

Argyll and Bute Council

Annual Report to Members and the Controller of Audit

31 October 2011



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1 Introduction

Scope

- 1.1 The Accounts Commission for Scotland appointed Grant Thornton UK LLP as auditors of Argyll and Bute Council (the Council) under the Local Government (Scotland) Act 1973 (the 1973 Act) for the period of 2006-07 to 2010-11. This is therefore the final year of our appointment. This document summarises our responsibilities as external auditors for the year ended 31 March 2011 and our approach to issues impacting the Council's activities in that year.
- 1.2 We carry out our audit in accordance with our statutory responsibilities under the 1973 Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB) and the wider responsibilities embodied in Audit Scotland's Code of Audit Practice (the Code).

Summary of findings

- 1.3 We planned and performed our 2010-11 audit in accordance with our Audit Plan issued in February 2011. The Code objectives and key findings arising from the audit are summarised in Exhibit 1 below.

Exhibit 1 - Key findings from the 2010-11 audit

	Summary
Financial position	<ul style="list-style-type: none"> The Council reported total comprehensive income and expenditure for 2010-11 of £101.5 million (2010 deficit: £50.7 million). Net cost of services was £209.3 million (2010: £242.4 million). The main movements reflect changes in the assumptions used to calculate the Council's pension liabilities. The Council reported a budget underspend of £2.2 million in its annual report. The General Fund balance at 31 March 2011 was £33 million, with the un-earmarked balance at £3.9 million (1.5% of net budget expenditure). The Council's net worth increased from £111.5 million to £212.6 million as at 31 March 2011. This reflects the reduction in pension liabilities from changes in the actuarial assumptions. Capital expenditure was significantly behind budget, continuing the trend to underspend in recent years. We note that central government budget allocations for capital will fall significantly over the next 2 years. The Scottish Government announced funding allocations for local government in their comprehensive spending review on 21 September 2011. Total allocations will fall over the next three years. The Council's current budget funding gap will be £3.7 million by 2014.
Financial statements	<ul style="list-style-type: none"> We issued an unqualified report on the Council's financial statements for the year to 31 March 2011. The Council's trading organisations achieved their statutory target of breaking even over the three year period to 31 March 2011. This is the first year the Council prepared its accounts under the Code of Practice on Local Authority Accounting in the United Kingdom, which is

	Summary
	<p>based on International Financial Reporting Standards (IFRS). The Council prepared well for the introduction of IFRS, and there were only a small number of adjustments processed during the audit.</p> <ul style="list-style-type: none"> • The Council has published a Remuneration Report for the first time, reflecting changes in accounting disclosures introduced by statute. • The Council is closer to settling outstanding equal pay claims, with a provision of £600,000 recognised for claim balances. • The Group accounts record net assets of £18.8 million compared to £212 million in the Council's single entity balance sheet, reflecting mainly the Council's share of the liabilities associated with the unfunded police and fire pension schemes.
Governance	<ul style="list-style-type: none"> • We have concluded that the Council's systems of internal financial control are operating adequately. The Council continues to develop its financial management and budgetary control arrangements to meet the challenges ahead. • The Council generally complies with CIPFA guidance on the role of the head of internal audit. The Council has recently completed a best value review of internal audit and is currently considering how to take forward the outcomes from that review. • The Council has improved its participation in the NFI exercise, and is close to finalising the processing of all required matches • The Council complied with relevant statutory and internal guidance on its redundancy scheme.
Performance	<ul style="list-style-type: none"> • The Council continues to improve its best value arrangements, we note in particular the recent review of the Council's approach to performance management reporting. • The Assurance and Improvement Plan was updated for the revised risk assessment in April 2011. A number of areas of improved performance were noted and the Council has been categorised as 'low risk' by its auditors and inspectors. • The Single Outcome Agreement was reviewed and a progress report issued. of the 72 targets in the SOA, 59 have been rated 'green' with improved performance, and 12 with performance falling or targets not met. • The Council has met the requirements of reporting Statutory Performance Indicators, although we noted a number of amendments were required to draft figures following reviews by internal audit. • Following the Council's recent decision not to proceed with its proposals to rationalise the school estate, it currently has no clear way forward for addressing the strategic issue relevant to the development of that estate. The Council will also need to consider how the efficiency savings contribution expected from the education service will now be met.

Acknowledgements

- 1.4 We would like to take this opportunity to thank the staff who have been involved in the 2010-11 audit for their assistance and co-operation.
- 1.5 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.

- 1.6 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.

2 Financial position

Comprehensive Income and Expenditure Account

- 2.1 The Council reported total comprehensive income and expenditure for 2010-11 of £101.5 million (2010 deficit: £50.7 million). Net cost of services was £209.3 million (2010: £242.4 million).

Table 1: Financial results for 2011 and 2010

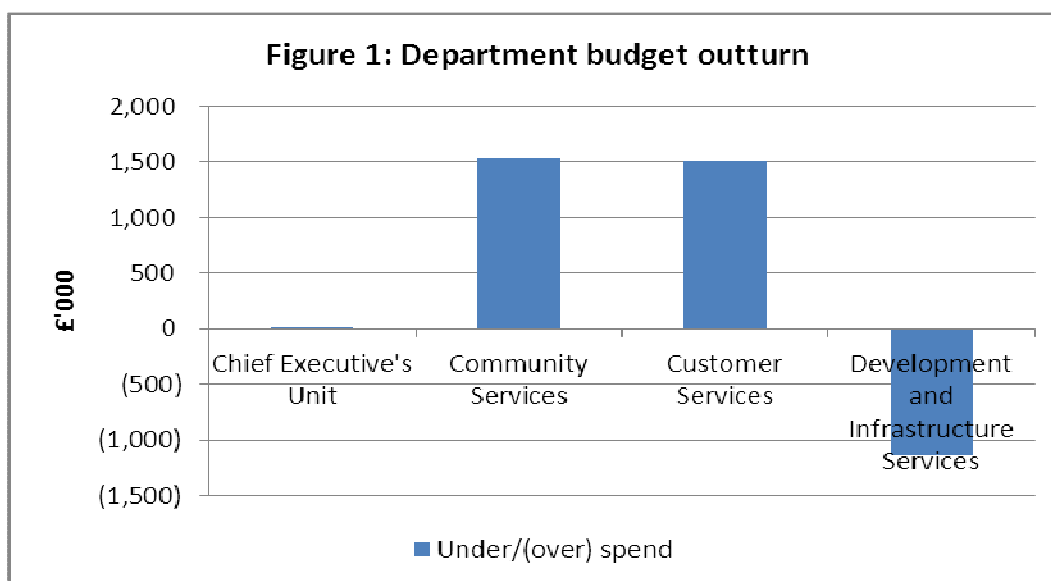
	2011 £'000	2010 £'000
Net Cost of Services	209,324	242,450
Other operating income and expenditure	1,453	1,501
Financing and investment income and expenditure	15,670	20,934
Taxation and non-specific grant income	(279,925)	(277,497)
Surplus on the provision of services	(53,478)	(12,612)
Other comprehensive income and expenditure	(47,572)	63,326
Total Comprehensive Income and Expenditure	(101,050)	50,714

