Dumfries and Galloway Council

Report to Members on the 2005/06 Audit

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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 key 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 Dumfries and Galloway Council for 2005/06. We have, however, drawn attention to a failure to comply with the statutory requirement that all significant trading organisations break even on a rolling three year basis.

The council's net revenue expenditure in 2005/06 was £284.619 million, after transfers from the renewal and repair fund (£2.251 million) and capital fund (£2.000 million). This was met by government grants and local taxation of £283.950 million, resulting in a net general fund deficit of £0.669 million. In his foreword to the financial statements, the director of finance says that it was anticipated that £5.324 million of brought forward balances would be used in 2005/06. Therefore, the overall results for the year showed a favourable variance of £4.655 million. Although the council's overall financial position was better than the budgeted position, the council faced a number of particular budget difficulties in education and community services (ECS), combined services (CS) and with private sector housing grants throughout the year.

The council had corporate governance systems in place during 2005/06 that operated well within a generally sound control environment. Improvements to be made include embedding the risk management process into all council activities and reviewing the performance monitoring of internal audit services.

The chief executive provided his annual report for 2005/06 to the council in June 2006. While the council has reported some improvements in service in the annual report, the report does not clearly link performance to the corporate plan priorities or the strategic priority projects. The council is taking forward the development of performance management to demonstrate progress made against corporate priorities. This includes a planned review of the public performance reporting framework.

Alongside the council's internal project performance measures, the council's comparative performance can be measured by statutory performance indicators (SPIs). In 2005/06, no general trend of continuous improvement can be identified from a review of the indicators. Performance is mixed, with a number showing some improvement whilst others have reported a deterioration in performance. Two indicators have been classified as unreliable, adult social work 4: home care / home helps services and adult social work 5: respite care, because no audit trail to support all the calculations of the indicators could be provided. The process to publish SPIs should be improved.

A recent Social Work Inspection Agency (SWIA) report rates five areas of performance as weak including delivery of key processes, resources and capacity building and capacity for improvement. The strategic leadership of the service is rated as unsatisfactory. In advance of the report being published the council announced a major change in the management of social work services. In response to the SWIA report, the council will be required to put in place an action plan for change.

The financial pressures on the council are significant. In February 2006, the council's alliance administration was replaced by a minority labour administration. The council approved a challenging budget for 2006/07, restricting council tax rises to 3%. It is anticipated that of the £28.368 million general fund balances at 31 March 2006, £7.145 million will be required in 2006/07 to support revenue expenditure.

Significant efficiencies are necessary to release funding for improvements to service delivery and to respond to the challenges of funding settlements and the government's efficient government agenda. Since February, the council's key priority has been the development and implementation of a financial efficiency strategy for the period 2006/07 to 2008/09, which includes the council's initiatives to generate savings under the efficient government agenda. The council acknowledges that a more structured approach to measuring and monitoring outputs, integrated with the council's developing performance management systems, is essential to underpin this.

The increase in the council's pension liabilities has had a substantial impact on the net worth of the council which is reported in the balance sheet at 31 March 2006 as a negative net worth of £130.333 million compared to a negative net worth of £87.533 million in 2004/05. The combined deficit on the local government, police and fire pension schemes is £377.777 million. This has risen from £329.300 million in 2004/05.

Outlook for future audits

Implementation and delivery of the financial efficiency strategy for the period 2006/07 to 2008/09 is essential. It is a key driver in the council's continuous improvement agenda and essential to the financial stability of the council. It will be challenging for the council to deliver on this programme of initiatives to deliver savings while managing the impact on overall objectives.

The performance management framework is essential to support this. Work is continuing to incorporate the process fully into the planning and reporting cycles. Work on reshaping the corporate plan into a format which can be better recorded, with clear objective statements and associated actions is on going. In advance of its first best value audit, the council's key challenge is its ability to demonstrate that the framework is effective in driving the continuous improvement in council services.

At the date when the accounts were finalised, the council was anticipating using £7.145 million of unallocated revenue balances in 2006/07 which would reduce the balances to £5.119 million. This estimate is changing as the year progresses. The use of these balances reflects the increasing financial pressures on the council. The three year financial strategy agreed with the 2006/07 council tax in March 2007 is to move towards a balanced budget and to restore balances to 2% of net expenditure in that period. A high level revenue budget for 2007/08 has been set, based on an council tax inflation rate of 3%.

In common with many other Scottish councils, the council has sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer equal pay payments to specific groups of employees as part of a compensation package. The council has completed a review and an £4.800 million estimate has been made of the total cost of these payments, with £4.320 of these costs being recognised in the 2005/06 accounts in accordance with accounting rules. While this will help to reduce financial risk, there remain significant risks, particularly while existing pay and reward structures remain in place.

The council has not implemented the single status agreement but has a planned implementation date of October 2006. 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 there is significant variation in the level of potential costs which can be up to 10% of the current pay-bill on a continuing basis. Whilst the recent focus of the council has been on equal pay and single status, there has been some progress in some other aspects of workforce management. The council needs to ensure that the strategies and arrangements put in place, link and fully support the council's overall priorities and objectives, taking the opportunities for job redesign provided by single status.

In taking the development of performance management forward, the council recognises the inherent difficulties in measuring the impact of partnership working on improved service delivery. This is to be addressed through the development of the performance management framework.

Developing modern infrastructure is essential for supporting the delivery of improved services. Successful delivery of the 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 the council's assets are used effectively and efficiently to deliver services in line with the council's priorities.

Changes to the code of practice on local authority accounting (ACOP) will have a significant impact on the presentation of the 2006/07 annual financial statements which will require to be more consistent with the accounts of other public and private sector organisations.

This is the final year of our current appointment to the audit of the council. From 2006/07 Audit Scotland will remain as the council's appointed auditor and the new engagement lead will be Peter Tait.

Audit Scotland

October 2006

Introduction

1. This report summarises the findings from our 2005/06 audit of Dumfries and Galloway Council. The scope of the audit was set out in our audit risk analysis and plan, which was submitted to the audit committee on 12 June 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.

Performance

Introduction

3. 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 progress against agreed improvement actions arising out of any local performance audit work and the findings of national performance audit studies.

Corporate objectives and priorities

4. The corporate plan for 2003 —2007 sets out the council's principles, values and priorities until 2007 and explains how it plans to achieve these. The plan sets out three priorities which match with the three themes of the community plan, and which cut across a variety of services:

   - enterprising and learning communities;
   - safe and healthy communities; and
   - inclusive communities.

   Strategic priorities across these themes include activities to:

   - improve the provision of services for vulnerable people;
   - improve the health of people in Dumfries and Galloway;
   - develop and improve lifelong learning opportunities through out the region; and
   - increase the prosperity and sustainable economic regeneration of the region.

   The council has then specified 14 strategic priority projects through which it aims to achieve the strategic priorities.

