

# Perth & Kinross Council

## **Report to Members on the 2005/06 Audit**





# Contents

<b>Key Messages</b>	<b>2</b>	<b>Governance</b>	<b>20</b>
<b>Introduction</b>	<b>5</b>	<b>Financial statements</b>	<b>24</b>
<b>Performance</b>	<b>6</b>	<b>Final Remarks</b>	<b>29</b>
<b>Financial position</b>	<b>12</b>	<b>Appendix A: Action Plan</b>	<b>30</b>



# Key Messages

## Introduction

In 2005/06 we looked at the key strategic and financial risks being faced by the Council. We audited the financial statements and we looked at aspects of performance management and governance. This report sets out our main findings, summarising key outcomes in 2005/06 and the outlook for the period ahead.

## Key outcomes from 2005/06 audit

We have given an **unqualified** opinion on the financial statements of Perth & Kinross Council for 2005/06.

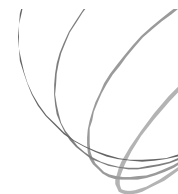
The Council had corporate governance systems in place during 2005/06 that operated well within a sound control environment. Continuing development of performance management arrangements and the integration of service planning and the budgeting process will further strengthen arrangements.

A number of initiatives are underway to further develop the Council's improvement culture, such as outcome based performance indicators within each service. Full implementation of all initiatives will support both members and officers in actively managing the Council's performance and the risks it faces in delivering against its objectives and priorities.

There have been delays in revising the Corporate Plan, which was due to be completed in June 2006. Revision of the Corporate Plan is a key step in linking corporate priorities more closely with budgets. The new plan will have fewer corporate priorities and will link in to the proposed phased introduction of policy led budgeting. The corporate Human Resources Strategy, which was due to be completed by May 2006, has not yet been submitted for committee approval. The HR strategy has been drafted and the underlying HR themes are currently in the process of being drafted.

Within Perth & Kinross, community planning frameworks are well established and continue to be developed. A review of community planning was undertaken during 2005/06, and an improvement plan was approved. Planned improvements include specific training for elected members, implementation of a community engagement strategy and the establishment of a Customer & Communities Group to provide clear strategic direction, including links between the Council's Corporate Plan and the Community Plan.

The Council's performance as measured by SPIs has, in the main, improved over the last year. Although a number of indicators have declined since 2004/05, the decline has been slight.



The Council has approached the challenge of the efficiency agenda in a structured and systematic manner and it is evident at this stage that there is a clear commitment to efficient government objectives. However, the Council is not yet in a position to fully demonstrate that its efficiency savings have not impaired service outcomes or quality.

At the end of the year the Council had a favourable variance against its 2005/06 budget, with the uncommitted balance on the general fund broadly in line with the reserves strategy.

## Outlook for future audits

In common with many other Scottish councils, Perth & Kinross Council has sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer payments to specific groups of employees as part of a compensation package. Costs of £3.061 million have been recognised in the 2005/06 financial statements for the estimated one-off cost of these payments. While moves to agree compensation payments will help to reduce financial risk in this area to some extent, there remain risks while existing pay and reward structures remain in place. The future implementation of the single status agreement provides an opportunity to address any underlying inequalities in pay and other conditions of service.

The planned implementation of the single status agreement in the Council has been delayed pending discussions and agreement with the trade unions. Until a local agreement is concluded the initial and continuing costs of single status cannot be reliably estimated. This represents a significant financial risk to the Council. Evidence from other councils is that variation in the level of potential costs can be up to 10% of the current pay-bill on a continuing basis. The Council currently anticipates additional costs over the first 5 years of implementation of approximately 9.4% of current pay costs of groups affected by single status. In securing a local agreement the Council needs to ensure it maximises the opportunity for service and job redesign to ensure it achieves value for money from its investment in its staff.

Significant change in 2007, with the introduction of proportional representation and multi-member wards, may mean that current political governance structures will require to be considered by the newly elected Council. The Council has commissioned consultants to examine a variety of democratic models which may be used following the elections.

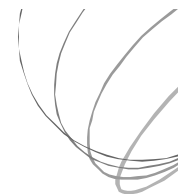
Developing modern asset infrastructure is essential for supporting the delivery of improved services. Successful delivery of the Investment In Learning schools modernisation project will remain a key component of the Council's improvement strategy. The Council also needs to further develop its asset management process to ensure that all assets are used effectively and efficiently to deliver services in line with priorities.



Changes to accounting rules will have a major impact on the presentation of the 2006/07 annual financial statements. The Council should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure continued transparency.

This is the final year of our current appointment to the audit of the Council. From 2006/07 Henderson Loggie will be the Council's appointed auditor. The co-operation and assistance given to us by Perth & Kinross Council members and staff over the five years of our audit appointment is gratefully acknowledged.

**Audit Scotland  
October 2006**



# Introduction

1. This report summarises the findings from our 2005/06 audit of Perth & Kinross Council. The scope of the audit was set out in our Audit Risk Analysis and Plan, which was issued in May 2006. This plan set out our views on the key business risks facing the Council and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a range of reports this year, and we briefly touch on some of the issues we raised in this report. Each report set out our findings and recommendations and the Council's agreed response. Appendix A of this report sets out the key risks highlighted in this report and the action planned by management to address them.
3. This is the final year of a five year audit appointment. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Council during the course of our audit work.



# Performance

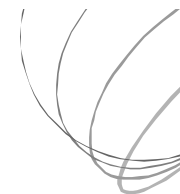
## Introduction

4. In this section we summarise key aspects of the Council's reported performance and provide an outlook on future performance, including our views on the current status of identified risks. We also comment on the findings of national performance audit studies.