Source: Argyll and Bute Council 2010-11 financial statements

- 2.2 The main movements in the Comprehensive Income and Expenditure Account relate to pension movements resulting from two changes to the actuarial assumptions used to calculate the Council's liabilities in the Strathclyde Pension Fund.
- 2.3 The first change has arisen as a result of the change in the index used to measure pension inflation from the Retail Price Index (RPI) to the Consumer Price Index (CPI). Although both indices measure the average change in the cost of a basket of retail goods and services, CPI is generally lower than RPI and by switching to CPI for measuring pension inflation, the value of pension liabilities is reduced. The impact of the change is that a past service gain of £42.2 million is recognised in the 2010-11 accounts and this has been credited to Non-Distributed Costs within Net Cost of Services.
- 2.4 The assumption for salary increases has also changed in 2010-11 to take into account the Government's public sector pay freeze. This change to the salary increase assumption has led to a reduction in the value of active members' liabilities in the year. This has contributed to actuarial gains on the Council's share of the Fund of £38.9 million (2010: an actuarial loss was recorded of £74 million resulting from a change in the discount rate).

Performance against budget

- 2.5 The Council reported an underspend of £2.2 million against budget (0.9% of the overall revenue budget) after processing audit adjustments. An analysis of budget outturn by department is shown in Figure 1 below.



The largest department outturns versus budget are as follows:

- Community Services - an underspend of £1.5 million. The main underspend relates to £2.6 million savings in adult care services arising from changes to the charges applied to residential care services. In addition there was savings of £1.5 million from vacancy savings and reduced spending on festivals and events, private sector housing grants and homelessness services. This is offset by an additional £2.5 million costs in education, mainly arising from teacher's early retirement.
- Customer Services- an underspend of £1.5 million. The underspends in this department relate to savings in transport, catering and cleaning and property services arising from actions taken before the savings review, and also from vacancy savings.
- Development and Infrastructure Services- an overspend £1.1 million. This related to mainly to increased winter maintenance costs following the severe weather over the Winter of 2010/11.

Balance sheet

- 2.6 The total net worth of the Council at 31 March 2011 was £212.5 million (2010 restated: £111.5 million).

Table 2: Balance sheet as at 31 March 2011 and 2010

	31 March 2011 £'000	31 March 2010 £'000
Long term assets	478,875	464,277
Current assets	47,527	29,667
Current liabilities	(44,421)	(55,693)
Long term liabilities	(269,404)	(324,724)
Total assets less liabilities	212,577	111,527
Unusable reserves	176,135	75,055
Usable reserves	36,442	36,472
Total reserves	212,577	111,527

Source: Argyll and Bute Council 2010-11 financial statements

- 2.7 The movement in net worth reflects the significant fall in the Council's share of pension liabilities in the Strathclyde Pension Fund. The total pension liability has decreased from £108 million to £26 million as a result of the issues noted at sections 2.3 and 2.4.

General Fund

- 2.8 For the year ending 31 March 2011, the Council had a total general fund reserve balance of £33 million, of which £29.1 million was earmarked for specific purposes, leaving £3.8 million available for new expenditure or to meet the costs of contingencies and unforeseen events. Table 3 below provides a breakdown of general fund balances at 31 March 2011.

Table 3: General Fund balances as at 31 March 2011 and 2010

	31 March 2011 £'000	31 March 2010 £'000
PPP Smoothing Funds	15,327	15,993
Strategic Housing Fund	7,366	6,953
Unspent grants	328	1,044
Contributions carried forward	265	465
Unspent budget carried forward	502	1,796
Schools budget carried forward	657	595
Unspent budget for existing legal commitments	115	258
CHORD	908	860
Process for change	326	574
Additional SG Grant carried forward	2,455	-
Reserves committed for 2011-12 budget	876	-
Total Earmarked	29,125	28,538
Unearmarked	3,848	4,482
Total General Fund	32,973	33,020

Source: Argyll and Bute Council 2010-11 financial statements (Note 5)

- 2.9 The unearmarked proportion of the general fund at 31 March 2011 is 1.5% of net budgeted expenditure for 2011-12, and within the Council's current reserves policy.
- 2.10 In the 2011-12 budget setting process, the Head of Strategic Finance presented a report on reserves and balances, which formulates the Council's strategy on maintaining the general fund reserve. In addition, a review of year end reserve balances was presented to the Council in June 2011 which provided a review of the outturn against the strategy. Our review of the general fund reserves as at 31 March 2011 highlighted the following:
- The Council continues to earmark a proportion of the general fund to deal with fluctuations in the payment profile of the Waste Management PPP Scheme and the Schools NPDO Scheme. The Council is planning to review this reserve to determine the optimal level of reserves versus the current levels of the reserve to ensure it remains adequate for the two scheme's models. In 2010-11, the Council allocated a portion of the reserve to meet the costs of the restructuring programme (£728,000). Contributions from future budgets will restore the Smoothing Funds to the required levels.
 - The earmarked balance for the Strategic Housing Fund arises from the additional council tax collected on second homes. The fund was £7.3 million as at 31 March 2011, The Council approved a new strategy for the fund in August 2010, to improve the methodology for reviewing and approving bids and to take account of recent changes in Scottish Government funding of social housing projects. The new strategy aims to channel the fund to support registered social landlords in the current financial climate, while recognising the continuing demand for housing in the Argyll and Bute area.
 - The Council received £2.4 million from the Scottish Government at the end of the 2010-11 financial year as one-off funding, to compensate for the higher than average reduction in

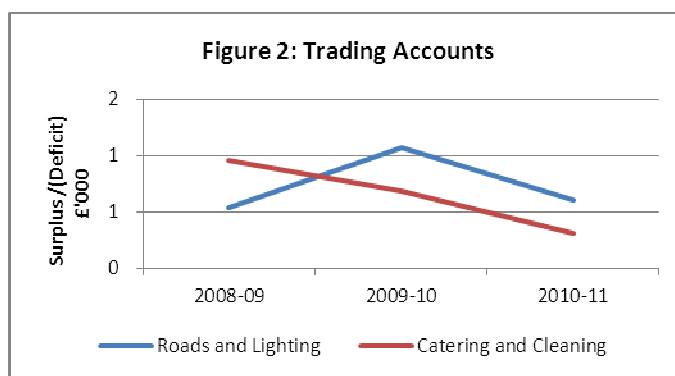
funding as part of the finance settlement for 2011-12. These funds are accounted for as grant income in the 2010-11 accounts, but have been earmarked to cover expenditure in 2011-12, in line with budgetary commitments.

