City of Edinburgh Council

Report to Members and the Controller of Audit on the 2008/09 Audit

Audit Scotland

City of Edinburgh Council

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Contents

Key Messages

We have given an unqualified opinion on the financial statements of City of Edinburgh Council. However, our opinion draws attention to the failure of four significant trading operations (direct cleaning, BlindCraft, catering services – school and welfare catering and refuse collection) to breakeven on a rolling three year basis). These significant trading operations have made deficits for the past three years. The council has plans in place to deliver improvements in these services and needs to ensure that sufficient progress is being made. More generally within the council, there are satisfactory governance arrangements in place.

The economic recession impacted on Edinburgh through the collapse of the property market, falling investment values and severe restrictions in bank lending capacity. For the council this was most noticeable through the group development companies, EDI Group, Waterfront Edinburgh Limited (WEL) and Shawfair Development Limited, which all experienced financial difficulties leading to consideration of their ability to continue as going concerns. To ensure the ongoing viability of WEL, the council was heavily involved in discussions with the company's bank which led to debt forgiveness of £3.2 million and it also provided funding of £7.5 million to WEL in exchange for assets. Also, to support the EDI Group, the council approved the use of prudential borrowing to fund the purchase of EDI assets.

The conclusion from a council review of group development companies confirmed that governance arrangements could be improved by consolidating the number of companies and joint ventures owned by the council. It also proposed that CEC Holdings Limited's role be enhanced as the main vehicle through which the council co-ordinates and implements its development and regeneration activities. This should streamline and tighten roles and responsibilities where company matters are concerned.

The city also felt the effect of the disruption caused by the tram project which has resulted in improved traffic management arrangements being implemented. This major project got underway in 2008/09 but was disrupted by a range of contractual difficulties over the year. In an attempt to reach a conclusion, formal dispute resolution procedures have been implemented and the outcome is awaited in January 2010. It has been recognised that it will be difficult to deliver the existing project within the overall budget of £545 million and implementation is now forecast for 2012. In particular, the council's contribution of £45 million based largely on projected developers' contributions is less likely to be available in the short term due to the current economic climate and therefore the council is re-examining that aspect of the financial framework.

Lothian Pension Fund also experienced the impact of the recession through falling investment values. Net assets reduced from £3 billion to £2.4 billion. The triennial review carried out at 31 March 2008 will increase the council's employer's contributions from 20% to 21.3% over the next 3 years. An updated 2008 actuarial position was provided at 31 March 2009 to reflect the change in the market over the year which saw assets further reduce in value. No immediate action was required as such investments need to be considered over a longer term.

In response to the economic recession, the council prepared an economic resilience plan to support the city and business community, has reviewed its economic strategy and is currently considering how best to organise its group companies in line with a revised regeneration strategy for the city.

For 2008/09 the council outturn showed a surplus of £2 million against budget. This was a significant improvement on the projected outturn reported in January 2009 which indicated an overspend of £1.9 million. While services show an improving position, there is a need for them to maintain close scrutiny on budgets as the outturn was largely achieved through a £5 million benefit from treasury management processes. However, a number of actions were implemented such as a freeze on recruitment in some parts of the council and delays in filling vacancies. The financial statements show an accounting deficit of £74 million for the year after the council contributed £5 million to the general fund as part of its planned strategy to restore its unallocated balances.

At 31 March 2009, the council has £1.1 billion debt, an increase of £123 million compared to the previous year. The most significant purchase during the year was the council's headquarters located at Waverley Court at £91 million. Over the last two years, the council's cash fund has invested £6 billion with either banks or local authorities. For 2008/09 the council achieved £1.92 million additional income compared to industry benchmark for the performance of its cash fund.

Going forward however the council's overall revenue budget funding projections for the next three years indicate a funding shortfall of £40 million in 2010/11, rising cumulatively to £62 million by 2011/12 and £86 million by 2012/13. This will continue to provide significant challenges for the council in returning a balanced budget especially as services are facing increased demands. There will be increased pressure on the council to deliver planned efficiencies on schedule. For example, savings of at least £11 million per annum are anticipated from procurement from 2010/11. In addition, the council has yet to implement single status as part of its overall pay modernisation agenda. The council also continues to progress its improvement agenda, the achieving excellence initiative. In light of the significant pressures ahead, there is a need for these major initiatives to produce substantial savings.

The co-operation and assistance given to us by City of Edinburgh Council members, officers and staff is gratefully acknowledged.

AUDIT SCOTLAND

October 2009

Introduction

1. This report is the summary of our findings arising from the 2008/09 audit of City of Edinburgh Council (the council) and other relevant work carried out by Audit Scotland. A number of detailed reports have already been issued in the course of the year in which we make recommendations for improvements (see Appendix A). We do not repeat all of the findings in this report. Instead we focus on the financial statements and any significant findings that have arisen from our review of the management of strategic risks.

2. 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 council are:

   - The impact of the race equality duty on council services.
   - Improving energy efficiency.
   - Asset management in councils.
   - Overview of drug and alcohol services.
   - Mental health overview.
   - Civil contingencies planning.
   - Strategic procurement.

3. We mention the key findings from some of these reports and the implications for City of Edinburgh Council in the performance and use of resources sections of this report. Full copies of the studies can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk

4. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and have agreed to take the specific steps set out in the column headed *Planned Management Action.* We do not expect all risks to be eliminated or even minimised. What we are expecting to see is that the council understands its risks and has in place mechanisms to manage them. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to be duly assured that the proposed action has been implemented.

5. This report is addressed to Members and the Controller of Audit. It will be published on our website after consideration by the council. The Controller of Audit may use the information in this report for her annual overview of local authority audits to the Accounts Commission. The overview report is published and it is also presented to the Local Government and Communities Committee of the Scottish Parliament.

Financial statements

Introduction

6. In this section we summarise key outcomes from our audit of the council's financial statements for 2008/09, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit Opinion

7. We have given an unqualified opinion that the financial statements of City of Edinburgh Council for 2008/09 give a true and fair view of the financial position and expenditure and income of the council and its group for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

8. We have, however, drawn attention to a failure to comply with the Local Government in Scotland Act 2003. Four significant trading operations (STOs) have failed to breakeven, on a cumulative basis, over a three year period. The STOs are: direct cleaning, Blindcraft, catering services – school and welfare catering and refuse collection (including trade waste). Although this does not affect the overall opinion on the accounts it is a clear signal that the STOs concerned are not operating within budget and consequently their funding and performance should be subject to review for remedial action. This is the third year that we have reported a failure to comply and while we are aware of the plans in place to deliver improvements in these services, the council needs to ensure that sufficient progress is being made.

Key Risk Area 1

9. In line with recommended practice, the statement of internal financial control has been replaced by a governance statement. Following discussion during the audit process, the statement was revised and extended. We were satisfied with disclosures made in the revised governance statement and the adequacy of the process put in place by the council to obtain assurances on systems of control. Improvements are however required in terms of the coverage of the statement and the adequacy of the supporting evidence in respect of the council and its group.

Key Risk Area 2

10. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Working papers to support the 2008/09 accounts continue to improve in that more information is being made available in a standard format although the quality is not yet consistent across services. Further improvement is required in the quality of supporting information and audit

trails submitted by service finance managers. Also, there has been some delegation and re-allocation of tasks to reduce the reliance placed on one officer for the production of the accounts and in dealing with audit queries.

11. We will continue to work in partnership with Finance to clarify our requirements and help improve the processes for the preparation and audit of the financial statements.

Key Risk Area 3

12. The accounts were certified by the target date of 30 September 2009. They were presented to members on 15 October 2009 and are now available for publication. The financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Accounting issues

13. 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). No major changes were introduced by the 2008 SORP. We were satisfied that the council prepared the accounts in accordance with the 2008 SORP and the financial statements were adjusted to reflect audit findings. Details of significant accounting issues arising in the course of our audit are summarised below.

Available for sale financial assets

14. With the introduction of new accounting requirements for financial instruments in 2007/08, the council's investments in Lothian Buses plc and CEC Holdings Limited were classified as available for sale financial instruments and were valued based on the distributable reserves held by the companies and the net worth of the balance sheet respectively. Following clearer guidance issued in April 2009 by CIPFA/LASAAC in LAAP Bulletin 81 - Closure of 2008/09 accounts, this type of investment does not fall within the scope of FRS 26 and has therefore been removed from the council's financial instruments. Previous year figures were also adjusted to reflect the revised guidance.

Impairment of fixed assets

15. During the year operational assets were impaired by £115 million and non-operational assets by £14 million. Estates officers considered capital expenditure incurred during the year, property valuations and the level of impairment required. The most significant impairments included Waverley Court (the council's headquarters) £12.8 million, council housing estates currently being demolished so that sites can be cleared in preparation for a new phase of building £46.6 million, the Usher Hall £6.7 million and Meadowbank Stadium £7.4 million.

16. Waverley Court was purchased during the year at a valuation based on rental payment streams and was subsequently revalued on a basis more in line with the council's owner/occupier status. The Usher Hall underwent significant refurbishment and now that the project is substantially complete, an impairment review was carried out to reflect the revised valuation. In addition, Meadowbank Stadium has been impaired to reflect its current poor condition.

Council house valuations

17. In 2007/08, we raised concerns about the method of valuation adopted by the council in respect of its housing stock. While there has been no change in the method of valuation in 2008/09, we understand that an improved basis is currently being considered for implementation in 2010/11 to ensure compliance with the new International Financial Reporting Standards. This requires the fair value of council dwellings to be measured using an existing use basis i.e. that the property will continue to be let, and that it is used for social housing.

Key Risk Area 4

Audit testing

18. As part of our work, we took assurance from a number of the council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:

- Main accounting system (Financial ledger)
- Payroll
- Accounts payable
- Accounts receivable
- Cash and banking
- Council tax
- Non-domestic rates
- Housing rents
- Housing and council tax benefits

Group accounts

19. The diversity of service delivery vehicles used by local authorities means that consolidated group accounts are required to give a true and fair view of a council's income and expenditure.

