

North Ayrshire Council

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



October 2007



North Ayrshire Council

Report to Members and the Controller of Audit

on the 2006/07 audit

Contents

Key Messages	1
Introduction	3
Performance	4
Financial position	16
Governance	26
Financial statements	31
Appendix A: Action Plan	39



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 North Ayrshire Council for 2006/07.

Managing their financial position is a challenge for all councils. The council's reserves strategy is to maintain a minimum unallocated general fund balance of 3% of the net annual budget. As at 31 March 2006, mainly as a result of equal pay compensation payments during the year, the unallocated general fund balance was £1.449 million. By March 2007 the council had successfully re-instated its unallocated general fund balance to £8.672 million.

The council had corporate governance systems in place during 2006/07 that generally operated within a sound control environment.

Following the 2007 elections, the council revised its decision making structure, replacing the traditional committee style structure with a cabinet model, led by the council executive. The council should set a timetable for a review of the effectiveness of the structure once it is bedded in.

Overall the council has made steady progress against the improvement actions agreed as a result of its 2004/05 best value audit.

Progress has continued on the four schools being built under the councils PPP (public private partnership) scheme with the first school handed over to the council in August 2007, two schools to be transferred to the council in October 2007 and the remaining one being completed in January 2008.

The council has a 30 year plan in place for the improvement of its housing stock which will enable it to meet the Scottish Housing Quality Standard by 2015.

The council implemented the single status agreement with effect from 28 July 2007 following unsuccessful negotiations with the trade unions. It is estimated that appeals have been lodged by around 980 staff who are appealing the assessment of their role under job evaluation.



Outlook for future audits

In the course of our work we identified some of the strategic risks that the council will need to manage in delivering on its stated objectives and priorities. These can be grouped into the following themes:

- Managing performance to achieve best value.
- Ensuring the affordability and sustainability of services.
- Good governance and real accountability.
- Community planning and effective partnership working.
- Securing the efficient use of resources.

In common with many other Scottish councils, North Ayrshire Council sought to limit its exposure to the financial risk associated with equal pay claims by agreeing to offer payments to specific groups of employees as part of a compensation package. Provision for £2.911 million has been recognised in the 2006/07 financial statements for the estimated one-off cost of these payments. While moves to agree compensation payments will help to reduce financial risk in this area to some extent, there is a risk that other categories of employees may lodge claims which the council has not provided for. Therefore an element of risk remains for the period prior to the implementation of single status.

Approximately 980 staff have appealed their banding under single status and until these appeals are heard the initial and continuing costs of single status cannot be reliably estimated which represents some financial risk to the council. Evidence from other councils is that variation in the level of potential costs can be up to 10% of the current pay-bill on a continuing basis. The council has estimated that additional costs of £3.8 million per annum will be incurred in respect of single status.

The council are in the process of implementing a new asset and resource management system (ARMS) which when fully operational will provide the council with a comprehensive basis on which to record, assess and monitor their assets.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of North Ayrshire 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 chief executive on 31 March 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:
 - Managing performance to achieve best value.
 - Ensuring the affordability and sustainability of services.
 - Good governance and real accountability.
 - Community planning and effective partnership working.
 - Securing the efficient use of resources
3. Overall conclusions about the council's management of key risks are discussed throughout this report.
4. We also undertook a number of detailed exercises on main financial systems which resulted in a separate audit report. Within this report, we highlight key messages from that report. 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 progress against agreed improvement actions arising out of the best value audit which was carried out in 2004/05 and the findings of national performance audit studies.

Corporate objectives and priorities

7. The council plan for 2006 – 2009 set out the key goals and priorities for the council until 2009 and explains how it planned to achieve these. The plan was set out in twelve themes, which cut across a variety of services:
 - Getting people into work.
 - Increasing educational achievement.
 - Improving travel & transport links.
 - Providing a cleaner, greener & more attractive environment.
 - Delivering decent, affordable housing.
 - Improving roads & footways.
 - Promoting healthier & more active communities.
 - Making our communities safer & better protected.
 - Reducing disadvantage & promoting equal opportunities.
 - Improving our customer service.
 - Using our resources more efficiently & effectively.
 - Attracting, retaining & developing our employees.
8. A total of 136 priorities are established across these themes. These priorities include the following pledges by the council's administration:
 - Tackle barriers to childcare and employment through implementation of the Working Families initiative.
 - Complete a formal local plan amendment in respect of (a) rural development and (b) affordable housing.



- Improving educational buildings and resources.
 - Develop and implement measures to prevent homelessness occurring.
 - Achieve year on year reductions in rent arrears.
 - Meet and improve on national target times for processing housing and council tax benefit claims whilst maintaining high standards of accuracy of processing.
 - Set and stay within budgets in a way that ensures effective frontline delivery of council services, the reduction of overhead costs, a prudent level of reserves and a responsible level of Council Tax to contribute towards these objectives.
 - Implement a revised pay & grading structure and harmonised terms and conditions of service for local government employees by October 2007.
9. Following the May 2007 elections, the labour group, being the largest single party, formed a minority administration. Membership of the council is made up of 12 Labour, 8 SNP, 5 Independent, 3 Conservative and 2 Liberal Democrat councillors. The council has recently finalised the council plan 2007-2010, and it will be put to the executive committee in October 2007. The decision has also been taken to roll the plan forward annually so that the council are always working to a revised three year plan. It is anticipated that the plan for 2008-2011 will be in place by the 1 April 2008.

Overview of performance in 2006/07

Public performance reporting

10. Being able to assess the council against its corporate priorities and objectives and being able to easily identify if service outcomes are improving or declining is vital for stakeholders in order that they can hold the council to account for its performance. This area is of prime importance as the new Scottish Government expects outcome agreements in place for all thirty two local authorities in Scotland by April 2008. Initially these agreements may contain high level outcomes which councils are expected to follow by putting in place detailed local outcomes for service users. Performance monitoring systems which measure and monitor outcomes therefore require to be in place.
11. The council's main method of reporting its performance is via its own newspaper, "North Ayrshire Now". This is published three times per year and is distributed to all households in North Ayrshire. The newspaper is a comprehensive document which gives a clear insight into the council's priorities and what action has been taken to meet the council plan, as well as a summary of the council's financial performance. The paper is signed by both the leader of the council and the chief executive, which endorses the content and makes a firm commitment to continue to strive to meet and develop the council plan.



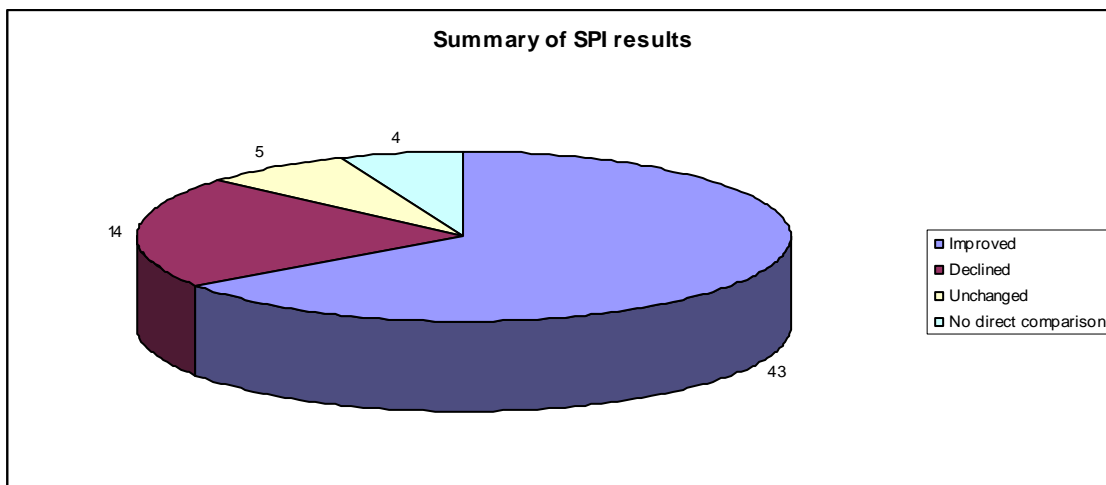
12. In addition to the newspaper, each service reports its performance using a number of methods including newsletters and the council web-site. Statutory performance indicators (SPIs) are also produced annually and published on the web-site. While "North Ayrshire Now" includes mainly success stories, a more balanced picture of the council's performance can be seen using the SPIs.

