



OVERVIEW REPORT

# Overview of the 2000/01 Local Authority Audits

Controller of Audit's statutory report and  
Accounts Commission's findings

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## The Accounts Commission

The Accounts Commission is a statutory, independent body, which through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has five main responsibilities:

- securing the external audit
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- reviewing the management arrangements which audited bodies have in place to achieve value for money
- carrying out national value for money studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils and 35 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

## Audit Scotland

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Accounts Commission and the Auditor General for Scotland. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

## About this publication

This publication contains the Controller of Audit's overview report on the 2000/01 local authority audits. The report is preceded by an executive summary.

The Accounts Commission has considered the Controller's report and its findings are set out on page 1.

# Commission findings

## Completion of audits

It is good to note the continuing improvement in the completion of audits by the Commission's target date. It is, however, a matter of concern that, even with the improvement, only 72% of the audit certificates were completed by the due date.

## Governance

In previous years the Commission has expressed its disappointment that a number of councils have not yet adopted Audit Committee principles. It is a matter of concern that only around half of them had in place by 2000/01 Audit Committees or their equivalent as a focus for councillors' important role in audit, scrutiny and performance monitoring.

Proper relationships with bodies which they fund are an important element of sound governance. We welcome Audit Scotland's intention to give detailed consideration to this area which we understand will include a survey of actual practice in Scottish local government. This will enable us to update the Code of Practice on Following the Public Pound.

## Financial stewardship

There is continuing concern about weaknesses in fundamental financial controls in some councils. In preparation for the requirement to include a statement on internal financial control systems, councils must now take action to meet these concerns. We also note that some councils are slow to act on audit recommendations, and urge them to respond more quickly.

We note the wide variation in the extent to which councils finance capital expenditure from current revenue. While there is room for local variation depending on the circumstances of individual councils, we think it is noteworthy that some councils see the need to finance up to 60% of their capital expenditure on housing from one year's revenue.

## Best Value

We wish to emphasise the importance of councils carefully considering options for ways of delivering services and the financial implications of their decisions.

## Housing and council tax benefits

We continue to be concerned about levels of fraud, accepting that this is a complex issue, and we expect the audit process to keep it under review.

## DLOs/DSOs

We welcome the continuing improvement in the financial performance of councils' direct labour and direct service organisations.

## Council performance

We welcome the general indications of improvement in councils' performance in the past three years. However, we would like to see this information developed further in future years.

# Executive summary

## Introduction

- 1 This statutory report is prepared under section 102(1) of the Local Government (Scotland) Act 1973 to advise the Accounts Commission of the main issues arising from the 2000/01 local authority audits. It is also made available to all local authorities to enable them to assess their progress in key areas of financial stewardship and performance. It draws on reports prepared by external auditors at the conclusion of their audits and covers all the significant matters arising from the 2000/01 audits of the 32 councils and 35 related local authority bodies, such as police and fire boards.
- 2 The report is in two parts. The first part relates to recurrent general issues and shows the broader results and trends for local authorities in Scotland as a whole. The second part relates to matters arising primarily during 2000/01.

## Part 1: Annual results and trends

### *Completion of accounts and audits*

- 3 The deadlines for the completion of accounts and audits are challenging. The performance of councils in completing their accounts by the statutory date of 30 June was commendable. The performance of external auditors in completing audits represented an overall improvement over previous years, but there is scope for further improvement.
- 4 The 2000/01 accounts of two of the 32 councils were qualified, an improvement compared with 1999/2000 when four were qualified. One of the 35 'other' local authority bodies' accounts for 2000/01 was qualified.

### *Corporate governance and financial controls*

- 5 The audit committee concept is an integral component of good governance. External auditors reported that councils are increasingly adopting audit committee principles, often as part of a wider review of committee structures and scrutiny arrangements. In 2000/01 about half of the 32 councils had audit committees or their equivalent in place.
- 6 Internal audit is a key element of the internal control system established by a council's management. The Accounts Commission report '*A job worth doing – raising the standard of internal audit in Scottish councils*' (August 2001) identified that some performed significantly better than others but that all had room for improvement. Twenty of the 32 councils complied with over 70% of CIPFA's standards for internal audit.

- 7 It is disappointing that auditors' 2000/01 reports referred to continuing weaknesses in fundamental financial controls including:
- no reconciliations between key financial systems
  - internal control weaknesses in major financial systems such as payroll, housing benefits administration, commercial and industrial rents systems
  - weaknesses in budgetary control and monitoring systems.
- 8 In future local authorities will need to include within their accounts a statement on the internal financial control systems in operation. Such statements are already required in most parts of the public sector and emphasise that the responsibility for sound systems of internal control rests with management. Internal financial control statements within the accounts of local authorities will enable them to set out the framework within which financial control is managed and reviewed and the main components of the system, including the arrangements for internal audit.
- 9 In order to maintain confidence in the conduct of public business it is in the interest of councils to create a culture where significant issues are brought to the attention of management so that corrective action can be taken. External auditors reported that councils are making progress in implementing 'whistleblowing' policies but that some have been slow to take action.

#### *Financial position*

- 10 The total value of reserves held by councils at 31 March 2001 was some £586 million, though there were wide variations in the amounts held by individual councils. Auditors have indicated that the statutory basis and purpose of amounts described as 'other reserves' is not always clear.
- 11 Total General Fund capital expenditure in 2000/01 across all councils was £590 million of which £87 million (15%) was financed from current revenue. Housing Revenue Account capital expenditure totalled £356 million of which £118 million (33%) was financed from current revenue. Again, within these overall figures, there was wide variation in the extent to which capital expenditure was financed from current revenue.
- 12 The total amount due to councils (net of bad debt provisions) at 31 March 2001, for the four main account areas relating to charges levied against taxpayers and council tenants, increased to £609 million. This is a 3% increase from 2000 and results from increases in net amounts due for council tax and housing rent arrears, offset by a decrease in net amounts due for community charge and non domestic rates.

#### *DLO/DSO performance*

- 13 The Direct Labour/Service Organisation (DLO/DSO) results show further improvement over recent years with 97% of all DLOs/DSOs in Scotland achieving the statutory break-even target with net surpluses totalling £52 million. In 1999/2000 94% achieved break-even with total surpluses of £41 million.
- 14 The Local Government Bill proposes the repeal of Compulsory Competitive Tendering (CCT) and its replacement with a statutory duty of Best Value. In the meantime, councils are reviewing services under the existing Best Value framework. Where these services remain subject to the CCT regime, Best Value initiatives may lead to developments which are not consistent with the existing CCT legislation.

### *Housing and council tax benefits*

- 15 External auditors must be satisfied that councils' housing and council tax benefit subsidy claims are fairly stated and that councils' underlying systems for calculating and paying benefit are sound. In light of the sums and risks involved and the complexity of the system, it is anticipated that housing and council tax benefits will continue to feature significantly in external auditors' work programmes in future years.

### *Financial relationships with external parties*

- 16 External auditors assessed the extent to which councils comply with 'The Code of Guidance on Funding External Bodies and Following the Public Pound' and found a mixed picture of the reliability and adequacy of such arrangements. In view of auditors' reports of difficulties at councils in achieving compliance with the existing Code, and the increasing use by councils of arms-length arrangements, Audit Scotland intends a more detailed review of this area.

### *Audit follow-up*

- 17 Where external auditors conclude that action needs to be taken, they agree action plans with the local authority which they then monitor and follow up. In cases where remedial action has not been agreed or where the local authority has been slow to implement agreed action, Audit Scotland may pursue the matter directly with the authority. The Controller of Audit may also report formally to the Accounts Commission on any matter arising from an audit. The various measures available in terms of follow-up of audit findings provide a flexible framework for action in relation to the annual audit of accounts, stewardship of funds and governance matters.

## Part 2: Matters arising during the year

### *Statutory reports*

- 18 During 2001, the Controller of Audit prepared four statutory reports for consideration by the Accounts Commission, including last year's overview report. Two were follow-up reports on the progress being achieved at Inverclyde Council in addressing weaknesses in accounting procedures and financial administration. The fourth report, on Scottish Borders Council, was concerned with the financial management of the council's education budget.

### *General accounting issues*

- 19 The main accounting issues reported by auditors related to councils' compliance with the capital accounting regime and the implications of new requirements for pensions accounting. Auditors highlighted the potential pressures faced by fire boards in funding firefighters' pensions.
- 20 There are a number of public/private partnerships (PPP) and private finance initiative (PFI) contracts at various stages of completion in councils in Scotland. External auditors review the processes by which councils progress their interests in these schemes and, where appropriate, provide preliminary views on the proposed accounting treatment. Audit Scotland is examining the value for money of recent Private Finance Initiative schools deals in Scotland with a view to making recommendations to help promote good practice in the preparation and delivery of PFI schemes.

### *Matters arising at individual councils*

- 21 The auditors of Clackmannanshire Council expressed serious concerns about the council's lack of progress in reviewing its financial interests in external bodies. At Comhairle nan Eilean Siar (Western Isles Council) the auditors reported that the Building Maintenance and Roads DLOs failed to achieve break-even with deficits of £321,000 and £253,000 respectively. These are significant in terms of the level of DLO activity, representing over 10% of turnover in each case. The external auditor of Midlothian Council referred to a contract for an extension to a school in which there had been a £560,000 (over 30%) overspend. At South Lanarkshire Council the auditor expressed concerns about a contract for debt recovery services.

