City of Edinburgh Council

Report to Members and the Controller of Audit on the 2009/10 Audit

October 2010

AUDIT SCOTLAND

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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 five significant trading operations (direct cleaning, BlindCraft, catering services – school and welfare catering, other catering and refuse collection) to breakeven on a rolling three year basis despite action taken by management to address on-going issues. Four of these significant trading operations have made deficits for the past four years which, to some extent, have arisen from the settlement of equal pay claims. In addition, we have included an emphasis of matter paragraph in the audit report describing the significant uncertainty which exists around the future of the tram project.

In 2009/10, the council spent £2 billion on the provision of public services, with £1.6 billion on revenue services and the remainder on its capital programme. In overall terms, all services managed their budgets with all departments achieving surpluses this year for the first time. This enabled the council to return a surplus of £3.9 million after £2.3 million was contributed to unallocated balances. Plans remain on target to restore its balance to £12.8 million by 31 March 2012 representing 1% of expenditure.

At 31 March 2010, the council has £1.2 billion debt, an increase of £76 million compared to the previous year. The most significant purchase during the year was the council's acquisition of property from group companies which was undertaken as part of an overall strategy to reduce borrowing costs for the group and stabilise the financial position within EDI Ltd and Waterfront Edinburgh Ltd. The inclusion of schools PPP assets in the council's financial statements resulted in an increase in assets valued at £550 million and around £220 million of liabilities now being recognised on the balance sheet.

The tram project continued to face disruption during 2009/10 as a result of the ongoing dispute with the contractor. In an attempt to reach a conclusion, formal dispute resolution procedures were implemented in 2009. Overall, there have been 20 matters dealt with through this process which has reduced claims from the contractor by £11 million. The council has recognised that it will be difficult to deliver the full project within the overall budget of £545 million and has started to plan for a contingency of 10%. Discussions are ongoing to enable fully costed options to be prepared for elected members to assist in a formal decision being taken about the future of the tram project.

In January 2010, the council initiated a statutory process to progress the implementation of modernised pay. The majority of staff responded positively which enabled the council to proceed with plans to implement the new pay and conditions with effect from 4 October 2010. As previously reported, the new arrangements will increase the council's payroll costs by £11.5 million. Since June 2009, a pay dispute has been in progress with the refuse collection staff. While the service has been supported by the use of private contractors, in our view, this is not sustainable in the long term if the desired service improvements are to be implemented.

In general terms there are satisfactory governance arrangements in place. The Audit Committee continues to consider its role in terms of scrutiny and there is scope for it to be more involved in considering the financial statements. There has been significant coverage on the council's proposals for care and support services which has resulted in the preparation of a commissioning strategy and, more widely, a review of the council's tendering arrangements. Audit Scotland's Housing Benefit Audit identified a number of key significant risks within the service and therefore requested improvement within a short timescale. An update by the service is required within 6 months and therefore a progress report is anticipated by 31 October.

Outlook

Going forward however the council's overall revenue budget funding projections for the next three years indicate a funding shortfall of approximately £90 million. There is also the possibility of additional significant costs arising from equal pay claims. In response the council is working on a programme of savings, the first tranche amounting to £16 million was approved by council in September 2010. Other savings are being identified through the council's 5Ps framework which considers efficiencies by theme – procurement, property, processes, people and prioritisation, and the Alternative Business Model project which is progressing plans for the potential outsourcing of a range of services. In recognition of the scale of change required to meet the funding shortfall, there is a need for these major initiatives to deliver substantial savings. The likely scale of the reductions means the council faces the risk of poor morale and motivation amongst staff as well as dissatisfaction amongst some service users.

In June 2010, we submitted our final shared risk assessment and assurance and improvement plan (AIP) to the council. This document was produced by the local area network of scrutiny bodies and describes the work planned on corporate activities over the next three years. Evaluation exercises are now in progress by Audit Scotland so that lessons can be learned from experiences, improvements made to the AIP process and the level of consistency across all assessments strengthened.

From 2010/11, a separate audit opinion is likely to be required for pension fund accounts. In preparation for this, 2009/10 was treated as a shadow year during which we worked with Investment and Pensions staff to address the additional requirements so far identified for a separate audit opinion. Also, from 2010/11, local government is required to fully comply with International Financial Reporting Standards (IFRS). This will result in additional work for Finance and audit with the requirement for a restated opening balance at 1 April 2009, shadow IFRS accounts for 2009/10 and fully compliant IFRS accounts for 2010/11.

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

AUDIT SCOTLAND

October 2010

Introduction

1. This report is the summary of our findings arising from the 2009/10 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 in the last year of direct interest to the council are:

   - Improving public sector efficiency
   - Overview of local government in Scotland 2009
   - Protecting and improving Scotland's environment
   - Scotland's public finances – preparing for the future
   - Making an impact – overview of best value audits 2004-09
   - Getting it right for children in residential care
   - Roles and working relationships: are you getting it right?

3. All of these reports have been sent to the council for consideration and we have presented a number at the council's Audit Committee during the year. Full copies of the reports are available 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 his 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 2009/10, 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 2009/10 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. Five 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, other catering and refuse collection (including trade waste). Although this does not affect the overall opinion on the accounts, for several years now, we have reported a failure to comply on these services. In respect of cleaning and catering services, deficits were after meeting the costs of equal pay claims and in other cases, we are aware of remedial action being taken to minimise spending and where appropriate to try and deliver improvement. Paragraphs 68 – 71 provide further information on refuse collection and BlindCraft.

Key Risk Area 1

9. We have also included an emphasis of matter paragraph in the audit report describing the significant uncertainty which exists about the future of the tram project, in terms of cost, timing and completeness. Such a paragraph highlights a significant uncertainty, the resolution of which is dependent upon future events and which may affect the financial statements. The addition of an emphasis of matter paragraph does not affect our audit opinion as we are satisfied that appropriate disclosures covering the uncertainty have been included in the Director of Finance's foreword and in note 31 to the accounts.

Key Risk Area 2

10. We were satisfied with the disclosures made in the governance statement and the adequacy of the process put in place by the council to obtain assurances from service directors. The quality of the statement is improving and should continue to be strengthened in respect of the group when a revised operating structure is approved and implemented.

Key Risk Area 3

11. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. We continued to work in partnership with Finance regarding working papers to support the 2009/10 accounts. Overall, we found continued improvement although the quality is not yet consistent across services. Corporate Finance staff have devoted significant effort in expanding the year end instructions to accommodate audit requirements which has assisted the improvement process. More work is however required in the quality of supporting information and audit trails submitted by service finance managers.

Key Risk Area 4

12. The accounts were certified by the target date of 30 September 2010. They were presented to council on 14 October 2010 and are now available for publication. On conclusion of the audit there were a number of presentational changes made to the accounts and the Director's Foreword. In addition, changes were made to correct the classification of long and short term debtors, the treatment of capital contributions and a cut off error. Each year there are also a number of changes to the group accounts to reflect the audited results received from group companies in September. The council's 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. In accordance with the 2009 Statement of Recommend Practice (the SORP) and the council's decision to adopt some aspects of International Financial Reporting Standards (IFRS) in 2009/10, for example, the inclusion of school PPP assets on the balance sheet, the identification of leases, the reclassification of industrial properties and the revaluation of council house stock, the council amended its opening balance sheet and comparative information in the financial statements as set out below.

PPP and other prior year adjustments

14. The inclusion of schools PPP assets in the council's financial statements resulted in an increase in expenditure of £3.7 million in the restated 2008/09 income and expenditure account and with regard to the balance sheet, assets valued at £550 million and around £220 million of liabilities are now recognised at 31 March 2010 including the restatement of prior year figures. This accounting did not however impact on the council's overall outturn position.

15. In common with many councils, the City of Edinburgh Council entered into an agreement with PwC to use their financial model to calculate the fair value of the lease liability. We examined the assumptions adopted to support the model and overall, were satisfied that these were reasonable. However, in response to queries raised during the process by PwC/officers/auditors about assumptions, the discount factors used in the financial models were amended. The impact of the changes has been reflected in the audited accounts e.g. lease liabilities increased by £9 million.

16. Other changes to the prior year included:

- **Re-classification of Investment Properties in accordance with IAS40**. Where assets held assist the council in meeting its policy objectives then they should be classed as operational assets. Investment properties valued at £118 million were therefore transferred from non-operational to operational assets.
- **Non-domestic rates**. The 2009 SORP changed the accounting requirements for non-domestic rates (NDR). The arrangement between the Scottish Government and councils for the billing and collection of NDR is regarded as an agency agreement. The council is therefore required to only recognise the debtor/creditor with the Scottish Government.
- **Leases.** The council has adopted the IFRS accounting requirements for lease arrangements, early, resulting in a number of operating leases being reclassified as finance leases. The net impact on the income and expenditure account is minor while the balance sheet includes an additional £7 million within its assets and liabilities.

