



cutting through complexity

Scottish Borders Council

Annual audit report to the Members of
Scottish Borders Council and the Controller of Audit

Audit: Year ended 31 March 2013

2 October 2013

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the Code").

This report is for the benefit of Scottish Borders Council ("Council") and is made available to Audit Scotland and the Accounts Commission (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

This annual audit report summarises our findings in relation to the audit of the Council for the year ended 31 March 2013. Our audit work is undertaken in accordance with Audit Scotland's Code of Audit Practice ("the Code").

This report also sets out those matters specified by ISA (UK and Ireland) 260: *Communication with those charged with governance* in relation to the financial statements for the year ended 31 March 2013.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Council staff during the course of our work.

Area	Summary observations	Analysis
Strategic overview and use of resources		
Key issues and challenges	The Council continues to support its communities in a difficult environment. There are a number of service challenges emerging, with demand and resource pressures growing against a backdrop of reform in public services. This includes reforms to welfare, health and social care and the police and fire boards. In response and for the first time, the Council has developed a five year financial plan which assesses the likely level of resources available over the period and the budgetary adjustments required to ensure that the Council's financial plans remain prudent and sustainable in the longer term. The strategy reflects the Council's duty to set a prudent and sustainable budget.	Page 6
Financial position	<p>The Council achieved a revenue outturn of £0.8 million under spend against the final, revised budget. Audit Scotland's analysis of 32 local authorities continues to show the Council in the lower quartile for useable reserves as a proportion of revenue spend. The Council has reviewed the level of reserves to ensure that the reserves held are proportionate to the risks that the Council faces. Including the capital fund, the Council has usable reserves of £23.3 million.</p> <p>The Council recorded an accounting deficit on the provision of services of £71.1 million in 2012-13 (2011-12: £15.1 million surplus). Contributing to the deficit recognised in 2012-13 was £28.4 million of impairment charges relating to the valuation of education properties and an accounting loss on disposal of £44.4 million relating to transfer of the Borders Railway asset (although over the lifetime of the project to date the impact of the Borders Railway project has been revenue neutral for the Council through funding received in prior years).</p>	Page 9
Financial planning	In the period covered by the five year financial strategy, the Council has set a balanced budget each year based on total use of reserves of £200,000; the reserve strategy is based on a costed register. Over this period, the Council has assumed that council tax will remain frozen, but that total council tax income will increase by £1.7 million at the end of the five years by increasing the council tax base.	Page 13
Financial statements and accounting		
Accounting policies	There have been no significant changes to accounting policies in 2012-13. The impact of adopted IAS 19 (revised), effective next year, has been disclosed in the financial statements and is not considered material. No other newly effective accounting standards are expected to have a material impact on next year's financial statements.	Page 18
Key judgement areas	Our audit approach reflected our assessment of financial statement level risks and consideration of key judgement areas. These have been concluded satisfactorily.	Pages 21 to 23

Audit conclusions	<p>We have issued an unqualified audit opinion on the 2012-13 financial statements. In arriving at our opinion, one adjustment was required to change the classification of housing benefit expenditure on the Comprehensive Income and Expenditure Statement (“CIES”). Two other differences were identified, the first relating to the classification of impairment charges on the CIES and the second to the Council not recognising a provision for future costs associated with its landfill sites. These remain unadjusted, but we accept this position on the grounds of materiality.</p>	<p>Page 19</p>
Financial statements process	<p>The draft financial statements, explanatory foreword, annual governance statement and remuneration report were received by the statutory date and were supported by good quality working papers. Management has responded promptly to our requests for additional information and we note the additional effort that management have put into preparing audit briefing papers on key issues.</p>	<p>Page 20</p>
Performance management arrangements		
Performance management	<p>The Council is developing a new performance improvement framework which builds on the Council's previous arrangements and seeks to address perceived shortcomings of the previous system. The new performance improvement framework will incorporate various new performance indicators and management intend to work with elected members to ensure that the new set of indicators are suitable to allow elected members to have greater involvement in the monitoring and improvement of Council performance.</p> <p>We completed our work on the follow up of Audit Scotland's <i>Scotland's public finances: Addressing the challenges</i> report. Overall, we found that, in response to future challenges, the Council has reviewed the budget setting process for 2013-14 and beyond. Although management reviews and utilises performance information, management recognise this is still an area for improvement. We have considered the Council's arrangements for responding to Audit Scotland and Accounts Commission national studies and are satisfied that the Council has arrangements in place to consider such reports.</p>	<p>Page 24</p>
Governance and narrative reporting		
Governance arrangements	<p>Over-arching and supporting corporate governance arrangements provide a sound framework for organisational decision-making. During 2012-13, the management structure and committee membership changed.</p>	<p>Page 29</p>
Systems of internal control	<p>Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that the majority of controls relating to financial systems and procedures are designed appropriately and operating effectively. We note that management have made progress against control weaknesses identified in our interim management report, particularly in relation to reconciliations.</p>	<p>Page 30</p>

Purpose of this report

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit of the Council and its financial statements for 2012-13. It is addressed to both those charged with governance at the Council and the Controller of Audit. The scope and nature of our audit were set out in our audit strategy document which was presented to the audit committee at the outset of our audit.

Responsibilities

It is the responsibility of the Council and the chief financial officer to prepare the financial statements in accordance with the proper practices set out in the *Code of Practice on Local Authority Accounting in the United Kingdom 2012-13*. An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks identified are only those which have come to their attention during their normal audit work in accordance with the Code, 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 internal control.

Under the requirements of International Standard on Auditing (UK and Ireland) ('ISA') 260 *Communication with those charged with governance*, we are required to communicate audit matters arising from the audit of financial statements to those charged with governance of an entity. This annual audit report to Members and our presentation to the audit committee, together with previous reports to the audit committee throughout the year, discharges the requirements of ISA 260.

Context of the audit

A local area network ("LAN") of local audit and inspection representatives annually undertake a shared risk assessment process for each local authority in Scotland, to identify targeted, risk-based scrutiny. This results in each council receiving an Assurance and Improvement Plan ("AIP") each year.

Further information on the AIP has been included elsewhere in this report, but the overall conclusion of the AIP was that "the Council continues to be relatively low scrutiny risk." Our audit approach was informed by the conclusions from the shared risk assessment, including the absence of any specific, significant audit and inspection activity.

Strategic overview and use of resources

Our perspective on the Council's approach to key issues affecting the local government sector and its use of resources

The Council is continuing to monitor and take appropriate action to respond to a range of external developments:

- **It is closely monitoring developments in welfare reform policy in order to mitigate associated risks.**
- **A separate committee has been established to provide local scrutiny on the national police and fire services.**
- **Active consideration is being given to the implications of the Integrated Health and Social Care Bill.**

A pilot audit of community planning partnerships by Audit Scotland identified that the Council has made many significant changes, but that further work is required to demonstrate how the CPP has improved outcomes.

Audit Scotland's report *Responding to challenges and change: An overview of local government in Scotland* highlighted a number of service challenges in 2013, with demand and resource pressures continuing to build, against a backdrop of reform in public services. The report highlights a large number of issues which councils face, the majority of which are applicable to the Council.

The Council is therefore operating in a challenging economic environment, with funding reductions and increasing expenditure pressures. In response, for the first time, the Council has set a five year financial strategy from 2013-14. This strategy has been developed so that the Council can assess the level of resources available and to ensure that the Council's financial plans remain prudent and sustainable in the context of the external environment.

The Council continues to have a comparatively low level of useable reserves in relation to other Scottish local authorities. The Council has, however, carried out a review to determine the level of reserves required, in line with its corporate risk register and reflecting the Council's assessment that it is comparatively low risk and is therefore able to hold a lower level of useable reserves.

Welfare reform

As a result of the Welfare Reform Act 2012, there are a number of significant changes in how councils deliver benefit services. The most significant change is the introduction of 'universal credits', which is an integrated working age benefit which will replace existing benefits, including housing benefit. Universal credits will be administered by the Department of Work and Pensions. While responding to the introduction of universal credits, which not only impacts the nature of benefits available in the future, but also the Council's role in the administration of these benefits, will present challenges for the Council, it is clear through discussion with management that action has commenced by officers to mitigate the associated risks.

