

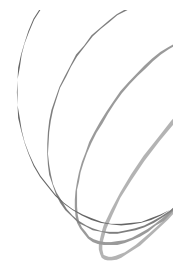
# Tayside Contracts Joint Committee

Report to Members on the 2005/06 Audit

October 2006

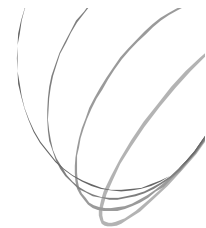


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# Key Messages

In 2005/06 we have audited the financial statements and looked at aspects of governance and performance within Tayside Contracts Joint Committee. This report sets out our main findings.

Overall, we found the financial stewardship of Tayside Contracts Joint Committee during the year to be satisfactory. The main conclusions and outcomes from the audit are highlighted below:

- An unqualified audit opinion has been issued on the financial statements for 2005/06;
- The Statement on the System of Internal Financial Control included in the accounts complies with accounting requirements and is not inconsistent with audit findings;
- Final accounts preparation procedures and working papers were good and this enabled the audit to progress smoothly;
- Many aspects of a sound corporate governance framework are in place;
- A 5-year Business Plan for the period 2006 to 2011 had been developed in conjunction with members and constituent councils that identifies future opportunities and risks;
- Anti-Fraud Strategy and Guidelines are in place.

The annual report on the work carried out by the Internal Audit & Control function concluded that “The work carried out during the year continues to demonstrate that the necessary controls are in place and that the Joint Committee can have confidence in the underlying systems of financial control and in financial service provided”.

Key issues for the Joint Committee in the future include closing the projected income gap identified over the 5 years of the business plan, specific cost pressures which may arise from the need to fund increased pension costs, implementation of the Single Status Job Evaluation exercise and falling school rolls which has an associated risk of reducing the Facilities Services workload.

This is the final year of our current appointment to the audit of the Joint Committee. From 2006/07, however, Audit Scotland will remain as the Joint Committee’s appointed auditor and Pearl Tate will continue as the engagement lead. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members of the Joint Committee over the five years of our audit appointment.

**Audit Scotland  
October 2006**

# Introduction

1. The members and officers of the Joint Committee are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
  - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed;
  - the Joint Committee's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests;
  - the Joint Committee has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability;
  - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption;
  - the Joint Committee has proper arrangements for securing best value in its use of resources.
2. This report summarises the most significant issues arising from our work during 2005/06.

# Financial statements & financial position

3. In this section we summarise key outcomes from our audit of the Joint Committee's financial statements for 2005/06, aspects of the Joint Committee's reported financial position and performance to 31 March 2006, and provide an outlook on future financial prospects and financial reporting issues.

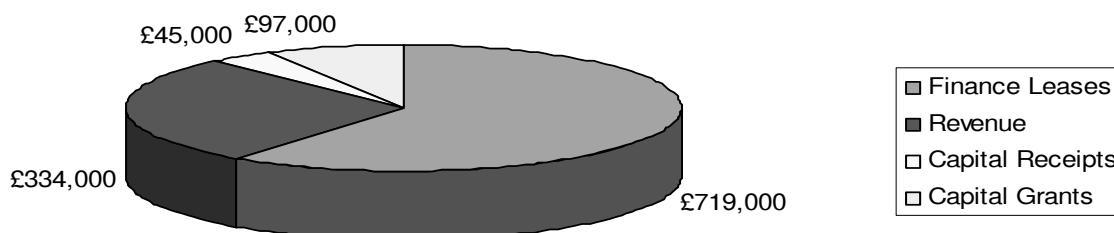
## Auditor's report

4. We have given an unqualified opinion on the financial statements of Tayside Contracts Joint Committee for 2005/06, concluding that:
  - the financial statements present fairly the Joint Committee's financial position at 31 March 2006 and income and expenditure during the year;
  - the financial statements have been properly prepared in accordance with the Local Government (Scotland) Act 1973.
5. The Joint Committee's balance sheet has an excess of liabilities over assets of £14.15 million due to the accrual of pension liabilities in accordance with accounting standards. Auditing standards require auditors to consider an organisation's ability to continue as a going concern when forming an opinion on financial statements. One of the indications that may give rise to going concern considerations is an excess of liabilities over assets.
6. The Joint Committee has considered it appropriate to adopt a going concern basis for the preparation of the financial statements as future actuarial valuations of the pension fund will consider the appropriate employer's contribution rate to meet the fund's commitments. The constituent authorities of the Joint Committee are also liable to fund the Joint Committee's liabilities as they fall due. We are satisfied that the process the Joint Committee has undertaken to consider going concern is reasonable.