Council house valuations

17. In 2007/08, we raised concerns about the method of valuation adopted by the council in respect of valuation of its housing stock. In 2009/10 a revised basis of valuation using social housing was adopted. 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. Our review of the process confirmed that it was carried out using the Beacon principle, the supporting evidence was comprehensive and comparison was made with District Valuer activity across the city.

18. Having discussed the approach with other auditors, we found that different discount rates had been used across Edinburgh and the Lothians. A discount factor of 51% was used for Edinburgh while East Lothian and Midlothian adopted 24.1% and 25% respectively.

19. FRS 15 Accounting for Fixed Assets requires internal valuation activity to be reviewed by an external valuer. This involves review of a sample of properties sufficient for the external valuer to express an opinion on the overall adequacy of the valuation exercise. Although Edinburgh has made comparison with District Valuer activity, the council has not used independent valuers to validate its assumptions and approach. As full compliance with IFRS is required from 2010/11, we would suggest that Edinburgh liaise with other councils and/or engage external valuers to ensure consistency of the approach and be better placed to demonstrate full compliance with IFRS.

Key Risk Area 5

Equal pay claims and the implementation of single status

20. At 31 March 2010, the council has a provision of £36 million in respect of Equal pay compensation costs, an increase of £29 million on the previous year. In addition, the council has earmarked balances of £13.8 million to fund equal pay claims and the contingent liabilities note reflects the potential additional liability for pay protection cases with the implementation of Single Status with effect from 4 October 2010.

21. During 2009/10, the council paid out £8.3 million bringing the total payments to date to £35.7 million. Having taken account of legal advice, the increase in the provision represents the council's estimate for specific types of claims which are recommended for settlement. Such decisions are based on counsel's opinion of emerging caselaw. Further significant costs 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 became due when pay protection was implemented as part of the single status agreement.

FRS17 net pension liability

22. The council's net pension liability has increased from £276 million to £680 million based on the latest annual FRS 17 valuation update for accounting purposes undertaken by the actuary. This considers the long term view for the council in meeting its future commitments having taken employers' contribution rates and revenues generated from investments into account. The deficit arising from this valuation does not require an immediate cash injection but is intended to be funded by increased contributions over the long term. The deficit arises from the difference between the fair value of the council's share of the assets and the present value of the obligations. Exhibit 1 shows the increase in Edinburgh's deficit over the last 3 years.

Exhibit 1

- FRS 17 Net pension liability/Deficit

	2009/10	**2008/09**	**2007/08**
Fair value of assets	1,417,285	1,038,934	1,296,168
Liabilities - present value of defined benefit obligation	(2,096,893)	(1,315,115)	(1,394,315)
Net pension liability/Deficit	**(679,608)**	**(276,181)**	**(98,147)**
Discount rate	**5.5%**	**6.9%**	**6.9%**

23. The assumptions used by the actuary in determining the FRS17 valuation are market based and therefore volatile. The present value of the obligations is calculated using a discount factor that reflects a high quality corporate bond of equivalent currency and term to the scheme liabilities. Exhibit 1 shows that while asset returns have increased this year, there has been a fall in the real discount rate from 6.9% to 5.5% which had a significant impact on the liabilities and therefore the deficit.

24. A review of FRS 17 and IAS 19 reporting has been carried out on behalf of Audit Scotland by PwC. This work was designed to provide support to auditors when assessing the assumptions and approach adopted by actuaries. Having considered PwC's report and other information held locally, we are satisfied the assumptions used within the FRS 17 valuation are appropriate and are considered consistent with that of the council.

Audit testing

25. 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 and pensions
- Accounts payable
- Accounts receivable
- Cash and banking
- Council tax
- Non-domestic rates
- Housing rents
- Housing and council tax benefits

Group accounts

26. 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.

Going concern

27. At 31 March 2010, the group balance sheet shows a net liability of £155 million. The main reason for this result is the inclusion of pension liabilities in respect of the council's subsidiaries and associates. Overall the additional pension liabilities account for £1.161 billion of which £943 million relates to Lothian & Borders Police. As a constituent member, the council has an obligation to meet a proportion of the expenditure of the joint boards and with regard to Lothian & Borders Police pension liabilities of £1.7 billion, the group share amounts to £943 million (56%).

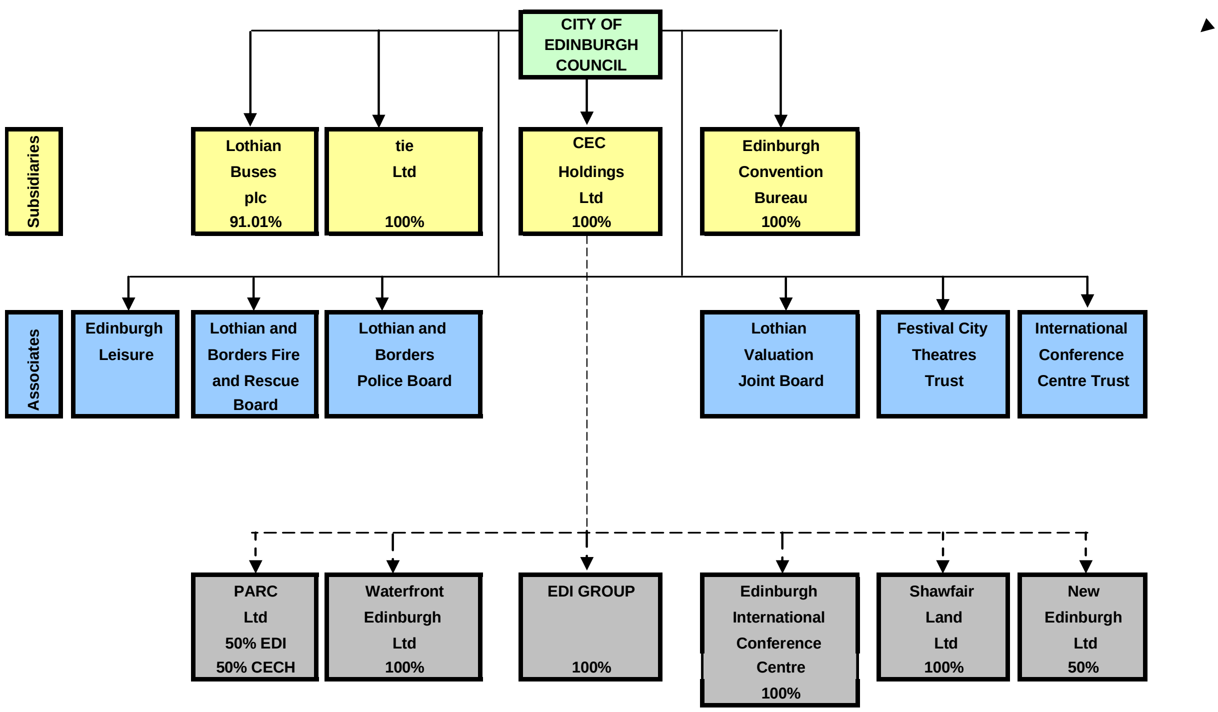
28. The council has considered the scale and reason for the net liability position and determined that it is appropriate to prepare the accounts on a going concern basis and we concur with this assessment. Whilst the deficit funding position of the pension funds indicates that the expected liabilities are not fully met at the balance sheet date, pension liabilities will be funded as they fall due through employee and employer contributions and revenues generated from pension fund investments.

29. The council has interests in four subsidiaries and a total of six associates 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 2). 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.

Subsidiaries and associates

Exhibit 2

- City of Edinburgh Council Group Structure



30. 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.
- 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 line with International Standards on Auditing (ISA) requirements, we met with external auditors responsible for the audits of the higher risk entities within the group to discuss their approach and outcome of their audits. Overall, we feel there is scope to strengthen the arrangements so that the accounting and auditing requirements for individual entities and the group can be improved. While efforts were made by the council to bring forward group reporting deadlines for 2009/10, this was achieved with limited success.
- A review of the council's group structure commenced in 2008/09 with a view to streamlining its governance arrangements. In response to the economic recession, the focus was on stabilising the financial position of EDI and Waterfront Edinburgh Limited. While discussions have continued in 2009/10, the council has not yet made a final decision on a revised structure for its group.

Key Risk Area 6

- During the year the council purchased £61 million of EDI Group assets and £7.5 million of Waterfront Edinburgh Limited's assets which have now been included in the council's balance sheet under other land and buildings. Following the council's acquisition, the assets were revalued to £82 million, an increase of £13.5 million. In order to reduce the overall bank lending costs of the group, the council acquired the assets as part of a strategy to stabilise the financial difficulties being experienced by these companies following the economic recession. In both cases the assets were acquired using prudential borrowing with rental streams anticipated to meet borrowing costs.

