

Clackmannanshire Council

Report on the 2006-07 Audit

31 October 2007

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Executive Summary

Introduction

Grant Thornton UK LLP has been appointed by the Accounts Commission for Scotland as the external auditor of Clackmannanshire Council (the Council) for the five year period commencing 2006-07. Matters arising from our audit have been summarised in reports issued during the year (Appendix A). This report summarises the key elements of our audit and key messages for members.

We planned and performed our 2006-07 audit in accordance with our Audit Plan issued in January 2007. In accordance with the Code of Audit Practice, we have the following audit objectives:

Code Objective	Key Findings
<p>Financial statements</p> <p>To provide an opinion on the Council's financial statements for the year ending 31 March 2007.</p>	<ul style="list-style-type: none"> We gave an unqualified opinion on the Council's 2006-07 financial statements on 27 September 2007. The Council's finance team prepared well for implementing the 2006 Statement of Recommended Practice (SORP) and the standard of accounts and supporting working papers were good. The accounts record unearmarked reserves of £1 million, which is below the Council's policy to maintain a minimum reserves balance of £1.8 million. This presents a risk that future financial plans will not be achievable. The Council is forecasting a significant funding gap over the next 3 years. The development of a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget represents a key corporate priority.
<p>Governance</p> <p>To review and report on the Council's corporate governance arrangements, including: systems of internal financial control, arrangements for the prevention and detection of fraud and corruption, standards of conduct and the Council's financial position.</p>	<ul style="list-style-type: none"> We have concluded that the Council's systems of internal financial control are generally operating adequately, however, reconciliations between the Council's ledger and subsidiary systems are not always prepared timeously. The Council prepared well for the May 2007 elections and overall governance arrangements are generally sound. However, there is scope to further develop the role of the scrutiny committee and to develop an assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. The Council's internal audit section does well in undertaking and reporting its work but has not made sufficient progress in meeting the requirements of the Code of Practice for Internal Audit. In particular, there are two vacancies at a senior level within Internal Audit and a longer term plan is needed for the delivery of a stable and robust internal audit function. There is scope to develop the Council's participation in the National Fraud Initiative, to increase levels of identified savings and to improve arrangements to prevent and detect fraud and corruption.
<p>Performance</p> <p>To review and report on the Council's arrangements to achieve Best Value, other aspects of arrangements to manage performance in the use of resources and arrangements for preparing and publishing statutory performance indicators.</p>	<ul style="list-style-type: none"> Audit Scotland issued its report on Best Value to the Council in September 2007. The report found that the Council faces a number of significant challenges if it is to fully meet Best Value expectations. The Council does not yet have an effective performance management system in place to support its performance and improvement agenda. The early introduction of such a system represents a key priority. The Council has not yet developed an efficient government strategy and needs to take action to build anticipated efficiency gains into future budgets and its programme of best value reviews. The Council's risk management arrangements need to be updated and improved.

Action Needed by the Council

Our audit identified the following key actions for the Council in the coming year. The Council should:

- develop a sustainable medium term financial strategy, aligned to corporate priorities, that explicitly incorporates anticipated efficiency savings, delivers a balanced budget and maintains reserves at an acceptable level;
- prepare early to ensure full compliance with the requirements of the 2007 SORP in producing the Council's 2007-08 financial statements;
- undertake a post implementation review of the Three Schools PPP Project to learn wider lessons for future contracting arrangements;
- develop both the role of the scrutiny committee and the framework which supports it. In particular, the Council should move towards arrangements which would support an annual Statement on Internal Control, including strengthening internal audit, improving risk management arrangements and developing more tailored training for scrutiny committee members; and
- prioritise the development of a performance management framework across all Council services.

Action plans have been agreed with the Council and included in our audit reports issued during the year (Appendix A).

Status of our Report

This report is part of a continuing dialogue between the Council and Grant Thornton UK LLP and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices. The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place upon it.

Acknowledgements

We would like to take this opportunity to thank the Chief Executive, the Head of Finance, and other officers who have been involved in this audit for their assistance and co-operation.

Grant Thornton UK LLP

October 2007

Financial Statements

Introduction

We have audited the Council's 2006-07 accounts in accordance with our Audit Plan issued in January 2007. The key messages arising from our financial statements audit are contained in our Report to those Charged with Governance, issued in September 2007 and summarised below.

