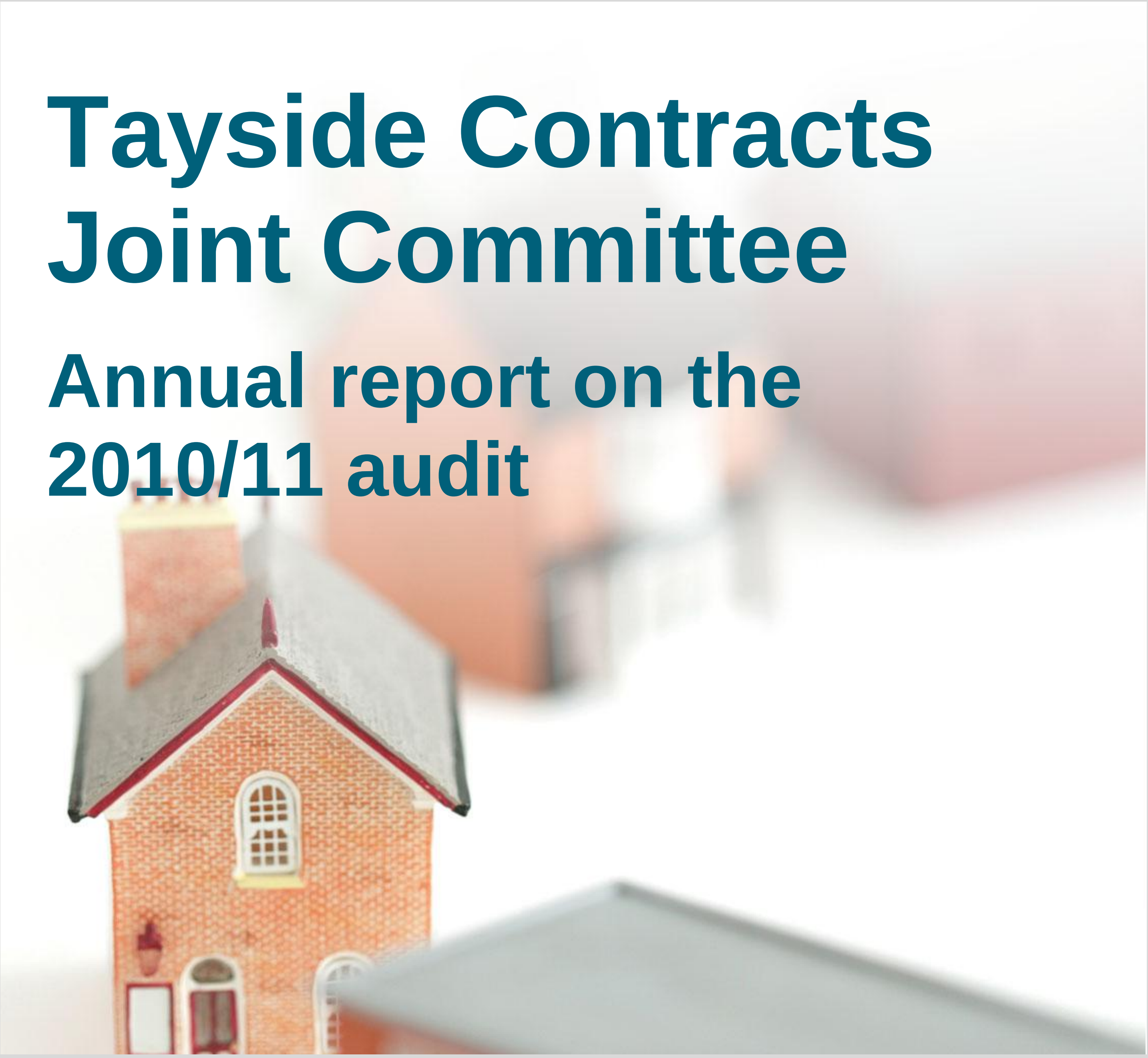
Tayside Contracts Joint Committee

Annual report on the 2010/11 audit



AUDIT SCOTLAND

Prepared for Members and the Controller of Audit
October 2011

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Auditor General for Scotland and the Accounts Commission. Together they ensure that the Scottish Government and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

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Key messages

2010/11

In 2010/11 we have audited the financial statements and looked at aspects of governance within Tayside Contracts Joint Committee (the joint committee). This report sets out our main findings.

