

Inverclyde Council

Report to Members on the 2005/06 Audit



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Key messages

Introduction

In 2005/06 we looked at the key strategic and financial risks being faced by the council. We audited the financial statements and looked at aspects of performance management and governance. This report sets out our key findings, summarising key outcomes in 2005/06 and the outlook for the period ahead.

Key outcomes from 2005/06 audit

We have given an **unqualified** opinion on the financial statements of Inverclyde Council and its group for 2005/06.

The council had corporate governance systems in place during 2005/06 that operated well. However, we have taken the opportunity in our interim reporting to make recommendations to enhance the overall control environment.

The council's progress on embedding risk management lost momentum during the year. It is acknowledged that new arrangements have been put in place to drive this forward and the expectation is that increased activity will take place during 2006/07.

The council has made steady progress against its best value improvement plan, once the new chief executive took up post. Re-structuring is almost completed and further progress in tackling performance issues is expected during the remainder of 2006/07. The council will undergo an Accounts Commission follow-up audit during November/December 2006 with a report anticipated in January 2007. A more in depth and up-to-date picture of the council's progress will be obtained from this process.

Continued development of performance management arrangements is required. Performance information available to elected members and management in 2005/06 did not provide a clear picture of the extent to which the council is delivering on its priorities and strategic objectives. While some services have developed performance indicators, the council continues to rely on statutory performance indicators to measure its performance in most services.

Overall, the improvements in reported statutory performance indicators slightly outnumber the reductions in service performance. A major performance gain, as a result of the implementation of the council's waste strategy in 2005/06, has seen recycling increase from 5.8% in 2005/06 to 19.2% for 2005/06. One area which sees a continued deterioration is that of housing's current tenants rent arrears, which moved from 17.9% to 18.9% over the year.



There have been delays in progressing the council's school investment programme as a result of prolonged consideration of the rationalisation proposals and affordability issues. However, plans are now in place to provide four new schools using a public private partnership arrangement. A further two new schools will be built and refurbishment using traditional sources of finance.

The council's capacity to respond to the efficient government agenda has been affected by its focus on the implementation of the best value improvement plan and the departure of some senior officers. The council's progress has, therefore, been slower than ideal. The limited response, thus far, has been uncoordinated and lacking in clear leadership from either members or senior officers.

The out-turn for the general fund for 2005/06, before the exceptional costs in relation to equal pay and the reduction on earmarked reserves, showed an under spend against the budget of £4.338 million.

The capital plan for 2005/06 was some £12 million under spent against the planned spend of £24.6 million.

Equal pay costs of £3.9 million were approved by the council on 25th May 2006. To date some £3.6 million has been disbursed to claimants. Around 60 individuals have declined to accept the package offered by the council and these cases may ultimately proceed to tribunals. A further £1.1 million has been provided for this eventuality and the possibility of other groups of employees seeking compensation.

The council is continuing to develop its single status proposals to be submitted to trades unions. This stage has almost been completed.

Outlook for future audits

Until a local agreement is concluded, the initial and continuing costs of single status cannot be reliably estimated. This represents a significant financial risk to the council. Evidence from other councils is that there is significant variation in the level of potential cost, when compared to the current pay-bill on a continuing basis. The council has not yet fully developed or costed its proposals.

No clearly prioritised plan with a strategic focus is in place to address the efficient government agenda. Neither are procedures in place to allow efficiency savings to be properly assessed and calculated. Following council re-structuring a lead director has been appointed and the five efficient government streams will be driven through a senior officer efficient government group. One of the first tasks of this group will be to prepare a prioritised plan with appropriate input from members. Our review of efficient government arrangements concluded that a list of "efficiency" savings claimed for 2006/07 included amounts which appear to be reasonably categorised as efficiencies; there were, however, other amounts which, in our view, may be difficult to justify in terms of the principles of the efficient government initiative.



Work is continuing on the introduction of a more systematic performance management system, with key performance indicators now being reported to committee by each service, although services are at different stages in this process. As well as underpinning performance improvement, an effective performance management system is an essential tool to support decision making if the council is to be clear on the extent to which potential savings will impact on outputs and quality.

Developing modern infrastructure is essential for supporting the delivery of improved services. Successful delivery of the schools modernisation project and housing stock transfer remain key components of the council's strategy. The council also needs to further develop its asset management process to ensure that all assets are used effectively and efficiently to deliver services in line with the corporate priorities.

Changes to the code of practice on local authority accounting (ACOP) will have a significant impact on the presentation of the 2006/07 annual financial statements with the aim of making them more consistent with the accounts of other public and private sector organisations.

This is the final year of our current appointment to the audit of Inverclyde Council. From 2006/07, Audit Scotland will remain as the council's appointed auditor and the new engagement lead will be Peter Tait.

**Audit Scotland
October 2006**



Introduction

1. This report summarises the findings from our 2005/06 audit of Inverclyde Council. The scope of the audit was set out in our audit risk analysis and plan, which was submitted to the audit committee on 11 May 2006. This plan set out our views on the key business risks facing the council and described the work we planned to carry out on financial statements, performance and governance.
2. We have issued a number of reports this year, and we briefly touch on some of the issues we raised, in this report. Each report set out our findings and recommendations and the council's agreed response. Appendix A of this members' report sets out the key risks highlighted in this report and the action planned by management to address them.
3. During the year, the council began to address the issues arising from its best value audit. The action points arising from this report should, where appropriate, be considered within the context of taking forward the council's improvement plan.



Performance

Introduction

4. In this section we summarise key aspects of the council's reported performance and provide an outlook on future performance, including our views on the current status of identified risks. We also comment on the best value audit which was reported during the year, and the progress against agreed improvement actions arising out of this best value audit and the findings of national performance audit studies.

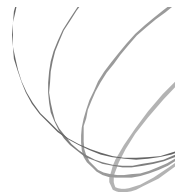
Corporate objectives and priorities

5. The corporate plan for 2006/2007 was approved in June 2006 and sets out the five priorities and explains how the council plans to achieve these, through the aims underpinning them. The priorities are:
 - Promoting economic development;
 - Promoting lifelong learning;
 - Promoting health, well-being and active citizenship;
 - Promoting a safe and sustainable environment; and
 - Developing the organisation.

The structure and format of the corporate plan 2006/07 represents a significant improvement over the previous document as it lists outcomes for each of the "aims" which support the achievement of the planning priorities.

Best value audit

6. The Local Government in Scotland Act 2003 established best value and community planning as statutory duties for local authorities. In response, the Accounts Commission introduced new arrangements for the audit of best value based on a cyclical approach involving a full review by a specialist team once every three years. In the intervening years short follow-up reviews are carried out by the local auditor.
7. The council underwent a full best value audit during 2004/05. The report issued by the Accounts Commission in May 2005 contained a number of trenchant criticisms of the council. The impact of the report on the council was profound, and in September 2005 the then chief executive took a voluntary severance package. Following a period under an interim chief executive, a new permanent chief



executive, John Mundell, was appointed in February 2006. Mr Mundell took up the post in March 2006.

8. During the interim chief executive's tenure an improvement plan was prepared and approved by the council. The first stage of this plan was the appointment of a new chief executive to drive forward the rest of the plan. The improvement plan is now being implemented on target and new corporate directors have been appointed to fill the top level of the new organisational structure. The next step is to complete the appointments of heads of service. This will be done through a competitive process including external candidates and, following due process, postholders will be in place in the early part of 2007.
9. Despite a slow start, there are detectable signs that progress is being made. Perhaps the most striking example of this is the transformation of IT services from a failing service to a viable and trustworthy service which is advancing the council's IT capabilities on a number of fronts.
10. The Accounts Commission has requested a follow-up review of progress made by Inverclyde Council. The central best value team is to perform this review during November and December 2006 and report to the Commission in January 2007.

Performance reporting

11. The council's performance reporting to the local and wider community is limited and consists, in the main, of the annual financial statements and the annual performance report (which consists of statutory performance indicator information only). While these are important documents, both of which would benefit from a higher standard of presentation, no formal narrative reports are published either by the chief executive, directors or the administration. Such reports are becoming common practice among those councils perceived to be leaders in best value and public performance reporting. Such reports typically cover a council's most important achievements of the year, outline progress with ongoing major areas of work and draw attention to issues to be addressed in future years. The council is reviewing how it reports its performance to members, the local community and the wider stakeholder body.

