Government and Public Sector

September 2006

East Ayrshire Council

Annual Report to Council Members and the Controller of Audit

2005/06 Audit

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29 September 2006

Our ref: CDR/JM/LM

Ladies and Gentlemen

Annual Report to Council Members and the Controller of Audit 2005/06

We have completed our audit of East Ayrshire Council (the "Council") and its financial statements for the year ended 31 March 2006.

The Annual Report is primarily designed to direct your attention to matters of significance that have arisen out of the 2005/06 audit process and to confirm what action is planned by management to address the more significant matters identified for improvement.

We would like to take this opportunity to offer our thanks to those members of management and staff who have assisted us during the course of the audit.

Yours faithfully

PricewaterhouseCoopers LLP

Our Report Structure

Our report structure reflects our wider public sector audit responsibilities as set out in Audit Scotland's Code of Audit Practice.

The Model	Areas of Responsibility	Explanation
Public Sector Audit Model	Financial Statements	The financial statements of the audited body are an essential means by which it accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.
	Governance & Business Control	Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour at the upper levels of the organisation. The three fundamental principles of corporate governance - openness, integrity and accountability – apply equally to all bodies.
	Performance	The wider dimension of the public sector audit requires that the audit process gives consideration to the way in which the audited body secures economy, efficiency and effectiveness in the use of its resources. The terms economy, efficiency and effectiveness are frequently referred to under the generic term "value for money".

Contents

1. Audit Opinion

Our Audit Opinion

1.1 The Local Government (Scotland) Act 1973 requires that, following the completion of an audit, the auditors shall place on the abstract of accounts a certificate which sets out the basis on which they have formed their audit opinion. Our opinion on the accounts states:

- that the audit has been conducted in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Code of Audit Practice;
- the respective responsibility of management and auditors in relation to the accounts; and
- whether, in the auditors opinion, the accounts present fairly the financial position of the Council as at 31 March 2006.

1.2 Our audit opinion for the year ended 31 March 2006, which is in the format prescribed by the Accounts Commission, is **unqualified**. However, the explanatory paragraph shown below has been included within the opinion as two Council statutory trading services failed to breakeven over the three years ending 31 March 2006:

1.3 *"Local Authorities have a duty under section 10 of the Local Government in Scotland Act 2003 to conduct each of their significant trading operations so that income is not less than expenditure over each three year period. The authority failed to comply with this statutory requirement for the three years ending 31 March 2006 in respect of the Catering and Cleaning Statutory trading operations.*

Within page 13, Note 9 of the financial statements, the Council has drawn attention to the fact that Catering and Cleaning trading operations show a cumulative deficit over the three year period due to the inclusion in both accounts of the cost of compensation payments made in respect of Equal Pay claims, and in the case of catering the inclusion of Financial Reporting Standard 17 pension adjustments".

1.4 Our opinion is set out in full in **Appendix 5.**

2. Financial Performance and Position – 2005/06

Financial Position 2005/06

2.1 The Council's net general surplus balance for 2005/06 was £0.3 million with brought forward reserves of £16.8 million. The Council's overall position for the year is shown in **Appendix 1**.

2.2 At the start of the 2005/06 financial year the Council forecast an in-year surplus of £0.8 million, which included the utilisation of certain departmental balances carried forward from 2004/05. However, the actual out-turn for the year ended 31 March 2006 was an in-year surplus of £0.3 million. In achieving this surplus the Council had also funded a number of unbudgeted expenditure areas including £7.5 million in respect of equal pay compensation claims, a transfer of £2.5 million to the capital fund and £1.7 million to the insurance fund. Additional unbudgeted savings and additional income, totalling £12.3 million was received to offset this expenditure.

2.3 Therefore, during the year the movement between the budgeted surplus and actual out-turn was as follows:

	£m
At April 2005:	
Initial budgeted in-year surplus	**0.8**
Less utilisation of reserves to fund in year expenditure	(1.1)
Overall forecasted deficit in year	**(0.3)**
During 2005/06:	
Unbudgeted savings and additional income received (see paragraph 2.4)	12.3
Unbudgeted expenditure:	
Equal pay compensation claims	(7.5)
Transfer to capital fund	(2.5)
Transfer to insurance fund	(1.7)
Year end surplus achieved as at 31 March 2006	**0.3**

2.4 The key reasons for in-year savings of £12.3 million compared with budgeted income and expenditure have been presented to members as follows:

	£m
Reduction in debt charges – Overall borrowing was reduced from £20.3 million to £7.7 million due to slippage within the capital programme. This led to lower than budgeted debt charges in-year.	3.1
Greater than budgeted surplus by Building and Works – Improved performance in-year led to an increased number of jobs being completed by 31 March 2006 than forecast. In addition, additional contracts were completed which were delivered by Building and Works with no additional overhead costs being incurred.	2.6
Council Tax Collection rates – Additional income received in year through penalties of 10% applied at final council tax reminder stage. As collection rates increased the need to involve Sheriff Officers in collecting debt reduced resulting in lower than forecast expenditure. Additional income from previous years was also collected in excess of the bad debt provision.	1.1
Change in benefit subsidy regulations – New funding arrangements, the effect of which was not known at the time the budget, was approved resulting in higher than anticipated grant income.	0.8
Contingency Fund – Contingency built into the budget for unforeseen events such as variations in the levels of winter maintenance forecast which were not required.	0.3
Departmental Underspends and efficiency savings – A number of in-year efficiencies were achieved by all departments and a number of areas of expenditure which were forecast for 2005/06 did not arise.	4.4
Total in-year unbudgeted savings and additional income	**12.3**

2.5 As at 31 March 2006 Council reserves were £17.1 million, of which £8.6 million has been committed for specific purposes. The Council's reserve strategy requires that uncommitted reserve balances should be between 2% and 4% of net budgeted expenditure (Between £6 million and £12 million).