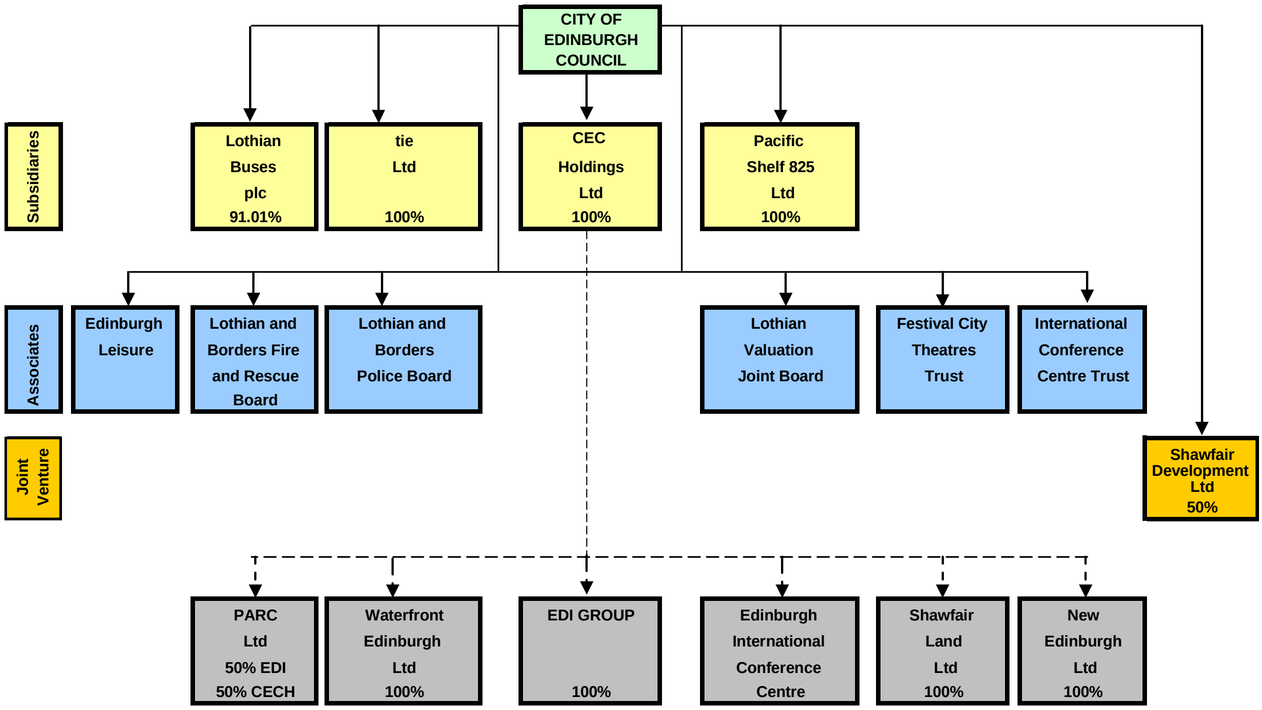
Joint ventures and companies

20. The council has interests in four subsidiaries and a total of six associates and joint ventures which are consolidated in the group accounts. In addition the EDI Group has interests in a further 20 active entities as well a number of dormant companies. All of these interests have been included in group accounts in accordance with the SORP (refer to Exhibit 1). Audit assurances were obtained through review of board minutes, correspondence and legal documents, and audited accounts. We completed

this work through a mix of audit questionnaires and meetings with auditors of the more significant companies. This provided useful context to enable us to conclude our audit of the group.

Exhibit 1

- City of Edinburgh Council Group Structure



21. Following conclusion of our audit of the group financial statements, we would like to highlight the following issues:

- All bodies within the group received unqualified audit opinions from their external auditors. CEC Holdings Limited and the EDI Group included an emphasis of matter paragraph which is explained in paragraph 22 below.
- In accordance with recommended accounting practice, key policies for component bodies such as pension costs and the valuation of fixed assets at market value have been aligned with the council's accounting policies.
- In contravention of the requirements of the Companies Act, audited accounts for Shawfair Development Limited (SDL) have not been finalised in respect of 2007/08 within the required timescales and it is unclear when formal accounts will be prepared in respect of 2008/09. The auditors of SDL have expressed concern over the future of the company and are unable to certify

the accounts on a going concern basis. Following discussion with the auditor, we are satisfied that appropriate provision has been made in the council's accounts for losses incurred by the company.

22. During the year the council undertook a review of its group structure with a view to streamlining governance arrangements. This, combined with the economic recession which generated a number of significant financial challenges for consideration by the council, has resulted in a number of changes. In particular:

- **CEC Holdings Limited (the holding company for EDI Group):** the auditors of both the EDI Group and CEC Holdings Limited included an emphasis of matter paragraph in their audit reports to reflect going concern issues associated with EDI Group. Such a paragraph highlights a significant matter affecting the financial statements which is covered in detail by a note to those accounts. The EDI Group results for the year to 31 December 2008 show a loss of £5.9 million and a decrease in net worth from £38.4 million to £17.6 million. These financial difficulties arose as a result of the collapse of the property market, falling investment values and severe restrictions in bank lending capacity. In early 2009, it was confirmed that the company had breached the 'loan to value' covenants of its banking facility. As a result of the breach, bank loans of £51 million (at 31 December 2008) are technically repayable on demand and have therefore been classified as current liabilities. This matter has not yet been fully resolved and discussions are ongoing about possible restructuring of bank facilities. Post year end, in May 2009, the council approved in principle the purchase of EDI Group's investment portfolio (£60.5 million) and in September 2009, the council approved financial assistance if required, to the extent of £0.75 million. As a result, the bank continues to support the company. Overall, EDI Group's auditors were satisfied that the company can meet projected outgoings for the next twelve months and therefore had no immediate going concern issues but highlighted these matters in their audit opinion by means of an emphasis of matter paragraph.
- While the financial difficulties experienced by EDI Group are a significant matter for the council and are fully reflected in the council's accounts, the emphasis of matter disclosure in the EDI Group's and CEC Holdings' audit certificates are not material to the overall group's ability to continue as a going concern and therefore do not impact on the audit opinion we have given for City of Edinburgh Council. However, we agreed further disclosure of all post balance sheet events in the council's accounts to ensure that the potential additional assistance available from the council was fully reflected within the group accounts.
- In prior years, CEC Holdings and the EDI Group have operated satisfactorily and the profits generated from the property development schemes they have been party to have generated dividends which have been paid over to their primary shareholder, the council. In addition they have been the vehicles to fulfil regeneration schemes planned across the city, often in partnership with third parties. In view of the economic recession and impact on property development in the past two years those profits and dividends have not been generated and this will have impacted on

the financial planning considerations of the council. Furthermore, the net worth value of the companies have rapidly declined, impacting on the overall net worth of the council.

- **Waterfront Edinburgh Limited (WEL)**: This was previously a joint venture between the council and Scottish Enterprise but is now a wholly owned subsidiary of CEC Holdings Limited. WEL incurred a loss of £11.8 million for the year to 31 March 2009 and, continuing a trend from previous years, its net assets reduced from £14.4m to £1.4m as a result of the reduction in value of investment properties associated with the collapse of the property market. WEL commenced life with a capital injection of £33 million from the public sector. Similar to the EDI Group, WEL breached its bank facilities which resulted in complex negotiations with the company's bankers to finalise an agreement to clear the company's outstanding debt. This included an element of the debt being 'forgiven' by the bank concerned (£3.2 million). During this period the council acquired Scottish Enterprise's shareholding for nil consideration.
- On 30 March 2009, the council became the sole shareholder of WEL and transferred the company to CEC Holdings Limited. Since 31 March 2009, the council provided £7.5 million to WEL to clear debts with its bank and in return received the company's rental property investment portfolio. Title to this property passed in August 2009 while WEL continues to manage those properties on the council's behalf.
- WEL was established as a project to regenerate the north aspect of Edinburgh, and plans were closely integrated with the intention to construct the Phase 1b Line of the new Edinburgh tram. However, as explained in paragraph 90 later, the tram project has been subject to re-evaluation and Phase 1b has been postponed indefinitely. At 31 March 2009, the council's investment in WEL was reduced from £16.6 million to £4.4 million to reflect the loss made by the company during the year, the restructuring undertaken and the level of debt 'forgiven'.
- **Shawfair Developments Limited**: This was a joint venture between the council, Miller Developments Limited and Midlothian Council. Investment in the project continued in the first half of 2008/09 but in the second half of the year, as a result of the deteriorating economic climate Miller indicated their intention to withdraw from the venture and consequently the remaining partners were required to purchase the loan stock and other amounts invested by Miller. It should be noted however that this was not a decision taken lightly by the council and it only made payment to Miller having obtained a legal opinion. For City of Edinburgh Council, the full amount involved was £1.6 million which has been reflected in the council's financial statements.
- **Joint Boards:** It has recently been identified that *the Local Government Pension Reserve Fund (Scotland) Regulation 2003* which provides the statutory basis for local authorities to remove costs based on *FRS 17 Retirement benefits* from being a charge to the general fund, does not apply to the new pension schemes for police and fire that were set up from 6 April 2006. In respect of both the Lothian Police and Fire Joint Boards, the amounts involved were considered to be material and therefore adjustments were made to their accounts to avoid a qualified audit opinion. There was no impact on the council with regard to Lothian and Borders Police as they held sufficient reserves,

however there was an additional liability of £121,000 in respect of Lothian and Borders Fire and Rescue Service which has been adjusted for.

23. Issues arising associated with group governance arrangements are discussed within the Governance and Accountability section of this report.

Trust funds

24. Local authorities with registered charitable bodies are required to comply with the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund. However the Office of the Scottish Charities Regulator (OSCR) has deferred the date of full implementation until 2010/11. This means that reliance can be placed on the existing disclosures for trust funds in the council's financial statements, supplemented by appropriate working papers.

25. In December 2008, the council approved a plan for the reorganisation of the council's 120 trusts and work is ongoing in consultation with OSCR to consolidate and simplify the administration of the existing trusts. For 2008/09, there was a reduction in the value of trust funds from £16.8 million to £14 million as a result of the fall in market prices due to the recession.

Common good fund

26. In December 2007, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued a guidance note for practitioners. The guidance requires the common good fund to be disclosed within the financial statements and a separate common good asset register to be in place by March 2009.

27. A separate account for the common good is disclosed in City of Edinburgh Council's financial statements and a separate fixed asset register is also maintained. Further work is being carried out to ensure the completeness of common good assets. Following a detailed review of specific title deeds in 2007/08, assets valued at £11 million were transferred from the council's fixed assets to the common good. While it was acknowledged that significant time was involved in reviewing title deeds, it was agreed that hereon title will be examined whenever land/buildings are identified for disposal or change of use. In addition, the council agreed to introduce criteria to identify assets which might be common good assets and to introduce a rolling programme of title deed review.