Action Point 1

12. If the council chooses to expand and enhance its public performance reporting there needs to be clear links to the corporate plan and community plans. The reporting should comment on performance targets and indicators directly linked to the objectives and priorities in the plan.
13. For 2005/06, the council intends to publish an enhanced presentation of its annual financial statements. This is a step in the right direction, however, the content of this published document is limited to the annual financial statements. Complementary to the full accounts, the council is again

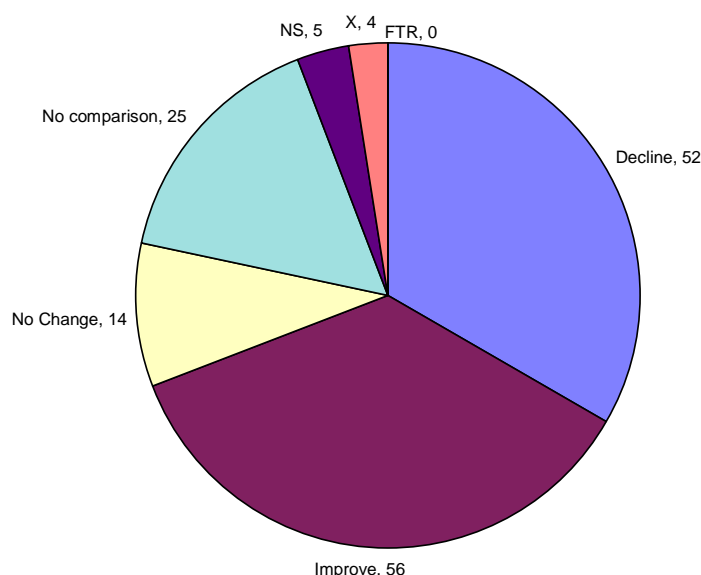


producing its award winning summarised accounts leaflet, which provides a concise account in layman's terms of how it spent the money available during the year and its financial position. Inverclyde Council can justifiably claim to have broken new ground with this document which other councils are now replicating.

Statutory performance indicators

14. In the absence of other performance indicators, the council's performance is measured by statutory performance indicators (SPIs). Historically, the council has generally been in the lower quartile of national comparisons. The chart below provides an analysis of Inverclyde council's performance. Each separate part of a single indicator has been counted as 1 for the purposes of this analysis.

Analysis of 2005/2006 SPI Performance



15. In the chart above, four indicators are recorded as being unreliable. Three of these relate to benefits administration indicator 3 parts b and c. These indicators were assessed as unreliable as a consequence of a "bug" in the software system used by the council. This is particularly disappointing as we consider the administration of benefits to be a well managed and effective activity of the council. The remaining indicator assessed as unreliable was waste management indicator 1 (complaints) due to the absence of a full year's worth of data.
16. As the chart also shows, there were no "failures to report", and a small number of no service responses (that is, where the council did not provide the service being measured). Overall the improvements slightly outnumber the reductions in service performance.



17. Substantial improvements have been made in a number of areas, for example:
 - the time taken to process new benefit claims;
 - the percentage of rent due in the year that was lost due to voids; and
 - the percentage of invoices paid within 30 days.

18. One area of performance which should be highlighted for special attention is the dramatic improvement in waste management indicator 3 (refuse re-cycling). In 2004/05, 5.8% of refuse was re-cycled; this increased to 19.2% in 2005/06. This reflects the implementation of the council's waste management strategy in 2005/06 and the bringing into commission of its new waste re-cycling facility in Greenock.

19. Performance has, however, declined markedly in other areas, notably:
 - the number of council house sales within 26 weeks, and the average time taken to sell council houses;
 - the value of current tenants arrears as a percentage of net rent due; and
 - the average time taken to assess homelessness cases.

Performance outlook – opportunities and risks

Introduction

20. In our audit risk analysis and plan we identified some of the strategic risks to Inverclyde Council delivering on its stated objectives and priorities. We grouped these into six risk areas which will drive and support service delivery.

Strategic management and organisational restructuring

21. In the past 18 months three members of the council's corporate management team have left the council: the director of social work and housing services, the director of corporate services and, most recently, the chief executive. One of the findings of the best value report in May 2005 was that there were *"fundamental weaknesses in leadership and direction by both elected members and senior management"*. Further reports commissioned from external consultants have served to underline the findings in the best value report and made recommendations on strategic leadership, restructuring of the council and culture change.

22. In December 2005, the council adopted an eight point, 18 month plan to bring about the necessary changes. The first part of the plan, the recruitment of a new chief executive, was achieved ahead of target with John Mundell taking up his post in March 2006. A new structure for the council was agreed in early summer and the recruitment process for four executive directors has recently been



advanced with the appointment of the corporate directors of improvement and performance, of environment and community protection, and of regeneration and resources. The appointment of the corporate director of education and social care has been delayed by the decision to re-open the candidate list.

23. The preliminary process matching of heads of service was completed in June in accordance with the chief executive's timetable. The remaining appointments will be made through a competitive process and will be completed in early 2007.
24. Our audit risk analysis and plan commented that significant change entails risks that expected benefits are not delivered, or that they are only delivered at significantly greater time and cost. If not handled well, successful business transformation may be put at risk by existing departmental cultures, behaviours and loyalties. We also considered the risk that the council may not have the capacity to deliver the business transformation planned at the pace required or, once delivered, change may fail to deliver the performance improvements necessary.
25. It is encouraging to note that the achievement of the 18 month improvement plan, mentioned at paragraph 8, has been on target, with no evidence of compromise of the council's operational capacity. The next phase of the plan, improving performance through business transformation and cultural change, will be a considerable challenge for the new corporate management team and careful monitoring of progress will be needed to ensure that the council fulfils its role as a provider of improved service and support to the community.

Performance management and improvement

26. In the absence of a performance management framework, there is little robust and consistent basis for holding services, and consequently the council, to account for performance. The best value report published in May 2005 identified the lack of a comprehensive performance management framework as a major contributory factor to the council's lack of progress on best value.
27. There have been efforts by senior officers to enhance the performance information being reported to committee. Among the items noted as being indicators of service performance are:
 - service plan outturn against targets. (Education services' *"Standards and Quality Report 2004/05"* provided to the education and lifelong learning committee is an excellent example of what can be provided.);
 - reporting interim statutory performance information and other performance information to the community committee;
 - reporting a number of corporate service indicators to committee on a quarterly basis; and



- reporting managing absence statistics to committee.

28. This is clearly an improvement in what was previously being provided. Notwithstanding, this does not yet, as senior officers recognise, constitute a comprehensive performance management framework. It is anticipated that the new corporate director of improvement and performance will be able to build on the efforts already made, to refine and better focus the information being provided for both members and the corporate management team.

Action Point 2

Corporate governance and risk management

29. Our audit risk analysis and plan noted that there are a number of challenges to the council's corporate governance capabilities; crucially the implementation of the recovery plan and the continuity of service provision throughout the period of implementation. Other key areas identified included risk management, support for elected members in their scrutiny role, development of senior officers and preparations for the introduction of proportional representation in the 2007 council elections. The issues raised and our assessment of the progress made is more fully set out in the corporate governance section of this report.

Affordability and sustainability

30. Failure to plan and manage services within allocated resources has significant implications for Inverclyde Council which already has one of the highest rates of council tax in the country. The council, through its improvement plan, has an opportunity to create a structure fit for the purpose of delivering joined up services and embracing the modernising and efficient government agendas. Pressures on resources through, for example single status pay settlements, the future funding of community regeneration or reviews of supporting people funding, are recurring themes for all councils.

Housing stock transfer

31. The demand for council housing in Inverclyde has reduced significantly over a number of years, leading to an increase in the number of closed houses and demolitions. The housing stock requires substantial investment to achieve the Scottish housing quality standard. Against a background of £72 million debt and reducing tenancies, the council expects that transferring the stock as part of the community ownership programme will provide the opportunity to replace the area's current housing stock with fewer houses at a higher standard.

32. The council has, over the past five years, been progressing its strategy of seeking to transfer its council housing stock to a registered social landlord. The major advantage of such a transfer is that the capital debt outstanding on the housing account will be written off by the Scottish Executive. The proposed transfer to River Clyde Homes is subject to the result of a ballot of tenants. An external

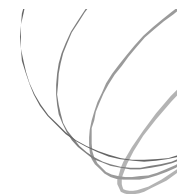


consultant has been appointed to oversee the process and the tenants' ballot has been fixed for November this year. The date of transfer, subject to tenants voting yes, has still to be finalised.

33. There have been a number of successful stock transfers in recent years. There have also been a number of high profile cases where tenants have voted 'no', for example, Edinburgh City Council, and Renfrewshire Council. The possibility of a 'no' vote entails a substantial financial risk for the council. The council has, in collaboration with external consultants, developed a costing model which provides an indication of the resources and consequent rent levels required over the next 30 years to deliver a similar level of service to that envisaged by River Clyde Homes. Together with the chief executive's proposals for the management structure, this forms a basic framework to progress in the event of tenants rejecting the proposals.

Schools estate strategy

34. Over the past five years, the council has been developing a schools estate strategy based on provision under a public private partnership (PPP). The strategy is that all of the council's schools are to be replaced or refurbished over the next 10 years. The council has been provisionally awarded £5.73 million per annum by the Scottish Executive, equivalent to a capital investment of not less than £80 million, to fund the PPP element of the rationalisation of the schools estate. In the primary sector this will include closing 14 primary schools, building three new schools and refurbishing others; in the secondary sector the existing provision of eight schools will be reduced to five - three new build schools and two refurbishments. The balance of the investment required to deliver the council's school estate strategy, total cost £180 million, will be funded through council borrowing.
35. In August 2005 a preliminary assessment of the proposed accounting treatment of the PPP element of the scheme was provided by Audit Scotland. The assessment concluded that:
- the process followed to determine whether the council should account for the transaction on or off its balance sheet appears in accordance with the current underlying guidance; and
 - the financial advisor's initial view is that "*an off balance sheet treatment from the Council's perspective is considered achievable*". They also conclude that "*it is not obvious (from the initial assessment) which party has an asset of the property. Therefore a full quantitative analysis is likely to be required at the preferred bidder stage*". This initial view appears reasonable.
36. As at August 2006, the scheme has been refined to the point where an advertisement has been placed in the Official Journal of the European Union requesting expressions of interest for the provision of four new schools (two secondary and two primary schools). The tender seeks expressions of interest for the design, build, financial management, lifecycle maintenance and other property related services for a period of 30 years.