2.6 The reconciliation between actual financial out turn and that forecast within the Council's Budget Scrutiny Group papers as shown above was not immediately apparent. It is therefore recommended that the Council reviews its budget monitoring papers to ensure that financial information presented, in particular commentary in respect of the overall financial position of the Council and each individual services financial position, can be easily understood with appropriate explanations provided for variances arising.

Action 1

General fund Capital Expenditure 2005/06

2.7 General fund capital expenditure was forecast as £29.4 million at the start of the financial year. However, due to unpredicted programme slippage and delays, actual capital expenditure as at 31 March 2006 was £10.9 million. An explanation for this underspend of £18.5 million is shown within **Appendix 2**.

2.8 Going forward, Council Management should undertake a fundamental review of its General Fund Capital programme, in particular how capital projects are included in the programme, the profiling of projects within the financial year and an assessment of the Council resources available to deliver the programme to ensure that the general fund programme is completed in accordance with agreed timescales. If the capital plan is not appropriately profiled the Council cannot effectively manage its required borrowing within the prudential framework and resulting debt charges for each financial year.

Action 2

Housing Services Capital Expenditure 2005/06

2.9 Budgeted housing capital expenditure for 2005/06 was £8.9 million. Actual expenditure in year was £8.8 million resulting in a small underspend of £0.1 million. This was due to minor slippage within the roofing programme.

Pension Fund

2.10 The Council participates in the Local Government (Scotland) Superannuation Scheme, administered by Glasgow City Council through the Strathclyde Pensions Fund. The Council participates in two formal schemes, the Local Government Superannuation (Scotland) Scheme, which is administered by Glasgow City Council and the Teachers' Scheme.

2.11 Pension Liabilities are valued on an actuarial basis, which assesses the future liabilities of the fund. The valuation undertaken by Hymans Robertson, the independent actuaries of the pension fund, is based on a valuation as of 31 March 2005. The Net Pension Liability as at 31 March 2006 is £90.0 million compared with £98.2 million as at 31 March 2005. This decrease is primarily due to actuarial gains during 2005/06.

2.12 The Council, in conjunction with the Pension Fund, should continue to monitor closely the Pension Fund position. In particular, budgets should continue to be set to ensure that any required increases in contributions can be met.

Action 3

3. Forecast Financial Position 2006/07

3.1 For the purposes of this report we have summarised the projected 2006/07 financial position for East Ayrshire Council in the table below:

	£m	£m
Departmental Gross Expenditure	293.1	
Trading Services Income	(1.9)	
Net service expenditure		**291.2**
Funded by:		
Council Tax	44.2	
Aggregated external finance	196.6	
Other income (for example Supporting People, Council Tax Benefit)	50.4	
Total income		**(291.2)**
Contribution from pension reserve		0.3
Forecast 2006/07 surplus		**0.3**

Financial forecast as at July 2006 (Period 4)

3.2 As at July 2006 the Council were forecasting a general fund in-year surplus of £2.1 million. This £1.8 million surplus greater than forecast arose due to:

	£m
Forecasted Departmental Overspends within Social Work and Education Services	(2.5)
Departmental Underspends (for example pay award settled at lower than budgeted and unfilled staff vacancies)	1.6
Additional income received (for example increased Council Tax collection and additional benefit subsidy)	1.1
Departmental savings to be carried forward to 2007/08	1.6
Overall surplus for 2006/07	**1.8**

3.3 In October 2006, Council Management undertook a review of the savings achieved to date and the Council's level of uncommitted reserves. As at 31 March 2006 uncommitted reserves were £8.6 million. The minimum uncommitted reserves to be held, as set out in the Council's reserves strategy is £6 million. Additional savings of £2.7 million as at Period 4 have also been achieved by the Council through additional income received, e.g. Council Tax income (£1.1 million) and departmental underspends (£2.6 million). Therefore it has been determined that £5.1 million can be used to fund non-recurring projects during 2006/07.

3.4 A number of potential usages of the £5.1 million identified have been considered. Each individual Service Director, in consultation with the individual committee chairs are to consider any sums allocated to them in line with the strategic priorities set out within the Community Plan. Proposed projects should be assessed to ensure that they are non-recurring in nature and have no ongoing financial implications beyond 2006/07 which would require additional funding by the Council.

Action 4

Capital Programme 2006/07

3.5 As part of the 2006/07 budget setting process a capital allocation of £26.1 million was approved for the General Fund and an allocation of £12.4 million set aside for Housing capital works. However, during the first quarter of 2006/07 a number of schemes within the general fund capital programme had been identified which were yet to have started or delays were known. Therefore, at an Emergency Powers Committee meeting in July 2006, Council members approved the re-profiling of £17.7 million capital expenditure to 2007/08.

3.6 As reported in paragraph 2.8, it is essential that the Council undertakes a fundamental review of its capital planning processes, in particular how programmes are included in the annual programme and an assessment of the resources available internally within the Council to deliver the planned general fund capital programme.

