INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Clackmannanshire Council

Annual audit report for 2005-06 to the members of Clackmannanshire Council and the Controller of Audit

10 October 2006

AUDIT

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

Notice: About this report

This report has been prepared in accordance with the responsibilities set out within Audit Scotland's *Code of Audit Practice* ('the Code') and *Statement of Responsibilities of Auditors and Audited Bodies.*

This report is for the benefit of only Clackmannanshire Council and is made available to Audit Scotland (together the beneficiaries), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes but that we have not taken account of the requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

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Contents

Executive summary	1
Introduction	3
Financial position	5
Corporate governance	12
Financial statements	16
Performance management	20
Appendices	24

Executive summary

Financial position

The Council reported a general fund deficit in 2005-06 of £1.2 million (2004-05: £1.3 million surplus) against an original budget of breakeven. The primary variance against budget was the inclusion of a provision for equal pay of £1.4 million.

Total general fund reserves brought forward into 2005-06 amounted to £5.09 million. Appropriations during the year, combined with the in-year deficit resulted in a carry forward of £3.9 million.

The Council has a recommended reserves policy of an amount equivalent to 2.5% of annual revenue expenditure to provide for future unforeseen expenditure. During 2006-07 members recommended holding a minimum general reserve of £3 million.

The Council's net liabilities in relation to the Falkirk Pension Fund at 31 March 2006 were £52.627 million, an increase from £47.342 million at 31 March 2005.

The housing revenue budget set in February 2005 forecast a surplus of £63,000, but was subsequently amended during the year to a surplus of £767,000. The final outturn was a surplus of £861,000. The accumulated surplus on the housing revenue account was £6.07 million at 31 March 2006.

The Council's two significant trading operations achieved their three year breakeven target with a joint, cumulative surplus of £851,000.

Corporate governance

The internal financial control statement for 2005-06 notes that:

- work on development of the Council's financial ledger to improve the extraction and availability of management information would enhance control mechanisms; and
- all the issues formally raised by the Benefit Fraud Inspectorate during 2005-06 have either been addressed, or are in the process of being met, and the Department for Work and Pensions has confirmed that they will not be proposing further action on the strength of improvements being made.

In conclusion, the Council's internal auditors have noted that "with the exception of the areas of weakness noted, … reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems in the year to 31 March 2006".

We issued two reports as a result of our work over the existence and operating effectiveness of controls operating over payroll, creditors and service expenditure, significant trading operations, housing rents, fixed assets and contracts and tendering (31 March 2006) and the controls over housing and council tax benefit systems (30 June 2006). We reported 11 priority one recommendations, of which officers accepted seven. In addition we reviewed and reported on the Council's information technology general controls (September 2006), including four priority one recommendations accepted by officers.

Financial statements

On 29 September 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the Council and its group for the year ended 31 March 2006.

Draft financial statements for the Council and its group were presented for audit on 30 June 2006 in line with the agreed timetable. A number of amendments were made as a result of the audit process, however, these related to presentation and disclosure items only.

In line with the SORP requirements officers engaged the District Valuer to formally value all Council dwellings and DM Hall, Chartered Surveyors, to value all other operational and non-operational land and buildings. Formal reports and associated working papers were presented in line with the original timetable. However, discrepancies in DM Hall's report, due to errors in the underlying data provided by the Council were identified during the audit process and a revised report was received on 20 September 2006. This resulted in a late adjustment to the financial statements to show an increase in the impact of the revaluation of £210,000.

During the course of the audit process the Council recognised a provision for equal pay of £1.4 million in the financial statements for the year ended 31 March 2006, including amounts payable to HM Revenue & Customs to meet related tax and national insurance obligations. The provision does not include pension contributions, which is clearly stated in the signed agreements between the Council and its employees.

The value of a title swap subsequent to the year end between the Council and Ceteris (the former enterprise trust) will allow the Council to recover outstanding debt currently owed by Ceteris. In addition, the Council will retain valuable office accommodation and pass on properties to Ceteris for the benefit of local businesses.

Premia arising on switches to lender option borrower option loans has been amortised to revenue over the period of the replacement loans as permitted by the statement of recommended practice. We understand that the Council considers that the overall economic effect of the original and replacement borrowing is substantially the same.

Performance management

2005-06 priorities and risks framework

The human resources service reports management information on workforce composition and employment trends to management, elected member and trade union forums on a quarterly basis. The Council workforce consists of diverse functional specialisms, often with very small numbers of particular professional disciplines, limiting the value of a uniform approach to succession planning and workforce risk management.

The Council is an integral part of the local community health partnership with committee meetings held on a quarterly basis and sees these as an opportunity to bring together services and has developed a pooled budget with the Forth Valley NHS Board in respect of mental health day care services.

Efficient government

The Council has implemented formal controls over asset management, procurement and is leading a partnership of local authorities towards stage one of a shared service solution covering transactional and administrative processes within human resources, finance, payroll and procurement. Officers have identified time and cash releasing efficiency savings of nearly £0.7 million in each of the three years to 2008-09.

Best value

Audit Scotland commenced their work at the Council in July 2006 and plan to report in December 2006.

Statutory performance indicators

The Council's systems have been able to produce reliable information for most of the required statutory performance indicators, but three indicators were deemed to be unreliable in our report to Audit Scotland on 31 August 2006.

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

Introduction

Audit framework

2005-06 was the final year of our five-year appointment as external auditors of Clackmannanshire Council ("the Council"). This report summarises our opinion and conclusions and highlights significant issues arising from our work. While a requirement of Audit Scotland's *Code of Audit Practice*, this report also discharges our obligations under International Auditing Standard 260: *Communication of audit matters to those charged with governance*.

The framework under which we operate under appointment by Audit Scotland was outlined in the audit plan for the year discussed with the Council's audit committee on 23 February 2006. The scope of the audit was to:

- provide an opinion on, to the extent required by the relevant authorities, the Council's financial statements in accordance with the standards and guidance issued by the Auditing Practices Board;
- review and report on, to the extent required by relevant legislation and the requirements of the *Code*, the Council's corporate governance arrangements in relation to systems of internal control, the prevention and detection of fraud and irregularity, standards of conduct, and prevention and detection of corruption; and the Council's financial position; and
- review and report on, to the extent required by relevant legislation and requirements of the *Code,* aspects of the Council's arrangements to manage its performance, as they relate to the economy, efficiency and effectiveness in the use of resources.

