired;
- all property, plant and equipment is completely and accurately disclosed and valued appropriately in line with the requirements of IAS 16 property, plant and equipment, using consistent accounting policies;
- leases have been accounted for appropriately and in line with the requirements of IAS 17 *leases*;
- I confirm that the Council's share of the Strathclyde Pension Fund has been accounted for as a defined benefit plan and the Scottish Teachers' Superannuation Scheme has been accounted for as a defined contribution plan in accordance with IAS 19 *Employee Benefits*. There are no other plans;
- on the basis of the process established by the Council, and having made appropriate enquiries, I am satisfied that the actuarial assumptions underlying the valuation of pension plan liabilities are consistent with its knowledge of the employee population profile;
- I agree with the findings of Hyman Robertson LLP as the Council's actuarial specialist in preparing the pension plan valuations. In connection with the actuarial specialist's study, I have provided the specialist with all significant and relevant information of which I am aware. I did not give or cause any such instructions to be given to the actuarial specialist with respect to the values or amounts derived in an attempt to bias their work, and I am not otherwise aware of any matters that have had an impact on the independence or objectivity of the actuarial specialist; and
- the change from Retail Prices Index to Consumer Prices Index for pension increases has been appropriately accounted for as a change in benefit in line with the Urgent Issues Task Force Abstract 48 and the Local Authority Accounting Panel's Bulletin 89.

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Appendix four – action plan

The action plan summarises specific recommendations, together with related risks and management's responses.

- **High risk issues are fundamental and material to your system of internal control. We believe that these issues might mean that you do not meet a system objective or reduce (mitigate) a risk.**
- **Moderate risk issues have an important effect on internal controls, but do not need immediate action. You may still meet a system objective in full or in part or reduce (mitigate) a risk adequately, but the weakness remains in the system.**
- **Low risk issues would, if corrected, improve the internal control in general, but are not vital to the overall system. These are generally issues of best practice that we feel would be of benefit to you if introduced.**

Ref	Issue and risk	Recommendation and risk	Management response
1	The Code requires that assets valued on a depreciated historic cost basis provides the current cost of replacing an asset with its modern equivalent asset. The internal valuer has applied this principle to assets valued during the year through application of a proxy to estimate the modern equivalent.	We recommend, however, that as part of the future rolling valuation programme that estates and finance staff continue to take account of the changing requirements of the Code when preparing valuations, to ensure that these remain appropriate. **Low risk**	We will continue to take account of the changing requirements on an ongoing basis **Responsible officer**: Estates Officer **Implementation deadline**: completed & ongoing
2	The Council reports against probable outturn from period eight onwards and these movements are indicative that the actual outturn was not as accurately predicted as may have been desirable.	We recommend that management review the reasons for the significant increase in actual year end surplus to identify whether these should have been anticipated and reported on earlier. **Low risk**	A number of the larger variances are due to actions taken or budgets phased towards the end of the financial year and as such would not be apparent until nearer the year end. We are satisfied that these variances would not have been due reported earlier in the year However, we will continue to develop and monitor our budgetary control process as part of our ongoing continuous improvement programme. **Responsible officer**: Finance Manager **Implementation deadline**: 31 March 2012
3	The anticipated year end movement in general fund balances as a result of budget variances is not reported on a monthly basis as part the Council's budgetary control reporting.	We recommend that management report the impact on the general fund balance of budget variances as part of its budgetary control reporting. **Moderate risk**	Appropriate budgetary reporting information will be considered as we continue to develop the budgetary process as part of our ongoing continuous improvement programme. **Responsible officer**: Finance Manager **Implementation deadline**: 31 March 2012

Appendix four – action plan (continued)

Ref	Issue and risk	Recommendation and risk	Management response
4	Management continues to enhance the financial statement preparation process, but there are still areas in the preparation of the financial statements which could be made more effective and efficient, resulting in earlier completion of the audit process.	It is recommended that management implement a process to gather and implement relevant guidance such as LAAP bulletins in a timely manner. Page seven of this report identifies other potential areas for increased efficiency and it is recommended that these should be incorporated in the financial statement preparation timetable in future years. **Low risk**	We will formalise the process to gather and implement relevant guidance within our year end timetable and continue to work with our external auditors to develop areas for increased efficiency in the year end process **Responsible officer**: Finance Manager **Implementation deadline**: 31 March 2012

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