



Clackmannanshire Council

Report on the 2007-08 Audit

30 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. 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. However, the Council's un-audited accounts included an error which had the effect of overstating income by £0.4 million. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million. The Council has un-earmarked reserves of £0.4 million, significantly below the Council's policy to maintain a minimum required reserves balance of £1.8 million. The Council continues to face significant financial pressures which may impact on its ability to meet existing budget commitments and achieve its corporate objectives. The development of a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget and adequate reserves level, continues to represent a key and immediate priority.
<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 generally operating adequately. The Council's governance arrangements are generally sound. There is scope to further develop the role of the scrutiny committee and to develop an assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. The Council's internal audit section has undergone significant change in the past year. Internal audit continue to face a challenge in remaining fully resourced to deliver the 2008-09 audit plan, and a longer term plan is needed for delivery of a stable and robust internal audit function.
<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"> The Council is making good progress in addressing the key recommendations made in Audit Scotland's report on Best Value issued in September 2007. The Council recognises that further development of performance and risk management systems is required to support the efficiency and improvement agenda. The Council has agreed to adopt the Public Sector Improvement Framework performance management model and is making good progress in developing its performance and risk management arrangements. The significant financial constraints referred to above highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

1.2 Action needed by the Council

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

- review arrangements for updating the ledger to ensure complete and accurate financial reporting to members during the financial year, and consistency with the draft accounts prior to submission for audit
- take urgent action to develop a sustainable medium term financial strategy, aligned to corporate priorities that delivers a balanced budget, incorporates anticipated efficiency savings, and maintains reserves at an acceptable level
- develop both the role of the scrutiny committee and the framework which supports it. In particular, the Council should move towards arrangements which would support an annual Statement on Internal Control, including strengthening internal audit, improving risk management arrangements and developing more tailored training for scrutiny committee members
- prioritise the development of a performance management framework across all Council services.

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
30 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 un-audited accounts included an error which had the effect of overstating income by £0.4 million. The error arose as the Council had not correctly updated the financial ledger at the beginning of the financial year to reflect audit adjustments made to the 2006-07 accounts. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million.

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 complied with the 2007 SORP in preparing its accounts. This was a significant achievement, particularly as a key member of the Council's small finance team was absent on long term sick leave during the accounts preparation and audit process.

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 have a significant impact on the way the Council's financial results are reported in the future, in particular it is likely that the assets leased as part of the Three Schools PPP scheme will require to be recorded on the Council's balance sheet.

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. It is important, however, that the Council prepares early for IFRS implementation.

2.5 Financial results

The Council reported a deficit on the Income and Expenditure account for 2007-08 of £14.2 million (2006-07: £10.8 million). The net increase on the general fund was £1 million (2006-07: £0.1 million decrease).

The increase in the general fund balance for the year can be attributed to the following key factors:

- higher than expected income from government grants (£1.3 million) and council tax (£0.9 million) due to the impact of the government's revised funding settlement and increased house building in the area which has raised the council tax base
- a reduction in the provision for bad debts (£0.2 million) to reflect improvements in council tax collection rates
- the surplus generated from trading activities (£0.5 million) was £0.1 million greater than budget
- increased income was offset by increased service costs. In particular, social work services costs were £0.75 million greater than budget, largely due to increased costs of residential care and foster care.

The Council performed well against budget overall, with outturn expenditure £1 million below budget for the year. This underspend has been carried forward as an earmarked reserve within the 2008-09 general fund.

2.6 General Fund

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £4.8 million, of which £4.4 million was earmarked for specific purposes, leaving £0.4 million available for new expenditure or to meet the costs of contingencies and unforeseen events. This is below the Council's target level for un-earmarked reserves of £1.8 million.

The Council has set aside over £0.65 million from its 2008-09 budget to increase its level of un-earmarked reserves, however, it is unlikely that the target level of un-earmarked reserves will be met until 2009-10 at the earliest. We have recommended that the Council develops a medium term financial strategy which ensures it meets the target level of un-earmarked reserves as soon as practical.

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.

2.7 Housing Revenue Account

The Housing Revenue Account (HRA) ended the year with a deficit of £4.6 million, however, statutory adjustments mean that the HRA balance for the year increased by £0.9 million. This outcome was £0.9 million greater than budget, largely due to lower than expected capital financing costs and higher than expected rental income.