Priorities and risks

In September 2005, Audit Scotland published the *Priorities and Risks Framework: 2005-06 National Planning Tool for Local Government* ("PRF") setting out eight areas for consideration during the planning of the audit. We built on and updated our understanding of the Council's processes and management arrangements in these areas in focusing our audit effort. In addition, our own planning process identified a number of other areas for specific attention, including:

- timely and accurate information to prepare group financial statements;
- implementation of the single status agreement and the cost of settling equal pay claims;
- plans to achieve efficiency savings;
- timing of receipts and payments related to the rail link project; and
- fixed asset revaluations.

Basis of information

External auditors do not act as a substitute for the Council's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

During 2005-06 we issued three reports each accompanied by an action plan, including officers' responses and dates for implementation of agreed recommendations. This report summarises the main points arising from that work, but we have not repeated those action plans.

To a certain extent the content of this report comprises general information that has been provided by, or is based on discussions with, management and staff of the Council. Except to the extent necessary for the purposes of the audit, this information has not been independently verified. The contents of this report should not be taken as reflecting the views of KPMG LLP except where explicitly stated as being so.

Acknowledgement

Our audit has continued to bring us into contact with a wide range of Council staff. We wish to place on record our appreciation of the continued co-operation and assistance extended to us by staff in the discharge of our responsibilities. It is our intention to minimise the disruption to the Council from a change in auditor through briefing and liaison on unresolved issues with the incoming auditor's staff.

Contents

Executive summary	1
Introduction	3
Financial position	**5**
Corporate governance	12
Financial statements	16
Performance management	20
Appendices	24

Financial position

General fund

The Council reported a general fund deficit in 2005-06 of £1.2 million (2004-05: £1.3 million surplus). Figure 1 summarises the performance of the Council against the budget set for 2005-06.

Figure 1: comparison of 2005-06 actual outturn against budget

	Budget £000	Actual outturn £000	Variance over (under) £000
General fund services	85,786	89,097	3,311
Council tax income	18,580	18,630	(50)
Aggregate external finance	67,206	67,381	(175)
Provision for equal pay	-	1,435	1,435
Miscellaneous services, debt charges, pension costs etc.	-	(3,312)	(3,312)
(Surplus)/deficit for the year	**-**	**1,209**	**1,209**

The key variances against the general fund services budget were as follows:

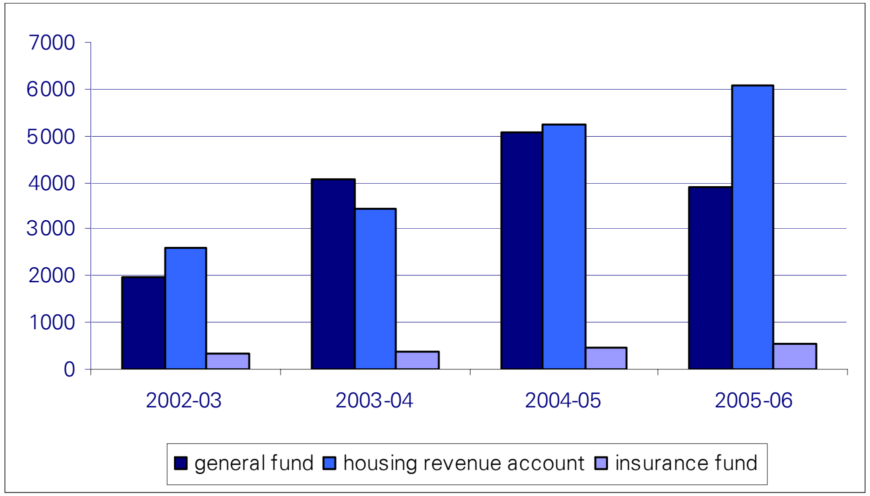
- impairment loss of £3 million;
- decrease in the net cost of housing benefits of £330,000;
- increase in specific grant funding for education and community services of £139,000;
- increase in the bad debt provision of £110,000 in addition to amounts budgeted; and
- allocation of central support costs to general fund services was £120,000 greater than budgeted.

Officers intended to use excess reserves to meet the costs of equal pay settlements, but there was no specific entry in the budget. We understand that unbudgeted costs of £414,000 associated with the PPP secondary schools project may be recovered in future years.

Reserves and balances

Total general fund reserves brought forward into 2005-06 amounted to £5.09 million. Appropriations during the year, combined with the deficit detailed in Figure 1, resulted in a carry forward of £3.9 million, summarised in Figure 2. In addition to the general fund, the Council maintains an earmarked insurance fund reserve (£551,000) and has an accumulated housing revenue account balance of £6.07 million.

Figure 2: general fund balances 2002-03 to 2005-06



Financial position (continued)

The Council has a recommended reserves policy of an amount equivalent to 2.5% of annual revenue expenditure to provide for future unforeseen expenditure. During 2005-06 members recommended holding a minimum general reserve of £3 million. £1.4 million was used during 2005-06 to fund the provision for equal pay settlements. We understand that the remaining excess will be utilised either to meet additional spending priorities in 2006-07, or considered as part of budget deliberations for 2007-08.

Under the terms of the scheme of devolved management to schools and services within education, the Council has earmarked a portion of general fund reserves, representing the devolved budget carried forward each year. The balance at 31 March 2006 is £1.016 million following net increases to the fund since 1 April 2003 when the reserve balance was £0.488 million. Officers should review current spending policies to ensure that this fund is used for the purposes intended and for the benefit of local education services.

Pension reserve

The Council is required to account for its superannuation schemes with the Falkirk Pension Fund ("the Fund") as a defined benefit scheme. The effect of this is to record the assets and liabilities of the pension scheme on the balance sheet and reflect the change in the scheme assets or liabilities (other than that arising from contributions to the scheme) in net operating expenditure. The Council has established a pension reserve so that there is no impact on local taxation from accounting for the pension scheme.

The net liabilities at 31 March 2006 were £52.627 million, an increase from £47.342 million at 31 March 2005. Figure 3 shows the net movement on the pension reserve year on year.

The Council's contribution to the Fund is expressed as a percentage of the employee's contribution and for 2005-06 was set at 210%. This gave rise to total contributions of £3.8 million (2004-05 £3.6 million).

