INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

East Renfrewshire Council

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

4 October 2006

AUDIT

Contents

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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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Executive summary

Financial position

Whilst managing its financial affairs within its operational budget, the Council reported a general fund deficit in 2005-06 of £2.61 million (2004-05: £0.22 million surplus) against an original budget of breakeven. The primary variance against budget was the settlement of equal pay of £3.477 million. In addition a sum of £2 million has been contributed to a capital reserve.

Total general fund reserves brought forward into 2005-06 amounted to £7.566 million. Appropriations during the year, combined with the in-year deficit resulted in a carry forward of £4.952 million.

The Council has an approved reserves policy of an amount equivalent to 4% of annual revenue expenditure to provide for future unforeseen expenditure. The carry forward general fund reserve represents 2.1% of annual revenue expenditure.

The Council's net liabilities in relation to the Strathclyde Pension Fund at 31 March 2006 were £52.327 million, a decrease from £53.201 million at 31 March 2005.

The housing revenue budget for 2005-06 was set for net break even position, which was exceeded by £267,000 in the actual outturn for the year (before transfers from the pension reserve). The final outturn was a surplus of £247,000 after a £20,000 transfer from the pension reserve.

The Council's five significant trading operations achieved their three year breakeven target with a joint, cumulative surplus of £1.045 million prior to equal pay expenditure. However, after accounting for the impact of equal pay expenditure, two of the Council's five significant trading operations reported three year cumulative deficits individually.

Corporate governance

The statement on corporate governance for 2005-06 notes that:

- The Corporate Management Team regularly monitors governance arrangements to secure the planning, control and delivery of services and believes these arrangements to be effective. The Audit Committee performs a scrutiny role in relation to the application of the Code of Corporate Governance. The Audit Committee regularly monitors the performance of the Council's Internal Audit Section.
- During 2005/06, the Council put in place appropriate management and reporting arrangements to ensure that the approach taken towards Corporate Governance was both adequate and effective in practice.
- The Code of Corporate Governance was reviewed in 2005 by both the Council's Corporate Management Team and the Audit Committee. This ensured that the Code remained up-to-date and reflected changes taking place within the Council's management arrangements.

In conclusion, the Council's internal auditors have noted that "*a number of instances of non-compliance with the Council's recruitment policy and procedures have been noted since the year end. The issues which are of concern are: failure to establish employees correct identity prior to entering onto the payroll system, absence of proper monitoring procedures by operational managers to ensure that employees were working for hours claimed and paid, and failure to obtain Disclosure Scotland checks for all relevant staff within the Facilities Management section. Except for instances of non-compliance with the Council's recruitment policy and procedures noted above, it is my opinion, that reasonable assurance can be place upon the adequacy and effectiveness of the Council's internal control system 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, cash, treasury management, billing and collection of non-domestic rates, billing and collection of council tax, housing rent income, and main accounting system (31 March 2006) and the controls over non-pay service expenditure and creditors, budgeting, housing benefits and council tax benefits and significant trading operations (30 May 2006). In addition we reviewed and reported on the Council's information technology general controls (September 2006), including one priority one recommendations.

Financial statements

On 29 September 2006 we issued an audit report expressing an unqualified opinion on the financial statements of the Council 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.

The premiums arising from debt rescheduling have been amortised to revenue over the period of 20 years. We understand that the Council considers that the overall economic effect of the original and replacement borrowing is substantially the same.

Performance management

Best value

A Best Value and community planning audit of the Council was carried out by Audit Scotland during 2004-05 and findings reported in October 2005. The Council has since submitted an improvement plan to the Accounts Commission. There were ten improvement action points identified in the report and seven have been fully implemented.

2005-06 priorities and risks framework

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 audit. We built on and updated our understanding of the Council's processes and management arrangements in these areas in focusing our audit effort.

Efficient government

A priorities and risk framework report was issued on 31 March 2006 summarising the findings from our review. Main strengths identified includes a clear commitment at both member and senior officer level, top level commitment supported by a member approved strategy paper setting out the overall goal and supporting objectives, an established process for monitoring the implementation of the strategy, a broad range of cash releasing savings and a clear linkage between identifying efficiencies and the budget and business plan setting process. Areas for improvement identified include refining the measurement of efficiencies and development of a methodology for identifying time releasing efficiency savings.

Statutory performance indicators

The Council's systems have been able to produce reliable information for all of the required statutory performance indicators. However, the draft statutory performance indicator return contained a number of errors which were corrected following the audit. This would suggest that the process for compiling and reviewing the return for accuracy could be improved.

Following the Public Pound

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. There were three grade one recommendations made in the report.

Audit Scotland did not determine any additional centrally directed studies during 2005-06 for completion by us.

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Introduction

Audit framework

2005-06 was the final year of our five-year appointment as external auditors of East Renfrewshire 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 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:

- implementation of the single status agreement and the cost of settling equal pay claims;
- plans to achieve efficiency savings;
- capital works contract tendering arrangements;
- financial performance over three years of significant trading operations;
- classification of capital expenditure; 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 two 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.