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

Trust funds

32. 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. For 2008/09, the council provided OSCR with a document comprising a Trustee' annual report and summary financial information for all the trusts for which the council is responsible. This will be repeated for 2009/10.

33. 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. Following detailed discussion with OSCR, the council approved the transfer of its poverty related trusts to external charities in June 2010. This will significantly reduce the number of trusts administered by the council and in future, OSCR's filing of accounts requirements will therefore be much less onerous for the council.

Legality

34. 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

Full compliance with International Financial Reporting Standards (IFRS)

35. Local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2010/11. As already mentioned in paragraph 13, the council has adopted some aspects of IFRS in 2009/10. With regard to 2010/11, the council will require to prepare:

- a comparative opening balance sheet as at 1 April 2009
- shadow IFRS compliant accounts based on the 2009/10 financial statements
- 2010/11 financial statements including group accounts on a fully IFRS compliant basis
- accruals which recognise material untaken holiday pay.

36. We will continue to work with Finance to ensure that the opening balance sheet and shadow accounts are reviewed prior to 31 March 2011. This should identify any issues which need to be addressed before the preparation of IFRS compliant accounts for 2010/11.

Key Risk Area 7

Pension funds

37. The Scottish Government is consulting on the requirement for a separate audit opinion for pension fund accounts in place of the existing arrangements where the audit is carried out as part of the administering council's audit. This requirement is likely to apply for financial year 2010/11. In preparation, we have treated 2009/10 as a shadow year during which we aimed to identify the additional audit requirements for a separate audit opinion. Discussions were held with officers covering our audit requirements and interim reporting arrangements were agreed. For 2009/10, we reported to the council's Audit Committee as the body charged with governance but plans are in place to engage with the Pensions and Trusts Committee to ensure there are appropriate governance arrangements for the separate audit in the longer term.

38. In October 2010, Lord Hutton provided his interim report on behalf of the Independent Public Service Pensions Commission. The report sets out a comprehensive analysis of public sector pensions, the challenges faced by the sector and the four aspects which need to be addressed:

    - affordability and sustainability of pension provision
    - adequacy and fairness - providing an adequate level of retirement income with a reasonable degree of certainty.
    - supporting productivity by removing barriers to the movement of employees e.g. implications for outsourcing and third sector service provision
    - transparency and simplicity for scheme members and taxpayers.

39. Lord Hutton's final report, expected in 2011, will set out options for each of those aspects. With a rise in scheme members' contributions and a change in the basis of the scheme from final salary to career average among the issues being considered, the report is likely to have significant implications for the Local Government Pension Scheme.

Use of resources

Financial results

40. In 2009/10, City of Edinburgh Council spent £2 billion on the provision of public services. Almost £1.6 billion was on revenue services and the remainder was spent on capital. The council's income and expenditure account shows net operating expenditure in 2009/10 of £1.082 billion. This was met by central government and local taxation of £998 million, resulting in an accounting deficit of £84 million, 7.8% of the net operating expenditure for the year.

41. After taking account of statutory adjustments and a contribution from reserves, the actual funding outturn was £999.7 million against a revised budget of £987.2 million (Exhibit 5). The budget set for 2009/10 was based on a Band D council tax level of £1,169.

42. A favourable outturn of £3.9 million was made by the council for 2009/10 with all six departments returning underspends. This is a significantly different result from previous years when we focused on the overspends reported by some frontline services. Exhibit 3 demonstrates the improved position for 2009/10. In setting the budget for 2009/10, the council was aware of the funding gap in respect of 2010/11 and beyond. With ongoing pressures such as the implementation of modernised pay and the handling of equal pay claims, more savings are required. Given the scale of the challenge, it was therefore accepted that new models of business and service delivery needed to be considered. The 2010/11 budget process launched the Alternative Business Model project.

Exhibit 3

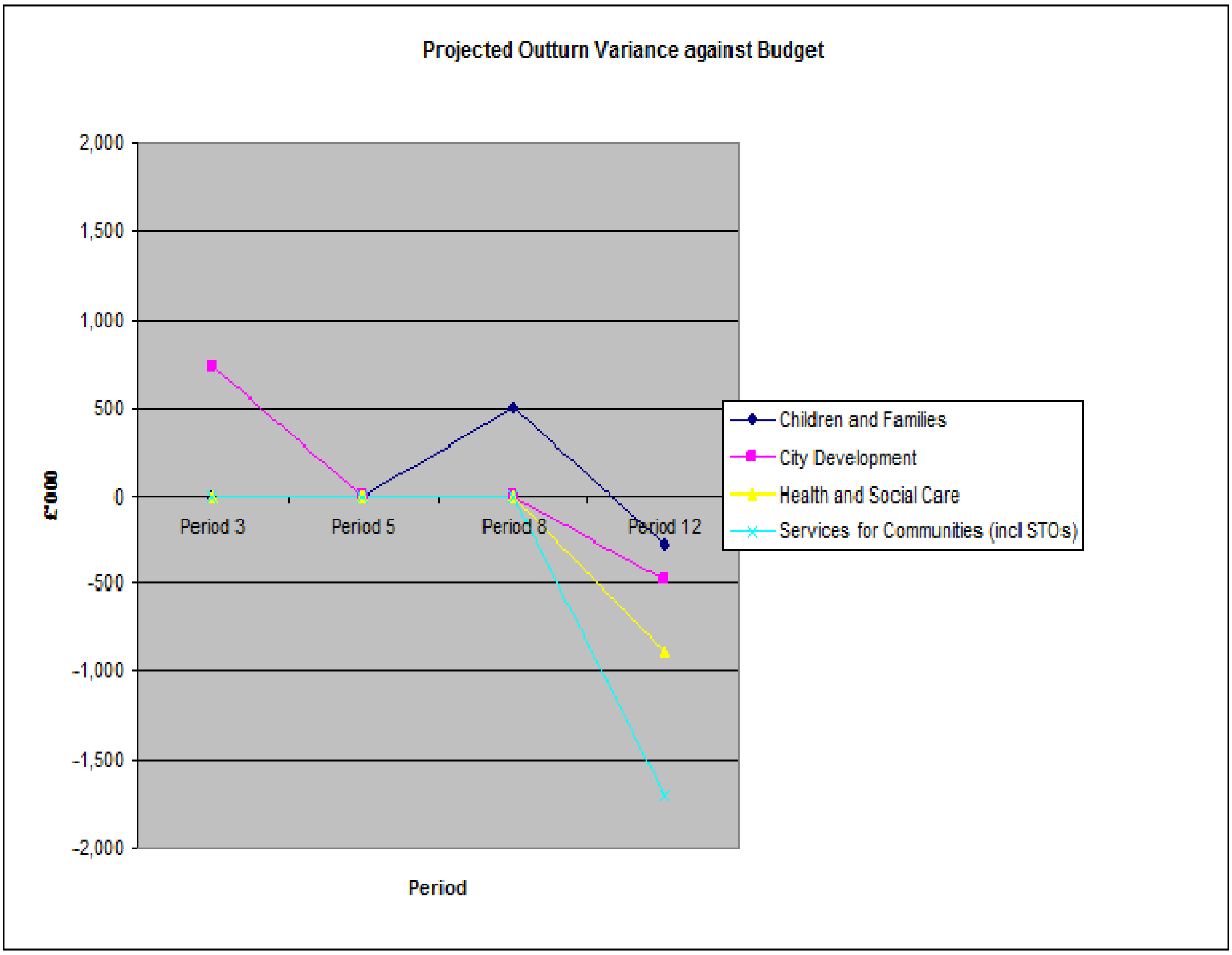
- Service (underspend)/overspend

	2009/10 £million	2008/09 £ million	2007/08 £ million	2006/07 £ million
Children and Families	(0.3)	2.3	4.1	9.6
City Development	(0.5)	0.7	0.6	2.8
Health and Social Care	(0.9)	(0.4)	4.9	2.3

43. Exhibit 4 shows the departmental projected results reported on a regular basis to members and highlights the tight management of costs during the year.

Exhibit 4

- 2009/10 projected outturn figures



44. Exhibit 5 shows that the council funded additional expenditure of £10 million between setting its budget in February 2009 and its revised budget position in January 2010, and a further £9 million by the close of the financial year. The council received additional funding through redeterminations from the Scottish Government and was therefore in a position to increase budgets. In overall terms the council experienced a surplus of £3.9 million against its revised budget. This was achieved through tighter expenditure control by services leading to a greater focus on priorities and the identification of savings.

45. In addition, a £7 million benefit from treasury management processes was delivered as a result of lower interest rates and a reduction in the provision for non-collection of council tax. Combined these items were used to fund increased expenditure for equal pay claims and housing benefits.

