

Tayside Contracts Joint Committee

**Report to Members and the Controller of Audit on the
2008/09 Audit**

September 2009



 **AUDIT SCOTLAND**



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Key Messages

In 2008/09 we have audited the financial statements and looked at aspects of governance and performance within Tayside Contracts Joint Committee. This report sets out our main findings.

Overall, we found the financial stewardship of Tayside Contracts Joint Committee during the year to be satisfactory. The main conclusions and outcomes from the audit are highlighted below:

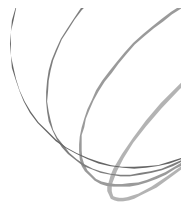
- An unqualified audit opinion has been issued on the financial statements for 2008/09;
- The Statement on the System of Internal Financial Control included in the accounts complies with accounting requirements and is not inconsistent with audit findings;
- Many aspects of a sound corporate governance framework are in place although the risk register needs to be further developed;
- A 5-year Business Plan for the period 2006 to 2011 is in place. Its replacement, the 2010 to 2013 Business Plan, is being developed in conjunction with members and constituent councils and will identify future opportunities and risks;
- An anti-fraud and corruption strategy is in place.

The annual report on the work carried out by the internal control & audit function concluded that “The work carried out during the year continues to give confidence that the necessary controls are in place and where weaknesses have been identified appropriate remedial action is taken so that the Joint Committee have confidence in the underlying systems of financial control and the financial service provided”.

We note that 70% of the areas considered high and medium risk in the 2008/09 internal audit plan had not been reported on in the annual internal control and audit report. However, we reviewed the key controls for main internal financial control systems and found that they were substantially unchanged from previous years and continued to provide a robust internal financial control framework.

Ongoing key issues for the Joint Committee in the future include specific cost and income pressures arising from the current recession, increased competitiveness in the construction market place, pressure on local government funding, and funding of future pension liabilities.

**Audit Scotland
September 2009**



Introduction

1. The members and officers of the Joint Committee are responsible for the management and governance of the organisation. As external auditors, we review and report on the arrangements in place and seek to gain assurance that:
 - the financial statements have been prepared in accordance with statutory requirements and that proper accounting practices have been observed,
 - the Joint Committee's system of recording and processing transactions provides an adequate basis for the preparation of the financial statements and the effective management of assets and interests,
 - the Joint Committee has adequate corporate governance arrangements which reflect the three fundamental principles of openness, integrity and accountability,
 - the systems of internal control provide an appropriate means of preventing or detecting material mis-statement, error, fraud or corruption, and
 - the Joint Committee has proper arrangements for securing best value in its use of resources.

2. This report summarises the most significant issues arising from our work during 2008/09.



Financial statements

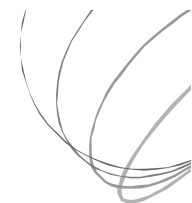
3. In this section we summarise key outcomes from our audit of the Joint Committee's financial statements for 2008/09, aspects of the Joint Committee's reported financial position and performance to 31 March 2009, and provide an outlook on future financial prospects and financial reporting issues.

Auditor's report

4. We have given an unqualified opinion on the financial statements of Tayside Contracts Joint Committee for 2008/09, concluding the financial statements:
 - give a true and fair view, in accordance with relevant legal and regulatory requirements and the 2008 SORP, of the financial position of Tayside Contracts as at 31 March 2009 and its income and expenditure for the year then ended; and
 - have been properly prepared in accordance with the Local Government (Scotland) Act 1973.
5. The Joint Committee's balance sheet has an excess of liabilities over assets of £15.6 million due to the accrual of pension liabilities in accordance with accounting standards. Auditing standards require auditors to consider an organisation's ability to continue as a going concern when forming an opinion on financial statements. One of the indications that may give rise to going concern considerations is an excess of liabilities over assets.
6. The Joint Committee has considered it appropriate to adopt a going concern basis for the preparation of the financial statements as future actuarial valuations of the pension fund will consider the appropriate employer's contribution rate to meet the fund's commitments. The constituent authorities of the Joint Committee are also liable to fund the Joint Committee's liabilities as they fall due. We are satisfied that the process the Joint Committee has undertaken to consider going concern is reasonable.

