

City of Edinburgh Council

Report to Members and the Controller of Audit
on the 2006/07 Audit

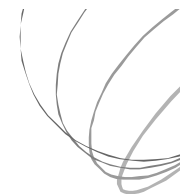


October 2007



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Key Messages

Introduction

In 2006/07 we looked at the key strategic and financial risks being faced by the council. We audited the financial statements and we looked at aspects of performance management and governance. This report sets out our main findings, summarising key outcomes in 2006/07 and the outlook for the period ahead.

Key outcomes from 2006/07 audit

We have given an **unqualified** opinion on the financial statements of the City of Edinburgh Council. The council dealt well with significant changes to the format of the accounts.

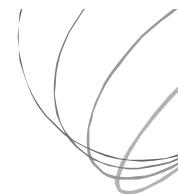
We have, however, drawn attention to a failure to comply with the statutory requirement that all statutory trading organisations break even on a rolling three year basis. For the three year period to 31 March 2007, five trading organisations failed to achieve the statutory requirement. In the case of three of these – Direct Cleaning, School and Welfare Catering and Other Catering – this was due to unplanned costs associated with the settlement of equal pay claims. BlindCraft and Refuse Collection experienced trading difficulties.

A Best Value and Community Planning audit of the council was completed in early 2007. This concluded that the council displayed many of the features of a Best Value council. In particular, the report highlighted that the council had strong and generally effective leadership, worked well with strategic partners and had invested in an extensive change programme. Services were generally improving, albeit from a low starting point in some areas.

Further improvements in performance were reported by the council during 2006/07, with around 60% of targets measured through balanced scorecards met during the year. Progress was reported in addressing a number of priorities set out in the corporate plan.

The council ended 2006/07 with virtually no unallocated balance on its general fund despite achieving planned savings of some £14 million and making a contribution of £20 million from the capital fund to cover debt repayment costs. Within the overall outturn, some services had significant overspends, most notably children and families which overspent by £9.5 million. There were particular pressures in services for vulnerable children, emergency foster care and the rising use of specialist schools. In addition, however, rising costs were not anticipated due to inadequate use of commitment accounting and failure by management to take effective action in response to monitoring information.

The housing benefits section received adverse comment on a range of issues in the Benefit Fraud Inspectorate's report published in January 2007. The service had also been experiencing a period of



backlog in processing applications leading to the diversion of resources to deal with priorities. As a result the council's response in dealing with the benefits element of the National Fraud Initiative has been slow, although steps have now been taken to progress investigations.

Otherwise, the council had generally good governance systems in place that operated well within a sound control environment. Risk management is developing with most services becoming increasingly risk aware and a high quality internal audit service continues to be provided.

Significant work has been undertaken to develop a performance management framework using the covalent system. Further work is now required to produce information which is timely, concise and meaningful and therefore more effective in assisting the decision making processes within the council.

Outlook for future audits

In the course of our work we identified some of the strategic risks that the council needs to manage in delivering its corporate objectives and priorities. These have been grouped into the following themes:

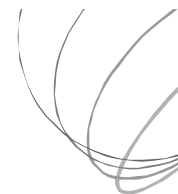
- Realising the vision, transforming service delivery.
- Sustainable and affordable use of resources.
- Improving partnership working.
- Maintaining sound governance.

The council faces serious and difficult challenges in curtailing its spending to bring expenditure back in line with available resources. This will require hard decisions to be taken in the period ahead and the Director of Finance has highlighted the urgent need for departments to consider measures to reduce service activity levels as a means of addressing significant and on-going overspends in a number of areas. A range of corrective budget measures for 2007/08 were proposed by directors and approved by the council.

Improvements require to be made in financial monitoring arrangements. Prompt action is required to ensure the availability of good quality information to assist management in dealing with its serious financial situation. It is critical that directors and other budget holders meet their responsibilities in managing service expenditure within available resources.

The council has already come through a period of significant change involving service restructuring and the re-location of staff, but clearly further change is ahead. A recent staff survey has highlighted increased concerns about job security. These are likely to prove difficult to ease as the council works to implement single status proposals and attempts to curtail overspending on the revenue budget. The council will have to manage a number of risks in relation to the morale and motivation of some staff groups and in particular, their response to service reduction proposals and the impact of overtime and recruitment restrictions.

There are a number of new councillors and a revised political governance structure is being introduced. As the new arrangements bed in, the council will need to keep their effectiveness under review and ensure



that elected members are appropriately supported, including through the provision of appropriate learning and development.

The council acted promptly to agree and publish a new corporate plan setting out its strategic objectives and priorities for 2008 - 2011. This will help ensure some clarity of purpose in the period ahead, although there is a risk that budget difficulties may limit the progress that is achievable. Now that the performance management system is established, more development is required to ensure that appropriate targets are being measured and that information is available promptly to assist in the decision making process and in managing progress against strategic objectives.

The council agreed its Best Value Improvement Plan with the Accounts Commission in summer 2007. Mechanisms now need to be put in place to monitor progress, ensuring that the impact on services and outcomes can be demonstrated.

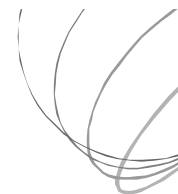
The co-operation and assistance given to us by the City of Edinburgh Council councillors and staff during the year is gratefully acknowledged.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of the City of Edinburgh Council, the first year of a five year appointment. Findings are drawn together within four sections, namely, performance, financial position, governance and financial statements. Within each of these sections we have also provided an outlook setting out key issues and concerns facing the council going forward.
2. The scope of the audit was set out in our Audit Risk Analysis and Plan (ARAP), which was submitted to the Council's Management Team and Audit Committee in spring 2007. Under the following strategic themes, the ARAP set out our views on the key business risks facing the council and described the work we planned to carry out:
 - Realising the vision, transforming service delivery;
 - Improving partnership working;
 - Sustainable and affordable use of resources; and
 - Maintaining sound governance.
3. Overall conclusions about the council's management of key risks are discussed throughout this report.
4. We also undertook several detailed exercises which resulted in separate audit reports, for example, managing financial resources and governance arrangements around Community Health Partnerships. Within this report, we highlight key messages from those separate reports for the consideration of members. Appendix A of this report sets out the key risks highlighted in this report which we wish to draw to the attention of members and the action planned by management to address them.
5. We would like to take this opportunity to express our appreciation for the assistance and co-operation provided by officers and members during the course of our audit work.



Performance

Introduction

6. In this section we summarise key aspects of the council's reported performance during 2006/07 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 carried out during the year, and the findings of national performance audit studies.

Corporate objectives and priorities

7. The council's Corporate Plan: Edinburgh 2007, covering the period 2003 – 2007, was agreed by the Council in September 2003. It sets out the vision for Edinburgh and the council's priorities. The plan was set out under ten themes, which cut across a variety of services:
 - keeping the City attractive and clean;
 - ensuring that Edinburgh remains a safe place to live, and protecting its citizens;
 - providing a stimulating environment for learning, leisure, sporting, artistic and cultural activities;
 - making sure that the City has modern effective transport arrangements;
 - supporting the local economy and developing employment opportunities;
 - supporting Edinburgh's international reputation as a place to visit and do business;
 - providing a good start for children and young people;
 - responding to people who need extra help;
 - helping people to have the homes they want; and
 - improving performance within the council.
8. A total of 110 priorities are established across these themes and a number of the more significant are listed below:
 - implement a waste management strategy and increase recycling in the city from 10% to 25% by 2006;
 - develop new ways to intervene with persistent young offenders and establish a Youth Justice Assessment Team;
 - develop plans for three tram routes in the city;
 - refurbish and build at least ten schools and two community centres;



- improve services for older people addressing delayed discharge and extending levels of respite care and short breaks for carers;
 - over 5 years, bring 5000 council houses up to the Edinburgh Standard for Housing and tackle homelessness;
 - develop a suite of performance measures covering all major areas of activity.
9. Following the May 2007 elections, the former Labour administration of the City of Edinburgh Council was replaced by a Liberal Democrat and Scottish National Party coalition. A new corporate plan 'Our Priorities 2007 – 2011' incorporating the council's vision and priorities for the next four years was approved by the new council in June 2007. The new plan continues to reflect many of the challenges from 'Edinburgh 2007'.

Overview of performance in 2006/07

Annual Report

10. In August 2007, the Chief Executive provided his 2006/07 annual report to the council. This report highlighted the council's most important achievements over the previous 12 months, outlined progress with ongoing major areas of work and identified issues to be addressed in the coming year. Key conclusions that were reported included:
- the council has undergone major change in terms of the Fit for Future investment programme, internal review and restructuring through the Council Review 2007. This included the rationalisation of office accommodation and the HQ development at Waverley Court, the formation of the new Services for Communities Department and the ongoing development of the joint Health and Social Care Directorate;
 - efficiency improvements of £20 million were made ensuring low council tax levels were maintained;
 - progress was made in the development of four new care homes which will provide 240 new places by 2009 and in reducing the problems associated with delayed discharge of patients from hospital; other significant developments included an increase in the number of social worker posts by 34 since 2005 and a reduction in the vacancy rate from 34% in 2004 to a current average of 5%;
 - agreement of new local community planning frameworks and the establishment of new Neighbourhood Partnerships;
 - recycling has risen by 4% with a significant increase in the number of households covered by garden waste collection and kerbside recycling boxes;



- the performance management framework is well established but needs to be developed, a regular process of two monthly scorecard reporting is now supplemented by broader information e.g. six monthly household surveys, statutory performance indicators and the staff survey.

