# West Lothian Council

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

AUDIT SCOTLAND

October 2007

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**on the 2006/07 Audit**

# Contents

# 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 West Lothian 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 £2 million. At 31 March 2006, mainly as a result of funding equal pay compensation payments during the year, the unallocated general fund reserve was taken below this amount to £1.155 million. By March 2007 the council has successfully reinstated its unallocated general fund balance to £2.249 million.

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

The council continues to demonstrate a clear commitment to improvement and has made steady progress against the improvement actions agreed as a result of its 2005 best value audit. Work is ongoing to improve the council's public performance reporting.

Following the 2007 elections, the council has revised its decision making structure, replacing the traditional committee style structure with a cabinet style structure, led by a Council Executive.

The council's corporate plan 2003-2007 states that the council is committed to enhancing the quality of life for everyone living, working and doing business in the area. The council has pledged to do this by working in partnership with other public sector agencies such as the health services, police and voluntary sector. Two large projects currently ongoing which support these aims are the construction of a new civic centre in Livingston, in partnership with several other public bodies, and the schools public private partnership project (PPP3), to build two new schools. During the year we undertook a review of the tendering exercise for the main construction contract for the civic centre, and provided opinions on the accounting treatment and value of money of the PPP3 project. This work concluded that the council's final judgement on the proposed accounting treatment is acceptable and that the project represents overall value for money.

The council is acting as a pathfinder pilot for the development of a single outcome agreement with the Scottish Government. In a report to the council in June 2007, the Chief Executive noted that positive discussions have been ongoing with senior officials at the Scottish Government post election and that while there is still considerable work to be undertaken, he is confident that a formal outcome agreement covering the period to 2011 will be ready for consideration by the council prior to end of March 2008.

## 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:

- affordability and efficient use of resources
- developing the improvement culture
- moving from services to communities
- delivering modern infrastructure for a growing population
- supporting political governance
- a modern and streamlined workforce.

The council's reserves have just been restored to the minimum level and the projected financial position in future years is tight. In addition, it is not yet clear what impact the new Scottish Government will have on local government finance, in particular in relation to the local government settlement and council tax funding. Medium term financial plans will need to be closely monitored to adapt to take account of such pressures.

In the short term in response to these pressures, the revenue budget for 2007/08 includes general and workforce planning efficiencies. Strategies are being devised by heads of service to meet budgets in this environment.

The council has demonstrated a clear commitment to the efficiency agenda at both member and officer level and has reported total efficiencies achieved in 2006/07 were £4.941 million. Going forward, cashable efficiencies of £3.610 million are included in the approved revenue budget for 2007/08. It will be a challenge for the council to achieve these efficiencies whilst continuing to deliver high quality services.

The council has met its revised planned date for full implementation of the single status agreement of 1 October 2007, and only one affected employee has not accepted their new contract under this agreement. As a result of the implementation date being 1 October 2007, the council will need to make additional equal pay compensation payments of around £900,000. A provision of £2.221 million has been included in the financial statements for the additional compensation payments and any potential additional costs arising from the appeals process. The provision is based on the most up to date information available from legal services.

A significant amount of work has been undertaken during 2007 to develop the council's corporate asset management planning and capital investment strategy.  A ten year corporate asset management plan has been developed and is to be considered by members in 2007.  This demonstrates the council's commitment to effective asset management and will help to ensure that asset management is clearly linked with revenue and capital programmes.

The co-operation and assistance given to us by West Lothian Council officers and members during the year is gratefully acknowledged.

**Audit Scotland**
**October 2007**

# Introduction

1. This report summarises the findings from our 2006/07 audit of West Lothian Council, the first year of a five year appointment. Findings are in four sections: performance, the financial position, governance and the 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 presented to the Audit Committee in June 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:

   - affordability and efficient use of resources
   - developing the improvement culture
   - moving from services to communities
   - delivering modern infrastructure for a growing population
   - supporting political governance
   - a modern and streamlined workforce.

3. Overall conclusions about the council's management of key risks are discussed throughout this report.

4. We also undertook a number of exercises which resulted in separate audit reports, for example, an audit review of a number of key financial systems, a review of internal audit, a computer services review and a review of the tendering exercise for the civic centre project. Where appropriate in this report, we refer to key messages from those separate reports for the consideration of members.

5. 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.

6. 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

7. In this section we summarise key aspects of the council's reported performance during 2006/07 and provide an outlook on future performance, including our views on the current status of identified risks. We also comment on the progress against agreed improvement actions arising out of the best value audit and the findings of national performance audit studies.

## Corporate objectives and priorities

8. The corporate plan for 2003 – 2007 sets out the key goals and priorities for the council until 2007 and explains how it planned to achieve these. The plan was set out in six themes, which cut across a variety of services:

- a learning community
- a caring community
- a prosperous community
- a changing community
- a safer community
- a healthy community.

9. A total of 47 priorities are established across these themes. These include the following pledges:

- investing in improving schools and providing additional capacity where necessary
- continuing to provide services for people who are homeless or threatened with homelessness
- facilitating the development of another 1,000 affordable quality homes for rent
- ensuring that education, health and transport infrastructure is provided in tandem with development
- promoting the vitality and viability of traditional town and village centres.

10. Following the May 2007 elections, the former Labour administration of West Lothian Council was replaced by a Scottish National Party/Action to Save St John's Hospital coalition. The draft corporate plan 2007-2011 was approved by the new council on 12 June 2007. The new plan has been prepared on a basis consistent with the community plan and the proposed local outcome agreement which has still to be finalised with the Scottish Government. It is intended that the corporate plan will form the

policy context for the preparation of locality plans for the nine multi member wards and the annual management plans prepared by individual services. The issues raised in this report remain relevant for the council moving forward under its new corporate plan.

# Overview of performance in 2006/07

## Annual report

11. The council's annual report was published in Autumn 2007 and provides a brief round-up of the performance of services provided by West Lothian Council for 2006/07. It includes a joint statement from the Leader of the Council and the Chief Executive highlighting the most significant achievements and developments during the year, including the council's success in becoming the first Scottish council to achieve a Charter Mark, the government's award for excellent customer service, for each of its services. The council also became the first unitary local authority in the UK to achieve the corporate Charter Mark standard for the whole council.

12. The report describes aspects of performance and achievements across each of the corporate plan themes, including:

- ***Learning community*** – increases in attainment across most levels of primary and secondary education; achievement of 'school of ambition' status for Burnhouse School; implementation of the Additional Support for Learning Act to ensure that the learning needs of pupils with additional needs are met effectively and in the most appropriate environment; partnership with developers investing in housing continued to provide schools and community facilities.
- ***Caring community*** – a site for a new development offering a range of services to people with disabilities has been identified in Uphall; two purpose built young people's centres for children and young people who cannot be looked after at home will open this year in Livingston and Whitburn.
- ***Prosperous community*** – in March 2007, the council and its economic partners launched a revised Economic Strategy covering 2007-2010; work began on the £90 million extension of Almondvale Shopping Centre, the new Civic Centre and a new £75 million distribution centre, creating 200 new jobs.
- ***Changing community*** – Livingston town centre continued to expand with the development of phase 3 (the Elements) underway; support for traditional towns continued during the year with the establishment of town centre management groups in Armadale, Linlithgow and Whitburn; 28% of household waste is now being recycled.
- ***Safer community*** – during 2006 the road safety plan 2006-2010 was published and central to this is the commitment to reduce road casualties; an ambitious capital investment programme in roads, footways, street lighting and structures continued with a total 3 year expenditure of £72

million to March 2007; investment of £340,000 in cycling, walking and safer streets schemes and investment of £500,000 in schemes to improve road safety around schools.