### *Value for money studies*

- 22 The Accounts Commission approves an annual programme of value for money studies undertaken centrally by Audit Scotland. Reports on 2000/01 study topics related to: pre-school education; property risk management in schools; internal audit; and homecare services for older people.

### *Best Value*

- 23 Best Value was introduced in Scotland in 1997. It requires councils to provide high quality services that meet the needs of their customers and communities, and achieve value for money. Councils must also demonstrate that they are accountable and delivering continuous improvement. The Scottish Executive is expected to introduce legislation that will place a statutory duty on councils to deliver Best Value. The Accounts Commission published a progress report in December 2001 ('*Making Progress with Best Value*') that provided a snapshot of councils' performance management and planning arrangements.

### *Performance Indicators*

- 24 The Local Government Act 1992 places upon the Accounts Commission an annual duty to direct local authorities to publish information which will, in the Commission's opinion, assist in the making of appropriate comparisons. By reference to the criteria of cost, economy, efficiency and effectiveness, comparisons can be made between the standards of performance achieved by different authorities in a financial year and the standards of performance achieved by individual authorities in different financial years. In 2000/01 councils, fire brigades and police forces were required to report their standards against 76 statutory performance indicators covering a wide range of services.
- 25 The statutory performance indicators are only one means by which the performance of councils can be measured and need to be interpreted in a broader context. Nevertheless, it is encouraging to note that the general trend is one of overall improvement, with the majority of councils improving on most indicators between 1998/99 and 2000/01.

# Controller of Audit's report

## 1 Introduction

- 1.1 This report covers all the significant issues arising from the 2000/01 audits of the 32 Scottish councils and 35 related local authority bodies, such as joint fire and police boards. While focusing on the main council audits, references to specific topics affecting the 'other' local authority bodies are included where appropriate.
- 1.2 This report has been prepared in response to a request from the Accounts Commission under section 102(1) of the Local Government (Scotland) Act 1973. The information has been drawn principally from reports prepared by external auditors at the conclusion of their audits for the financial year ended 31 March 2001. Where appropriate I have supplemented this with other relevant, contextual information.
- 1.3 The report is in two parts. The first part relates to recurrent general issues and shows the broader results and trends for local authorities in Scotland as a whole. The second part relates to matters arising primarily during 2000/01.

# Part 1: Annual results and trends

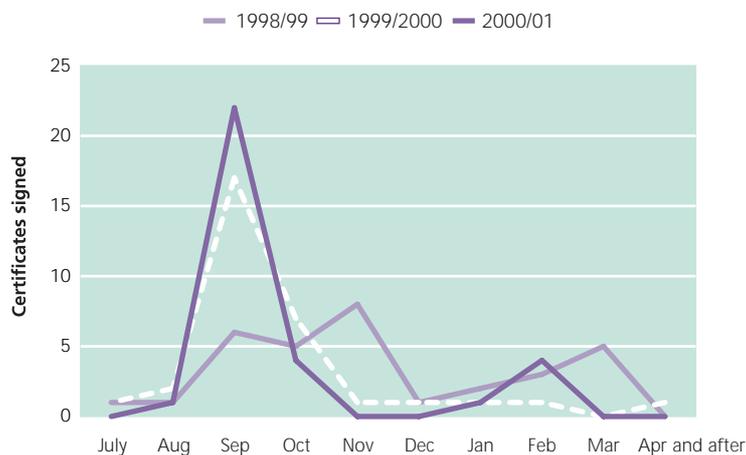
This part covers:

- completion of accounts and audits
- corporate governance and financial controls
- financial position
- DLO/DSO performance
- housing and council tax benefits
- financial relationships with external parties
- audit follow-up.

## 2 Completion of accounts and audits

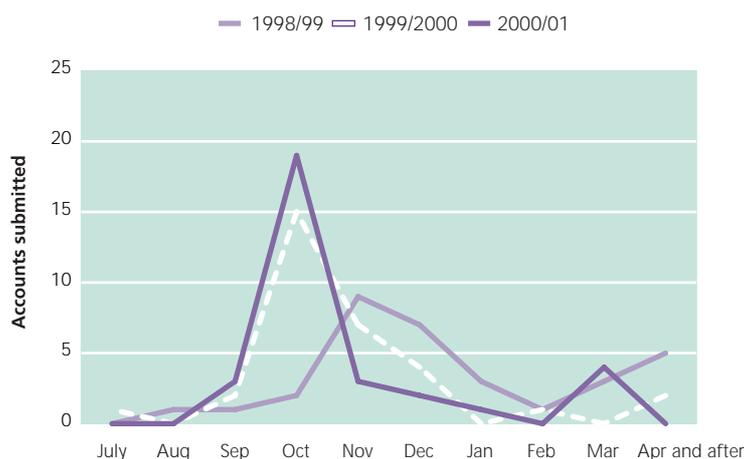
- 2.1 The Local Authority Accounts (Scotland) Regulations 1985, as amended, require local authorities to submit their annual accounts for audit by 30 June in the next financial year. All 32 councils in Scotland, and 34 of the 35 'other bodies', achieved the statutory deadline.
- 2.2 Under their terms of appointment, external auditors were required to complete the 2000/01 audits by 30 September 2001. Exhibit 1 shows the dates by which the 2000/01 accounts were signed off by auditors and compares the position with previous years.

Exhibit 1: Date by which audit certificates were signed 1998/99 - 2000/01



2.3 The sign-off date is important because it signals the completion of the audit of the accounts. Twenty-three accounts (72%) were signed off by 30 September 2001. Having received the external auditor's certificate, councils can proceed to publish their audited accounts, thereby reporting to their taxpayers on financial stewardship and performance. Exhibit 2 shows the dates on which audited accounts were submitted to Audit Scotland by councils' external auditors.

Exhibit 2: Submission of audited accounts 1998/99 - 2000/01



2.4 Exhibits 1 and 2 indicate that, on average, there continues to be a delay of about one month between sign-off by the external auditors and the date on which the accounts were submitted. This appears to be due in part to the time taken by councils to produce the final version of the accounts. In some cases, councils' published annual reports may follow even later.

2.5 The deadlines for the completion of accounts and audits are challenging. The performance of councils in completing their accounts by the statutory date was commendable. Overall, the performance of external auditors in completing audits represents an improvement over previous years, but there is scope for further improvement.

2.6 The value of financial information is enhanced if the audited accounts are published as soon as possible after the completion of the audit. In terms of format, there may also be merit in publishing the financial results with other performance information. Timely publication of a combined financial and performance report would be a significant contribution towards effective public reporting under Best Value and would assist the public in assessing the overall performance of councils.

2.7 The 2000/01 accounts of two of the 32 councils were qualified in respect of three matters. Details are contained in Exhibit 3. This represents an improvement compared with 1999/2000 when four accounts were qualified in respect of six matters. Only one of the 35 'other' local authority bodies' accounts for 2000/01 was qualified.

### Exhibit 3: Audit qualifications in 2000/01

Local authority	Reason for qualification
Inverclyde Council	<ul style="list-style-type: none"><li>■ £13.5 million borrowed in advance of need, outwith council's borrowing powers.</li><li>■ Unexplained differences arising from accounting reconciliations (debtors: £149,000; creditors: £332,000).</li></ul>
Shetland Islands Council	<ul style="list-style-type: none"><li>■ Disagreement about the way in which the council had accounted for a property transaction in a previous year (ongoing impact on reserves).</li></ul>
Strathclyde Passenger Transport Authority	<ul style="list-style-type: none"><li>■ Disagreement about the accounting treatment of deferred charges.</li></ul>

2.8 Other significant issues can arise during the course of a local authority audit which, while not affecting the auditor's opinion on the accounts, may need to be included within the audit certificate. This allows the external auditor to draw attention to important issues without qualification of the audit opinion.

2.9 The 2000/01 accounts of ten councils contain such references in respect of ten issues all of which were Direct Labour/Service Organisation (DLO/DSO) related matters. This represents a reduction on the 1999/2000 position when 12 accounts carried 14 references, 12 of which related to DLOs/DSOs. Further details of DLO/DSO performance are contained in Section 5 of this report.

## 3 Corporate governance and financial controls

### Introduction

3.1 The term 'corporate governance' came into common use in the UK in a company context following publication of the Cadbury Report in 1992. Since then, there have been a number of initiatives to extend good governance principles into the public sector, including councils.

3.2 '*Corporate Governance in Local Government – A Keystone for Community Governance*', was produced in 2001 jointly by CIPFA (Chartered Institute of Public Finance and Accountancy) and SOLACE (Society of Local Authority Chief Executives) and is intended to assist councils in developing and improving their corporate governance arrangements. It defines corporate governance as 'the system by which local authorities direct and control their functions and relate to their communities' and identifies the underlying principles as openness and inclusivity; integrity; and accountability. The CIPFA/SOLACE paper, and their related guidance for Scottish councils, sets out an approach for reviewing corporate governance arrangements and suggests how councils may go about demonstrating compliance with the principles of good governance. It calls for councils to prepare and adopt a local code of corporate governance by 31 March 2002.