37. The implementation of a cohesive schools estate strategy has been subject to a number of delays over the past five years and continues to be the subject of questions from interested parties. The council has made considerable efforts to arrive at this position where tenders are now being invited, after a long and difficult process.

Capital expenditure

38. Capital expenditure is expenditure on the purchase or construction of a new asset or expenditure which will enhance or extend the life of an asset currently in use by the council. In general, capital expenditure is incurred to facilitate the delivery of services to the community over a number of years. Inverclyde Council prepares a three year capital programme which provides details of capital expenditure on various individual projects.
39. During the course of our audit, it became clear that there was considerable slippage in the capital programme for 2005/06. When we sought to quantify this, officers were initially unable to meet our request to provide an analysis of performance against target for the year. Eventually a schedule was prepared showing slippage against target of £7.997 million (non-housing) and £4.063 million (housing) making total slippage on the approved capital programme for 2005/06 of £12.060 million. Results reported to the policy and strategy committee (non-housing) in February and to the environment and regeneration committee (housing) in March did not indicate slippage of this magnitude and masked the significant under performance on the 2005/06 capital expenditure programme.
40. Satisfactory monitoring of the council's capital programme requires that each year's plan is clearly stated and the achievement against the plan critically compared during the year and at the year end to identify any areas requiring corrective action. Whether failure to meet the plan was through an over-ambitious plan/under-capacity to execute, slippage through un-forecast difficulties, underestimation of costs or for any other reasons, this information is of value to management and members in assessing performance and should be produced as a matter of course.

Action Point 3

41. The format of and language used in committee reports on capital spend does not, in our view, promote a ready understanding of the position to members and officers with no formal financial training. In order to ensure that members are adequately informed, reports need to be formatted so that targets and actual achievement are clearly set out and the language used is "plain English" avoiding euphemisms and jargon.

Action Point 4



Effective partnership working

42. The Local Government in Scotland Act 2003 provides a statutory basis for the community planning process. Inverclyde Council has a duty under the act to initiate, facilitate and maintain community planning. Much of the development to date has focused on structures and processes. Increasingly, the council is dependent on partnership working to deliver service improvements. There is a key risk that partners are unable to work effectively in a joined-up manner and do not achieve best value in the use of public resources as a result.
43. The community planning process in Inverclyde is overseen by the Inverclyde Alliance Board consisting of representatives from a number of statutory bodies and community groups. The Alliance Board was to have been supported by a senior manager advisory group (SMAG). No SMAG meetings took place in the six months after the previous chief executive left. The new chief executive convened a meeting of SMAG shortly after taking up his post and arranged for the Local Government Improvement Service to run a workshop in April. Due to pressures on senior managers' time no further meeting was held until August. The development of the community planning process was also retarded by the uncertainties surrounding the future of one of the key partners, the Argyll and Clyde Health Board.
44. Community planning requires the development of effective engagement processes, such as local community planning partnerships. Services have to be configured in a manner that allows them to respond to identified needs and local priorities in a co-ordinated and effective manner. The partnership is in the process of reviewing its community planning structure and decision making processes. The main driver of change is a perception that there was excessive bureaucracy associated with the original five "themes" (in terms of the number of meetings and the preparations required for each of these meetings). The partnership considers that the aims and objectives of the partnership will be better met by reducing this burden. This rationalisation process is in line with the findings and recommendations flowing from Audit Scotland's initial review of community planning arrangements published in June 2006.
45. The council's regeneration outcome agreement with the Scottish Executive lists 16 outcomes and these are being used as the performance indicators of success. The revised arrangements are due to go to the Alliance Board in late October for approval.
46. Funding of community planning is an area where little progress has been made. Funding is almost wholly drawn from the community regeneration funding provided from the Scottish Executive. There is little evidence of any joint budgeting or contributions to a single budget for administration by the Alliance Board. This is an area which the council should lead in developing.

Action Point 5



Efficient government

47. The continuous improvement agenda has been a feature in Scottish local government for a number of years, but has been given added impetus by the Local Government in Scotland Act 2003 and the efficient government initiative. Following a period of voluntary commitment, this act established best value as a statutory duty of local authorities. The efficient government initiative was launched by the minister for finance and public services in June 2004 and is a central part of a programme of investment, reform and modernisation. In seeking continuous improvement and responding to increasing demands for council services, the council needs to work with its partners to promote efficiency by getting the most from available resources to enhance services to local people.
48. Inverclyde Council's efficient government effort has to be viewed in the context of the aftermath of the highly critical best value report. The council's capacity to respond to the efficient government agenda has been affected by its focus on the implementation of the best value improvement plan and the departure of some senior officers. The council's progress has, as a consequence, been slower than ideal.
49. A fundamental restructure of the organisation is in progress. It is likely that this process will be completed within three months, following which the council's overall response to the efficient government agenda will be clearer. The council's progress with the best value improvement plan does impact on member and officer capacity to implement, more quickly, the key aspects of the efficient government initiative. For example, the development of robust management systems to track efficiency savings is an integral part of the council's developing performance management framework, which itself is an essential element within the best value improvement plan. The council is dealing with this and other improvement priorities and there is an explicit commitment to a change programme which will also address the efficient government initiative.
50. The response thus far has been uncoordinated and lacking in clear leadership from either members or senior officers. While the preoccupation with, and devotion of limited resources to, implementing the council's best value improvement plan is understandable, the council needs to sharpen its response to the efficient government agenda.

Action Point 6

51. Because of the Scottish Executive's arrangements to make deductions from the council's annual grant settlement, on the basis of assumed efficiency savings, there is a real financial penalty if the council do not make adequate arrangements to secure the necessary efficiencies. During our review of efficient government arrangements a list of "efficiency" savings claimed for 2006/07 was provided to us. This included amounts which on the face of it appear to be reasonably categorised as efficiencies; there were, however, other amounts which, in our view, may be difficult to justify in terms of the principles of the efficient government initiative.



52. As external auditors to the council we believe that any claim to efficiency savings needs to be clearly demonstrated and justified by reference to baseline performance measurement and consistent costing of inputs. In the event of our being required to sign off future efficiency statements the council should be clear that it will not be sufficient to simply assert that a service has either improved or remained the same, any assertion will have to be demonstrated by reference to performance information. The council needs to put in place adequate arrangements for the identification and measurement of claimed efficiencies.

Action Point 7

53. The new corporate plan provides an opportunity to enshrine the tenets of efficient government in the council's strategic framework and provide a guide to services on how they should be designing and providing services to the community. The plan acknowledges the efficient government agenda as one of the key drivers in the council's strategic approach to the provision of services. One of the priorities set out in the corporate plan is "*Developing the Organisation*". This priority makes explicit the council's commitment to the efficient government agenda and sets out a number of aims including the development of the performance management framework and a review of the corporate efficiency framework.

National studies

54. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year include reviews of public sector pension schemes, and the *National Fraud Initiative*, summarised later in this document. Other reports published during the year and of direct interest to the council are set out below. Further information on these studies and reports can be obtained from Audit Scotland's website at www.audit-scotland.gov.uk.

A mid-term report: a first stage review of the cost and implementation of the teachers' agreement *A Teaching Profession for the 21st Century*

55. In May 2006 Audit Scotland published the results of a review of the implementation of the teachers' agreement arising from the 'McCrone' report. This found that the agreement has brought benefits for the teaching profession, but the lack of performance measures makes it difficult to assess the wider impact of the £2.15 billion investment. The report recommends that the Scottish Executive work with other parties to the agreement to identify and report on a set of comprehensive performance measures.



Council housing transfers

56. In March 2006 Audit Scotland published the results of a review of how well the Scottish Executive's housing transfer policy has been implemented and whether transfers have provided good value for money. This found that the transfer of council housing ownership is bringing benefits for tenants, including more investment in properties, promoting tenant control, facilitating increased repairs and maintenance and the building of new homes. The report also finds that the management of transfers is improving but better, clearer measures are needed to assess impact and value for money. The report recommends that the Scottish Executive should reinforce its approach with clearer goals and measures for quality of service and tenant involvement.

