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 2014

30 September 2014

Contents

The contacts at KPMG in connection with this report are:

David Watt
Director, KPMG LLP

Tel: 0141 300 5695
Fax: 0141 204 1584
david.watt@kpmg.co.uk

Andrew Dobson
Manager, KPMG LLP

Tel: 0191 401 3729
Fax: 0191 401 3751
andrew.dobson@kpmg.co.uk

Rhona Mitchell
Audit Associate, KPMG LLP

Tel: 0141 228 4295
Fax: 0141 204 1584
rhona.mitchell@kpmg.co.uk

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. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the beneficiaries, even though we may have been aware that others might read this report. We have prepared this report for the benefit of the beneficiaries alone.

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.

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Headlines

This annual audit report summarises our findings in relation to the audit of Scottish Borders Council for the year ended 31 March 2014. 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 2014.

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	Management undertake regular analysis of the key areas of public reform, which should support achievement of strategic priorities in a changing environment; there are a number of service challenges emerging, with demand and resource pressures continuing against a backdrop of reform in public services. The Council's response to these challenges is reflected in its five year financial services strategy and its future model of public service delivery project.	Page 6
Financial position	The Council's revenue expenditure was £254.6 million, representing a £451,000 under spend against the final, revised budget (2012-13: under spend of £800,000 against final, revised budget). The outturn for 2013-14 is in accordance with the Council's financial strategy. This included delivery of efficiency savings of £6.3 million and reflects management addressing matters on an in-year basis in accordance with budgeted resources. The Council has reviewed the level of reserves to ensure that the reserves held are proportionate to the risks that the Council faces. Audit Scotland's analysis of 32 local authorities shows the Council in the lower third for useable reserves as a proportion of revenue spend.	Page 8
Financial strategy	In the period covered by the five year financial strategy approved in February 2013, the Council has set a balanced budget each year based on total use of reserves of £200,000; the reserves strategy is based on a costed risk 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 12
Financial statements and accounting		
Audit conclusions	Our approach reflected our assessment of financial statement level risks and consideration of audit focus areas. These have been concluded satisfactorily. We have issued an unqualified audit opinion on the 2013-14 financial statements.	Page 15
Accounting policies	There have been no significant changes to accounting policies in 2013-14. The impact of changed arrangements for accounting for employee post-employment benefits, has been disclosed in the financial statements but is not considered material. No other newly effective accounting standards are expected to have a material impact on next year's financial statements.	Page 19
Financial statements process	The draft financial statements, explanatory foreword, annual governance statement and remuneration report were received by the statutory date and were supported by high quality working papers. Management has responded promptly to our requests for additional information.	Page 20

Headlines (continued)

Charitable trusts and common good funds	The implementation of the audit and reporting requirements of the Office of the Scottish Charity regulator (OSCR) has required that full audited financial statements for the Council's charitable trusts and common good funds are prepared for the first time.	Page 21
Corporate governance		
Governance arrangements	Over-arching and supporting corporate governance arrangements provide a sound framework for organisational decision-making. A new corporate management structure came into effect on 1 April 2014 aimed at improving the efficiency of services as part of the service transformation programme.	Page 23
Systems of internal control	Our testing (combined with that of internal audit) of the design and operation of financial controls over significant risk points confirms that generally, controls relating to financial systems and procedures are designed appropriately and operating effectively. In our interim management report we noted opportunities for management to further strength the control environment in relation to council wide policies, bank reconciliations and amendments to supplier master data. Management has made progress against these control weaknesses, particularly in relation to bank reconciliations.	Page 23
Performance management arrangements		
Performance management	The Council has developed Best Value and performance management arrangements further during the year and demonstrates commitment to continuous improvement. The Council monitors statutory performance indicators throughout the year and completes the Local Government Benchmarking Framework exercise. Audit Scotland's consideration of progress by Scottish Borders Community Planning Partnership demonstrated clear progress against its improvement agenda, noting a sense of energy and commitment. Audit Scotland's risk assessment of housing benefit arrangements noted that claim processing times had significantly improved and that the Council had developed sound performance management arrangements for this service. This includes a collaborative approach to the welfare reform agenda. The Council's response to Audit Scotland's reports *Major Capital Investment in Councils* and *Arms Length External Organisations: Are you getting it right?* was evaluated. The former had been considered by the Council's corporate management team, but not the full Council or other relevant committees, while the latter is to be considered by the audit committee. There is no formal action plan specifically in response to either report, but changes are been made to the capital management processes which encompass recommendations from the report and management have confirmed that the *Are you getting it right?* report will be considered as part of the work on the potential establishment of the two new ALEOs.	Page 28

Scope and responsibilities

Our annual audit report is designed to summarise our opinion and conclusions on significant issues arising from our audit of the Council for 2013-14. 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.

The context of our audit is one of an overall reduced level of risk, based on the shared risk assessment of the Council's arrangements.

Responsibilities

Audit Scotland's *Code of Audit Practice* ("the Code") sets out the Council's responsibilities in respect of preparation of financial statements, systems of internal control, prevention and detection of fraud and irregularities, standards of conduct and arrangements for the prevention and detection of bribery and corruption, financial position and Best Value.

The Code sets out the wider dimensions of public sector audit which involves not only the audit of the financial statements, but also consideration of areas such as financial performance and corporate governance.

An audit of the financial statements is undertaken in accordance with legislation and International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board and the Code, but 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 our attention during our audit work in accordance with the Code, and may not be all that exist. Communication 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 or to maintain an adequate system of 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 that committee during the year, discharges the requirements of ISA 260.

Context of the audit

A local area network ("LAN") of local audit and inspection representatives undertakes a shared risk assessment for each local authority in Scotland, to identify targeted, risk-based scrutiny. Following a review of the shared risk assessment process in 2013, there has been a shift in focus to identifying councils' position in implementing the Scottish Government's reform agenda.

The shared risk assessment process results in each council receiving an annual assurance and improvement plan ("AIP"). During 2013-14, a refresh of the Council's AIP for the period 2014-17 was undertaken, which was subsequently published in June 2014. The change in focus from the review of the shared risk assessment process is reflected in the structure of the AIP.

The Council's 2013-16 AIP reported that the Council has continued to take forward its improvement and service modernisation agenda at a time of significant political and managerial change. An important development for the Council and its partners has been a major review of community planning arrangements for the Scottish Borders area; the review found that the Scottish Borders Community Planning Partnership ("CPP") has a real opportunity to deliver more impact from partnership working. Follow-up audit activity to assess progress that is being made by the CPP in taking forward its improvement agenda is scheduled to take place during 2014-15.

Overall, the context for our audit planning was one where the Council continues to be relatively low scrutiny risk. That is reflected in the absence of any significant audit and inspection activity. Whilst the AIP identified some areas where further information is required, most of this 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.

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

Key issues

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 national police, fire and rescue services.**
- **Active consideration is being given to preparing for the implementation of the Public Bodies (Joint Working) (Scotland) Act.**

Audit Scotland's report *An overview of local government in Scotland 2014* highlighted the challenges of reducing budgets and increasing demands. This is coupled with further expected budget reductions, the public's expectation of service delivery and demographics becoming more biased towards older people, who typically need more public services.

The Council is therefore operating in a challenging economic environment, with funding reductions and increasing expenditure pressures. In response, the Council set a five year financial strategy from 2013-14. This strategy was developed so that the Council could assess the level of resources available ensuring that 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. 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.

