



Argyll and Bute Council

Report on the 2007-08 Audit

31 October 2008

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1 Executive Summary

1.1 Introduction

This report summarises the outcome of our audit and key messages for members. We planned and performed our 2007-08 audit in accordance with our Audit Plan issued in February 2008. The Code of Audit Practice objectives and key findings for the audit are summarised in Exhibit 1 below.

Exhibit 1 - Key findings from the 2007-08 audit

| Code Objective | Key Findings |
|--|---|
| <p>Financial statements</p> <p>To provide an opinion on the Council's financial statements for the year ending 31 March 2008.</p> | <ul style="list-style-type: none"> • We gave an unqualified opinion on the Council's 2007-08 financial statements on 30 September 2008. • Our audit opinion, however, draws attention to a failure to comply with the statutory requirement that all significant trading organisations break even on a rolling three year basis. • The Council's finance team prepared well for implementing the 2007 Statement of Recommended Practice (SORP) and the standard of accounts and supporting working papers were generally good. • The Council's current financial position is healthy, however, additional cost pressures have emerged in the last year which may impact on the Council's ability to meet its financial targets going forward. The Council should review the appropriateness of the financial assumptions contained within its three year budget plan to ensure it continues to be achievable. |
| <p>Governance</p> <p>To review and report on the Council's corporate governance arrangements, including: systems of internal financial control, arrangements for the prevention and detection of fraud and corruption, standards of conduct and the Council's financial position.</p> | <ul style="list-style-type: none"> • We have concluded that the Council's systems of internal financial control are operating adequately. • The Council has generally good financial management and budgetary control arrangements. However, there is scope to further improve the linkage between budget setting and corporate priorities. • The Council's governance arrangements are generally sound although there is scope to develop the role of internal audit and ensure it is fully resourced to meet audit plan commitments. The appointment of non-councillors as chair and vice chair of the audit committee goes beyond good practice, and strengthens overall governance and scrutiny arrangements. • We found weaknesses in the Council's project management arrangements in relation to major capital projects, and further work is required to improve performance in this area. • We found a number of areas for improvement in the Council's arrangements for participating in the National Fraud Initiative (NFI) exercise, in particular the need for improved documentation of progress monitoring, investigation and closure of case matches. |

| Code Objective | Key Findings |
|---|--|
| <p>Performance</p> <p>To review and report on the Council's arrangements to achieve Best Value, other aspects of arrangements to manage performance in the use of resources, and arrangements for preparing and publishing statutory performance indicators.</p> | <ul style="list-style-type: none"> • As part of our 2007-08 we have worked with Audit Scotland to follow up the Council's progress in addressing the recommendations made in the Best Value report issued in February 2006. The findings from our review are expected to be published in December 2008. • The Council should continue to build on the progress made in addressing the recommendations made in inspection reports and share the lessons learned from the improvement in education more widely across Council services. • The Council should develop a clear framework for identifying, monitoring and reporting efficiency savings and integrating these savings into the Council's financial plans. |

1.2 Action needed by the Council

Our audit identified the following key actions for the Council in the coming year. The Council should:

- revise its medium term financial strategy to take account of emerging financial pressures and ensure reserves are maintained at an acceptable level
- take action to address the significant deficits recorded by the Catering and Cleaning Trading Account and consider whether it continues to deliver best value
- develop its project management arrangements for major capital projects to ensure they operate consistently across all Council services
- take action to ensure internal audit remain adequately resourced to deliver the 2008-09 audit plan.

Detailed action plans have been agreed with the Council and included in our audit reports issued during the year (Appendix A).

1.3 Acknowledgements

We would like to take this opportunity to thank the staff who have been involved in the 2007-08 audit for their assistance and co-operation.

This report is part of a continuing dialogue between the Council and Grant Thornton and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices.

The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it.

Grant Thornton UK LLP
31 October 2008

2 Financial Statements

2.1 Introduction

We have audited the Council's 2007-08 accounts in accordance with our Audit Plan issued in February 2008. The key messages arising from our financial statements audit are contained in our Report to those Charged with Governance, issued in September 2008, and summarised below.

2.2 Audit opinion

We gave an unqualified opinion on the Council's 2007-08 financial statements on 30 September 2008.

The Council's catering and cleaning trading operation has recorded a £3.7 million deficit over a rolling 3 year period and has, therefore, failed to meet its statutory financial target for the third successive year. This matter has been referred to in an explanatory paragraph in the audit report.

