AUDIT SCOTLAND

Falkirk Council

Annual Audit Report to Members and the Controller of Audit

September 2015

The Accounts Commission is a statutory body which appoints external auditors to Scottish local government bodies. (www.audit-scotland.gov.uk/about/ac)

Audit Scotland is a statutory body which provides audit services to the Accounts Commission and the Auditor General. (www.audit-scotland.gov.uk)

The Accounts Commission has appointed Fiona Mitchell Knight as the external auditor of Falkirk Council for the period 2011/12 to 2015/16.

This report has been prepared for the use of Falkirk Council and no responsibility to any member or officer in their individual capacity or any third party is accepted.

This report will be published on our website after it has been considered by the council. The information in this report may be used for the Accounts Commission's annual overview report on local authority audits published on its website and presented to the Local Government and Regeneration Committee of the Scottish Parliament.

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Key messages

Audit of financial statements	• Unqualified auditor's report on the 2014/15 financial statements. • Unqualified auditor's report on the Falkirk Temperance Trust administered by the council.
Financial management and sustainability	• The council has reported significant overspends in the last two financial years, particularly on social work services. Management of annual budgets needs to improve. • The council reported an overall deficit of £3.94 million in its running costs for 2014/15 and utilised General Fund reserves to meet this shortfall. The council recognises that the use of reserves on this scale to support revenue costs is neither appropriate nor sustainable. It is also inconsistent with the council's reserves strategy. • The council has to make savings of £46 million over the next three years, of which some £15.2 million relating to 2017/18 have yet to be agreed. The Accounts Commission has significant concerns that the council's approach to this challenge is inadequate and that there is a need for more ambitious and financially sustainable plans going forward.
Governance and transparency	• After an unacceptable and protracted period of ineffective scrutiny in the council, members are participating in revised governance arrangements. The council needs to demonstrate that scrutiny is now effective. • Adequate systems of internal control were in place during 2014/15. • The council has an effective internal audit function and sound anti-fraud arrangements. • Much still needs to be done for health and social care integration from 1 April 2016. The Order establishing the Falkirk Integration Joint Board has been laid before parliament and will come into force on 3 October 2015.

Best Value	• In August, the Accounts Commission reported its findings on a Best Value audit on the council. Due to its concern on a number of issues the Commission requires a progress update by the end of 2016. • Falkirk generally delivers a good standard of council services, particularly in education. However, the Accounts Commission has significant concerns that the council is not well equipped to maintain or improve services in the future. • The council's Business Transformation Project needs to be more strategic and to make more of an impact. Stronger leadership is needed for this to happen. • Falkirk Council has a range of tools for managing its performance but needs to use them in a more systematic way to make improvements happen.
Outlook	• Councils face rising demands for services and continued funding pressures alongside managing major reforms in welfare and health and social care. Effective arrangements for Best Value will be essential for efficient use of available resources, and strong governance and leadership will be needed to achieve continuous improvement. The Accounts Commission says that 'the council has a great deal to do to provide assurances that it can deal with the financial challenges ahead.'

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of Falkirk Council. It reflects on the Best Value audit report published in August 2015 and considered by the Accounts Commission. The report is divided into sections which reflect our public sector audit model.

2. The management of Falkirk Council is responsible for:
   - preparing financial statements which give a true and fair view
   - implementing appropriate internal control systems
   - putting in place proper arrangements for the conduct of its affairs
   - ensuring that the financial position is soundly based.

3. Our responsibility, as the external auditor of Falkirk Council, is to undertake our audit in accordance with International Standards on Auditing, the principles contained in the Code of Audit Practice issued by Audit Scotland in May 2011 and the ethical standards issued by the Auditing Practices Board.

4. An audit of financial statements is not designed to identify all matters that may be relevant to those charged with governance. It is the auditor's responsibility to form and express an opinion on the financial statements; this does not relieve management of their responsibility for the preparation of financial statements which give a true and fair view.

5. A number of reports, both local and national, have been issued by Audit Scotland during the course of the year. These reports, summarised at **appendices II and III**, include recommendations for improvements.

6. **Appendix IV** is an action plan setting out our recommendations to address the high level risks we have identified during the course of the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "Management action/response". We recognise that not all risks can be eliminated or even minimised. What is important is that Falkirk Council understands its risks and has arrangements in place to manage these risks. The council and corporate management team should ensure that they are satisfied with proposed action and have a mechanism in place to assess progress and monitor outcomes.

7. We have included in this report only those matters that have come to our attention as a result of our normal audit procedures; consequently, our comments should not be regarded as a comprehensive record of all deficiencies that may exist or improvements that could be made.

8. The cooperation and assistance afforded to the audit team during the course of the audit is gratefully acknowledged.

Audit of the 2014/15 financial statements

Audit opinion	• We have completed our audit and issued an unqualified independent auditor's report. • The valuation of council houses complies with current guidance but it understates their value and is to be brought in line with other councils in 2015/16.
Going concern	• The financial statements of the council, its group and the associated charitable trust have been prepared on the going concern basis. We are unaware of any events or conditions that may cast significant doubt on the council, its group and associated charitable trust's ability to continue as a going concern.
Other information	• We review and report on other information published with the financial statements, including the management commentary, annual governance statement and the remuneration report. We have nothing to report in respect of these statements.
Charitable trust	• We have completed our audit of the 2014/15 financial statements of the Falkirk Temperance Trust administered by Falkirk Council and issued an unqualified independent auditor's report.
Group accounts	• Falkirk Council has accounted for the financial results of two subsidiaries, two associates and the common good funds in its group accounts for 2014/15. The overall effect of consolidating these balances on the group balance sheet is to reduce total reserves and net assets by £2.256 million.
Whole of government accounts	• The council submitted a consolidation pack for audit by the deadline. This is currently being audited and the certified return will be submitted to the Scottish Government.

Submission of financial statements for audit

9. We received the unaudited financial statements on 22 June 2015, in accordance with the agreed timetable. The working papers were of a good standard and council staff provided good support to the audit team which assisted the delivery of the audit on time.

10. The council has taken steps to declutter the financial statements in 2014/15 and we acknowledge that there have been a number of improvements. However, officers should consider modernising the format of the financial statements to improve the experience for the reader.

Overview of the scope of the audit of the financial statements

11. Information on the integrity and objectivity of the appointed auditor and audit staff, and the nature and scope of the audit, were outlined in our Annual Audit Plan presented to the Audit Committee on 20 April 2015.

12. As part of the requirement to provide full and fair disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2014/15 agreed fee for the audit was set out in the Annual Audit Plan and, as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

13. The concept of audit risk is of central importance to our audit approach. During the planning stage of our audit we identified a number of key audit risks which involved the highest level of judgement and impact on the financial statements and consequently had the greatest effect on the audit strategy, resources and effort. We set out in our Annual Audit Plan the audit work we proposed to undertake to secure appropriate levels of assurance. **Appendix I** sets out the significant audit risks identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

14. Our audit involved obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

Materiality

15. Materiality can be defined as the maximum amount by which auditors believe the financial statements could be misstated and still not be expected to affect the decisions of users of financial statements. A misstatement or omission, which would not normally be regarded as material by amount, may be important for other reasons (for example, an item contrary to law).

16. We consider materiality and its relationship with audit risk when planning the nature, timing and extent of our audit and conducting our audit programme. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively.

17. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of the council we set our planning materiality for 2014/15 at £6.6 million (1% of gross expenditure). Performance materiality was calculated at £3 million, to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding planning materiality level.

18. On receipt of the financial statements and following completion of audit testing we reviewed our materiality levels and concluded that materiality for 2014/15 should be amended to £6.123 million (1% of gross expenditure). All misstatements over £61,000 are to be reported. Performance materiality remained consistent with the planning level at £3 million.

Evaluation of misstatements

19. All misstatements identified during the audit, which exceeded our threshold of £61,000, have either been amended in the financial statements or recorded as an unadjusted error.

20. A number of presentational and monetary adjustments were identified within the financial statements during the course of our audit. These were discussed with relevant officers who agreed to amend the unaudited financial statements in most instances. The effect of the monetary adjustment is to reduce net assets on the balance sheet by £0.831 million. This adjustment relates to an increase in the provision for the aftercare costs of an inactive landfill site (Kinneil Kerse). As this adjustment is capital in nature there is no impact on the council's funding position.

21. Unadjusted errors, if corrected, in the financial statements would have the cumulative effect of reducing the council's net assets by £0.315 million. The net impact on the council's funding position would also be a reduction of £0.315 million. The largest error identified is in the accounting for carbon reduction commitments, as described in the table below. The council has decided not to make these adjustments. This is not material in respect of our audit.

Management Commentary

22. *The Local Authority Accounts (Scotland) Regulations 2014* introduced the requirement for local authority annual accounts to include a management commentary. Local Government Finance Circular 3/2015 Management Commentary (the circular) from the Scottish Government provides guidance on its preparation. We reviewed the management commentary presented for audit and concluded that overall the council has complied with the guidance. However, we did identify some issues that we would like to bring to your attention:

- The guidance requires the management commentary to provide a balanced picture. Section 4 (Performance) of the management commentary focusses on significant achievements of the council without specific reference to areas for improvement. It is our view that more balance is needed in this section.
- Section 5 (Future Plans) refers to the council's business transformation agenda and the expectation that the projects identified will make a significant contribution towards dealing

with the financial pressures. As outlined at section 65 to 67 of this report, the recent Audit Scotland Best Value audit of the council concluded that much of the current activity in the transformation project is small in scale and the pace of change has been slow.

The Local Authority Accounts (Scotland) Regulations 2014

23. Section 10 (1) (b) of the above regulations states that a local authority or a committee of that authority whose remit includes audit or governance functions must aim to approve the annual accounts for signature no later than 30 September immediately following the financial year to which the accounts date.