### Audit committees

- 3.3 The Accounts Commission has endorsed the audit committee concept as an integral component of good governance. One particularly important role of an audit committee (or its equivalent) is to ensure action is taken in response to recommendations in internal and external audit reports. External auditors' 2000/01 reports indicate that councils are increasingly adopting audit committee principles, often as part of a wider review of committee structures and scrutiny arrangements. In 2000/01 about half of the 32 councils had audit committees (or equivalent) in place.
- 3.4 Each council should determine the arrangements appropriate to its particular circumstances. Exhibit 4 provides examples of the steps being taken in this area, highlighting the approaches taken by three Scottish councils.

#### Exhibit 4: Implementing audit committee principles

##### Clackmannanshire Council

In August 2001, the council decided to establish a Policy and Audit Committee. Its remit covers: community planning; performance management; audit; Best Value; budget monitoring; and the co-ordination of strategic economic development.

The auditors noted that the committee already appears to have had some success in achieving positive action in relation to audit points.

##### East Lothian Council

The council has set up performance review panels to examine performance related issues across the range of council activity. In addition a Council Performance Review Panel will consider service reviews, performance indicators, actual performance against targets and reports from the external auditors and other inspection agencies.

The auditors highlighted that in the existing panels there may be inadequate time to consider fully financial and audit matters and suggested such matters warrant a separate panel.

##### Perth and Kinross Council

The council revised its arrangements for dealing with internal and external audit matters by abolishing its Audit Committee and replacing it with a Member/Officer Audit Working Group which it considers a more appropriate forum for dealing with audit outputs.

An additional committee, the Scrutiny Committee, was also established whose role and remit covers *inter alia* consideration of certain matters of relevance to the audit process such as the audit of corporate policies and reviews of areas within the council's scheme of administration/ delegated authority such as tender and contracting procedures and financial limits of delegation.

### Internal audit

- 3.5 Internal audit is a key element of the internal control system established by a council's management. Audit Scotland undertook a study of the performance of the internal audit function in all Scottish councils during 2000/01. The resulting Accounts Commission report '*A job worth doing – raising the standard of internal audit in Scottish councils*' (August 2001) identified that there was room for improvement in all councils but that some performed significantly better than others. Almost two-thirds of councils (20) complied with more than 70% of the standards in the CIPFA Code of Practice for Internal Audit in Local Government. Exhibit 5 shows the key features most commonly found in better performing councils which were usually absent in the poorer performing councils.

#### Exhibit 5: Internal audit – key features in better performing councils

- An audit committee (or similar) to hold internal audit to account and ensure agreed audit recommendations are implemented.
- A comprehensive risk assessment to determine internal control priorities and internal audit work programmes.
- A richer 'skill mix' in audit staff.
- Annual reporting by the chief internal auditor giving an overall assessment of internal control.

- 3.6 External auditors review the work undertaken by internal audit as part of their review of the council's internal control framework. If the assessment is satisfactory the external auditor can rely on the work of internal audit. This approach ensures the effective and efficient use of the combined resources available for audit.
- 3.7 The internal audit of joint boards may be undertaken by one of the constituent authorities' internal audit departments under a service level agreement or similar arrangement. Auditors highlighted cases where the level of internal audit coverage provided to the boards under such arrangement was insufficient. It is important that members and managers of joint boards ensure that the level of internal audit coverage is appropriate.

#### *Internal control issues arising*

- 3.8 It is the responsibility of officers and elected members of local authorities to ensure that proper internal control systems exist to safeguard the authority's assets and prevent and detect fraud or errors in the financial records. One of the key roles of both external and internal auditors is to evaluate financial control systems and report on any identified weaknesses.
- 3.9 It is disappointing to note from external auditors' reports on 2000/01 audits references to continuing weaknesses in fundamental financial controls. Examples of the matters reported by auditors include:
- the absence of reconciliations between key financial systems
  - weaknesses in internal control in major financial systems such as payroll, housing benefits administration, commercial and industrial rents systems
  - weaknesses in budgetary control and monitoring systems.
- 3.10 In addition auditors noted cases where councils had been slow to act on audit recommendations. Audit Scotland is currently pursuing matters arising from the 2000/01 audits with the individual authorities concerned with a view to securing their assurance that remedial action has or will be taken within acceptable timescales. Details of the audit follow up arrangements are included in Section 8 of this report.

#### *Governance developments*

- 3.11 Increasingly, as part of the development of corporate governance within the public sector, there is a requirement for a statement to be made by the organisation on how the principles of corporate governance have been applied.

- 3.12 In future years local authorities will require to include within their accounts a statement on the internal financial control systems in operation. Such statements are already required in most sectors and emphasise that the responsibility for sound systems of internal control rests with management.
- 3.13 The internal financial control statement within the accounts of local authorities will enable the council to set out the framework within which financial control is managed and reviewed and the main components of the system, including the arrangements for internal audit. The statement will also report on identified material weaknesses and the action taken to address these.
- 3.14 It is anticipated that the requirement for internal financial control statements for councils will be introduced by the 2002 Accounting Code of Practice and will apply from the 2002/03 financial year.

#### *Standards of conduct and 'whistleblowing'*

- 3.15 In addition to ensuring that sound systems of internal control are present within an organisation, one of the most important methods of preventing fraud is to create an organisational culture that makes it clear that high standards of conduct are expected. The conduct of elected members will be governed by a national code of conduct which will be introduced by councils in response to the Ethical Standards in Public Life etc (Scotland) Act 2000.
- 3.16 It is important, however, that local authorities also have in place codes of conduct, including anti-fraud policies and procedures, for staff. One particular aspect of this is covered by the Public Interest Disclosure Act 1998 (the 'whistleblowing' legislation) which provides protection to employees who make disclosures in the public interest. It applies to workers who disclose information about malpractice or mal-administration where they consider it is in the public interest to do so.
- 3.17 In order to maintain confidence in the conduct of public business it is in the interest of local authorities to create a culture where significant issues are brought to the attention of management so that corrective action can be taken. This is preferable to a situation where an employee feels that he or she must make the disclosure to an external agency or to the press because of fear of reprisals or lack of action by management. Evidence from external auditors' 2000/01 reports suggests that councils are making progress in implementing 'whistleblowing' policies but some authorities have been slow to take action.

## 4 Financial position

### *Revenue*

- 4.1 Councils' revenue expenditure is financed from three main sources: government grants (which includes yields from non-domestic rates), council tax and fees and charges. About 80% of financing for local government expenditure comes from central government grant, council tax funds about 15%, and the balance (5%) is funded mainly from fees and charges. Expenditure on council housing is met mainly from rents.

- 4.2 Income and expenditure on council services other than housing is reflected in the General Fund. The Housing Revenue Account (HRA) records transactions relating to the provision of council housing. The HRA is 'ring-fenced' in that councils may not subsidise council housing activities from the General Fund.
- 4.3 Each year councils are required to set council tax at a level that will ensure that income will meet anticipated expenditure, taking into account other sources of finance. Councils may decide to utilise some of their reserves when drawing up their annual budget. For this reason the General Fund surplus or deficit for the year is not in itself a reliable measure of financial performance. The accumulated General Fund balance, together with other balances held, give a more meaningful indication of a council's financial health.
- 4.4 At 31 March 2001 councils had General Fund balances totalling £191 million (31 March 2000: £169 million) representing 2.7% of General Fund net expenditure (31 March 2000: 2.5%). General Fund balances at individual councils ranged from less than 1% to over 12% of General Fund net expenditure. Inverclyde Council was the only Scottish local authority with an accumulated deficit on its General Fund at 31 March 2001 amounting to £0.3 million, although this was offset by other reserves of £5.3 million, giving a net position of £5 million.
- 4.5 At 31 March 2001, 28 councils had surplus balances on their Housing Revenue Accounts, totalling £88 million (31 March 2000: 26 councils had balances totalling £96 million). The remaining four councils had nil balances on their HRAs (31 March 2000: six councils had nil balances).

### Reserves

4.6 Councils hold a variety of other reserves in addition to the General Fund and Housing Revenue Account balance. The total value of these funds at 31 March 2001 was £307 million (31 March 2000: £287 million). These mainly consist of renewal and repair funds, insurance funds and capital funds. These totals exclude significant balances held by Orkney and Shetland Islands councils arising principally from harbour related activities.

4.7 The total level of councils' reserves is shown in Exhibit 6.

**Exhibit 6: Councils' total reserves**



- 4.8 The total value of reserves held by councils at 31 March 2001 was of the order of £586 million (31 March 2000: £552 million). Within the overall figures there are wide variations in the amounts held by individual councils. In terms of amounts described as 'other reserves', auditors have indicated that the statutory basis and purpose of these reserves is not always clear.
- 4.9 Reserves are funded predominately from government grant and council tax. Auditors will continue to monitor utilisation of reserves as part of their overall review of councils' stewardship of public funds, and will follow up those cases where the statutory basis and purpose of reserves is not clear.