Measuring Performance

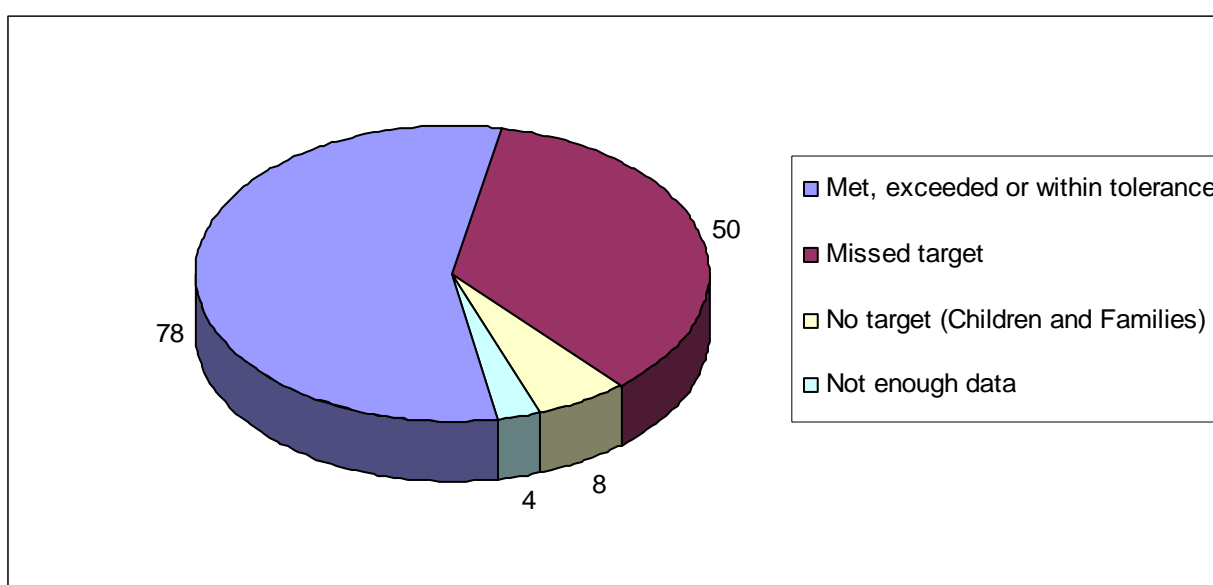
11. The council continued to develop Covalent, its performance measurement system of balanced scorecards and performance indicators. Initially, a 2 year development pilot phase was implemented which is now nearing completion. Continued development of the framework is being co-ordinated by the Performance Management Group which has representation from all services and meets regularly.
12. Performance reports are prepared every two months. These were previously submitted to the Executive and Scrutiny Panels but will now be submitted to the new Policy and Strategy and Executive Committees. The rate of progress in developing scorecards has varied across service departments as has the stability of the performance indicators used to measure and monitor progress against targets. Overall, three reports are produced covering Services, the Strategic Work Programme and Statutory Trading Organisations involving some 140 indicators.
13. Our review of the process confirmed that significant resources have been involved in the development of the framework and that extensive information is produced. We understand that a review is underway to identify improvements and to move to a thematic approach involving high level indicators aligned with corporate objectives. This will be implemented shortly to help better measure the extent to which resources are being used most effectively to address the corporate priorities.
14. While information has been submitted to the corporate management team and members in accordance with an approved timetable, this means data is being considered three months after the month to which it relates. This does not support timely decision making. There is likely to be merit in identifying a reduced number of key indicators linked with core activities and priorities which should be reported more promptly to assist the decision making process.

Key Risk Area 1



15. The following chart summarises progress over 2006/07 against the **140 targets** measured through the balanced scorecard.

Chart 1 : Achievement of City of Edinburgh Council's targets 2006-07



Total 140 indicators

16. During the year there have been some strong operational achievements but the council also faced a range of challenges. A summary of progress in relation to a number of objectives set out in 'Edinburgh 2007' is provided in table 1 below.

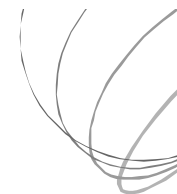


Table 1: 'Edinburgh 2007': a selection of achievements and challenges

Keeping the city attractive and clean

- EU targets require recycled waste to be 65% of municipal waste by 2015. At 31 March 2007, the council's recycled waste was just over 24%. Nationally, Audit Scotland's recent report on Strategic Waste Management confirmed that recycling rates vary across councils from 10% to 40%.
- There are insufficient facilities to treat waste that is not recycled. In March 2007, the Scottish Executive announced infrastructure funding for two council groups to develop residual waste treatment facilities. One of those groupings is made up of Edinburgh, Lothians and Borders. However, there are early indications that there is insufficient time to get these facilities in place to meet the 2013 targets.

Supporting the local economy and developing employment opportunities

- A 4% improvement in processing householder planning applications was made. More work is required to publicise the on-line system for lodging planning applications. Although a target of 12% was set, only 6% of applications were received via this route. Greater success was, however, achieved with building warrants where 20% were processed electronically. Overall, the trend is one of improvement in the service albeit it is still falling short on targets.

Making sure that the City has modern effective transport arrangements

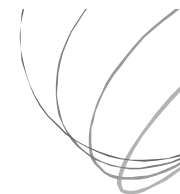
- During 2006/07, there was increased expenditure on roads maintenance and excellent performance in lighting repairs/replacements and in other priority work.

Responding to people who need extra help

- Adult social care experienced increasing demand exacerbated by the slippage in the completion of new care homes and concerns about overnight respite care. Care homes are improving and indicators confirmed that staff in care homes are better qualified and management is improving.
- The capacity of respite care for older people was reduced to accommodate some of the demand for long stay beds. However the volume of residential respite was targeted to increase to 3,500 persons but the actual volume at 31 March 2007 was 1,657, a significant shortfall.

Improving performance within the council

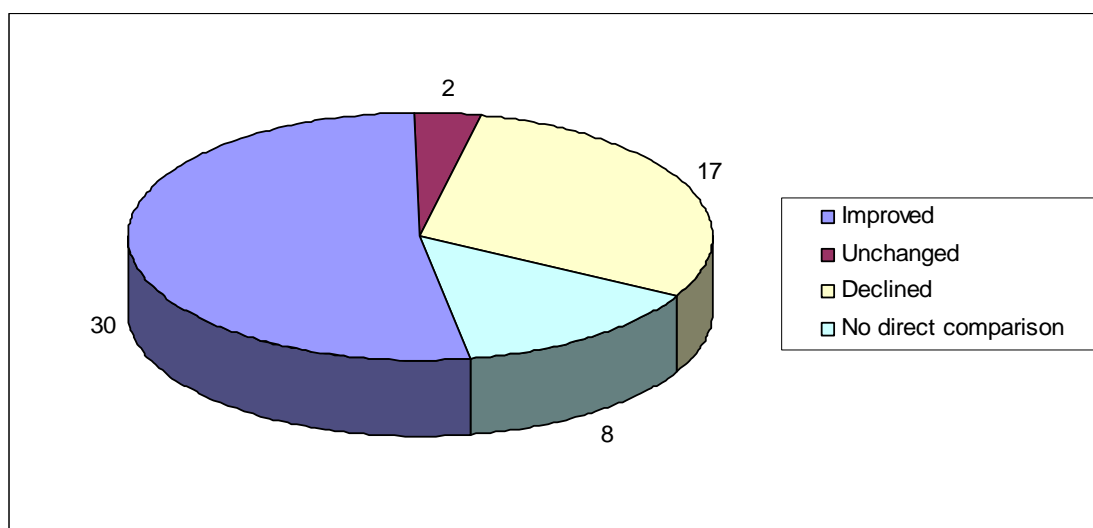
- Many services are experiencing high levels of sickness absence. For example, the statutory performance indicators showed that the absence rates for chief officers and local government employees had risen from 5.7% to 6.1% and sickness absence amongst craft employees increased from 7.0% to 8.9%. This is recognised by management and a detailed report is being prepared for submission to the Policy and Strategy Committee.



Statutory performance indicators

17. One of the ways of measuring council performance is through the statutory performance indicators (SPIs). Within the City of Edinburgh Council, key SPIs are already included within service scorecards. With regard to 2006/07, a total of **57 SPIs** were required. These were published by 30 September 2007 and were submitted to the Council's Policy and Strategy Committee. In overall terms, the following chart confirms that the council has made improvement in a number of areas, some of which are described within Table 1.

Chart 2: Improvements demonstrated by SPIs (Total 57 indicators)



18. Each year we review the reliability of the council's arrangements to prepare SPIs. Overall, the quality of working papers provided to support the SPIs was variable and we will work with the council to improve the overall arrangements. Four indicators were classified as unreliable compared with five in 2005/06. Data needs to be improved with regard to corporate management – condition of operational property; usage of swimming pools and other leisure facilities, as out of hours community use is incomplete, and library stock turnover, as the system does not yet provide complete information in terms of movements. With the exception of operational property, which was a new indicator for 2006-07, the others have been repeatedly assessed as unreliable over several years.

Key Risk Area 2

Best Value audit

19. 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 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.



20. The Best Value audit of City of Edinburgh Council was carried out in 2006 and the findings published in February 2007. Overall conclusions from the audit are included in Table 2.

Table 2 : Conclusions from the Best Value Audit – February 2007

The City of Edinburgh Council has an ambitious vision and clear strategic direction for a city which has a high national and international profile and which faces a range of challenges to continued growth, in particular in providing an effective transport infrastructure and increasing the supply of affordable homes.

The council has strong and generally effective leadership, it works well with strategic partners and has invested in an extensive change programme. Services are generally improving, albeit from a low starting point in some areas.