4. The financial statements audit process and accounting issues

Audit Process

4.1 The Financial Statements and supporting schedules were presented to us for audit within the agreed timetable. The quality of working papers provided and internal review process undertaken by Management were of a high standard. Overall, we believe an effective audit process was achieved for the Financial Statements element of our audit, and an effective working relationship exists with your officers.

4.2 The Council achieved the deadline for lodging accounts with the Controller of Audit by 30 June 2006 and co-operation between us as external auditors and the Council has ensured the timely completion of the audit by 29 September 2006.

Audit Adjustments

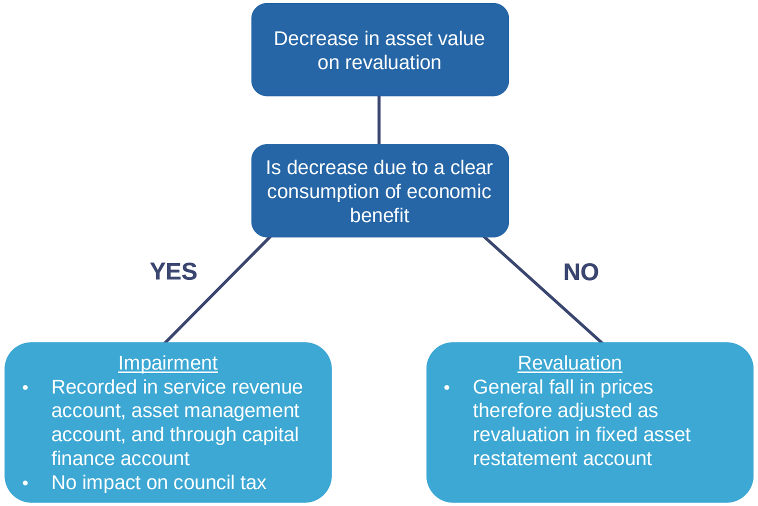
4.3 A number of adjustments to the format of and figures within the draft financial statements have been made as a result of our audit work. These have been agreed and processed by the Executive Head of Finance in the final set of financial statements.

4.4 During the course of the Financial Statements element of our audit we identified a number of issues that we are required to report. Following the introduction of ISA 260 “Communication of audit matters to those charged with governance” we are required to report all unadjusted differences to management and invite them to adjust the accounts as required.

4.5 The most significant adjustments made, and those not adjusted by Management are summarised within this section of the report. A separate Final Management Letter has also been produced for management which details a number of additional, less significant issues that need to be addressed by the Council.

Impairments

4.6 During 2005/06 the Council demolished 327 Council houses in line with a planned demolition programme. The Council properties demolished were valued at £3.9 million within the balance sheet. This transaction was originally recorded as a downward revaluation within the financial statements. However after Council Management engaged in dialogue with us it was agreed that it would be appropriate to class the write down in asset value due to demolition as an impairment with the financial statements.



4.7 The financial statements have been amended to reflect an impairment of £3.9 million. This impairment has been reflected in the Asset Management Revenue Account on the face of the Consolidated Revenue Account and adjusted within the Capital Financing Account so as not to impact on Council Tax Payers.

4.8 Going forward, Management should continue to assess downward revaluations for potential impairment and discuss the proposed treatment with external audit.

Action 5

Depreciation of Council House Additions

4.9 During 2005/06 the Council incurred capital expenditure of £10.0 million in respect of housing. This capital expenditure consisted of kitchen and bathroom replacements, central heating upgrades and rewiring in a number of Council properties.

4.10 Council houses are grouped and recorded as one asset within the Council's fixed asset account. Therefore the capital expenditure of £10.0 million is being depreciated over twenty three years, which is the remaining useful life of the actual Council houses. However, a more appropriate useful life, taking account of the nature of the actual additions would be eight years or less. Therefore the Council is understating its depreciation charge in the 2005/06 financial statements and in future years as follows:

	£m
Current depreciation within the 2005/06 financial statements based on a life of twenty three years	0.4
Depreciation based on a useful life of eight years	1.2
Under-depreciation charged in 2005/06 and each year going forward	**0.8**

4.11 This under-depreciation has not been adjusted within the financial statements and would not have impacted on the Council's in-year surplus of £0.3 million as depreciation is recorded within the Asset Management Revenue Account and subsequently reversed out through an appropriation to the Capital Financing Account.

4.12 Going forward it is recommended that Management considers the introduction of component accounting. This would allow the Council to continue to recognise such expenditure as capital expenditure, but importantly ensure depreciation on future additions are split to enable depreciation to be calculated over the true useful life of the various asset classes.

Action 6

Treatment of Deferred Income in-year

4.13 The Balance Sheet includes £2.4 million described in Council working papers as "Revenue Support Grant Deferred". This was ring fenced income received from the Scottish Executive that was not spent by the Council as at 31 March 2006.

4.14 Income can be deferred in this manner when it meets 2 principal criteria:

- The paying agency requires the return of any unspent grant; or
- The grant awarded in subsequent years is reduced by the deferred amount.

4.15 If these criteria cannot be demonstrated by the Council it is more appropriate to recognise the income received within the Consolidated Revenue Account as opposed to the Balance Sheet.

4.16 Clear compliance with the criteria set out in paragraph 4.14 for the £2.4 million income deferred during 2005/06 was not established for all balances. However, no audit adjustment has been made to the financial statements for 2005/06 as this approach is consistent with prior year treatment and in line with the approach followed at most other councils.