### *Capital*

- 4.10 Capital expenditure is mainly financed by borrowing which allows costs to be spread over future years in order to match the benefits from the expenditure incurred. However, councils can decide to fund capital expenditure from current revenue. This increases their capital spending capacity but the expenditure falls to be met in full by council taxpayers or council tenants in the year in which the expenditure is incurred.
- 4.11 Total General Fund capital expenditure in 2000/01 across all councils was £590 million, of which £87 million (15%) was financed from current revenue (1999/2000: £613 million, of which £95 million (15%) was financed from current revenue). For the Housing Revenue Account, capital expenditure in 2000/01 totalled £356 million of which £118 million (33%) was financed from current revenue (1999/2000: £351 million of which £107 million (30%) was financed from current revenue). Within these overall figures, there is wide variation in the extent to which councils finance capital expenditure from current revenue. This is particularly evident on the Housing Revenue Account where the amount of capital expenditure financed from current revenue in 2000/01 ranged from nil to 60% (1999/2000: from nil to over 50%). About a quarter of all councils in Scotland financed more than 40% of Housing Revenue capital expenditure from current revenue in 2000/01 (1999/2000: a third).
- 4.12 There are plans for the current regime of central government controls over local authorities' capital expenditure to be changed. Currently, capital expenditure by councils is controlled by Scottish Ministers under section 94 of the Local Government (Scotland) Act 1973 and related regulations. Councils are provided with consent to incur expenditure and can only exceed these limits by disposing of assets to generate capital receipts or by making revenue contributions to capital. The forthcoming Local Government Bill proposes to replace this with a more flexible system.
- 4.13 CIPFA is currently developing a Prudential Code for Capital Finance in Local Authorities. The objectives of the Code are to provide a framework for local authority capital finance that will ensure, for individual local authorities, that:
- all external borrowing and other long term liabilities are within prudent and sustainable levels
  - capital expenditure plans are affordable

- treasury management decisions are taken in accordance with professional good practice
- the local authority is accountable by providing a clear and transparent framework.

The framework is also intended to be consistent with and support local strategic planning, asset management planning and proper option appraisal for capital investment.

4.14 The Accounts Commission has welcomed the development of the Prudential Code as part of a framework for capital expenditure control. The Commission will expect auditors to review the extent to which councils have complied with the Code and to report on matters arising if and when the Code is adopted in Scotland.

*Amounts due to councils (local taxes and housing rents)*

4.15 Auditors have reported that the total amount due to councils (net of bad debt provisions) at 31 March 2001, for the four main account areas relating to charges levied against taxpayers and council tenants, has increased to £609 million. This compares with £593 million due to councils at 31 March 2000. This overall increase of 3% is a result of increases in net amounts due for council tax (8%) and housing rent arrears (2%), off set against a decrease in net amounts due for community charge (2%) and non-domestic rates (5%). Exhibit 7 shows the overall position.

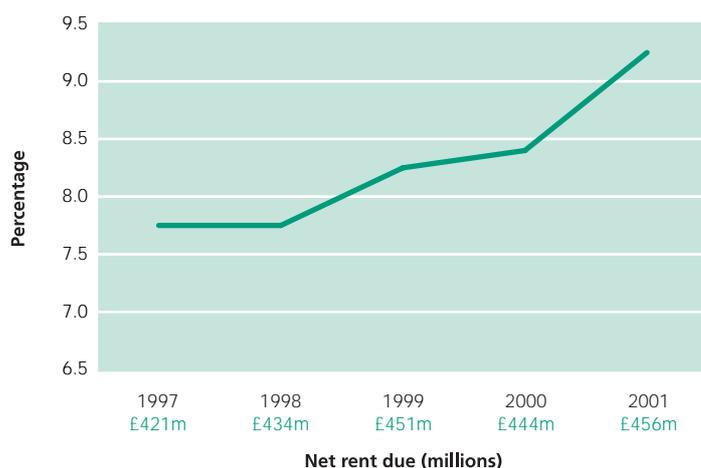
**Exhibit 7: Amounts due to councils (local taxes and housing rents)**



4.16 Although the amount of council tax debt has increased from the previous year, the percentage of the current year's tax collected in-year was the highest since 1996/97, representing 89.2% of the £1.34 billion due (1999/2000: 88.3% of £1.26 billion). Collection rates varied from 96.4% (Orkney) to 79.6% (West Dunbartonshire).

4.17 Housing rent arrears continue to rise. In 2000/01 council tenants were due to pay £456 million in rent of which £42 million (9.2%) was in arrears at 31 March 2001. In the previous year tenants were due to pay £444 million of which £37.4 million (8.4%) was in arrears. Within these figures there are wide variations between councils. Current tenants' arrears as a percentage of net rent due in 2000/01 varied between 2.4% (Moray and Scottish Borders) and 23.5% (West Dunbartonshire).

Exhibit 8: Current tenants' arrears as a percentage of net rent due



4.18 The level of serious rent arrears has been increasing year on year since 1998/99. In 2000/01, 6.1% of council house tenants had arrears of more than £250 and were over 13 weeks in arrears compared with 5.8% of tenants in 1999/2000.

4.19 The reasons for rent arrears arising can be complex. The Accounts Commission's 2000 report '*Managing rent arrears – getting the balance right*' recommended actions that should be taken by councils to improve the management of rent arrears including:

- giving rent collection a high priority and having a formal arrears policy in place
- maintaining effective liaison between council staff dealing with tenants, most particularly rent arrears and housing benefit staff
- managing the recovery of overpaid housing benefit separately from rent arrears
- developing a 'performance culture', where council staff are given support to perform well, and are involved in setting targets and monitoring performance.

## 5 DLO/DSO performance

### Overall position

5.1 The main statutory provisions governing the operation of councils' Direct Labour Organisations (DLOs) and Direct Service Organisations (DSOs) under Compulsory Competitive Tendering (CCT) are contained in the Local Government, Planning and Land Act 1980 and the Local Government Act 1988 respectively, and in related secondary legislation.

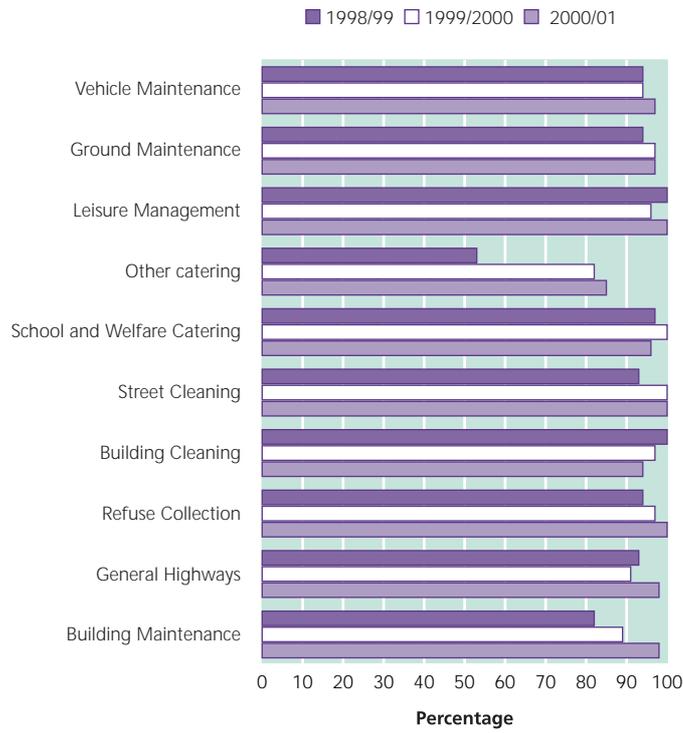
- 5.2 In consequence of local government reorganisation in Scotland (which was effective from 1 April 1996), CCT was largely suspended. With the development of the Best Value regime, there has been an extension of the moratorium on existing CCT activity. Only construction work in excess of £500,000 is currently required to be exposed to competition under CCT. However, councils are still required by statute to prepare a detailed specification and calculation of the charge to be made by their DLOs and DSOs for carrying out work. They are also required by statute to maintain accounts and to break-even each year for each defined category of work.
- 5.3 The DLO/DSO results for 2000/01 show further improvement over recent years with 97% of all DLOs/DSOs in Scotland achieving the statutory break-even target with net surpluses totalling £52 million. Exhibit 9 compares performance in 2000/01 with the previous three years.

**Exhibit 9: DLO/DSO performance 1997/98 - 2000/01**

	% Achieving break-even	£ million		
		Total surpluses	Total deficits	Net surpluses
2000/01	97	53	1	52
1999/2000	94	43	2	41
1998/99	91	43	5	38
1997/98	82	32	15	17

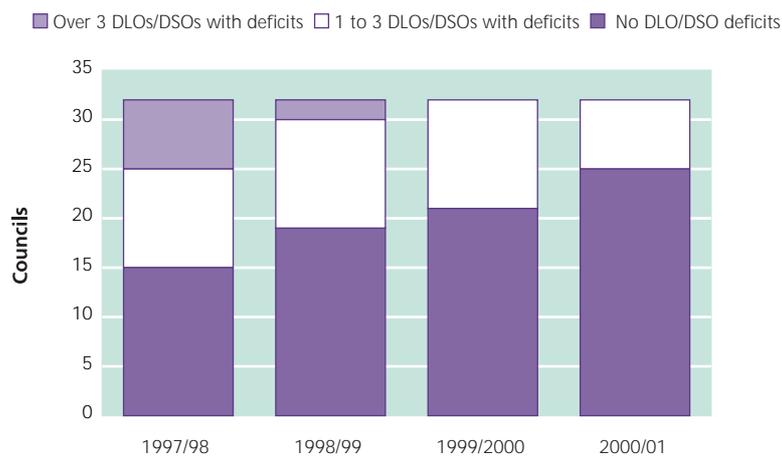
- 5.4 Exhibit 10 summarises financial performance for each activity against the statutory break-even target in 2000/01 and compares this with 1999/2000 and 1998/99.