The Council has engaged at a national level with the welfare reform agenda; although it is unlikely to have a significant financial impact in 2013-14 it is important that the Council continues to prepare for universal credit and wider reaching elements of welfare reform.

We will continue to monitor managements arrangements for implementing the changes to the welfare system and ensure financial risks are monitored and reflected in future budgets.

Police and fire reform

The Police and Fire & Rescue Reform (Scotland) Act 2012 created a national police force and a national fire and rescue service from 1 April 2013. It replaced local authorities' role as police authorities and fire and rescue authorities through the creation of the Scottish Police Authority ("SPA") and the Scottish Fire & Rescue Service ("SFRS"). The Act includes a framework for the delivery of local scrutiny and engagement arrangements.

As noted in the previous year, the Council has established a Scottish Borders police, fire & rescue and safer communities board. The main role of this board is to scrutinise and review the Scottish Borders police, fire and rescue and safer communities plans. During 2012-13 the Council participated in a local pathfinder project to implement joint local scrutiny arrangements. The Council intends to review the effectiveness of the scrutiny delivered by this board to inform a decision on the longer-term structures for scrutiny and engagement with both police and fire and rescue services. This review has still to take place and this board is continuing in its role of providing scrutiny in 2013-14.

Integrated health and social care

The Scottish Government has introduced draft legislation creating Health and Social Care Partnerships (“HSCPs”) seeking to bring together a range of existing NHS and local authority services within a formal partnership to focus their combined resources on supporting more people to be supported in their own homes and communities than is currently the case, thereby shifting the balance of care and improving service outcomes.

The Integrated Health and Social Care Bill, and its implications for the Council, has been recently considered at both the social work & housing committee and the full Council. It was agreed that a pathfinder Health and Social Care Board be established with the following responsibilities:

- to assess and scope the detailed arrangements required for integration in the Scottish Borders which will be developed and determined in line with draft legislation;
- ensure appropriate stakeholder engagement in joint strategic policy and planning in relation to Integration; and
- to recommend to the partner bodies actions relating to the implementation of agreed commissioning strategies.

A project director role has been appointed to oversee the integration project. Management has stated that the current preference is for a body corporate model, although there is more uncertainty over exactly what form this model will take. There are still a number of issues to be resolved, one of which is the accounting and audit arrangements of the organisation. A programme to move integration forward has now been agreed with NHS Borders.

Community planning/partnership working

Community Planning Partnerships (“CPPs”) offer part of the solution to the pressures on resources and will play a crucial role in public service reform. The Scottish Government expects CPPs to take the lead in improving outcomes with reduced budgets.

The Council and its local partners has recognised the need to improve community planning in the Scottish Borders and has established a community planning partnership strategy board (“CPPSB”).

The role of the CPPSB is to set the strategic direction for the community planning partnership (“CPP”), consistent with the Council’s and partners’ vision and priorities, and to monitor and scrutinise performance at a strategic level, using the single outcome agreement and to approve an annual public performance report.

The Council agreed (along with two other councils) to participate in an early audit for the Accounts Commission and Auditor General for Scotland to test the CPP audit framework. The main aim of these audits was to assess whether CPPs had made a difference to the local communities. The final report was published in March 2013 and has been considered by the CPPSB.

The high level findings of the report are that the partnership has shown a good level of self-awareness and has made many significant changes and now has many of the fundamental structures and processes in place. However, further work is still required before the CPP can demonstrate clearly how it is improving outcomes for its communities.

The report identifies a number of detailed recommendations and areas where improvement is required. The CPPSB has grouped these into the following five headings:

- strategic direction;
- governance and accountability;
- performance management;
- use of recourses; and
- community engagement.

Responsibility for progressing work for two of these has been allocated to designated Council officials with the remainder led by partners. An action plan has been formulated in response to the findings of the report.

Equal pay

The Council has recognised a provision of £300,000 against potential future payment in relation to specific equal pay settlements that it may be required to make. In recent months there have been a number of Court rulings relating to equal pay claims and these have resulted in many organisations reassessing the appropriateness of equal pay provisions and specifically if an increase to the provision is required.

Whilst at the time of this report, the Council has not fully completed its analysis of the recent cases, management are satisfied that the current provision of £300,000 continues to remain appropriate on the basis of current information. We have considered the appropriateness of the provision and are satisfied that the overall provision recognised by the Council in the financial statements is reasonable. However, management should continue to assess the appropriateness of the provision in light of the recent Court cases and any future cases.

Shared risk assessment

Following the publication of the Crerar report in September 2007, the Scottish Government's response stated its aim of establishing a simplified and coherent approach to delivering local government scrutiny. A key aspect of this agenda is to better coordinate and streamline scrutiny and achieve greater effectiveness, while at the same time protecting the independence of scrutiny bodies. Scrutiny bodies that engage with local government established a shared assessment of the risks in each council and developed a range of proportionate approaches in response to the risk assessment.

Local area networks have been established for each council. These bring together local scrutiny representatives in a systematic way with the common aims of joint scrutiny scheduling and planning, sharing risk assessment and the delivery of a single corporate assessment through the Best Value 2 audit process. As your external auditor, we are a key member of the shared risk assessment process.

A national scrutiny plan sets out how Scotland's scrutiny agencies coordinate their work and focus on the key issues at each council. This plan is underpinned by an assurance and improvement plan ("AIP") for individual councils. The shared risk assessment process for 2012-13, while identifying a number of areas for further consideration, did not identify any significant areas where the Council was not making progress. The assessment also did not identify any significant areas for external audit follow up.

The shared risk assessment has been updated and the AIP for 2013-14 has been finalised. We have reviewed the AIP for consistency with our understanding of the Council.

The Council outturn for the year against revised departmental budgets was an underspend of £810,000 against final budgeted expenditure of £268 million.

The social work budget was increased by £3.3 million during the year to account for increased demand pressures. Management has revised the assumptions for the budget for 2013-14.

Performance against budget

In February 2012 the Council approved the 2012-13 annual revenue budget of £264.2 million. This expenditure was to be funded from a combination of income from Council services, revenue support grant, non domestic rates grant and council tax.

The budget is updated regularly throughout the year to reflect known changes as part of the financial monitoring process. This resulted in a final budgeted expenditure of £268 million. The audited outturn position was an underspend of £810,000 against the final revised budget. The table below shows the variance against the revised budget for each of the departments at the year end.

	Revised budget 2012-13 £000	Actual 2012-13 £000	Variance £000
Chief executive's department	1,930	1,913	17
Resources	18,487	18,430	57
Education & Lifelong Learning	94,272	94,138	134
Social work	78,953	78,946	(7)
Environment & infrastructure	33,660	32,797	863
Corporate programmes, partnerships & projects	1,437	1,335	102
Other	39,219	39,242	(23)
Expenditure	267,968	266,801	1,167
Council tax income	(50,917)	(50,817)	(100)
Other grants and reserve transfers	(217,051)	(216,794)	(257)
Surplus in the year	-	810	810

Source: Executive Committee 11 June 2013

The variance of environmental & infrastructure can mainly be attributed to a combination of SBc Contracts performance being better than budgeted and the identification of an additional £263,000 to flood related expenditure that is claimable as Bellwin funding.

The outturn expenditure includes a £200,000 fine to the Information Commissioner. This decision has since been overturned and the fine has been rescinded.

The table shows variances against the final budget which has been adjusted throughout the year to account for demand pressures etc. The social work budget was increased by £3.3 million during 2012-13. The increase was required due to service demands and difficulties in achieving efficiency savings in line with the original budget assumptions. Many areas of social work provision are non-discretionary and demand led so the Council has limited autonomy on the provision of services. Management have adjusted the assumptions used to set the 2013-14 budget to reflect recurring pressures from 2012-13.