2.3 Accounting requirements

The 2007 SORP introduced significant accounting changes for 2007-08, including the introduction of a revaluation reserve, the creation of a new capital adjustment account, and the introduction of new standards for the accounting and disclosure of financial instruments. The Council largely complied with the 2007 SORP in preparing its accounts and this is reflected in only a small number of adjustments made to the draft accounts following our audit. This was a significant achievement for the Council's finance team.

2.4 International Financial Reporting Standards

The Council will be required to adopt International Financial Reporting Standards (IFRS) in the preparation of the 2010-11 accounts. The Council's 2009-10 accounts will also require to be re-stated under IFRS accounting rules to provide appropriate comparative information.

The adoption of IFRS is likely to impact on the way the Council's financial results are reported in the future, in particular the service contracts for the Schools NPDO scheme and the Waste Management PPP scheme may be recorded on the Council's balance sheet. We are aware that the Council has initiated an early review of the impact of IFRS on the accounting treatment for leased assets.

Grant Thornton provides an annual training workshop for the Council's finance staff on developments in accounting and auditing standards and we will continue to work closely with the Council's finance team over the period of our appointment.

2.5 Financial results

The Council reported a surplus on the Income and Expenditure account for 2007-08 of £5.1 million (2006-07: £0.4 million). The net increase on the general fund was £5.9 million (2006-07: £10 million).

The total net worth of the Council has increased by £44.2 million over the course of the year, mainly due to actuarial gains on the Strathclyde Pension Fund and revaluation gains on fixed assets.

2.6 Trading Accounts

The Council operates trading accounts for Roads and Lighting and Catering and Cleaning operations, having re-classified Leisure Trading and Waste Management as non-trading activities, and closed the Building Maintenance trading account as a result of the transfer of the Council's housing stock.

Roads and Lighting Trading Account

The Roads and Lighting Trading Account recorded a surplus of £68,000 (2006-07 £208,000) for the financial year on a turnover of £13.2 million (2006-07 £11.6 million) and achieved its key financial target to break even over a rolling three year period.

Profitability, however, declined significantly during the year as the overall surplus fell by 67% whilst turnover increased by 14% over the same period, highlighting that costs increased faster than income over the financial year. This outcome is caused mainly by the impact of higher salary costs resulting from implementation of the single status agreement.

Catering and Cleaning Trading Account

The Catering and Cleaning Trading Account recorded a deficit of over £1 million (2006-07 £1 million) for the financial year on a turnover of £7 million (2006-07 £7.1 million) and has recorded a £3.7 million deficit over a rolling 3 year period, failing to meet its statutory financial target for the third successive year. The key factor impacting on this outcome is higher salary costs resulting from the implementation of the single status agreement, and the costs associated with equal pay settlements.

The high level of the cumulative deficit on this trading account means that it is unlikely to meet its financial break-even target for the foreseeable future. The Council has a duty to demonstrate best value and competitiveness from its operations and is taking forward an action plan to address the deficit position.

2.7 General Fund

The Council's reserves policy for the year ending 31 March 2008 was to retain un-earmarked reserves of at least 1.9% of net operating expenditure. At 31 March 2008 the Council's un-earmarked reserves totalled £4.9 million, representing 2.3% of net operating expenditure in line with this policy.

From 2008-09, the target level of un-earmarked reserves has been reduced to 1.5% of net operating expenditure reflecting the Council's decision to prioritise spending on corporate objectives. We note that the Council's target level for reserves has not been calculated as part of a risk based assessment of the balances required to be held to meet contingencies and respond effectively to unforeseen events. In addition, the revised target is unlikely to be achieved for the 2008-09 financial year, and this could represent a risk to the achievement of corporate objectives.

Additional cost pressures have emerged in the last year, linked to higher than expected energy costs and wage inflation, which may impact on the Council's ability to meet its financial targets going forward. The Council should review the appropriateness of the financial assumptions contained within its three year budget plan to ensure it continues to be achievable, and to maintain un-earmarked reserves at a level commensurate with risk.

2.8 Capital Expenditure and the Prudential Code

The Council incurred gross capital expenditure of £34.2 million during the year (2006-07 £38.4 million), reflecting a continuing high level of spending on schools and roads with additional projects to redevelop harbours and Oban airport undertaken during the year. The Council's level of outstanding debt rose by 19% from £158 million in 2006-07 to £188 million at 31 March 2008.

Local authority capital expenditure and borrowing is regulated by the Prudential Code which requires councils to ensure capital plans are affordable, borrowing is prudent and sustainable, and treasury management arrangements reflect good practice. The Council approved a set of prudential indicators for 2007-08 and managed capital expenditure within these approved limits.

