ACCOUNTS COMMISSION

OVERVIEW REPORT

Overview of the 2001/02 local authority audits

Controller of Audit's statutory report and Accounts Commission's findings

PREPARED BY AUDIT SCOTLAND

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The Accounts Commission

The Accounts Commission is a statutory, independent body, which through, the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has five main responsibilities:

- securing the external audit
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- reviewing the management arrangements which audited bodies have in place to achieve value for money
- carrying out national value for money studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils and 35 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

Audit Scotland

Audit Scotland is a statutory body set up in April 2000, under the Public Finance and Accountability (Scotland) Act 2000. It provides services to both the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Accounts Commission’s findings

Performance

We welcome the continued improvement in the performance of councils measured by the statutory performance indicators.

Completion of audits

The continued improvement by councils in submitting their accounts on time is welcome. It is an important part of good governance arrangements that accurate reports on financial affairs are prepared and published on time and the Commission now expects councils and auditors to work together to improve the completion of audits and the submission of audit reports by their deadlines. This will make an important contribution to the successful development of Public Performance Reporting by councils in future years.

Governance and financial stewardship

The Commission is concerned that successive overview reports refer to examples of weaknesses in fundamental financial controls, budgetary control and risk management procedures. These are some of the fundamentals of good governance and it is not acceptable that they continue to recur. All councils should not only have Audit Committee mechanisms in place, but they should also be committed to making sure that they are effective.

DLOs/DSOs

The Commission commends the majority of councils for maintaining sound financial performance in DLOs and DSOs. There remain, however, some councils where the failure to meet break-even targets shows that performance must improve. With the abolition of CCT and the move towards the Best Value regime and trading accounts councils will have to pay particular attention to their arrangements for these activities.

Following the public pound

It is a matter of continuing concern to the Commission that councils’ financial involvement with external bodies arises in auditors’ reports, demonstrating that arrangements for monitoring the proper and effective use of public funds could be improved. This is an area which will be reviewed by the Commission this year and where an improvement in council performance will be looked for.

Pensions

It is too early to say what the impact of the decline in value of world stock markets will be on local authority pension funds. Pensions will be an important area for us to consider in the light of future audit reports.

PFI/PPP

The report refers to the key recommendations of the Commission's report on PFI in schools published in June 2002: the need for a wider choice of procurement; the need to take account of the true cost of borrowing; other cost effectiveness measures are needed; the Scottish Executive needs to lead in this area; best practice guidelines are needed.

These recommendations were welcomed by local authorities and Ministers. We look to future audit reports to assess how these recommendations are being implemented.

Waste management

One area where councils need to achieve greater improvement is in waste management and recycling where performance remains considerably short of the target. If Scotland's recycling record is to improve councils need to give recycling greater priority.

Best Value

The areas covered in the Controller's report and these findings will be important for councils to look at as we move into the Best Value regime. Councils will have to demonstrate that they undertake a rigorous review of service provision based on a clear strategy and identification of priorities for improvement.

Controller of Audit's report

Executive summary

Introduction

Public sector audit

1. The special accountabilities attached to public business and the use of public money mean that audit in the public sector requires to be planned and undertaken from the wider perspective of providing not only assurance on the financial statements but also a view on matters such as regularity, propriety and use of resources in accordance with the concepts of value for money and best value.

2. The Accounts Commission is a statutory independent body whose purpose is to hold local authorities to account through the audit process. Audit appointments are made by the Commission. Issues arising from the audit are reported to the Commission by the Controller of Audit. Audit Scotland provides services to the Commission, guidance and support to auditors and monitors auditor performance.

3. Joint scrutiny arrangements with inspectorates enable Audit Scotland and the inspectorates to discharge their respective responsibilities in a more efficient and 'joined up' manner and minimise the audit and inspection burden on local services.

Purpose of this report

4. This report has been prepared in response to a request from the Accounts Commission under section 102(1) of the Local Government (Scotland) Act 1973. The information has been drawn principally from reports prepared by external auditors at the conclusion of their 2001/02 audits. Where appropriate this has been supplemented with other relevant, contextual information.

Corporate governance

The governance agenda

5. Councils are responsible for putting in place effective corporate governance arrangements and for monitoring the adequacy and the effectiveness of these in practice. They should be reviewing their

arrangements to ensure that best practice standards of governance are being met.

6. The Accounting Code of Practice (ACOP) requires local authorities from 2002/03 to include within their accounts a statement on their system of internal financial control. Some councils included statements on corporate governance arrangements and internal financial controls in their 2001/02 accounts, in advance of the ACOP requirement.

7. In completing the internal financial control statement the Chief Financial Officer will have to draw on information from a number of sources and seek assurances from other heads of service. The expectation of Chief Financial Officers in this context confirms their key role within a council's governance framework.

Audit findings

8. It is disappointing that auditors' reports on 2001/02 local authority audits continue to contain references to weaknesses in financial controls. Sound financial procedures and effective controls are essential. Without them, councils cannot know if their financial systems have been compromised, exposing them to unacceptable risk. Fundamental weaknesses in financial control arrangements are likely to require disclosure in the internal financial control statement.

9. Effective audit committees have a pivotal role in corporate governance. Audit committees (or their equivalent) can help to promote internal control, focus audit resources and monitor audit performance. Most councils have now adopted audit committee principles fully within their business structures; auditors will continue to assess their effectiveness as part of the audit.

10. The external auditors' reports for 2001/02 identify a significant number of cases where they were unable to place reliance on internal audit or where the degree of reliance was limited. It is noteworthy that in most of the cases where external auditors reported that they were unable to place reliance on the work of internal audit the councils had audit committees (or equivalent) in place in that year.

11. Audit committees working closely with internal audit can provide important assurance on the adequacy of an organisation's internal control arrangements. But audit committees have a wider role, including liaison with external audit and monitoring the implementation of audit recommendations. The onus is on audit committees to ensure that they are effective and act in accordance with their corporate governance responsibilities.

Financial stewardship

Completion of accounts and audits

12. All 32 councils and 34 of the 35 'other' local authority bodies achieved the statutory deadline for the submission of their accounts for audit.

13. 2001/02 shows an overall improvement in the time taken to complete audits. But there is scope for further improvement. This will assume increasing importance with the introduction of Best Value from April 2003 which includes a duty on local authorities to produce public reports containing financial and performance information.

Audit certificates

14. Of the 63 audits completed at the date of this report (ie, all 32 councils and 31 of the 35 other local authority bodies), audit qualification was only required in one case (Inverclyde Council).

Budgetary control

15. Councils are responsible for the proper stewardship of the public funds under their control. Effective budgetary control is a key aspect of financial management and an indication of the quality of stewardship in councils. Weaknesses in budgetary control can lead to significant overspends with implications for service provision and local taxpayers.

16. It is important that satisfactory control and monitoring arrangements are maintained throughout the financial year to ensure that variations from budget are identified in time to allow any corrective action to be taken effectively.

Reserves and balances

17. Against a backdrop of overall annual revenue expenditure of £9 billion, the total value of reserves held by councils at 31 March 2002 was of the order of £687 million (31 March 2001: £586 million). Within the overall figures there are wide variations in the amounts held by individual councils.

Capital expenditure

18. Total General Fund capital expenditure in 2001/02 across all councils was £664 million of which £61 million (9%) was financed from current revenue. For the Housing Revenue Account, capital expenditure in 2001/02 totalled £360 million of which £82 million (23%) was financed from current revenue. Within these overall figures, there is wide variation between councils.

19. The repeal of existing capital expenditure controls and their replacement with a system based on affordability and prudent capital planning will represent a significant change to local government finance. Councils will need to give full and proper consideration to how they respond to these new arrangements in advance of their anticipated implementation in April 2004.

DLO/DSO performance

20. The audit shows that 91% of all DLOs/DSOs in Scotland achieved break-even in 2001/02 with net surpluses totalling £43 million. In 2000/01 97% achieved break-even with net surpluses of £52 million. Overall, the trend of improved financial performance which developed in the four year period to 31 March 2001 was not maintained in 2001/02.

21. It is disappointing that improvements in DLO/DSO performance in recent years have not been maintained in the run up to Best Value. Under the new legislation councils will have greater discretion in deciding on how they deliver services. Councils will, however, be expected to demonstrate reasons for choosing a particular method of service delivery and the financial implications of that decision. They will also have to conduct their significant trading operations so that revenue is not less than expenditure.

Housing/council tax benefits

22. Councils are responsible for paying housing and council tax benefits on behalf of the Department for Work and Pensions (DWP). In view of the sums and risks involved and the complexity of the benefits system, this area continues to feature prominently in external auditors' work programmes. The level of reported benefit fraud in Scotland in 2001/02 was £6.5 million (2000/01: £6.9 million). While this figure is significant it has to be viewed in the context of the £1.4 billion in benefits paid in the year.

Following the public pound

23. Issues concerning councils' financial involvement with external bodies continue to be a recurring theme in auditors' reports. From these, it is clear that scope exists for improvement in the arrangements for monitoring the proper and effective use of funds. Audit Scotland is currently undertaking a national review designed to identify the nature and extent of councils' financial involvement in external organisations and the monitoring procedures which have been developed.

24. Local authorities are not unique in funding external bodies. Similar types of funding arrangements with external organisations exist in other parts of the Scottish public sector and it is likely that the work carried out by Audit Scotland in the local government sector will have wider application.

Pensions

25. Pensions are a complex area for local authorities. They participate in a range of different schemes covering general council staff, teachers, police officers and firefighters, each with its own rules and funding arrangements.

26. Contribution rates for employers participating in the main local government scheme have increased significantly over the past ten years. The extent to which each of the local authority pension funds has been exposed to recent declines in stock market values will vary depending on the proportion of equity based funds and the investment strategy adopted. However, any prolonged decline in stock market values may affect employers' future contribution rates which, in turn, are met from council tax and government grants.

27. In light of the significant developments in pension funds and pension accounting, auditors will be expected to keep this area under review.

PFI/PPP

28. Public/private partnership (PPP) and private finance initiative (PFI) contracts are at various stages of completion in councils across Scotland. This is a significant area of council activity – councils' accounts indicate that, across Scotland, current annual commitments are of the order of £100 million. This is expected to rise as new schemes are completed.

29. External auditors continue to review the procedures by which councils progress their interest in these projects. Where projects are operational, auditors have indicated their intention to review the way in which councils monitor compliance with contract provisions.

Performance

Value for money studies

30. The value for money reports published by the Accounts Commission relating to study work undertaken during 2001/02 were:

- *Dealing with offending by young people*
- *Local economic forums – A baseline performance statement*
- *Made to measure – An overview of trading standards services in Scotland.*

Performance indicators

31. In 2001/02 councils, fire brigades and police forces were required to report their service standards against 76 statutory performance indicators (PIs). These indicators covered a wide range of services and highlighted both the variation in performance between councils and change in performance over time. The results for 2001/02 are published in full in separate Audit Scotland publications.

32. In general terms, it is pleasing to note that the trend continues to be one of overall improvement, with the majority of councils improving on most indicators between 1999/2000 and 2001/02.

Best Value

Best Value proposals

33. The Best Value policy was introduced for Scottish councils in 1997, and the current Local Government in Scotland Bill contains statutory duties in relation to Best Value, Community Planning and Public Performance Reporting. Local authorities will need to make arrangements which secure Best Value, defined as "*continuous improvement in the performance of the authority's functions*", and play a leading role in Community Planning.

2001/02 PMP audit

34. The 2001/02 PMP audit was the third year in which councils' progress in establishing Best Value arrangements was examined. It looked at a selection of specific service areas in each council, and also assessed what improvement had taken place in those areas audited in previous years.

35. Effective corporate management in councils is an important pre-requisite for Best Value and for Community Planning. The arrangements councils have in place at a corporate level were examined in the PMP audit during 2000/01 and a range of improvement actions were agreed. One year on, all councils had made improvements in more than 75% of the areas identified for development.

Best Value audit proposals

36. The Accounts Commission has approved the key design principles and overall approach to be taken by Audit Scotland in developing the new Best Value audit. The audit will incorporate issues of good management practice and corporate governance, and will draw on a wide range of information that is available on the performance of a council. The Accounts Commission is committed to supporting and

encouraging improvement and it is expected that, in most cases, the audit results will focus on broad strengths and weaknesses and the agreed improvement action plan.

37. At the conclusion of the audit a statutory report will be submitted by the Controller of Audit to the Accounts Commission and copied to the council. The Commission will produce findings on every report.

38. The Accounts Commission anticipates that the overall process will contribute to increased public accountability and support continuous improvement in the provision of public services by local government.

Part 1: Introduction

This part of the report covers:

- public sector audit
- the purpose of this report.

1 Public sector audit

Background

1.1 The special accountabilities attached to public business and the use of public money mean that audit in the public sector requires to be planned and undertaken from the wider perspective of providing not only assurance on the financial statements but also a view on matters such as regularity, propriety and use of resources in accordance with the concepts of value for money and best value.