Audit Opinions

We gave an unqualified opinion on the Council's 2006-07 financial statements on 27 September 2007. The adjustments that were made to the accounts following our audit amended the reported deficit in the draft accounts from £11.7 million to £10.7 million in the published accounts.

We confirmed on 6 March 2007, that we were not minded to challenge the view that, in applying the Treasury Task Force guidance, the newly created assets of the Three Schools PPP Project should be accounted for as off the Council's balance sheet. Our opinion recommended that the Council liaise with the Scottish Government to clarify rules relating to the application of capital receipts to PPP projects.

Implementation of the 2006 and 2007 SORP

The Council's accounts are prepared in accordance with the requirements of the 2006 Statement of Recommended Practice (the SORP). The 2006 SORP contained a number of significant changes to improve the presentation of local government accounts, including replacing the Consolidated Revenue Account with an Income and Expenditure account that reports actual financial performance for the year.

In preparing the 2006-07 accounts in accordance with the new SORP, the Council restated the 2005-06 accounts, resulting in the Council's reported financial position for that year changing from a surplus of £3.9 million to a deficit of £12.6 million. Statutory adjustments ensure there is no overall impact on the Council's general fund position.

The 2007 SORP will introduce further changes to the presentation of the Council's accounts and the Council will again have to plan well in advance to ensure it is adequately prepared to implement the new requirements. The key changes for 2007-08 accounts include:

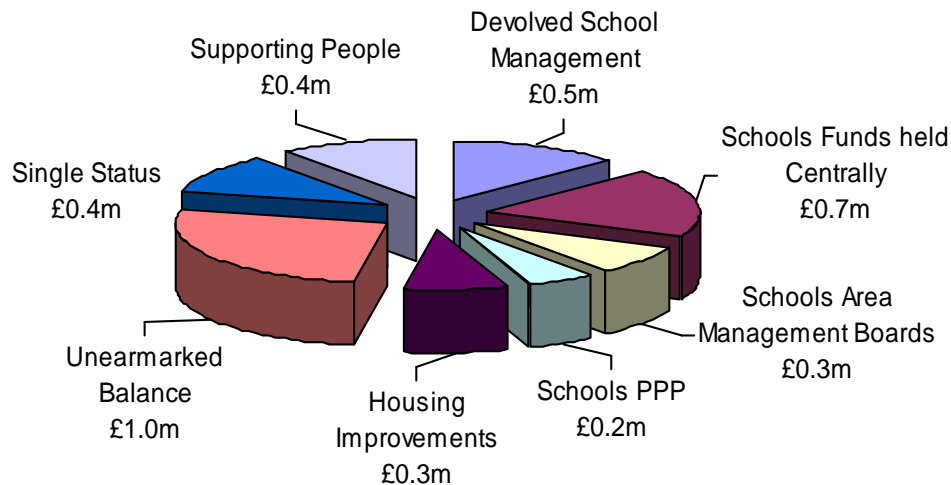
- replacement of the fixed asset restatement reserve and capital financing reserve by a revaluation reserve and capital adjustment account;
- implementation of Financial Reporting Standards 25, 26 and 29 which introduce changes to accounting for financial instruments. This may impact on how the Council accounts for premiums from debt rescheduling; and
- an additional note to the group accounts disclosing the value of assets and liabilities and gross income and expenditure of charitable funds.

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 practice. In 2006-07 Grant Thornton provided a training event for the Council's finance staff on issues emerging from the 2006 SORP that helped the Council prepare for its introduction. We have agreed to provide a similar training event on the 2007 SORP to support the Council's preparations for implementation.

