AUDIT SCOTLAND

Fife Council

2014/15 Audit

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 of Gillian Woolman as the external auditor of Fife Council for the period 2011/12 to 2015/16.

This report has been prepared for the use of Fife 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.

Key contacts

Gillian Woolman, Assistant Director
gwoolman@audit-scotland.gov.uk

Bruce Crosbie, Senior Audit Manager
bcrosbie@audit-scotland.gov.uk

Parminder Singh, Senior Auditor
psingh@audit-scotland.gov.uk

Audit Scotland
18 George Street
Edinburgh
EH2 2QU
Telephone: 0131 625 1500
Website: www.audit-scotland.gov.uk

Contents

Key messages

Audit of financial statements	• Unqualified auditor's report on the 2014/15 financial statements. • Unqualified auditor's report on the Fife Council Charitable Trust administered by the council.
Financial management and sustainability	• The council has sound financial management arrangements. • Significant budget pressures identified over the years 2016 to 2018 with potential savings required of £75 million. • Short to medium term strategy in place to help bridge the funding gap, with acknowledgement of further transformation required in delivering services. Change programme to be developed to address transformational approach.
Governance and transparency	• Sound governance arrangements in place. • Systems of internal control operated effectively. • The council has an effective internal audit function and sound anti-fraud arrangements. • Overall, Fife Council is transparent in its decision making processes and in reporting performance.

Best Value	• Well established approach to best value. • Public performance reporting is effective and is supported by effective performance. management with performance measured against key themes. • Benchmarking is used to monitor and improve performance.
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 continued strong governance and leadership will be needed to achieve continuous improvement.

Introduction

1. This report is a summary of our findings arising from the 2014/15 audit of Fife Council. The report is divided into sections which reflect our public sector audit model.

2. The management of Fife 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 Fife 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 Fife Council understands its risks and has arrangements in place to manage these risks. The council and executive officers group 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.
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, corporate governance statement and the remuneration report. We have nothing to report in respect of these statements.
Charitable trusts	• We have completed our audit of the 2014/15 financial statements of the charitable trust administered by Fife Council and issued an unqualified independent auditor's report.
Group accounts	• Fife Council has accounted for the financial results of seven companies and the common good and trusts funds as subsidiaries in its group accounts for 2014/15. The overall effect of consolidating these balances is to increase total reserves and net assets by £3.4 million.
Whole of government accounts	• The council submitted a consolidation pack for audit by the deadline. This is in the process of being audited and the certified return will be submitted to the Scottish Government by the due date.

Submission of financial statements for audit

9. We received the unaudited financial statements on 30 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 to deadline.

Overview of the scope of the audit of the financial statements

10. 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 Standards and Audit Committee on 26 February 2015.

11. 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.

12. 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.

13. 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

14. 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).

15. 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.

16. We summarised our approach to materiality in our Annual Audit Plan. Based on our knowledge and understanding of Fife Council we set our planning materiality for 2014/15 at £12.5 million (1% of gross expenditure). We report all unadjusted misstatements greater than £100,000.

17. Performance materiality was calculated at £6.3 million, to reduce to an acceptable level the probability of uncorrected and undetected audit differences exceeding our 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 should be amended to £11.6 million and performance materiality to £5.8 million.

Evaluation of misstatements

19. A number of 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. None of these adjustments had an impact on the general fund balance.

20. We are required to report to those charged with governance all unadjusted misstatements which we have identified during the course of our audit, other than those of a trivial nature and request that these misstatements be corrected. Two monetary misstatements have not been processed through Fife Council's financial statements by management. If adjusted this would result in an estimated net charge of £3.1m in the 2014/15 Comprehensive Income and Expenditure Account. Due to the application of statutory mitigations, the impact of the errors on the general fund balance and the net assets of the council and its group would be a reduction of £2.9 million.

Significant findings from the audit

21. 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 judgment, are significant to the oversight of the financial reporting process.

