

Comhairle Nan Eilean Siar

Report to the Members and the Controller of Audit
on the 2006/07 Audit



October 2007



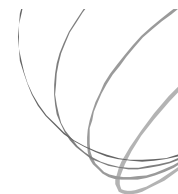
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Key Messages

Introduction

In 2006/07 we looked at the key strategic and financial risks being faced by the Comhairle. We audited the financial statements and looked at aspects of performance management and governance. This report sets out our main findings, summarising key outcomes in 2006/07 and the outlook for the period ahead.

Key outcomes from 2006/07 audit

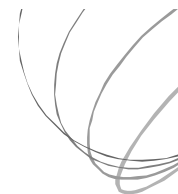
We have given an **unqualified** opinion on the financial statements of Comhairle nan Eilean Siar for 2006/07. We have, however, drawn attention to a failure to comply with the statutory requirement that all significant trading organisations break even on a rolling three year basis as the bus operation trading organisation generated a loss of £0.085 million due to the impact of FRS 17 adjustments.

The Comhairle had corporate governance systems in place during 2006/07 that operated well within a sound control environment. However, further development of the performance management mechanisms are required to identify improvements or declines in performance, including arrangements for collecting and reporting Statutory Performance Indicators. The risk management process continues to be developed, however, the Comhairle should ensure that operational risks at department level are monitored.

The Comhairle has made steady progress against the improvement actions agreed as a result of its 2006 best value audit, and has mechanisms in place to monitor this.

The Comhairle recognised that many of the strategic objectives in its existing corporate strategy were vague and identified three themed priorities. However, the lack of clear outcome focused targets has made effective and meaningful performance management difficult to achieve. The Comhairle therefore plans to ensure that the 2007-2011 corporate strategy contains clear outcome focused targets to enable it to monitor, report and be held accountable for its performance at a strategic level.

Changes to the decision making structure that were scheduled to coincide with the 2007 elections are beginning to take shape. This includes the reduction in the number of departments from seven to six, and a reduction in the number of committees from seven to four. The Comhairle recognises the importance of working with partners to deliver service improvements and is in the process of reviewing its community planning arrangements. One of the outcomes of this is the planned reduction in the number of partnerships from five to three and the identification of three themes (migration, shared services, and climate change) that have a major impact on the Western Isles. We will continue to monitor the effect that these changes have on performance and on the decision making processes.



The financial results for the year were £1.725 million better than planned. This was mainly due to the estimated cost of implementing single status (£1.8 million) not reaching the stage of payment in 2006/07 and therefore being carried forward into the 2007/08 budget. The unallocated general fund balance at 31 March 2007 is £4.3 million, compared to a minimum balance target of £1.8 million. A range of financial issues which could impact on the reserve position are highlighted below.

Outlook for future audits

The Comhairle plans to use some of its general fund balance in 2007/08 and has set a budget deficit of £0.814 million. This will reduce the amount of reserves, but will ensure that the Comhairle's general fund remains above its target to maintain a minimum uncommitted balance of £1.8 million. However, it is not yet clear what the impact of the new Scottish Government will have on local government finance, in particular in relation to local government settlement and council tax funding. This, combined with existing additional costs associated with single status and costs of mainland placements in social work, and uncertainties regarding PPP funding means that financial plans will need to be closely monitored to take account of such pressures.

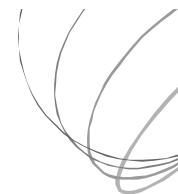
In the short term in response to these pressures, the revenue budget for 2007/08 includes £0.919 million of efficiency savings. There is also on-going development of aspects of policy led budgeting to help ensure that resources are being directed to meet agreed policy priorities.

The Comhairle has settled the overwhelming majority of its equal pay claims and is on course to meet single status by, or soon after, the end of 2007. Negotiations are presently ongoing with the Trades Unions on the terms and conditions of the implementation. Plans are underway to gain the approval of Unison or, failing that, to impose it upon their members. It is estimated that single status could result in a 5% rise in overall pay bill costs (which equates to 12% of the affected payrolls), phased over a four year period. The future implementation of the single status agreement provides an opportunity to address any underlying inequalities in pay and other conditions of service.

Work is underway to develop the Comhairle's corporate asset management strategy. The initial work done, whilst not yet comprehensive for all services, should be used wherever possible to help shape the 2008-12 capital programme.

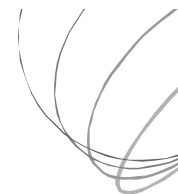
The co-operation and assistance given to us by Comhairle members and staff is gratefully acknowledged.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of Comhairle Nan Eilean Siar, the first year of a five year appointment. Findings are drawn together within four sections, namely, performance, financial position, governance and financial statements. Within each of these sections we have also provided an outlook setting out key issues and concerns facing the Comhairle going forward.
2. The scope of the audit was set out in our Audit Risk Analysis and Plan (ARAP), which was submitted to the Comhairle's Audit Panel in June 2007. Under the following strategic themes, the ARAP set out our views on the key business risks facing the Comhairle and described the work we planned to carry out:
 - Improving partnership working.
 - Funding and supporting local services.
 - Demonstrating good governance and real accountability.
 - Enabling service improvement.
 - A sustainable workforce.
 - Procuring and managing assets.
3. Overall conclusions about the Comhairle's management of key risks are discussed throughout this report.
4. We also undertook a number of detailed exercises which resulted in separate audit reports, for example, our composite report on the Comhairle's main internal control systems and the computer services review. Within this report, we highlight key messages from those separate reports for the consideration of members. Appendix A of this report sets out the key risks highlighted in this report which we wish to draw to the attention of members and the action planned by management to address them.
5. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members during the course of our audit work.



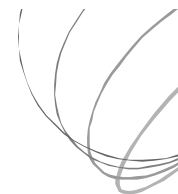
Performance

Introduction

6. In this section we summarise key aspects of the Comhairle's reported performance during 2006/07 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 the best value audit that was reported to members in August 2006.

Corporate objectives and priorities

7. The Corporate Strategy for 2004 – 2007 contains a single corporate priority, “providing best value services to sustain and improve the quality of life”, supported by nine strategic themes which cut across a variety of services:
 - Giving priority to creating a diverse economy.
 - Listening and responding to the community.
 - Developing our staff.
 - Building on our cultural and social strengths.
 - Promoting the Gaelic language and lifelong learning.
 - Promoting our heritage and culture.
 - Improving our health and wellbeing.
 - Providing leadership for the islands.
 - Promoting the distinctive identity of Na H-Eileanan An Iar.
8. A total of 80 strategic objectives support these themes. The Comhairle identified three themed priorities in recognition that such a large number of strategic objectives required prioritisation. These are:
 - **Economic Development** – giving priority to creating a diverse economy.
 - **Leadership for the islands** – improving health and well being, developing our staff and listening and responding to the community.
 - **Promoting the distinct identity of the Western Isles** – a distinctive heritage and culture, the Gaelic language and lifelong learning and building on cultural and social strengths.



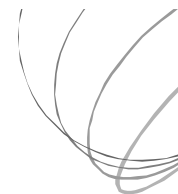
9. However, many of the objectives in the existing corporate strategy are vague. This, and the lack of clear outcome focused targets, has made effective and meaningful performance management difficult to achieve. The Comhairle therefore plans to ensure that the next corporate strategy contains clear outcome focused targets to enable it to monitor, report and be held accountable for its performance at a strategic level.
10. The draft Corporate Strategy for 2007- 2011 was recently issued to various parties for consultation. One of the main issues facing the Comhairle is the expected population decline and the impact this will have on the viability of services and possible decline in services on the islands. Once comments on the draft strategy have been assessed, a seminar for Members will be held to establish a work plan for the next four years and what needs to be done to achieve that plan. If members agree to the approach, committees will be formed to take forward key tasks and department work plans will flow from these key tasks. If the Comhairle is to demonstrate that it is meeting its objectives, it is essential that both these and the forthcoming corporate strategy are more outcome focused than in the past.
11. Concurrent to this, a community appraisal was sent to all households in the Western Isles in September 2007. This was jointly developed with consultants to identify what is important to the people of the Western Isles. It is entitled "Listening to your views – The Outer Hebrides' Community Survey". This information will be useful for community planning partnerships, but as it will not be available until the end of 2007, its findings will not be incorporated into the new 4 year corporate strategy.

Key risk area 1

Overview of performance in 2006/07

Annual Report

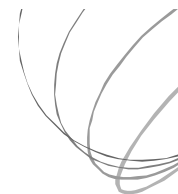
12. The Comhairle's annual report for 2005/06 was published in *January 2007* and provided a brief round-up of the performance of services provided by the Comhairle. It included a statement from the Convenor highlighting how the report takes each of the themes contained in the corporate strategy and gives information about what the Comhairle is doing to achieve them or where this information is available.
13. The report described aspects of performance and achievements across the overall corporate priority and each of the nine corporate strategy themes, including:
 - **Giving Priority to creating a diverse economy** – introduced a number of new award bearing vocational course for pupils to reflect the needs of the local economy.
 - **Listening and responding to the community** – formally registered Hebridean Housing Partnership with Communities Scotland as a registered social landlord.