28. During 2008/09, 2 further assets valued at £119k were transferred to the common good. We also noted that the Capital Asset Management Group had recently approved criteria for a rolling programme of reviews. We are satisfied with the arrangements in place for identifying common good assets.

Pension fund

29. A full actuarial valuation of the pension fund was undertaken as at 31 March 2008 and the actuary's final report was presented to the council's Pensions and Trusts Committee in March 2009. This recommended the council's employer contribution rates for 2009/10 to 2011/12 to ensure that sufficient funds are available to pay future benefits. As at 31 March 2008 the pension fund had a funding level of 85% with a funding shortfall of £524 million. As a result, the council's employer's contributions will increase from 20% to 21.3% over the next 3 years from April 2010. The fund's asset value reported by the actuary at the valuation date was £3,029 million. The next actuarial valuation will be as at 31 March 2011. For accounting purposes the actuary provides an annual update and at 31 March 2009, the value placed on the council's share of the assets was £1,039 million.

Legality

30. Through our planned audit work we consider the legality of the council's financial transactions. In addition the Director of Finance confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and regulations. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Financial reporting outlook

IFRS adoption

31. Local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2010/11. Because local government has already adopted some aspects of IFRS, we expect the transition to be fairly smooth. Indeed, next year, councils will be expected to account for PFI projects on an IFRS basis, but it is important that the council starts the transition period in 2009/10. A comparative balance sheet as at 1 April 2009 will be required and whole of government accounts will also be required on an IFRS basis from 2009/10.

Key Risk Area 5

Pension funds

32. The introduction of the IFRS based accounting code of practice in 2010/11 is likely to require separate pension fund reports and accounts, something also supported by LASAAC. Although it is unlikely pension funds will be separate audit appointments (as they are not statutory bodies in their own right) it may be necessary for us to treat them separately. This is something we will be discussing with the CIPFA Directors of Finance Group.

Use of resources

Financial results

33. In 2008/09, City of Edinburgh Council spent £1.9 billion on the provision of public services. Almost £1.5 billion was on revenue services and the remainder was spent on capital. The council's income and expenditure account shows net operating expenditure in 2008/09 of £1 billion. This was met by central government and local taxation of £983 million, resulting in an accounting deficit of £74 million, 7.3% of the net expenditure for the year.

34. After taking account of statutory adjustments, a further £13.4 million was met from reserves resulting in an actual funding outturn of £946.8 million against a revised budget of £945.3 million. The budget set for 2008/09 was based on a Band D council tax level of £1,169.

35. In previous years we have commented on the budget pressures experienced by the main services which led to overspends. In setting the budget for 2008/09, the council recognised that there were particular pressures on some of these services and allocated increased core funding. That said, there has been an improving position as shown by Exhibit 2.

Exhibit 2
- Service overspends (underspends)

	2008/09 £ million	2007/08 £ million	2006/07 £ million
Children and Families	2.3	4.1	9.6
City Development	0.7	0.6	2.8
Health and Social Care	(0.4)	4.9	2.3

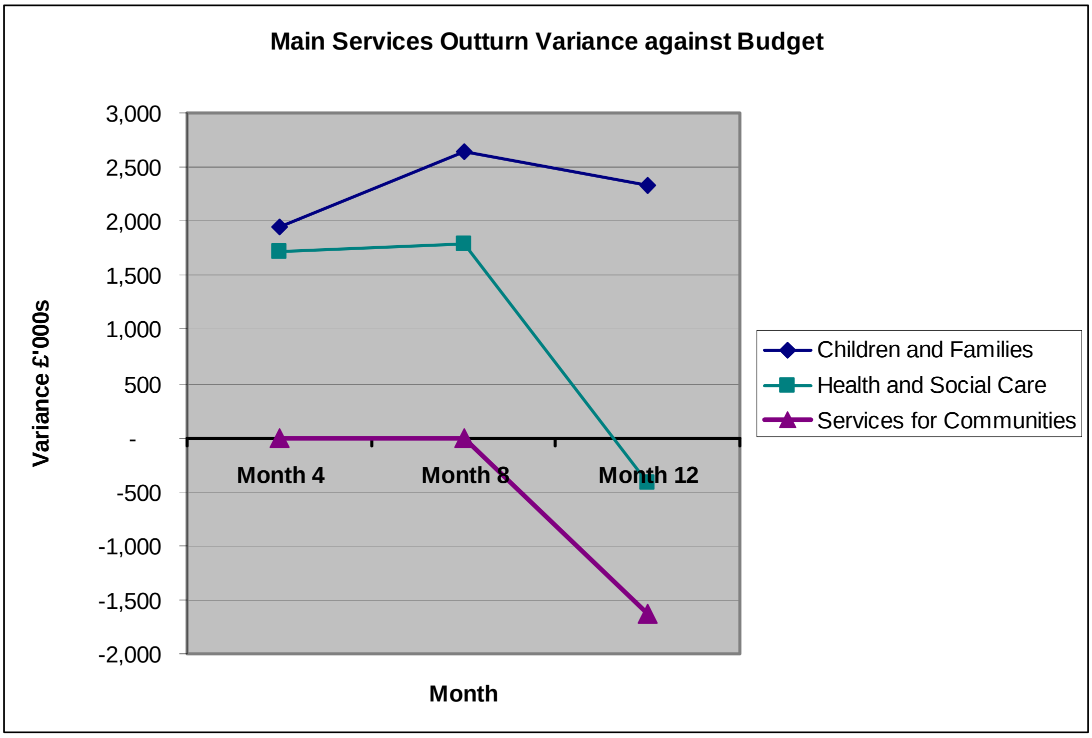
36. The corporate management team kept budgets under close review during the year to improve the financial position. Where necessary directors were tasked with identifying savings and efficiencies so that expenditure could be delivered in line with budgets. This resulted in much closer scrutiny and challenge of budget outturns by service management teams and the production of action plans to manage budget pressures for consideration by members at service committees.

37. Exhibit 3 shows the departmental projected results reported on a regular basis to members and clearly highlights the change in spending patterns in the final quarter of the year. Health and social care and services to communities have significantly restricted spending in comparison with month 8

projected outturns. Children and Families while still showing a deficit has also returned an improved position over the anticipated result at month 8.

Exhibit 3

- 2008/09 projected outturn figures



38. While the General Fund services outturn position for the year showed an adverse variance of £209,000 in respect of services (Exhibit 4), this was significantly better than the projected £4.6 million overspend reported in January 2009. There are a range of reasons for the improved position including the reduction in employee costs arising from a recruitment freeze in some parts of the council and delays in filling vacancies.

39. Exhibit 4 shows that the council was required to fund additional expenditure of £12 million between setting its budget in February 2008 and its revised budget position. In overall terms the council experienced a surplus of £2 million against its revised budget. This was largely achieved through a £5 million benefit from treasury management processes. The weighted average maturity of the cash fund at the beginning of the year was increased to take advantage of higher interest rates, and more liquid assets were held due to slippage in previous years' capital programmes which affects 2008/09 loan charges. Similar savings have been identified by the council in previous years in drawing together the year end results. In addition, the outturn position is assisted by the planned use of the capital fund. It would improve the budget monitoring process if the projected outcome of treasury activity could be separately identified in quarterly outturns. We note that this action has been implemented in 2009/10

budget monitoring reports. (Cash management and temporary investments are considered further in paragraphs 55 to 60 and Exhibits7 and 8.)

Exhibit 4

- Outturn against budget 2008/09

	Outturn £000	Revised Budget £000	Approved Budget - Feb 2008 £000	Outturn variance £000
Children and Families	356,094	353,764	353,083	2,330
Health and Social Care	161,581	161,935	157,275	(354)
Services for Communities	132,969	134,596	131,627	(1,627)
General Fund Services	**835,323**	**835,114**	**822,952**	**209**
Total expenditure to be funded	944,761	945,307	931,750	(546)
Funding	946,775	945,307	931,750	(1,468)
General Fund Surplus	**2,014**	**nil**	**nil**	**(2,014)**

40. This is the third year in which we have commented on the significant movements in the last quarter of the financial year. Further work is required by services to understand and strengthen monitoring processes to ensure that more accurate projections are made throughout the year.

41. We have reviewed the budget for 2009/10 and are conscious that the council continues to face budget pressures in a range of its services and is aware of the need to take action to balance its budget. Additional pressures are anticipated in future years with tighter allocations from the Scottish Government and the continuing need to deliver sustainable efficiencies. We would therefore suggest that the council continues to review its budget setting assumptions to ensure they remain robust and take cognisance of the experience of services.

Reserves and balances

42. Exhibit 5 shows the balance in the council's funds at 31 March 2009 compared to the previous year. Funds include a capital fund which may be used to defray capital expenditure or repay loan principal, and a repair and renewal fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets. At 31 March 2009, the council had total funds of £92.8 million, an increase of £23.8 million on the previous year.

Exhibit 5

- Reserves

Description	31 March 2009 £ Million	31 March 2008 £ Million
General Fund	59.6	28.9
Repair and Renewal Fund	10.3	7.6
Capital Fund	22.9	32.5
	92.8	**69.0**

43. The general fund increased by £30.7 million during the year to a balance of £59.6 million which equates to 5.9% of the council's net annual expenditure. Of this balance £53.1 million has been earmarked for specific purposes, for example, equal pay, insurance and unspent grant income received in advance of planned expenditure. This leaves an unallocated balance of £6.5 million (2007/08 £1.8 million) to cope with risks and deal with unforeseen costs or losses. This amount is below the council's preferred reserves policy and it has a strategy in place to restore its free reserves to £12.8 million by 31 March 2012 (1% of net expenditure). During 2008/09 a planned contribution of £5 million was made to the general fund in line with this strategy.

Group balances and going concern

44. The overall effect of inclusion of all of the council's subsidiaries, associates and joint ventures on the group balance sheet is to reduce net assets by £608 million, mainly because of pension liabilities in joint boards. Because pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax, all group bodies' accounts have been prepared on a going concern basis.

45. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Lothian and Borders Police, Lothian and Borders Fire and Rescue and Lothian Valuation) had an excess of liabilities over assets at 31 March 2009 due to the accrual of pension liabilities. In total these deficits amounted to £3,223 million (2007/08 £2,048 million), with the council's share being £723 million (2007/08 £695 million).