- Budget carried forward was £0.5 million (2010: £1.7 million), a reduction of £1.2 million from 2010. The Council's year end review of the general fund reserve balance included a separate review of each area of budget carried forward to 2010-11. The reduction in carry forward represents a stronger analysis of carry forward requests, which now must be supported and approved by the Senior Management Team based on a business case.

2.11 The Council's total cash backed reserves as at 31 March 2011 were £36.4 million. This is 7th out of the 32 local authorities in Scotland. Per head of population, this is approximately £408 (7th highest in the country, the same as in 2010). The Council's cash backed reserves position remains strong, and is above the mean average for Scottish local authorities of £273.85 (excluding Shetland and Orkney Councils).

Trading accounts

2.12 The Council maintains two trading accounts: roads and lighting and catering and cleaning. Section 10 of the Local Government in Scotland Act 2003 requires that local authorities' significant trading organisations break even over a three year rolling period. Figure 2 highlights the performance of the Council's two trading accounts over the three year period.



2.13 In previous years, the Catering and Cleaning trading account has not met the statutory three year break even target. The recorded deficit largely resulted from the impact of the cost of equal pay claims and implementing single status, which was not accounted for when the budget recharges were originally set.

2.14 The Council prepared a financial strategy to return the trading account to a break even position and new budget recharges were agreed to better reflect the trading account's cost base. For the past three years, both trading accounts have reported surpluses and have achieved their statutory targets.

Capital expenditure

2.15 Total capital expenditure in the year was £21.3 million versus a budget of £30.1 million, an underspend of £8.8 million (29%). This continues the trend of underspends against the Council's capital budget in recent years. Table 4 below highlights capital expenditure by funding source versus budget, and the budget position for 2011-12 financial year.

Table 4: Capital budget position

Funded from	Budget 2010-11	Actual expenditure 2010-11	Budget 2011-12
Borrowing	22,055	13,182	14,333
Capital funded from current revenue	0	915	0
Grants	7,804	7,095	12,651
Capital receipts	250	147	0
Capital Fund	0	12	0
	30,109	21,351	26,984

Source: Argyll and Bute Council 2010-11 financial return

2.16 Although the capital project as a whole is currently behind budget, the costs for current capital schemes is forecast to marginally overspend budget by £0.9 million out of the total budget of £135 million. The key project showing an overspend at the year end was the Campbeltown Infrastructure Improvement scheme where an overspend of £1.1 million was forecast. We understand that the Council has recently reviewed this project and now expect an outturn closer to the original budget.

2.17 Going forward, the Council has a number of ongoing capital projects including the CHORD programme to redevelop the waterfronts in Campbeltown, Helensburgh, Oban, Rothesay and Dunoon. There are active projects in place for Campbeltown and Helensburgh, with other CHORD projects at the business case stage for the other towns. In addition, there are ongoing capital works to improve the transport infrastructure, and business cases for a new swimming pool and office in Helensburgh are being reviewed.

Completion of these projects will depend on the ability of the Council to finance the ongoing capital plan, which has been made more difficult by reductions in central government financial support. The Spending Review announced by Cabinet Secretary for Finance and Sustainable Growth to the Scottish Parliament cuts capital grants to local authorities from £691.8 million in 2011-12 to £563 million in 2012-13 and £517.3 million in 2013-14, before rising back to £759.7 million the year after. This rescheduling of capital grants may have an impact on the timing and availability of resources for the capital plan. The Council is considering the sustainability of the capital plan in light of recent announcements as part of its annual review of the capital budgeting process.

Treasury management

2.18 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 2010-11 and managed capital expenditure within these approved limits.

2.19 Table 5 below highlights the Council's treasury management position with regards to cash and loan balances.

Table 5: Treasury management

	31 March 2011	31 March 2010
Cash and cash equivalents	30,446	3,350
Short term borrowing	496	12,639
Long term borrowing	160,229	131,242

Source: Argyll and Bute Council 2010-11 financial return

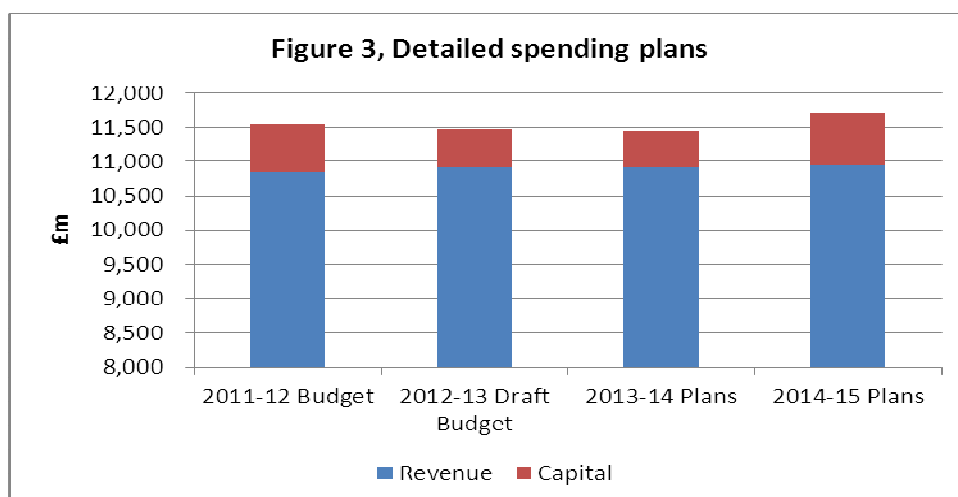
- 2.20 Total cash balances are significantly higher reflecting the Council's drawdown of further loan finance from the Public Works Loan Board (PWLB). The loans are to support the Council's capital programme.
- 2.21 Overall long term borrowing levels for the Council are £160 million, which is 20th out of 32 local authorities in the country. This approximates to £60,000 per head of the population (17th highest in the country). This outcome is partly historical reflecting the Council's capital funding position. The Council remains well within its prudential borrowing indicators and its relative borrowing position has reduced over the year as it applies cash backed reserves to manage its overall level of indebtedness.