Recommendation 1

It should be noted that the above underspend is on the assumption that Bellwin scheme income of £1.46 million will be received in respect of flood related costs. Under the terms and conditions of this grant the Council is required to fund £550,000 of this expenditure from its own resources.

The financial statements reflect an accounting deficit on the provision of services of £71.1 million compared to a surplus of £15.1 million in 2011-12.

The outturn includes significant charges in relation to the accounting for revaluation of property (£28.2 million) and a loss on disposal of Borders Railway (£44.4 million). The impact of the accounting for the Borders Railway has, however, been revenue neutral for the Council over the project lifetime as related revenue was received in prior years.

Comprehensive Income and Expenditure Statement ("CIES")

In 2012-13 the Council reported an accounting deficit on the provision of services of £71.1 million compared to a £15.1 million surplus in the previous year. Below is a summarised version of the CIES with discussion of the causes of significant variances between years.

	2011 -12 Net Expenditure £000	2012-13 Net Expenditure £000	Variance £000
Education	102,703	131,524	28,821
Social work	74,070	74,539	469
Other Services	64,898	70,450	5,552
Police and fire board expenditure	16,590	15,733	(857)
Net cost of services	258,261	292,247	33,986
(Gain)/loss on disposal of assets	925	44,361	43,436
Financing & investment income and expenditure and other	12,062	15,320	3,258
Taxation and non-specific grant income	286,332	280,781	(5,551)
(Surplus)/deficit on provision of services	(15,084)	71,146	86,230

Source: Financial statements

Expenditure on education has increased by £28.9 million from 2011-12. The majority of this increased expenditure (£28.2 million) relates to impairment charges due to the downward valuation on education properties.

The reduction in expenditure in relation to the Police and Fire boards is due to the redistribution of reserves from these now abolished bodies. The affect of this redistribution is that the expenditure figures shown are reduced by £1.4 million from the amount requisitioned. The amount of funding available from Scottish Government in 2013-14 will be adjusted to reflect this redistribution and hence the funding available to the Council will be reduced.

The loss on disposal of fixed assets relates to the disposal of the Borders Railway asset following the transfer of responsibility to Transport Scotland and Network Rail. In previous years, the Council had been assembling land for this asset and showed the resultant capital expenditure as an asset under construction on the balance sheet. Over the lifetime of the project to date, the impact of the Borders Railway project has been revenue neutral for the Council as grant funding was received in prior years. This grant funding has been recognised as income on the CIES in previous years, but with the project expenditure all being recognised in the CIES this year.

Balance sheet

The Council did not enter into any new long term loans during 2012-13. Temporary, short term borrowing increased in 2012-13 due to a £6.1 million loan entered into with Edinburgh City Council on 27 March 2013 and repaid on 28 June 2013.

Long term debtors increased by £2.6 million due to the granting of a loan to the National Housing Trust to support new housing provision in Galashiels and Innerleithen. This arrangement has been entered into as part of the Council's wider strategy to increase housing availability. Previously, the Council had agreed to draw down prudential borrowing amounts so that it could provide such loan facilities to certain organisations. Scottish Government approval was obtained prior to granting of this loan.

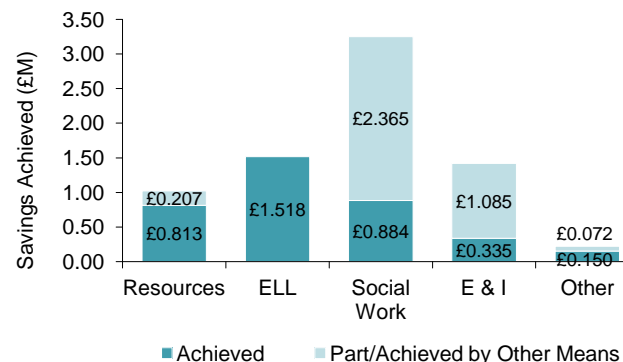
Based on an Audit Scotland survey of draft financial statement for 2012-13, the Council is placed in the lower quartile of the following ratios:

- total useable reserves carried forward as a proportion of net revenue spend; and
- usable reserves carried forward as a proportion of net revenue spend.

These ratios indicate that the Council has, in comparison to other Scottish local authorities, a relatively low level of reserves available to apply to any future budget deficits. The Council has, however, considered the level of reserves against the risks captured through the corporate risk register and is also indicative of what management consider to be a relatively low risk Council. The Council therefore considers that the existing reserves level (£23 million) is appropriate. The demands of the current financial environment have been addressed through the development of a five year revenue financial plan and ten year capital financial plan.

Efficiency savings

The delivery of ongoing savings associated with business efficiencies and transformation projects remains a challenge to the Council and will require to be a significant focus of management attention in future. The Council achieved efficiency savings of £7.3 million in 2012-13 against a budget target of £4.1 million. Of this amount, 49.5% was fully achieved by departments per the original plan, with 51.5% delivered via alternative corporate savings and additional income. Achievement of efficiency savings by directorate, and the means by which they were achieved, is shown below.



Source: Financial statements

The diagram demonstrates that efficiency savings in 2012-13 for social work and environment & infrastructure were achieved by means other than originally intended. Achievement of efficiency savings is reported monthly to the corporate management team as part of the revenue monitoring process. As the achievement of efficiency savings targets plays a key role in the Council achieving its overall budget, the visibility of progress made in delivering these savings should be increased by reporting progress to elected members as part of the revenue monitoring process.

Recommendation 2

Capital expenditure was £2.8 million below budget and reflected £1.8 million of project slippage.

Major capital projects in 2012-13 included £4.6 million on West Linton primary school and £2.8 million on the Borders Railway project.

Capital programme

Total capital expenditure in 2012-13 was £23.3 million, compared to a budget of £26.1 million and expenditure of £31.2 million in 2011-12.

The £2.8 million under spend against budget can be further broken down into (i) project slippage of £1.8 million and (ii) project under spend of £1 million. The slippage related to a number of capital projects and the largest was approximately £330,000. Although net slippage is significantly below the level reported for the previous two years, management should consider reasons for general slippage in capital projects and any implications for capital budgeting to continue to reduce the amount of slippage.

Included in the above capital expenditure figure is £2.8 million on the Borders Railway project. This was fully funded by the draw down of funding from Transport Scotland and has no net financial impact on the statement of comprehensive income and expenditure.

The capital programme was funded from a mixture of capital grants, borrowing, contributions from earmarked reserves and developer contributions as shown in the table on the right.

Source	%
Capital fund / capital receipts	1.3
Developer contributions	0.4
General Scottish Government capital grant	40.1
Specific Scottish Government capital grant	4.3
Other grants and contributions	5.6
Capital grants (Borders Railway)	12.4
Plant and vehicle replacement fund	4.7
Borrowing	31.2
Total	100

Source: Financial statements

The 2013-14 budget anticipates a breakeven position and does not require funding from the Council's reserves.

The Council has created a five year financial strategy assuming that council tax will remain frozen throughout this period.

Revenue budget

To better understand and respond to the sources of pressure and funding uncertainties over a longer period, the Council has moved from the preparation of a three year budget to preparing a five year financial strategy. It is acknowledged that the figures for the next two years are more reliable than the rest of the forecast period (due to the timings of the local government finance settlements) and hence that the financial strategy will need be adapted over time in response to changing circumstances.

The below table shows the budgeted amounts for 2013-14 and the corresponding amounts from 2012-13 and our analysis of the key assumptions underlying the budget is shown further below.

	2012-13 £000	2013-14 £000	Variance £000
Chief executive's department and Resources	20,417	20,241	(176)
Education & Lifelong Learning	94,272	94,008	(264)
Social Work	78,953	77,051	(1,902)
Environment & Infrastructure	33,660	31,186	(2,474)
Corporate programmes, partnerships & projects and Other	40,656	26,161	(14,495)
Expenditure	267,968	248,647	(19,321)
Council tax income	(50,917)	(50,926)	9
Other grants and reserve transfers	(217,051)	(197,721)	(19,330)
Surplus in the year	(810)	-	810

Source: Financial Plan 2013/14- 2017/18- Scottish Borders Council committee 7 February 2013

The key assumptions underlying the five year financial strategy are:

- council tax continues to remain frozen;
- capital programme financed by £21.3 million of loan charges per year; and
- continue risk-based approach to determining minimum reserve levels.