## Corporate objectives and priorities

5. The Corporate Plan for 2004 – 2008 sets out the key goals and priorities for the Council and explains how it plans to achieve them. The plan covers eight corporate priorities, which cut across a variety of services:
  - Area Based Initiatives
  - Community Safety
  - Economic Growth
  - Education and Lifelong Learning
  - Environment
  - Health and Care
  - Housing Supply and Quality
  - Rural Communities
6. A total of 34 outcomes are outlined across these themes, including:
  - raising standards of attainment and achievement for all children and young people;
  - working with the community to continue to increase the proportion of household waste that is diverted from landfill;
  - working with Community Planning partners to provide tailored individual care packages for all vulnerable adults and older people;
  - ensuring land and appropriate transport infrastructure is available for new housing to meet the needs of communities;
  - supporting rural businesses and promoting the use of local products;
  - working with Community Planning partners and communities to sustainably manage the local environment.
7. The Corporate Plan was due to be revised by June 2006. This process has been delayed and the revised Corporate Plan is expected to be submitted for Council approval in November.





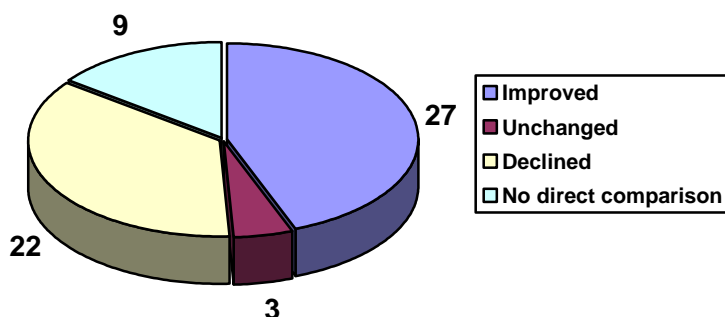
## Overview of performance in 2005/06

### Annual report

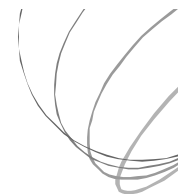
8. The annual performance report for 2005/06 is in the process of being drafted and will be submitted for Council approval in November. The report will highlight the Council's most important achievements over the previous year, outline progress with ongoing major areas of work and identify issues to be addressed in 2006/07.
9. Regular performance reports are submitted throughout the year to elected members and the Executive Officer Team. These reports are presented in an easily understood "performance dashboard" format. They include key performance indicators as well as progress updates on major projects and programmes.
10. A review of the public performance reporting framework is planned for completion by June 2007.

### Statutory performance indicators

11. Alongside its own performance indicators included within service plans, the Council's performance is also measured by statutory performance indicators (SPIs). Historically, the Council's SPIs have demonstrated a mixed performance. In 2005/06 many SPIs have demonstrated improvement in year on year performance. Although 22 have declined since 2004/05, in most cases this decline has been slight.



12. Substantial improvements have been made in a range of areas such as:
  - the educational attainment of looked after children;
  - the total number of homecare hours supplied to people aged over 65;
  - the percentage of people aged over 65 receiving personal care and/or homecare services during weekends and evenings;
  - food safety hygiene inspections of premises.



## Performance outlook – opportunities and risks

### Introduction

13. In our Audit Risk Analysis and Plan we identified some of the strategic risks to Perth & Kinross Council delivering on its stated objectives and priorities. These risks have been grouped into five risk themes.

### Delivering modernisation and managing change

14. The Council requires physical infrastructure and assets that are suitable and sufficient to meet the requirements placed on them in delivery of the themes and objectives set out in the Corporate Plan. They need to support the provision of high quality services now and into the future in a sustainable manner. The Council has recognised that it needs better schools, housing and other assets, and plans are being put in place to achieve an ambitious programme of improvements.
15. Developing modern infrastructure is essential for supporting the delivery of improved services. While progress has been good in relation to the schools PPP project, the Council has not fully developed its asset management process which should ensure that assets are used effectively and efficiently to deliver services in line with priorities. Full implementation of asset management planning is not expected until 2008.
16. The Council has improved its corporate approach to project management in the wake of project overspends in previous years, such as Auchterarder Community School. The Project Management Toolkit now provides a systematic, structured approach to project management. Training has been provided to all senior managers and is being extended to other staff. The Business Change and Improvement Unit records major projects on a central register and reports on progress to the Executive Officer Team (EOT) monthly and to elected members on a quarterly basis. In addition, our follow up work on migration to new ICT systems has indicated good progress in implementing recommended actions for improvement.

### Funding future improvement

17. In the absence of a comprehensive policy-led approach to budgeting and in the context of increasing financial pressures arising from, for example, energy price increases, single status and pension costs, there are risks that the Council will be unable to resource sustainable performance improvements while meeting new demands for its services.



18. The Council has undertaken a strategic best value improvement review of policy led budgeting and will be developing a policy led budgeting framework on a phased basis. This will provide a clear link between Corporate Plan outcomes, service plan targets and the actions and related costs/resources required to deliver these targets.

## **Delivering improved performance**

19. The Council needs to work hard to support continuous improvement in areas where performance is already relatively high and to address areas where performance is poorer than average or declining.
20. A number of initiatives are underway to further develop the Council's improvement culture. Following the introduction of the Council's performance management framework, work is continuing on the development of outcome based performance indicators within each service. The Council has developed and implemented its own comprehensive self-assessment tool, which provides a structured framework for examining services' systems and processes, the resources used and what is achieved. Full implementation of all initiatives will support both members and officers in actively managing the Council's performance and the risks it faces in delivering against its objectives and priorities.