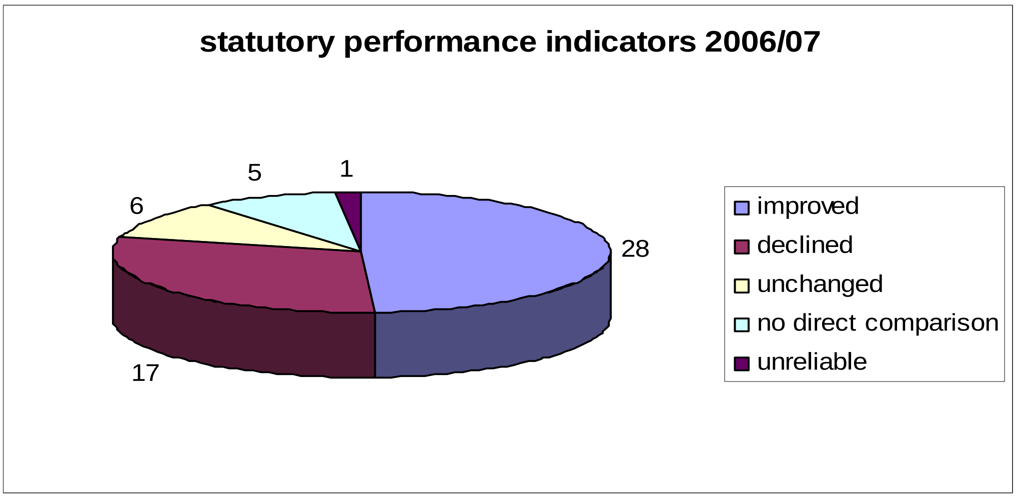
- ***Healthy community*** – an external evaluation of the community health and care partnership highlighted the strengths as being its impact on customer service and partnership effectiveness; nutritional targets set for schools have been met through the provision of improved school menus and uptake of healthy eating choices in school menus has improved.

13. However, as audit reported in 2005/06, the council's current method of annual performance reporting via the annual report 'factfile', does not currently provide a rounded assessment of the extent to which the range of objectives and priorities set out in the corporate plan are being achieved. Officers have explained that the outcome agreement will detail measures, baseline and targets against which the council will report. This will be developed along with the council's approach to public performance reporting and incorporated into the revised West Lothian web site. The council's annual report will continue in its current form and level of detail as a successful means of communication with the public, but will include detail as to where further information on performance can be obtained.

## Statutory performance indicators

14. One of the ways of measuring council performance is through statutory performance indicators (SPIs). Within West Lothian Council, performance is measured using both local and statutory performance indicators.

15. Historically, the council's performance as measured by SPIs has been good, so the council has to work hard to support continuous improvement in areas where performance is already relatively high. In 2006/07, the council has reported continued improvement and high performance for a substantial proportion (49%) of its SPIs:



16. Substantial improvements from the previous year have been made in:

- the number of people age 65+ receiving homecare
- the housing benefit overpayments recovered as a percentage of housing benefit overpayments in the year
- the proportion of looked after children seen by a supervising officer within 15 days
- the number of attendances per 1,000 population for other indoor sports and leisure facilities, excluding pools in a combined complex
- the number of complaints per 1,000 households regarding the household waste collection service
- the percentage of municipal waste collected by the authority during the year which was recycled.

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

- the average time taken to provide community care services from first identification of need to first service provision
- the cost of collecting council tax per dwelling. It is noted that the cost has risen in 2006/07 due to the council's heightened focus on debt recovery
- the percentage of the road network that should be considered for maintenance treatment. Officers have explained that the decline in this indicator is due to the effect of capital investment in the road network not being fully reflected in the 2006/07 indicator due to the timing of the capital work
- the net cost of refuse collection and disposal per premise. It is noted that the cost increase is due to the council's use of more recycling initiatives.

18. Each year we review the reliability of the council's arrangements to prepare SPIs. Overall the quality of working papers provided to support the SPIs this year was good, however there were some inconsistencies in the way services completed the audit statements provided to support the calculation of each SPI. One indicator (cultural and community services – lifelong learning) was classified as unreliable in 2006/07 (none in 2005/06). A new IT system was introduced midway through the year and the information that it provides in relation to this indicator is not considered to be reliable. The figures used to calculate the indicator were taken from the old system and were taken midway through the year whereas the guidance states that the figures need to cover the period April to March. Officers are currently liaising with the system providers to ensure the issues are addressed for future years.

## 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 West Lothian Council was carried out in 2005 and the findings published in June 2005. In response, the council approved a best value improvement plan in September 2005 setting out the ten 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's ongoing performance management arrangements. Progress reports have been considered by the Performance Committee on a six monthly basis. The latest report, as at March 2007, was presented to the Performance Committee on 12 June 2007.

22. Good progress has been made by the council in implementing the improvement plan. Of the ten improvement agenda items, six have now been completed and the remaining four have been well progressed. These remaining actions relate to members training, public performance reporting, efficient government and the mid-point review of the community plan, all of which are discussed within the performance outlook section below.

# Performance outlook – opportunities and risks

## Introduction

23. In the course of our audit work we identified some of the strategic risks to West Lothian Council delivering on its stated objectives and priorities in the years ahead. In our ARAP, these risks were grouped into six 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.

## Affordability and efficient use of resources

24. The financial pressures on the council are significant. Revenue budgets have been constrained to meet the demands of single status developments and the efficiency agenda. Other financial

pressures include increasing pension costs, the implications of the national waste strategy, and increasing energy costs. All known and anticipated financial pressures are accounted for in the council's revenue budgets.

25. The main financial pressures which faced the council during 2006/07 were equal pay and single status. These are covered in more detail at paragraphs 93 – 97.

26. In the 2007/08 revenue fund monitoring report to 30 June 2007, presented to the Council Executive in August 2007, the Head of Finance notes that emerging pressures will be difficult to contain especially as services will need to accommodate these in addition to the general and workforce planning efficiencies that were applied in the budget. The report identifies some emerging pressures and notes that measures are being identified by heads of service to manage pressures within approved budgets or to devise strategies to address these pressures. The Head of Finance stressed in the report that this is particularly important as reserves have just been restored to the minimum level and the projected financial position in future years is tight.

27. The council has made good progress in planning its overall financial position over the medium term, and is working towards longer term integrated capital investment and asset management planning. This is described at the financial position section of this report.

28. In June 2006, the Policy, Partnership and Resources Committee approved a corporate procurement policy which set out the rules governing the council's procurement activities to ensure that best practice is employed by the council consistently. A short term procurement strategy for the period 2007/08 was approved by the Policy, Partnership and Resources Committee in March 2007. This sets out how purchasing services will deliver the aims and objectives of the procurement policy through a number of strategic objectives including the adoption of the McClelland report recommendations and the continued development of green purchasing and key performance indicators.