Capital performance 2008/09

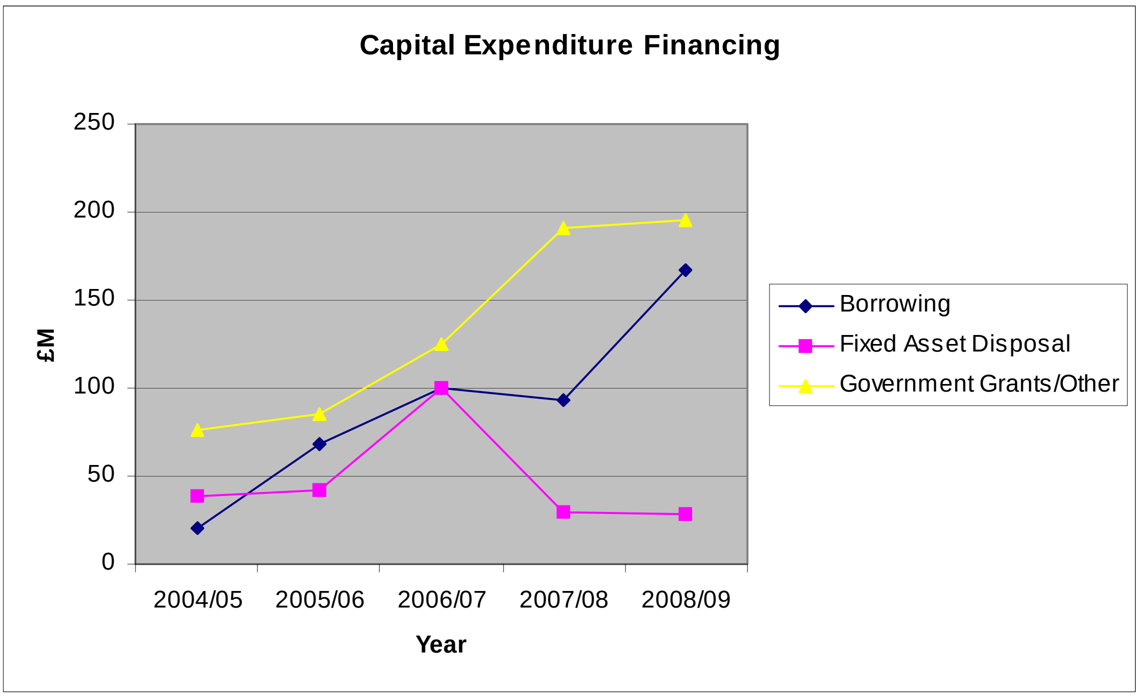
46. The council's prudential indicators for 2008/09 were set in February 2008. Capital expenditure in 2008/09 totalled £392 million, an increase of £80 million from 2007/08 but £50 million less than the revised budget. The council manages its capital programme by over programming projects in the knowledge that all projects will not proceed in accordance with plans. For 2008/09, over programming totalled £17 million. This enables other projects to proceed to absorb available funding. During the year, the council was unable to realise sufficient capital receipts to fund the entire planned capital programme as a result of a slow down in the property market due to the recession. Overall, £25 million of receipts were not realised as scheduled. The council needs to continue to tightly manage its capital programme and to assess the impact of such slippage on service delivery.

47. Significant projects during the year included the tram project which incurred £138 million of expenditure which was largely funded by the Scottish Government (£120 million). The opportunity arose for the council to purchase its headquarters at Waverley Court. Following valuation based on future rental streams, a price of £91 million was agreed. Loan charges arising on the purchase price are less than the rental charges the council would have incurred over the remaining period of the lease. An impairment review was subsequently carried out to reflect the use of the building as owner/occupier which reduced the valuation by £12.8 million.

48. The trend in capital investment and sources of funds is reflected in Exhibit 6.

Exhibit 6

- Sources of finance for capital expenditure 2004/09



49. It is also likely that capital receipts will be less than forecast for the medium to long term. This means that the council will have to consider alternative sources of capital funding or reduce capital budgets.

Treasury management

Policy and strategy

50. At an early stage, the council reacted to warning signals about the risks facing financial institutions from the US subprime debt issues. In September 2007, it responded to identified financial risks by approving greater investment with counterparties of higher credit rating. In particular, it agreed

- changes to its Treasury Policy Statement to increase credit criteria ratings for the highest rated banks
- an increase in the size of deposits with top credit rated institutions from £30 million to £60million.

51. While the revised policy was designed to concentrate risk in fewer institutions, it was also believed that those institutions would be the most able to survive turbulent market conditions.

52. The council monitors the top three recognised industry credit ratings as part of its normal treasury management activities but it does not use such ratings exclusively to compile its counterparty list. Thus the Icelandic banks have never been included in the council's counterparty list. The problems experienced by those banks arose from their rapid expansion and high borrowing. This meant that they were unable to repay short-term deposits due to mature especially in the face of the global credit crunch. The council did not experience such problems with its counterparties as all deposits were repaid as they fell due.

53. Following investigations into investments in Icelandic banks by English local authorities, it has been identified that one of the key controls in this area is the existence of a named committee to undertake the scrutiny of treasury management activity. Within the City of Edinburgh Council, the Finance and Resources Committee has this role and responsibility. Given the scale of borrowing and investment activity undertaken by the council, it was disappointing to note that plans to provide council members with a treasury management seminar had to be postponed as only four out of 58 members expressed an interest to attend.

Borrowing

54. All borrowing undertaken by the council was in accordance with the Prudential Code to ensue that it was affordable and sustainable. At 31 March 2009, the council had £1.1 billion debt, an increase of £123 million compared to the previous year. As stated in paragraph 47, significant projects in 2008/09 included the purchase of Waverley Court at £91 million. Exhibit 7 sets out an analysis of the council's treasury management activity for 2008/09. Clearly the council has a very significant level of debt

which is considered as part of its overall financial strategy to ensure that there are clear plans for repayment.

Exhibit 7

- Analysis of Edinburgh's treasury management activity

	2007/08 £000s	2008/09 £000s
Borrowing as at 31/3/09		
Short term borrowing	12,583	50,568
Long term borrowing	1,014,782	1,100,284
Total borrowing	1,027,368	1,150,852
Cash Fund		
Short term investments held by cash fund as at 31/3/09	146,493	141,698
Cash fund deposits in the year	3,669,720	2,692,041
Additional income from cash fund investments compared to industry benchmark	293	1,920
Impact on Budget		
Reduction on loan charges/interest on revenue balances against budget	3,476	5,030

Cash management and temporary investments

55. In recent years, some councils have held significant amounts of cash and temporary investments to take advantage of favourable interest rates for planned capital programmes. In these circumstances, the early borrowing must be justified in its own right as representing the best time for borrowing the amount required. This should be assessed without regard to temporary investment possibilities, otherwise the action may be judged to be unlawful or to have subjected public money to unnecessary speculation risk.

56. The council's cash fund is a relatively unique operation within local government treasury management. It seeks to deliver fair and transparent interest for all bodies investing money in the fund whilst combing deposits to maximise interest returns. These bodies include the council, Lothian Pension Fund and joint boards who, on a daily basis, have their cash deposits invested in the fund.

57. The daily invested figures show that over the last two financial years the cash fund has actively invested over £6 billion with either banks or other local authorities. All investments have been in accordance with the council's Treasury Management Strategy. A summary of cash fund activity is shown in Exhibit 7.

58. The council achieved £1.92 million additional income compared to industry benchmark for performance of its cash fund investments. Early in 2008/09, council treasury managers recognised that interest rates were likely to fall and a number of material deposits up to twelve months were made with banks at around 5% interest. This activity is illustrated in Exhibit 8.

59. Exhibit 8 illustrates that since March 2009 the various rates came closer together, decreasing the opportunities for above benchmark performance. It would be unlikely that, should interest rates remain this low or start to rise, the 2008/09 performance level would be repeated.

Exhibit 8

- Cash fund performance against Bank of England base rate and industry benchmark rate

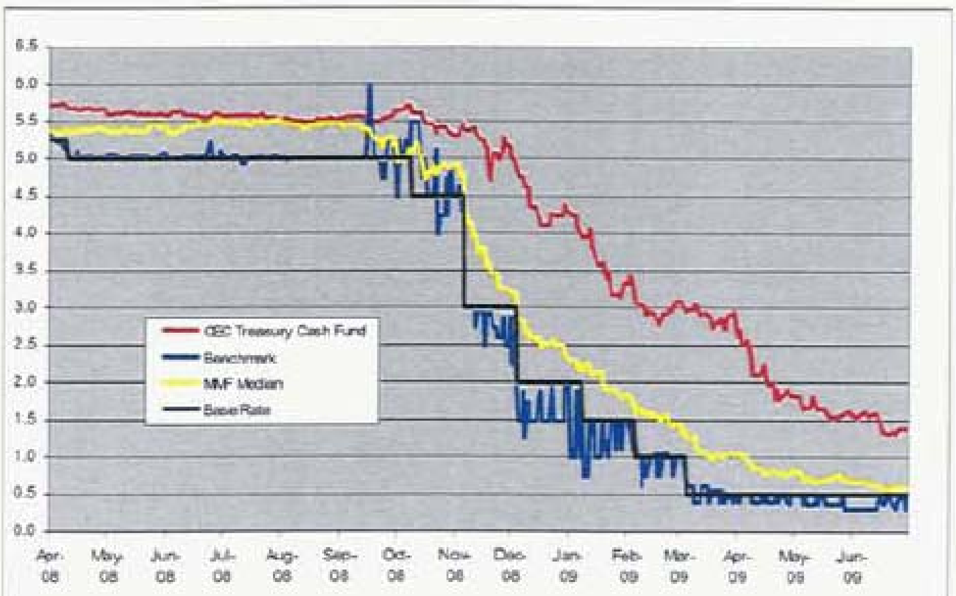


Figure 7 - Treasury Cash Fund Investment Performance Since 01 April 2008

60. As at 31 March 2009, the City of Edinburgh Council held cash and temporary investments totalling £142 million of which £99 million related to the council and the reminder was held on behalf of other bodies. We received specific representation from the Director of Finance that all borrowing in advance of immediate requirements was made for a legitimate purpose in accordance with legislation and was on-lent in the interests of prudent cash management. In the Director’s assessment any early borrowing is justified in its own right as representing the best time for borrowing the amounts required, without regard to temporary investment possibilities and the ‘profit’ that might arise from these.