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

- an unqualified opinion has been issued on the financial statements for 2010/11
- the statement on the system of internal financial control included in the accounts complies with accounting requirements and is not inconsistent with our findings
- final accounts preparation procedures and working papers were good and this enabled the audit to progress smoothly
- many aspects of a sound governance framework are in place.

After adjustments for expenditure required by statute and non-statutory practice to be charged to the general fund the joint committee's surplus for the year was £1.343 million. This was £433k better than budgeted and enabled £1.200 million to be returned to constituent councils in accordance with agreed profit sharing percentages. The general reserve balance carried forward at the year end was £0.885 million.

Both the Construction and Facilities Services Divisions have met the statutory target to break even over a three year rolling period.

Outlook

The economic conditions which prevailed at the end of last year remain. Although the UK has left recession there is still considerable concern over the health of the economy and growth remains slow. The joint committee will not be immune from the impact of the current financial constraints on the public sector or from the difficult trading environment. The Business Plan 2011-2014 sets out the joint committee's strategy for managing these risks and will need to be closely monitored to ensure that targets are met and exposure to risk is minimised.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of Tayside Contracts Joint Committee. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.

2. A Corporate Governance and Internal Control report was issued in August 2011 in which we made recommendations for improvements. We do not repeat all of the findings in this report, but instead we focus on the financial statements and any significant findings from our wider review of the joint committee.

3. Appendix A is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the joint committee understands its risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

4. This report is addressed to members of the Tayside Contracts Joint Committee and the Controller of Audit and will be published on our website after consideration by the joint committee.

5. The management of the audited body is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

6. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

7. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements

8. Auditors review and report on, as appropriate, other information published with the financial statements, including the managing directors' report, statement on internal financial control and the remuneration report. This section summarises the results of our audit on the financial statements.

Audit opinion

Opinion on the financial statements

9. We have given an unqualified opinion on the financial statements of Tayside Contracts Joint Committee for 2010/11, concluding that the financial statements:
   - give a true and fair view in accordance with applicable law and the 2010/11 Code of the state of the affairs of the joint committee as at 31 March 2011 and of the income and expenditure of the joint committee for the year then ended
   - have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2010/11 Code, and
   - have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

10. We have also stated that in our opinion:
    - the part of the remuneration report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 1985; and
    - the information given in the Foreword to the Accounts for the financial year for which the financial statements are prepared is consistent with the financial statements.

Going concern

11. The joint committee's balance sheet has an excess of liabilities over assets of £20.6 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.

12. 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 committee's liabilities as they fall due. We are satisfied that the process the joint committee has undertaken to consider going concern is reasonable.

Legality

13. 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 the 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 the Tayside Contracts Joint Committee, the financial transactions of the joint committee were in accordance with the relevant legislation and regulations governing its activities. 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

14. The 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.

15. The statement complies with accounting requirements and is not inconsistent with the findings of our audit.

Accounting issues

16. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom ('the Code') which constitutes proper accounting practice for the purposes of section 12 of the Local Government Scotland Act 2003.

17. The 2010/11 Code required local authorities to prepare their financial statements under International Financial Reporting Standards ('IFRS'). This has resulted in some significant changes to the presentation of the financial statements

18. A further significant change was introduced by the Local Authority Accounts (Scotland) Amendment Regulations 2011 which introduced the requirement for a remuneration report to be included in the financial statements from 2010/11 onwards.