1.2 The basic principles of financial audit are common to both the public and private sectors. However, in addition to giving an independent and objective opinion on the financial statements public sector auditors also review and report on aspects of the arrangements made to ensure the proper conduct of public business and to manage performance and the use of resources.

1.3 Audit in the public sector adds value not just by analysing and reporting what has happened, but also by being forward looking, by identifying areas where improvements can be made and by encouraging good practice. In this way it seeks to promote improved standards of corporate governance, better management and decision-making, and a more effective use of resources.

The Accounts Commission and Audit Scotland

1.4 The Accounts Commission is a statutory independent body whose purpose is to hold local authorities to account using the audit process to:

- give assurance on probity, stewardship and financial management
- effect continuous improvement
- promote the economic, efficient and effective use of resources
- secure the fair presentation of financial and performance information.

1.5 Issues arising from the audit are reported to the Commission by the Controller of Audit. The Commission has the power to report and make recommendations to Scottish Ministers and local authorities and can hold hearings. If it considers that there has been an illegality or a financial loss due to negligence or misconduct, it can apply sanctions to councillors and officers.

1.6 Audit Scotland is a statutory body that provides services to the Accounts Commission and to the Auditor General (in relation to his responsibilities for the audit of public bodies other than local authorities). Audit appointments are made by the Commission and the Auditor General to Audit Scotland staff and private audit firms. Audit Scotland provides guidance and support to all auditors on technical matters and monitors the performance of auditors. Auditors act independently in carrying out their responsibilities and in the exercise of their professional judgement.

Joint work with inspectors and regulators

1.7 Audit Scotland has joint scrutiny arrangements in place with inspectorates for fire, police and education. Under these arrangements, auditors contribute to the examination of financial and resource management and Best Value. This process enables Audit Scotland and the inspectorates to discharge their respective responsibilities in a more efficient and 'joined up' manner. It also minimises the audit and inspection burden on local services. Audit Scotland also works closely with Communities Scotland (in relation to housing matters) and the Benefit Fraud Inspectorate (in relation to housing and council tax benefit matters) and is developing closer links with the Social Work Services Inspectorate.

1.8 This work provides a solid foundation for developing the audit of Best Value which will become a statutory requirement in 2003.

Code of audit practice

1.9 Consistent with the nature of public sector audit described above, the Code of Audit Practice was developed as a basis for defining the responsibilities of auditors appointed by the Accounts Commission or the Auditor General. Compliance with the Code is a condition of audit appointment.

1.10 The Code sets out the elements of the audit in relation to three main areas:

- Corporate governance
- Financial stewardship
- Performance management.

The Code is prepared on the basis of an approach in which work in relation to one element of the audit is complementary to the other parts of the audit.

2 The purpose of this report

2.1 This report covers all the significant issues arising from the 2001/02 audits of the 32 Scottish councils and 35 related local authority organisations, such as fire and police joint boards. The overall annual revenue spend of these bodies is of the order of £9 billion. While focusing on the main council audits, references to 'other' local authority bodies are included where appropriate.

2.2 This report has been prepared in response to a request from the Accounts Commission under section 102(1) of the Local Government (Scotland) Act 1973. The information has been drawn principally from reports prepared by external auditors at the conclusion of their audits for the financial year ended 31 March 2002. Where appropriate this has been supplemented with other relevant, contextual information.

2.3 At various stages throughout the report, extracts from auditors' reports have been used to form exhibits. It is emphasised that these are intended only to exemplify the points at issue; further examples may exist in other auditors' reports.

2.4 The structure of the report reflects the elements of the audit set out in the Code of Audit Practice (see paragraph 1.10 above). Part 2 of the report covers corporate governance issues and Part 3 deals with financial stewardship in 2001/02. Part 4 highlights performance audit related matters. Finally, Part 5 refers to the Best Value proposals set out in the Local Government in Scotland Bill and the implications for audit.

Part 2: Corporate governance

This part of the report covers:

- the governance agenda
- audit findings.

3 The governance agenda

3.1 The Code of Audit Practice states that corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of an organisation.

3.2 Councils are responsible for putting in place effective corporate governance arrangements and for monitoring the adequacy and the effectiveness of these in practice. The framework of control and processes for monitoring and review provide a good base on which to build. But councils should be reviewing their arrangements to ensure that they are meeting best practice standards of governance – and to ensure that the arrangements are sound and are seen to be sound.

3.3 '*Corporate Governance in Local Government – A Keystone for Community Governance*', was produced jointly by CIPFA (Chartered Institute of Public Finance and Accountancy) and SOLACE (Society of Local Authority Chief Executives) to assist councils in developing and improving their corporate governance arrangements. It identifies the underlying principles as openness and inclusivity; integrity; and accountability and sets out five dimensions of council activity in which these principles should be applied: community focus; service delivery arrangements; structures and processes; risk management and internal control; and standards of conduct.

3.4 The CIPFA/SOLACE framework called for councils to prepare and adopt a local code of corporate governance by 31 March 2002 as a means of demonstrating how the council will apply the key principles of good governance.

3.5 Auditors evaluate the adequacy of local authorities' corporate governance arrangements as they relate to:

- the authority's review of its systems of internal control, including its reporting arrangements

- the prevention and detection of fraud and irregularity
- standards of conduct, and arrangements in relation to the prevention and detection of corruption
- the financial position of the audited body.

Exhibit 1 sets out the auditor's comments on governance at the City of Edinburgh Council.

Exhibit 1: Corporate governance at the City of Edinburgh Council

City of Edinburgh Council

The auditor of the City of Edinburgh Council reported that the Council has many aspects of a sound corporate governance framework in place. The Council:

- has addressed key issues in its decision making structures and processes in relation to the roles of elected members and arrangements for political management, the conduct of business and the delegation of authorities;
- has developed an underlying ethos that is based around consultation with stakeholders about the future direction of services and operates a three-year planning and budgeting process;
- reviews its risk management and internal control arrangements, primarily through the operation of internal audit. Internal audit is a key element of the Council's corporate governance arrangements;
- operates arrangements aimed at ensuring that members and employees are not influenced by prejudice, bias or conflicts of interest, including the adoption of a formal code of conduct for elected members, a whistleblowing policy and maintenance of registers of interests and gifts;
- has arrangements in place to ensure compliance with statutory financial requirements and the achievement of financial targets and undertakes a range of public performance reporting at both corporate and service levels.

..but needs to develop the following areas:

- formal risk management systems need to be introduced
- development of arrangements to support the inclusion of an internal financial control statement in the 2002/03 accounts
- an officers' code of conduct needs to be introduced
- improvements need to be made to the annual reporting of the Council's financial position and performance, activities and achievements, current performance in service delivery and plans to maintain and improve service quality.

Source: Auditor's report

Standards of conduct

3.6 As part of the overall corporate governance framework it is important that an organisational culture exists to promote high standards of conduct by individuals. In March 2002 the newly formed Standards Commission for Scotland circulated '*The Councillors' Code of Conduct*' which was made by Scottish Ministers and approved by the Parliament. Several councils have adopted local codes of conduct or endorsed the national Code.

3.7 Councils should also have in place a code of conduct for officers, to complement the Councillors' Code. The existence of clear anti-fraud and 'whistleblowing' policies are further evidence of a council's commitment to high ethical standards.

Statement on the system of internal financial control

3.8 Increasingly, as part of the development of corporate governance within the public sector, there is a requirement for a statement to be made by the organisation on how the principles of corporate governance have been applied.

3.9 The Accounting Code of Practice (ACOP) requires local authorities from 2002/03 to include within their accounts a statement on their system of internal financial control. Information to be included in the statement is set out in Exhibit 2. The internal financial control statement requires to be signed, as a minimum, by the Chief Financial Officer (normally the Director of Finance) but may be signed in addition by the Chief Executive. The Code gives authorities the option of publishing a wider ranging statement on the system of internal control and/or a statement on the adoption of a local code of corporate governance and how they have complied with such a code and monitored its effectiveness. Where wider ranging statements are included these should be signed on behalf of the elected members.

3.10 Some councils included statements on corporate governance arrangements and internal financial controls in their 2001/02 accounts, in advance of the ACOP requirement.

Exhibit 2: Information to be included in the internal financial control statement

Information to be included in the Statement

- An acknowledgement of responsibility for internal financial control.
- An indication of the level of assurance that a system of internal financial control can provide.
- A brief description of the main features of the system of internal financial control.
- A brief description of the role of internal audit and the management and reporting arrangements for internal audit.
- Details of any other reviews informing the assessment of the effectiveness and operation of internal financial control undertaken during the year.
- A concise explanation of any identified significant weaknesses in the system of internal financial control, together with the actions undertaken or planned to address these.

Source: Accounting Code of Practice, 2002

3.11 In completing the internal financial control statement the Chief Financial Officer will have to draw on information from a number of sources and seek assurances from other directors and/or heads of service. The expectation of Chief Financial Officers in the context of the statement confirms their key role within a council's governance framework. Exhibit 3 is an extract from CIPFA's recent publication '*A Statement on the role of the Finance Director in Local Government*'.

Exhibit 3: Governance – the chief financial officer

' Although the ultimate responsibility for an effective approach to governance rests with the authority itself the finance director has a key role to play in assessing risk, evaluating options and ensuring that effective controls are in place.'

Source: '*A Statement on the role of the Finance Director in Local Government*'
CIPFA, January 2003

3.12 Auditors' reports highlight the action required to meet the internal financial control statement requirements; an example is contained in the auditors' 2001/02 report on Fife Council (Exhibit 4).

Exhibit 4: Preparing for the internal financial control statement – Fife Council

Fife Council

The auditors recommended that the Head of Finance and Asset Management (the Council's Chief Financial Officer), the Audit Services Manager, the Standards and Audit Committee and the Council management team should consider the assurance mechanism required to allow the information to be gathered for the Internal Financial Control Statement. Interaction of internal audit and the Standards and Audit Committee work should be considered in the context of the assurances they can provide to the Head of Finance and Asset Management in his role as the person responsible for signing the statement. Early consideration should be given to ensure identification of any known areas of weakness in internal financial control to enable appropriate action to be agreed for inclusion in the statement.

Source: Auditors' report

3.13 Audit Scotland is currently developing guidance on the auditor's role in relation to statements of internal financial control and wider ranging statements. The likely approach will be for auditors to consider the statement and its disclosures as presented by the authority and to assess whether these are in accordance with the Accounting Code of Practice or other guidance and consistent with the information which they are aware of from their work under the Code of Audit Practice. If there is non-compliance or inconsistency and the authority is unwilling to amend the statement, the auditor will highlight such matters in the audit report.

4 Audit findings

Systems of internal control

4.1 One of the key roles of external auditors is to evaluate financial control systems and report on any weaknesses identified.

4.2 Auditors' reports on 2001/02 local authority audits contain references to weaknesses in fundamental financial controls. Examples of issues arising are included in Exhibit 5. As indicated in the introduction, this and subsequent exhibits containing extracts from auditors' reports at individual councils are intended only to exemplify the points at issue – similar cases are often included in other auditors' reports.

Exhibit 5: Examples of internal control weaknesses reported by auditors

Fife Council

The auditors of Fife Council identified numerous weaknesses within the processes carried out by the Council's central pay unit. Significant weaknesses were identified for all of the key control objectives for the payroll covering administrative, professional and technical staff.

The auditors found that there was a lack of basic controls over many areas reviewed. Where controls existed their effectiveness was limited as they were not always adhered to. The auditors' overall conclusion was that the internal controls within the Council's central payroll unit were unsatisfactory.

Council management agreed to implement the auditors' recommendations. The auditors will be following up the Council's actions as part of their audit.

Scottish Borders Council

The auditors noted that year-end reconciliations were not carried out between the debtors and creditors systems and the financial ledger to demonstrate that the financial statements were accurate.

Council officers had to prepare a reconciliation at the request of the auditors to explain a difference of £650,000 between the amount outstanding recorded by the debtors system and the balance recorded in the financial ledger.

Although the statement provided a satisfactory explanation for the significant variance the auditors expressed concern that control account reconciliations are not a standard feature of the Council's system of internal control.

Source: Auditors' reports

4.3 It is disappointing to note continuing weaknesses in financial controls of the type highlighted in Exhibit 5, at these and other councils. Sound financial procedures and effective controls are essential. Without them, councils cannot know if their financial systems have been compromised, exposing them to unacceptable risk. Auditors will be monitoring the action taken by councils to address weaknesses identified during the audit. Councils should also be aware that fundamental weaknesses in financial control arrangements are likely to require disclosure in the statement on internal financial control required in local authority accounts from 2002/03 onwards (see paragraph 3.9).

Risk management

4.4 Risk management is increasingly recognised as an essential element of internal control. The main components of a system of risk management are set out in Exhibit 6.

Exhibit 6: Components of effective risk management

The three components of a system of risk management are:

- timely identification of key business risks
- assessment of the likelihood of risks crystallising and the significance of the consequent financial or other impact
- prioritising the allocation of resources available to control risk and the setting and communicating of clear objectives.

