

Financial Review

- The Council made a deficit of £6.1m for the year (previous year — surplus of £1.2m). (See 2.1)
- General Fund Reserves are now £10.8m (previous year - £16.7m). (See 2.2)
- The Council have reached agreement with staff representatives on equal pay. (See 2.4)
- The Council decided to proceed with a proposal in respect of a PPP project, with a build cost of £56m to rebuild and refurbish schools, against Chief Officer advice. (See 2.5)
- The financing of proposed Flood Alleviation Schemes will have a significant impact on future finances. (See 2.7)

Financial Statements

- We have issued an unqualified audit opinion on the financial statements. (See 3.1)
- The Council have prepared group accounts for the first time for 2005/06. (see 3.4)
- Two of the Council's significant Trading Operations failed to achieve their statutory financial target. (see 3.5)

Corporate Governance

- The Council have made progress with implementation of their Risk Management policy. (See 4.1)
- The Council has made progress with the National Fraud Initiative. (See 4.9)

Performance Audit

- Audit Scotland has issued a critical report on progress with Best Value. (See 5.2)
- We assisted HM Inspectorate of Education in carrying out a review of progress following the 2003 report on the education functions. (See 5.4)

Action Plan

Four recommendations are made:

- *The Council should continue to monitor progress and slippage in respect of their capital plan.*
- *The Council should consider whether the trading operations which are in deficit, represent Best Value.*
- *The Council should continue to monitor progress with the Best Value and Community Planning Improvement plan.*
- *The Council should continue to monitor progress with implementation of agreed action arising from the Education Inspection report.*

Acknowledgement

This is our final year as auditors of the Moray Council. We take this opportunity to thank the staff of the Council for assisting and co-operating with us during the course of our work.

The purpose of the financial review is to consider the general financial standing of the Moray Council by looking back at financial performance in 2005/06 and to look ahead to the future financial position. Our review is aimed at helping Council members understand the financial position of the Moray Council at a particular point in time. It should not be regarded as definitive or comprehensive and the Council should not seek to rely on this summary in isolation.

Contents:

- **Financial Performance 2005/2006**
- **Reserves**
- **Financial Plan 2006/07**
- **Single Status and Equal Pay**
- **PPP**
- **Capital Expenditure**
- **Flood Alleviation Scheme**
- **Accounting Treatment of Premiums Incurred on the Early Repayment of Debt**

2.1 Financial Performance 2005/06

The Consolidated Revenue Account (CRA) for the year ended 31 March 2006 shows a deficit for the year of £6.1m (previous year — surplus of £1.2m). The general fund total carried forward is now £11.8m (previous year £17.8m). Council policy is to maintain a minimum of £6m in the General Fund as a working balance.

When comparing the performance with the previous year we note that there was an increase in Net Operating Expenditure of £15m (representing approximately a 9.8% increase). This has been funded primarily from:

	Increase £m	% Increase
Revenue Support Grant	6.0	7.1
Council Tax	2.2	7.3
General Fund Reserve	5.9	-

2.1 Financial Performance 2005/06 (cont'd)

The Council originally approved the budget in February 2005. Further commitments were made during the year as follows:-

	Council Approved	£m
Budget	February 2005	155
From Reserves	July 2005	4.1
Additional RSG		1.6

		160.7
Net Expenditure per CRA		162.7

Overspend against planned expenditure		2 =====

This overspend represents 1.2% of net expenditure.

This reconciles to the deficit in the accounts as follows:

	£m
Planned deficit (i.e. utilisation of reserves)	5.3
Additional income from RSG and Council Tax	(1.2)
Overspend	2.0

Deficit per accounts	6.1 =====

2.2 Reserves

Movement on General Fund Balance

In general, the use of surplus balances is restricted to non-recurring projects, to avoid placing reliance on excess funds, and to smooth out irregular patterns of expenditure. In his report to members in February 2005, on the Financial Plan 2005/08, the Chief Financial Officer recommended a minimum working balance of £6m.

Actual balances for the previous 31 March were established in June 2005 and the Council was asked to consider the level of reserves and their application in July. Balances on reserves were also reconsidered as part of the preparation of the 2006/09 Financial Plan in February 2006. (see 2.3)

	£m
Balance at 31 March 2005	17.8
Less: Earmarked Balances	(0.9)
Approved in July 2005	(4.1)
Anticipated deficit 2005/06	(1.2)

Anticipated balance at 31 March 2006	11.6
Overspend per 2005/06 Accounts less additional income	(0.8)

Actual Closing balance (excluding earmarked balances)	10.8
	===

2.2 Reserves (cont'd)

Utilising the General Fund Balance

When considering the draft Accounts for 2005/06 at the meeting in July 2006, the Council agreed to carry forward previously approved projects totalling £3.3m, and additional projects of £1.2m to be met from reserves. This leaves a balance of £0.3m uncommitted in the General Fund.

	£
Balance at 31 March 2006	10.8
Approved in July	(4.5)

Balance available	6.3
	===
Target Balance	6.0

Surplus	0.3
	===

The Chief Financial Officer in his report on the accounts highlighted the potential of significant financial risks in respect of the implementation of single status and equal pay settlements (see 2.4) the requirements of Efficient Government savings, and the increased demand for Community Care services.

He also referred to the council's significant commitments in respect of Flood Alleviation projects and the need for substantial investments in the Schools estate.

2.3 Financial Plan 2006/09

The Council's Financial Plan for 2006–2009 was presented to the Council on 9 February 2006.

In November 2005 the Chief Financial Officer presented a report on Reserves to all members and this was considered by the Service Development Group (comprising the Chairs and Vice-Chairs of the service committees). This concluded, on the basis of known balances at 31 March 2005, and recent Revenue Monitoring reports, that reserve balances of £2.4m would be available for non-recurring expenditure.