24. The Audit Committee will approve the accounts for signing at its meeting on 21 September 2015. Thereafter, the accounts will be submitted to the full council for the attention of all members.

Significant findings from the audit

25. International Standard on Auditing 260 requires us to communicate to you significant findings from the audit, including:

- The auditor's views about significant qualitative aspects of the entity's accounting practices, including accounting policies, accounting estimates and financial statement disclosures.
- Significant difficulties encountered during the audit.
- Significant matters arising from the audit that were discussed, or subject to correspondence with management.
- Written representations requested by the auditor.
- Other matters, which in the auditor's professional judgement are significant to the oversight of the financial reporting process.

26. During the course of the audit we identified the following significant issues that, in our view, require to be communicated to you.

Significant findings from the audit

Issue	Resolution
Equal pay claims: The Equal Pay Act 1970 makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay and are dissatisfied with the council's proposed resolution or compensation can elect to have a case heard before an employment tribunal. Falkirk Council has received a significant number of claims for compensation. Whilst there have been recent developments in case law, as in previous years, the ultimate cost to the council remains uncertain and it is likely that the issue will take some time to resolve. The Council recognises a provision in respect of equal pay in the 2014/15 financial statements and discloses a contingent liability. A report to council on 24 August 2015 provided a revised estimate of the equal pay liability. This information was not available at the time of preparing the accounts and we are satisfied that the provision is not materially misstated in terms of our audit of the financial statements.	Management continue to monitor the equal pay provision to take account of developments.
Council dwellings valuation: The council has used a discounted cash flow approach to the valuation of its council dwellings since 1 April 2010, which understates their value. The LASAAC Mandatory Guidance on the Valuation Methodology for Council Dwellings (the LASAAC Guidance), October 2010, states that '*Scottish local government organisations that are not already using a beacon approach methodology to value their council dwellings shall adopt the beacon approach methodology at their next full formal valuation of their council dwellings*'. LASAAC recognised that enforcing immediate adoption would disrupt revaluation cycles and incur additional costs and in recognition of this concluded that '*those Scottish local authorities affected should be required to move to the beacon approach methodology at their next full revaluation point, and in any event no later than 2015/16'*. Officers are in the process of establishing a valuation using the beacon approach methodology for inclusion in the 2015/16 financial statements.	The council's approach to council house valuation will be brought into line with the LASAAC Guidance in 2015/16.

Issue	Resolution
Non-depreciation of council house dwellings: As in previous years, the council has not charged depreciation on its council house dwellings. The discounted cash flow method of valuation adopted by the District Valuer results in a very low valuation of council dwellings, approximately £3,000 per dwelling. The Code of Practice on Local Authority Accounting in the UK 2015/16 section 4.1.2.39 states that '*the only other ground for not charging depreciation is when the residual value of an asset is equal to or greater than the asset's carrying amount'*. It is on this basis that the council does not charge depreciation on its council dwellings. All depreciation charges are reversed out through statutory adjustments between the accounting and funding basis and therefore would not impact upon the housing revenue account fund balance.	The council will charge depreciation on its council house dwellings from 2015/16 when the new approach to valuation is applied.
International Accounting Standard (IAS) 19 pension liability: The pension liability represents the difference between the expected future payments to be made to former employees of the council and their spouse in the form of pension payments and the underlying value of pension fund assets to meet this cost. The calculation of the liability is assessed by professional actuaries each year and is an estimated figure. There has been a further increase in the net pension liability from £253.264 million at 31 March 2014 to £381.288 million at 31 March 2015. This is largely due to falling bond yields being only partially offset by better than expected investment performance. The falling bond yields leads to a lower discount rate (i.e. the net price of inflation) which leads to a higher value being placed on liabilities. Also, the 2014/15 IAS19 figures are based on a roll forward from the March 2014 fund valuation (the 2013/14 figures were based on the March 2011 fund valuation). Changes in the assumptions used (e.g. life expectancy) have also contributed to the increase in the liability. Although the liability will continue to vary, this information is necessary for the council to ensure the pension fund remains affordable and adequately funded.	The 2014 triennial valuation of the Falkirk Council Pension Fund carried out by Hymans Robertson LLP provides assurance that the pension fund remains adequately funded. The council's financial statements have been prepared on the basis of these assumptions.

Issue	Resolution
Accounting for Carbon Reduction Commitment (CRC): The Code requires that where authorities purchase CRC allowances in a forecast sale (i.e. prospectively in April) for the purpose of settling current or future years' CRC responsibilities, the allowances should be classified as intangible assets. Current year CRC responsibilities should be charged as an expense at 31 March and a liability created for the surrender of the allowances to the CRC Registry. When the allowances are surrendered to the CRC Registry in October after the reporting period (e.g. October 2015), the intangible asset and the liability will be reduced by the allowances surrendered. The council has accounted for the associated expenses correctly but has not created an intangible asset and corresponding liability. The impact of the error on the balance sheet is that intangible assets and current liabilities are understated by £0.592 million. The overall impact on the balance sheet position is nil.	The council has decided not to adjust the accounts for this error on the basis that the amount is not material. CRC allowances will be accounted for correctly in 2015/16.
Note 23 (property, plant & equipment) disclosures: The cost/valuation and the accumulated depreciation/impairment figures for property, plant & equipment as at 1 April 2013 and 1 April 2014 have been amended to change the presentation of accumulated impairment in Note 23 to the accounts. The amendment has been made to ensure that going forward the gross values agree to the asset register. There is no impact on the net book value of the assets and therefore, no impact on the figures disclosed in the core financial statements.	Note 23 to the accounts has been revised to agree with the asset register.
Housing Revenue Account (HRA) income: The unaudited financial statements included a transfer of £0.461 million from the general fund to the HRA. The council no longer receives ring-fenced funding for hostels from the Scottish Government and so equivalent funds have been transferred to the HRA to match the expenditure in the year relating to hostels. In accordance with Schedule 15 of the Housing (Scotland) Act 1987 a transfer of funds from the general fund to the housing revenue account in this way requires approval from Scottish Ministers. Officers have requested retrospective approval for the transfer of these funds.	Retrospective approval for the transfer of funds is expected to be received soon.

Issue	Resolution
Council tax bad debt provision: An error in the council tax spreadsheet used to calculate the bad debt provision has resulted in the bad debt provision being understated by £0.315 million. Despite this error, we are still of the view that the bad debt provision in the accounts is sufficient. The error identified is not material to our audit.	Officers have acknowledged the error but are of the opinion that the bad debt provision remains adequate and do not intend to amend the accounts.

Future accounting and auditing developments

Revisions to the Code of Practice

27. The financial statements of the council are prepared in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom (the Code) which interprets and adapts International Financial Reporting Standards (IFRS) to the local authority context. The following paragraphs set out the most significant changes to accounting requirements introduced by the Code in the coming years.

28. **(IFRS) 13 Fair value measurement:** Although the measurement requirements for operational property, plant and equipment will not change, enhanced valuation disclosures will be required. In addition, the 2015/16 Code requires surplus assets to be measured at fair value in accordance with IFRS. The council will need to make the necessary preparations to ensure that new requirements are addressed for the 2015/16 financial statements.

29. **Transport infrastructure assets:** The council's highway assets are currently carried within infrastructure assets in the balance sheet at depreciated historic cost. The 2016/17 Code will require highways to be measured, for the first time, on a depreciated replacement cost basis. This is a major change in the valuation basis for highways and will require the availability of complete and accurate management information on highway assets.

30. We are liaising with management on a regular basis to ensure that they are well prepared to meet the new Code requirements going forward.

Health and Social Care Integration

31. From 1 April 2016 Integrated Joint Boards (IJBs) will be accountable for the provision of health and social care. IJBs will be required to produce financial statements in compliance with the Code of Practice on Local Authority Accounting in the UK. The council auditors are to audit the IJB financial statements.

Financial management and sustainability

Net expenditure budget £332.996m

- Actual net expenditure £337.181m
- Overspend against budget £4.185m

Planned capital expenditure £68.136m

- Actual capital spend £61.451m
- Capital budget underspend £6.685m

Usable reserves

- Total usable reserves £43.243m
- Reduction in usable reserves £5.975m

Uncommitted general fund reserves

- Uncommitted general fund reserves £8.369m
- Reduction in uncommitted general fund reserves £3.940m

Financial management

32. In this section we comment on the council's financial outcomes and assess the council's financial management arrangements.

33. The council sets an annual budget to meet its service and other commitments for the forthcoming financial year. The setting of the annual budget impacts directly on residents as it determines council tax and other fees and charges. Regular monitoring of expenditure and income against agreed budgets is central to effective financial management.

Financial outcomes

34. In 2014/15, the council reported a total overspend of £2.870 million against its general fund revenue budget for the year. This is made up of an overspend against net expenditure of £4.185 million offset by higher than anticipated revenue support grant and council tax income of £1.315 million. After adjusting for a transfer of £0.430 million from the spend to save reserve the overspend is reduced to £2.440 milion. The council is facing significant demand pressures from services at the same time as reduced funding.

35. The most significant overspend occurred in social work services where the net expenditure position was £3.343 million (3.7%) over budget at the year end. This has been largely attributed to the uncertain demand for care services including children's residential schools, children's residential care, foster care, adult 24 hour care and adult care purchasing.

36. A notable overspend of £0.443 million (or 0.3%) was also reported in education services, although the financial position did improve significantly in the final quarter of 2014/15 from the forecast overspend of £0.883 million (or 0.5%). The main reason for the overspend was the increase in provision of residential school places, which has also been reflected in social work services.

37. The council also incurred costs of £1.124 million relating to voluntary severance packages in the year that were not included in the budget. Officers have advised that the costs at the time of setting the budget were unknown and that reserves were available to fund the packages. We would expect an estimate of all anticipated costs for the year to form part of the approved budget in line with good financial management practices.