Measuring performance

13. Performance against the priorities in the council plan is monitored on a quarterly basis using the council plan performance monitoring system which was developed by the information technology department. This system maintains a record of each priority and uses a traffic light system to track progress against the actions which underpin the corporate priority. Progress against actions was reported to members at sub-committee level prior to the re-structure of the council to a cabinet style approach. Monitoring progress against the council plan now falls under the remit of the scrutiny committee.
14. SPIs are monitored throughout the year with remedial action taken where necessary. A balanced scorecard mechanism is in place to report service performance. This information is presented to members with the service context, budget and how the indicators support the corporate priorities outlined. In addition, the reports show the highs and lows of service performance as well as any action plans arising from the performance information. Local performance indicators are reported twice yearly to members. The council are clearly taking a pro-active approach both in trying to improve service performance but also in ensuring that members are fully aware of how well services are doing to enable corrective action to be taken where necessary.

Statutory performance indicators

15. One of the ways of measuring the council's comparative performance is using statutory performance indicators. Historically, the council has been well placed in national comparisons and has placed substantial emphasis in using targets to improve performance in these areas. In 2006/07, the council has reported continued improvement and performance for a substantial proportion of its SPIs, as illustrated in the pie chart below.



16. Substantial improvements have been made and maintained in:

- the average time taken to provide community care services, from the first identification of need to first service provision
- the percentage of residential care places occupied by other adults that are in single rooms
- the percentage of residential care places occupied by other adults that have en-suite
- the proportion of probationers seen by a supervising officer within one week
- the gross administration cost per council tax or housing benefit application
- the average time taken to process new benefits claims
- the percentage of public service buildings that are suitable and accessible to disabled people
- learning centre and adult learning points – number of users as a % of the resident population
- the percentage of council house sales completed within 26 weeks
- the percentage of empty houses relet within 4 weeks
- the percentage of consumer complaints completed within 14 days of receipt by Trading Standards.

17. However, performance has declined in the following five areas:

- Percentage of care staff in council residential homes for other adults who are qualified.
- Number of litigation claims per 10,000 population.
- Percentage of the national target met for replenishing library lending stock for children and teenagers.



- Percentage of homelessness cases reassessed as homeless or potential homeless within 12 months of case being completed.
 - Net cost of refuse disposal per property.
18. Each year we review the reliability of the council's arrangements to prepare SPIs. The council have a co-ordinated approach to producing and reviewing performance against SPIs and have sound procedures in place for generating SPIs and supporting documentation. Internal audit were also involved in the review of the SPIs to the extent that we were able to place reliance on their work. None of the indicators produced were considered to be unreliable.

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 North Ayrshire Council was carried out in December 2004 and the findings published in February 2005. In response, the council approved a best value improvement plan setting out the 50 improvement agenda items from the report together with the planned actions and timescales for implementation.
21. Since this time, the improvement plan has been incorporated into the council plan which is used to monitor the achievement of priority areas.
22. Whilst the council has made good progress against the priorities set out in its best value improvement plan, some slippage has been experienced, for example:
- The review of all trading activities to ensure appropriate strategies – including consideration of specifications, service level agreements and voluntary competitive tendering.



Performance outlook – opportunities and risks

Introduction

23. In the course of our audit work we identified some of the strategic risks to North Ayrshire Council delivering on its stated objectives and priorities in the years ahead. These risks were set out in our Audit Risk Analysis and Plan (ARAP) and grouped into five 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. Where appropriate, matters arising in a number of these areas are also reported in more detail elsewhere in this report. Risk exists in all organisations which are committed to continuous improvement 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.

Managing performance to achieve best value

24. Opportunities for service reconfiguration are offered by new technologies and the council is facing requirements to provide more responsive, joined up services – often in partnership with other agencies. The efficient government initiative expects savings to be generated through service redesign, streamlined bureaucracy and shared service support. Failure to deliver such savings could increase pressure on existing resources. The council provided assurance that identified savings would be monitored by the Corporate Management Team (CMT) and that any savings identified would be considered as part of the service planning and budget process. In 2006/07, the council had £1.582 million of their funding settlement top-sliced, which was to be balanced by efficiency savings. The council’s annual efficiency return for 2006/07 shows that they have made £3.145 million in cashable savings and £0.300 million non-cashable, £2.014 million of which was cash limiting budgets. In 2007/08 the council will have £1.503 million of their funding settlement top-sliced so they will need to ensure that they continue to deliver efficiency savings year on year.

25. The Local Government in Scotland Act 2003 set out the need for local authorities to identify and report on the performance of significant trading operations. The council transferred former DLO/DSO’s to trading operations in 2003/04 but took a decision in May 2006 to have a moratorium on all but one of their trading operations. This meant that only the financial position of the building services trading operation was disclosed in the financial statements, on the grounds that the charging policy on which services were operating was out of date and was not reflecting the true cost of providing the service. The council provided assurance that they would be revising all of their charges in view of the equal pay / single status costs and re-instate reporting on significant trading operations in 2008/09. In September 2007, the council appointed consultants to devise service level agreements for catering



and cleaning, with a view to these being in place by 1 April 2008. The remaining trading operations will be reviewed by management.

Ensuring the future affordability and sustainability of services

26. The Equal Pay Act requires equitable wages for equivalent jobs. In 2005/06 the council made compensation payments to staff who were assessed as having been underpaid under existing terms and conditions. Staff were offered payments, which by accepting they waived the right to pursue the council for any further compensation. The council included £7.389m in respect of equal pay claims in the 2005/06 financial statements, being £5.161m relating to settled cases and a provision of £2.228m for unsettled cases, which have been taken to tribunal. Due to the delay in implementing single status, the council made further compensation payments of £1.891 million and increased their provision in respect of unsettled cases to £2.911 million in 2006/07, however as none of the cases at tribunal have been heard to date, there is no certainty as to whether the level of provision is adequate.
27. The council have agreed a 30 year business plan to exceed and maintain standards for their housing stock set by the Scottish housing quality standard by the year 2015. The modernisation programme is to be funded by increasing rents at a rate of RPI plus 4.5% for the initial 5 years of the plan. Thereafter, rent increases are proposed at RPI plus 1%. 2006/07 was the third year of the large rent increases and the statutory performance indicator for rent arrears has shown a consistent improvement in the level of collection, which suggests that tenants are managing to meet the rising costs.
28. The council have identified major spending pressures beyond the current year but have not yet set a budget beyond 2007/08, as they were awaiting details of their funding settlement. The chancellor has recently announced the government's three year comprehensive spending review. It is not clear at this stage what impact this will have on funding for local government in Scotland. The Scottish Government will notify local authorities of their grand settlement in due course. The council should prepare three year budgets once this is known.

Refer action point 1

29. The council has a formal reserves policy which sets out the level of reserves they intend to hold, how they plan to build up these reserves and how the money will be spent. The policy set a level of 3% of the annual budget for the uncommitted general fund balance. The council had uncommitted reserves of £8.672 million at 31 March 2007, representing 3.3% of net expenditure. The council made a number of one-off gains in 2006/07 which has enabled them to build balances so they will need to monitor reserve levels in 2007/08 to ensure that they continue to meet the 3% threshold.
30. The council are in the process of building new schools under a schools Public Private Partnership (PPP). The plan will see the development of four modern schools, the first of which opened in August



2007, two schools are to be transferred to the council by the end of October 2007 and the remaining one is due to be completed in January 2008. The fixed nature of the PPP funding from the Scottish Government and the increasing unitary charge which the council will have to pay over the 30 years of the project means that an increasing funding gap will develop, which represents an inflationary pressure. The council plan to meet the funding gap as part of its annual budget consideration.