4.17 Nevertheless, we recommend that this treatment is reviewed during 2006/07 taking account of the SORP and guidance received from Audit Scotland, and future deferred income be considered for recognition in the Revenue Account where necessary.

Action 7

Accounting Treatment of Premiums incurred on the Early Repayment of Debt

4.18 The Council's Balance Sheet as at 31 March 2006 includes a balance of £15.7 million in respect of premiums paid by the Council. These premiums were incurred as the Council repaid certain debt earlier than scheduled. This debt rescheduling was undertaken as part of a number of Council wide debt re-profiling exercises. Of the £15.7 million, £4.5 million relates to the replacement of a fixed rate interest loan with a Lender Option Borrower Option (LOBO) agreement. This agreement is fixed interest for an initial predetermined period determined by the lender. After this initial period the Lender has the option to renegotiate the rate of interest payable. If the rate of interest is not acceptable to the Council (the borrower), the Council has the right to break from the loan agreement.

4.19 During 2005/06 the Council reviewed its current policy of writing off debt restructuring premiums over the life of the replacement in response to initial guidance issued by Audit Scotland. This resulted in the Council amending its accounting policy to write off the debt premium incurred up to the break point built into the LOBO as opposed to the full life of the loan. This amended accounting treatment resulted in expenditure of £2.9 million being included in the Consolidated Revenue Account, compared with expenditure of £0.4 million in 2004/05.

4.20 However, after discussions with us and in light of further guidance issued by Audit Scotland the Council revised the treatment adopted in the draft financial statements, reverting back to the previous accounting policy of amortising £0.4 million to revenue on an annual basis. The original proposed treatment resulted in increased expenditure in 2005/06 of £2.5 million, which would have impacted on Council Tax payers. By adopting the treatment reflected in the financial statements for 2005/06 and waiting for new guidance in 2006/07 which will be contained in FRS 25 and 26 and the 2007 SORP the Council may be able to avoid such write offs having an impact on Council Tax payers.

4.21 The £2.5 million saved by not adopting the initial treatment has been transferred to the Capital Fund by the Council to either fund capital expenditure or finance the repayment of debt in future years should it be required.

Action 8

5. Prevention and Detection of Fraud and Irregularities

Fraud and Corruption Reviews

5.1 As part of our rotational plan to review the key mechanisms for the prevention and detection of fraud and corruption, we have reviewed the Council's fraud and corruption internal regulations and controls, the actioning of fraud warning bulletins received and a review of Members and Staff Conduct policies and procedures.

Audit Scotland Guidance – Fraud and Legality

5.2 We have reviewed the guidance issued by Audit Scotland throughout 2005/06 in particular Technical Bulletins (2005/04, 2006/01, 2006/02 and 2006/03), Notes for Guidance and relevant Urgent Issues Notes, and undertaken work accordingly. There are no specific matters to report to the Council from this work.

Fraud Submission

5.3 A fraud return has been made to Audit Scotland of all the reported frauds that have occurred within the Council during the year. A number of Housing Benefits/Council Tax Claimant first tier frauds were reported by the Council during 2005/06, of which 2 were in excess of £5,000 (£5,750 and £9,969 respectively). In addition, 3 second tier frauds were reported, which were less than £5,000. The Council has established a framework for action against such individuals and has had a number of successful fraud prosecutions.

National Fraud Initiative

5.4 The National Fraud Initiative (NFI) is a data-matching exercise that helps detect fraudulent and erroneous payments from the public purse. It runs every two years, assisting participants across the UK from Local Government, Central Government and the NHS to identify fraud and error. In total around 1,500 organisations supply almost 3,500 sets of data in areas such as housing benefit, payroll and occupational pensions. The NFI then cross-matches all of this data to identify inaccuracies or potential fraud and sends matches back to each organisation for investigation where appropriate.

5.5 During 2005/06 the Council submitted detailed returns to the Audit Commission outlining its overall approach to NFI and the actions and data matches arising. From the list of potential matches advised to the Council a number of cases were investigated and as a result of this exercise a number of cases have been referred to the procurator fiscal.

5.6 The 2004/05 final NFI report outlining data matches and action taken was submitted to the Audit Commission in April 2006. The next NFI data matching exercise is scheduled for October 2006.

5.7 Management should continue to ensure that they provide the Audit Commission with the required extracted information from all the relevant systems, in particular Council tax, housing benefit and creditors data in accordance with the prescribed NFI timescales.

Action 9

6. System of Internal Control including the Council's Statement on Internal Financial Control

Statement on the System of Internal Financial Control

6.1 The "Code of Practice on Local Authority Accounting in Great Britain, a Statement of Recommended Practice" (the "SORP" for 2002) introduced the requirement from 2002/03 onwards for local authorities to include within their financial statements a statement on the system of internal financial control (SSIFC).

6.2 Our responsibility is to consider whether:

- the format of the SSIFC complies with the requirements of the SORP; and
- the information contained therein is consistent with our knowledge of the Council.

6.3 Based on our normal audit procedures, the statement made by the Council is consistent with our understanding and the SSIFC is in the format required by the SORP.