Future financial position

- 2.22 The Scottish public sector continues to face a period of sustained financial austerity. The initial reduction in the Council's budget settlement for 2011-12 was £11.389 million (4.9%), which is significantly higher than the national average of 2.59%. The Council's higher share of the cuts reflects significant variation in funding for two areas:
- the Special Islands Needs Allowance (SINA) following the reclassification of Seil as an island which leads to a reduction of £400,000
 - Supporting People allowance - a reduction of £5.6 million due to an alternation in the distribution process for this allowance by the Scottish Government. The reduction was significantly more than anticipated by the Council in the budget setting process.
- 2.23 A later re-allocation of government funding provided an additional £1.3 million in funding to the Council to reduce the impact of the changes in Supporting People funding, giving a total reduction for 2011-12 of £10 million. There is no certainty that this support will continue going forward. The Council has asked services to carry out service reviews to identify options if they had to operate with budget cuts of up to 20%.
- 2.24 The Council faces significant budget cuts in line with the rest of the local authority sector public sector more widely. We have considered the Council's financial projections and its plans to ensure it can continue to deliver services in light of significant budget cuts.

Local government settlement in the Spending Review

- 2.25 The Spending Review announced by Cabinet Secretary for Finance and Sustainable Growth to the Scottish Parliament on 21 September 2011 allocates a total funding package amounting to £11.5 billion to local government. Figure 3 below highlights the 2011-12 allocations and plans for expenditure levels in subsequent years.

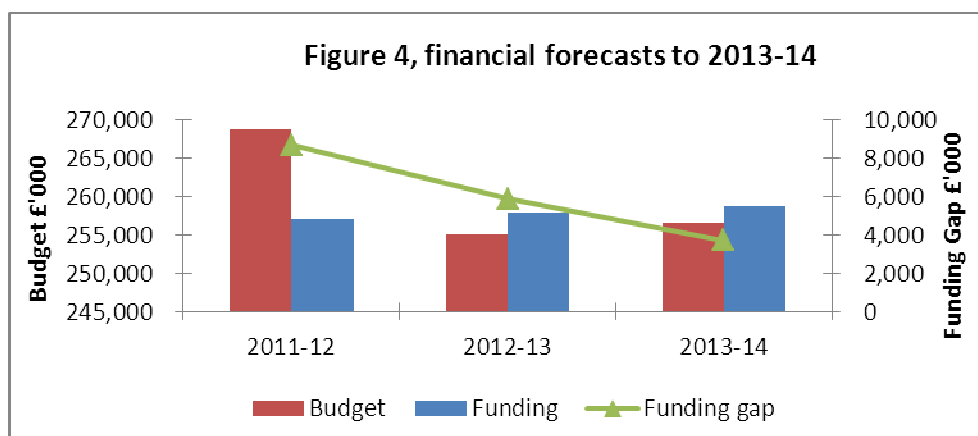


- 2.26 As in prior years, the level of spend available to local authorities will be dependent on agreeing a council tax freeze for the fifth consecutive year. The Review also announced the Scottish Government's commitments to maintain police and teacher numbers in Scotland.
- 2.27 The Council will be reviewing the impact of the spending review on its forecast of future revenue support grant funding, and individual council allocations will be known in December 2011.

Projected financial position

- 2.28 The Council has been analysing the impact of reductions in central government support, and performing scenario planning to determine the likely impact on its financial position. The Council has adopted a three year budget planning cycle, and set a target of maintaining a balanced budget over this term.

Figure 4 below highlights the current financial forecasts, taking into account the Council's assumptions on future reductions in central government grants, and inflationary and demand pressures.



- 2.29 The total forecasted budget deficit by 2014 represents a funding gap of £3.7 million. The size of the budget deficit highlights the significant financial pressures on the Council's financial position, and presents a major challenge in sustaining current levels of service provision and quality.
- 2.30 The Settlement and Distribution Group are currently reviewing the allocation of supporting people funding and the potential reinstatement of the prior methodology for awarding this revenue support which was removed in 2011-12. The Council will monitor the outcomes from this review and the potential impact on future budget forecasts.

Service reviews

- 2.31 The Council is currently undertaking a review of services in order to plan ahead for the challenging financial position as well identifying ways of securing best value in the delivery of services. The aim is to review the baseline budget of each service, benchmark services with similar service providers, identify future challenges and cost pressures and identify options for meeting an initial 15% savings target rising to 20% for year three service reviews. A project team is appointed to carry out each review and this is led by the head of each service. All reports are reviewed and approved by the Council's Transformation Board.
- 2.32 At this stage of the process, the Council has reviewed the following services:

- Housing Services
- Adult CareSupport Services

- Property Services
- Planning
- Streetscene
- Roads Design
- Network and Environment
- Fleet

2.33 A report was produced for the Executive meeting on 29 September 2011 sets out the findings of each service review for member consideration.

3 Financial statements audit

Introduction

- 3.1 We have audited the Council's 2010-11 accounts in accordance with our Audit Plan issued in February 2011. The key messages arising from our financial statements audit are contained in our Report on the 2010-11 Accounts Audit, issued on 14 September 2011, and summarised below.

Audit opinion

- 3.2 We gave an unqualified opinion on the Council's 2010-11 financial statements on 30 September 2011.
- 3.3 There were a number of audit adjustments to the draft financial statements:
- to correct the valuation methodology for the former Hermitage Academy site
 - to update the equal pay provision following receipt of post balance sheet information from the Council's solicitors
 - a requirement to recognise the police capital grant as income, with an equivalent amount of expenditure, in both 2010 and 2011
 - to release provisions previously made that no longer meet the definition of a provision under IAS 36
 - increase the bad debt provision for aged debts over one year
 - to correct the group accounts following changes in the recognition of the pension costs of injury benefits at two associates.
- 3.4 There is one unadjusted misstatement, and there would be no impact on the reported surplus for the year, or on the general fund balance if it had been adjusted.

Significant accounting issues

Implementation of IFRS

- 3.5 Local authorities are required to comply with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code). From 2010/11 this Code is based on International Financial Reporting Standards (IFRS) rather than a UK GAAP based Statement of Recommended Practice (SORP). The Code requires a restated balance sheet at 1 April 2009, restated 2009/10 accounts and full published IFRS accounts for 2010/11. During the year, we performed an arrangements review to provide feedback on the Council's approach to restatement with detailed work on the restated figures taking place during the 2010/11 final accounts audit.
- 3.6 Our report, Review of arrangements for implementation of International Financial Reporting Standards (IFRS), was presented to the audit committee in June 2011 and summarised our review. Overall we found that the Council had made good progress in the transition to IFRS, with further work required in the areas of fixed asset re-categorisation and group accounts.