In his report the Chief Financial Officer notes the commitment to Flood Alleviation Schemes and the potential for substantial Equal Pay Claims. He concluded that 'the use of reserves to support Revenue expenditure (currently £1m per year) cannot be sustained'.

2.4 Single Status and Equal Pay

In 1999 an agreement was reached between the Scottish Local Government Employers and the Trade Unions to introduce a new national (Scottish) agreement on terms and conditions and to merge the negotiating machinery for administrative and manual workers (i.e. single status).

The new arrangement allows for a significant element of local negotiation which did not exist under the previous agreement. The original intention was to introduce the new "single status" terms and conditions in 2002, but this was delayed. Because of the scope for local negotiation no "deadline" was put in place but a revised target for implementation during the year commencing 1 April 2004 was agreed. One of the difficulties, and, paradoxically, one of the drivers of single status implementation is the Equal Pay Act 1970.

2.4 Single Status and Equal Pay (cont'd)

Implementation of single status involves job evaluation. If two differing posts are rated as equal under job evaluation, but one has historically attracted a higher rate of pay, then the Council could be at risk to claims for equal pay which may be backdated. Recent court cases in the public sector in England have confirmed the reality and potential cost of this risk.

In March 2005 the Policy and Resources committee agreed that the Council should seek a negotiated settlement of the equal pay issue, in conjunction with the implementation of single status.

The Council have reached agreement with the main staff representatives and have made payments to staff under the Equal Pay legislation at an estimated total cost of £5m.

The Council are close to agreeing the single status element of the legislation which will have an ongoing annual cost of £5m plus.

2.5 PPP

The Moray Council approved the submission of an Outline Business Case (OBC) to the Scottish Executive in February 2004. This provided for the construction of three new schools (2 primary and 1 secondary) and the refurbishment of one secondary school.

The build costs were estimated at £40m, with an annual charge to the Council of £4.9m over 30 years.

In December 2004 the Council received notification of a conditional offer of funding from the Scottish Executive. Also in December 2004 the Council appointed external consultants to the project team. The consultants carried out a financial and technical re-appraisal of the project which forecast increased costs resulting in an "affordability gap" commencing at £1.8m in year 3 rising to £5.2m in year 30.

As a result of this, and other considerations, the original plan was reduced to a preferred option to build two new schools (one secondary and one primary). This proposal was submitted for public consultation.

Following the consultation, on the recommendation of the Educational Services Committee to depart from the previous decision and to provide two secondary schools. The estimated build cost of this proposal is £56m. This decision was taken against clear advice from the council's chief officers, including the Chief Executive, Chief Financial Officer, Director of Educational Services, Chief Legal Officer and Monitoring Officer.

The Council has a statutory duty under the Local Government in Scotland Act 2003, to secure Best Value in the use of resources. It is for the Moray council to demonstrate that this is achieved.

2.5 PPP (cont'd)

Due to the delays in finalisation of this project we have passed over responsibility to the incoming auditors, Audit Scotland, and their PPP team. We understand that they have already commenced reviewing the affordability and Value for Money aspects of the project.

2.6 Capital Expenditure

We reported in previous years on the trend of slippage (i.e. underspend) in respect of the approved Capital Programme. This has continued in respect of the General Services element of the plan:-

	Budget £m	Actual £m	Under- spend £m	%
2001/02	11.5	10.4	1.1	9.5
2002/03	13.4	11.8	1.6	11.9
2003/04	15.0	11.5	3.5	23.3
2004/05	24.2	19.1	5.1	26.5
2005/06	23.4	20.4	3.0	12.8

This indicates that the trend of slippage in the last few years has been slowed.

The capital budget comprises three main elements monitored by three separate committees. (see overleaf)

2.6 Capital Expenditure (cont'd)

	Monitored by	Budget at start of year £m	Slippage identified in year £m	Other in-year movements £m	Revised Final Budget £m	Actual £m
General Service	Policy and Resources Committee	20.5	- 9	4.8	16.3	12.5
Flood Alleviation	Flood Alleviation Sub Committee	5.9	- 3	-	2.9	3.9
Housing	Community Services Committee	4.4	-	- 0.2	4.2	4.2
		30.8	- 12	4.6	23.4	20.4

This indicates that slippage from the original plan has been high (33.7%). However this has been identified through in-year monitoring and is explained for specific projects in these monitoring reports.

We understand that, in future, the Flood Alleviation and General Services will be reported in aggregate to the Policy and Resources Committee.

Recommendation

The Council should continue to monitor progress and slippage in respect of their capital plan.

2.7 Flood Alleviation

Following a series of serious floods in Elgin in 1997, 2000 and 2002, the Council resolved, in their Corporate Plan 2001-2004, to provide "a comprehensive flood alleviation scheme for Moray".

The Chief Financial Officer's (CFO) report on the financial plan for 2006/2009 forecasts a total cost of £148m for a number of schemes including those at Elgin, Forres and Rothes.

Grants of 80% are anticipated leaving a balance of £29.7m to be met by the Council. Of this approximately half (£14.9m) is to be met by utilising all of the Council's Capital fund reserve. The remaining £14.8m is planned to be funded from borrowing. This could result in additional Council Tax increases of 3% in 2008/09.

The Council recognise that these schemes represent the biggest capital works ever undertaken in Moray. Clearly rigorous project management will be required to ensure that these schemes deliver the intended benefits on time and on budget.

The Council has established a Flood Alleviation Sub-Committee which receives progress reports every two months.

2.8 Accounting Treatment of Premiums Incurred on the Early Repayment of Debt

The Council's balance sheet at 31 March 2006 includes £10.1m relating to premiums paid by the Council incurred on the early redemption of debt which was replaced as part of debt restructuring exercises in previous years. Of this amount £3m relates to restructures where fixed interest rate loans were replaced with similar fixed rate loans (albeit at a lower rate of interest) whilst £7.1m relates to restructures involving fixed interest rate loans being replaced by Lender Option Borrower Option loan agreements (LOBOs).