Follow Up Report on Previous Control Matters

Status	Number of Recommendations			
	Annual Report to Members 2004/05	Final Management Letter 2004/05	Interim Management Letter 2004/05	Follow Up of remaining Outstanding Recommendations
Action implemented	18	14	8	14
Action in progress	2	3	1	1
Little Action to date	-	-	-	-
TOTAL	**20**	**17**	**9**	**15**

6.4 At the time of our review in April 2006, 51 out of a total of 61 recommendations were fully implemented (84%). Since April Council Management has taken further action to implement the outstanding recommendations and the position in the table above has been updated to reflect this action. We recommend that Members ensure progress is made to fully implement the 7 outstanding recommendations. None of the recommendations outstanding were business critical.

Internal Controls Report 2005/06

6.5 An Internal Controls Report was issued to the Council in April 2005. The Council has completed an action plan detailing the individuals responsible for implementing our recommendations and the timetable for completion. Five new recommendations were raised in our report, of which none of the matters identified were considered business critical in nature.

Internal Audit's Report on the Council's Internal Controls

6.6 An extract from the Internal Auditor's opinion for 2005/06 as presented to the Risk and Audit Scrutiny Group, 21 June 2006 is replicated below:

"Overall, Internal Audit is of the opinion that reasonable assurance can be placed upon the systems of internal control in operation"

7. Business Issues

Efficient Government Agenda

7.1 The Efficient Government initiative is a five year programme with the aim of attacking 'waste, bureaucracy and duplication in Scotland's public sector'. A key feature of the initiative is that it focuses on the public sector as a whole, rather than individual organisations, with the intention of realising efficiencies through joining up – in purchasing, in accommodation, and in support services. The primary objective is to deliver the same services with less money or to enable frontline services to deliver more or better services with the same money.

7.2 The Efficient Government Plan sets targets to achieve £745 million (rising to £900 million) of cash-releasing savings, and £300 million (rising to £600 million) of time-releasing savings, by 2007-08.

7.3 Audit Scotland required all auditors to complete, together with their audited bodies, an "Efficient Government Diagnostic" – a self assessment tool covering the key themes of the Efficient Government agenda:

- Asset Management;
- Managing Absence;
- Procurement;
- Shared Support Services; and
- Streamlining Bureaucracy.

7.4 The key findings within the diagnostic return submitted to Audit Scotland can be summarised as follows:

Asset Management:

7.5 A report to the Policy and Resources Committee in February 2006 set out the Council's asset management strategy in particular the procurement of a comprehensive asset management information system, establishing an asset management team and undertaking a review of the Council's surplus assets.

7.6 The Council has a number of co-located offices which are shared with its Community Planning Partners for example Dalmellington Area Centre (Local Authority, NHS and Police and the soon to be open North West Kilmarnock Centre (Local Authority, NHS and Dental Teaching facility).

7.7 Overall, the Council's asset management plans will be progressed in line with the approved asset management strategy. In particular, once a number of detailed property portfolio reviews are completed the Council feels that it will be in a position to quantify the anticipated time and cash releasing savings to be generated.

Managing Absence:

7.8 The Council has established the following policies and processes in respect of absence management:

- A sickness absence policy is in place which is made available to all staff;
- Sickness absence is recorded and reported to both the Chairs Monitoring Group and the Corporate Management Team on a quarterly basis.

7.9 As at March 2005, sickness accounted for 6% of total days available for the year. The Council's overall strategy is to review sickness absence on a regular basis with a view to reducing absence throughout the Council. During 2006/07 work is planned to allow the Council to set realistic targets for each service for time releasing and cash releasing savings. In particular, priority will be given to reducing absence in areas which currently exceed the Council's own targets for example on-site services.

Procurement:

7.10 During 2004/05 the Council procured supplies and services of £104.5 million. Procurement is undertaken through a centralised procurement team and in line with a Council wide procurement policy.

7.11 At the time of our review the Council was in the process of fully implementing an e-procurement system and progress had been made in ensuring all procurement was undertaken by the centralised team.

7.12 Going forward, once e-procurement is fully implemented time and cash efficiency savings for the procurement process will be quantified.

Shared Support Services:

7.13 Partnership working is a key commitment for the Council, which is driven through the Council's Community planning process. The Council is also in discussion with neighbouring Council's around sharing services in respect of Non Domestic rates, internal audit, and selected procurements.

Streamlining Bureaucracy:

7.14 The Council has adopted its Community Plan as the Sovereign Planning document alongside its Community Planning Partners. As part of its plans to streamline bureaucracy the Council plans to undertake a review of back office services in particular focusing on redesigning how services are delivered.

Overall:

7.15 The Council is continuing to progress with the efficient government agenda with the aim of identifying and defining in monetary terms actual time and cash releasing savings during 2006/07.

Action 10

Expenditure Reductions

7.16 The national grant settlement anticipates that councils will make year on year expenditure reductions by increasing efficiency and reconfiguring services. The key areas in accordance with the national efficiency agenda were highlighted above. Therefore, the Council has applied in 2005/06 going forward expenditure reduction targets to each individual Service Department's annual budget. A lower level of expenditure reduction has been reflected within Social Work and Education to reflect Council and Community Plan priorities. Built into these reduction targets is the presumption that in all department's administration costs will be examined before any amendments to existing service provision is undertaken.