The position at the Council is one of positive engagement. The Council has integrated its welfare reform project into the local community planning process, with the project forming part of its 'future model of public service delivery' theme. This theme is managed by a joint delivery team comprising senior executives from partner organisations and the Council's chief executive. The Council's revenues and benefits manager has been seconded to manage the welfare reform project. The long-established strategic partnership against poverty group, which comprises a range of external stakeholders, carries out the functions of the project board and meets quarterly to monitor progress.

The Council has no housing stock, but is proactively collaborating with local registered social landlords, Citizen's Advice Bureau and the Department of Work and Pensions to help mitigate the adverse impacts of the welfare reform agenda. Rent arrears are being monitored by the registered social landlords and the additional discretionary housing benefit funding that the Council received during 2013-14 has been used to minimise these arrears; a recent appointment of an additional officer in this area is part of the Council's efforts to maximise discretionary housing benefit take up.

Wider external communications on welfare reform and its likely impact for local residents has been through conferences and awareness sessions for local groups, partners and stakeholders, along with targeted campaigns for those directly affected.

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. These set out the policing and fire and rescue service priorities and objectives for the Scottish Borders. Plans covering the three year period 2014-15 to 2016-17 have been produced by local senior officers from Police Scotland and the Scottish Fire and Rescue Service, respectively, and were approved by the Council in March 2014.

The plans provide the basis for strategies to be followed by the Police and Fire and Rescue services over the next three years. They will also provide the basis for scrutiny on performance by the Scottish Borders Police, Fire and Rescue and Safer Communities Board.

Integrated health and social care

The Public Bodies (Joint Working) (Scotland) Act was passed by the Scottish Parliament on 25 February 2014, with a proposed date for implementation of 1 April 2015. This requires all councils and NHS Boards to formally and legally establish integration of health and social care by April 2016. Detailed legislation and broader statutory guidance is being devised.

Locally, it was thought to be appropriate, with the main legislation agreed by the Scottish Parliament, to progress matters beyond the scope of the previous Pathfinder Board and move to a Shadow Board to operate in 2014-15, ready for the start of the Joint Integration Board from 1 April 2015.

Therefore, the Council disbanded the Pathfinder Board and replaced it with a Shadow Integration Board until 1 April 2015, with the same responsibilities for services as the final Joint Integration Board would have when legislation had been fully enacted.

Employee claims

The Council brought forward a provision of £300,000 in 2013-14 against potential future payments in relation to specific equal pay settlements that it may be required to make. During 2013-14, £11,000 was released reducing the balance to £289,000.

Following a European Court of Justice ruling in May 2014, employers may be required to pay holiday pay to staff at a rate commensurate with any commission or over time that they regularly earn, instead of at their basic pay level. Legal advice is pending and management are reviewing any potential retrospective liability, therefore it was considered appropriate that a contingent liability be recognised in the 2013-14 financial statements.

Financial position

The outturn for the year against revised departmental budgets was an underspend of £451,000 against final budgeted expenditure of £255 million. The social work budget was increased over the prior year, however continued pressures resulted in a small overspend against the final budget for 2013-14.

For 2013-14 the Council reported an accounting deficit on the provision of services of £6.5 million compared to a £76 million deficit in the previous year, the latter a result of various accounting adjustments.

Performance against budget

In February 2013 the Council approved the 2013-14 annual revenue budget of £248.6 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 final, budgeted expenditure of £255 million. The audited outturn position was an underspend of £451,000 against the final revised budget. Achievement of this position required management to proactively address in-year pressures from within budgeted resources, as well as maintain a strong system of control.

The table shows the variance against the final revised budget for each of the departments at the year end.

The variance for the chief executive department can mainly be attributed to staff costs savings as a result of an interim management structure being in place pending the implementation of the new corporate management arrangements from 1 April 2014, in addition to reduced utility costs from the mild winter and additional income from industrial premises and recharges to the capital programme.

Education and lifelong learning delivering a balanced position as the variance shown relates to a reserve transfer of an earmarked balance for schools in 2013-14.

The outturn for environment and infrastructure was positively affected by reduced costs of winter maintenance as result of weather conditions during the year.

The social work budget was increased by £3.3 million over the prior year. Many areas of social work provision are non-discretionary and demand led so the Council has limited autonomy on the provision of services. The minor performance variance against the final budget in 2013-14 is due to a continued increase in demand for children's placements. Management has also adjusted assumptions for the 2013-14 budget reflecting ongoing pressures.

	Revised budget 2013-14 £000	Actual 2013-14 £000	Variance £000
Chief executive's department	26,131	25,851	280
Education & lifelong learning	94,336	94,040	296
Social work	74,950	75,022	(72)
Environment & infrastructure	29,819	29,704	115
Other	30,035	29,941	94
Expenditure	**255,271**	**254,559**	**712**
Council tax income	(51,069)	(51,070)	(1)
Other grants and reserve transfers	(204,202)	(203,940)	(262)
Surplus in the year	**-**	**(451)**	**451**

Source: Revenue outturn 2013-14

Financial position (continued)

The financial statements reflect an accounting deficit on the provision of services of £6.4 million compared to a deficit of £76 million in 2012-13. The outturn shows significant variances as a result of charges in the prior year in relation to the accounting for revaluation of education property and a loss on disposal of Borders Railway.

At 31 March 2014 the Council has net liabilities of £26.6 million arising mainly from post-employment employee benefits which fall due over the longer term.

Comprehensive Income and Expenditure Statement ("CIES")

In 2013-14 the Council reported an accounting deficit on the provision of services of £6.4 million, however this is a significant reduction on the £76 million deficit in the previous year which was driven mainly by specific accounting losses on asset revaluations and transfers.

The following table is a summarised version of the CIES with discussion of the causes of significant variances between years.

Expenditure on education has decreased by £24 million from 2012-13. The majority of this decreased expenditure relates to significant prior year impairment charges due to the downward valuation on education properties as part of the rolling five yearly valuation cycle. When the effect of fixed asset impairments is excluded, there is no material variation in this category.

The reduction in expenditure in relation to the Police and Fire boards is due to the abolition of these bodies following the creation of the Scottish Police Authority and the Scottish Fire and Rescue Service. The effect of this is that the expenditure is no longer part of the Council's financial statements. The amount of funding available from Scottish Government in 2013-14 has been adjusted to reflect this and hence the funding available to the Council has been reduced.

The variance on (gain)/loss on disposal of fixed assets relates to the prior year disposal of the Borders Railway asset following the transfer of responsibility to Transport Scotland and Network Rail. This was a one-off item with no equivalent in 2013-14. This loss on disposal was the crystallisation of an accounting loss on expenditure that was funded by external grants that were written down in previous years in line with applicable accounting treatment.

	2013 -14 Net Expenditure £000	2012-13 Net Expenditure £000	Variance £000
Education	107,523	131,524	(24,001)
Social work	76,505	74,539	1,966
Other services	68,275	70,667	(2,392)
Police and fire board expenditure	-	15,733	(15,733)
Net cost of services	**252,303**	**292,463**	**(40,160)**
(Gain)/loss on disposal of assets	(785)	44,361	(45,146)
Financing & investment income and expenditure and other	11,459	12,063	(604)
Net interest expense	8,389	8,149	240
Taxation and non-specific grant income	(264,930)	(280,781)	15,851
Deficit on provision of services	**6,436**	**76,255**	**(69,819)**

Source: Financial statements

Balance sheet

As at 31 March 2014, the Council was in a net liabilities position of £26.6 million (2013: net liabilities of £30.9 million), which includes £198.4 million of post-employment employee benefit liabilities relating to benefits payable over the longer term. The £4.3 million decrease in net liabilities is due to:

- £10.8 million increase in long term assets mainly due to additions (£28.8 million) and revaluations (£10.8 million), offset by impairments (£8.6 million) and depreciation (£19.9 million); and
- £4 million decrease in long term liabilities due mainly to the reduction in deferred liabilities.