Recommendation 1

38. The overspend has been financed from the general fund reserve resulting in a net transfer of £3.940 million from the general fund in the year. This is significantly higher than the £1.500 million set out in the original budget. The general fund balance remains within the parameters set out by the council's reserves strategy. However, the strategy states that reserves should not be used to fund recurring annual expenditure.

39. The council is required by legislation to maintain a separate housing revenue account (HRA) and to ensure that rents are set to at least cover the costs of its social housing provision. Rent levels are therefore a direct consequence of the budget set for the year. HRA

expenditure has been in line with budget and the balance on the HRA reserve of £5.093 million will be maintained.

Financial management arrangements

40. As auditors, we need to consider whether councils have established adequate financial management arrangements. We do this by considering a number of factors, including whether:

- the proper officer has sufficient status within the council to be able to deliver good financial management
- financial regulations are comprehensive, current and promoted within the council
- reports monitoring performance against budgets are accurate and provided regularly to budget holders
- monitoring reports do not just contain financial data but are linked to information about performance
- members provide a good level of challenge and question budget holders on significant variances.

41. We assessed the role and status of the proper officer against CIPFA's "Statement on the role of the Chief Financial Officer in Local Government" and concluded that the council complies with the statement's five principles. The council has revised its management structure and we noted that the Chief Finance Officer no longer reports directly to the Chief Executive, but to the Director of Corporate & Housing Services.

42. The Chief Finance Officer will, however, continue as a member of the corporate management team. It is important that the Chief Finance Officer continues to retain a high profile within the organisation in his capacity as section 95 officer. This is particularly important given the position of financial constraint that the council faces.

43. There has been a lack of succession planning for other key finance positions, including Depute Chief Finance Officer. Also, there has been a steady reduction in numbers of experienced finance staff through normal and early retirement. As a result, corporate and service finance staff capacity to support council activities has reduced over the three years to 2014/15.

44. It is acknowledged that finance services require to share the burden of generating savings along with other council services. However, these changes are taking place at a time when council service managers are even more reliant on accurate and timely financial information in order to achieve necessary savings targets.

45. We reviewed the council's financial regulations, which were revised in June 2013 and can be found on the council's website. These will be subject to a comprehensive review in 2015/16 to ensure they are up to date and reflect recent restructuring within the council.

46. Financial monitoring reports (both revenue and capital) are submitted to the Executive and Full Council on a quarterly basis. Reports provide a picture of the overall budget position at service level and include high level explanations for large variances. There is evidence that these routine reports are supplemented with further

information if necessary. A special financial monitoring report[1] was presented to members in September 2014 to highlight the significant overspend within social work services. This provided further detail on the financial position of the service and the action being taken to tackle the problem. Revised governance arrangements were implemented in May 2015 following a 2 year period of ineffective scrutiny. All members are now attending the Executive and Scrutiny Committees. Members need to ensure that budget monitoring reports receive sufficient scrutiny and challenge as part of these new arrangements. We will continue to monitor revised arrangements through attendance at committee meetings and the Best Value follow-up audit.

Conclusion on financial management

47. Whilst adequate financial management arrangements are in place, the council has incurred significant overspends in the last two financial years and this has led to a notable drop in the level of reserves held by the council.

48. The council needs to maintain budget discipline going forward and ensure that budgets reflect service priorities. This will be particularly challenging for social work services due to the demand led nature of its activities.

[1] *Financial Position – Social Work Services,* Report to Falkirk Council Executive, 30 September 2014

Financial sustainability

49. The council delivers a broad range of services, both statutory and discretionary, to its communities. Financial sustainability means that the council has the capacity to meet the current and future needs of its communities.

50. In assessing financial sustainability we are concerned with whether:

- there is an adequate level of reserves
- spending is being balanced with income in the short term
- long term financial pressures are understood and planned for
- investment in services and assets is effective.

51. Effective long-term financial planning, asset management and workforce planning are crucial to sustainability.

Reserves

52. The overall level of usable reserves held by the council decreased from £49.218 million in 2013/14 to £43.243 million in 2014/15; a decline of £5.975 million as illustrated in Exhibit 1 overleaf.

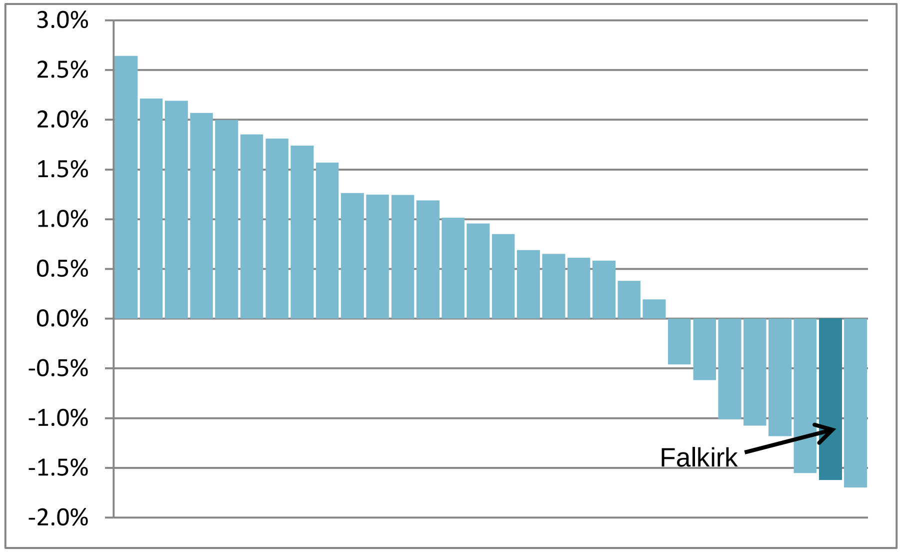
53. The General Fund balance includes £8.369 million of uncommitted general fund reserves. Planned commitments from the general fund balance amounted to £15.657 million and include devolved schools management, economic development, unspent revenue grants, energy efficiency and spend to save initiatives.

Exhibit 1: Analysis of usable reserves

Description	31 March 2014 £ million	31 March 2015 £ million
General fund	25.757	18.933
Housing revenue reserve	5.093	5.093
Capital grants unapplied	4.373	3.869
Capital receipts reserve	5.055	5.778
Insurance fund	4.568	4.826
Repair and renewal fund	4.371	4.744
Total usable reserves	**49.218**	**43.243**

Source: Falkirk Council 2014/15 financial statements

Exhibit 2: Revenue reserves - usable - movement as a proportion of net revenue stream and dwelling rents



Source: Scottish councils' unaudited accounts 2014/15

54. From an analysis of Scottish councils' (excluding Orkney and Shetland) unaudited 2014/15 accounts, only 8 out of 30 councils reported a reduction in usable reserves in the year.

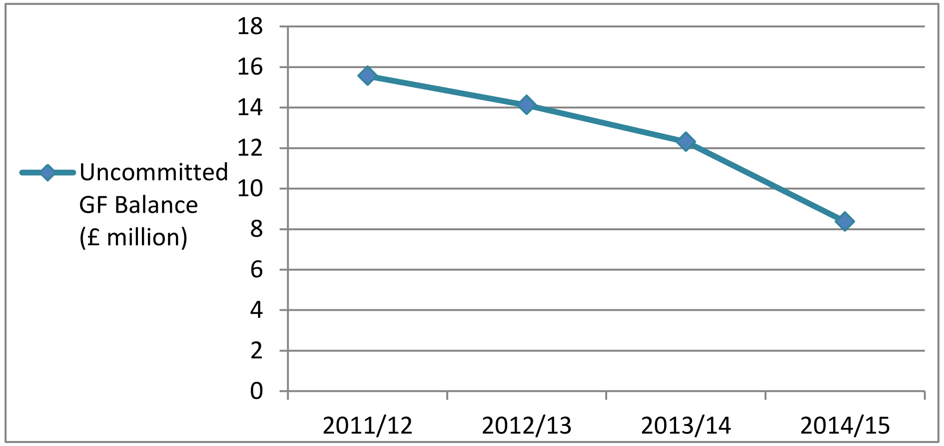
55. Exhibit 2 opposite shows the movement in usable reserves relative to the size of the council. This indicates that Falkirk Council has experienced the second largest reduction in its usable reserves in the year.

56. The general fund reserve has no restrictions on its use. The principal purpose of holding a general fund reserve is to provide a contingency fund to meet unexpected events and as a working balance to help cushion the impact of uneven cash flows.

57. The council reviewed its reserves strategy during the year and concluded that the existing framework is fit for purpose, although it was agreed that this will be kept under review. The existing strategy reflects the CIPFA best practice guidance of holding unallocated general fund reserves equal to 2% to 4% of revenue expenditure.

58. The balance on the council's uncommitted general fund has been steadily depleting over the last 4 years as outlined in Exhibit 3 below. The balance at 31 March 2015 was £8.369m or 2.5% of revenue expenditure. The current balance is within the council's reserves strategy range of £6.6 million to £10 million.

Exhibit 3: Analysis of uncommitted general fund balance over the last 4 years



Source: Falkirk Council audited accounts 2011/12 to 2014/15

59. Reserves have been utilised to fund annual recurring expenditure. The use of funds in this way is not sustainable and is contrary to the council's stated reserves strategy. The council has recognised this and both the 2015/16 and 2016/17 budgets do not assume any use of the uncommitted general fund.

Recommendation 2

Accounting deficit

60. The Comprehensive Income and Expenditure Statement for the year reported a deficit of £33.684 million. The deficit is largely attributable to the depreciation and impairment charges for the year and the IAS19 pension costs. After applying the statutory adjustments between the accounting and funding basis to reflect the true amount to be charged to the taxpayer, the council reported a deficit, or reduction in the general fund balance, of £6.824 million. This was offset by transfers from earmarked reserves of £2.884 million to give the overall reduction in the uncommitted general fund balance of £3.940 million.