The accumulated balance on the HRA was £7.4 million at the year end (2006-07: £7.3 million). The Council has been increasing its HRA reserve balances in recent years to meet its commitment to exceed the requirements of the Scottish Housing Quality Standard (SHQS) by 2015.

2.8 Capital Expenditure and the Prudential Code

The Council incurred gross capital expenditure of £19.1 million during the year (2007: £22.6 million), reflecting a continued high level of spending on council housing (£9.3 million) to meet the SHQS, further development of the schools estate (£2.2 million) and upgrading of Kilncraigs (£1 million) in addition to a wide range of other capital development and improvement projects. The Council's outstanding debt rose from £95.2 million in 2006-07 to £110.9 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. In February 2006 the Council approved an increase in the authorised limit for external debt to £161.1 million, with an increased operational boundary of £145 million. However, we note that the three year Capital Plan approved by the Council in February 2008 will result in net borrowing falling to less than half of the approved level for 2009-10 by 2010-11.

The planned increase in the Council's debt levels will result in a significant long term financial commitment to meet higher interest payments and repay the debt over time. The Council should fully consider these additional costs when developing a medium term financial strategy to address the cost pressures referred to above.

2.9 Three Schools PPP Project

The Council contracted for three replacement secondary schools to be built under a 'Public Private Partnership' (PPP) agreement during the 2007-08 financial year. This agreement commits the Council to pay an annual charge of £6.7 million (adjusted each year for inflation), over a 30 year contract period, in return for the construction of the schools which have a capital value of some £67 million.

The construction of the three schools has progressed well and they are all expected to become operational during the 2008-09 financial year. As part of the PPP contract, the Council has agreed to make a significant capital contribution of £16.35 million in three tranches, 6 months after each of the schools becomes operational. This means that these payments will be due in 2008-09.

The Council's financial model for the Project sets out an expectation that the capital injection would be funded from capital receipts generated mainly from the sale of surplus land from the replaced school sites. We note that recent changes in economic conditions have deflated property prices across the UK and, as a result, the Council is unlikely to generate the level of capital receipts anticipated. This will create a funding gap and will require the Council to re-visit its financial model for the PPP Project.

The Council had also planned to part-fund the Project from above inflation increases in council tax for 12 years of the contract. The Scottish Government has confirmed its intention to replace council tax with a form of local income tax and has reached an agreement from councils not to increase council tax levels as part of the 'concordat' with local government. We note that the financial settlement for the Council does not incorporate an allowance to meet the existing commitment to fund the PPP Project.

In addition, the Council had planned to use £0.2 million per annum from Schools Fund grant to fund the Project. Recent changes to the funding arrangements for local government now mean that this grant can no longer be applied to fund PPP Projects.

As we reported in 2006-07, PPP Projects are set up as contracts for the provision of services and are revenue in nature. Under current local government financing regulations, the Council cannot apply capital receipts to a revenue purpose. Our 2006-07 report recommended that the Council seek formal authorisation from the Scottish Government to apply capital receipts to the Project before proceeding to implement its existing financing model. We note that formal authorisation has not yet been obtained.

2.10 Single Status and Equal Pay

The Council has recognised that its current pay structure is not consistent with the requirements of the Equal Pay Act 1970 and this is reflected in compromise payments of £0.4 million to some categories of employees during the financial year.

In addition, the Council set aside £1.2 million from its 2006-07 and 2007-08 budgets for costs associated with the implementation of the Single Status Agreement (Red Book) which contains national conditions of service for local government employees.

As we reported in 2006-07, the Council has not yet implemented a new pay and grading model or made an offer to employees on the implementation of single status. It remains important that the Council formalise agreements on single status and equal pay issues with employees in the near future, to establish financial certainty over the likely costs associated with implementing the new agreements, to resolve existing claims for compensation, and to limit the potential for future claims to emerge.