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Financial position

General fund

The Council reported a general fund deficit in 2005-06 of £2.61 million (2004-05: £0.22 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
Net departmental expenditure	-	168,940	-
Less: miscellaneous services, debt charges, pension costs	-	(3,469)	-
Amount to be met by government grants and local taxes	162,280	165,471	3,191
Aggregate external finance	(121,570)	(122,154)	(584)
Council tax/ Community charge income	(40,710)	(40,703)	7
(Surplus)/deficit for the year	**Nil**	**2,614**	2,614

Source: audited financial statements 2005-06

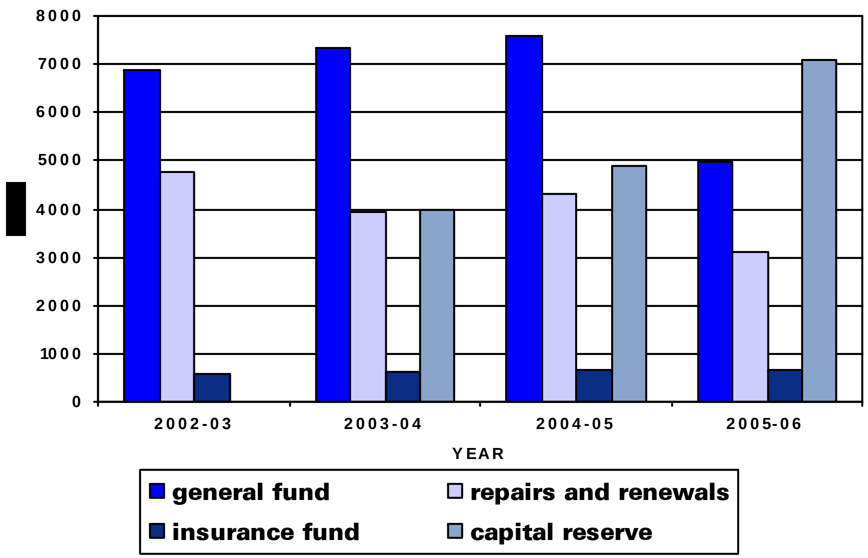
The key factors impacting the in year outturn were as follows:

- decision to transfer £2 million to the capital reserve to fund future capital expenditure;
- costs associated with equal pay awards to Council employees of £3.477 million; and
- provision for additional costs associated with early retirements awarded during the year totalling £709,000.

Reserves and balances

Total general fund reserves brought forward into 2005-06 amounted to £7.566 million. Appropriations during the year, combined with the overall deficit detailed in figure one, resulted in a carry forward of £4.952 million, summarised in Figure 2. In addition to the general fund, the Council maintains an earmarked insurance fund reserve (£681,000), a capital reserve (£7.096 million), a repairs and renewals fund (£3.111 million) and has an accumulated housing revenue account balance (£572,000).

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



Source: East Renfrewshire Council (31 March 2006)

The Council has an approved reserves policy of an amount equivalent to 4% of annual revenue expenditure to provide for future unforeseen expenditure. The Council has earmarked elements of the general fund balance as follows:

- £958,000 for the future equalisation of PFI payments;
- £500,000 'spend to save reserve' for the upfront investment envisaged in order to implement and deliver the Council's obligations under the efficient government agenda; and
- £572,000 for future costs associated with the housing stock (this represents the balance on the housing revenue account as at 31 March 2006).

This leaves a net undesignated general fund balance of £3.494 million, which will be used to fund additional cost pressures in future years. The Council's aim is for this balance to remain at around 4% of net revenue expenditure.

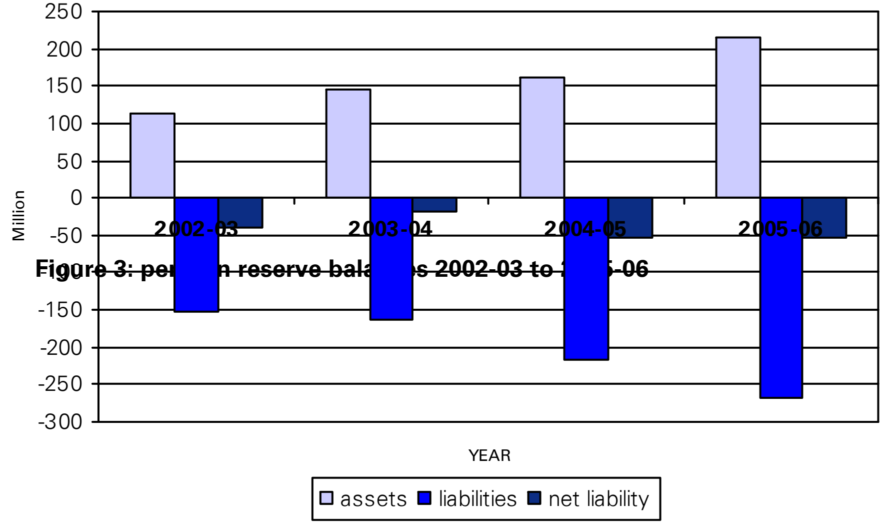
Pension reserve

The Council is required to account for its superannuation schemes with the Strathclyde 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 £52.327 million, a decrease from £53.201 million at 31 March 2005.