The planned increase in capital expenditure, reflected in the increase in the Council's debt levels, will result in a long term financial commitment to meet higher interest payments and repay the debt over time. The Council has fully considered these additional costs in developing its medium term financial strategy.

2.9 Key actions going forward

In summary, the key recommendations arising from our audit of the financial statements are that the Council should:

- review the appropriateness of the financial assumptions contained within the three year budget plan to ensure it continues to be achievable
- continue to progress the action plan to reduce the significant deficits recorded by the Catering and Cleaning Trading Account and ensure it delivers best value
- take early action to prepare for the implementation of International Financial Reporting Standards.

A detailed action plan has been agreed with the Council to address these key issues and is contained in our Report on the 2007-08 Accounts Audit issued in September 2008.

3 Governance

3.1 Introduction

In accordance with the 2007-08 Audit Plan we have reviewed key aspects of the Council's governance arrangements. The detailed findings from our governance review are contained in our interim report issued in August 2008. Key messages are summarised below.

3.2 Overview of arrangements in 2007-08

We have concluded that the Council's systems of internal financial control and governance arrangements are generally operating adequately. Key findings from our review included:

- the Council generally has good arrangements for financial management and budgetary control. However, we noted that there is scope to align departmental budgets more clearly with corporate priorities
- more generally, there is scope for greater challenge in the plans the Council has to apply all earmarked reserves, including those currently earmarked within departmental budgets
- overall, we found that the Council has good controls over its IT systems, networks and applications. In addition, the Council's arrangements to ensure compliance with the Data Protection Act 1998 are satisfactory.

3.3 Contract management

As part of our 2007-08 audit we reviewed the Council's overall arrangements for contract management, including an overview of the Oban Airport contract. Our review found significant scope for the Council to improve its arrangements for project and risk management in relation to large capital projects.

3.4 Audit Committee arrangements

Our review found that the Council's audit committee operates effectively and complies with the majority of good practice principles outlined in the CIPFA guidance. In particular, the approach adopted by the Council to appoint non-councillors as chair and vice chair of the audit committee goes beyond good practice, and significantly strengthens overall governance and scrutiny within the Council.

3.5 Internal Audit

As part of our 2006-07 audit, we reviewed the Council's internal audit department against the eleven standards set out in the Code of Practice for Internal Audit. We found that the internal audit section did well in undertaking and reporting its work but was not sufficiently resourced to deliver its audit plan effectively.

Our review on the progress of implementation of prior year recommendations found that only 4 out of the 12 outstanding recommendations from our 2006-07 report have been fully implemented. We have highlighted below the key areas for further improvement:

- the Council has not yet created a 'chief internal auditor' position
- further work is required to ensure the assurance grading provided by audit work is consistent with evidence contained in audit working papers
- a longer term plan for internal audit is required to ensure it remains fully resourced to meet audit plan commitments.

3.6 National Fraud Initiative

The Council participates in the National Fraud Initiative (NFI) Exercise, but has identified only one housing benefit fraud following its 2006-07 review. We found a number of areas for improvement in the Council's arrangements for participating in the NFI exercise, in particular the need for improved documentation of progress monitoring, investigation and closure of case matches.

3.7 Key actions going forward

In summary, the key recommendations arising from our governance audit are that the Council should:

- undertake a review of its approach to project management in relation to major capital projects to ensure it meets good practice consistently
- align departmental budgets more clearly with corporate priorities
- ensure plans to utilise earmarked reserves within departmental budgets are challenged effectively
- develop a longer term plan for internal audit to ensure it remains fully resourced to meet audit plan commitments.

Detailed action plans have been agreed with the Council to address these key issues and are contained in our Interim Report issued in August 2008, our report on IT Systems and Applications issued in June 2008, our report on Contract Management issued in draft in October 2008 and in our follow up report on Internal Audit issued in May 2008.

4 Performance

4.1 Introduction

In accordance with the 2007-08 Audit Plan we have reviewed key aspects of the Council's performance arrangements during 2007-08. The detailed findings from our performance review are contained in our Interim Report. The key findings from our audit of the Council's performance arrangements are summarised below.

4.2 Best Value

Audit Scotland issued its report on Best Value to the Council in February 2006. As part of our 2007-08 audit we were commissioned by Audit Scotland (on behalf of the Accounts Commission) to undertake a review of the Council's progress in addressing the recommendations made in the 2006 Best Value report. We completed our review in June 2008 and reported the draft findings to the Council in August 2008. Audit Scotland's report will be considered by the Accounts Commission in November 2008 and is expected to be published in early December 2008.