Source: Audit Scotland

4.5 Auditors reported that several councils had yet to implement risk management procedures or had inadequate procedures in place. Examples of auditors' comments are included in Exhibit 7. This is an area which auditors will require to consider when reviewing internal financial control statements for 2002/03. It is essential that risk management is embedded in strategic and operational planning activity.

Exhibit 7: Risk management

Dumfries and Galloway Council

The auditor reported that the Council does not have a systematic approach to risk management and highlighted that this is an area that requires to be developed.

Perth and Kinross Council

As part of the corporate governance review the auditor recommended that the Council:

- approves a corporate risk management strategy to assist in developing processes for identifying, evaluating and monitoring all financial and non-financial risks
- produces an annual assessment of its risk management arrangements and internal controls to support the internal financial control statement (a requirement from 2002/03).

The auditor noted that the Council's Strategic Policy and Resources Committee approved a corporate risk management strategy in July 2002.

Source: Auditors' reports

Audit committees

4.6 Effective audit committees have a pivotal role in corporate governance. Audit committees (or their equivalent) promote internal control, focus audit resources and monitor audit performance. The Accounts Commission has endorsed audit committee principles as a focus for elected members' role in audit, scrutiny and performance reporting.

4.7 Exhibit 8 highlights two particular cases where the auditors considered that audit committees (or their equivalent) are working well.

Exhibit 8: Audit committees in operation

Renfrewshire Council

The auditor reported that the Council continues to operate a well established Audit Panel and has more recently set up a Scrutiny Board which includes elected member participation. The auditor considered that these arrangements represent a robust mechanism for considering audit and governance issues and conducting reviews of specific areas of performance eg sickness absence and rent collection levels.

West Lothian Council

The auditor noted that the Council's audit committee was working well and had adopted guidance notes to assist it in carrying out its role of reviewing and monitoring corporate governance issues.

A key area of work for the audit committee is in regard to monitoring the implementation of internal and external audit recommendations. These are reported to the committee on a regular basis and provide focus and accountability for senior management in ensuring that appropriate action is taken on audit recommendations.

Source: Auditors' reports

4.8 External auditors' reports indicate that, of the 32 councils, only Falkirk, Shetland and Stirling councils had yet to adopt audit committee principles fully within their business structures. Developments at Falkirk Council are highlighted at Exhibit 9. At Shetland and Stirling the auditors' recommendations relating to the adoption of audit committee principles are under active consideration. Auditors will continue to assess the effectiveness of audit committees (or their equivalent) as part of their audit.

Exhibit 9: Falkirk Council – adopting audit committee principles

Falkirk Council

The auditors reported that in April 2002 the Council's Policy and Resources Committee approved a local Code of Corporate Governance. This Code included a recommendation to establish an audit scrutiny function that is intended to follow audit committee principles. As of September 2002, the audit scrutiny function has not yet been fully implemented. In developing this function, the auditors highlighted the need for members and officers to consider the following points:

- the audit scrutiny function of the Policy and Resources Committee should have detailed terms of reference, including assigning responsibility for liaising with the internal and external auditors, reviewing the effectiveness of internal audit, receiving reports and monitoring action taken to implement recommendations and ensuring internal audit has appropriate standing in the organisation
- audit scrutiny training should be provided to all Members
- arrangements should be introduced to keep audit scrutiny function members up to date with topical technical accounting issues, such as new financial reporting standards and the requirements of the Accounting Code of Practice.

The Council agreed to produce an action plan which will detail the steps required to integrate audit committee principles within the Council's committee structures.

Source: Auditors' report

Internal audit

4.9 As part of the annual audit cycle external auditors assess the extent to which they can rely upon councils' internal audit arrangements to ensure that audit resources are used efficiently by avoiding duplication of effort. This assessment considers the quality of work produced by internal audit and the extent to which it has covered the main financial systems.

4.10 The external auditors' reports for 2001/02 identify a significant number of cases where they were unable to place reliance on internal audit or where the degree of reliance was limited. Exhibit 10 sets out those cases where the external auditors concluded that they were unable to place reliance on the work of internal audit to gain assurances on the satisfactory operation of financial controls.

Exhibit 10: Cases where external auditors were unable to place reliance on internal audit

Council	Reasons why external auditors were unable to place reliance in 2001/02	Audit Committee (or equivalent)
Clackmannanshire	Improvements required to staffing, structure and output	Yes
Dumfries and Galloway	No systems review work undertaken in 2001/02	Yes
Dundee	Did not complete planned work in 2001/02; wide variation between planned and actual level of activity	Yes
East Dunbartonshire	Did not achieve planned input on systems reviews	Yes
Inverclyde	Slippage against plan, no new systems work in 2001/02	Yes
Orkney	Resourcing and time spent on non-audit work	Yes
South Ayrshire	Evaluation of internal audit identified a number of areas of concern	Yes (from May 2002)

Source: Auditors' reports

4.11 In most of the cases where external auditors reported that they were unable to place reliance on the work of internal audit for the purpose of their 2001/02 audit, the councils had audit committees (or equivalent) in place in that year. Guidance on the operation of internal audit is contained in the Accounts Commission publication '*A job worth doing – Raising the standard of internal audit in Scottish councils*'. This identified having an audit committee which held internal audit to account for its performance as one of the key features of councils with effective internal audit functions. Exhibit 11 shows how audit committees can achieve this.

Exhibit 11: Audit committees (and their equivalent) – holding internal audit to account

Role of audit committee in relation to internal audit:

- approve internal audit work plans
- review internal audit output and performance
- monitor output against plans
- ensure a mechanism exists to verify that audit recommendations have been implemented.

Source: Audit Scotland

4.12 Audit committees working closely with internal audit can provide important assurance on the adequacy of an organisation's internal control arrangements. But audit committees have a wider role, including liaison with external audit and monitoring the implementation of audit recommendations. The onus is on audit committees (or their equivalent) to ensure that they are effective and act in accordance with their corporate governance responsibilities.

Joint boards/joint committees

4.13 Joint boards and committees are formed where two or more local authorities agree or are obliged to provide services across a wider geographic area. Examples of services run by joint boards include police, fire, major road bridges and country parks. In these circumstances a lead authority is usually nominated to undertake the administrative functions, such as payroll processing. Often internal audit will also be provided by the lead authority.

4.14 Auditors reported that some joint boards had yet to establish audit committees or an equivalent scrutiny mechanism. Central Scotland Joint Police Board, Grampian Fire Board, Strathclyde Fire Joint Board and Strathclyde Joint Police Board are among the largest of the joint boards and auditors reported that, in each case, audit committee principles had yet to be adopted within the boards' business structures.

4.15 Auditors also reported that in several joint boards no internal audit work had been undertaken. It is important that joint boards and committees ensure that the level of internal audit coverage is appropriate in the context of systems and transactions specific to their organisations.

Part 3: Financial stewardship

This part of the report covers:

- completion of accounts and audits
- audit certificates
- budgetary control
- reserves and balances
- capital expenditure
- DLO/DSO performance
- housing/council tax benefits
- following the public pound
- pensions
- PFI/PPP.

5 Completion of accounts and audits

Completion of accounts

5.1 The local authority financial year ends on 31 March. The Local Authority Accounts (Scotland) Regulations 1985, as amended, require local authorities to submit their annual accounts for audit by 30 June in the next financial year. All 32 councils and 34 of the 35 'other' local authority bodies achieved the statutory deadline. The accounts of Central Scotland Valuation Joint Board were available by the end of August 2002.

5.2 The Chief Financial Officer (usually the Director of Finance) is responsible for the preparation of the accounts and is required to sign and date the accounts, stating that they 'present fairly' the financial position of the authority at 31 March and its income and expenditure for the year then ended. The Chief Financial Officer is responsible for ensuring that the accounts presented for audit (and made available under the public inspection process) are accurate.

5.3 Auditors have reported that the accounts of several councils required significant adjustment following audit. In the case of Aberdeen City Council audit adjustments of £11 million were required (albeit the adjustments related to transfers between accounts with no net impact on the year's results). At Highland Council and Inverclyde Council adjustments resulted in movements in the year's results between the unaudited and audited figures of about £2 million.

5.4 In the case of Clackmannanshire Council, net audit adjustments of £416,000 changed the year's surplus of £80,000, as shown in the unaudited accounts, to a deficit of £336,000 in the published audited accounts. The auditors identified the main reasons for changes in the general fund results, which included reassessment of the accounting treatment of restructuring costs. They also highlighted that significant changes were required to the balance sheet and related notes.

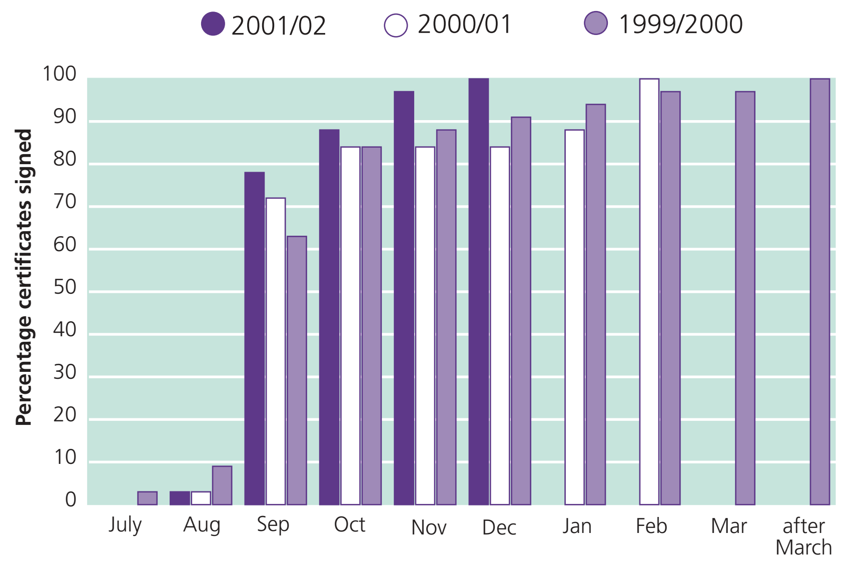
5.5 At Tayside Joint Police Board the auditor considered that the accounts presented for audit were deficient. He reported that the resolution of issues arising from the poor standard of the accounts presented for audit required greater resources to complete the audit and that this would impact on the level of audit fee.

Completion of audits

5.6 As indicated above, most local authorities achieved the statutory deadline for the submission of accounts for audit.

5.7 Under their terms of appointment, external auditors were required to complete the 2001/02 audits by 30 September 2002. Exhibits 12 and 13 respectively show the dates by which the council audits and the 'other' local authority audits were signed off by auditors and compare the position with previous years.

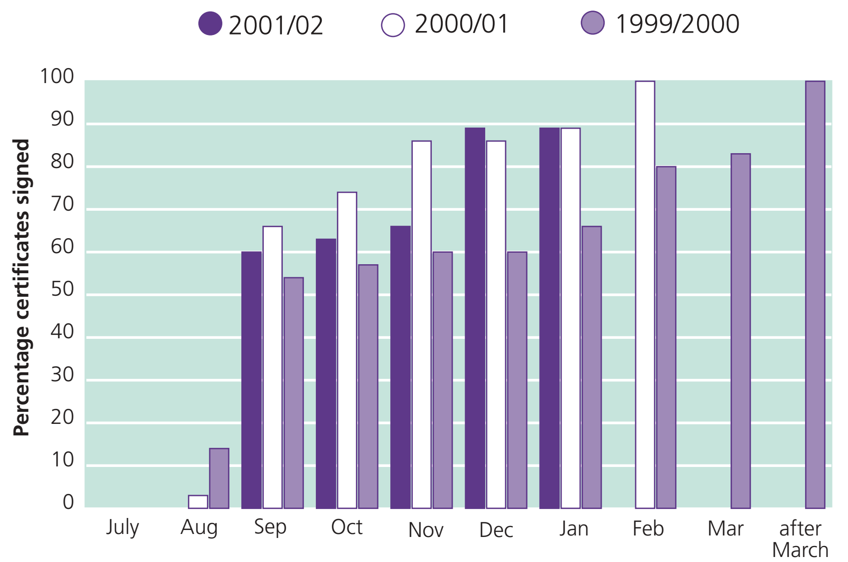
Exhibit 12: Councils – date by which audit certificates were signed 1999/2000 – 2001/02



Source: Audit Scotland

5.8 Twenty five council (78%) audits were signed off by the 30 September deadline. This represents a further improvement over recent years (2000/01: 23 audits (72%); 1999/2000: 20 audits (63%)). 2001/02 is also the first year that all 32 council audits were completed by 31 December.