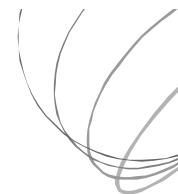
The council is aware of where improvement is most needed; it needs sustained action to improve community planning, refuse collection, planning and some aspects of adult social care. It needs to take a more strategic approach to workforce planning and longer term financial planning; and performance information needs to be used more widely throughout the council to report on the progress of strategic initiatives and projects. The council now needs to implement and further develop its improvement programme to provide a clear focus for investment and action.

21. To enable the council to focus on the elections, the Accounts Commission delayed agreement of the Best Value Improvement Plan with the council until July 2007. Review of progress against the improvement plan will be undertaken as part of future audits. Comments on a number of the areas covered by the improvement plan are provided throughout this report.

Performance outlook – opportunities and risks

Introduction

22. In the course of our audit work we identified some of the strategic risks to the City of Edinburgh Council delivering its stated objectives and priorities in the years ahead. These risks were set out in our Audit Risk Analysis and Plan and grouped into four risk themes. In the following paragraphs, we comment on the progress made by the council during the year and the key risks yet to be fully addressed. Risk exists in all organisations which are committed to continuous improvements and, inevitably, is higher in those undergoing significant change. The objective is to be 'risk aware', and have sound processes of risk management, rather than 'risk averse'. Indeed, organisations that seek to avoid risk entirely are unlikely to achieve best value.



Realising the vision, transforming service delivery

23. Significant, wide-ranging plans were put in place involving large scale organisational restructuring, a considerable transport agenda, affordable housing options and a schools rationalisation programme. During 2006-07, the council experienced mixed success in taking forward these major projects. For example:
- the council made good progress in completing its internal restructuring and relocating staff to the new Waverley Court headquarters;
 - the Administration of the new Scottish Parliament requested a review of the Edinburgh trams project and Tie's Earl Project. This ultimately resulted in an endorsement of the council's trams project but the discontinuation of the Earl project;
 - more recently, the new council administration withdrew its consultation programme with regard to the intended schools rationalisation proposals. These have now been abandoned and a new approach is required to ensure best use of educational resources;
 - there is a recognised shortage of affordable housing and while a number of units have been secured during the year, a significant shortfall remains;
 - the council's Housing Investment Plan sets out its aims to provide further social rented housing in partnership with housing associations and the work to be completed to ensure that its own stock meets Scottish Quality Housing Standards;
 - the council is currently consulting on a proposed homelessness strategy for the period 2007-12.
24. Existing plans for ambitious change have largely been endorsed by the new council through inclusion in the new corporate plan. A key concern for the council, however, is its ongoing capacity to deliver those strategic objectives against a backdrop of complex workforce tensions.
25. With recent restructuring and the move to Waverley Court, staff have experienced a period of significant change. A recent staff survey has highlighted increased concerns about job security. These are likely to prove difficult to ease as the council works to implement single status proposals and attempts to curtail overspending on the revenue budget. Overall the staff survey confirmed a substantial improvement in staff attitude since the last survey in 2003, but the council currently experiences high levels of sickness absence. It is clearly important that the council finds resolutions which will encourage ongoing improvement and ensure there is adequate capacity to deliver its strategic objectives.



Improving partnership working

26. The council reviewed its community planning arrangements, resulting in a new Local Community Planning framework. Following the May 2007 elections, 12 Local Community Planning Partnership areas were established and working practices are currently being developed. The council needs to manage the revised arrangements to ensure that opportunities are taken to accelerate the pace of community planning across the City of Edinburgh.

27. Other new partnerships are also being developed, such as the Community Health Partnerships, the South East Regional Transport Partnership and Lothian and Borders Community Justice Authority. A team of auditors drawn from Audit Scotland staff working across the NHS Lothian and City of Edinburgh Council audits identified partnership working, specifically Community Health Partnerships (CHPs), as an area for review in 2006/07. We recognise that CHPs are at an early stage of development as outlined in the case study below which summarises the results of our initial work.

Table 3 : Case study – Delivering community health in the capital

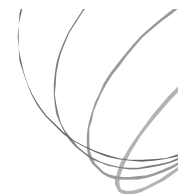
Community Health Partnerships (CHPs) were set up in April 2005 to develop community based health and social services.

A Joint Directorate of Health and Social Care was established in 2005 following the approval from the Council and the Health Board. The Joint Director assumed line management control of both Edinburgh CHPs from 1 October 2006. This created a strong structural framework in which to promote and develop shared management which was enhanced when the two CHPs were amalgamated in April 2007.

Respective internal auditors worked in partnership to prepare joint reviews of the implementation and performance of key CHP systems, e.g. single shared assessment. It is also anticipated that the proposed Healthy Living Centre in Wester Hailes will seek to maximise the opportunities for integration of health and social care services.

Now that the organisational framework is in place, the CHP needs to improve decision making processes by demonstrating how it intends to fund the continuing shift of services to a local level. While 5 year rolling financial plans are prepared by NHS Lothian which include the CHPs in overall terms, detailed budgets are only prepared on an annual basis. The CHP is therefore not yet in a position to demonstrate how the range of services included in their plans, which run for more than one year, can be provided within the resources currently available. In addition, there is a need for the CHP to work towards minimising the use of non-recurring funding to fund ongoing revenue expenditure to allow them to move forward on a sound financial basis.

Key Risk Area 3



28. Another dimension for the council is the services it delivers in partnership through companies and arms length external organisations. Increasingly, there is also an appetite to deliver more services through the use of trusts. Already some leisure services are operated through a trust and potential options for delivery of cultural, leisure and sport services continue to be explored. While these vehicles offer innovative ways of delivering services, strong governance arrangements need to be put in place to ensure that the council's corporate objectives are delivered.
29. The council is involved in a wide range of partnership opportunities, many of them in the early stages of development. It is critical that strong frameworks are implemented including good direction and leadership, robust decision making processes and agreed performance targets to ensure that the success of these arrangements can be measured.

Sustainable and affordable use of resources

30. The council continues to face serious challenges both in relation to delivery of its improvement agenda but also with regard to managing ongoing financial pressures. Significant savings were built into the 2006-07 budget and in many cases, these were achieved. Overall, however, the council experienced substantial overspends, particularly in Children and Families Services. There is a need to curtail the current level of spending and find sustainable solutions if the council is to continue to deliver its existing range of services. Difficult decisions lie ahead and there appears to be the potential for service reduction and strike action if sufficient funding options are not identified. A detailed review of the council's financial position is undertaken in the following section.

Maintaining sound governance

31. In common with many councils, the elections resulted in a new coalition administration and a high number of new councillors. This requires substantial support from officers to ensure that adequate training and development programmes are being provided. Furthermore, the council took the opportunity to review its political management structure and new arrangements were implemented in August 2007. There are additional difficulties and tensions associated with a coalition administration which members will need to address if the strategic objectives are to be delivered.
32. The council's corporate governance arrangements and the implications of the May 2007 election are discussed in more detail below in the governance section of this report.

National studies

33. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Key points from the report on Sustainable Waste Management published in September 2007 are summarised earlier in this document. Other reports of direct interest



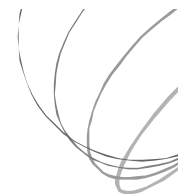
to the council are set out below. Further information on these studies and reports can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk

Dealing with offending by young people

34. Audit Scotland published reports on *Dealing with offending by young people* in December 2002 and November 2003. A follow-up study to ascertain improvements in performance of agencies was carried out during 2006/07 in the context of a changing policy landscape.
35. The key findings from the study confirmed the Scottish Government's consistent commitment to improving youth justice services by increasing funding from £235 million in 2001/02 to £336 million in 2005/06, however, the impact of this on services and outcomes could not be demonstrated. Nationally, robust outcome measures need to be established so that the impact of the additional expenditure on local needs and levels of offending behaviour can be assessed.
36. The report highlights some specific developments in the City of Edinburgh Council since the initial review in 2002:
 - prevention services now include Streetwork, maintaining young people in education, youth literacy, community programmes, Youth Action Team police officers and intensive family support services;
 - early intervention/diversion - police restorative warnings, restorative justice projects, pupil support programmes in schools;
 - persistent/ serious offending – youth justice services undertaking assessments and delivering offence –focused programmes; Lighthouse project for children with sexually problematic behaviour and Includem services for children requiring intensive levels of support.
37. In 2002, the council ran the Junction project which undertook assessments and worked with persistent offenders which involved 8 members of staff. In comparison, the above initiatives for persistent and serious offending involve 52 staff. This indicates an increasing commitment that has been made by the council to progress one of its corporate objectives.

Scotland's school estate

38. A national review of how effective recent investments in the Scottish school estate have been in terms of improving the quality of the learning and teaching environment. The performance of the Scottish Government and local authorities in improving the schools estate within the context of the 2003 strategy 'Building our Future' – Scotland's school estate will be considered. This work is currently in progress and due to be reported by February 2008.



Financial position

Introduction

39. In this section we summarise key aspects of the council's reported financial position and performance to 31 March 2007, providing an outlook on future financial prospects, including our views on potential financial risks. Our findings and key messages are set out in this section, highlighting the significant challenges being faced by the council in managing ongoing financial pressures in funding existing service delivery and future improvement.

Council tax and the general fund

Operating performance 2006/07

40. The presentation of the 2006/07 financial statements has changed significantly from previous years. They now include an income and expenditure account and a separate statement on the movement of the general fund balance, replacing the consolidated revenue account. The latter statement reflects items that require to be taken into account when determining a council's budget requirement and in turn its council tax level, as determined by statute.

41. The surplus or deficit on the income and expenditure account is the best measure of the council's financial result for the year, recognising the resources that have been consumed and generated in accordance with Generally Accepted Accounting Principles. The council's net operating expenditure in 2006/07 was £735 million. This was met by government grants and local taxation of £782 million, resulting in an Income and Expenditure Account surplus of £47 million.