- **Developing our staff** – established a trainee social worker post, with cross-departmental funding to improve support and services to people affected by domestic violence.
 - **Building on our cultural and social strengths** – achieved a good HMIE report on community education.
 - **Promoting the Gaelic language and lifelong learning** – set targets for individual pupils in all primary schools using national test data and standardised tests, and extending this to secondary schools.
 - **Promoting our heritage and culture** – approved the township heritage scheme for Stornoway.
 - **Improving our health and wellbeing** – put effective and efficient arrangements in place for P7 to S1 transition.
 - **Providing leadership for the islands** – lobbied successfully with the two other island councils to achieve amendments to the Management of Offenders Bill, securing the future of direct local service provision.
 - **Promoting the distinctive identity of Na H-Eileanan An Iar** – continued to make progress with the Outer Hebrides building project.
14. In addition to recording achievements, the annual report made reference to how the Comhairle were performing in relation to some of the statutory performance indicators (SPIs). However, the annual report did not provide a rounded assessment of the extent to which the range of objectives and priorities set out in the corporate strategy were being achieved, nor did it explain why some SPIs are included yet other are omitted or the reasons for high or poor performing SPIs. In the absence of performance targets and indicators directly linked to the key challenges and goals in the corporate strategy it is difficult for members and the public to consider the extent to which resources are being used most effectively to address the corporate priorities.

Key risk area 2

15. This matter will be addressed with the development the balanced scorecard method of performance management. The balanced scorecard is intended to be measured continuously and performance information will be available in real time. Further details of how the Comhairle intend to introduce the balanced scorecard to improve its means of measuring and monitoring performance are recorded below. This will help to underpin future public performance reporting.
16. A business plan progress report for 2006/07 was presented to the P&R Committee in September 2007. This lists achievements and progress during the year. This and the balanced scorecard will inform reporting to the public on service provision in future years. However, no annual performance report to the public is currently planned for 2006/07.



Measuring Performance

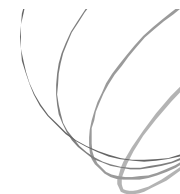
17. Appropriate, reliable, and timely performance information is an essential component of any performance management culture. The Comhairle acknowledges that its performance management arrangements require improvement. In December 2006 the Comhairle agreed the phased introduction of the balanced scorecard method of performance management starting with pilot work in two services (Legal Services and Project Management). The balanced scorecard is a management framework that translates an organisation's strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and management system.
18. A timetable has been prepared which aims to have the preferred performance management system embedded for all services by the end of April 2008. Approval has been granted and funding is in place to procure an electronic performance management system to support this.
19. Once the new software is in place there will also be a need to change management attitudes and practices with regard to gathering and reporting performance measures. Our audit of the SPIs, which is referred to later in this report, identified cases where performance information is not maintained throughout the year and used for management purposes but, instead, is only gathered and recorded at the year end when required by the auditors. Directors and staff need to be made fully aware on the importance of recording this information and using it as a management tool. It is also important that services develop appropriate measures of performance and procedures to identify and record them.

Key risk area 3

20. Initially, it may be beneficial to limit performance measures to a small number of measures which reflect the key elements of the service's performance and corporate targets. There will be a significant element of training required to change the culture to value performance measures. This is expected to take place over the next two years.

Statutory performance indicators

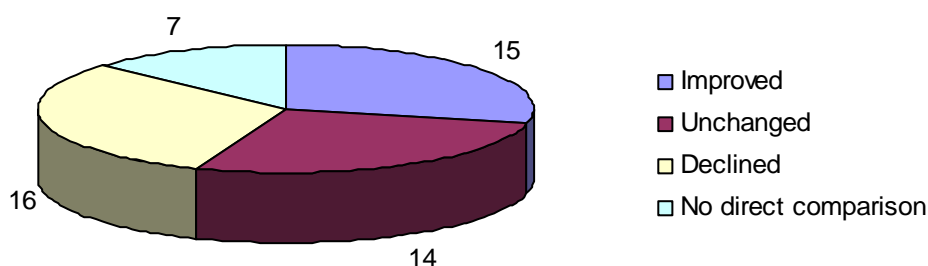
21. Each year we review the reliability of the Comhairle's arrangements to prepare SPIs. Overall, the quality of working papers provided to support the SPIs this year had fallen, with wide inconsistency across services. One indicator was not reported, and a further six indicators were classified as unreliable compared to four in 2005/06. Our audit work also identified other indicators that did not agree to supporting evidence or did not conform to the direction and therefore required to be corrected.
22. There was a lack of delegated authority regarding who was responsible for providing evidence in support of the indicator. This meant that we encountered delays in obtaining basic SPI data or back up information from some services. Taking all of these factors into account, we concluded that there



is not enough ownership of the indicators by services. Directors and heads of service need to be aware of the importance of identifying, gathering and recording key indicators, whether SPIs or as part of the balanced scorecard process, as a means of demonstrating improvements or reductions in service provision.

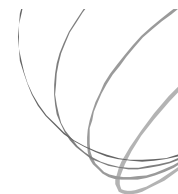
Key risk area 3

23. SPIs provide an important means for the Comhairle to measure improvements in performance, either year on year, or with other councils. However, the unique nature of being an island council means that, historically, some of the indicators reported by the Comhairle have been at the extreme end of the scale in national comparisons. The Comhairle should identify and develop appropriate benchmarks or comparable councils with which to compare performance. In the meantime, we have summarised year on year SPIs to determine whether or not performance is improving and where this is arising. In 2006/07, there is an equivalent improvement and decline in Comhairle performance as measured by its SPIs:



24. Substantial improvements have been made and maintained in:

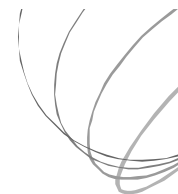
- **Submission of children's hearing reports** – the proportion of reports that were requested by the Reporter which were submitted within the target time.
- **Looked after children** – the proportion of children seen by a supervising officer within 15 days.
- The total hours of **daytime respite care** provided to adults over 65 years old.
- **Public access** – the number of Comhairle buildings in which all public areas are suitable for and accessible to disabled people.
- Attendance at **indoor sports and leisure facilities**.
- **Inspection of medium risk trading premises** within the prescribed frequency.



25. However, performance has declined in the following areas:
- **Respite care** – the total overnight respite nights provided for children up to 17 years old.
 - **Refuse collection** – cost of collection and cost of disposal per premise.
 - **Community care services** – the average time taken to provide community care services from first identification of need to first service provision.
 - **Sickness absence** – chief officers, local government employees, and craft workers.
 - **Use of libraries** – the number of borrowers as a percentage of the resident population.
 - The proportion of **street lighting columns** that are over 30 years old.
26. SPIs are reported in the annual performance report along with achievements in relation to the corporate strategy. However, only in a few instances is it possible to see a direct correlation between the achievements and the SPIs. We have accepted management assurances that the new corporate strategy, together with the balanced scorecard for performance measurement will help to provide a closer relationship between service objectives and the performance measures reported to members and the public.

Best Value audit

27. The Local Government in Scotland Act 2003 established best value and community planning as statutory duties for local authorities. In response the Accounts Commission introduced new arrangements for the audit of best value based on a full review by a specialist team once every three years. In the intervening years short follow-up reviews are carried out by the local auditor.
28. The Best Value audit of Comhairle nan Eilean Siar was carried out in 2006 and the findings published in August 2006. In response, the Comhairle approved a Best Value Improvement Plan (BVIP) in October 2006 setting out the sixteen improvement agenda items from the report together with the planned actions and timescales for implementation.
29. Since this time, the improvement plan has been incorporated into the Comhairle's ongoing performance management arrangements. Progress reports have been considered at each meeting of the Audit and Scrutiny Committee. Most of the improvement plan actions are progressing in accordance with the agreed timetable, however, some items in the BVIP are not progressing as planned or are not scheduled for further progress until later in 2007. One such item that has not progressed as intended is the roll out of staff development and appraisal programme as part of the Comhairle's desire to develop its approach to workforce planning and development, particularly succession planning. Overall, we are satisfied that the Comhairle are addressing each of the items in the BVIP and have good procedures in place to monitor progress.



Performance outlook – opportunities and risks

Introduction

30. In the course of our audit work we identified some of the strategic risks to the Comhairle delivering on its stated objectives and priorities in the years ahead. These risks were set out in our Audit Risk Analysis and Plan and grouped into six risk themes. In the following paragraphs, we comment on the progress made by the Comhairle during the year and the key risks yet to be fully addressed. Where appropriate, matters arising in a number of these areas are also reported in more detail elsewhere in this report. Risk exists in all organisations which are committed to continuous improvement and, inevitably, is higher in those undergoing significant change. The objective is to be “risk aware”, and have sound processes of risk management, rather than “risk averse”. Indeed, organisations that seek to avoid risk entirely are unlikely to achieve best value.