Figure 3 shows the net movement on the pension reserve year on year.

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



Source: East Renfrewshire Council (31 March 2006)

The Council's contribution to the Fund is expressed as a percentage of the employee's contribution, and for 2005-06 was set at 250% with contributions being £6.275 million for 2005-06 and £5.226 for 2004-05. This gave rise to total contributions of £1,726 million (2004-05 £429,000).

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

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
Catering	67	34	(577)	**(476)**
Vehicle services	54	93	49	**196**
Building cleaning	22	1	(566)	**(543)**
Building maintenance	230	(265)	243	**208**
Highways maintenance	220	22	184	**426**
Total trading	**593**	**(115)**	**(667)**	**(189)**

Source: East Renfrewshire Council (31 March 2006)

Figure 4 shows that two of the Council's significant trading operations have reported a three year cumulative deficit. This represents non compliance with statutory requirements. We understand that the primary reason for the deficits is due to additional costs associated with equal pay settlements, as indicated in note 14 to the consolidated revenue account. Prior to equal pay the catering operation generated a cumulative surplus of £180,000 and the cleaning operation a cumulative surplus of £35,000 over the three year period. However, robust long term financial planning should prevent any such cost pressures from impacting performance against key statutory targets.

The latest revenue budget monitoring report provides an update on the projected three year rolling position to 31 March 2007. Whilst the 2006-07 budgets include expected costs associated with the implementation of single status within each significant trading operation, there have been no plans to generate in year surpluses in order to return to a three year cumulative surplus position for the catering and building cleaning operations, which reported three year cumulative deficits in 2005-06. This will mean that whilst continuing to generate operating surpluses, the reported three year cumulative position to 31 March 2007 will also likely show a deficit position for these two significant trading operations. The projected results are shown in Figure 5.

Financial position (continued)

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
Catering	9	(534)
Vehicle services	20	162
Building cleaning	19	(546)
Building maintenance	231	209
Highways maintenance	14	220
Total trading	**293**	**(489)**

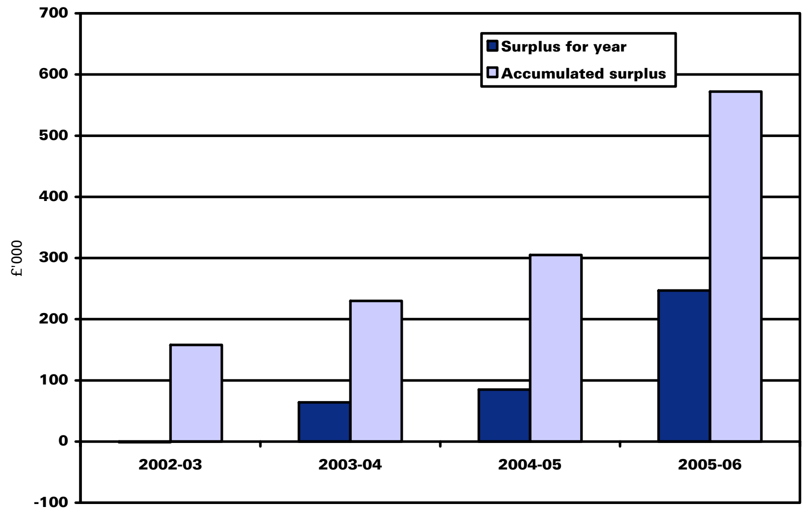
Source: East Renfrewshire Council (31 March 2006)

Housing revenue account – financial position

Income of £8.022 million (budget £7.935 million) exceeded expenditure of £7.775 million (budget £7.935 million), resulting in a surplus of £247,000 after a £20,000 transfer from the pension reserve. The budget for 2005-06 was set for net break even position, which was exceeded by £267,000 in the actual outturn for the year (before transfers from the pension reserve).

The accumulated surplus was £572,000 at 31 March 2006. Movements on the housing revenue account balances are shown in Figure 6.

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



Source: East Renfrewshire Council (31 March 2006)

The Council plans to utilise some of the surplus balance in 2006-07 to fund repairs and maintenance of the housing estates roads. However, we would recommend that sufficient housing revenue reserves are maintained to fund any unforeseen liabilities impacting the HRA and the Council's 3,306 Council houses, which currently represents £173 per Council house or 7.4% of net expenditure. Reserves should be sufficient to prevent 'peaks and troughs' in HRA expenditure significantly impacting rent levels up to 2015.

During 2004-05 the Council undertook a housing option appraisal exercise and subsequently decided to retain the housing stock. There is a requirement to significantly adjust the housing capital programme to ensure that the Council is able to meet the Scottish Housing Quality Standard ("SHQS") by 2015 and maintains standards beyond. It is estimated that the programme will require to be increased to in excess of £4 million per annum in the short term which is currently not reflected in the analysis in table six. The Council has recognised this long term financial investment within its 5-year HRA capital programme.