Exhibit 5
- Outturn against budget 2009/10

	Outturn £000	Revised Budget £000	Approved Budget - Feb 2009 £000	Outturn variance £000
Children and Families	369,882	370,161	368,028	(279)
City Development	25,490	25,970	27,124	(480)
Health and Social Care	168,503	169,387	168,052	(884)
Services for Communities	136,804	138,497	136,355	(1,693)
General Fund Services	**865,180**	**869,052**	**862,541**	**(3,872)**
Total expenditure to be funded	995,778	987,208	977,090	8,570
Funding	(999,666)	(987,208)	977,090	(12,458)
General Fund Surplus	**(3,888)**	**0**	**0**	**(3,888)**

Reserves and balances

46. Exhibit 6 shows the balance in the council's funds at 31 March 2010 compared to the previous year. Funds include a capital fund which may be used to defray capital expenditure or repay loan principal, and a renewal and repairs fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets. At 31 March 2010, the council had total funds of £110.5 million, an increase of £17.7 million on the previous year.

Exhibit 6
- Reserves

Description	31 March 2010 £ Million	31 March 2009 £ Million
Capital Fund	22.5	22.9
Capital Grants Unapplied Account	1.1	Nil
Renewal and Repairs Fund	13.8	10.3
General Fund (including earmarked balances)	73.1	59.6
	110.5	**92.8**

47. The general fund increased by £13.5 million during the year to a balance of £73.1 million which equates to 6.75% of the council's net operating expenditure. Of this balance £64.1 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 £9 million (2008/09 £6.5 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 (approximately 1% of net expenditure). During 2009/10 a planned contribution of £2 million was made to the general fund in line with this strategy.

Financial position

48. Exhibit 7 provides some information about the council's financial position compared to other Scottish councils.

Exhibit 7

- Budget comparison

Ratio	Description	City of Edinburgh Council 2008/09	City of Edinburgh Council 2009/10	Range for mainland Scottish Councils
Working capital (Current assets as a ratio of current liabilities)	This is an indicator of the council's ability to pay its current liabilities in the short term	**1.05** 304,932 / 291,431	**1.13** 322,485 / 284,875	0.33 to 2.48
Useable reserves as a percentage of general revenue expenditure	This shows the proportion of revenue expenditure that could be met from i) useable reserves	**9.09%** 92,846 / 1,021,146	**10.21%** 110,495 / 1,082,203	4 – 20%
	ii) useable reserves excluding earmarked balances	**3.89%** 39,743 / 1,021,146	**4.18%** 45,271 / 1,082,203	Local ratio calculated to reflect that the majority of the general fund balance is earmarked for specific use.
Long term borrowing compared to tax revenue	This ratio illustrates the proportion of a council's tax related income that would be needed to pay off long term debt (excluding housing debt which has a separate income stream)	**4.96** 1,208,237 / 221,998	**3.61** 1,438,191 / 238,523	0.48 – 6.79
Long term assets compared to long term borrowing	This gives an indication of the ability to borrow to replace or repair assets	**2.47** 2,992,471 / 1,208,237	**2.34** 3,368,197 / 1,438,191	1.78 – 7.55

49. These ratios give a partial indication of the liquidity and financing position of the council. In making comparisons between councils, there are a number of factors which affect the indicators. These include the council's group structure, asset management arrangements (e.g. housing stock transfers) and financial strategies. For example, Edinburgh's ratios, as calculated in Exhibit 7, reflect instances of borrowing which are supported by business cases, approved on the basis that the borrowing would produce savings in the long run (e.g. the purchase of the council's headquarters at Waverley Court) or separate income streams had been identified to cover the costs of the prudential borrowing (e.g. the acquisition of rental properties from group companies).

50. We have compiled this information for the first time this year to establish a starting point which can be monitored in future and trends identified. The council should consider whether the ratios indicate any areas for further consideration within the context of its financial strategies.

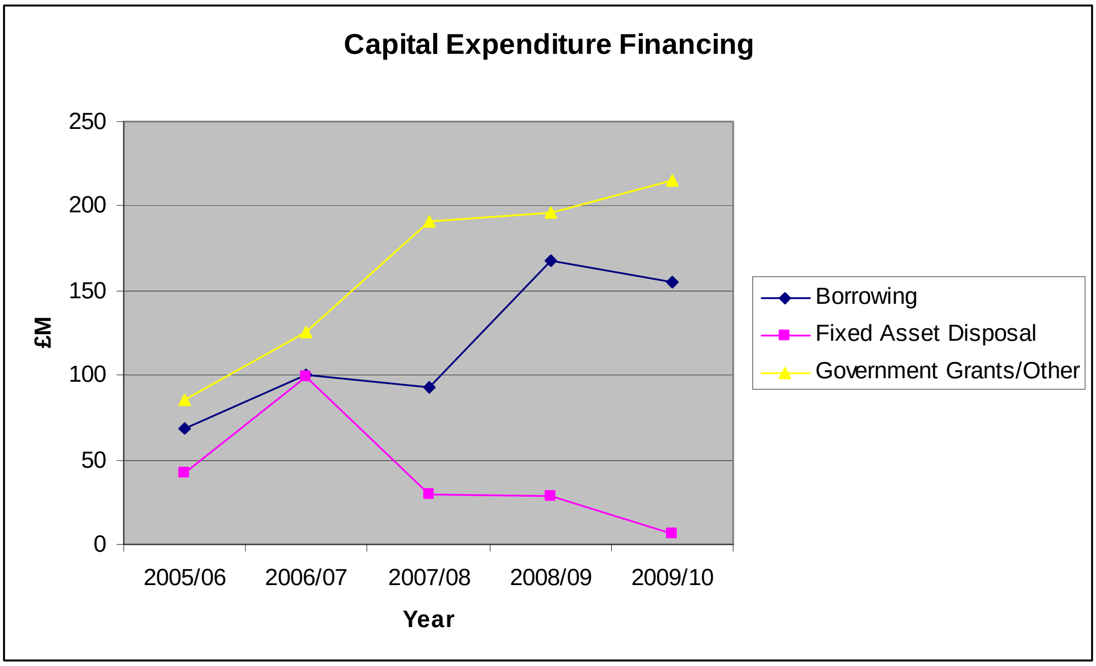
Capital performance 2009/10

51. The council's prudential indicators for 2009/10 were set in February 2009. Capital expenditure in 2009/10 totalled £377 million, a reduction of £15 million from 2008/09. The council's practice has been to manage its capital programme by over programming projects in the knowledge that all projects will not proceed in accordance with plans. For 2009/10 capital plans also felt the impact of the economic recession as the council was unable to generate the anticipated level of capital receipts. The capital programme was therefore re-prioritised to address a funding shortfall of £55 million. The tram project is likely to put further pressure on available funding options.

52. The trend in sources of funding for capital financing is reflected in Exhibit 8.

Exhibit 8

- Sources of finance for capital expenditure 2005/10



Borrowing

53. All borrowing undertaken by the council should be in accordance with the Prudential Code which requires the council to demonstrate that it is affordable and sustainable. At 31 March 2010, the council had £1.2 billion debt, an increase of £76 million compared to the previous year.

54. Exhibit 9 sets out an analysis of the council's treasury management activity for 2009/10. This analyses the increase in borrowing and shows a significant movement away from short term borrowing to the longer term. The main reasons for the increase in long term borrowing were as follows:

- the council's acquisition of property from group companies - EDI Ltd and Waterfront Edinburgh Ltd – as described in paragraph 30, final bullet. The council however anticipates that rental income streams from these properties will exceed the associated borrowing costs.
- the conversion of short term borrowing of £42 million to longer term debt. This amount was originally borrowed to fund the purchase of Waverley Court in 2008/09 and its conversion to longer term debt was approved as part of the council's 2009/10 borrowing strategy.
- In order to take advantage of low interest rates, £6 million of the 2010/11 funding requirement was borrowed at the end of 2009/10.

Exhibit 9

- Analysis of Edinburgh's treasury management activity

	2008/09 £000s	2009/10 £000s	Change £000s
Borrowing as at 31st March			
Short term borrowing	64,742	28,029	(36,713)
Long term borrowing	1,100,284	1,213,186	112,902
Total borrowing	1,165,026	1,241,215	76,189
Cash Fund – Deposits			
Short term investments held by cash fund as at 31st March	142,035	161,862	19,827
Additional income from cash fund activities compared to industry benchmark	1,920	997	923
Impact on Budget arising from Treasury Management activities			
Reduction in council's loan charges/interest on revenue balances against budget	5,030	6,925	1,895

55. The council achieved approximately £1 million additional income compared to industry benchmark for performance of its cash fund investments. In addition, the council undertook two debt restructuring packages during the year which resulted in annual interest savings of approximately £0.5 million.

Longer term debt totalling £51 million at an average interest rate of 4.34% was replaced by shorter/medium term debt averaging 3.37% interest.

56. For 2009/10, the council incurred loan charges (which included interest and repayments of debt) of £119 million which represents 11% of the council's net operating expenditure. The council has a significant level of debt which needs to be monitored as part of its overall financial strategy. Repayment plans are kept under review to ensure that the council is in a position to continue to demonstrate that its level of borrowing is both affordable and sustainable.