22. 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
Employee related claims: Since 2013/14, the council has increased its provision in connection with equal pay compensation claims. The ultimate cost to the council remains uncertain and an element has been considered as a contingent liability. Judgement is applied by management to determine the level of the provision and we have been advised by management that the provision is the best estimate of the liability, based on information available at this time. We have also been advised that management believe that the council has a robust case for contesting any claims that are not currently included in the estimated provision.	• We have reviewed the calculation of the equal pay provision and concluded that the provision is adequate based on the information currently available. We will maintain dialogue with council officers up to the date of the audit opinion and seek written representations from management that the provision is adequate based on the most current available information on that date.
Group accounts: A formula error has resulted in both gross income and gross expenditure in the Group Comprehensive Income and Expenditure Statement being overstated by £27.1 million. This has no impact on the group net cost of services or group balances. In addition, a number of disclosures required under the new group requirements, as detailed in the 2014/15 Code were not included in the financial statements. Further amendments were identified by council officers following the receipt of the audited accounts for one of the subsidiaries (Fife Resources Solutions LLP). Errors contained in the draft accounts used by the council in the preparation of the group accounts resulted in the CIES being overstated by £0.7 million and both the net assets and reserves balance being overstated by £1.7 million.	• Management agreed to amend the financial statements for all of these errors.

Issue	Resolution
Finance lease arrangement of common good assets: Officers undertook a review of heritable property assets prior to 2014/15 to identify assets which were included in the Council's Balance Sheet as council assets (due to being operated and managed by council services) but were actually owned by the Common Good. The process resulted in the setting up of an arrangement from 1 April 2014 to account for these assets under a finance lease arrangement in the financial statements. Under this arrangement, assets to the value of £58.8 million are included in the Council Balance Sheet as Property, Plant & Equipment at 31 March 2015. £58.2 million of these assets were already included in the Balance Sheet and the finance lease arrangement now formalises this arrangement. The remaining £0.6 million was identified through the council review. The arrangement has been disclosed in the notes to the financial statements but in our view there would be merit in including comment in the Management Commentary.	• Management agreed to include commentary on the arrangements in the Management Commentary.
Non-current assets awaiting demolition. Four properties, two schools and two care homes are due to be demolished in 2015/16. These assets should have been subject to an impairment review and written down from £4.6 million to £0.3 million to reflect their remaining useful lives (one year). The assets remain on the asset register with a remaining useful life of 16 -18 years for the schools and 5 years for the care homes. Due to statutory mitigations, this misstatement has no impact on the general fund balance.	• Management decided not to amend the accounts for this misstatement but has agreed to write off the assets in 2015/16.

Issue	Resolution
ERP Accounts Payable (ERP AP) processing errors: A number of processing errors were identified in the ERP AP system which have the impact of understating both creditors and service expenditure. The creditors balance of £151.2 million includes accruals of £11.8 million. However this sum includes £3.6 million of debit balances which have reduced the accruals balance. Testing of the 10 largest balances, totalling £2.1 million, revealed that 7 were in error, totalling £1.9 million. The remaining £1.7 million of debit balances is represented by over 3,000 debit balances. In order to estimate the extent of the error we have extrapolated our results to arrive at an overall error of £2.9 million. Management has chosen not to investigate the remaining debit balances further, nor to amend the financial statements on the grounds of materiality.	• Management decided not to amend the accounts for this misstatement but has agreed to issue clear instructions to operators and to introduce a control check in 2015/16.

Future accounting and auditing developments

Revisions to the Code of Practice

23. 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 2015/16 Code.

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

25. **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.

Health and Social Care Integration

26. 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 and the Accounts Commission will appoint auditors to audit the financial statements. The Executive Director Finance and Corporate Services is to ensure appropriate financial assurance measures are completed and reported in line with Scottish Government guidance prior to 31 March 2016.

Financial management and sustainability

Net service budget expenditure £700.3m

Service Outturn £708.1m

Service Budget Overspend £7.8m

Original planned capital expenditure £196.1m

Outturn Capital spend £156.6m

Capital underspend £39.5m

Usable reserves £100.5m

Outturn usable reserves £100.5m

Increase in usable reserves over 2013/14 £9.9m

General fund balance £92.4m

Committed balances £60.0m

Uncommitted balances £32.4m

Financial management

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

28. 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

29. The council reported an accounting surplus of £2.3 million on the provision of services in 2014/15. Adjusting this balance to remove the accounting entries required by the Code, the council actually increased its general fund balance by £14.8 million (1.9% of total revenue budget). The surplus was achieved despite significant overspends in the provision of services which totalled £7.8 million, and were mainly due to overspends of £4.0 million in Education and Children's Services and £5.5 million in Health and Social Care, offset by underspends in other services.