Improving partnership working

31. Councils are increasingly dependent on partnership working to plan and deliver service improvements. This brings an inherent risk that partners are unable or unwilling to work effectively in a joined-up manner and do not achieve best value in the use of public resources as a result. The Outer Hebrides Community Planning Partnership (CPP) has been in place since 2001, however there are insufficient links between this and Comhairle strategic objectives and budgets. This could lead to the risk that community planning objectives will be side-lined as “secondary” to service plans and strategic objectives. This could, in turn, lead to the failure to meet community planning objectives overall.
32. The Comhairle recognises this, and is in the process of reviewing its community planning arrangements, resulting in a new Local Community Planning framework. Following the May 2007 elections, it intends to slim down the number of partnerships from five to three.
33. Three themes are considered to have a major impact on the Western Isles. These are migration, shared services, and climate change. These will feature as cross cutting themes in each of the restructured community partnerships. It is still being decided which of the existing initiatives and themes will be taken forward by the restructured partnerships and which ones will be withdrawn. Some of the work that was previously carried out (for example on Gaelic and tourism) will be taken forward by other means or forums.
34. Important issues such as governance arrangements and the links between the highest tiers of partnerships and the various representative groups on the forums still require to be considered in more detail once the objectives of the new forums and partnerships have been determined. It is still

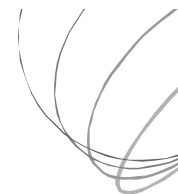


unclear whether this will be achieved by an evolution from the previous arrangements, or by introducing new structures.

35. Other issues that require to be decided include whether and how to include Hebridean Housing Partnership within the community planning process; how to take forward the outcome of the Outer Hebrides Community Survey; and to assess the outcome of the needs assessment that was carried out at South Uist with a view to how the model for community planning partnerships can work most effectively on a small scale.
36. In June 2007 the Western Isles Community Health and Social Care Partnership (CHaSCP) was launched. This Partnership, between the Comhairle and NHS Western Isles, aims to jointly manage all community health services and a range of social care functions. Early indications suggest that this has helped to improve relations between the Comhairle and the Health Board.
37. In February 2007 the Comhairle agreed the establishment of a Joint Services Committee with equal representation from the Comhairle and the Health Board to take forward joint futures with particular reference to community care. From June 2007 the committee has a remit of agreeing policies and procedures with a view to joint decision making being in place from 1 January 2008.

Funding and Supporting Local Services

38. The sustainability of the area and of local services is a key challenge for the Comhairle in the context of tightening financial settlements. While annual budget changes are largely incremental, guidance was issued for the 2007/08 business plans which required departments to follow a standard format and focus on a small number of key performance targets linked to service standards for major service areas rather than completion of tasks. Departments must now incorporate the Best Value Improvement Action Plan actions into their business plans. On-going development of policy led budgeting is necessary to help demonstrate links to the new corporate strategy and to help ensure that resources are being successfully directed to meet agreed policy priorities.
39. The Comhairle continues to face significant challenges both in relation to delivery of its improvement agenda but also with regard to managing ongoing financial pressures such as implementing single status and funding the Hybrid PPP. Savings were built into the 2006-07 budget and in many cases these have been achieved. Overspends occurred within Social Work Services and Transport Services, however, these were offset by the remaining services underspends, resulting in an overall deficit of £0.025 million for the financial year. Further details of the Comhairle's operating performance for 2006/07 and financial statements are recorded later in this report.

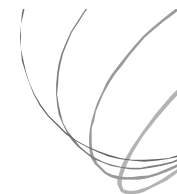


Demonstrating good governance and real accountability

40. The Comhairle is in the process of establishing comprehensive governance arrangements. Good governance arrangements are essential in assisting and facilitating the Comhairle in demonstrating their success in achieving corporate policies and monitoring the effect of these on service delivery. The best value audit highlighted that improvements could be made in the Comhairle's political and corporate governance arrangements. For example, elected members need more opportunities and better information to enable them to consider strategic policy development and monitor progress against objectives.
41. Following the May 2007 election, the Comhairle continues to have no overall ruling "administration" group, with 25 of the 31 councillors being independent. Members consider, debate and vote on recommendations on an issue by issue basis. The election resulted in 13 new members to the Comhairle. This required substantial support from officers to ensure that adequate training and development programmes were provided. Job descriptions were prepared for councillors and members' induction programmes took place. This covered many of the responsibilities and duties of committees and councillors, and also covered the impact of multi member wards.
42. The Comhairle approved a new Scheme of Administration which has seen the number of service committees reduced from seven to four. The Policy and Resources committee is now supported by three joint committees and more emphasis will be placed on the Audit and Scrutiny committee.
43. Concurrent to this, the Chief Executive carried out a "root and branch" review of the Comhairle, including the political and managerial structures and processes and service delivery mechanisms. Its findings are being phased in from May 2007, the biggest impact of which is the reduction in the number of Comhairle departments from seven to six.
44. The next stage consisted of reviewing the sections and structures beneath the Head of Services level, and commenced with a review of the Chief Executive's department. A draft consultation document was prepared proposing that it comprise the executive office, external strategy, continuous improvement and human resources. It also proposed the establishment of an organisational development section to deal with all aspects raised in the Best Value report. We will continue to monitor developments and assess the impact that this has on service delivery.

Enabling service improvement

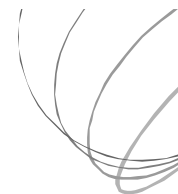
45. The Comhairle is committed to improvement but are still in the early stages of setting up the basic mechanisms to adequately assess and demonstrate whether corporate priorities are being met, resources are being used effectively or that they are achieving continuous improvement in services.



46. Progress against business plans and the corporate strategy are reported to members. However, the current corporate strategy does not contain clear outcome focused targets, therefore there is no mechanism in place to adequately monitor performance against corporate objectives. The balanced scorecard method of performance management is being gradually introduced throughout the Comhairle. This should help provide better quality information to demonstrate whether there are improvements in service performance.
47. Performance reporting to the public is restricted, mainly, to the Statutory Performance Indicators. These are reported in the annual performance report, which also gives information about the progress of corporate objectives. Improvements are being made to address this, and the 2007–2011 corporate strategy will have clear outcome focused targets.
48. The November 2006 Social Work Inspection Agency (SWIA) performance inspection report found that the Social Work department deliver some effective services, particularly residential and day care. Local organisations and groups are well represented in planning and delivering services. However, the priority given to these services left weaknesses in the way other services were run. These included important parts of home care services and children and families services. They also found weaknesses in some key work processes, particularly risk assessment, case recording, and the availability of up to date guidance for staff. This report will be followed up by SWIA.

A sustainable workforce

49. Audit Scotland's Best Value report issued in August 2006 identified that there was a lack of corporate management and coordination in Human Resources. The Chief Executive's root and branch review outlined proposals to address this through an Organisational Development section to be jointly managed by the Head of Human Resources and the Head of Continuous Improvement. However, the Chief Executive's proposals have still to be formally agreed.
50. The Best Value report also identified weaknesses in succession planning and staff appraisal and development arrangements. Internal audit's recent review of Human Resources identified that there is still no formal process for succession planning within the organisation. This increases the risk to the Comhairle by reducing its ability in terms of continuity.
51. Internal audit recommended that, when compiling the annual training programme, the training service in conjunction with departmental chief officers should identify the career paths of employees, so they receive appropriate training on a timely basis, reflecting the future needs of both the individual and organisation.

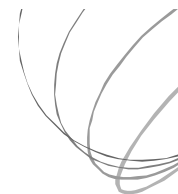


52. Internal Audit also noted that although a number of departments have embraced the Staff Development and Appraisal (SDA) process, a large number have not made sufficient progress in its implementation. They also noted that there is no formal review of the strategic staffing requirements of the authority on an annual basis.
53. Recommendations were made to address these weaknesses and the Human Resources section is currently considering how best to implement them.

Key risk area 4

Procuring and managing assets

54. Asset management and procurement are two of the five efficient government workstreams. Asset management covers acquisition and disposal, replacement, improvement and the maintenance of capital assets. It is essential that the Comhairle takes a strategic approach to asset management, viewing assets as a corporate resource to support new ways of working, including partnership working.
55. The Comhairle are still at the early stages of developing an asset management plan (AMP). The ultimate aim is that the AMP will inform the capital planning programme. The initial work done, whilst not yet comprehensive for all services, will help to shape the capital programme 2008-12 wherever possible.
56. Concerns have been raised regarding the condition of some assets. In particular, there is a backlog on roads maintenance which could run into £10's of millions. Other assets specifically mentioned in need of repair were the Nicholson Institute and the Sir E Scott School. These will be addressed provided the schools hybrid PPP is progressed.
57. The Comhairle has made some progress in making its buildings accessible to disabled people. The Comhairle have appointed consultants to carry out access audits and this could result in considerable capital expenditure being required. There is a risk that the magnitude of capital expenditure requirements cannot be financed from within existing financial resources. This increases the importance of developing a robust corporate AMP, and ensuring that project management skills are improved.
58. The forthcoming capital programme is scheduled to address maintenance of assets, statutory investment needs and new projects. It will also ensure there is appropriate investment in infrastructure.