Significant trading operations

2005-06 represents the third year in which local authorities have been required to maintain and disclose trading accounts for significant trading operations within the financial statements. As there is a statutory target of generating revenues not less than expenditure over a rolling three year period, 2005-06 represents the first year in which we are required to report on the achievement of these targets.

Figure 3: pension reserve balances 2002-03 to 2005-06

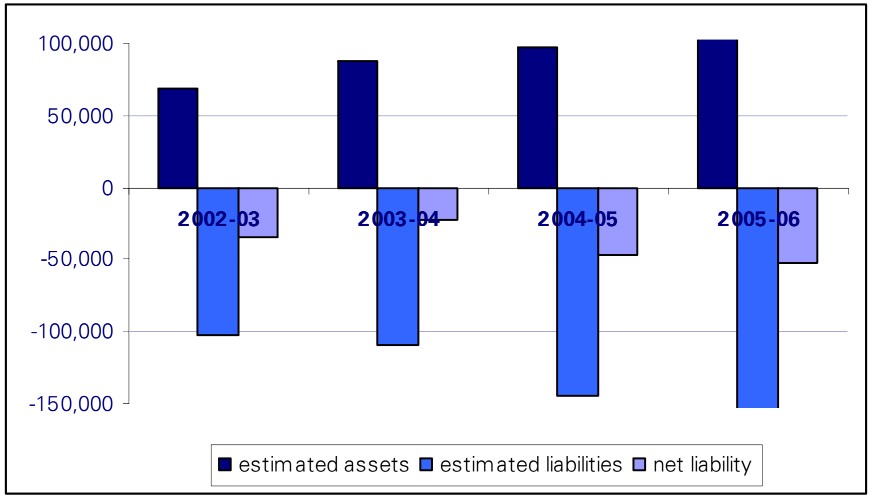


Figure 4 shows the summarised financial position of the trading accounts maintained by the Council for the three year period ended 31 March 2006.

Financial position (continued)

Figure 4: three year financial results of significant trading accounts

Trading operation	2003-04 surplus / (deficit) £000	2004-05 surplus / (deficit) £000	2005-06 surplus / (deficit) £000	3 year surplus / (deficit) £000
Property contracts	152	124	241	**517**
Environmental and engineering contracts	167	53	114	**334**
Total	**319**	**177**	**355**	**851**

The financial results to 31 August 2006 do not identify any significant variances to the projected 2006-07 outturn. The projected results are shown in Figure 5.

Figure 5: significant trading operations' 2006-07 projections

Trading operation	Projected surplus / (deficit) 2006-07 £000	Three year projected surplus / (deficit) to 31 March 2007 £000
Property contracts	250	615
Environmental and engineering contracts	80	247
Total	330	862

Housing revenue account – financial position

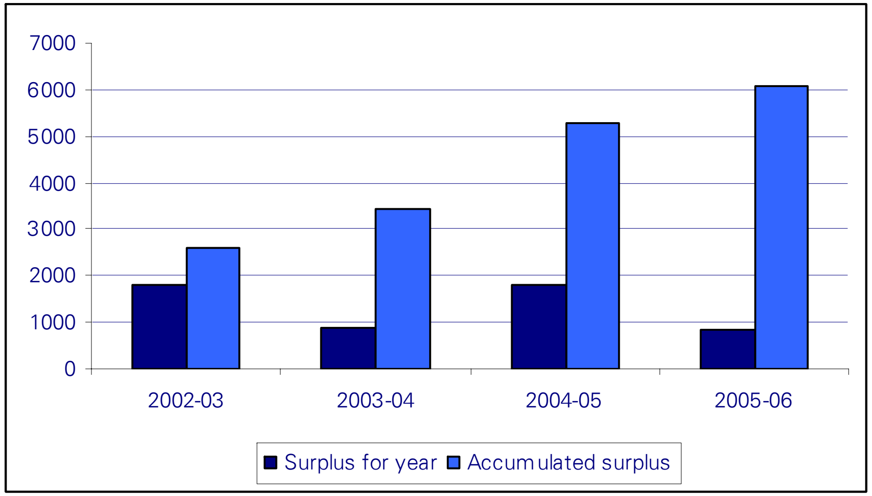
The housing revenue budget set in February 2005 forecast a surplus of £63,000, but was subsequently amended during the year to £767,000. The final outturn was a surplus of £861,000.

The accumulated surplus was £6.07 million at 31 March 2006. Movements on the housing revenue account balances are shown in Figure 6.

We reported in previous years that there was considerable scope for improving the housing revenue budget setting process, with a number of inaccurate assumptions being made. This continues to be evident in 2005-06, linked with the roll forward of the prior year budget. However, in response to previous recommendations, officers performed a detailed review during the financial year and the budget was updated to reflect known changes. The 2006-07 budget outturn was set at £128,000 in February 2006 and subsequently adjusted to £135,000 in September 2006, indicating improvements in the budgeting setting process.

Following the Council's decision on 8 December 2005 to retain all housing stock, officers have implemented outline plans to meet the Scottish Housing Quality Standard, but these have still to be developed into detailed plans. The intention is to produce a ten year business plan for the housing stock. Work has commenced to draft asset management plans, but these have not yet been approved by members.

Figure 6: housing revenue account balances 2002-03 to 2005-06



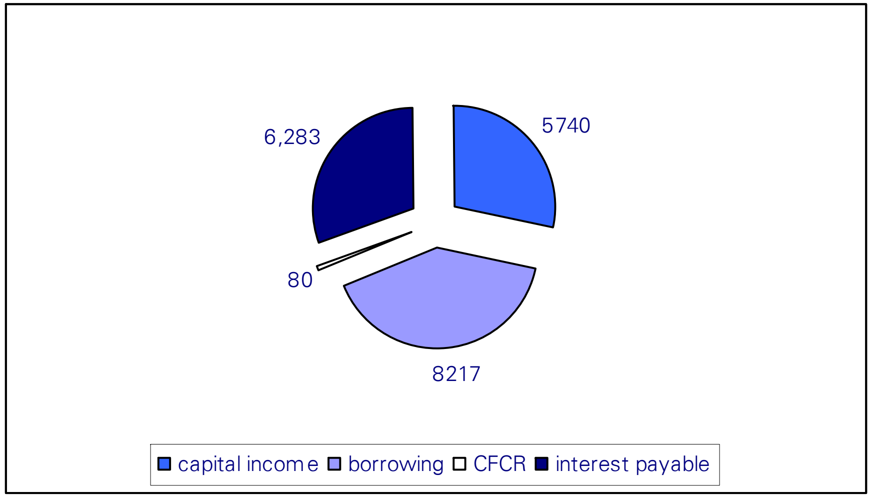
Financial position (continued)

The Council did not develop a specific fuel poverty plan during 2005-06, but we understand that this has since been completed. The head of housing has indicated that reducing poor energy efficiency within the housing stock is an area for development and has prioritised heating system installation within the housing stock to improve the service provided to tenants.