30. Key variations in performance of services against budget include:

- Education and Children's Services overspend of £4.0 million, mainly due to overspends on purchased care placements (£9.0 million), offset by underspends in the management of devolved school budgets arising from shortages in both permanent and supply teachers to take up vacancies and cover staff absences (£5.2 million)
- Health and Social Care overspend of £5.5 million, mainly due to higher than anticipated levels of homecare, nursing and residential placements for older people service (£2.4 million), high number of complex care packages within adult placements (£2.6 million), the non-achievement of savings in reshaping the social work programme (£1.2 million), offset by an underspend in staff costs (£1.6 million) due to ongoing vacancy management.

31. The £7.8 million overspend in the services' budgets was offset by £17.1 million of underspends in non-service budgets turned the £7.8 million overspend into a £9.3 million underspend. The non-service underspends included loan charges underspends of £11.4 million (mainly due to re-phasing of the capital plan and changes to borrowing strategies) and contingency budgets underspends of £5.3 million (arising from lower levels of spending against funding set aside for Welfare Reform, impact of extreme weather, inflation and the revenue consequences of capital spending).

32. Additional income of £5.5 million was also received for non-domestic rates (unanticipated Business Rates Incentive Scheme income of £2.5 million) and council tax (£3.0 million due to changes in council tax legislation and increased Scottish Government funding in relation to the council tax reduction scheme). This, when added to the £9.3 million underspend above resulted in the increase in the general fund balance of £14.8 million.

33. The amounts available in 2014/15 to offset service overspends may not be sustainable in the long term and could impact on the longer term financial sustainability of the council.

Refer action plan, point 1

34. The council is required by legislation to maintain a separate housing revenue account 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. The HRA budget was set at £102.1 million with actual spend during the year of £101.6 million, which resulted in a small underspend of £0.4 million.

Financial management arrangements

35. 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.

36. 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.

37. We also reviewed the council's financial regulations, which are revised as required and at least once per council term, and concluded that they are comprehensive.

38. Financial monitoring reports (both revenue and capital) are submitted to the Executive Committee on a quarterly basis. Broadly, the reports are comprehensive and clearly written. In our 2014/15 report on key internal controls we noted that issues with the implementation of the new Oracle Enterprise Resource Planning ERP) system had resulted in these reports containing caveats, which stipulated that due to problems extracting information from the ERP financial system, data manipulation had been required to produce financial monitoring report. Nevertheless, officers consider the information presented to members to be robust for scrutiny purposes. Our 2014/15 key controls report contained an action plan point to seek improvement in this area.

39. As auditors we attend a number of council and committee meetings each year. Members provide a good level of challenge and question budget holders on significant financial variances and service performance issues.

Conclusion on financial management

40. We have concluded that the council's financial management arrangements are broadly satisfactory. However, there are some areas where improvements could be made to enhance existing arrangements.

Financial sustainability

41. 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.

42. 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.

Effective long-term financial planning, including workforce planning is crucial to sustainability.

Reserves

43. As shown in Exhibit 1, the overall level of usable reserves held by the council increased by £9.9 million compared to the previous year and totalled £100.5 million.

Exhibit 1: Usable reserves

Description	31 March 2014 £ million	31 March 2015 £ million
General fund	85.0	92.4
Housing revenue reserve	2.0	2.0
Capital grants unapplied	nil	1.6
Capital receipts reserve	nil	nil
Insurance fund	3.6	4.5
Total usable reserves	**90.6**	**100.5**

Source: Fife Council 2014/15 financial statements

44. Of the total amount for useable reserves, £92.4 million is within the general fund, which has no restrictions on its use. The principal purpose of holding a general fund balance is to provide a contingency fund to meet unexpected events and as a working balance to help cushion the impact of uneven cash flows.