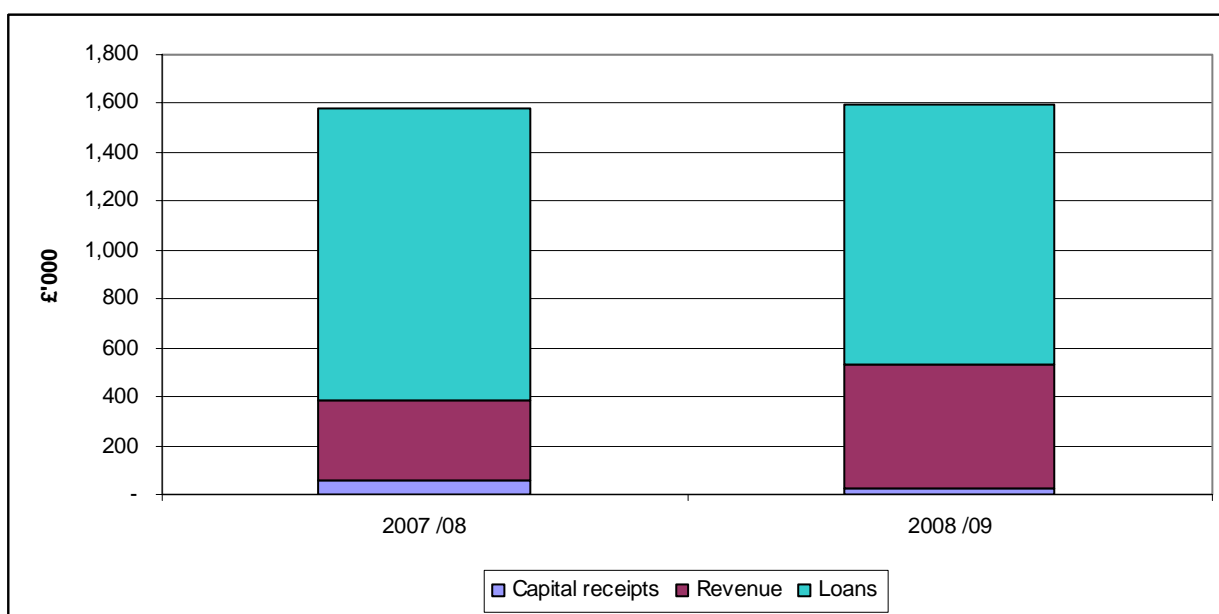
Financial position

7. The Joint Committee's Income & Expenditure account shows a net surplus of £992,000 for the year. The net surplus figure measures the Board's financial results in the year under Generally Accepted Accounting Principles. The movement on the general reserve balance is also an important figure when considering the Board's financial stewardship. Adjustments are made to the net surplus figure to take account of expenditure that statute and non-statutory proper practice require to be charged to the general reserve. Following these adjustments, the surplus for the year increased to £1.09 million, £1 million of which is to be distributed to the constituent councils in accordance with the profit sharing



percentages approved by the Joint Committee on 11 May 2009. The general reserve balance carried forward at the year end was £389,000.

8. 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, which are required to break even over a three year rolling period. In the three years to 31 March 2009 the Construction Division Statutory Trading Account achieved an aggregate surplus of £758,000 and the Facilities Services Statutory Trading Account made an aggregate surplus of £1,406,000. Both Statutory Trading Accounts, therefore, met the statutory target.
9. The Joint Committee continues, however, to face operational pressures, especially within the construction division, with the adverse effects of the current economic recession on the construction market and expected cuts in local government funding. There are therefore increasing challenges to be faced in continuing to meet the statutory objectives.
10. Capital expenditure in the year totalled £1.598 million. The majority of this expenditure related to the addition of items of plant and vehicles for the Construction Division, including spreaders, tipping trucks, winter fleet and a crusher for the quarry. The level of capital expenditure was consistent to the previous year and was funded by borrowing, capital receipts and revenue as shown in the graph below. The relative increase in revenue funded capital is a consequence of a more profitable year for the Joint Committee in 2008/09 which also resulted in less borrowing being required:





Issues arising

11. The Joint Committee's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation procedures and working papers were improved on prior years and this enabled the audit to progress smoothly.
12. 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'). No major changes were introduced by the 2008 SORP. Overall, we were satisfied that Tayside Contracts had prepared the accounts in accordance with the revised SORP.
13. Audited accounts were finalised prior to the target date of 30 September 2009 and are now available for presentation to the Joint Committee and for publication. The financial statements are an essential means by which the Joint Committee accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.
14. Further matters arising from the audit of the financial statements which requires to be brought to the attention of members are summarised below.

Legality

15. Each year we request written confirmation from the Proper Officer that the Joint Committee's financial transactions accord with relevant legislation and regulations. Significant legal requirements are also included in audit programmes and checklists. The Proper Officer has confirmed that, to the best of her knowledge and belief and having made appropriate enquiries of members and officials of Tayside Contracts Joint Committee, the financial transactions of the Joint Committee were in accordance with the relevant legislation and regulations governing its activities.
16. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work. The Joint Committee has recognised a liability in the financial statements in relation to the potential contravention of this Act. Until the equal pay/ single status liabilities (see paragraph 23 below) are settled, there remains the possibility that the Joint Committee could be judged to have contravened the 1970 Act.
17. There are no additional legality issues arising from our audit which require to be brought to members' attention.



Statement on the system of internal financial control

18. The 2008/09 financial statements include a Statement on the System of Internal Financial Control which highlights the Proper Officer's view that reasonable assurance can be placed upon the adequacy and effectiveness of the Joint Committee's internal financial control system.
19. The statement complies with accounting requirements and is not inconsistent with the findings of our audit.
20. We noted that chief officers do not undertake a formal high level review of the adequacy and effectiveness of internal financial controls in support of disclosures in the Statement. The Joint Committee therefore cannot evidence that appropriate internal assurance work was performed in support of its view that reasonable assurance can be placed upon the adequacy and effectiveness of its internal financial control system.

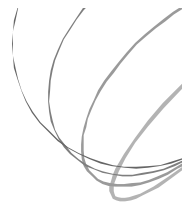
Key risk area 1

21. The SORP states that authorities *may choose* to include a wider statement of internal control in place of a statement of internal financial control. The CIPFA framework document *Delivering good governance in local government* recommends that the review of the effectiveness of the system of internal control should be reported in an annual governance statement. LAAP bulletin 71 *The Annual Governance Statement* clarifies that authorities are encouraged (but not required) to include an annual governance statement with their accounts. The Joint Committee may wish to consider moving to an Annual Governance Statement in future years to reflect best practice.

Future outlook

Single Status

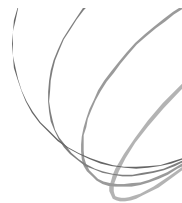
22. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a presumption 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.
23. 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. Tayside Contracts implemented the agreement on 30 June 2008, however all liabilities have not yet been settled. At 31 March 2009, the



Joint Committee had not set aside any funds for the cost of single status. On-going costs associated with single status are largely confined to Facilities Services. While both Facilities Services and the Construction Division will absorb the on-going costs, we understand that appropriate billing arrangements will be put in place to recover the additional costs from constituent councils.