Exhibit 13: 'Other' local authority bodies – date by which audit certificates were signed 1999/2000 – 2001/02



Source: Audit Scotland

5.9 Twenty one (60%) of the 'other' local authority audits were signed off by 30 September 2002. This compares with 23 (66%) in 2000/01 and 19 (54%) in 1999/2000. As at 5 February 2003, four 2001/02 local authority audits have yet to be signed off (Ayrshire Valuation Joint Board and Central Scotland Valuation Joint Board (auditors: KPMG in both cases); Lothian and Borders Police Board and Tayside Contracts Joint Committee (auditors: Audit Scotland in both cases)).

5.10 2001/02 shows an overall improvement in the time taken to complete audits. But there is scope for further improvement, with greater emphasis required in meeting the 30 September deadline and in the earlier completion of 'other' local authority audits generally. Audit Scotland will continue to monitor auditors' performance in completing audits. This will assume increasing importance with the introduction of Best Value from April 2003 with the need to produce timely public performance reporting and audit reports based on audited accounts.

5.11 The value of financial information is enhanced if the audited accounts are published as soon as possible after the completion of the audit. Analysis of the dates on which the audits were completed (signed off by the auditor) and the dates on which the accounts were published (as indicated by the date on which the auditors submitted a copy of the certified accounts to Audit Scotland) suggests that there is still a delay of about one month in making the audited financial information available publicly.

5.12 Looking to the future, there would be considerable merit in publishing the financial results with other performance information. Timely publication of a combined financial and performance report would be a significant contribution towards effective public reporting under Best Value and would assist the public in assessing the overall performance of their councils, thereby promoting improved accountability.

6 Audit certificates

Qualifications

6.1 Of the 63 audits completed at the date of this report (ie, all 32 councils and 31 of the 35 other local authority bodies), audit qualification was only required in one case.

6.2 The accounts of Inverclyde Council were qualified due to a limitation in the evidence available to the auditor to support the accounting treatment of cash income of £1.1 million received during the year. The Council treated the income as a prior year adjustment as it considered the income to relate to non-domestic rate debtors for previous years which had previously been written off. The Council was, however, unable to make available to the auditor the accounting records necessary to demonstrate that the debtors had been written off. There were no other satisfactory audit procedures that the auditor could adopt to confirm that prior year income, as disclosed in the accounts, was properly recorded. The qualification has no impact on the overall position on the General Fund.

Failure to comply with a statutory requirement

6.3 The auditors' reports for 14 councils contained a paragraph referring to failures to comply with statutory requirements. These relate to issues which, although significant, do not impact on the accuracy of the figures contained in the accounts and do not, therefore, require the auditor's opinion on the accounts to be qualified.

6.4 All these references, covering 31 individual instances of the failure to meet a statutory requirement related to DLOs/DSOs. Of these, 26 concerned failures to meet the statutory break-even target for defined activities; the remainder related to circumstances where councils had failed to keep separate accounts for statutorily defined DSO activities and the auditor was, therefore, unable to determine whether the statutory target had been achieved. The overall position on DLOs/DSOs in 2001/02 is considered at section 10 of this report.

7 Budgetary control

7.1 Councils are responsible for the proper stewardship of the public funds under their control. Effective budgetary control is a key aspect of financial management and an indication of the quality of stewardship in councils. An example of a case where auditors have identified good practice is set out in Exhibit 14.

Exhibit 14: Fife Council – example of good budgetary control arrangements

Fife Council

The auditors of Fife Council found that a coherent and planned approach had been taken to the setting of the 2002/03 budget and the establishment of three year budgeting. The explanation of the process, identification of key areas of pressure and savings targets, use of balances and involvement of services and councillors all provide a basis for ensuring budgets are set appropriately.

Budget monitoring is carried out timeously using various reporting styles depending on the needs of the users and/ or committees. Reports provide sufficient exception reporting to identify areas for attention.

Source: Auditors' report

7.2 Weaknesses in budgetary control mechanisms can lead to significant overspends on the annual budget. Examples of issues reported by auditors are set out in Exhibit 15.

Exhibit 15: Overspending against budget

Argyll and Bute Council

The Council ended the 2001/02 year with an overspend of £891,000 on its education budget (which was reduced to £691,000 as a result of internal accounting transfers).

In response to concerns over the budgetary position a dedicated finance team was set up within the Education Department in November 2001. The team reports regularly to the Education Finance Working Group and has revised the approach to budget monitoring and reporting. It has been considered necessary to examine budget variances at a lower level than in other departments and budget holders will be required to provide explanations for variances of a relatively low amount. The authority consider that this should provide greater control and encourage budget holders to take ownership of their budgets and become fully involved in the financial monitoring process.

The external auditor has indicated that he will review this area as part of 2002/03 audit.

East Dunbartonshire Council

The Council had an overspend of £1.1 million (6%) in 2001/02 on its social work budget of £17.9 million, the full extent of which was not reported to elected members until June 2002, more than two months after the end of the financial year.

The Council initiated an internal audit investigation into financial management and control to prevent a recurrence of a similar situation in future years. In addition the Council appointed external consultants to establish the full reasons for the overspend.

The consultants concluded that:

- there was a lack of financial expertise within the Social Work and Joint Venture section
- the lack of budgetary control and up-to-date information throughout the year resulted in the scale of the overspend not being anticipated
- there was an absence of a clear policy framework for decision making for a service that required complex care arrangements to be made within limited financial resources
- there was a need to differentiate between statutory, mandatory and discretionary responses to service demands
- there was a lack of information on the budget available at the point of purchasing.

The auditor intends to monitor this area in 2002/03.

Scottish Borders Council

Following previous statutory reports concerning a £3.9 million overspend on education and weaknesses in financial management, the Controller of Audit reported (S.R. 2002/4) an overall improvement in the financial position of Scottish Borders Council in the period to October 2002 and in the arrangements for the financial management of the education service. The Council had also made good progress in addressing the main areas of concern identified in the previous statutory reports. However, the Controller emphasised the need for the improved arrangements to be sustained and the benefits achieved in practice.

The Commission accepted the Controller's conclusions and shared the view that the Council needs to maintain the momentum of its progress in order to secure the benefits from the improvements which have been made. Progress is now being monitored by the appointed auditors as part of their routine work.

Source: Auditors' reports and Audit Scotland

7.3 It is important that satisfactory budgetary control and monitoring arrangements are maintained throughout the financial year to ensure that any required corrective action such as reducing service levels or transferring sums between budget heads can be taken early. Matters highlighted from auditors' reports include those set out in Exhibit 16.

Exhibit 16: Budget monitoring – examples of issues reported by auditors

East Renfrewshire Council

The auditors reported that revenue budget monitoring reports presented to members did not cover the whole of the 2001/02 financial year; the final report on the budget was submitted on 20 December 2001; and no final year end budget monitoring report was submitted to members.

The auditors also reported that the Council's senior management team did not, as a matter of course, review departmental budgetary control reports.

Shetland Islands Council

The auditors stated that no formal report comparing the budget and actual results during the year was routinely prepared and submitted to the Council. The auditors highlighted that the monitoring of actual financial outturns to budgets is a fundamental control which requires the oversight of elected members, and action requires to be taken to implement such reporting, together with an analysis and explanation of variances, as soon as possible.

South Ayrshire Council

Based on their review of the social work department's budgetary control procedures, the auditors identified the following points:

- budget monitoring reports do not specify the action required to address budget variances or record whether previously agreed action has been successfully implemented
- monitoring reports presented to budget holders do not contain any explanatory narrative to assist interpretation of the reports
- monitoring reports presented to budget holders within the social work department do not contain projected year end outturn figures. As a result the budget holders do not have all the information necessary to make informed decisions.

Source: Auditors' reports

8 Reserves and balances

Revenue

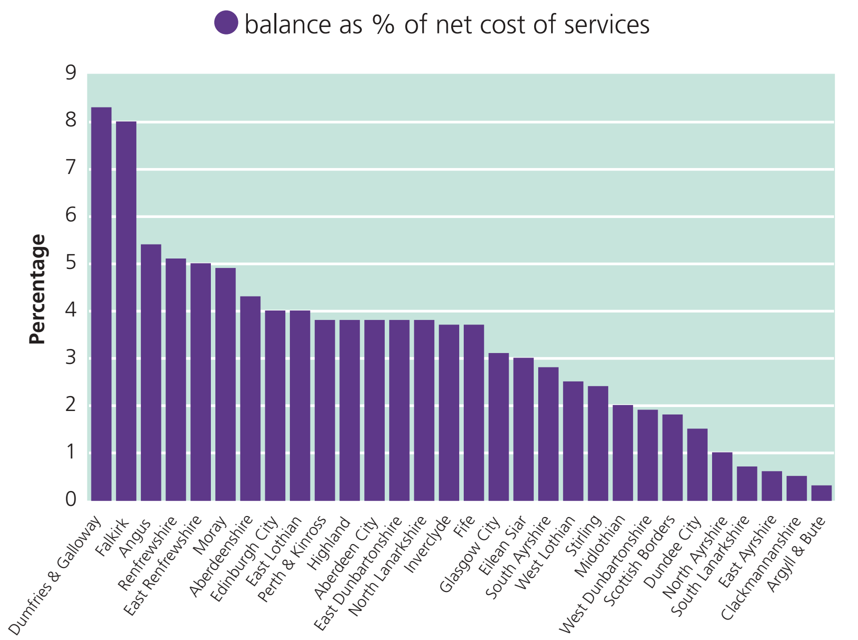
8.1 Councils' revenue expenditure is financed from three main sources: government grants (which includes yields from non-domestic rates), council tax and fees and charges. About 80% of financing for local government expenditure comes from central government grant, council tax funds about 15%, and the balance (5%) is funded mainly from fees and charges. Expenditure on council housing is met mainly from rents.

8.2 Income and expenditure on council services other than housing is reflected in the General Fund. The Housing Revenue Account (HRA) records transactions relating to the provision of council housing. The HRA is 'ring-fenced' in that councils may not subsidise council housing activities from the General Fund.

8.3 Each year councils are required to set council tax at a level that will ensure that income will meet anticipated expenditure, taking into account other sources of finance. Councils may decide to utilise some of their reserves when drawing up their annual budget. For this reason the General Fund surplus or deficit for the year is not in itself a reliable measure of financial performance. The accumulated General Fund balance, together with other balances held, give a more meaningful indication of a council's financial health.

8.4 At 31 March 2002 councils had General fund balances totalling £260 million (31 March 2001: £191 million) representing 3.6% of General Fund net expenditure (31 March 2001: 2.7%). General Fund balances at individual councils ranged from less than 1% to over 8% of General Fund net expenditure. (Exhibit 17). The exhibit excludes Orkney and Shetland Islands Councils – see paragraph 8.6 below.

Exhibit 17: Councils' general fund balances, 31 March 2002



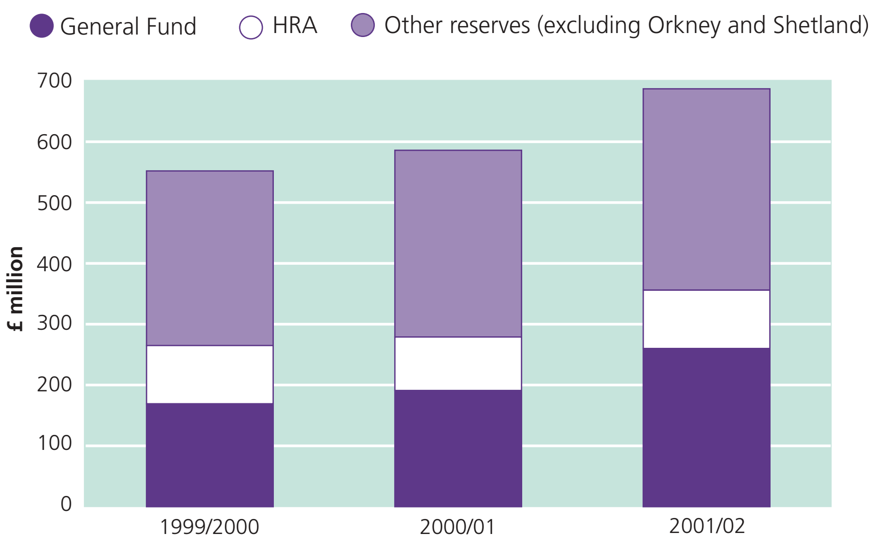
Source: Audit Scotland

8.5 At 31 March 2002, 25 councils had surplus balances on their Housing Revenue Accounts, totalling £96 million (31 March 2001: 28 councils had balances totalling £88 million). The remaining seven councils had nil balances on their HRAs (31 March 2001: four councils had nil balances).

8.6 Councils hold a variety of other reserves in addition to the General Fund and Housing Revenue Account balance. The total value of these funds at 31 March 2002 was £331 million (31 March 2001: £307 million). These mainly consist of renewal and repair funds, insurance funds and capital funds. These totals exclude significant balances held by Orkney and Shetland Islands Councils arising principally from harbour and oil related activities.