Financial position (continued)

At 31 March 2014 the Council has net liabilities of £26.6 million (2013: net liabilities of £30.7 million) arising mainly from post-employment employee benefits which fall due over the longer term.

These movements are offset by:

- £7.1 million increase in the post-employment employee benefit liabilities due to changing actuarial assumptions; and
- £3.2 million decrease in current assets as a result of the disposal of the short term investments.

The Council did not enter into any new long term loans during 2013-14. Temporary, short term borrowing decreased in 2013-14 due to a £6.1 million loan repayment to Edinburgh City Council in June 2013.

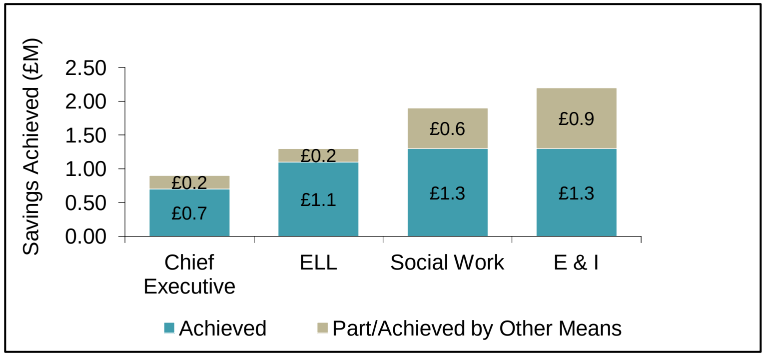
The Council's overall usable reserves, including the capital fund, were £25.7 million at 31 March 2014 (2013: £23.3 million), within the levels set by the five year financial strategy. These usable reserve levels were considered against the risk captured through the corporate risk register which is regularly reviewed; the Council therefore considers this existing level of reserves as acceptable.

Based on the Audit Scotland survey of 32 local authorities' draft financial statements for 2013-14, the Council is placed in the lower third in terms of total useable 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 budgetary pressures, although this comparison is not adjusted to reflect differences between councils operating a housing revenue account (with the ability to recycle any surpluses) and those which do not (the case at the Council) and the consequent comparative risk profile. The reserves position is justified by the Council on the basis of the robust risk review processes and an indication that management considers it to be a relatively low risk Council in terms of service objectives.

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 £6.3 million in 2013-14. Of this amount, 70% was fully achieved by departments in line with the original plan on a permanent basis, with 30% delivered via alternative corporate savings and additional income. The comparative achievement on a permanent basis in 2012-13 was 49.5%, demonstrating an improvement in the Council's processes. Achievement of efficiency savings by directorate, and the means by which they were achieved, is shown in the table. As reported last year, the table demonstrates that much of the efficiency savings for social work and environment & infrastructure were achieved by means other than originally intended. This is now reported to elected members as part of the revenue monitoring process, as previously recommended.



Source: Financial statements

Financial position (continued)

Efficiency savings of £6.3 million were achieved in the year.

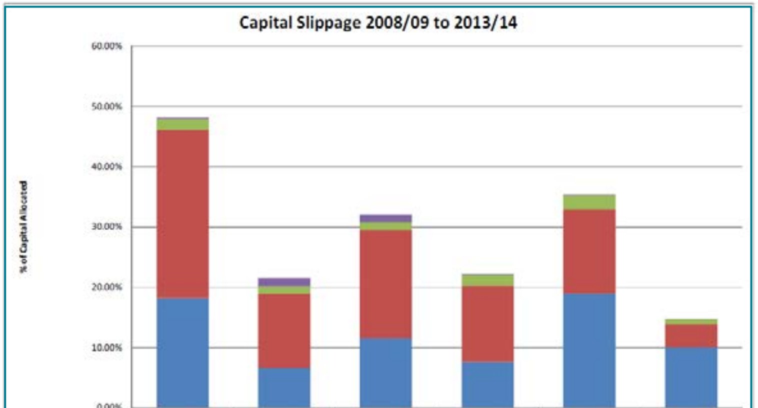
At £27.6 million, capital expenditure in the year was £2.3 million below budget and reflects £2.2 million of project re-profiling.

Major capital projects in 2013-14 included £4.3 million on Peebles High School sports facilities and £2.7 million on Galashiels flood protection.

Capital programme

Total capital expenditure in 2013-14 was £27.6 million, compared to a budget of £29.9 million and expenditure of £23.3 million in 2012-13. The cumulative level of re-profiling in 2013-14 was significantly less in comparison to the previous year indicating a higher level of management control.

A £2.3 million under spend against budget can be further broken down into (i) project re-profiling of £2.2 million and (ii) project under spend of £100,000. The re-profiling related to a number of capital projects, with the largest approximately £300,000. Although capital budget re-profiling in 2013-14 is at the lowest level when compared to the five preceding years, management should continue to explore reasons for re-profiling in capital projects and any implications for capital budgeting to continue to reduce the amount of re-profiling.



	2008/09	2009/10	2010/11	2011/12	2012/13	2013/14
Other	0.11%	1.33%	1.22%	0.21%	0.05%	0.05%
Business Infrastructure	1.87%	1.27%	1.36%	1.78%	2.38%	0.87%
Property	27.94%	12.35%	17.92%	12.60%	14.03%	3.75%
Engineering	18.25%	6.58%	11.60%	7.67%	18.96%	10.14%

Source: Executive Committee report, 10 June 2014

£1.2 million of borrowing was used to finance the recognition of the landfill liabilities. In addition to the capital expenditure on the Council's assets, £1.7m of capital expenditure was incurred for the National Housing Trust initiative which delivered new house building in the Scottish Borders in partnership with a local developer and the Scottish Futures Trust.

Capital programme – funding source	%
Capital fund / capital receipts	8.8
Developer contributions	1.6
General Scottish Government capital grant	36.8
Specific Scottish Government capital grant	5.5
Other grants and contributions	7.1
Capital financed from current revenue	1.3
Plant and vehicle replacement fund	1.4
Borrowing	37.2
Returned Police & Fire reserves	0.3
Total	**100**

Source: Financial statements

Financial strategy

The revenue budget for 2014-15 is £252 million and anticipates a breakeven position which does not require funding from the Council's reserves.

The Council's five year financial strategy assumes that council tax will remain frozen throughout this period and that service cost pressures will be met from service transformation projects and efficiency savings.

Revenue budget

To better understand and respond to the sources of pressure and funding uncertainties over a longer period, the Council moved from a three year budget to a five year financial strategy, the first of which was approved in February 2013. The Council acknowledges this changing environment and will continue to review and adapt its financial strategy in response to this.

The key assumptions underlying the five year financial strategy are:

- council tax continues to remain frozen;
- capital programme financed by £21 million of loan charges per year; and
- continue risk-based approach to determining minimum reserve levels, quantified as £5.6 million.