**Exhibit 10: DLOs/DSOs achieving the break-even target (%)**



5.5 Exhibit 11 shows a continuation of the trend of an increasing number of councils where all their DLOs/DSOs achieved the statutory break-even target.

**Exhibit 11: DLO/DSO deficits in councils**



- 5.6 Financial difficulties faced by DLOs at Comhairle nan Eilean Siar (Western Isles Council) and associated action taken by the Scottish Executive are highlighted in Section 11 of this report.

#### *Service developments affecting DLOs/DSOs*

- 5.7 In April 2001 responsibility for the maintenance of trunk roads in Scotland was taken over by two private operating companies. This work had previously been undertaken by local authorities' DLOs. A report prepared by the Auditor General ('*The new trunk road contracts*', November 2000) following a study of the tendering process, indicated that about 500 local authority staff had been affected in some way, including 86 who had been made redundant and 159 who had been redeployed within the councils. A further 218 staff transferred to the new operating companies and approximately 60 left employment with the councils for other reasons. Councils reported an overall reduction in income of approximately £45 million a year as a consequence of the transfer of responsibilities. Councils have adapted to these changes by working in partnership with the new companies, by restructuring and by reviewing policy on local road maintenance for which they retain responsibility.
- 5.8 Local authority auditors referred to the changes in their 2000/01 final reports. Examples of the local impact drawn from these reports are set out in Exhibit 12.

#### **Exhibit 12: Impact of change in responsibility for trunk road maintenance**

**Fife Council's** auditor reported that the reduction in income for the Roads DLO has been estimated at £1.6 million as a result of the Scottish Executive's decision to transfer the contract for trunk road maintenance to a commercial contractor in April 2001, following competitive tendering. The council is examining the operation of the Roads DLO in light of this.

**Renfrewshire Council's** auditor reported that the Roads DLO also suffered a substantial reduction in income and has managed the process by non-renewal of temporary employment contracts, retiral and redeployment of staff and disposal of surplus assets. In addition there has been some displacement of staff to new posts in the private sector.

**South Ayrshire Council's** auditor reported that the council has not suffered significant or immediate financial consequences from the loss of the trunk roads work. The council managed the situation by terminating temporary staff contracts, returning seconded staff to their original posts and redeploying remaining staff.

- 5.9 The full extent of the impact on councils of the change in arrangements for trunk road maintenance will become apparent during 2001/02. External auditors are monitoring the position, with particular reference to the consequential effect on councils' finances.

#### *Best Value and CCT*

- 5.10 The Local Government Bill, scheduled to be introduced in the Scottish Parliament this year, proposes the repeal of CCT and its replacement with a statutory duty of Best Value.
- 5.11 In the meantime, councils are reviewing services under the existing Best Value framework (see Section 13 of this report). In cases where these services remain subject to the CCT regime Best Value initiatives may lead to developments which are technically in breach of the CCT legislation. Examples of this were reported by the external auditor of Glasgow City

Council who reported that, as a result of restructuring of vehicle fleet management and street cleaning activities, income for statutory and non-statutory functions are now inseparable. Consequently he was unable to conclude that the DSOs had complied with the break-even requirement in relation to the defined statutory activities of vehicle maintenance and street cleaning.

- 5.12 Under the proposed Best Value arrangements councils will have greater discretion in deciding on how they will go about delivering services. It is anticipated that councils will be required to demonstrate reasons for choosing a particular method of service delivery and the financial implications of that decision and that external auditors will review councils' arrangements and report their findings.

## 6 Housing and council tax benefits

- 6.1 Councils are responsible for paying housing and council tax benefits on behalf of the Department for Work and Pensions (DWP) and receive reimbursement from the DWP through annual claims for subsidy based on the amount of eligible benefit paid. Annual subsidy claims are subject to audit certification. External auditors must be satisfied that the claims are fairly stated and that councils' underlying systems for calculating and paying benefit are sound. In addition, each year the Benefit Fraud Inspectorate (BFI) undertakes in-depth examinations of a number of Scottish councils and reports on how they administer housing and council tax benefit, with particular reference to the prevention and detection of fraud. Audit Scotland works with the BFI to develop complementary roles and avoid unnecessary duplication of work. This relationship is governed by a memorandum of understanding.
- 6.2 The statutory Performance Indicators published by the Accounts Commission show that in 2000/01 the average time taken by Scottish councils to process new claims was 48 days. The time taken to process new claims for benefit ranged from 15 days (South Lanarkshire) to 107 days (East Ayrshire). Some of the delays may be attributable to factors outwith councils' control, such as time spent waiting for claimants to provide further necessary information. Delays in processing benefit claims have an adverse impact on the level of rent arrears.
- 6.3 DWP has drawn up a Verification Framework setting out the information to be collected from claimants in support of their claim for benefit. The purpose of the framework is to improve councils' prevention of claimant fraud. In 2000/01 twelve Scottish councils had adopted the Verification Framework, an increase of four from the previous year.
- 6.4 The National Fraud Initiative (NFI) is a data-matching exercise run by the Audit Commission every two years to help combat public sector fraud. Two Scottish councils (City of Edinburgh and Scottish Borders) participated successfully in the NFI 2000 exercise, on a pilot basis. Working in partnership with the Audit Commission, Audit Scotland hopes that more Scottish councils will be involved in NFI 2002 which commences later this year.

- 6.5 The housing and council tax benefit system is complex, involves a high volume of transactions and is susceptible to claimant fraud. The level of detected fraud reported in 2000/01 was £6.9 million (1999/2000: £6.9 million). While this figure is significant, it has to be viewed in the context of the estimated £1.4 billion in benefits paid each year by Scottish councils.
- 6.6 The level of fraud reported to Audit Scotland varies widely between councils, both in terms of the overall amounts and the areas where fraud has been detected ie rent rebates (council tenants) and rent allowances (tenants in private accommodation).
- 6.7 In light of the sums involved, the complexity of the system and the risks involved, it is anticipated that housing and council tax benefits will continue to feature significantly in external auditors' work programmes in 2001/02 and future years.

## 7 Financial relationships with external parties

- 7.1 Councils have powers in certain circumstances to enter into agreements with external bodies who undertake functions which might normally be carried out by councils themselves. The external body may be a council funded trust or company. In other cases the relationship may be with grant aided organisations and voluntary bodies. The nature of these agreements is often wider than a simple contract for services. The common feature of these arrangements is that, in the council's view, services can be delivered more effectively outwith the local authority regulatory framework.
- 7.2 In the case of trusts operating leisure facilities, for example, there is more flexibility available to the non-statutory sector in relation to revenue generating activities. In the case of social welfare projects, local authorities can legitimately fund projects producing wider social benefits than the relatively narrowly defined client group permitted by social services legislation. The Local Government Bill scheduled to be introduced to the Scottish Parliament in 2002 proposes a new general power for councils to 'promote and improve the well-being of their area'. This, together with the initiatives such as joined-up working and pooled budgets under modernising government and community planning (which encourages co-operation between local authorities and other public sector bodies such as NHS trusts) is likely to result in further use of external bodies set up by councils for specified purposes.
- 7.3 It is important that appropriate monitoring mechanisms are in place to enable councils to discharge their stewardship and accountability duties in relation to the public funds provided to such bodies. The Code of Guidance on Funding External Bodies and Following the Public Pound, developed jointly by the Accounts Commission and the Convention of Scottish Local Authorities (COSLA), sets out the principles of best practice for councils in establishing relationships with companies, trusts and other bodies where there is substantial local authority funding. The Code was supplemented by operational guidance issued by COSLA in 1998.
- 7.4 External auditors assess the extent to which councils comply with the Code. A mixed picture has emerged in 2000/01 of the reliability and adequacy of such arrangements in reviews conducted by auditors.

- 7.5 Exhibit 13 highlights an example of good practice identified by the auditors of Aberdeenshire Council. Section 11 of this report illustrates the difficulties experienced by Clackmannanshire Council in dealing with external funding arrangements inherited at local government reorganisation.

**Exhibit 13: Following the public pound: an example of good practice**

The auditors of Aberdeenshire Council reported that good practice had been followed in drawing up an agreement with a housing partnership. The agreement specifically considers the Following the Public Pound Code and addresses the following key areas:

- the partnership's responsibility to maintain accounting records
- requirements for regular reporting and accountability by the partnership to the council
- access by the council to accounting records
- establishment by the partnership of a set of corporate governance standards
- an 'exit strategy' for the authority.

- 7.6 In light of auditors' reports of difficulties at councils in achieving compliance with the existing Code, and the increasing use of arms-length arrangements, Audit Scotland intends more detailed consideration of this area. This will inform a review and update of the existing guidance to ensure it reflects best practice and remains relevant in changing circumstances.