Financial planning

61. The council approved its 2015/16 budget in February 2015. The 2015/16 revenue budget was set at £335.230 million and assumes savings of £12.4 million.

62. As at 31 July 2015 the council was reporting a projected overspend of £2.6 million in social work services (children's and adult services) for the 15/16 financial year[2]. The report highlights children's residential care as a particular challenge and outlines action being taken to reduce the use of external provision by developing local care and educational alternatives. This indicates that the problems within the social work budget have still not been fully addressed.

See also Recommendation 1

[2] *Financial Position 2015/16*, Report to Falkirk Council Executive, 18 August 2015

63. Looking to the medium term, the council has set indicative budgets for 2016/17 and 2017/18 and in doing so has identified a funding gap of £46 million over the next three years to 2017/18. Savings of £12.4 million and £18.4 million have been identified to balance the budget in 2015/16 and 2016/17 respectively. However, savings of £15.2 million still remain to be agreed for the financial year 2017/18.

64. There is a risk that the council will be unable to identify and deliver the necessary savings to bridge the funding gap. The Accounts Commission, in its recent Best Value audit report for the council, also raised concerns about the council's ability to produce clear and detailed plans for how it will make these savings.

Recommendation 3

Council specific transformational programme /efficiency strategy

65. The Best Value audit reviewed the council's business transformation project. This was set up in September 2013 with the intention to *'be a different organisation in the future and provide a framework for how council services can be delivered more effectively and efficiently'*.

66. The report concluded that much of the council's current activity in its transformation project is small in scale and that the pace of change has been slow. The report also highlighted that eighteen months on, the council had still to identify clearly the anticipated savings for many of the individual transformation projects. Where potential savings have been identified, these are at a lower level than the council needs to make over a short period.

67. The Accounts Commission says that the council needs to be more ambitious in its plans and increase the pace and scale of change. Also, senior managers need to provide more effective leadership and work with councillors to ensure they develop plans that will lead to the significant changes required[3].

Capital programme 2014/15

68. The council approved its general services capital programme for 2014/15 in February 2014. Actual spend on the general services capital programme amounted to £26.389 million. Some of the more significant general services capital projects included the expansion and refurbishment of schools, improvements in roads infrastructure, the vehicle replacement programme, the Helix and the Tax Incremental Finance (TIF) Project.

69. The council has reported an underspend of £5.214 million (or 16.5%) against the general services revised capital budget of £31.603 million. Of this amount, £1.982 million has been classified as slippage, with the remainder being re-profiled to future years[4]. The most significant area of slippage occurred in education services under the expansion for early years where a number of factors delayed the project, including changes in the location and size of the facilities.

[3] *Falkirk Council Best Value Audit 2014/15*, Audit Scotland, August 2015
[4] *Capital Programmes Outturn 2014/15*, Report to Falkirk Council, 18 August 2015

70. The council approved its housing capital programme for 2014/15 in February 2014. Actual spend on the housing capital programme amounted to £35.062 million, which was £1.471 million (or 4.2%) less than the approved budget. The most significant areas of expenditure included elemental improvements (e.g. external fabric, kitchens/bathrooms, electrical upgrading), upgrade/replacement of heating systems to improve energy efficiency, new build housing, and council house buy backs. The capital slippage relates to new build housing where there was some delay due to utility connections and bad weather, although this is not expected to have an impact on the planned completion date.

71. The council has a capital planning and review working group that meets every 6-8 weeks to monitor progress against the capital programme. All services are represented on the group and officers have advised that there are clear expectations that deviations from budget should be communicated at the earliest possible date so that action can be taken to minimise slippage against the overall capital budget. Officers should work together to maximise this facility and reduce slippage in future years.

Asset Management

72. The council's existing Corporate Asset Management Strategy covers the period 2011 to 2014. This is supported by other documents such as the Property Asset Management Plan. Officers have advised that these documents are currently being rolled forward and updated as appropriate, with a revised strategy expected to be in place by April 2016.

73. A Corporate Asset Management Group is responsible for leading the implementation of the Corporate Asset Management Strategy. Each of the six asset classes (property, open space, roads infrastructure, housing, fleet and ICT) identified by the Corporate Asset Management Strategy has a lead officer sitting on the group to drive work in that area.

74. As part of the normal audit process we will continue to monitor developments to ensure that the council's asset management strategy and supporting documents are brought up to date.

Workforce Management

75. Effective workforce management is essential to ensure that the council maximises the effectiveness of its employees. A workforce strategy is key to setting out how the council will ensure it has appropriately skilled people in place to deliver its services. The council's existing workforce strategy covers 2011 to 2014 and we have been informed that a new strategy will not be developed until later in 2015 so that it can be aligned with the budget strategy.

76. The council's approved savings for 2015/16 and 2016/17 include reducing the council's workforce by 429 full time equivalents, 5.8% of its total workforce. If this cannot be achieved through voluntary means then other actions may need to be taken.

77. The Best Value audit found that these savings proposals were not fully informed by the council's business transformation programme or other improvement activity, such as service reviews and self-assessments, to consider the costs and benefits of the proposals

and alternative options[5]. Audit Scotland have previously highlighted that councils need to ensure that staff reductions are considered within the context of comprehensive workforce strategies and plans that minimise any adverse impact on services[6].

Risk Management

78. In our annual audit plan we highlighted risk management as an area of risk for our wider dimension audit of the council. In particular we noted that the Audit Committee had not received an update on risk management arrangements since September 2013 and it is within the committee's remit to provide independent assurance on the adequacy of the risk management framework and associated control environment within the council.

79. The existing Corporate Risk Management Policy and Framework was approved in November 2014. It has since been subject to routine annual review by management and the revised document was presented to the Audit Committee in April 2015. The Audit Committee is due to receive further updates on risk management at its meeting on 21 September 2015.

80. It is good practice for the Audit Committee to receive regular updates on risk management to demonstrate that the arrangements, as set out in the policy and framework, are operating effectively and remain fit for purpose. We will monitor developments in this area through the annual shared risk assessment process.

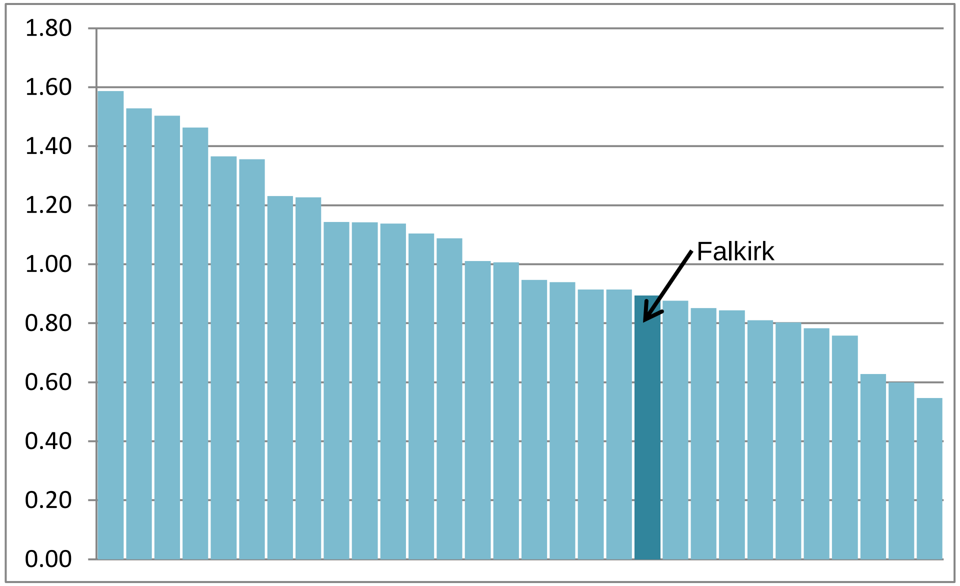
Treasury Management

81. At 31 March 2015 long term borrowing stood at £202.6 million, an increase of £26 million on the 2014 borrowing level of £176.6 million. During the same period, short term borrowing increased from £22 million to £26 million. The council's actual borrowing requirement for the year was £37 million. However, a decision was taken to borrow £52 million in line with the approved 2014/15 Treasury Management Strategy. Management felt it was prudent to take advantage of favourable interest rates whilst available. Interest payable and similar charges rose by £0.440 million in 2014/15 to £23.333 million.

82. Analysing long term borrowing as a proportion of net revenue stream gives an indication of the relative indebtedness of the council. Exhibit 4 overleaf shows long term borrowing as at 31 March 2015 as a proportion of net revenue stream plus dwelling rents for all mainland councils in Scotland. This indicates that Falkirk Council's borrowing levels are on the lower side of the median compared with other Scottish councils.

[5] *Falkirk Council Best Value Audit 2014/15*, Audit Scotland, August 2015
[6] *An overview of local government in Scotland 2015*, Accounts Commission, March 2015.

Exhibit 4: Net external debt as a proportion of net revenue stream plus dwelling rents



Source: Scottish councils' unaudited accounts 2014/15

Pension liability

83. The council's balance sheet position has fallen from an £86.859 million net asset position at 31 March 2014 to a £46.033m net liability position at 31 March 2015. This is predominantly due to the net pension liability which has increased by £128.024m (or 50.5%) in the year from £253.264m in 2013/14 to £381.288m in 2014/15. This is also reflected in the balance sheet for the group. The net pension liability represents the difference between the expected future payments to be made to former employees of the council and their spouse in the form of pension payments and the underlying value of pension fund assets to meet this cost. The calculation of the liability is estimated by professional actuaries each year.

84. The 2014/15 IAS19 figures are based on a roll forward from the March 2014 fund valuation (the 2013/14 figures were based on the March 2011 fund valuation). This has led to a considerable movement between the years due to changes in assumptions. In addition, the actuaries have reported that falling real bond yields have led to a significant rise in the deficit. This has been partially offset by a better than expected return on assets.