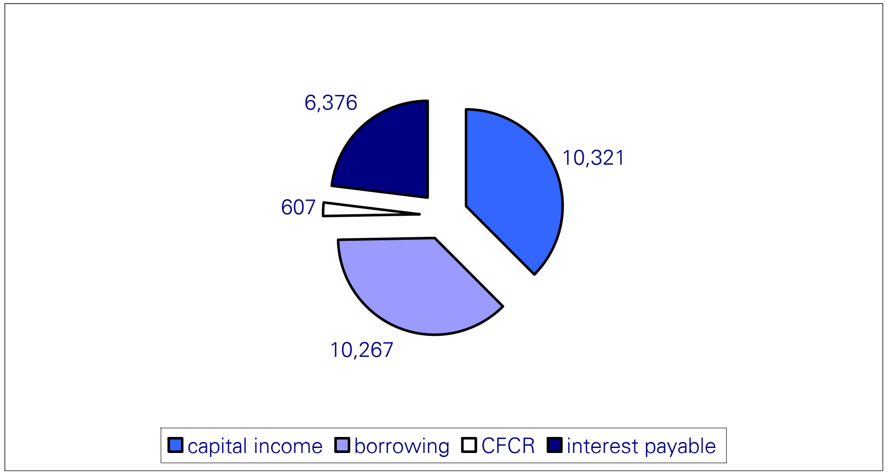
The Council has developed a specific fuel poverty plan. Energy efficiency is an integral part of delivery plans for meeting Scottish Housing Quality Standards. Most measures will be met through the housing capital programme and the Council applies for "Warm Deal" grant assistance wherever possible to enhance spending power on such measures. This process is regularly monitored by the Fuel Poverty Strategy Working Group, which includes an elected member, a number of senior officers, an energy efficiency specialist and housing association representatives.

Capital investment programme and prudential borrowing

The Council incurred capital expenditure during the year of £21.195 million. This was funded through a combination of new borrowing (£10.267 million), capital income (£10.321 million) and capital financed from current revenue (£607,000).

Figure 7 demonstrates the main sources of capital funding for general fund capital projects, as well general fund interest payable during 2005-06.

Figure 7: capital expenditure funding



Source: East Renfrewshire Council (31 March 2006)

The service analysis provided by the Council in the capital expenditure statement details that the Council spent £6.443 million on education services, £2.509 million on roads and transport services, £2.294 million on social work services and £4.786 million on other general fund services. The general services capital programme for 2005-06 was underspent by £384,000 due to slippage in a number of projects in the Council's capital programme.

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.

Financial position (continued)

Figure 8: proposed capital expenditure projections under the prudential regime

£'000	2004-05 actual	2005-06 actual	2006-07 estimate	2007-08 estimate	2008-09 estimate
General fund services	13,023	16,032	15,973	6,789	7,418
Housing	2,551	5,163	4,484	4,522	7,237
Total	**15,574**	**21,195**	**20,457**	**11,311**	**14,655**

Source: East Renfrewshire Council (31 March 2006)

The treasury prudential indicators for 2005-06 set an authorised limit for external debt of £94.3 million, with an operational boundary of £89.8 million. The Council's actual external debt was £92.8 million. This exceeds the operational boundary because of the PWLB repayment after the year-end referred to below.

The 2005-06 financial statements disclose a net increase in cash and short term investments of £7.27 million. The key reason for the increase in cash is a decision by the Council to undertake a loan rescheduling exercise during the year. The Council borrowed an additional £12.66 million in 2005-06 from PWLB. £4.7 million of this additional borrowing was used to repay existing PWLB higher rate debt in April 2006.

By waiting until after the financial year end, the Council was able to reduce the premiums on this rescheduling to a nominal amount. The remaining £7.9 million will be used to fund future capital expenditure.

Future financial plans

Budgeting process

The Council's revenue budget for 2006-07 was approved in February 2006, incorporating a 4.9% increase in council tax. However, the council tax charge is below the Scottish Band D average and lower than 18 of the 29 mainland councils in Scotland. The budgeted net expenditure figure is £185,793 million, compared to the 2005-06 budget of £171,105 million. The report presented by the director of finance, identified the key reasons for the increase in budgeted expenditure, in addition to factors such as pay increases.

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

- £7.368 million increase in education expenditure relating to the continued implementation of the McCrone agreement and the new PPP schools contract;
- £2.250 million increase in social work expenditure relating primarily to increased nursing care and free personal care;
- £1.167 million increase in environmental services expenditure arising from increased investment in road maintenance; and
- £1.493 million increase in community services expenditure reflecting cost increases on refuse disposal (primarily through the contribution to the Greengairs landfill site and increases in landfill tax).

Single status agreement and equal pay

The 2006-07 budget includes a provision to meet the net costs of the single status agreement. An equal pay provision is recognised in the 2005-06 financial statements reflecting expected costs associated with 77 employees who have not yet accepted compromise agreements.