Accounts submission

19. The unaudited accounts were submitted to the Controller of Audit prior to the 30 June deadline. Final accounts preparations and working papers were of a good standard and this enabled the audit to progress smoothly.

20. Audited accounts were finalised prior to the deadline of 30 September and are now available for presentation to the joint committee and for publication.

Prior year adjustments

21. 2010/11 is the first year that the local authority accounting Code has been based on international financial reporting standards (IFRS). The move to an IFRS based Code from a UK GAAP based SORP has resulted in a number of significant changes in accounting practice which, in turn, have resulted in the restatement of prior year balances. We have reviewed the joint committee's arrangements for restating the prior year balances and found them to be satisfactory.

Outlook

Pension costs

22. Two significant matters that are likely to impact on the joint committee's pension fund liabilities under IAS19 are:

    - the June 2010 Budget announced the intention to change the rate of pension increase from the Retail Price Index (RPI) to the Consumer Price Index (CPI), effective from April 2011
    - recent turmoil in the world's stock markets has led to significant movements in share prices affecting the asset valuation of pension fund assets.

23. The effect on the asset values of the pension fund and the future outlook for employers' contributions was assessed at the triennial valuation of the Tayside Superannuation Fund as at 31 March 2011. The joint committee will need to take the findings of this valuation into account in the decision to set future employers' contribution rates.

24. Further changes are likely to result as the Government considers the findings of the Hutton Report which sets out a number of options for the reform of public sector pension schemes. If adopted many of the findings are likely to have a significant impact on the Local Government Pension Scheme.

Audit appointment for 2011/12

25. Audit appointments are made by the Auditor General or the Accounts Commission, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment. The procurement process for the next five years was completed in May 2011. From next year (2011/12) the auditor for Tayside Contracts Joint Committee will be KPMG LLP. As this is the last year of our audit appointment, we would like

to acknowledge the good working relationship that existed during our current appointment term with the joint committee and thank officers and members of the committee for their assistance during the last five years. We will be meeting with the incoming external auditors, KPMG LLP, as part of a managed changeover process.

Financial position

26. Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based.

27. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

28. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

29. The joint committee's Consolidated Income and Expenditure Statements show a surplus on the provision of services of £8.159 million. This surplus figure measures the joint committee's surplus for the year under Generally Accepted Accounting Principles. The movement on the general reserve balance is also an important figure when considering the joint committee's financial stewardship. Adjustments are made to this 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 was £1.343 million, £1.200 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 March 2009. The amount distributed to constituent councils was £400,000 more than agreed by the constituent councils, reflecting strong financial performance during year. The general reserve balance carried forward at the year-end was £0.885 million.

30. 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 2011the Construction Division Statutory Trading Account achieved an aggregate surplus of £5.285 million and the Facilities Services Statutory Trading Account made an aggregate surplus of £6.267 million. Both trading accounts therefore met the statutory target.

31. Capital expenditure in the financial year totalled £1.817 million. The majority of this expenditure related to the acquisition of vehicles, plant and equipment for the Construction Services Division. This expenditure was financed by borrowing and loans (£1.295 million), capital receipts (£0.049 million) and capital funded from current revenue (£0.473 million).

Budgetary control

32. Both service divisions exceeded their budgeted income targets for the year. Gross operating income of £65.931 million was some £6.167 million greater than budgeted. However, this was off-set by increased expenditure of £64.588 million resulting in a surplus of £1.343 million. These variances arose principally as a result of significant additional winter maintenance activity due to the extreme weather conditions at the turn of the year.

Outlook

33. The economic conditions which prevailed at the end of last year remain. Although the UK has left recession there is still considerable concern over the health of the economy and growth remains slow. The joint committee will not be immune from the financial pressures arising from the impact of:

- Government spending cuts on the budget of constituent councils and other public sector customers
- increases in the costs of input factors (labour, materials, fuel, etc.) due to higher inflation
- the current economic situation on private sector markets

34. The Business Plan 2011-14 sets out the aim of addressing these risks through securing income streams, managing cost pressures, and seeking efficiencies. The joint committee will need to monitor progress against these aims closely to ensure that targets are met and exposure to risk is minimised.