2.11 Key actions going forward

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

1. Address the underlying financial position of the Council

- take urgent action to ensure un-earmarked reserves reach their target level as soon as practicable
- develop a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget, as a key and immediate priority
- formalise agreements on single status and equal pay issues with employees in the near future
- re-visit the affordability model for the Three Schools PPP Project to ensure it reflects the Council's current financial circumstances and wider economic conditions. In particular, the Council should formalise financing arrangements for the contracted capital injection to the Project.

2. Prepare for the 2008-09 accounts and future year's accounts

- take early action to prepare for the implementation of International Financial Reporting Standards
- review arrangements for updating the ledger to ensure complete and accurate financial reporting to members during the financial year, and consistency with the draft accounts prior to submission for audit

A detailed action plan has been agreed with the Council to address these key issues and is contained in our ISA260 Report on the 2007-08 Annual Accounts 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 September 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
- the Council is required to achieve efficiency savings of 2% of budget (around £2 million) to meet government targets. In addition, financial pressures will require additional savings of around £1 million to deliver a balanced budget for 2008-09. The Council currently monitors efficiency savings generated through the involvement of the Business Improvement Team through the Customer First Project Steering Group, and is in the process of developing its arrangements for monitoring and reporting efficiency savings through that Group, but does not yet have a systematic approach to monitoring, measuring or reporting the achievement of efficiency savings generated through the budget process.
- the current volatility within the financial markets increases the risk of failure of investment institutions, and the Council should review its treasury management policy as a result.

3.3 Audit Committee arrangements

CIPFA recommends that all local authorities have an audit committee in place. In Clackmannanshire Council, the audit committee role is mainly undertaken by the Scrutiny Committee although the full Council has sole responsibility for reviewing and approving the financial statements. Our review found that the Scrutiny Committee complies with a number of the good practice principles outlined in the CIPFA guidance. However, we identified some areas where arrangements could be improved, including:

- reviewing and updating the committee's remit to ensure it incorporates all the areas recommended by CIPFA
- completing an annual self-review of the effectiveness of the committee, particularly in relation to its role as the Council's audit committee
- establishing a formal training programme tailored to meet the needs of Scrutiny Committee members

3.4 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 had not made sufficient progress in meeting the Code of Practice on Internal Audit requirements since Audit Scotland's national review in 2001. Key findings from our review included:

- internal audit was not sufficiently resourced to deliver its audit plan effectively
- the skills and competency levels required for each grade of auditor had not been defined and formal annual performance appraisals had not been undertaken
- internal audit work was not prioritised by risk, and audit resources were not systematically targeted to areas of highest risk. This reduced the effectiveness of internal audit work
- there were no formal performance measurements or targets assigned to internal audit.

Since our report, the Council's Internal Audit department has experienced significant change as two key members of staff left the department in 2007-08. The Head of Finance contracted with Scott-Moncreiff to provide additional internal audit resource during the financial year to help deliver the audit plan and a new senior auditor was appointed in May 2008.

Internal audit continue to face a challenge in remaining fully resourced to deliver the 2008-09 audit plan and a longer term plan continues to be needed for the delivery of a stable and robust internal audit function.

In light of the significant change undergone within the internal audit department, we have agreed to follow up the progress made in addressing the key recommendations made in our 2006-07 report during our 2008-09 audit.

3.5 Statement of Internal Financial Control

The Head of Finance's 'Statement on the Systems of Internal Financial Control' (SIFC) is included within the annual accounts and concludes that reasonable assurance can be placed on the adequacy and effectiveness of the Council's internal financial control systems. This conclusion is supported by the work of Internal Audit.

As we reported in 2006-07, the Council should plan to replace the SIFC with an annual Statement on Internal Control (SIC) in its financial statements in order to meet best practice in governance and in the presentation of its financial statements. The SIC provides assurance on the adequacy and effectiveness of all of the Council's systems (including those covering risk and performance) and is not restricted to financial systems only.

The Council should develop an appropriate assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. This framework should include effective risk management arrangements, an extension of the role of internal audit to provide assurances on the operation of non-financial systems, and arrangements to enable Directors to provide signed 'statements of assurance' each year confirming the effective operation of systems of internal control.

3.6 National Fraud Initiative

The Council participates in the National Fraud Initiative (NFI) exercise, and has identified significant savings following its 2007-08 review. We found a number of areas for improvement in the Council's arrangements for participating in the NFI exercise, in particular the need to update the key contact and co-ordinator roles, and for improved documentation of progress monitoring of case matches.