45. Planned commitments from the general fund balance amounted to £60.0 million, leaving an uncommitted general fund balance of £32.4 million. Planned commitments include the support to social work during transition (£7.6 million), reforming public services (£6.8 million), windpower (£6.2 million) and investment to support community projects in Fife (£6.5 million).

46. CIPFA best practice guidance recommends that councils should hold unallocated general fund balances of between 2% - 4% of

revenue expenditure. The council's own policy is to hold a minimum of 2% of their annual turnover over the medium term. The council's unallocated general fund balance of £32.4 million (as at 31 March 2015) represents 4.2% of their revenue budget, which exceeds the council's policy and is also just above the upper end of the CIPFA best practice range.

47. While the unallocated general fund balance is high, we recognise that there are significant financial challenges ahead which could significantly diminish the council's balances going forward, including potential equal pay liabilities, workforce change and increased demand for services. The Executive Director Finance and Corporate Services is therefore exercising caution in maintaining the council's balances.

Financial planning

48. The council's 2015-18 budget report (February 2015) describes the next three years as "the most difficult the council has ever faced" and estimates a continuing budget gap of £33 million in 2016/17, rising to £73 million by 2017/18 (£73 million is equivalent to a cut of almost 10% in the council's total revenue expenditure). Since the budget report, a revision in the budget gap has been reported to the Executive Committee in August 2015 amending the gap to £21 million in 2016/17, rising to £75 million in 2018/19.

49. While the council is actively seeking to identify savings opportunities, the realisation of these savings will become progressively more challenging year on year and the council has recognised that further transformational change will be required.

50. The council has a financial strategy to address the budget gap consisting of two elements:

- Generating efficiency savings over the three year period 2016-19 (2.5% in 2016/17 followed by a further 1% per annum over the period 2017-19), coupled with savings from corporate initiatives over that period e.g. mobile and flexible working
- These savings will not be sufficient to meet the gap and services are being tasked with identifying longer term transformation in the way they deliver services, based on outcomes and within indicative service resources (based on the funding gap). The council intends to establish a change programme from this process.

Council transformational programme

51. In 2013/14, the council introduced the Shared Support Services (3S) Programme as an enabler for the transformation of the way the council delivers their services.

52. Key strands of the programme going forward are:

- Transforming procurement
- Creating shared support services (centralising business support and back office services).

53. Savings of £10 million were included in the council's 2014/15 budget calculations for the period 2014-17 for these two initiatives, with a further £2 million of savings identified for 2016/17 in the 2015/16 budget calculations for Creating shared support services. These

savings have already been accounted for in arriving at the budget gap figures noted above.

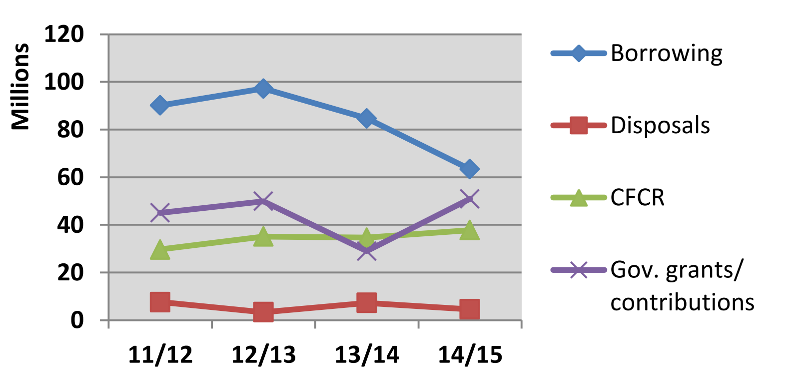
Capital programme

54. The council spent £156.6 million on its 2014/15 capital programme (£71.7 million on the HRA programme and the remaining £84.9 million on other general fund services). This was £39.5 million less than planned expenditure of £196.1 million.