Following the public pound – a follow-up report

57. In December 2005, Audit Scotland published the results of a study of council funding of arms length and external organisations (ALEOs) to provide information about their funding and how councils perform against the *Code of Guidance on Funding External Bodies and Following the Public Pound*. The report stated that Scottish councils provided £220 million to 14,000 organisations - including companies, trusts and voluntary organisations - to deliver a wide range of council-related services such as support for people with disabilities and the management of leisure centres.
58. The Accounts Commission found that no council fully complied with guidance which sets out best practice principles for the funding of external organisations, although only five councils had a low level of compliance. Inverclyde Council was included in the moderate category of compliance.
59. There is scope for councils to improve their financial and performance monitoring. Councils should apply a risk-based approach taking account of factors such as the amounts of money involved, the size of organisations funded and how they are managed. The report recommends that councils have a register of funding to external organisations, develop a corporate policy on free or subsidised use of council properties, vehicles and facilities, take a risk-based approach to dealing with the organisations they fund, focus their resources on organisations who contribute to the council's objectives and have arrangements for scrutiny and explore joint working with other councils.

Community planning – an initial review

60. In June 2006, Audit Scotland published its initial review of community planning arrangements. This found that community planning is progressing but complex structures make aims difficult to achieve. While community planning partnerships have made progress, they need to do more to show how their work is improving public services. The report also calls on the Scottish Executive to support community planning more effectively. In particular the large number of national policy initiatives, each with their own funding arrangements can make it difficult for partnerships to plan and deliver



effectively. This report contains a useful evaluation framework of the characteristics of community planning partnerships which could be used as a checklist by the council.



Financial position

Introduction

61. In this section we summarise key aspects of the council's reported financial position and performance to 31 March 2006, providing an outlook on future financial prospects, including our views on potential financial risks.

Council tax and the general fund

Revenue performance 2005/06

62. The council's net revenue expenditure in 2005/06 was £178.724 million, after transfers from the housing revenue account (£1.416 million) and capital financing account (£4.026 million). This expenditure was met by government grants and local taxation of £164.371 million resulting in a net general fund deficit of £14.353 million.
63. The budget set for 2005/06 was based on a Band D council tax level of £1,176. In his foreword to the financial statements, the chief financial officer has commented on the deficit on the general fund for the year amounting to £14.353 million. During 2005/06, exceptional costs of £5 million for equal pay compensation claims were charged to revenue by the council.
64. The council saw the balance of earmarked reserves fall by £11.303 million in 2005/06, resulting in the general fund balance falling to £10.611 million at the end of the financial year. The outturn for the general fund for 2005/06, before the exceptional costs in relation to equal pay and the reduction on earmarked reserves, showed an under spend against the budget of £4.338 million.
65. The main revenue budget variances during the year were as follows:
- education services- an under spend of £1.998 million against budget. Main areas of under spend were staff costs, insurance, PPP slippage and childcare strategy; and
 - social work services –under spend against budget £3.721 million. Most of the budget variance comprises under spends on delayed discharge, supporting people and the Inverclyde Centre Phase I.

Reserves and balances

66. At 31 March 2006, the council had total cash backed reserves and funds of £14.179 million, including an education fund for the replacement of equipment and an insurance fund that underpins the council's self-insurance arrangements.



Table 1
Reserves and Funds 2005/2006

Description	2005/06 £ million	2004/05 £ million
General Fund	10.611	24.964
General Fund – Housing revenue account balance	0.388	1.804
Insurance Fund	3.039	1.986
Education Fund	0.141	0.173
	14.179	28.927

67. In setting its 2005/06 budget, the council's strategy was to maintain a general fund balance of £3.5million. The actual general fund balance of £10.611 million includes amounts earmarked by the council totalling £4.329million, leaving an unallocated general fund balance of £6.282 million approximately 3.5% of the council's budget.
68. All councils hold reserves which consist of both earmarked amounts set aside to support future expenditure and unexpected events. The council's earmarked reserves fell by £11.303 million during the year to £4.329 million at 31st March 2006. This was partially due to the council spending £6.4 million of the £6.8 million earmarked for *Better Neighbourhood Services Fund* (BNSF). This money was previously subject to audit comment due to the considerable slippage which had occurred over the first three years of the funding initiative. BNSF was the largest earmarked reserve in the 2004/05 financial statements representing 41% of the total value.
69. Earmarked reserves have also fallen due to unspent funds being carried forward as deferred income within creditors rather than recognising the income during 2005/06 and carrying forward as earmarked reserves. Some £4.5 million was carried forward in the creditors figure at the year end. Excluding the BNSF spending, there is a marginal reduction in the amount of earmarked resources carried forward to 2006/07. It is important that management continues to monitor this area to ensure the effective spending of specific and ring fenced grant. Significant earmarked amounts carried forward include:
- social protection team wardens - £1.194m; and
 - modernising government fund- £0.829m
70. The council anticipates using £0.32 million of unallocated balances within the general fund in 2006/07 which would reduce the general fund balances to £10.291 million including earmarked balances of £4.329million. This would maintain the general fund above the council's recommended minimum level of balances, net of earmarked reserves, of 2% of budget.



Rents and the housing revenue account

71. The council is required by legislation to maintain a separate housing revenue account (HRA) and to ensure that rents are set to at least cover the costs of its social housing provision. It was anticipated to use £0.507 million of the previously accumulated HRA reserve during 2005/06.
72. Actual outturn on the HRA account was a £1.416 million deficit. The principal reason for the £0.909 million increase in deficit was funding amounting to £0.645 million provided to the council's heat with rent scheme.
73. The HRA balance has decreased from £1.804 million at the end of 2004/05 to £0.388 million at 31 March 2006. This level is below the £0.5 million recommended minimum working balance. The 2006/07 HRA budget has been set in order to allow replenishment of HRA balances by £0.332 million.

Group balances and going concern

74. Arrangements for the preparation of group accounts are mandatory for the first time in 2005/06. Many local authorities are exploiting novel service delivery arrangements including the use of limited companies and trusts. The purpose of group accounts is to ensure that a comprehensive account of a council's activities is presented to the public by way of consolidated group accounts. The need for a record of group activity has become more important with the *Prudential Code for Capital Finance in Local Authorities* which requires authorities to take note all of their commitments, including those in the accounts of alternative service delivery vehicles controlled by the council.
75. The council prepared group accounts following a review to determine its interest in subsidiaries, associated entities and joint ventures. The 2005/06 financial statements report the Inverclyde Council group in accordance with recommended accounting practice. The group accounts are primary accounting statements of the council. The background to their introduction and basis of their preparation is briefly summarised in the foreword to the accounts; also included is a brief commentary on the group results and financial position.
76. The council consolidated associates into its group accounts. This includes the Strathclyde Police Joint Board, Strathclyde Fire and Rescue Joint Board, and Strathclyde Passenger Transport Authority, all of which had an excess of liabilities over assets at 31 March 2006. In the case of the two joint boards this relates to the substantial pension liabilities from their unfunded pension schemes, being in total some £4.5 billion, of which the council's share is £171.3 million. For the Strathclyde Passenger Transport Authority, the net liability arises mainly from the long-term borrowing required to fund new investment in rail and other passenger transport facilities. The overall effect of inclusion of the council's associates on the group balance sheet is to reduce reserves and net assets, reducing net assets by £171 million and giving a net liability on its group balance sheet of £47.044 million.



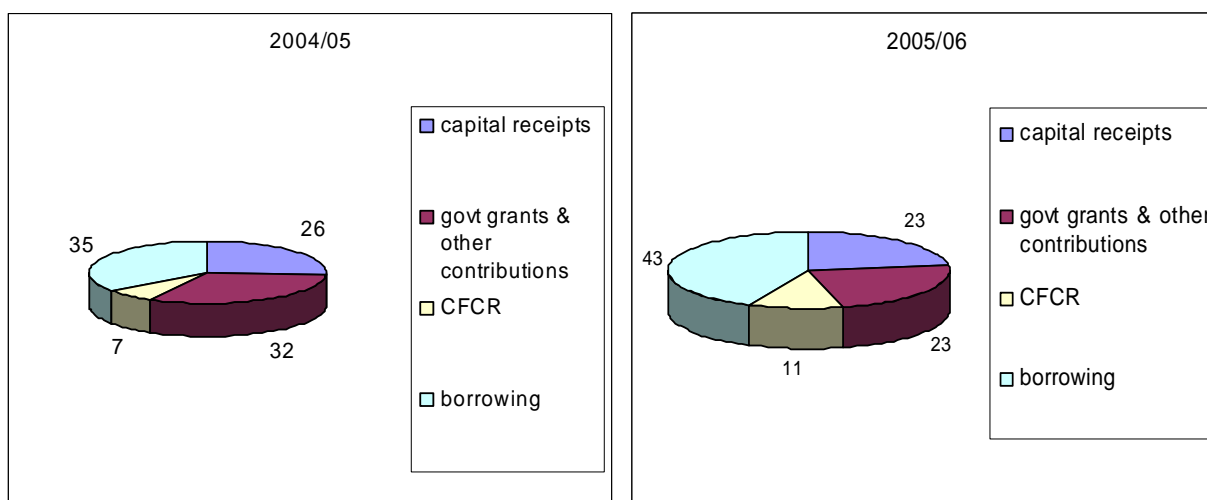
77. All group associates have prepared their accounts on a going concern basis. Statutory arrangements in place with the Scottish Executive and constituent authorities for the funding of the deficit on police and fire pensions means that the financial position of the boards remain assured. Similarly, funding arrangements are in place between the Scottish Executive, constituent authorities and the Strathclyde Passenger Transport Authority. The chief financial officer of the council has, therefore, taken the view that group financial statements should be presented on a going concern basis, as there is no reason to suggest that future funding will not continue.
78. In compiling group accounts, the council has achieved compliance with group accounting policies in accordance with the accounting code of practice for local government (ACOP). One exception relates to the valuation of the land and buildings of the Strathclyde Passenger Transport Authority which have been valued at historic cost. The difference in accounting treatment has been disclosed within the group accounts and efforts are to be made to ensure compliance from 2006/07.