57. As at 31 March 2010, the City of Edinburgh Council held cash and temporary investments totalling £162 million of which £123 million related to the council and the remainder was held on behalf of tie Limited. For the council, this represents an increase in cash held at the year end of £30 million compared to prior year. As shown by Exhibit 6, there has been an increase in useable reserves of £17 million and as stated in paragraph 54 (final bullet), the council took advantage of favourable interest rates to bring forward borrowing in respect of 2010/11 requirements.

58. 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

59. The council is responsible for the management and administration of two pension funds: the Lothian Pension Fund and the Lothian Buses Pension Fund. £967 million (2008/09 £585 million) of the Lothian Pension Fund (31%; 2008/09 26% of total fund investments) is managed in-house, and the rest externally. With regard to Lothian Buses Pension Fund, £38 million (17%) is managed in-house compared with less than one percent the previous year. The value of the investment assets are illustrated in Exhibit 10.

Exhibit 10

- Pension Fund Investments

	31/03/07 £000	31/03/08 £000	31/03/09 £000	31/03/10 £000
Lothian Pension Fund	3,101.6	3,026.7	2,417.2	3,305.6
Lothian Buses Pension Fund	196.8	198.8	163.4	232.1

60. The effects of the economic climate significantly impacted on pension fund investments over 2008/09. This position however reversed during 2009/10 with improved market conditions and returns more in line with or above benchmark. With regard to Lothian Pension Fund, annual investment monitoring

noted disappointing performance from the fund managers in general. This will be monitored by the Investment Strategy Panel and if appropriate, a more in-depth review will be carried out. Exhibit 11 shows the 2009/10 return against benchmark while Exhibit 12 shows performance for the last 10 years.

Exhibit 11

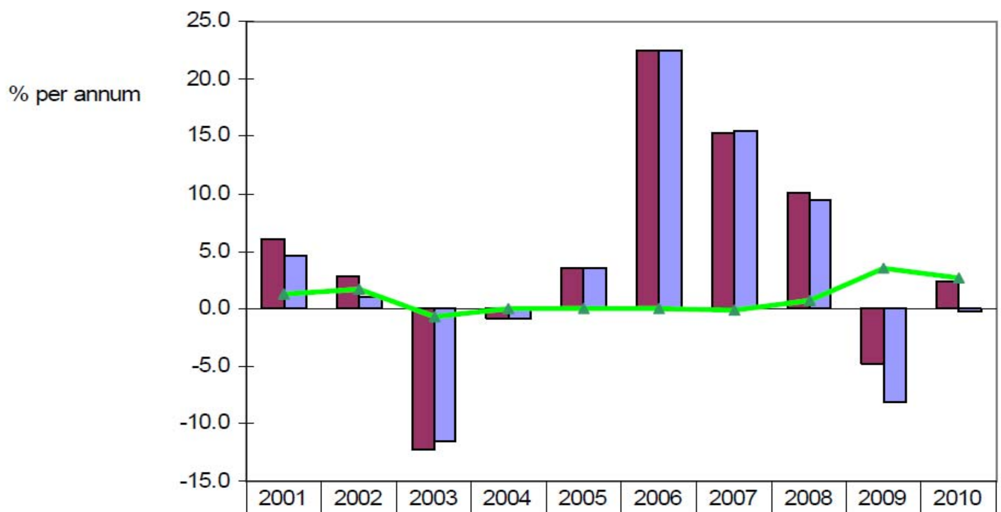
- Lothian Pension Fund – fund and benchmark return 2009/10

	30/06/09 %	30/09/09 %	31/12/09 %	31/03/10 %	Annualised return %
Lothian Pension Fund	5.1	15.3	3.4	7.3	34.5
Benchmark	7.7	16.2	4.2	5.4	37.5
Lothian Buses Pension Fund	6.0	18.0	5.5	8.1	42.6
Benchmark	6.6	17.3	4.1	7.7	40.0
Scottish Homes*	4.8	11.5	2.3	4.3	24.6
Benchmark	5.0	11.2	2.1	4.5	24.6

* 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.

Exhibit 12

- Lothian Pension Fund – rolling 3-year performance



	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
LPF	6.0	2.8	-12.2	-0.9	3.5	22.5	15.3	10.1	-4.8	2.5
BENCHMARK	4.6	1.0	-11.5	-0.9	3.5	22.4	15.5	9.4	-8.1	-0.2
RELATIVE	1.3	1.7	-0.7	0.0	0.0	0.0	-0.2	0.7	3.6	2.7

Financial planning

61. At a corporate level, the council has many challenges to address over the next three years in particular the need to deliver an estimated £90 million funding shortfall, manage the impact of implementing modernised pay, address anticipated equal pay claims, fund any overrun on the tram project and stabilise the financial position of group companies. We have highlighted this as a significant risk for the council as the level of change required is on a greater scale than anything previously experienced by the council. Difficult decisions lie ahead and the council has already reported that a reduction in staff cannot be avoided. An initial tranche of savings totalling £16 million was approved by council in September 2010 with further proposals being considered as part of the 2011/12 budget setting process. The Alternative Business Model project continues to work towards market testing a range of corporate and environmental services e.g. payroll, revenues, refuse collection, ground and road maintenance, with a view to implementing major service redesign and delivering significant savings in the longer term.

Procurement

62. The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and to deliver value for money and increased efficiency through improved structures, capability and processes. In 2009, the Scottish Government promoted the use of an annual procurement capability assessment (PCA) to assess procurement performance in all public sector bodies and as a basis for the sharing of best practice and continuous improvement. Results are summarised as non-conformance, conformance, improved performance and superior performance

63. The City of Edinburgh Council is a conforming council with an overall score of 25% which is above the Scottish average of 22.6%. Within a framework of eight categories, Edinburgh was above average in 4 categories, average in 3 categories and below average in the one category as set out in Exhibit 13. The council has an improvement plan in place which we will monitor as part of the 2010/11 audit.

Exhibit 13

- Procurement Capability Assessment – classification of Edinburgh's scores

Above average (4)	Leadership and governance, key purchasing processes and systems, people and performance management.
Average (3)	Specification of goods and services, sourcing strategies and collaborative procurement, contract and supplier management
Below average (1)	Strategy and objectives

64. The council's arrangements for delivery of care and support services are referred to in paragraphs 77 – 81.

65. Improved procurement arrangements are an important element of the council's savings and efficiency plans. In August 2010, the council's 2009/10 Annual Efficiency Statement identified £3.4 million savings from procurement compared with an anticipated £4.6 million reported in the Procurement Savings Plan update provided to Finance Management Team in May 2010. We found it difficult to follow the audit trail between estimated savings reported during the year and actual savings achieved. For example, on an ongoing basis, estimates of savings are calculated for contracts being reviewed and/or awarded but details of the calculation are not always retained.

66. It is important that actual savings, estimates and savings targets built into budgets are supported by detailed calculations and that actual amounts are reported alongside estimates and targets to ensure that assumptions made are confirmed and/or revisions made to future estimates. This will provide opportunities for greater scrutiny of performance by both management and members.

Managing people

67. The council finally implemented single status with effect from 4 October 2010. It was the last Scottish council to implement the agreement and this was partly because the council decided to implement it as part of a wider modernising pay project. Nonetheless, trade union negotiations proved difficult and it was necessary for the council to initiate a statutory process in January 2010. In June 2010, 13,500 staff were invited to agree to the changes on a voluntary basis, 9000 accepted and the remainder were issued with a statutory notice of dismissal along with an offer of re-engagement. Overall, only a handful of staff did not accept the new terms and conditions.

Statutory Trading Operations (STOs)

68. In paragraph 8 we highlighted the STOs which failed to breakeven. Some of the activities e.g. cleaning and catering services, are expected to breakeven on final settlement of equal pay claims. We would however draw specific attention to refuse collection and BlindCraft where this is not the case.

69. **Refuse collection**: In 2007, Edinburgh's Best Value Improvement Plan included as a high priority the need to agree a timetable for market testing the refuse collection service. While a transformation plan has been in place and the level of deficits made by the service has reduced, single status had not been implemented and therefore it is more difficult for the council to demonstrate the competitiveness and relative performance of the service. In spring 2010, the council issued an Official Journal of the European Union (OJEU) notice covering refuse collection and other services identified by the Alternative Business Model Project for market testing using a competitive dialogue process. A report on the outcome of the initial stage of that dialogue process is scheduled to be considered by council in November 2010.

70. Since June 2009, there has been a pay dispute affecting the refuse collection service. Final negotiations with trade unions have recently been unsuccessful. In order to progress planned service improvements, management wish to implement revised job descriptions. If this cannot be achieved by negotiation, it is possible the council will initiate a statutory process. We understand that planned

improvements linked with potential savings cannot be progressed until the pay dispute has been resolved. In the interim the service has been supported through the use of private contractors which has added £3 million to the cost of the service. These have largely been contained within departmental contingencies and a reduction in previous overtime levels.