Pension liabilities

24. 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. In accounting for pensions, Financial Reporting Standard 17 (Retirement of 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 a very large future liabilities being recognised on the face of annual accounts.
25. The Joint Committee participates in the Local Government superannuation Scheme (Tayside Superannuation Fund), a defined benefits scheme administered by Dundee City Council. Note 33 to the Core Financial Statements highlights that the Joint Committee's scheme net liabilities at 31 March 2009 are £17.748 million, an increase of £9.8 million from the previous year (as restated), largely as a result of falling pension asset values.
26. A full actuarial valuation of the Tayside Superannuation Fund was carried out as at 31 March 2008 which shows an increase in the funding level, calculated as the ratio of fund assets to past service liabilities, increasing from 91% as at March 2005 to 97.6% as at March 2008. This is mainly due to the fund achieving a better rate of investment return than had been anticipated in the previous valuation and better statistical outcomes than assumed in 2005, for example, lower number of retirements and less death in service. The actuary is required to make a 3-year assessment of the contributions that should be paid by the employing authorities as from April 2009 to maintain the solvency of the fund. The current 3-year assessment shows that budgeted contributions will remain constant at 18.5% of pensionable payroll.
27. In 2006/07 changes to the pension regulations allowing individuals to elect to receive a larger lump sum payment in return for a reduced annual pension. An assumption that 50% of retirees would opt to take the larger lump sum in return for a reduced annual pension was made and Dundee City Council, the administering authority for the pension fund, had agreed to have this assumption monitored over time against the actual take up of the higher lump sum. Last year, Joint Committee officials advised us that this assumption would be monitored at each triennial valuation rather than annually. However, we are not aware of any confirmation of the accuracy of this assumption, or indeed, any other being undertaken as part of the latest valuation. We would highlight that actuarial



reports are only advisory and the Joint Board should confirm it is satisfied with the assumptions/rates used in these reports

Action plan, no 2

Economic conditions

28. The current economic conditions have brought fresh challenges to the Joint Committee in achieving its statutory breakeven objective. We will monitor the actions planned or taken by the Joint Committee to address these challenges during the 2009/10 audit.



Corporate governance

29. In this section we comment on key aspects of the Joint Committee's governance arrangements during 2008/09.

Overview

30. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. In previous years we have concluded that the Joint Committee has many aspects of a sound corporate governance framework in place and have reached the same conclusion this year.

31. Internal audit should play a key role in the Joint Committee's governance arrangements, providing an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system.

32. In prior years, we highlighted concerns about the environment in which the internal control officer operates, for example:

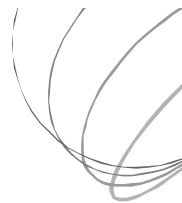
- the internal control officer works alone and it is unclear to what extent his work is planned, supervised and reviewed
- the internal control officer is not independent of management.

33. During 2008/09 we were advised that discussions had taken place with a view to identifying alternative means of providing effective internal audit services to the Joint Committee. However, there has been limited progress on the provision of such services. In the meantime, the internal control officer has developed an audit plan for 2009/10. In terms of the 2008/09 internal audit plan, we note that 70% of the areas considered high and medium risk had not been reported on in the annual internal control and audit report.

Action plan, no 3

Risk Management

34. Whilst a corporate risk register is in place, senior officers recognise that this has yet to be fully developed. Progress has been slow in developing the risk register and leaves the Joint Committee exposed to the possibility that the key risks faced are not being adequately addressed and managed.



We understand that strategic risks will be addressed in the 2010 to 2013 Business Plan which is being developed.

Anti-fraud and corruption arrangements

35. The Joint Committee has appropriate arrangements in place to prevent and detect fraud and corruption. These arrangements include the councillors' Code of Conduct, Fraud Guidelines and a whistle-blowing policy.

Systems of internal control

36. The Managing Director presented an annual report on the work carried out by the Internal Control & Audit function to the Joint Committee in May 2009 which concluded that "The work carried out during the year continues to give confidence that the necessary controls are in place and where weaknesses have been identified appropriate remedial action is taken so that the Joint Committee have confidence in the underlying systems of financial control and the financial service provided".
37. As part of our 2008/09 audit, we reviewed controls over key financial systems and corporate governance arrangements. We also assessed the Joint Committee's computer services. A number of risks outlined, including:
- All servers and back up tapes are situated on the same site,
 - The lack of an approved ICT strategy,
 - The need to update/develop a number of ICT policies.



Performance

38. In this section we comment on key aspects of the Joint Committee's reported performance during 2008/09.

Overview

39. The delivery of high quality and cost effective public services is a cornerstone of current government policy. Performance management and improvement involves raising the standards and quality of performance, achieving greater efficiency in the use of public funds and becoming more responsive to the needs and aspirations of both individual service users and the communities served. Performance management systems will need to be robust to handle changing requirements.