7.17 Expenditure reduction targets for 2006/07 are set at an overall target of £6 million, split between the Service Departments as follows:

	% of Savings	**£m**
Education	2.9	2.8
Social Work	2.9	1.3
Neighbourhood Services	4.0	0.9
Development and Property Services	4.0	0.5
Central and Corporate Services	4.7	0.5
Total savings reduction		**6.0**

7.18 The above savings are used to reduce each individual Service Department's forecast gross expenditure so that the overall budget presented and approved by Members shows net forecast expenditure for all Services. When the budget is monitored by the budget scrutiny group it is assumed that each Service Department has a savings plan in place to meet its target and that this saving will be met in the current year. Members will know if a savings target has not been allocated or achieved as a variance will appear in-year. This means that Members may not be fully aware of specific actions taken by Executive Directors to improve efficiency or reduce costs. Going forward, consideration should be given to how efficiency savings are monitored by Members.

Action 11

Priorities and Risks Framework

7.19 To assess the effectiveness by which Local Government bodies are implementing required reforms, Audit Scotland developed with PricewaterhouseCoopers and other partners a "Priorities and Risks Framework" ("PRF") which is designed to identify key business challenges and the main risks which could prevent their achievement.

7.20 As part of our 2005/06 audit, we consulted with numerous officers and reviewed selected documentation within the Council to assess the Council's status in addressing the six key areas of the PRF, namely:

- Strategy for Housing;
- Working Together for Communities and Users;
- Performance Management and Improvement;
- Financial Strategy;
- Workforce Planning; and
- Strategic Planning in Social Services.

7.21 As a result of our discussions and review of Council documentation a report was presented to Members in June 2006 outlining our findings and actions recommended.

Single Status Agreement

7.22 The Single Status Agreement relates to the Local Government Employees pay award body, which encompasses the APT&C and Manual workers groups. The agreement aims to harmonise pay and conditions of service arrangements for Local Government Employees and ensure equality of treatment in pay and grading matters.

7.23 To support the development of local pay and grading structures a job evaluation scheme was developed by the Scottish Joint Council, which the Council is utilising. The job evaluation process focuses on the tasks and responsibilities within the job, not the performance of the staff member undertaking the job.

7.24 As at 31 March 2006 the Council had not yet implemented the single status agreement. The equality impact assessment report on the Council's proposals relating to job evaluation and the proposed new pay and grading structure has been issued to the trade unions for a formal response. Once a response from the Trade Unions is received this will be considered by the Corporate Governance Committee and a final version of the pay and grading structure will be approved for issue to the Trade Unions in order to allow formal consultation with Union members. Therefore, it is anticipated that the Council will be in a position to introduce a new pay and grading structure during 2006/07. The Council has included initial costs in respect of single status within the 2006/07 agreed budget which will be quantified once implemented and the recurring financial impact on the Council assessed.

Action 12

8. Performance Audit

8.1 Our responsibilities with respect to performance management set out in the Code of Audit Practice have been discharged by completing and reporting our findings in relation to the following studies:

- Performance Indicators; and
- Follow Up of Following the Public Pound

8.2 Separate reports and agreed management action plans have been issued for these reviews. Detailed in the following paragraphs is a summary of the work undertaken and our key findings:

Performance Indicators

8.3 It is the responsibility of the Council to ensure that, as far as practicable, the information which is published is complete and accurate. There are 56 Performance Indicators ("PIs") in total, all of which have to be graded as either 'A', 'X', 'FTR', or 'N/S' as follows:

A The data appears to be reliable in material respects.

X The lack of available systems, and/or reliable data, and/or decision rules has resulted in the Council producing information which, in the auditor's view is unreliable.

FTR The Council has not returned any figures for the indicator as no accurate inventory is maintained. This is classified as a 'Failure to Report'.

N/S No service provided by the Council and therefore not applicable.

All of the Council's performance indicators were graded A "data appears reliable in material aspects".

8.4 Overall, the quality of systems used for data collection and analysis, and supporting documentation provided to us was of a good standard, for which Council Management should be commended.

Following the Public Pound

8.5 The original performance study involved two main activities:

- Mapping how much the Council spent on external organisations in the year ended 31 March 2004; and
- Reviewing the Council's level of compliance with the Code of Guidance on Funding External Bodies and Following the Public Pound (published by COSLA and the Accounts Commission).

8.6 A total of five recommendations were made and agreed for action by Management. The recommendations were followed up during September 2006 and of the five recommendations made, three have been completed, one is ongoing and one has not yet been actioned. The one recommendation where no action has been taken to date is as follows:

- Grant funding to external organisations should be reviewed regularly and approved by Service Committees. However, Service Committees do not receive, on an annual basis a summary of all grants made to external bodies for each respective committee in order to allow members to scrutinise the payments made to organisations throughout the year. Therefore, it is recommended that on an annual basis a report outlining the grants awarded to external bodies by each service is presented and discussed by individual service committees.

Appendix 1: Financial Position 2005/06

The Council's overall financial position for 2005/06 is shown below, extracted from the Council's Consolidated Revenue Account.