The 2005 SORP allows premiums on the early repayment of debt to be amortised to revenue over the period of the replacement loans when the repurchase is coupled with a restructuring or refinancing of borrowing and the overall economic effect is substantially the same. This treatment is an exception to the standard accounting treatment set out in FRS4 which requires immediate recognition of the premium. The SORP itself does not provide a definition of the term 'overall economic effect', and the SORP guidance notes provide the only extant working definition i.e.

- the size of the authority's overall loan portfolio remains approximately the same; or
- overall finance cost should remain approximately the same.

The Council has relied upon this definition and concluded that, on this basis, LOBOs have substantially the same overall economic effect as fixed interest rate loans. The council has therefore followed the exception allowed by the SORP and is amortising the premium over the life of the replacement loans.

2.8 Accounting Treatment of Premiums Incurred on the Early Repayment of Debt

Notwithstanding the definition in the SORP guidance notes, in our view, there are strong arguments for concluding that the overall economic effect or fixed rate loan is different from that of a LOBO. However, there is a lack of reliable evidence to conclusively support that view and therefore there is no impact on our opinion on the 2005/06 accounts in that regard.

It will be necessary for this issue to be considered by the incoming external auditors in 2006/07. However, the adoption of new accounting standards by the SORP from 2007/08 will mean that, in the majority of cases, the option to amortise premiums will be removed. It is however intended that regulations or statutory guidance will come into force that will mitigate the impact of this change on council tax.

The respective responsibilities of the Council, and Tenon Audit are summarised in Appendix 2. The purpose of this section of our report is to highlight and explain our formal opinion on the financial statements, and to comment on the main issues arising from our audit of the financial statements.

Contents:

- **Audit Opinion**
- **Timetable and Procedures**
- **FRS17**
- **Capital Accounting**
- **Trading Operations**
- **Group Accounts**

3.1 Audit Opinion

We have issued an unqualified audit opinion on the accounts of The Moray Council for the year ended 31 March 2006. A copy of our audit opinion is attached to this report at Appendix 1.

3.2 Timetable and Procedures

The timetable for the production of the Council's annual accounts is:-

- the Council needs to submit accounts by 30 June following the year end.
- we are required to conclude our audit by 30 September following the year end.

In order to achieve these deadlines the accounts preparation procedures require good planning, commitment, and resources.

We discussed plans for the preparation and audit of the accounts with the Chief Financial Officer and key staff in a series of meetings commencing in December 2005. A series of weekly meetings were held to monitor progress on the audit.

We are pleased to report that the audited accounts were submitted to the Controller of Audit by the due date of 30 September 2006. We are grateful to all of those in the Finance and other departments who helped to achieve this.

3.3 FRS 17

We reported in previous years on the introduction of Financial Reporting Standard 17 (FRS 17). This FRS relates to Accounting for Pension Scheme Contributions and Liabilities, particularly in respect of defined benefits schemes (i.e where the employees entitlement to a pension is dependent on factors such as final salary, and length of service).

The effect on the financial statements is disclosed in note 8 to the Consolidated Revenue Account and note 12 to the Consolidated Balance Sheet.

We have reviewed the preparation and disclosure of pensions information and are satisfied that this is in accordance with actuarial information and the disclosure requirements of the Code of Practice.

3.4 Capital Accounting

We reported in previous years on the requirements of the Code of Practice on Local Authority Accounting in the United Kingdom, in respect of capital accounting. We reported that we considered that improvements could be made in the recording of information in respect of assets, which would ensure that the capital accounting requirements were met, but more importantly would assist in developing a corporate approach to the management of Council assets.

Since that time the issue of management of Council assets has been given a greater prominence by the introduction of the Prudential Code (see 2.5). This is intended to give the Scottish Executive the comfort that Local Authorities have made appropriate plans for the management of their assets, and funding of additions and improvements, whilst giving greater freedom to the Authority.

In 2006 the Council's Asset Management Working Group was given the task of progressing arrangements for a Corporate Asset Management plan. The approach adopted was to develop corporate aims and objectives, and identify categories of assets for which separate plans would be developed. Two priorities were the School Estate Management Plan (SEMP) and the Housing Standard Delivery Plan.

As part of the overall process condition surveys have now been completed for all of the Council's operational property.

3.4 Capital Accounting (cont'd)

In a report to the Policy and Resources Committee in March 2006, the Chief Financial Officer reported that £10m of work would be required over the next 5 years to bring these properties to an acceptable condition. Over £1.5m would be required in year 1 to address urgent Health and Safety and / or legislative issues.

This report also proposed a vision statement and corporate objectives, together with a detailed action plan.

This plan aims to provide a full Corporate Property Asset Management Plan by September 2007, which will be incorporated into the 2008-11 financial plan.

3.5 Trading Operations

The Local Government in Scotland Act 2003 repealed the Compulsory Competitive Tendering (CCT) legislation and effectively abolished D.L.O's and D.S.O's. However, the 2003 Act now has a requirement for Local Authorities to disclose trading accounts for each of its "significant trading operations", and for those operations to break-even over a three year period.

The Chartered Institute of Public Finance and Accountancy (CIPFA) and the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) jointly produced guidance on the implementation of the requirements of the 2003 Act.

The Chief Financial Officer reported to the Policy and Resource Committee on 31 March 2004, following an extensive exercise to identify and assess all of the Council's trading activities. This identified a total of 33 trading activities of which 7 were considered to be significant in terms of the guidance. All of these were formerly DLO / DSO operations. It was also agreed that the remaining three former DLO / DSO operations be maintained as internal trading accounts (i.e. not disclosed in the accounts).