31. Supporting people is an integrated policy and funding framework for housing support services which was introduced in April 2003. Councils are required to undertake a review of all their supporting people services to acquire an in-depth knowledge of the services they fund, their strategic fit and ensure that they represent value for money as well as good quality services for users. Once service reviews are carried out, councils are then required to enter into full contracts with the service providers. The council have experienced some slippage against the plan to introduce full contracts by 1 April 2007, with a revised implementation date of April 2008 being set. The lack of formal contracts means that there is a risk that the council are buying in services which do not represent value for money since the review process has not yet been completed. During our review of the supporting people grant return for 2006/07, we found that only 2 of the council's 38 external service providers have contracts in place and there are no service level agreements for internal providers.

Refer action point 2

Good Governance and real accountability

32. The May 2007 elections resulted in the introduction of new members to the council. Our ARAP highlighted the need to ensure that new and experienced members should receive training on their role and how the council conducts its business. The council devised an induction package for all members which included training on the role of a member, local government finance, corporate responsibilities and policies and the role and key information of all of the council departments. This training should have given the members vital background information to enable them to conduct their role effectively.
33. In common with many councils, the elections have resulted in a new administration and a considerable number of new councillors. This has required substantial support from officers to ensure that adequate training and development programmes were provided. Alongside this, the council took the opportunity to review its political management structure. The council's previous traditional committee and sub-committee structure has been replaced with a cabinet style model, with effect from May 2007. The new cabinet model comprises the executive, the education executive, the scrutiny committee, the planning committee and the licensing and regulatory committee. The council should undertake a review of this revised arrangement once the new set up has fully bedded in to identify whether this approach is meeting the needs and enhancing the effectiveness of the political management for the council.



34. Sound internal controls are vital for ensuring that systems operate effectively and that the council is safeguarded from the risk of fraud, either by staff or third parties. Our review of the accounts payable system identified a number of key control weaknesses which, if left unaddressed, may expose the council to the risk of fraud. These weaknesses include:

- the audit trail of formal authorisation procedures for high value payments
- a lack of audit trail to track changes on the creditors system.

The council are currently in the process of upgrading their financial management system and have agreed to take account of the risks raised following the upgrade. It should however be noted, that no inappropriate payments were identified during our review of the system.

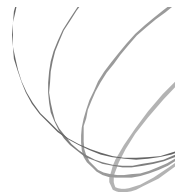
Community planning and effective partnership working

35. To ensure that the community plan is continuing to meet the needs of stakeholders, it is essential that the council review its partnership activity. When we produced our ARAP, the council had not undertaken a review to ensure that its partnership activity was contributing to the strategic objectives outlined in the community plan. The community planning coordinator has met with community planning partnership (CPP) board members to increase the focus of community planning, a year after its launch. This included the production of the "Momentum" report which includes both an action plan and a progress report which went to the CPP board in September 2007.

Securing the efficient use of resources

36. The key resource of the council is its staff. The council have a number of managers in post who may retire within the next three to five years including those at director and head of service level. It has a growing population of older employees and has in the past experienced recruitment difficulty in particular sectors. It is essential therefore that the council examine its age profile and career intentions of senior officers and other employees where recruitment difficulties may be anticipated, using that data to inform future succession planning and workforce management. The council workforce strategy was agreed by the corporate management team in May 2007 which aims to ensure that the council has robust people management processes in place which enable the council to deliver its objectives and priorities. The workforce strategy and its associated action plans, which are currently being taken forward by a cross-service workforce planning group, includes a review of workforce skills and skills gaps to ensure that people have the relevant skills to do their jobs.

37. Whilst the council operates an appraisal system for its chief officers, and a personal development review (PDR) system for other employee groups, the application of the latter operates sporadically across services. The council needs to extend the use of its personal development review system across all services as a means of assessing the current and future skills requirements when set



against the council plan and service plan objectives. Appraisal systems should also be extended to assess staff performance with like to training, re-skilling, development and organisational performance strategies. The council reported to the scrutiny committee in October 2007 on the level of completion of PDR reviews across the council. The workforce planning group is currently revising the PDR process to ensure that all employees are subject to PDR and that the process is simplified. The council aim to implement the revised approach on a phased basis between April 2008 and March 2009.

Refer action point 3

38. The council introduced the PECOS system for procurement on the recommendation of the Scottish Government. Initially the council had set a four phase plan for implementation which saw the roll out of the package in a number of council departments. The initial plan has now been completed and staff are using Pecos in key departments such as social work and IT. The council are in the process identifying how PECOS can interface with SEEMIS, the management system used by Education, to allow successful rollout to Education. The council has recently piloted an integration model which will enable PECOS to be integrated with the accounts payable system. The pilot was deemed to be successful and the council intend to roll it out to all PECOS users on completion of some technical upgrades. This should generate efficiencies through removing duplicate processing in the two systems.

Refer action point 4

39. Assets are key resources for the council in its service provision and it is therefore important that the council have the necessary assets in place in the required condition to allow officers to deliver front line services. The council have approved an asset management plan. Following the recent secondment of the assistant chief executive who had responsibility for asset management to the urban regeneration company the plan has not yet been presented to the corporate management team or members. Responsibility for asset management has been transferred to the corporate director (property services). Since our ARAP was produced, an asset management team has been formed which includes a system administrator, a surveyor and a property officer. The asset register management system (ARMS) is anticipated to be rolled out within the next 18-24 months.

Refer action point 5

40. Our ARAP stated that there was a risk that the council were failing to identify opportunities for joint working with the other Ayrshire councils and NHS Ayrshire and Arran or identify and recover cost savings from joint working. The council advised that they have an extensive programme for developing shared services and that the three councils had agreed to identify any savings derived. During 2006/07 further areas of joint working with East and South Ayrshire Councils were progressed which included the proposed creation of a single 'Ayrshire Resilience' to increase response capacity



to emergencies and avoid additional costs arising from the civil contingencies act, further sharing of roads plant and equipment and the setting up of a single noise team. Proposals are also in place for sharing accommodation with NHS Ayrshire and Arran.

National studies

41. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports of direct interest to the council are set out in paragraphs 42 – 50 below. Further information on these studies and reports can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk.

Sustainable waste management

42. There is an increasing awareness of the need to protect the environment and to promote the sustainable use of resources. As a result of UN conventions and EU Directives, the UK government introduced a landfill tax to discourage the disposal of waste in landfill sites and set a (non-statutory) target that Local Authorities should recycle 25% of household waste by 2000. This target was not achieved by the public sector in the UK.
43. Further EU Directives required Member States to “take appropriate steps to encourage the prevention, recycling and processing of waste” and to set out details of measuring processes within waste management plans. Subsequently a series of targets was set over the period to 2020 to reduce the amount of biodegradable waste going to landfill. The EU can impose a fine on the UK of up to £350,000 per day if it fails to meet its targets.
44. The purpose of Audit Scotland's study was to examine the performance of local authorities, the Scottish Environmental Protection Agency (SEPA) and the Scottish Government in reducing the amount of municipal waste being disposed of at landfill, including the impact and value for money achieved by the investment in this area.
45. The key findings from Audit Scotland's national report published in August 2007 highlighted that:
 - While significant progress has been made in meeting interim recycling targets, the rate varies considerably between councils and the type of collection system employed.
 - There has been slow progress in developing facilities to treat residual waste. There is therefore a significant risk that EU directive targets may not be met.
 - Increased recycling has led to increased costs.
 - All parties need to work effectively together to make a rapid progress in waste minimisation, recycling and waste treatment to achieve the landfill targets.



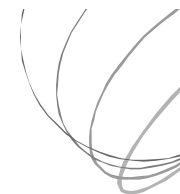
46. The level of public participation in recycling exceeded the national average in North Ayrshire however the council are currently recycling only 15% of waste compared to the highest performing Scottish council at 29%.