Financial position

At the financial year end, the Council held usable revenue reserves of £10.7 million (£10.5 million 2005-06) representing 10% of the net cost of services. £6.4 million of this total is held on behalf of the Housing Revenue Account, £0.5 million is held to meet potential insurance claims, and £3.8 million is available for general use. A more detailed analysis of the Council's general reserves is contained in Figure 1 below:

Figure 1 - Analysis of 2006-07 General Reserves



The Council has earmarked £2.8 million of its £3.8 million general fund balance for specific purposes, leaving only £1 million available to fund unanticipated expenditure. The Council's reserves policy is to retain a minimum revenue balance of £1.8 million for unplanned expenditure and unforeseen events, and the current low level of reserves, therefore, presents a risk that financial plans may not be achievable. This risk is particularly high in the current financial climate as the Council continues to face significant financial pressures, including:

- additional costs from single status and equal pay agreements;
- additional costs associated with a growing elderly community and higher costs of residential schools; and
- the existing long term financial commitment to fund the Three Schools PPP Project.

In light of these financial pressures, there is a priority need to develop a sustainable medium term financial strategy, aligned to corporate priorities, that explicitly incorporates anticipated efficiency savings, delivers a balanced budget and maintains reserves at an acceptable level.

In addition, the Council must improve its financial management systems to better support the efficiency and improvement agenda in the following key areas:

- the Council's budget should be more clearly aligned to corporate priorities;
- the linkage between financial and performance management, including use of benchmarking and unit costs should be further developed; and
- the Council should build planned efficiency savings into its budget management, monitoring and reporting arrangements.

Capital Expenditure and the Prudential Code

The Council incurred gross capital expenditure of £23.6 million during the year, rising from £14 million in 2005-06, reflecting increased spending on housing to meet the Scottish Quality Housing Standard, further development of the schools estate, upgrading of Alloa Town Centre and the purchase of Lime Tree House. The Council's outstanding debt rose from £90.3 million in 2005-06 to £94.2 million at 31 March 2007.

Local authority capital expenditure and borrowing is regulated by the Prudential Code which requires councils to ensure capital plans are affordable, borrowing is prudent and sustainable, and treasury management arrangements reflect good practice. In February 2006 the Council approved an increase in the authorised limit for external debt to £161.1 million, with an increased operational boundary of £145 million. The significant increase is required to meet the Council's forecast of a 52% increase in external debt between 2004-05 and 2008-09, primarily to support ongoing capital investment, including plans for the following:

- £16 million contribution to construction costs as part of the Three Schools PPP Project;
- £9 million investment annually on housing expenditure in the three years to 2009; and
- £0.9 million contribution to the Stirling-Alloa-Kinross rail link.

The planned increase in the Council's debt levels will result in a significant long term financial commitment to meet higher interest payments and repay the debt over time. The Council should fully consider these additional costs when developing a medium term financial strategy to address the cost pressures referred to above. In addition, the Council must ensure it has the necessary capacity to deliver these major capital projects within the timescales envisaged.

In 2006-07 the Council identified £2.9 million of capital expenditure that did not add value and was written off to reserves (£11.7 million in 2005-06). The Council should consider the impact of its decision to increase its external debt to continue to fund capital expenditure, a large proportion of which is unlikely to add value and not result in creation of an asset recognised on the balance sheet, when developing a medium term financial strategy. In addition, the Council should take action to develop a more robust policy for capitalising expenditure to minimise the levels of non-enhancing expenditure currently being reported.

Three Schools PPP Project

The Council contracted to build three new secondary schools during the financial year under a 'Public Private Partnership' (PPP) agreement. This agreement commits the Council to pay an annual charge of £6.6 million (updated each year for inflation) from 2008-09, for a 30 year contract period, in return for the construction of the schools which have a capital value of some £67 million.

The financial arrangements for PPP schemes can be complex, and the Council appointed advisors to assist in developing its financial model for the Project. The Council's accounts record that it paid some £1million in advisors fees during the financial year that were not included within the 2006-07 budget. These costs, originally estimated at £0.5 million, had instead been included and reported within the overall assessment of the lifetime cost of the Project. This approach limited the opportunity for effective scrutiny and monitoring of these costs.

The Council had difficulty controlling the overall cost for financial advice for the PPP Project as contract payments were made on a day rate basis. This meant that the Council bore the majority of the contractual risk should the project be delayed or negotiations become more complex than anticipated. The Council should undertake a post implementation review of the Three Schools PPP Project to learn wider lessons for future contracting arrangements.

Single Status and Equal Pay

The Council has recognised that its current pay structure is not consistent with the requirements of the Equal Pay Act 1970 and this is reflected in compromise payments of £0.9 million to some categories of female employees during the financial year. The total cost to the Council for settling equal pay claims is likely to be at least £2.5 million.