Overview of performance in 2005/06

Annual report

5. The chief executive provided his annual report for 2005/06 to the council in June 2006. The report highlighted the council's most important achievements of the previous year, outlined progress with ongoing major areas of work and identified issues to be addressed in 2006/07. Service performance achievements highlighted include:

   - putting in place a three year financial efficiency strategy;

- the start of the *Customer First* strategy;
- progress on the Dumfries and Galloway Leisure Complex;
- that the waste management private finance facility will soon be operational;
- regeneration projects are starting in Stranraer, Dumfries, Annan and Gretna and several rural communities; and
- completion of the 2002-2005 education improvement plan and publication of a new plan for 2005-2008.

6. While the council has reported some improvements in service in the annual report, the report does not clearly link performance to the corporate plan priorities or the strategic priority projects. Progress against the projects, using local performance measures, is reported quarterly to the business review and performance committee only. It is, therefore, not possible to assess from the annual report whether the resources of the council are being used most effectively to address the corporate priorities.

7. The council has plans to address this. As part of the development of the council's performance management processes, a review of the public performance reporting framework is planned. This review should consider the range of information made available to the public, including the format of the annual report.

Statutory performance indicators

8. Alongside internal project performance measures, the council's comparative performance can be measured by statutory performance indicators (SPIs). Historically, the council's performance varies from indicator to indicator within each service, and when used in national comparisons. In 2005/06, no general trend of continuous improvement can be identified from a review of the indicators. Performance is mixed, with a number showing some improvement whilst others have reported a deterioration in performance, for example the inspection of trading premises indicators.

9. In previous years, we have reported that there remain a number of SPIs where working papers are not adequate and/or are difficult to obtain. In addition, a number of errors were identified in the indicator calculations. In 2004/05, the council accepted our recommendations to improve the publication of indicators and agreed that documentation to support the indicators would be provided wit cross referencing to the underlying data sources; and that the council would introduce some internal checking of indicators before they are passed to audit.

10. Although the process to publish some of the 2005/06 indicators was considered satisfactory, audit recommendations had not been implemented in full. A significant number of working papers were not cross referenced to supporting information and internal checking was not carried out or was not

effective. Two indicators have been classified as unreliable, adult social work 4: home care / home helps services and adult social work 5: respite care. This was because the council was unable to provide an audit trail to support all of the figures included in the calculations of the indicators.

Social Work Inspection Agency (SWIA) report

11. The council recognises that the social work services part of education and community services in particular is experiencing difficulties in meeting service demands within the financial resources of the service. The social work department has recently been inspected by the Social Work Inspection Agency (SWIA). The report, issued in September, rates five areas of performance as weak, including delivery of key processes, resources and capacity building and capacity for improvement. The strategic leadership of the service is rated as unsatisfactory. In advance of the report being published, the council announced a major change in the management of social work services, as it recognised that it needs to look at how social work is managed within the council.   Changes have already taken place, including the streamlining of the senior management structure. In response to the SWIA report, the council will be required to put in place an action plan for change, which will be monitored by the council.

Performance outlook – opportunities and risks

Introduction

12. In our audit risk analysis and plan we identified some of the strategic risks to Dumfries and Galloway Council delivering on its stated objectives and priorities. These risks have been grouped into six risk areas which will drive and support service delivery.

Affordability

13. The financial pressures on the council at present are significant. In February 2006, the council's alliance administration was replaced by a minority labour administration. The council approved a challenging budget for 2006/07, restricting council tax rises to 3%, whilst the indicative council tax increase for the period which was used in financial planning was 6.9%. The budget reversed some of the savings proposed by the previous administration and which had been reflected in the council's financial strategy at that time. The annual budget for 2006/07 reflects only those savings which do not affect "front line services". At the time that the accounts were finalised, it was anticipated that, of the £28.368 million general fund balances at 31 March 2006, £7.145 million would be required to support revenue expenditure in 2006/07. See below for more detail on the financial outlook.

14. In seeking continuous improvement and responding to increasing demands for services the council needs to work with its partners to promote efficiency, getting the most from available resources to enhance services to local people. Significant efficiencies are necessary to release funding for

improvements to service delivery and to respond to the challenges of funding settlements and the government's efficient government agenda. Since February, the council's key priority has been the development and implementation of a financial efficiency strategy for the period 2006/07 to 2008/09. The three year strategy, agreed in March 2006, includes the council's initiatives to generate savings under the efficient government agenda. The financial efficiency strategy has four main components: budget strategy, control of spend, '*more with less'* and a business transformation programme.

15. Significant effort will be required to deliver the level of efficiencies required while continuing to improve performance. The council has recognised that this requires leadership at a corporate level and this is now being managed as part of the council's overall financial efficiency strategy. The council acknowledges that a more structured approach to measuring and monitoring outputs, integrated with the council's developing performance management systems, is essential to underpin this.

16. These pressures are in addition to the council facing the cost implications of equal pay and single status settlements. As a result, there is a risk that the council is unable to afford the changes needed to improve its performance in developing and delivering its services.

Improving performance

17. The council has recognised that, in order to demonstrate its commitment to best value, work is required to promote a culture of continuous improvement that is well embedded throughout the organisation. Opportunities for improvement in existing processes and the increasing expectations of stakeholders present significant challenges for the council, especially within the context of affordability outlined above. The council aims to achieve improvements in performance across its activities through its performance management framework. The elected members, the chief executive and the corporate directors have all been actively involved in taking forward the development of performance management. The framework has been put in place, but work is continuing to incorporate the process fully into the planning and reporting cycles. In advance of its first best value audit, the council's key challenge is its ability to demonstrate that the framework is effective in driving the continuous improvement in council services. Ultimately, a failure to demonstrably improve may lead to loss of credibility.

18. As highlighted above, the financial efficiency strategy is also a key driver in the continuous improvement agenda, with the business transformation programme aiming to achieve efficiencies and service improvement through long term and fundamental changes in the way the council operates and delivers services.

Workforce planning

19. 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. During 2005 and 2006, the focus of the council has been the resolution of the equal pay arrangements, in conjunction with planning for the single status agreement. This is commented upon in the financial position section of this report. At this time, the council is particularly exposed to risks in relation to the morale of affected staff and the potential for industrial relations difficulties. The council also experiences particular difficulties recruiting skilled staff due to its isolated location.

20. The council is facing these challenges and is introducing a human resources strategy across the council. It has also included in its improvement plans for 2006/07, the development of a workforce strategy linked to staff appraisal, the overall HR strategy, succession planning and development strategies. It also aims to address a lack of general management and leadership skills, identified as a key risk, through its management appraisal scheme. This is a considerable agenda, which could challenge the capacity of the council to deliver.

21. To address specific problems with social work vacancies, in September 2004 members of the ECS committee agreed a set of proposals aimed at both retaining social work staff and improving recruitment. As at July 2006, the council employed 138 WTE social workers, a rise of 16.6 % since July 2005. However, vacancies account for 16% of total posts. Of the 27 vacancies then, four have now been filled and eight are at varying stages in the recruitment process. At the ECS committee in August 2006, members agreed to adopt annual recruitment targets to help fill gaps and develop services. The aim is to bring in ten new staff each year for the next four years; 30 of which will be additional posts and ten replacements for staff who have retired.