The Council's budget for 2014-15 was agreed in February 2014. Approval followed a public consultation, including use of a new online budget simulator tool. This gave people the opportunity to lay out their spending priorities and see how choices would affect the Council's services. Data from the consultation was analysed and used to help shape budget plans.

The revenue budget for 2014-15 is £252 million. It includes additional funding for social work services, including elderly care and free personal care, and early years services. Increased spending in these areas is offset by savings through revised staff terms and conditions and reductions in back office costs.

The table shows the budgeted amounts for 2014-15 and the corresponding amounts from 2013-14.

Revenue budget

	2013-14 £000	2014-15 £000	Variance £000
Chief executive's department and Resources	25,518	27,150	1,632
Education & lifelong learning	93,487	95,014	1,527
Social work	73,622	75,102	1,480
Environment & infrastructure	29,797	30,010	213
Loan charges and other	26,223	24,932	(1,291)
Expenditure	**248,647**	**252,208**	**3,561**
Council Tax income	(50,926)	(51,126)	200
Other grants and reserve transfers	(197,721)	(198,906)	1,185
Deficit in the year	**-**	**2,176**	**2,176**

Source: Financial Plan 2014/15 – 2018/19

The Council has recognised that its current service model needs to change in order to achieve significant savings, meet demand and ensure that the quality of services is maintained. However, there is an funding gap between income and expenditure of £28.7 million over the next five years. This gap is the sum the Council needs to identify in order to fund future budget plans, including some areas of significant growth.

A service transformation programme has been introduced to help deliver the Council's priorities, meet financial challenges and maximise efficiency. Importantly, the Council is also developing a track record of being able to secure savings.

Financial strategy (continued)

The Council has set a 10 year capital plan. In 2014-15 the Council plans to spend £28.6 million on a range of capital projects.

One of the important projects associated with the transformation programme is changes to employment terms and conditions, important because, as with most councils, employee costs account for the majority of the Council's expenditure. In December 2013 the Council was able to announce that agreement had been reached with the recognised trades unions for revision to terms and conditions with effect from 1 April 2014. This will apply to all staff, other than teaching staff who are subject to separate nationally negotiated terms, and is predicted to save £2.8 million.

Capital plan

The Council has formulated a ten year capital plan to 2022-23 with £271 million planned for investment. 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 Council.

There are a number of projects within the capital plan for 2014-15 where funding has yet to be confirmed. If funding is not received, then the scope of the project would have to be altered of 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 2014-15 is £28.6 million and is to be funded from the sources shown in the table.

Capital plan funding source	£000
Capital fund/capital receipts	2,427
Developer contributions	100
General Scottish Government capital grant	13,433
Specific Scottish Government capital grant	443
Other grants and contributions	4,992
Borrowing	7,181
	28,576

Source: Capital Finance Plan Resources 2013-14- 2022-23

The most significant (by value) capital projects in the three-year operational plan are shown in the table below, although in some cases the sums shown are only part of larger, long term projects such as the Selkirk flood protection scheme (£30 million) and Kelso High School (£21 million).

Project	£000
Transport interchange	4,591
Roads	2,780
Selkirk flood protection	8,642
Kelso High School	3,867
Duns Primary School and locality support centre	3,025
Broadband delivery UK (BDUK)	4,200

Source: Capital Finance Plan Resources 2013-14- 2022-23

Financial statements and accounting

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

Audit conclusions and materiality

We have issued an unqualified audit opinion on the financial statements. Our work was based on a revised approach to materiality related to the Council's expenditure for the year.

Audit conclusions

Our audit work is completed and we have issued an unqualified opinion on the truth and fairness of the state of the Council's affairs as at 31 March 2014, and of the Council's deficit 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 key risks and audit focus areas;
- 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 continued to work with management to identify areas where the content of the financial statements could be enhanced to make the information more understandable and/or relevant to the reader whilst still satisfying the relevant disclosure requirements. Management have been pro active in this task.

Materiality

Planning materiality was provided in the audit strategy and plan 2013-14 dated 4 November 2013 and discussed with the Council's audit committee later that month. We revised materiality prior to the commencement of the final audit, following consideration of updated internal sector guidance and receipt of the draft financial statements.

Planning materiality re-set at £6.4 million (previously £10 million) which is approximately 2% of total expenditure in 2013-14 and we revised our approach to reflect this materiality level. We designed our procedures to detect errors at a lower level of precision of £4.8 million. We report identified errors greater than £320,000 to the audit committee.

Significant risks and audit focus areas

The main audit focus areas are discussed on the following pages.

These were identified in the audit strategy and plan and are significant risks in respect of:

- **management override of controls; and**
- **revenue recognition fraud risk.**

and other focus areas of:

- **accounting for asset decommissioning obligations in relation to landfill sites;**
- **accounting for employee benefits; and**
- **the valuation of property, plant and equipment.**

Significant risks that Auditing Standards require us to raise in all cases

International Standards on Auditing require us to consider two specific risks for all organisations in terms of fraud risk through management override of controls and revenue recognition.

Our audit approach to address these was set out in our audit plan and strategy. We did not consider fraudulent revenue recognition to be a significant risk for the Council as there are limited incentives and opportunities to manipulate the way income is recognised given the nature of the Council's income sources. We therefore rebutted this risk and did not incorporate specific work into our audit plan in this area over and above our standard fraud procedures. Although we did not consider the presumed risk of fraud from revenue recognition to be applicable, we remained alert to indications of fraud during the course of the audit.

As part of our work to address the significant risk of management override of controls we performed the following tests:

- testing of journals at the year end and during the year;
- review of unusual transactions in the year;
- enquiries with employees outside the finance department; and
- controls testing, including higher level controls.

We do not have any findings to bring to your attention in relation to these matters. No control overrides were identified.

Other areas of audit focus

Accounting for asset decommissioning obligations

During the year, the Local Authority (Scotland) Accounts Advisory Committee issued interim guidance on how local authorities should be accounting for asset decommissioning obligations in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Under this standard, the future costs (including decommissioning, restoration and ongoing monitoring) should be recognised when the asset is brought into use and an associated provision created on the balance sheet which future costs would be charged against.

We found that management had considered the LASAAC guidance and applied its principles. Our year end audit procedures included gaining an understanding of on any actions the Council had taken and evaluating the Council's treatment against the guidance. Management has considered the future capital costs associated with the decommissioning of open cells at its Easter Langlee landfill site, and a provision has been recognised on the balance sheet at 31 March 2014 for relevant capital costs. As these costs were estimated at £1.2 million, on the grounds of materiality, management did not restate prior period financial statements. We agree with this treatment. The Council is still in the course of determining its future strategy in relation to landfill and has not recognised obligations for ongoing aftercare and monitoring costs that may be incurred after decommissioning. Management has disclosed a contingent liability in the financial statements in relation to these costs. Following discussions, we consider this to be in line with the guidance as there are a number of uncertainties relating to the estimation of these costs, not least in the absence of a strategy which determines that these will fall to the Council.

