

South Lanarkshire Council
Annual Report to Members and the Controller of Audit
Year ended 31 March 2010



Contents

	Page
Members' Overall Commentary	1
 Detailed Findings	
1. Managing in a Period of Financial Uncertainty	7
2. Financial Statement and Audit Opinion	11
3. Performance	15
4. Governance and Control	22
Appendix A – Action Plan	27
Appendix B – Future Accounting, Audit and Regulatory Developments	31
Appendix C – Communications to Management	33

The principal objective of our audit procedures is to enable us to meet with the requirements of the Audit Scotland Code of Audit Practice and to express our opinion on the financial statements as a whole. Our audit opinion does not guarantee that the financial statements are free from misstatement.

This Annual Report to Members, together with our reports to the Risk and Audit Scrutiny Forum throughout the year, discharges the requirements of International Standard on Auditing (UK & Ireland) ('ISA 260'): "Communication of audit matters to those charged with governance".

Any oral comments made in discussions with you relating to this report are not intended to have any greater significance than explanations of matters contained in the report. Any oral comments that we make do not constitute oral advice unless we confirm any such advice formally in writing.

The matters raised in this and other reports that flow from the audit are only those which have come to our attention arising from or relevant to our audit that we believe need to be brought to your attention. They are not a comprehensive record of all the matters arising, and in particular we cannot be held responsible for reporting all risks at South Lanarkshire Council or all internal control weaknesses. This report has been prepared solely for your use and should not be quoted in whole or in part without our prior written consent. No responsibility to any third party is accepted as the report has not been prepared for, and is not intended for, any other purpose.

South Lanarkshire Council
Annual Report to Council Members and the Controller of Audit
Year ended 31 March 2010

Members' Overall Commentary

Members' Overall Commentary

Introduction

The Annual Report which follows is primarily designed to direct your attention to matters of significance that have arisen out of the 2009/10 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

Our overall responsibility as external auditor of South Lanarkshire Council (the Council) is to undertake our audit in accordance with the principles contained in the Audit Scotland Code of Audit Practice ("the Code"), revised and published in March 2007.

We have a dual reporting responsibility for the audit: to the Council Members and to the Controller of Audit.

Managing in Uncertain Times – Section 1

The Chancellor's Comprehensive Spending review announcement on 20 October 2010 indicated that there will be a reduction in block grant to Scotland of £3 billion in real terms over the next few years, equating to a 7% reduction in revenue spend and 38% reduction in capital spend.

While some local authorities will be more vulnerable than others, there will be an impact on all Councils, including South Lanarkshire Council. Regardless of the perceived strength or weakness of an authority's financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Completeness and awareness of the size of the challenge;
- Strong leadership;
- Need to engage with the whole organisation and external stakeholders;
- Realistic and detailed plans to resolve the situation;
- Rigorous implementation (programme management arrangements); and
- Financial control and discipline.

We suspect that much of the relatively easier savings decisions will already have been taken and in many cases, these are already on the road to being realised. Therefore, the ability of the Council to respond to a prolonged wave of revenue reduction arising from the re-assessment of public sector spending levels and priorities is likely to be particularly difficult. Forecasts for the next three to four years should therefore include “downside” scenarios and a range of savings and redesign options determined from a priority based budgeting approach.

Clearly, any failure to act fully and promptly in respect of the financial challenge agenda could have significant negative implications on a Council, such as its continued ability to deliver on its key service priorities. This area of risk will represent the greatest area of challenge for the Council and other Councils over the next few years.

As part of the savings options devised to address this period of significant financial pressure, the Council initially calculated that it would be required to achieve savings of £80 million over the next three years.

Subsequent to this initial calculation this requirement was increased to £120 million and an assessment of the potential impact this level of savings could have on service provision commenced during August and September 2010.

However, more recently finance officers identified that this £120 million was overstated and the Council’s latest financial gap projection for the next three years was re-stated to £80 million.

We have been engaged by the Council to undertake a specific review into the processes which led to these changes in the Council’s financial savings requirement. The output of this review is scheduled to be reported during November 2010 to the Leader of the Council and the Chief Executive.

It should be recognised that the Council has embarked upon the identification of a savings plan to address this latest gap. A relative scoring matrix is also in preparation to enable flexibility and recognition of emerging issues. Effective use of the scoring matrix should enable the Council to focus on an updated savings target, which should become clearer following the announcement of the proposed level of government grant to South Lanarkshire Council, in early December 2010.

As part of the Council’s potential savings for 2011/12 the Chief Executive plans to include proposals to reduce the size of the senior management team in the Council. As part of discussions concerning the Council’s Corporate Management Team, the Executive Director (Finance and Information Technology Resources) will retire during April 2011.

Financial Statement and Audit Opinions – Section 2

The financial statements of the Council for the year ended 31 March 2010 have been prepared to comply with accounting requirements contained in the 2009 SORP (Statement of Recommended Practice on Local Authority Accounting).

Our audit opinion for the year ended 31 March 2010, which is in the format prescribed by Audit Scotland, is unqualified.

The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management were of a high standard. Overall an efficient audit process was achieved through a continued effective working relationship with your staff.

A number of important accounting matters arose, were discussed and agreed with management during the audit. The most significant discussions are summarised in Section 2 and related to:

- equal pay and single status;
- the treatment of PFI/PPP Schools; and
- provisions

Performance – Section 3

In 2009/10, South Lanarkshire Council spent £1.013 billion on the provision of public services. The Council's net operating expenditure in 2009/10 was £753.2 million. This was primarily met through Central Government and local taxation, totalling £687.9 million. A net surplus for the year of £2.253 million was achieved and when added to the 2008/09 General Fund surplus brought forward of £4.223 million, resulted in a General Fund balance of £6.476 million being carried forward into 2010/11. In addition to the cumulative General Fund carry forward balance, the Council held £65.976 million in other reserves as at 31 March 2010.

The most material estimate included in the accounts is for pension liabilities in respect of employees who are members of the Council's pension schemes. The net pension liability at 31 March 2010 is £500.7 million. In 2007/08 the Council reported a small and manageable deficit on the pension scheme of £62.5 million. Since then the assets have increased in value by £104.5 million (11.1%) but in the same period, the pension scheme liabilities have increased by £542.6 million (53.8%). The deterioration in the net position is primarily as a result of the global economic downturn and adverse movements in mortality assumptions.

This net deficit position is an important factor in the consideration of the level of future pension contributions, particularly in light of the future reductions in public sector funding. However, we acknowledge that pension funding and the extent of balance sheet pension liabilities is not an issue specific to South Lanarkshire, with the vast majority of local authorities facing similar challenges. Much of how this issue is addressed will be driven from Central Government policy, with reform expected as a result of the recommendations made by Lord Hutton in his review of public sector pensions.

South Lanarkshire Council operates 5 trading operations (Facilities Management, Fleet Services, Grounds Maintenance, Roads, and Building Maintenance). Each trading operation achieved its statutory performance target of 'breaking-even', over a three year period.

The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and 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. Results are summarised as non-conformance (0-24%), conformance (25-49%), improved performance (50-74%) and superior performance (75%-100%).

South Lanarkshire Council scored 11% overall, well below the Local Authority average and taking it into the non-conformance band. This assessment clearly indicates that the Council's procurement arrangements require a significant overhaul in order to ensure conformance with best practice.

However, management recognised the inefficiencies within the Council's procurement arrangements, prior to the PCA assessment outcome being reported in November 2009. The Executive Committee had approved, in June 2009, a business case for revised centralised procurement arrangements.

The implementation of this new centralised procurement function is nearing completion, with the Council's current financial strategy for 2011 to 2014 including an efficiency savings target of £10 million in respect of procurement. On the basis of the new procurement arrangements, management have set a target for the 2010/11 PCA assessment of at least 'Conformance' (25%-49%).