Effective partnership working

22. Increasingly, if the council is to deliver effectively on the priorities 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. To do so, it needs to work effectively with partners to engage with and respond to customers, clients and communities.

23. The current Dumfries and Galloway ***c***ommunity plan covers the five years to 2009. Annual reports are published showing progress against the key performance indicators which have been chosen to demonstrate achievement of the community plan. The 2005 report shows that the general trend is of improving performance for eleven of the indicators including gross value per head, diversity awareness promotion, drugs related deaths and life expectancy inequalities. Improvements are still to

be demonstrated or achieved in the remaining indicators which include employment rate, average wage, incidents of anti-social behaviour and premature deaths from strokes.

24. In addition to the community plan, the council has investigated sharing significant support services with a number of local public sector organisations but has not yet been able to conclude an agreement. Major players in other fields, for example the NHS and Scottish Enterprise Dumfries and Galloway, are already committed to national arrangements for the delivery of processing support services, restricting the scope for developing shared public sector support services within Dumfries and Galloway. Despite this, the council has some ongoing initiatives including:

- the development of an asset management system run in conjunction with NHS Dumfries and Galloway. From that, there may come a sharing of property services departments; and
- the *South of Scotland Broadband Pathfinder Project*: this is a £27 million project to introduce broadband technology into schools, libraries and council offices in the south of Scotland. It is a partnership between Dumfries and Galloway Council and Scottish Borders Council. Funding of up to £27 million will be made available by the Scottish Executive together with a sum of up £850,000 towards the cost of external advisors and a dedicated project staff team.

25. The council recognises the inherent difficulties in measuring the impact of partnership working on improved service delivery, and the risk that partnership working is not driving forward service improvements. Much of the development to date in partnership working has focused on structures and processes, with difficulties existing in measuring the impact of partnership working on improved service delivery. This is something which is being addressed through the council's performance management framework. The council is also focussing on working with partners to ensure sound governance and accountability arrangements for the new community health partnership Initiative and address areas of concern highlighted in relation to the joint future agenda, in respect of joint assets, budgets, appointments and governance arrangements.

26. In 2004/05, we reported that HM Inspectorate of Constabulary for Scotland had published a follow-up report to its 2002 primary inspection, which identified that a service level agreement (SLA) is yet to be agreed between the police force and the council. The agreement of an SLA is in progress; the target date is 31 October 2006. We have noted the considerable delay in this action.

Responding to customers, clients, communities and organisational change

27. Services have to be configured in a manner that allows them to respond effectively to the needs of the local community and individuals in the context of local priorities both for the council and local community planning partnerships. In an environment of increasing needs and expectations, there is a risk that services are not prioritised in a way which makes the most of limited financial and staff resources. The budgetary reporting process for 2005/06 has identified particular difficulties in

resourcing demand led services such as social work services. The council is reviewing budget processes for these services as part of the financial efficiency strategy discussed above.

28. The aim of the strategy's '*more with less'* component is to improve the targeting of resources through policy led and zero based budgeting, and the integration and monitoring of the council's option review programme. The business transformation programme aims to achieve efficiencies and service improvement through long term and fundamental changes in the way the council operates and delivers services. Ongoing developments include reviews of shared support services, back office economies, alternative methods of service delivery, for example arm's length management organisations, and a review of management structures.

29. 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. In response, the council is planning a review of committee structures following the election of the new council in May 2007. A review of individual training needs and personal development plans for the newly elected members will be carried out in the context of new remuneration arrangements.

Asset management and capital investment

30. The council needs facilities, infrastructure and assets that are suitable and sufficient to meet the requirements placed on them for the provision of services and the delivery of council objectives, now and in the future, in a sustainable manner. Capital plans need to be based on robust asset management planning as part of the council's developing asset management processes. A requirement for significant investment has been identified in a range of areas including a leisure complex and school buildings. There are risks to service delivery and resource pressures if capital projects are not effectively managed and delivered on schedule. In recognition of this, the council is implementing a range of improvements in the management of capital projects, including applying the principles of PRINCE2 project management processes to all projects.

31. The council has an asset management system (ADAM) that is operated in conjunction with other local public sector organisations and consists of a comprehensive database of land and buildings. This links to a corporate asset management plan which is being developed and is scheduled for completion towards the end of 2006. This will link into the strategic services development plans and will address the asset implications of the council's strategic objectives.

32. The council is currently reviewing all capital assets to determine whether they are being used to best effect. The council expects that surplus land and buildings will be identified with a sale value of between £2 and £8 million. To meet budget pressures a target of £3.1 million capital receipts has been set in 2006/07.

33. In May 2005, following a detailed evaluation process carried out by the council's external advisors, the council decided to cancel its £103 million school renewal and refurbishment PPP, as the proposals presented by the sole bidder could not demonstrate value for money. The council is now taking forward a re-scoped PPP project worth £100 million that consists of the new build and refurbishment of ten schools. The work is expected to start in 2007. The council is also working on a series of five year plans to bring the rest of the schools estate up to standard, at an estimated cost of £45.6 million. The refurbishment programme is at the centre of the school estate management programme.

34. A waste management/recycling PFI contract with Shanks group plc has been running from 2004. The payments under the contract, which has a 25 year duration and will expire in 2029/30, were £6.006 million in 2005/06. The construction of the new Dumfries and Galloway Leisure Complex is underway. The estimated cost for this project is currently £17.268 million with the council attracting grant funding of £2.903 million towards these costs.

35. The local housing strategy was updated in 2005 and reflects the priorities set in the community plan. In 2004 the council transferred its housing stock to Dumfries and Galloway Housing partnership (DGHP) as part of this strategy. The housing strategy includes the council's objectives to tackle homelessness, as required by legislation. The council acknowledges that there is a mismatch between the profile of homeless applicant's needs and the profile of properties that become available for rent, which could worsen with the predicted increase in homelessness. As a result, a review of the homelessness service is to be carried out.

36. The extent of activity around asset management and development in the council is considerable, which will stretch the council's capacity. This area presents significant ongoing risk to the council, not just in completing initiatives and financing them, but in monitoring in the longer term.

Best value

37. 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 cyclical approach involving 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.

38. The council will receive a best value audit in 2006/2007. In the meantime the council is progressing areas for improvement identified in transitional best value audits carried out in the last two years. Key areas under development are:

- inclusion of equal opportunities and explicit sustainability performance measures and targets in all service plans; and
- development of the performance management arrangements.

National studies

39. 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 include reviews of public sector pension schemes, and the *National Fraud Initiative,* as summarised later 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 for Audit Scotland's webpage at 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 21st Century*

40. 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

41. 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 founds that the management of transfers is improving but better, clearer measures are needed to assess impact and value for money. The report recommends that the Scottish Executive should reinforce its approach with clearer goals and measures for quality of service and tenant involvement. This would help increase the overall impact and the value for money of transfers.