The overall budgeted expenditure has reduced by £19.3 million from 2012-13; £17 million of this is due to the abolition of the regional police and fire bodies and hence the Council does not have to pay these levies (2012-13 expenditure to these bodies was £17 million). There has been a corresponding reduction in the Council's revenue support grant allocation to reflect the new police and fire arrangements.

As stated previously, the social work budget had to be significantly increased during 2012-13 due in part to unexpected service demands. Management has recognised the need to revise the underlying assumptions on which the social work budget was set on in the previous year. The 2013-14 budget has increased by £1.4 million from the budget originally set for 2012-13 to recognise recurring pressures from the previous year.

The budget has been set on the basis that the provision against council tax non-collection will continue to increase at £715,000 per annum. As the level of council tax will remain constant (through out the five year period) this is a reasonable assumption.

As with most councils, employee costs account for the majority of the Council's budgeted expenditure. The budget assumes a 1% increase in employee costs. In light of the current pay policies and recruitment restrictions this may be considered a reasonable assumption at the present time, but will require further refinement through the period of the financial strategy.

The five year financial strategy has been set on the assumption that the Council will achieve recurring efficiency savings over the period of £8.4 million with a target of £2.8 million in 2013-14.

The Council has recognised that demographic changes are going to increase financial pressures over the coming years and so has made adjustments in the strategy for the additional expenditure that will result from increased service pressures. The financial strategy shows that, due specifically to recognised demographic pressures, the Council will be spending an additional £5.9 million per year by 2017-18.

The Council has set a balanced budget for the first financial strategy period under the assumption that the Council will only require the use of Council reserves of £200,000 in 2014-15 and that no other reserves will be required. Although the Council is only intending to use a relatively small amount of its reserves it should be emphasized that, especially from 2015-16 onwards, the level of government funding is less certain and so there could need to be greater use of reserves if services are to be maintained, at least temporarily, at assumed levels.

As highlighted earlier in the report, the Council has a comparatively low level of useable reserves compared to other Scottish local authorities. Therefore, the Council is limited in its ability to use reserves to fund future budget deficits or unexpected expenditure. This emphasizes the importance of the Council maintaining effective financial husbandry and undertaking regular reviews of the budget assumptions.

A risk register was developed to reflect the risks inherent in setting the revenue budget and this has been used in setting appropriate reserves levels for 2013-14. The risk register will be reviewed periodically and any reduction in perceived risk will result in proposals to return balances to fund service expenditure. The useable general fund balance is projected to be maintained at £5.6 million in 2013-14 (£6.9 million in 2011-12). This amount is considered sufficient to cover 58% of the risks should they materialise.

This emphasises the importance of effective risk management arrangements throughout the year so that the appropriateness of the projected cover can be monitored throughout the period.

The achievement of efficiency savings is a crucial element in the Council achieving its budget and so progress against delivery requires close monitoring. In 2012-13 the social work directorate experienced issues in achieving the savings target and various remedial actions were taken. This demonstrates the importance of regular monitoring of achievement in this area and further emphasises the earlier recommendation that elected members should also be kept updated specifically on the progress in achieving efficiency savings targets.

The affects of pensions auto enrolment have not been included in the budget, as management believes that the behavioural aspects are difficult to predict. The potential impact of all un-enrolled employees electing to enrol could be an additional cost of £1.1 million per year. It is, however, unlikely that the maximum financial impact of this will materialise as auto enrolment occurs as employees have the option to opt out (and hence the Council would not be liable for any expenditure in relation to that employee). However, enrolment levels should continue to be monitored throughout 2013-14 so that management can be alert to any significant additional costs that the Council may incur.

The five year financial strategy has been set on the assumption that the council tax charge per property remains fixed, but also on the assumption that total council tax income will increase by £1.7 million over this period. This increased income will be largely generated by increasing the council tax base i.e. the number of payers. This increase will equate to approximately an additional 1,550 properties being constructed over the next five years. The Council is undertaking various initiatives to increase housing availability in the region such as the £2.6 million loan in 2012-13 to the National Housing Trust.

The Council has set a 10 year capital plan. In 2013-14 the Council plans to spend £24.8 million on a range of capital projects.

Capital plan

The Council has formulated a ten year capital plan to 2022-23. This plan has been split into a three year operational plan and an indicative strategic plan for the remaining seven years. This is in line with the recommendations from the review of capital planning and monitoring processes that was undertaken in 2009-10.

The strategic plan is intended to provide an indication of the level of resources and the type of demands on the capital financial plan. It is acknowledged that this will be subject to continuous refinement and will be subject to amendment reflecting the priorities of the new Council administration.

The principles of affordability and sustainability have been applied in developing an affordable draft capital financial plan. The total capital resource assumed throughout the 10 year capital plan has been increased by £25.9 million from the previous iteration. The significant elements of this increase are an assumed extra £9 million of general capital grant funding and £9.6 million relating to grant award for Kelso High School.

There are a number of projects within the capital plan for 2013-14 where funding has yet to be confirmed. These projects total £1.1 million and, if funding is not received, then the scope of the project would have to be altered or funded from other sources, for example, revenue or external borrowing. It is therefore important that management continue to monitor the funding situation in relation to these projects so that any remedial action can be taken promptly if required.

Planned capital expenditure in 2013-14 is £24.8 million and is to be funded from the sources shown in the table on the right.

Capital plan funding source	£000
Capital fund/capital receipts	830
Developer contributions	100
General Scottish Government capital grant	8,783
Specific Scottish Government capital grant	2,305
Other grants and contributions	2,410
Borrowing	10,371

Source: Capital Finance Plan Resources 2013-14- 2022-23 Scottish Borders Council committee 7 February 2013

The most significant (by value) capital projects in 2013-14 are shown in the table below:

Project	£000
Galashiels flood protection	2,730
West Linton primary school	1,200
Peebles High School sports facilities	4,294
LUPS strategic business land	1,391
Transport interchange	2,228
Roads	2,180

Source: Capital Finance Plan Resources 2013-14- 2022-23 Scottish Borders Council committee 7 February 2013

Financial statements and accounting

Our perspective on the preparation of the
financial statements and key accounting
judgements made by management

There have been no substantive changes to the financial reporting framework as set out in the *Code of practice on Local Authority Accounting in the United Kingdom 2012-13* and therefore there have been no significant changes to accounting policies in 2012-13. All accounting policies have been applied consistently and are considered appropriate.

Disclosure has been included in respect of the impact of revisions to IAS 19 *Employee benefits*. The Council had net liabilities of £30.1 million at 31 March 2013. The financial statements have been prepared on a going concern basis, reflecting the long term nature of some liabilities.

Accounting framework and application of accounting policies	
Area	KPMG comment
Code of practice on Local Authority Accounting in the United Kingdom 2012-13 ("the Code")	<p>The 2012-13 financial statements have been prepared in accordance with the Code which is based upon International Financial Reporting Standards ("IFRS"). The 2012-13 Code has a number of amendments from the 2011-12 version and management have reflected these changes to the reporting requirements in the financial statements. The amendments include:</p> <ul style="list-style-type: none"> ■ changes in relation to the objective of the financial statements and the qualitative characteristics of financial information; ■ encouragement for local authorities to prepare the explanatory foreword taking into consideration the requirements of the Government's Financial Reporting Manual (FRoM); ■ a requirement to recognise as an asset allowances under the carbon reduction commitment scheme; ■ clarification of situations in which a Council may be acting as principal, rather than agent, in the collection of non-domestic rates; and ■ amendments in relation to IFRS 7 <i>Financial Instruments: Disclosures (transfer of financial assets)</i>.
Impact of revised accounting standards	<ul style="list-style-type: none"> ■ Disclosure has been included in the financial statements highlighting that the impact of revisions to IAS 19 <i>Employee benefits</i> if the standard had been adopted early in 2012-13 would not have been material, with the estimated change to the amount charged to the Comprehensive Income and Expenditure Statement being of order £5 million. ■ No other newly effective accounting standards are considered to have a material impact on the Council's financial statements and the Council have included a disclosure to this effect.
Going concern	<ul style="list-style-type: none"> ■ Management consider it appropriate to adopt a going concern basis for the preparation of these financial statements and disclosed these circumstances within the financial statements. The balance sheet shows that at 31 March 2013 the Council has net liabilities of £30.1million i.e. liabilities exceed assets. This includes a pension fund liability of £191.2 million which will only crystallize over the long term. Given the general nature of the funding arrangements of the Council and that the pension deficit does not become due in the next 12 months, we are satisfied that it is appropriate for the financial statements to be prepared on the basis adopted.