42. However, the movement on the general fund balance is also an important aspect of the council's stewardship as the main budget reference point, the main differences being:

- capital investment is accounted for as it is financed, rather than when fixed assets are consumed;
- retirement benefits are charged as amounts become payable to pension funds and pensioners, rather than as future benefits are earned.

43. After adjusting for these items and following a contribution of £20 million from the capital fund for the repayment of scheduled debt principal, the council achieved a general fund surplus of £12 million. This enabled the council to begin to restore the position at 31 March 2006, when the council had no unallocated balance to fall back on and earmarked balances exceeded available balances. When this surplus is added to the amount brought forward from 2005/06, the council has a general fund balance of £21 million. The budget set for 2006/07 was based on a Band D council tax level of £1,152 with a planned contribution of £9.2 million to the unallocated general fund.



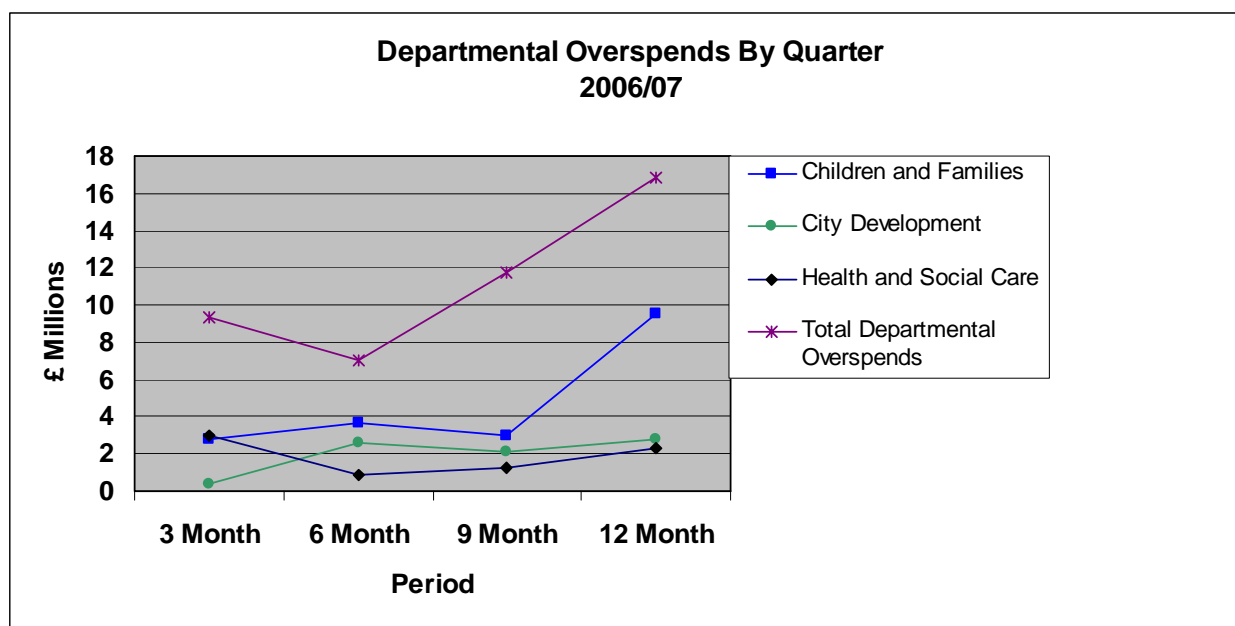
44. Despite strong warnings from the Director of Finance about the need to contain spending within budgets, the overall outturn included significant overspends for the following services:

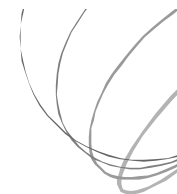
Table 4 : Significant service overspends 2006-07

- **Children and Families £9.5 million** – the anticipated management action to control expenditure in the closing months of the year did not materialise and coupled with the service’s failure to fully adopt the council’s commitment accounting system, these were significant factors in the overspend. There are particular pressures within services for vulnerable children with regard to, for example, use of voluntary organisations for emergency foster care, a rising trend in specialist school placements and the use of independent schools.
- **City Development £2.8 million** – while some of the additional costs relate to the management of the repairs and maintenance service, the majority of the overspend relates to the Fit For Future project. The scope of the project was extended resulting in additional IT infrastructure, staff costs and office accommodation.
- **Health and Social Care £2.3 million** - the overspend arose from a range of additional costs including learning disabilities staff costs, pension fund strain payments and free personal care.

45. Chart 3 below shows the projected results reported on a quarterly basis and clearly highlights the increased spending between months 9 and 12 in Children and Families and Health and Social Care. Financial monitoring issues are discussed at paragraphs 110 to 112 below.

Chart 3 : Quarterly projected overspends 2006/07





46. Outturn figures also reflect the impact of the following significant funding decisions and savings:
- an additional £5 million generated from improvements in council tax collection and a review of discounts and exemptions;
 - some £3 million of debt management savings;
 - plans are in place with BT to release £22.3 million of efficiency savings over the next ten years of which £4 million was secured in 2006/2007.

Reserves and balances

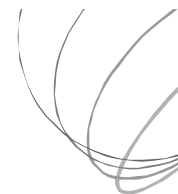
47. At 31 March 2007 the council had total cash backed funds of £52 million, including a capital fund which may be used to defray capital expenditure or repay loan principal and a repair and renewal fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets.

Table 5: Reserves and Funds

Description	31 March 2007 £ Million	31 March 2006 £ Million
General Fund	20.809	8.942
Repair and Renewal Fund	4.061	5.748
Capital Fund	27.127	3.848
	51.997	18.538

48. At 31 March 2007, the General Fund balance was £20.809 million of which £20.436 million was earmarked for specific purposes leaving an unallocated balance of £0.373 million. Earmarked amounts have been identified for devolved education management balances held by individual schools, insurances, monies from the Scottish Government for specific purposes and council tax income received in respect of second home discounts which is due to be paid across to registered social landlords.
49. The council reviews the level of its unallocated general fund balance annually as part of the budget setting process. A contribution of £9 million was included in the budget but only £3.5 million was available. At 31 March 2007, however, the actual unallocated balance was £0.4 million. Steps need to be taken to restore reserves in line with the Council's strategy.

Key Risk Area 4



Group balances and going concern

50. The widening diversity of service delivery vehicles used by local authorities means that group accounts are required to present fairly all the activities of councils. The overall effect of inclusion of all of the council's subsidiaries, associates and joint ventures on the group balance sheet is to reduce net assets by £777 million, substantially as a result of pension liabilities. All group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax.
51. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Lothian and Borders Police, Lothian and Borders Fire and Rescue and Lothian Valuation) had an excess of liabilities over assets at 31 March 2007 due to the accrual of pension liabilities. In total these deficits amounted to £1.520 million, with the council's group share being £849 million.

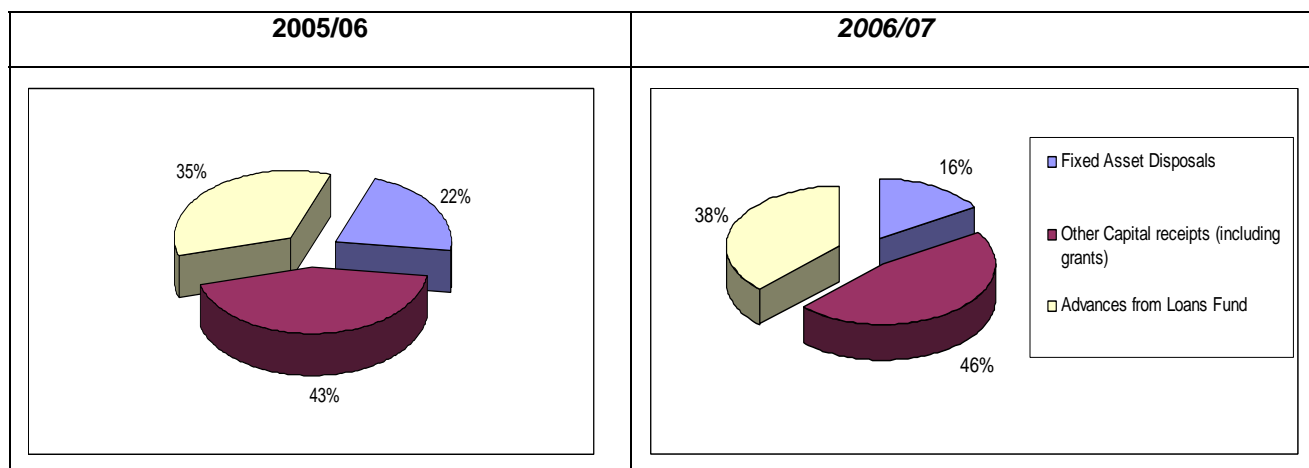
Spending on assets and long-term borrowing

Capital performance 2006/07

52. Following the introduction of the prudential code in April 2004 the council can decide locally on a capital investment strategy which meets best value requirements as well as being affordable. The council's prudential indicators for 2006/07 were set in February 2006 and significant increases in capital expenditure have been made as the council seeks to improve its asset infrastructure.
53. Capital expenditure in 2006/07 totalled £269 million, rising from £196 million in 2005/06 with significant additional expenditure being undertaken within City Development. Capital investment in the last two years was funded as shown in Chart 4. Overall, £40 million less than planned required to be funded through borrowing. While there was an underspend of £60 million against the plan, £20 million was due to an absence of funding through asset sales which did not materialise and reduced grant income. Most services experienced slippage but the main reasons were in relation to delays in acquiring sites, confirmation of funding packages and time elapsed awaiting the necessary planning permissions.