The Council should closely monitor the actions it has put in place to address its sub optimal procurement arrangements, with a view to ensuring it can demonstrate that it is achieving best value across the various performance categories.

Governance and Control – Section 4

Following the results of the Council's best value review (reported by Audit Scotland in 2009), the Council reviewed and amended certain of its political and management arrangements based on CIPFA's best practice governance guidance. In particular, key committee meetings and forums are now open to members of the public.

We have also considered other aspects of the control environment, including partnership working and community engagement. Appropriate arrangements and reporting were also noted.

Whilst corporate risks are being managed on an active basis, the Council's 2009/10 end of year risk management report highlighted a differing performance in terms of risk management arrangements within Resources (Services), whereby the recording of mitigating controls and actions was not being undertaken consistently.

Given the internal audit resources currently available to the Council, and the status of the 2010/11 Internal Audit Plan, it is appropriate that Internal Audit reconsiders all work planned for 2010/11 based on the contribution it will make to the significant risks and challenges faced by the Council. On this basis, internal audit work should be re-prioritised to ensure that appropriate value protecting and enhancing reviews take place on a timely basis, by appropriately qualified staff and with full quality review. Internal audit should therefore take the opportunity to re-align its resource capabilities and arrangements to those best practice arrangements being achieved by leading edge internal audit providers.

During September and October 2010 the Council incurred a significant amount of media interest and criticism in relation to a reported creditor's fraud (see paragraph 4.16), members' expenses and also in respect of the Council's financial position. During this time it was reported that a number of Members spoke directly to the media, airing personal and other concerns, as well as political groupings releasing various press statements. In addition, a series of emails were sent direct to all Council employees, including to the Chief Executive. Much of this activity has been detrimental to the Council's image and reputation.

Action is currently being taken by the Leader of the Council and Chief Executive to address these matters including reviews by PwC relating to the reporting of the financial gap and arrangements for members expenses. Following the completion of these actions it is hoped that media interest of this nature will diminish and appropriate Council interactions and business will resume.

Acknowledgement

We would like to formally extend our thanks to all South Lanarkshire Council Officers for the assistance they have given us during the audit process.

PricewaterhouseCoopers LLP
141 Bothwell Street
Glasgow
G2 7EQ
30 October 2010

South Lanarkshire Council
Annual Report to Council Members and the Controller of Audit
Year ended 31 March 2010

Detailed Findings

1. Managing in a Period of Financial Uncertainty

- 1.01 The UK economy went into recession in mid-2008 for the first time since 1991. By summer 2009, UK economic output had fallen for five consecutive quarters. Significant financial pressures remain and the future economic position is uncertain and difficult to predict.
- 1.02 In response to the recession the UK Government almost doubled its level of borrowing to £175 billion in 2009/10 to allow it to increase public spending to support the economy. This level of borrowing means that the UK Government will need to pay higher debt interest payments, which in turn reduces the amount left for spending on the public sector. The recent UK General Election has resulted in a change of Government and this has led to a change in the plans for repaying the national debt with the new coalition government planning to halve the debt by 2013/14. In order to achieve this ambitious target, significant reductions in public sector spending will be required. A recent paper by the Scottish Government's Chief Economist predicted that public sector spending in Scotland may fall in real terms by 3% every year to 2014/15 and will take a total of 12 to 15 years to get back to 2009/10 levels.
- 1.03 Further details of this challenge became clearer after the 22 June 2010 UK emergency budget and Comprehensive Spending Review announcement by the Chancellor on 20 October 2010. This most recent announcement indicated that there will be a reduction in block grant to Scotland of £3 billion in real terms over the next four years, equating to a 7% reduction in revenue spend and 38% reduction in capital spend.
- 1.04 It is clear that due to their relatively heavy dependence on the public sector for employment, Scotland, Northern Ireland, Wales and the North East of England are likely to suffer the most, increasing the potential for a greater impact on Scottish Local Authorities.
- 1.05 Scottish Government funding from the UK Government will fall from £28.2 billion in 2010/11 to £27.3 billion in 2011/12, £27.6 billion in 2012/13, £27.5 billion in 2013/14 and £27.7 billion in 2014/15.
- 1.06 The impact on Scotland's public bodies will be felt throughout, but particularly in 2011/12 due to the Scottish Government delaying 2010/11 savings actions until 2011/12 (effectively having to action savings for 2010/11 and 2011/12 in 2011/12). Local Government may also be faced with identifying additional savings should the Scottish Government continue to "protect" spending levels in the Health Sector.
- 1.07 The precise impact on the Council will become clearer during November/December 2010 following the Scottish Government's November announcement of its budget for 2011/12.
- 1.08 Taken together, these factors will have serious consequences for the Scottish budget. As a result of the developing financial position, Audit Scotland and the Scottish Government have previously issued a number of reports on the matter. Key reporting themes from four of these reports are highlighted below.

Audit Scotland - Scotland's Public Finances: Preparing for the Future

- 1.09 In November 2009 Audit Scotland published its report: 'Scotland's Public Finances: Preparing for the Future'. This report highlighted the fact that the Scottish Government budget is likely to have peaked in 2009/10 for the foreseeable future. This means that individual public bodies will have smaller budgets in future years. It highlighted that in addition, other public sector income is likely to be less than previously forecast. The report concluded that we are at a real historical breakpoint in public finances.

Audit Scotland - Improving Public Sector Efficiencies

- 1.10 Following on from the Scotland's Public Finances report, Audit Scotland published a further report in February 2010: 'Improving public sector efficiency'. It provided a position statement on the first year (2008/09) of the Efficient Government Programme (the Programme), which aims to deliver £1.6 billion of efficiency savings over the three years to 2010/11. It also gave an update on how the Scottish Government and public bodies have addressed the recommendations made in a 2006 Audit Scotland report about the previous efficiency programme.
- 1.11 The report noted that Scottish public bodies had reported more efficiency savings than the Government's two per cent target. However, there were serious financial challenges ahead – the biggest since devolution – and making required savings simply through efficiency will become increasingly difficult.
- 1.12 The report recommends that to deal with reduced future funding, public bodies need to consider fresh approaches to improving efficiency and productivity. They must take a more fundamental approach to identifying priorities, improving the productivity of public services, and to improving collaboration and joint working.

Audit Scotland – Annual Overview of Local Government in Scotland 2009

- 1.13 This report details a broad ranging insight into issues affecting all aspects of Local Government. Whilst predominantly focused on how effectively local authorities managed their resources in 2008/09, issues such as: increased difficulty in collecting cash due from council tax and business rates, increases in employer's pension contributions and the social care implications of an aging population, are all discussed against the backdrop of the 'significant pressures facing public finances'.
- 1.14 Management responded to this report by taking a paper to the Executive Committee detailing how key issues would be dealt with in respect of South Lanarkshire Council.

Independent Budget Review

- 1.15 The Independent Budget Review was commissioned by John Swinney, Cabinet Secretary for Finance and Sustainable Growth, as part of the Scottish Budget process for 2010/11. The review was undertaken by a panel of three under the Chairmanship of Crawford Beveridge, with the intention of 'informing public and Parliamentary debate' ahead of the Comprehensive UK Spending Review (due to conclude in October 2010).
- 1.16 The review contextualises the extent and length of future funding challenges, noting that figures from the Scottish Government show that it may be as many as 15

years before budgets return, in real terms, to 2009-10 levels. This is echoed by the sentiment that while the review's remit covered the period from 2011/12 to 2014/15, it is noted that challenges will persist well beyond that timeframe and, therefore, a more strategic longer-term perspective needs to be developed.

- 1.17 How the funding deficit will be addressed is also discussed, with the review noting that contributions from efficiency savings alone will not be sufficient and that radical redesign in the way that services are provided to the public will need to be seriously considered. Service redesigns and organisational restructuring will undoubtedly lead to a reduction in public sector headcount.