Following the completion of our audit work, the Council have introduced a Planning and Performance Management Framework and decided to take forward the opportunities identified in the shared services diagnostic project. The Council considers these projects will contribute positively to their approach to Best Value.

4.3 Efficient Government

The efficient government initiative is a central part of the government's programme of investment, reform and modernisation. The Efficient Government Plan sets targets for local government bodies to achieve 2% cash-releasing savings by 2010-11. For Argyll and Bute Council this equates to a savings target of around £4 million over the three year reporting period.

In order to claim an efficiency, the Council needs to demonstrate that service outcomes have been maintained or improved and this can only be achieved through a robust performance management system that captures information and baseline data covering both cost and quality aspects of service provision. As we reported in 2006-07, the Council is currently at an early stage in developing such a system.

The Council recognises the need to further develop its performance systems to support the 'efficiency statement' it is required to submit annually to the Scottish Government. In particular, the Council currently produces limited information on service quality and volume.

In its 2007-08 'efficiency statement', the Council estimates that it achieved cash releasing savings of £3.314 million (representing 1.6% of its net cost of services) for that year and forecasts that additional savings of up to £3.553 million will be required for the 2008-09 financial year.

The financial constraints referred to earlier in this report highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

4.4 Statutory Performance Indicators

The Council is required to prepare Statutory Performance Indicators (SPIs) in accordance with a direction issued annually by the Accounts Commission. We audit these indicators to ensure they are prepared in accordance with the guidance. In the absence of locally determined performance measures, SPIs represent the main source of performance information for the Council.

The Council has generally satisfactory arrangements for producing SPI information, but has been unable to produce reliable performance information for one of the 78 SPIs relating to the number of visitor numbers for council funded museums. The Council has agreed to ensure this information is available for reporting on its SPI performance for 2008-09.

4.5 Inspection Reports

The Social Work Inspection Agency (SWIA) reported on the Authority in October 2007 and found some examples of good services delivered by social work services and partner agencies. The inspection also noted that the attitude and motivation for improving social work services was positive.

SWIA use a six point scale ranging from excellent (level 6) to unsatisfactory (level 1). Out of ten evaluation areas assessed by the inspectors only one, capacity for improvement, was rated as good (level 4). Six of the evaluation categories were rated as adequate (level 3) and three were rated weak (level 2), including leadership and direction.

The Council has prepared an action plan to address the key recommendations for improvement made in the SWIA report and both SWIA and the Scottish Ministers have commented favourably on the Council's progress to date.

In June 2007, Her Majesty's Inspectorate of Education (HMIE) published a follow up report to its original 2005 inspection of the education authority. The original inspection identified four main areas for improvement and, overall, the favourable follow up report states that the authority had made, 'notable progress'. In particular, HMIE reported that, 'the authority had taken very effective action to implement the recommendations and showed clear capacity for improvement. It had made very good progress on three action points and good progress on the remaining one.'

There is a need for the council to build on this positive report, which reflects the Council's long term drive to invest in education, and share the lessons learned for the improvement in education more widely in the council.

4.6 Key actions going forward

In summary, the key recommendation arising from our performance audit is that the Council should continue to build on the progress made in addressing the recommendations made in inspection reports and share the lessons learned from the improvement in education more widely across Council services.

Grant Thornton UK LLP
31 October 2008

Appendix A

Audit Reports Issued During the Year

A summary of the audit reports issued during 2007-08 is provided below:

| Report Title | Key Topic | Month Issued |
|--|--|------------------------|
| Annual Audit Plan | Summary of the 2007-08 planned audit work, demonstrating how we will discharge our responsibilities under Audit Scotland's Code of Audit Practice. | February 2008 |
| Follow up review of Internal Audit | Follow up of the Council's progress in implementing agreed recommendations following our 2006-07 review of Internal Audit | May 2008 |
| Review of IT Systems and Applications | Overview of the effectiveness of key controls over IT systems and applications. | June 2008 |
| Interim Report | Review of the operation of the Council's key financial systems and governance arrangements. | August 2008 |
| Review of Contract Management Arrangements | Review of the operation of the Council's key financial systems and governance arrangements. | October 2008 (Draft) |
| Report on the 2007-08 Accounts Audit | Summary of key issues emerging from the audit of the Council's financial statements. | September 2008 |
| Annual Report to Members | Summary of the key issues emerging from the 2007-08 audit. | October 2008 |
| Follow-Up Review of Best Value | Summary of the Council's progress in addressing the recommendations made in Audit Scotland's Best Value Report issued in September 2007. | Expected December 2008 |



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