Capital investment programme and prudential borrowing

The Council incurred capital expenditure during the year of £14.037 million. This was funded through a combination of new borrowing (£8.256 million), capital income (£5.74 million) and capital financed from current revenue (£80,000). Figure 7 demonstrates the main sources of capital funding for general fund capital projects, as well as general fund interest payable during 2005-06.

Figure 7: capital expenditure funding



Capital expenditure in 2005-06 includes £178,000 on the Stirling-Alloa-Kincardine rail link project. In addition, £11.8 million of income and expenditure on the rail link project was treated as revenue as it relates to assets that are not owned by the Council and is being grant funded by the Scottish Executive and Scottish Enterprise Forth Valley. £4.5 million of funding is included within debtors at 31 March, which was received post year end and £4.9 million was deferred in the balance sheet to match future expenditure in 2006-07.

The service analysis provided by the Council in the capital expenditure statement details that the Council spent £6.3 million on development and environmental services, £1.6 million on education and community services, and £0.7 million on other general fund services. The general services capital programme for 2005-06 was underspent by £9.6 million, due to slippage in a number of projects, including:

- Pavilion and Dumyat business park development (£3 million);
- PPP secondary schools project (£1.4 million);
- Kilncraigs preservation project (£1.2 million);
- Alloa town centre upgrading (£0.8 million); and
- Alloa heritage museum (£0.7 million).

The 2006-07 capital programme totals £63.8 million, of which £9.4 million is planned expenditure on Council housing. £36.9 million relates to the Stirling-Alloa-Kincardine rail link project. Total expenditure on the project is forecast at £62 million, to which the Council will contribute £2.5 million.

Prudential Code

Since 1 April 2004, the Council has been operating under the CIPFA *Prudential Code for Capital Finance in Local Authorities.* The code sets out indicators which must be used, and factors to be considered, in order that local authorities can demonstrate that they have fulfilled the objectives of the code. Figure 8 shows the actual capital expenditure for 2005-06 compared to the Council's estimated expenditure in 2006-07 to 2008-09.

Figure 8: proposed capital expenditure forecasts under the prudential regime

£'000	2004-05 actual	2005-06 actual	2006-07 estimate	2007-08 estimate	2008-09 estimate
General fund services	6,968	8,438	19,615	11,698	10,496
Housing	4,472	5,599	9,370	9,420	9,126
Total	**11,440**	**14,037**	**28,985**	**21,118**	**19,622**

The treasury prudential indicators approved by committee for 2005-06 set an authorised limit for external debt of £106.3 million, with an operational boundary of £95.3 million. The Council's actual external debt was within both indicators at £90.7 million.

The 2005-06 financial statements disclose a net increase in cash and short term investments of £10.5 million. The key reasons for the significant increase in cash is slippage in the 2005-06 capital programme of £8.4 million and borrowing during 2005-06 to finance capital expenditure in 2006-07 to mitigate the risk of anticipated rises in interest rates.

In February 2006 the Council approved an increase in the authorised limit for external debt to £161.1 million, with an increased operational boundary of £145 million. The significant increase is required to meet the Council's forecast of a 52% increase in external debt between 2004-05 and 2008-09, primarily to support ongoing capital investment, including:

- £9.75 million contribution to construction costs as part of the PPP secondary schools project, in addition to £6.6 million of capital receipts as part of the Council's gross contribution of £16.4 million;
- £9.3 million, £9.4 million and £9.1 million on housing expenditure in the three years from 2006-2009; and
- £0.9 million contribution to the Stirling-Alloa-Kincardine rail link.

The Council should ensure that the costs of funding of capital expenditure are carefully considered, particularly in relation to capital expenditure that does not add value and is immediately written off to reserves. 85% of capital expenditure in 2005-06 was written off during the year as non-enhancing expenditure (2004-05: 84%). The Council should consider its decision to increase its external debt to continue to fund capital expenditure, a large proportion of which is unlikely to add value and not result in creation of an asset recognised on the balance sheet.

In addition, the majority of the £27.8 million planned expenditure on housing stock will be incurred to meet Scottish quality housing standards, for which the accounting code of practice and capital guidelines contain strict criteria potentially limiting the Council's ability to capitalise this expenditure.

Future financial plans

Budgeting process

The Council has 41 corporate priorities that help guide investment activities. As reported previously, three year plans are developed on a rolling basis and there is an improving link between service plans and budgeting. During 2005-06 there has been enhancement to the budgeting process following the establishment of a budget working group with primary responsibility to develop and challenge budgets.

The Council is undertaking a three year trend analysis of service expenditure to support an informed analysis of budget proposal at service level. Financial reports now include increased narrative and more time is spent on gathering financial information from officers to support and strengthen the financial monitoring process.

Key risk areas and financial pressures highlighted in the 2006-07 revenue budget include:

- £0.3 million (4.4%) increase in contributions to the fire, police and valuation joint boards;
- £0.4 million to budget for the net costs of implementation of the single status agreement;

- £0.7 million increase in loan charges following an increase of £9 million in external borrowing during 2005-06; and
- £0.7 million to support an increase in energy costs.

Single status agreement and equal pay

The 2006-07 budget includes £400,000 to meet the net costs of the single status agreement, representing £600,000 gross costs combined with estimated savings of £200,000 from staff leaving.

General fund reserves are significantly higher than originally budgeted over the last two years, and, during 2005-06, £1.4 million has been utilised to cover the costs of equal pay settlements. A provision of £1.4 million has been reflected in the 2005-06 financial statements following payment of £1.1 million to 261 employees in June 2006 and includes an estimate of £0.3 million for claims unsettled at the time of finalising the financial statements. The above figures are inclusive of related tax and national insurance liabilities payable to HM Revenue & Customs. We understand that the payments are made exclusive of pension contributions, which has been agreed with employees concerned.