## Financial position

7. The Joint Committee returned a surplus for the year of £589,000 to be distributed to the constituent councils in accordance with the profit sharing percentages approved by the Joint Committee on 8 May 2006.
8. The Local Government in Scotland Act 2003 replaced compulsory competitive tendering regulations with a duty to maintain and disclose trading accounts for significant trading operations, which are required to break even over a three year rolling period. The first three year period ended in 2005/06.

9. In the three years to 31 March 2006 the Facilities Services Trading Account made an aggregate surplus of £0.344 million, and the Construction Division Trading Accounts achieved an aggregate surplus of £1.033 million, both, therefore, met the statutory target. Both trading operations, however, face on-going pressures and management are looking at ways of closing the income gap identified in the 5-year Business Plan which was developed in the year.
10. Capital expenditure in the year totalled £1.195 million. The majority of this expenditure related to the addition of items of plant and vehicles for the Construction Division, including gritters and snowploughs for winter maintenance work, and plant items for the quarry which were purchased with the assistance of government grants from the Waste and Resource Action Programme. Capital was funded by:



## Issues arising

11. The Joint Committee's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation procedures and working papers were good and this enabled the audit to progress smoothly.
12. Audited accounts were finalised prior to the target date of 30 September 2006 and are now available for presentation to the Joint Committee and for publication. The financial statements are an essential means by which the Joint Committee accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.
13. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom —A Statement of Recommended Practice (the 'SORP'). There were a number of adjustments made to the figures in the unaudited accounts made available for public inspection. These related mainly to disclosures in the Consolidated Balance Sheet in respect of the treatment of equal pay claims totalling £6.43 million. In the unaudited accounts, the amount calculated to be paid to eligible employees was netted off against the reimbursement due from the constituent councils. The audited accounts were amended to reflect the gross figures.

14. Further matters arising from the audit of the financial statements which requires to be brought to the attention of members are summarised below.

### *Equal Pay*

15. The £6.43 million liability and associated reimbursement included in the accounts for equal pay claims to relevant staff covered a five year period up to 31 August 2006. This should only have included the costs up to 31 March 2006 with the balance for the five months to August 2006 being recorded in the 2006/07 accounts. As a result the income, expenditure, assets and liabilities are overstated in 2005/06 by approximately £500,000. It should be noted, however, that the amounts net off against each other in the Consolidated Revenue Account, Facilities Trading Account and Consolidated Balance Sheet and there is, therefore, no bottom line impact.

### *Capital Expenditure*

16. Two government grants were received in 2005/06 worth £94,000 which were used to purchase fixed assets. These grants were netted off in the 2005/06 accounts against capital funded from current revenue (CFCR) additions in the year. The SORP requires capital grants and contributions to be accounted for using a deferred credit method. To comply with the SORP, the grants should have been credited to a government grants deferred account and released to the Asset Management Revenue Account over the life of the relevant asset to match any charges for depreciation. As the total grant received was not material and no additional grants are anticipated, it was agreed that this would not be amended.

## **Legality**

17. Each year we request written confirmation from the Proper Officer that the Joint Committee's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Proper Officer has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of members and officials of Tayside Contracts Joint Committee, the financial transactions of the Joint Committee were in accordance with the relevant legislation and regulations governing its activities.
18. 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 highlighted earlier in this report, the Joint Committee has recognised a liability in the financial statements in relation to the potential contravention of this Act. Until the single status agreement (see paragraphs 23-26) is implemented, however, there remains the possibility that the Joint Board could be judged to have contravened that Act.
19. There are no additional legality issues arising from our audit which require to be brought to members' attention.