8.7 The total level of councils' reserves is shown in Exhibit 18.

Exhibit 18: Councils' total reserves



Source: Audit Scotland

8.8 Against a backdrop of total annual revenue expenditure of about £9 billion, the total value of reserves held by councils at 31 March 2002 was of the order of £687 million (31 March 2001: £586 million). Within the overall figures there are wide variations in the amounts held by individual councils. In terms of amounts described as 'other reserves', auditors have again indicated that in some cases the statutory basis and purpose of these reserves is not always clear.

8.9 Reserves are funded predominantly from government grant and council tax. Auditors will continue to monitor utilisation of reserves as part of their overall review of councils' stewardship of public funds, and will follow up those cases where the statutory basis and purpose of reserves is not clear.

9 Capital expenditure

9.1 Capital expenditure is mainly financed by borrowing which allows costs to be spread over future years in order to match the benefits from the expenditure incurred. However, councils can decide to fund capital expenditure from current revenue. This increases their capital spending capacity but the expenditure falls to be met in full by council taxpayers or council tenants in the year in which the expenditure is incurred.

9.2 Total General Fund capital expenditure in 2001/02 across all councils was £664 million of which £61 million (9%) was financed from current revenue (2000/01: £590 million, of which £87 million (15%) was financed from current revenue). For the Housing Revenue Account, capital expenditure in 2001/02 totalled £360 million of which £82 million (23%) was financed from current revenue (2000/01: £356 million of which £118 million (33%) was financed from current revenue). Within these overall figures, there is wide variation in the extent to which councils finance capital expenditure from current revenue. This is particularly evident on the Housing Revenue Account where the amount of capital expenditure financed from current revenue in 2001/02 ranged from nil to 69% (2000/01: from nil to 60%). About a fifth of all councils in Scotland financed 40% or more of Housing Revenue capital expenditure from current revenue in 2001/02 (2000/01: a quarter).

Capital spending controls and prudential guidelines

9.3 Under section 94 of the Local Government (Scotland) Act 1973 local authorities require consent from Scottish Ministers to incur capital expenditure. Consent is given annually by Scottish Ministers in a letter to local authorities. After each financial year end authorities are required to prepare a return in accordance with the consent letter and submit it to the Scottish Executive. Generally, the return compares the gross consent available with the authority's capital payments.

9.4 The Local Government in Scotland Bill has completed its passage through the Scottish Parliament. It contains provisions to repeal section 94 of the Local Government (Scotland) Act 1973 and replace it with a duty on a local authority to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure in accordance with regulations made by Scottish Ministers. The Bill also gives Ministers the power to set the maximum amounts which a local authority may allocate to capital expenditure which would supersede any determination made by the authority. It is anticipated that these provisions will come into force on 1 April 2004. Regulations made by Scottish Ministers under the provisions of the Bill may refer to the requirements of codes of practice.

9.5 A Code of Practice for Capital Finance in Local Authorities (the Prudential Code) is being developed by CIPFA at the request of the Government and provides a framework for local authority capital finance to ensure that capital expenditure plans are affordable, external borrowing and other long term liabilities are within prudent and sustainable levels and that treasury management decisions are taken in accordance with professional good practice. The Code will set out good practice in relation to the planning and management of capital expenditure, including prudential indicators for capital financing costs, external debt and treasury management that each authority is required to set and monitor in accordance with the Code.

9.6 The repeal of existing capital expenditure controls and their replacement with a system based on affordability and prudent capital planning represents a significant change to local government finance. Councils will need to give full and proper consideration to how they will respond to these new arrangements in advance of their anticipated implementation in April 2004. This is likely to include a review of existing procedures for planning, monitoring and reporting capital expenditure, updating capital investment strategies and putting in place arrangements to meet the requirements of the Prudential Code and any regulations issued by Ministers. The external auditors will be expected to monitor developments in this area as part of their ongoing audit responsibilities.

Accounting for fixed assets

9.7 The way councils account for fixed assets was changed in recent years with a view to increasing transparency in relation to the economic effects of using assets. Fixed assets held by councils should be included on the balance sheet at current values and a charge made to service accounts for the use of assets. Councils should maintain a comprehensive asset register, updated for acquisitions, disposals, changes in use and revaluations. The asset register forms the basis for the calculation of annual charges to revenue accounts.

9.8 Auditors report that councils do not always maintain appropriate fixed asset registers and that valuations are not always carried out within the required five year cycle. These are essential pre-requisites of the proper management of fixed assets, in which significant amounts of public money are invested. There is also a need to ensure that the full benefit of managing assets in this way is realised. Examples of the type of issues reported by auditors are set out at Exhibit 19.

Exhibit 19: Capital accounting

City of Edinburgh Council

The 2001/02 audit revealed that although the Council complies with mandatory capital accounting requirements with a material impact on figures reported in the annual accounts, there remains significant scope for improvement in a number of areas.

The auditor noted, overall, it is apparent that the Council has taken a 'compliance' approach to many aspects of the capital accounting system, which is primarily to meet the requirements of the Accounting Code of Practice in relation to the preparation of the annual financial statements. The system has made little contribution to date to the management of assets at a corporate or operational level:

- the Council has not actively considered how best to secure the optimum benefits from operating the required approach, including the contribution it can make to improved asset management
- capital charges are not incorporated into the Council's budgetary control system.

Moray Council

In Moray, assets with a value of £308 million are included in the accounts at 31 March 2002. These generated capital charges of £16 million.

The Council does not maintain a single register for all assets. The Estates section maintain a property register for all properties, other than council dwellings, which are held in the records of the housing department. All other assets are recorded on spreadsheets held by the Finance department, whose responsibility it is to ensure that the capital accounting requirements are met. The auditors' review identified a number of areas where improvements could be made. They consider that it would assist the Council in developing a corporate approach to the management of assets if a more comprehensive and accessible system was in place to record asset information. The Council has established a working group to develop a corporate approach to asset management.

Source: Auditors' reports

10 DLO/DSO performance

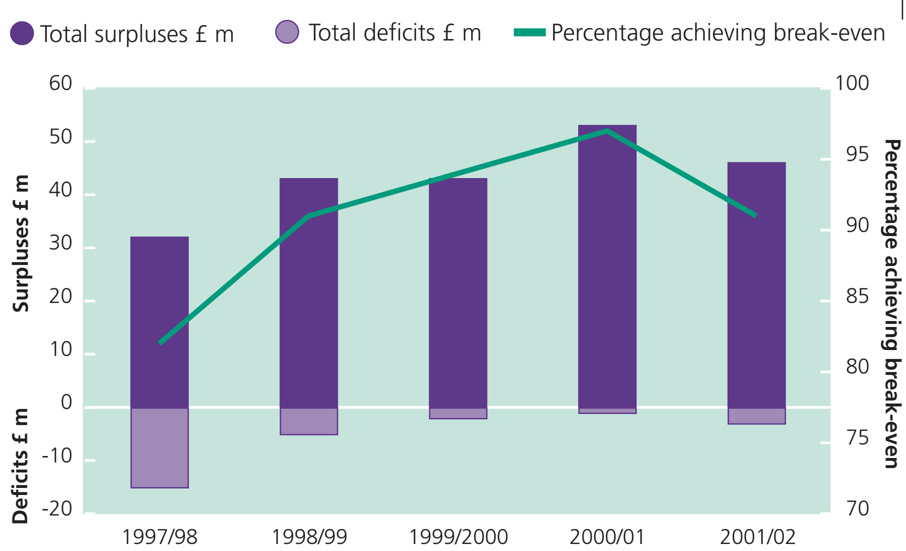
Overall position

10.1 The main statutory provisions governing the operation of councils' Direct Labour Organisations (DLOs) and Direct Service Organisations (DSOs) under Compulsory Competitive Tendering (CCT) are contained in the Local Government, Planning and Land Act 1980 and the Local Government Act 1988 respectively.

10.2 In consequence of local government reorganisation in Scotland (which was effective from 1 April 1996), CCT was largely suspended. With the development of the Best Value regime, there has been an extension of the moratorium on most existing CCT activity. However, councils are still required by statute to prepare a detailed specification and calculation of the charge to be made by their DLOs and DSOs for carrying out work. They are also required to maintain accounts and to break-even each year for each defined category of work.

10.3 Following widely reported financial difficulties in 1997/98, an improving picture developed across Scottish DLOs/DSOs. The results show that this trend was not maintained in 2001/02, although 91% of all DLOs/DSOs in Scotland achieved the statutory break-even target with net surpluses totalling £43 million. Exhibit 20 compares performance in 2001/02 with the previous four years.

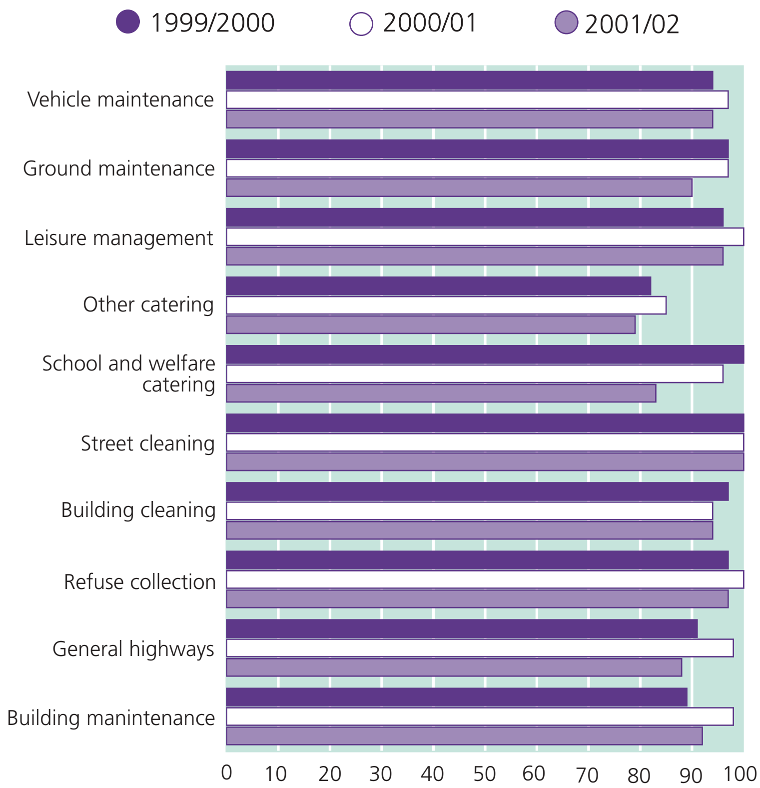
Exhibit 20: DLO/DSO performance 1997/98 – 2001/02



Source: Audit Scotland

10.4 Exhibit 21 summarises financial performance for each activity against the statutory break-even target in 2001/02 and compares this with 2000/01 and 1999/2000.

Exhibit 21: DLOs/DSOs achieving the break-even target (percentage)



Source: Audit Scotland

10.5 The largest single deficit (£682,000) was incurred by the Highland Council's Roads DLO. The auditor's report sets out the circumstances and his comments are summarised in Exhibit 22.

Exhibit 22: Highland Council – Roads DLO

Highland Council

The auditor's report indicated that the Road Maintenance DLO – Non Trunk Roads incurred a deficit of £682,000 on a turnover of £19 million (3.6%) – (2000/01: surplus £3 million).

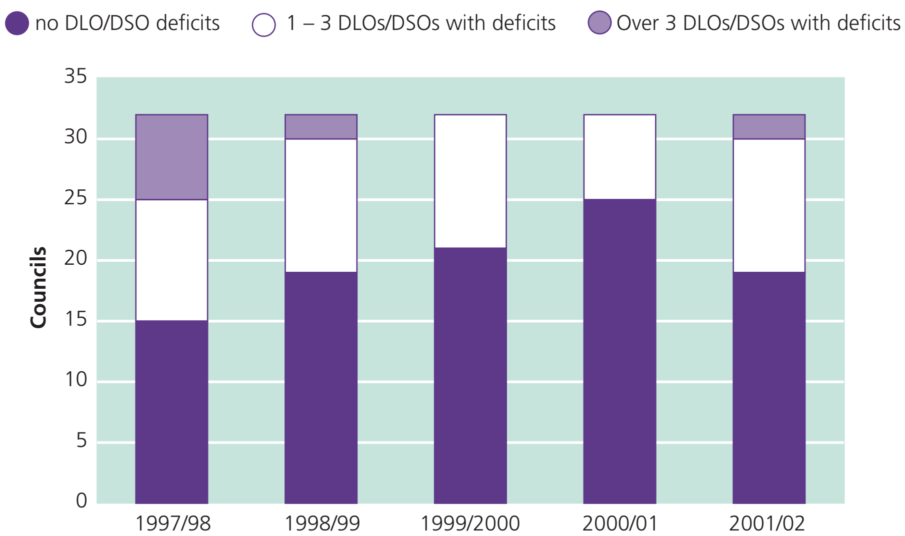
The loss of the trunk roads contract has required significant change to the Roads DLO. Restructuring has continued throughout the year ended 31 March 2002 although for the year under review, the significant loss of income of approximately £3 million, in comparison with the previous year, was not matched by an equivalent reduction in costs. 2001/02 was, however, an exceptional year and as part of the restructuring process the Roads DLO now forms part of the new Transport, Environmental and Community Services department.