We expect to issue have issued an unqualified audit opinion on the financial statements.

The financial statements and draft governance statement were made available on a timely basis and were accompanied by high quality working papers.

Audit conclusions

Our audit work is complete, following receipt of management representations and update of our subsequent events work to the date of signing of the financial statements. This included remaining informed of the position in respect of litigation action currently being pursued against the Council. We issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2013, and of the Council's surplus for the year then ended. There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

We have also worked with management to identify areas where the content of the financial statements could be removed and/or considered to make the information more understandable and/or relevant to the reader whilst still satisfying the relevant disclosure requirements. We are pleased to report that management have been co-operative in this task and have adopted many of the suggested presentational amendments.

Financial statements preparation

- High quality working papers and full draft financial statements were provided by the statutory deadline of 30 June 2013. This included the explanatory foreword, remuneration report and governance statement. The latter had already been considered and approved by the Council's audit committee.
- In advance of our audit fieldwork, we issued a 'prepared by client' request setting out a list of required analyses and supporting documentation. The standard of documentation was very good and there was evidence of accountability and ownership of working papers across the finance department.
- We provided feedback to management on the content of the financial statements, annual report and governance statement, and we are pleased to report that these were consequently prepared appropriately.
- We are pleased to report that management have demonstrated progress in acting on our previous recommendation in relation to reconciliations and the number of general ledger codes. More detailed work around these areas will be undertaken as part of work for next year.
- Audit differences are reported in appendix one. There was one adjusted difference and two unadjusted audit differences to the primary financial statements.
- There are no significant matters in respect of (i) auditor independence and non-audit fees; and (ii) management representation letter content, as reported in appendix two.

We have considered specific technical accounting issues, in relation to retirement benefits, property, plant & equipment and provisions.

We concur with management's judgements.

Key accounting judgements	
Area	KPMG comment
Retirement benefits	<p>The Council accounts for its participation in the Scottish Borders Pension Fund in accordance with IAS 19 <i>Retirement benefits</i>, using a valuation report prepared by actuarial consultants. Our audit of the accounting for retirement benefits includes consideration of the data underlying the actuarial report. This includes primarily the level of contributions made during the year, the financial assumptions and membership data provided to the actuary and the Council's share of the pension fund assets.</p> <p>The level of contributions made by the Council in the year is estimated based on data prior to the year end. It is important that this number is accurate as it is used to inform the calculation of the liabilities at the year end. Our testing included review of actual data against that used in the actuarial calculations. No issues were identified.</p> <p>The actuaries use a number of assumptions in their calculations based on market conditions at the year end, including a discount rate to derive the anticipated future liabilities back to the year end date and assumptions on future salary increases. IAS 19 requires the discount rate to be set by reference to yields on high quality (i.e. AA) corporate bonds of equivalent term to the liabilities. Our actuarial colleagues have reviewed the assumptions and concluded that those used fall within the range that we would normally consider acceptable for the purpose of IAS19 for a typical Local Government Pension Scheme employer.</p> <p>The rate of salary increases is set taking into account the Council's expected long term rate of salary increases, including incremental drift. The rate used (4.8%) is at the higher end of the range some other public sector clients (excluding councils) are using, but is in line with the assumption used by the majority of other Scottish local authorities. Management should ensure that in setting this assumption it reflects the Council's long term plans and strategy.</p>
Accounting for landfill sites	<p>During the year, it was recognised that local authorities' accounting for landfill sites they operate may not be in accordance with IAS 37 <i>Provisions</i>. Under this standard, the future costs (including decommissioning, restoration and ongoing monitoring) should be capitalised when the landfill is brought into use and an associated provision created on the balance sheet which future costs would be charged against. The landfill asset is then impaired.</p> <p>Management has considered the future costs of relevant landfill sites, but no provision has been recognised on the balance sheet at 31 March 2013 on the basis that, in management's opinion, the costs cannot be sufficiently reliably estimated at present. Management's current estimates are that costs may be in the region of £900,000. We have included this as an unadjusted audit difference as it is our opinion that the costs could be estimated to a suitable precision that would allow for the creation of a provision. Adoption of a revised basis of accounting in future years will have implications for both revenue and capital funding and these will require consideration.</p>

Recommendation 3

Other accounting and audit matters

Area	KPMG comment																																										
Property, plant and equipment	<p>Under the Code and IFRS, property, plant and equipment (“PPE”) is required to be held on the balance sheet at fair value which for specialised assets is assumed to be depreciated replacement cost and for other PPE is open market value. In order to comply with these accounting requirements, Council assets are subject to rolling valuations on a department basis. In between formal valuations, PPE are considered for any indications of impairment and where these are identified, formal valuations are performed and reflected in the financial statements.</p> <p>In accordance with the Council’s valuation cycle, during the year education assets were subject to revaluation resulting in total downwards revaluations of £33.5 million. Of this, £28.2 million was charged to the Comprehensive Income and Expenditure Statement (“CIES”) and £5.3 million to the revaluation reserve. This is noted in the table below analysed into a number of elements.</p> <table border="1"> <thead> <tr> <th colspan="6">Analysis of downwards revaluations</th> </tr> <tr> <th></th> <th>NBV pre valuation £m</th> <th>2012-13 Valuation £m</th> <th>Total change £m</th> <th>Charge to reserves £m</th> <th>Charge to CIES £m</th> </tr> </thead> <tbody> <tr> <td>PFI schools</td> <td>69.4</td> <td>57.0</td> <td>(12.4)</td> <td>-</td> <td>(12.4)</td> </tr> <tr> <td>Other schools</td> <td>28.9</td> <td>15.7</td> <td>(13.2)</td> <td>(2.8)</td> <td>(10.3)</td> </tr> <tr> <td>Tower Mill, Hawick</td> <td>4.5</td> <td>1.9</td> <td>(2.6)</td> <td>-</td> <td>(2.6)</td> </tr> <tr> <td>Other, non significant movements</td> <td>43.9</td> <td>38.7</td> <td>(5.2)</td> <td>(2.5)</td> <td>(2.7)</td> </tr> <tr> <td>Total</td> <td>146.8</td> <td>113.3</td> <td>(33.5)</td> <td>(5.3)</td> <td>(28.2)</td> </tr> </tbody> </table> <p><i>Source: audit working papers</i></p> <p>PFI schools</p> <p>The Council has three PFI projects which were brought onto the balance sheet in 2009-10 and 2010-11 in relation to new high schools. When brought onto the balance sheet these were initially capitalised using the operator’s financial model in accordance with the applicable guidance at that time. However, it has been identified that this model included a number of costs which are not included in Council valuations such as borrowing costs and other development costs. This was not identified when the assets were capitalised, but has been identified through the Council’s routine valuation work.</p>	Analysis of downwards revaluations							NBV pre valuation £m	2012-13 Valuation £m	Total change £m	Charge to reserves £m	Charge to CIES £m	PFI schools	69.4	57.0	(12.4)	-	(12.4)	Other schools	28.9	15.7	(13.2)	(2.8)	(10.3)	Tower Mill, Hawick	4.5	1.9	(2.6)	-	(2.6)	Other, non significant movements	43.9	38.7	(5.2)	(2.5)	(2.7)	Total	146.8	113.3	(33.5)	(5.3)	(28.2)
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Other accounting and audit matters	
Area	KPMG comment
Property, plant and equipment	<p>Other schools and Tower Mill, Hawick</p> <p>This relates to a number of other schools and Tower Mill, Hawick which have been constructed in recent years and subject to first valuation in 2012-13. Those identified above have been subject to a net downwards revaluation of £15.8 million. This relates to a number of differences between assets that have been capitalised and the valuation basis used (which is in line with the Royal Institution of Chartered Surveyors' Red Book and the Code). This includes costs in relation to infrastructure, site preparation and certain fit out costs which have not been separately identified.</p> <p>Accounting transactions resulting from these revaluations raise a number of issues in relation to capital accounting which management should consider further. In particular, consideration should be given to undertaking formal revaluations for major PPE assets (including PFI assets) when they are brought into use outwith the existing revaluation cycle. In addition, they should ensure that assets are accurately categorised during construction (for example splitting elements of infrastructure from land and buildings) which may require further information from the construction companies and /or internal planners.</p> <p style="text-align: right;">Recommendation 4</p> <p>Changes in assets</p> <p>There are number of assets where there were either shared areas/premises which have moved assets or where areas of a surplus property have been used for new purposes (for example, parts of a former school used as a nursery with the rest of the building written down when the new school is brought into use). The impact of this can be that the impairment charge in the Comprehensive Income and Expenditure Statement and the movement in the revaluation reserve are both overstated. For example, the revaluation upwards to create a new asset is charged to the revaluation reserve where the impact of the revaluation downwards may be charged to the Comprehensive Income and Expenditure Statement. The accounting transactions for this are complicated but we have estimated that the maximum impact of this is £2.2 million which we have noted as an unadjusted audit difference. We do not consider this to be material.</p> <p style="text-align: right;">Recommendation 5</p> <p>Impairment review</p> <p>The annual impairment review carried out by the Council for PPE includes consideration by the valuer of any specific indications of impairment. This includes consideration of the nature, state and obsolescence of assets. We believe that this review should include consideration of the costs capitalised on the balance sheet, i.e. whether a valuation would support those costs.</p> <p style="text-align: right;">Recommendation 6</p>