29. As noted in the financial position section of this report, the council has demonstrated a clear commitment to the efficiency agenda and has reported the achievement of £4.941 million efficiencies in 2006/07 in its draft efficiency statement.

## Developing the improvement culture

30. The council's best value audit concluded that a culture of continuous improvement is well embedded throughout the organisation, although continued development in performance management and member scrutiny would further support the achievement of key aims and policy objectives.

31. The council is acting as a pathfinder pilot for the development of a single outcome agreement with the Scottish Government. The single outcome agreement is a new approach to developing and delivering council services which places the focus on outcomes, setting key targets and priorities which reflect the Scottish Government's national priorities based on local needs. The approach involves the measurement of the impact of council services and therefore requires a rigorous and robust performance management framework which provides evidence of achievement that all parties can rely on. In a report to the council in June 2007, the Chief Executive noted that positive discussions have been ongoing with senior officials at the Scottish Government post election and that while there is still considerable work to be undertaken, he is confident that a formal outcome agreement covering the period to 2011 will be ready for consideration by the council by March 2008.

32. Members' scrutiny of performance was enhanced with the introduction of a performance committee during 2006/07. The committee's workload is planned so that at each meeting the committee reviews a different service's performance information and makes recommendations for improvement. In our ARAP we noted that while a range of actions had been agreed at committee meetings and taken forward by officers, target deadlines had not been set for the services to report back on progress made. Therefore, we identified that there was a risk that the actions requested by the committee are not satisfactorily progressed. Officers agreed that reporting deadlines would be specified by the new committee following the May 2007 elections. We will continue to monitor progress.

33. One of the improvement actions set out in the best value audit report was to further develop public performance reporting in line with statutory guidance. The position as reported to the performance committee in June 2007 is that the development of a framework for consultation, engagement and policy partnership and resources on a locality basis is continuing in conjunction with the development of an outcome agreement for West Lothian and the new corporate plan. The council is in the process of developing a public performance reporting (PPR) web facility as part of this.

34. The Benefits Fraud Inspectorate (BFI) reported in October 2006 on their inspection of the council's security arrangements. Although the report identified some good practice areas, key weaknesses were also highlighted and the council took immediate action to make changes to procedures and prepared an action plan to address the remaining recommendations. Internal audit published a report in August 2007 on their review of performance in implementing the recommendations contained within the BFI report and concluded that significant progress has been made. However, it was noted that a number of the agreed actions are in the early stages and these will be further reviewed by internal audit during 2007/08.

35. The Social Work Inspection Agency (SWIA) undertook a performance inspection of the council's social work services and published a report in March 2007. The report gives a very positive account of social work services, with no area graded less than 'good', and the council was the first authority to receive an 'excellent' grading. The report notes that most people were receiving very good services

from West Lothian social policy, that the overwhelming majority of staff were highly motivated, enthusiastic and well trained and that social policy was well managed in most areas. Some areas of improvement were identified and the council will now agree an action plan with SWIA, and a follow up inspection will be undertaken in March 2008.

36. HM Inspectorate of Education (HMIe) undertook a review of the council and issued a report in June 2007. The report identified several areas of good practice and concluded overall that the authority achieved a very high level of performance. As a result, HM Inspectors will make no further reports in connection with the 2007 inspection. Instead, the District Inspector will continue to monitor progress as part of his regular work with the council.

## Moving from services to communities

37. The council is in the process of shifting its focus from services to communities with priorities being set on a locality rather than a service basis.

38. The locality planning model will be key to the successful delivery of the planned outcome agreement at a local level. The model was previously based on the catchment areas of non-denominational secondary schools but these will be revised to be based on the new multi-member wards created by the 2007 election. Locality plans have been developed to highlight the needs of local communities and set out how the council and its partners will deliver improved services. Each locality plan is led by either a senior council officer or a senior officer of one of the council's community planning partners. Going forward, it is anticipated that the local members will have a central role in the development, delivery and governance of the locality planning process.

39. The council's best value report, published in June 2005, concluded that the council demonstrates a clear commitment to community planning and has a track record of delivering modern, integrated services through good partnership working. In June 2006, Audit Scotland reported on the results of a baseline study on community planning, *Community planning: an initial review* and many of the recommendations made in the report form part of the council's improvement agenda.

40. The council's community plan was reviewed during 2006 and improvement actions were identified to help take community planning forward. It was originally anticipated that a revised community plan would be ready for consultation by the end of 2006. However, delivery was delayed by the pilot of the single outcome agreement. New community plan key priorities are now being developed which will link in with those set in the outcome agreement and it is intended that the revised community plan will be finalised once the outcome agreement has been agreed with the Scottish Government.

## Delivering modern infrastructure for a growing population

41. Perhaps the most significant challenge currently facing the council is the predicted rate of growth of the West Lothian population and the resulting impact on infrastructure and council services.

42. The council recognised that there is a shortage of affordable housing in the area, and has pledged to provide 1000 homes at affordable rent. During 2006/07 and as part of the wider housing strategy aimed at addressing social housing issues throughout West Lothian, the council disposed of six residential development sites to registered social landlords, and plans future disposal of a further two sites to allow the provision of new homes for rent by council applicants.

43. The 2007/08 housing capital programme includes £6.2 million investment in new build housing in partnership with Communities Scotland and other development partners. In addition, in June 2007, the PPR committee approved proposals for the first phase of a programme to build new council houses. The first phase will provide a total of 240 houses for rent and it is intended that work will start in March 2008, with completion by August 2010. The total estimated cost for this phase is £27.7 million.

44. In addition to the above plans, the West Lothian local plan 2005 supports a sustained level of growth with up to 12,000 houses planned within three Core Development Areas (CDAs). This scale of housing development will result in demand for additional and improved facilities within the local communities. In June 2007, and following a consultation exercise, the PPR committee approved that supplementary planning guidance on developer contributions for town and village centre improvements in the CDAs be adopted as council policy. In addition, the council has identified that the housing expansion will require new education provision of one denominational and 2 non-denominational secondary schools, to be funded by developer contributions.

45. Communities Scotland reported on their housing inspection of the council in October 2006. The council was graded as excellent for housing management and property maintenance, and as fair in respect of its homelessness services. The report concluded that the council's approach to delivering its homelessness service, including access to temporary accommodation and assessing applications, needed to improve significantly. The council prepared an improvement plan to address the weaknesses identified and will report progress to Communities Scotland in November 2007. We noted in our ARAP that there was a risk that the council may not meet its statutory duties in respect of homelessness in 2006/07, and assurances have been sought from the council, via the ISA 580 letter of representation, in respect of this.

46. The council is undertaking a significant project to build a new civic centre in conjunction with six other public sector organisations, namely Lothian and Borders Police Board, the Scottish Courts Service, the Crown Procurator Fiscal Service, the Children's Reporter, the Community Health and Care

Partnership and Lothian and Borders Fire and Rescue (Operations and Community Safety). Construction work began on site in February 2007 with occupation expected in summer 2009. In addition to cost savings, the project provides a real opportunity to improve joint working, however, the number of partners involved in the development present particular challenges for the management of the project. We undertook a review of the tendering of the main construction contract, and reported to officers in March 2007. We concluded that the tendering process complied with EU requirements and the requirements of the council's own standing orders, financial regulations, finance guidelines and scheme of delegation. Good practice was demonstrated in a number of areas.