This will provide the opportunity to develop flexible working arrangements with other service activities which, in turn, may enable the Roads Maintenance (Non Trunk Roads) activity to return to a surplus position on its operations.

Source: Auditor's report

10.6 In recent years, the number of councils with no DLO/DSO deficits has been increasing. However, Exhibit 23 shows that this trend was not maintained in 2001/02. More councils had more than one DLO/DSO in deficit. Two councils, Stirling and Eilean Siar (Western Isles) had more than three DLOs/DSOs in deficit. The position at these councils is considered in Exhibit 24.

Exhibit 23: DLO/DSO deficits in councils



Source: Audit Scotland

Exhibit 24: DLOs/DSOs at Stirling Council and Comhairle nan Eilean Siar (Western Isles Council)

Stirling Council

The break-even target was not achieved in 2001/02 for the following defined activities:

Activity	Deficit
Road maintenance	£437,000
Ground maintenance	£64,000
Refuse collection	£45,000
Vehicle maintenance	£90,000
School and welfare catering	£66,000
Other catering	£39,000

The auditors' report highlights the significant deterioration in the financial performance of the Council's DLOs/DSOs. In 2000/01 the combined activity of these organisations delivered a contribution of over £1 million to the General Fund. In 2001/02, an overall deficit of £0.2 million had to be funded from reserves.

The Council has taken action by reviewing the way in which services are provided and by considering alternative approaches, including partnership working, to address the financial position of its DLOs/DSOs.

Comhairle nan Eilean Siar (Western Isles Council)

Following the poor financial performance of the Building Maintenance DLO and the Roads DLO in 1999/2000 and 2000/01, the Scottish Executive initiated statutory action under the CCT legislation (section 19 of the Local Government, Planning and Land Act 1980). The statutory Direction issued in November 2001, permitted the Council to continue to undertake building maintenance and road works subject to the re-tender of these services and the review of DLO management and governance arrangements.

The results for 2001/02 show a deficit for building maintenance work of £169,000 (2000/01: deficit £321,000) and a deficit for road work of £245,000 (2000/01: deficit £253,000).

During 2001/02 the Council re-tendered both categories of work. From 2002/03, the Council's DLO will undertake building maintenance and, in two of the four geographic areas, road work. The remaining roads areas will be maintained by external contractors. The external auditor has indicated his intention to review the operation of the new contracts and to monitor the Council's compliance with the remaining requirements of the Executive's Direction.

In addition to the DLO deficits, the Council's Vehicle Maintenance DSO and School Catering DSO failed to break-even (deficits of £23,000 and £14,000 respectively). The auditor highlighted the specific factors leading to the 2001/02 deficits and will be reviewing the action taken by the Council to restore these activities to surplus as part of the 2002/03 audit.

Source: Auditors' reports

Service developments affecting DLOs/DSOs

10.7 In April 2001 responsibility for the maintenance of trunk roads in Scotland was taken over by two private operating companies. This work had previously been undertaken by local authorities' DLOs. Councils have adapted to these changes by working in partnership with the new companies, by restructuring and by reviewing policy on local road maintenance for which they retain responsibility.

10.8 Local authority auditors referred to the changes in their 2001/02 final reports. Examples of the local impact drawn from these reports are set out in Exhibit 25. (See also Exhibit 22 regarding Highland Council).

Exhibit 25: Impact of change in responsibility for trunk road maintenance

Aberdeenshire Council

The auditor's report indicates that the Council was successful in minimising the impact of the loss of the trunk roads contract. Although costs had to be reduced to reflect the loss of work with a value of £1.5 million there was no significant impact on staffing levels as a result of restructuring within the service in 2001.

South Ayrshire Council

The auditors reported that as a result of the loss of the trunk roads work, the roads workforce was reduced by ten members of staff. The loss of the trunk road work also necessitated a reduction in the number of vehicles required by the DLO.

Scottish Borders Council

The auditors noted that a deterioration of DLO performance in 2001/02 was largely attributable to the loss of the trunk roads maintenance contract. They also reported that the DLO is forecasting improved results in 2002/03 as a significant amount of the trunk road maintenance work has been won on a sub-contract basis from the lead contractor.

Source: Auditors' reports

10.9 It is disappointing that improvements in DLO/DSO performance in recent years have not been maintained in the run up to Best Value. Under the proposed Best Value arrangements councils will have greater discretion in deciding on how they will go about delivering services. Councils will be expected to demonstrate reasons for choosing a particular method of service delivery and the financial implications of that decision. They will also have to conduct their significant trading operations so that revenue is not less than expenditure. External auditors will review councils' arrangements and report their findings.

11 Housing/council tax benefits

11.1 Councils are responsible for paying housing and council tax benefits on behalf of the Department for Work and Pensions (DWP) and receive reimbursement from the DWP through annual claims for subsidy based on the amount of eligible benefit paid. Annual subsidy claims are subject to audit certification. External auditors must be satisfied that the claims are fairly stated.

11.2 The housing and council tax benefit system is complex and is also subject to constant change (Exhibit 26). The DWP issued 73 different circulars in 2001/02. Auditors are required to develop and maintain sufficient benefits expertise to be able to conduct at least some work annually on housing and council tax benefit systems and certify claims to the DWP for housing and council tax benefit subsidy.

Exhibit 26: Initiatives introduced by the DWP

April 2001	Weekly Incorrect Benefit (WIB) fraud incentive scheme introduced on a voluntary basis for one year as an alternative to the Weekly Benefit Savings (WBS) scheme
2001/02	Performance Standards developed by BFI/DWP for launch in April 2002
July 2001	Discretionary Housing Payments replaced exceptional hardship and exceptional circumstances payments
April 2002	WIB fraud incentive scheme re-named Security Against Fraud and Error (SAFE) and made compulsory
April 2002	Verification Framework (VF) divided into 3 modules to facilitate compliance

Source: Audit Scotland

11.3 The housing and council tax benefit system involves a high volume of transactions and is susceptible to claimant fraud. The level of detected fraud in Scotland reported in 2001/02 was £6.5 million (2000/01: £6.9 million). While this figure is significant, it has to be viewed in the context of the £1.4 billion in benefits paid in 2001/02. The total number and value of related over-payments detected and reported by Scottish councils and the total amount of benefits paid over the past three years is set out in Exhibit 27.

Exhibit 27: Housing benefit/council tax benefit fraud detected

	2001/02	2000/01	1999/2000
Number of frauds	11,525	10,988	12,243
Value of fraud related overpayments	£6.5 million	£6.9 million	£6.9 million
Value of benefits paid by councils	£1.4 billion	£1.4 million	£1.4 billion

Source: Audit Scotland

11.4 Auditors are required to complete a report on the annual total benefit fraud detected at the end of the year, and reports on individual housing and council tax benefit frauds with a value in excess of £2000 throughout the year. These reports are returned to Audit Scotland, where they are collated and analysed. The results for individual councils are not published as it is recognised that they only reflect the fraud detection activity in individual councils and do not reflect the equally important measures taken by councils to prevent and deter benefit fraud. The information is disseminated to auditors to inform the audit.

11.5 A new Statutory Performance Indicator was introduced for 2001/02 on the proportion of recoverable housing benefit overpayments that were recovered by Scottish councils. The results indicated that they recovered 46% of the recoverable overpayments available. The percentage of overpayments recovered by individual councils varied widely from 21% in West Dunbartonshire to 89% in Eilean Siar (Western Isles). Four councils recovered in excess of 60% and three recovered less than 25% of their recoverable overpayments.

11.6 The Benefit Fraud Inspectorate (BFI) undertakes in-depth examinations of a number of Scottish councils and reports to the Secretary of State for Work and Pensions on how they administer housing and council tax benefit, with particular reference to the prevention and detection of fraud. Audit Scotland works with the BFI to develop complementary roles and to avoid unnecessary duplication of work; this relationship is governed by a memorandum of understanding.

11.7 After the BFI has reported on a council's performance, the DWP invites the council to respond to the BFI report and submit proposals for improvement. If, after considering the council's proposals, the Secretary of State for Work and Pensions considers it necessary, directions may be given to the council as to the standards which it is to attain within a given period. Such a direction was issued to East Lothian Council following the issue of a second inspection report by the BFI dated September 2001 (see Exhibit 28).

Exhibit 28: East Lothian Council – Direction issued by Secretary of State for Work and Pensions

East Lothian Council

The Benefit Fraud Inspectorate's report on the Council (September 2001) concluded that the Council had made definite improvements in areas such as day to day claims processing and fraud investigation. In the BFI's view, however, there was a lack of demonstrable commitment at senior manager level to address a number of issues first raised in 1998.

In June 2002, the Secretary of State for Work and Pensions issued a Direction to the Council under section 139D of the Social Security Administration Act 1992. The Direction specified a number of reductions to be achieved in processing times for new and renewal claims. This requires the Council to achieve a series of improvements in processing times.

Source: Auditor's report

12 Following the public pound

12.1 Councils have powers in certain circumstances to enter into agreements with external organisations who undertake functions which might normally be carried out by councils themselves. The external body may be a council funded trust or company. In other cases the relationship may be with a voluntary organisation. The nature of these arrangements is often wider than a contract for services. The common feature of these arrangements is that, in the council's view, services can be delivered more effectively outwith the local authority regulatory framework.

12.2 It is not uncommon for elected members and council officers to sit on boards and management committees of external bodies which receive council funding. There is clearly scope for conflicts of interest to arise from this situation. In addition, council members could find themselves with personal liabilities arising from such arrangements. The Councillors' Code of Conduct (see paragraph 3.6) gives guidance on such situations (Exhibit 29).

Exhibit 29: Appointments to partner organisations

'If you become a director of a company as a nominee of the Council you will assume personal responsibilities under the Companies Acts. It is possible that a conflict of interest may arise for you as between the company and the Council. In such cases it is your responsibility to take advice on your responsibilities to the Council and to the company. This will include questions of declarations of interest.'

'In relation to service on the boards and management committees of limited liability companies, public bodies, societies and other organisations, you must decide, in the particular circumstances surrounding any matter, whether to declare a non-financial interest. Only if you believe that, in the particular circumstances, the nature of the interest is irrelevant or without significance, should it not be declared. You must always remember that the public interest points towards transparency and, in particular, a possible divergence of interest between the Council and another body'.

Source: The Councillors' Code of Conduct

12.3 It is important that appropriate monitoring mechanisms are in place to enable councils to discharge their stewardship and accountability duties in relation to the public funds provided to such bodies. *The Code of Guidance on Funding External Bodies* and *Following the Public Pound*, developed jointly by the Accounts Commission and the Convention of Scottish Local Authorities (COSLA), sets out the principles of best practice for councils in establishing relationships with companies, trusts and other bodies where there is substantial local authority funding. The Code was supplemented by operational guidance issued by COSLA in 1998.

12.4 A particular issue which emerged in 2001/02 related to Fife Council's involvement with a local charity which had been established to provide lunch clubs for older people. In light of the significant public interest in this matter I requested the Council's external auditors to report and, subsequently, I reported to the Accounts Commission. Exhibit 30 summarises the position at Fife Council.

Exhibit 30: Fife Council – The Third Age Group

In May 2002, the Controller of Audit made a report (S.R. 2002/2) to the Accounts Commission on Fife Council's involvement in providing financial and other support to the Third Age Group, a charity established to provide lunch clubs for older people. The report was made following public concern about the circumstances in which the Council had continued to provide support to Third Age after its management committee had resigned.

In relation to '*following the public pound*', the report concluded that

- grants provided to Third Age had, in all material respects, been used for the purpose intended although there was a lack of monitoring by the Council
- the internal process instigated by the Council to review the position which emerged was consistent with the principles of good corporate governance
- Council staff had inappropriately assumed management responsibility for the Group's activities. The Controller emphasised that councils and their officers need to be clear about their respective roles and responsibilities in dealing with any arms' length organisation.
- an elected member who served as the Group's paid co-ordinator should have disclosed this as an employment interest but had failed to do so
- pending the national review of Scottish councils' involvement with arms' length organisations, councils should identify and review existing arrangements to ensure that suitable safeguards are in place, taking account of the level of funding provided and the potential risk to public funds.

Source: Audit Scotland

12.5 Issues concerning councils' liabilities arising from their financial involvement with external bodies and weaknesses in monitoring arrangements continue to be a recurring theme in auditors' reports. Exhibit 31 highlights some of the auditors' comments.

Exhibit 31: Auditors' comments on councils' '*following the public pound*' arrangements

Aberdeenshire Council

As part of its work in improving governance arrangements, the Council is implementing a good practice guide in relation to 'following the public pound'.

East Ayrshire Council

The Minute of Agreement between the Council and a leisure Trust states that the Council will 'reimburse the Trustees to the extent of any losses incurred by the Trustees…arising from the operation of the leisure centre in each financial year'.