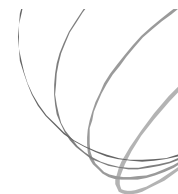


National studies

59. 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 of direct interest to the Comhairle are set out in paragraphs 60 to 68 below. Further information on these studies and reports can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk.

Sustainable waste management

60. There is an increasing awareness of the need to protect the environment and to promote the sustainable use of resources. As a result of UN conventions and EU Directives, the UK government introduced a landfill tax to discourage the disposal of waste in landfill sites and set a (non-statutory) target that Local Authorities should recycle 25% of household waste by 2000. This target was not achieved.
61. Further EU Directives required Member States to “take appropriate steps to encourage the prevention, recycling and processing of waste” and to set out details of measuring processes within waste management plans. Subsequently a series of targets was set over the period to 2020 to reduce the amount of biodegradable waste going to landfill. The EC can impose a fine on the UK of up to £350,000 per day if it fails to meet its targets.
62. The purpose of Audit Scotland's study was to examine the performance of Local Authorities, the Scottish Environmental Protection Agency (SEPA) and the Scottish Executive in reducing the amount of municipal waste being disposed of as landfill, including the impact and value for money achieved by the investment in this area.
63. The key findings from Audit Scotland's national report published in September 2007 highlighted that:
- While significant progress has been made in meeting interim recycling targets, the rate varies considerably between councils and the type of collection system employed.
 - There has been slow progress in developing facilities to treat residual waste. There is therefore a significant risk that EU directive targets may not be met.
 - Increased recycling has led to increased costs.
 - All parties need to work more effectively together to make rapid progress in waste minimisation, recycling and waste treatment to achieve the landfill Directive targets.
64. The Comhairle has increased the amount it recycled or composted from 14% in 2005/06 to 19.1% in 2006/07.

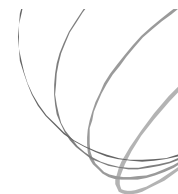


Dealing with offending by young people

65. Audit Scotland published reports on *Dealing with offending by young people* in December 2002 and November 2003. A follow-up study was undertaken to ascertain improvements in performance since 2002 of agencies who deal with young people who offend in the context of a changing policy landscape. The performance update report was published in August 2007.
66. The key findings from the study are:
- The Scottish Executive has shown a consistent commitment to improving youth justice services and has increased funding for youth justice services from £235 million in 2000/01 to £336 million in 2005/06 together with practical support and guidance to help youth justice services to improve performance.
 - However, the impact of this on services and outcomes is not yet demonstrated. Limited outcome measures are available and there are weaknesses in performance management arrangements. Therefore, it is not possible to assess the effectiveness of the additional expenditure in reducing offending and improving the quality of life of local communities.
67. The report includes a number of recommendations that should be considered by the Comhairle.

Scotland's School Estate

68. A national review of how effective recent investments in the Scottish school estate have been in terms of improving the quality of the learning and teaching environment. The performance of the Scottish Executive and local authorities in improving the schools estate within the context of the 2003 strategy 'Building our Future' – Scotland's school estate will be considered. This work is currently in progress and due to be reported by December 2007.



Financial position

Introduction

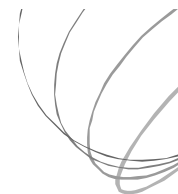
69. In this section we summarise key aspects of the Comhairle's reported financial position and performance to 31 March 2007, providing an outlook on future financial prospects, including our views on potential financial risks. Under the strategic theme of 'funding and supporting local services', our audit risk analysis and plan recognised the significant challenges being faced by the Comhairle both in relation to delivery of its improvement agenda but also with regard to managing ongoing financial pressures such as implementing single status. Our findings and key messages are set out in this section.

Council tax and the general fund

Operating performance 2006/07

70. The presentation of the 2006/07 financial statements has changed significantly from the previous year, as a result of changes to the *Code of Practice on Local Authority Accounting in the United Kingdom 2006 (the SORP)*. In place of the previous consolidated revenue account, the accounts now include an income and expenditure account and a statement on the movement of the general fund balance. The income and expenditure account discloses the income receivable and expenditure incurred in operating the Comhairle for the year. The surplus incurred on the income and expenditure account represents the amount by which income is more than expenditure. The income and expenditure account is prepared using essentially the same accounting conventions (UK GAAP) that a large unlisted company would use in preparing its annual financial statements. However, there are items of income and expenditure that need to be included in the general fund and therefore taken into account when determining a local authority's budget requirement and its council tax demand. These items are determined by statute and non-statutory proper accounting practices, rather than being in accordance with UK GAAP and are reported in the statement of the movement on the general fund. The general fund deficit for the year is disclosed within the statement on the movement of the general fund balance; previously this was disclosed on the consolidated revenue account.

71. The Comhairle's net operating expenditure in 2006/07 was £97.405 million. This was met by government grants and local taxation of £102.211 million, resulting in an Income and Expenditure surplus of £4.806 million. However, the net effect of including items required by statute when determining the movement on the general fund balance for the year resulted in a deficit of £0.025 million on the general fund balance for the year. When this deficit is subtracted from the general fund balance brought forward from 2005/06, the Comhairle has a general fund balance of £10.255 million at 31 March 2007.



72. The budget set for 2006/07 was based on a Band D council tax level of £999. A deficit of £1.750 million was planned. This incorporated forecast expenditure of £1.8 million in respect of implementation of Single Status, which has now been delayed until 2007/08. In year rises in expenditure, superannuation increases and overspends in Social Work and Technical Services were offset by various savings, including Joint Board requisitions and the return of unused contingencies and centrally held budget to balances.
73. The social work budget was increased by £0.750 million during the year to reflect the ongoing uncontrollable costs associated with mainland placements. Despite this, it had the largest department overspend of £0.391 million. The principal areas of overspend were domiciliary care, transportation and care homes but these were partially offset by savings in community care placements and children's services. The Comhairle continues to have the on-going pressures of an increasing number of mainland placements, both in adult and children's services.

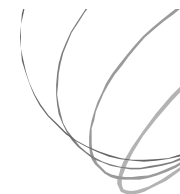
Reserves and balances

74. The Comhairle's financial position at the end of 2006/07 is relatively stable with a general fund balance of £10.255m compared to £10.280 million the previous year. At 31 March 2007 the Comhairle had total cash backed reserves and funds of £12.877 million, including a capital fund to fund capital expenditure or the repayment of borrowing.

Reserves and Funds

Description	2006/07 £ Million	2005/06 £ Million
General Fund	10,255	10,280
Capital Fund	2,294	-
Repairs and Renewals Fund	-	278
Useable Capital Receipts Reserve	328	2,107
	12,877	12,665

75. Earmarked funds held within the general fund were £5.881 million at 31 March 2007. This leaves an uncommitted balance of £4.374 million. This is well in excess of the Comhairle's aim to maintain a minimum uncommitted balance of £1.8 million in reserves, however costs associated with single status and other financial uncertainties require to be financed from this. A range of financial issues which could further impact on the reserves position are discussed in our Financial Outlook section below.



76. Significant earmarked amounts include £1.603 million for loans fund restructuring and £1.159 million of departmental carry forwards.

Rents and housing revenue account

77. A major development for the Comhairle in 2006/07 was the transfer of its entire council housing stock of 1,796 houses to the Hebridean Housing Partnership on 12 September 2006. At that date the £38.452 million of debt associated with the housing stock was met by the Scottish Executive and repaid to the Public Works Loans Board. The remaining housing revenue account reserve of £0.117m was transferred to the general fund.

Group balances and going concern

78. The Comhairle has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Northern Joint Police Board, Highland and Islands Fire Board) had an excess of liabilities over assets at 31 March 2007 due to the accrual of pension liabilities. The pension deficits are substantial at £415 million, with the Comhairle's group share being £69.2 million. The pension schemes for police officers and fire fighters are unfunded and met entirely from current and future council tax payers as payments fall due.
79. The overall effect of inclusion of all of the Comhairle's subsidiaries and associates on the group balance sheet is to reduce net assets by £62.1 million, mainly as a result of these liabilities. The results of the Highlands and Western Islands Valuation Joint Board are not included as they are not material to the group. All group bodies' accounts have been prepared on a going concern basis.