Following the public pound – a follow-up report

42. In 2004/05 I reported on the local results of a national study of the Council's funding of arms length and external organisations (ALEOs). In December 2005, Audit Scotland published the results of the national study of council funding of arms length and external organisations (ALEOs) to provide information about their 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.

43. The Accounts Commission found that no council fully complied with guidance which sets out best practice principles when councils fund external organisations, although only five councils had a low level of compliance. Dumfries and Galloway Council was included in the moderate category of compliance.

44. The national report identified there is scope for councils to improve their financial and performance monitoring. Councils should apply a risk-based approach taking account of factors such as the amounts of money involved, the size of organisations funded and how they are managed. 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.

Community planning – an initial review

45. In June 2006, Audit Scotland published its initial review of community planning arrangements. This 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. This report contains a useful evaluation framework of the characteristics of community planning partnerships which could be used as a checklist by the council.

Financial position

Introduction

46. 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.

Going concern

Accounting for retirement benefits (FRS 17)

47. 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 including projecting increased life expectancy. 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. 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 on the face of annual accounts.

48. The council participates in four separate pension schemes. The local government superannuation scheme is a funded defined benefit scheme. The police pensions scheme and the fire pensions scheme are unfunded defined benefit schemes. The teachers' pension scheme is a defined benefit scheme that is administered by the Scottish Executive. Under FRS 17, councils have to reflect the full costs of benefit entitlements earned by employees and not simply the cost of employers' contributions made to the pension fund. Although these benefits will not actually be payable until employees retire, the council has a commitment to make the payments, and this needs to be accounted for at the time the employees earn their future entitlement. Under these arrangements the council is required to show the actuarially assessed net pensions deficit/liability within the balance sheet.

49. As at 31 March 2006, the combined deficit on the local government, police and fire schemes reflected in the council's balance sheet is £377.777 million. This has risen from £329.300 million in 2004/05. Note 11 to the accounts shows the movement in the scheme liabilities. The largest deficit of £200.100 million is with the police scheme (2004/05 - £166.700 million).

50. The increase in the pension liability has had a substantial impact on the net worth of the council which is reported in the balance sheet at 31 March 2006 as a negative net worth of £130.333 million

compared to a negative net worth of £87.533 million in 2004/05. To demonstrate that the director for finance has considered the impact this has had on the ability of the council to continue to deliver services in the future and consideration as to whether the preparation of the accounts under the going concern concept remains appropriate, notes on pensions are included in the explanatory foreword and the accounting policies.

51. A full actuarial valuation of the local government 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 106% at 31 March 2002 to 89% as 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 as 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. This shows that budgeted contributions are expected to rise from 290% to 310% by 2008/09. The council has budgeted for these increases.

Council tax and the general fund

Revenue performance 2005/06

52. The council's net revenue expenditure in 2005/06 was £284.619 million, after transfers from the renewal and repair fund (£2.251 million) and capital fund (£2.000 million). This was met by government grants and local taxation of £283.950 million resulting in a net general fund deficit of £0.669 million.

53. The budget set for 2005/06 was based on a Band D council tax level of £988. In his foreword to the financial statements, the director of finance says that it was anticipated that £5.324 million of brought forward balances would be used in 2005/06. Therefore the overall results for the year showed a favourable variance of £4.655 million. The main contributors to the favourable variance are:

- funding for specific projects which will require to be carried forward such as the waste PFI project, which has a £2.257 million underspend;
- additional council tax income of £1.000 million from new dwellings and improved long term collection rates;
- savings on loan charges of £2.464 million; and
- savings on unallocated service funding of £3.916 million (of which £3.499 relates to schools PPP and single status costs).

Budget difficulties

54. Although the council's overall financial position was better than the budgeted position throughout the year the council faced a number of budget difficulties:

55. **Education and community services (ECS):** The ECS budget reported a £0.422 million underspend against its outturn budget, although this was a £2.174 million overspend against the services' original budget. During the year there were a number of budget virements to ECS from unallocated corporate resources and policy headroom funding plus a significant draw down of service reserves, to fund overspends on pupil support and adults with physical and learning disabilities. Even with the increases to the budget, a number of specific spending control measures were introduced to contain expenditure within the revised budget figure. This indicates that the effectiveness of the ECS budget setting procedures should be reviewed.

56. **Combined services (CS):** CS budgeted for a surplus of £81,000. The actual outturn was a deficit of £2.411 million. The deficit arose due to adverse variances across all of the services, and losses in all services except roads maintenance. The areas of most concern were:

    - the property maintenance trading operation, which had been forecast to break even, reported a deficit of £0.987 million. Between January and March external income fell substantially particularly from the Dumfries and Galloway Housing Partnership contract which provides 80% of income, and these reductions in income are likely to continue. As a consequence, the council is restructuring the service, and reducing staff costs through early retirements, voluntary redundancies and redeployment of staff. These costs will need to be charged to the trading operations accounts. The service is also planning to identify new sources of income; and
    - land and street services budgeted for a surplus but reported a loss of £965,000. This is primarily due to increased staff and fuel costs. The council has introduced a number of measures to reduce staff costs across services.

57. **Private sector housing grants:** In January a potential overspend of £1.6 million on private sector housing grants was brought to the attention of the finance sub-committee. This arose as the council had anticipated receipt of £1.000 million from Communities Scotland, based on previous funding awards, which was not provided. Communities Scotland did, however, agree that the council could bring forward £1.200 million of its 2006/07 funding and this has been accrued in the 2005/06 accounts. The council now faces pressures on its funding for 2006/07 and has revised its grant scheme to restrict awards and to improve the financial management of the scheme.

Reserves and balances

58. At 31 March 2006, the council had total cash backed reserves and funds of £48.612 million, including a capital fund established to aid delivery of the capital programme, a renewal and repair fund and an insurance fund that underpins the council's self-insurance arrangements.

Description	2005/06 £ Million	2004/05 £ Million
General Fund	28.368	29.037
Capital Fund	3.920	5.667
Usable Capital Receipts Reserve (set aside for housing regeneration)	13.705	13.705
Renewal and Repair Fund	0.620	2.871
Insurance Fund	1.999	1.955
	48.612	**53.235**

59. The general fund balance of £28.368 million includes amounts earmarked by the finance sub committee in June 2006 totalling £16.104 million, leaving an unallocated general fund balance of £12.264 million. Significant earmarked amounts include:

- contributions to the anticipated costs of the strategic waste management PFI contract of £4.256 million;
- funds to address regeneration and housing related issues of £2.827 million;
- contribution to the anticipated costs for 2006/07 of equal pay compensatory payments and of single status costs of £2.343 million; and
- devolved school management balances of £0.884 million.

60. In 2006/07, the council is anticipating using £7.145 million of unallocated balances which would reduce the balances to £5.119 million. This is below the council's agreed policy on the retention of balances, which would indicate a balance of £6 million be held. This position reflects the increasing financial pressures on the council.