## Supporting political governance

47. In common with many councils, the elections have resulted in a new administration and a considerable number of new councillors (13 of the 32 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.

48. The council's previous traditional committee and sub-committee structure has been replaced with a cabinet style structure, with effect from August 2007. The new structure is led by the Council Executive which has wide ranging decision making powers and a remit reflecting that of the previous Policy, Partnership and Resources Committee. The Executive is supported by a number of special committees with scrutiny functions (such as the Audit Committee), nine policy development and scrutiny panels and nine local area committees. The council will continue to meet every six weeks and its powers will comprise those reserved to it by law, and additional reservations felt to be desirable, for example, setting the council's prudential indicators and setting the level of housing rents.

49. The council is of the view that with the new administration, the new structure will be more effective as decision-making resources and processes will now concentrate more on wider strategic issues rather than on the detail of service provision. The effectiveness of the new structure will be kept under review on an ongoing basis.

50. The council recognised that the newly elected members should be assisted in acquiring the knowledge and skills required to allow them to carry out their new role. Immediately after the election, all councillors were provided with a comprehensive induction pack providing key information. An induction day was hosted by the Chief Executive on 8 May 2007, to which all newly elected members were invited.

51. Opportunities were made available for members to participate in core training during their first few weeks in office. The purpose of this training was to assist members to understand the working of the council, provide knowledge of priority areas for service delivery and to assist members to understand code of conduct, ethical standards and core processes such as business and financial planning.

Uptake of training has been positive, with elected members attending events of relevance to them and their role. All new members and almost all continuing members attended the initial induction sessions on the urgent core topics. Ongoing training and development events will be offered to allow members to further develop their knowledge, skills and possibly qualifications relevant to their role. Individual opportunities are identified during one to one development planning meetings as part of continuous personal development planning.

52. The council also recognised the importance of ensuring that all elected members were made aware of the new arrangements and changes to their role, in particular with regard to multi-member ward working. A protocol on multi-member ward working for members was prepared and presented to the full council meeting on 26 June 2007. The protocol sets out some of the key issues which will evolve in multi member ward working, for example, sharing information, dealing with constituents and ward working practices.

## A modern and streamlined workforce

53. The successful delivery of council services, whether directly by council staff or by others and monitored by council staff, depends on the capacity, capability and competency of the workforce.

54. The council has a corporate people strategy in place which helps to ensure that the council has a suitably trained workforce to meet current and future demand for services. The Head of Housing and Building Services is leading a review of the strategy, which will include performance criteria and success measures.

55. Workforce planning is one of the council's key efficiency workstreams, and each service has been given a target for the reduction in workforce costs over the next 5 years. It is intended that workforce efficiencies of 5% will be achieved council-wide over the next 5 years, of which 1.2% (£1.030 million) relates to 2007/08.

56. In our ARAP we noted that five year workforce plans were being piloted in housing services and will be rolled out across the council in due course. These plans will identify when vacancies are likely to arise and determine whether these vacancies can be rationalised in order to make efficiencies. The Head of Support Services has advised that very basic workforce planning has been applied in various areas. The Organisational Development team within Human Resources are currently developing a more sophisticated corporate workforce planning approach, which is likely to include the use of predictive technology to model attrition rates.

57. A risk arose in the year from the introduction of age discrimination legislation from October 2006. This legislation prohibits direct and indirect discrimination on the grounds of age and, as such, linking length of service to pay and benefits could give rise to indirect age discrimination as some age groups

are more likely to have the necessary length of service than others. To ensure compliance with the age discrimination legislation, the council undertook an equality impact assessment of all of its policies. This assessment included age, race and gender and amendments were made to policies where appropriate.

## National studies

58. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the council are set out in paragraphs 59 – 66 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

59. 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.

60. 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 EC can impose a fine on the UK of up to £350,000 per day if it fails to meet its targets.

61. 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 as landfill, including the impact and value for money achieved by the investment in this area.

62. Audit Scotland's national report was published in September 2007 and includes a number of recommendations which should be considered by the council. The key findings from the report 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 more effectively together to make rapid progress in waste minimisation, recycling and waste treatment to achieve the landfill directive targets.

63. Throughout our audit we will consider the findings of the national report in the context of the council.

## Dealing with offending by young people

64. 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. The key findings from the study are:

- The Scottish Executive has shown a consistent 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.

65. The report includes a number of recommendations which should be considered by the council.

## Scotland’s School Estate

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

# Financial position

## Introduction

67. 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 'affordability and efficient use of resources', our ARAP outlined 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

68. 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 the movement on the general fund. 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.

69. The council's net operating expenditure in 2006/07 was £294.657 million. This was met by government grants and local taxation of £290.180 million, resulting in an income and expenditure account deficit of £4.477 million. As explained in paragraph 68, this position is required to be shown for accounting purposes, and this deficit is offset by a net surplus on the statement of movement on the general fund balance of £5.172 million, resulting in a general fund surplus of £0.695 million for the year. When this surplus is added to the general fund balance brought forward from 2005/06, the council has a general fund balance of £4.293 million at 31 March 2007.

70. The budget set for 2006/07 was based on a Band D council tax level of £1,101, an increase of 2.5% from 2005/06. The budget did not assume any use of the general fund balance.

71. Within his explanatory foreword, the Head of Finance notes that the general fund net surplus of £0.695 million for the year was £1.094 million better than expected, after taking account of £0.399 million of net expenditure on commitments funded from the balance. This underspend comprised a net service underspend of £0.323 million, an underspend of £0.181 million on joint boards and a favourable variance relating to funding of £0.590 million mainly as a result of improvement in council tax collection levels and a saving in council tax benefits.

## Reserves and balances

72. At 31 March 2007 the council had total cash backed reserves and funds of £46 million, including a capital fund, an insurance fund 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 | 4.293 | 3.598 |
| General Fund – Housing Revenue Account balance | 0.925 | 0.916 |
| Insurance Fund | 6.062 | 4.634 |
| Repair and Renewal Funds | 0.086 | 0.222 |
| Capital Fund | 34.466 | 29.671 |
| | **45.832** | **39.041** |

73. The council aims to maintain a minimum unallocated general fund balance of £2 million. At 31 March 2006, the unallocated general fund balance was reduced to £1.155 million as a consequence of funding equal pay compensation awards and the repayment of charges made for food preparation. The general fund balance at 31 March 2007 was £4.293 million, of which £2.044 million is committed. This leaves an uncommitted general fund balance of £2.249 million. A range of financial issues which could further impact on the reserves position are discussed in our Financial Outlook section below.

74. Earmarked amounts are £1.110 million for delegated schemes within education, £0.434 million for the energy efficiency fund, £0.416 million for the core development areas project team and £0.084 million for the local planning enquiry.

## Group balances

75. 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 overall effect of inclusion of all of the council's associates and joint ventures on the group balance sheet is to reduce net assets by £138.162 million, substantially as a result of the pension liabilities of joint boards. All group bodies' accounts have been prepared on a going concern basis.