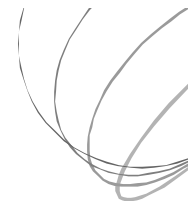
Performance Management and Improvement

40. As part of our 2008/09 audit, we reviewed controls over performance arrangements and business improvement and efficiency initiatives. A number of areas for improvement were agreed with management including:

- Baseline information against which future efficiencies can be measured may not be consistent and of high quality across all services and areas.
- Efficiency measures and targets are not always SMART.
- Performance reports do not clearly conclude on whether performance or efficiency targets have been met.
- Whilst a number of initiatives are underway, the corporate risk register does not reflect the impact of not delivering on efficiencies.

41. The 2006/11 Business Plan acknowledges the need to improve efficiency and productivity and to make best use of assets and people in order to minimise the impact of cost pressures in the next five years. The Joint Committee's progress in meeting the objectives of the Business Plan is subject to on-going review.

42. An income gap had been identified in the Business Plan and, to date, Tayside Contracts has been successful in bridging the annual income gap by generating sufficient additional income, making efficiency improvements and cost savings.



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	20	<p>Chief Officers do not undertake a formal high level review of the adequacy and effectiveness of internal financial controls in support of disclosures in the Statement. The Joint Committee therefore cannot evidence that appropriate internal assurance work was performed in support of its view that reasonable assurance can be placed upon the adequacy and effectiveness of its internal financial control system.</p> <p><i>Risk: There is no formal internal mechanism to assure the Joint Committee that internal financial controls operate effectively and that appropriate remedial action is taken where necessary.</i></p>	<p>In previous years, Chief Officers have been asked to provide a statement of assurance regarding internal financial controls within their respective areas of responsibility. This assurance will be requested in future years.</p> <p>There is no evidence, from either internal and external audit work or other management investigations and reviews, to suggest that internal financial controls cannot be relied upon.</p>	Head of Finance	30 June 2010



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
2	28	<p>In accounting for pensions, Financial Reporting Standard 17 (Retirement of 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 a very large future liabilities being recognised on the face of annual accounts. An actuarial calculation of the FRS17 impact is provided to the Joint Board each year however no review of the assumptions or rates applied by the actuary is carried out to ensure the Joint Committee is satisfied that these are appropriate to local circumstances.</p> <p>Risk: FRS 17 pension costs, assets and liabilities are based on inaccurate or inappropriate assumptions.</p>	<p>Tayside Contracts Joint Committee participates in the Tayside Superannuation scheme under "Admitted Body" status, and as such relies upon the Pensions and Treasury functions within Dundee City Council for expert pensions' services and advice. Given Tayside Contracts relatively small share (<5%) of the total fund, we are content to rely on the expertise of the actuaries who prepare the FRS17 report. The underlying assumptions and rates applied are common to the overall pension fund, and have been reviewed and accepted by Dundee City Council as the administering body. The key assumptions are disclosed to the Joint Committee in the Annual Report under Note 33 to the Core Financial Statements. Notwithstanding the above comments, it is agreed that the Joint Committee should be asked to note the key assumptions underpinning the actuary's FRS17 calculations each year, as set out in the Unaudited Statement of Accounts. Further, the Joint Committee will be asked to note that these key assumptions have been reviewed and accepted by Dundee City Council as administering authority.</p>	Head of Finance	30 June 2010
3	33	<p>The internal control officer has developed an audit plan for 2009/10. In terms of the 2008/09 internal audit plan, we note that 70% of the areas considered high and medium risk had not been reported on in the annual internal control and audit report.</p> <p>Risk: Risks identified by management in the internal audit plan are not addressed, reducing assurances to the Joint Committee that internal controls function as intended.</p>	<p>The CMT has introduced a quarterly review of internal audit work and progress against the 2009/10 plan, together with review of audit reports and findings. This will enable more formal and transparent review of progress, adherence to the internal audit plan and where necessary agreed re-prioritisation of work.</p>	Head of Finance	May, August, November 2009 and March 2010