55. The slippage of £39.5 million is an increase in the level of £7.0 million reported in 2013/14. The main areas of slippage include £19.2 million for the HRA investment programme (including £15.8 million due to the re-profiling of Affordable Housing expenditure following more robust projections), £5.6 million for the non-HRA investment programme (including £5.2 million for the on-lending of funds for the National Housing Trust (NHT) Initiative and the timing of the payment for the NHT project in Rosyth for which payments originally planned for March 2015 slipped to April 2015) and £5.7 million for Area Services i.e. community facilities etc. (including £2.1 million for the Kelty Community Hub due to a delay in the demolition of the previous community centre).

56. Capital expenditure was funded as shown at Exhibit 2:

Exhibit 2: Sources of finance for capital expenditure 2011/12–2014/15



Source: Fife Council Annual Accounts 2011/12 to 2014/15

57. The requirement to borrow reduced as a result of the reduced capital investment plan for 2014/15, while Government grants and contributions increased significantly, mainly due to additional capital grants received for specific projects such as Energy Conservation and the Levenmouth School project and for national priorities in relation to Children and Young People, Early Years and Free School Meals.

58. Going forward, the council plans to invest £1,053 million in capital projects during the period 2015-2025, with 56% of the planned expenditure due within the next three years. Significant capital investments will include £82.5 million on schools, £22.7 million on care for older people, £69.3 million on roads infrastructure, £134.3 million on affordable housing and £350.1 million on the Scottish Housing Quality Standards.

Workforce Management

59. 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.

60. The council introduced a workforce change programme in 2011 and it remains committed to the programme of planned workforce reduction as part of a council-wide programme of improvements and efficiencies to mitigate the impact of projected budget reductions. Council services have developed their own workforce change plans to deliver future savings to assist in closing the council's predicted budget gap.

61. In June 2015, a report to the Council Executive Team reassessed the estimated workforce reduction over the period 2011 to 2018 at 2,375 full time equivalent (FTE) posts. Of this total amount, 1,894 FTE posts have already been released up to 2014/15 with 1,125 reductions funded through exit packages and the remaining 769 through what the council terms as 'mitigating factors' e.g. natural turnover.

62. The scale of the financial challenge facing the council means that a further reduction in the workforce is probable as these reductions alone are not sufficient to close the projected budget gap over the period to 2018/19, however the decision to approve applications is likely to become tougher as the workforce shrinks and the potential impact on service delivery is amplified.

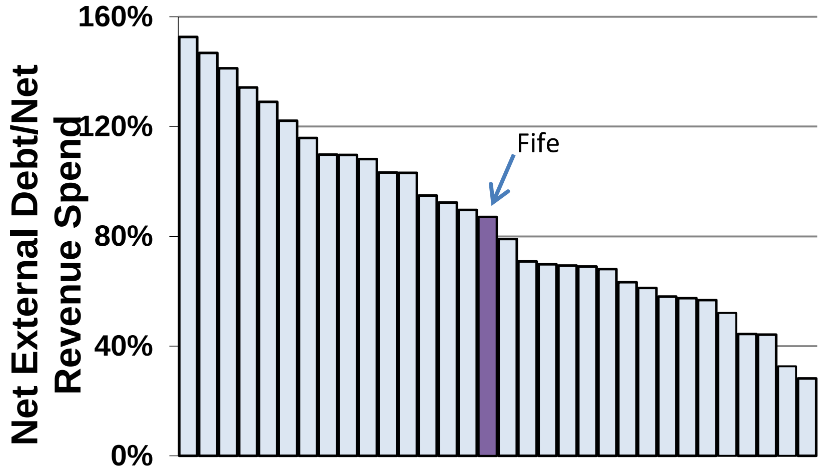
Treasury Management

63. High levels of debt may reduce a council's budget flexibility going forward as revenue resource has to be set-a-side to service that debt. The impact that debt levels have on net revenue expenditure will be affected by interest rates and repayment periods.

64. At 31 March 2015 long term borrowing stood at £675.7 million, an increase of £30.7 million on the 2014 borrowing level of £645.0 million. During the same period, short term borrowing reduced from £83.6 million to £64.4 million.