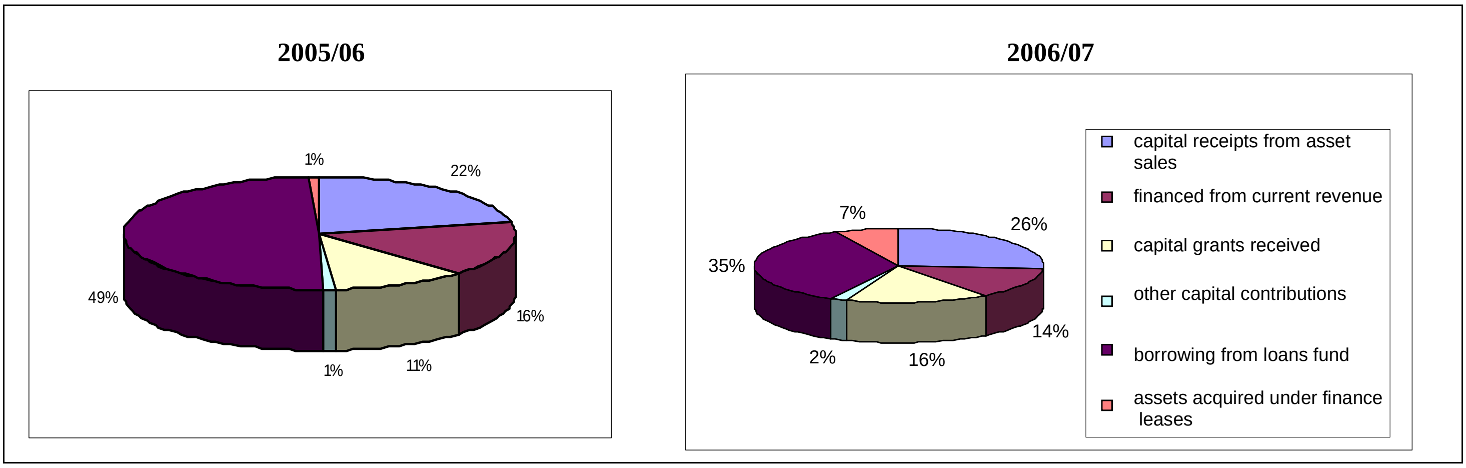
76. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Lothian and Borders Police, Lothian and Borders Fire and Rescue, and Lothian Valuation) had an excess of liabilities over assets at 31 March 2007 due to the accrual of pension liabilities for staff. In total these net liabilities amounted to £1.521 billion, with the council's group share being £139 million. These are significant amounts as the pension schemes for police officers and fire fighters are unfunded and met entirely from current and future council tax payers as payments fall due.

## Spending on assets and long-term borrowing

### Capital performance 2006/07

77. 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. Since 2004/05, significant increases have been made in capital expenditure under these freedoms as the council seeks to improve its asset infrastructure. The council's 2006/07 prudential indicators show that the approved capital investment programmes will have no incremental impact on council tax or council house rents in 2006/07, 2007/08 or 2008/09.

78. Capital expenditure in 2006/07 totalled £78.554 million, a reduction from £84.004 million in 2005/06 (£72.806 million in 2004/05). Capital investment in the last two years was funded as shown in the chart below.




79. The revised capital programme for 2006/07 approved by PP&R committee on 21 March 2006, was £52.457 million. The final outturn was £47.092 million against a final revised budget of £47.569 million, representing an underspend of £0.447 million. This underspend is net of £2 million of over-programming included in the original programme. These resources will be carried forward to be matched against 2007/08 expenditure. There were a number of areas of slippage in the 2006/07 capital programme, the most significant of which was in Education and Cultural Services of £2.033 million, mainly on the Howden Park Centre (£0.919m) and the new Bathgate swimming pool (£0.725m) projects.

80. The original 2006/07 housing capital programme approved by the Health and Care committee in April 2006 was £30.156 million. The final outturn was £28.821 million against a revised budget of £30.578 million, representing an underspend of £1.757 million. The main area of slippage was £1.528 million on the Social Housing Quality Standard (SHQS) projects, which are needed to bring council housing up to the required standard.

81. Aggregate long term borrowing at 31 March 2007 was £288 million. Almost all (99%) of the council's long-term borrowing at the year-end matures after more than 10 years. The council has actively managed its exposure to variable interest rate movements and at 31 March 2007, only £1.8 million (0.6%) of total outstanding debt was held at variable rate. The council's treasury management indicator for the upper limit of variable rate borrowing for the three years to 2008/09 is 35%.

## Forward capital programme

82. The approved general fund capital programme for 2007/08 is £65.117 million, which includes £6 million of over-programming. The anticipated outturn as reported to the corporate management team in September 2007 is £57.055 million. The capital monitoring exercise has indicated that there is a significant amount of slippage forecast in the capital programme and services have been asked to identify projects to be brought forward as accelerated spend in 2007/08.

83. The 2007/08 housing capital programme is £24.847 million, which includes £11 million on SHQS projects and £6.2 million on new build housing. The programme also includes £0.495 million of over-programming.

84. As noted above, there has again been some slippage on a number of projects during 2006/07 and going forward, officers need to continue to closely monitor the achievement of the capital programmes.

**Key risk area 1**

## Borrowing and temporary investments

85. In recent years, a number of councils have disclosed significant amounts under temporary investments largely as a result of decisions to take advantage of favourable interest rates when considering borrowing requirements to fund planned capital programmes. In these instances, councils are still required to demonstrate their consideration and compliance with the principles of Audit Scotland's long standing Note for Guidance Number 96/5. 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.

86. West Lothian Council had significant short term investments of £114 million at 31 March 2007. Of this total, £52.7 million relates to the advanced borrowing undertaken to take advantage of low interest rates. The balance will reduce in line with planned capital expenditure in the capital programme. The current forecasted balance on temporary investments at 31 March 2008 is £95 million, however if rates are considered to be beneficial in 2007/08, further borrowing may be undertaken. We will continue to monitor the position.

87. We undertook a review of the council's borrowing in 2006/07 against the guidance contained in note for guidance 96/5. We found that the council had borrowed to take advantage of low interest rates, producing financial benefits for the council. In addition, there was sufficient documentation of the council's decisions and that the decision to borrow in advance was not influenced by potential income which could be generated from temporarily investing surplus funds. The council has complied with the requirements of the note for guidance.

## Debt restructuring

88. In January 2007, interest rates were low and an opportunity arose for the council to reschedule some of their outstanding borrowing. Public Works Loans Board (PWLB) loans totalling £87.2 million, held at an average interest rate of 4.64% and held for 20-30 years were selected for repayment. Four new loans, each for £17 million, and one for the balance of £19.2 million, were taken with the PWLB, for

periods ranging from 46 to 50 years and at an interest rate of 4.25%. This represented a saving of £0.343 million per annum for eight years and £0.165 million per annum for a further 20 years. Including interest savings on cash flow, the council has calculated the total savings over the next ten years as being £3.9 million. There were no premiums or discounts incurred by the council in respect of this rescheduling exercise.

## Significant trading operations

89. 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.