This means that the Council effectively has an unlimited liability for any losses incurred by the Trust. The auditors noted that, while the Trust made a surplus in the current year, a risk exists for the Council in this arrangement. The auditors recommended that the Council explores options for capping or removing any future liabilities.

Moray Council

Moray Council has formally adopted the Code of Guidance. The Council has also adopted guidelines on the application of the Code and has in place a standard form of agreement to be completed for funding arrangements. Internal audit monitor the application of the Code as part of their strategic plan.

Scottish Borders Council

Scottish Borders Council acts as guarantor for a loan of £1 million advanced to a Trust by the Public Works Loan Board. In June 2002 the Trust defaulted on a half yearly instalment of £30,000 which the Council was obliged to pay under the terms of the guarantee. An outstanding balance of £986,000 remains on the loan, which the Council will have to finance if the Trust fails to improve its financial position.

An agreement is in place which requires the Trust to provide regular information to enable the Council to monitor the financial position. The auditors reported that this information was not provided by the Trust on a regular or timely basis resulting in the Council not identifying the Trust's deteriorating financial position at an early stage.

Stirling Council

The auditors reported that the Council has not fully embraced the principles laid down in the Code of Guidance and a number of weaknesses exist in the way significant financial relationships with external bodies are set up and managed. Findings include:

- the Council has not established policy or procedural guidance documenting its approach to significant financial relationships with external bodies.

- the Council strategies which will be supported when setting up any significant financial relationship with an external body should be documented.
- the Council should specify a minimum standard of internal financial control to be followed by bodies with which it has a significant financial relationship. The system of internal control should be based on a risk assessment which identifies the key threats to the success of the relationship and the steps that have been taken to minimise these threats.
- a clear exit strategy should be developed for each significant financial relationship.

Source: Auditors' reports

12.6 Audit Scotland is currently undertaking a national review designed to identify the nature and extent of councils' financial involvement in external organisations and the monitoring procedures which have been developed. It is clear that scope exists for improvement in the arrangements for monitoring the proper and effective use of funds. The detailed findings will be contained in a public interest report which I intend to make to the Accounts Commission in the summer. It is anticipated that the report may be helpful in informing any future review of the Commission/COSLA '*Following the public pound*' Code.

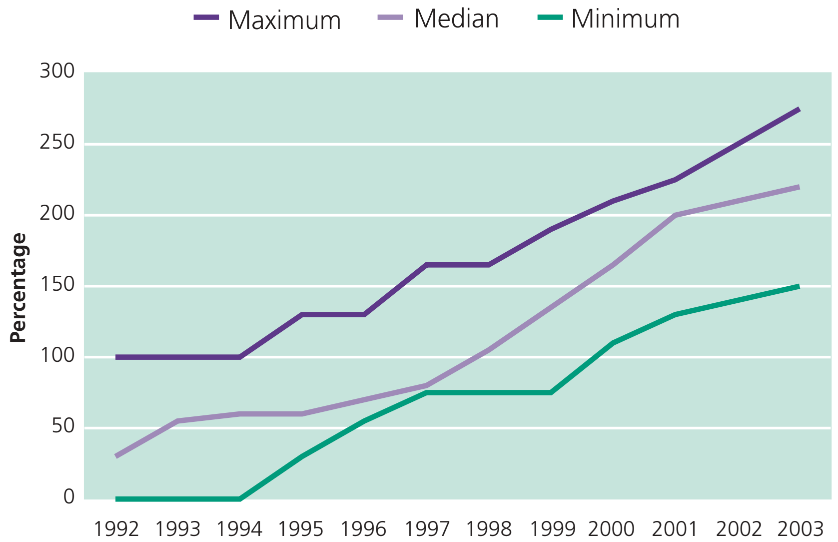
12.7 Local authorities are not unique in funding external bodies. Similar types of funding arrangements with external organisations exist in other parts of the Scottish public sector and it is likely that the work carried out by Audit Scotland in the local government sector will have wider application.

13 Pensions

13.1 Pensions are a complex area for local authorities. They participate in a range of different schemes covering general council staff, teachers, police officers and firefighters, each with its own rules and funding arrangements. The main scheme, however, is the Local Government Pension Scheme (Scotland). This is a defined benefit multi-employer scheme. Eleven councils administer pension schemes in Scotland; the remaining councils, and other public bodies, are admitted members of these schemes. Funds are invested to produce returns which will, subject to performance, meet employers' liabilities under the scheme. It is possible for an employer to identify its share of the assets and liabilities of the scheme on a consistent and reasonable basis.

13.2 Employees' contributions are fixed by statute and employers' contributions are assessed every three years by actuaries. The actuaries examine the assets and liabilities of the fund and certify a rate at which employers should contribute in the future in order to maintain long term solvency. Contribution rates for employers participating in the scheme have increased significantly over the past 10 years. Although there is wide variation among authorities, as an indication of magnitude, employers' contribution rates typically increased from 60% to over 200% of employees' contributions over that period (Exhibit 32).

Exhibit 32: Employers' contributions as a percentage of employees' contributions



Source: Audit Scotland

13.3 In common with pension schemes in other sectors, funded schemes administered by councils invest in equities. Typically, about 75% of local authority pension fund assets are held in equities or equity based funds.

13.4 In recent months, world stock markets have experienced a general but significant decline in value. The extent to which each of the local authority pension funds has been exposed to the decline in stock market values will vary depending on the proportion of equity based funds and the investment strategy adopted. However, any prolonged decline in stock market values may affect employers' future contribution rates which, in turn, are met from council tax and government grants.

Accounting

13.5 For the purposes of their 2001/02 accounts, local authorities were required by the Accounting Code of Practice to disclose additional information in the notes to their accounts. The main development from previous years was for authorities to disclose their share of the assets and estimated liabilities in the funds and the resulting surplus or deficit. Auditors reported general compliance with the requirements. The position at the City of Edinburgh Council is summarised at Exhibit 33.

Exhibit 33: Pension disclosures at the City of Edinburgh Council

City of Edinburgh Council

The Council's auditor reported that the Council complied with the disclosure requirements for 2001/02, while observing that a note to the Consolidated Balance Sheet highlights that the Council's estimated pension liabilities at 31 March 2002 exceeded its share of assets in the Lothian Pension Fund by £33.3 million. Full application of FRS 17, although not required at present, would require a provision to be made for this sum in the Council's financial statements. This net pension liability exceeds the Council's General Fund Reserve of £22.8 million at 31 March 2002.

Source: Auditor's report

13.6 Local authorities are required to continue to follow the timetable of transitional disclosure requirements in 2002/03 leading to full incorporation of the accounting requirements of Financial Reporting Standard 17 in their 2003/04 financial statements.

13.7 In light of the significant developments in pension funds and pensions accounting, auditors will be expected to keep this area under review.

14 PFI/PPP

14.1 Public/private partnership (PPP) and private finance initiative (PFI) contracts are at various stages of completion in councils across Scotland. This is a significant area of council activity – councils' accounts indicate that, across Scotland, current annual commitments are of the order of £100 million. This is expected to rise as new schemes are completed.

14.2 Schools are a key PFI area in the local authority sector. In 1998 the Scottish Office approved revenue support of £50 million a year to twelve PFI schools projects (for 80 schools) with an estimated capital value of more than £600 million. In 2002 the Scottish Executive approved support for a further 13 schools projects (for around 300 schools) with an estimated capital value of more than £1 billion.

14.3 Following an in-depth study which considered a sample of the earlier projects, covering 65 schools, the Accounts Commission issued a report, '*Taking the initiative – using PFI contracts to renew council schools*', in June 2002. The Commission's key recommendations regarding future projects are set out in Exhibit 34.

Exhibit 34: PFI study – Accounts Commission recommendations

The five key recommendations in the Accounts Commission's report on schools PFI are as follows:

1. There is a need for a wider choice of procurement options for future projects including PFI and non-PFI. The prospect of increased flexibility in capital finance for councils offers the opportunity to test whether the lessons learned from PFI can be transferred to other types of procurement.

2. The current review of the PSC (Public Sector Comparator) should take account of the true cost of borrowing for councils to improve its usefulness as a cost benchmark.

3. Other cost effectiveness measures are needed to guide the development and assessment of future schools projects and promote value for money.

4. The Scottish Executive should consider developing a leadership role to ensure that the special experience and skills learned from current PFI schools projects is transferred to future projects.

5. Best practice guidelines, about what constitutes a minimum acceptable standard for classroom size, heating, lighting and other factors that affect the learning environment, are needed.

Source: Audit Scotland

14.4 External auditors continue to review the procedures by which councils progress their interest in these projects and, where appropriate, provide preliminary views on the proposed accounting treatment. Where projects are operational, auditors have indicated their intention to review the way in which councils monitor compliance with contract provisions.

Part 4: Performance

This part of the report covers:

- value for money studies
- performance indicators.

15 Value for money studies

15.1 The Accounts Commission approves an annual programme of value for money studies undertaken centrally by Audit Scotland. This work may culminate in the publication of national reports, management papers and management handbooks. Councils are expected to use these to challenge their current levels of performance and take action to achieve the standards of the best.

15.2 Exhibit 35 summarises the value for money reports published by the Accounts Commission relating to study work undertaken during 2001/02. Copies of these reports are available from Audit Scotland (www.audit-scotland.gov.uk).

Exhibit 35: Reports published on 2001/02 study topics

Study topic	Publication date
Dealing with offending by young people (joint report for Accounts Commission and Auditor General) This was a major cross-cutting study looking at how well councils and a range of other agencies deal with young people who offend. It made a number of recommendations for improvement, particularly relating to: ■ reducing the time taken to deal with young people who offend ■ ensuring decisions are made in line with good practice – to reduce the variation across Scotland in what happens to young people ■ increasing the provision of effective community based services for offenders ■ ensuring there are sufficient social workers to provide core services. Local audit work is currently underway and focuses on a number of risk areas, including review of unallocated social work cases.	Dec 2002
Local economic forums – A baseline performance statement (joint report for Accounts Commission and Auditor General) This report set out what LEFs aim to achieve and reviews measures against which their performance can be assessed. A follow-up report will be published in winter 2003/04.	Oct 2002
'*Made to measure – An overview of trading standards services in Scotland*' '*Made to measure*' was a study which piloted a new approach to performance audit for those services where there is no inspectorate. Its main recommendations were: ■ councils should consider joining up delivery of their trading standards services, reflecting that smaller departments perform less well than larger ones and may lack the capacity to improve. ■ councils need to work to meet the standards of the new National Performance Framework.	Oct 2002

Source: Audit Scotland

15.3 Appointed auditors conduct local follow-up action to ensure that councils implement appropriate improvements in response to the recommendations contained in the Commission's value for money reports.

16 Performance indicators

16.1 In 2001/02 councils, fire brigades and police forces were required to report their service standards against 76 statutory performance indicators (PIs). These indicators covered a wide range of services and highlight both the variation in performance between councils and change in performance over time.

16.2 Among the key messages highlighted in the published performance indicators are that:

- Scotland's fire brigades attended more fires on time despite an overall increase in the number of fires
- councils collected over 90% of the £1.42 billion council tax due for 2001/02 during the year. This is the highest proportion so far achieved
- only six councils have reduced tenants' rent arrears to the agreed target levels of 3% for semi-urban and rural councils and 7% for city and urban councils
- of the 491 young people leaving council care away from home, 184 met the national target for achieving Standard Grades in both English and Maths
- nearly 96% of four-year-olds and 90% of three-year-olds received some level of pre-schooling in 2001/02. The proportion of three-year-olds in pre-schooling has risen by 15% in two years
- just over 7% of Scotland's waste was recycled. The target is for councils to recycle 25% by 2006.

16.3 For the second year, Perth & Kinross Council did not meet the statutory obligation to publish its performance information in one of the specified forms. A number of councils, including Perth & Kinross, published the information in their own 'in-house' publications. Nevertheless, the decision by Perth & Kinross Council not to meet a statutory obligation placed upon it remains a matter of some concern.

16.4 Further analysis of a wide range of indicators shows the pattern of improvement across Scottish councils. Exhibit 36 shows the number of indicators where councils' performance has improved or declined since 1999/2000. The last column shows the ratio of improved indicators to indicators where performance has deteriorated.

Exhibit 36: Performance change in councils

Councils vary in the number of indicators that show improvement and in those that show decline in performance.