Our Perspective on South Lanarkshire Council

- 1.18 While some local authorities will be more vulnerable than others, all Councils, including South Lanarkshire, will be impacted. Regardless of the perceived strength or weakness of an authority's financial position, difficult decisions are going to have to be made. We recommend looking at six key areas that our experience in other sectors has shown may be relevant to addressing the challenges ahead:

- Completeness and awareness of the size of the challenge;
- Strong leadership;
- Need to engage with the whole organisation and external stakeholders;
- Realistic and detailed plans to resolve the situation;
- Rigorous implementation (programme management arrangements); and
- Financial control and discipline.

Action 1

- 1.19 We suspect that much of the relatively easier savings decisions will already have been taken and in many cases, these are already on the road to being realised. Therefore, the ability of the Council to respond to a prolonged wave of revenue reduction arising from the re-assessment of public sector spending levels and priorities is likely to be particularly difficult. Forecasts for the next three to four years should therefore include "downside" scenarios and a range of savings options determined from a priority based budgeting approach.

- 1.20 Clearly, any failure to act fully and promptly in respect of the financial challenge agenda could have significant negative implications on a Council, such as its continued ability to deliver on its key service priorities. This area of risk will represent the greatest area of challenge for the Council and other Councils over the next few years.

2010/11

- 1.21 The Council has approved its budget for the period 2010/11, which provides for a break-even position, with expenditure projected at £724.779 million. This includes an efficiency savings target of £17.5 million which was revised downwards from £22.2 million, following communication from the Scottish Government that the 2010/11 financial settlement would be greater than originally anticipated. As the Council had previously identified potential efficiency savings in the region of £22.2 million, £17.5 million of efficiency savings in 2010/11 should be achievable.
- 1.22 As reported to the Executive Committee in September 2010, the Council is still anticipating a breakeven position for 2010/11.

2011/12 to 2013/14

- 1.23 It is widely anticipated that the three year period from 2011 to 2014 will see the greatest negative impact on public sector funding.
- 1.24 As part of the savings options devised to address this period of significant financial pressure, the Council initially calculated that it would be required to achieve savings of £80 million over the next three years.
- 1.25 Subsequent to this initial calculation this requirement was increased to £120 million and an assessment of the potential impact this level of savings could have on service provision commenced during August and September 2010.
- 1.26 However, more recently finance officers identified that this £120 million was overstated and the Council's latest financial gap projection for the next three years was re-stated to £80 million.
- 1.27 We have been engaged by the Council to undertake a specific review into the processes which led to these changes in the Council's financial savings requirement. The output of this review is scheduled to be reported during November 2010 to the Leader of the Council and the Chief Executive.
- 1.28 It should be recognised that the Council has embarked upon the identification of a savings plan to address this latest gap. A relative scoring matrix is also in preparation to enable flexibility and recognition of emerging issues. Effective use of the scoring matrix should enable the Council to focus on an updated savings target, which should become clearer following the announcement of the proposed level of government grant to South Lanarkshire Council, in early December 2010.
- 1.29 As part of the Council's potential savings for 2011/12 the Chief Executive plans to include proposals to reduce the size of the senior management team in the Council. As part of discussions concerning the Council's Corporate Management Team, the Executive Director (Finance and Information Technology Resources) will retire during April 2011.
- 1.30 Management need to work quickly to ensure that tangible savings and change initiatives are in place for 2011/12 (and beyond). These plans should be flexible and be refreshed regularly in order to address the ever changing environment and requirements which will now be imposed following October's Comprehensive Spending Review announcement and the subsequent Scottish Government Budget announcement in November 2010.

Action 1

2. Financial Statement and Audit Opinion

Audit Opinion

- 2.01 Our opinion on the financial statements sets out the respective responsibilities of management and the auditors, and concludes on whether the statements:
- give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2009 SORP (Statement of Recommended Practice on Local Authority Accounting), of the financial position of South Lanarkshire Council and its group as at 31 March 2010 and its income and expenditure for the year then ended; and
 - have been properly prepared in accordance with the Local Government (Scotland) Act 1973.
- 2.02 We have given an unqualified opinion that the financial statements of the 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.

Audit Process

- 2.03 The financial statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided by management were of a high standard. Overall an efficient audit process was achieved through a continued effective working relationship with your staff.

Basis of Preparation

- 2.04 The draft financial statements were signed by the Deputy Chief Executive and Executive Director of Finance and IT Resources on 24 June 2010 and submitted to the Controller of Audit by 30 June 2010. Effective co-operation between management and ourselves has ensured the timely completion of audited financial statements by the 30 September 2010 deadline.

Unadjusted Misstatements

- 2.05 Under ISA 260 - "Communication of audit matters to those charged with governance", we are required to report to you all unadjusted misstatements (audit adjustments which management have not processed) which we have identified during the course of our audit, other than those which we deem to be of a trivial nature. As a result of our work, we proposed a number of audit adjustments and all of these have been processed by management in the finalised version of the 2009/10 financial statements. We, therefore, have no unadjusted misstatements to report.

Group Balances

- 2.06 As part of the financial statement process, in accordance with the SORP, the Council has prepared group accounts. Recognised within the Council's group accounts are:
- Strathclyde Fire and Rescue Board;
 - Strathclyde Police Joint Board;
 - Strathclyde Passenger Transport Authority;
 - Strathclyde Concessionary Travel Scheme Joint Board;
 - Lanarkshire Valuation Joint Board;
 - Clyde Valley Learning and Development Joint Committee;
 - Regen FX Youth Trust; and
 - South Lanarkshire Leisure Limited.
- 2.07 The accounts of all group bodies have been prepared on a going concern basis.

Accounting Issues

Equal Pay

- 2.08 Equal pay has received significant media attention recently following the failure of a number of English local authorities to defend equal pay claims, often resulting in a significant financial cost. Legal firms representing the successful claimants are turning their attention to Scottish local authorities in the hope of achieving similar tribunal outcomes. South Lanarkshire Council is not immune to this attention and currently has around 2,000 equal pay claims lodged. This represents an elevated audit risk as the sums of money involved could be material to the financial statements.
- 2.09 Management continue to treat these claims as a contingent liability within the financial statements, rather than a provision, based on the following rationale:
- Single status was fully implemented by the Council in 2002;
 - Independent legal support for the robustness of the job evaluation scheme, implemented as part of Single Status;
 - The final outcomes of the claims lodged with the Tribunal are not certain, and it may be several years before any decision is reached; and
 - Even if a proportion of claims were to be successful, there is uncertainty around the amount of settlement payable to each applicant for arrears.

- 2.10 We performed work around the Council's accounting treatment of equal pay claims and concluded that the treatment as a contingent liability was in accordance with the Statement of Recommended Practice (SORP) and accounting standards.

PFI/PPP Arrangements

- 2.11 In the move towards full International Financial Reporting Standards (IFRS) compliance in 2010/11, the 2009 SORP adopted an interpretation of International Financial Reporting Interpretations Committee (IFRIC) 12: 'Service Concession Arrangements'. As a result, the Council was required to account for its PFI/PPP arrangements 'on-balance sheet'.
- 2.12 As a result, the secondary school modernisation programme assets (schools) were brought on balance sheet, with a corresponding liability (amounts owed to the contractor) recognised and initially measured at the fair value of the related assets. Due to the material nature of this change in accounting treatment, a restatement of the 2008/09 figures was also required.
- 2.13 We undertook a work programme to obtain comfort that these transactions had been accounted for correctly and that the estimation of unitary charge payments into service, liability and interest elements were reasonable.