PPP secondary schools project

The Council has made significant progress towards agreement of the planned public private partnership ("PPP") project to replace its three secondary schools by 2008. However, management has indicated that the agreement may not be signed until late October 2006, seven months after the original plan, following delays in agreeing contracts with the private sector.

FRS 11 'impairment of fixed assets and goodwill' ("FRS 11") requires that "*a review for impairment of a fixed asset or goodwill should be carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset or goodwill may not be recoverable*". Finalisation of the PPP agreement will constitute an 'event' in the context of FRS 11 and officers should formally document an impairment review at this time.

Demand led services

The Council in conjunction with the other councils in the Forth Valley area (Falkirk and Stirling) and Forth Valley Health Board have appointed contractors to complete an evaluation of need for social care services over the next five years in detail and the next ten years in summary. Cost evaluation and consequent funding gaps will be established on the receipt of the outcome of this evaluation.

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

Corporate governance

Introduction

Corporate governance is concerned with structures and processes for decision-making, control and behaviour at the upper levels of the Council in accordance with the fundamental principles of openness, integrity and accountability. Management is responsible for establishing arrangements for the conduct of its affairs, including compliance with applicable guidance, ensure the legality of activities and transactions and to monitor the adequacy and effectiveness of these arrangements in practice. The *Code* requires auditors to review aspects of the corporate governance arrangements as they relate to:

- the Council's review of its systems of internal control;
- the prevention and detection of fraud and irregularity;
- standards of conduct, and the prevention and detection of corruption; and
- its financial position.

Performance management

Service plans continue to be the keystone of performance management at a corporate level and contain a set of improvement actions over three years and performance measures. Plans include linkages to corporate priorities and also set a context for budget working group discussion. In both 2004 and 2005 service plans were submitted for approval earlier than in previous years and close to the start of the financial year. The 2006 service plans included budget information, however, this was limited to one financial year and did not include future financial planning information.

Risk management

The Council has a risk management framework that includes a risk management policy that is reviewed and updated annually, a corporate risk register and a risk management group responsible for updating the risk register and the risk management policy. The risk management process involves all levels of officers and management to promote completeness of risks identified and is embedded at operational and strategic levels. The risk management group is currently focussing on business continuity and managing risks relating to emergency planning, the budgeting process, and non-compliance with national objectives, laws and regulations.

Systems and controls

In preparation for our audit of the financial statements, we reviewed the design and operating effectiveness of controls over a number of systems to assess if they were operating effectively to prevent or detect a material misstatement in the financial statements. Two reports issued as a result of this work covered controls operating over payroll, creditors and service expenditure, significant trading operations, housing rents, fixed assets and contracts and tendering (31 March 2006) and the controls operating over housing and council tax benefit systems (30 June 2006). In addition we reviewed and reported on the Council's information technology general controls (September 2006).

The following significant (priority one) recommendations were made as a result of the findings reflected in the reports:

- payroll reconciliations and exception reports should be evidenced as reviewed by a management level personnel prior to payroll payments being made;
- a formal reconciliation between the financial ledger and the housing rents system should be completed, including evidence of preparation and review, on a monthly basis;
- the Council should develop and monitor progress against a three year business plan and budget for each significant trading operation;
- the Council should develop a fixed asset register system and ensure it is updated on a regular basis;
- a physical verification exercise should be completed on all non land and building assets annually;
- routine exception reports from the benefits system should be produced and reviewed and any discrepancies should be corrected;
- established procedures regarding the checking and reviewing of claims should be strictly adhered to;

- sufficient documentation should be maintained on file to support all overpayments;
- the benefits system should be formally reconciled to the general ledger on a monthly basis and documentation of the reconciliation should be maintained;
- all manual journals should be evidenced as independently reviewed;
- a reconciliation should be performed between the assessor's reports and the changes that have been made to the council tax system;
- the ICT security policy should be a corporate level document and be reviewed on a regular basis;
- the IT user acceptance policy should be formally approved and responsibility for implementation assigned to a named individual; and
- a formal change management policy and disaster recovery plan should be formally approved and implemented.

Four of the above recommendations were not accepted by officers, who have noted that they accept the risk presented by the observations reported.

Internal audit

In completing our audit, we sought, where appropriate, to rely on the work carried out by the Council's internal auditors. The relevance of internal audit reports and changes to the internal audit plan were subject to review throughout our audit to maximise the reliance placed on their work.

We planned to place reliance on the work of internal audit in four areas, stock payroll, bank reconciliations and statutory performance indicators. However, internal audit did not attend the stock count and we were unable to rely on this area as planned. In addition, we draw attention to the lack of internal audit work over council tax and housing benefit systems. This was highlighted in the 2005-06 internal audit plan, but causes concern over the risk of fraud and error and resulted in additional work being performed by us as part of our interim fieldwork.

In conclusion, the Council's internal auditors have noted that "with the exception of the areas of weakness noted, that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control systems in the year to 31 March 2006".

External inspections

The Council was subject to an inspection of security by the Benefit Fraud Inspectorate ("BFI") in September 2005. The report concludes that "*following our scrutiny of the Council's partial self-assessment against the claims administration, security and resource management themes … we found that the Council met standard in eight of the 35 enablers set for these themes.*"

The report (January 2006) identified 23 recommendations. Officers presented an update on the Council's response to these recommendations to the performance and audit committee on 21 September 2006. The paper reports that 15 of the recommendations are now complete and action is ongoing in response the remaining eight areas, which is forecast to be completed by December 2006.

Statement on internal financial control / corporate governance

As part of the development of corporate governance, public sector bodies are required to make a statement of how they have applied the principles of corporate governance. We are required to review this to assess whether the description of the process adopted in reviewing the effectiveness of the system of internal control appropriately reflects the process.

We are not required to provide an opinion on the Council's systems of internal controls. The statement for 2005-06 notes that:

- work in the ongoing development associated with the Council's main financial ledger system, to improve the extraction and availability of management information, would enhance control mechanisms; and

- all the issues formally raised by the Benefit Fraud Inspectorate during 2005-06 have either been addressed, or are in the process of being met, and the Department for Work and Pensions has confirmed that they will not be proposing further action on the strength of improvements being made.

Fraud and irregularity, standards of conduct, integrity and openness

Work in these areas has been addressed over the duration of our appointment. In relation to fraud, we have had regard to relevant auditing standards when completing our work. Work in relation to standards of conduct etc has included monitoring of the Council's arrangements for adopting and reviewing standing orders and financial instructions, schemes of delegation and compliance with applicable codes of conduct. We have not identified any significant weaknesses in these areas.