Performance management

Our perspective on the performance
management arrangements, including follow
up work on Audit Scotland reports

Our work has identified that the Council's Best Value and performance management arrangements are maturing.

Best Value / performance management arrangements

The Council's vision is to "Seek the best quality of life for all the people in the Scottish Borders, prosperity for our businesses and good health and resilience for all our communities". To assist in the realisation of this vision the Council has a new five year corporate plan 2012-13 to 2017-18 and a performance management framework which were approved by the Council on 25 April 2013. The aim of the new corporate plan is to clearly set out a vision, value and standards as well as priorities for the coming years. The aim of the performance management framework is to allow elected members and officers to assess how well work is progressing towards addressing the priorities. These documents are centred around the Council's eight priorities.

Under each of the eight Council priorities, a set of performance indicators is being developed in order that reporting can be undertaken for various purposes and at various levels. The intention is that elected members will have input into the tailoring of the new management information reports so that the information will be suitable for needs of the various boards and committees. The performance management framework includes a timetable of how performance will be monitored throughout the year. Also, an annual report will be produced reporting performance against the performance indicators.

The performance management framework also includes the use of self assessment mainly using the Public Service Improvement Framework (PSIF). The intention is that the Council will be undertaking a bi-annual self assessment using PSIF. This will be supplemented by a rolling programme of more in depth PSIF assessments will also be carried out across departments.

The creation of a new corporate plan performance management framework will not automatically lead to performance improvement as that is dependent on the effective use of the information. As the Council has a number of committees and boards (which will need to make effective use of this information) it will need to be ensured that all committees make relevant use of the information to drive forward performance improvements.

We will continue to monitor the implementation and effectiveness of the above arrangements as part of our overall risk assessment of the Council.

The shared risk assessment process has concluded that the Council continues to be a relatively low scrutiny risk.

We have performed follow-up work in relation to the Audit Scotland national report: *Scotland's public finances*. We concluded that management's use of performance information is an area for future development.

<p>Shared risk assessment</p>	<p>The Council's Assurance and Improvement Plan ("AIP") has been updated as a result of a shared risk assessment exercise that commenced in October 2012. The update process drew information from a number of sources including the 2011-12 annual audit report. The output of the AIP update process is a timetable for proposed audit and inspection activity between April 2013 and March 2016 which reflects the revised and updated scrutiny risk assessment. The updated AIP was presented to the audit committee on 25 June 2013.</p> <p>The updated AIP continues to identify 15 areas as "no scrutiny required" with an additional three areas also now assessed as "no scrutiny required". In the updated AIP, eight areas have now been classified as "further information required".</p> <p>The summary of the AIP is "Overall, the Council continues to be relatively low scrutiny risk. That is reflected in the absence of any significant audit and inspection activity arising from this year's local SRA process. Whilst the AIP has identified some areas where further information is required, most of this activity is focused on the LAN monitoring the impact of the significant community planning and organisational developments on services, use of resources, and their impact on outcomes, throughout the year."</p> <p>Due to the nature of the scrutiny risk profile the LAN has agreed that "alongside its monitoring of key developments it will focus its effort this year in engaging with the Council's corporate management team ("CMT") to develop a strong understanding of the priorities and risks facing the Council. The LAN will therefore meet with the CMT during the autumn for a joint mid-year priorities, risks and performance review workshop with the CMT to inform the 2014 SRA refresh process."</p> <p>We have reviewed the content of the AIP for consistency with our knowledge of the Council and have not identified any inconsistencies.</p>
<p>Local response to national studies and Audit Scotland reports</p>	<p>We have considered the Council's response to the national report <i>Commissioning social care</i>, concluding that the report assisted the Council in seeking constructive improvements to aspects of its work, although the final impact is uncertain at this time or significant change appears unlikely.</p> <p>We have also considered the Council's response to the Audit Scotland report <i>Scotland's public finances: addressing the challenges</i>. Our high level conclusion on this report is that, in response to future challenges, the Council has reviewed the budget setting process for 2013-14 and beyond. Although management reviews and utilises performance information, management recognise that this is still an area for future development.</p> <p>We note that such reports are considered by the audit committee or other formal working group and continue to be satisfied with the arrangements in place.</p>

Internal audit testing identified errors in the draft SPIs.

Nine SPIs showed an improvement, whilst ten SPIs showed a decline in performance.

Statutory performance indicators and benchmarking

The Council submitted the Statutory Performance Indicators (SPIs) for 2012-13 to Audit Scotland on 29 August 2013 in line with the agreed timetable. As the external auditor, our responsibilities extend to understanding arrangements and systems that the Council uses to generate performance results and consequent reports. Through the audit process we identified there was no independent review arrangement to agree the completeness and accuracy of data used.

Internal audit reviewed an initial sample of four SPIs and found two errors related to planning application processing times and carriageway condition. This resulted in an additional sample of four SPIs been reviewed by internal audit and two further SPIs been reviewed by us. No further errors were identified. We recommend that specific arrangements are established to assure the accuracy and completeness of all indicators submissions to the Local Government Benchmarking Framework going forward.

The Council's performance, as measured by these SPIs, shows that in comparison to 2011-12:

- nine SPIs have improved;
- ten SPIs have declined; and
- two SPIs have remained unchanged.

The majority of the changes in performance, as measured by the SPIs, are relatively insignificant, with only a small number of indicators showing material changes in performance.

Performance against the Council's performance indicators is reported in an annual performance report which is publically available.

The Local Government Benchmarking Framework has been developed to help councils compare their performance using a standard set of indicators. The indicators in the framework replace the specified SPIs from 2013-14 onwards.