Provisions

- 2.14 The Council holds a 25% equity share in 11 properties at Blackbraes, East Kilbride, as a result of accepting an assignation of a debt due from house builder, Persimmon Homes. The debt related to monies which Persimmon owed the Council following the sale of land for the purpose of house building at the East Kilbride site. The private housing market entered a period of depression shortly following this transaction and a management decision was taken that accepting the debt assignation and reclaiming the debt from the 11 individual homeowners would be of lower risk than settlement of the debt from Persimmon.
- 2.15 Due to the depression in house prices at the time of this transaction, management deemed it appropriate to create a 50% provision against the recovery of this assigned debt. The housing market has since stabilised and the provision does not meet the necessary requirements of a provision. The provision has been released, resulting in a £0.283 million increase to the Council's Housing Revenue Account surplus.
- 2.16 In addition, we questioned the appropriateness of the debt for equity transaction that resulted in the Council being exposed to fluctuations in the residential housing market as opposed to the receipt of contractual debt. Management noted that it had taken legal advice at the time and that the transaction was permissible within the prescriptions of the Housing (Scotland) Act 1987. Management should ensure that any transactions of a similar nature are fully supported with a sound business and legal case, and are only undertaken in exceptional circumstances.

Action 2

Revision of Assumptions in the Accounting of the Pension Liability

- 2.17 The Chancellor of the Exchequer announced in his Emergency Budget on 22 June 2010 that the consumer prices index rather than the retail prices index will be the basis for future public sector pension increases. In relation to Financial Reporting Standard (FRS) 17, this is considered to be a non-adjusting post balance sheet event. At our request, the Council has included additional disclosure within its Pension Note.

Future Accounting, Audit and Regulatory Developments

- 2.18 A number of accounting, audit and regulatory developments will impact the Council's financial statements and audit arrangements for the 2010/11 financial year. The principal changes in relation to the following developments are discussed within **Appendix B**:
- Full compliance with International Financial Reporting Standards (IFRS);
 - Clarity International Standards on Auditing;
 - Carbon Reduction Commitment compliance.

3. Performance

Financial Results 2009/10

- 3.01 In 2009/10, South Lanarkshire Council spent £1.013 billion on the provision of public services. The Council's net operating expenditure in 2009/10 was £753.2 million. This was primarily met through Central Government and local taxation, totalling £687.9 million.
- 3.02 The Council's financial position as at 31 March 2010 is set out below, extracted from the financial statements for 2009/10:

Extracted from the Income and Expenditure Account:		£m
Net operating expenditure		(753.209)
Income received (Council Tax, Government Grants and Non Domestic rates)		<u>687.859</u>
Deficit in year		(65.350)
Statement on the Movement in General Fund Balance:		
Net additional amount required by statutory and non-statutory practices to be debited and credited to the General Fund in year (including FRS17 pension costs and fixed asset depreciation charges)		<u>67.603</u>
Increase in General Fund Balance 2009/10		2.253
General Fund Balance brought forward from 2008/09		4.223
		—
General Fund Balance carried forward to 2010/11		<u>6.476</u>

3.03 The table above illustrates that the Council achieved a surplus of £2.253 million for 2009/10. This surplus was in line with the financial position forecast by management throughout 2009/10, as reported to the Executive Committee.

Reserves

3.04 The net surplus for the year of £2.253 million has been added to the 2008/09 General Fund surplus brought forward, of £4.223 million, resulting in a General Fund balance of £6.476 million being carried forward into 2010/11. In addition to the cumulative General Fund carry forward balance, the Council held £65.976 million in other reserves as at 31 March 2010. These are broken down below:

	£m	Purpose
Repairs and Renewals Reserve	15.660	Designed to finance expenditure incurred in repairing, maintaining and replacing Council assets.
Capital Fund	15.847	Money earmarked by the Council to fund individual capital programmes and to fund the repayment of loans fund principal.
Insurance Fund	6.012	Each individual Council Resource contributes to the fund during the year, with the balance used to meet the costs of fire damage, public liability, employer liability and various other claims.
Useable Capital Receipts Reserve	28.457	Receipts from the sale of fixed assets.
	65.976	

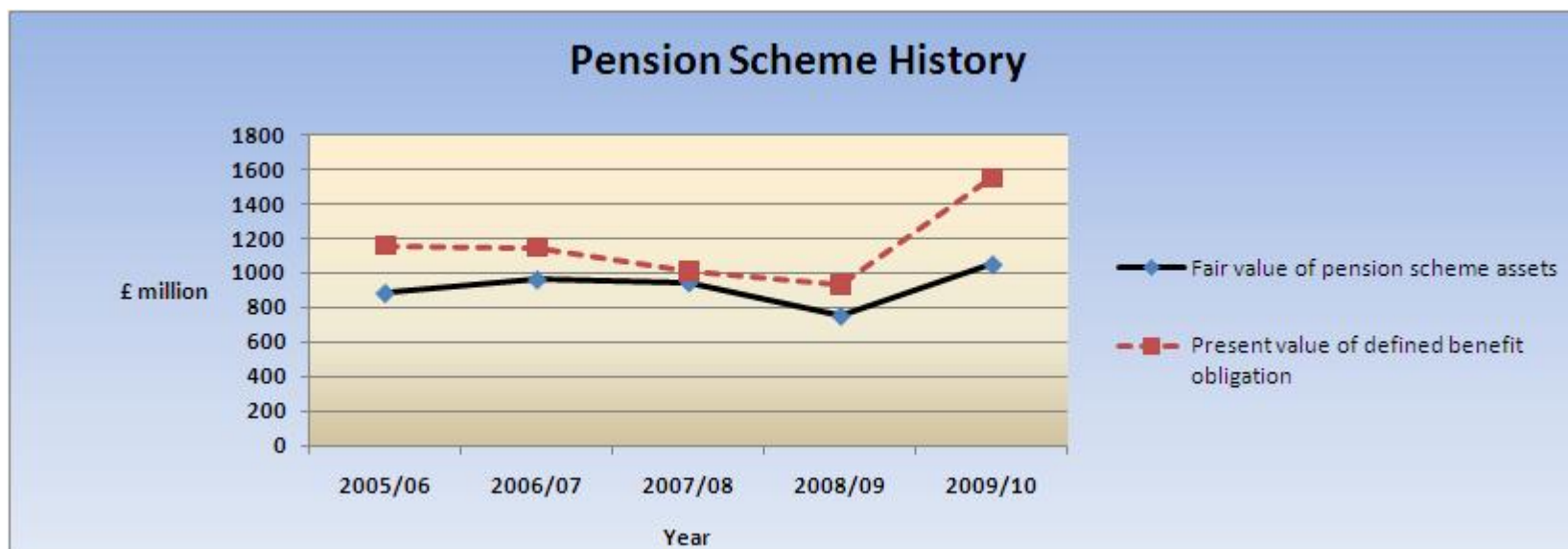
Pension Funding

3.05 As part of the terms and conditions of employment of its officers and other employees, the Council offers retirement benefits. The Council participates in two pension schemes:

- The Strathclyde Pension Fund Local Government Pension Scheme is administered by Glasgow City Council in accordance with the Local Government Pension Scheme (Scotland) (Administration) Regulations 1998. This is a defined benefit scheme, meaning that the Council and employees pay contributions into the fund, calculated at a level intended to balance the pension liabilities with investment assets.
- The Teachers' Pension Scheme is currently administered by the Scottish Public Pensions Agency, an Executive Agency of the Scottish Government. It provides teachers with defined benefits upon their retirement, and the Council contributes towards the costs by making contributions based on a percentage of members' pensionable salaries. However, as the Scheme is not able to identify each body's share of the underlying liabilities on a consistent and reasonable basis, the pension costs are accounted for as if it were a defined contribution scheme.