Conclusion on financial sustainability

85. In the last two years the council has had to draw on reserves to fund expenditure. The council recognises this is not sustainable and the approved budgets for 2015/16 and 2016/17 do not assume any use of the uncommitted general fund reserve.

Outlook

86. The Scottish Government's 2016-17 budget proposals will not be produced until after the UK government's spending review in late November. The Scottish government is anticipating a reduction in the block grant available to fund devolved services which will only exacerbate the financial challenges facing Scottish councils.

87. The Account's Commission has reported that Falkirk council has a great deal to do to provide assurance that it can address the financial challenges ahead. A continuing reliance on small-scale savings reduction and service charge increases is not sufficient.

Governance and transparency

Governance arrangements, in particular decision-making structures, have not been working effectively over the past two years.

An Integration Joint Board has still to be formally constituted and the Integration Scheme has yet to be approved.

Revised governance arrangements agreed in March 2015

NFI work needs to be progressed and the issue relating to blue badges needs to be addressed.

Adequate systems of internal control were in place during 2014/15.

88. Members and management of the council are responsible for establishing arrangements to ensure that its business is conducted in accordance with the law and proper standards, that public money is safeguarded and for monitoring the adequacy and effectiveness of these arrangements.

89. The Best Value audit report (August 2015) concluded that the council's governance arrangements were not working effectively over the past two years. Revised governance arrangements are in place and the council needs to demonstrate that scrutiny is now effective.

90. Citizens should be able to hold the council to account about the services it provides. Transparency means that citizens have access to understandable, relevant and timely information about how the council is taking decisions and how it is using its resources. Overall we concluded that the council demonstrates a number of good practices in terms of openness and transparency, although there is scope for improvement.

Corporate governance

91. The council's governance and accountability arrangements were a key area of the Best Value audit report. The Accounts Commission expressed concerns at the lack of proper scrutiny over the past two years.

92. The report highlighted that the council had introduced an Executive structure in May 2013 with the aim of supporting more effective working. The administration and opposition councillors generally agreed with the new structure. However, not all councillors participated in the new structures due to concerns about some of the underpinning arrangements such as representation on new committees and panels. The problem was exacerbated by difficult working relationships and political tensions between councillors. As a result the new governance arrangements did not work effectively. The Accounts Commission also concluded that councillors and senior officers could have done more to resolve the situation.

93. Revised governance arrangements were agreed in March 2015. The main change is the creation of an Internal and External Scrutiny

Committee, which are chaired by a member from the largest opposition party rather than by a member of the administration. Current evidence indicates that all members are now engaged in the Scrutiny Committees and Executive meetings, although it is still too early to say how effective the new arrangements will be.

94. The council's scheme of delegation and standing orders were revised in May 2015 to reflect changes in the council's governance arrangements. We will continue to monitor the effectiveness of the council's governance arrangements as part of our annual audit process and through the Best Value follow-up audit due to be completed by the end of 2016.

Internal control

95. As part of our audit we reviewed the high level controls in a number of systems fundamental to the preparation of the financial statements. Our objective was to obtain evidence to support our opinion on the council's financial statements.

96. We reported our findings to the Audit Committee in June 2015. Our overall conclusion was that key controls within the council's main financial systems were adequate and no significant weaknesses were identified. We also made a number of recommendations to improve the systems of control and an action plan has been agreed with management to address our findings.

Internal audit

97. Internal audit provides members and management of the council with independent assurance on risk management, internal control and corporate governance processes. We are required by international auditing standards to make an assessment of internal audit to determine the extent to which we can place reliance on its work. To avoid duplication we place reliance on internal audit work where possible.

98. Our review of internal audit concluded that the internal audit function operates in accordance with Public Sector Internal Audit Standards (PSIAS) and has appropriate documentation standards and reporting procedures in place. Moreover, internal audit were able to deliver on their 2014/15 planned work despite carrying a vacancy.

99. We were able to place reliance on aspects of the work of internal audit including non-domestic rates, council house buy backs, payroll (overtime and allowances) and the continuous auditing of selected high value transactions.

100. In terms of our wider code responsibilities we considered the work of internal audit in a number of areas including procurement, statutory performance indicators and strategic projects (TIF). We also said we would consider work on health and social care integration. This work is in progress and we will review it upon completion.

ICT audit

101. ICT is a key area of control because it underpins all the systems used by the council. As part of our audit planning process we carried out a high level review of the council's ICT arrangements. These included the council's technology strategy, data security and protection and business continuity management. A summary of our key findings can be found below:

- Falkirk Council has received a Public Services Network Compliance Certificate for the year up to 27 January 2016. The council's application was supported by an independent IT health check of the PSN infrastructure. The outcome of this work was reported by Pen Test Partners in October 2014. Although full accreditation has been granted, the review did identify a number of areas for improvement for the council to consider going forward.
- Management have still to develop detailed plans to provide a secure ICT environment with partners to support the delivery of integrated health and social care services. A number of projects and initiatives are being progressed in preparation for health and social care integration. Relevant groups within Forth Valley Health Board and Falkirk Council have established key links through the Forth Valley Data Sharing Partnership, and have made progress on data sharing protocols. The Health and Social Care Data Integration and Intelligence Project (HSCDIIP) has been set up to combine health and social care data, in order to aid planning of services for both. Further information on health and social care integration can be found at section 116 to 124 of this report.

Arrangements for the prevention and detection of fraud

102. The council has a number of arrangements for preventing and detecting fraud including an anti-fraud and corruption strategy, a hotline for reporting suspected housing benefits and council tax frauds and a whistleblowing policy. The latter is going to be updated in the coming year.

103. On the whole, we concluded that the management has put in place adequate arrangements for the prevention and detection of fraud.

National Fraud Initiative in Scotland

104. The National Fraud Initiative (NFI) in Scotland is a biennial counter-fraud exercise led by Audit Scotland and overseen by the Cabinet Office for the UK as a whole. It uses computerised techniques to compare information about individuals held by different public bodies and on different financial systems that might suggest the existence of fraud or error. The 2014/15 NFI exercise commenced in October 2014 with outcomes due to be reported in June 2016.

105. Auditors are required to assess the arrangements that bodies put in place in relation to NFI. We know from our knowledge of the council that the Internal Audit Manager oversees NFI activity and provides support and advice to staff investigating matches. He also ensures

that NFI is given a high profile within the council by providing progress reports on NFI activity to the Audit Committee.

106. Currently, the NFI database shows that for the 1,270 recommended matches in Falkirk Council; only 119 (9%) have been processed with the remainder either in progress or yet to be reviewed. The council tax single persons discount exercise has been prioritised over processing benefits matches but a full time investigator has now started investigating these. There have been no fraud cases identified to date.

107. Last year we reported problems in investigating blue badge matches. The Accounts Commission have flagged this as an area for improvement across Scotland. In the current year we noted that no data on blue badges was submitted by the council. Officers explained this was due to difficulties extracting the data from the Scottish Government's Blue Badge Information System. Other councils are not reporting similar problems and have submitted the data for matching and investigation.

Recommendation 4

108. We concluded that, subject to the comments on blue badges, the council gives sufficient profile to NFI but progress in investigating matches could be improved.

Arrangements for maintaining standards of conduct and the prevention and detection of corruption

109. The arrangements for the prevention and detection of corruption in Falkirk Council are satisfactory and we are not aware of any specific issues that we need to record in this report.

Transparency

110. The council is able to demonstrate that it operates in an open and transparent manner in a number of ways. Members of the public can attend council and committee meetings including the Scrutiny and Audit Committees. The public also have access to council and committee papers on the internet. Additionally, the audited financial statements are accessible on the council's website.

111. Other developments have seen the council increase its openness and transparency in how it consults on its budget proposals. For example, in November 2014 a budget options paper was presented to the full Council and this was followed by consultation with the public through its website and focus groups using the council's citizen's panel.

112. The Best Value audit report noted that scrutiny of service performance is not conducted in public. The council's Performance Panel is responsible for scrutinising performance but its meetings are held in private. Also, the performance reports received by the Performance Panel are not publicly available. The Best Value team could not see a reason for the Performance Panel not conducting its business in public.

113. Overall, we concluded that the council meets good practice principles in a number of aspects of openness and transparency although there is scope for improvement.

Freedom of Information (FOI) requests

114. The council's website provides information on how to submit a FOI request. In 2014/15, the council received 1,229 such requests and responded to 1,139 (92.7%) of these within the statutory timescale. A total of 105 refusal notices were also issued, resulting in 16 requests for review. There were no appeals submitted to the Scottish Information Commissioner in respect of Falkirk Council.

115. Overall, we concluded that the council is meeting its responsibilities in terms of Freedom of Information requests and we are not aware of any concerns that require to be brought to the attention of members.

Integration of health and social care

116. The Public Bodies (Joint Working) (Scotland) Act received royal assent on 1 April 2014. The Act provides the framework for the integration of health and social care services in Scotland. It is one of the most significant public sector reforms of recent years and is to be implemented by 1 April 2016.

117. The council and NHS Forth Valley (the partnership) agreed to adopt the 'body corporate' model for the provision of integrated health and social care within the Falkirk area. This will result in the delegation of functions to a new legal entity – Integration Joint Board (IJB) – which will be accountable for overseeing the provision of these functions.

118. A Transitional Board has been established to oversee integration arrangements within the Falkirk area until such time as an IJB is formally constituted. Core voting members have been appointed to the IJB and they form the membership of the Transitional Board. Chair arrangements have also been agreed.

119. The partnership submitted its draft integration scheme to the Scottish Government by the required date (31 March 2015) for review and approval. The scheme was returned to the partnership with comments for consideration. A revised scheme was then returned to the Scottish Government in June 2015. The Order establishing the Falkirk IJB has been laid before the Scottish Parliament and will come into force on 3 October 2015.