The Council has set aside £1.2 million from its 2006-07 and 2007-08 budgets for costs associated with the implementation of the Single Status Agreement (Red Book) which contains national conditions of service for local government employees. The Council has not yet implemented a new pay and grading model or made an offer to employees on the implementation of single status.

It is important that the Council formalise its agreements on single status and equal pay issues with employees in the near future, to establish financial certainty over the likely costs associated with implementing the new agreements, to resolve existing claims for compensation, and to limit the potential for future claims to emerge.

Key actions going forward

In summary, the key recommendations arising from our audit of the financial statements are that the Council should:

- develop a sustainable medium term financial strategy, aligned to corporate priorities, that explicitly incorporates anticipated efficiency savings, delivers a balanced budget and maintains reserves at an acceptable level;
- improve its financial management systems to better support the efficiency and improvement agenda;
- take early action to prepare for the implementation of the 2007 SORP;
- undertake a post implementation review of the Three Schools PPP Project to learn wider lesson for future contracting arrangements; and
- formalise its agreements on single status and equal pay issues with employees in the near future.

Governance

Introduction

In accordance with the 2006-07 Audit Plan we have reviewed key aspects of the Council's governance arrangements during 2006-07. The detailed recommendations from our governance review are contained in our interim report issued in September 2007 and our key findings summarised below.

Overview of arrangements in 2006-07

We have concluded that the Council's systems of internal financial control and governance arrangements are generally operating adequately. Key findings from our review included:

- reconciliation procedures between the Council's ledger and subsidiary systems (for example, the rents, housing benefits and non-domestic rates systems) are not always carried out and this represents a material weakness in internal control arrangements; and
- the Strategix ledger system, whilst adequate, is now outdated and unable to produce adequate unit cost and financial performance information to fully meet the demands of the Council's performance and best value agenda. In addition, the ledger is unable to integrate with a number of the Council's other financial systems, leading to additional workload for staff in inputting data and preparing reconciliations.

The Head of Finance's Statement on the Systems of Internal Financial Control (SIFC) is included within the annual accounts and concludes that reasonable assurance can be placed on the adequacy and effectiveness of the Council's internal financial control systems. Two further areas for further improvement in the SIFC:

- the need for further development of the Council's financial ledger system, to improve the extraction and availability of management information; and
- the approval of a formal corporate debt policy, to improve the Council's sundry debtors processes.

Prevention and detection of fraud and corruption

At a corporate level, the Council has adequate arrangements in place to prevent and detect fraud and corruption. These arrangements include codes of conduct for elected members and staff, a whistle blowing policy and defined remits for relevant regulatory committees.

The Council is participating in the National Fraud Initiative (NFI) which is a nationwide data matching exercise run jointly by Audit Scotland and the Audit Commission. The NFI was a major success in its first year identifying £15.1 million of fraud, overpayments and forward savings.

The Council has improved its arrangements for participating in the NFI during the year, but there is scope to develop arrangements for future participation further to increase levels of identified savings and to improve arrangements to prevent and detect fraud and corruption.

Governance Framework

In order for the Council to meet best practice in governance and presentation of financial statements going forward, it should consider developing its governance framework to support an annual Statement on Internal Control (SIC) to replace its existing SIFC. The SIC provides assurance on the adequacy and effectiveness of all of the Council's systems (including those covering risk and performance) and is not restricted to financial systems only.

An appropriate assurance framework should include effective risk management arrangements, an extension of the role of internal audit to provide assurances on the operation of non-financial systems, and arrangements to enable Directors to provide signed 'statements of assurance' each year confirming the effective operation of systems of internal control.

The Council has revised its arrangements for scrutiny following the elections and a scrutiny committee has been set up to undertake this function. We found some scope for the Council to further develop the role of the scrutiny committee, and the framework which supports it, in the following key areas:

- clearer guidelines outlining the key information sources available to the committee and the reporting cycle;
- greater clarity around the scrutiny committee's role in discharging functions traditionally associated with an audit committee, including reviewing the Council's financial statements, statement on internal financial controls, reviewing internal and external audit arrangements and tracking the progress in implementing agreed recommendations from internal and external audit, inspectorates and others; and
- greater clarity around how the committee should report its work to the Council; and
- development of a specific training needs assessment for scrutiny committee members to enable member to fulfil their role as effectively as possible.