3.06 In 2009/10, the Council made contributions to the schemes amounting to £60.892 million (2008/09: £52.238 million).

- 3.07 The most material estimate included in the accounts is for pension liabilities in respect of employees who are members of the Councils Benefit Schemes. The net pension liability (based on all assets and liabilities which could arise at 31 March 2010) is £500.7 million. In 2007/08 the Council reported a small and manageable deficit on the pension scheme of £62.5 million. Since then the assets have increased in value by £104.5 million (11.1%) but in the same period, the pension scheme liabilities have increased by £542.6 million (53.8%). The chart below shows the trend in pension assets and liabilities attributable to the Authority over the last 5 years, together with the worsening net pension liability position:



- 3.08 We have reviewed the reasonableness of the assumptions underlying the pension liability in the accounts in accordance with International Standards of Auditing (UK&I) 540 'Audit of accounting estimates' and consulted with our pension specialists in relation to the actuarial assumptions used.
- 3.09 This net deficit position is an important factor in the consideration of the level of future pension contributions, particularly in light of the future reductions in public sector funding. However, we acknowledge that pension funding and the extent of balance sheet pension liabilities is not an issue specific to South Lanarkshire Council, with the vast majority of local authorities facing similar challenges. Much of how this issue is addressed will be driven from Central Government policy, with reform expected as a result of the recommendations made by Lord Hutton in his review of public sector pensions.

Capital Expenditure 2009/10

- 3.10 At the start of the 2009/10 financial year, the Council was working towards a revised capital budget (excluding the housing programme) of £150.2 million. Actual capital expenditure incurred as at 31 March 2010 was £134.8 million. Therefore, capital expenditure for 2009/10 was £15.4 million less than budgeted.

- 3.11 The principal reason for the capital programme underspend can be attributed to the inclement weather conditions encountered over the winter months. The primary school modernisation programme was the most significantly disrupted capital project.. .
- 3.12 Each year, in line with the Code of Practice, the Council produces a Treasury Management Strategy. The Treasury Strategy describes the Prudential and Treasury Indicators introduced and monitored on a regular basis to demonstrate that the Council's investment plans are managed within a sound financial environment. Monthly investment management meetings are held to discuss progress against the Capital Plan and ensure expenditure is funded in the most efficient manner and in accordance with the Treasury Management Strategy.
- 3.13 As at 31 March 2010, South Lanarkshire Council held cash and short term investments (liquid assets) totalling £16.1 million (2008/09: £85.2m) and short and long term borrowings totalling £606.2 million (2008/09: £589.8m). The current economic climate means that interest rates on investments are low – the council received £0.780 million in investment income this year compared to £6.034 million last year and as a result, the Council chose to utilise its liquid assets in the year. Borrowing rates are also low and despite the Council holding a significant proportion of its debt at fixed rates the average cost of borrowing fell from 6.10% in 2008/09 to 5.70% in 2009/10.

Trading Operations

- 3.14 South Lanarkshire operates 5 trading operations (Facilities Management, Fleet Services, Grounds Maintenance, Roads, and Building Maintenance). Each trading operation achieved its statutory performance target of 'breaking-even', over a three year period.

Performance Management Arrangements

- 3.15 The Council measures approximately 1,000 performance indicators with the management, coordination and tracking of these measures being recorded on the Council's performance management system, 'IMPROVe'. The IMPROVe system is now fully implemented and facilitates greater management reporting against the Council's objectives, as set out within the Council Plan, Connect and within the Single Outcome Agreement. In addition, actions in each Resource (Service) Plan are to be included on IMPROVe, allowing for more accurate and timely monitoring.
- 3.16 The Council's Corporate Improvement Unit is responsible for coordinating corporate improvement activity within the Council. Performance is monitored and overseen by the Corporate Improvement Advisory Board and comprises Resource representatives and members of the Corporate Improvement Unit.

Statutory Performance Indicators

- 3.17 The Accounts Commission has a statutory responsibility to specify information that Councils must publish about their performance in the form of statutory performance indicators. For 2009/10, the Accounts Commission reduced the number of required Statutory Performance Indicators (SPIs) to 25.

- 3.18 Auditors are expected to review those arrangements in place for collecting, recording and publishing performance data. Based on the work performed by PwC, and the Research function of the Council's Finance and IT Resource , we are content that most Services have systems in place for gathering and reporting performance information.

Managing People

- 3.19 Our previously submitted Audit of Best Value and Community Planning Follow-Up Report detailed that a draft Workforce Planning Strategy had been formulated in direct response to the Council's improvement agenda. This strategy has now been finalised and was approved by the Corporate Resources Committee in June 2010.
- 3.20 The Council noted staff turnover for 2009/10 of 2.3% and an absence rate of 4.0%, compared with 3.0% staff turnover in 2008/09 and 4.0% absence rate. The decrease in staff turnover can be explained as a symptom of the macro-economic landscape and the increase in national unemployment over the same period, reducing the external opportunities for council employees. In order to meet the future financial challenges (as detailed in Section 1), savings will be required across all cost lines. From the reduction in staff turnover it is evident that management may not be able to realise staff savings purely from natural wastage, with more active rather than passive action being required.

Best Value Improvement Plan

- 3.21 The Councils Corporate Improvement Unit is responsible for coordinating corporate improvement activity within the Council, including monitoring progress against the action plan devised to address the Audit of Best Value and Community Planning Improvement Agenda. We formally reported on progress in addressing each of the improvement items within our 'Follow-Up of Audit of Best Value and Community Planning' report, which was presented to the Council's Risk and Audit Scrutiny Forum on 27 April 2010. The table below is an extract from that report detailing progress reported:

No.	Improvement Agenda Item	Progress assessed by PwC
1	Make scrutiny and decision-making more open and transparent by implementing good practice guidance and by having scrutiny forums in public.	IMPLEMENTED
2	Determine the future role for area committees.	IMPLEMENTED
3	Ensure elected Members are more fully engaged in community planning, risk management and the continuing review programme.	IMPLEMENTED
4	Make community planning more inclusive by involving more partners beyond main public sector agencies.	IMPLEMENTED
5	Improve the reporting of the impact of community planning by developing more effective outcome measures.	IMPLEMENTED
6	Fully implement the Community Engagement Framework.	PARTIALLY IMPLEMENTED
7	Develop a forward looking workforce planning strategy and advertise senior management posts externally.	PARTIALLY IMPLEMENTED
8	Review staff survey arrangements to improve the return rate.	IMPLEMENTED
9	Fully implement the procurement strategy and guidelines across the council.	PARTIALLY IMPLEMENTED
10	Improve the balance of Public Performance Reporting.	IMPLEMENTED
11	Improve the condition of the roads and service performance in criminal justice services.	PARTIALLY IMPLEMENTED
12	Address the imbalance of customer satisfaction across the four main geographic areas.	IMPLEMENTED
13	Review the continuous improvement activity taking place to ensure that it is being prioritised and co-ordinated effectively.	IMPLEMENTED
14	Ensure that the recent efforts on sustainable development are maintained and tangible progress is achieved.	IMPLEMENTED

Procurement

- 3.22 The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and 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. Results are summarised as non-conformance (0-24%), conformance (25-49%), improved performance (50-74%) and superior performance (75%-100%).
- 3.23 All Councils have been assessed by Scotland Excel and were collectively scored as non-conformant (Average Council score of 22.6%). This means that Councils, collectively, are not achieving best value across their procurement activities.
- 3.24 South Lanarkshire Council scored 11% overall, well below the Local Authority average and taking it into the non-conformance band. This assessment clearly indicates that the Council's procurement arrangements require a significant overhaul in order to ensure conformance with best practice.
- 3.25 However, management recognised the inefficiencies within the Council's procurement arrangements, prior to the PCA assessment outcome being reported in November 2009. The Executive Committee had approved, in June 2009, a business case for revised centralised procurement arrangements.
- 3.26 The implementation of this new centralised procurement function is nearing completion, with the Council's current financial strategy for 2011 to 2014 including an efficiency savings target of £10 million in respect of procurement. On the basis of the new procurement arrangements, management have set a target for the 2010/11 PCA assessment of at least 'Conformance' (25%-49%).
- 3.27 The Council should closely monitor the actions it has put in place to address its sub optimal procurement arrangements, with a view to ensuring it can demonstrate that it is achieving best value across the various performance categories.