Significant risks and audit focus areas (continued)

Other areas of audit focus (continued)
Employee benefits
The Council accounts for post employment benefits arising from its participation in the Scottish Borders Pension Fund in accordance with IAS 19 *Employee benefits*, using a valuation report prepared by actuarial consultants covering the Council's share of the assets in the fund and measurement of liabilities. Our audit of the accounting for employee benefits includes evaluation of the actuarial consultants as a third party expert, consideration of the data underlying the actuarial report, including the level of contributions made during the year, the financial assumptions and membership data provided to the actuary by the Council and the Council's share of the pension fund assets. We found that the actuarial consultant as a third party expert was objective and had the appropriate experience and expertise to provide the information for use by the Council. 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. 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. Using our own actuarial specialists, we 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. The Council adopted IAS 19 (Revised) in 2013-14. Under IAS 19, interest cost on the defined benefit obligation and an expected return on plan assets were recognised in the statement of comprehensive net expenditure within interest payable. Under IAS 19 (Revised), these two amounts have been replaced by a single measure called 'net interest' calculated on the net defined benefit liability. We found that the Council has appropriately applied IAS 19 (Revised) in its financial statements by restating the prior year comparative information given in 2013-14 financial statements. There was no impact on the previously reported net asset position.

Significant risks and audit focus areas (continued)

Other areas of audit focus (continued)

Valuation of property, plant and equipment

Under the Code of Practice on Local Authority Accounting, 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 is considered for any indications of impairment and where these are identified, formal valuations are performed and reflected in the financial statements. Valuations are undertaken by the Council's estates manager. In addition, following our 2012-13 audit, management agreed to undertake formal revaluations for major PPE assets (including PFI assets) when they are brought into use, even when this is outwith the existing revaluation cycle.

We found that the Council's estates manager was appropriately professionally qualified and had sufficient experience and expertise to provide the information for use by the Council.

We also found that, in accordance with the Council's valuation cycle approach, industrial units and other planning and economic development properties had been subject to revaluation. Surplus assets and the new West Linton primary school had also been subject to revaluation in 2013-14. The latter was revalued in accordance with the Council's revised approach to valuations, thus implementing the prior year audit recommendation. Using our own valuation specialists, we considered the methodology applied by the Council's estates manager and concluded that it had been applied satisfactorily in accordance with guidance issued by the Royal Institution of Chartered Surveyors. We did note however that the valuer comments that limited inspection of assets has taken place and that, consistent with the approach applied in previous years, the valuation is largely undertaken on a "desktop" basis. The valuations are therefore subject to more limited due diligence in comparison to a full valuation with inspection. There is potential for carrying out more detailed valuations, however, it was considered reasonable that the Council's estates manager has sufficiently detailed knowledge of the properties to carry out valuations this way. Therefore, we are satisfied with the methodology used.

A total downward revaluation of £8.3 million has been reflected by the Council in its financial statements. Of this, £3.7 million has been charged to the Comprehensive Income and Expenditure Statement ("CIES") and £4.6 million against the revaluation reserve. We have concluded that this has been accounted for correctly. The various elements of the revaluation are summarised in the table.

Analysis of downwards revaluations

	CIES £m	Revaluation reserve £m	Total £m
Planning and economic development	1.3	4.0	5.3
Surplus assets	1.2	0.4	1.6
West Linton Primary School	0.6	0.2	0.8
Other non significant movements	0.6	0.0	0.6
Total	**3.7**	**4.6**	**8.3**

Source: audit working papers

Accounting framework

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 2013-14*** and therefore there have been no significant changes to accounting policies in 2013-14. 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 financial statements have been prepared by management on a going concern basis.

Accounting framework and application of accounting policies	
Code of practice on Local Authority Accounting in the United Kingdom 2013-14 ("the Code")	The 2013-14 financial statements have been prepared in accordance with the Code which is based upon International Financial Reporting Standards ("IFRS"). The 2013-14 Code has a number of amendments from the 2012-13 version. Management have reflected these changes to the reporting requirements in the financial statements, where appropriate. The amendments include: ■ accounting for allowances in respect of the Carbon Reduction Commitment Energy Efficiency Scheme; ■ amendments to the Comprehensive Income and Expenditure Statement as a result of changes to IFRS; ■ clarification of the treatment of overdrafts or the balance sheet and cash flow statement; ■ augmentation to pensions on service concession arrangements; ■ amendments to the accounting for retirement benefits; and following amendments to IAS19 *Employee benefits*; and ■ a number of clarifications and augmentations as a result of the CIPFA/LASAAC post implementation review.
Impact of revised accounting standards	■ Disclosure has been included in the financial statements on revisions to IAS 19 *Employee benefits.* The restatement to 2012-13 figures resulted in an estimated change to the amount charged to the Comprehensive Income and Expenditure Statement of around £5 million. ■ No other newly effective accounting standards are considered to have a material impact on the Council's financial statements and the Council has included a disclosure to this effect.
Group financial statements	■ We developed our audit plan for 2013-14 on the basis that the Council would also be preparing group financial statements. During the course of the year, management re-evaluated its remaining interests in charitable trust and common good funds and arm's length external organisations providing leisure services (following the abolition of police and fire joint boards) and determined that group financial statements were not required. ■ We found that the Council had considered guidance relevant to the compilation of group financial statements, concluding that these were not required for 2013-14 due to the Council not having sufficient control over charitable trust and common good funds and the leisure trusts. Considerations also indicated that group financial statements were not required under the qualitative aspects of materiality.
Going concern	■ Management consider it appropriate to adopt a going concern basis for the preparation of these financial statements. The balance sheet shows that at 31 March 2014 the Council has net liabilities of £26.6 million i.e. liabilities exceed assets, however, this includes a pension fund liability of £198.4 million which will only crystallise 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.

Financial statements preparation

Council management has continued to develop arrangements for compilation of draft financial statements and associated reports.

New regulations will apply to reporting arrangements for 2014-15.

Financial statements preparation

- High quality working papers and full draft financial statements were provided by the statutory deadline of 30 June 2014. This included the explanatory foreword, remuneration report and governance statement. The latter had already been considered, along with supporting evidence, 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.
- Management has demonstrated progress in acting on our previous recommendation in relation to the compilation of bank reconciliations and to satisfactorily resolve the underlying systems issue. Further work around this area will be undertaken as part of our interim audit work next year in order to ensure that revised arrangements are fully embedded.
- No objections were received to the unaudited financial statements during the prescribed statutory public inspection period.
- Audit differences are reported in appendix two. There were two adjusted differences and no unadjusted audit differences to the primary financial statements.
- The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014, replacing regulations which have applied since 1985. The regulations contain provisions for the unaudited annual financial statements as submitted to the auditor to be considered by the audit committee no later than 31 August, and the audited financial statements to be presented to the audit committee for consideration and approval prior to auditor signature before 30 September. Management should review the new regulations and assess any impact and make any necessary changes to the financial statements preparation and reporting processes.

Charitable trusts and common good funds

Revised financial reporting and audit arrangements were applicable to the Council's charitable trusts and common good funds for 2013-14.

The application of the legislation and related regulations requires that a separate trustees' report and financial statements is required for the charitable trusts and common good funds in accordance with *Accounting and Reporting by Charities*: Statement of Recommended Practice.

We have satisfactorily concluded our audit work on these financial statements.