## 8 Audit follow-up

- 8.1 External auditors are required to report on matters arising from their audits. Where the auditors conclude that action needs to be taken, they agree action plans with the local authority which specify the action required, where responsibility for action rests and a timetable for its implementation. Implementation of the actions plan is monitored and followed up by the auditors.
- 8.2 In cases where remedial action has not been agreed or where the local authority has been slow to implement agreed action, Audit Scotland may pursue the matter directly with the authority. As Controller of Audit, I may also report formally to the Accounts Commission on any matter arising from the audit.
- 8.3 The various measures available in terms of follow-up of audit findings provide a flexible framework for action in relation to the annual audit of accounts, stewardship of funds and governance matters.
- 8.4 In accordance with the Accounts Commission's policy of rotating audit appointments at regular intervals (five years), new audit appointments have been made with effect from financial year 2001/02. Incoming auditors will take account of matters arising in previous years in planning and conducting their audits.

### *New powers for the Accounts Commission*

- 8.5 The Ethical Standards in Public Life etc (Scotland) Act 2000 gives the Accounts Commission new powers to censure local authority officers or councillors. The Commission also has a right to suspend councillors for up to one year or disqualify them from office for up to five years. These powers replace the previous power to recommend surcharge. The Commission is now also able to implement the sanction directly rather than referring the matter to Scottish Ministers, as was previously the case.
- 8.6 Any action taken by the Commission will be based on its findings following consideration of a special report under section 102(3) of the Local Government (Scotland) Act 1973. I can issue such a report where there has been a financial loss, illegal expenditure, a failure to account for money or an error in the accounts which has not been put right. The Commission may decide to hold a hearing on the matter or may decide to take no action. The new system also introduces a right of appeal.
- 8.7 Council officers and elected members should take steps to ensure sound governance arrangements, including proper financial procedures and appropriate internal controls in financial systems. Local codes on corporate governance and standards (see Section 3 of this report) will assist councils in demonstrating their commitment to the principles of good governance.

## Part 2: Matters arising during the year

This part covers:

- statutory reports
- general accounting issues
- matters arising at individual councils
- Performance Audit: value for money studies
- Performance Audit: Best Value
- Performance Audit: performance indicators.

### 9 Statutory reports

- 9.1 During the year to 31 December 2001 I prepared four statutory reports for consideration by the Accounts Commission. These are set out in Exhibit 14.

#### Exhibit 14: Statutory reports in 2001

S.R. 2001/1	Inverclyde Council: progress report January 2001
S.R. 2001/2	Overview of the 1999/2000 local authority audits
S.R. 2001/3	Inverclyde Council: progress report May 2001
S.R. 2001/4	Scottish Borders Council: Education Department overspend

#### *Inverclyde Council*

- 9.2 Following its consideration of statutory reports which highlighted significant weaknesses in financial management at Inverclyde Council, the Accounts Commission held a public hearing at the council's offices in August 2000 at which evidence was taken from a senior elected member and senior officers. In its subsequent findings, the Commission expressed concern about the position and instructed me to report early in 2001 on the extent to which the commitments set out in the council's action plan had been achieved.
- 9.3 Based on a review by the council's appointed auditors, I reported in January 2001 (S.R. 2001/1) that, while progress had been achieved, there was an urgent need for the council to address remaining issues which I considered fundamental to the proper administration of the council's finances. In view of the action proposed at that time by the council's chief executive the Commission agreed to review the position at a future date and, at its meeting in May 2001, the Commission requested a further report on progress.

- 9.4 Based on a review by the council's external auditors, I reported in June 2001 (S.R. 2001/3) that there had been significant improvement in the council's financial management in 2001 which was sufficient to enable me to conclude that the council had addressed the main areas of concern identified in earlier statutory reports.
- 9.5 In its findings the Commission welcomed the reported improvements and, while noting that there may be remaining weaknesses in the council's financial controls, considered that these could be monitored through the audit process. Inverclyde Council's external auditors are continuing to monitor progress as part of their ongoing audit responsibilities.

#### *Scottish Borders Council*

- 9.6 Accounts prepared by Scottish Borders Council for 2000/01 showed expenditure on education services of £62.9 million. The initial budget for that year was £59 million and, consequently, the cumulative overspend in 2000/01 was £3.9 million, or nearly 7% of that year's budget. An overspend of this magnitude, against a background of a significant overspend in the previous financial year, raised concerns about the financial management of a significant element of the council's finances, with potential implications for the stewardship of public funds and the levels of local taxation.
- 9.7 Having considered this matter and in view of the public interest I decided to report to the Accounts Commission. The report (S.R. 2001/4), which was based mainly on information provided by the council's external auditors, was completed in October 2001 and concluded that:
- there had been serious weaknesses in the financial management of education services, resulting in significant overspending in the Education Department's budget
  - budgetary control had been deficient in a number of areas
  - operational and financial management responsibilities within the Education Department were not well aligned
  - financial management responsibilities were not fully discharged
  - elected members were poorly served as regards the quality of reports received from officers. Nevertheless when presented with reports highlighting potential financial problems, the council's Education Committee had not investigated the position or considered appropriate courses of action to address these matters.
- 9.8 The Accounts Commission considered the statutory report and the council's response. The Commission approved the report's conclusions and in its findings highlighted that:
- there had been a failure to apply financial systems properly and that this demonstrated a failure in governance, primarily due to organisational cultures and attitudes
  - the Education Committee had failed to monitor and regulate financial performance
  - senior officers in the Finance and Education departments had not fully carried out the requirements of their responsibilities for financial administration.
- 9.9 The Commission has requested that I monitor the council's progress and make a further report on the position as at 31 March 2002.
- 9.10 The Commission also drew to the attention of Scottish councils a number of general concerns arising from its consideration of the position at Scottish Borders Council. These are set out in Exhibit 15.

## Exhibit 15: Wider lessons from the statutory report on Scottish Borders

Following its consideration of the Controller of Audit's report on the overspend on the Education budget at Scottish Borders Council the Accounts Commission drew the following points to the attention of all Scottish councils.

- Members of councils and senior management under the leadership of the chief executive have a responsibility to foster the culture and attitudes which are necessary for good governance.
- Part of a regime of good governance is the creation and implementation of procedures for the effective discharge of the statutory responsibilities of the chief financial officer in relation to the overall financial management of the council.
- Officers who have delegated responsibility within services must also be accountable for budgetary matters and there should be appropriate machinery in place for monitoring and remedial action.
- Option appraisal remains one of the key mechanisms for achieving Best Value in service delivery.
- Careful consideration needs to be given to the operation of the devolved school management scheme to ensure that sound costing and monitoring procedures are in place.

## 10 General accounting issues

### *Capital accounting*

- 10.1** Local authorities are required to account for most types of fixed assets at current value and to make charges to service accounts which reflect the cost of using the asset.
- 10.2** The Accounting Code of Practice (ACOP) requires assets to be revalued every five years to keep values up to date. Auditors reported that several authorities have not complied with this requirement for some of their assets. This has arisen largely from delays in rolling programmes of revaluations designed to revalue groups of assets each year. Some auditors also continued to report deficiencies in asset registers and adjustments to the accounts presented for audit due to capital accounting entries.
- 10.3** None of the deficiencies noted in relation to capital accounting resulted in 2000/01 accounts being qualified. It is important, however, that those authorities which have been slow to comply fully with the capital accounting requirements take steps to address this. Matters arising will be followed up in accordance with the arrangements set out in Section 8 of this report.
- 10.4** On a more positive note, it is encouraging that auditors have reported general compliance with the requirement to charge depreciation on assets, although this area will require to be revisited at some councils in relation to particular classes of asset, notably housing stock and non-operational assets.

### *Pensions accounting*

- 10.5 Changes in accounting for pensions (set out in Financial Reporting Standard 17: Retirement Benefits) will have a significant impact on local authority accounting. For the purposes of their 2000/01 accounts local authorities were required by ACOP to disclose, by way of a note to the accounts, obligations in respect of any discretionary increases in pension payments (eg discretionary added years). Auditors reported general compliance with this requirement.
- 10.6 Local authorities are required to follow a timetable of transitional disclosure requirements in 2001/02 and 2002/03 leading to full incorporation of the accounting requirements of FRS17 in the 2003/04 financial statements. Councils should be aware of these developments and ensure that information is available to them (including actuarial calculations) which will enable them to comply with ACOP's disclosure and accounting requirements.
- 10.7 As indicated in last year's report external auditors have highlighted a particular problem relating to the firefighters' pension scheme, which applies across Scotland. This is an unfunded scheme which means that pensions are paid from current employees' contributions with any shortfall being met from the relevant authorities' revenue accounts. A large number of firefighters who joined the service in 1974 following a recruitment drive will be eligible for retirement in 2004. The estimated costs which will fall on the accounts in 2004/05 are likely to be significant. In the case of Strathclyde Fire Board, for example, additional costs of about £6 million will fall to be met in 2004/05 if current funding arrangements are maintained.
- 10.8 Discussions are taking place between fire authorities and the Scottish Executive concerning the future funding of firefighters' pensions.

### *Public/private partnerships/PFI*

#### **Accounting**

- 10.9 There are a number of public/private partnerships (PPP) and private finance initiative (PFI) contracts at various stages of completion in councils in Scotland.
- 10.10 External auditors are reviewing the processes by which councils are progressing their interests in these schemes and, where appropriate, are providing preliminary views on the proposed accounting treatment.