71. **BlindCraft**: For some time the council has been examining options to reduce its subsidy to the organisation including an extensive dialogue with trade unions to reduce costs in this area. In February 2010, the Audit Committee also considered a report on the STO's activities and costs. In line with a previous budget motion, the council however intends to reduce its subsidy to BlindCraft by £700,000 for 2011/12 onwards. Proposals to progress this action are currently out for consultation. In the current economic climate, BlindCraft has experienced a downturn in demand. The proposed funding reduction will therefore have a further significant impact on the STO's trading ability.

Shared services

72. The Accounts Commission has previously commented on the lack of progress in developing shared services. 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. As reported last year, progress to date has been limited and crystallisation of these discussions into actions still seems a long way off.

Outlook

73. Clearly we are in a period of reduced economic growth with significant implications for the council's resources and the demand for services. At the same time as the council tries to support its local economy and provide best value services, it is likely to face a severe reduction in resources. The council needs to continue to plan for reduced resources over the medium term. Decisions will be needed soon to deliver cost reductions in a managed way.

Governance and accountability

Introduction

74. 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.

Structure and policies

75. 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. Building upon these principles, in 2009/10 committee members have placed more emphasis on learning and development opportunities through the receipt of short presentations on specific topics in advance of each committee meeting e.g. housing repairs, developers' deposits and the National Fraud Initiative.

76. We would however highlight the following matters as areas of work where the committee need to focus more attention:

- while the committee reviews the proposed audit opinion and considers matters arising from the audit of the financial statements, our view is that there is insufficient briefing and consideration of the content of the financial statements. The main financial focus within the council continues to be the revenue budget outturn reports. Due to the timetable for council meetings and the committee cycle, it has been difficult to allocate dedicated time for councillors to consider the council's financial statements. In order to comply with IFRS, there will be further significant changes to the financial statements in 2010/11 as notified to the Audit Committee in February 2010 in an initial paper from Finance. In order to fully comply with CIPFA principles for Audit Committees, further training should be provided on the content of the financial statements to enable members to more fully challenge officers on the reported figures.

- the committee has regularly discussed how it can keep track of critical issues and action points arising from the business of the committee. We have also previously reported on the need for a more formal process to provide the committee with assurance that recommendations are being implemented and making a difference. We feel there is scope for a more formal process of tracking and follow up by the committee to ensure it obtains its necessary assurances.

Key Risk Area 8

Care and support services

77. The council's arrangements for delivery of care and support services has been the subject of much debate and review since its decision in February 2010 not to award any contracts but to review the tendering arrangements. As a result of the tendering process in 2009, many service users opted for a change to direct payments enabling them to purchase their own care and therefore retain current service providers. An increase in the number of service users on direct payments would reduce the potential number receiving services through a formal contract. This therefore seriously impacted on the assumptions forming the basis of the proposed contracts.

78. The council undertook an in-depth 'lessons learned review' on the handling of the proposals for the tendering of care and support services. This was considered by the Policy and Strategy Committee in June 2010 and referred to the Audit Committee for detailed scrutiny. Throughout the period of review and beyond, the council continued to provide existing levels of care to service users across the city.

79. The council had not anticipated the extent of public reaction it received indicating flaws in the communication and consultation mechanisms around this project. There were also weaknesses in project management which was exacerbated by the size of the project and the fact it extended across several services. There are similarities with the review of the Craigroyston school project two years ago which was hampered by poor project management. On that occasion, project management procedures were strengthened for all large/sensitive projects through the issue of new guidance which was shared with members and considered by the Audit Committee.

80. In addition to the 'lessons learned', we also understand that the Head of Legal and Administration Services is undertaking a review of the council's current tendering practices with a view to identifying best practice proposals by December 2010. One of the main activities currently being undertaken is the development of a commissioning strategy which will set out the framework in which such services will be procured and delivered. This was expected to be considered by the Policy and Strategy Committee in October but due to ongoing consultation has been delayed to a later meeting.

81. With reference to care and support services, the Edinburgh Local Area Network identified tendering arrangements as an area of concern within the Assurance and Improvement Plan. This is an area we will undertake further scrutiny work on as part of the 2010/11 audit.

The Edinburgh Tram Project

Contractual difficulties

82. In our report on the 2008/09 audit, we referred to the contractual difficulties which disrupted the tram project to the extent that dispute resolution procedures were implemented in order to progress matters to a conclusion. Negotiations following this formal contractually-led approach continued throughout 2009/10 and are ongoing as at October 2010.

83. Since the beginning of the project, 20 matters were escalated to be handled by the dispute resolution process (DRP) as summarised in Exhibit 14. In total, the application of the process has reduced the consortium's claims for additional payment by £11 million. Overall, the outcome from DRP has produced mixed results. While the outcome has clarified interpretation of the contractual position on these matters, it has required significant commercial and legal support.

Exhibit 14

- Dispute resolution process

Dispute resolution process	Number
Resolved by negotiation	3
Resolved by external mediations	3
Referred for external adjudication	9
Negotiation in progress	5
Total	**20**

84. Since August 2009, a detailed report to council covering all possible contractual options has been anticipated. This was scheduled to be considered on a number of occasions, but each time it was not delivered due to sensitivities around the ongoing dispute negotiations. As alternatives, the council was provided with project update reports covering interim progress and developments on a range of issues. Discussions are currently ongoing to enable fully costed options to be prepared for elected members. Members envisage that this information will be available to allow the council to make a decision about the future of the tram project in December 2010.

Key Risk Area 2

Funding

85. The funding package agreed for the tram project was split between the Scottish Government (£500 million) and the council (£45 million) with any additional cost beyond the capped amount of £545 million to be funded by the council. The Scottish Government's financial contribution was set out in its grant offer letter.

86. In June 2010, the council indicated that it was unlikely the full cost of phase 1a could be delivered for £545 million and began to plan for a contingency of 10%. However there was, and still is, a lack of clarity on the programme and associated costs. The council is examining contingency planning options up to a capital cost of £600 million. In light of these circumstances, the council is continuing discussions with Transport Scotland to review the grant offer letter and the current conditions, taking cognisance of possible outcomes of ongoing dialogue with the consortium.

87. The council has so far secured £16 million of its original £45 million share. The accumulated amount of developers' contributions is not at the level originally expected due to the effects of the recession. The council is therefore exploring options for further funding under the prudential borrowing framework. The

council's funding strategy in respect of the tram project is reviewed on a six monthly basis and the results reported to the council's Internal Strategy Group.

Expenditure and progress

88. At 31 March 2010, the cumulative cost incurred on the project over the last 3 years was approximately £350 million as shown in Exhibit 15.

Exhibit 15

- The tram project: expenditure and progress

	2007/08	**2008/09**	**2009/10**	**Total**
	£m	£m	£m	£m
Infrastructure and vehicles	30.6	45.2	83.5	159.3
Utilities diversions	18.4	33.4	10.6	62.4
Design	24.4	4.7	2.1	31.2
Land and compensation	16.8	1.7	1.6	20.1
Project management and other resources	42.9	16.0	15.9	74.8
Total	**133.1**	**101.0**	**113.7**	**347.8**

89. Within the council's accounts the main elements are infrastructure assets of £310 million and assets under construction, representing the construction of the tram vehicles and a depot, totalling £30 million. The remaining amounts relate to the acquisition of land.

90. In terms of progress the council recently reported the position set out in Exhibit16.

Exhibit 16

- Elements and completion of the project

	Percentage of budget	**Percentage of project complete**
Infrastructure	46	24
Vehicles	11	60
Utilities diversions	10	95
Design, land and compensation	12	100
Project management and other resources	21	N/A
Total	**100%**	**65%**

Governance arrangements

91. During the year, several papers were submitted to the council covering the governance arrangements for the tram project. Long term plans provided for one integrated transport company in Edinburgh – Transport Edinburgh Limited (TEL). Steps were therefore taken during the year to bring existing arrangements in respect of trams and Lothian Buses under the umbrella of TEL and to establish a board of directors capable of delivering integrated transport for the city. Key decisions included:

- In August 2009, responsibility for all strategic and other material decisions was transferred to TEL. tie Limited retained responsibility for day to day management, control and execution of the tram project. Direction to tie Limited would be through the Tram Project Board, a formal sub-committee of TEL.
- In December 2009, a revised structure for the board of TEL was approved by the council which introduced representation from Lothian Buses plc.

92. The Accounts Commission and Auditor General for Scotland have asked Audit Scotland to prepare a report on the trams project for publication in early 2011. This report will use the findings reported in the annual audit reports for Transport Scotland and the City of Edinburgh Council. It is anticipated that this will be an interim report which focuses on how the project is progressing, how much it has cost to date and the key issues which need to be managed for the project going forward. It may be followed up by a further, more detailed, report by Audit Scotland in due course.