Chart 4: Sources of finance for capital expenditure 2006/07



54. Almost 93% of long-term borrowing at the year-end matures after more than 10 years. The council has actively managed its exposure to variable interest rate movements with minimum debt exposed to variable rate risk.

Forward capital programme

55. Revised General Fund capital investment programmes for 2007/08 and 2008/09 anticipate annual capital expenditure of £294 million and £46 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 £135 million over the two years.

Borrowing and temporary investments

56. In recent years, a number of councils have held significant amounts of cash and temporary investments largely as a result of decisions to take advantage of favourable interest rates when considering borrowing requirements to fund planned capital programmes. In these circumstances the early borrowing must be justified in its own right as representing the best time for borrowing the amount required. This should be assessed without regard to temporary investment possibilities, otherwise the action may be judged to be unlawful or to have subjected public money to unnecessary speculation risk.

57. As at 31 March 2007, the City of Edinburgh Council held cash and temporary investments totalling £238 million. We have requested and received a specific representation from the Director of Finance that all borrowing in advance of immediate requirements has been made for a legitimate purpose in accordance with legislation and has been on-lent in the interests of prudent cash management. In the Director's assessment any early borrowing is justified in its own right as representing the best time for



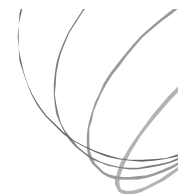
borrowing the amounts required, without regard to temporary investment possibilities and the 'profit' that might arise from these.

58. Furthermore, our review confirmed that the majority of funds on deposit at 31 March 2007 related to balances held on behalf of the pension funds and joint boards. In both cases, the council manages bank accounts on behalf of these entities. Only £41 million of the total amount represents investment of council monies.

Significant trading operations

59. 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 (STOs), which are required to break even over a three year rolling period.
60. The council has nine STOs of which five continued to return a cumulative deficit for the three years to 31 March 2007. In the case of three of these – Direct Cleaning, School and Welfare Catering and Other Catering – this was due to the impact of equal pay costs. These results mirror the outcome in 2005/06. A review undertaken by the council some time ago indicated its intention to reduce the number of STOs from 9 to 5 but this had still to be implemented at 31 March 2007.
61. One of the issues highlighted by the Best Value audit was the need for the refuse collection service to demonstrate its competitiveness. The council had decided in August 2005 to re-tender the service but following review, a transformation plan was approved by members in summer 2006 which would enable the service to make a number of improvements before any decision on tendering. Since October 2006, the service has been assisted by external management consultancy in developing and implementing a comprehensive change management programme across waste management services including refuse collection.
62. As a result, a number of refuse collection service improvements have been made, options considered and a timetable is being prepared for procurement of the service. At this stage, however, the decision has not been taken to go to tender and with current EU tendering regulations, a new contract is not likely to be in place before 2010 in any regard. The council needs to closely monitor the improvements being made in the service and the future planned developments to ensure that the service's competitiveness can be demonstrated.

Key Risk Area 5



Pension funds

63. The council is responsible for the management and administration of two pensions funds – the Lothian Pension Fund and the Lothian Buses Pension Fund. The investment assets for both funds are largely under the management of external fund managers and have been on the upward trend over the last few years as indicated by the following table:

Table 6: Pension Fund Investments

	31/03/04 £000	31/03/05 £000	31/03/06 £000	31/03/07 £000
Lothian Pension Fund*	1,837.5	2,089.0	2,855.8	3,101.6
Lothian Buses Pension Fund	131.6	144.9	188.4	196.8

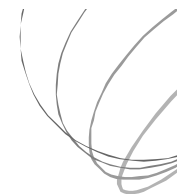
* From 2005/06, Scottish Homes became and admitted body of the Lothian Pension Fund.

64. With regard to the Lothian Pension Fund, £633 million is managed in house representing 21% of total fund investments while Lothian Buses investments are all managed externally.
65. A full actuarial valuation of both funds as at 31 March 2005 was reported in early 2006. Factors such as volatile stock markets and increasing life expectancy have resulted in the funding level for the Lothian Pension Fund, calculated as the ratio of fund assets to past service liabilities, falling from 96% at 31 March 2002 to 85% at March 2005. Interim valuations have, however, since demonstrated an improved funding position.

Financial outlook

Current budget

66. In setting the 2007/2008 budget, assumptions were included for additional efficiency savings relative to the previous year. These have proved challenging to deliver in the timescale envisaged. This combined with the unanticipated overspending in 2006/07 led to a forecasted overspend of £10 million in the current financial year. In June 2007, the Director of Finance reported on the urgent action being undertaken to address budget pressures and restore balances. This required the directors of each of the 3 overspending departments to provide action plans setting out proposals to bring expenditure back in line with budget. Also, as a precaution, other directors were requested to identify savings of 1%. He also highlighted the urgent need for departments to consider measures to reduce service activity levels as a means of addressing significant and on-going overspends in a number of areas.



67. The Director reported that the indicative budget for 2008/09 already assumed a 3.5% uplift in council tax. He estimated that a further 3 -4 % increase would be required to cover any overspending if it continues at the current level and support the restoration of general fund balance balances.
68. A range of corrective budget measures have been approved by the council and these are currently being progressed by respective service management teams. Clearly, the council faces significant challenges in ensuring that planned activity is affordable within available resources. There are likely to be significant consequences for services and staffing levels in the longer term if underlying expenditure issues fail to be addressed.

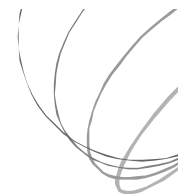
Key Risk Area 4

Equal pay

69. 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. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2005/06.
70. As detailed in our 2005/06 report, estimated costs of £22.7 million were recognised in the financial statements to deal with the equal pay legislation. A settlement offer was made to 3,000 staff in mainly female non-bonus earning manual work groups which was accepted by 2,700 staff. Known settlements in 2005/06 amounted to £15.7 million. During 2006/07, the council incurred further expenditure of £6 million linked with compromise agreements and a further £12.5 million has been reflected as a provision in the balance sheet at 31 March 2007 with regard to backdated pay claims.

Single status

71. In 1999 a single status agreement was reached between Scottish local authorities and trade 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.
72. 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.



73. Around half of Scottish councils have now implemented single status or have firm plans in place for implementation by 31 December 2007. The City of Edinburgh Council is one of a number of councils that do not expect to implement until 2008. A significant amount of work has been done in terms of job evaluation, however, until single status is implemented, the initial and continuing costs to the council cannot be reliably estimated, representing a continuing risk.

Key Risk Area 6

Efficient government

74. As part of the continuing drive to improve the efficient use of resources committed to delivering public services, the Scottish Government expects public sector organisations to apply the principles of the efficient government initiative in their day-to-day operations with an aspiration to achieve recurring efficiency gains of £1.5 billion by 2007/08. In the case of councils, efficiency savings have been incorporated into the annual financial settlement provided to councils by the Scottish Government. The principles of the efficient government initiative encourage the delivery of services for lower unit cost without compromising the quality of the service provided.
75. The council incorporated £17 million efficiency savings into the 2006/07 budget presenting itself with the challenge of confirming how achievable its assumptions were. Any failure to achieve the planned savings would increase existing financial pressures.
76. During 2006, councils across Scotland recognised that as part of their partnership arrangement with the Scottish Government, they had a responsibility to report efficiencies on the five key operational themes as set out in "Building a Better Scotland" (procurement, absence management, asset management, shared services and streamlining bureaucracy) on a consistent basis. As a result, the Improvement Service was commissioned to devise a set of standard measures which would allow councils to publish unaudited efficiency statements on a common basis. Guidance was issued to all councils in May 2007.
77. The council considered its first Annual Efficiency Statement in August 2007. This highlighted savings of £21 million spread over the different efficiency themes. These savings were a mix of cashable and non-cashable items which had not necessarily been budgeted for. Key savings included:
- in procurement, a reduction in non-catalogue spend;
 - renegotiation of the BT contract;
 - improvements in Edinburgh Building Services in partnership with external management consultants;
 - improvements in council tax and non-domestic rates services resulting in higher collection rates.



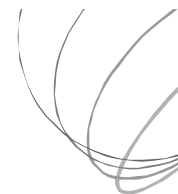
78. The council has furthermore been identified as regional lead authority with regard to the development of purchasing “hubs” as an integral part of the Scotland Excel project, the supporting rationale of which is based upon the McClelland Review. The council also received funding to lead a shared services pathfinder project which aims to identify opportunities for efficiency savings and service improvement through shared council services. The outcome from this project and the associated business case have been prepared but are not yet at a stage to be submitted to council.
79. An Efficiency Board was established, chaired by the Chief Executive, to co-ordinate monitoring activities council-wide and with the aim of making processes more systematic and embedded. Progress in achieving savings is monitored as part of the council's performance management framework through the two monthly scorecard reporting mechanism.
80. The council distinguished between efficiencies (the job is reorganised) and rationalisation (where an activity is carried out with less resource) and budgeted to save a combined £17 million. In overall terms, £14 million of this amount was achieved in cashable efficiencies leaving £3 million to be funded from existing budgets.

Pension liabilities

81. 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. A recent Audit Scotland report on public sector pension schemes highlighted that the combined funding shortfall and unfunded liabilities of the six local government pension schemes in Scotland may be as high as £53 billion. 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.
82. 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.
83. The council's estimated pension liabilities at 31 March 2007 exceeded its share of the assets in the Lothian Pension Fund by £253 million, reducing from £372 million in the previous year. The actuary was required to make a three-year assessment of the contributions that should be paid by the employing authorities from 1 April 2006 to maintain the solvency of the fund. The contribution levels are based on percentages of employee contributions, normally 5% - 6% of salary. Budgeted contributions are expected to rise from 320% of employee contributions in 2006/07 to 330% by 2008/09, reflecting the reduction in the funding level as at 31 March 2005.