We reviewed the process the Council undertook in this exercise and were satisfied that they had carried out the review of trading operations in accordance with the CIPFA / LASAAC guidance.

During the three years to 31 March 2006 the seven trading operations continued to be considered significant in terms of the guidance.

3.5 Trading Operations (cont'd)

The 2003 Act requires that each operation break-even over a three year period.

Two of the seven operations (Catering; and Cleaning) failed to achieve this.

This required an additional paragraph in our formal audit opinion of the financial statement.

The council may wish to reconsider whether the use of these Trading operations represents Best Value.

Recommendation

The council should consider whether the trading operations which are in deficit, represent Best Value.

3.6 Group Accounts

The requirement to prepare 'group' accounts has existed in the commercial sector for a number of years. Requirements in respect of Local Authorities have been less stringent until now. The Code of Practice for Local Authorities in the United Kingdom (the ACOP) now contains modified requirements for the preparation of group accounts for the year ended 31 March 2006.

This represented a major exercise in establishing:

- entities in which the Council has an interest
- Those which fall to be accounted for as a subsidiary, joint venture or simple investment

The council's conclusion was that they had four 'associated' entities:

- Grampian Fire and Rescue Joint Board
- Grampian Police Joint Board
- Grampian Valuation Joint Board
- Moray Leisure Ltd

As a result Group Accounts were prepared and the Common Good Fund and Trust Funds maintained by the council were incorporated.

We reviewed these accounts as part of our audit.

Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. The respective responsibilities of the Moray Council and Tenon Audit are summarised in Appendix 2.

This section of our report comments on the main aspects of our work, and highlights particular issues which arose.

Contents:

- **Statement on Corporate Governance**
- **Risk Management**
- **Internal Audit**
- **Systems of Internal Control**
- **Management Letters**
- **Grant Claims**
- **The National Fraud Initiative in Scotland**
- **Other Governance responsibilities**
- **Follow-up of 2004/05 Action Plan**

4.1 Statement on Corporate Governance

The Council have included in their financial statements, a statement on Corporate Governance. This follows on from the adoption of a local Code of Corporate Governance by the Council in March 2003. The statement clearly sets out the Council's arrangements under each aspect of the code, and is a valuable enhancement of public accountability.

Although we are not required to form an opinion on the adequacy and effectiveness of the Authority's Code of Corporate Governance, we are required to report where a statement does not comply with the requirements of ACOP or other guidance, or if it is misleading or inconsistent with other information of which we are aware.

In our opinion the statement is not misleading or inconsistent with other information which we are aware of from our other audit work.

4.2 Risk Management

Although the term "Risk Management" has become relatively common recently, the underlying principles —of identifying and assessing risks and taking action to minimise their occurrence and impact, are well established. The Council's Standing Orders, Financial Regulations, and Internal Audit functions are all examples of policies and procedures which address potential risks. However, it is now generally recognised that this process needs to become explicitly established as part of a management culture, and requires the implementation of consistent best practice through formal policies and procedures.

We reviewed progress on the Council's Risk Management Framework and made recommendations for improvement in our Interim Management Letter of April 2004.

We followed up progress in implementing the agreed actions from this management letter as part of our 2005/06 audits. Of the nine agreed actions, four had been implemented; four were in progress; and one had still to be implemented.

The Team Leader —Internal Audit had been tasked with progressing these actions but had been unable to make much progress until an additional staff member, with specific responsibilities for assisting with Risk Management, was appointed in May 2005.

We have reported this follow-up exercise as a separate Management Letter.

4.3 Internal Audit

We adopt a managed approach in planning our audit work at your Council. This means that we work closely with Internal Audit and place formal reliance on their work. This avoids duplication of effort and means that we can both direct our resources where they are most needed.

Our relationship with Internal Audit is governed by the International Auditing Standard ISA610 "Considering the work of Internal Audit".

It is the responsibility of management to determine the extent of the internal control system required. Internal Audit is an important element of the internal control system.

Wherever possible we use the work of the internal auditor to assist us in our assessment of the effectiveness of the internal controls in the Council's main financial systems. We review internal audit reports and use the work of the internal auditor to plan our work and to inform our own risk assessment. However, to enable us to rely on the work of Internal Audit, we need to be satisfied that the audit work has been properly planned, controlled, performed, recorded and reviewed in accordance with the Internal Audit Standards and ISA 610.

We are pleased to confirm that we were able to derive the planned assurance in the areas examined and that the Internal Audit Service was carried out generally in accordance with the Code of Practice for Internal Audit in Local Government.

4.3 Internal Audit (cont'd)

In 2005/06 we placed reliance on assignments carried out by Internal Audit in the following areas:-

- Accounts payable (part)
- Benefits (part)
- Year end Stocktakes
- Performance Indicators
- Payroll (part)
- Debtors (part)

4.4 Systems of Internal Control

The respective responsibilities of the Council and ourselves as auditors and a summary of the systems covered during the year, are set out at Appendix 2.

Through the results of our own testing, and our reliance on areas examined by Internal Audit, we have concluded that the fundamental key financial systems of the Council are generally operating satisfactorily.

We have made suggestions for improvements to procedures, where appropriate, in management letters (see Section 4.5)

4.5 Management Letters

It is our practice to send interim management letters to the Council's management during the audit year which report, principally, on weaknesses in internal control. Our recommendations have generally been responded to positively and appropriate action has or will be taken by the Council.

A summary of management letters issued to date is set out below:

Interim Management Letter	Date issued in draft (all 2006)	Action plan agreed (all 2006)	Reported To Audit Committee (all 2006)
Interim 1 Interim 2 (Follow up on Risk Management)	April August	August October	(scheduled for December 2006 meeting)

A further management letter will be issued following the conclusion of our final accounts work.

We expect the Audit and Performance Review Committee to monitor the implementation of the Action Plan which forms part of the management letter.