## Statement on the system of internal financial control

20. The 2005/06 financial statements include a Statement on the System of Internal Financial Control which highlights the Proper Officer's view that reasonable assurance can be placed upon the adequacy and effectiveness of the Joint Committee's internal financial control system.
21. The Statement is supported by a high level review of the adequacy and effectiveness of internal financial controls undertaken by Chief Officers. The Managing Director presented an annual report on the work carried out by the Internal Audit & Control function to the Joint Committee in May 2006 which concluded that "The work carried out during the year continues to demonstrate that the necessary controls are in place and that the Joint Committee can have confidence in the underlying systems of financial control and in financial service provided".
22. The statement complies with accounting requirements and is not inconsistent with the findings of our audit.

## Future outlook

### *Single Status*

23. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, 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.
24. 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, was extended by agreement between local authorities and unions to April 2004. To date only one council, South Lanarkshire, has implemented single status.
25. Tayside Contracts has yet to implement the agreement. At 31 March 2006, the Joint Committee had not set aside any funds for the cost of single status, although £2 million per annum has been allocated from 2006/07 onwards.
26. Until a local agreement is concluded the initial and continuing costs to the Joint Committee cannot be reliably estimated. This represents a significant financial risk to the Joint Committee. Evidence from councils is that variation in the level of potential costs can be up to 10% of the current pay-bill on a continuing basis. In securing a local agreement the Joint Committee needs to ensure it maximises the opportunity for service and job redesign to ensure that it achieves value for money from its investment in its staff.

## *Pension liabilities*

27. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. In addition, there are proposals to amend the Local Government Pension Scheme which are designed to reduce the ongoing cost, although these have not yet been 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 in the annual accounts.
28. The Joint Committee participates in the Local Government Superannuation Scheme (Tayside Superannuation Fund), a defined benefits scheme administered by Dundee City Council. Note 13 to the Consolidated Balance Sheet highlights that the Joint Committee's net liabilities at 31 March 2006 total £15.557 million, a decrease of £4.992 million from the previous year. Although the Joint Committee's estimated pension liabilities increased by £8.717 million in the year this was offset by its pension fund assets increasing by £13.709 million as a result of improved stock market conditions.
29. The full triennial actuarial valuation of the Tayside Superannuation Fund was reported in early 2006. Factors such as the volatile stock market and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 97% as at March 2002 to 91% as at March 2005. The actuary is required to make a 3-year assessment of the contributions that should be paid by the employing authorities as from April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. The current 3-year assessment shows that budgeted contributions are expected to rise from 275% of employee contributions to 315% by 2008/09.

## *Financial reporting*

30. A number of changes have been made to the 2006 SORP, including:
  - replacement of the consolidated revenue account with a traditional 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;
  - replacement of the statement of total movement in reserves with a statement of total recognised gains and losses.
31. These changes will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Joint Committee should take this opportunity to review the presentation of its budget and summary

financial results to members and the wider public to ensure that financial planning and activity is fully transparent.

**Action point 1**

# Governance



32. In this section we comment on key aspects of the Joint Committee's governance arrangements during 2005/06 and provide an outlook on future governance issues.

## Overview


33. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. In previous years we have concluded that the Joint Committee has many aspects of a sound corporate governance framework in place and have reached the same conclusion this year.
34. During 2005/06 a revised risk assessment of the Joint Committee's internal control systems was prepared and the results were reported to the Corporate Management Team in March 2006.
35. Internal audit should play a key role in the Joint Committee's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. Our Follow Up of Previous Years' Action Plans report issued in June 2006 stated that the internal control function within Tayside Contracts still did not transparently demonstrate an objective review of the systems of internal control that a properly established, and planned, internal audit function would.

## Anti-fraud and corruption arrangements

36. The Joint Committee has appropriate arrangements in place to prevent and detect fraud and corruption. These arrangements include the Councillors' Code of Conduct, Anti -Fraud and Corruption Strategy, which was approved by the Joint Committee in May 2006, along with supporting policies and guidelines and a whistle-blowing policy.