Financial statements preparation

- In line with good governance and following implementation of the Council's common good and trust fund investment strategy, and in anticipation of the revised auditing arrangements described below, during 2013-14 the Council progressed re-organisation of the 289 trusts and endowments where it acts as trustee. 112 of these trusts and endowments were registered separately with the Office of the Scottish Charity Regulator. On 27 March 2013 the Council registered Scottish Borders Council Charitable Trusts as a new charitable trust and transferred the activities of 76 of the existing registered trusts to this entity which are accounted for as restricted funds consistent with their original purpose. The remaining 36 registered trusts are subject to re-organisation into three new charitable trusts which the Council is establishing covering the relief of poverty, education and community enhancement.
- The preparation and audit of financial statements prepared by registered charities is regulated by the Charities and Trustee Investment (Scotland) Act 2005 and The Charities Accounts (Scotland) Regulations 2006. The 2006 regulations require charities to prepare a statement of account, and require an accompanying auditor's report where any legislation requires an audit. Section 106 of the Local Government (Scotland) Act 1973 applies the accounting and audit requirements of the Act to any trust fund where an authority, or some members of the authority, are the sole trustees. As section 106 requires an audit, the appointments of local authority auditors have been extended from 2013-14 to include the provision of an auditor's report for charitable funds covered by that section.
- Draft trustees' reports and financial statements covering Scottish Borders Council Charitable Trusts and Scottish Borders Council Common Good Funds for 2013-14 were received for audit slightly beyond the statutory date of 30 June 2014. The subsequent audit process identified a number of presentational and disclosure amendments required to achieve full compliance with the framework set out in *Accounting and Reporting by Charities*: Statement of Recommended Practice. To date, the accounting records provided for trusts and endowments have been mainly Excel spreadsheet based and consideration should be given to formalising and streamlining underlying systems and documenting relevant Council policies and procedures to be followed.
- We have concluded our work in relation to Scottish Borders Council Charitable Trusts and Scottish Borders Council Common Good Funds and issued unqualified opinions. There were no matters to be brought to your attention by exception.
- Our work in respect of 2013-14 identified that the Council was not in compliance with the independent examination and OSCR return requirements for 2012-13.

Governance and narrative reporting

Update on your governance arrangements

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

Corporate governance arrangements

Corporate governance arrangements continue to provide a sound framework for organisational decision-making.

A re-structuring of the corporate management team was undertaken during the year, with two, new deputy chief executives taking up their posts from April 2014.

The Council's systems of internal control continue to underpin financial and operational reporting.

Corporate governance arrangements	Following the local government elections in May 2012, the Council approved a new scheme of delegation on 30 August 2012. The Council continues to operate a cabinet structure, with some changes to committees which 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 structure, including the audit committee. These provide scrutiny and challenge to strategic decisions and performance. The scheme of administration maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour. During 2013-14 an assessment commenced as to how the revised arrangements are working, but, at the time of this report, has not been concluded and will therefore form part of our audit work in 2014-15. As part of the transformation programme aimed at enhancing the effectiveness of services, during 2013-14 a restructuring of the Council's corporate management team was undertaken. This included the appointment of two, new deputy chief executive posts – covering people and place – from April 2014 and the introduction of a corporate transformation and services director who will concentrate on leading a range of corporate functions and programmes. Again, the impact of these changes, and other changes in the corporate structure will be assessed during the 2014-15 audit. The Council's risk management strategy and supporting documentation, including service and corporate risk registers, demonstrate 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.
Annual governance statement	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. This was considered by the audit committee in April 2014 which we consider good practice. We reviewed the governance statement against disclosure requirements and considered its contents against our knowledge and understanding of Council.
Systems of internal control	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. Our reporting throughout the year identified a number of areas of the financial control framework that could be enhanced, including in respect of bank reconciliations, and it is noted that progress has been made in these areas. Our financial statements audit work has not identified any further issues in relation to systems of internal control and therefore overall we consider that these are effective.

Corporate governance arrangements (continued)

The work of the Council's in-house audit team continues to be risk-based, using risk registers and consultation to determine areas of audit coverage.

Internal audit concluded that the control environment and governance arrangements were adequate for all audit areas.

Internal audit	The Council's corporate governance arrangements are also supported by the work of internal audit. The internal audit plan is developed using a risk based approach which includes the use of the risk registers within Covalent as the basis of the audit coverage and consultation with appropriate stakeholders on the audit coverage. This ensures the internal audit plan reflects the key risks facing the organisation. The chief officer – audit & risk has managerial responsibility for the functions which develop, support and advise on the frameworks in place at the Council on risk management (including insurance and business continuity planning), wellbeing & safety, and counter fraud. An opinion on the Council's risk management arrangements is provided annually in the internal audit annual report. 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 the work of internal audit in the following areas: ■ non-domestic rates and council tax revenue; ■ performance management; ■ ALEOs (sports trusts); and ■ testing of SPIs (more information on page 28). Internal audit concluded that in 2013-14, the control environment and governance arrangements were adequate for all audit areas. Internal audit's annual report confirms that there were only two "priority one (high risk, material observations requiring immediate action)" recommendations made during the year, both of which have been accepted with an action plan. The first covered the need for management to consider the need for the establishment of an IT governance group to formally assess and prioritise business need within the Council, and to consider the implications of how resources are allocated. The second was for management to assess and identify staff who require training regarding the income policy framework in order that they may take any appropriate action concerning raising invoices, income collection and debt recovery. Internal audit findings in 2013-14 are consistent with earlier years in terms of the Council's control environment. This may allow scope for future revisions in approach.
Remuneration report	We considered the contents of the remuneration report and reviewed these against the requirements of the regulations. We confirmed that this report reflects both interim and new corporate management arrangements appropriately. Lastly, we satisfactorily tested a sample of exit packages and other disclosures in the remuneration report to supporting documentation.
Prevention and detection of fraud	A key mechanism in the allocation of authority, accountability and responsibility and the prevention and detection of fraud is the existence and maintenance of strategic and financial documentation. The Council has appropriate policies and codes of conduct for staff and councillors including a whistle blowing policy. Management and internal audit have confirmed that no significant fraud or irregularities have been identified during the year.

Corporate governance arrangements (continued)

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

Maintaining standards of conduct and the prevention and detection of corruption	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. This reinforcement of values will contribute to the effective prevention and detection of corruption at the Council. The Council is also supported in this regard by a standards committee which assists in monitoring and scrutinising councillor and senior officer conduct. Councillors are required to follow the Commissioner for Ethical Standards' code of conduct. In July 2014, the Commissioner for Ethical Standards reported to the Standards Commission for Scotland he had concluded that a councillor had contravened the councillors' code of conduct relating to declaration of interests.
National fraud initiative	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. The Council is responsible for investigating data matches from the latest round and we are required by Audit Scotland to review the Council's progress and engagement with the NFI process. We prepared a short return to Audit Scotland in January 2014 and at the current time are satisfied with the arrangements the Council has made in establishing processes and investigating the data matches.
Shared risk assessment	The Council's assurance and improvement plan ("AIP") has been updated as a result of a shared risk assessment exercise that commenced in October 2013. The update process drew information from a number of sources including the 2012-13 annual audit report. The output of the AIP update process is a timetable for proposed audit and inspection activity between April 2014 and March 2017 which reflects the revised and updated scrutiny risk assessment. The updated AIP was presented to the audit committee on 24 June 2014. The AIP identifies 17 areas as "no specific scrutiny required", with one area identified as "scrutiny required" involving targeted work by external audit to contribute to the council's review of governance and accountability". This is part of a wider Council review which has not yet been concluded, therefore audit work has not yet been pursued in this area. There were no areas of "scrutiny required" and eight areas of "further information required" in the prior year. In terms of the AIP, "Scottish Borders Council remains a relatively low risk council in relation to scrutiny requirements. The Council continues to work towards putting effective arrangements in pace to ensure its long term financial sustainability and its capacity to drive effective change. To this end it has agreed a long term financial strategy and undergone a significant management restructure."