Governance and accountability

35. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

36. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

37. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption

38. In this part of the report we comment on key areas of governance.

Corporate governance

Processes and committees

39. Tayside Contracts is a joint local authority trading organisation operating under a joint committee comprising of 18 elected members from the three constituent councils (5 elected members from Angus Council, 6 from Dundee City Council and 7 from Perth and Kinross Council).

40. The joint committee meets regularly throughout the year and meetings are open to the public. Public notice of meetings is given by way of a notice in the reception of the main office of Tayside Contracts. Minutes of meetings are published on the Tayside Contract's website.

41. However, the joint committee could do more to improve openness and accountability by using its website to publicise meetings and distribute agendas and reports to the public and stakeholders in advance of those meetings.

Refer Action Plan No.1

Internal control

42. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial

systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

43. As part of our audit work for 2010/11 we undertook a review of the joint committee's key financial systems and were able to conclude that these systems provide a robust internal control framework.

44. Internal audit plays 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. The joint committee's internal audit service is provided by Henderson Loggie.

45. As external auditors, we are required by auditing standards to work closely with internal auditors to make optimal use of available audit resources. We sought to rely on the work of internal audit wherever possible, and therefore our plan included an assessment of the internal audit function in accordance with International Standard on Auditing 610. Based on our review of internal audit, we were able to place formal reliance on work undertaken by them.

46. Henderson Loggie have submitted their final report on the work undertaken in 2010/11 and have concluded that, with the exception of one area, '*the Organisation operates adequate and effective internal control systems as defined in the Audit Needs Assessment. Proper arrangements are in place to promote and secure Value for Money*'.

47. The Internal Auditor drew attention to the limited progress made in formalising the business continuity and disaster planning arrangements. Business continuity and disaster planning arrangements are key risk management tools that seek minimise and manage an organisation's exposure to the risk of loss of income and/or reputation. We note that management have agreed to progress this matter.

48. The Internal Auditor's Annual Report was submitted to officers on 12 August, after the date of signing of the Statement on the System of Internal Control by the Managing Director and the Proper Officer. As the Annual Report is a key source of assurance for the Statement on the System of Internal Financial Control it would be appropriate for the report to be submitted to the joint committee prior to these officers signing the statement.

Refer Action Plan No.2

Prevention and detection of fraud and irregularities

49. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. Auditors review and report on these arrangements.

50. The Business Plan 2011-14 sets out the joint committee's commitment to delivering high standards of corporate governance and also sets out the framework through which the joint committee will demonstrate good governance, including:

- the development of a local code of corporate governance in line with the principles identified by the Nolan Committee and CIPFA/Solace's "Delivering Good Governance in Local Government"
- corporate and unit service improvement plans detailing how the aims, objectives and targets in the business plan will be achieved
- annual reporting to the joint committee on progress against the aims, objectives and targets in the business plan

NFI in Scotland

51. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. The NFI has generated significant savings for Scottish public bodies (£40 million to 2008). If fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

52. The current NFI round is being carried out under new powers approved by the Scottish Parliament in terms of the Public Finance and Accountability (Scotland) Act 2003 (as amended) and which came into force from 20 December 2010. These provide for more collaboration with other UK agencies to detect ‘cross border’ fraud, extend the range of public sector bodies involved, and allow data matching to be used to detect other crime as well as fraud.

53. The joint committee took part in the NFI for the first time in 2010/11. Payroll and finance staff have investigated matches between payroll and UK Visa and Pension data. All recommended matches and 93% of all other matches have now been investigated, ahead of the required timetable. Outcomes have been positive with no frauds and only one non-monetary error identified.

54. The Audit Scotland report *The National Fraud Initiative in Scotland; making an impact* (May 2010) highlighted that much of the information used in the last NFI round was collected before the recession really took hold. An economic downturn is commonly linked to a heightened risk of fraud, and public bodies need to remain vigilant.