65. Analysing long term borrowing as a proportion of net revenue stream gives an indication of the relative indebtedness of the council. Exhibit 3 shows long term borrowing as at 31 March 2015 as of net revenue stream a proportion of the actual outturn for the year for all mainland councils in Scotland.

Exhibit 3: Scottish councils' long term borrowing as a percentage of net revenue stream



Source: Scottish councils' unaudited accounts 2014/15

66. The exhibit shows that Fife Council continues to be in the middle range relative to other Scottish councils.

Pension liability

67. The net pension liability on the council's balance sheet has increased from £777.7 million in 2013/14 to £862.4 million in 2014/15, an increase of £84.7 million. A similar position is also reflected in the balance sheet for the group, with the group pension liability increasing from £785.5 million to £876.4 million. The pension liability represents the difference between expected future pension payments and the underlying value of pension fund assets available to meet this cost. Movements in the value of the real discount factor, used to estimate the current value of future pensions, can have a significant impact on the value of the pension liability. The real discount factor has reduced from 1.5% at March 2014 to 0.8% at March 2015. This has contributed to the increased net pension liability at 31 March 2015.

68. A triennial valuation of the Fund was carried out as at 1 April 2014. The valuation reported that the Fund was 87.8% funded and had assets of £1,589 million. New contribution rates were put in place from 1 April 2015. It is expected that new contribution rates will increase convergence between the pension liability and the underlying assets.

Conclusion on financial sustainability

69. The council has an adequate level of reserves and is generally containing its expenditure within annual budgets (albeit that this is only being achieved through corporate savings, which may not be sustainable). Rising demand for and costs of services will continue to place a strain on the council's capacity to deliver services at the current levels. The council has developed a strategy to achieve efficiency savings in the short to medium term. Overall we have concluded that transformational change is required if the council's financial position is to remain sustainable in the longer term.

Outlook

70. Councils face increasingly difficult financial challenges. In the context of overall reductions in public sector budgets, between 2010/11 and 2013/14, Scottish Government funding for councils decreased by 8.5 per cent in real terms to £10.3 billion. At the same time, demand for council services has increased, largely due to population changes. Increased pension contributions and national insurance changes will create further cost pressures on the council.

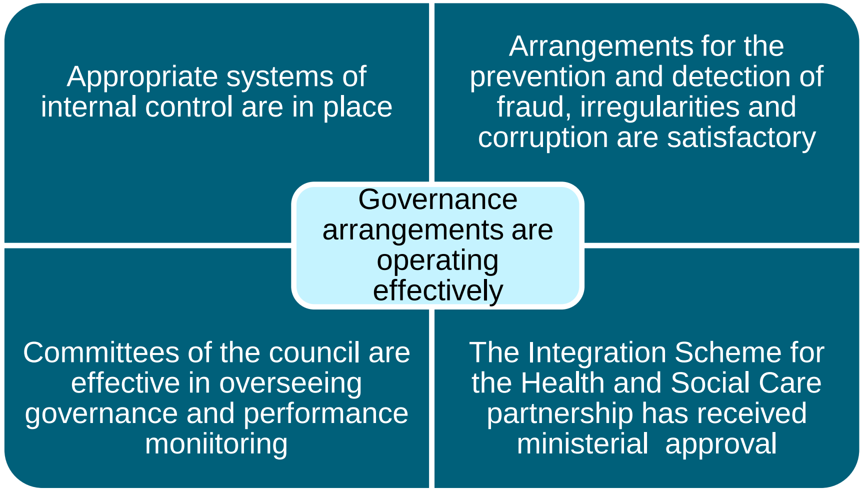
71. The council has approved a revenue budget of £772.6 million for 2015/16, including a surplus (contribution to reserves) of £4.3 million. The latest reported position for the 2015/16 revenue budget (September 2015) indicates that the council is projected to achieve its budgeted surplus. However within this, service overspends of £7.2 million have been incurred, primarily within Education and Children's Services (£2.8 million), Health and Social Care (£1.9 million) and Enterprise and Environment (£2.3 million) which have been offset by continued savings in loans charges (£4.6 million) and additional Council Tax income (£2.6 million).