	Performance change between 1999/2000 and 2001/2002		
	Total number that declined by >5%	Total number that improved by >5%	Overall ratio of improvement to decline
Aberdeen City	13	19	1.5
Aberdeenshire	11	16	1.5
Angus	14	14	1.0
Argyll & Bute	13	19	1.5
Clackmannanshire	19	12	0.6
Dumfries & Galloway	10	16	1.6
Dundee City	12	13	1.1
East Ayrshire	12	13	1.1
East Dunbartonshire	16	19	1.2
East Lothian	6	19	3.2
East Renfrewshire	10	19	1.9
City of Edinburgh	11	18	1.6
Eilean Siar	13	9	0.7
Falkirk	15	17	1.1
Fife	11	16	1.5
Glasgow City	10	22	2.2
Highland	16	13	0.8
Inverclyde	16	14	0.9
Midlothian	12	14	1.2
Moray	13	16	1.2
North Ayrshire	4	28	7.0
North Lanarkshire	11	17	1.5
Orkney Islands	13	9	0.7
Perth & Kinross	14	19	1.4
Renfrewshire	10	19	1.9
The Scottish Borders	8	12	1.5
Shetland Islands	17	15	0.9
South Ayrshire	11	24	2.2
South Lanarkshire	10	24	2.4
Stirling	14	18	1.3
West Dunbartshire	15	13	0.9
West Lothian	15	17	1.1
Scotland	**395**	**533**	**1.3**

Source: Audit Scotland

16.5 Clearly, a council's individual priorities will affect where it focuses its improvement efforts. It is also more difficult to improve if performance is already relatively high. However, given the duty of Best Value, councils should be looking to improve overall performance across the range of services provided. Of particular interest is what has happened to indicators where councils reported relatively poor performance since 1999/2000.

16.6 Exhibit 37 shows how many relatively poor performances have improved since 1999/2000. It shows the extent to which councils have made material improvement (5% or greater) in indicators where they were ranked 25 or worse in 1999/2000.

Exhibit 37: Change in indicators showing relatively poor performance

Councils have had varying degrees of success in tackling indicators where their performance was relatively poor.

Improvement in at least 75%	Improvement in between 50 and 75%	Improvement in fewer than 50%
Dumfries and Galloway	Aberdeen City	Dundee City
East Dunbartonshire	Aberdeenshire	East Ayrshire
East Lothian	Angus	Comhairle nan Eilean Siar
East Renfrewshire	Argyll and Bute	Orkney Islands
Moray	Clackmannanshire	Renfrewshire
North Ayrshire	City of Edinburgh	Stirling
Perth and Kinross	Falkirk	West Dunbartonshire
Scottish Borders	Fife	
South Ayrshire	Glasgow	
West Lothian	Highland	
	Inverclyde	
	Midlothian	
	North Lanarkshire	
	Shetland Islands	
	South Lanarkshire	

Source: Audit Scotland

16.7 Not all indicators which were poorly ranked are of equal importance to the council or to service users, so it is important to use this summary in conjunction with the more detailed information in the '*Council Profiles 2001/02*' which is available on Audit Scotland's website. However, with that caveat, the majority of councils have improved in over half the areas where performance had been relatively poor two years previously.

Part 5: Best Value

This part of the report covers:

- Best Value proposals
- the 2001/02 Performance Management and Planning (PMP) audit
- Best Value audit proposals.

17 Best Value proposals

17.1 The Best Value policy was introduced for Scottish councils in 1997, and the current Local Government in Scotland Bill contains statutory duties in relation to Best Value, Community Planning and Public Performance Reporting. Local authorities will need to make arrangements which secure Best Value, defined as "*continuous improvement in the performance of the authority's functions*", and play a leading role in Community Planning. In addition to the primary legislation, Ministers will issue statutory guidance to assist councils in implementing the various duties.

17.2 Since 1999, the arrangements that councils have in place to plan and manage their performance under Best Value have been audited through the Performance Management and Planning (PMP) Audit. The audit was designed to examine the extent to which councils and their various services had the basic building blocks for Best Value in place, in particular the key management processes required. The Accounts Commission is developing new audit arrangements for councils in preparation for the legislation's enactment during the Spring of 2003. The new approach is outlined below, following a review of last year's PMP.

18 The 2001/02 Performance Management and Planning (PMP) audit

18.1 The 2001/02 PMP audit was the third year in which councils' progress in establishing Best Value arrangements was examined. It looked at a selection of specific service areas in each council, and also assessed what improvement had taken place in those areas audited in previous years.

18.2 Overall, the service areas audited in 2001/02 scored higher than service areas audited in 2000/01, showing that councils continue to make progress in developing effective arrangements for planning and managing their performance. Half of the audited service areas had

70% or more of the best practice features of performance management and planning arrangements in place, with a quarter (16 service areas) having more than 80% in place (See Exhibit 38). However, in a small number of councils, specific service areas were still some way behind and the councils concerned need to address this as a matter of some urgency in view of the impending statutory duty. Similarly, the improvement made by service areas audited in previous years was patchy, and again, action will need to be taken by the councils concerned.

Exhibit 38: Service areas that had more than 80% of good practice elements in place

Four councils each had two services in this category.

Council	Service audit
Angus	Chief Executive's Department
	Law and Administration Department
Dundee City	Finance Department
East Dunbartonshire	Legal and Administration Services
Edinburgh City of	Finance Department
	Libraries and Information Services
Glasgow City	Development and Regeneration Services
Highland	Benefits Service - Finance
Midlothian	Library Services
North Lanarkshire	Children's Residential Services
	Area Registration Service
Renfrewshire	Legal Services Division
Scottish Borders	Information Technology Unit
South Lanarkshire	Benefits Service
	Adult Services
West Lothian	Information and Social Strategy

Source: Audit Scotland

18.3 Effective corporate management in councils is an important pre-requisite for Best Value, and indeed for Community Planning as well. The arrangements councils have in place at a corporate level were examined in the PMP audit during 2000/01 and a range of improvement actions were agreed. One year on, all councils had made improvements in more than 75% of the areas identified for development.

18.4 There has also been improvement in areas identified in previous audits as in need of attention, including:

- clear leadership from senior managers and elected members
- an inclusive approach to the development and practice of Best Value
- a clear focus on the customer.

18.5 However, these and other areas – in particular option appraisal, performance reporting (internal and public) and partnership working – remain problematic for services in some councils and further improvement is required.

18.6 The PMP audits have shown that there are large differences between and within councils in their development of performance management and planning arrangements. With the statutory duty of Best Value, councils will need to be aware of which service areas have most progress to make and target improvements accordingly. The new audit approach for Best Value will hold councils to account at a corporate level for the performance of all of their services. As a result of this and other changes in approach, the Accounts Commission has applied a limited PMP audit in councils for 2002/03. As a transitional arrangement, the audit work has been restricted to following up previous assessments and improvement action plans from the last two years with no new service audits taking place.

19 Best Value audit proposals

19.1 The Accounts Commission has approved the key design principles and overall approach to be taken by Audit Scotland in developing the new audit, and a period of informal consultation with stakeholders took place on these matters during October and November 2002. Feedback from the consultations was positive and further detailed development work is now underway. Following final approval by the Commission, the first Best Value audits will be undertaken from November 2003 onwards.

19.2 The key features of the new approach include:

- the adoption of a more integrated and holistic approach to performance, applying the audit to each council as a corporate body
- a greater focus on the outcomes that result from a council's management processes rather than the processes themselves
- an approach that will lead to a more targeted and proportionate audit
- an approach that supports accountability and continuous improvement through agreed improvement actions, structured follow-up and reporting

- a commitment to learn from earlier approaches and build on what has been done before
- providing a means of identifying the need for intervention, where this arises.

19.3 There will continue to be a significant role for a council's own evidence based self-assessment of performance, management arrangements and areas in need of improvement. Councils will be expected to report on how they satisfy their statutory duties under the legislation. The audit team will then consider the evidence available to support this assessment.

19.4 Councils will, in normal circumstances, be subject to a full Best Value audit once every three years, with improvement progress being checked in the intervening period. This will provide for greater depth of audit, allow time to implement improvement actions, and reduce the risk of excessive audit burden.

19.5 The audit will incorporate issues of good management practice and corporate governance, and will draw on a wide range of information that is available on the performance of a council, including local audit work, inspection reports, value for money studies, statutory performance information and a council's own performance information and reporting. This will involve close liaison with inspection bodies such as HM Inspectorate of Education, and regulatory bodies such as Communities Scotland, to access their views in relation to specific services and professional standards and practice in the council concerned. In addition, joint working between the Commission and the Auditor General for Scotland will help ensure that the broad principles and objectives associated with Best Value will, over time, be applied to the audits of all Scottish public services.

19.6 At the conclusion of the audit, the results will be compiled in a report in draft form to the council. A statutory report will then be submitted by the Controller of Audit to the Accounts Commission and copied to the council. The Commission will produce findings on every report. It also remains open to the Controller of Audit to report to the Commission at any time if circumstances warrant this.

19.7 The Best Value audit will not result in a single rating for councils at the end of the process, although it will endeavour to provide as clear a picture as possible of the overall performance of the council. The Accounts Commission is committed to supporting and encouraging improvement, and it is expected that, in most cases, the audit results will focus on broad strengths and weaknesses and the agreed improvement action plan. Where a more critical response is required or where, in subsequent years, there is evidence that a council has not addressed or progressed the agreed areas of improvement action, the Commission may take further graduated action to hold a council to account. The legislation provides for the Commission to:

- direct the Controller of Audit to carry out further investigations
- hold a hearing
- state resulting findings (which may include recommendations to the Scottish Ministers).

19.8 The Accounts Commission anticipates that the overall process will contribute to increased public accountability and support continuous improvement in the provision of public services by local government.

Appendix

2001/02 audit appointments

Aberdeen City Council	Ernst & Young
Aberdeenshire Council	Audit Scotland, West
Angus Council	Audit Scotland, East
Argyll and Bute Council	Audit Scotland, West
Clackmannanshire Council	KPMG
Comhairle nan Eilean Siar (Western Isles Council)	Audit Scotland, West
Dumfries and Galloway Council	Audit Scotland, West
Dundee City Council	Audit Scotland, East
East Ayrshire Council	PricewaterhouseCoopers
East Dunbartonshire Council	Audit Scotland, West
East Lothian Council	Audit Scotland, East
East Renfrewshire Council	KPMG
City of Edinburgh Council	Audit Scotland, East
Falkirk Council	PricewaterhouseCoopers
Fife Council	Henderson Loggie
Glasgow City Council	Audit Scotland, West
Highland Council	Audit Scotland, West
Inverclyde Council	Audit Scotland, West
Midlothian Council	Audit Scotland, East
Moray Council	Blueprint Scotland
North Ayrshire Council	PricewaterhouseCoopers
North Lanarkshire Council	Audit Scotland, West
Orkney Islands Council	Audit Scotland, East
Perth and Kinross Council	Audit Scotland, East
Renfrewshire Council	Audit Scotland, West
Scottish Borders Council	Scott-Moncrieff
Shetland Islands Council	PricewaterhouseCoopers
South Ayrshire Council	KPMG
South Lanarkshire Council	Audit Scotland, West
Stirling Council	Scott-Moncrieff
West Dunbartonshire Council	Audit Scotland, West
West Lothian Council	Audit Scotland, West
Authorities Buying Consortium	Audit Scotland, West
Ayrshire Valuation Joint Board	KPMG
Central Scotland Fire Board	PricewaterhouseCoopers
Central Scotland Joint Police Board	Scott-Moncrieff

Central Scotland Valuation Joint Board	KPMG
Clyde Muirshiel Park Authority Joint Committee	Audit Scotland, West
Dunbartonshire and Argyll & Bute Valuation Joint Board	Audit Scotland, West
Forth Road Bridge Joint Board	Audit Scotland, East
Glasgow and Clyde Valley Joint Structure Plan Committee	Audit Scotland, West
Grampian Fire Board	Audit Scotland, West
Grampian Joint Police Board	Ernst & Young
Grampian Valuation Joint Board	Blueprint Scotland
Highland and Islands Fire Board	Audit Scotland, West
Highland and Western Isles Valuation Joint Board	Audit Scotland, West
Kelvin Valley Countryside Project	Audit Scotland, West
Lanarkshire Valuation Joint Board	Audit Scotland, West
Loch Lomond and the Trossachs Interim Committee	Audit Scotland, West
Lothian and Borders Fire Board	Audit Scotland, East
Lothian and Borders Police Joint Board	Audit Scotland, East
Lothian Valuation Joint Board	Audit Scotland, East
Mugdock Country Park Joint Committee	Audit Scotland, West
Northern Joint Police Board	Audit Scotland, West
Orkney and Shetland Valuation Joint Board	PricewaterhouseCoopers
Renfrewshire Valuation Joint Board	Audit Scotland, West
Scottish Local Government Information Unit	Audit Scotland, West
Scottish Nuclear Free Local Authorities	Audit Scotland, West
Strathclyde Concessionary Travel Scheme Joint Committee	PricewaterhouseCoopers
Strathclyde Fire Board	Audit Scotland, West
Strathclyde Joint Police Board	Audit Scotland, West
Strathclyde Passenger Transport Authority	PricewaterhouseCoopers
Tay Road Bridge Joint Board	Audit Scotland, East
Tayside Contracts Joint Committee	Audit Scotland, East
Tayside Fire Board	Audit Scotland, East
Tayside Police Joint Board	Audit Scotland, East
Tayside Valuation Joint Board	Audit Scotland, East

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