120. The IJB's Chief Officer has a key role to play in terms of project management and ensuring the development of a strategic plan by the required date of 31 March 2016. No Chief Officer was appointed to the Falkirk partnership following a recruitment process earlier in the year. Instead, an Interim Chief Officer was appointed on 20 July 2015 for a fixed period of one year. The Falkirk partnership also agreed to appoint a part-time Chief Finance Officer for a fixed period

of one year but the recruitment process was unsuccessful and a new recruitment round is planned for the autumn.

121. A number of working groups are progressing aspects of the integration scheme including budgets, workforce and organisational development. Firm dates for the publication of the Falkirk IJB's financial and strategic plans have yet to be agreed although early February 2016 looks the most likely date.

122. Before the transfer of council funds to the IJB, due diligence is to be carried out to sign off the amounts to be transferred. The council's plans for this are outlined in the integration scheme. Management have advised that work is well underway in this area. The council and the health board have exchanged information for review on scope and budgets. This is a high risk area for the council given challenges in budgeting for social work services reported elsewhere in this report. Falkirk Council, the Audit Committee and the IJB can expect update reports on the due diligence process.

123. In July 2015, the Care Inspectorate and Healthcare Improvement Scotland published a report on their inspection of adult services in the Falkirk Partnership. The report raised concerns about progress with integration, which it described as slower than other partnerships.

124. In conclusion, while progress has been made on health and social care integration there still remains a risk that integration arrangements may not be fully developed or in place by the statutory date. This is particularly concerning given the short timescale remaining until implementation and the complexity of the task in hand.

Recommendation 5

Welfare Reform

125. Members are provided with regular updates on the welfare reform changes and the support being provided to minimise the impact on the local community. An overview of the most recent update report has been provided below:

- Falkirk Council has entered into a Delivery Partnership Agreement with the Department of Works and Pensions (DWP) to provide support to individuals affected by Universal Credit.
- Work is ongoing with partner organisations and the DWP to devise a training plan for staff.
- The Universal Credit waiting period is such that the individual will not receive their first payment until 1 month and 14 days after the application date. Officers are anticipating a surge in applications for Scottish Welfare Fund Crisis Grants and a strain on rent collection as a result.

126. We have concluded that the council has a good awareness of welfare reform and its impact on the local community. Members also receive comprehensive information on ongoing developments.

Housing and council tax benefits performance audit

127. The latest DWP statistics on average speed of processing benefits claims in Scotland for 2014/15 shows that the council has made good progress in this area.

128. Audit Scotland carried out a risk assessment of the council's benefits system in 2014 following which an action plan for improvement was agreed with management. The main areas for improvement were identified as:

- ensuring there are sufficient resources to continue to improve service performance and cope with the additional burdens arising from the government's welfare reform agenda
- addressing the reasons for the decline in overpayment recovery
- the need to publicise successful prosecutions to act as a deterrent and raise the profile of the Compliance and Investigation Team.

129. Audit Scotland's specialist benefits team will review progress against the action plan in December 2015.

Local scrutiny plan

130. The 2014/15 Local Scrutiny Plan (LSP) initiated the Best Value audit work referred to throughout this report. The 2015/16 Local Scrutiny Plan (LSP) prepared by the Local Area Network of scrutiny partners for the council was submitted to Falkirk Council in March 2015. The following scrutiny activity led by Audit Scotland was planned:

- **Community Planning Partnership (CPP) audit follow-up**: Falkirk is one of eight areas where the CPP was subject to audit. Audit Scotland plan to undertake some follow-up work in the near future to assess progress against the improvement agenda for the CPP.
- **Housing benefit performance audit**: as noted in section 129, Audit Scotland plans to review progress against the action plan agreed following the 2014 housing and council tax benefits risk assessment.

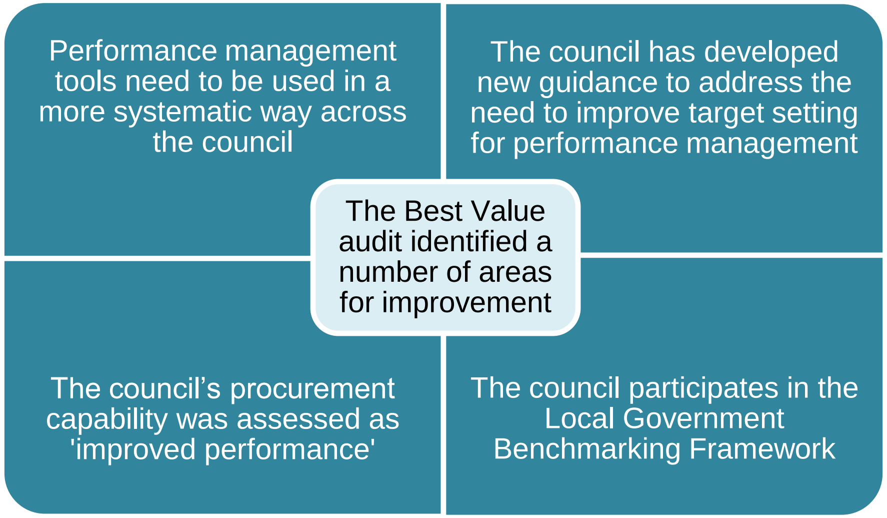
Outlook

131. The council will need to review the effectiveness of its new governance arrangements and structures to ensure they meet the challenges of future financial constraints.

132. The council has undertaken a full scale review of its service structure to reflect the impact of health and social care integration. A new Children's Service has been created and the council has moved from a 4 department to a 3 department structure from August 2015. We will continue to monitor developments in this area as part of the annual audit process.

133. Good governance will be particularly important where council resources and service delivery are devolved to third party organisations. This is of immediate priority for the council with regard to the IJB.

Best Value



134. The Local Government in Scotland Act 2003 created a statutory duty of Best Value for all councils, and the Accounts Commission for Scotland is responsible for reporting to the public on the extent to which individual local authorities meet this duty. Staff from Audit Scotland carry out the audit work on Best Value and the Controller of Audit provides audit reports to the Commission.

135. The council should have systems and processes to ensure that it can demonstrate that it is delivering Best Value by assessing and reporting on the economy, efficiency, effectiveness and equality in service provision.

Best Value audit

136. A targeted audit of Best Value at the council was carried out in November/December 2014. The aim of the audit was to assess if the council's governance arrangements are working effectively, and supporting strategic decision-making and scrutiny of service delivery. It also considered whether the council's performance management arrangements support the planning, delivery and improvement of services in the context of reducing resources and growing demand.

137. The report, published in August concludes that Falkirk generally delivers a good standard of council services, particularly in education. However, the Accounts Commission has significant concerns that the council is not well equipped to maintain or improve services in the future. It says that the council needs to make a step-change in its pace of improvement. The council's business transformation project needs to be more strategic and make a greater impact. Stronger leadership is needed for this to happen.

138. The audit identified a number of areas for improvement, some of which are referred to in this report. These relate to the scale and pace of change at the council and its approach to scrutiny, performance management and performance reporting[7]. The council is to consider the findings of the Best Value audit at a meeting on

[7] *Falkirk Council Best Value Audit 2014/15*, Audit Scotland, August 2015

7 October 2015. It will then develop an improvement plan to respond to the findings.

Recommendation 6

Procurement

139. In 2009 the Scottish Government introduced an annual evidence-based assessment, the procurement capability assessment (PCA), to monitor public bodies' adoption of good purchasing practice and as a basis for sharing best practice.

140. The council achieved an overall PCA score of 70 or ‘improved performance’ in December 2014, an increase of 10 points on the previous year. These results support the council’s procurement vision for continuous improvement as it strives to achieve ‘superior performance’ PCA status.

141. A Corporate Procurement Strategy 2014-17 was approved in April 2014. This sets out the procurement vision for the council and identifies core themes and 6 areas for development to help achieve this vision. This includes structures and systems, sustainability and small & medium sized enterprises (SMEs) and, skills and savings. A Procurement Board has been set up to monitor progress against the strategy. Overall, there is a clear commitment to further improve procurement activities within the council.

Following the Public Pound

142. The council has a statutory obligation to comply with the Code of Guidance on Funding External Bodies and Following the Public Pound alongside their wider statutory duty to ensure best value. This means that councils should have appropriate arrangements in place to approve, monitor and hold third parties to account for public funding provided to them.

143. Falkirk Council’s External Scrutiny Committee is responsible for considering Following the Public Pound reports and in particular, performance reports from the council’s largest arms-length external organisation (ALEO), Falkirk Community Trust Ltd. A reporting schedule detailing the timing of reports to the External Scrutiny Committee for each funded body is available on the council’s intranet.

144. In May 2014, we issued a letter to the Chief Executive of the council outlining the findings from our targeted follow-up audit of *Arm's-length external organisations: Are you getting it right?*[8] We highlighted that it is good practice for regular financial and performance reports on ALEOs to be presented to the council for scrutiny so that follow-up actions can be initiated where performance standards are not being met. We also indicated that opposition members should take up positions on the board of Falkirk Community Trust Ltd at the next opportunity.

145. The council has yet to fully address our recommendations. The weaknesses identified were not significant and we will continue to monitor progress as part of our annual audit process.

[8] *Arm’s-length external organisations: Are you getting it right?* Audit Scotland, June 2011

Performance management

146. The council has developed clear links between its own strategic priorities, as outlined in its Corporate Plan 2012-17, and the priorities set out in the Falkirk Community Planning Partnership Single Outcome Agreement (SOA). The corporate and SOA priorities then follow through into the service performance plans for 2014-17. Service performance is reported regularly to the council's Performance Panel.

147. As part of the Best Value audit[9], the council's performance management arrangements were assessed, in particular, how the existing arrangements support the planning and delivery of services with reduced resources.