Action 3

4. Governance and Control

Overall Governance Arrangements

- 4.01 Following the results of the Council's best value review (reported by Audit Scotland in 2009), the Council reviewed and amended certain of its political and management arrangements, based on CIPFA's best practice governance guidance. In particular, key committee meetings and forums are now open to members of the public.

Partnership Working

- 4.02 Partnership working in South Lanarkshire is set out in 'Connect to Success 2009/10 to 2011/12', a Single Outcome Agreement (SOA) that received Government approval in July 2009. The SOA details the steps that the Council and its local partners are undertaking to contribute to the Scottish Government's National Outcomes. The SOA shares the same vision as the Council's Community Plan 'Stronger Together', which is designed *"To improve the quality of life for all in South Lanarkshire by ensuring equal access to opportunities and to services that meet people's needs"*
- 4.03 The Community Plan is scheduled for revision in 2010/11, at which time it will be aligned fully with the SOA.
- 4.04 Partnership working is also evidenced in relation to the actions to respond to the Arbutnott review into shared services within the Clyde Valley, with the Council leading on the 'Property Sharing' and 'Local Management in Hubs' workstreams. The Council is also leading on one element of developments for the 'Integrated Health and Social Care Service' and contributing to work on other workstreams led by neighbouring Clyde Valley partners.

Risk Management

- 4.05 The Council reviews and updates its Corporate Risk Register on a bi-annual basis. During 2009/10, the top 5 risks facing the Council were identified as:
1. Reductions in central funding
 2. Reductions in income
 3. Difficulty in achieving targeted efficiencies
 4. Equal pay
 5. Reputational damage caused by service change and efficiencies

- 4.06 Whilst corporate risks are being managed on an active basis, the Council's 2009/10 end of year risk management report highlighted a differing performance in terms of risk management arrangements within Resources (Services), whereby the recording of mitigating controls and actions was not being undertaken consistently.

Action 4

Internal Audit

- 4.07 The role of internal audit is determined by management and therefore its objectives differ from those of external audit.
- 4.08 As detailed within our Interim Management Letter, we were able to place reliance on the work of internal audit in respect of one area, its audit of payroll controls.
- 4.09 In accordance with normal practice internal audit presented a progress report to the Risk and Audit Scrutiny Forum in September 2010. This progress report set out that 42 incomplete audit reviews from 2009/10 had delayed the start to the 2010/11 programme and that only 11% of the 2010/11 internal audit programme had been completed to a draft stage.
- 4.10 The reasons which were reported for the slippage in internal audit progress were the delays in completing the 2009/10 plan and undertaking additional unplanned and investigative work. Included within the paper, internal audit also highlighted that a number of assignments were being closed off without full client meetings with the Head of Service. In addition, the report highlighted that certain audit files were subject to a lesser form of senior team member review, thereby reducing the quality guarantee from internal audit. Whilst we recognise that this approach is designed to lead to the speedier completion of the internal audit plan, there is a significant risk that all necessary control shortcomings and related corrective recommendations may not be identified and reflected in audit outputs.
- 4.11 Also, as reported to the September 2010 Risk and Audit Scrutiny Forum, internal audit has been involved in a number of unplanned and investigative work, for example, missing lunch money at primary schools, the misappropriation of heating parts and an inquiry into the creditor's bank details fraud (discussed further at 4.16 below). While time is built into the internal audit plan to undertake unplanned and investigative work of this nature, at the time of reporting, a significant majority of this has been utilised. This circumstance has contributed to the internal audit plan falling behind schedule and assuming further unplanned and investigative work is undertaken in the remainder of the period, will further impact internal audit's ability to complete the 2010/11 plan. Management should review whether the length of time taken on these investigations are a valuable use of internal audit time in the context of the significant risks facing the Council, where we believe internal audit should more appropriately play its part.
- 4.12 Following discussion with the Risk and Audit Manager it was established that internal audit is not responsible for conducting all unplanned and investigative work. A risk assessment process is in place with only high risk issues being subject to internal audit scrutiny, medium risk issues being referred back to the Resource for investigation, while low risk issues are logged. This is unclear from the internal audit papers presented to the Risk and Audit Scrutiny Forum. Further clarity should be provided in these papers to enable those charged with governance to fully understand where internal audit resources are being committed.

Action 5

- 4.13 Given the internal audit resources currently available to the Council, it is recommended that Internal Audit reconsiders all work planned for 2010/11, as well as the compilation of the 2011/12 internal audit plan, based on the contribution it will make to the significant risks and challenges faced by the Council. On this basis, internal audit work should be re-prioritised to ensure that appropriate value protecting and enhancing reviews take place on a timely basis, by appropriately qualified staff and with full quality review. Internal audit should therefore take the opportunity to re-align its resource capabilities and arrangements to those best practice arrangements being achieved by leading edge internal audit providers.

Action 6

Overview of Fraud Arrangements

- 4.14 As reported in our Interim Management Letter (dated April 2010), we have reviewed certain of the Council's overall corporate arrangements for the prevention and detection of fraud and corruption, through discussion of key risk areas with senior management as well as reviewing certain Council wide controls and selected documentation.
- 4.15 In addition to considering these overall arrangements, we review on a rotational basis work undertaken by the Council, including internal audit on the controls in place for the prevention and detection of fraud and corruption within key financial systems.
- 4.16 As part of our engagement, we were informed by the Council of a £0.102 million fraud whereby a third party posed as one of the Council's suppliers, changing the supplier's bank details to defraud the Council. Following this instance, we have been informed that management have introduced additional creditor payment checks to prevent re-occurrence. These revised controls have been reviewed by internal audit.

National Fraud Initiative

- 4.17 The National Fraud Initiative (NFI) is an exercise whereby data is taken from Councils and other public bodies, and cross matched to identify the potential for fraud. Councils are informed of the resulting matches, for investigation and resolution.
- 4.18 As reported in our Interim Management Letter (dated April 2010), no exceptions were noted from our review of this area. In addition, the national report issued by Audit Scotland (National Fraud Initiative in Scotland – Making an Impact) made no specific reference to any shortcomings in South Lanarkshire Council arrangements. However, a more recent internal audit report has highlighted a deterioration in arrangements whereby weaknesses have been identified in the recording of NFI investigations and the collection of data. An action plan has been developed to address these issues and we will revisit this area during our 2010/11 external audit.

Action 7

Statement of Governance and Internal Control

- 4.19 The Code of Audit Practice requires us to review and report on the Council's Statement of Governance and Internal Control. The Council has used the correct format for its Statement and has gone beyond the mandatory requirement by preparing the Statement on Internal Control as opposed to restricting its Statement to Financial Control only. The Statement outlines the processes the Council has employed to identify and evaluate risks, together with key elements of the Council's control framework. Based on our normal audit procedures, we do not disagree with the disclosures contained within the Statement.

Systems of Internal Control

4.20 The results of our work on systems of internal control were communicated to the Risk and Audit Scrutiny Forum in our Interim Management Letter (dated April 2010). The report contained 12 recommendations to improve controls, two of which were graded as higher risk. The control weaknesses assessed as higher risk related to:

- Council Tax discounts and exemptions being awarded without required documentation being retained as evidence of eligibility; and
- Bank reconciliation not being undertaken or reviewed on a timely basis, with a number of reconciling items not investigated by management

4.21 The Council has completed an action plan detailing those individuals responsible for implementing our audit recommendations.

Follow up of outstanding recommendations

4.22 We followed up the Council's progress in implementing audit recommendations made by us in the prior year. The results of this follow-up were included in the Interim Management Letter (April 2010), with progress as follows:

Status	Total
Fully implemented	6
Action in progress	4
Not implemented	2
Total	12

4.23 The recommendations not implemented do not relate to higher risk findings.

Media Coverage (September/October 2010)

4.24 During September and October 2010 the Council incurred a significant amount of media interest and criticism in relation to the reported creditor's fraud (see paragraph 4.16), members' expenses and also in respect of the Council's financial position (see paragraphs 1.24 to 1.29). During this time it was reported that a number of Members spoke directly to the media, airing personal and other concerns, as well as political groupings releasing various press statements. In addition, a series of emails were sent direct to all Council employees, including to the Chief Executive. Much of this activity has been detrimental to the Council's image and reputation.