#### **The PFI and schools in Scotland**

- 10.11 There continues to be extensive public interest and debate about the relative advantages and disadvantages of the private financing of public services. In general the public audit approach accepts that the PFI offers the possibility – but not a guarantee – of superior value for money compared to conventional procurement. Schools are a key PFI area in the local authority sector. Current and prospective schools PFI deals in Scotland have a forecast investment value of more than £600 million and a potential lifetime expenditure commitment of several billion pounds. Local authorities have recently conducted feasibility work that may result in a further tranche of developing PFI deals.

10.12 The Accounts Commission and the Auditor General for Scotland both consider it will be important to scrutinise and report independently on lessons emerging from PFI procurement projects. In light of this Audit Scotland, on behalf of the Accounts Commission, is appraising the value for money of recent PFI schools deals in Scotland with a view to making recommendations to help promote good practice in the preparation and delivery of PFI schemes.

10.13 The study is intended to inform the debate on this high profile initiative. It will examine the impact of the PFI in a thematic service-oriented way, and will be the first substantive audit review of the PFI in the UK local authority sector. It should provide lessons for future procurement and service provision decisions, which could help improve value for money (including wider lessons for non-schools PFI projects). It is anticipated that a report will be published in the early summer of 2002.

## 11 Matters arising at individual councils

### *Clackmannanshire Council*

11.1 The external auditors of Clackmannanshire Council highlighted the large number of direct and indirect commitments to external bodies. They referred to the principles contained within the COSLA/Accounts Commission guidance on 'Following the public pound' (see Section 7 of this report). While acknowledging that the council had been innovative in its use of external bodies in its attempt to maximise the availability of financial resources, the auditors reported that limited staff resources available at the council meant that necessary monitoring procedures had not always been in place.

11.2 The council's auditors referred in particular to issues surrounding a company established by the predecessor district council which had an interest in a hotel. The auditors expressed serious concerns on a number of aspects including:

- the basis for the district council's initial financial involvement
- the sale of the hotel could lead to a significant (indirect) loss to the council
- reporting to the district council had been wholly inadequate, and reporting weaknesses had continued at the new council
- while no direct acts of impropriety had been identified, the lack of proper records left officers exposed and made it impossible to conclude that impropriety had not taken place.

11.3 The auditors also expressed serious concerns about lack of progress by the council in reviewing its other interests in external bodies. They recommended that the council's detailed guidance on Following the Public Pound, first issued in 1996, is reviewed in detail to identify where improvements in the arrangements could be made.

### *Comhairle nan Eilean Siar*

11.4 The auditors reported that the Building Maintenance DLO and the Roads DLO of Comhairle nan Eilean Siar (Western Isles Council) failed to achieve break-even in 2000/01 with deficits of £321,000 and £253,000 respectively. They highlighted that this was the second consecutive year in which the financial target had not been achieved and that the deficits were significant in terms of the level of activity undertaken by the DLOs (representing over 10% of turnover in both cases).

11.5 The Scottish Executive initiated statutory action in June 2001 and in November 2001 issued a direction under section 19B of the Local Government, Planning and Land Act 1980. This set out the conditions with which the council must comply in order to continue undertaking these DLO activities. In essence, the council is required to provide information to Scottish Ministers by specified dates on its progress in achieving financial recovery and in reviewing DLO management and governance arrangements. The council's external auditor will be reviewing the position at the end of the financial year 2001/02 and will report to me as part of that year's audit.

#### *Midlothian Council*

11.6 The external auditor of Midlothian Council referred to a contract for an extension to a school in which there had been a £560,000 (over 30%) overspend. The extension was opened for use two months behind schedule.

11.7 The council instructed a full investigation. The external auditor concluded that this had been conducted in a proper and thorough manner.

11.8 The auditor reported that the main factors contributing to the project overspend were the number, significance and timing of changes to the original design. In particular the tender and contract documentation had been finalised prior to completion of the design stage and a number of significant changes were made when construction was at an advanced stage.

11.9 The external auditor made a number of recommendations including the appointment of a project manager for all similar projects in future and a review of cost monitoring systems. Remedial action has been agreed between the auditor and council management.

#### *South Lanarkshire Council*

11.10 The external auditor of South Lanarkshire Council reported the outcome of an investigation of allegations concerning the award of a contract for debt recovery services without competition.

11.11 The auditor found that the council sought to improve its collection rates on local taxes by adopting new approaches to debt recovery. This included the award of debt recovery work to a specialist debt recovery firm as a 'pilot' exercise.

11.12 The scope of the exercise was not specified, no criteria or timescales were set for its evaluation and no formal report was prepared on its outcome. The 'pilot' exercise became a full-scale service for the collection of debt during the period November 1999 to March 2001. During this period, £29 million of debts were passed for collection and fees of more than £740,000 were paid to the firm.

11.13 The auditor found that senior officers in the council were aware of and had approved the revised debt recovery arrangements. The council's standing orders required that all services costing more than £30,000 should be subject to competition. The auditor found that from November 1999 until May 2001, the debt recovery work was carried out without a formal contract between the council and the firm; that formal reporting to elected members on the debt recovery services was inadequate; and that there had

been no members' approval to enter into an agreement above the £30,000 threshold without competition.

11.14 An action plan which addresses the issues arising from this matter will be agreed between the auditor and the council.

## 12 Performance audit: value for money studies

12.1 The Accounts Commission approves an annual programme of value for money studies undertaken centrally by Audit Scotland. This work may culminate in the publication of national reports, management papers and management handbooks. Councils are expected to use these to challenge their current levels of performance and take action to achieve the standards of the best.

12.2 Exhibit 16 summarises the value for money reports published by the Accounts Commission relating to study work undertaken during 2000/01. Copies of these reports are available from Audit Scotland ([www.audit-scotland.gov.uk](http://www.audit-scotland.gov.uk)).

### Exhibit 16: Reports published on 2000/01 study topics

Study topics	Publication date
A good start: Commissioning pre-school education	March 2001
A safer place: revisited – a review of progress in property risk management in schools	June 2001
A job worth doing: Raising the standards of internal audit in Scottish councils	August 2001
Homing in on care: A review of home care services for older people	November 2001

12.3 External auditors conduct local follow-up action to ensure that councils implement appropriate improvements in response to the recommendations contained in the Commission's value for money reports.

## 13 Performance audit: Best Value

### Background

13.1 Best Value was introduced in Scotland in 1997. It requires councils to provide high quality services that meet the needs of their customers and communities, and achieve value for money. Councils must also demonstrate that they are accountable and delivering continuous improvement. The Scottish Executive is expected to introduce legislation that will place a statutory duty on councils to deliver Best Value.

- 13.2** The Accounts Commission's Performance Management and Planning (PMP) audit examines the extent to which councils have put in place the management arrangements required to support Best Value. For 2000/01, the second year of the PMP audit, each council selected three services for the PMP audit. There was also a corporate PMP audit. The corporate audit looked at the council's approach to supporting and monitoring the development of Best Value across the council's services. The service audits concentrated on the application of performance management and planning arrangements in practice. The PMP audit approach requires councils to assess themselves. External auditors validated the self-assessments and agreed with each council what improvements would be made to the service and corporate PMP frameworks. Auditors also reviewed what progress had been made by the services that had been subject to a PMP audit in the previous year.
- 13.3** The performance of some council services is also reviewed by statutory inspectorates. Audit Scotland works closely with the inspectorates for fire, police and education services to agree joint methodologies and to reduce the risk of duplication.
- 13.4** The Accounts Commission published a progress report in December 2001 (*'Making Progress with Best Value'*) that provided a snapshot of councils' performance management and planning arrangements.
- 13.5** About half of councils and two-fifths of audited services had a significant number of the elements of effective performance management and planning arrangements in place, with a small number reaching a significant level of achievement. (Exhibit 17). A third of councils and almost half of services were still some way behind the 'leaders'.

**Exhibit 17: Councils and services that met a significant proportion of the audit criteria**

Council	Corporate audit	Service audit
Angus	✓	
Argyll & Bute		✓ Personnel
Dundee City		✓ Architectural Services
East Dunbartonshire	✓	
City of Edinburgh	✓	✓ Catering & Cleansing DLO
Glasgow City	✓	✓ Education
North Lanarkshire		✓ Education (Primary Teaching & Learning)
Perth & Kinross	✓	
Renfrewshire	✓	✓ Administration (Corporate services) ✓ Leisure Management
Stirling		✓ Secondary Education
West Lothian		✓ Housing

13.6 For some aspects of performance management and planning (including service planning, consultation, Best Value reviews and integrating equalities) the corporate arrangements were often more developed than in individual services. This is not surprising. Most councils have developed corporate frameworks, guidance and approaches but it takes time for these to be applied fully in services. It is also likely that each service has had to make progress from a different starting point. The key issue for councils is that developing corporate frameworks and guidance is not enough on its own. Sustained effort is required for a corporate initiative to have an impact on all the council's services.

13.7 There have been improvements in other elements of services' performance management and planning frameworks, including the areas of concern raised in the previous year's overview of the PMP audit:

- evaluation of options for service delivery
- linking service priorities to available resources
- monitoring service performance.