4.6 Grant Claims

As appointed auditors, we also have a duty to audit and certify various grant claims and returns during the year. A summary of the status of the work is shown at Appendix 3.

4.7 The National Fraud Initiative in Scotland (NFI)

In 2005/06 the Council took part in the National Fraud Initiative in Scotland. The exercise forms part of the Council's audit and involves assistance from officers in Audit Scotland and the Audit Commission, who process the information collected for the exercise. Among other things, NFI aims to help identify and reduce fraud by bringing together data from councils, police and fire boards and other agencies, to help detect a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. If the exercise is approached appropriately and little or no such fraud is identified, assurances can be taken about internal arrangements for preventing and detecting fraud.

The NFI 2005/06 results (data matches) were distributed to the Council on CD-Rom in late January 2005 and participating bodies are required to follow up the matches, as appropriate, and provide savings returns reporting progress made as at 31 May 2005, 30 September 2005 and 31 December 2005. We monitored the Council's involvement in NFI 2005/06 during the course of the audit.

4.7 The National Fraud Initiative in Scotland (NFI) (cont'd)

Moray Council are committed to this exercise and supplied the data for matching to the Audit Commission within the required timescale. A notice was printed on the payslips for all Council staff advising them about the National Fraud Initiative. The Revenues Manager, Fraud Officer and the Deputy Payments Manager were given access to the initial review of the data and passed cases to the Fraud Officer and Deputy Payments Manager.

The highest priority matches were examined first, with staff working through the information available to ascertain whether cases required further investigation. The Council have reported to the Audit Commission for the period to 31 May 2005. The Council are continuing to review cases and report on these to the relevant Council Committees.

4.8 Other Governance responsibilities

Prevention and Detection of Fraud and Irregularities

The respective responsibilities of the Council and ourselves as auditors are set out in Appendix 2. During the year, we have reviewed the overall arrangements through our transactions testing and our review of systems.

The Council also has in place an Anti-Fraud and Corruption Strategy, and a Confidential Reporting (whistle-blowing) policy.

In overall terms, we are satisfied that these arrangements are adequate.

Legality

Again, the respective responsibilities of the Council and ourselves as auditors are set out in Appendix 2.

Our review of the Council's transactions and arrangements has revealed no areas of concern.

Standards of Conduct, Integrity and Openness

We have reviewed the Council's arrangements which include:-

- A Register of Members' Interests and information regarding their appointment to outside bodies and organisations.

We have commented on this in the Following the Public £ follow up report.

4.9 Follow-up of 2004/05 Action Plan

We made four recommendations in our 2004/05 Report and Action Plan. A detailed update is provided at Appendix 4.

In summary, each of the recommendations have been satisfactorily actioned although action in respect of the Education Inspection report is ongoing.

The Local Government in Scotland Act 2003 imposes a duty to secure Best Value. The Local Government (Scotland) Act 1973 gives the Accounts Commission the right to initiate examinations into the economy, efficiency and effectiveness in the use of resources.

The wider dimension of the public sector audit requires that the audit process gives consideration to the way in which the Council secures economy, efficiency and effectiveness in its use of resources. These terms are frequently referred to under the generic term Value for Money. Achievement of Value for Money depends on the existence of sound management arrangements, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources.

Contents:

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- **Best Value**
- **2005/2006 Performance Audit Programme**
- **Following the Public Pound**
- **A Teaching profession for the 21st century**
- **Education Inspection**
- **Performance Indicators**

5.1 Overall Arrangements

The wider dimension of the public sector audit requires that the audit process gives consideration to the way in which the Council secures economy, efficiency and effectiveness in its use of resources. These terms are frequently referred to under the generic term Value for Money. Achievement of Value for Money depends on the existence of sound management arrangements including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources.

The Local Government in Scotland Act 2003 introduced the statutory duty on local authorities to secure best value. Included within the requirements is the need for the local authority to have regard to efficiency, effectiveness, and economy in maintaining an appropriate balance between:

- The quality of performance functions
- The cost to the authority of that performance
- The costs to persons of any service provided on a chargeable basis.

Our duty is to review the arrangements made by the Council in discharge of this statutory obligation. We do this by reviewing the progress made in implementing the Best Value framework, and also reviewing the effectiveness of arrangements made by the Council over a range of activities. We also review and assess the statutory performance indicators which the Council are required to publish each year.

Where appropriate, we have made recommendations where we considered arrangements could be improved. The most significant of these are summarised in this report.

5.2 Best Value

We reported in previous years on the new arrangements for the audit of Best Value by the Accounts Commission. The main features are:

- Audits will be carried out on a cyclical basis (i.e once every three or four years)
- Transitional audit work will be carried out prior to a Council's first full Best Value audit and in between full audits.

Moray Council were not one of the seven authorities selected for the full audit in the first year, but were selected as part of the second year's group.

We assisted the study team from Audit Scotland on their work. The final report was issued in February 2006. The main points of the report are summarised below.

The Commissions findings are summarised as follows:

- The Council has lacked effective corporate leadership and direction.
- A lack of reliable performance management information.
- That there are a number of requirements which the council will have to meet if it is to deliver Best Value by continuous improvement of the services it provides.

5.2 Best Value (cont'd)

The main report highlights the following:

- The Council has a long way to go to respond to its statutory duties on Best Value.
- Sound management practices such as performance monitoring and checks on the competitiveness of services have been weak.
- There are signs that things are beginning to change.
- The Council has not had clear strategic direction in the past.
- Most of the key elements of Best Value, such as effective performance management and scrutiny, have been missing from the way the Council is organised to deliver services.
- It is not possible to provide a full picture of the standard of services being provided by the Council.

The report also identified examples of good practice:

- staff management has a relatively lean structure
- Absence rate is low
- Long established staff appraisal system

The Council prepared and agreed a Best Value and Community Planning Improvement Plan in April 2006.