	£m	£m
Gross Expenditure	360.7	
Total Income	(133.0)	
Net Cost of Services		**227.7**
Other Activities including Trading Operations, Asset Management Revenue Account, Interest on Revenue Balances		3.7
Net Operating Expenditure		**231.4**
Transfer to various funds and reserves including Insurance Fund, Repairs and Renewals, Capital Fund		(15.2)
Amounts to be met from Government Grants and Council Tax		**216.2**
Revenue Support Grant	128.6	
Non-Domestic Rate Income	44.8	
Council Tax	43.1	**(216.5)**
Net General Fund Surplus for the Year		**(0.3)**
Balance on General Fund Brought Forward		**(16.8)**
Balance on General Fund Carried Forward		**(17.1)**

Appendix 2: Capital Programme – General Fund 2005/06

Outlined below are the main reasons as to why the capital programme slipped by £18.5 million during 2005/06:

	£m
Education Services	**3.5**
A number of projects were delayed during 2005/06. In particular Galston Primary School did not commence as an objection in respect of flood prevention work was still ongoing. There was general slippage in relation to window and boiler replacements. These were completed in the first quarter of 2006/07.	
Social Work	**2.7**
Slippage in replacement of Children's homes due to site issues. Upgrade of Older Peoples care facilities delayed pending a review of how older people services should be delivered and additional delays due to planning and design issues in respect of Disability Discrimination Act (DDA) compliance upgrades. In addition, expenditure of £0.4 million was not incurred as anticipated due to a change of site to accommodate client preferences.	
Neighbourhood Services	**2.8**
The CCTV Centre was delayed due to a change in the scope of the project and other issues e.g. planning approval. Minor projects for example Palace Theatre upgrade is to be done during 2006/07 as part of a larger project, and libraries work will be undertaken during 2006/07.	
Development and Property Services	**9.5**
Galston Flood prevention capital works of £5.9 million were delayed due to outstanding objections to the planned work. Slippage to roads and infrastructure of £1.2 million and a number of other projects delayed until 2006/07	
	18.5

Appendix 3: Management Action Plan

Report Reference	Issue/Agreed Action	Responsible for Implementation	Due Date
Action 1	Council Management should review its budget monitoring papers to ensure that financial information presented, in particular commentary in respect of the overall financial position of the Council and each individual services financial position, can be easily understood with appropriate explanations provided for variances arising.	Executive Head of Finance	December 2006
Action 2	Council Management should undertake a fundamental review of its General Fund Capital Programme, in particular how capital projects are included in the programme, the profiling of projects within the financial year and an assessment of the Council resources available to deliver the plan to ensure that the plan is completed in accordance with agreed timescales.	Executive Director of Development and Property Services	March 2007
Action 3	The Council, in conjunction with the Pension Fund, should continue to monitor closely the Pension Fund Deficit. In particular, budgets should continue to be set to ensure that any required increases in contributions can be met.	Executive Head of Finance	February 2007
Action 4	Proposed projects should be assessed to ensure that they are non-recurring in nature and have no ongoing financial implications beyond 2006/07 which would require additional funding by the Council.	All Executive Directors	November 2006

Report Reference	Issue/Agreed Action	Responsible for Implementation	Due Date
Action 5	Management should continue to assess downward revaluations for potential impairments and to discuss the proposed treatment with external audit.	Executive Head of Finance	June 2007
Action 6	Going forward, it is recommended that Management considers introduces component accounting. This would allow the Council to continue to recognise such expenditure as capital expenditure, but importantly ensure depreciation on future additions are split to enable depreciation to be calculated over the true useful life of the various asset classes.	Executive Head of Finance	April 2008
Action 7	We recommend the treatment of deferred income is reviewed during 2006/07 taking account of the SORP and guidance received from Audit Scotland, and future deferred income be considered for recognition in the Revenue Account where necessary.	Executive Head of Finance	June 2007
Action 8	The Council should continue to be aware of the implications of the introduction of FRS 25 and 26 and adopt the appropriate accounting treatment where appropriate.	Executive Head of Finance	June 2008

Report Reference	Issue/Agreed Action	Responsible for Implementation	Due Date
Action 9	Management should ensure that they continue to provide the Audit Commission with the required extracted information from all relevant systems, in particular Council Tax, Housing Benefit and Creditors data in accordance with the prescribed NFI timescales.	Executive Head of Finance	October 2006
Action 10	Council Management should seek to quantify time and cash releasing savings during 2006/07 across all areas of the efficiency government agenda.	Executive Head of Finance	June 2007
Action 11	Going forward consideration should be given to how efficiency savings are monitored by Members.	Executive Head of Finance	June 2007
Action 12	The Council should implement Single Status during 2006/07 and update the budget with the financial implications once known.	Executive Head of Finance	March 2007

Appendix 4: Responsibilities of External Audit

The matters dealt with in this report came to our notice during the conduct of our normal audit procedures which we carried out in accordance with the framework and principles contained within the Audit Scotland's Code of Audit Practice.

As a result, we may not have identified all the issues and matters that may exist. It is the responsibility of the Council and its management to maintain adequate and effective financial systems and to arrange for a system of internal controls. To discharge our audit responsibility we evaluate significant financial systems and associated internal controls and where appropriate, report to management any weaknesses identified. In practice, we do not examine every financial activity and accounting procedure and we cannot substitute for management's responsibility to maintain adequate systems of internal control.

This report is intended to assist the Council regarding its arrangements to implement appropriate controls surrounding the production of certain management information and processing systems. The report does not purport to provide information or advice to any person not associated with the Council and we accept no responsibility to such persons. Specifically, the report should not be interpreted as providing legal advice to the Council or any other person.

The prime responsibility for the prevention and detection of fraud and irregularities rests with the Council. It also has a duty to take reasonable steps to limit the opportunity for corrupt practices. As part of our approach we consider these arrangements, but our work does not remove the possibility that fraud, corruption or irregularity has occurred and remained undetected.

It is the responsibility of the Council and its officers to prepare the Accounts in compliance with statutory and other relevant requirements. We are responsible for providing an opinion on the Accounts.