61. **Police and fire allocated reserves:** Balances are included in the allocated service reserves for police and fire services as follows:

	2004/05	Utilised	2005/06
Fire	£681,000	£426,000	£255,000
Police	£877,000	£351,000	£526,000

In previous years, the allocated service reserves have included sufficient amounts to cover commuted pension payments in full, but this is no longer the case. In future years the burden of these payments will be met increasingly from revenue budgets. The estimated commuted pension payments for fire services in 2006/07 are £0.427 million, of which £0.318 million is to be met from the revenue budgets. The estimated commuted pension payments for police services in 2006/07 are £1.232 million, of which £0.950 million is to be met from the revenue budgets.

Other funds

62. During the year, £2.000 million was transferred from the capital fund to the general fund balances. As a result the capital fund has decreased from £5.667 million at 31 March 2005 to £3.920 million at 31 March 2006. The transfer related to funding put aside for the Dumfries Theatre Royal project, which has now been cancelled. The remaining fund represents: £2.509 million for the Dumfries and Galloway Leisure Complex, £0.488 million for theatrical provision in Dumfries and £0.923 million is unallocated. The use of this fund should be reviewed to ensure it is meeting its purpose and is sustainable in the future.

63. In 2004/05, the council set up a renewal and repair fund and transferred a balance of £2.871 million into the fund. The council's committee papers explained that "*the fund was set up to address the pressing need to repair, maintain, replace and renew the Council's fixed assets*" arising from a maintenance backlog. Education and community services, planning and environment and combined services have all used the fund during 2005/06. As a result the balance on the fund has now been reduced to £0.620 million at 31 March 2006. No contributions were made to the fund from services in the year. The use of this fund should be reviewed to ensure it is meeting its purpose and is sustainable in the future.

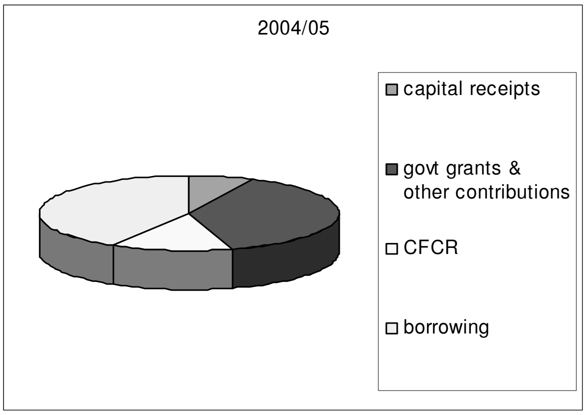
Spending on assets and long-term borrowing

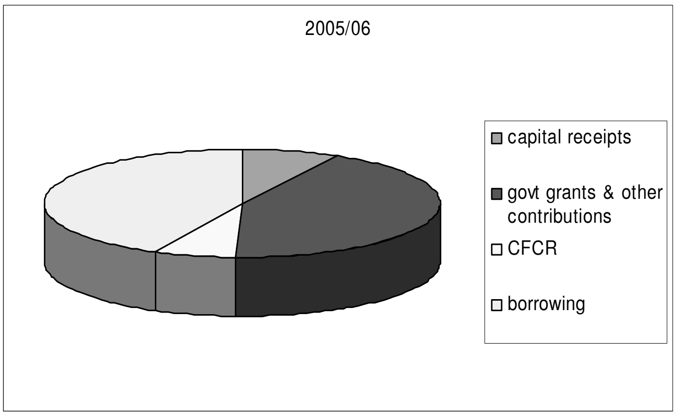
Capital performance 2005/06

64. 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 capital investment strategy for 2005/06 was set in January 2005. This highlighted the council's priority for investment as the Dumfries and Galloway Leisure Complex.

65. As in the previous year, there was considerable slippage in the capital programme during 2005/06. The total capital programme was £27.051 million, of which only £17.286 million (64%) was spent in the year; slippage totalled £9.444 million. This mainly related to the award of funding to projects before they were ready to start and project timescales being unrealistic, with the main slippage being in the Dumfries and Galloway Leisure Complex, the schools PPP project, the regeneration of Dumfries town centre and on children with learning difficulties' projects. New project management methodologies have been adopted, and the council expects to reduce slippage on its 2006/07 capital programme. Currently, it is difficult to form a view as to whether or not there has been improvement in 2006/07.

66. Capital investment in the last two years was funded as shown below. The level of borrowing has remained stable in the period 2004/05 to 2005/06.





Forward capital programme

67. General services capital plans anticipate annual capital expenditure of £28.656 million for 2006/07, £21.905 million for 2007/08 and £16.790 million for 2008/09.

68. The three year capital investment strategy 2006/07 highlights the council's priorities for investment as the Dumfries and Galloway Leisure Complex, the schools modernisation programme and essential upgrading of facilities. In recognition of the budget pressures faced by the council, no new development projects are to be started before 2009/10. The expenditure is to be funded by a number of sources including capital receipts, grants and other contributions and borrowing.

Significant trading operations

69. 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.

70. The council has four significant trading operations, catering and cleaning, cleansing and grounds maintenance, roads maintenance, and property maintenance. In the three years to 31 March 2006 only roads maintenance made an aggregate surplus of £0.409 million, meeting the statutory target. The catering and cleaning aggregate deficit of £1.232 million arose primarily as a result of the equal pay costs of £1.287 million incurred in 2005/06. However, it is acknowledged that the cleansing and grounds maintenance and the property maintenance aggregate deficits of £1.078 and £0.788 million respectively have arisen due to a deterioration of trading performance over the last three years. In recognition of this, the council is to carry out a fundamental review of these trading operations.

71. Due to the failure of three trading operations to meet the statutory requirement to break even over a rolling 3 year period, an explanatory paragraph has been included in the 2005/06 auditor's report.

Pension funds

72. Dumfries and Galloway Council in its capacity as trustee, administers the local government superannuation scheme (LGPS). 68% of the council's staff who are in pension schemes are covered by the LGPS (excluding teachers, policemen and firemen). The finances of the pension scheme are reflected in the council's accounts. As a result, the council's audit includes consideration of the arrangements in place to manage and administer the scheme. We review the controls in place for ensuring that funds are invested in accordance with statutory requirements and approved policy, acquisitions and disposals are properly controlled and recorded, all income earned is received and properly recorded and investment performance is adequately monitored and appraised**.** The main findings are as follows.

73. Like many other local government pension funds, the biggest challenge facing the scheme is financial sustainability. This is highlighted in the financial position section of this report. The council's actuary reported a net liability at 31 March 2006 of £127.777 million (£119.800 million at 31 March 2005).

74. In 2003 the pension fund produced a "*Statement of Investment Principles & Compliance Statement for the CIPFA Pension Panel's Ten Investment Principles of Investment Decision Making*," (*Myners' investment principles*). The council complies with most of the principles. The statement is currently being updated to reflect the new pension fund arrangements discussed below.