Dealing with offending by young people

47. Audit Scotland published reports on *Dealing with offending by young people* in December 2002 and November 2003. A follow-up study was undertaken to ascertain improvements in performance since 2002 of agencies who deal with young people who offend in the context of a changing policy landscape. The performance update report was published in August 2007.
48. The key findings from the national study are:
- The Scottish Government has shown a commitment to improving youth justice services and has increased funding for youth justice services from £235 million in 2000/01 to £336 million in 2005/06 together with practical support and guidance to help youth justice services to improve performance.
 - However, the impact of this on services and outcomes is not yet demonstrated. Limited outcome measures are available and there are weaknesses in performance management arrangements. Therefore, it is not possible to assess the effectiveness of the additional expenditure in reducing offending and improving the quality of life of local communities.
49. The review of files for the 2002 study found that there were no records of contact between social workers and children on supervision in 50% of the cases checked for North Ayrshire Council, making them the lowest performers in this aspect of the study. Care plans were only in place for 40% of the cases sampled, well below the Scottish average of 63%. We have been advised that the council developed an action plan to address the weaknesses identified in the 2002 study and have made significant progress in improving their performance in this area.

Scotland's School Estate

50. A national review is being carried out on 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.



Financial position

Introduction

51. 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. Under the strategic theme of 'sustainable and affordable use of resources', our ARAP recognised the significant challenges being faced by the council both in relation to delivery of its improvement agenda but also with regard to managing ongoing financial pressures such as implementing single status. Our findings and key messages are set out in this section.

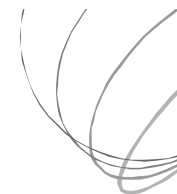
Council tax and the general fund

Operating performance 2006/07

52. The presentation of the 2006/07 financial statements has changed significantly from the previous year, as a result of changes to the *Code of Practice on Local Authority Accounting in the United Kingdom 2006 (the SORP)*. In place of the previous consolidated revenue account, the accounts now include an income and expenditure account and a statement on the movement of the general fund balance. The income and expenditure account discloses the income receivable and expenditure incurred in operating the council for the year. The deficit incurred on the income and expenditure account represents the amount by which income is less than expenditure. The income and expenditure account is prepared using essentially the same accounting conventions (UK GAAP) that a large unlisted company would use in preparing its annual financial statements. However, there are items of income and expenditure that need to be included in the general fund and therefore taken into account when determining a local authority's budget requirement and its council tax demand. These items are determined by statute and non-statutory proper accounting practices, rather than being in accordance with UK GAAP, and are reported in the statement of movement on the general fund balance. The general fund surplus for the year is disclosed within the statement on the movement of the general fund balance; previously this was disclosed on the consolidated revenue account.

53. The council's net operating expenditure in 2006/07 was £267.6 million. This was met by government grants and local taxation of £262.2 million, resulting in an income and expenditure deficit of £5.4 million. The statement of movement on the general fund balance shows that a general fund surplus of £8.691 million was achieved in year. When this surplus is added to the general fund balance brought forward from 2005/06, the council has a general fund balance of £12.095 million at 31 March 2007.

54. The budget set for 2006/07 was based on a Band D council tax level of £1,125, an increase of 4.6% from 2005/06.



55. Within his explanatory foreword, the assistant chief executive (finance) reported that the council achieved an underspend of £7.710 million against budget. This underspend arose from a number of areas including the delay in the introduction of single status (£2.186 million), an overprovision for pay awards (£0.978 million) and savings in borrowing costs (£1.232 million). The council also improved its council tax collection in recent years which has enabled them to reduce their bad debt provision by £2.194 million.

Reserves and balances

56. At 31 March 2007 the council had total cash backed reserves and funds of £34 million, including an insurance fund that underpins the council's self-insurance arrangements and repair and renewal funds to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets.

Reserves and Funds

Description	2006/07 £ Million	2005/06 £ Million
General Fund	12.095	3.404
Housing revenue account balance	3.968	2.919
Repair and Renewal Funds	4.864	4.458
Insurance Fund	3.949	3.539
Capital Fund	9.061	12.957
	33.937	27.277

57. The council aims to maintain a minimum uncommitted general fund balance of 3% of the annual budget. At 31 March 2007, the council had an uncommitted balance of £8.672 million, representing 3.3% of the net general fund expenditure. This balance was built up through a number of one-off gains, including through the revision of the bad debt provisions, so the council will need to monitor the position to ensure that they continue to operate within their reserves strategy.

58. Significant earmarked amounts include £1.470 million for affordable housing, £1.205 million for the education capital items replacement and £0.748 million for devolved education management balances held by individual schools.



Rents and housing revenue account

59. The council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to at least cover the costs of its social housing provision. The budget set for 2006/07 was based on an average weekly rent level of £44.19 an increase of 7% on the previous year. The council has entered into a 30 year significant housing improvement programme which resulted in large rent increases for the first 5 years. 2006/07 was the third year of these large increases.
60. In 2006/07, building services made a surplus of £2.118 million, which enabled them to return £1.4 million to clients. This meant that the housing revenue account had a closing surplus of £3.968 million.

Group balances and going concern

61. 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 (Strathclyde Joint Police Board, Strathclyde Fire and Rescue and Ayrshire Valuation Joint Board) had an excess of liabilities over assets at 31 March 2007 due to the accrual of pension liabilities.
62. The overall effect of inclusion of all of the council's subsidiaries and associates on the group balance sheet is to reduce net assets by £218 million, substantially as a result of these liabilities. All group bodies' accounts have been prepared on a going concern basis.

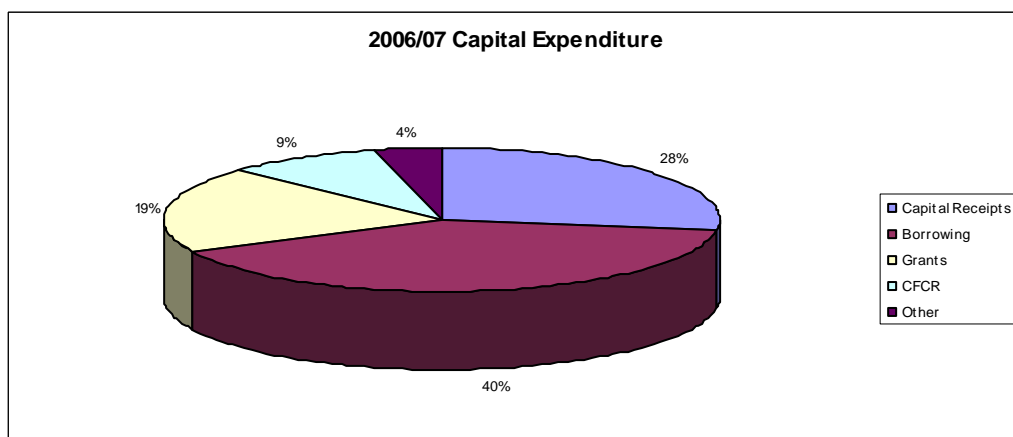
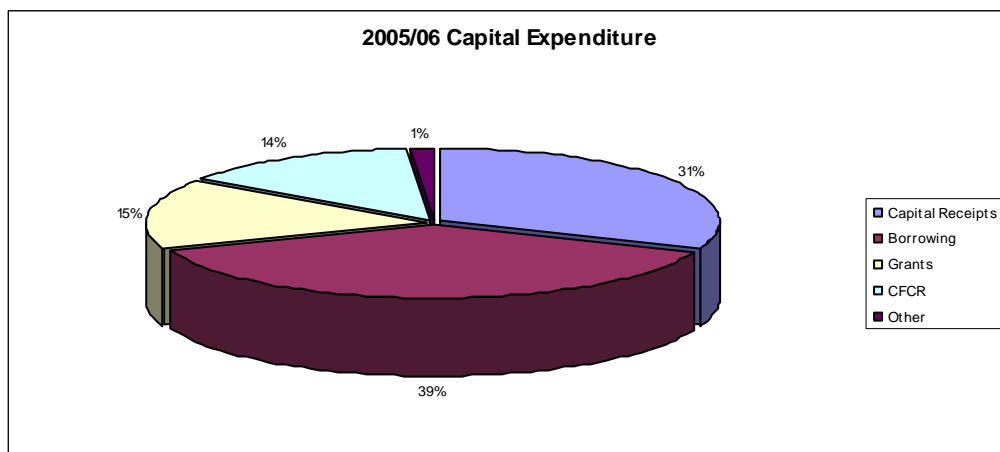
Spending on assets and long-term borrowing

Capital performance 2006/07

63. Following the introduction of the prudential code in April 2004 the council can decide locally on a capital investment strategy which must meet best value requirements as well as being affordable. The council's prudential indicators for 2006/07 were set in February 2006.
64. Capital expenditure in 2006/07 totalled £44.2 million, falling from £44.6 million in 2005/06. Capital investment in the last two years was funded as shown below. While the council has decreased its capital spending, the proportion funded by debt has increased to £17.826 million, an increase of £0.740 million on the previous year.