Private Finance Initiative / Public Private Partnership

The Council has three ongoing PFI / PPP projects in place providing capital assets in primary and high schools and the construction of the Glasgow Southern Orbital

Financial position (continued)

Road and the M77 extension (a collaborative arrangement with South Lanarkshire Council and the Scottish Executive). The financial statements for 2005-06 include annual net costs to the Council of £4.06 million (providing for annual contributions from the Scottish Executive of £5.2 million, not including a variable direct support payment in relation to the roads PFI contract). The Council's total net undischarged obligations under these schemes at 31 March 2006 amounted to £102.2 million. There have been no new PFI or PPP schemes entered into during 2005-06.

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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

There is a systematic approach to corporate performance management, with each service regularly producing a "Performance Profile". At a corporate level, the council has a well-established framework for monitoring its performance. The core element is the production of quarterly Performance Profiles by each department. These follow a standard format, pulling together a range of information such as Statutory Performance Indicators, progress in implementing action plans, and commentary on performance highs and lows.

Role and development of elected members

Since 1999, the traditional system of service committees has been replaced with a more streamlined arrangement of a Cabinet (made up of five members of the administration). The key forums for monitoring and scrutinising performance (the audit committee and the policy review committee) are both chaired by members of the opposition.

Training is provided to members on an ad hoc basis after initial induction training is provided and there is no specific budget for members training or development support.

Risk management

A June 2005 audit report found that the council's approach to risk management is at an early stage with key milestones being developed to help ensure ongoing progress. Further work was needed in establishing departmental risk registers. There was also a need to ensure that the results of risk management processes were regularly monitored and used to feed into the council's corporate and service plans.

Since that date significant progress has been made to embedding risk management within the Council. Extensive training has been undertaken across the Council. Operational risk registers have been approved for all services and are linked to the Council's business objectives.

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. The two reports issued as a result of this work covered controls operating over payroll, cash and bank, treasury management, billing and collection of local taxes, housing rent income and the main accounting system (31 March 2006) and the controls operating over non-pay service expenditure and creditors, budgetary controls, housing and council tax benefit claims and significant trading operations (30 May 2006).

There were no significant (priority one) recommendations made as a result of the findings reflected in the reports.

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 continual review throughout our audit to maximise the reliance placed on their work.

We planned to place reliance on the work of internal audit in nine areas:

- housing rents
- debtors
- creditors
- payroll (manual workers)
- budgetary controls
- contracts and tendering
- attendance at stock takes
- housing and council tax benefits
- statutory performance indicators

In her annual report for 2005-06, the chief internal auditor has concluded that "except for instances of non-compliance with the Council's recruitment policy and procedures… it is my opinion… that reasonable assurance can be placed upon the adequacy and effectiveness of the Council's internal control system in the year to 31 March 2006." The areas of non-compliance referred to in the report relate to instances where standard recruitment procedures had not been followed and do not materially impact the Council's 2005-06 financial statements.

External inspections

National Best value Audit

Audit Scotland and KPMG LLP completed a Best Value review at the Council during 2005-06. The Council completed a Best Value improvement plan following the review and we have summarised the progress made against this improvement plan in this report under the "Performance Management" section.

Other external inspections

The Council was subject to a number of other external inspections in 2004-05, which were reported on in early 2005-06, including:

- Her Majesty's Inspectorate of Education (February 2005)
- Social Work Inspection Agency – Criminal Justice (February 2005); and
- Communities Scotland (April 2005).

We summarised the findings of these inspections in our 2004-05 annual audit report and we have not duplicated these findings here.

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:

- the National Best Value Audit conducted in the year found the Council to be successful and enthusiastic in seeking continuous improvement. The key areas for further improvement identified in the Best Value improvement plan include the need for greater emphasis on outcomes, scrutiny, option appraisal and public performance reporting;
- work is ongoing to demonstrate " community focus", including several consultation exercises and the planned creation of an East Renfrewshire Assembly;
- the Council has entered into partnership arrangements with Renfrewshire Council (through the provision of non-domestic rates administration services)

and the NHS (through the ongoing implementation of Community Health and Care Partnerships); and

- structures and internal governance processes are well established and risk management is now being embedded throughout the Council.

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

Audit opinion

On 29 September 2006 we issued an audit certificate expressing an unqualified opinion on the financial statements of the Council 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. We are pleased to report that documentation provided was complete, cross referenced to our 'prepared by client' request and was of a high standard.
Response to audit queries
We are pleased to report that all 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.

Figure 10: financial statement adjustments

	Consolidated revenue account £'000	Consolidated balance sheet £'000
Reclassification of amounts in trade creditors to "accrued payrolls etc"		(3,169)
		3,169
Debit balance in trade creditors reclassified to debtors (less than 1 year)		(136)
		136
Net adjustment	**Nil**	**Nil**

There were also a number of presentational changes to the financial statements which did not impact the consolidated revenue account or consolidated balance sheet. There were no unadjusted audit differences identified.

Confirmations and representations

We confirm that as of 29 September 2006, in our professional judgement, KPMG LLP is 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 audit committee.

In accordance with auditing standards, we obtained representations from the Council on material issues prior to signing our opinion.