3.7 There was two issues arising relating from the introduction of IFRS in the financial statements audit:

- The revaluation of the former Hermitage Academy site under the Code
- We also recommended that the Council investigate methods of improving data collection on officer's leave and holiday entitlements for the holiday pay accrual. The implementation of the Council's new HR system is expected to address this matter.

Remuneration Report

3.8 During the year, Scottish Ministers approved an amendment to the Local Authority Accounts (Scotland) Regulations 1985 to publish a remuneration report as part of their annual accounts. The report is similar to that produced for listed companies and public sector bodies that report under the Government Financial Reporting Manual.

3.9 The amendments to the Regulations require the Council to disclose:

- remuneration policies for senior members and senior officers
- remuneration paid to senior members and senior officers for 2009-10 and 2010-11
- pension benefits including pension contributions paid by the Council and the value of accrued pension benefits at the balance sheet date
- information of the number of employees earning in excess of £50,000 per year.

3.10 We concluded that the Council's remuneration report complied with the new regulations. In future years, the Council will also be required to disclose summary information in relation to exit packages, including compulsory and voluntary redundancy costs, ex-gratia payments and other departure costs.

Equal pay claims

3.11 In 1999, local authorities in Scotland agreed that a new pay and grading system would be introduced (single status), which would ensure equality in pay structures across employee grades. The Council implemented its new pay and grading model in 2007-08.

3.12 Under the Equal Pay Act 1970, employees are entitled to make claims for equal pay settlements for a period up to six years. As at 31 March 2010, the Council recognised a provision of £163,000 relating to the claims received, with a contingent liability for those claims it could not quantify at that time.

3.13 During 2010-11, the Council was nearing agreement of the settlement of all outstanding claims and the provision was increased to £2.4 million in the draft accounts. Post balance sheet correspondence with the Council's solicitors, however, highlighted that the status of the claims was not as advanced as previously thought, and the Council revised the provision to £0.6 million to match the project settlement amounts provided by its solicitors. The Council has recognised a contingent liability for those claims where a final settlement figure is not yet known

Group accounts

3.14 The Council's group accounts consolidate the following bodies:

- Strathclyde Police Joint Board
- Strathclyde Fire and Rescue Joint Board
- Strathclyde Partnership for Transport
- Strathclyde Partnership for Transport Concessionary Fares
- Dunbartonshire Argyll and Bute Valuation Joint Board

- Oban Common Good Fund
- Campbeltown Common Good Fund.

3.15 The net worth of the Group is £18.8 million (2010: deficit of £113 million) compared to the Council's individual net worth of £212 million (2010: £112 million). The difference reflects the Council's share of deficits in the pension schemes of the Strathclyde Police Joint Board and the Strathclyde Fire and Rescue Joint Board, both of which are unfunded schemes. The schemes are effectively underwritten by the Scottish Government from funding provided to local authorities.

3.16 In September 2011, the Cabinet Secretary for Justice announced plans to establish a single police force and a single fire brigade for Scotland. It is anticipated that single forces will be established from April 2013. The creation of single police and fire services could impact in how such services are delivered and may lead to a fundamental change in the group structure of the Council when implemented.

4 Governance

Introduction

- 4.1 In accordance with the 2010-11 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 on 6 June 2011.

Core Financial Systems

- 4.2 During the year we reviewed the effectiveness of the Council's core financial systems and financial management and budgetary control arrangements.
- 4.3 Our overall conclusion is that the core financial systems continue to operate effectively, however we identified three medium risk issues in our financial statements audit:
- bank reconciliations for the deposit bank accounts not completed during the year
 - transactions in 2010-11 relating to two of the Council's bank accounts were not originally included in the general ledger for the year or on the original year end bank reconciliations.
 - the bad debt provision methodology should be reviewed on an annual basis, including a review of significant individual debtors for impairment.
- 4.4 We reviewed the Council's progress in implementing agreed recommendations to improve financial planning and budgetary control arrangements. Overall, we concluded that the Council continues to closely monitor its finances and the impact of the deterioration of the wider public sector finances. We have provided commentary on the Council's updated financial position at Section 2.25.

IT systems and applications

- 4.5 Our overall conclusion is that the controls over IT systems and applications continue to operate effectively. We made four new recommendations from our audit of which three are classed as medium risk:
- the access rights of leavers should be disabled in a more timely manner
 - network password settings should be encrypted to improve security and reduce the risk of unauthorised access to the network
 - Oracle access rights should only be granted after being authorised by a member of staff included in the list of designated approvers.
- 4.6 The Council has reported that they have now implemented the encryption of network password settings. The other two medium risk recommendations were not accepted by management.

Contract management

- 4.7 Our 2009-10 audit found that the Council had made significant improvements to its contract management procedures since our original audit review in 2007-08. In particular, we noted that the Gateway process has now been implemented and embedded into the Council's working practices.

- 4.8 There were two recommendations relating to the Argyll Air Services project, which require further management action to fully implement: completing a post completion review of the project; and finalising the draft business plan. The business plan was approved by the Executive at its meeting in June 2011.

Internal audit

- 4.9 We have continued to follow up our recommendations following our 2006-07 review of the Council's internal audit department against the requirements The Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) issued by CIPFA. In addition, in our 2008-09 audit, we recommended that the Council perform a review of the future strategic direction of internal audit and consider the best way of providing the service.
- 4.10 In June 2010, the Council appointed a 'Head of Internal Audit' (HIA) to lead the department, and this addresses one of the main areas of previous non-compliance with the Code. As part of the 2010-11 audit, we have assessed the extent to which the Council meets the requirements of CIPFA guidance on the role of the HIA. Our review found that the Council have adopted the majority of the guidance although we noted that the Council's constitution, terms of reference for the internal audit department and the internal audit manual all require updating to take account of the recent changes in the internal audit department, and this is currently being actioned.
- 4.11 We raised concerns that the vacancy in the audit manager position will impact on the department's ability to meet the 2011-12 audit plan. However we are aware that the Council intends to use contractors and partnership resources to meet the deficit in audit resource. We are aware the Council is currently reviewing the future provision of internal audit, and this should include a review of resources and consider the appropriate mix of qualified staff.