90. The council has one STO, commercial properties. The actual surplus for the year as reflected in the income and expenditure account was £0.893 million. For the purposes of assessing whether the trading operation has met the statutory target, a cost of capital is to be included in the expenditure for the year and disclosed in the memorandum note to the core financial statements (note 13). The trading operation then incurred a statutory deficit of £0.237 million in 2006/07. In the three years to 31 March 2007, the trading operation made a statutory aggregate surplus of £0.387 million, therefore meeting the statutory target. The budget for 2007/08, including an element of loans fund interest, is £0.486 million, and the council projects a statutory aggregate surplus for the three year period to 2007/08 of £0.143 million.

## Financial outlook

### Current budget

91. 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 £1,128 which is an increase of 2.5% from 2006/07. This council tax level was calculated assuming a collection rate in year of 97.5% (97% in 2006/07). The budget does not assume any use of the general fund balance. The 2007/08 budget includes an increase of £200,000 to assist with the costs associated with a new pay and grading structure. Achievement of the budget is challenging but is essential if the council is to maintain its target level of unallocated general fund balances of at least £2 million.

**Key risk area 2**

92. In his revenue budget 2007/08 report, the Head of Finance notes that the Minister for Finance and Public Sector Reform and COSLA have agreed areas where progress would be made by local government. These include bearing down on council tax increases in 2007/08 and future years,

pushing in year council tax collection rates higher, developing asset management, continuing to deliver efficiency savings and clarifying the position regarding free personal care so that the same level of performance is provided across Scotland. The Head of Finance has recognised that the public sector will face a tight financial situation in 2008/09 to 2010/11 and it will be important for the council to deliver a medium term financial and efficiency strategy that achieves balanced budgets, while maintaining effective service delivery.

**Key risk area 3**

## Single status

93. 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.

94. The original national single status agreement specified that implementation should take place by April 2002 but, following difficulties in establishing a model job evaluation scheme, was extended by agreement between local authorities and unions to April 2004.

95. Each member of staff affected by single status was advised by their line manager of the outcome of the salary review in early June 2007. As at the implementation date of 1 October 2007, only one affected employee had not accepted the new contracts under this agreement.

96. The original equal pay compensation payments made to employees covered the period to 1 February 2007. As a result of the implementation date being 1 October 2007, the council will need to make additional equal pay compensation payments of around £900,000. A provision of £2.221 million has been included in the financial statements for the additional compensation payments and any potential additional costs arising from the appeals process. The provision is based on the most up to date information available from legal services.

97. As a result of the implementation of single status, the council has been able to reduce the number of payruns it operates from 14 to one payrun, from 1 October 2007. This will result in significant operational efficiencies for the council.

## Efficient government

98. 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 Executive. The principles of the efficient government initiative encourage the delivery of services for lower unit cost without compromising the quality of the service provided.

99. During 2006, councils across Scotland recognised that as part of their partnership arrangement with the Scottish Executive, they had a responsibility to report efficiencies on the Executive'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.

100. The council has demonstrated a clear commitment to the efficiency agenda. It is clear that the council have driven the recognition and achievement of efficiencies for some time and as a result there is genuine commitment from key staff and elected members. The council are approaching the efficient government initiative in a systematic manner to identify areas where there is scope for efficiencies, both on a council wide and service basis.

101. The council's efficiency statement was submitted to COSLA in August 2007. The draft statement reports that the council achieved total efficiencies of £4.941 million in 2006/07. These are summarised against the Scottish Executive's efficient government themes in the table below.

***Claimed efficiencies in 2006/07***

| Efficient Government Theme | Cashable efficiency £m | Non cashable efficiency £m | Total efficiency £m |
|---|---|---|---|
| Procurement | 0.500 | 0 | 0.500 |
| Asset Management | 0.330 | 0.900 | 1.230 |
| Managing Absence | 0.050 | 0 | 0.050 |
| Other | 3.161 | 0 | 3.161 |
| Total efficiencies | **4.041** | **0.900** | **4.941** |

102. 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 introduction of an energy management strategy to reduce energy and water consumption by 10%.

103. A number of efficiency savings and measures have been included within the 2007/08 revenue budget and Directors and Heads of Service have provided assurances to the Head of Finance that the

efficiencies can be delivered without adversely impacting on front line services. Cashable efficiencies of £3.610 million for 2007/08 have been approved.

**Key risk area 2**

## Asset management

104. 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.

105. 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.

106. Significant work has been ongoing during 2007 to develop the council's corporate asset management planning system. Service level asset management plans were prepared in February 2007, these resulted in strategic outline business cases which included option appraisal and measures of the benefits of the proposed capital projects. Core investment projects were identified, these are the areas of work which must be done, and the remaining projects were prioritised using a scoring mechanism. This process has resulted in a ten year corporate asset management plan which has now been discussed and agreed by the corporate management team. The proposed ten year plan will be presented to members in 2007 for their consideration.

107. Officers consider that a particular area of good practice identified through the work undertaken to develop the corporate asset management plan is the proposed change to be made to the arrangements for procuring IT assets. The purchase of IT assets was previously a matter for individual services however, an IT asset management plan has now been produced and it is proposed that IT services will now be responsible for the procurement and management of all IT assets. This should result in operational efficiencies for the council.

108. Work is also continuing on the development of a suite of performance indicators to measure the effectiveness and performance of assets over time and support future decision making. The Asset Manager has advised that performance data has been collected and analysed in respect of 2006/07, this has been included in the asset management plan and is currently being input to the Covalent performance management system.

109. The CIPFA Local Government Directors of Finance section published guidance on option appraisal in December 2006, which provides a framework for establishing an option appraisal process in a local authority. The council's capital investment strategy, due to be presented to the council by the end of 2007, incorporates the principles of this option appraisal framework, to be used to identify, assess and prioritise a range of options to deliver the outputs from the asset management plan.

## Pension liabilities

110. 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 main public sector 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.

111. 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 financial statements.

112. The council's estimated pension liabilities at 31 March 2007 exceeded its share of the assets in the Lothian Pension Fund by £86.075 million, reducing from £134.620 million in the previous year. A full actuarial valuation of the Lothian Pension Fund was reported in March 2006. 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 96% at 31 March 2002 to 85% 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 310% of employee contributions in 2006/07 to 320% by 2008/09.

113. There is currently a proposal for the introduction of a new local government pension scheme, to take effect from 1 April 2009.

# Governance

## Introduction

114. 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

115. 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.

116. A Statement of Assurance on Corporate Governance is included within the annual financial statements which provides a commentary by the Leader of the Council and the Chief Executive on progress made during the year in taking forward issues to be addressed to comply with the local code of corporate governance.

117. Internal audit has been given responsibility for reviewing the adequacy, effectiveness and extent of compliance with the council's local code of corporate governance. During 2006/07, internal audit reviewed compliance with the structures and processes section of the code, and concluded that overall, the council's compliance was satisfactory.

### Audit committee

118. Effective scrutiny is central to good governance, with a significant role for councillors to scrutinise performance, hold management to account on service delivery and support the reform and modernisation agenda. Membership of the council's audit committee changed in August 2006 and although new members were recruited thereafter, the level of challenge within the committee was less effective. It is noted that officers consider that the period August 2006 to May 2007 was one of transition, prior to the establishment of a new committee in May 2007.