75. The investment sub-committee reviews the performance and considers the investment strategy of the pension fund on a quarterly basis. During the year, a review of the fund's management arrangements and investment management structure was carried out, which replaced Deutsche Asset Management as the sole managers of the fund with the introduction of three other managers: State Street Global advisors and Legal and General Investment Management appointed as equity managers; Aberdeen Asset Management as fixed interest assets' managers; and Deutsche Asset Management, under the name of RREEF, retaining property investments. This change spreads the investment risk of the fund which is in accordance with best practice. The performance of the fund will be reviewed as part of the ongoing audit.

Financial outlook

Current budget

76. Following the change in the council's administration highlighted above, the 2006/07 budget was based on a band D council tax level of £1,018, a rise of 3.0% from 2004/05. When the accounts were finalised, the council was anticipating using £7.145 million of unallocated balances in 2006/07 which would reduce the balances to £5.119 million. This is below the council's £6 million agreed policy on the retention of balances. This position reflects the increasing financial pressures on the council. The three year financial strategy agreed with the 2006/07 council tax in March 2007, anticipates a move towards a balanced budget and the restoration of balances to 2% of net expenditure in that period. A high level revenue budget for 2007/08 has been set provisionally. This assumes an inflation rate of 3% for council tax, which has been accepted by the council for provisional planning purposes.

77. Local authorities have yet to be provided with details of provisional Scottish Executive aggregate external finance allocations for 2008/09. The council has yet to agree a high level revenue budget or issue an indicative council tax level for this year.

Equal pay

78. 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.

79. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2005/06. There are risks for councils not only on whether traditionally female roles have been underpaid but also in relation to many mainly male manual workers in areas such as cleansing, grounds maintenance and building trades receive bonus

payments that typically are not available in areas such as catering and cleaning staff where the workforce is predominantly female.

80. In common with many other Scottish councils, the council has sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer equal pay payments to specific groups of employees as part of a compensation package. The council has completed a review and an £4.800 million estimate has been made of the total one-off cost of these payments, with £4.320 of these costs being recognised in the 2005/06 financial results. The extent to which the actual costs vary from current estimates will depend on a number of factors including take-up rates and level of awards of any cases taken to tribunal. Costs above that already budgeted will increase further the financial pressure on the council. The risk that compensation payments may increase beyond this amount and that other groups of employees may claim compensation is recognised as a contingent liability.

81. Approximately 92% of the settlement offers have now been accepted by staff. The remaining 8% have either rejected the offers or have not replied. It is acknowledged that the actual costs that will be incurred to settle these cases will depend on the level of awards of any cases taken to tribunal. Current experience in England suggests claims taken to tribunal are settled at up to four times the original offers. If this was the case for the council, the provision should be increased by approximately £1.000 million. We asked that the council's £4.320 million provision be reviewed based on the current information compiled by legal services as to the likely level of settlement. In response, the council accepts that the provision may now be understated but not by an amount that merits a change to the accounts.

82. We have also been informed that 214 classroom assistants previously excluded from the equal pay offers, are taking a joint case to tribunal in an attempt to claim a settlement. The council previously excluded this group from the offers based on legal advice at that time. Further legal advice is now being sought on the likelihood of these claims being successful. Currently, the council's view is that the probability is that these claims will not be successful and therefore a provision is not required.

83. While moves to agree compensation payments to affected employees will help to reduce financial risk in this area, there remain significant risks, particularly 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

84. In 1999 a single status agreement was reached between Scottish local authorities and trades unions which would 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.

85. 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, this was extended by agreement between local authorities and unions to April 2004. To date only once council, South Lanarkshire, has implemented the single status agreement. Dumfries and Galloway council's current timetable is for the agreement to be implemented in April 2007. The council has set aside £4.500 million in the 2006/07 revenue budget to fund the single status agreement.

86. 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 there is significant variation in the level of potential costs which can be up to 10% of the current pay-bill on a continuing basis. The annual amount currently budgeted by the council represents around 2.4% of current pay costs (based on the 2005/06 staff costs). 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

87. 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. 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.

88. 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. Although the Scottish Executive has not notified councils of the efficiency savings they should achieve each year, it anticipated that Dumfries and Galloway Council's contribution to the top-sliced target of £168.3 million will be £5.112 million over three years. Although this is a relatively small sum compared to the council's gross revenue spend of £446.052 million in 2005/06, it requires to be considered alongside other financial pressures facing the council such as the costs associated with the single status agreement and equal pay claims, and the revenue consequences of the revised three year budgets.

89. The council's financial efficiency strategy for the period 2006/07 to 2008/09 includes the council's initiatives to generate savings under the efficient government agenda.

90. The council has not quantified any savings for specific efficient government projects in 2005/06. Overall efficiencies currently anticipated for the three years commencing 2005/06 under the efficient government agenda are unlikely to compensate for reductions in grant support, however shortfalls have been anticipated in the savings requirements identified by the council. In June 2006 the council's financial efficiency strategy is showing :

	2006/07 Million	**2007/08 Million**	**2008/09 million**
Total expenditure reductions/ savings requirements	£2.458	£11.000	£15.000
Anticipated efficient government projects (cashable and non cashable) under the control of spend project	£1.253	£1.358	To be determined
Anticipated efficient government projects under the other projects	To be identified by the council	To be identified by the council	To be identified by the council

91. Significant effort will be required to deliver the level of efficiencies required while continuing to improve performance. The council has recognised that this requires leadership at a corporate level and this is now being managed as part of the council's overall financial strategy. It acknowledges that a more structured approach to measuring and monitoring outputs, integrated with the council's developing performance management systems, is essential to underpin this, particularly if the council is to demonstrate that service outcomes have been maintained or improved in order for it to claim savings for efficient government projects.

Governance

Introduction

92. 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

93. 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 many aspects of a sound corporate governance framework in place and have reached the same conclusion this year.

94. A corporate governance assurance statement is included within the annual financial statements, with the aim is of providing assurance to stakeholders on the adequacy of arrangements. The council has concluded that it is satisfied that the council has in place appropriate arrangements for the governance of its affairs and that, where necessary, improvements are being identified and actioned. Areas reported for improvement include incorporating the performance management and reporting process fully into the planning and reporting cycles; a review of the public performance reporting framework; implementing the transitional audit of best value action plan; and a review of member appointments to outside bodies.

95. At a corporate level, the council has appropriate arrangements in place which aim to prevent and detect inappropriate conduct and corruption. These arrangements include codes of conduct for elected members and staff, a whistle blowing policy and defined remits for relevant regulatory committees.

96. The council's audit committee adheres to CIPFA's guidance note *Audit Committee Principles in Local Authorities in Scotland* and provides a contribution to the overall control environment. The effectiveness of the committee is to be kept under review.

97. 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 and concluded that external audit reliance will be placed on the work produced by internal audit. However, there remain areas where the internal audit service does not fully comply with the CIPFA *Code of Practice for Internal Audit in Local Government* and external audit expectations. The areas to be addressed by the service are as follows.