We will continue to monitor the effectiveness of governance arrangements as they develop and, as an interim measure, we intend to undertake a review of the operation of the Council's scrutiny committee against existing good practice standards as part of our 2007-08 audit.

We reviewed the Council's internal audit department against the eleven standards set out in the Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) issued by CIPFA and issued our draft report in August 2007.

We found that the internal audit section does well in undertaking and reporting its work but has not made sufficient progress in meeting the Code requirements since Audit Scotland's national review in 2001. The Council is partially compliant across many of the Code's requirements but is fully compliant with only four of its eleven standards. Key findings from our review include:

- internal audit is currently not sufficiently resourced to deliver its audit plan effectively;
- the skills and competency levels required for each grade of auditor have not been defined and formal annual performance appraisals had not been undertaken;
- internal audit work is not prioritised by risk, and audit resources are not systematically targeted to areas of highest risk, thereby reducing the effectiveness of internal audit work; and
- there are no formal performance measurements or targets assigned to internal audit.

Governance

The Council needs to review options for a stable and effective internal audit function going forward that is able to fully support the Council's improvement agenda, scrutiny and governance frameworks (including the development of a Statement on Internal Control) and partnership working arrangements.

Risk Management

The Council has developed a risk register that incorporates key risks at a strategic corporate level. The Council's risk management arrangements have not, however, been reviewed for some time and risk registers have not been fully developed at an operational level. As a result, risk management is not yet embedded into everyday management activity across all council services.

Following the Public Pound

Community planning arrangements and higher levels of partnership working can create ambiguity about lines of accountability. In such a complex environment, the Code of Practice on '*Following the Public Pound*' will become increasingly relevant to councils.

The Council has made limited progress in implementing the recommendations within Audit Scotland's *Following the Public Pound* report (issued in March 2004) and has yet to produce an action plan in response. This means that the Council does not yet have reliable information on the bodies it funds or on whether these bodies have used public funds for the purposes intended. The need for the Council to implement the 'Following the Public Pound' Code is more significant following the move to greater reliance on partnership working.

Key actions going forward

In summary, the key recommendations arising from our audit of the financial statements are that the Council should:

- improve reconciliation procedures between the ledger and subsidiary systems;
- take steps to update its financial, risk and performance management systems to better support the Council's improvement agenda and improve the effectiveness of scrutiny and governance arrangements;
- develop both the role of the scrutiny committee, and the framework which supports it, in order to support an annual Statement on Internal Control, including improved internal audit and risk management arrangements and more tailored training for scrutiny committee members;
- review options for a stable and effective internal audit function going forward; and
- implement the recommendations emerging from Audit Scotland's 'Following the Public Pound' Report to ensure it has reliable information on the bodies it funds or on whether these bodies have used public funds for the purposes intended.

Performance

Introduction

In accordance with the 2006-07 Audit Plan we have reviewed key aspects of the Council's performance arrangements during the year. The detailed recommendations from our performance review are contained in our Interim Report issued in September 2007, and in Audit Scotland's report on Best Value also issued in September 2007. The key findings from these audits of the Council's performance arrangements are summarised below.

Best Value

Audit Scotland issued its report on Best Value to the Council in September 2007. The report found that the Council provides good services in parts of social work, planning and building control and waste recycling. Education services have also been praised by Her Majesty's Inspectorate of Education. The Council does, however, face significant challenges arising from the relatively small scale of its operations, the social, economic and geographical circumstances of the Clackmannanshire area, and the lack of good transport links. Audit Scotland recommended improvement in the following key areas if the Council is to achieve best value:

- more effective leadership by elected members;
- sharper articulation of priorities and policies with a clearer linkage to resource decisions;
- greater consistency between community, corporate and service plans;
- improved political structures which give clarity on roles and responsibilities;
- a clearer approach to competition in relation to service delivery mechanisms; and
- development of a human resources strategy.

The Council had already recognised many of the issues raised by Audit Scotland and has taken steps to improve its Best Value arrangements. The Council is now required to produce a more formal Improvement Plan to demonstrate how it will address the findings of the Best Value audit. We will review the Council's progress in implementing its Improvement Plan as part of our 2007-08 audit.