Sources of Finance for Capital Expenditure



65. Capital improvement programmes experienced severe capital slippage during 2006/07. General services capital outturn reports show capital spending of £24.936 million in 2006/07 against a programme of £42.663 million.



66. The council's treasury portfolio position as at 31 March 2007 was as follows:

Treasury portfolio	As at 31 March 2006 £000	As at 31 March 2007 £000	Change in year
Long Term Borrowing			
PWLB – fixed rate	168,696	151,277	(17,419)
Money Market	35,344	50,253	14,909
Others	614	250	(364)
Total external borrowings	204,654	201,780	(2,874)
Investments	(35,000)	(42,500)	(7,500)

Forward capital programme

67. General services capital plans for 2007/08 and 2008/09 anticipate annual capital expenditure of £51.037 million and £26.466 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 £28 million over the two years. The general services capital budget includes an underspend of £7.828 million which has been carried forward from 2006/07.
68. The council has recognised the importance of delivering the capital programme within a time frame that brings maximum benefit to the community however the plan assumes slippage of 22% over the five year plan to accommodate problems with site surveys etc.

Borrowing in advance of need

69. In recent years, a number of councils have disclosed significant amounts under 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 instances, councils are still required to demonstrate their consideration and compliance with the conditions set out in Audit Scotland's long standing Note for Guidance Number 96/5.
70. This guidance sets out the key factors to be considered by a council when determining whether the decision to borrow in advance of need and lend on temporarily is reasonable. From our review of North Ayrshire Council's borrowing activities, we found that the council had taken one loan during 2006/07. The council had £42.500 million of short term investments on the balance sheet at 31 March 2007 which officers have advised was to take advantage of low interest rates rather than borrowing in advance of need.



Significant trading operations

71. 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. The first three year period ended in 2005/06.
72. In 2005/06 the council had 5 STO's but in 2006/07 the decision was taken to suspend all trading accounts with the exception of Building Services. This decision was made on the basis that the contracts on which transactions were based were out of date and that the financial information was not reflective of the true cost of providing the service. The council undertook to employ consultants to develop service level agreements (SLA's) for the STO's to ensure that they were charging based on more accurate information. The council appointed consultants to review the catering and cleaning STO's in September 2007, with a view to having SLA's in place for 1 April 2008. We will continue to monitor progress in the review of STO's.

Refer action point 6

73. The council reported only the building services STO within their financial statements in 2006/07. The STO has an in year surplus of £2.118 million, £1.4 million of which was refunded to the housing revenue account. Building services has achieved a three- year surplus of £5.740 million.

Financial outlook

Current budget

74. The council's revenue budget for 2007/08 was approved in February 2007. The budget is based on a band D council tax level of £1,152 which is an increase of 2.4% from 2006/07. The council tax level was calculated assuming a collection rate in year of 96%. The budget assumes the use of £0.739 million from the general fund balance. The 2007/08 budget assumes efficiency savings of £4.941 million across all services. If achieved, these should significantly exceed the £1.503 million which the Scottish Government requires the council to make in 2007/08.
75. The housing revenue account budget has been set based on an average rent of £47.28, based on 52 weeks, which represents an increase of 7% from 2006/07. As set out earlier in this report, the council plan to exceed the Scottish housing quality standard but to do this required to set large rent increases to ensure that the improvements were affordable. Indicative rent levels for 2008/09 and 2009/10 based on a 7% increase per annum have been set, resulting in the average rents being £50.59 per week and £54.13 per week respectively.



Equal pay

76. 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.
77. The council made compensation payments to high risk employees in 2005/06 on the basis that single status would be implemented by July 2006. Since single status was not implemented until July 2007, the council were facing the potential of further compensation claims to cover the period from July 2006 to July 2007. To address this risk the council made second compensation payments in 2006/07, amounting to £1.9 million and increased their provision to £2.911 million for cases which were to be settled at tribunal. To date no tribunal cases have been heard.

Single status

78. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a presumption that single status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.
79. 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.
80. The council implemented single status in July 2007, following lengthy discussions with unions which failed to reach an agreement. Current indications are that there are around 980 employees who have lodged an appeal against the outcome of their job evaluation. Based on the initial outcome of job evaluation, the council anticipate annual costs of £3.8 million on the pay-bill and budget provision has been made for this sum.
81. Until the single status appeals process has been completed the initial and continuing costs to the Council cannot be reliably estimated. This represents some financial risk to the council. Evidence from other councils is that variation in the level of potential costs can be up to 10% of the current pay-bill on a continuing basis.



Efficient government

82. As part of the continuing drive to improve the efficient use of resources committed to delivering public services, the Scottish Government expect 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.
83. 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 Scottish Government's 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.
84. The council has strategies and plans in place to ensure that all services identify and deliver efficiencies. Frameworks are in place to allow identified efficiencies to be managed effectively. The council utilise efficiency gains to minimise council tax increases and to invest in the authority's strategic objectives.
85. The council's efficiency statement was submitted to COSLA in August 2007. The statement reports that the council achieved total efficiencies of £3.445 million in 2006/07. These are summarised against the Scottish Government's efficient government themes in the table below.

Efficient Government Theme	Cashable efficiency £m	Non cashable efficiency £m	Total efficiency £m
Procurement	0.240	0	0.240
Streamlining Bureaucracy	0.188	0	0.188
Asset Management	0.269	0	0.269
Other	2.448	0.300	2.748
Total efficiencies	3.145	0.300	3.445

86. Overall, the council has complied with the Improvement Service guidance in preparing its efficiency statement for 2006/07. The efficiencies reported for the year have been achieved as a result of changes in operational practices, for example, improved procurement practices and the improved cost of collecting council tax with no negative impact on collection rates.



87. A number of efficiency measures have been identified for 2007/08 including the further implementation of the procurement strategy and continuous improvement and competitiveness reviews. The budget setting process for 2007/08 identified efficiency savings for all services, which the council believe will not be detrimental to their ability to deliver front line services.

Asset management

88. Scottish councils control land, property and equipment valued at around £22 billion. Capital assets are the second highest cost incurred by local authorities after staffing. Prior to 2004, the legislation that controlled capital investment by local government did not contribute towards good asset management. Part 7 of the Local Government in Scotland 2003 Act introduced the *Prudential Code* which gave local authorities freedom to invest as long as their capital spending plans are affordable, prudent and sustainable. The code is a fundamental component of an authority's financial governance and management which requires authorities to have regard to option appraisal, strategic planning and asset management planning.
89. The efficient government initiative identified asset management as one of five key areas for achieving efficiency improvements. Proper asset management is a vital part of being an efficient organisation including arrangements to ensure there are:
- strategies to reduce maintenance costs
 - proactive asset disposal policies
 - long-term capital planning and budgeting
 - robust asset management monitoring information.
90. Our 2006/07 ARAP highlighted that there was a risk that the council do not take appropriate steps to integrate asset management into its culture and thus will not obtain maximum benefit from the initiative.
91. The council are in the process of introducing ARMS (asset register management system) which incorporates a lease management module, condition surveys, smart CAD plans, suitability surveys, photographs, timesheets and financial monitoring of projects. In July 2007, 20,000 records were imported to the live database, 14,000 of which were council houses. A major data cleansing exercise is currently ongoing to verify this data and to manually input data which cannot be imported electronically due to either software issues or cost. To date no formal timescale has been set for the full implementation of ARMS however the council have recently appointed a project manager to oversee the implementation process and set milestones and targets to enable progress against the plan to be monitored. The council are currently anticipating that ARMS will be rolled out within the next 18 – 24 months, with a number of modules fully operational at an early stage of the programme.