Housing benefit

93. The council administers housing benefits on behalf of the Department of Work and Pensions (DWP). The council reclaims the money paid to benefit claimants annually through a subsidy return to the DWP. In our 2009/10 report to members, we concluded that £1.5 million had been over claimed by the council in respect of 2007/08 and 2008/09 due to the misclassification of benefit overpayments.

94. Before DWP make a decision on clawback of subsidy, the final stage in the process is for them to give the council an opportunity to formally respond and raise any final matters. Consequently, in summer 2010 issues were raised about an aspect of the extrapolation exercise used within our audit so DWP permitted the council an opportunity to submit another sample of overpayments.

95. Results from the final sample increased the reported error rate from 35% to 45%. The impact on the extrapolation exercise and potential clawback of subsidy is an increase of approximately £0.135 million. This increases the potential level of clawback in respect of 2007/08 from £0.835 million as previously reported to £0.970 million. While this amount has been provided for in the council's 2009/10 accounts, a final decision from DWP is now awaited. In overall terms the council may be required to repay subsidy of £1.6 million in relation to 2007/08 and 2008/09.

96. The Head of Revenues and Benefits promptly took on board the action plan arising from the 2007/08 subsidy claim audit. Responsibilities within the benefits section were reviewed and restructured and training was carried out at all levels to ensure staff were aware of processing requirements. In early 2010, the officer was seconded to the Alternative Business Model project. Given the importance of improving the performance of the benefits service, the post had a critical role in sustaining the initial improvement and ensuring performance was raised. An assistant head of service was appointed through an internal process to take forward the service into 2010/11.

97. We are currently working on the audit of the 2009/10 subsidy claim which requires to be certified by 30 November 2010. Our initial overview of the figures as part of the audit of the financial statements confirmed that the council had exceeded the local authority error threshold. Previously the council had overclaimed subsidy because this figure had been understated due to the misclassification of overpayments. For 2009/10, the threshold has been exceeded and therefore no subsidy has been claimed or is eligible for such overpayments. While overpayments are still occurring, they would appear to be correctly classified by benefits staff. At this stage we would conclude that any clawback for 2009/10 will not be at the levels highlighted in previous years. It is important however that the council makes further improvement in its processes as it continues to lose subsidy as a result of the high levels of local authority error being recorded.

98. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team carried out a programme of risk assessments of benefits services in all councils over a two year period. The risk assessment of Edinburgh's benefits service was one of the final assessments to be undertaken in this first round of assessments. The risks were assessed in March 2010 and a detailed report was issued in April 2010 which was considered by the Audit Committee in June 2010. Risks were identified in the following key areas:

- A long standing problem with a backlog of claims processing work which was being addressed by deploying additional resources to tackle the problem. There had been an improvement since September 2009 but no assurance was given on timescale for clearance of the backlog at the time of the assessment. This had a direct bearing on the level of local authority error being reported which could result in a reduction in subsidy.
- Since April 2008, the council had been unable to measure its speed of processing performance and could not validate DWP Single Housing Benefit Extract (SHBE) reports. This differed from the experience in other councils who use the Northgate system where it had been possible to introduce local statistics to monitor claims processing performance.
- The council did not have any formal quality assurance framework in place to help improve the quality of its benefits performance.
- The council had only planned to start interventions activity in May 2010. Caseloads had not been reviewed for a number of years for possible fraud and error.

99. The outcome of the assessment therefore highlighted serious risks. In response to the council's improvement plan which indicated that most planned actions would be implemented by September 2010, Audit Scotland's Director of Audit Strategy requested that the council provide a progress update by 31 October 2010. Depending on the assessment of progress, one of the options for Audit Scotland is to progress to a full audit of the benefits service. Other councils made the necessary improvements in line with their improvement plans and within the timeframe requested by the Director of Audit Strategy. Consequently, it has so far not been necessary to advance beyond the risk assessment stage in any council.

Key Risk Area 9

Prevention and detection of fraud and irregularities

100. 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

101. 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 outcomes for Scottish public bodies (£21 million during the 2008/09 NFI cycle and £58 million cumulatively up to end March 2010). If fraud or overpayments are not identified and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.

102. The most recent data matching exercise collected data from participants in October 2008 and the national findings were published by Audit Scotland in May 2010. At that time Edinburgh had identified 66 frauds and 149 errors totalling £472,000. Recovery action was taking place in relation to 103 matches covering amounts totalling £151,000.

103. Instructions for the 2010/11 NFI exercise were issued by Audit Scotland in June 2010 and participants have recently provided the requested data at the beginning of October. The national report published in May 2010 included a self-appraisal checklist that all participants were recommended to use prior to NFI 2010/11.

Outlook

104. Looking ahead, the establishment of new ways of working provide a good foundation for planning ahead, jointly with strategic partners, and for the consideration of the joint delivery of certain services. At the same time the restriction of resources will add to the challenge in reaching decisions over priorities and attainable outcomes. This is where robust governance arrangements and clear lines of accountability will become of paramount importance.

Performance management and improvement

Introduction

105. 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.

Vision and strategic direction

106. Over the next 12 months three members of the council's corporate management team will retire including the chief executive. Challenges therefore lie ahead for the council to ensure the necessary continuity in corporate leadership from the executive team to see a number of projects through to satisfactory resolution.

107. 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. A reporting cycle for SOA monitoring has been implemented which provides six monthly reports to the Policy and Strategy Committee and annual reports to council.

Overview of performance in 2009/10

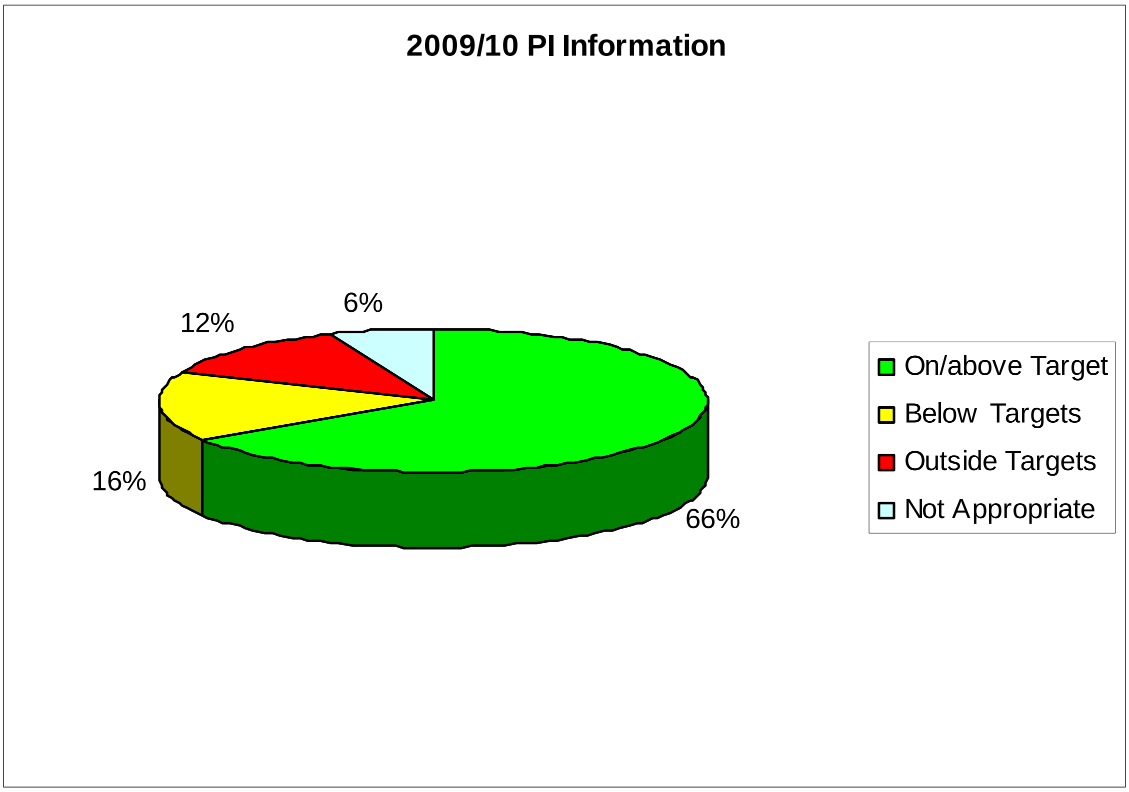
Balanced scorecards

108. The council continues to use 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.

109. Overall, 164 service indicators are reported regularly to elected members through the balanced scorecard. Exhibit 17 summarises the position as at March 2010.

Exhibit 17

- Achievement of City of Edinburgh Council's targets at March 2010



110. Areas where there is a need for improvement include responding to freedom of information requests, sickness absence and percentage of reports received by reporter within timescales.