It is the responsibility of the Council to put in place proper arrangements to ensure the proper conduct of its financial affairs, and to monitor their adequacy and effectiveness in practice. As external auditors we have a responsibility to review and, where appropriate, report on the financial aspects of the audited body's corporate governance arrangements, as they relate to:

- The legality of transactions that might have significant financial consequences;
- The financial standing of the audited body;

- Systems of internal financial control; and
- Standards of financial conduct, and the prevention and detection of fraud and corruption.

It is the responsibility of the Council to put in place proper arrangements to manage its performance, to secure economy, efficiency and effectiveness in its use of resources. We have a responsibility to review and, where appropriate, report on the arrangements that the Council has put in place to secure economy, efficiency and effectiveness in its use of resources.

We also have a responsibility to undertake reviews arising from national studies commissioned by Audit Scotland where these have been designated as mandatory studies.

For more details on any of the issues raised in this document reference should be made to those detailed reports issued by us to the Council during the year and as listed at **Appendix 6**.

Appendix 5: Audit Opinion

Independent auditor's report to the members of East Ayrshire Council and the Accounts Commission for Scotland

We certify that we have audited the Financial Statements of East Ayrshire Council and its group for the year ended 31 March 2006 under Part VII of the Local Government (Scotland) Act 1973. These comprise the Consolidated Revenue Account, the Council Tax Income Account, Non-Domestic Rate Account, Housing Revenue Account, Consolidated Balance Sheet, Statement of Total Movement in Reserves, Single Entity and Group Cash Flow Statement and Group Accounts and the related notes. These Financial Statements have been prepared under the accounting policies set out within them.

This report is made solely to the parties to whom it is addressed in accordance with the Local Government (Scotland) Act 1973 and the Code of Audit Practice approved by the Accounts Commission and for no other purpose as set out in paragraph 43 of the Statement of Responsibilities of Auditors and of Audited Bodies prepared by Audit Scotland, dated July 2001. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

Respective responsibilities of the Chief Finance Officer and auditor

The Chief Finance Officer's responsibilities for preparing the Financial Statements in accordance with applicable laws and regulations and the Code of Practice on Local Authority Accounting in the United Kingdom 2005 - A Statement of Recommended Practice (the 2005 SORP) are set out in the Statement of Responsibilities.

Our responsibility is to audit the Financial Statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission.

We report our opinion as to whether the Financial Statements present fairly the financial position of the local authority in accordance with applicable laws and regulations and the 2005 SORP, and have been properly prepared in accordance with the Local Government (Scotland) Act 1973. We also report if, in our opinion, the Foreword is not consistent with the Financial Statements, if the local authority has not kept proper accounting records, or if we have not received all the information and explanations we require for our audit.

We review whether the Statement on the System of Internal Financial Control reflects the authority's compliance with the SORP. We report if, in our opinion, it does not comply with the SORP or if it is misleading or inconsistent with other information we are aware of from our audit of the Financial Statements. We are not required to consider, nor have we considered, whether the statement covers all risk and controls. Neither are we required to form an opinion on the effectiveness of the local authority's corporate governance procedures or its risk and control procedures.

We read the other information published with the Financial Statements, and consider whether it is consistent with the audited Financial Statements. This other information comprises only the Foreword by the Executive Head of Finance and Statement of Responsibilities for the Statement of Accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with Part VII of the Local Government (Scotland) Act 1973 and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board as required by the Code of Audit Practice approved by the Accounts Commission. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the Chief Finance Officer in the preparation of the financial statements, and of whether the accounting policies are appropriate to the local authority's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion

- the financial statements present fairly, in accordance with applicable laws and regulations and the 2005 SORP, the financial position of the local authority and its group as at 31 March 2006 and its income and expenditure for the year then ended; and

- the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973.

Failure to comply with a statutory requirement

It has not been necessary to qualify our opinion in respect of the following matter.

Local authorities have a duty under section 10 of the Local Government in Scotland Act 2003 to conduct each of their significant trading operations so that income is not less than expenditure over each three year period. The authority failed to comply with this statutory requirement for the three year period ending 31 March 2006 in respect of the Catering and Cleaning Statutory Trading Operations. As explained in Note 9 to the Consolidated Revenue Account, page 13 of the financial statements.

Within page 13, Note 9 of the financial statements, the Council has drawn attention to the fact that Catering and Cleaning of Buildings Trading Operations show a cumulative deficit over the three year period due to the inclusion of the cost of compensation payments made in respect of Equal Pay claims, and in the case of Catering, the inclusion of FRS 17 pension adjustments.

PricewaterhouseCoopers LLP
Glasgow

29 September 2006

Appendix 6: Other formal reports submitted during the 2005/06 Audit Process

Output	Date	Financial Statements	Governance and Business Control	Performance
Annual Service Plan	December 2005	-	-	-
Follow up report prior year recommendations	April 2006	✓	✓	✓
Internal Controls Report	April 2006	✓	✓	-
Priorities and Risk Framework	May 2006	-	✓	✓
Fraud Return	June 2006	-	✓	-
Statutory Performance Indicators	August 2006	-	-	✓
Information Technology General Computer Controls	September 2006	✓	-	-
Following the Public Pound Local Report Follow Up	September 2006	-	-	✓
Annual Report to Council Members	September 2006	✓	✓	✓
Final Management Letter	October 2006	✓	✓	-