Pension funds

61. The council is responsible for the management and administration of two pension funds: the Lothian Pension Fund and the Lothian Buses Pension Fund. £585 million of the Lothian Pension Fund (26% of total fund investments) is managed in-house, and the rest externally. The investments for Lothian Buses Pension Fund are all managed externally. The value of the investment assets are illustrated in Exhibit 9.

Exhibit 9

- Pension Fund Investments

	31/03/06 £000	31/03/07 £000	31/03/08 £000	31/03/09 £000
Lothian Pension Fund	2,855.8	3,101.6	3,026.7	2,417.2
Lothian Buses Pension Fund	188.4	196.8	198.8	163.4

62. The effects of the economic climate significantly impacted on pension fund investments over the course of the year. Equity markets were particularly volatile while governments around the world were struggling to restore confidence in the banking system with capital injections. Lothian Pension Fund dropped in value, delivering a return of -17.0%. However this compared favourably to the benchmark figure of -24.4%. Exhibit 10 shows the negative performance of the funds over 2008/09.

Exhibit 10

- Lothian Pension Fund – fund and benchmark return 2008/09

	30/06/08 %	30/09/08 %	31/12/08 %	31/03/09 %
Lothian Pension Fund	-0.63	-7.66	-1.08	-8.58
Benchmark	-1.51	-8.30	-8.99	-8.03
Lothian Buses Pension Fund	+0.01	-9.25	-3.45	-7.37
Benchmark	-1.72	-7.15	-3.58	-8.14
Scottish Homes*	+0.20	-3.85	-0.01	-7.56
Benchmark	+0.44	-3.58	-0.59	-7.33

* City of Edinburgh Council is the administering authority of the fund created prior to the wind up of the Scottish Homes Residuary Body. Financial results are consolidated with those of the Lothian Pension Fund.

63. The long term impact of global market conditions will be monitored on an ongoing basis by the council.

Financial planning

64. The council continues to face difficult financial pressures in 2009/10 with the ongoing challenges of delivering services within budget and identifying the required level of efficiencies. Additional pressures are faced by the council in the medium term from further equal pay claims and the ongoing costs associated with modernising pay, demography, increased demand for services, building and infrastructure maintenance backlog, affordable housing and homelessness. It is also anticipated that capital receipts will continue to be difficult to realise in the foreseeable future placing further pressure on the delivery of the capital programme.

65. The Scottish Government has made it clear that public expenditure will be constrained for the medium term. This means that councils need to plan now for a future where there is no real growth in funding. The council's overall budget projections for the next three years indicate a funding shortfall of £40 million in 2010/11, rising cumulatively to £62 million by 2011/12 and £86 million by 2012/13. This is a significant challenge for the council and if it continues to freeze council tax, it will need to look at fees and charges as sources of additional income as well as securing cost reductions.

66. The council has recently produced a long term financial plan which brings together all the different commitments for the council and should be a helpful starting point in identifying solutions to funding shortfalls. The planning process is supported by four workstreams, namely workforce planning, property, procurement and service prioritisation, which are designed to mitigate some of the financial pressures. As part of this process, the council is taking forward its Alternative Business Models Project which is considering a range of services which could be delivered through other mechanisms such as shared services or partnerships. Proposals are currently being developed for consideration as part of the 2010/11 budget process. The council's Procure to Pay Project is discussed in paragraphs 74 and 75.

Asset management

67. Effective management of council assets helps the council achieve its objectives and get best value from its investment in property. Effective asset management benefits service delivery by making council buildings work better for staff and service users now and in the future. It also reduces the opportunity cost of money locked up in surplus property and reduces the council's carbon footprint.

68. In 2009, we published *Asset Management in Councils.* Our study found that strategic asset management was not well developed in most councils. For Scottish councils as a whole, over a quarter of all properties were in poor condition and slightly less than that were not suitable for the services being delivered from them.

69. With regard to the City of Edinburgh Council, office accommodation rationalisation projects have been in existence since 2000. Through these projects, the council streamlined its number of operational

buildings and re-located its headquarters to Waverley Court. As a result, less than 5% of the council's buildings are considered to be poor in terms of condition and suitability.

70. A property maintenance backlog totalling £1.4 billion was reported by councils as part of the study. With the financial pressures facing councils this position may worsen with councils experiencing a rising level of reactive maintenance. The City of Edinburgh Council has however prioritised asset management works in the development of the ten year capital investment plan. The ratio of planned to reactive maintenance is considered a good indicator of the effectiveness of a council's maintenance regime. Overall, only nine councils achieved the 60:40 good practice planned:reactive maintenance benchmark. This included the City of Edinburgh Council which reported approximately 35% reactive maintenance.

71. The report highlighted the need for more information to be provided to elected members on property management. In this regard a useful checklist was appended to the report with good practice indicators for councillors to consider.

Procurement

72. Local authorities spend significant sums of money annually on purchasing goods and services and as part of the efficient government initiative, the Scottish Government anticipated that scope existed for significant financial savings through improved procurement procedures and practices. The McClelland report on procurement published in March 2006 confirmed that significant savings were possible but concluded that public sector procurement processes still had weaknesses in resources, skills, organisational structures and practices.

73. In response to the McClelland report the Scottish Government introduced the Public Procurement Reform Programme (the Programme) in April 2006. In July 2009, Audit Scotland reported the extent to which the Programme had progressed nationally. This report concluded that while some significant steps had been made, more work was required before the Programme could achieve its full potential.

74. The City of Edinburgh Council joined Scotland Excel in 2008 and to date there are approximately 30 contracts available to the council ranging from electricity to educational materials and catering supplies. The main thrust of the council's procurement activity has however been its pathfinder project 'procure to pay'. Over the last couple of years the council has worked with consultants to scope and design a procurement category management model which will operate strategically across the council at themed levels rather than each service operating in isolation. The business case assumed that Edinburgh would lead for the south east with partners including Fife, the Lothian councils and Scottish Borders Council. The council's share of expected savings is anticipated to be at least £11 million per annum from 2010/11.

75. Although savings are beginning to occur, it is vital, given the financial challenges facing the council, that anticipated savings are delivered on schedule. Potential partners have hesitated in formally joining the project pending evidence of savings and improvements. Recent council developments include:

- a revised procurement and payments structure based on category managers for learning and care, construction and consultancy, environment and waste and corporate
- a review of major learning and care contracts e.g. homeless accommodation and care and support services; which is anticipated to produce savings of 10-20%
- the development of a procurement academy to provide staff training and increase awareness.

Key Risk Area 6

Managing people

76. The council is now one of the last in Scotland to implement single status. This is partly because the council decided to implement the agreement as part of a wide modernising pay project which is now scheduled for completion in 2010/11. At 31 March 2009, the council made provision for £6 million for outstanding equal pay compensation costs, having already paid out £35 million in recent years. Further significant costs, possibly in the region of £20 million, are likely to be incurred by the council following the Bainbridge case in England. This crystallised the risk of claims in respect of any period of pay protection where pay protection continues a previously discriminatory element of pay. This is a potential liability which will become due if such pay protection is implemented as part of the single status agreement. At this stage, however, limited budget provision has been identified by the council to fund this probable substantial cost. It should be noted however that the Scottish Government recently confirmed that borrowing may be permitted to assist councils fund equal pay cases.

Key Risk Area 7

77. In summer 2008, the council established an HR Service Centre in its offices located at Chesser House and implemented e HR, a computerised employee management system. These projects had initially been planned for introduction in 2007. During the course of the audit we were aware of ongoing 'teething problems' as the transitional period passed and the new processes settled in. In December 2008, BT reported the outcome of a review of payroll/HR services undertaken on behalf of Corporate Services. The report contained a comprehensive action plan which detailed 'quick win' solutions and 'long term recommendations'. The services are also developing a joint service improvement plan.

78. The main issues highlighted by BT were the separate locations and lines of responsibility of the HR Service Centre and Payroll. The report indicated that it was essential the two services be co-located under one management structure. We would concur with this recommendation. For example, with regard to the recovery of overpayments, we were unable to clarify who was responsible for

implementing tighter controls and recovery of those overpayments. Overpayments tend to be the result of late notification of changes from managers rather than errors made by Payroll or HR staff, however the lack of consensus as to who is properly and formally responsible for overpayments is a risk. We also noted that service centre performance information is at an early stage of development and that the partnership agreement has not yet been finalised.

Key Risk Area 7

Shared services

79. The Accounts Commission commented on the lack of progress in developing shared services in its *Overview of the local authority audits 2008.* They recommended that councils should give this high priority in the light of financial pressures and the drive for efficiency. Along with Fife, Scottish Borders and the other Lothian councils, Edinburgh is one of six local government partners exploring options to share services with a focus on transactional processes. In addition to the procurement pathfinder mentioned in paragraph 74 above, other areas for consideration include: pension funds, payroll, road maintenance, development of more flexible working practices. However crystallisation of these discussions into actions still seems a long way off because, to-date, the potential level of benefits to be realised have not fully persuaded the partners involved to embark on substantial service change.

Outlook

80. Clearly we are in a period of reduced economic growth with significant implications for the council's resources and the demand for services. The council needs to remain alert to the impact of the recession on the community it serves and what that means for the provision of public services and the prioritisation of its key objectives. At the same time as the council tries to support its local economy and provide best value services, it is likely to face a reduction in resources in real terms.

Governance and accountability

Introduction

81. We believe that an effective council is committed to high standards of probity and can demonstrate high standards of governance and accountability. It has effective political and managerial structures and processes to govern decision-making and the exercise of authority within the organisation, supported by mature and effective relationships between members and officers. An effective council is committed to public performance reporting as a key element of public accountability. It clearly sets out service standards which reflect the needs of local people and other stakeholders, and is balanced in its assessment of the council's strengths, weaknesses and challenges for the future.

Structure and policies

82. Corporate governance is about direction and control of organisations. Councils are large complex organisations and so good governance is critically important. The council has assessed its own arrangements against the CIPFA/SOLACE guidance: *Delivering Good Governance in Local Government*. The assessment has identified a number of areas for improvement, but overall, the results suggest that the council has a sound governance framework.

83. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda. The City of Edinburgh Council's Audit Committee remit includes risk management, IT security and anti-fraud reporting. The committee also has a wider role in terms of promoting, monitoring and developing continuous improvement. The committee is well attended and in overall terms its remit and working practices are in accordance with the good practice principles. For example, the committee:

- is a formally constituted committee with clear terms of reference which reports directly to council and usually meets in public.
- membership is in line with the political balance of the council and there is regular attendance by appropriate senior officers of the council.
- considers internal and external audit plans and respective annual reports.
- reviews the audit certificate and considers matters arising from the audit of the annual accounts.

84. In our 2007/08 report, we highlighted that members should participate in further learning and development opportunities to better equip them to challenge officers and therefore increase the effectiveness of the committee's work. A training event arranged for the committee in 2009 had to be postponed due to non-availability of members. There are now plans in place to provide short training sessions in advance of each committee meeting. As listed below, we also highlighted a number of

areas where the committee needed to focus attention. While these matters have been discussed by the committee and good progress made, in our opinion they have not yet been fully addressed:

- the committee currently receives a selection of internal audit reports and is advised of significant issues by the external auditor. The area for improvement is in relation to the implementation of action plans. A more formal process needs to be put in place which will provide the committee with assurance that recommendations are being implemented and making a difference.
- the detail of inspection reports is addressed by the relevant services and executive committees but good practice suggests audit committees have a scrutiny role in monitoring implementation to ensure that key risks faced by the council are being addressed. It may be that this scrutiny aspect lies elsewhere in the council with regard to inspection reports.
- the Accounts Commission issue a range of national study reports and an overview of local government each year. These reports are now being considered by the committee but there is scope to hear more from officers on the council's position in relation to the recommendations made in the national report.

Key Risk Area 8

Governance and internal control

Group arrangements

85. As previously articulated in paragraphs 19 to 23, the council has a complex and diverse group structure. While this offers innovative ways of delivering services, strong governance arrangements need to be put in place to ensure that the council's corporate objectives are delivered.

86. In 2008, the Director of City Development commissioned a review of the council's development companies to assist an assessment of whether these companies continue to be the best mechanism for the council to delivery key priorities. The conclusions from the review were reported to Council in September 2008 and confirmed that governance arrangements could be improved by consolidating the number of companies and joint ventures owned by the council with proposals that CEC Holding Limited's role be enhanced as the main vehicle through which the council co-ordinates and implements its development and regeneration activities.

87. Towards the end of 2008, it became clear that a number of the group companies were experiencing financial difficulties linked with the economic downturn. The council was proactive in minimising the loss on these activities and therefore the impact on its revenue account. This increased the need for a restructuring of the group and a strengthening of the role of CEC Holdings Limited. By March 2009, the council's investments in Waterfront Edinburgh Limited, PARC Craigmillar Limited and Shawfair Land Limited were transferred to CEC Holdings Limited.

88. During 2008/09 there were significant changes in board membership across many of the companies in the group. In addition, there was close involvement of the Director of City Development and the Director of Finance (and their representatives) as they considered options to minimise the impact on the council while maximising ongoing strategies for regeneration across the city. Accepting that this was a challenging time, we would like to highlight the following key governance related issues which indicate a need to tighten up responsibilities in a number of areas:

- tie Limited – the executive chairman resigned in November 2008 and was no longer actively involved with the company, yet was registered at Companies House as an executive director until April 2009. In contrast there were several months between appointment of the new chief executive and him being formally registered as a board director of tie Limited.
- Waterfront Edinburgh Limited has no executive directors on its board, not even the chief executive. Although council officers attend board meetings, the members of the board at 31 March 2009 were all councillors of City of Edinburgh Council.
- Waterfront Edinburgh Limited – in order to stabilise the company and minimise costs, there was a significant amount of activity between December 2008 and May 2009. During this time council officials were heavily involved and every effort was made to keep the board informed. That said, relationships between shareholders and the board were challenging at times. Following the departure of Scottish Enterprise as a shareholder, there was also a change in a number of directors. With the company in financial crisis and board membership changing, it was decided to suspend the audit committee for a period of time. Given this was a challenging period, ongoing arrangements for scrutiny would have been appropriate.
- The chair of CEC Holdings Limited has generally been the council's Finance Convenor. During the year the Transportation and Finance Convenors swapped roles but it was decided that the former Finance Convenor would retain his role as chair of CEC Holdings Limited. This became the subject of debate at full council which would suggest a need for greater clarity and understanding around such actions in advance of the decision making process.
- Shawfair Development Limited – as previously referred to, audited accounts have not been finalised in respect of 2007/08 or 2008/09. While it is our understanding that the company is now dormant and will be wound up, it is a concern that it is not apparent who had responsibility for ensuring the completion and submission of audited accounts.

Key Risk Area 9

The Edinburgh Tram Project

89. tie Limited, a wholly owned subsidiary for the City of Edinburgh Council, is responsible for the delivery of the Edinburgh Tram project. Initially the project was to be delivered by 2011 within a funding limit of £545 million. The bulk of this major project got underway in 2008/09 but was disrupted by a range of contractual difficulties over the year. In an attempt to reach a conclusion, formal dispute resolution

procedures have been implemented in accordance with the contract and the outcome is awaited in January 2010. It has been recognised that it will be very difficult to deliver the existing project within £545 million and implementation is now forecast for 2012. The project appears on the council's corporate risk register in recognition of the fact it is a major element of the council's transport strategy and is very politically sensitive with strong media interest.

90. Key events during the year in relation to this project include:

- Following a procurement process, preferred bidders were identified and financial close reached in May 2008.
- The city experienced disruption following road closures on the Mound in 2008 and Princes Street in February 2009 in order to advance different phases of the project. As a result of those experiences, lessons have been learnt by the council and improved traffic management arrangements are in place.
- The economic assumptions on which the tram project was based indicated that Phase 1a was expected to generate benefits of £1.77 per £1 of cost. An update of the development assumptions in North Edinburgh was undertaken in 2008 and reported to council in December 2008. This confirmed that the original objectives were still achievable. However with the impact of the economic recession on the proposed housing and commercial development of Granton Waterfront, it was agreed in April 2009 to postpone Phase 1b at the current time. Costs of £6 million had been incurred on this element of the project.
- The council's financial contribution of £45 million was based largely on projected developers' contributions. In the course of 2008/09 it became evident that developers are no longer in a position to make those contributions in the short term and the council is re-examining that aspect of the financial framework. The council has disclosed as a contingent liability in the accounts that were the costs of the tram project to exceed £545 million in total the council will be liable for those additional costs. Through the Transport Edinburgh Limited business plan and contingency arrangements, delivery scenario options have been re-examined to produce preferred strategic outcomes for the project.
- A new chief executive was appointed with effect from 1 April 2009 following the resignation of the former executive chairman on 30 November 2008.
- In terms of governance, the Tram Project Board meet every four weeks and work closely with tie Limited's board. Regular information is considered in terms of performance and finance.
- Political group leaders within the council are regularly briefed on the project by the Director of City Development and Director of Finance. There have been restrictions on the level of financial information included within council papers due to the sensitivity of the project. In addition, councillors who receive full information in their position as a board member of tie Limited or the

Tram Project Board are unable to share this information more widely with their political group colleagues. Consequently, this continues to cause tensions and frustrations within the council.

91. We will discuss these matters further in a more detailed report on the tram project which will be issued in the first instance to the Director of Finance in January 2010.

Key Risk Area 10

Housing Benefit Subsidy

92. The council administers housing benefits on behalf of the Department of Works and Pensions (DWP). The council reclaims the money paid to benefit claimants annually in what is called a subsidy return to the DWP. For 2007/08, the council claimed £172 million in subsidy for benefit paid in the year. The service deals with around 500,000 pieces of mail each year and processes around 50,000 claims, either as new claims or as changes of circumstances.

93. In November 2008, we provided a qualified audit opinion on the council's 2007/08 subsidy return due to misclassification of overpayments. Following consideration of our report, the DWP requested the council to undertake further sample work which we would review and conclude upon. Following the additional work, we concluded that the local authority error threshold had been exceeded and therefore subsidy had been over claimed by £0.835 million. The council's 2008/09 accounts made provision for a potential repayment of £1.5 million. This represented £0.835 million in respect of 2007/08 and £0.650 million in respect of 2008/09. However, it is for DWP to decide what course of action to take, if any.

94. Whilst this amount is not material within the context of the council' s annual £1.5 billion expenditure budget, it does represent income which the council had anticipated and has potentially been lost as a result of processing errors which could have been avoided.

95. An action plan was agreed with the Head of Revenues and Benefits in July 2009 setting out the additional training and quality assurance checks to be undertaken by the service to reduce the level of overpayment misclassification. An update was provided to the Audit Committee in September 2009. We also note that the service has been experiencing a processing backlog which has required the use of temporary staff to deal with the increased workload. However, it is anticipated that improvements arising from the initiatives set out in the action plan will start to positively impact on performance statistics in the second half of the financial year 2009/10.

Key Risk Area 11

Prevention and detection of fraud and irregularities

96. At the corporate level, the council has appropriate arrangements in place to help 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

97. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, 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. The NFI has generated significant savings for Scottish public bodies (£40 million to 2008). If fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

98. The most recent data matching exercise was carried out in October 2008 and national findings will be published by Audit Scotland in May 2010. The City of Edinburgh Council made significant progress in raising awareness and commitment to the NFI. In May 2009, we reported that the planning stages for the 2008/09 NFI exercise were completed on time and within guidelines. All recommended matches were reviewed or were under investigation. However, we felt that the council needed to make better use of the software in terms of documenting its approach and findings, and recording outcomes. In addition, an overall strategy was needed for managing planned work where services had a significant number of data matches.

99. Over the summer, the council has continued to investigate matches and so far nine frauds have been identified largely related to housing benefits and 27 errors have been recorded following a comparison of private residential care homes and deceased person matches. There are also further cases which may produce possible monetary outcomes. In overall terms the current potential outcome is savings of £114,182 with processes in place to recover £50,100. It should be noted however that the council will continue their investigations in the coming months and hopefully identify further monetary outcomes.

Outlook

100. The Accounts Commission acknowledges that Single Outcome Agreements (SOAs) are still at an early stage of development. At this stage in the evolution of this new approach to planning, we are interested in the processes rather than the outcomes. In 2010/11, we expect to see further developments in clarifying accountability, governance and public performance reporting.

101. As the SOA demonstrates, partnership working is critical to the council's success. We are developing our approach to the audit of partnerships through the new approach to best value. In future, we shall increasingly be looking at the contribution of partners as well as the council's own contribution to the delivery of outcomes.