## **Workforce management**

21. People play the key role in delivering high performing services. The Council needs to make sure it has the right skills, in the right place, at the right time. This requires effective workforce planning, successful recruitment and retention practices and good industrial relations.
22. The Council has drafted a Human Resource Strategy, a high level document which will be underpinned by a series of HR themes incorporating detailed action plans. The Human Resources Strategy has been presented to the Organisational Development Group but has not yet been submitted for Committee approval.

## **Working in partnership and responding to customers, clients and communities**

23. Increasingly, if the Council is to deliver effectively on the themes and objectives set out in its Corporate Plan, it needs to ensure that services and professions work more closely together to focus the design of services around the needs of individuals and communities.



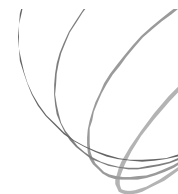
24. In June 2006, Audit Scotland published *Community planning – an initial review* which found that community planning is progressing, but complexities make aims difficult to achieve. While community planning partnerships have made progress, they need to do more to show how their work is improving public services. The report also calls on the Scottish Executive to support community planning more effectively. In particular, the large number of national policy initiatives, each with their own funding arrangements, can make it difficult for partnerships to plan and deliver effectively.
25. Within Perth & Kinross, community planning frameworks are well established and continue to be developed. A review of community planning was undertaken during 2005/06, and an improvement plan was approved. Planned improvements include specific training for elected members, implementation of a community engagement strategy and the establishment of a Customer & Communities Group to provide clear strategic direction, including links between the Council's Corporate Plan and the Community Plan.

## Best value

26. The Local Government in Scotland Act 2003 established best value and community planning as statutory duties for local authorities. In response the Accounts Commission introduced new arrangements for the audit of best value based on a full review by a specialist team once every three years. In the intervening years short follow-up reviews are carried out by the local auditor.
27. The Council will receive a best value audit in November 2007 and, in preparation, continues to monitor the themes raised in the best value reports published to date and incorporate these into its own improvement plans.

## National studies

28. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year on reviews of public sector pension schemes, community planning and the National Fraud Initiative are summarised elsewhere in this document. Other reports published during the year and of direct interest to the Council are set out below. Further information on these studies and reports can be obtained from Audit Scotland's webpage at [www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk).



## **A mid-term report: a first stage review of the cost and implementation of the teachers' agreement *A Teaching Profession for the 21<sup>st</sup> Century***

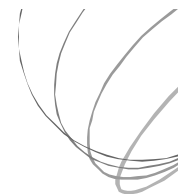
29. In May 2006 Audit Scotland published the results of a review of the implementation of the teachers' agreement arising from the McCrone report. This found that the agreement has brought benefits for the teaching profession, but the lack of performance measures makes it difficult to assess the wider impact of the £2.15 billion investment. The report recommends that the Scottish Executive work with other parties to the agreement to identify and report on a set of comprehensive performance measures.

### **Council housing transfers**

30. In March 2006 Audit Scotland published the results of a review of how well the Scottish Executive's housing transfer policy has been implemented and whether transfers have provided good value for money. This found that the transfer of council housing ownership is bringing benefits for tenants, including more investment in properties, promoting tenant control, facilitating increased repairs and maintenance and the building of new homes, and keeping rent increases down. The report also found that the management of transfers is improving but better, clearer measures are needed to assess impact and value for money.
31. Perth & Kinross Council is not planning to transfer ownership of its housing stock and will instead invest over £70 million over the next 5 years to ensure that its housing meets the required standard.

### **Following the public pound – a follow-up report**

32. In December 2005, Audit Scotland published the results of a study of council funding of arms length and external organisations (ALEOs) to provide information on the scale of funding and how councils perform against the code of guidance on funding external bodies and following the public pound. This report stated that Scottish councils provided £220 million to 14,000 organisations - including companies, trusts and voluntary organisations - to deliver a wide range of council-related services such as support for people with disabilities and the management of leisure centres.
33. The study found that no council fully complied with the guidance, although only five councils had a low level of compliance. Perth & Kinross Council was included in the moderate category of compliance.
34. The report recommends that councils have a register of funding to external organisations, develop a corporate policy on free or subsidised use of council properties, vehicles and facilities, take a risk-based approach to dealing with the organisations they fund, and focus their resources on organisations who contribute to the council's objectives, have arrangements for scrutiny and explore joint working with other councils.



# Financial position

## Introduction

35. In this section we summarise key aspects of the Council's reported financial position and performance to 31 March 2006, providing an outlook on future financial prospects, including our views on potential financial risks.

## Council tax and the general fund

### Revenue performance 2005/06

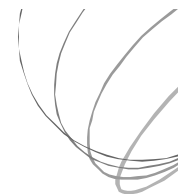
36. The Council's net revenue expenditure in 2005/06 was £242.680 million and was met by government grants and local taxation of £245.843 million, resulting in a net general fund surplus of £3.163 million.

37. The budget set for 2005/06 was based on a Band D council tax level of £1,088. As in prior years, this level was determined after taking into account carried forward budget flexibility and balances. In his Foreword to the financial statements the Head of Finance highlights that, after allowing for £11.060 million earmarked for commitments at 31 March 2005, the overall results for the year were £4.023 million better off than budgeted as a result of a number of factors, including:

- reduction in council tax discounts on second and unoccupied homes of £0.902 million;
- improvements in tax collection of £0.845 million;
- additional net income on the Asset Management Revenue Account of £0.883 million as a consequence of historically low long term interest rates on borrowing and improved returns on short term lending;
- staff vacancies in education and social work services of £0.738 million;
- savings of £0.408 million due to changes in the management and operation of the vehicle fleet.