Spending on assets and long-term borrowing

Capital performance 2005/06

79. Following the introduction of the prudential code in April 2004 the council can decide locally on a capital investment strategy which must meet best value requirements as well as being affordable, sustainable and prudent. In April 2005, the policy and strategy committee approved a range of “prudential indicators” for 2005/06 for the purpose of monitoring the council’s capital activity.
80. Capital expenditure in 2005/06 totalled £21.8 million, rising from £14.9 million in 2004/05. Capital investment in the last two years was funded as shown below.

*Chart 1
Sources of finance for capital expenditure 2005/2006*





81. In 2004/05 it was reported that there was considerable slippage in the capital programme. Spending on the council's 2005/06 capital programme was some £12 million (46%) less than plan. Some of the slippage carried forward from 2004/05 was made up during the year. Further comment on the capital spending outcome is included in the performance section of this report.
82. In total, £217 million (88%) of the council's long and medium term loans at the year-end mature after more than 10 years. The council has actively managed its exposure to variable interest rate movements with less than 2.5% of all debt exposed to variable rate risk. This is well below its prudential maximum exposure of 35%. The under spend in the capital programme resulted in the council borrowing £6.6 million less than originally planned.

Forward capital programme

83. General services capital plans for 2006/07 and 2007/08 anticipate annual capital expenditure of £21.41 million and £37.453 million respectively. This is expected to be funded by a number of sources including capital receipts, grants and other contributions and further increases in borrowing totalling £14.45 million over the two years.
84. The council is in the process of arranging a ballot of tenants on its housing stock transfer proposals. A positive vote would see the council's housing stock transfer to River Clyde Homes during the early part of 2007. Consequently, no new housing capital programmes have been planned to start in 2007/08.

Financial outlook

Current budget

85. The 2006/07 budget was based on a Band D council tax level of £1,206 an annual rise of 2.5 %. A contribution of £0.320 million from the general fund reserves is planned. The council decided not to set any indicative council tax level for 2007/08.
86. General allowances for pay and cost inflation pressures were built into the budget and £1.5 million costs relating to the future implementation of single status have been allowed for in the 2006/07 budget.
87. Local authorities have yet to be provided with details of provisional Scottish Executive aggregate external finance allocations for 2008/09. A high level revenue budget and an indicative council tax level for this year have yet to be set.

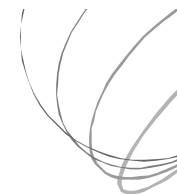


Equal pay

88. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay can put forward claims to an employment tribunal.
89. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2005/06. The risks for councils arise not only from the question of whether traditionally female roles, in areas such as catering and cleaning have been underpaid, but also in relation to bonus payments made to predominantly male manual workers in areas such as cleansing, grounds maintenance and building trades typically not available staff where the workforce is predominantly female.
90. In common with many other Scottish councils, Inverclyde Council has acted to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer compensation payments to specific groups of employees. The estimated cost of the compensation package reported to the policy and strategy committee in May 2006 was £3.85 million.
91. The extent to which the actual compensation cost varies from current estimates will depend on a number of factors including take-up rates and level of awards of any cases taken to tribunal. Information currently available suggests that around 60 affected staff have rejected the compensation offer and plan to proceed to tribunals. The council have set aside an additional £1.1 million to meet potential future costs arising from tribunal decisions, legal expenses and claims by new groups of employees. Costs above that already budgeted will further increase financial pressures on the council.
92. While moves to agree compensation payments to affected employees will help to reduce financial risk to some extent, significant risks remain, particularly while existing pay and reward structures remain in place. The future implementation of the single status agreement provides an opportunity to address any underlying inequalities in pay and other conditions of service.

Single status

93. In 1999 a single status agreement was reached between Scottish local authorities and trades unions which would harmonise the terms and conditions of manual and administrative, professional, technical and clerical (APT&C) workers. The agreement covered, working hours, leave and negotiating mechanisms. There was a presumption that single status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.



94. The original national single status agreement specified that implementation should take place by April 2002 but, following difficulties in establishing a model job evaluation scheme the timescale was extended by agreement between local authorities and unions to April 2004. Inverclyde Council has yet to implement the single status agreement. The head of personnel services anticipates that revised conditions of service will be submitted to trades unions before the end of November. The chief executive has expressed a clear expectation that effective implementation will be 1 April 2007. Provision of £1.5million has been made in the 2006/07 budget and it planned to increase this sum in subsequent years.
95. Until a local agreement is concluded, the initial and continuing costs to the council cannot be reliably estimated. This represents a significant financial risk to the council. Evidence from other councils is that there is significant variation in the level of potential costs, which can be up to 10% of the current pay-bill on a continuing basis. The council should maximise the opportunity for service and job redesign to ensure that it achieves value for money from its investment in its staff.

Action Point 8

Efficient government

96. The efficient government initiative is a central part of the government's programme of investment, reform and modernisation and is a five year programme aimed at attacking waste, bureaucracy and duplication in Scotland's public sector.
97. The efficient government initiative sets targets to achieve £745 million of cash-releasing savings, and £300 million of time-releasing savings, by 2007/08. It is anticipated that local government as a whole will contribute £325 million in cash-releasing savings to the overall target. Although the Scottish Executive has not notified councils of the efficiency savings they should achieve each year it can be calculated that Inverclyde Council's share of the top-sliced target of £168.3 million was approximately £1.06 million in 2005/06.
98. Assumed efficiency savings have been incorporated into annual financial settlements, presenting an immediate challenge as efficiency gains through service redesign are likely to take longer than one year to be fully realised. Failure to achieve the level of savings anticipated will increase financial pressures and may impact adversely on the quality of services provided. In order to claim an efficiency, councils need to be able to demonstrate that service outcomes have been maintained or improved and be able to evidence the link between resources and performance measurement.



99. Inverclyde Council's progress on efficient government has been slower than ideal. The council's ability to respond to the efficient government agenda has been curtailed to some extent by the uncertainty over future management structures. With the new chief executive now in position and corporate directors appointed, the council's response to efficient government should become clearer and more focused in the second half of 2006/07.
100. The council is aware of the most challenging aspects of efficient government which includes mechanisms to ensure that outcomes and quality are not adversely affected by financial savings. In common with other councils, much work is still required to ensure that appropriate guidance is issued to staff to clarify what constitutes efficiency and how it should be measured, monitored and reported. Elected members need to be fully involved in the council's response to the efficient government agenda and a strategic plan put in place to ensure that systematic and measurable progress is made. The Improvement Service has commissioned an external partner to develop measures of productivity and efficiency in local government services. These measures will be available to councils for the financial year 2006/07 to assist in their forward planning and to aid them in demonstrating efficiency gains.

Action Point 6

Pension liabilities

101. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long and the estimation process is complex involving many areas of uncertainty including projections of increased life expectancy. The Scottish Executive has proposed to amend the local government pension scheme in order to reduce ongoing costs, however, there remains considerable uncertainty as to whether or how far the proposals will be implemented. In accounting for pensions, *Financial Reporting Standard 17 (Retirement benefits)* is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised on the balance sheet.
102. The council's estimated pension liabilities at 31 March 2006 exceeded its share of the assets in the local government pension scheme by £69.395 million, reducing from £78.412 million in the previous year. The deficit on the pension fund will be addressed by increased contributions over the remaining working life of employees as assessed by the scheme actuary.
103. A full actuarial valuation of the Strathclyde Pension Fund was carried out as at 31 March 2005 by Hymans Robertson. The next full valuation of the scheme is due as at 31 March 2008. Factors such as volatile stock markets and increasing life expectancy resulted in a funding level of 97% as at 31 March 2005 (calculated as the ratio of fund assets to past service liabilities). Hymans Robertson was commissioned to review the funding level again in 2006, and as at 18 May 2006, the funding level had



improved to 100.4%. The actuary is required to make a 3-year assessment of the contributions that should be paid by employing authorities to maintain the solvency of the fund. The latest assessment indicates that contributions are expected to rise from 240% of the employees' contribution in 2004/05 to 280% by 2008/09.

104. In addition to participation in the Strathclyde Pension Fund, most of the council's teaching staff are members of the teachers' pensions scheme which is administered directly by the Scottish Executive. This is a multi-employer unfunded defined benefit scheme. During 2005/06, the council paid £3.0803 million (12.5% of teachers' pensionable pay) in contributions to this scheme.