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 our 2004-05 annual audit report, we noted that the 2004-05 draft financial statements showed a significant increase to the value of Council land and buildings, specifically land associated with the operational school estate assets. An issue arose in relation to the interpretation of the RICS guidance and the requirements of the SORP in determining an appropriate valuation basis for land assets associated with specialist properties. Specifically, whether it is permissible to assign an open market value rather than value in existing use. This issue was not resolved at the deadline for lodging the audited financial statements and management decided to proceed to finalisation, reflecting operational land and buildings values as at 31 March 2004, but taking into account capital expenditure in 2004-05 that was classified as being additions or enhancing. We noted in our report an intention to resolve the matter in 2005-06 following consultation with appropriate parties.

The draft 2005-06 financial statements show a similar significant increase in the value of land and buildings (£53.032 million of which £41.287 million related to school land. During the course of the 2005-06 audit, we have therefore held discussions with relevant Council officers to determine the rationale for the increase and to ascertain whether the valuation has been conducted in accordance with FRS 15 as applied by the SORP and RICS guidelines. The SORP states that:

- non specialised operational properties should be valued on the basis of existing use value (EUV);
- specialised operational properties should be valued on the basis of depreciated replacement cost (DRC); and
- investment properties and surplus properties should be valued at market value (MV).

The Council has valued operational land at net realisable value in existing use. However, the valuer was not able to value school land at existing use. Guidance was therefore obtained from RICS, which indicated that it was appropriate to use residential value as an indicator of value in existing use. Recent trends in land sales for residential purposes have therefore been used to determine the value of such land.

We have also confirmed that the Council’s valuer postponed realising implied increases in land values over the past five years until there was sufficient market evidence to support the revaluation. Management decided that the sale of Williamwood High School land in 2004-05 represented sufficient evidence in this respect. As a result the valuation recognised in the 2005-06 financial statements reflects increases in land values experienced over a number of years.

The valuer applied a methodology for revaluing these land assets inherited from the predecessor local authority. An assessment was made as to the typical land value per hectare across two distinct regions within the Council. This was then applied to relevant land assets according to their measured size, discounted by 30% to reflect local factors according to the valuer’s professional judgement.

Equal pay

As part of the Single Status Agreement, the Council undertook a job evaluation exercise in 2005-06 to identify employees whose remuneration was the subject of potential gender bias. A comprehensive list of all such employees was created from payroll and personnel records. Following ongoing consultation with the Council’s legal services department, a total of 771 employees were offered compromise agreements, clearing the Council of any further obligation in respect of equal pay claims. Around 90% of these employees had signed a compromise agreement at 31 March 2006.

In accordance with FRS 12, the Council has made a provision in the 2005-06 financial statements for £344,000 representing the total possible equal pay claims that may be made by the remaining employees.

Lender Option Borrowing Option ("LOBO")

The accounting code of practice states that "gains or losses arising on the repurchase of 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 £16.7 million of LOBO borrowings. The amount held within the consolidated balance sheet as at 31 March 2006 in respect of debt premium was £3.341 million, of which £1.944 million relates to premium incurred on a switch to LOBOs carried out during 2004-05. The remaining £1.397 million relates to PWLB borrowing being replaced by new PWLB borrowing, this having been carried out during 1998-99.

The premia has been amortised to revenue over the period of the replacement loans as permitted by the 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

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
- 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*. 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.

Figure 11: efficient government savings and targets

£'000	**2005-06**	**2006-07**	**2007-08**
Procurement	1,155	382	280
Asset management	99	437	70
Managing absence	287	110	161
Shared support services	-	241	-
Streamlining bureaucracy	82	336	80
Other	678	706	149
Total	**2,301**	**2,212**	**740**

Figure 12: efficient government arrangements

Key arrangements

- The Council included efficiency savings in the 2006-07 budget. Each service department was set a 2% efficiency target against existing budgets. The identified savings amounted to £1.638 million which were then deducted from department budgets and re-invested in areas of priority.
- Completion of the Local Government Improvement Service return in November 2005 highlighted that further work was required to establish a robust measurement framework. Since completing the November 2005 return the Council has sought to strengthen the framework for identifying, measuring and monitoring efficiencies. The aim is to continue to refine the methodology for identifying, measuring and quantifying planned efficiency savings arising from national and local initiatives. A central register of efficiencies has been recently established to help co-ordinate this across service departments and ensure a consistent approach.
- The CMT considered an Efficient Government progress report in February 2006. This provided the CMT with plans to pilot a corporate approach of business improvement and efficiency through the internal Best Value service reviews. The report also included a project action plan for implementing an Efficient Government strategy with a range of initiatives highlighted. Achievement of the action plan will be monitored by the CMT with savings captured in the central register.

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

- further refining of the measurement of efficiencies will be required building on the experience of completing the diagnostic tool for this review. Clear guidance should then be disseminated across the organisation assisting the process of identifying savings that meet the definition of an efficiency saving; and
- particular consideration should be given to developing a methodology that provides an incentive for service departments to routinely identifying time releasing efficiency savings.