84. The next full actuarial valuation will assess the position at 31 March 2008. This will determine contribution rates for 2009-10 and the next two financial years. Recent changes to the Local Government Pension Scheme regulations are expected to release some future financial benefits, while providing additional flexibility to future pensioners. For example, on retirement, members can now elect to receive a larger lump sum payment in return for a reduced annual pension which has the effect of reducing the overall cost to the pension fund. The 2005 valuation did not make any allowance for these and they are expected to be reflected in contribution rates established following future actuarial assessments.



Governance

Introduction

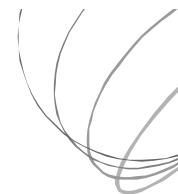
85. In this section we comment on key aspects of the council's governance arrangements during 2006/07. We also provide an outlook on future governance issues, including our views on potential risks.

Overview of arrangements in 2006/07

86. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Based on the work undertaken, we concluded that the council had systems in place that operated well within a sound control environment.
87. The council has adopted a local code of corporate governance based on best practice identified jointly by CIPFA and SOLACE. A Statement of Assurance on Corporate Governance is included within the annual financial statements and has been signed by the Leader of the Council and the Chief Executive. The management and review arrangements include an annual internal audit review of arrangements. This concluded that the Code remains relevant and the level of compliance with the Code is adequate in all areas.

Audit Committee

88. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account on service delivery and support the reform and modernisation agenda. During 2006/07, members in Edinburgh continued to have the opportunity to challenge service activities and performance through the operation of a range of scrutiny panels, including the Resource Management and Audit Scrutiny Panel which dealt with financial and governance matters. Following the May elections, an interim panel was put in place until the new arrangements were finalised.
89. In August 2007, a new Audit Committee was formed and will focus on three main themes in addition to audit - risk management, IT security and anti-fraud reporting including benefit fraud. The committee also has a wider role in terms of promoting, monitoring and developing continuous improvement. Discussions are ongoing to determine how the committee will address this requirement. It is also pleasing to note the continuity in leadership with the convener continuing to chair the new committee. In view of the high number of new members to the committee, it is important that appropriate training and development arrangements are in place. Members have already received financial training as



part of their induction, and a risk management workshop is scheduled which will result in the committee developing a risk register.

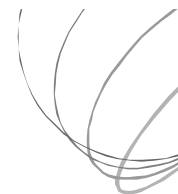
90. A review of the committee's remit and attendance at early meetings indicated that it operates in accordance with CIPFA's good practice principles for audit committees. However, we will be considering this in more detail over the course of the 2007/08 audit as the committee develops and we are in a more informed position to comment on the effectiveness of the committee. CIPFA sets out a number of good practice statements under three main principles i.e. the control environment, risk related performance, and annual accounts and the external auditor.

Internal Audit

91. The environment in which internal audit functions operate has changed markedly since the publication of CIPFA's Code of Practice for Internal Audit in Local Government in 2003. To ensure that the Code's requirements continue to be fit for purpose, CIPFA's Audit Panel published a revised Code in December 2006. In general, the Code was brought in line with existing good practice and current professional standards.
92. Such changes to the Code have expanded internal audit's role and status within the council's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system.
93. We carry out an annual review of the council's internal audit arrangements and found that the function continues to deliver quality work in accordance with a risk based framework. There was some slippage in the audit plan but all work on which we planned to place reliance was completed and the relevant assurances obtained.

Systems of internal control

94. A Statement on the System of Internal Financial Control for the council and its group was included within the financial statements. In accordance with the Code of Practice on Local Authority Accounting, the Statement reflects the internal control environment for the group position. Following receipt of a range of assurances from managers across the council, the chief internal auditor and self-assessment questionnaires from subsidiary and associate companies, the Director of Finance concluded that he was satisfied that reasonable assurance could be placed on the adequacy and effectiveness of the systems of internal control operated by the council and its group.
95. Having noted action taken during the year with regard to monitoring the implementation of management action arising from budget monitoring reports, the Director acknowledged that further work is required to promote effective budget monitoring. He also noted his intention to formalise



monitoring mechanisms in relations to subsidiary and associate companies which will strengthen the assurances received in respect of the group.

96. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on a number of the council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:

- Payroll
- Housing rents
- Main accounting system
- Debtors and income
- Creditors payments
- Council tax
- Non-domestic rates

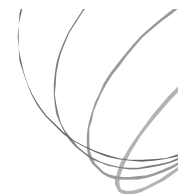
Prevention and detection of fraud and irregularities

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

NFI in Scotland

98. In 2006/07, the council again took part in the National Fraud Initiative (NFI) in Scotland. The exercise is undertaken as part of the audits of the participating bodies. NFI brings together data from councils, police and fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. For 2006/07, the exercise was extended to include information about tenants and councils were asked to submit further specified datasets where the risks merited their inclusion. The NFI has generated significant savings for Scottish public bodies (£27 million to 2005) but, if fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

99. The NFI 2006/07 results ('matches') were made available to councils on 29 January 2007 via a new secure web-based application. Participating bodies follow up the matches as appropriate, and record the outcomes of their investigations in the application. We monitored the council's involvement in NFI 2006/07 during the course of our audit.



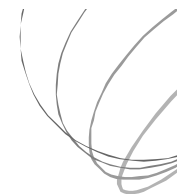
100. Overall, 8,395 matches were identified in respect of the City of Edinburgh Council. At 31 May 2007, some 8% of the matches have been cleared or were under investigation. There had been action in investigating payroll and pension 'matches' but no work had commenced on reviewing benefit cases. We therefore encouraged the Revenues and Benefits section to progress the matter with some urgency. In total there was 4,415 matches for housing benefits which equated to 57% of the total.
101. It is clear that a number of issues have contributed to delays in progressing early action in response to the data matching exercise. The council was inspected by the Benefits Fraud Inspectorate (BFI) in 2006 and a number of issues needed to be addressed following the publication of the BFI report in January 2007. We are pleased to note that an action plan has been developed and is being progressed. A number of operational difficulties have also been experienced by the benefits section e.g. the suspension of quality assurance checks while the team were re-assigned other priorities; the backlog carried forward from 2005-06; and the possibility that housing benefit subsidy has been over claimed due to the instructions given to clear that backlog. Our work on auditing the housing benefit subsidy claim is continuing.
102. At 30 September 2007, approximately 65% of matches had been cleared or were under investigation. This is an improved position but the council still has work to do.
103. One of the areas of concern noted in the BFI report was the council's low profile with regard to anti-fraud arrangements. More recently the council entered a pilot scheme through the Department of Works and Pensions which will use voice recognition technology over the telephone to assist in the identification of potentially fraudulent cases. A number of matches have now been identified from the NFI data for follow up using this new technology with a target clearance date of 31 December 2007. In our opinion, the matches are likely to be most effective if investigated at an early stage so the late investigation and clearance of these cases may not provide the same level of savings.

Key Risk Area 7

Governance outlook

Impact of the 2007 elections

104. Following the May 2007 elections, the former Labour administration of the City of Edinburgh Council was replaced by a Liberal Democrat and Scottish National Party coalition. The council's cabinet style of management led by an Executive supported with scrutiny panels has been changed in favour of an overarching Policy and Strategy Committee, Executive Committees and an Audit Committee.



105. In establishing the new structure, the Chief Executive reported his views on the need to retain the scrutiny and performance management strengths of the Executive/Panel system. His comments summarised below describe the key attributes of the council's intended future scrutiny model.

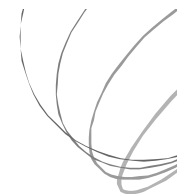
Table 7: Intended features of future scrutiny model

- *in replacing the Executive/Scrutiny structure with a streamlined Committee system, it will not be sufficient to simply re-distribute the decision making functions of the Executive to a range of Committees, each with a defined service 'territory';*
- *there should be no reversal of the significant reduction in routine reports on operational matters or for information only which were in 'the old system'. The time for scrutiny, performance monitoring and policy review must be maintained;*
- *a streamlined committee system can satisfy the criteria for effective political management if an established part of the committee business is devoted to scrutinising the efficiency and standards of services delivered within each committee's remit, and to assessing performance and dealing with improvement where necessary;*
- *the tone of the council's governance arrangements must remain holistic and joined up – reflecting the efforts made in the Council Review process to reduce service 'silos' and operate broader range service responsibilities in departments.*

106. The new committee structure was announced in June 2007 with the arrangements for performance monitoring advised in August 2007. The council will continue to develop its balanced scorecard reporting but provide the Policy and Strategy Committee with reports covering progress against the strategic objectives while the Executive Committees will each receive reports relevant to the performance of services within their remits. It is intended that the new arrangements will be in place by January 2008 and we will keep the effectiveness of these under review in future audits.

107. In total terms, 28 of the council's 58 councillors are newly elected and therefore require a package of support from officers by means of training and development. An initial programme of training provided shortly after the May elections was well attended and focused on areas of core knowledge such as councillors code of conduct, departmental briefings, audit and media awareness.

108. In June 2007, the council approved a learning and development programme for councillors which is based on an approved role description and competencies framework for councillors. This will enable development according to need in a range of areas including change, corporate focus, decision making and leadership.



109. As the new arrangements and structures bed in, the council should keep their effectiveness under review and ensure that any areas are quickly identified where further guidance or training is required.

Financial monitoring arrangements

110. In response to the 2006/07 outturn position, the Director of Finance commented on the non-delivery of management action to control expenditure and the material level of expenditure not recorded in the council's commitment accounting system. Immediate action was therefore taken to improve the financial management information available across the council and also with regard to Oracle itself, steps have been taken to strengthen the council's commitment accounting processes so that forecasts can be as accurate as possible.