The Chief Executive reported progress to the Policy and Resources Committee on 30 April 2006. This found that of the 51 actions, 14 had been completed, 20 were on target and 8 had missed their target date for completion

The Chief Executive explained that this was because the consultation and approval process had taken longer than anticipated.

Recommendation

The council should continue to monitor progress with the Best Value and Community Planning Improvement plan.

5.3 2005/06 Performance Audit Programme

The Accounts Commission is the statutory independent body which is responsible for securing the external audit of local authorities in Scotland. They also have a responsibility to:

- Review the management arrangements which audited bodies have in place to achieve Value for Money
- Carry out national Value for Money studies to improve the economy, efficiency and effectiveness in local government

Each year the Accounts Commission through Audit Scotland advise us of any local performance audit studies to be carried out. In 2005/06 there were no studies with a local involvement.

As part of the 2005/06 Performance Audit work we followed-up the agreed action from our local report in "Following the Public Pound" in December 2005. This found that, of the 13 agreed actions, 2 had been completed, 9 were in progress and 2 were still to be implemented. We have issued a separate management letter detailing our findings.

5.4 Education Inspection

We reported last year on the inspection of the Council's education function in 2003. We assisted HM Inspector of Education (HMIE) in their review.

The inspection reviewed the following areas of the service:

- Strategic management of the service
- Consultation and communication
- Operational management
- Resource and financial management
- Performance monitoring and continuous improvement

The inspection identified a number of key strengths:

- The approachability of the members of the Directorate and centrally-employed staff
- The very good arrangements for Support for Pupils
- The quality of financial reporting
- ICT provision and the associated training to improve learning and teaching in schools
- The range of approaches to communication, including the use of ICT

5.4 Education Inspection (Cont'd)

The main points for action identified by the inspection were:

- The Directorate team should provide clearer strategic direction, improve the policy framework and increase their involvement in school improvement activities.
- More focused steps should be taken to raise attainment, particularly in primary schools, and at S1/S2 and S5/S6 in secondary schools.
- Arrangements for quality assurance should be improved to ensure better targeted support and challenge to schools and departments.
- Audit arrangements should be improved and clearly quantifiable improvement objectives identified in service planning.
- The management of resources should target areas of need and improvement more effectively.
- Further steps should be taken to develop consultation with a wider range of stakeholders.

Eighteen tasks were identified and the Council set up nine working groups with a membership of Councillors, the Chief Executive, Education Officers, Head Teachers from different schools, a Parent Representative, union representation from teaching and support staff and the external consultant. The working groups developed action plans to ensure that the eighteen tasks are achieved within the specified timescales and comply with the relevant success criteria.

5.4 Education Inspection (Cont'd)

An interim follow-up visit was carried out in February 2005. The interim report noted that 'a number of positive steps had been taken', but that 'there remained considerable scope for elected members to further improve the targeted use of resources'. The interim report concluded that 'Overall, in the year since the original inspection the authority had established a range of positive initiatives which were beginning to have a positive impact on educational provision'.

A further review was undertaken in December 2005. The report was issued in May 2006. This report identified the progress which has been made with each of the main action points.

Recommendation

The Council should continue to monitor progress with implementation of agreed action arising from the Education Inspection report.

5.7 Performance Indicators

The Local Government Act 1992 placed a duty on the Accounts Commission for Scotland to direct relevant bodies to publish information in the form of performance indicators. The Accounts Commission issue an annual direction in December which covers the next financial year. This direction requires that information in respect of Performance Indicators is published, in a prescribed format by 30 September following the financial year-end.

External auditors are required to assess the reliability of performance indicators as (a) or (x), where (a) represents data which appears to be reliable and (x) represents data which appears unreliable. There is also a requirement to identify items which have not been reported as "Failed to Report" (FTR).

We have given an (a) grading to all indicators published, with the exception of two which have been reported as (x).

The collection of this information has been improved by the appointment of performance staff in the service areas. There are however, still difficulties in getting staff to prepare and retain working papers to support the data they submit. Staff should also identify the reasons for major movements between years.

Adult Social Work Indicator 3

We are pleased to report that all areas were classed as (a) this year with no (x) classifications.

Para Ref	Recommendation	Responsible Officer	Agreed Action	Timescale
2.6	The Council should continue to monitor progress and slippage in respect of their capital plan.	Chief Financial Officer	Continue to develop planning arrangements to separate approval and provisional projects. Establish a 5-year capital plan.	February 2007
3.5	The Council should consider whether the trading operations which are in deficit, represent Best Value.	Director of Environmental Services	Best Value Reviews are being undertaken for Cleaning and catering.	January 2007
5.2	The Council should continue to monitor progress with the Best Value and Community Planning Improvement plan.	Chief Executive	Continue to monitor progress against the improvement plan.	February 2007
5.4	The Council should continue to monitor progress with implementation of agreed action arising from the Education Inspection Report.	Director of Educational Services.	The HMIE follow-up report published in February 2006 was a very positive Report. HMIE indicated a continuing Interest in the management of the School Estate and the Attainment agenda and requested an update report in February 2007.	February 2007

Independent Auditors' Report

To the members of Moray Council and the Accounts Commission for Scotland

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

Respective responsibilities of the Chief Financial Officer and Auditors

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

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

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

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

We read the other information published with the financial statements, and consider whether it is consistent with the audited financial statements. This other information comprises only the Statement of Accounting Policies, and Statement of Responsibilities for the Accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Independent Auditors' Report (cont'd)

Basis of audit opinion (cont'd)

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

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

Opinion

In our opinion:

- the financial statements present fairly, in accordance with applicable laws and regulations and the 2005 SORP, the financial position of the local authority and its group as at 31 March 2006 and its income and expenditure for the year then ended; and
- the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1073.