- monitoring of the performance of the internal audit section by the audit committee is limited and should be reviewed. Performance indicators or target measures, against which the service or the audit committee can monitor internal audit's performance should be developed further as part of the council's performance management framework;
- the audit report cycle should be reviewed and brought into line with the financial year to which the plan relates;
- to assist in the implementation of improvement actions, timescales should be set for issuing reports to ensure that findings are agreed with service managers prior to the annual assurance statements being completed by internal audit in June of each year; and
- work should only be reported as complete when reports are finalised.

98. The council is striving to improve its risk management processes. In June 2005, workshops were held to update the corporate risk assessment and a corporate risk manager has been appointed. The risk management action plan is being kept under review by the business review and performance committee. The council now plans active management of the highest priority items on the corporate risk register and aims to ensure that risk management is part of all new projects and initiatives.

Systems of internal control

99. 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, reasonable assurance can be placed upon the adequacy and effectiveness of the council's internal control system.

100. Recommendations made in internal and external audit reports are monitored by management and internal audit, with progress reported to the audit committee. Our 2005/06 audit also included follow-up of progress made in implementing previous audit recommendations. The majority of recommendations have been implemented or progress is satisfactory. Outstanding recommendations are being taken forward by the council.

101. *A*s 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 central financial systems and assessed that they had a satisfactory level of control for our purposes.

Prevention and detection of fraud and irregularities

102. At the corporate level, the council has appropriate arrangements in place which aim to prevent and detect fraud. Each year Audit Scotland gathers information on actual cases of fraud identified by councils. In 2005/06, we reported that the council had identified no cases of non-benefit fraud, while

four cases of benefit fraud with a value of greater than £5,000 were identified, with losses totalling £33,205.

103. 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 initiative also enables bodies to detect overpayments made in error or through honest misunderstandings. 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.

104. In this council, benefit overpayments of £13,568 in total were identified and reported as part of this initiative. These amounts reflect the council's investigations into high risk matches identified through the exercise; follow-up work on medium to low risk cases is continuing. The amount of overpayments identified appears low for a council of this size. However a recent report to the audit committee considered this and explains that this is due to the council's good fraud prevention procedures. A BFI review is currently ongoing which will report on whether or not this is the case.

105. 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.

Governance outlook

106. As noted above continuing development of risk management and audit committee scrutiny arrangements will further strengthen the council's corporate governance arrangements. Other areas of governances identified for improvement include the following:

Council tax collection rates

107. Council tax collection rates for the percentage of income collected by the end of each financial year are 94%, with long term collection rates in excess of 96%. Although the council is continually reviewing collection procedures to identify areas for improvement, no local targets have been set against which service performance can be measured. Targets should be considered.

Dumfries and Galloway leisure complex catering contract

108. At the Dumfries and Galloway leisure complex ad hoc sub-committee on Tuesday 2 May 2006, members considered two options for awarding this catering contract: an external tender, or to negotiate a service level agreement (SLA) with combined services. The committee authorised officers to negotiate a SLA for an initial period of up to three years with combined services based on the revenue projections as detailed within the DGLC business plan. They approved this, subject to officers receiving professional advice from external advisers as necessary, including seeking assurance from Audit Scotland that the council is demonstrating best value through this process.

109. In June, we were requested to provide an opinion as to whether or not the approach used by the council in proposing to award the Dumfries and Galloway leisure complex catering contract would meet audit's expectations regarding the securing of best value for this service. Since that time we have reviewed the factors that the committee considered in reaching its decision and have requested a range of information. We reported that we are satisfied that, overall, the approach used by the council in proposing to award the Dumfries and Galloway leisure complex catering contract meets audit's expectations regarding the securing of best value for this service except that, before a final decision is made, the members of the ad hoc sub-committee should be given the opportunity to scrutinise the results of catering benchmark exercises conducted, to enable them to question any of the assumptions used or conclusions reached. In addition, the council should monitor the contract and continue to benchmark costs, in order to demonstrate that the contract is delivering best value over the term of the contract.

Disaster recovery and business continuity plan

110. In response to audit recommendations in previous years, the council has confirmed that it is preparing a disaster recovery and business continuity plan. The council should ensure that once implemented the arrangements have been adequately tested and are effective.

Financial statements

Introduction

111. 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.

112. We audit the financial statements and give an opinion on:

- whether they present fairly of the financial position of the council and its expenditure and income for the period in question; and
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

113. We also review the corporate governance assurance statement 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 in the statement are consistent with our knowledge of the council.

Overall conclusion

114. We have given an unqualified opinion on the financial statements of Dumfries and Galloway Council for 2005/06. We have, however, drawn attention to a failure to comply with a statutory requirement. This does not impact on the fairness of the financial statements and, therefore, does not affect the opinion on the accounts.

115. The Local Government in Scotland Act 2003 requires councils to maintain and disclose trading accounts for significant trading operations, which are required to break-even over a three year rolling period. As highlighted in the financial position section off this report, in the three years to 31 March 2006, the catering and cleaning trading organisation made an aggregate loss of £1.232 million, the cleansing and grounds maintenance trading organisation made an aggregate loss of £1.078 million and the property maintenance trading organisation made an aggregate loss of £0.788 million. As a result that the council has failed to meet this statutory requirement.

116. 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.

117. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the council and for publication. The financial statements are the 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

118. 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'). A number of narrative amendments were made to the accounts provided for public inspection. These had no effect on the surplus for the year. Details of significant accounting issues arising in the course of our audit are summarised below.

Government grant income

119. The accounts include, as part of creditors, £3.960 million relating to unspent grants at the year end (£3.211 million revenue support grant (RSG) and £0.749 million supporting people grant) and are being carried forward to 2006/07. It is my view that in accordance with proper and transparent accounting practice, these balances should be shown as part of the closing general fund balance and be ring fenced for use in 2006/07. The council has clear plans to spend the unspent grant. This treatment has also led to the RSG income figure in the accounts being understated by £3.211 million. As at 31 March 2006, there was no requirement to return the money to the Scottish Executive as it had approved the carry forward of the funds to be spent in 2006/07, and some funds have been spent to date.

120. This matter has been discussed with colleagues in Audit Scotland, as the treatment is common across a number of councils. Because the letters from the Scottish Executive on the carry forward of these balances are often open to interpretation in accounting terms, and because the accounting treatment of grants, in general, is being considered by technical authorities in the UK and elsewhere, this matter will be considered further in 2006/07, and a consistent approach agreed in all councils, which have unspent grant. I have not required that the accounts be changed for these grants this year.

Group accounts

121. 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. This has become more important with the *Prudential Code for Capital Finance in Local Authorities* which requires authorities to take note of all their commitments, including those in alternative service delivery vehicles. Unlike most

councils, the police and fire services for the Dumfries area are already reflected in the council's financial statements.