## Reserves and balances

38. At 31 March 2006 the Council had total cash backed reserves and funds of £34.646 million, including a capital fund to aid delivery of the capital programme, an insurance fund that underpins the Council's self-insurance arrangements and a renewal and repairs fund used to finance expenditure to be incurred in repairing, maintaining, replacing and renewing fixed assets.



## Reserves and Funds 2005/2006

Description	2005/06 £ Million	2004/05 £ Million
General Fund	19.760	16.597
General Fund – Housing revenue account balance	7.068	5.232
Capital Fund	1.577	1.931
Usable Capital Receipts Reserve	3.484	0.501
Renewal and Repair Fund	1.208	1.379
Insurance Fund	1.549	1.143
	<b>34.646</b>	<b>26.783</b>

39. In setting its 2005/06 budget, the Council projected a minimum uncommitted balance on general fund reserves of 2.1% of the revenue budget (excluding the Housing Revenue Account). At year end, the actual uncommitted general fund balance (excluding HRA) is £5.322 million. This represents 2.2% of the revenue budget (excluding HRA) and is therefore in line with the Council's reserve strategy. The Council, however, faces a range of financial issues which will significantly impact on its reserves position and this is discussed further in our Financial Outlook section below.
40. Significant earmarked amounts include:
- housing revenue account committed balances £5.872 million;
  - contribution to the anticipated costs of further equal pay compensation payments of £2.939 million;
  - provision for the single status strategy of £2.550 million;
  - devolved school management balances of £1.214 million;
  - an estimate of £0.750 million in respect of a potential liability to repay charges levied for food preparation in relation to free personal care.

## Group balances and going concern

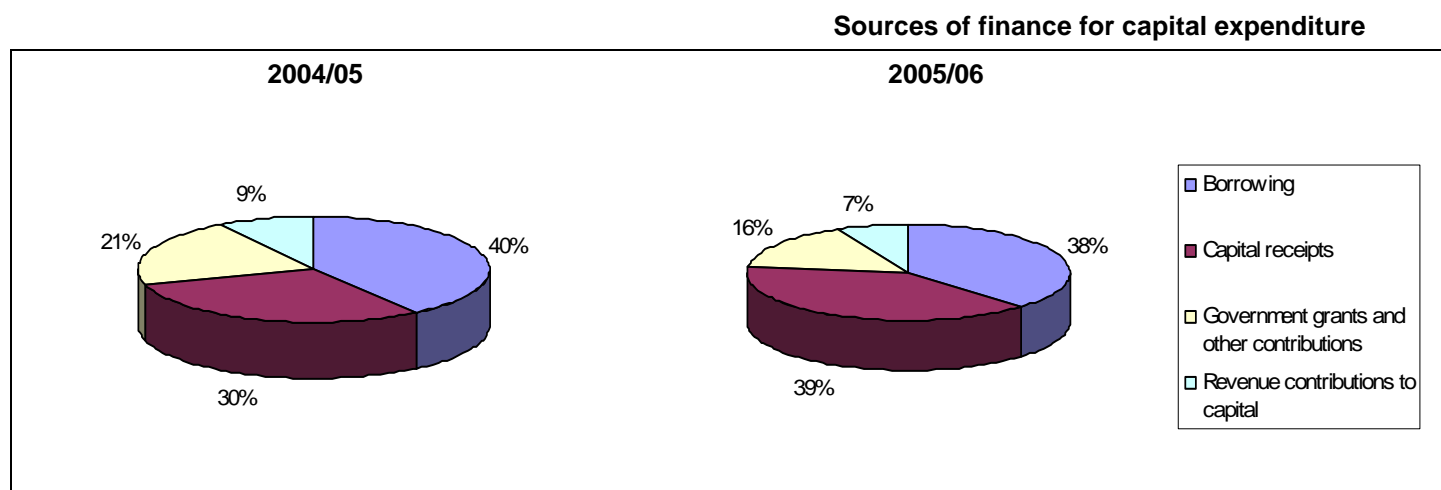
41. The Council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Tayside Police Board, Tayside Fire and Rescue Services and Tayside Valuation Joint Board) had an excess of liabilities over assets at 31 March 2006 due to the accrual of pension liabilities.
42. The overall effect of inclusion of the Council's associates on the group balance sheet is to reduce net assets by £186.9 million, substantially as a result of these liabilities. All group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax.



## Spending on assets and long-term borrowing

### Capital performance 2005/06

43. Following the introduction of the prudential code in April 2004 the Council can decide locally on a capital investment strategy which must meet best value requirements as well as being affordable. The Council's prudential indicators for 2005/06 were set in February 2005 and significant increases in capital expenditure will be made in future under these freedoms as the Council seeks to improve its asset infrastructure, particularly in relation to housing stock and the schools estate.
44. Capital expenditure in 2005/06 totalled £29.8 million, a slight decrease from £30.7 million in 2004/05. £27.7 million was spent in 2003/04, the last year of central capital controls. Capital investment in the last two years was funded as shown below.

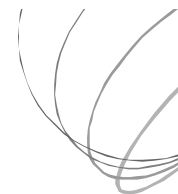


45. Around 91% of long and medium term loans at the year-end mature after more than 10 years and the Council has actively managed its exposure to variable interest rate movements with most of its debt on fixed interest.

### Forward capital programme

46. General services capital plans for 2006/07 and 2007/08 anticipate annual capital expenditure of £31.227 million and £21.378 million respectively. This is expected to be funded by a number of sources including capital receipts, grants and other contributions and increases in borrowing. The Council's financial strategy assumes a 1% annual increase in council tax until 2008/09, matched by service efficiency savings to the same value to assist in funding planned investment in the schools estate.