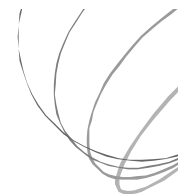
111. In addition, an investigation was undertaken by the Chief Internal Auditor to determine other specific circumstances which had impacted on officers' ability to manage budgets. This highlighted that budget lines and expenditure were not aligned making monitoring and control difficult, inadequacies in commitment accounting and the confusion caused by the different financial systems held at school establishment level.

112. It will take time to fully address and resolve these issues; however, prompt action is required to ensure the availability of good quality information to assist management in dealing with its serious financial situation. It is critical that directors and other budget holders meet their responsibilities in managing service expenditure within available resources.

Key Risk Area 4

Local code of governance

113. CIPFA/SOLACE has recently issued ***Delivering Good Governance in Local Government – a Framework*** which sets out principles and standards to help local authorities to develop and maintain their own codes of governance and discharge their accountability for the proper conduct of business. The council is aware of the revised guidance and is currently reviewing its current framework against it to identify any improvements which may be necessary.



Financial statements

Introduction

114. In this section we summarise key outcomes from our audit of the council's financial statements for 2006/07. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues. We audit the financial statements and give an opinion on:

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

115. We also review the Statement on the System of Internal Financial Control by considering the adequacy of the process put in place by the council to obtain assurances on systems of internal financial control and assessing whether disclosures in the statement are consistent with our knowledge of the council.

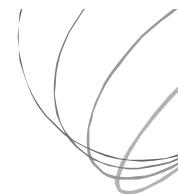
Overall conclusion

116. We have given an **unqualified** opinion on the financial statements of City of Edinburgh Council for 2006/07. We have, however, drawn attention to a failure to comply with a statutory requirement. This does not impact on the fairness of the financial statements and, therefore, does not affect the opinion on the accounts.

117. 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. As highlighted earlier in this report, five of the nine statutory trading organisations made aggregate losses in the three years to 31 March 2007, with the result that the council failed to meet this statutory requirement for the following trading organisations - Direct Cleaning; Blindcraft; Other Catering; School and Welfare Catering and Refuse Collection.

Key Risk Area 8

118. The council's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation processes and working papers merit some review to ensure there is an adequate package available for audit. We would also highlight that in our view there is too much reliance placed on one officer for the production of the accounts and in dealing with audit queries. Steps need to be put in place to minimise the risk in this area. Audited accounts were finalised prior to the target date of 30 September 2007 and are now available for presentation to the



council and publication. The financial statements are an essential 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.

Statutory objection

119. A statutory objection under section 101(2) of the Local Government (Scotland) Act 1973 was made in respect of the council's financial statements. We considered this objection and held a hearing in accordance with the legislation. None of the issues raised impacted on our opinion on the financial statements.

Accounting practice

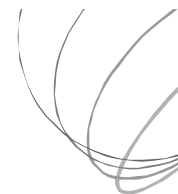
120. Local authorities in Scotland are required to follow the *Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice* (the 'SORP'). The 2006 SORP required a number of significant changes to be made to the 2006/07 financial statements to make them more consistent with the accounts of other public and private sector entities. These included:

- 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;
- similar changes to the housing revenue account;
- parallel changes to the group accounts that would result in them being easier to understand and have a common format to single entity statement of accounts;
- restatement of the 2005/06 comparative figures.

121. Overall, we felt that the council made an excellent attempt in preparing the accounts in accordance with the revised SORP.

122. In order to improve the presentation of information within the accounts several amendments were agreed but these did not impact on overall balances. For example:

- identification and separate disclosure of surplus assets awaiting disposal;
- transfer from provisions to earmarked balances of the amount of council tax income received as a result of lower discount for second homes which will be paid over to registered social landlords;



- insurance related liabilities included in contingent liabilities were transferred to provisions;
- a general contingent liability note was added to reflect potential unknown claims.

123. There was one significant event which resulted in several adjustments to the figures included in the unaudited accounts provided for public inspection. Shortly after the unaudited accounts were made available, officers identified that the information which had been submitted to the actuary to determine the liabilities in respect of pension payments was incomplete. In total terms, the impact was a reduction in the pension liability of approximately £9 million but in terms of the general fund, the effect was limited to further costs of £0.110 million. With regard to the financial statements, the impact of this required amendments throughout the core statements and to the notes to the accounts. In view of the pervasive nature of the changes to the accounts that were required we requested that the audited accounts were dated as having been prepared at the end of September, recognising the extent of change that had been made to those that had been submitted for audit.

Fixed assets

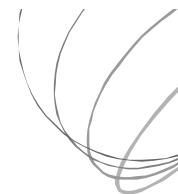
124. The SORP supports the introduction of component accounting for spending on the replacement of individual building components such as council house kitchens and bathrooms. This requires such assets to be separately identified and depreciated over a shorter useful life than the buildings. The council is progressing significant kitchen and bathroom replacement programmes, and the adoption of such an approach would better ensure that such expenditure can be clearly defined as capital.

Key Risk Area 9

125. Software licences are likely to meet the definition outlined in the SORP for intangible assets and should be capitalised and amortised to revenue over the period of the licence. In the 2006/07 financial statements, such items have been treated as revenue expenditure and as a result we estimated that fixed assets are understated by £0.450 million. We were satisfied that this did not have a material impact on the accounts.

Provision for non-collection of council tax

126. At 31 March 2007, the provision for non-collection of council tax was £122 million against a debtor of £129 million. In order to reflect improved collection rates, the basis for calculating the provision was changed to 4% of outstanding debt billed in 2006/07 (from 5% in 2005/06). This change in basis has been reflected in a note to the financial statements. This approach does not seem unreasonable with regard to 2006/07 but should be kept under review in future years as further evidence of trends emerges.

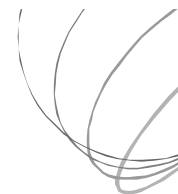


Group accounts

127. The widening diversity of service delivery vehicles used by local authorities means that consolidated group accounts are required to present fairly the activities of an authority. The Council has interests in 3 subsidiaries and a total of 7 associates and joint ventures which have been included in group accounts in accordance with the SORP. Audited accounts were received by the council in respect of all group component bodies and the latest information included in the group accounts.
128. The SORP requires that policies for component bodies are brought into line with the council for the purposes of group accounts. The key policies likely to require alignment are in respect of pension costs and the valuation of fixed assets at market value. One of the subsidiary companies, Lothian Buses Plc, however, has land and buildings included at historic cost. This is a departure from group accounting policies and we sought and received assurances from the Director of Finance that the impact is not material to the results of the group.
129. The council has not included its interests in Shawfair Developments Ltd and Pacific Shelf 825 Ltd within the group. In our opinion these meet the criteria to be included as joint ventures/associates. While we are satisfied the overall impact on the group accounts is not material, we would suggest the reasons for current exclusion are re-considered.

Public Private Partnership

130. When considering public private partnership arrangements, key stages are the audited body providing an initial and final view on the accounting treatment of a project, based on business case information. The auditor then reviews the audited body's position and comments on whether the proposed treatment is in accordance with current underlying guidance. In February 2006, the council provided a view on the treatment of the schools PPP2 project for the construction of eight new schools. A full quantitative analysis was carried out following the appointment of the preferred bidder and we concluded in March 2007 that the council's final judgement on the proposed accounting treatment off balance sheet is reasonable.
131. In addition to reviewing the accounting treatment, we are required to consider the council's assessment of the value for money provided by a project, taking account of both whole of life costs and quality. We concluded in May 2007 that the quantitative assessment undertaken showed that the project represented overall value for money, in accordance with the current guidance in place.

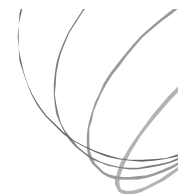


Legality

132. Each year we request written confirmation from the Director of Finance that the council's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes. The Director of Finance has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Chief Executive and the Corporate Management Team, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.
133. The Office of the Scottish Charities Regulator (OSCR) is responsible for facilitating and monitoring compliance with the Charities Accounts (Scotland) Regulations 2006. In discussion with the CIPFA Directors of Finance section, OSCR has agreed transitional arrangements for 2006/07, highlighting a wish to adopt a proportionate approach to any remedial action taken in response to breaches of the legislation. In particular, it will be sufficient that the audited accounts of the council under the local government SORP be passed to OSCR by 31 December 2007 together with a further analysis providing a breakdown of the accounts of each registered charitable body. Discussion is continuing in relation to arrangements for the future transition toward full compliance with the requirements of the regulations.
134. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Financial reporting outlook

135. Overall the council is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. It has a record of responding positively to audit issues and to changing accounting rules.
136. The requirements of newly introduced charities legislation are onerous in terms of enhanced accounting requirements. While the regulations provide some scope to rationalise existing charitable trust arrangements, significant effort will be required to ensure that the council complies fully with legal requirements in future financial reporting in relation to its registered charitable trusts. In the interim it is essential that the council maintains a continuing dialogue with OSCR and meets the requirements of any transitional arrangements that may be agreed.
137. Other challenges ahead include a number of changes that have been made to the 2007 SORP and the work required in relation to aspects of accounting practice such as component accounting.