72. In common with many other councils, Fife Council is now reporting gaps between income and the cost of providing services over the next few years. With further funding reductions expected, councils face tough decisions to balance their budgets. These decisions must be based on a clear understanding of the current financial position and the longer-term implications of decisions on services and finances.

73. For the council to meet its future budget requirements, further transformational change will be required as recognised in a report to the Executive Committee on 18 August 2015 in which the Executive Director, Finance and Corporate Services stated that "…services cannot continue to be delivered in the same way as they currently are"

Refer action plan, point 2

Governance and transparency



74. 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. Based on our observations and audit work our overall conclusion is that the governance arrangements within Fife Council are operating effectively.

75. 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.

76. We have concluded that overall, Fife Council is transparent in its decision making processes and in reporting performance.

Corporate governance

77. The corporate governance framework within Fife Council is centred on the full Council which is supported by a number of standing committees, including the Executive Committee, two scrutiny committees, the Standards and Audit Committee and 7 geographically based Area Committees.

78. Committees are politically balanced, with the chairs of the committees being spread across the political parties within the Council. Fife Council is devolving more powers to the local Area Committees to empower all Councillors in the decision making processes.

79. As auditors we attend a number of council and committee meetings each year and have concluded that Members provide a good level of challenge and questioning.

Local code of corporate governance

80. The council has a local code of corporate governance (in the form of a series of interlinked governance documents) setting out how the committee structures work and the roles and responsibilities of the members on the committees. These documents reflect the key

components as set out in the *CIPFA/SOLACE Framework Corporate Governance in Local Government: A Keystone for Community Governance.* The governance documentation is up to date and easily accessible to the public on the council's website, Fife Direct.

Internal control

81. 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.

82. The roll out of the new Oracle Enterprise Resource Planning (Oracle ERP) system, which comprises of new financial ledger and accounts payable modules, had significant impact on the controls in place during the year within those areas. A key weakness in the financial ledger controls was the absence of key account reconciliations in the first half the year (and not carried out until the year end for the Accounts Payable reconciliation). We noted that these reconciliations were all completed for the year end.

83. We also noted that the accounts payable system experienced problems with data migration and system interfaces and inbuilt system controls that did not work as intended, resulting in work around controls being put in place. Our financial statements testing included tests which addressed the impact of these control weaknesses on the financial statements.

84. We reported our findings from our review of the council's key internal controls to the Standards and Audit Committee in June 2015. Other than the matters noted at paragraphs 82 to 83 above, no material weaknesses in the accounting and internal control systems were identified which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements. Our findings included a number of recommendations to enhance the control system in operation.

Internal audit

85. 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.

86. Internal audit services for Fife Council are provided by the council's Audit and Risk Management Services (ARMS). Our review of internal audit concluded that ARMS operates in accordance with the Public Sector Internal Audit Standards and has sound documentation standards and reporting procedures in place. We placed formal reliance on the work of ARMS for housing rents, council tax billing, council tax valuation and some aspects of payroll and expenses.

ICT audit

Change Management (Shared Support Services Programme) Follow Up

87. In 2014/15, we undertook a follow up review of the action plan included in our 2013/14 report, Change Management (Shared Support Services (3S) Programme). The follow up review considered progress with the ten actions that had been agreed in the 2013/14 action plan.

88. Our review revealed that although some progress had been made, 2 actions were only partially complete and 4 others deferred to align dates with other aspects of the programme.

89. Overall we consider that the action plan has proved to be challenging and that proposed timescales were optimistic, given the organisational pressure on resources within the council.

Management of Information and Communications Technology (ICT) and Change Partnership

90. As part of our 2014/15 audit we have undertaken a review of the ICT and Change Partnership, a partnership between Fife Council and Cap Gemini. This arrangement involves the introduction and implementation of new systems to support the council's transformation work. At this time we are in the process of drafting a report. The report will be agreed with management prior to issue and we plan to present the report to the Standards and Audit Committee in November 2014.

Arrangements for the prevention and detection of fraud

91. The council's arrangements in relation to the prevention and detection of fraud and irregularities and maintaining standards of conduct overall were satisfactory.