47. The Council has budgeted within the Housing Investment Programme for investment of more than £70 million over the next 5 years to improve its housing stock. This is expected to be funded mainly by a combination of capital receipts and increased borrowing. The Council completed its housing stock review in 2005/06 and has identified that this investment is required over the next five years to meet the housing quality standard set out in the Local Housing Strategy.

## Significant trading operations

48. The Local Government in Scotland Act 2003 replaced compulsory competitive tendering regulations with a duty to maintain and disclose trading accounts for significant trading operations, which are required to break even over a three year rolling period. The first three year period ended in 2005/06.
49. The Council has a single significant trading operation, Building Services. In the three years to 31 March 2006 it made an aggregate surplus of £0.069 million, meeting the statutory target.

## Financial outlook

### Current budget

50. The 2006/07 budget was based on a Band D council tax level of £1,088, an annual rise of 4.9%. General allowances for pay and cost inflation pressures were built into the budget, together with allowances for demographic pressures on demand led services in education and adult and elderly services. Additional annual pay costs resulting from the future implementation of single status were also allowed for. A number of efficiencies and other savings were built into the budget.

### Equal pay

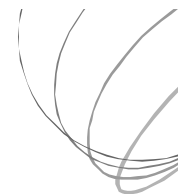
51. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay can put forward claims to an Employment Tribunal. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2005/06.
52. In common with many other Scottish councils Perth & Kinross Council has sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer payments to specific groups of employees as part of a compensation package. Costs of £3.061 million have been recognised in the 2005/06 financial statements for the total one-off cost of these payments. Most of this estimated liability relates to the Council's share of Tayside Contracts' equal pay liability.



53. The extent to which the actual costs vary from current estimates will depend on a number of factors including take-up rates, any employees not covered by the calculations and the level of awards of any cases taken to tribunal. Costs above that already budgeted will increase further the financial pressure on the Council. In recognition of this, the Council has earmarked £2.9 million of the general fund balance for potential additional costs.
54. While moves to agree compensation payments to affected employees will help to reduce financial risk in this area to some extent, there remain risks in this area while existing pay and reward structures remain in place. The future implementation of the single status agreement provides an opportunity to address any underlying inequalities in pay and other conditions of service.

## **Single status**

55. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a presumption that single status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.
56. The original national single status agreement specified that implementation should take place by April 2002 but, following difficulties in establishing a model job evaluation scheme, was extended by agreement between local authorities and unions to April 2004. To date only one council, South Lanarkshire, has implemented Single Status.
57. Perth & Kinross Council remains to implement the agreement as discussions are continuing with trade unions over the evaluation scheme to be applied. £2.550 million has been accumulated to 31 March 2006 as an earmarked part of the general fund to be applied to the costs of the single status job evaluation exercise.
58. Until a local agreement is concluded the initial and continuing costs to the Council cannot be reliably estimated. This represents a significant financial risk to the Council. Evidence from other councils is that variation in the level of potential costs can be up to 10% of the current pay-bill on a continuing basis. The Council currently anticipates additional costs over the first 5 years of implementation of approximately 9.4% of the current pay costs of groups affected by single status. In securing a local agreement the Council needs to ensure it maximises the opportunity for service and job redesign to ensure that it achieves value for money from its investment in its staff.

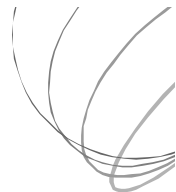


## Efficient government

59. The efficient government initiative is a central part of the government's programme of investment, reform and modernisation and is a five year programme aimed at attacking waste, bureaucracy and duplication in Scotland's public sector.
60. The Efficient Government Plan sets targets to achieve £745 million of cash-releasing savings, and £300 million of time-releasing savings, by 2007/08. It is anticipated that local government as a whole will contribute £325 million in cash-releasing savings to the overall target. This includes assumed efficiency savings of £168 million top-sliced from annual finance settlements. Although the Scottish Executive (SE) has not notified councils of the efficiency savings they should achieve each year, it is anticipated that Perth & Kinross Council's contribution to the £168 million target will be £4.430 million over three years, equating to £1.406 million for 2005/06.
61. The majority of these assumed efficiency savings have been incorporated into annual financial settlements, presenting an immediate challenge as efficiency gains through service redesign are likely to take longer than one year to be fully realised. Failure to achieve the level of savings anticipated will increase financial pressures and may impact adversely on the quality of services provided. In order to claim an efficiency councils need to demonstrate that service outcomes have been maintained or improved.
62. Based on information supplied by councils across Scotland, it is apparent that:
- few councils have a system in place to properly monitor, measure and report efficiency gains and that effort is still required to ensure that appropriate guidance is issued to staff to clarify what constitutes an efficiency;
  - the level of projected efficiencies varies significantly between councils;
  - the majority of planned efficiencies relate to areas and projects other than the SE's five key work streams of procurement, asset management, absence management, streamlining bureaucracy and shared support services;
  - plans for projects to create time releasing efficiencies are not well developed and little in the way of efficiencies is expected to be generated by 2007/08 through shared support services. In both cases this is indicative of the time required to develop plans for fundamental service redesign.