Performance management and improvement

Introduction

102. We believe that an effective council has a clear and ambitious vision for what it wants to achieve for its locality and communities to secure high quality services and effective outcomes for local people. The vision is effectively promoted by the member and officer leadership of the council and supported by staff and partners. It is backed up by clear plans and strategies to secure improvement, with resources aligned to support their delivery. An effective council has a performance management culture which is embedded throughout the organisation. The council's performance management framework is comprehensive and integrated with service planning and delivery. Staff have a customer first culture. The council is able to demonstrate significantly improved outcomes for citizens and more effective and efficient services because of its performance management arrangements.

Vision and Strategic Direction

103. Since the introduction of Single Outcome Agreements (SOAs), the council has dropped its corporate plan and now aims to link the community plan with SOA and service plans. In September 2009, the council reported in its SOA Annual Report the significant delivery of outcome focused services and indicated that 62% of local outcomes were assessed as being on schedule. A reporting cycle for SOA monitoring has been implemented which will provide six monthly reports to the Policy and Strategy Committee and annual reports to council.

104. The second stage of Edinburgh's SOA, the Edinburgh Partnership SOA 2009-12 was approved by the Edinburgh Partnership Board in April 2009 and agreed with the Scottish Government in June 2009.

105. We also noted the specific work undertaken in response to the economic recession. The council prepared an economic resilience plan to support the city and business community, has reviewed its economic strategy and is currently considering how best to organise group companies in line with a revised regeneration strategy for the city.

Overview of performance in 2008/09

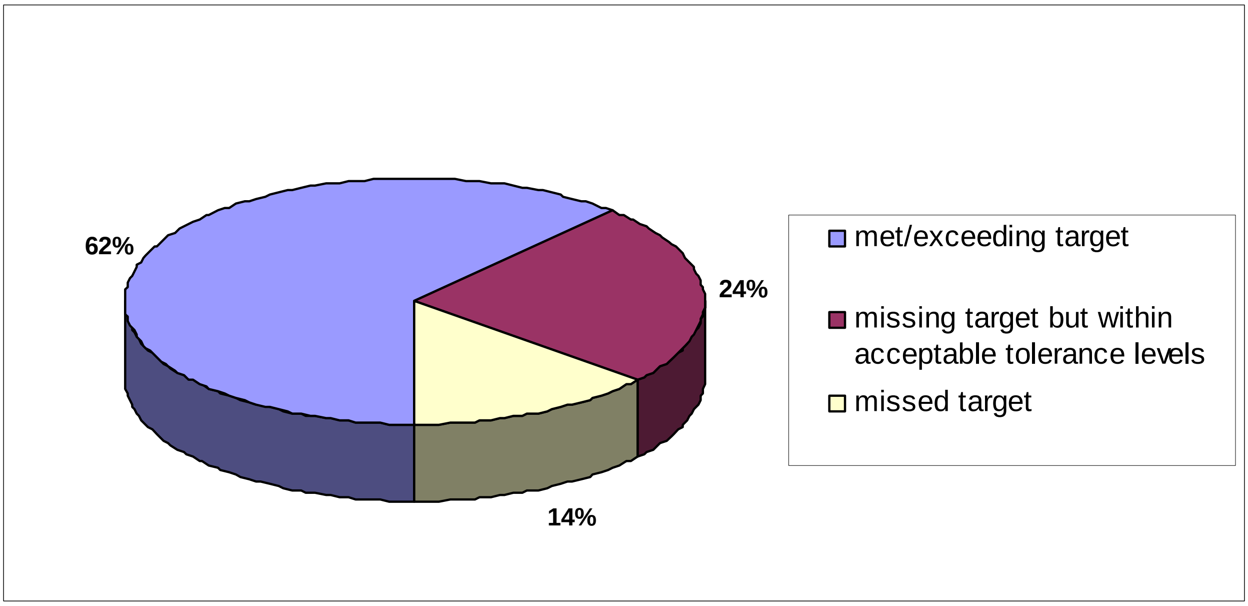
Balanced scorecards

106. The council uses Covalent to provide a series of balanced scorecards and performance indicators. Reports are prepared every two months and submitted to the Policy and Strategy Committee and executive committees.

107. Overall, 95 service indicators are reported regularly to elected members through the balanced scorecard. Exhibit 11 summarises the position as at March 2009.

Exhibit 11

- Achievement of City of Edinburgh Council's targets at March 2009



108. Areas where there is a need for improvement include housing repairs job completion, use of temporary B&B accommodation, delivery of efficiency savings, sickness absence, reports received by the social work reporter and timescales for carrying out initial child protection case conferences.

Annual report

109. The chief executive provided his annual report to the council in September 2009. This report highlighted the council's most important achievements over the previous 12 months, outlined progress with ongoing major areas of work and identified issues to be addressed in the coming year. Substantial progress was reported on each of the eight targets identified as priorities in 2008. Overall, four were reported as complete and four remain as work-in-progress as listed below.

Completed targets

- revision of the city wide community plan strategic outcome priorities and incorporate with the Single Outcome Agreement;
- finalisation of local Community Plans via Neighbourhood Partnerships;
- delivery of the second version of the full Edinburgh Partnership Single Outcome Agreement;

- implementation of phase 1 of the ‘Achieving Excellence’ change management programme.

Work-in-progress

- implementation of the Modernising Pay Project;
- review of the Communication Service;
- delivery of the Social Work Inspection Agency Improvement Plan;
- review of the communications service.

110. Also, in June 2009, the chief executive reported to council on the good progress made in implementing the Administration’s commitments as set out in their 2007 Coalition Agreement.

Edinburgh Resident Survey

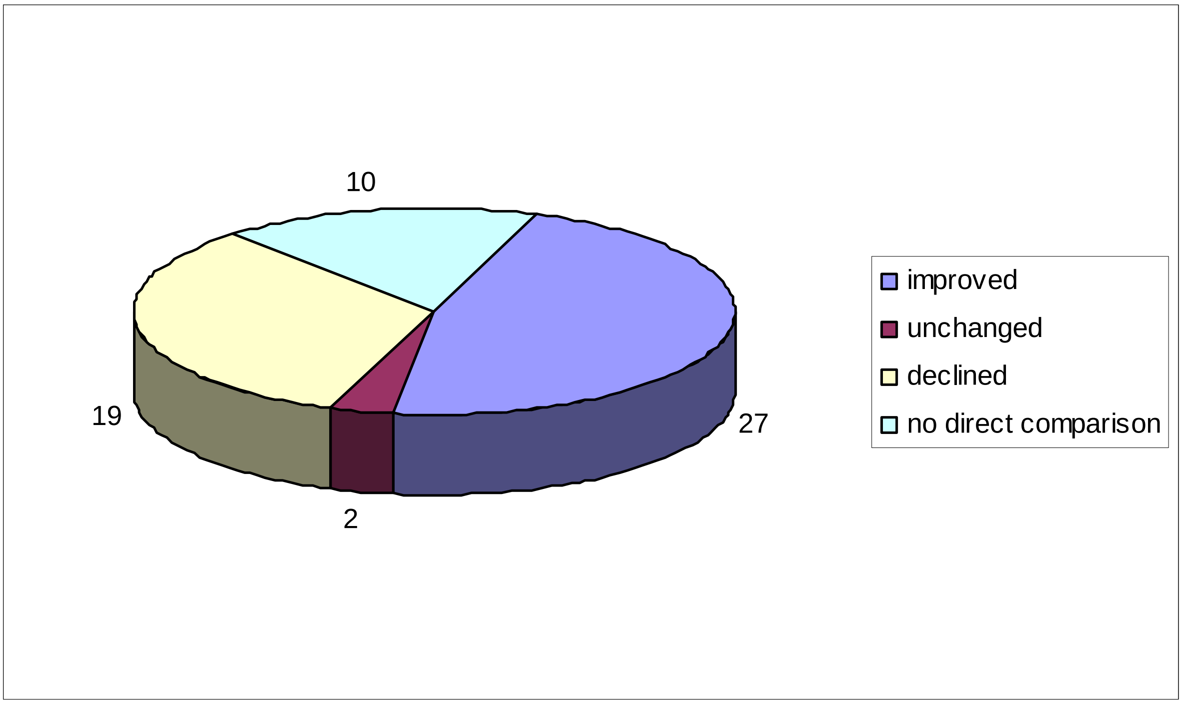
111. The council arranges for an independent six monthly residents survey to be undertaken. The latest was undertaken in April/May 2009. In excess of 90% continue to be satisfied with Edinburgh as a place to live. Similarly there is no change in the issues residents are most concerned about i.e. traffic congestion and waste and recycling. Significant numbers had changed their travel patterns in the last 12 months and specifically in relation to trams, the survey reported that more needed to be done to reduce the disruption caused by the tram works in the city centre and improved information needs to be provided to the public on roads affected and duration of the disruption.

Statutory Performance Indicators

112. One of the ways of measuring council performance is through the statutory performance indicators (SPIs). Within the City of Edinburgh Council, key SPIs are already included within service scorecards. With regard to 2008/09, a total of 58 SPIs were required. These were published by 30 September 2009 and were submitted to the council’s Policy and Strategy Committee. SPIs provide a consistent form of measurement for councils to review their performance over time and to make comparisons with other councils. In overall terms, Exhibit 12 confirms that the council has made improvement in a number of areas.

Exhibit 12

- Improvements demonstrated by SPIs (Total 58 indicators)



113. Each year we review the reliability of the council's arrangements to prepare SPIs. Overall, the quality of working papers provided to support the SPIs continued to be variable. With a change in the council's SPI co-ordinator in 2008/09, there is a need to improve the arrangements for submission of the data for audit. The council was not able to report results in respect of three indicators due to new computer systems which were not yet able to produce the required data: public access, asset management and academic achievement. In addition, two indicators continued to be classified as unreliable: usage of swimming pools and other leisure facilities. It should however be noted that the council relies on external bodies to provide the data for academic achievement and the use of pools and leisure facilities.

Equality and Diversity

114. In 2008, we published a study examining how councils responded to their race equality duty, *The impact of the race equality duty on council services.*

115. This study found that all councils have developed policies and processes on race equality. A number of initiatives are in place to meet the diverse needs of local communities, such as the provision of interpretation and translation services, and information packs for recent migrants. However, councils lack information about minority ethnic communities, their needs and experiences. Councils are also unable to show how race equality is routinely built into the design and delivery of services.