Refer action point 5

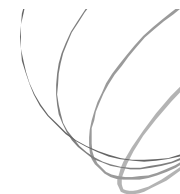


Pension liabilities

92. 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.
93. 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.
94. The council's estimated pension liabilities at 31 March 2007 exceeded its share of the assets in the Local Government (Scotland) Superannuation Scheme by £39.142 million, reducing from £77.874 million in the previous year. A full actuarial valuation of the Local Government (Scotland) Superannuation Scheme was undertaken in March 2005. Factors such as the volatile stock markets and increasing life expectancy have resulted in the funding level, calculated as the ratio of fund assets to past service liabilities, falling from 94% at 31 March 2002 to 84% at 31 March 2005. The actuary is 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. This shows that budgeted contributions are expected to rise from 260% of employee contributions in 2006/07 to 270% in 2007/08 and 280% in 2008/09.
95. From October 2006, employees could sacrifice part of the annual pension in favour of an increased lump sum on retirement. Actuaries have estimated that uptake of this scheme is likely to be 25% for 2006/07. This has reduced the council's pension liability by £5.112 million in 2006/07. Given that this scheme was only introduced in Scotland in 2006, it has not been possible to assess the trend of uptake which means that the assumptions made by the actuaries may be significantly different to actual uptake. This could mean that the council's pension liabilities may be mis-stated in 2006/07.

Refer action point 7

96. The council also has an obligation to meet a proportion of the pension expenditure of the joint boards and committees of which it is a constituent member. The main commitments are to the Strathclyde Police, Strathclyde Fire and Rescue and the Strathclyde Partnership for Transport. These bodies had an excess of pension liabilities over assets at 31 March 2007, and a share of these liabilities will be paid by the council as they fall due.



Governance

Introduction

97. 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

98. 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.

Scrutiny Committee

99. 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. Prior to the May elections, the council had an audit & standards committee whose role included monitoring the annual work programme of internal audit as well as considering matters arising from external audit and ensuring that effective controls were in place within services. Overall the audit & standards committee was effective in its role.
100. The new scrutiny committee was established following the May 2007 elections, following the councils move to a cabinet style approach. The scrutiny committee consists of nine members of the council, excluding any members of the executive, and comprises of three members appointed by the Labour group, three members appointed by the SNP, one member appointed by the Conservative group and two members appointed from the Independents. The chair of the committee is a member of the opposition.
101. Since the May elections resulted in a number of new members to the council, training on the role of the scrutiny committee is fundamental to ensuring the effectiveness of the scrutiny process. Members induction training included the role of the scrutiny committee and a number of members recently went to Aberdeenshire to view their scrutiny arrangements. The council are also endeavouring to arrange training on financial scrutiny which they have asked CIPFA to deliver. Attendance at training is not compulsory and no record is maintained of attendance at training opportunities.
102. The council should consider reviewing the effectiveness of the new scrutiny committee against the CIPFA in Scotland guidance note "audit committee principles in local government" in due course.



Internal Audit

103. 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, which are mandatory for all local authorities and other relevant bodies under section 95 of the Local Government (Scotland) Act 1973, 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.

104. We carried out an annual review of the council's internal audit arrangements and found that the function is operating in accordance with the code. We reviewed the progress of internal audit against their annual plan and found that they had completed 98% by their year end.

105. As part of our review we also look at the planned audit work in compiling our own plan in order to identify areas where reliance on internal audit is possible. The following areas were specifically identified as areas where reliance could be placed:

- Statement on the system of internal financial control
- Payroll
- Cash Collection
- Creditors
- Debtors
- Non Domestic Rates
- Housing Benefits
- Supporting People
- Capital Accounting

Risk Management

106. The council's risk management arrangements are well developed through the use of both a corporate risk register and departmental registers. Departmental risk registers are populated using risks identified by chief officers as part of the annual service planning and budget process and each service



completes a strategic risk assessment summary. Progress against risks is monitored and reported to management.

Systems of internal control

107. In his annual report for 2006/07 the chief internal auditor provided his opinion that, based on the internal audit work undertaken during the year, the council's systems of internal control are operating effectively to provide reasonable assurance that management policies are adhered to, assets are safeguarded, reliable financial information is produced and statutory requirements are met.

108. As part of our 2006/07 audit activity, we undertook a review of the main financial systems which were identified as part of our preliminary assessment work. The purpose of these reviews was to evaluate whether appropriate internal controls were in place to enable us to gain assurance on the system output for our opinion on the annual financial statements. We undertook high level reviews of 13 financial systems, with 5 of these being subject to a more comprehensive review.

109. The issues identified were raised with management in our "Review of Main Financial Systems" in September 2007, which includes the council's response and agreed actions to remedy the issues. We will re-visit this area in 2007/08 to ensure that agreed actions have been implemented.

Prevention and detection of fraud and irregularities

110. At the corporate level, the council has appropriate arrangements in place to 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

111. 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 (£27M 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.

112. The NFI 2006/07 results (data 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.

113. The council has taken a positive approach to the ongoing NFI exercise and significant progress has been made in following up referrals and, where appropriate, taking action to prevent further loss and to recover fraudulent payments. Matches have been prioritised and the council has concentrated on the higher priority cases. Some lower priority risk-based matches, where the returns are likely to be small in relation to the effort required, have not yet been examined. The council will not follow up potential matches in areas, such as creditors, where work previously undertaken has given adequate assurance.

114. A total of 2247 matches were made including 236 individuals who appeared more than once. At 5 October, 951 referrals had been investigated with 82 in the process of being followed up. Eight frauds have been discovered totalling £51,695.

115. Members and senior managers are aware of the exercise and progress is reported as part of the chief internal auditor's report to the scrutiny committee. Progress reports can also be accessed direct from the NFI web-based application by staff involved and by audit.

Governance outlook

Impact of the 2007 elections

116. As detailed in the performance section of this report, the council's traditional committee structure was replaced with a cabinet style structure which comprises of the executive, the education executive, a scrutiny committee, a planning committee and a licensing and regulatory committee. The revised political management structure was agreed at the meeting of the full council on 22 May 2007.

117. All members were given the opportunity to receive training on a wide variety of issues as set out below, and while attendance was not compulsory, we were advised that there was a high level of uptake. The subjects covered in the induction programme were:

- An Introduction to North Ayrshire Council.
- The role of the councillor.
- Statutory meeting of the council.
- Local government finance.
- Planning.
- Corporate services.



- Social services.
- Education services.
- Property services.

118. Of the 30 members of the council, 16 of these were returning members and 14 were newly elected, although some of the new members have previous experience as a councillor. Given the significant number of new members to the council, it is essential that the council strive to offer relevant training to ensure that they can fulfil their responsibilities effectively.

Changes at senior officer level

119. The council has recently announced that the corporate director, educational service will be retiring during 2007/08 and that his replacement has been appointed. His replacement is an internal candidate who has been with the council since 2005, following a career as both a primary and secondary teacher and then in the education departments of both North Lanarkshire Council and Stirling Council.



Financial statements

Introduction

120. 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
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

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

Overall conclusion

122. We have given an unqualified opinion on the financial statements of North Ayrshire Council for 2006/07.

123. The council's un-audited financial statements were submitted to the controller of audit prior to the deadline of 30 June. Final accounts preparation processes and working papers were generally good and this enabled the audit to progress smoothly. 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.