63. Perth & Kinross Council has approached efficient government in a structured manner and has integrated the initiative within its existing business change and improvement agenda. The Council is aware of the most challenging aspects of efficient government which requires mechanisms to ensure that outcomes and quality are not adversely affected by financial savings. In common with other councils, much work is still required to ensure that appropriate guidance is issued to staff to clarify what constitutes efficiency and how it should be measured, monitored and reported.
64. The Council has submitted several bids to the Efficient Government Fund for projects which are intended to deliver efficiency savings. Areas where efficiencies are planned include procurement, asset management and shared support services. In partnership with three other councils, a key bid is to develop a shared service centre covering finance, payroll, procurement and human resources. The Council has undertaken a strategic review of procurement and is also part of two Efficient Government Fund procurement bids which relate to the implementation of e-procurement and developing a centre of procurement excellence in Scotland.
65. Other planned savings will be achieved through the management of staff vacancies and service re-design. The Council's risk based programme of best value reviews, intended to focus on those areas where changes will have the greatest impact, will support the achievement of efficiencies through service re-design.
66. Significant effort will be required to deliver the level of efficiencies required while continuing to improve performance. A structured approach to measuring and monitoring outputs, integrated with the Council's developing performance management systems, is essential to underpin this.
67. The Improvement Service has commissioned an external partner to develop and implement measures of productivity and efficiency in local government services. These measures will be available for councils to assist in their forward planning and to aid them in demonstrating their efficiency gains for the financial year 2006/07. The Auditor General for Scotland intends to publish a report around the end of 2006 to summarise the position across the Scottish public sector on the efficient government initiative. The Council should consider the findings and any recommendations included in this report when reviewing their own position.



## Pension liabilities

68. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. A recent Audit Scotland report on public sector pension schemes highlighted that the combined funding shortfall and unfunded liabilities of the six local government pension schemes in Scotland may be as high as £53 billion. In addition there are proposals to amend the Local Government Pension Scheme which are designed to reduce the ongoing cost, although these have not yet been implemented.
69. In accounting for pensions, Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised in the annual accounts.
70. The Council's estimated pension liabilities at 31 March 2006 exceeded its share of the assets in the Tayside Pension Fund by £72.541 million, decreasing from £95.783 million in the previous year. A full actuarial valuation of the Tayside Pension Fund was reported in early 2006. Factors such as the volatile stock markets and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 97% at 31 March 2002 to 91% at 31 March 2005. The actuary is required to make a 3-year assessment of the contributions that should be paid by the employing authorities from 1 April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. Employer contributions are expected to rise from 275% of employee contributions to 315% by 2008/09.



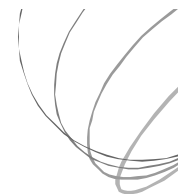
# Governance

## Introduction

71. In this section we comment on key aspects of the Council's governance arrangements during 2005/06. We also provide an outlook on future governance issues, including our views on potential risks.

## Overview of arrangements in 2005/06

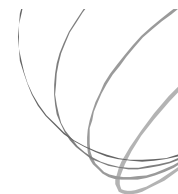
72. Corporate governance is concerned with structures and processes for decision making, accountability, control and behaviours at the upper levels of the organisation. In previous years we have concluded that the Council had systems in place that operated well within a sound control environment and have reached the same conclusion this year.
73. A Statement of Assurance on the System of Internal Control is included within the annual financial statements, with the Council concluding that governance arrangements were operating satisfactorily in 2005/06. A number of areas where the Council is strengthening arrangements are also detailed.
74. At a corporate level the Council has appropriate arrangements in place to prevent and detect inappropriate conduct and corruption. These arrangements include codes of conduct for elected members and staff and revised whistle blowing procedures. The Council has recently installed a dedicated telephone number and e-mail address specifically for staff to report any concerns they may have regarding possible fraud or corruption. The Council also supports the national charity "Public Concerns at Work" which offers advice to people who raise concerns about wrongdoing at their place of work.
75. The Council's Audit Sub-Committee, set up in February 2005, adheres to CIPFA's guidance note *Audit Committee Principles in Local Authorities in Scotland* and continues to develop its role in providing a sound contribution to the overall control environment. The Council has commissioned consultants to examine a variety of democratic models which may be used following the 2007 elections, which will incorporate a review of scrutiny across all committees.
76. The Council has a risk management strategy and a corporate risk management group which promotes the risk management policy throughout the organisation. The approach to risk management is well developed and continues to be improved.



77. Internal audit plays a key role in the Council's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. We carry out an annual review of the Council's internal audit arrangements. The internal audit work programme for 2005/06 was completed as planned and we concluded that we could place reliance on the work of internal audit in a number of key areas.
78. A service review and restructure was carried out within internal audit towards the end of 2005/06. This resulted in an increase in the number of qualified staff and the total level of available resources, addressing two areas of concern which we have raised in previous years. The new structure is now in place and two qualified senior internal auditors have been appointed. However, prior to the appointment of these staff, the section was not operating at its full capacity due to a combination of factors such as sickness absence and personnel issues. This will have an impact on the completion of internal audit's 2006/07 planned programme of work.

## Systems of internal control

79. In his annual report for 2005/06 the Chief Internal Auditor provided his opinion that, based on the internal audit work undertaken during the year, the systems of internal control that are in place within the Council are, in the main, satisfactory.
80. Recommendations made in previous years' internal and external audit reports are monitored by management and internal audit, with progress regularly reported to the Audit Sub-Committee. Our 2005/06 audit also included follow-up of progress made in implementing recommendations arising from previous audits of the SX3 Housing Management System, the SWIFT social work system and an overview of the website. Good progress has been made by the Council in implementing these recommendations.
81. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on a number of the Council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:
- Payroll
  - Creditors payments
  - Housing rents
  - Council tax
  - Non-domestic rates
  - Main accounting system
  - Debtors and income