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

Audit opinion

On 29 September 2006 we issued an audit certificate expressing an unqualified opinion on the financial statements of the Council and its group for the year ended 31 March 2006.

Audit completion

An important measure of proper financial control and accountability is the timely closure and publication of audited financial statements. Figure 9 summarises the key elements of the audit process with which we require management to engage.

Figure 9: key elements of the audit process

Completeness of draft financial statements
A fully complete set of unaudited financial statements was received in advance of the start of the audit on 30 June 2006.
Quality of supporting working papers
In accordance with our normal practice, we issued a 'prepared by client' request that set out a number of documents required for our audit of the financial statements. The majority of the documentation requested was provided.
Response to audit queries
The majority of audit queries were dealt with in a timely manner.

Financial adjustments and confirmations

In Figure 10 we draw attention to adjustments to the financial statements made by management as a result of the audit process. The decrease number and volume of adjustments highlighted in Figure 10 compared to previous years demonstrate improvements in the financial statement preparation process.

Figure 10: financial statement adjustments

	Consolidated revenue account £'000	Consolidated balance sheet £'000
Provision for equal pay	(1,435)	(1,435)
Net adjustment	**(1,435)**	**(1,435)**

Confirmations and representations

We confirm that as of 29 September 2006, in our professional judgement, KPMG LLP was independent within the meaning of regulatory and professional requirements and the objectivity of audit staff is not impaired. This will be confirmed separately in writing to the Council.

In accordance with auditing standards, we obtained representations from the Council on material issues prior to signing our opinion. Management have not adjusted a number of audit differences which they believe to be immaterial, both individually and in the aggregate, to the financial statements taken as a whole. A summary of unadjusted audit differences was attached to the management representation letter.

Significant accounting issues

Group accounts

The 2004 accounting code of practice introduced modified requirements for the preparation of group accounts. Authorities were required to consider their interests in all types of entities when considering the requirement for group accounts. The Council chose to use an exemption to these requirements for 2004-05, but was required to prepare group accounts in 2005-06, including 2004-05 comparatives.

Draft group accounts were presented for audit on 30 June 2006 in line with the agreed timetable. A number of amendments were made as a result of the audit process, however, these related to presentation and disclosure items only.

Revaluation of fixed assets

In line with the SORP requirements, officers engaged the District Valuer to formally value all Council dwellings and DM Hall, Chartered Surveyors, to value all other operational and non-operational land and buildings. Formal reports and associated working papers were presented in line with the original timetable. However, discrepancies in DM Hall's report were identified during the audit process and a revised report was received on 20 September 2006. The primary correction made related to the physical area of two of the Council's significant properties due to inaccuracies in the original data provided by the Council. This resulted in a late adjustment to the financial statements to show an increase in the impact of the revaluation of £210,000. In addition, a number of presentational and version control errors were rectified in the final version of the report. The Council recognised an impairment loss of £3 million in compliance with the requirements of the accounting code of practice.

Equal pay

The Equal Pay Act 1970 makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work; work rated as equivalent; or work of equal value. An amendment to the Equal Pay Act in 2004 extended the period over which back pay could be claimed from two to five years in Scotland bringing UK legislation into line with the European Union.

The Council has made offers of compensatory payments to groups of employees in catering, cleaning and homecare to settle potential historic equal pay claims. The Council identified approximately 330 such employees and to date has concluded legally binding compromise agreements with 261 at a net cost of £0.85 million. The accounting treatment of this offer is determined by FRS 12 'provisions, contingent liabilities and contingent assets' ("FRS 12").

The payments made to employees relate to periods of employment in the past and the Council recognises its ability to transfer benefits, which is consistent with all other Scottish local authorities, and as such meet conditions within FRS 12. The Council's settlement offers have been accepted by 261 employees in June 2006 and demonstrates the Council's ability to quantify its obligation and this has been used as a basis for estimating future settlements to other employees with existing claims.

During the audit process the Council recognised a provision of £1.4 million in the financial statements for the year ended 31 March 2006, including amounts payable to HM Revenue & Customs to meet tax and national insurance obligations. In addition, officers have confirmed that there are no additional pension contributions, which has been agreed with employees.

The financial statements continue to disclose a contingent liability in recognition of the possibility of future claims that have not yet been submitted. The degree of uncertainty surrounding the likelihood, volume and value of such claims meet the definition of a contingent liability in FRS 12.

Leisure services

With effect from 1 April 2005 the management of all leisure and community hall facilities were brought back within the direct control of the Council. There were no costs arising from this and staff transferred back to the Council.

Ceteris

In 1980s, the Clackmannan District Council established an enterprise trust (now known as "Ceteris") to promote business and economic growth in the area. In 1988 the Council agreed on a new strategy for the local enterprise trust to create additional business space (through Ceteris) and let it out. This was in response to a lack of acceptable accommodation at the time and a lack of demand for new property development. During the 1990s the Council provided low cost accommodation to Ceteris so that this could be passed on to businesses to encourage economic development and employment opportunities.

Ceteris encountered significant financial difficulties during the late 1990s and outstanding debt reached £10 million. A number of options have been considered by members and officers and, subsequent to 31 March 2006, a decision was reached to meet the objectives of both organisations. Ceteris will receive title to properties currently leased from the Council in return for the Council receiving title to Lime Tree House, currently leased from Ceteris. The value of the title swap will allow the Council to recover outstanding debt currently owed by Ceteris. In addition, the Council will retain valuable office accommodation and pass on properties to Ceteris for the benefit of local businesses.

The Council has disclosed this transaction in the 2005-06 financial statements, although the transfer will not be recognised until the financial statements for the year ending 31 March 2007.

Lender Option Borrowing Option ("LOBO")

The accounting code of practice states that, "gains or losses arising on the repurchase or early settlement of borrowing should be recognised in the consolidated revenue account in the periods during which the repurchase or early settlement is made. Where however the repurchase of borrowing was coupled with a refinancing or restructuring of borrowing with substantially the same overall economic effect when viewed as a whole, gains or losses should be recognised over the life of the replacement borrowing." LOBOs are variable rate loans whereby, if the lender decides to change the interest rate at certain predetermined dates, the borrower has the option whether to accept the change or to repay the loan principal.