4.25 All Council members should adhere to the National Code of Local Government conduct. This Code of Conduct reflects the ethical standards in Public Life etc. (Scotland) Act 2000 and sets out 9 key principles:

- Duty
- Selflessness
- Integrity
- Objectivity
- Accountability and Stewardship
- Openness
- Honesty
- Leadership
- Respect

4.26 The Code sets out a number of principles which must be observed in all situations including:

- Relationships with Council employees
- Conduct in the Chamber or in Committee
- Responsibilities to the Council as a member of the public
- Dealings with the Council

4.27 Action is currently being taken by the Leader of the Council and Chief Executive to address these matters including reviews by PricewaterhouseCoopers relating to the reporting of the financial gap and arrangements for members expenses. Following the completion of these actions it is hoped that media interest of this nature will diminish and appropriate Council interactions and business will resume.

Appendix A – Action Plan

Ref	Issue and Recommendation	Risk Rating	Management Response, Responsible Officer and Implementation Date
<p>Action 1</p>	<p>Issue: Regardless of the perceived strength or weakness of an authority's financial position, difficult decisions are going to have to be made in meeting the significant funding challenges ahead.</p> <p>Recommendation: As part of initiatives to generate efficiency savings, management should consider six key areas that our experience in other sectors has shown may be relevant in addressing the financial challenges ahead:</p> <ul style="list-style-type: none"> • Completeness and awareness of the size of the challenge • Strong leadership • Need to engage with the whole organisation and external stakeholders • Realistic and detailed plans to resolve the situation • Rigorous implementation (programme management arrangements) • Financial control and discipline <p>Management need to work quickly to ensure that tangible savings and change initiatives are in place for 2011/12 (and beyond). These plans should be flexible and be refreshed regularly in order to address the ever-changing environment and requirements of the forthcoming Scottish Budget announcement.</p>	<p style="text-align: center;">●</p> <p style="text-align: center;">High</p>	<p>Management Response:</p> <p>Agreed. We agree with the 6 key areas identified and with the need for flexibility in our plans. These elements remain fundamental to the Council's financial strategy and will be refined through the savings prioritisation exercise.</p> <p>Responsible Officer:</p> <p>Chief Executive</p> <p>Implementation Date:</p> <p>March 2011</p>

Ref	Issue and Recommendation	Risk Rating	Management Response, Responsible Officer and Implementation Date
Action 2	<p>Issue: The Council engaged in a debt for equity exchange with Persimmon Homes. We have been informed that legal advice was taken prior to completing the transaction.</p> <p>Recommendation: We recommend transactions of a material or unusual nature and that transactions of this nature are only undertaken in exceptional circumstances supported with a sound business and legal case.</p>	<p>● Medium</p>	<p>Management Response: Agreed</p> <p>Responsible Officer: Chief Executive</p> <p>Implementation Date: December 2010</p>
Action 3	<p>Issue: South Lanarkshire Council scored 11% overall in the Scottish Government's Procurement Capability Assessment, well below the Local Authority average and taking it into the non-conformance band. This assessment clearly indicates that the Council's procurement arrangements require a significant overhaul in order to ensure conformance with best practice.</p> <p>However, management recognised the inefficiencies within the Council's procurement arrangements, prior to the PCA assessment outcome being reported in November 2009. The Executive Committee had approved, in June 2009, a business case for revised centralised procurement arrangements.</p> <p>The implementation of this new centralised procurement function is nearing completion, with the Council's current financial strategy for 2011 to 2014 including an efficiency savings target of £10 million in respect of procurement. On the basis of the new procurement arrangements, management have set a target for the 2010/11 PCA assessment of at least 'Conformance' (25%-49%).</p> <p>Recommendation: The Council should closely monitor the actions it has put in place to address its sub-optimal procurement arrangements, with a view to ensuring it can demonstrate that it is achieving best value across the various performance categories.</p>	<p>● High</p>	<p>Management Response: Agreed. Procurement arrangement and performance will be monitored and reviewed to ensure conformance with best practice.</p> <p>Responsible Officer: Chief Executive</p> <p>Implementation Date: March 2011</p>

Ref	Issue and Recommendation	Risk Rating	Management Response, Responsible Officer and Implementation Date
Action 4	<p>Issue: While risk appears to be well managed at a Corporate level, the Council's 2009/10 Risk Management report noted that inconsistent progress was being made in embedding risk management arrangements across Resources (Services).</p> <p>Recommendation: The Council should promote consistent risk management activity throughout the organisation, whereby the recording of mitigating controls and actions are applied regularly and uniformly.</p>	<p>● Medium</p>	<p>Management Response: Agreed. The management of risk is promoted through Resource Risk Sponsors who are assigned the responsibility for embedding the management of risk. Since the 2009/10 annual risk management report, compliance levels in Resources have significantly improved and the performance indicator for delivery of risk controls actions has risen to 74%.</p> <p>Responsible Officer: Risk and Audit Manager</p> <p>Implementation Date: November 2010</p>
Action 5	<p>Issue: Following discussion with the Risk and Audit Manager it was established that internal audit is not responsible for conducting all unplanned and investigative work. A risk assessment process is in place with only high risk issues being subject to internal audit scrutiny, medium risk issues being referred back to the resource for investigation, while low risk issues are merely recorded. This is unclear from the internal audit papers presented to the Risk and Audit Scrutiny Forum. Further clarity should be provided in these papers to enable those charged with governance to fully understand where internal audit resources are being committed.</p> <p>Recommendation: Internal audit adopt a revised reporting format for presentation at the Risk and Audit Scrutiny Forum, enabling Forum members to clearly understand the role of internal audit in unplanned and investigative work undertaken in respect of risk issues facing the Council.</p>	<p>● Medium</p>	<p>Management Response: Agreed. The format of Forum papers will be revised to make clear whether Internal Audit or a Resource is investigating.</p> <p>Responsible Officer: Risk and Audit Manager</p> <p>Implementation Date: December 2010</p>

Ref	Issue and Recommendation	Risk Rating	Management Response, Responsible Officer and Implementation Date
<p>Action 6</p>	<p>Issue: At the end of August 2010, 5 months into the financial year, it was noted that only 11% of the Council's 2010/11 internal audit plan had been completed. While this does not reflect work in progress, unfilled vacancies in the internal audit department coupled with a high volume of unplanned investigative work has led to concerns that the 2010/11 internal audit plan will not be completed in a timely or quality assured manner.</p> <p>Recommendation: Given the internal audit resources currently available to the Council, it is recommended that Internal Audit reconsiders all work planned for 2010/11, as well as the compilation of the 2011/12 internal audit plan, based on the contribution it will make to the significant risks and challenges faced by the Council. On this basis, internal audit work should be re-prioritised to ensure that appropriate value protecting and enhancing reviews take place on a timely basis, by appropriately qualified staff and with full quality review. Internal audit should therefore take the opportunity to re-align its resource capabilities and arrangements to those best practice arrangements being achieved by leading edge internal audit providers.</p>	<p>● High</p>	<p>Management Response: Agreed. The audit planning strategy and the audit plan for 2011/12 will be shared with PWC as part of the usual consultation process for comment prior to formal approval. However it should be noted that in terms of the 2010/11 plan, only 25% of the plan remains to be started.</p> <p>Internal Audit included a significant project on continuous controls monitoring in its 2010/11 plan as a result of network sessions with leading external audit practitioners from both the public and private sectors during 2009. Internal Audit has also recently assessed its practices against CIPFA's Effective Internal Audit guidance.</p> <p>Responsible Officer: Risk and Audit Manager Implementation Date: July 2011</p>
<p>Action 7</p>	<p>Issue: An internal audit investigation noted weaknesses around the recording and investigation of National Fraud Initiative (NFI) matches. The NFI exercise, when undertaken effectively, is a useful tool in detecting fraudulent activity and strengthening the Council's control environment. Management have implemented procedures to address these weaknesses.</p> <p>Recommendation: Internal audit should be engaged to perform a follow-up review in respect of the NFI weaknesses identified in order to ensure the procedures implemented by management have been successful.</p>	<p>● Medium</p>	<p>Management Response: Agreed; Follow up work is included in all audit plans</p> <p>Responsible Officer: Risk and Audit Manager Implementation Date: August 2011</p>