## Prevention and detection of fraud and irregularities

82. At the corporate level, the Council has appropriate arrangements in place to prevent and detect fraud. These arrangements include an anti-fraud and corruption policy which was approved during the year.
83. Under the National Fraud Initiative (NFI), councils compare information about benefit applicants, students, public sector employees and pensioners with other public bodies to find fraud and errors. The findings of the 2004/05 exercise were published in May 2006, highlighting that across Scotland £15.1 million of fraud, overpayments and savings were found, including:
- 270 cases where pensions were being paid to people who had died;
  - 564 cases of public sector employees and pensioners either fraudulently claiming housing benefits or receiving them in error;
  - 215 cases of housing benefit overpayments to students;
  - 53 cases referred to the Procurator Fiscal and 32 employees who have been dismissed, disciplined or who resigned as a result of the initiative.
84. In Perth & Kinross, 191 data anomalies were directly related to payroll data and these were investigated by Internal Audit. Most of these (149) were due to incorrectly recorded national insurance numbers which have been rectified. Sixteen Perth & Kinross Council employees were found to hold second posts in other authorities, but had not completed the necessary documentation informing the Council. These employees have now completed the correct documentation. Housing benefit work undertaken in relation to the NFI has yielded 10 overpayments of housing benefit, totalling £32,021, and 11 overpayments of council tax benefit totalling £12,761.
85. Audit Scotland is working with the Audit Commission to widen the scope of the NFI during 2006/07. Public bodies will provide information again in October this year and will have fresh information to investigate in early 2007. The Council needs to ensure that it uses the opportunities presented by the NFI on an ongoing basis to assist in the detection of fraud.

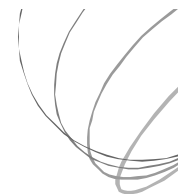
## Governance outlook

86. Continuing development of performance management arrangements and the integration of service planning and the budgeting process will further strengthen the Council's corporate governance arrangements.





87. The forthcoming local government elections in May 2007, bringing the introduction of proportional representation and multi-member wards, have potential implications for the political make-up and governance of the Council. The Scottish Executive's intention is also to remove barriers to encourage the widest possible range of people to serve as councillors, with changed remuneration arrangements for members. These reforms will require significant input from the Council to ensure its governance arrangements are fit for purpose, including committee structures, role/remits of members and arrangements for training new members.



# Financial statements

## Introduction

88. In this section we summarise key outcomes from our audit of the Council's financial statements for 2005/06. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues.
89. We audit the financial statements and give an opinion on:
- whether they present fairly the financial position of the Council and its expenditure and income for the year; and
  - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
90. We also review the Statement on the System of Internal Control by considering the adequacy of the process put in place by the Chief Executive and Council to obtain assurances on systems of internal control and assessing whether disclosures are consistent with our knowledge of the Council.

## Overall conclusion

91. We have given an **unqualified** opinion on the financial statements of Perth & Kinross Council for 2005/06.
92. The Council's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation processes and working papers were generally good and this enabled the audit to progress smoothly. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the Council and publication. The financial statements are an essential means by which the Council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

## Accounting practice

93. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice (the 'SORP'). Some accounting adjustments were made to the figures included in the unaudited accounts provided for public inspection. The net effect of these was to reduce the surplus for the year by £0.078 million, primarily due to the incorrect posting of a transaction for building services' income and housing revenue account expenditure. Other significant accounting issues arising in the course of our audit are summarised below.

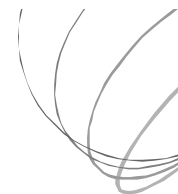


## Debt restructuring costs

94. Lender option borrower option arrangements (LOBOs) are variable rate loans whereby, if the lender decides to change the interest rate at certain predetermined dates, the borrower has the option whether to accept the change or to repay the loan principal. Although LOBOs do not fully provide the guaranteed long term interest rate stability of PWLB fixed rate maturity loans, longer term stability has improved in recent years with longer call intervals, and loan maturity now available up to 60 years.
95. There is currently a debate over the appropriate accounting treatment of LOBOs. One issue is whether the characteristics of a LOBO require any premium arising from replacing existing PWLB debt to be recognised immediately rather than over the life of the replacement borrowing.
96. The Council had LOBO debt totalling £38.2 million at 31 March 2006. Its accounting policy was to recognise the cost of premiums arising from all debt restructuring, including that involving use of LOBOs, over the full life of the replacement borrowing. The Council has now changed its policy to write off premiums and discounts arising on any new debt rescheduling in the year incurred, in recognition of the potential risks arising from the future application of new accounting rules to local authorities (FRS 25 and FRS 26). A total of £6.7 million of rescheduling costs relating to the use of LOBOs was being carried on the balance sheet at 31 March 2006.
97. The carry-forward of premiums is only permissible under the SORP if the overall economic effect of the original and replacement borrowing is substantially the same. We requested and received a specific assurance from the Council which confirmed this. In reaching this view the Council has taken into account the definition of the term 'overall economic effect' offered by the SORP guidance notes, the expected stability of interest rates over the period of replacement borrowing and that there is no evidence that lenders have sought in practice to impose significant interest rate increases or that authorities have refused to accept any changes. We are satisfied that this is a reasonable approach.

## Group accounts

98. Modified arrangements for the preparation of group accounts were mandatory for the first time in 2005/06. The widening diversity of service delivery vehicles used by local authorities means that consolidated group accounts are required to present fairly the activities of an authority. The group accounts are primary accounting statements of the Council.