119. The new audit committee was established following the May 2007 elections. Four of the five committee members, including the chair, attended audit committee training provided by CIPFA in June 2007. The training covered corporate governance; roles and responsibilities; committee operation; risk and performance management; and working with internal and external audit. The remaining member will attend this training in November 2007.

120. We noted in our ARAP that the audit committee's remit included a requirement to monitor the overall performance of internal audit, including productivity, effectiveness and customer satisfaction. During 2006/07, although the audit committee received all major reports prepared by internal audit on the results of reactive work undertaken, they received only a small number of the reports prepared in respect of systems reviews and performance/best value audit work (1 of 23 prepared in 2005/06). In order to address the requirement to monitor effectiveness and to enable the committee to fully assess the quality of internal audit work, officers agreed to review the level of reporting to committee following the May elections. The Internal Audit Manager has advised that the level of reporting is in the process of being reviewed, to commence with the September 2007 meeting.

121. The council should consider reviewing the effectiveness of the new audit committee against the CIPFA in Scotland guidance note *Audit Committee Principles in Local Government in Scotland* in due course.

## Internal audit

122. In December 2006, CIPFA published a revised Code of Practice for Internal Audit in Local Government, which updated the previous 2003 Code.

123. We carry out an annual review of the council's internal audit arrangements and found that during 2006/07, the internal audit unit continued to operate in accordance with the code. During the year the internal audit unit successfully retained its quality management standard ISO 9001: 2000 after inspections by the British Standards Institute (BSI) in September 2006 and March 2007. In addition, a review by a Charter Mark assessor in February 2007 concluded that the internal audit unit continued to demonstrate ongoing compliance with the Charter Mark Standard and no non-compliance or partial compliance issues were raised.

124. All reports prepared by internal audit are reviewed and considered as part of our audit. We concluded that we were able to place reliance on the following specific pieces of work in 2006/07:

- housing and council tax benefits
- council tax
- budgetary control
- European social fund grants
- statutory performance indicators

125. Of particular note are the findings of internal audit's review of the council's arrangements for compliance with the Protection of Children (Scotland) Act 2003, reported in May 2007. The overall conclusion of the report was that the level of control within the council in relation to compliance with the Act requires improvement. It was also concluded that, in relation to the letting of Education and Cultural Services premises, control is unsound. An agreed action plan was included in the report, containing six actions assessed by internal audit as 'critical' and six which are 'significant'.

### Risk management

126. The council's risk management arrangements are well developed and include a risk management strategy and steering group, and risk management has been embedded within the West Lothian Assessment Model (WLAM). Future planned improvements include designating 'risk champions' to ensure services adopt the corporate approach to risk management.

## Systems of internal control

127. In his annual report for 2006/07 the Internal Audit Manager provided his opinion that, based on the internal audit work undertaken during the year, the systems of internal control that are in place within the council are generally satisfactory. However, specific comment was made in relation to three areas of work undertaken in the year:

- child protection, as detailed at paragraph 125 above
- the audit of three European Social Fund grant claims concluded that the level of control was poor, as all three projects significantly exceeded the standard timetable for the submission of claims. An action plan has been agreed with management and will be followed up during 2007/08
- progress made in implementing the council's revised IT strategy.

128. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on the council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes in 2006/07:

- budgetary control
- main accounting system
- housing and council tax benefits
- treasury management
- cash income and banking
- council tax billing and collection
- non domestic rates billing and collection
- housing rents

129. As part of our review we issued a report to officers summarising our findings in these areas. The report included some areas for improvement on which the council has agreed to take action.

## Prevention and detection of fraud and irregularities

130. 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, a whistle blowing policy, codes of conduct for elected members and staff, and defined remits for relevant regulatory committees.

## NFI in Scotland

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

132. 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.

133. The council has responded positively to NFI, adopting a structured approach to the 2006/07 exercise. The Head of Finance met with representatives from housing services and HR/payroll to discuss the strategy for dealing with NFI referrals. Quarterly meetings are held to monitor progress and officers from housing rents, payroll and housing benefit sections have been reviewing relevant referrals.

134. A total of 2,089 referrals were received in 2006/07, however this included 177 individuals who appear on two reports, leaving 1,912 referrals to be reviewed. Included in this figure were 598 DWP referrals which are being investigated by the DWP. As at the end of August 2007, 761 referrals had been processed with 74 in the process of being investigated.

135. Total savings identified to date for 2006/07 are £9,210. Of this total, £4,490 relates to tenants who had housing rent arrears and were employed by the council. Arrangements are now in place to recover these arrears. The remaining £4,720 relates to students who did not qualify for housing benefit and is also in the process of being recovered.

136. The work on reviewing and investigating NFI referrals is ongoing and further savings may be identified. The next tranche of reports to be investigated includes the housing benefit to pension matches. Officers have advised that it is anticipated that by mid-November, the online information will be updated to show further savings. The council needs to ensure that it maintains the current momentum on addressing NFI and uses the opportunities presented by NFI on an ongoing basis to assist in the detection of fraud.

# Governance outlook

## Impact of the 2007 elections

137. As detailed at the performance section of this report, the council's traditional committee structure has been replaced with a cabinet style structure led by a Council Executive supported by Special Committees (including Audit, Performance and Social Work Complaints Review), nine policy development and scrutiny panels and nine local area committees. The effectiveness of the new structure will be kept under review on an ongoing basis.

138. CIPFA/SOLACE have recently produced *Delivering Good Governance in Local Government – Framework* which sets out principles and standards to help local authorities to develop and maintain their own codes of governance and discharge their accountability for the proper conduct of business. The council is aware of this new guidance and is awaiting the publication of the Scottish guidance notes before reviewing their corporate governance structures against the framework.

139. In future years, the council's corporate governance working group will review the content of the local code of corporate governance to take account of future developments in outcome agreements and locality planning.

# Financial statements

## Introduction

140. 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.

141. 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.

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

## Overall conclusion

143. We have given an **unqualified** opinion on the financial statements of West Lothian Council for 2006/07.

144. The council's unaudited financial statements were submitted to the Controller of Audit on 5 June 2007, which was prior to the deadline of 30 June. Final accounts preparation processes and working papers were generally good, enabling 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.

## Accounting practice

145. 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'). As noted at paragraph 68, 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.

146. Overall, we were satisfied that the council had prepared the accounts in accordance with the revised SORP. A number of changes were made to the unaudited accounts to comply with the SORP requirements, including:

- adding more information to the explanatory foreword
- disclosure of group organisations in which the council has a non-material interest.

147. The council made a number of adjustments to the accounts to reflect our findings. As is normal practice, some small errors remain unadjusted and these have been reported to the Head of Finance and the Audit Committee via our letter issued in line with International Standard on Auditing 260 (ISA 260) *communication of audit matters with those charged with governance*. Details of significant accounting issues arising in the course of our audit are summarised below.

## Equal pay provision

148. In 2005/06, a provision was created for the estimated costs to the council of £6.750 million for the total one-off cost of dealing with the equal pay legislation. During 2006/07, the council utilised £5.972 million of this provision. Equal pay compensation payments covered the period to 1 February 2007. The single status implementation date of 1 October 2007 means that the council will be required to make additional equal pay compensation payments to cover the period February to October 2007

totalling around £900,000. The council has provided for £2.221 million in the financial statements in respect of these further equal pay compensation payments and additional payments which may arise from the appeals process. The provision is based on the most up to date information available from legal services.