Since 2007, the Council has embarked on a significant programme of works to provide increased levels of flood protection at a number of locations. The development of the Selkirk flood protection scheme (Selkirk FPS) was initiated in acknowledgement of the high risk of flooding to various parts of the town.

As cost increases on the project will be borne fully by the Council, the project board requested an independent, high-level review of the project's financial management strategy. Overall, we gained assurance that, at a high-level, the development of the financial aspects of the Selkirk FPS business case had been undertaken within a controlled environment.

Selkirk flood protection scheme	■ The Selkirk FPS commenced its design in October 2009 and became operative under the Flood Risk Management (Scotland) Act 2009 in August 2012. It was awarded its Deemed Planning Permission by the Scottish Ministers in October 2012. The Scottish Government provides funding to assist local authorities with the delivery of local flood protection schemes. In December 2013 an 'Invitation to tender' for funding was issued, for which the Council had been planning its response, which was due by 21 January 2014. Based on the eligibility criteria for this next round of Scottish Government Flood Protection Scheme funding, Scottish Government funding would be available for up to 80% of the Scheme's expected costs (£28.8 million), with the balance to be met by the Council. In addition, all cost increases after the final grant award will also be borne by the Council. ■ The project team for the Selkirk FPS has developed a financial management strategy ("FMS") as part of the project. The project board for the Selkirk FPS recognised as a risk the fact that any cost increases on the project will be borne fully by the Council. As a result, the project board requested an independent, high-level review of the FMS for the Selkirk FPS. ■ We found that PRINCE 2 project management methodology had been adopted for the Selkirk FPS; the project was then at stage six of the eight identified stages. Based on our high-level consideration of the project management arrangements, including discussions with the project manager and consideration of key stage documentation, we concluded that those arrangements appeared appropriate for the project. The adoption of a formal project management methodology met the requirements of HM Treasury's Green Book for such complex projects. Overall, we gained assurance that, at a high-level, the project has been undertaken within a controlled environment. ■ The Selkirk FPS has been undertaken in accordance with the Flood Risk Management (Scotland) Act 2009, supplemented by Scottish Government regulations and guidance. In the absence of this in the early stages of the project, adapted English guidance was followed, in accordance with Scottish Government instructions. Updated guidance published by the Scottish Government in 2012 was incorporated into the later stages of the project, principally the detail design stage following the timing of the approval of the Selkirk FPS in August 2012. To the extent necessary for the completion of our work, we were satisfied that there was evidence to support the project team's reference to, and guidance by, the appropriate and relevant documentation. ■ There is detailed reporting on the approach to meeting the requirement to build optimism bias into the project in accordance with the requirements of HM Treasury's Green Book and supplementary guidance. Where appropriate, a distinction has been made between 'standard' and 'non standard' civil engineering to reflect factors assessed as complex, difficult or innovative. Overall, we were satisfied that the project team had demonstrated meeting the requirements of HM Treasury's Green Book in the inclusion, and estimation of, the optimism bias factors in the calculation of the basic construction costs. This has subsequently been updated to reflect Scottish Government guidance. ■ We reviewed the risk register which was maintained by the project manager during the course of the project. We reviewed the minutes of risk workshops held, as well as the minutes of the project board meetings at which risks were considered. In our view, this met the suggested content requirements for a project risk register set out in the Green Book.

Performance management

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

Performance management

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

Follow up work in relation to the Scottish Borders Community Planning Partnership audit in 2012 demonstrated clear progress in taking forward the improvement agenda, with partners demonstrating more of a leadership role in the CPP.

Only one area was scored as 'no' in an assessment of the Council's public performance reporting to demonstrate Best Value in a range of areas.

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". In 2012-13, the Council developed a five year corporate plan to 2017-18, which set out its vision and values, and eight Council priorities. Under each of these priorities, there is a set of performance indicators, which management reports on quarterly, allowing elected members and officers to assess how well work is progressing towards addressing the priorities. The performance management framework 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 to be carried out across departments. The performance management framework includes a timetable of how performance will be monitored throughout the year. An annual report will be produced reporting performance against the performance indicators. A new Single Outcome Agreement ('SOA') has been developed by the Council and related partners. The SOA is an agreement between the Scottish Borders Community Planning Partnership and the Scottish Government, setting out how each party will work to improve outcomes and reduce inequalities for Scottish Borders residents. The Scottish Borders Community Planning Partnership has completed a Scottish Borders Strategic Assessment 2014, analysing each national outcome at a local level along with national drivers, local policy framework and indicators demonstrating how the Council and related organisations are contributing to the named outcome. This allows the Council to demonstrate how it is achieving Best Value against the national outcomes. Audit Scotland recently undertook work in relation to Scottish Borders Community Planning Partnership to follow up in progress made since an audit in 2012. Audit Scotland reported itself encouraged to see the progress made by the CPP in relation to its improvement agenda, noting an evident energy and commitment among partners to drive forward the agenda. Partners are now taking more responsibility for the community planning process, with changes in governance structures and agreement of a small number of priorities in the Single Outcome Agreement contributing to this change. Partners were found to be demonstrating more of a leadership role in the CPP, supporting a positive direction of travel. Work is currently being undertaken to align the budgets of partners to the themes of the CPP as an important first step in identifying the resources available to deliver agreed outcomes. This will inform discussions between partners about the extent to which they can share or better target resources to deliver the shared priorities in the Single Outcome Agreement. Work has also commenced to develop a performance management framework, a critical development for the CPP in enabling it to monitor and evaluate progress and demonstrate continuous improvement. Audit Scotland's Director of Performance and Best Value reported to the Accounts Commission on public performance reporting in June 2014, on whether councils reported on a range of information sufficient to demonstrate Best Value in a range of areas. The Council achieved a 'yes' score in 13 areas, a 'partial' score in seven areas and a 'no' score in the area of inclusion of improvement targets. The report identified areas of good practice for the Council in reporting education performance, with additional indicators provided across a range of education areas which are compared across years using graphs and good narrative.

Performance management (continued)

Audit Scotland's risk assessment of housing benefit arrangements noted that claim processing times had significantly improved and that the Council had developed sound performance management arrangements for this service. This includes a collaborative approach to the welfare reform agenda.

We have performed detailed follow-up work in relation to the Audit Scotland national reports: *Major Capital Investment in Councils* and *Arms Length External Organisations: Are you getting it right?* Management had considered the findings in relation to the Council's existing arrangements, albeit there had been an absence of formal reporting at member or committee level.