99. The Council prepared group accounts in accordance with the new requirements following a review to determine its interest in subsidiaries, associated entities and joint ventures. The background to their introduction and basis of their preparation is summarised in the Foreword to the accounts, and commentary on the group financial position is provided in the notes to the group accounts. However, the Statement on the System of Internal Control for 2005/06 refers only to the Council itself. In future years there is an opportunity to take a wider perspective of the group as a whole.
100. The group accounts do not include Perth and Kinross Leisure as the Council considers that it has no interest in this body as defined by the SORP. The Council has confirmed that it has no binding obligation (whether legal or constructive) to contribute to any losses or deficits generated by Perth and Kinross Leisure and has a right to terminate the agreement and use the services of another provider if Perth and Kinross Leisure becomes insolvent.

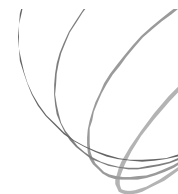
## **Common Good Funds**

101. The Council administers the common good accounts for ten former burghs within Perth & Kinross. During the course of our audit we found that the supporting documentation relating to the existence and valuation of common good assets was inadequate. The standard of documentation is such that it may not stand up to legal challenge and the Council may be unable to demonstrate common good ownership of assets.

### **Action point 1**

## **Legality**

102. Each year we request written confirmation from the Head of Finance that the Council's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes. The Head of Finance has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Chief Executive and Executive Officer Team, the financial transactions of the Council were in accordance with relevant legislation.
103. There has been continuing press coverage surrounding councils which have charged for the preparation of food which may contravene the terms of the Community Care and Health (Scotland) Act 2002 in relation to free personal care. The Council has previously charged for food preparation but, following consideration of the legal and policy position, decided in September 2005 to cease charging for these services. £750,000 has been earmarked in the general fund balance to meet any potential retrospective liability on the part of the Council. A contingent liability has also been recognised in the accounts.



104. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work. As highlighted earlier in this report, the Council has recognised a liability in the financial statements in relation to the potential contravention of this Act. Until the single status agreement is implemented, however, there remains the possibility that the Council could be judged to have contravened the Act.
105. There are no additional legality issues arising from our audit which require to be brought to members' attention.

## Financial reporting outlook

106. Overall the Council is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. It has a record of responding positively to audit issues and changing accounting rules. Challenges ahead include a number of changes that have been made to the 2006 SORP:
- replacement of the consolidated revenue account with a traditional income and expenditure account;
  - a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit;
  - replacement of the statement of total movement in reserves with a statement of total recognised gains and losses; and
  - similar changes to the housing revenue account and group accounts.
107. These changes will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Council should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity continues to be fully transparent.

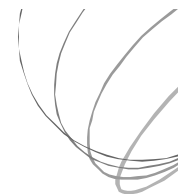
### **Action point 2**

108. Further ahead, there are proposed changes to the application of financial reporting standards (FRS) 25 and 26 in 2007. Application of these standards to local authorities may require the premium on loans that have been re-scheduled to be charged to revenue in full in the year it is incurred rather than being written off over the period of the replacement loan, which can be up to 40 to 50 years. Such a change could have significant implications on council tax levels and Directors of Finance have been discussing with the Scottish Executive how this risk can be avoided through the issue of regulations.



## **Change of external auditor**

109. Regular rotation of auditors is required by auditing standards and is an important component in guarding against perceived or actual threats to auditors' objectivity and independence. Audit Scotland's policy is to rotate auditors at least once every five years. Where the audit is carried out by Audit Scotland staff rather than a private firm, the engagement lead and other key staff will be rotated.
110. This is the final year of our current appointment to the audit of Perth & Kinross Council. From 2006/07 Henderson Loggie will be the Council's appointed auditor. The change of auditor represents an opportunity to build on existing good practice to continuously improve accounts preparation processes in partnership with the incoming auditor.

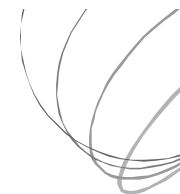


# Final Remarks

111. The members of Perth & Kinross Council are invited to note this report. We would be pleased to provide any additional information that members may require.

112. We have made a number of recommendations in the various reports we have issued during the course of the year and have obtained assurances from officials that action will be taken as appropriate. Attached to this report is a list of significant matters arising from the audit which we consider to be of particular interest to members.

113. The co-operation and assistance given to us by Perth & Kinross Council members and staff over the five years of our audit appointment is gratefully acknowledged.



# Appendix A: Action Plan

## Key Risk Areas and Planned Management Action

Action Point	Refer Para. No	Risk Identified	Planned Action	Responsible Officer	Target Date
1	101	<p><b>Common Good</b></p> <p>Supporting documentation relating to the existence and valuation of common good assets is inadequate.</p> <p><b>Risk: the Council may be unable to demonstrate common good ownership of assets.</b></p>	<p>Recent case law and publications have led the Council to believe that more properties are held on the "common good" than had previously been thought. Currently the Council looks at all properties before selling or letting on long lease to try and determine if they are held on the common good or not.</p> <p>Estates Management and Legal Services are currently in discussion in order to carry out a wider review of this area. However at this time an exact target date is unknown due to the level of resources available.</p>	Russell Thomson (Head of Property Services)	Unknown
2	107	<p><b>Financial reporting</b></p> <p>Changes have been made to the 2006 SORP which will have a significant impact on the presentation of the 2006/07 annual financial statements.</p> <p><b>Risk: in the event of insufficient preparation, the 2006/07 financial statements may not comply with accounting requirements. Differences between financial reporting requirements and budget monitoring during the year may result in a lack of transparency for members and the public.</b></p>	<p>A review of the major changes to the 2006 SORP will be carried out to identify the impact on the 2006/07 Financial Statements. Early work will be undertaken to restate last year's figures into the new format.</p>	John Symon (Head of Finance)	May 2007