105. The council also has an obligation to defray a proportion of the expenditure of the joint boards of which it is a constituent member. Four of these boards, had year end net liabilities due to their pension liabilities. As disclosed on the group balance sheet Inverclyde Council's share of its associates' combined pensions liability stood at £173.1 million at the close of the financial year.



Governance

Introduction

106. In this section we comment on key aspects of the council's governance arrangements during 2005/06. We also provide an outlook on future governance issues, including our views on potential risks.

Overview of arrangements in 2005/06

107. Corporate governance is concerned with structures and processes for decision making, accountability, control and behaviours at the upper levels of the organisation. On the whole, a sound scrutiny system is in place; however improvements to the quality of information provided to committees would, in our view, improve the effectiveness of corporate governance.

108. The council complies with CIPFA's guidance note *Audit Committee Principles in Local Authorities in Scotland* through the operation of an audit committee. In addition to this the council's best value and corporate services committee deals with performance issues. The audit committee fulfils the important role of holding officers to account through receiving internal and external audit reports and questioning senior officers on reported findings. The audit committee is still developing and its continued development requires that members are provided with adequate support mechanisms, including access to external experts. Committee members underwent some training, provided by internal and external audit, during the year and the provision of training with a special emphasis on audit issues for members of this committee is to be continued.

109. Internal audit plays a key role in the council's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. Our annual review of the council's internal audit arrangements concluded that the function continues to be well managed and produces good quality work. Consequently we have been able to place reliance on the work of internal audit in forming our opinion on the council's financial statements for 2005/06.

110. During the first half of 2005/06 there was significant staff turnover in the internal audit service, including the unexpected resignation of the chief internal auditor. On taking up the position in September 2006, the interim chief internal auditor implemented a revised 2005/06 audit plan in consultation with both ourselves and the audit committee to take account of the resources available. At the end of 2005/06, 13 reports out of 28 in the revised audit plan were finalised with an additional eight audits having had the field work completed. The remaining audit reports were in the process of being completed.



111. Since the departure of the previous chief internal auditor, the internal audit service has been led, on a part time consultancy basis, by a highly experienced individual with a sound background knowledge of both Inverclyde Council and public sector audit in general. Nevertheless, a permanent solution to the internal audit service's management arrangements needs to be found. Under the direction of the chief financial officer an options appraisal was carried out towards the end of 2005/06, which included an approach to neighbouring authorities to explore the possibility of service sharing. The best option identified was the appointment of a new permanent chief internal auditor. However, because of the re-structuring and anticipated appointment of a new senior management team the decision was taken to delay recruitment pending the implementation of the new structures. It is anticipated that the new structure appointments will all be in place within the next three months and that a firm decision on the future of the council's internal audit arrangements will be determined thereafter.

Action Point 9

Systems of internal control

112. In her annual report for 2005/06 submitted to the audit committee on 11th May 2006, the interim chief internal auditor provided her opinion that, based on the internal audit work undertaken during the year, the majority of the systems of internal control that are in place within the council operated as intended to meet management's control requirements.

113. Recommendations made in previous years' internal and external audit reports are monitored by management and internal audit. Progress made in addressing issues raised in external audit reports is reported at each audit committee meeting.

114. In addition to placing reliance on the work of internal audit, the 2005/06 audit involved a review of a number of the council's systems. The main findings from the areas examined are summarised in the following paragraphs.

115. A review of the debtors system was undertaken during 2005/6. We concluded that the controls operating over the system were generally sound but we also suggested that management could make better use of information from the debtors system for performance monitoring. It was also recommended that a comprehensive charging policy and formal guidance for the withdrawal of services from non-paying debtors should be introduced.

116. A review of the housing and council tax benefit systems was undertaken resulting in our assessment that a sound control environment was being maintained. Our sole recommendation was that the council should continue to implement the remaining action plan points from the Benefit Fraud Inspectorate report of 2005.



117. The council's capital planning process was also reviewed during 2005/06. A number of important issues were drawn to management's attention. In summary, there was an absence of a corporate capital strategy linking to key objectives; robust options appraisal is not being performed for capital projects nor is any corporate evaluation tool used to appraise proposed capital projects; documentation in support of investment decisions and sensitivity analysis performed on capital projects is not retained; and, council committees are not being provided with full details of projects being considered for capital funding.

ICT services

118. The ICT senior management team has made significant progress with the reorganisation of the functions and staffing of the department to reflect the individual demands of services and the overall corporate requirements of the council. Other significant elements of the ICT transition and transformation programme which have been progressed are the introduction of the new ICT service desk and strategic partnership agreements for the desktop refresh and network upgrade projects. The ICT strategy and e-government strategy is also progressing with delivery of the corporate address gazetteer and the concessionary travel scheme for the elderly and disabled. Work in progress includes the redevelopment and redesign of the council's website to improve electronic communication between the council and the public and meet the Improvement Service's electronic service delivery targets.

119. Our ICT service review issued in August 2006 did however, identify a number of areas where further attention was required and an action plan to address the issues raised was agreed with management. Issues included out of date security policies; instances of unsatisfactory back up arrangements; and absence of a comprehensive asset register of equipment and software.

120. Our main concern was the absence of a business continuity plan. With the increasing reliance being placed on the availability of ICT, it is important that the council has documented disaster recovery and business continuity plans. If planning is not in place it is likely that in the event of computer systems failing recovery will not be effective.

Prevention and detection of fraud and irregularities

121. At a corporate level the council has appropriate arrangements in place to prevent and detect inappropriate conduct and corruption. These arrangements include codes of conduct for elected members and staff, an anti-fraud and corruption policy, a whistle blowing policy and defined remits for relevant regulatory committees.



122. Under the *National Fraud Initiative* (NFI), councils compare information on benefit claimants, students, public sector employees and pensioners with other public bodies to detect overpayments made through fraud or error. The findings of the 2004/05 exercise were published in May 2006, highlighting that across Scotland £15.1 million of fraud, overpayments and savings were found, including:

- 270 cases where pensions were being paid to people who had died;
- 564 cases of public sector employees and pensioners either fraudulently claiming housing benefits or receiving them in error;
- 215 cases of housing benefit overpayments to students; and
- 53 cases referred to the Procurator Fiscal and 32 employees who have been dismissed, disciplined or who resigned as a result of the initiative.

123. Inverclyde Council has shown good commitment to the NFI exercise and systematically followed up data matching leads provided to them. Overpayments identified at 31 December 2005 amounted to £95,000 and ongoing investigations throughout 2006 has resulted in additional overpayments of some £83,000 being identified to date.

124. Audit Scotland is working with the Audit Commission to widen the scope of the NFI during 2006/07. Public bodies will provide information again in October 2006 and will have fresh information to investigate in early 2007. The council should ensure that it continues to use the opportunities presented by the NFI on an ongoing basis to assist in the detection of fraud.

125. Each year Audit Scotland gathers information on fraud and irregularities in Scottish public sector bodies. For 2005/06, the council identified and reported two minor cases of theft of computer equipment from its schools.

126. Since the end of the financial year one notable case of benefit fraud was identified and prosecuted by the council. This has recently received good coverage in the local press. The fraud was discovered as a result of the vigilance of the benefit processing staff. The council's benefits fraud team investigated and established that a fraud amounting to a minimum of £21,000 had taken place. The perpetrator was prosecuted and is currently awaiting sentence. All officers involved in obtaining the prosecution of this individual, in particular the benefits processing staff involved, are to be congratulated on their efforts.

Governance outlook

127. Inverclyde Council had made excellent progress over the two years to 2004/05 in implementing a comprehensive and coherent risk management strategy. Momentum was lost on this important element of governance in early 2005/06 following the departure of the two officers, the director of



corporate services and the chief internal auditor, who were driving the process. In addition the focus of the council was concentrated on the implementation of the post best value audit improvement plan.

128. There is a clear acknowledgement at member and senior officer level of the importance of risk management. The council's interim chief internal auditor has been remitted to regain the momentum and re-establish a corporate approach to risk management. Some progress has been made, for example, the service risk register format has been redesigned and training for officers and members has been provided by the council's insurers.

129. The council faces a challenging task to regain momentum and embed risk management as a governance tool throughout the organisation. The responsibility for corporate risk management falls within the remit of the new corporate director of performance and improvement.

Action Point 10

130. The local government elections of May 2007 see the introduction of proportional representation and multi-member wards. These changes to the democratic processes have significant implications for the political make-up and governance of the council. In making the changes, one of the Scottish Executive's stated intentions is to remove barriers and encourage the widest possible range of people to serve as councillors. These reforms will impel the council to consider its governance arrangements including committee structures, role/remits of members and arrangements for training new members to ensure that they are best suited to the new circumstances.