Housing benefit performance	During a risk assessment phase of the Council's housing benefit arrangements, carried out in May 2014, Audit Scotland looked at the benefits service's self-assessment and supporting evidence, and analysed information from a number of other sources. Work was focused on national and local priorities, business planning and reporting and delivering outcomes. Audit Scotland reported that, due to actions taken by the service, processing of new claims has improved significantly from autumn 2013. The latest management information showed new claims being processed in an average of 20 days or below. In addition, it was found that the service has a wide range of practices and arrangements to help minimise error and overpayments including contracting a consultant to design a bespoke overpayment monitoring report which allows the service to improve the reporting of recovery performance, and a report that selects cases for checking which provides a deterrent against internal fraud. Audit Scotland was also pleased to report that the Council has adopted an effective collaborative approach to the welfare reform agenda by working with partners as part of the community planning partnership to progress the future model of public service delivery. Rarely, the Council has not been requested to complete an action plan.
Local response to national studies and Audit Scotland reports	Audit Scotland published *Health inequalities in Scotland* in December 2012 and as part of the audit for 2013-14 we considered the Council's response to it. We concluded that the report is being used to inform strategic assessment, the Single Outcome Agreement, the Director of Public Health's Annual Report and the development of a Community Planning Partnership *Reducing Inequalities Strategy*. We completed work on the follow up of Audit Scotland's *Major Capital Investment in Councils* and *Arms Length External Organisations: Are you getting it right?* reports. *Major Capital Investment in Councils* had been considered by the corporate management team, but not the full Council or other relevant committee. There is no formal action plan specifically in response to the report, but changes are being made to capital management processes which encompass recommendations from the report. For example, appointment of an interim capital director was made in November 2013, with one of the aims of the appointment being to improve the effectiveness of the Council's capital management. The Council has recognised scope for improvements in its arrangements in this area and is taking actions to address these. *Arms Length External Organisations: Are you getting it right?* is to be formally considered by the audit committee in September 2014. It also forms part of the terms of reference of a review that internal audit undertook in respect of the ALEOs, albeit this report has not yet been considered by the audit committee. Management confirmed that the report will be considered as part of the work on the potential establishment of the two new ALEOs.

Performance management (continued)

Statutory performance indicators and benchmarking	As part of our review of performance management, Audit Scotland requires specific consideration of SPIs. The aim of this work is to assess how authorities are compiling and reporting data and ensuring it is complete and accurate. Local authorities have a statutory duty to ensure appropriate arrangements are in place for collecting, recording and publishing performance information. Auditors have a statutory duty to be satisfied that the council has made adequate arrangements for collecting and recording information, and for publishing it, as are required for the performance of their duties. Consideration has been given to the Council's procedures for collecting and reporting information on SPIs, in line with Audit Scotland requirements. The audit of SPIs is a two stage process. Our results of the stage one assessment will be reported to Audit Scotland and our responses are outlined in a separate report. The results of the second stage, assessing the quality of PPR, will be reported to the Accounts Commission by May 2015. In 2013-14, Statutory Performance Indicators were not specified and were drafted by the Council based on categories provided by Audit Scotland. The specified indicators have been replaced by the Scottish Local Government Benchmarking Framework. The Local Government Benchmarking Framework has been developed to help councils compare their performance using a standard set of indicators. Performance against the Council's performance indicators is reported in an annual performance report, publically available and discussed at committee. The 2013-14 report is being finalised.
Benchmarking	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 Statutory Performance Indicators ('SPI's') from 2013-14 onwards. Results are analysed in 'family groups' to ensure comparison is between authorities with similar characteristics. The Council has made the benchmarking information available online, which includes a quartile report for 2012-13. This sets out which quartile the Council is in for each indicator and the overall trend between 2011-12 and 2012-13. Scottish Borders is in the top quartile for 13 (out of 54) indicators, with 15 indicators showing an improvement in ranking between 2011-12 and 2012-13. This included a first place ranking for the gross cost of 'children looked after' in residential based services, per child, per week.

Appendices

Mandatory communications

There were two audit adjustments relating to property, plant and equipment which were both adjusted for in the financial statements. In our view, these did not 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	There were two audit adjustments relating to property, plant and equipment required to the draft financial statements: ■ accounting for the revaluation of property, plant and equipment; and ■ the recognition of extra depreciation that would have been charged if there was a timely transfer out of assets under construction of certain assets after they became operational. A number of numerical and presentational adjustments were required to some of the financial statements notes.	Appendix 2
Unadjusted audit differences	We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you. There are no unadjusted audit differences.	-
Confirmation of Independence Letter issued by KPMG to the Audit Committee	We have considered and confirmed our independence as auditor and our quality procedures, together with the objectivity of our Audit Director and audit staff.	Appendix 3
Schedule of Fees Fees charged by KPMG for audit and non-audit services	Audit fees were agreed with management in accordance with the range specified by Audit Scotland. There were no non-audit services in 2013-14, but additional audit fees were secured for the requested work in relation to the Selkirk flood protection scheme.	
Management representation letter Letter issued by the Council to KPMG prior to audit sign-off	We requested specific representations from management last year in respect of the disclosure of all interests in landfill sites. This is not required in 2013-14 and there are no further changes to the representations required for our audit from last year.	-

Audit differences

There are two adjusted audited differences to the draft financial statements.

Adjusted and unadjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There are two adjusted audit differences and no unadjusted audit differences.

The first was identified through our audit work over the revaluation of property, plant and equipment and our review of its accounting treatment. It was identified that the upwards valuations had not been stated correctly in the financial statements, although this had no effect on the net book value of the relevant assets and no impact on the rest of the financial statements. The adjustment totalled £1.57 million and this has been reflected.

The second was identified due to staff at the Council identifying the late transfer of two assets out of assets under construction after they were operational. The adjustment totalled £731,000 and is the recognition of the depreciation that would have been charged if there had been a timely transfer. This has also been corrected in the financial statements, which the Council did voluntarily as the amount was below audit materiality. No specific recommendation has been raised in relation to this and management have committed to reaffirm checks as part of the transition of fixed asset accounting into the capital team as part of the corporate finance restructure implementation.

A number of numerical and presentational adjustments were required to some of the financial statements notes, to add extra disclosures or to include additional information to aid the reader of the financial statements. The most significant was the addition of a contingent liability relating to potential employee claims as a result of a European Court of Justice ruling.

Auditor independence and non-audit fees

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 Council 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 16 September 2014, 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 Council and should not be used for any other purpose.

Yours faithfully

KPMG LLP

Action plan

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
1 Landfill site provision		**Grade two**
No provision has been recognised for the ongoing aftercare and monitoring costs that will be incurred after decommissioning.	There are a number of uncertainties relating to the estimation of these costs and it is recommended that management continues to monitor the situation, clarify the strategy and ensure accounting treatment is appropriate.	Management will review the new guidance and statutory mitigation information and continue to engage with the waste project team to gain clarity on the costs involved and their categorisation in relation to relevance to the provision. **Responsible officer:** Capital & Investment Manager **Implementation date:** 31 March 2015

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Local Authority Accounts (Scotland) Regulations 2014		**Grade three**
The Local Authority Accounts (Scotland) Regulations 2014 will come into force on 10 October 2014, replacing regulations which have applied since 1985. The regulations contain provisions for the unaudited annual financial statements as submitted to the auditor to be considered by the audit committee no later than 31 August, and the audited financial statements to be presented to the audit committee for consideration and approval prior to auditor signature before 30 September.	Management has already made progress in preparing for these changes coming into effect. It is recommended that management continue to assess their impact and make any necessary changes to the financial statements preparation processes and reporting.	Management will build the requirements of the new regulations into the 2014-15 year end timetable. **Responsible officer:** Corporate Finance Manager **Implementation date:** 30 June 2015
3 Audit Scotland reports		**Grade three**
While follow up work in relation to reports and recommendations issued by Audit Scotland showed that management had considered these in terms of applicability, there was no formal reporting to members on these.	Consideration should be given to a means by which Audit Scotland and other national reports are evaluated in terms of applicability to the Council and then reported to members in an appropriate forum. The audit committee should have oversight of this process.	Management will establish processes to capture and report on Audit Scotland reports to audit committee and, where appropriate, other committees including any recommendations that are applicable to the Council. **Responsible officer:** Chief Officer – Audit & Risk **Implementation date:** 31 December 2014

cutting through complexity