148. The Best Value audit report acknowledged that the council has a range of tools for how it performs such as a programme of service reviews and a self-assessment tool based on the Public Sector Improvement Framework. The report concluded that the council needs to do more to make sure it uses its performance management arrangements in a more systematic way. Performance monitoring and management should drive improvement and support the transformation of service delivery. The report also says that Members' decision making needs better support from the council's performance management system.

[9] *Falkirk Council Best Value Audit 2014/15*, Audit Scotland, August 2015

Overview of performance targets in 2014/15

149. As reported in previous years, the council still has work to do to improve target setting. The Best Value audit report [10] identified the following areas for improvement:

- In some instances there was no baseline figure provided in order to assess whether the services had improved or otherwise, the use of trend arrows was inconsistent and often confusing and there was a lack of contextual information to help interpret the data.
- Some performance indicators were not SMART, did not have a clear target, and used the wording 'reduce', 'maintain' or 'increase' without stating how much reduction or increase was required.[11]
- Errors in some of the traffic light reporting, with indicators showing 'green' when performance was actually poor or not meeting its target.

150. The council's corporate Best Value Working Group (BVWG) has recently reviewed the performance measures that are in place across the council and developed new guidance designed to improve target setting for performance improvement.[12] It is too early to conclude on the impact that the guidance has had on the

[10] *Falkirk Council Best Value Audit 2014/15*, Audit Scotland, August 2015
[11] Specific, Measurable, Achievable, Relevant, Timely
[12] Performance Framework Guidance, Falkirk Council, July 2015.

council's performance reporting, however, we will continue to monitor progress in this area.

151. At the time of reporting the council's 2014/15 annual performance statements were not available. Therefore, we were unable to comment on overall performance for the year. Performance information should be published on the council's website in a timely manner to ensure that the performance information available to the public is relevant.

Statutory performance indicators (SPIs)

152. The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils to provide citizens with fair, balanced and engaging performance information reporting.

153. For 2014/15 three (SPIs) were prescribed:

- SPI 1: covering a range of information relating to areas of corporate management such as employees, assets and equalities and diversity
- SPI 2: covering a range of information relating to service performance
- SPI 3: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

154. An evaluation of all Scottish councils' approaches to public performance reporting was carried out by Audit Scotland's Performance Audit and Best Value group during 2014/15 and reported to the Accounts Commission in June 2015. An individual assessment for Falkirk Council was issued to the Leader, Chief Executive and Chair of the Audit Committee in July 2015.

155. In terms of compliance with SPI 1 and SPI 2 and more specifically, the eighteen themes within them, Falkirk Council was one of the poorer performing councils. The assessment concluded that there was scope for improvement in 8 out of the 18 corporate management and service performance themes.

156. Audit Scotland's Director of Performance Audit and Best Value submitted a report on *Statutory Performance Information 2013/14: An Evaluation of Council's Responses to the 2012 Direction (June 2015)* to the Accounts Commission in June 2015. It highlighted a number of examples of good practice in public performance reporting across Scottish local authorities. The council should consider examples of good practice as it seeks to improve its approach to public performance reporting. We will continue to monitor progress in this area through the annual audit and shared risk assessment process.

157. In 2015, Audit Scotland found that all Scottish councils, including Falkirk, reported on performance information as required by the Local Government Benchmarking Framework.

National performance audit reports

158. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for

Scotland. During 2014/15, a number of reports were issued which are of interest to the council. These are outlined in appendix III.

159. In light of our previous recommendation the council has introduced a process for responding to Audit Scotland's national performance reports. This was presented to the Audit Committee in April 2015. The Audit Committee will receive an annual update showing how national performance reports have been reviewed, which committee considered them and any actions to be taken locally by service directors in response to national findings.

160. The above process should ensure that all national reports and their impact on the council are appropriately considered by both officers and members.

Equalities

161. The Equality Act 2010 introduced a new public sector 'general duty' which encourages equality to be mainstreamed into public bodies' core work. The Act requires that by no later than 30 April 2015 and every two years thereafter, public bodies must publish a report on the progress made to achieve the equality outcomes it has set.

162. At its meeting on 28 April 2015 the Executive of the council considered the Equality Mainstreaming and Equality Outcomes update report is readily accessible on the council's website.

163. We reviewed the aforementioned report and concluded that the council has met its statutory duty and has addressed the following key areas:

- publish information on progress made in mainstreaming equality within the council
- report on progress towards achieving quality outcomes published in 2013
- publish annual employee information and details of the progress made in gathering and using information to better meet the duty
- publish gender pay gap information.

164. The report also includes an action plan outlining the areas for improvement over the next two year period. We concluded that the council is taking positive steps to ensure that equality is embedded throughout the organisation.

Outlook

165. Falkirk like other councils faces the key challenges of reducing budgets, an aging population and a growing demand for services. The council recognises that it will have to prioritise services, and spending commitments, to make the best use of available resources as well as challenge existing ways of doing things.

166. The Accounts Commission's Best Value report said that council needs to be more ambitious in its plans and demonstrate an increased pace of change and improvement. The Commission requires a report on progress from the Controller of Audit by the end of 2016. It is important, therefore, that the council is able to demonstrate that action has been taken to address the improvement areas identified by the Best Value audit.

The audit of Falkirk Temperance Trust

167. The preparation and audit of financial statements of 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 annual accounts, and require an accompanying auditor's report where any legislation requires an audit.

168. The Local Government (Scotland) Act 1973 specifies the accounting and audit requirements for any trust fund where a local authority, or some members of the authority, are the sole trustees (i.e. only members of the authority are trustees).

169. Therefore, as a consequence of the interaction of Local Government (Scotland) Act 1973 with the charities legislation, a full and separate audit and auditor’s report is required for each registered charity where members of Falkirk Council are sole trustees, irrespective of the size of the charity.

170. Our duties as auditors of the charitable trust administered by Falkirk Council are to:

- express an opinion on whether the charity's financial statements properly present the trusts financial position and are properly prepared in accordance with charities legislation
- read the trustees' annual report and express an opinion as to whether it is consistent with the financial statements
- report on other matters by exception to the trustees and to the Office of the Scottish Charity Regulator (OSCR).

171. We have given an unqualified opinion on these matters with respect to the 2014/15 financial statements of the Falkirk Temperance Trust.

Appendix I – Significant audit risks

The table below sets out the financial statement audit risks we identified during the course of the audit and how we addressed each risk in arriving at our opinion on the financial statements.

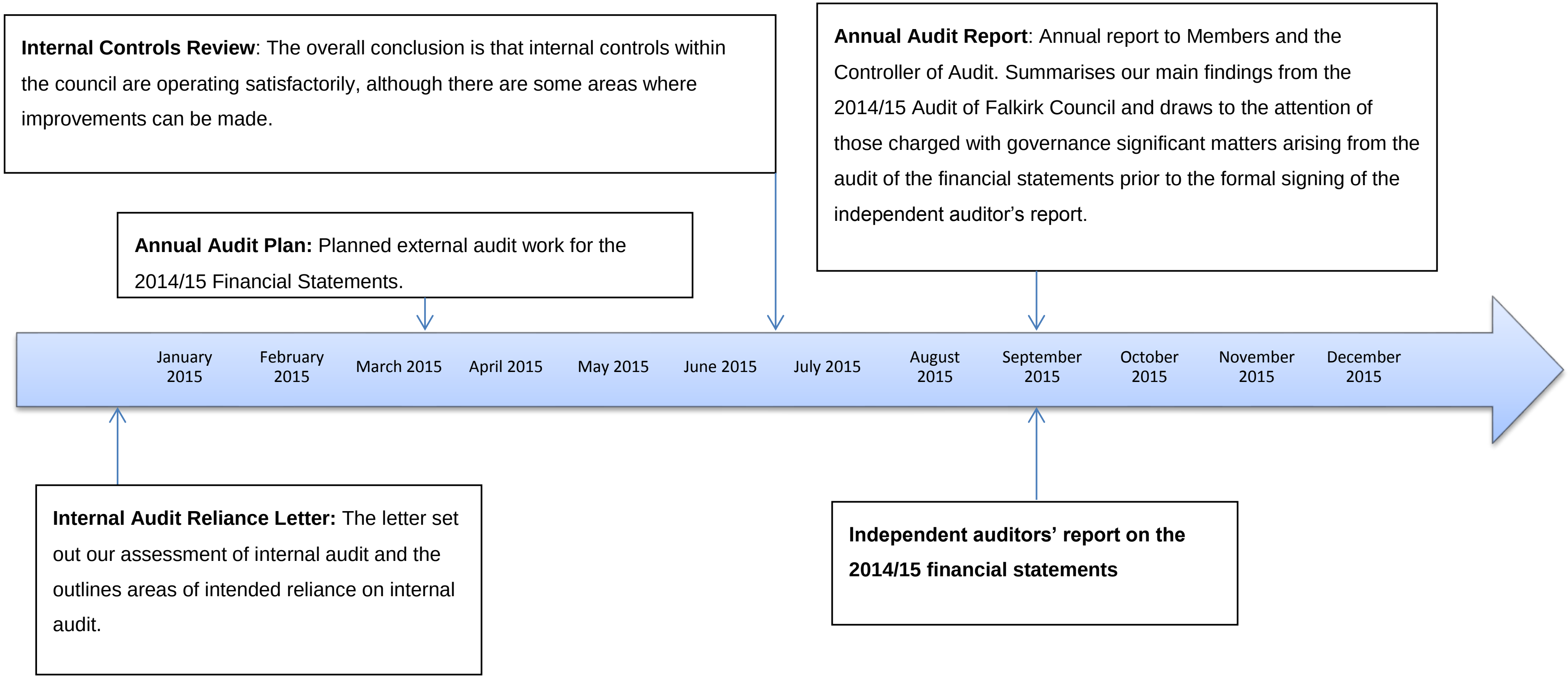
Audit Risk	Assurance procedure	Results and conclusions
Risk of material misstatement		
Income: Auditing standards (ISA 240 *The auditor's responsibility to consider fraud in an audit of financial statements*) requires auditors to presume a risk of fraud where income streams are significant. Falkirk Council receives a significant amount of funding from the Scottish Government; however some £296m is received from other sources, including service income from fees and charges. The complexity of income means there is an inherent risk that income could be materially misstated. It is our opinion that the council has mitigating controls in place to reduce this risk although risk can never be fully eliminated.	• Controls testing of the accounts receivable system and transaction testing covered service income areas. • Detailed testing of revenue transactions focused on areas considered to be of higher risk. • Tested of significant grants received. • Focused testing on local taxation systems.	We carried out the assurance procedures as planned and did not identify any significant errors. On this basis, we concluded that income is free from material misstatement.