Appendix B – Future Accounting, Audit and Regulatory Developments

As noted in paragraph 2.18, a number of accounting, audit and regulatory developments will impact the Council's financial statements and audit arrangements for the 2010/11 financial year. Further details in respect of the most significant changes are detailed below:

International Financial Reporting Standards (IFRS)

The adoption of International Financial Reporting Standards (IFRS) represents a significant change in financial reporting in the UK public sector. The process has already started for local authorities, as this year's SORP adopted the new accounting arrangements for PFI and service concessions, while previous SORPs have adopted IFRS style accounting for financial instruments, such as fair value disclosures in respect of the Council's financial assets and liabilities.

The IFRS-based Code of Practice on Local Authority Accounting will complete the transition process and applies to local authority accounts from 1 April 2010. As well as preparing the 2010/11 accounts under IFRS, authorities must restate their balance sheet at the point at which the Code is adopted (1 April 2009), and present restated comparatives for 2009/10.

The format of the financial statement will change, with the Income and Expenditure Account and Statement of Total Recognised Gains and Losses being combined to form a new Comprehensive Income and Expenditure Statement. In addition, the Statement of Movement on the General Fund Balance will be replaced by the new Movement in Reserves Statement.

As well as these changes to the format of statements, there will be significantly increased levels of disclosure in the notes to the account and certain items may be brought onto the balance sheet for the first time.

Work has already been started by the Council's finance department to ensure this change is managed effectively and the transition to full IFRS is a smooth one. A full restated balance sheet has been prepared and work is ongoing to provide a full set of restated 2009/10 comparatives for external audit review in advance of the 2010/11 year end process.

Clarity International Standards on Auditing (ISAs)

The Auditing Practices Board (APB) has issued 33 clarity ISAs (UK &I), based on the IAASB's clarity International Standards on Auditing (ISAs), effective for audits of financial statements for periods ending on or after 15 December 2010.

A number of the standards have been completely revised and new requirements have been introduced. There are approximately one-third more explicit requirements applying to entity audits and extra new requirements that apply to group audits, with about half of the total increase resulting from clarification of the existing standards, and about half relating to new requirements designed to improve audit quality and, consequently, financial reporting.

The actual impact on cost of audits will depend on a variety of factors such as the effectiveness of current execution; the size and complexity of the entity; and how effectively we can work with you to obtain any additional information needed to enable us to perform the required procedures. The full impact of Clarity ISAs will be detailed within our 2010/11 audit plan, scheduled for presentation to the Risk and Audit Scrutiny Forum on 16 December 2010.

Carbon Reduction Commitment (CRC)

This mandatory emissions trading scheme started in April 2010. It aims to promote energy efficiency and help reduce carbon emissions. It is UK-wide, covering large businesses and public sector organisations. Authorities with an annual spend of more than £400,000 - 500,000 on electricity each year are likely to be in the scope of CRC and South Lanarkshire have registered to participate.

As a participant, the Council must monitor energy use and file an annual return with the Environment Agency which sets out their energy usage. The Council will then have to purchase allowances from the Government to use energy in the following year. The Government will compare the energy efficiency of each participant by ranking them in a published league table.

The first annual reporting year is April 2010 – March 2011 and the first sale of allowances will take place in April 2012 – March 2013. Organisations that are required to participate fully in the scheme and the Council will need to consider how to account for the purchase of allowances, the obligation to deliver allowances and the receipt of revenue recycling payments. An internal audit review has been scheduled, as part of the 2010/11 plan, to assess the Council's preparedness for participation in the CRC.

Appendix C – Communications to Management

International Standards on Auditing (“ISA”) (UK&I) 260 – Reporting to those charged with Governance, requires that the External Auditor communicates certain matters to those charged with governance. Those charged with Governance is taken to be the Members of the Audit Committee with responsibility discharged through the regular meetings of the Audit Committee during the year. Summarised below are the requirements set out within ISA 260 together with reference to the relevant communication with you during 2009/10 or comments as appropriate.

Communication Required under ISA 260	Reference/Comment
Engagement Letters	Signed Engagements Letter with Audit Scotland at the start of our 5 year appointment and updated annually.
Independence	Audit Planning document report to 16 December 2009 Risk and Audit Scrutiny Forum and confirmed no member of audit team has any direct interest, financial or otherwise, in South Lanarkshire Council.
Audit Approach and Scope	Audit Planning document (reported to Risk and Audit Scrutiny Forum on 16 December 2009)
Accounting Policies/Practices with a Material Effect on the Financial Statements	Section 2 of our Annual Report to Members and the Controller of Audit.
Potential Effects of Material Risks and Exposures	Audit Planning document (16 December 2009).
Audit Adjustments	Section 2 of our Annual Report to Members and the Controller of Audit.
Material Uncertainties relating to Going Concern	None identified.
Disagreement with Management about Matters that could be Significant to the Financial Statements	Not applicable.
Expected Modifications to the Auditor’s Report	No modifications identified. A true and fair opinion provided
Letter of Representation	Signed by management 28 September 2010.

Communication Required under ISA 260	Reference/Comment
Material Weaknesses in Internal Control	Internal Controls findings reported separately in our Interim Management Letter (27 April 2010), Section 5 of our Annual Report to Members and the Controller of Audit.
Fraud	Discussed fraud arrangements with the Audit Committee (16 December 2009) and management throughout audit process.
Laws and Regulations	We have not identified any material breaches of laws and regulations in the period which impact on the 2009/10 Financial Statements.
Audit Materiality	Audit Planning document – presented to Audit Committee in 16 December 2009.
Fair Value Measurement and Disclosure	Included in representation letter, signed by management dated 28 September 2010.
Related Parties	Other than those transactions disclosed in the financial statements we have not identified any further transactions requiring disclosure.

Formal Reporting to Management during 2009/10

During the year we have presented a number of formal reports to Management and the Audit Committee and produced certain outputs. Our principal outputs during 2009/10 are summarised below:

Formal Output	Timing
Audit Plan	16 December 2009
Detailed Timetable for 2009/10 Financial Audit	16 December 2009
Interim Management Letter Including Follow Up of Prior Year Recommendations	27 April 2010
Follow-up of Audit of Best Value and Community Planning	27 April 2010
Audit Opinion	28 September 2010
Annual Report to Board Members and the Controller of Audit	30 October 2010

Freedom of Information Act (Scotland) 2002

In the event that, pursuant to a request which the institution has received under the Freedom of Information Act (Scotland) 2002 or the Environmental Information Regulations 2004 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the "Legislation"), South Lanarkshire Council is required to disclose any information contained in this report, it will notify PwC promptly and will consult with PwC prior to disclosing such report. The Council agrees to pay due regard to any representations which PwC may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such report. If, following consultation with PwC, the Council discloses any of this report or any part thereof, it shall ensure that any disclaimer which PwC has included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

© 2010 PricewaterhouseCoopers LLP. All rights reserved. "PricewaterhouseCoopers" refers to the PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, other member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity. This report is protected under the copyright laws of the United Kingdom and other countries. Any other use or disclosure in whole or in part of this information without the express written permission of PricewaterhouseCoopers LLP is prohibited.