As at 31 March 2006, the Council had £18.5 million of LOBO borrowings. The amount held within the consolidated balance sheet as at 31 March 2006 in respect of debt premium was £5.22 million of which £3.58 million relates to premia incurred on switches to LOBOs (this assumes that the debt premium arising in 1999-2000 should not be included).

The premia has been amortised to revenue over the period of the replacement loans as permitted by the statement of recommended practice ("SORP"). We understand that the Council considers that the overall economic effect of the original and replacement borrowing is substantially the same. In reaching this view the Council has taken into account:

- the definition of the term 'overall economic effect' offered by the SORP guidance notes;
- the expected stability of interest rates over the period of replacement borrowing; and
- that there is no evidence that lenders have sought in practice to impose significant interest rate increases or that authorities have refused to accept any increases.

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

Priorities and risks framework

Audit Scotland's 2005-06 *Priorities and Risks Framework: 2005-06 National Planning Tool for Local Government* ("PRF") set out the following eight areas for consideration during the planning of the audit:

- financial strategy;
- housing strategy;
- performance management and improvement;
- role and development of elected members;
- efficient government;
- workforce planning;
- strategic planning in social services; and
- working together for communities and users.

Our work and findings from the first four of these areas has been narrated earlier in this report. The key findings from the remaining areas are summarised below.

Efficient government

In line with Audit Scotland requirements, we completed the *efficient government – management arrangements diagnostic*, although there were some difficulties in obtaining supporting documentation within the required timescale. Figure 11 summarises the savings achieved and future annual targets solely resulting from efficient government initiatives, while Figure 12 highlights the key issues reported in this diagnostic.

We reported a number of recommendations for improvement based on our work, including:

- the Council should implement a formal system to monitor, measure and report efficiency savings; and
- systems should be established to record underlying activity data including building occupancy rates and staff redeployment.

Figure 11: efficient government savings and targets

£'000	2005-06	2006-07	2007-08
Asset management	-	-	-
Managing absence	-	-	-
Procurement	49	155	218
Shared support services	-	-	-
Streamlining bureaucracy	-	-	-
Other	629	528	473
Total	**678**	**683**	**691**

Figure 12: efficient government arrangements

Key arrangements

- The Council has a formal operational property strategy and asset management plan and has established a corporate asset management planning team.
- The centralised procurement function operates in line with the Council's procurement policy and provides regular reports to management. Goods to the value of £1.4 million were procured in collaboration with other organisations during 2005-06.
- The Council has led a partnership of local authorities (Stirling, Falkirk, Perth and Kinross East Dunbartonshire and Clackmannanshire) in making a stage one proposal to the Scottish Executive for a shared service solution with an initial scope covering administrative and transactional processes within human resources, finance, payroll and procurement. Initial analysis of the financial case suggests a £20 million investment may realise £30 million savings over ten years.

Workforce planning

The Council's workforce reflects the diversity of its conditions. There are many different job types and specialisms, some relatively large, including tenders and many small or singleton professionals. Officers believe that a uniform system of succession and workforce planning is not appropriate to this situation. Approaches to assessing need and risks are tailored to the group or service. The human resources department produces statistical information which is reported on a quarterly and ad hoc basis to senior management, service areas, members and joint trade union committee forums. For certain major professional groups, notably teaching and social care, national standards are prescribed and the workforce is monitored and adjusted to reflect these. In addition, programmes of service re-organisation have been ongoing across the Council with staff resource planning a core part of such reviews. Where major reorganisation is completed such as in the housing department recently, then these issues are considered and plans developed within the department. However, this is not a systematic approach Council-wide.

Strategic planning in social services

The Council is an integral part of the local community health partnership with meetings held on a quarterly basis and sees these as an opportunity to bring together services and has developed a pooled budget with the Forth Valley NHS Board in respect of mental health day care services. The Council has disclosed this budget in a memorandum note to the revenue account in the 2005-06 financial statements.

Best value

The Local Government in Scotland Act 2003 introduced new statutory duties relating to Best Value and community planning. As a result, the Accounts Commission introduced new arrangements for the audit of Best Value. The scope of Best Value and community planning is broad, but in overall terms a successful council will:

- work with its partners to identify a clear set of priorities that respond to the needs of the community in both the short and the longer term;
- be organised to deliver those priorities; and
- meet and clearly demonstrate that it is meeting the community's needs.

Normally, a Best Value audit will only be carried out once in a three year period at each council. Audit Scotland commenced their work at the Council in July 2006 and plan to report in December 2006.

Statutory performance indicators

The Local Government Act 1992 requires the Council to publish information relating to their activities in any financial year which will facilitate the making of appropriate comparisons (by reference to the criteria of cost, economy and efficiency) between the standards of performance achieved by different authorities in that financial year; and the standards of performance achieved by such bodies in different financial years.

The Accounts Commission issues a Direction each year establishing the performance indicators to be published. There were some minor changes to the performance indicators required in 2005-06.

The Council's systems have been able to produce reliable information for most of the required statutory performance indicators, but three indicators were deemed to be unreliable:

- cultural and community services indicator two - attendance at other indoor sports and leisure facilities, for which the Council was unable to confirm the reliability of the underlying data;
- housing indicator one b) & j) – housing response repairs, which are unreliable due to administrative errors; and
- roads and lighting indicator four - street lighting columns, for which the Council reported a best estimate of the total number of columns over 30 years old as there is no accurate data available.

Following the Public Pound – an update

During 2004-05, a review of local authorities' funding arrangements with arms length and external organisations ("ALEOs") was developed by Audit Scotland and carried out at each local authority. Audit Scotland published their national report on the study on 15 December 2005. This report graded all 32 councils according to their level of performance in complying with the Code of guidance on funding external bodies and following the public pound. Nationally, nine councils were graded high, 18 were graded moderate with the balance of five councils graded as low. The Council's individual grading was moderate.

The Council has not implemented a formal system to record and monitor action taken in response to recommendations raised in this report.

Her Majesty's Inspectorate of Education

Her Majesty's Inspectorate of Education ("HMIE") performed a pilot inspection of the education functions of the Council in September 2005. The report summarises the Council's position against a total of 11 quality indicators, two 'very good', six good, two 'adequate' and one 'weak'. Resource and financial management indicators are reported as 'good' and management information systems are considered to be 'adequate'.