Workforce planning

In January 2006, the corporate management team considered a report on the Civil Contingencies Act 2004 and business continuity implications for the Council. This included a business continuity management project plan committing the Council to, among other things, prepare and implement a generic workforce business continuity planning template document by May 2006.

The health and safety of employees, the public and others is safeguarded through risk assessment and various risk control measures. Corporate guidance in this area is well developed and communicated through training, consultation and via the intranet. In 2004-05 the Council revised the health and safety policy; reinvigorated the health and safety audit programme and extended electronic staff health and safety guidance notes. Also during 2004-05 60 of the Council's managers attended a day-long course on health and safety aimed at promoting positive health and safety cultures and suggesting practical ways of promoting health and safety in the workplace. The Council has also recently made a commitment to piloting an HSE project on work-related stress.

The Council has also implemented a violent warning marker scheme to ensure employees are protected from potentially violent customers and the Council strategic risk register includes workforce related issues.

Strategic planning in social services

Strategy groups have been the main forum for service planning across care groups, including carers. These have developed plans and strategies using information from population census, demographic projections and service user and carer consultations and/or surveys. These have been matched against age-specific patterns of service use to project additional service development needs. Health needs and dependency measures have also been used in developing strategies.

The integrated Community Health and Care Partnership will enable this to be done more holistically as will electronic systems to support the single shared assessment process. (Refer to PRF section on working with community for information on the CHCP).

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. A Best Value and community planning audit of the Council was carried out by Audit Scotland during 2004-05 and findings reported in October 2005. The Council has since submitted an improvement plan to the Accounts Commission. Figure 13 sets out the key aspects of the Best Value improvement plan and the status of these action points at September 2006.

Figure 13: Best value improvement plan progress update

Improvement action	Status at September 2006
Consider ways in which the Council can seek to develop the scrutiny role of the Policy Review Committee	**The Policy Review Committee has gathered momentum over the last 9 months and is playing a key role in the scrutiny of individual policy areas, with elected members actively involved in the detail of the investigations. In November 2005, the Committee agreed a list of areas for investigation.**
Establish Area Forums in the 4 geographical areas currently covered by the Council's Area Committees	Each Area Forum had met at least once by 31 March 2006. Three of the four had met twice.
Establish an East Renfrewshire-wide Forum or Assembly	**First East Renfrewshire Assembly held in June 2006.**
Consider the scope for more effective linkages between the performance management framework and the Policy and Financial Plan	**PFP streamlined to enable departments to link actions more closely to key service objectives. Performance management procedures have also been streamlined.**
Continue discussions with the Scottish Executive to pilot an outcome-based approach for measuring performance	Discussions with the Scottish Executive continue at both political and officer levels. A proposed approach has since been developed internally and discussed with the Scottish Executive Officers.
Update the Strategic Risk Register ensuring that control measures are in place. Continue to review and improve existing operational risk registers.	**The Strategic Risk Register was updated in August 2006 and an update was presented to the Audit Committee.**
Implement revised absence management policy	**Revised absence management policy was implemented in November 2005.**
Develop a corporate policy on option appraisal	Ongoing - the CMT have had an in-depth discussion on potential approaches to option appraisal (paper and Minutes available) and a further paper is currently being drafted to develop these ideas into more tangible arrangements.
Draft Sustainability action plan and monitoring framework	**A Sustainability Strategy action plan was approved by Cabinet in April 2005. Monitoring of the action plan is ongoing.**
Review and update PPR framework and issue new service-level guidance on PPR requirements	**Review completed and updated framework agreed by CMT in 2006. New performance management and reporting arrangements introduced summer 2006.**

In summary, of the ten improvement action points identified, seven have been fully implemented with three ongoing.

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 all of the required statutory performance indicators. However, the draft statutory performance indicator return contained a number of errors which were corrected following the audit. This would suggest that the process for compiling and reviewing the return for accuracy could be improved.

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.

Three grade one recommendations were made in this report:

- the Council should introduce formal risk assessment procedures prior to entering into significant funding agreements with ALEOs;
- the Council should formalise monitoring procedures with Social Work, to ensure that funding agreements with ALEOs are subject to regular monitoring and that consistent files are maintained containing records of all meetings and monitoring reports produced; and
- the Council should ensure that audit and accountability arrangements in line with the Code are put in place through formal contracts with the ALEOs at the outset of a new funding agreement.