The National Fraud Initiative

- 4.12 The National Fraud Initiative (NFI) is a nationwide data matching exercise run jointly by Audit Scotland and the Audit Commission. In our 2009-10 audit we made a number of recommendations for the Council to take action on to improve their participation in the NFI process. We are pleased to note that the Council's procedures in place for NFI have improved significantly, and at this stage, a large proportion of the matches have now been processed. We were also pleased to note that regular updates on NFI are now provided to the audit committee and SMT.
- 4.13 As at 30 September 2011, the Council have processed five out of six datasets in the NFI matches. Further work is required to complete the processing of matches received for housing benefits. In addition, the Council will be required to process matches from the electoral register and council tax when they are received later in the year. To date there has been no recorded frauds noted from the process.
- 4.14 We are due to complete a summary review of the Council's participation in the NFI scheme for Audit Scotland. A national report on the process in Scotland is due to be published in 2012.

Corporate restructuring

- 4.15 In view of the potential significance of severance schemes in the public sector and the associated interest from stakeholders in the costs and impact of such schemes, auditors have a role in considering the arrangements for such schemes as part of their responsibilities in respect of probity, regularity and value for money
- 4.16 In 2009-10, the Council completed a significant restructuring of the Strategic Management Team and service heads. This involved replacing the four Strategic Directors with three Executive Directors, and a restructure of the services, with a realignment of services leading to the creation

of 12 new services to replace the previous 15. As such, there was a reduction in the number of heads of service from 15 to 12. The changes took effect from 1 April 2010. During 2010-11, the Council introduced a voluntary severance scheme, which is expected to contribute significantly to the required cost savings over the next three years.

- 4.17 Our review was carried out in line with guidance in Audit Scotland's note for guidance, *Severance schemes*, the Council's process for undergoing the restructure process and concluded that it was in compliance with relevant legislation and guidance.

Audit Committee

- 4.18 In 2008-09, we carried out a review of the audit committee's compliance with best practice, as set out in the CIPFA guidance note, *Audit committee principles in local authorities in Scotland: a guidance note*. The Council has now implemented the majority of our recommendations following this review.
- 4.19 Previous results of the self assessment carried out by audit committee members highlighted that progress was to be made, in particular with regard to induction training for new members. The Committee held an away day in January 2011 which determined a training programme to address this improvement objective.
- 4.20 The audit committee appointed a new Vice Chair in 2010-11. A key challenge going forward will be finding a replacement for the current Chair when his term of office expires in April 2012. The Committee has made good progress in ensuring its role is discharged effectively and is continuously seeking to improve. There is some scope for the Committee to consider how it could better measure and report on the impact of its work in improving financial stewardship, governance and performance management within the Council. For example the Committee could enhance its impact by closer working with, and reporting to, the Council's senior management team and the executive committee to improve governance overall and communication links with both members and senior officers.

5 Performance

Introduction

5.1 In accordance with our Audit Approach Memorandum and the Assurance and Improvement Plan, we continue to review the Council's arrangements for delivering Best Value and reporting on performance. The Local Government in Scotland Act 2003 established Best Value as a statutory requirement for all councils. The Act defines Best Value as 'continuous improvement in the performance of the authority's functions'. The objective of Best Value is to ensure that councils deliver better and more responsive public services by:

- balancing the quality of services with cost
- continuously improving the services provided
- being accountable and transparent, by listening and responding to the local community
- achieving sustainable development in how the council operates
- ensuring equal opportunities in the delivery of services.

Assurance and Improvement Plan

5.2 Under the National Scrutiny Plan for Local Government 2010-11, Scotland's scrutiny agencies work together to develop a shared risk assessment and AIP for each council area. As part of our 2010-11 audit, we have followed up the progress made by the Council, both in addressing the improvement agenda and against specific areas of risk or uncertainty identified by scrutiny partners.

5.3 The Council's Local Area Network (LAN) published an updated Shared Risk Assessment and Assurance and Improvement Plan in April 2011. The scrutiny partners agreed that Argyll & Bute Council has a number of areas of improving performance, particularly in corporate management arrangements, early years services, primary education and some aspects of social care services. The revised management structure, planning and performance management framework, and transformation programme are now embedded and beginning to make a real difference to the effectiveness of services. Overall the LAN has categorised the Council a 'lower risk' for the purposes of scrutiny planning which is a significant achievement.

5.4 The LAN drew attention to the following aspects of the Council's services it categorised as 'improving':

- Sustainable growth
- Aftercare for care leavers
- Organisational development and modernisation
- Leadership and culture
- Competitiveness
- Managing people
- Equalities.

5.5 The SRA also found that, whilst services are improving overall and corporate management processes appear to be operating well, there were some services where the LAN regarded performance direction as uncertain or where there was a higher risk that performance might not improve in the way the Council would like:

- Management of the School Estate
- Community support for children
- Support for adults at home
- Local access to social housing
- Services for homeless people
- Road network performance
- Impact and outcomes from the Transformation Programme.

5.6 The LAN acknowledged that the Council had plans to improve these services and it did not regard performance as high risk. The LAN will continue to keep the Council's overall performance under annual review.

Managing Performance

5.7 One of the key sources of information for the LAN is the Council's approach to performance management and self-evaluation. The Council's Planning and Performance Management Framework (PPMF) was revised in March 2011 to reflect the council's revised structures. The PPMF ensures that all services contribute to the delivery of the Corporate Plan and report on performance, outcomes and challenges in a consistent way. The Council also adopted the Public Service Improvement Framework (PSIF) approach to self-evaluation and continuous improvement in 2009. The corporate self assessment was completed in May 2010, and helped the Council identify a number of areas for improvement. These actions are being taken forward in the Corporate Improvement Plan, and include an organisational development framework, a number of leadership development programmes, and further improvements in internal communications. A programme of PSIF reviews are also being rolled out across service areas.

5.8 Under the PPMF, the objectives within the Corporate Plan are translated into reporting outcomes in quarterly scorecards at corporate and department level. The scorecards, produced from the Pyramid performance management system, are reported to the Executive quarterly, but are also available widely on the performance pages of the Council's website.

Single Outcome Agreement

5.9 Single Outcome Agreements (SOAs) are the main mechanism in place to align and report on public sector activity with national priorities. The shared risk assessment and BV2 processes draw upon evidence contained within SOAs in order to consider outcomes more widely, as planning for and managing the delivery of outcomes should be central to all aspects of the council's activity.

5.10 Successful delivery of SOAs depends on the degree to which they are supported by effective planning, budgeting and performance management arrangements at service-level, within councils and across partner agencies. We noted that arrangements to extend the Council's performance and risk management processes to the Community Planning Partnership (CPP) are now embedded. The Council's partners have access to the Pyramid system and are able to populate and comment upon data within the scorecards.