122. The council has concluded that a group relationship existed with the Crichton Development Company, on the basis that the council has guaranteed a loan for the company. This relationship has been explained in a note to the accounts, but was not considered material. Group accounts were not required this year. This requirement is to be kept under review in future years.

Debt restructuring costs

123. 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.

124. Over the last four years, the commercial money market has been increasingly competitive with new products such as LOBOs being of particular interest to councils as an additional form of borrowing over the longer term. 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.

125. There is currently a debate over the appropriate accounting treatment of LOBOs, specifically whether the characteristics of a LOBO requires any premium arising to be recognised immediately rather than over the life of the replacement borrowing. As at 31 March 2006, Dumfries and Galloway Council had £11.500 million of LOBOs. However none of the debt premium balance of £2.335 million in the accounts relates to premiums incurred on switches from PWLB to LOBOs.

Food preparation charges

126. 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. These charges were introduced in 2002 and were in place until January 2006. There is currently uncertainty regarding whether there is a legal obligation to repay charges levied. The council has disclosed a contingent liability for the potential repayment of food preparation costs in the accounts. A report on this issue is to be discussed by the ECS committee later this month. Current estimates indicate that total costs could be £2.193 million. The council is awaiting a decision regarding the legal obligation to pay back these amounts. Because of the level of uncertainty regarding the council's obligation to make any payments the council does not feel it is appropriate to include an estimated value of the contingent liability in the note in the accounts.

Common good funds

127. The council uses a number of common good fund properties for operational purposes on which they do not pay an economic rent, for example the Midsteeple and Castle Douglas Town Hall. The common good income will therefore be understated by an amount that cannot be quantified by audit. The council should pay an economic rental to the common good funds for any properties used.

128. The council's accounts include £0.201 million costs for the repair of the Midsteeple building which is a Dumfries common good asset. This expenditure should be charged to the common good fund and not the council. If these costs were to be charged to the common good fund it would be reporting a deficit of £49,000. This would result in the fund reporting a balance owed to the council which is not permitted. The council has therefore not amended the accounts to reflect this transaction. However in 2006/07, the practices regarding funding of repairs on common good assets are to be reviewed. This issue may have an impact on future accounts as the estimated total repair costs for the Midsteeple are £1.500 million.

Fixed assets

129. We have reported for a number of years that the council is to complete an exercise to establish where all its heritable properties are, who holds title to them and what the value is. This is important to ensure that both the council's and any common good fixed asset figures are fairly stated. The exercise has not been completed and discussions suggest that the exercise will take some time to complete. The council is to monitor completion of this exercise and consider the implications of the findings from the exercise in 2006/07.

Legality

130. Each year we request written confirmation from the director of finance that the council's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes. The director of finance has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the chief executive and council management team, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.

131. 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.

132. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Financial reporting outlook

133. 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. Significant challenges ahead are summarised below.

134. A number of changes have been made to the 2006 SORP. These include:

- changes to the single entity statement of accounts which include the 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; and the replacement of the statement of total movement in reserves with a statement of total recognised gains and losses; and
- parallel changes to group accounts that would result in them being easier to understand and have a common format to the single entity statement of accounts.

135. 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 is fully transparent.

136. Further ahead, there are proposed changes to the application of financial reporting standards (FRS) 25 and 26 in 2007. These standards will require the premium on loans that have been re-scheduled by the council to be charged to the revenue account in full in the year of re-scheduling rather than being written off over the period of the replacement loan, which can be up to 40-50 years. Every council will be affected by these charges of potentially millions of pounds to the revenue account and the impact this could have on council tax. Directors of finance have been talking to the Scottish Executive about legislation or regulation which would remove the risk of increasing council tax through the application of accounting practice. Audit Scotland has been participating in this debate and will continue to be involved in trying to find a solution to this matter.

Change of external auditor

137. 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.

138. This is the final year of our current appointment to the audit of Dumfries and Galloway Council. From 2006/07 Audit Scotland will remain as the council's appointed auditor and the new engagement lead will be Peter Tait. 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

139. The members of Dumfries and Galloway Council are invited to note this report. We would be pleased to provide any additional information that members may require.

140. 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.

141. This is the final year of a five year audit appointment. I would like to take this opportunity to express my appreciation for the co-operation and assistance given to us by Dumfries and Galloway Council's members and staff over the five years of our audit appointment.

Appendix A: Action plan

Key risk areas and planned management action

Action Point	Para ref	Risk Identified	Planned Action	Responsible Officer	Target Date
1	7 18	It is not possible to assess whether the resources of the council are being used most effectively to address the corporate priorities.	The performance management framework is to demonstrate progress made against corporate priorities. The framework is to be incorporated into the planning and reporting cycles.	Chief Executive	March 2007
2	11	Statutory performance indicators are not produced to comply with the annual direction.	Documentation to support the indicators is to be provided cross referenced to the underlying data sources; and the council is to introduce some internal checking of indicators before they are passed to audit.	Group Manager — Policy & Improvement	March 2007
3	12	Social work resources are not used in a way which provides best value for the council.	The council is to demonstrate improvements in social work services through implementation of the improvement plan in response to the SWIA report.	Chief Executive	December 2006
4	15	The council is under significant financial pressure putting the financial stability of the council at risk. The level of balances could fall below the council's policy on retention of balances.	The financial efficiency strategy for the period 2006/07 to 2008/09 is to be implemented in full. The level of balances is to be kept under review.	Director of Finance	Ongoing
5	20	The council may not have the right skills, in the right place, at the right time to deliver high performing services.	The development of a workforce strategy linked to staff appraisal, the overall HR strategy, succession planning and development strategies. Is to be completed.	Group Manager Human Resources	March 2007
6	25	The council cannot demonstrate that partnership working is driving forward service improvements.	This is to be addressed through the council's performance management framework.	Corporate Director of Corporate Services	March 2007
7	28	Services may not be configured in a manner that allows them to respond effectively to the needs of the local community.	The business transformation programme aims to address this through driving long term and fundamental changes in the way the council operates and delivers services.	Corporate Director of Corporate Services	March 2007

Action Point	Para ref	Risk Identified	Planned Action	Responsible Officer	Target Date
8	31	Council facilities, infrastructure and assets may not be suitable and sufficient to meet the requirements placed on them in the provision of services and the delivery of council objectives.	The corporate asset management plan is to be developed and it will link into the strategic services development plans and will address the asset implications of the council's strategic objectives.	Corporate Director of Corporate Services	March 2007
9	65	Slippage on capital projects results in corporate objectives not being achieved.	The effectiveness of new project management methodologies to reduce slippage is to be kept under review.	Capital Officers Working Group	March 2007
10	70	The performance of the cleansing and grounds maintenance and the property maintenance statutory trading operations continues to deteriorate.	The council is to carry out a fundamental review of these trading operations.	Corporate Director of Combined Services	March 2007
11	128	The council's fixed assets are not fairly reflected in the accounts.	The council is to complete the exercise to establish where all its heritable properties are, who holds title to them and what the value is.	Director of Finance & Corporate Director of Corporate Services	March 2007