Recommendation 7

Governance and narrative reporting

Update on your governance arrangements

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

While the year saw changes in the political administration of the Council, over-arching and supporting corporate governance arrangements remained primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance arrangements

The May 2012 elections saw a change in administration, changing from a Conservative / Independent / Liberal Democratic coalition to a Independent / SNP / Liberal Democratic coalition. Following the local government elections in May 2012, the Council approved a new scheme of delegation on 30 August 2012. The Council continued to operate a cabinet structure, with the new scheme of administration approved which incorporated parts of the executive/scrutiny structure which have worked well into a new, sustainable decision-making structure which is fit for the future. This has led to a review of the current decision-making structure and a desire for a more inclusive committee structure which still meets the needs of the Council, its partners, and the communities it serves.

A number of existing committees and subcommittees were disbanded and the new structure now has an executive committee augmented by three service committees: education, environment & infrastructure and social work & housing. Amongst the other committees that support the Council is an audit and a petitions committee. The new structure came into effect October 2012. The Council maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour.

To ensure inclusivity, opposition members form part of the membership of the main committees in the new structure, including the audit committee. These provide scrutiny and challenge to strategic decisions and performance. The new scheme of administration maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour.

Following our interim audit we reported that the risk management strategy and supporting documentation, including service and corporate risk registers, demonstrated a commitment to good practice and increased focus by senior officers. The risk register is regularly reviewed and updated. Management continues to recognise the need to embed risk management at an operational level and increase cultural awareness that it is everyone's responsibility to manage risk on a day to day basis.

The Council's corporate governance arrangements are also supported by the work of internal audit. Internal audit's annual opinion for 2012-13 on the system of internal financial control was "the systems of internal financial control are operating satisfactorily". Internal audit's annual report also confirms that there were no "priority one (high risk, material observations requiring immediate action)" recommendations during the year.

The Council has attempted to improve the way in which it reports information and to make information more user focussed. This is evidenced through the improved explanatory foreword to the financials statements, in which the Council has amended the content to better communicate to the reader the key messages and issues faced by the Council. The Council has also adjusted the placement of the remuneration report in the financial statements; the placement of the remuneration report is now in line with our expectation of good practice.

<p>Annual governance statement</p>	<p>The governance statement provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. It describes a number of sources of assurance for the accountable officer and identifies areas for improvements to be focussed on in the future. We reviewed the governance statement against disclosure requirements and considered its contents against our knowledge and understanding of Council. A small number of minor presentational adjustments were made to the statement.</p>
<p>Remuneration report</p>	<p>We considered the contents of the remuneration report and reviewed against the requirements of the regulations. A small number of presentation adjustments were required, but we are satisfied with the content of the remuneration report. We satisfactorily tested a sample of exit packages and other disclosures in the remuneration report to supporting documentation.</p> <p>We are pleased to note that management has acted on our feedback from the previous year's audit and adjusted the placing of the remuneration report in the published statement of accounts. The remuneration report is now positioned in line with our expectation of good practice.</p>
<p>Systems of internal control</p>	<p>As the financial and operating environment in which the Council operates continues to change, with developing priorities and new and emerging financial and non-financial risks, it is increasingly important that the Council plan, supporting service plans and other developments are underpinned by effective organisation-wide controls, robust financial management processes and effective key financial controls.</p> <p>Our reporting throughout the year has identified a number of areas of the financial control framework that could be enhanced, including in respect of reconciliations and journal authorisation processes, but our financial statements audit work has not identified any further issues in relation to system of internal control.</p>
<p>Prevention and detection of fraud</p>	<p>The Council has policies and codes of conduct for staff and Councillors including a whistle blowing policy. Management has confirmed that no significant fraud or irregularities have been identified during the year. However, the absence of a number of controls identified by us as part of the interim audit process does, in our view, increase the possibility of fraud, or other irregularity not being prevented or detected on a timely basis.</p>
<p>Maintaining standards of conduct and the prevention and detection of corruption</p>	<p>The Council has various organisational policies and procedures in place designed to prevent and detect corruption. Organisation-wide policies are important as they set the tone of the Council, outline expectations of employees, document key processes to be followed by all staff, and communicate the culture of honesty and ethical behaviour. The majority of these policies have recently been updated to reflect new requirements and are available to all staff on the intranet. The Council is also supported in this regard by a standards committee which assists in monitoring and scrutinising councillor and senior officer conduct.</p>

<p>Changes to local authority reporting</p>	<p>The Scottish Government has commenced a consultation period on proposals to amend The Local Authority Accounts (Scotland) Regulations. The consultation period closes on 4 October 2013. The proposed draft regulations include a number of changes designed to help strengthen corporate governance processes. The intention is that the proposed regulations will be applicable to 2013-14 onwards and consideration should be given to the implications for the Council's reporting arrangements arising from the content of the consultation draft.</p> <p>The Council has eight common good funds and 289 trust funds of which 112 are registered charitable trust funds. From 2013-14, all charitable trust funds registered with the Office of the Scottish Charity Regulator ("OSCR") will require an audit. The audit of these charitable trust funds may result in a significant administrative and financial cost to the Council. The Council is intending to commence a rationalisation process which will see the number of registered trusts significantly reduced. This rationalisation process will require authorisation from OSCR. Many other councils are seeking to follow a similar process and hence this will result in significant additional work for OSCR. To ensure that OSCR have time to complete this work, management should ensure this process is progressed so that the rationalisation is completed by 31 March 2014.</p>
<p>National fraud initiative</p>	<p>The National Fraud Initiative ("NFI") is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches. NFI helps participating bodies to identify possible cases of fraud and to detect and correct under or overpayments. NFI also helps auditors to satisfy their duties to assess bodies' arrangements for preventing, deterring and detecting fraud.</p> <p>The Council is responsible for investigating data matches from the latest round and to date progress made is as follows:</p> <ul style="list-style-type: none"> ■ 68% of reports have been opened and 27% of the reports have already been closed. The remaining 5% of reports have still to be opened; and ■ four frauds and 352 errors have been identified, but with limited financial impact. <p>We are required by Audit Scotland to review the Council's progress and engagement with the NFI process. We will prepare a short return to Audit Scotland by January 2014 and will report these findings to the audit committee separately, but at the current time are satisfied with the arrangements the Council has made in establishing processes and investigating the data matches.</p>

Internal audit

As set out in our audit plan and strategy, we have evaluated the work of internal audit and concluded that we can rely, where relevant, on their work. The content of the internal audit plan is in line with our expectations. We relied on internal audits work in the following areas:

- non-domestic rates and council tax revenue;
- performance management;
- financial planning and management reporting and efficiency savings;
- performance management; and
- sports trusts.

We also relied on internal audits testing of SPIs (more information on page 26).

During 2012-13 a self-assessment of the Council's internal audit practices was carried out against the new Public Sector Internal Audit Standards (PSIAS) that came into effect 1 April 2013. The internal audit charter which formally defines the terms of reference for the internal audit service was updated to reflect the new PSIAS.

Appendices

There was one audit adjustment and one unadjusted audit difference to the CIES. In our view, neither have a material impact on the CIES or balance sheet.

Area	Key content	Reference
Adjusted audit differences Adjustments made as a result of our audit	<p>There was one audit adjustment required to the draft financial statements relating to the classification adjustment of £29 million of housing benefit expenditure from the 'central services' lines on the CIES to the 'general fund housing services' line. This adjustment did not impact on the net assets or the surplus and deficit for the year.</p> <p>A number of numerical and presentational adjustments were required to some of the financial statements notes. The most significant of these related to the cash flow statements, movement in reserves statement and segmental reporting.</p>	
Unadjusted audit differences	<p>We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are two unadjusted audit differences:</p> <ul style="list-style-type: none"> ■ in some instances, where an asset was revalued, the asset was separated into two separate assets. Where this occurred, the revalued amount was treated entirely as a revaluation increase. However, in some instances the original asset was revalued downwards and all of the change in valuation was treated as a revaluation downwards and so did not take into account the value of the newly created asset. The effect of this is that the 'net cost of services' line on the CIES is overstated by £2.2 million with the corresponding understatement on the 'other comprehensive income and expenditure' line. There is no affect on the 'total comprehensive income and expenditure' line on the CIES; and ■ the Council has not recognised a provision for landfill site decommissioning costs. Had a provision been recognised, the estimated financial impact of the changes would be for liabilities on the balance sheet to increase by £900,000 and net cost of services expenditure to increase by the same amount. 	
Confirmation of Independence Letter issued by KPMG to the Audit Committee	<p>We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our Audit Director and audit staff. There were no non-audit fees in the year.</p>	Appendix 1
Management representation letter Letter issued by the Council to KPMG prior to audit sign-off	<p>There were no changes to the representations required for our audit from last year. One specific representation where we requested representation from management was in respect of the disclosure of all interests in landfill sites.</p>	-

Auditing Standards require us to consider and confirm formally our independence and related matters in our dealings with the Council.