Contents

Executive summary	**1**
Introduction	**3**
Financial position	**5**
Corporate governance	**12**
Financial statements	**16**
Performance management	**20**
Appendices	**24**

I. Action plan

Appendix I – action plan

This appendix summarises the performance improvement observations we have identified during the financial statements audit. Each of our observations has been allocated a risk rating, which is explained below.

	Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the Council or systems under consideration. The weakness may therefore give rise to loss or error.		**Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future.** The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.		**Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors.** The weakness does not appear to affect the availability of the controls to meet their objectives in any significant way. These are less significant observations than grades one and two, but we still consider they merit attention.

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
1	**Impairment** FRS 11 'impairment of fixed assets and goodwill' ("FRS 11") requires that "*a review for impairment of a fixed asset or goodwill should be carried out if events or changes in circumstances indicate that the carrying amount of the fixed asset or goodwill may not be recoverable*". Finalisation of the PPP agreement will constitute an 'event' in the context of FRS 11 at which point the carrying value of the land and buildings may be less than the realisable value.	Officers should formally document an impairment review at the date of the agreement to ensure compliance with FRS 11 and accuracy of the financial statements.	Agreed. This action has already been noted by management as a consequence of the schools project. The results of our impairment review will be incorporated in the 2006-07 financial statements, assuming finalisation of the PPP agreement.	Head of finance 31 March 2007

Appendix I – action plan (continued)

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
2	**Asset management** Officers provided details from the Council's asset records to DM Hall to be used as the basis of the fixed asset revaluation at 1 April 2005. Discrepancies in DM Hall's report were identified during the audit process and a revised report was received to correct errors in the physical area of two of the Council's significant properties due to inaccuracies in the original data provided by the Council. We understand that this will be discussed by the executive management team in future meetings. There is a risk that inappropriate or incorrect decisions are made based on inaccurate underlying data.	Officers should ensure that a comprehensive review of assets is undertaken and that asset management records are subsequently updated. This should provide assurance that the underlying data is correct for decision making and management purposes.	Agreed.	Head of property services 31 March 2007

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
3	**Insurance fund** LASAAC guidance on 'accounting for insurance in local authorities in Scotland' recommends that councils should obtain a regular independent valuation of the cumulative value known claims, outstanding liabilities and projection of incidents incurred by not yet reported. The Council has a balance of £551,000 in the fund at 31 March 2006 and believes this is insufficient to allow adequate self-insurance, but has not obtained a formal valuation of existing and potential claims. There is a risk that the level of the fund is inappropriate compared to the potential level of claims. Insufficient funding or over provision could have an equally detrimental financial or reputational impact on the Council.	The Council should obtain a formal valuation of known claims, outstanding liabilities and projection of incidents incurred by not yet reported prior to the 2007-08 budget process and preparation of the 2006-07 financial statements. This should provide officers with assurance over the relative value of the fund and mitigate future risks of inaccurate forecasting.	Agreed. This was noted as an action point at the performance and audit committee on 24 August 2006.	Head of finance 31 December 2006
4	**Non-domestic rates** The non-domestic rates system did not agree to the financial ledger at 31 March 2006. In addition, management could not explain the difference and no reconciliation was available. The build-up of unreconciled differences may result in the risk of misstatement of the financial statements.	Officers should ensure that monthly reconciliations are prepared and reviewed in a timely manner. This should ensure that reconciling differences are investigated and resolved in a timely manner and provide assurance over the accuracy of transfers from the non-domestic rates system into the financial ledger.	Agreed. All non-domestic rate income, reductions and charges are reconciled to the financial ledger on a monthly basis. Year end entries in the financial ledger are based on the non-domestic rates system. This process will be reviewed to ensure full reconciliations are performed.	Revenue services manager Accounting and budgeting manager 31 March 2007

Appendix I – action plan (continued)

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
5	**Devolved management responsibility** The balance on the devolved budget at 31 March 2006 is £1.016 million following net increases to the fund since 1 April 2003 when the reserve balance was £0.488 million. There is a risk that the balance is not appropriately allocated to education services in a timely manner in line with original plans.	Officers should review current spending policies to ensure that this fund is allocated to education services in a timely manner and is used for the purposes intended.	Agree. Half of the balance belongs to the Council's schools under the devolved schools management agreement which allows for carry forward of 3% subject to a spending plan. This scheme has been adhered to. The centrally held part is being spent on various topics - Alva access roads, setting up area management boards, and carrying out a pilot of ASN under DSM.	Heads of schools March 2007
6	**Financial ledger** The Council's financial ledger and chart of accounts, covering both revenue and balance sheet items, does not facilitate reconciliation to the financial statements. The requirement for an increasingly complex and extended reconciliation increases the risk of misstatement in the financial statements, and decreases the risk of detection of fraud or error in the financial ledger.	Officer should ensure that sufficient financial and staff resources are available to complete ongoing work in development of the Council's main financial ledger system to improve the extraction and availability of management information.	This will be addressed by the introduction of the advanced general ledger, when the use of analysis fields will enable extraction and conversion of ledger data into the BVACOP categories disclosed in the financial statements.	Accounting and budgeting manager 31 March 2007

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
7	**Outstanding debtors** The Council has made provisions for non-recovery of aged sundry, council tax, community charge and housing benefits debtors. A number of these debts are over three years old or some date back to 1993, relate to deceased members of the community of businesses that have ceased to exist. There is a risk of error or misstatement as a result of the ongoing requirement for increasingly significant calculations and adjustments on an annual basis.	Officers should prepare a policy for debt write-off covering all key debt categories. This should reduce the risk of error and provide management with readily available and accurate information on recoverable outstanding debt.	Agreed. A draft corporate debt write off policy has been prepared and presented to the Council's budget working group. A final version of the policy is in preparation and will be presented to the performance and audit committee for approval.	Revenue services manager 31 December 2006
8	**Benefits overpayments** Overpayments of benefits are reported to the DWP on a quarterly basis. Incorrect figures were used by the Council during 2005-06, but were subsequently corrected in the annual return. In addition, one of the quarterly forms was not submitted during the year. There is a risk of incorrect information being submitted to the DWP, which may result in incorrect receipts and payments.	Officers should revise the process for collating and reporting overpayments information to the DWP to ensure that appropriate controls are in place over the timeliness and accuracy of information.	Agreed. This process has now been reviewed and a revised process implemented.	Complete