Failure to comply with a statutory requirement

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

Local authorities have a duty under Section 10 of the Local Government in Scotland Act 2003 to conduct each of their significant trading operations so that income is not less than expenditure over each three year period. The authority failed to comply with this statutory requirement for the three year period ending 31 March 2006 in respect of the following significant trading operations:

- Catering
- Cleaning

Tenon Audit Limited
10 Ardross Street
Inverness IV3 5NS

29 September 2006

Financial Statements

It is the responsibility of the Moray Council to:-

- *Ensure the regularity of transactions by putting in place systems of internal control.*
- *Maintain proper accounting records.*
- *Prepare financial statements which present fairly the financial position of the Council and its expenditure and income in accordance with the ACOP.*

We are required to give an opinion on:-

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

In carrying out this responsibility we provide reasonable assurance that, subject to the concept of materiality, the financial statements:-

- *Are free from material misstatements.*
- *Comply with the statutory and other requirements applicable.*
- *Comply with relevant requirements for accounting presentation and disclosure.*

Corporate Governance

Corporate Governance is concerned with structures and processes for decision making, accountability, control and behaviour at the upper levels of the organisation. Three fundamental principles apply:-

- *Openness*
- *Integrity*
- *Accountability*

We have a responsibility to review and, where appropriate, report findings on the Council's corporate governance arrangements as they relate to:-

- *The Council's review of its systems of internal control including its reporting arrangements.*
- *The prevention and detection of fraud and irregularity.*
- *Standards of conduct and arrangements in relation to the prevention and detection of corruption.*
- *The financial position of the Council.*

Our work has focused upon our review of the Council's Risk Management arrangements, systems of internal control, Internal Audit, consideration of the controls to prevent and detect fraud and corruption, and the audit of the final accounts.

In giving an opinion on the accounts our audit strategy requires us to ensure that the fundamental financial systems are adequately covered each year. Whenever possible, to avoid duplication of effort, we seek to rely on the work of Internal Audit.

However, our work cannot cover every financial activity and accounting procedure. We plan and perform our audit to give reasonable assurance that the financial statements are free from material misstatement and that they comply with statutory and other requirements.

Risk Management

The Council's Responsibility

It is the responsibility of the Council to identify and address its operational and financial risks and to develop and implement proper arrangements to manage them, including adequate and effective systems of Internal Control.

The Role of Tenon Audit Limited

In planning our audit, we consider and assess your risk management arrangements as part of our assessment of audit risk. This helps us to tailor our audit plans so that they are both appropriate to your circumstances and directed to the areas of greatest risk.

Systems of Internal Control

The Council's Responsibility

The Council has a responsibility to develop and implement systems of internal control, including risk management, and systems of financial, operational and compliance controls.

Three components of a system of risk management are:-

- Timely identification of key business risks.*
- Consideration of the likelihood of the risks crystallising and the significance of the consequential financial or other impact.*
- Establishment of priorities for the allocation of resources to control risk and the setting and communicating of key objectives.*

The monitoring of controls provides assurance that managers are assessing the existence of risk and the effectiveness of controls over the risks. The internal audit arrangements form an important part of management's monitoring and review of internal control arrangements, and in ensuring that appropriate monitoring of risks and controls takes place.

The role of Tenon Audit Limited

In broad terms the external auditor is expected to assess the internal controls in the Council's main financial systems and report on any significant control weaknesses identified. This does not absolve management from its responsibility for the maintenance of an adequate internal control system.

Systems of Internal Control (cont'd)

The systems reviewed during our audit were:-

- *Standards Commission Compliance*
- *Control Environment*
- *Creditor Payments (IA)*
- *Payroll (IA)*
- *Prevention of Fraud and Corruption*
- *Council Tax*
- *Benefits*
- *Non-Domestic Rates*
- *Debtors (IA)*
- *Cash Control*
- *Asset Register/Capital Accounting (as part of Final Accounts audit)*
- *Treasury Management*
- *Housing Rents*
- *Capital Expenditure*
- *Trading Accounts*
- *Budgeting, Monitoring and Reporting*
- *IS Overall Arrangements*

(IA) indicates where we were able to place reliance on work performed by Internal Audit.

Prevention and Detection of Fraud and Irregularities

The Council's Responsibility

It is the responsibility of the Council to establish arrangements to prevent and detect fraud and other irregularity. It therefore needs to put in place proper arrangements for:-

- Developing, promoting and monitoring compliance with standing orders and financial instructions.*
- Developing and implementing strategies to prevent and detect fraud and other irregularity.*
- Receiving and investigating allegations of breaches of proper standards of financial conduct or of fraud and irregularity.*

The Role of Tenon Audit Limited

External audit is required to review the adequacy of the measures taken by the Council, to test compliance, and to draw the attention of management to any weaknesses or omissions.

Legality

The responsibility for ensuring the legality of all activities and transactions rests with the Council.

The responsibility of the external auditor is to review the legality of the Council's transactions and to be aware of the requirements of statutory provisions.

Standards of Conduct, Integrity and Openness

Propriety is concerned with the way in which public business should be conducted. It is concerned with fairness and integrity. It must be recognised that the public view of propriety is as much about perception as reality.

The Council's Responsibility

It is the responsibility of the Council to ensure that its affairs are managed in accordance with proper standards of conduct. It needs therefore to put in place proper arrangements for:-

- Implementing and monitoring compliance with appropriate guidance on standards of conduct.*
- Expressing and promoting appropriate values and standards across the authority.*
- Developing, promoting and monitoring compliance with Codes of Conduct that advise Members, Officers or Managers of their personal responsibilities and expected standards of behaviour.*
- Developing, promoting and monitoring compliance with standing orders and financial instructions.*

The Role of Tenon Audit Limited

It is our role to consider whether the Council has put in place adequate arrangements to maintain and promote proper standards of financial conduct and to prevent and detect corruption. We discharge this duty by reviewing and where appropriate examining evidence that is relevant to these arrangements.