## Systems of internal control

37. A brief review of the action taken by the Joint Committee to implement recommendations agreed in our prior year reports on the following systems was carried out during 2005/06:
- Main Accounting;
  - Tendering Arrangements;
  - Internal Control Function;
  - Ordering and Certification.

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38. It was disappointing to note during this year's review that seven of the 15 outstanding recommendations had not been actioned and three had been only partially implemented. Revised completion dates for all outstanding points were agreed with management during the year.

# Performance

39. In this section we comment on key aspects of the Joint Committee's reported performance during 2005/06 and provide an outlook on future performance.

## Overview

40. The delivery of high quality and cost effective public services is a cornerstone of current government policy. Performance management and improvement involves raising the standards and quality of performance, achieving greater efficiency in the use of public funds and becoming more responsive to the needs and aspirations of both individual service users and the communities served. Performance management systems will need to be robust to handle changing requirements.

## Performance Management and Improvement

41. We undertook a follow up review of the agreed actions in our Performance Management report from 2004/05. We are pleased to report that, of the nine recommendations agreed with management in relation to performance management, eight of these have been implemented as part of the business planning for the 2006-2011 Business Plan which was approved by the Joint Committee in March 2006. In particular:
- a Business Plan Project Team of senior officers from Tayside Contracts and the constituent councils was established and will meet every six to eight weeks to review progress against the business plan;
  - four business objectives have been agreed along with performance indicators that will measure the success in meeting these objectives over the next five years;
  - Tayside Contracts joined the National Highways Benchmarking Club during 2005;
  - the planning process identified the main risks and opportunities facing Tayside Contracts over the next five years, along with the planned action to address these;
  - budgetary information provided by constituent councils was used to develop a five year financial plan. This provided a realistic financial projection, both for the business overall and by statutory trading accounts, for the medium-term and identified an ever expanding income gap from 2006/07 onwards. Tayside Contracts is being proactive in addressing this gap;
  - since 1995/96 Tayside Contracts has planned to make an annual surplus of £1 million which was then returned to constituent authorities. The 2006/11 Business Plan highlights that £500,000 of surpluses from 2006/07 onwards will be returned to constituent authorities with the balance to be used to help fund the planned capital investment programme over the next

few years and also to increase the general reserve balance to a suitable level to militate against potential financial insecurity;

- once the planned regular reporting of performance indicators to the Joint Committee and the planned expansion of information on the website is in place Tayside Contracts will have made progress in meeting its statutory duty to develop public performance reporting arrangements.

42. The only recommendation yet to be implemented related to training of members in preparation for the Local Government elections in May 2007, when the Joint Committee is likely to have new members from its constituent councils. An information pack relating specifically to Tayside Contracts should be available for any new members of the Joint Committee from August 2006.

## Future outlook

43. The 2006-11 Business Plan acknowledges the need to improve efficiency and productivity and to make best use of assets and people in order to minimise the impact of cost pressures in the next five years. The Joint Committee's progress in meeting the objectives of the Business Plan will be subject to on-going review over the next few years.

# Risk summary and action plan

No.	Issue & risk	Responsible officer	Response & agreed action	Action date
1.	<p><b>Financial reporting</b></p> <p>Changes have been made to the 2006 SORP which will have a significant impact on the presentation of the 2006/07 annual financial statements to make them more consistent with the accounts of other public and private sector entities. The Joint Committee should take this opportunity to review the presentation of its budget and summary financial results to members and the wider public to ensure that financial planning and activity is fully transparent.</p> <p><b><i>Risk: in the event of insufficient preparation, the 2006/07 financial statements may not comply with accounting requirements. Differences between financial reporting requirements and budget monitoring during the year may result in a lack of transparency for members and the public.</i></b></p>	A. Milne	<p>Training / awareness session will be arranged with CIPFA for senior Finance staff to ensure all are up to date on changes and their impact.</p> <p>Changes to reporting requirements will be built into Q3 information provided to CMT and Joint Committee.</p> <p>Format of accounts for 2006/07 will be revised and comparative figures for 2005/06 produced.</p>	<p>Dec 2006</p> <p>Jan 2007</p> <p>Mar 2007</p>