Standards of conduct and arrangements for the prevention/ detection of bribery and corruption

55. Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and have proper arrangements in place for implementing and monitoring compliance with standards and codes of conduct, standing orders and financial instructions. Auditors consider whether bodies have adequate arrangements in place. We have concluded that the joint committee's arrangements are satisfactory and we are not aware of any specific issues that we need to identify in this report.

Performance management and improvement

56. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value. The Local Government (Scotland) Act 1973 places a duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value.

57. This section includes a commentary on the performance management arrangements within the joint committee. We also note any headline performance outcomes/ measures used by the joint committee.

Management arrangements

Performance management

58. At its meeting on 9 May 2011, the joint committee approved a new Business Plan 2011-2014. The plan sets out the joint committee's vision and key business objectives for the period to 2014 under the theme of "*Transformation - delivering more for less*". Individual service unit plans are linked corporate objectives to support their delivery.

59. The business objectives are underpinned by identified key results areas. At present, although the objectives have been determined, they have not yet been translated into SMART targets. Setting clearly defined SMART targets would facilitate more effective performance management and support continuous improvement.

Refer Action Plan No. 3

60. Key performance outcomes reported to the joint committee in August 2011 highlight that performance continues to improve in the measured areas from the previous business plan (2006/07-2010/11).

- Operational turnover has continued to grow despite a decline in turnover from third parties, largely due to additional winter maintenance income, and the organisation has continued to improve its annual surplus.
- sickness absence levels across all employees were reduced to 5.8% (from 6.5% in 2006/07)
- the rate of recycling improved to 92%.
- quality and investors in people accreditations were retained.

Outlook

61. The current economic climate is likely to present a number of significant challenges to managing and improving performance due to rising costs, tougher market conditions and

public sector spending cuts will impact directly on the ability to deliver a surplus. Workforce morale is likely to decline due to pay constraints, inflation and changes to the public sector pension scheme and proposed organisational changes. These challenges will increase the importance of robust monitoring and management of performance to ensure that the joint committee can deliver more for less.

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	41	Processes and committees The Joint Committee could do more to improve openness and accountability and to increase stakeholder involvement by using its website to publicise meetings and distribute agendas and reports to the public and stakeholders in advance of those meetings. Risk:The Joint Committee may not demonstrate the highest standards of openness and accountability.	Agendas, reports and minutes are presently published on Tayside Contracts website immediately following Joint Committee meetings. We will liaise with the Committee Clerk to ensure agendas and appropriate reports are published ahead of Joint Committee meetings.	Managing Director	Nov 2011
2	48	Internal control The Internal Auditor's Annual Report was submitted to officers on 12 August, after the date of signing of the Statement on the System of Internal Control by the Managing Director and the Proper Officer. As the Annual Report is a key source of assurance for the Statement on the System of Internal Financial Control(the statement) it would be good appropriate for the report to be submitted to the Joint	The annual internal audit report provides a summary of findings from the audit reviews carried out during the year, and as such much of its content is already known. Nevertheless, in planning the internal audit programme for 2011/12, we will aim to have the annual report completed for submission to the Joint Committee at an earlier date.	Head of Financial Services	June 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		Committee prior to these officers signing the statement. Risk: The Managing Director and Proper Officer may lack the assurances necessary to sign the statement.			
3	59	Performance management The business objectives are underpinned by identified key results areas. At present, although the objectives have been determined, they have not yet been translated into SMART targets. Setting clearly defined SMART targets would facilitate more effective performance management and support continuous improvement. Risk: The Joint Committee may not achieve the maximum potential from its performance management arrangements.	Business Plan objectives and targets form the basis of the Corporate Improvement Plan, which in turn is the basis for each Division and Unit's Service Improvement Plan and subsequently team plans. Targets contained within these improvement plans are as far as possible "SMART".	N/A	N/A