Performance Management

The Council is at the earliest stages of developing its performance management framework and much work needs to be done in this area, including:

- development of performance targets that are aligned to corporate priorities;
- improved arrangements for monitoring performance against targets, benchmarks and over time;

Performance

- more focus on key performance information requirements, including information on service quality and volume; and
- further development of performance management reporting arrangements, including the frequency and format of reports for all levels of management; and
- clearer arrangements for identifying and tackling poor performance.

The Council is required to prepare statutory performance indicators (SPIs) in accordance with a direction issued annually by the Accounts Commission. We audit these indicators to ensure they are prepared in accordance with the guidance. In the absence of locally determined performance measures, SPIs represent the main source of performance information for the Council.

The Council is unable to produce reliable performance information for five of the 78 SPIs and it should review its arrangements for the collection and publication of SPI information to ensure it continues to meet its statutory obligations.

Efficient Government

The efficient government initiative is a central part of the government's programme of investment, reform and modernisation. 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 anticipated that Clackmannanshire Council's contribution to the top-sliced target of £168.3 million will be £2 million over three years, equating to around £0.7 million for 2006-07.

In order to claim an efficiency, councils need to demonstrate that service outcomes have been maintained or improved and this can only be achieved through a robust performance management system that captures information and baseline data covering both cost and quality aspects of service provision. The Council is currently at the earliest stages of introducing such a system.

The Council recognises the need to further develop its performance systems to support the 'efficiency statement' it is required to submit annually to the Scottish Executive. In particular, the Council produces limited information on service quality and volume.

The Council estimates that it achieved cash releasing savings of £3.3 million (representing 2% of its net cost of services) for 2006-07, exceeding the Government target and forecasts that additional savings of up to £3 million will be required for the 2007-08 financial year.

The Council has not yet developed an efficient government strategy and needs to take action to build anticipated efficiency gains into future budgets and its programme of best value reviews. The significant financial constraints referred to earlier in this report highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

Community Planning and Partnership Working

Community planning is the process through which public sector organisations work together and with local communities, the business and voluntary sectors, to identify and solve local problems, improve services and share resources. The Local Government (Scotland) Act 2003 provides the statutory basis for community planning. It requires councils to initiate and facilitate the community planning process, and for NHS boards, enterprise companies, the police and the fire and rescue service to participate.

Performance

Our review considered progress the Council has made in implementing a comprehensive community plan and in implementing the recommendations made in Audit Scotland's national report on community planning.

We found that the Council has a long history of partnership working and the 'Clackmannanshire Alliance' (now the Community Planning Partnership) predates community planning legislation. The Alliance has recognised that the development of baseline performance information from which to measure outcomes in the future represents a key areas of improvement for existing partnership working arrangements.

Key actions going forward

In summary, the key recommendations arising from our audit of the financial statements are that the Council should:

- develop its performance and risk management systems to support the efficiency and improvement agenda within the Council and to better monitor and manage the performance of the Community Planning Partnership;
- develop a systematic process for identifying, measuring, monitoring and reporting on efficiency;
- review its arrangements for the collection and publication of SPI information to ensure it continues to meet its statutory obligations. The Council should implement a system to identify and address areas of falling or low performance; and
- The Council should develop a corporate register of properties that are accessed by the public containing information on whether Council buildings comply with the Disability Discrimination Act.

Grant Thornton UK LLP

31 October 2007

Appendix A - 2006-07 Audit Reports Issued

Report Title	Key Topic	Month Issued
Annual Audit Plan	Summary of the 2006-07 planned audit work, demonstrating how we will discharge our responsibilities under Audit Scotland's Code of Audit Practice.	January 2007
Review of Internal Audit	Assessment of Internal Audit against the CIPFA Code of Practice.	August 2007
Interim Report	Review of the operation of the Council's key financial systems and governance arrangements.	September 2007
ISA260 - Communication of Audit Matter to those Charged with Governance	Summary of key issues emerging from the audit of the Council's financial statements.	September 2007
Annual Report to Members	Summary of the key issues emerging from the 2006-07 audit.	October 2007