However, there are areas which remain problematic for some services and where further development is required.

13.8 The PMP audits have shown that there are large differences between and within councils in their development of performance, management and planning arrangements. Councils need to know which of their services have most progress to make, and target their support accordingly. It is essential that no service is allowed to slip behind in delivering Best Value to the public.

#### 14 Performance audit: performance indicators

14.1 Since 1993/94, councils have been required to provide information on how well they are carrying out their activities. Councils have to publish the information in local newspapers by 30 September each year.

14.2 The Local Government Act 1992 places upon the Accounts Commission the duty each year to direct local authorities to publish information which will, in the Commission's opinion, assist in the making of appropriate comparisons – by reference to the criteria of cost, economy, efficiency and effectiveness – between:

- the standards of performance achieved by different authorities in a financial year
- the standards of performance achieved by authorities in different financial years.

14.3 In 2000/01 councils, fire brigades and police forces were required to report their service standards against 76 statutory performance indicators (PIs). These indicators covered a wide range of services and highlight both the variation in performance between councils and change in performance over time.

- 14.4 The following performance indicators publications are produced by Audit Scotland:
- Environmental and Regulatory Services
  - Leisure and Libraries
  - Benefits, Finance and Corporate Issues
  - Education Services
  - Housing Services
  - Social Work Services
  - Fire and Police.
- 14.5 Most of the statutory performance indicators are reflected in the '*Council profiles 2000/01*' report published by the Accounts Commission in February 2002. This report provides a summary of a wide range of performance information for each of Scotland's councils. All the information included has been published previously but it is prepared in the form of a profile of each council that shows trends in performance against the statutory performance indicators, together with a range of additional information.
- 14.6 The profiles highlight the extent to which councils recorded a significant decline or improvement in their actual recorded level of performance over the three years up to 2000/01. Exhibit 18 shows significant changes in performance, by council. It is important to note that for each council it is necessary to consider the information on improvement or deterioration in relation to how well it is doing in comparison with other councils. Councils which are already performing well have less scope to make significant improvement.

**Exhibit 18: Profile measures — significant changes in performance: council by council**

Band	Performance change between 1998/99 and 2000/2001								Ratio of improvement to decline
	Measures that declined by...				Measures that improved by...				
	>15%	10-14%	5-9%	Total	5-9%	10-14%	>15%	Total	
Aberdeen City	4	4	-	8	5	2	8	15	1.9
Aberdeenshire	5	-	1	6	2	2	7	11	1.8
Angus	6	1	3	10	5	-	5	10	1.0
Argyll & Bute	6	1	1	8	2	3	8	13	1.6
Clackmannanshire	7	1	5	13	2	1	4	7	0.5
Dumfries & Galloway	2	2	2	6	7	1	6	14	2.3
Dundee City	6	-	-	6	2	2	7	11	1.8
East Ayrshire	8	1	2	11	1	-	5	6	0.5
East Dunbartonshire	4	-	1	5	-	4	8	12	2.4
East Lothian	8	-	4	12	3	-	4	7	0.6
East Renfrewshire	1	2	2	5	1	3	8	12	2.4
City of Edinburgh	7	1	1	9	3	1	6	10	1.1
Eilean Siar	6	3	1	10	3	-	4	7	0.7
Falkirk	6	3	3	12	2	-	6	8	0.7
Fife	5	1	-	6	3	1	8	12	2.0
Glasgow City	4	3	-	7	3	1	10	14	2.0
Highland	6	1	1	8	3	2	4	9	1.1
Inverclyde	5	-	1	6	6	1	7	14	2.3
Midlothian	7	1	6	14	1	1	4	6	0.4
Moray	4	-	2	6	2	3	8	13	2.2
North Ayrshire	4	1	2	7	2	1	9	12	1.7
North Lanarkshire	4	5	3	12	5	-	7	12	1.0
Orkney Islands	2	2	2	6	2	-	4	6	1.0
Perth & Kinross	5	2	2	9	3	2	9	14	1.6
Renfrewshire	2	-	2	4	6	2	5	13	3.3
The Scottish Borders	3	4	1	8	1	1	5	7	0.9
Shetland Islands	5	1	2	8	1	1	8	10	1.3
South Ayrshire	4	3	1	8	1	2	12	15	1.9
South Lanarkshire	2	2	2	6	4	3	8	15	2.5
Stirling	7	3	4	14	1	2	8	11	0.8
West Dunbartonshire	7	2	-	9	4	-	6	10	1.1
West Lothian	2	1	1	4	4	3	9	16	4.0
<b>Scotland — average</b>	<b>4.8</b>	<b>1.6</b>	<b>1.8</b>		<b>2.8</b>	<b>1.4</b>	<b>6.8</b>		
<b>Scotland — total</b>				<b>263</b>				<b>352</b>	<b>1.3</b>

14.7 Further detail, including important contextual information, is available in the profiles report. The Accounts Commission is committed to working with all interested parties to develop the performance information it requires local authorities to publish.

# Appendix

## External auditors 2000/01

Aberdeen City Council	Chief Auditor, Inverness
Aberdeenshire Council	Ernst & Young
Angus Council	Chief Auditor, Inverness
Argyll and Bute Council	PricewaterhouseCoopers
Clackmannanshire Council	Scott-Moncrieff
Comhairle nan Eilean Siar (Western Isles Council)	KPMG
Dumfries and Galloway Council	Deloitte & Touche
Dundee City Council	Henderson Loggie
East Ayrshire Council	Chief Auditor, East Kilbride
East Dunbartonshire Council	KPMG
East Lothian Council	Scott-Moncrieff
East Renfrewshire Council	Chief Auditor, East Kilbride
City of Edinburgh Council	Chief Auditor, Edinburgh
Falkirk Council	Chief Auditor, Glenrothes
Fife Council	Chief Auditor, Glenrothes
Glasgow City Council	Chief Auditor, Glasgow
Highland Council	Chief Auditor, Inverness
Inverclyde Council	PricewaterhouseCoopers
Midlothian Council	Chief Auditor, Edinburgh
Moray Council	Chief Auditor, Inverness
North Ayrshire Council	Chief Auditor, East Kilbride
North Lanarkshire Council	PricewaterhouseCoopers
Orkney Islands Council	Chief Auditor, Inverness

Perth and Kinross Council	Deloitte & Touche
Renfrewshire Council	Chief Auditor, Glasgow
Scottish Borders Council	KPMG
Shetland Islands Council	Blueprint Scotland
South Ayrshire Council	Chief Auditor, Glasgow
South Lanarkshire Council	Chief Auditor, East Kilbride
Stirling Council	Chief Auditor, Glenrothes
West Dunbartonshire Council	PricewaterhouseCoopers
West Lothian Council	Chief Auditor, Edinburgh
Authorities Buying Consortium	Chief Auditor, Glasgow
Ayrshire Valuation Joint Board	Chief Auditor, Glasgow
Central Scotland Fire Board	Chief Auditor, Glenrothes
Central Scotland Joint Police Board	Chief Auditor, Glenrothes
Central Scotland Valuation Joint Board	Scott-Moncrieff
Clyde Muirshiel Park Authority Joint Committee	Chief Auditor, Glasgow
Dunbartonshire and Argyll & Bute Valuation Joint Board	PricewaterhouseCoopers
Forth Road Bridge Joint Board	Chief Auditor, Edinburgh
Glasgow and Clyde Valley Joint Structure Plan Committee	Chief Auditor, Glasgow
Grampian Fire Board	Ernst & Young
Grampian Joint Police Board	Chief Auditor, Inverness
Grampian Valuation Joint Board	Chief Auditor, Inverness
Highland and Islands Fire Board	Chief Auditor, Inverness
Highland and Western Isles Valuation Joint Board	Chief Auditor, Inverness
Kelvin Valley Countryside Project	Chief Auditor, Glasgow
Lanarkshire Valuation Joint Board	Chief Auditor, East Kilbride
Loch Lomond and the Trossachs Interim Committee	PricewaterhouseCoopers

Lothian and Borders Fire Board	Chief Auditor, Edinburgh
Lothian and Borders Police Joint Board	Chief Auditor, Edinburgh
Lothian Valuation Joint Board	Chief Auditor, Edinburgh
Mugdock Country Park Joint Committee	KPMG
Northern Joint Police Board	Chief Auditor, Inverness
Orkney and Shetland Valuation Joint Board	Blueprint Scotland
Renfrewshire Valuation Joint Board	Chief Auditor, Glasgow
Scottish Local Government Information Unit	Chief Auditor, Glasgow
Scottish Nuclear Free Local Authorities	Chief Auditor, Glasgow
Strathclyde Concessionary Travel Scheme Joint Committee	Deloitte & Touche
Strathclyde Fire Board	Chief Auditor, East Kilbride
Strathclyde Passenger Transport Authority	Chief Auditor, East Kilbride
Strathclyde Joint Police Board	PricewaterhouseCoopers
Tay Road Bridge Joint Board	Henderson Loggie
Tayside Contracts Joint Committee	Henderson Loggie
Tayside Fire Board	Henderson Loggie
Tayside Police Joint Board	Henderson Loggie
Tayside Valuation Joint Board	Henderson Loggie







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ISBN 1 903433 68 1