Action Point 11

131. Many of the assets that the council deploys to deliver services have a significant capital costs and continuing revenue costs associated with them, for example, regular maintenance. In order to achieve best use of its scarce resources and achieve the greatest benefit the council needs to carefully plan, using where appropriate, options appraisal techniques, the deployment of owned assets and new purchases. A robust asset management planning and evaluation process, linked to capital budgets is considered to be the best way of ensuring best value in the use of the council's financial resources and demonstrating that capital spending is affordable, sustainable and prudent. The council embarked on an asset management planning system in 2004. This is still being progressed via a "modernising government" funded development; however, there has been some delay caused in part by the council's re-structuring process over the past year.

Action Point 12

132. The council's arrangements for pursuing unpaid rent have been the subject of critical comment from both internal and external audit in each year of our five year engagement. A further deterioration of the council's rent arrears position is noted for 2005/06. The amount of rent outstanding as a percentage of net rent collectable has increased from 17.9% in 2004/05 to 18.9% in 2005/06.



Year	Total arrears £ million	Current tenants rent arrears as a percentage of net rent due.	Former tenant rent arrears £'000 £ million
2002/03	1.971	12.7%	0.936
2003/04	2.321	14.8%	1.232
2004/05	2.751	17.9%	1.579
2005/06	3.041	18.9%	1.649

133. The scale of the arrears level has a real cost to the council. At current levels, using an interest rate of 4.75% and assuming an acceptable level of current tenant arrears to be 7%, the annual cost to the council of funding the excess is estimated to be over £40,000. The trend needs to be arrested and reversed. The proposed stock transfer may relieve the council of the task of pursuing these debtors. However, should the transfer not proceed, allowing the position to deteriorate further will make it more difficult to collect outstanding debts and to reverse what now appears to be a developing culture of non-payment.

Action Point 13



Financial statements

Introduction

134. In this section we summarise key outcomes from our audit of the council's financial statements for 2005/06. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues.

135. We audit the financial statements and give an opinion on:

- whether they present fairly of the financial position of the Council and its expenditure and income for the period in question; and
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

136. We also review the statement on the system of internal financial control by:

- considering the adequacy of the process put in place by the chief executive, chief financial officer and corporate management team to obtain assurances on systems of internal control; and
- assessing whether disclosures in the statement are consistent with our knowledge of the council.

Overall conclusion

137. The financial statements are the means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the council and for publication. We have given an unqualified opinion on the financial statements of Inverclyde Council for 2005/06.

138. The council's unaudited financial statements were submitted to the controller of audit prior to the deadline of 30 June. The working papers prepared in support of the final accounts were generally good, and together with the nomination of principal accountants as points of contact, this enabled the audit to progress smoothly. This reflects a trend of continuing improvement over the five years of this audit engagement.

139. This was the first year of the mandatory preparation of group accounts. The finance service adopted a methodical approach to the process for identification and preparation of the group accounts. The group accounts presented complied with the minimum requirements of the SORP and its supporting



guidance. We were, however, of the opinion that the overall structure and presentation could have been improved. A set of group accounts and notes prepared by another council, which we considered to be a significantly better presentation was provided to the council and we encouraged officers to consider redrafting the group accounts into this format. This suggestion was declined. At a time when the council is facing scrutiny of its performance and should be exploring every means possible to demonstrate its commitment to continuous improvement, it is disappointing that the opportunity was not taken to adopt best practice.

Accounting practice

140. In accordance with normal audit experience a number of errors were identified in the accounts submitted for audit. None of the errors identified were either individually or cumulatively material to the accounts. The chief financial officer elected to amend the accounts for those errors which, even though not material in the context of final accounts, he regarded as significant. The one exception to this was a misstatement which, to have corrected, would have had a repercussive impact throughout the accounts and consumed a disproportionate amount of resources to correct. With this one exception, the chief financial officer took the view that the remaining uncorrected misstatements were neither material nor significant.

Provision for equal pay

141. A provision of £5 million in respect of equal pay has been included in the 2005/06 accounts. Under accounting rules these costs require to be recognised in full during 2005/06, based on the best estimate of final costs.

142. The initial calculation indicated that the total costs of an agreed settlement to be of the order of £3.9 million, including costs in respect of legal advice. These costs were approved by the council on 25 May 2006. To date some £3.6 million has been disbursed to claimants. Around 60 individuals have declined to accept the package offered by the council. These cases may ultimately proceed to tribunals. The chief financial officer has informed us that he estimates that this could cost a further £300,000 - £500,000. In addition, he is of the view that further equal pay claims will arise and the balance of the provision is to be retained to meet any further claims.

Debt restructuring costs

143. Lender option borrower option (LOBO) arrangements 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.



144. Over the last four years the commercial money market has become increasingly competitive with new products such as LOBOs being of particular interest to councils as an alternative form of long term borrowing. Although LOBOs do not fully provide the guaranteed long term interest rate stability of Public Works Loan Board (PWLB) fixed rate maturity loans, longer term stability has improved in recent years with longer call intervals, and loan maturity now available up to 60 years.

145. There is currently a debate over the appropriate accounting treatment of LOBOs. One issue is whether the characteristics of a LOBO requires any premium arising from replacing existing PWLB debt to be recognised immediately rather than over the life of the replacement borrowing. A secondary issue is whether interest should be charged according to the actual debt profile or smoothed over the loan period.

146. The council had eight LOBO contracts totalling £62.9 million and a total of £3 million of rescheduling costs relating to the use of LOBOs on its balance sheet as at 31 March 2006. The council's accounting policy is to recognise the cost of premiums arising from all debt restructuring, including that involving use of LOBOs, over the full life of the replacement borrowing. As stated in the representation letter signed by the chief financial officer his approach has been taken because the council considers that the overall economic effect of the original and the replacement borrowing is substantially the same. In reaching this view the council has considered:

- the definition of the term "overall economic effect" offered by the ACOP 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; and
- the expectation that the loans will run to maturity.

147. Following discussions with Audit Scotland's technical services unit, the treatment of the premium in relation to LOBOs has been reviewed. From our review of the position in Inverclyde, we have satisfied ourselves that the overall economic effect of writing off the premiums over a shorter period than currently used, where there is more certainty over interest rates, compared to the current period of write off, would not have a material impact on the financial statements.

Unspent grants as deferred balances

148. The accounts include, as part of creditors, some £4.5 million relating to unspent grants and other unspent balances carried forward at the year end. In previous years a significant proportion of this would have been included as part of the general fund and earmarked as appropriate. This change of policy has the effect of inflating the creditors figure on the consolidated balance sheet whilst causing an apparent reduction of the general fund reserve.



149. It is our view that, in accordance with proper and transparent accounting practice, these balances should more correctly be shown as part of the closing general fund balance and earmarked for use in 2006/07.

150. In discussion with colleagues we took the view that the letters from the Scottish Executive approving the carry forward of some of the grants involved were open to interpretation in accounting terms. In addition, various technical authorities are currently discussing the accounting treatment of grants in a wider context and this is likely to impact on local government accounts in the future. I have not required that the accounts be changed for these grants this year.

Fixed assets

151. During the course of the audit, three parcels of land which had not been previously included in the council's asset register were identified as having been sold. This precipitated some doubts as to the completeness of the council's asset register. Officers performed an exercise to identify similar assets which may have been excluded. We concluded that the exercise was sufficiently thorough to identify any other such assets excluded from the register. A number of similar sites were added to the asset register as a consequence and the valuation of one site was corrected.

152. Although the overall impact of the exercise was to increase the net book value by only some £90,000, the chief financial officer elected to restate the fixed asset totals and notes to the consolidated balance sheet to reflect the changes. Officers have advised that procedures are to be issued to ensure that where sites become vacant, the keeper of the asset register is informed of this and an appropriate valuation provided.

153. No intangible assets have been separately identified in the balance sheet. The council owns intangible assets in the form of software licences. We are advised that the council's IT service is preparing, for 2006/07, a comprehensive inventory of the council's software and a valuation for these assets will be included in the 2006/07 balance sheet. The council's chief financial officer has taken the view that the value of the council's intangible assets will not represent a material addition to the council's fixed asset total.

Statutory trading accounts

154. The Local Government in Scotland Act 2003 requires councils to maintain and disclose trading accounts for significant trading operations, which are required to break-even over a three year rolling period. Inverclyde Council has three statutory trading accounts and all trading operations made aggregate surpluses for the three years to 31 March 2006.



155. One statutory trading account, vehicle management, incurred a deficit of £53,000 for the year.

However, because the deficit is less than the aggregate of the surpluses made in the preceding two financial years the trading account achieved its statutory financial target. The operation of the trading account should be reviewed and a business plan put in place to mitigate the risk of failing to meet the statutory financial objective in future years.

Action Point 14

Heat with rent scheme

156. The council operates a “heat with rent scheme” through which heating is provided to council dwellings for an extra charge to the tenant. The council provides the fixed plant and equipment, for example, boilers and piping, and arranges bulk contracts for the provision of fuel from suppliers. Where council dwellings on this scheme are sold under right to buy legislation, owner occupiers also participate in the scheme for an annual payment.