We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.

Auditor independence

Professional ethical standards require us to provide to you at the conclusion of an audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This letter is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Company and its related entities for professional services provided by us during the reporting period. We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- regular communications;
- internal accountability;

- risk management; and
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail.

There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Audit Committee.

Confirmation of audit independence

We confirm that as of 24 September 2013, in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit Committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

Financial statements

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. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and

- participating, when required, in data matching exercises carried out by Audit Scotland.

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

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Financial position

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

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

The action plan summarises specific recommendations arising from our work, together with related risks and management’s responses.

Priority rating for recommendations

Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.

Grade two (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.

Grade three (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p>1 Budget assumptions</p> <p>The social work directorate experienced difficulties in delivering the original budget in 2012-13, due in part to increased demand pressures. The revised budget at the end of the year was £3.2 million higher than the original budget set at the start of 2012-13.</p> <p>There is evidence that management have made some changes to the social work budget setting process for 2013-14 and have recognised some of the recurring pressures from 2012-13. However, it is our view that a more fundamental review of the underlying budget assumptions for the social work directorate should take place to ensure that future budgets are more robust. The risk is that if such a review does not take place then further budget revisions may be required. As stated throughout this report, the Council has limited resources to be able to accommodate budget increases.</p>	<p>Management should undertake a review of the underlying budget assumptions for the social work directorate to ensure that the budget is robust, achievable and takes account of demand pressures.</p>	<p style="text-align: center;">Grade two</p> <p>Agreed. The assumptions underpinning the five year financial plan will be updated for future years’ budgets, to better reflect the demographic, price and demand challenges facing Council services.</p> <p>Responsible officer: Chief Financial Officer</p> <p>Implementation date: June 2014</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p>2 Monitoring of efficiency savings</p> <p>Management have set a balance budget for 2013-14 which incorporates the delivery of £2.8 million of efficiency savings. In 2012-13 the social work directorate experienced difficulties in achieving the designated savings target.</p> <p>Progress against delivering efficiency savings targets is monitored by the corporate management team, but there is no specific reporting to elected members. The risk is that difficulties will be experienced in 2013-14 and that the elected members will not have full visibility of progress in this key area.</p>	<p>Management should adapt the current revenue monitoring reports that currently go to elected members to include specific monitoring of the progress against the efficiency savings targets.</p>	<p style="text-align: center;">Grade two</p> <p>Agreed. Future reports to elected members will build on the practice already followed for Council management team reports and track delivery of efficiencies more explicitly.</p> <p>Responsible officer: Chief Financial Officer</p> <p>Implementation date: September 2013</p>
<p>3 Landfill site provision</p> <p>The Council has not recognised a provision for future costs associated with the decommissioning of its landfill sites. The risk is that the Council's continues not to recognise a provision and then will have to incur the whole of the expenditure in the year that it falls due. This would not be in line with the accruals concept under which financial statements should be prepared. There is also a risk that management will not acquire the required information in a suitable timeframe in order to be able to accurately recognise a provision in the 2013-14 financial statements unless there is a clear identification of the information required and a suitable timetable for its acquisition.</p>	<p>Management should seek to accurately estimate the future costs associated with its interests in landfill sites and recognise a provision in the 2013-14 financial statements. Management should also ensure that a timetable is devised to ensure that the required information is obtained in a suitable timeframe for the production of the 2013-14 financial statements.</p>	<p style="text-align: center;">Grade three</p> <p>Management accept the need to ensure accounting guidance is applied correctly to landfill sites and will review the position for 2013-14.</p> <p>Responsible officer: Chief Financial Officer</p> <p>Implementation date: March 2014</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p>4 Revaluing assets when brought into use</p> <p>Education properties were revalued in 2012-13 and through our review of this process we identified multiple instances where the assets were previously held on the balance sheet at cost-including the Council's three PFI schools. We would have expected that when significant assets are brought into use that they would be subject to a formal valuation.</p> <p>The risk is that when assets are held on the balance sheet on a cost basis that the difference between the cost and fair value is material. This is often the case as there will be capitalised costs which are not included in the valuation.</p>	<p>Consideration should be given to formally valuing all significant assets when they are brought into use.</p>	<p style="text-align: center;">Grade two</p> <p>Agreed. This policy will be enacted from September 2013.</p> <p>Responsible officer: Head of Properties and Facilities Management / Chief Financial Officer</p> <p>Implementation date: 30 September 2013</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p>5 Recording of capital expenditure</p> <p>When assets are subject to a formal valuation the valuer is required to exclude certain items from the valuation due to valuation methodology requirements. For example, fixtures and fittings are not included in the valuation. These excluded items are still Council assets and so the Council is able to recognise these assets in the balance sheet. However, it was identified that there were instances where the original cost of the asset had not been split between these different categories to enable the separate identification of these excluded items .</p> <p>Therefore, these excluded items were effectively written off by the Council a did not form part of the valuation and management did not have the required information in order to be able to retain the asset on the balance sheet. The risk is that the Council is writing off these assets before it is required and hence understating its asset base.</p>	<p>Management should ensure that future capital costs are appropriately split into different categories on the asset register to enable the separate identification of items that do not form part of the formal valuation and hence allow for management to still recognise these excluded items on the balance sheet</p>	<p style="text-align: center;">Grade three</p> <p>Agreed. Work to address this recommendation will be progressed during 2013-14 for completion by 31 March 2014.</p> <p>Responsible officer: Chief Financial Officer</p> <p>Implementation date: March 2014</p>

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
<p>6 Impairment review</p> <p>Management conducts an annual impairment review of fixed assets to identify if there possible indications of impairments having occurred during the year. This review includes consideration of the nature, state and obsolescence of the asset.</p> <p>The review does not include consideration of the costs capitalised on the balance sheet and hence whether a valuation would support these costs. The risk is that the impairment review may not identify material impairments.</p>	<p>Management should adapt the current impairment review process to include consideration of the costs capitalised on the balance sheet and whether a valuation would support these costs.</p>	<p style="text-align: center;">Grade two</p> <p>Agreed. Work to address recommendation will be progressed during 2013-14 for completion by 31 March 2014.</p> <p>Responsible officer: Chief Financial Officer</p> <p>Implementation date: March 2014</p>
<p>7 Review of performance indicators</p> <p>The Council was required to submit a return to the Scottish Government containing Statutory Performance Indicators (“SPI’s”). Internal Audit completed sample testing on eight of these indicators and identified two errors.</p> <p>With the new arrangements for benchmarking information and the Council’s introduction of new performance indicators as part of the performance improvement framework, there is a risk that the information used is not accurate and hence the value of the information and any comparisons made is reduced.</p>	<p>Management should ensure that all future performance indicators submitted externally by the Council are subject to appropriate internal review prior to submission to internal audit for sample testing. Management should also ensure that appropriate consideration is given of scrutiny arrangements for the information that is to be use in the performance indicators as part of the new performance management framework.</p>	<p style="text-align: center;">Grade three</p> <p>Agreed.</p> <p>Responsible officer: Head of Strategic Policy</p> <p>Implementation date: December 2013</p>



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