3.7 Follow up of prior year recommendations

We are pleased to report that the Council has made good progress in implementing the agreed audit recommendations made in our 2006-07 report. Five of the eleven recommendations are fully implemented, three are partially implemented, with progress on a further recommendation ongoing. Further information on the results of our follow-up review is reported in our ISA 260 Report issued in September 2008.

3.8 Key actions going forward

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

- review its treasury management policy to ensure it adequately reflects the higher risk of failure of investment institutions in the current financial climate
- review the role and remit of the scrutiny committee to ensure it continues to meet corporate governance objectives and incorporates all the areas recommended by CIPFA
- develop a longer term plan for internal audit to ensure it remains fully resourced to meet audit plan commitments
- develop an appropriate assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts.

A detailed action plan has been agreed with the Council to address these key issues and is contained in our Interim Report issued in September 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 and Best Value follow-up Report issued in October 2008. The key findings from these audits 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 September 2007. The report found that the Council faces a number of significant challenges arising from the relatively small scale of its operations, the social, economic and geographical circumstances of the Clackmannanshire area, and the lack of good transport links. Audit Scotland recommended improvement in the following key areas if the Council is to achieve best value:

- more effective leadership by elected members;
- sharper articulation of priorities and policies with a clearer linkage to resource decisions;
- greater consistency between community, corporate and service plans;
- improved political structures which give clarity on roles and responsibilities;
- a clearer approach to competition in relation to service delivery mechanisms; and
- development of a human resources strategy.

The Council issued its Best Value Improvement Agenda Action Plan in February 2008 which set out how it would respond to the recommendations made by Audit Scotland. As part of our 2007-08 audit, we followed up the Council's progress in addressing the issues raised by Audit Scotland.

We found that the Council has responded positively to the Best Value report and is making good progress in implementing the Action Plan developed to address Audit Scotland's recommendations. Key developments have included:

- development, together with community planning partners, of the Single Outcome Agreement (SOA) to direct improvement activity and investment
- further development of the Council's corporate plan and community plans, building on the SOA, to improve clarity and consistency of corporate aims and objectives
- the Council has agreed to adopt the Public Service Improvement Framework (PSIF) methodology as a basis for improving performance monitoring and reporting arrangements

- agreement of a new 'Scheme of Delegation' to clarify the roles and responsibilities of members and officers.

We issued our draft report on our follow-up review to the Council in October 2008 and we are in the process of agreeing this report with management. Our findings will be reported to the Scrutiny Committee when this process is complete.

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 Clackmannanshire Council this equates to a savings target of around £2 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 produces limited information on service quality and volume.

In its 2007-08 'efficiency statement', the Council estimates that it achieved cash releasing efficiency savings of £3.4 million (representing 3.4% of its net cost of services) for that year and forecasts that additional savings of up to £1 million will be required for the 2008-09 financial year.

The significant 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 Performance Management

The Council is in the process of developing its performance management framework, including the adoption of the PSIF framework as outlined above, and recognises that much work needs to be done in this area, including:

- further development of performance targets and milestones that are aligned to corporate priorities
- improved arrangements for monitoring performance against targets, benchmarks and over time
- more focus on key performance information requirements, including information on service outcomes including measures of quality and volume
- further development of performance management reporting arrangements, including the frequency and format of reports for members and all levels of management

- clearer arrangements for identifying and tackling poor performance.

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's 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 low demand houses remaining un-let at year end and the number of days and average time that these houses had been un-let at year end. The Council is taking action to ensure the information for this SPI is available for 2008-09.

4.5 Key actions going forward

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

- further develop its performance and risk management systems to support the efficiency and improvement agenda within the Council and to better monitor and manage the performance of the Community Planning Partnership
- there is a priority need to bring forward a programme of efficiency reviews across all Council operations.

A detailed action plan has been agreed with the Council to address these key issues and is contained in our Interim Report and Best Value Follow Up Report issued in October 2008.

Grant Thornton UK LLP
30 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
Interim Report	Review of the operation of the Council's key financial systems and governance arrangements.	September 2008
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.	October 2008



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