Accounting practice

124. 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 2005/06 comparative figures.

125. Overall, we were satisfied that the council had prepared the accounts in accordance with the revised SORP. There was only one significant adjustment made to the figures included in the un-audited accounts provided for public inspection. The net effect of this was to increase the general fund surplus for the year by £1.470 million, which is earmarked for affordable housing. Details of this adjustment and other significant accounting issues arising in the course of our audit are summarised below.

Treatment of deferred income

126. The council has a creditor of £918,849 within its financial statements in respect of deferred income. This related to children and families money which was received through the revenue support grant mechanism during 2006/07 but not spent by the council in 2006/07. We were informed that this income is 'ring fenced' in that it can only be used to fund specific projects such as those relating to anti social behaviour and working for families. The accounting treatment is not in line with current local authority accounting guidelines which recommend that the unspent grant should be recognised as income in the year it has been received and ring fenced in the general fund balance. The council have agreed to review this issue in 2007/08.

Refer action point 8

Capital expenditure

127. The current system of capital accounting is defined by SORP. The 2006 SORP governs the approach to preparing the 2006/07 financial statements. The 2006 SORP states that replacement programmes such as those for replacing bathrooms and kitchens etc in council dwellings can only be capitalised where the authority has adopted component accounting, which ensures that assets are individually recognised and depreciated based on their individual useful lives. The council has capitalised expenditure of £11.976m which per the SORP should be treated as revenue expenditure on the basis that it is part of a replacement programme. The council disagree on the basis that they have reduced



the useful lives of council dwellings overall to take account of the differing useful lives of the component parts. We have accepted the council's position and agreed to revisit this issue during our audit of the council's 2007/08 financial statements.

Refer action point 9

Depreciation of council dwellings

128. In 2005/06 the council changed their approach from depreciating council dwellings over 40 years to applying a percentage to the valuation of housing stock. The percentage was derived by taking the value of principal repayment of HRA debt as a percentage of the total HRA debt outstanding at the beginning of the year. While this treatment is not in accordance with the SORP, our view is that this is unlikely to result in a material difference in the depreciation charge. However we intend to review the position prior to the audit of the 2007/08 financial statements.

Refer action point 10

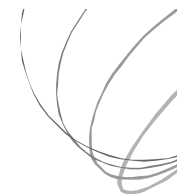
Objection to the accounts

129. We received an objection to the accounts from one elector who has raised a number of issues, the majority of which were raised in previous years. The objector has met with us in accordance with Section 101 of the Local Government (Scotland) Act 1973 and we have no significant issues to report at this time.

Asset register

130. The SORP requires the council to maintain an accurate asset register which correctly classifies assets between defined categories. The council are in the process of introducing a new asset management system (ARMS) which will be populated using the existing asset information and will allow greater monitoring over the condition and ownership of assets. Our review identified a number of instances where assets had been wrongly classified as investment properties and where the costs of the development of IT systems had been included within intangible assets. The council have agreed to review the classification of assets in 2007/08. The objection to the accounts, mentioned above, referred specifically to the failure of the council to maintain an adequate asset register for common good assets. The council advised that the owner of assets will be included within the new system. The council are in the process of reviewing the ownership of assets to ensure accurate population of the new system.

Refer action point 5



2nd home council tax discount

131. From 1 April 2005 the council tax (discount for unoccupied dwellings)(Scotland) Regulations 2005 replaced the scheme where a 50% discount was awarded to unoccupied properties with a 10% discount scheme. Under the terms of the schedule, the difference of 40% was to be used to fund the provision of new-build affordable housing. The Scottish Government issued guidance on 16 December 2005 which set out how councils should account for this money. The guidance requires councils to include this money as ringfenced in the general fund where the council have no specific plans for spending the money at the end of the financial year and where a service provider has been identified, the amount should be shown as a creditor. The council had included £777,000 in creditors for 2006/07 and £693,000 for 2005/06, rather than including these as earmarked amounts in the general fund. Given that no service provider has as yet been identified, this treatment was not in accordance with the guidance and understated the general fund balance by £1,470,000. The council agreed to amend the financial statements.

Refer action point 11

Equal pay

132. During 2006/07 the council made second compensation payments to high risk employees under equal pay legislation, to cover the period from July 2006 to October 2007. While a large number of employees accepted these compensation payments, a number of employees rejected these and chose to pursue their claims through tribunal. The council had shown a creditor in the accounts for £2.911m in respect of these claims. While this amount appears reasonable, the council should be showing this amount within provisions in the balance sheet as it meets the criteria set out in the SORP for a provision. The council agreed to amend the accounts.

Food preparation charges

133. In July 2002, the Scottish Government introduced free personal care to the elderly. While councils stopped making charges for some aspects of care for the elderly, there was no definitive legal position established as to whether councils could continue to charge for food preparation. In November 2006, North Ayrshire Council decided to stop charging for food preparation however actual invoices were not amended until April 2007 due to the difficulty in separately identifying food preparation charges. The council undertook an exercise to identify cases where food preparation charges were still being made after November 2006 and made a provision of £112,000 to refund this money to service users. The council agreed that in the absence of definitive legal guidance as to whether food preparation charges



were legal prior to November 2006 that they would include a contingent liability for any future refund claims.

Refer action point 12

Police grant

134. The Council included £13.679 million of income in the income & expenditure under 'Police Services'. This related to police grant which was paid direct from the Scottish Government to Strathclyde Police Board. To aid consistency across the whole of government accounts, officers agreed to amend the income & expenditure account to reduce both income and expenditure by this amount.

Capital slippage

135. There was significant slippage against the capital programme during 2006/07. General capital expenditure for the year amounted to £24.936 million against a plan of £42.663 million (actual spend at only 70% of the annual budget). The housing revenue account capital outturn was £19.3 million against a budget of £19.741 million. The council advised that the introduction of the prudential framework resulted in the requirement to spend in any one particular year becoming less relevant and that appropriate monitoring arrangements were in place over capital expenditure.

Refer action point 13

Group accounts

136. Modified arrangements for the preparation of group accounts were mandatory for the first time in 2005/06. 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 prepared group accounts in accordance with the new requirements following a review to determine its interest in subsidiaries, associated entities and joint ventures.

137. The group accounts include the 2006/07 results of a number of group entities including North Ayrshire Leisure Limited, North Ayrshire Ventures Limited and 5 joint boards based on unaudited accounts. The auditors of these bodies have confirmed that there are no planned changes to the un-audited accounts. We have also been provided assurances by the Assistant Chief Executive (Finance) that the council is not aware of any matters which would significantly affect the council's group accounts.



Public private partnership

138. The building of the new schools under the Schools PPP is nearing completion, with the first school transferred to the council in August 2007. 2007/08 will be the first year where the council are required to account for the costs (unitary charge) of the PPP.

139. In March 2007 the Chancellor announced that public sector financial statements will abide by international financial reporting standards (IFRS) from 2008/09. This is potentially a major change in the accounting treatment of all PPP projects in Scotland. The public sector standard setting bodies have yet to propose or determine the future rules that are to apply to the accounting treatment of PPP. There is a risk that this may change the treatment of virtually all Scottish PPP projects from 2008/09.

Legality

140. Each year we request written confirmation from the chief executive that the council's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes. The Assistant Chief Executive (Finance) has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the council's CMT, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.

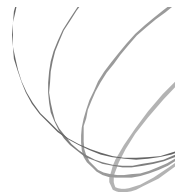
141. Local authorities with registered charitable bodies (i.e. registered trust funds) are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund. Clearly, this is an onerous task for local authorities and discussions are ongoing between the CIPFA directors of finance section and the office of the Scottish charities regulator to reach an acceptable solution.