Spending on assets and long-term borrowing

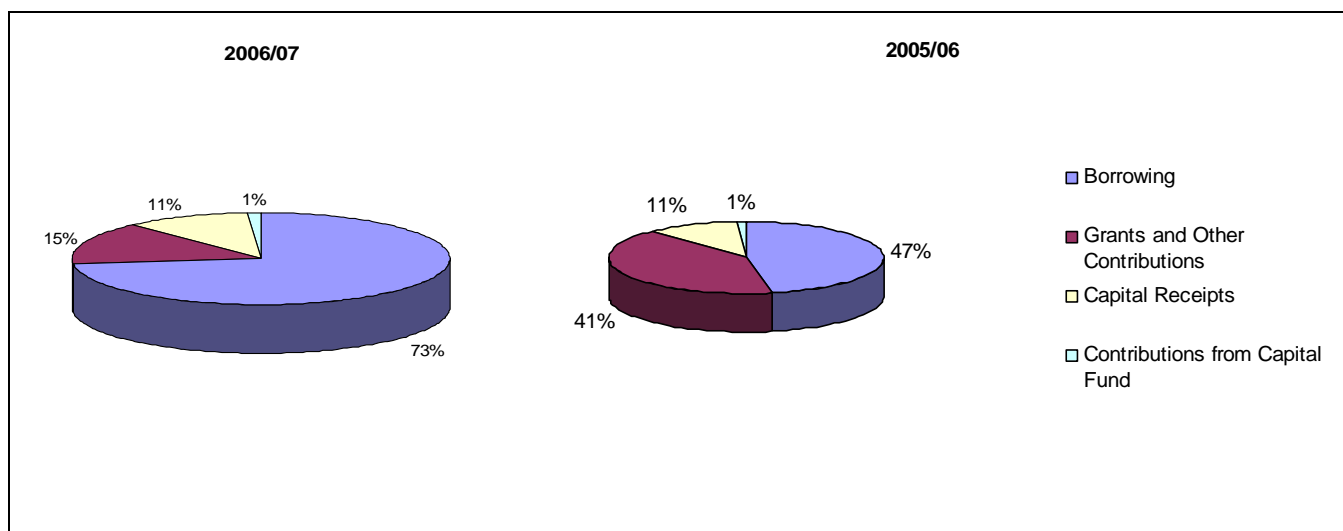
Capital performance 2006/07

80. Following the introduction of the prudential code in April 2004 the Comhairle can decide locally on a capital investment strategy which must meet best value requirements as well as being affordable. To date, the Comhairle has made limited use of these freedoms and none of the capital expenditure incurred in 2006/07 was funded through prudential borrowing. It is intended to use this in 2007/08, the final year of the four year capital programme.
81. Capital expenditure in 2006/07 totalled £21.499 million, a reduction from £28.221 million in 2005/06. This reduction is partly due to the Comhairle no longer requiring to finance housing revenue account capital expenditure, which reduced from £2.9 million in 2005/06 to £0.9 million in 2006/07 following the transfer of this function to Hebridean Housing Partnership in September 2006. Another contributing factor for this reduction is due to a large proportion of capital grants being funded from revenue in 2006/07 because of the strict adherence to the definition of capital expenditure. Now that CNES has



been granted permission to borrow for capital grants to third parties by the Scottish Parliament they will be included in capital again in 2007/08. Capital investment in the last two years was funded as shown below.

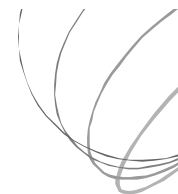
Sources of finance for capital expenditure 2006/07



82. The initial capital budget for 2006/07 of £26.3 million was subsequently reduced throughout the year to £22.045 million as the profile of project delivery was updated.

83. In September 2006, two and a half years into the four year capital programme, the programme was reviewed. This resulted in projects amounting to £6.7 million being withdrawn from the capital programme due to known changes in circumstances. These will be re submitted for consideration when setting the 2008-12 programme. The largest of these was the Harris Care Development which had an indicative budget of £2.5 million. Experience from the South Uist Care Development suggested that the actual cost could be in excess of £4 million with increased ongoing revenue costs. This project was therefore withdrawn from the capital programme until more funding is secured. The removal of these projects released funding of £2.9 million which has been re-invested into the remainder of the 2004-08 capital programme, including £2.1 million for roads to communities projects. This was the top renovation priority in the capital programme and this additional funding will help to compensate for the limited European funding and increased prices that have restricted progress on this project.

84. Long term debt decreased in 2006/07 (from £181.793 million at 31 March 2006 to £148.091 million at 31 March 2007). However, this reduction is largely due to the extinguishing of debt amounting to £38.452 million by the Scottish Executive in relation to the housing revenue account. Once this is excluded, debt outstanding increased by £4.750 million over the year to 31 March 2007. 98% of long and medium term loans at the year end mature after more than 10 years. The Comhairle has managed to its risk exposure as no debt is exposed to variable rate risks as at 31 March 2007.



Forward capital programme

85. Capital plans for 2007/08 anticipate annual capital expenditure of £35.4 million. This is based on delivering the remainder of the four year capital plan and assumes at this stage there will not be any slippage. This expenditure will be funded by a number of sources including capital receipts, grants and other contributions including the prudential borrowing that has not been utilised in recent years.
86. The 2008-12 capital programme is being developed and a framework has been approved for the process. The main determining factor in the size of the capital programme will continue to be the level of supported borrowing provided by the Scottish Parliament and this will not be known until late 2007. In the meantime the new programme is based on the current level of resources. Once the level of supported borrowing is known, the programme will be tailored to fit the available resources. Work is underway to develop the Comhairle's corporate asset management strategy and the initial work on this will influence the 2008-12 capital programme wherever possible.

Significant trading operations

87. 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 (STOs), which are required to break even over a three year rolling period. The first three year period ended in 2005/06.
88. The Comhairle has four STOs, refuse collection, building maintenance, highways and bus operation. In the three years to 31 March 2007 all the statutory trading operations except the bus operation, with an accumulated deficit of £0.085 million, met the statutory target. In the three years to 31 March 2006 the bus operation made a deficit of £0.232 million. All aspects of the bus operation have been reviewed as part of a recovery plan to enable the statutory objective to be met in 2007/08.
89. Building maintenance and roads contracts have a four year duration with two year options to extend. They both commenced in April 2002, with the two year extension due to end in March 2008. The building maintenance contract will be replaced under new BV legislation with a service level agreement between Technical Services and the Commercial Operations Unit. The Comhairle are currently in the process of preparing external tenders with Hebridean Housing Partnership and this will replace the in-house part of the contract relating to council houses. No decision has been reached regarding the roads contracts beyond March 2008.
90. The bus contract commenced in April 2005 and is scheduled to end in March 2010. Under best value there is no requirement to go back out to tender if best value can be demonstrated by retaining services in-house. The bus operation contract still has about two and a half years to go and no decision has been made regarding the next contract.

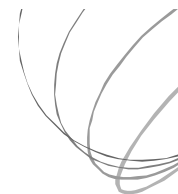


91. The refuse collection five year contract ended in 2005. Members granted permission to carry on with the terms and conditions of the contract due to the unknown factors involved at the time, for example, changing the waste disposal over to Anaerobic digestion, etc and the rapid changes to the refuse collection service which were planned. Refuse Collection is scheduled to take part in a STO best value review later in 2007/08.
92. The identification of statutory trading accounts is the responsibility of the Comhairle. LASAAC guidance suggests three tests should be applied to determine whether a trading operation falls within the ambit of the Act. These are:
- whether the service is provided in a competitive environment
 - whether the service is provided on a basis other than recharge of cost
 - a test of significance.
93. If all three conditions are met then the service should be accounted for as a statutory trading account. The Comhairle reviewed its trading activities during the year and concluded that statutory trading accounts were no longer required in respect of fuel at fishery piers.

Financial outlook

Current budget

94. The budget remains a challenge in the context of continuing pressure from residential mainland placements in Social Work, and uncertainty surrounding the implementation of single status. The 2007/08 budget was prepared based on a Band D Council Tax rate of £1,024, an increase of 2.5%. It incorporates £0.919million of efficiency savings, which is offset by additional investment of £0.300 million and £0.160 million in Social Work and Transportation respectively, and single status costs of £1.800 million. This culminates in a budget deficit of £814K, which results in projected uncommitted revenue fund balances in excess of £1.7 million at 31 March 2008. This is in addition to the Comhairle's budget strategy to hold minimum reserve balances of £1.8 million.
95. The first quarter monitoring report for 2007/08 shows a net overspend against budget at June 2007 of £0.389 million. All services except for Social Work (£0.507 million) are within the carry forward tolerance of 1% of revenue budget set by the Comhairle.
96. 2007/08 is the final year of the current three year settlement. The next three year settlement will not be announced until late 2007. This creates considerable uncertainty going forward. The announcement of additional resources for Scottish Local Authorities in December 2006, amounting to around £1.3m for the Comhairle, has reduced, but not eliminated, the need to find efficiency savings.



97. Reviews of SINA, capital distribution and the floor could have an impact on the Comhairle's share of funding. If this were to result in reduced central funding then, combined with the possibility of a freeze on council tax rises, this could have serious consequences on future budget planning.

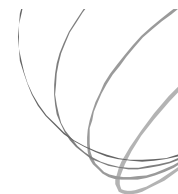
Key risk area 5

Equal pay

98. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay can put forward claims to an Employment Tribunal. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2005/06.
99. As detailed in our 2005/06 report, estimated costs of £3.7 million were recognised in the financial statements for the total one-off cost of dealing with the equal pay legislation. Over 99% of cleaning, catering and homecare workers have accepted the homecare package offered by the Comhairle. Since any remaining claims still to be agreed are immaterial, the Comhairle have not considered it necessary to make any further provision in the financial statements.