157. In 2005/06 a charge of some £645,000 was made to the housing revenue account (HRA) in respect of the heat with rent scheme. This charge had been described as a subsidy in a report to the environmental and regeneration committee of 13 December 2005 which subsequently approved the charge. We questioned whether this charge to the HRA was consistent with the provisions of Schedule 15 of the Housing (Scotland) Act 1987. An analysis of the charges made was provided, which were justified to us in terms of the HRA paying for the financing and maintenance of heating plant and equipment as part of the normal maintenance of its council housing stock. The council has acknowledged that the heat with rent scheme requires to be revised to ensure that there is a clear and unambiguous understanding of the charges to be met by participants and the HRA.

Housing services – repairs to council dwellings

158. Building services provides the repair service in respect of council dwellings to housing services.

Charges for this work are made by reference to a schedule of rates which is updated each year by the application of contractually specified published indices. Both services operate different software packages for the administration of the repairs service. During the course of our audit testing we established that housing services had not indexed their version of the schedule of rates. Although the charges made to the HRA are (correctly) on the basis of the indexed building services schedule of rates, the situation gives us some cause for concern as it militates against housing services maintaining sound budgetary control over a significant proportion of its annual expenditure.



Legality

159. Each year we request written confirmation from the chief financial officer that the council's financial transactions accord with relevant legislation and regulations. Review of significant legal requirements are also included in our audit programmes. The chief financial officer has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the chief executive and corporate management team, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.
160. The Community Care & Health (Scotland) Act 2002 was given royal assent in March 2002 and legislated for a number of improvements in care services including new provisions in relation to free personal care. Over the past year there has been continuing press coverage and questions in the Scottish Parliament on two aspects of the implementation of the legislation by councils. In summary these are:
- the powers of councils to make charges for the preparation of meals; and
 - the practice of some councils operating waiting lists for residential care.
161. We have been advised by officers that Inverclyde Council does not make charges for the preparation of food or operate waiting lists for residential care.
162. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work. As discussed previously in this report, the council has, under legal advice, recognised that it may have been in breach of the act and sought to limit its exposure to the consequent financial risk by offering compensation packages and recognising the cost in the 2005/06 accounts. Until the single status agreement is implemented, however, there remains the possibility that the council could be found to have been in breach of the act.
163. There are no additional legality issues arising from our audit which require to be brought to members' or the controller of audit's attention.

Financial reporting outlook

164. The council's capacity to produce its annual financial statements and supporting documents to an acceptable standard by the 30 June deadline has increased considerably over the course of this audit engagement. It is our view, however, that the efforts of finance services are, to some degree, dissipated by the lack of attention to final detail. Notwithstanding the more professional presentation of the final volume for 2005/06, the standard of narrative within the accounts could be considerably improved. We have previously, informally, recommended that the council surveys other sets of accounts and adopts best practice in terms of narrative and presentation. It remains our view



that further “easy wins” are available to the council in presenting itself, through the annual financial statements, in a slick, modern and professional manner.

Action Point 1

165. Nevertheless the council is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. The chief financial officer and his team have a record of responding positively to audit issues and changing accounting practice.

166. A number of significant changes have been made to the 2006 SORP. These include:

- changes to the single entity statement of accounts which include the replacement of the traditional consolidated revenue account with an income and expenditure account; a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit; and the replacement of the statement of total movement in reserves with a statement of total recognised gains and losses;
- similar changes to the housing revenue account; and
- parallel changes to the group accounts to provide a common format to the single entity statements of account.

167. The changes are being introduced to seek to make the financial statements of local authorities more consistent with the accounts of other public and private sector entities. These fundamental changes to the primary accounting statements will have a significant impact on the presentation of the 2006/07 annual financial statements. The council should take this opportunity to review the presentation of its budget and monitoring information to members to ensure that financial planning and reporting are aligned to allow clear and transparent monitoring of management activity and service delivery by those responsible for the governance of the council.

Action Point 15

168. Further ahead, there are proposed changes to the application of financial reporting standards (FRS) 25 and 26 in 2007. These standards will require the premium on loans that have been re-scheduled by the council to be charged to revenue expenditure in full in the year of re-scheduling rather than being written off over the period of the replacement loan, which can be up to 40-50 years. Every council will be affected by these charges of potentially millions of pounds to the revenue account and the impact this could have on council tax. Directors of finance have been talking to the Scottish Executive about legislation or regulation which would remove this risk of increasing council tax through the application of accounting practice. Audit Scotland has been participating in this debate and will continue to be involved in trying to find a solution to this matter.



Change of external auditor

169. Regular rotation of auditors is required by auditing standards and is an important component in guarding against perceived or actual threats to auditors' objectivity and independence. Audit Scotland's policy is to rotate auditors at least once every five years. Where the audit is carried out by Audit Scotland staff rather than a private firm, the engagement lead and other key staff will be rotated.
170. This is the final year of our current appointment to the audit of Inverclyde Council. From 2006/07 Audit Scotland will remain as the council's appointed auditor and the new engagement lead will be Peter Tait. Our relationship with management and members over the last five years has been cordial and constructive. Our approach has been to offer objective and constructive criticism whilst maintaining an open dialogue with senior officers in an effort to facilitate and assist in the change process which has been ever present in the council during our tenure. The change of auditor represents an opportunity to build on existing good practice and further strengthen the council's accountability reporting arrangements.

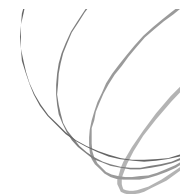


Final Remarks

171. The members of Inverclyde Council are invited to note this report. We would be pleased to provide any additional information that members may require.

172. We have made a number of recommendations in the various reports we have issued during the course of the year and have obtained assurances from officials that action will be taken as appropriate. Attached to this report is a list of significant matters arising from the audit which we consider to be of particular interest to members.

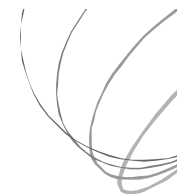
173. This is the final year of a five year appointment. I would like to take this opportunity to express my appreciation for the assistance and co-operation provided by officers and members of the council during the course of the audit appointment.



Appendix A: Action plan

Key risk areas and planned management action

Action Point	Risk Identified	Planned Action	Responsible Officer	Target Date
1	Performance reporting does not convey adequate information on the council's actual position. The council fares badly in inter-authority comparisons by stakeholders.	Improvements to these documents will be reflected in the 2005/06 Performance Report and 2005/06 Published Accounts.	Corporate Director, Improvement and Performance	December 2006
2	Absence of a comprehensive performance management framework makes monitoring of progress difficult.	Covered in Financial Strategy Audit	Corporate Director, Improvement and Performance	March 2007
3	Ineffective monitoring of capital plans lead to uncorrected slippage impacting on the council's ability to provide services.	Covered in Capital Strategy Audit	Corporate Director, Regeneration and Resources	April 2007
4	Lack of reporting clarity inhibits effective monitoring.	Covered in Capital Strategy Audit	Corporate Director, Regeneration and Resources	February 2007
5	Integrated service provision through effective partnership working is hampered by uncoordinated budgeting and lack of funding from partners.	Initial work has been undertaken in this regard and further detailed discussions will take place with partners to develop new Financial Management arrangements.	Chief Executive	June 2007
6	The council will be unable to replace the Scottish Executive's assumed savings if it does not create offsetting efficiencies.	Covered in Efficient Government Position Statement Audit	Corporate Director, Improvement and Performance	February 2007
7	The council is unable to adequately demonstrate that claimed efficiencies are valid.	Covered in Efficient Government Position Statement Audit	Corporate Director, Improvement and Performance	February 2007



Action Point	Risk Identified	Planned Action	Responsible Officer	Target Date
8	The cost of single status substantially increases payroll costs.	Detailed proposals will be concluded by the end of January to be factored into the budget process.	Chief Executive	January 2007
9	Continued temporary management arrangements adversely impact on the ability of the internal audit service to deliver quality services.	Options are being developed and will be considered as part of the Performance and Procurement Service restructuring.	Corporate Director, Improvement and Performance	April 2007
10	The council is unaware of or not taking mitigating action to reduce the risks it faces.	Risk Management agenda is being progressed and next phase is being developed.	Corporate Director, Improvement and Performance	May 2007
11	The council's governance arrangements do not fit with the post May 2007 proportional representation elections.	Covered in 18 month Management of Change Action Plan	Chief Executive	May 2007
12	The council is not using its assets in the most efficient and effective way in delivering its corporate objectives.	Covered in Financial Strategy Audit	Corporate Director, Regeneration and Resources	June 2007
13	The council loses all rent arrears outstanding on the transfer of housing stock. The housing stock transfer does not go ahead and the arrears position is more difficult to recover. A non-payment culture is developing.	A comprehensive write off programme will be undertaken in 2006/7 and agreement will be reached with RCH over treatment of debts at point of transfer.	Corporate Director, Environment and Community Protection	June 2007
14	The vehicle management trading account does not achieve its statutory financial objective in future years.	Detailed review of fleet management policy will be undertaken and impact on trading account will be factored in.	Corporate Director, Environment and Community Protection	March 2007
15	Monitoring by members is made difficult by a lack of alignment between the financial statements and approved budgets.	A review of how to better align budgets/ financial reporting will be carried out as part of the review of new political management arrangements.	Head of Finance	June 2007