142. The Freedom of Information (Scotland) Act 2003 came into force on 1 January 2005 and provides citizens with the right to obtain information and documents held by public authorities in Scotland. The act requires that councils respond to FOI requests within 20 days. In 2006/07 the council received 233 requests for information and has responded to 214 of these within the 20 day target response time. Therefore, responses to 19 FOI requests fell outwith the 20 days.

143. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Financial reporting outlook

144. 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. Challenges ahead include a number of changes that have been made to the 2007 SORP.

145. The main change is that the 2007 SORP requires authorities to comply with financial reporting standards (FRS) 25 and 26 in respect of loans, from 2007/08. This will result in large expenditure entries to the income and expenditure account as the SORP requires premiums on loans which have been rescheduled to be written off in line with the FRS. At present, councils are able to write off premiums over the period of the replacement loan, which can be up to 60 years. The regulations restrict the write off periods for new premiums incurred on lender options borrower options (LOBOs) from 1 April 2007 to a maximum of 20 years. Statutory guidance mitigates the impact on council tax by requiring authorities to reverse the entries in the statement of movement on the general fund balance.

146. Other changes include:

- changes to capital accounting requirements to introduce a revaluation reserve and capital adjustment account
- a requirement for further information to be disclosed in respect of charitable funds.

147. Central government and NHS bodies are to move from UK generally accepted accounting principles 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. It was recognised that there would need to be discussions with CIPFA/ LASAAC about the introduction of IFRS-based accounts for local government. Of particular note is that IFRS do not address PPP accounting in the public sector. The Treasury are therefore currently considering the most appropriate accounting treatment for PPP public sector transactions. If IFRS principles, or similar, were applied in the public sector then many PPP assets are likely be brought onto public sector balance sheets.

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 issue 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. A mechanism 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 members and staff is gratefully acknowledged.



Appendix A: Action Plan

Key Risk Areas and Planned Management Action

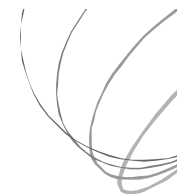
Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	28	<p>Three year budgeting</p> <p>The council have not prepared a three year budget due to the delay in receiving details of their funding settlement.</p> <p><i>Risk: The council cannot demonstrate how it intends to fund the priorities set out in the council plan.</i></p>	<p>The Council is currently in the process of producing a three year budget for the period 2008/09 to 2010/11 linked to its service planning proposals. This cannot be finalised until the levels of support from the Scottish Government are clarified in December 2007.</p>	<p>Assistant Chief Executive (Finance)</p>	<p>February 2008</p>
2	31	<p>Supporting people</p> <p>Supporting people contracts are not in place for all external service providers and SLAs are not in place for internal providers.</p> <p><i>Risk: The council are continuing to pay service providers for services which are not formally agreed.</i></p>	<p>Contract bases are currently being reviewed, advice has been provided by the Procurement Officer. Meetings have been arranged to consider a timetable for the implementation of new contracts.</p>	<p>Head of Service (Community Care)</p>	<p>April 2008</p>
3	37	<p>PDR reviews</p> <p>PDR reviews are not yet in place for all employees.</p> <p><i>Risk: Staff training needs are not being adequately recognised thus the council is not ensuring that staff are securing personal development.</i></p>	<p>The PDR process is currently being re-launched. Training sessions are being held for managers.</p>	<p>Assistant Chief Executive (Personnel)</p>	<p>Year 2008/09</p>
4	38	<p>PECOS</p> <p>PECOS has not yet been rolled out across all council departments.</p> <p><i>Risk: The package may not be delivering all potential savings due to the package not being used in all departments.</i></p>	<p>Discussions have taken place with Educational Services to ascertain a way forward given the complexity arising from the use of SEEMIS (the management system used by Education). Investigations are currently underway to identify how PECOS can interface to allow a successful rollout.</p>	<p>Assistant Chief Executive (Finance)</p>	<p>April 2009</p>



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
5	39 91 130	<p>Asset register management system</p> <p>The council have estimated a timescale of 18-24 months for the complete roll out of the asset register management system.</p> <p><i>Risk: Slippage on the implementation of the asset register management system could mean that the council are not fully identifying and effectively utilising their assets.</i></p>	The plan is in place for implementation over the next 18 – 24 months.	Asset Manager	March 2009
6	72	<p>Significant trading operations</p> <p>The council reported only the building services STO in 2006/07 on the basis that all STO's were to be reviewed by management by 2008/09.</p> <p><i>Risk: Slippage on the proposed timescale may mean that the council is unable to report on all identified STO's in 2008/09.</i></p>	Consultants are currently assisting in a review of Service Level Agreements for catering and Cleaning. This should be complete by 31 March 2008. The re-introduction of Trading Operations, however, will depend on a review of whether activities meet the criteria for such operations. This will be carried out by 31 March 2008.	Assistant Chief Executive (Finance)	March 2008
7	95	<p>Pension liability</p> <p>From October 2006, employees could sacrifice part of the annual pension in favour of an increased lump sum on retirement. Actuaries have estimated that uptake of this scheme is likely to be 25% for 2006/07. This has reduced the council's pension liability by £5.112 million in 2006/07.</p> <p><i>Risk: There is no historic basis for this assumption which could mean that the pension liability is mis-stated depending on the level of uptake of the scheme.</i></p>	Actuaries are appointed as expert advisors in this field. It would be difficult to contradict their current assumption. Their advice will be monitored to ensure that future predictions are based on experience.	Assistant Chief Executive (Finance)	May 2008



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
8	126	<p>Deferred income</p> <p>The council included unspent revenue support grant totalling £0.918k, mainly relating to children and families in creditors rather than as earmarked funds in the general fund balance. This reduces the surplus on the General Fund and overstates the creditors figure in the Balance Sheet.</p> <p><i>Risk: That the accounts do not present fairly the balance of funds available to the council.</i></p>	The Council has agreed to consider reviewing this treatment in 2007/08.	Chief Accountant	March 2008
9	127	<p>Capital expenditure</p> <p>The council have capitalised expenditure on replacing kitchens and bathrooms etc in its housing stock which is only permitted by the SORP where the council have adopted component accounting.</p> <p><i>Risk: The council may be overstating the valuation of fixed assets by not recognising the varying useful lives of the component assets.</i></p>	We would argue that the restriction in write off periods (see next item) is a reflection of component accounting. The Council will, however, review its position for the 2007/08 accounts.	Assistant Chief Executive (Finance)	April 2008
10	128	<p>Depreciation of council dwellings</p> <p>The council are depreciating their housing stock by applying the value of the principal repayment of HRA debt as a percentage of the HRA debt outstanding at the beginning of the year, rather than by estimating the useful lives of the housing stock.</p> <p><i>Risk: The council may be mis-stating the depreciation charge for its housing stock.</i></p>	This method of calculating a useful life basis for the housing stock will always result in a reduced asset life. The Council will, however, review the calculation as above.	Assistant Chief Executive (Finance)	April 2008



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
11	131	<p>2nd home council tax discount</p> <p>As at 31 March 2007 the council has £1.470 million within the general fund balance which is earmarked to fund affordable housing.</p> <p><i>Risk: If the council do not identify a service provider to utilise this fund, it will continue to grow and the council will be failing to deliver on its council plan priority of delivering affordable housing.</i></p>	The use of this resource is being considered by the Council at this time.	Head of Housing	March 2008
12	133	<p>Food preparation charges</p> <p>The council have only made provision to repay food preparation charges made following their decision to stop charging from November 2006.</p> <p><i>Risk: The decision could be taken that food preparation charges were unlawful under free personal care and the council could be required to make further repayments which it has not provided for.</i></p>	This has been identified as a contingent liability within the Council's accounts and will continue to be monitored. Guidance is awaited from the Scottish Government.	Corporate Director (Social Services)	March 2008
13	135	<p>Capital slippage</p> <p>There was significant slippage on the non-housing capital programme in the year.</p> <p><i>Risk: The council may not deliver its capital projects within set timescales.</i></p>	The capital plan 2007 to 2011 relies on a slippage. Prudential indicators have been based on slippage of £22m over that period.	No action required.	