Financial Position

The Council's Responsibility

It is the responsibility of the Council to conduct its affairs and put in place proper arrangements to ensure that the financial position is soundly based having regard to:-

- *Financial monitoring and reporting arrangements.*
- *Compliance with statutory financial requirements and achievement of financial targets.*
- *Levels of balances and reserves.*
- *The impact of planned future policies and known or foreseeable future developments.*

The Role of Tenon Audit Limited

It is our role to consider whether the Council has established adequate arrangements. We are also required to have regard to going concern as part of the audit of the financial statements. In carrying out this responsibility we consider:-

- *Financial performance in the year.*
- *Compliance with statutory financial requirements and financial targets.*
- *Ability to meet known statutory and other financial obligations actual or contingent.*
- *Responses to known developments which may have an impact on the Council's financial position.*

Grant Claim or Return	Status
<i>Non Domestic Rates Income Return</i>	<i>– completed</i>
<i>Social Work – Criminal Justice</i>	<i>– completed</i>
<i>Supporting People (Replacing Transitional Housing Benefits)</i>	<i>– completed</i>
<i>Housing and Council Tax Benefit Subsidy</i>	<i>– in progress</i>
<i>ESF</i>	<i>– completed</i>

Recommendation	Agreed Action	Timescale	Progress
The Council should ensure that appropriate management skills are in place to oversee progress of the Flood Alleviation project.	The Council has recently approved a new senior post to oversee the Flood Alleviation Scheme.	Target Start Date is Dec 2005	Implemented
The Council should ensure that their Risk Management Policy is fully implemented.	A briefing will be provided to all DMT's on the Council's risk management proposals for implementation of the policy at services level. This will include development of departmental, strategic and operational risk registers.	March 2006	Ongoing
The Council should continue to monitor progress with implementation of agreed action arising from the Education Inspection report.	Agreed actions have been implemented. The follow-up inspection is due in December 2005.	Report will be issued February 2006	Ongoing
The Council should ensure that action is taken to enable full reporting of all statutory performance indicators.	Assessment forms will be changed to include a tick box to identify respite Care. A system is now developed to ensure that any significant variances are analysed fully and explanation reported.	March 2006	Implemented

Tenon audit



THE MORAY COUNCIL

**YEAR ENDED 31 MARCH 2006
FINAL REPORT OF THE EXTERNAL AUDITORS TO THE
CONVENER AND MEMBERS OF THE MORAY COUNCIL
AND THE CONTROLLER OF AUDIT**

OCTOBER 2006

Tenon audit

The purpose of this report is to give a summary of our audit activity. It includes details of the more significant matters arising from the audit, sets out the respective responsibilities of management and external audit, and reports what action has been taken or is necessary by members or executive management.

Our audit of The Moray Council for the year ended 31 March 2006 has been carried out in accordance with statutory requirements and follows the practices prescribed by the Code of Audit Practice and guidance issued by the Auditing Practices Board (APB). The Code of Audit Practice sets out fully the responsibilities of the Council and its officers in relation to financial probity, control, preparation of accounts and the achievement of value for money in the provision of services. We are required under the Code to give an independent assessment of how the Council has discharged its stewardship of public funds. A summary of our responsibilities is contained in Appendix 2.

This report is part of a continuing dialogue between the Council and ourselves and is not, therefore, intended to cover every matter which came to our attention. For this reason we do not accept responsibility for any reliance that third parties may place upon it.

We have summarised the Key Issues arising from our audit in Section One. In providing the summary, it can be difficult to strike a balance between recognising good performance when achieved and highlighting scope for improvement. The items referred to represent Key Issues for management attention and should not be taken out of the context of the remainder of this report, or the detailed reports covering individual reviews. Our responsibilities are explained in our separate "Audit Responsibilities" document and are summarised in Appendix 2.

- We invite The Moray Council to receive this report and consider the recommendations we have made.*
- We would be grateful to receive the Council's response to the issues we have raised.*

Audit Responsibilities	Summary for Council Members
<p>To audit the financial statements in accordance with part VII of the Local Government (Scotland) Act 1973.</p> <p>To review and assess whether the financial statements have been prepared in accordance with all applicable statutory requirements.</p> <p>To review and assess whether proper accounting practices have been observed in the preparation of the financial statements.</p> <p>To give an opinion on whether the financial statements present fairly the financial position of the Council.</p>	<p>Our opinion is based on our:</p> <ul style="list-style-type: none"> ◆ review of certain financial systems ◆ year end audit of the Council's financial statements ◆ assessment of Internal Audit and review of their examination of the Council's financial systems <p>An unqualified audit opinion has been given on the Council's financial statements.</p> <p style="text-align: right;"><i>See details at Section 3</i></p>
<p>To consider and assess the Corporate Governance arrangements as they relate to:-</p> <ul style="list-style-type: none"> ◆ systems of internal control ◆ prevention and detection of fraud and irregularity ◆ standards of conduct, and prevention and detection of corruption ◆ the financial position 	<p>We have reviewed the Council's arrangements for Corporate Governance, and made recommendations we consider to be appropriate.</p> <p style="text-align: right;"><i>See details at Section 4</i></p>
<p>To review and report on the arrangements for collecting, recording and publishing prescribed performance information.</p>	<p>In most areas the Council achieves good practice but we have made a number of specific recommendations arising from our review.</p> <p style="text-align: right;"><i>See details at Section 5</i></p>
<p>To review and assess the management arrangements which are designed to secure economy, efficiency and effectiveness in the use of resources.</p>	<p>In many areas the Council's management arrangements are satisfactory, but we have made a number of specific recommendations arising from our programme of Performance Audit studies in separate reports.</p> <p style="text-align: right;"><i>See details at Section 5</i></p>

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