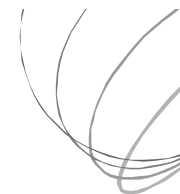


Changes to 2007 SORP

138. Amendments have been made to the 2007 SORP to incorporate the requirements of new accounting standards on financial instruments (FRS 25 and FRS 26). This will require any premium or discount on loans that have been re-scheduled to be charged to income and expenditure in the year it is incurred rather than being written off over the period of the replacement loan, which can be up to 40 to 50 years. The Scottish Government has issued statutory guidance which mitigates the impact on council tax by permitting authorities to reverse the entries in the statement of movement on general fund balance and replace an amount writing-off the premium or discount over the life of the replacement loan. However, the statutory guidance restricts the write-off period where replacement debt is a variable interest loan, or has an option or condition which allows the lender to vary the interest rate (known as LOBOs), to a maximum of 20 years.
139. The effect of this change will be to significantly increase the annual charge to the income and expenditure account in the year that any future restructuring takes place, with an adjustment being made to the charge to the general fund. Where the replacement debt is subject to a variable interest rate or is a LOBO, the annual charge to the general fund will typically be greater than currently experienced (broadly about twice as much). In other cases there will be no change to the impact on the general fund compared to current practice. Existing balances may continue to be written off over current periods.

International Financial Reporting Standards

140. Central government and NHS bodies are to move from UK Generally Accepted Accounting Principles (GAAP) to International Financial Reporting Standards (IFRS) with effect from 2008/09. The government also announced its intention to publish whole of government accounts on an IFRS basis from 2008/09.
141. After discussion, CIPFA/LASAAC has agreed for 2008/09 to continue to adopt IFRS within the SORP through the application of UK GAAP. It is considered that the accounts are likely to be materially similar to those prepared under IFRS because the SORP has been following the Accounting Standards Board's international convergence agenda. This option also allows for consideration of the long term future of the due process for the development and maintenance of proper accounting standards for local government.
142. CIPFA/LASAAC will also work with the Treasury to ensure that consolidation information, appropriate to the sector, is available in 2008/09 for local government whole of government accounts.



143. A move toward full IFRS compliance is anticipated in 2009/10. Any future move to IFRS in local government is likely to have a significant impact in two primary areas:

- accounting for fixed assets, particularly in relation to infrastructure and heritage assets. The first significant practical implication is that councils will need information systems to identify sufficient data, such as road lengths, to support new valuation models to be used in whole of government accounts from 2008/09. Comparative information will be required as at 31 March 2008;
- accounting for Public Private Partnership (PPP) schemes.

144. Existing IFRS do not address PPP accounting in the public sector, although they do address how these transactions should be accounted for in the private sector. The existing accounting practice in the public sector is significantly different from that indicated in the IFRS for the private sector. Current practice is based on an assessment of relative risk borne by either party to the PPP contract. The IFRS is based on who controls the services to be provided, to whom and at what price; and who controls the residual interest at the end of the PPP. The Treasury is considering the appropriate form of accounting for the public sector side of PPP transactions over the summer and expect to bring proposals to the Financial Reporting Advisory Board in the autumn.

145. Looking ahead, if IFRS principles are applied in the public sector then many PPP assets may well be brought onto public sector balance sheets.

Change of external auditor

146. 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.

147. The audit of 2007/08 will represent the second year of Audit Scotland's current five year appointment. Mark Taylor has been one of the senior staff on the City of Edinburgh audit for five years and will therefore require to end his involvement in the council's audit in accordance with the established ethical policy. The new engagement lead will be Gillian Woolman but, otherwise, there will be minimal change in the audit team.



Final Remarks

148. 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.

149. Attached to this report is an action plan setting out the key risks identified by the audit which we are highlighting for the attention of members. In response, officers have considered the issues and have agreed to take the specific steps set out in the column headed 'planned management action'. On occasion, officers may choose to accept the risk and take no action. Alternatively, there may be no further action that can be taken to minimise the risk. Where appropriate, the action plan clearly sets out management's response to the identified risks.

150. Appropriate mechanisms should be considered and agreed by members for monitoring the effectiveness of planned action by officers. We will review the operation of the agreed mechanism as part of the 2007/08 audit.

151. The co-operation and assistance given to us by City of Edinburgh Council members and staff is gratefully acknowledged.



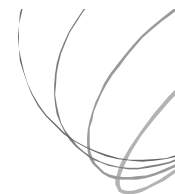
Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1.	14	<p>Performance management Data is examined 3 months after the month to which it relates which does not support timely decision making.</p> <p>Risk: ineffective use of resources preparing detailed balanced scorecard reports which are too dated to assist the decision making process.</p>	<p>Performance information is normally with Council Management Team one month after the reporting period. The scheduling of Council Executive and Scrutiny Panel meetings under the previous political management arrangements resulted occasionally in some unavoidable delays. However, the new arrangements should reduce the likelihood of this.</p> <p>A monthly scorecard of high level indicators for Council Management Team will be introduced this year.</p>	Senior Officer (Information) Performance, Strategy and Policy	January 2008
2.	18	<p>Statutory performance indicators Four indicators were regarded as unreliable due to incomplete information.</p> <p>Risk: indicators are not meaningful and make comparison difficult.</p>	<p>A sample system will be introduced to provide the required information for use of dry and wet school facilities in 07/08.</p> <p>A new report will provide better information for library stock in 07/08.</p> <p>No resources have been identified for surveying buildings and the condition of operational property is likely to be deemed unreliable in 2007/08.</p>	<p>Information and Research Manager (Children and Families)</p> <p>Library Officer, Service Development</p>	<p>July 2008</p> <p>July 2008</p>
3.	27	<p>Community health partnership Longer term planning and budgeting needs to be developed so that the CHP can demonstrate the viability of plans beyond one year.</p> <p>Risk: plans and objectives cannot be delivered due to inadequate funding.</p>	<p>The long-term planning and budgeting needs will be reviewed and addressed in the coming year.</p>	Director of Health and Social Care	August 2008



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4.	49 68 112	<p>Financial position and restoration of general fund balance</p> <p>Expenditure needs be contained within available resources and steps put in place to restore the unallocated general fund balance to sustainable levels.</p> <p>Budget monitoring processes need to be improved including the expansion of commitment accounting and the need for directors to take effective ownership of their own budgets.</p> <p>Planned efficiency savings need to be achievable to avoid further pressure on the financial position.</p> <p><i>Risk: unplanned action such as service reduction or a significant increase in council tax levels may be necessary to control expenditure within the approved budget.</i></p>	<p>Robust monitoring procedures and a timetable have been put in place, including action plans that identify measures to be taken by departments to manage expenditure within budget and nominating responsible officers.</p> <p>Reviews of the impact of management action will also be undertaken as part of the monitoring process.</p> <p>The Council Management Team has identified this as an avoidable risk and will consider a report covering this in early November. This report will highlight areas where the present use of the Oracle system commitment system could be expanded to additional appropriate areas of spend. The Director of Finance is currently considering the resource and control implications of expanding commitment accounting.</p>	Chief Executive, Director of Finance and all Service Directors	In progress
5.	62	<p>Refuse collection</p> <p>A clear decision is necessary with regard to plans for tendering the refuse collection service.</p> <p><i>Risk: the service is unable to demonstrate that its competitiveness in accordance with best value criteria.</i></p>	The council has a clear strategy through which it seeks to improve in-house performance and so demonstrate Best Value. If this is not successful then the council will review its earlier plans to tender the service.	Director of Services for Communities	In progress
6.	73	<p>Single status</p> <p>The Council remains to implement the single status agreement.</p> <p><i>Risk: the outcome of future litigation cannot be defined exactly. Costs may therefore be in excess of expected levels; the loss of earnings</i></p>	<p>Council is developing its single status framework and costing at 3% of payroll has been provided for in the three year revenue budget.</p> <p>The risks and costs associated with implementing the strategy will continue to be monitored and will be reported to council.</p>	Head of Human Resources	April 2008



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>associated with pay modernisation has a high risk of industrial relations problems in some areas.</i>			
7.	103	<p>National Fraud Initiative The council has made slow progress in following up reported matches, particularly with regard to benefits. Risk: potential cases of fraud are undetected and potential savings are not realised.</p>	<p>Of the initial 4,445 Revenues and Benefits matches, the Council has identified that 390 cases need to be taken forward for further investigation. The target clearance date is 31 December 2007.</p> <p>Matches in pensions, payments and payroll will continue to be progressed.</p>	<p>Head of Revenues and Benefits</p> <p>Head of Payments and Procurement Services / Head of Investments and Pensions</p>	<p>December 2007</p> <p>December 2007</p>
8.	117	<p>Statutory trading organisations (STOs) Five of the STOs continue to return cumulative losses. Risk: the council may not be achieving best value from current arrangements for services provided by those STOs.</p>	<p>Three of the STOs (Catering (2) and Cleaning) are affected by single status, and this will continue to impact on the financial operation until equal pay is implemented. The STOs will prepare business plans demonstrating best value in provision of service.</p> <p>Refuse Collection / Trade Waste - The Council has adopted a business plan for the transformation of the in house refuse collection service which, if successful, will deliver the necessary financial improvements. If that strategy is not successful then the service will review its earlier plans to tender the service.</p> <p>BlindCraft – the three-year service plan outlines the improvement in the overall business, including reduced costs and CEC subsidy £1.7m to £1m 2006/07), increased sales income, new product lines and new contracts with major suppliers.</p>	<p>Director of Corporate Services</p> <p>Director of Services for Communities</p> <p>Head of Social Care Performance</p>	In progress



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
9.	124	Component accounting The council is progressing significant kitchen and bathroom replacement programmes. The adoption of a component accounting approach would better ensure that such expenditure can be clearly defined as capital. <i>Risk: the council is unable to finance future kitchen and bathroom replacement programmes.</i>	The Council will implement component accounting, in 2007-08, including reallocating kitchens and bathrooms from 2006-07. The impact on depreciation and loan charges will first appear in the 2007-08 accounts. There is no net impact on the 2006-07 accounts.	Corporate Finance Manager	March 2008