- 5.11 The Council has agreed a revised vision and values with all partners in the CPP. Key priorities within the Community Plan are translated into outcomes and success measures within the CPP scorecard. The scorecards are reviewed within thematic groups, and by the CPP Management Committee on a quarterly basis. The key area for development in 2011-12 is to integrate the Community Plan and SOA into a single plan for the area by April 2012.
- 5.12 The SOA Progress Report for 2010-11 outlines a number of areas of success. Of the 71 measures where data is available in the SOA, 59 (81.9%) are green and have improved from the previous year or are exceeding the targets that have been set, and only 12 (18.1%) have seen performance fall or have not met the targets that have been set. Key successes include the delivery of Business Gateway business set-ups, and Highlands & Island Enterprise reported new growth plans for account managed businesses and social enterprises. Data from Visit Scotland also suggests that tourism numbers were above target in 2010-11. The Council has met its targets to implement the Curriculum for Excellence, and the number of school leavers achieving positive destinations increased to 87.8%.
- 5.13 Areas for improvement include secondary school attainment for reading and writing, and for looked after children. The SOA also raises concerns around increasing higher education activity due to the impact of the economy on the UHI.

Statutory Performance Indicators

- 5.14 One of the key ways that members of the public can measure council performance is through the statutory performance indicators (SPIs). In 2009/10, the Accounts Commission made a significant change to the SPI direction. The 2008 direction, which was introduced in 2009/10, has been retained for 2010/11. This direction requires that councils report:
- a range of sufficient information to demonstrate best value in relation to corporate management (SPI 1)
 - a range of information sufficient to demonstrate best value in relation to service performance (SPI 2).
- 5.15 In reporting against SPI 1 and SPI 2 above, all councils are required to report performance against 25 specified indicators, as defined in the 2008 direction. In addition, councils must select a range of non-specified indicators to demonstrate that best value and compliance with the 2008 direction.
- 5.16 To meet the requirements of the Direction, under the Council's Public Performance Reporting Framework, an Annual Report is produced in October. The report covers the specified SPIs, along with other indicators reported in the Scorecards, and includes national and family group benchmarking information. This, along with the quarterly performance reports and range of information on the Council's website, is sufficient to demonstrate that the Council has met the requirements of SPI 1 and SPI 2.
- 5.17 During the year the council's internal auditors have carried out sample testing on a range of the councils specified indicators. Eight indicators were selected by internal audit for testing. Eight SPIs were reviewed by Internal Audit. Although internal audit found that processes for compiling SPI data had improved, we noted that of the eight checked, five had to be amended after discussion with the staff involved in providing the figures, although all amendments were to improve the performance reported. The robustness of data is critical for all models of self-evaluation, which Council's and their scrutiny partners rely on. We were therefore pleased to note the further work that Internal Audit prepared on the arrangements for recording performance information on Pyramid, which highlighted no significant concerns.

- 5.18 Analysis of the SPIs highlights that 40% of the nationally specified indicators improved by more than 5% during the year, and a further 34% maintained levels of performance. Notable improvements were noted in processing homeless cases, and the levels of home care for people over the age of 65. However, sickness absence rates for teachers remain over the national average, and visitor numbers for leisure centres and museums fell in the year.

National Studies

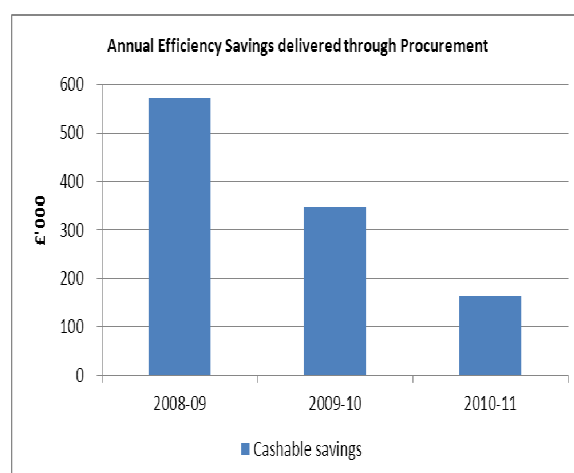
- 5.19 Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports published in the last year with a direct impact on the council include:
- How council's work: roles and working relationships: are you getting it right?
 - Improving energy efficiency: a follow up report
 - Getting it right for children in residential care
 - Physical recreation services in local government
- 5.20 Audit Scotland ask us to ensure that local government bodies review the national studies relevant to them and action them accordingly. We review whether the council has considered the national report at a council committee and whether the council has carried out a self-assessment against the national report and plans to take forward any improvements.
- 5.21 At Argyll & Bute Council, the Internal Audit Manager reviews and summarises all reports from external audit, including Audit Scotland, and prepares a report for the Audit Committee on a quarterly basis. This allows Audit Committee members to ask for further work to be done, or for copies of the full reports. We therefore consider that this is good practice, however, there is scope for Audit Committee to receive information which explains which elements of national report recommendations the Council considers are relevant and how the Council intends to take these recommendations forward. The Audit Committee agreed to this proposal at its meeting in September 2011.

Procurement

- 5.22 In 2009 Audit Scotland published a report on "Improving Public Sector Purchasing." The report examined the progress and impact of the Public Procurement Reform Programme which was launched in 2006. This programme aimed to improve public sector purchasing practice and make substantial savings. The 2009 Audit Scotland report highlighted the need for greater assurance on the quality of purchasing practice in over 150 public sector bodies.
- 5.23 In response to this report the Scottish Government brought out an assessment tool to monitor how effectively public bodies were adopting purchasing good practices. This tool is called the Procurement Capability Assessment (PCA). The PCA process is undertaken annually to drive continuous improvement in public sector procurement. In 2010 the Scottish Government published the findings of the first round of PCA reviews. The findings indicated that whilst there were instances of best practices throughout the Scottish public sector there was room for significant improvement in many public bodies.
- 5.24 Argyll & Bute Council's overall performance was ranked as conformant in its 2010 PCA. The score of 36% compared favourably with the national average of 22.6%. Our follow up review has found that the Council continues to build on this performance, although the 2011 PCA score will not be available until later this year.

5.25 The Council has a Procurement Board in place, which includes Service Managers from across the Council to ensure that Exchequer Services can influence and deliver good procurement practice at service level. The Council has also recently updated its Procurement Manual to increase its scope and reflect current best practice.

5.26 The Council's Annual Efficiency Statements (Figure 5) highlight that over £1million of cashable savings have been delivered by better procurement in the last three years. A further £212,000 of non-cashable savings were achieved due to the council's early adoption of the PECOS e-procurement system.