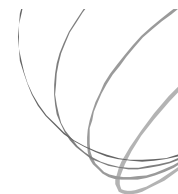
Single status

100. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a presumption that single status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.
101. The Comhairle have firm plans to implement Single Status by, or soon after, the end of 2007. Negotiations are currently ongoing with the Trades Unions on the pay model and terms and conditions. The Comhairle plan to carry out a quality impact assessment and present the revised pay model and terms and conditions for approval at the Policy and Resources Committee. It is estimated that single status could involve a 12% rise in the affected payroll costs (which equates to an increase of approximately 5% of the overall pay bill), phased over a period of four years.



Efficient government

102. As part of the continuing drive to improve the efficient use of resources committed to delivering public services, the Scottish Executive expect public sector organisations to apply the principles of the efficient government initiative in their day-to-day operations with an aspiration to achieve recurring efficiency gains of £1.5 billion by 2007/08. In the case of councils, efficiency savings have been incorporated into the annual financial settlement provided to councils by the Executive. The principles of the efficient government initiative encourage the delivery of services for lower unit cost without compromising the quality of the service provided.
103. During 2006, councils across Scotland recognised that as part of their partnership arrangement with the Scottish Executive, they had a responsibility to report efficiencies on the Executive's five key operational themes as set out in "Building a Better Scotland" (Procurement, absence Management, Asset Management, Shared Services and Streamlining Bureaucracy) on a consistent basis. As a result, the Improvement Service was commissioned to devise a set of standard measures which would allow councils to publish unaudited efficiency statements on a common basis. Guidance was issued to all councils in May 2007.
104. The Comhairle presented its 2006/07 efficiency statement to the Policy and Resources committee in September 2007. Measurable efficiencies of £0.955 million were achieved by streamlining bureaucracy (£0.693 million) and through procurement (£0.262 million). The streamlining bureaucracy savings arose through reduced costs and income generation. The Comhairle focused on cash releasing savings since these were necessary to enable the Comhairle to address ongoing budget pressures.
105. Procurement savings were attained from efficiencies in travel, the use of OGC contracts and from a more focused approach to insurance renewal. In addition, work commenced on implementing a new procurement strategy and planning the implementation of electronic procurement.
106. The 2006/07 efficiency statement makes reference to anticipated savings in 2007/08. These are estimated to be £1.248 million and are identified as streamlining bureaucracy £0.766 million and procurement £0.482 million.
107. The Comhairle is involved in two shared services bids. One of these, the integrated services project, aims to maximise the positive impact of the Scottish Executive's agendas for integrated service delivery and efficient government through the development of a service delivery model and governance arrangements that will secure the future of locally delivered and accountable public services in the islands. The project is at the scoping stage and is funded through the Executive's efficiency and reform fund. The other bid is at an earlier stage of development, and relates to the potential of shared financial services with six other authorities in the North of Scotland. These projects will not impact on services until 2008/09 at the earliest.



Asset management

108. Scottish councils control land, property and equipment valued at around £22 billion. Capital assets are the second highest cost incurred by local authorities after staffing. Prior to 2004, the legislation that controlled capital investment by local government did not contribute towards good asset management. Part 7 of the Local Government in Scotland 2003 Act introduced the *Prudential Code* which gave local authorities freedom to invest as long as their capital spending plans are affordable, prudent and sustainable. The *Code* is a fundamental component of an authority's financial governance and management which requires authorities to have regard to option appraisal, strategic planning and asset management planning.

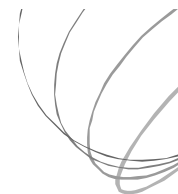
109. The Government's Efficient Government Initiative identified asset management as one of five key areas for achieving efficiency improvements. Proper asset management is a vital part of being an efficient organisation including arrangements to ensure there are:

- strategies to reduce maintenance costs
- proactive asset disposal policies
- long-term capital planning and budgeting
- robust asset management monitoring information.

110. Our 2006/07 Audit Risk Analysis and Plan highlighted that the Comhairle is at the early stages of developing an asset management plan. An ICT, Procurement and Asset Management Sub Committee was formed, and has approved a delivery mechanism for corporate asset management planning with the Director of Technical Services being charged with taking this forward. A new post of Corporate Asset Management Planning Manager has been approved, together with how this role will be incorporated within the management structure.

111. Progress reports to the sub committee make the distinction between asset owners and asset users. Care should be taken to ensure that users who are not also the owners do not disassociate themselves from the costs of maintaining assets.

112. Some services (such as Education) have better quality information regarding their asset base and requirements than others. The Asset Management Planning Coordinator is currently carrying out condition assessments, physical surveys, populating data etc to further establish the base position. It is important that there is a minimum level of corporate knowledge of assets held and their financial and other requirements, otherwise there is a risk that future spending decisions could be based on incomplete knowledge.



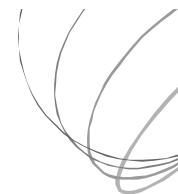
113. Other matters that will require early consideration include the Comhairle's approach to option appraisal, the relationship between asset management and procurement strategies, the development of a suite of performance indicators to measure the effectiveness and performance of assets over time, and how infrastructure fits into the asset management plan.

Pension liabilities

114. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. A recent Audit Scotland report on public sector pension schemes highlighted that the combined funding shortfall and unfunded liabilities of the six local government pension schemes in Scotland may be as high as £53 billion. 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.

115. In accounting for pensions, Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised in the annual accounts.

116. The Comhairle's estimated pension liabilities at 31 March 2007 exceeded its share of the assets in the Highland Council Pension Fund by £14.446 million, reducing from £24.548 million in the previous year. A full actuarial valuation of the Highland Council 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 105% at 31 March 2002 to 92% at 31 March 2005. The actuary is required to make a three-year assessment of the contributions that should be paid by the employing authorities from 1 April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. This shows that budgeted contributions are expected to rise from 270% of employee contributions in 2006/07 to 290% by 2008/09.



Governance

Introduction

117. In this section we comment on key aspects of the Comhairle's governance arrangements during 2006/07. We also provide an outlook on future governance issues, including our views on potential risks.

Overview of arrangements in 2006/07

118. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Based on the work undertaken, we concluded that the Comhairle had systems in place that operated well within a sound control environment.

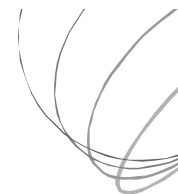
119. A Statement on the System of Internal Financial Control is included within the annual financial statements. This provides a commentary by the Director of Finance and Corporate Resources which confirms that internal financial control is maintained and operated in connection with the resources concerned.

Audit Panel

120. Effective scrutiny is central to good governance, with a significant role for councillors to scrutinise performance, hold management to account on service delivery and support the reform and modernisation agenda. Overall, the Comhairle's Audit Panel is effective and complies with most of CIPFA's good practice principles for audit committees. The panel also fulfils a scrutiny function by requesting follow up work in relation to areas of concern.

121. The audit panel consists of five members plus three substitutes. There have been changes to membership following the 2007 election, however, there has been continuity of the Convenor. All of the panel members, including the Convenor, attended seminars and training provided by internal audit and the external auditor. The training included corporate governance; roles and responsibilities; committee operation; risk and performance management; and working with internal and external audit. All internal audit and external audit reports, including plans and annual reports are presented to the audit panel. Internal audit progress reports are also presented.

122. The minutes of panel meetings are presented to the Audit and Scrutiny Committee. This committee has a wider role than the panel and considers performance reports, business plans, risk management and follow up of the best value improvement plan.

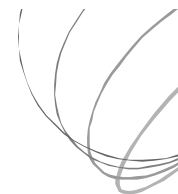


Internal Audit

123. In December 2006, CIPFA published a revised Code of Practice for Internal Audit in Local Government, which updated the previous 2003 Code.
124. Our annual review of the Comhairle's internal audit arrangements concluded that it provides a sound basis to assist management to discharge their duties. Although the Internal Audit section is small it performs its activities in a satisfactory way. Good quality reports, supported by structures and well laid out audit files are produced in accordance with the annual plan
125. However, the small internal audit section in relation to other councils means that, inevitably, internal audit spend a large proportion of their time on a wide range of projects (e.g. probity and regularity work, risk management and performance audits.) This means there is only limited time available to spend on system audits of the key financial systems. As a result, in terms of our final accounts work, there were only a few areas where we could place reliance on the work carried out by internal audit.
126. The three year internal audit plan to 31 March 2010 ranks projects and issues in order of risk and was prepared in consultation with heads of service. This states that internal audit intend to cover most of the key financial systems over the next three years. We recognise that internal audit faces many competing pressures on its resources but would stress the importance of ensuring that all/most of the key financial systems receive adequate internal audit coverage over the three year period.