116. City of Edinburgh Council is aiming to ensure that all of its activities comply with best practice in the field of equality and diversity. From November 2008 to March 2009, services undertook an extensive review of the current scheme. Consequently, a new equality scheme for the period 2009 to 2012 entitled ‘Fairness and Respect’ was approved in May 2009. The council has considered our report and believes that its new scheme embraces the main improvements sought and a progressive approach has been taken where possible.

Progress on delivery of the council’s best value improvement plan

117. A full review of best value and community planning was published in February 2007. In intervening years short follow-up reviews are carried out by the local auditor. The 2007 best value report highlighted that the council needed sustained action to improve community planning, refuse collection, roads, planning, educational attainment and some aspects of adult social care. The report stated that the council needed to take a more strategic approach to workforce planning and longer term financial planning, and performance information needed to be used more widely throughout the council to report on the progress of strategic initiatives and projects. The council was also advised to further develop its own improvement programme to provide a clear focus for investment priorities.

118. This year, we found that the council continued to move in the right direction but that progress is slower than anticipated. Implementation of the improvement plans in respect of social work and child protection services inspections continue to progress and are regularly reported to elected members. As reported elsewhere in this report, four significant trading operations continued to make deficits and the council has made a first attempt at preparing a long term financial plan. We would also like to highlight that the council has yet to implement the single status agreement. However, a new project manager was appointed to increase the momentum and enable delivery of the project in 2010/11.

Housing Benefit

119. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team are carrying out a programme of risk assessments of benefits services in all councils over a two year period.

120. The risk assessment of City of Edinburgh Council’s benefits service is scheduled for 2010. The self assessment exercise will be completed by 31 January 2010 and the risk assessment visit will be undertaken in March 2010.

Outlook

121. The long term and complex nature of many of the SOA outcome targets pose many challenges for performance management. For example, how can the council tell if its application of resources are making a positive difference? We recognise the challenges and whilst we have no plans to audit the outcome progress reports in 2010/11, we will pay attention to the systems City of Edinburgh Council have in place to monitor progress and take remedial action.

122. We are currently developing our approach to best value 2 by working with five pathfinder councils. Details of our new approach can be found at www.audit-scotland.gov.uk . From April 2010, we shall be rolling out the new approach to all Scottish councils. The timing of City of Edinburgh Council's best value audit will be determined by a risk assessment. We will report the risk assessment in March 2010.

123. The risk assessment will be carried out in conjunction with other scrutiny bodies. That means that not only will it determine the timing and scope of the best value 2 audit of Edinburgh, but it will also identify the timing and scope of other scrutiny work. Along with the other bodies, we intend to publish a scrutiny plan for each council covering all scrutiny activity over a three year period.

Appendix A

External audit reports and audit opinions issued for 2008/09

Title of report or opinion	Date of issue	Date presented to Audit Committee
Review of data handling and security arrangements	31/01/09	2/04/09
Strategic Audit Risk Analysis	31/03/09	2/04/09
Review of progress on the 2008/09 Action Plan	31/05/09	18/06/09
National Fraud Initiative, progress report	5/6/09	18/06/09
Housing and Council Tax Benefits – Subsidy implications	31/07/09	24/09/09
Report on financial statements to those charged with governance	30/9/09	24/09/09
Audit opinion on the 2008/09 financial statements	30/9/09	24/09/09

Appendix B: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1.	8	**Significant trading organisations** Four of the STOs continue to return cumulative losses. ***Risk: The council and service users may not be achieving best value from current arrangements from services provided by those STOs.***	<u>Refuse Collection</u>: In 2008/09 the STO produced a surplus of £0.155m and the cumulative position improved by £2.5m. Further improvement is expected this year on the three-year position, although the industrial dispute will have an impact on the rate of improvement. The service will be market tested in 2010/11.	Waste Services Manager	On-going
			<u>Direct Cleaning and School and Welfare Catering:</u> have returned losses as a result of equal pay payments – had these not been incurred, cumulative surpluses would have been reported.	Director of Corporate Services	On-going
			<u>BlindCraft</u>: A review of BlindCraft is currently being undertaken . An initial report went to the council's corporate management team (CMT) in September 2009 which set out the options that are being considered, progress to date and the financial implications. Discussions are ongoing with staff and the trade unions. A further report will be going to CMT in November followed by a report to members. The key decision to be made is the level of contribution that is appropriate for a sheltered workshop. This report will be considered in the development of the 2010/11 budget.	Director of Health and Social Care	On-going

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
2.	9	**Governance statement** Improved mechanisms need to be put in place to collate council and group assurances. ***Risk : Incomplete governance arrangements result in financial loss, service failure or reputational damage.***	The recent changes to company arrangements will enable this to be addressed by having fewer companies to review.	Chief Internal Auditor	May 2010
3.	10-11	**Working papers** Working papers to support the accounts are inconsistent across services and in specific important areas failed to provide an adequate audit trail. ***Risk: Additional work is required which may result in late delivery of the audit opinion.***	Further improvements are planned to the working papers process, including more detailed roll-out to business support teams and clarity on what constitutes back-up and audit trail. Feedback meetings on the 2008/09 process will be held with relevant officers.	Principal Finance Manager – Corporate Accounts	February 2010
4.	17	**Revaluation of council house stock** The council does not use Existing Use Value – Social Housing (EUV-SH) to value its housing stock. ***Risk : The value of the housing stock in the accounts does not comply with the new IFRS code and therefore the accounts do not present a true and fair view.***	The council house stock will be revalued for 2010 to the IFRS requirements which are expected to be in finalised form in December 2009. The current methodology uses the Beacon principle based on right to buy values. LASAAC issued guidance in July 2009 that the use of right to buy sale prices was not consistent with the draft code. The RICS requires the professional valuer to decide upon the appropriate methodology rather than prescribe adherence to a specific valuation approach. In September 2009 CIPFA/PWC issued 'IRFS Transition in Scottish Local Government – Implementation Notes' which advises that the following are the most common approaches for Council Dwellings:	Estate Manager (City Development)	March 2010

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			▪ Discount Factors for Social Housing. ▪ Income Stream (Discounted Cash Flow) Approach. We are consulting with valuers in other Scottish Authorities through the ACES Valuation Group on appropriate methodology. This will lead to valuers taking a consistent approach through an awareness of the IFRS code, valuation methodology and the effect of data interpretation and assumptions.		
5.	31	**IFRS** The council does not have a detailed project plan for implementing IFRS. ***Risk: The council does not produce IFRS compliant financial statements; the council incurs additional audit fees***.	The council has entered into a partnership agreement with CIPFA / Price Waterhouse Coopers to produce IFRS compliant accounts. A project team has been nominated and a workplan is being developed. Work streams have been delegated to appropriate officers.	Corporate Finance Manager	February 2010
6.	74 - 75	**Procurement** Significant savings are anticipated from the 'Procure to pay' pathfinder. There needs to be sufficient profile for the initiative with appropriate support from the corporate management team to ensure targets are achieved on time. **Risk: Savings are not delivered.**	Regular reports on the Procurement Savings Plan are now submitted to Council Management Team. Staffing to enable development of the remainder of the Procurement Categories are now in place and Savings Plans for these Categories are now being drawn up based on examination of spend. Increased supplier engagement is also being progressed.	Head of Payments and Procurement Services	On-going
7.	76	**Single status and pay** The council has yet to implement the single status agreement. ***Risk: Initial and continuing costs are considerably in excess of budgeted levels.*** ***The council may be judged to be contravening the***	The council is in discussions with Trade Unions on the implementation of single status. Working towards achieving the budgeted cost level, if possible. However, the final cost will not be known until the pay structure is implemented and any grading	Head of Human Resources	On-going

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		equal pay act.	appeals are resolved. Directions from the Director of Finance are that any costs in excess of budget must be offset by efficiency savings. The overall aim of all work commitments is to ensure that all pay inequalities are resolved on implementation of the new pay structure. An external gender impact assessor from Strathclyde University will assess all pay proposals to provide an independent view of the outcome.		
	77 - 78	The HR service centre and payroll need to be co-located under one management structure with an agreed partnership agreement. ***Risk: Clear lines of responsibility are not in place leading to fraud and error.***	Heads of Service for Payments & Procurement Services (P&PS) and HR have agreed to the Integration of Payroll and HR transactional services. This is expected to be delivered in financial year 2010/11.	Heads of Service for P&PS and HR	December 2010
8.	84	**Work of the Audit Committee** There is scope to improve the effectiveness of the audit committee. ***Risk: The committee is not fully complying with CIPFA Audit Committee principles*** ***There is no effective scrutiny function within the council.***	The work of the Audit Committee is only one part of the scrutiny function within the Council – it will be reviewed to seek continual improvement.	Directors of Corporate Services and Finance	March 2010
9.	88	**Group governance** Improved mechanisms such as the receipt of audited accounts, existence of audit committees and the role of directors need to be put in place to safeguard the council's interests. ***Risk: Weaknesses in governance arrangements across the group result in financial loss, service failure or reputational damage.***	The recent changes in structure will be reviewed to ensure continued compliance with council policy.	Chief Internal Auditor	May 2010

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		The council does not comply with the SORP.			
10.	90	**Edinburgh Tram Project** The project faces several risks associated with the resolution of contractual problems, the ongoing validity of economic assumptions, access to the council's financial contribution of £45 million and the availability of sufficient financial information in view of the sensitivity of specific issues. ***Risk: The project is not delivered as anticipated. The council incurs financial loss and reputational damage.***	Governance structures are in place and the council is undertaking robust financial monitoring of the project.	Directors of Finance and City Development	On-going
11.	95	**Housing Benefit Subsidy** Local authority errors have been misclassified leading to subsidy thresholds being exceeded and the amount of subsidy claimed overstated. ***Risk: Subsidy may have to be repaid to the Department of Work and Pensions and /or 2009/10 subsidy estimates may be less than planned resulting in less income for the council.***	**Action Taken** ▪ All staff involved in the classification of overpayments have had refresher training – completed August 2009. ▪ Staff have moved to working on a functional basis i.e. benefits work only – commenced July 2009. ▪ Target sampling of overpayments now being undertaken by Quality Team, thereafter results/actions required are reported to Finance Management Team - commenced September 2009. ▪ Staff now suspend payment of benefit on receipt of a change of circumstance thereby minimising the amount of local authority error – commenced September 2009.	Head of Revenues and Benefits	Complete