Sustainable Waste Management

5.27 In 2010-11, Audit Scotland asked us to conduct a targeted follow up review to assess what steps the council had taken in response to their *Sustainable Waste Management* report to ensure they would be able to meet future European Union and Scottish Government targets to improve waste management.

5.28 The Scottish Government's Zero Waste Plan sets out a roadmap for how Scotland can further improve its waste management efforts. The plan includes a range of targets to be achieved between 2010 and 2025. Table 6, below, illustrates that Argyll & Bute has performed well against targets to date. Initiatives such as the PPP scheme with Shanks, and a food waste collection in the Helensburgh and Lomond areas has meant that recycling rates have increased.

Table 6: Argyll & Bute Council progress against national targets

Target	National	Argyll & Bute
40% of municipal waste to be recycled or composted by the end of 2010 (Scottish Government target)	37% municipal waste recycled and composted	41.5% municipal waste recycled and composted
No more than 2.7 million tonnes of biodegradable municipal waste to be sent to landfill (Article 5 (2) of the EU Landfill Directive)	1.1 million tonnes of biodegradable municipal waste land filled	20,772 tonnes of biodegradable municipal waste land filled

Source: Argyll & Bute Council / SEPA

5.29 However, the Draft Zero Waste (Scotland) Regulations 2011 propose a change to the definition of recycled waste. Under the draft Regulations, Compost Like Output (CLO) would not be classified as recycling. This would have a significant impact on the performance of Argyll & Bute Council as the waste management contract with Shanks uses diversion into CLO, rather than sending waste to landfill. The Council estimates that such a change in definition would reduce their recycling rates from 41% to around 26%. The Council has responded positively to the Scottish Government's consultation on the draft Regulations to outline the impact that the change would have on practices and public opinion.

Schools estate strategy

5.30 In previous year's audits, our work has drawn the Council's attention to the relatively poor occupancy rates in the Council's schools and the significant backlog of maintenance in the schools estate (estimated at c£25 million).

- 5.31 On 17 May 2010, the Executive instructed officers to begin a review of the school estate in order to help deliver a sustainable education budget. An initial paper on options for rationalising the school estate was presented to the Council on 2 November 2010 and subsequently agreed to be put out to consultation on 25 November 2010. At its meeting on 5 January 2011, the Council suspended its school closure consultation process, with the exception of two schools with no pupils and formally ended the consultation process at its meeting on 14 June 2011
- 5.32 Following the Scottish Parliamentary elections in May 2011, and the formation of the new Scottish Government, the Cabinet Secretary for Education called for a moratorium in rural school closure plans for one year while a rural education commission was established to review the associated legislation passed in the previous Parliament on school closure consultations.
- 5.33 The Council's efficiency savings plans had initially included a contribution of £1 million from improved management of the school estate. Following the Council's recent decision not to proceed with its proposals to rationalise the school estate, it currently has no clear way forward for addressing the strategic issue relevant to the development of that estate. In addition, the efficiency savings anticipated from the school closure programme will not now be achieved and the Council will need to consider how the efficiency savings contribution expected from the education service will now be met.

6 Looking forward

- 6.1 Scottish public spending will continue to reduce significantly over the next four years to 2014-15, with capital budgets facing the largest reductions. The demand for public services is increasing, and this is likely to continue in the future. An ageing population, the effects of the recession and heightened expectations of the public all increase the demand for public services. This places an additional pressure on councils to provide efficient and quality services at a time when budgets are already stretched and reducing. This means that all public bodies, including the council, may find it difficult to continue to deliver the current level of services to citizens and continue to achieve efficiency savings in future years.
- 6.2 The initial reduction in the Council's budget settlement for 2011-12 was £11.389 million (4.9%), which is significantly higher than the national average of 2.59%. In addition to the scale of the savings required, the council faces an added challenge in meeting its savings plans as projected savings in the school estate will no longer be possible.
- 6.3 The Audit and Improvement Plan in arriving at its conclusions also notes the following areas where further progress may be required:
- a key challenge for the council will be to translate improvements in corporate working arrangements into demonstrably better service outcomes and outputs for its citizens
 - the council has clear plans in place to achieve the required level of budget savings, but faces a significant challenge to deliver those savings over the three year period of the budget
 - the council will need to consider how it is to address the backlog investment and school occupancy levels.
- 6.4 Local government elections are due to take place in May 2012 and have the potential to change the political dynamic of the Council. This presents a good opportunity for the Council to review its political management arrangements and ensure they continue to effectively meet the needs of the Council.
- 6.5 A number of initiatives and policy changes will also impact the future direction of the Council:
- Implementation of the Christie Commission report on the Future Delivery of Public Services in Scotland, including a focus on more preventative spending.
 - Efforts to increase collaboration and shared services amongst local authorities in Scotland, although many council's will be looking to the Clackmannanshire and Stirling Council's Shared Service Model.
 - Reforms to the provision of housing and council tax benefit arising from UK government policy and the Welfare Reform Bill 2011.
 - Changes to how Non Domestic Rates charges are applied in Scotland, which could impact on tax collection and the charges paid by the Council for its own properties.
- 6.6 The Council is alert to all of these issues and has implemented a range of significant improvements in recent years covering its corporate working arrangements, financial management arrangements and performance management framework. These changes have improved the Council's ability and capacity to meet the challenges of the future and placed it in a

good position to meet new challenges flexibly and effectively. We wish the Council every success as it takes forward this exciting new agenda.

A Audit reports issued during the year

Audit Area	Target Delivery	Outturn
Planning		
Audit Approach Memorandum	11 th February 2011	16 February 2011
Financial statements		
Interim report- implementation of IFRS	29 April 2011	22 April 2011
Report on the 2010-11 financial statements audit	22 August 2011	14 September 2011
Audit opinion on the 2009-10 financial statements	30 September 2011	30 September 2011
Whole of Government accounts return	30 September 2011	30 September 2011
Governance		
Interim report	27 May 2011	8 June 2011
Performance audit		
Audit and Assurance Improvement Plan	1 April 2011	Completed
National Performance Studies - impact assessments	As required	As required and summarised in annual report
Public sector purchasing	30 August 2011	Completed
Grant claim audits		
Education maintenance allowance	31 July 2011	Completed
Housing Benefit and Council Tax Benefit subsidy	30 November 2011	Not yet due (initial fieldwork completed)
Non Domestic Rates	February 2012	Not yet due
Overall audit		
Report to members and the Accounts Commission for Scotland	31 October 2011	31 October 2011



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