Risk Management

127. In December 2005 the Comhairle agreed 12 strategic risks facing the Comhairle and the Western Isles. A risk assessment was carried out for each risk and in December 2006 the Comhairle approved the scores and proposed control measures for each risk. A report was recently presented to members which updated them on the progress of how strategic risks are being addressed and controlled.
128. The Comhairle has a risk management policy and a risk management framework. It has adopted the code of practice BS 25999-1 for business continuity management, and a strategic risk management group has been set up to develop the Comhairle's approach to risk management. The risk management processes therefore continues to develop, but further improvements could be made to embed a culture of risk management throughout the organisation.
129. There is a strategic risk register and individual department risk registers. Responsibility for the strategic risk register lies with the Head of Continuous Improvement who has developed an online risk management training programme for staff and Members. In its work plan for 2007/08, the strategic risk management group recognised the need to focus on business continuity planning, updating the strategic and departmental risk registers and establishing a system of risk monitoring. In particular, it recognises that there is no formal system in place to ensure that departmental risk registers are up to



date or that progress in addressing risks are monitored. There is, however, a requirement for departmental risk registers to be discussed at every departmental team meeting.

Key risk area 6

Systems of internal control

130. In his annual report for 2006/07 the Chief Internal Auditor provided his opinion that, based on the internal audit work undertaken during the year, the Comhairle's systems of internal control appear to be adequate. However, specific comment was made in relation to the payroll system, where there continues to be areas where further improvements can be made, specifically, in terms of management, system access control, supervision, reconciliations and verification checks. Action is being taken to address these issues.

131. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on a number of the Comhairle's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes in 2006/07:

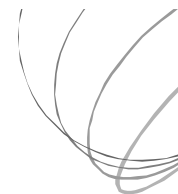
- Payroll
- Creditors payments
- Council Tax
- Non Domestic rates
- Main accounting system
- Cash and Banking
- Debtors
- Fixed Assets
- Loans Fund and Treasury Management

132. As part of our review we issued a report to officers summarising our findings in these areas. The report included some areas for improvement on which the Comhairle has agreed to take action. One issue of particular concern to us related to the absence of any reconciliations during the year between the creditors system and the financial ledger. A reconciliation was prepared, following a request by us, for transactions processed up to 31 March 2007.

Key risk area 7

Prevention and detection of fraud and irregularities

133. At the corporate level, the Comhairle has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption. These arrangements include an anti-fraud and corruption policy and response plan, a whistle blowing policy, codes of conduct for elected members and staff, and defined remits for relevant regulatory committees.



NFI in Scotland

134. In 2006/07 the Comhairle again took part in the National Fraud Initiative (NFI) in Scotland. The exercise is undertaken as part of the audits of the participating bodies. NFI brings together data from councils, police and fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. For 2006/07 the exercise was extended to include information about tenants and councils were asked to submit further specified datasets where the risks merited their inclusion. The NFI has generated significant savings for Scottish public bodies (£27 million to 2005) but, if fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

135. The NFI 2006/07 results (data matches) were made available to councils on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application. We monitored the Comhairle's involvement in NFI 2006/07 during the course of our audit.

136. The Comhairle have shown a clear, and ongoing, commitment to the NFI process through the allocation of responsibility to key officers with appropriate training and experience, a resolution to review all matches rather than filtering matches based on priority and ongoing progress monitoring.

137. As at mid September the Comhairle have identified a total of £2,593 in overpayments of which £2,169 is being actively recovered. To date, no cases of fraud have been identified.

138. The work on reviewing and investigating NFI referrals is ongoing and a further three cases are still being investigated. These cases may result in further savings. We consider it important that the Comhairle maintains its current momentum in addressing NFI and uses the opportunities presented by NFI on an ongoing basis to assist in the detection of fraud.

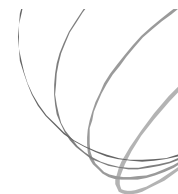
Governance outlook

Impact of the 2007 elections

139. As detailed in the performance section of this report, following the May 2007 elections and the Chief Executive's "root and branch" review, the number of Comhairle departments has been reduced from seven to six. Concurrent to this, a review of the political and decision making structure has seen the number of service committees reduced from seven to four and the Policy and Resources Committee being supported by three joint committees. This, combined with the large number of new members, may take time to settle in. We would therefore recommend that the Comhairle considers the preparation of a timetable to undertake a review of the new decision making structure to ensure its effectiveness.



140. CIPFA/SOLACE have recently produced *Delivering Good Governance in Local Government – Framework* which sets out principles and standards to help local authorities to develop and maintain their own codes of governance and discharge their accountability for the proper conduct of business. The Comhairle should consider using the guidance notes contained in this when reviewing their corporate governance structures against the framework.



Financial statements

Introduction

141. The financial statements are an essential means by which the Comhairle accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

142. In this section we summarise key outcomes from our audit of the Comhairle's financial statements for 2006/07. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues. We audit the financial statements and give an opinion on:

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

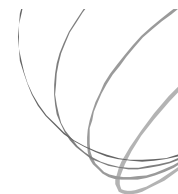
143. We also review the statement on the system of internal financial control by considering the adequacy of the process put in place by the Comhairle to obtain assurances on systems of governance and internal financial control and assessing whether disclosures in the statement are consistent with our knowledge of the Comhairle.

Overall conclusion

144. We have given an **unqualified** opinion on the financial statements of Comhairle nan Eilean Siar for 2006/07. We have, however, drawn attention to 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.

145. 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 earlier in this report, the bus operation organisation made an aggregate loss of £0.085 million in the three years to 31 March 2007, with the result that the Comhairle has failed to meet this statutory requirement. As explained by the Director of Finance and Corporate Resources in his foreword in the Comhairle's financial statements, this is due to the FRS17 adjustment.

146. The Comhairle's un-audited 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 very good and this enabled the audit to progress smoothly. Audited accounts were finalised prior to the target date of 30 September 2007 and are now available for presentation to the Comhairle and publication.



Accounting practice

147. 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'). As noted at paragraph 70, the 2006 SORP required a number of significant changes to be made to the 2006/07 financial statements to make them more consistent with the accounts of other public and private sector entities. These included:

- replacement of the consolidated revenue account with a traditional income and expenditure account
- a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit
- replacement of the statement of total movement in reserves with a statement of total recognised gains and losses
- similar changes to the housing revenue account
- parallel changes to the group accounts that would result in them being easier to understand and have a common format to single entity statement of accounts.

148. Overall, we were satisfied that the Comhairle prepared the accounts in accordance with the revised SORP. There was only one significant adjustment made to the figures included in the un-audited accounts provided for public inspection. The net effect of this was to reduce the surplus for the year by £0.255 million. The adjustment was required because a journal affecting the HRA Income and Expenditure Account had not been processed. Adjustments were also required to the debtors and creditors figures to correct amounts which had been incorrectly netted against one another.

149. The Comhairle made a number of adjustments to the accounts to reflect our findings. As is normal practice, some small errors remain unadjusted and these have been reported to the Director of Finance and Corporate Resources and the Audit Panel via our letter issued in line with International Standard on Auditing 260 (ISA 260) *communication of audit matters with those charged with governance*. Details of significant accounting issues arising in the course of our audit are summarised below.

Single status

150. The Comhairle's progress with regard to single status is noted at paragraphs 100 and 101. The 2006/07 accounts contained a budget of £1.8 million to meet the estimated costs to implement single status. Since agreement was not reached over the terms of single status during the year there was no actual cost incurred within the 2006/07 accounts. The expected cost of £1.8 million has therefore been included in the 2007/08 budget.



Group accounts

151. Modified arrangements for the preparation of group accounts were mandatory for the first time in 2005/06. The widening diversity of service delivery vehicles used by local authorities means that consolidated group accounts are required to present fairly the activities of an authority. The Comhairle prepared group accounts in accordance with this requirement following a review to determine its interest in subsidiaries, associated entities and joint ventures.

Public Private Partnership

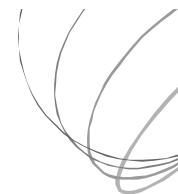
152. The Comhairle has provisionally secured £52m funding from the Scottish Executive for the hybrid Public Private Partnership initiative, involving five schools in the Western Isles. This money will be used for new building works and refurbishment. It is hoped that the first schools will be available for use by August 2009.

153. When considering public private partnership arrangements, key stages are the audited body providing an initial and final views on the accounting treatment of a project, based on business case information. The auditor then reviews the audited body' position and comments on whether the proposed treatment is in accordance with current underlying guidance.

154. The Comhairle was unable to undertake a traditional PPP contract, due to a lack of bidder interest for work on the Western Isles. The proposed hybrid model has taken a long time to evolve. The latest proposal involves a subsidiary company of the Comhairle creating a Limited Liability Partnership (LLP) and taking the majority of the partnership share. The LLP will manage the construction, and be responsible for awarding and monitoring facilities management and lifecycle maintenance contracts. This will be carried out under a long term (30 year) contract with the Comhairle. The Comhairle will fund the capital construction (via borrowing) and probably make payments directly to construction companies. The Comhairle will make unitary charge repayments to the LLP over the life of the contract.

155. The LLP needs working capital to cover the cash shortfall early in the project. This is estimated to be £8million. The Comhairle cannot borrow to provide this funding and does not have sufficient revenue resources. The latest discussions between the Comhairle and the Scottish Executive have covered this issue and whether central government funding or guarantee can be provided to enable the Hybrid model. The Comhairle is yet to provide a quantitative value for money assessment for the proposed model.