A report to Cabinet on 17 August 2006 entitled "Response to the Policy Review Paper on Grants to Community & Voluntary Organisations" confirms the Councils commitment to these areas

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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	**Fixed asset valuation** In response to our recommendation made in our annual audit report in 2004-05, and in accordance with the SORP, the Council has asked two external valuers to perform a desktop review of their valuation methodology, specifically in relation to school land. However, the absence of a full secondary revaluation on a sample of assets leaves scope for inaccuracies in the valuation process.	We would recommend that the Council seeks the opportunity to obtain a full independent valuation of a sample of land and buildings in future revaluation exercised. We also recommend that management review the annual revaluation exercise for accuracy and reasonableness to ensure that they are satisfied over the carrying value of Council land and buildings. This would provide additional assurance over the valuation methodology and the carrying values of tangible fixed assets in the balance sheet.	Management currently review the revaluation exercise. An independent review of the 2005/06 valuation methodology was undertaken and this provided appropriate reassurance on the methodology applied.	Director of Finance/Head of Property and Technical Services Ongoing

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
2	**Significant trading operations** Whilst generating operating surpluses, as a result of the settlement of equal pay, 2 two of the Council's five significant trading operations have reported a three year cumulative deficit for the period ended 31 March 2006. This represents non-compliance with statutory requirements and has resulted in a matter of emphasis in our 2005-06 audit opinion.	Management should establish robust financial plans to ensure that all the Council's significant trading operations are in a three year cumulative surplus position as at 31 March 2007. This will ensure compliance with statutory requirements and prevent an explanatory paragraph in future audit opinions.	3-year Business Plans for each significant trading operation covering the period 2006 – 2009 were considered and approved by the Cabinet at its meeting on 18th May 2006. Financial assumptions in these Plans assume operating surpluses and the Council meeting the statutory breakeven targets prior to the charging of equal pay costs as an exceptional item.	Director of Finance Ongoing

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
3	**LOBO loan premiums** The accounting code of practice states that "gains or losses arising on the repurchase of 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." A risk therefore exists that the Council does not treat premiums relating to rescheduling of loans involving LOBO facilities in accordance with the SORP.	In order to ensure continued compliance with he SORP, management should continue to carefully monitor relevant guidance in relation to accounting for LOBO loans and related premiums where these are used to reschedule existing debt. In particular, the following criteria should be considered on a regular basis: • 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 • the existence of any evidence that lenders have sought in practice to impose significant interest rte increases o that authorities have refused to accept any increases.	Currently undertaken.	Chief Accountant Ongoing
4	**Audit recommendations** A number of recommendations made in previous external audit reports remain ongoing or not implemented at September 2006. The failure to address agreed audit recommendations leaves the Council open to additional organisational risks.	The formal mechanism in place to monitor implementation of external audit recommendations should be directed at implementing outstanding recommendations as a matter of priority.	Monitoring arrangements are currently in place and resources will be directed to ensure timely action on recommendations.	Business manager (Finance) Ongoing

Appendix I – action plan (continued)

	Issue, risk and priority	Recommendation and benefit	Management response	Responsible officer and implementation timetable
5	**Statutory performance indicators** A number of errors were identified in the 2005-06 draft statutory performance indicator return. A risk exists that inaccurate performance management information is reported to members, the public and other key stakeholders.	We recommend that the draft statutory performance indicators are subject to a detailed independent review for accuracy prior to submission for audit.	2 changes to SPI figures (re: libraries and social work (adult PI5)) were made after the submission of the final spreadsheets to Audit Scotland on 31 August - these spreadsheets therefore had to be resubmitted in September. To mitigate against such errors in future, the Council will ensure that future years' internal audit reports are more robustly checked against final spreadsheets prior to submission	Assistant Chief Executive August 2006
6	**Fixed asset register** During the course of our audit we encountered difficulties in reconciling revaluation amounts in the fixed asset register to valuers reports. This represents a weak audit trail and may lead to inaccuracies within the fixed asset register not being identified by management.	Management should review the system for updating the fixed asset register for any land and building revaluations. The fixed asset register holder should retain copies of valuation certificates in support of revaluation adjustments in the fixed asset register. This will ensure a complete audit trail and the accuracy of the fixed asset register.	Agreed.	Principal Accountant (Capital) Ongoing
7	**Payroll suspense accounts** We identified that the Council's payroll suspense accounts are not being regularly reviewed and cleared by management. Whilst we confirmed that the account was cleared by 31 March 2006, such accounts are often a 'hiding place' for payroll fraud.	We would recommend that all suspense accounts are reviewed by management and cleared on at least a quarterly basis. This will ensure that any unusual or inaccurate transactions are identified and investigated on a timely basis. This will also help reduce the risk of payroll fraud in relation to the payroll suspense account.	These are now reviewed on a regular basis.	Revenues Management Accountant Ongoing

Appendix I – action plan (continued)

Issue, risk and priority		Recommendation and benefit	Management response	Responsible officer and implementation timetable
8	**Trust Funds** The Council has a number of Trust Funds that are registered with OSCR. All registered charities are required to submit charities SORP financial statements in accordance with OSCR regulations. There is a risk that the Council does not comply with these regulations in respect of their registered Trust Funds. There is also a possibility that additional financial statement disclosures are required in the 2006-07 Council financial statements. Guidance is currently awaited in respect of this matter.	Management should establish formal systems for monitoring compliance with charities regulations. In particular, the Council should prepare charities SORP compliance financial statements for all Council Trust Funds, as applicable. This will require accurate and reliable information on the purpose of each fund and its registered Trustees. In addition, management should monitor any developments in this area impacting the Council's financial statements.	Agreed. Guidance will be reviewed and applied as appropriate.	Chief Accountant Ongoing