## Public Private Partnership

149. When considering public private partnership arrangements, key stages are the audited body providing an initial and final view on the accounting treatment of a project, based on business case information. The auditor then reviews the audited body' position and comments on whether the proposed treatment is in accordance with current underlying guidance. In May 2007, the council provided a view on the treatment of the schools PPP3 project, for construction of two new schools. We concluded in our letter dated 13 June 2007 that the council's final judgement on the proposed accounting treatment off balance sheet is reasonable, subject to our reservations covering the potential for fixed assets not to be recognised on the balance sheet of either the purchaser or the contractor.

150. In addition to reviewing the accounting treatment, we are required to consider the council's assessment of the value for money provided by a project, taking account of both whole of life and quality. We concluded in June 2007 that the project represents overall value for money.

## Fixed assets

151. **Surplus assets:** The identification of surplus assets is important for effective asset management. At 31 March 2006, the council held £65 million of surplus assets on the balance sheet. The unaudited 2006/07 accounts showed a transfer of £51 million from surplus assets to investment properties. Audit testing established that £45 million of these assets were assets which were included in the council's planned disposal programme and should remain within surplus assets. Officers agreed with our findings and revised the surplus assets at 31 March 2007 to £57 million. It is noted that surplus assets comprise mainly development land which will be sold on a phased basis over the next four years. The proceeds will be used to help fund the council's capital programme over that period.

152. **Enhancement expenditure:** The council's approach to enhancement expenditure is to add all capital spend to the value of fixed assets, even though it is not certain whether the value of the asset has increased by the amount spent. When the assets are revalued as part of the council's rolling programme, the values will be updated at that time to reflect the impact of capital spend. With this approach, there is a risk that asset values are too high. While adding to the value of fixed assets pending revaluation is generally an acceptable approach, a valuation should be undertaken, in the year of spend, for any asset to which there are material additions. From 2007/08 onwards, the council should consider requesting that the valuer undertakes a revaluation in year of assets on which there is

material capital spend.  Officers have stated that the cost of such surveys can be prohibitive and therefore, value for money will be taken into account when considering whether to revalue in the year of spend.

## Legality

153. Each year we request written confirmation from the Head of Finance that the council's financial transactions accord with relevant legislation and regulations.  Significant legal requirements are also included in audit programmes.  The Head of Finance has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.  In respect of 2006/07, we also sought, and received, assurances that the council met its statutory obligations in respect of homelessness services.

154. There has been continuing press coverage surrounding councils which have charged for the preparation of food which may contravene the terms of the Community Care and Health (Scotland) Act 2002 in relation to free personal care.  The council had previously charged for food preparation but during 2006/07 ceased to charge for the food preparation element of elderly care and agreed to repay any charges already made.  A provision of £0.544 million was made in respect of this in the 2005/06 accounts.  Repayments totalling £0.527 million were made in late 2006, leaving a balance of £0.017 million on the provision at 31 March 2007.  Officers have explained that the majority of repayments have been made and those outstanding relate to deceased clients.  The amount due can be paid into a person's estate; however a responsible person has to make a claim for this.  If no further claims are received it is intended that the remaining provision will be written off in 2007/08.

155. 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.  It has now been agreed that as an interim measure in 2006/07, reliance can be placed on the existing disclosures for trust funds in the council's financial statements, supplemented by appropriate working papers to the Office of the Scottish Charities Regulator (OSCR) by 31 December 2007.  Further discussions between OSCR and CIPFA will take place in respect of the requirements for 2007/08 onwards.

156. 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 394 requests for information and has responded to 321 (81.5%) of these within the 20 day target response time.  Therefore, responses to 73 (18.5%) FOI requests fell outwith the 20 days.  However, this includes a number of requests closed on day 20, but later than the time of day originally logged

into the system. Such requests are still within the statutory 20 day time limit if they are despatched by the council on the 20th day.

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

## Financial reporting outlook

158. 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.

159. 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 FRSs. 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 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.

160. 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.

161. 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 PFI accounting in the public sector. The Treasury are therefore currently considering the most appropriate accounting treatment for PFI public sector transactions. If IFRS principles, or similar, were applied in the public sector then many PFI assets are likely be brought onto public sector balance sheets.

# Final Remarks

162. We have summarised our conclusions in the key messages section of this report. 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.

163. A mechanism should be considered and agreed by members for monitoring the effectiveness of the planned action by officers as detailed in the action plan to this report. We will review the operation of the agreed mechanism as part of the 2007/08 audit.

164. The co-operation and assistance given to us by West Lothian Council members and staff is gratefully acknowledged.

# Appendix A: Action Plan

## Key Risk Areas and Planned Management Action

| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|---|---|---|---|---|---|
| 1 | 84 | **Capital programme**<br>There was some slippage on both the housing and non-housing capital programmes in the year.<br>***Risk: The council may not deliver its capital projects on time, which are required to respond to the infrastructure needs of the growing population and the social housing quality standards.*** | A ten year strategic approach is being taken to the planning of the general services and housing capital programmes.<br><br>Monthly monitoring meetings will review progress, with increased emphasis on programme delivery. | Alan Logan (general services)<br><br>David Kelly (housing) | Housing 10 year programme – approved 2005<br><br>General services 10 year programme – Nov 2007<br><br>Monitoring meetings – from October 2007 |
| 2 | 91<br>103 | **Immediate financial pressures**<br>The council's 2007/08 budget is challenging and requires £3.610 million of cashable efficiencies to be achieved under the efficient government agenda alone.<br>***Risk: If the budget is not met the council may not be able to maintain its target minimum unallocated general fund balance of £2 million.*** | Heads of Service are fully aware of and committed to delivering their efficiencies in their service.<br><br>Service budgets are being closely monitored on a monthly basis to ensure target efficiencies are being delivered.<br><br>A 2007/08 efficiency statement will be produced verifying the efficiencies that have been achieved. | <br><br>Alan Logan/Heads of Service<br><br>Alan Logan | <br><br>Throughout 2007/08<br><br>May 2008 |

| Action Point | Refer Para No | Risk Identified | Planned Management Action | Responsible Officer | Target Date |
|---|---|---|---|---|---|
| 3 | 92 | **Financial pressures in the medium term**<br>It is not yet clear what impact the new Scottish Government may have on local government finance, and in particular, on the local government settlement and council tax funding.<br>***Risk: The council may not be able to deliver on its corporate plan objectives if the financial settlements do not reflect the council's expectations.*** | A draft financial model has been prepared for 2008/09 to 2010/11. | Alan Logan | Complete |
| | | | The outcome of the UK comprehensive spending review, the Scottish strategic spending review and the local government finance settlement will be fully reviewed and evaluated. | Alan Logan | October to December 2007 |
| | | | The impact of Scottish Government funding decisions will be fully incorporated into the 2008/09 budget along with the necessary level of efficiencies to deliver a balanced budget. | Alan Logan | February 2008 |
| | | | The same approach will be taken for the 2009/10 and 2010/11 budgets. | Alan Logan | Summer/ Autumn 2008 |