156. The affordability gap on the Schools PPP Project is currently estimated at £1.2m, and will require to be financed from the Education Department budget from 2009 (the desired date of completion). This may adversely impact the achievement of Education Department or corporate objectives and the Comhairle's ability to maintain uncommitted balances at the required level.



157. In the meantime, there is a risk that the timetable will slip further and the Comhairle will incur further delays to opening the new schools and incur ongoing costs of maintaining the existing schools to be replaced by the PPP buildings.

Key risk area 8

Legality

158. Each year we request written confirmation that the Comhairle's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes. The Director of Finance and Corporate Resources has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Chief Executive and the Comhairle's Management Team, the financial transactions of the Comhairle were in accordance with the relevant legislation and regulations governing its activities.

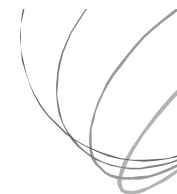
159. Local authorities with registered charitable bodies (i.e. registered trust funds) are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund. It has now been agreed that as an interim measure in 2006/07, reliance can be placed on the existing disclosures for trust funds in the Comhairle's financial statements, supplemented by appropriate working papers to the Office of the Scottish Charities Regulator (OSCR) by 31 December 2007. Further discussions between OSCR and CIPFA will take place in respect of the requirements for 2007/08 onwards.

160. 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 Comhairle has reached a settlement with most employees affected by this in relation to the potential contravention of this Act. Until the single status agreement is implemented, however, there remains the possibility that the Comhairle could be judged to have contravened the Act.

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

Financial reporting outlook

162. Overall the Comhairle 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 to changing accounting rules. Challenges ahead include a number of changes that have been made to the 2007 SORP.



163. The main change is that the 2007 SORP requires authorities to comply with financial reporting standards (FRS) 25 and 26 in respect of loans, from 2007/08. This will result in large expenditure entries to the income and expenditure account as the SORP requires premiums on loans which have been rescheduled to be written off in line with the FRSs. At present, councils are able to write off premiums over the period of the replacement loan, which can be up to 40 to 50 years. The regulations restrict the write off periods for new premiums incurred on LOBOs from 1 April 2007 to a maximum of 20 years. Such a change could have significant implications on council tax levels however; statutory guidance mitigates the impact on council tax by requiring authorities to reverse the entries in the statement of movement on the general fund balance.

164. Other changes include:

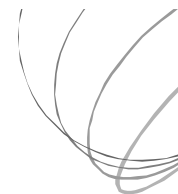
- changes to capital accounting requirements to introduce a revaluation reserve and capital adjustment account
- a requirement for further information to be disclosed in respect of charitable funds.

165. Central government and NHS bodies are to move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2008/09. The government also announced its intention to publish Whole of Government Accounts on an IFRS basis from 2008/09. It was recognised that there would need to be discussions with CIPFA/ LASAAC about the introduction of IFRS-based accounts for local government. Of particular note is that IFRS do not address PFI accounting in the public sector. The Treasury are therefore currently considering the most appropriate accounting treatment for PFI public sector transactions. If IFRS principles, or similar, were applied in the public sector then many PFI assets are likely be brought onto public sector balance sheets.



Final Remarks

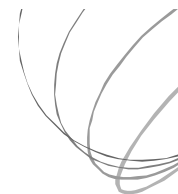
166. We have made a number of recommendations in the various reports we have issued during the course of the year and have obtained assurances from officials that action will be taken as appropriate.
167. Attached to this report is an action plan setting out the key risks identified by the audit which we are highlighting for the attention of members. In response, officers have considered the issue and have agreed to take the specific steps set out in the column headed 'planned management action'. On occasion, officers may choose to accept the risk and take no action. Alternatively, there may be no further action that can be taken to minimise the risk. Where appropriate, the action plan clearly sets out management's response to the identified risks.
168. A mechanism should be considered and agreed by members for monitoring the effectiveness of planned action by officers. We will review the operation of the agreed mechanism as part of the 2007/08 audit.
169. The co-operation and assistance given to us by Comhairle nan Eilean Siar members and staff is gratefully acknowledged.



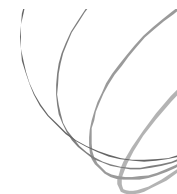
Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	<p>Corporate objectives and priorities</p> <p>Many of the objectives in the existing corporate strategy are vague.</p> <p>Risk: The lack of clear corporate targets that are outcome focussed could result in effective and meaningful performance management being difficult to achieve.</p>	<p>The new Corporate Strategy was approved on 11 October and included prioritised objectives and two commitments that:</p> <p>By the end of the Comhairle term we will be able to demonstrate:</p> <ul style="list-style-type: none"> that our service performance has improved improved population retention and in-migration. <p>This will be followed by Committee workplans and Departmental Business Plans.</p>	Head of Continuous Improvement	Completed
2	<p>Annual report</p> <p>Although the Comhairle's annual report details progress made by the Comhairle in relation to the corporate strategy themes, it does not currently provide a rounded assessment to which the range of objectives and priorities in the corporate strategy are being met.</p> <p>Risk: There is a risk that members and the public are not aware of how effectively the Comhairle is meeting its corporate priorities.</p>	<p>There will no longer be an annual performance report. However, we will further develop Public Performance Reporting to ensure it provides a balanced account of the Comhairle's performance, reported in a variety of accessible formats. This will be developed following implementation of the Balanced Scorecard method.</p>	Head of Continuous Improvement	End 2007
3	<p>Measuring performance</p> <p>Performance information is not being sufficiently gathered and recorded throughout the year and used for management information purposes.</p> <p>Risk: The Comhairle does not have information to demonstrate whether its corporate objectives are being met, or whether, where and why there are improvements and deteriorations in service provision.</p>	<p>The Balanced Scorecard has been adopted as the method for measuring performance. The Comhairle has approved procurement of an electronic monitoring tool based on this method. On 23 October the Management Team approved a project plan for rolling out the Balanced Scorecard for all services by the first quarter of 2008.</p>	Head of Continuous Improvement	First quarter of 2008



Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4	<p>A sustainable workforce</p> <p>The staff development and appraisal is not uniformly adopted throughout the Comhairle, and there is no formal review of strategic staffing requirements.</p> <p>Risk: The Comhairle may not have the capacity or skills to meet its long term objectives.</p>	<p>The Comhairle will ensure that all staff receive an annual appraisal. This will be monitored via the best value improvement plan monitoring process.</p>	<p>All Directors / Head of HR</p>	<p>July 2008</p>
5	<p>Financial pressures in the medium term</p> <p>It is not yet clear what impact the new Scottish Government may have on local government finance, and in particular, on the local government settlement and council tax funding.</p> <p>Risk: The Comhairle may not be able to deliver on its corporate strategy objectives if the financial settlements do not reflect the council's expectations.</p>	<p>The Comhairle has retained balances, above those agreed in its policy on reserves, in order to provide a buffer against any significant variance in the 2008-11 settlement.</p> <p>The assumptions made in the Comhairle's initial financial strategy for 2008-11 will be reviewed once the settlement is announced and a medium term strategy will be agreed that ties in with the corporate strategy.</p>	<p>Director of Finance and Corporate Resources</p>	<p>February 2008</p>
6	<p>Risk management</p> <p>There is no formal system in place to ensure that departmental risk registers are up to date or risks monitored.</p> <p>Risk: Operational risks may not be recorded, addressed or monitored at departmental level.</p>	<p>In September 2005 the Comhairle approved actions to ensure that risk is managed effectively in each service area within the agreed corporate strategy. Each departmental management team has responsibility to</p> <ul style="list-style-type: none"> • feed into the development of the corporate risk management strategy from a service specific perspective • ensure that the strategy is implemented effectively across its services • negotiate departmental budget requirements for risk control projects • disseminate the detail of the strategy and allocate responsibilities for implementation to service managers and staff • establish the training requirements of managers and staff with regard to strategy implementation <p>(cont)</p>	<p>Head of Continuous Improvement</p>	<p>1st quarter of 2008.</p>



Action Point	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<ul style="list-style-type: none"> work with the finance department in assessing departmental insurance requirements. <p>The Continuous Improvement Team will monitor compliance.</p>		
7	<p>Creditors control account</p> <p>There were no reconciliations carried out during the year between the creditors balance in the creditors system and the financial ledger.</p> <p>Risk: Transactions could be omitted from the financial ledger.</p>	<p>The reconciliation is currently being brought up to date and should be fully up to date by the end of 2007.</p>	Depute Director of Finance	31/12/07
8	<p>Schools PPP programme</p> <p>Further delays may arise regarding agreement for the funding for the schools PPP replacement programme, or may not be agreed at all if value for money cannot be demonstrated.</p> <p>Risk: The existing affordability gap could increase or cannot be met from resources; and the Comhairle could face escalating costs of maintaining the existing schools if PPP funding is not resolved soon.</p>	<p>The complexity and significance of this project means that it is kept under constant review with reports on progress being considered by the Education and Children's Services and Policy and Resources Committees at each series of meetings.</p>	Chief Executive	Ongoing