Audit Risk	Assurance procedure	Results and conclusions
Management override of controls: ISA 240 recognises that management are in a unique position and have the ability to manipulate accounting records, and prepare fraudulent financial statements, by overriding controls that would otherwise appear to be operating effectively. ISA 240 requires that this risk be recognised in audit plans.	• Testing on the appropriateness of journal entries and other adjustments recorded in the financial ledger and financial statements. • Reviewed the accounting estimates for bias. • Evaluated significant transactions that are outside the normal course of business • Focused testing of the regularity and cut-off assertions during the financial statements audit.	We carried out the assurance procedures as planned and did not identify any instances of management override of controls.
Accounting for non-current assets: Errors made in 2013/14 in relation to asset revaluation and componentisation resulted in material audit adjustments to Reserves/CIES amounting to £4 million. Management agreed to investigate the causes of these errors and take corrective action. There is still the potential for errors to occur and this represents a significant risk of material misstatement (RoMM).	• Early substantive testing of significant non-current asset areas. • Ongoing liaison with finance officers to discuss technical/Logotech issues.	We carried out the assurance procedures as planned and did not identify any errors in relation to asset revaluation and componentisation.

Audit Risk	Assurance procedure	Results and conclusions
Accounting for Exit packages: In recent years there have been errors in the allocation of exit package costs to the correct year of account. There is the risk of similar errors occurring in 2014/15 and, whilst there is no possibility of any breach of accounts materiality, the correct disclosure of these transactions has to be considered material by nature.	• Early substantive testing of supporting evidence for exit packages disclosures.	We carried out substantive testing of exit packages during the financial statements audit and concluded that exit packages have been disclosed in the correct accounting year.
Equal pay: The council has made a provision for equal pay; however, there is still the potential for this to be misstated as the legal position develops. We will monitor the situation throughout the year and review the equal pay provision as part of the 2014/15 financial statements audit process.	• Monitored legal developments nationally and assessed potential financial impact on the council. • Reviewed the calculations and assumptions supporting provision.	The council has included a provision in the 2014/15 accounts and a contingent liability has been disclosed. The actual cost to the council remains unknown, however, based on the information available we concluded that the provision is fairly stated.
Preparation of accounts: The substantive position of Depute Chief Finance Officer is still to be filled, and presently is being covered on an acting-up basis. The finance team will also be losing a number of experienced staff through retirement. This loss of intellectual capital represents a risk to the accurate and timely completion of the unaudited financial statements.	• Ongoing liaison with finance officers to discuss technical issues and overall progress.	The position of the Depute Chief Finance Officer is still being covered by a job share on an acting-up basis. Despite our concerns, the council were able to provide the unaudited accounts and a comprehensive working papers package in good time.

Appendix II

Summary of Falkirk Council local audit reports 2014/15



Appendix III

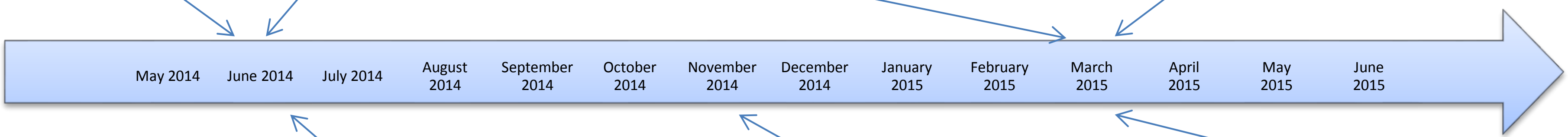
Summary of Audit Scotland national reports 2014/15

School education - Educational attainment is improving overall in Scotland, but there is a need to close the gap between the lowest and highest performing pupils.

Self-directed support - New legislation means councils will have to transform the way they deliver social care, offering people choice and control over the support they need.

Borrowing and treasury management in councils - Councils are meeting professional requirements but need to do more to set out the longer term implications of borrowing and other debt on their finances.

Update on developing financial reporting - Following the Smith Commission the framework for Scotland's public finances is undergoing fundamental change. The Scottish Parliament will have enhanced financial powers from April 2015. The report emphasises the importance of comprehensive, transparent and reliable financial reporting for accountability and decision-making. The report also notes that while the audited accounts of public bodies across Scotland provide a sound base for financial reporting and scrutiny, there is no single complete picture of the devolved public sector's finances.



Scotland's public finances - a follow up: Progress in meeting the challenges – Leaders and managers must produce balanced budgets and hold people in their organisations to account for how the money is used and what is achieved. Councillors have an important role in ensuring that approved budgets are used to best effect. To do this they need good-quality and timely financial information. They need to take a longer-term view on: options available for services; services standards and affordability; and, the sustainability of financial plans.

Community planning: Turning ambitions into action – Many Community Planning Partnerships are still not clear about what they are expected to achieve. Local data should be used to help set relevant, targeted priorities for improvement that will address inequalities within specific communities.

An overview of local government in Scotland – A high level, independent view on the progress councils are making in managing their finances and achieving Best Value.

Appendix IV

Action plan

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
1 **17/37** **21/62**	**Budgeting** The overspend against the approved budget in the year was largely attributable to spending in social work services and the omission of voluntary severance costs from the budget. Early financial position reports have forecast a significant overspend in social work services in 2015/16. **Risk** The budget submitted to members for approval does not accurately reflect the council's expenditure for the year. **Recommendation** The budget should include all anticipated costs and be reviewed to take account of areas of recurring overspend.	The overspend in Social Work was not anticipated at the time of the 2014/15 budget. The 2015/16 budget included £2 million to deal with budget pressures and members were fully aware of the pressures within Social Work through regular reports. Voluntary severance (VS) is not the council's first or only approach to reducing staff numbers. Staff numbers should be managed by a combination of : • Vacancy management • Not filling temporary posts when they terminate • Redeploying staff • VS as a last resort. As a result, it is difficult to predict VS costs at the start of the year. However, this is closely monitored throughout the year and reported to Members as appropriate. The means of funding any VS has also been reported to Members i.e. use of reserves and capital receipts to fund statutory elements of any compensatory lump sum. As numbers crystallise the budget will be updated.	Chief Finance Officer	February 2016

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
2 **21/59**	**Financial Management** The council has been utilising reserves over the last 2 years to offset overspends against the revenue budget. **Risk** The council depletes its reserves and is unable to maintain a sufficient contingency fund to respond to unexpected events or help cushion the impact of uneven cash flows. **Recommendation** In line with the council's reserves strategy, reserves should not be used to fund recurring annual expenditure.	Reserves necessarily need to be used where there is an aggregate overspend. The approved budget for 2015/16 and 2016/17 does not include the use of reserves to fund recurring annual expenditure. No further action proposed.	N/A	N/A

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
3 **22/64**	**Financial Sustainability** The delivery of savings over the next 3 years will continue to remain challenging, with £15.2 million of savings in 2017/18 still to be agreed. **Risk** The council is unable to achieve the necessary savings. **Recommendation** The council should identify the savings required and develop detailed plans to show how these will be delivered.	Work is well underway to produce a balanced budget for 2017/18, including the development of detailed plans. It is anticipated savings options will be presented to Members in October 2015	Chief Finance Officer	February 2016

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
4 29 / 107	**National Fraud Initiative** The council has not submitted data for blue badges as part of the 2014/15 NFI exercise. **Risk** There is a risk of fraudulent misuse of blue badges across the council area. This could have a detrimental impact on the availability of disabled parking spaces for genuine blue badge holders. **Recommendation** The council should ensure that blue badge data is submitted and matches are adequately investigated.	Blue Badge data is held centrally, in a national database, by the Scottish Government. Given the difficulties encountered in attempting to remotely download the required data, it would be helpful if, for future NFI exercise, one national submission of Blue Badge data could be made. Robust checking on eligibility for blue badges in undertaken as part of the three yearly renewal process. Consideration will, however, be given to the potential for additional checking of blue badge usage, but this will be sensitive and proportionate to the risk as it applies to Falkirk.	Internal Audit Manager	October 2016

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
5 **31 / 124**	**Health and Social Care Integration** The integration of health and social care services in Scotland requires to be implemented from 1 April 2016. **Risk** There is a risk that the council and the local health board will not be fully prepared for the integration of health and social care from 1 April 2016. This could adversely impact on the effectiveness of service delivery. **Recommendation** The council, with its health partner, needs to ensure that plans are progressed in order for the statutory deadline to be met.	There are a range of workstreams geared to ensure that the revised arrangements can be implemented from 1 April 2016. Periodic staus reports are submitted to Members and the Transitional Board.	Chief Executive	March 2016

No. Page/ para	Issue/risk/recommendation	Management action/response	Responsible officer	Target date
6 **34 / 138**	**Best Value Audit 2014/15** The audit identified a number of areas for improvement. These relate to the scale and pace of change at the council and its approach to scrutiny, performance management and performance reporting. **Risk** The council fails to make adequate progress against the improvement agenda in time for the Best Value follow-up audit in 2016. **Recommendation** The council should develop an action plan based to take forward the improvements and monitor progress.	Our report to council in October 2015 will include an action plan.	Director of Corporate and Housing	October 2015