111. The council is currently developing self-evaluation using an adapted version of the Public Sector Improvement Framework (PSIF) criteria known as the Edinburgh Improvement Model (EIM). Use of the model was piloted in Services for Communities and was also used by the council in preparation for the inspections of child protection services and housing management functions. All services are soon to complete their first round of self evaluation activity. Self evaluation is being promoted nationally as a means for councils to effectively demonstrate service improvement and therefore we will continue to monitor the council's activities in this area.

Annual report

112. The chief executive provided his annual report to the Policy and Strategy Committee in September 2010. 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 eleven targets identified as priorities in 2009. We have highlighted the following items from the chief executive's report as they are relevant to comments we have made on the topics elsewhere in this report and/or they are important priorities which we discussed earlier in the year as part of the shared risk assessment process.

Good progress made

- delivery of the Edinburgh Partnership SOA outcomes
- full implementation of the Modernising pay scheme
- resource management and budget control measures to obtain over £30million in savings in 2009/10
- taking forward the Alternative Business Models projects
- addressing the need for and providing more affordable housing

Work-in-progress

- property asset management work to address the backlog of works identified in the asset management plan
- progressing school infrastructure improvements.

Edinburgh resident survey

113. The council arranges for an independent six monthly residents survey to be undertaken. The latest was undertaken in April/May 2010. In excess of 90% stated they continue to be satisfied with Edinburgh as a place to live. Similarly there is no change in the issues residents said they were most concerned about i.e. traffic congestion and waste and recycling. The two most frequently identified reasons for dissatisfaction were the trams and negative perceptions of general management including poor use of funds and high council tax.

National Joint Scrutiny Plan and Shared Risk Assessment

114. A request from the Cabinet Secretary for Finance and Sustainable Growth, asking the Accounts Commission to take on a co-ordinating and gate-keeping role for corporate level scrutiny in councils, led to the development and publication of the National Scrutiny Plan for Local Government 2010/11. The national plan was the culmination of the shared risk assessment undertaken across all councils. Key messages from the plan included:

- compared to the level of scrutiny work undertaken in 2008, there is a 36% reduction in the planned time to be spent on strategic scrutiny work in councils in 2010/11
- 32 local area networks (LANs) of inspectors and auditors have been developed to enable all the relevant information held about an individual council to be shared
- the cyclical approach to audit and inspection activity in councils has stopped. Any cyclical work is now undertaken only as a result of specific requests by ministers e.g. child protection
- more proportionate and risk based approaches to scrutiny have been adopted by each scrutiny body.

115. This has been the first year of the new arrangements. It has been a significant exercise for all scrutiny bodies and councils involved. Evaluation exercises are now in progress by Audit Scotland so that lessons can be learned from experiences, improvements made to the process and the level of consistency across all assessments strengthened.

Outlook

116. The long term and complex nature of many of the SOA outcome targets pose many challenges for performance management. 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.

117. The Accounts Commission approved a new approach to best value in July 2010. Details of our new approach can be found at www.audit-scotland.gov.uk/work/scrutiny/index.php. The timing of City of Edinburgh Council's best value audit will be determined by a risk assessment. Initial indications are that this may be carried out in 2011/12. In addition, the AIP includes activity by other scrutiny bodies over the next three years including inspection of prison based social services, ongoing monitoring of child protection services and social work services and Social Work Inspection Agency's Initial Scrutiny Risk Assessment.

Appendix A

External audit reports and audit opinions issued for 2009/10

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan	31/01/10	01/04/10
Assurance and Improvement Plan	31/05/10	17/06/10
Review of progress on the 2009/10 Action Plan	31/05/10	17/06/10
Progress reports for consideration by the Audit Committee	Each committee cycle	1/04/10, 17/06/10, 23/09/10
Report on financial statements to those charged with governance	30/09/10	23/09/10
Audit opinion on the 2009/10 financial statements	30/09/10	23/09/10

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 operations** Five 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.***	BlindCraft - The future of BlindCraft is the subject of statutory consultation. A number of options are being considered, which will reduce the subsidy by £0.7m per annum.	Head of Social Care Performance	31/3/2011
			Refuse collection/trade waste - Financial performance has been adversely affected by industrial action and the loss of trade waste business due to the recession. In response the Council is at an advanced stage of considering Alternative Business Models (ABMs) for this service and is simultaneously progressing its internal improvement plan.	Waste Services Manager	Service improvements delivered from January 2011 on a phased basis. ABM implemented no earlier than May 2011 dependent upon council approval to go ahead with programme.
			The Direct Cleaning STO has achieved surpluses in each of the last three years totalling £1.37m. Equal pay charges of £3.614m over the same period have reversed these surpluses into deficit figures.	Direct Cleaning Manager	2012/13 (due to target being on a rolling three year basis)
			Edinburgh Catering Services – School and Welfare Catering has achieved surpluses in two of the last three years totalling £0.494m. Equal pay charges of £1.659m over the same period have reversed these surpluses into deficits.	Edinburgh Catering Services Manager	2012/13 (due to target being on a rolling three year basis)
			Edinburgh Catering Services – Other Catering has achieved surpluses in each of the last three years totalling £0.06m. Equal pay	Edinburgh Catering Services Manager	2012/13 (due to target being on a rolling three year basis)

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			charges of £0.063m over the same period have reversed these figures into deficits. In each of these last three STOs, the major equal pay settlements for female staff are likely to have been completed within the current financial year. It is likely, however, that claims from other groups will not be addressed until 2011/12 and beyond, These STOs are part of the integrated facilities management stream of ABM.		
2.	9 and 84	**Tram project** The council has acknowledged there is significant uncertainty over the future of the tram project in terms of cost, timing and completeness. ***Risk: The ultimate cost may impact on funding decisions of the council and consequently the delivery of other services.***	As a result of cost uncertainty the council have had to consider incremental delivery of the project given the current funding constraints. In tandem the council have made contingency plans to provide additional funding of £55 million. It is likely that a report will be provided for the council meeting in December 2010 following examination of a number of options to take the project forward. This will be underpinned by a thorough options appraisal. A project team has been tasked with completing this evaluation looking at all the financial, legal, commercial and technical issues to provide a recommendation to the council on the way forward.	Director of City Development	31/12/10

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
3.	10	**Governance statement** Improved mechanisms need to be put in place to collate group assurances. ***Risk : Incomplete governance arrangements result in financial loss, service failure or reputational damage.***	On completion of the review of council companies, a new mechanism to collate assurance across the group will be implemented.	Chief Internal Auditor	31/3/2011
4.	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.***	Review of working papers will be undertaken, together with further training as required by the business support teams.	Principal Finance Manager – Corporate Accounts	31/3/2011
5.	19	**Revaluation of council house stock** Review discount factors in consultation with neighbouring councils and/or independent valuers to ensure a consistent approach. ***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 housing stock discount rate is not prescribed in Scotland. The differential of market rented and social rented in the Edinburgh area was examined as set out in the guidance note. It is likely that the market in different areas will lead to different discount rates. It should be noted that the Office of the Deputy Prime Minister 2005 guidance note includes regional discount rates, divided into nine government office regions. Liaison with other local authority valuers on the assumptions and approach took place in 2009/10 and this will be repeated in 2010/11 through the ACES framework. This liaison work will be reviewed to ensure FRS15 compliance.	Group Leader Asset Investment	31/03/2011

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
6.	30	**Group accounts** The council needs to finalise its group structure and ensure that group companies comply with governance requirements e.g. submission of accounts to meet group timetable. ***Risk: The group structure is sub-optimal in terms of cost and for the delivery of council objectives.***	Work is ongoing to finalise the group structure and will be completed for the 2010/11 financial statements.	Director of City Development	31/03/2011
7.	36	**IFRS** The council needs to ensure preparations are advancing for the implementation of IFRS. ***Risk: The council does not produce IFRS compliant financial statements; the council incurs additional audit fees***.	The council is continuing with its work to restate the 2009/10 accounts on an IFRS compliant basis. The council has engaged the services of PwC and CIPFA to help with the restatement works. The financial statements for 2010/11 will be produced in line with IFRS requirements.	Corporate Finance Manager	30/6/2011 (for 2010/11 Financial Statements)
8.	76	**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*** ***Scrutiny arrangements are insufficient within the council.***	The Committee has recognised that improvement is required and has recently recommended that the council completes its scrutiny function return. Learning and development of members will continue to be a key part of the Audit Committee work programme.	Head of Financial Services	31/3/2011
9.	99	**Housing benefit** Improvement plan in response to the HB audit needs to be properly addressed. ***Risk: Benefits service is not adequately performing.***	Updated improvement plan will be provided to Audit Scotland by 29 October and also to the Council's Audit Committee on 11 November.	Assistant Head of Revenues and Benefits	31/10/2010