92. Fife Council has a range of measures in place to prevent and detect fraud, inappropriate conduct and corruption including an anti-fraud and corruption policy and response plan, a whistleblowing policy and codes of conduct for members and staff. Standing Orders and Financial Regulations are also in place, which assist in the prevention of fraud and irregularities.

National Fraud Initiative in Scotland

93. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. Matching data obtained from the systems of participating bodies allows the identification of potentially fraudulent claims on the public purse including housing benefit fraud, occupational pension fraud and payroll fraud. If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.

94. The National Fraud Initiative has sufficient profile within the council with data matches investigated and findings reported to the

Standards and Audit Committee. The August 2015 progress report to the Committee noted that the current NFI exercise was mostly complete and had identified £241,002 of errors (£199,597 related to 3 duplicate payments; £22,877 related to benefit errors and £13,528 related to a private care home). Recovery is in progress for the majority of the errors identified. A further report is to be presented to the Standards and Audit Committee in November to report the final outcome of the current exercise.

95. There are no issues of concern over the NFI process that we require to include in this report.

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

96. We have concluded that the council has appropriate arrangements in place for the prevention and detection of corruption and we are not aware of any specific issues that we need to record in this report

Transparency

97. Local residents should be able to hold the council to account for the services it provides. Transparency means that residents have access to understandable, relevant and timely information about how the council is taking decisions and how it is using its resources.

98. Members of the public can attend meetings of the Council and its standing committees and have access to Council and committee papers on the website.

99. A Councillors' register of interests is available to the public on Fife Direct, although we were unable to confirm that the register was up to date. Officers have agreed to review the process for updating the register of interests in 2015/16.

100. Information is also available to the public on council performance and the council's complaints system. The council has a well-structured approach to Public Performance reporting which provides a transparent assessment of the council's performance over the year.

101. Fife Council is continuing to explore ways of further improving its engagement with the public to improve transparency.

Following the Public Pound

102. The Chair of the Accounts Commission wrote to all council Leaders and council Chief Executives in March 2015 highlighting the importance of holding to account arm's length external organisations (ALEOs) and fulfilling their statutory obligations in respect of compliance with the Code of Guidance on Funding External Bodies and Following the Public Pound (the guidance). This code is based on the premise that to ensure public money is used properly and that Best Value is being secured, it must be possible to "follow the public pound" across organisational boundaries.

103. The Chief Executive circulated the letter to the Council Executive Team (CET) in May 2015 where discussions were held on the effectiveness of the council's "follow the public pound" arrangements for ALEOs.

104. The CET discussions focussed on the role of members, scrutiny of ALEOs' performance and Service Level Agreements. These discussions concluded that in the view of the CET, satisfactory processes were in place, although some improvement could be made in holding ALEOs to account for poor performance.

105. We have been advised that the Audit and Risk Management Services Manager has been tasked with undertaking further assurance work in this area in 2015/16 to ensure that the council is satisfying the requirements of the guidance.

Integration of health and social care

106. 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.

107. The council and its partner, NHS Fife agreed to adopt the Body Corporate model for the provision of integrated health and social care across Fife. This will result in the delegation of functions to a new legal entity, an Integration Joint Board (IJB), which will be accountable for overseeing the provision of these functions.

108. Within Fife the services to be managed by the IJB include services identified as 'in scope' by the regulations i.e. delegated adult social care, delegated primary and community healthcare services and additionally community children's service for health.

109. The partnership submitted its draft integration scheme to the Scottish Government by 31 March 2015 for review and approval. The Scottish Government requested that further work be carried out across a number of sections within the scheme and the Shadow Joint Board approved a revised integration scheme which was submitted to the Scottish Government in early August.

110. In September 2015, the Cabinet Secretary for Health approved the Fife integration scheme and as a result the Integration Joint Board for Fife will be formally established on 3 October 2015.

111. Although the Partnership will become a legal entity, services and resources within scope will not be fully developed until the Strategic Commissioning Plan (SCP) has been completed and approved by the Integration Joint Board.

112. The first draft of the full SCP was considered by the Shadow Joint Board in August 2015. The Joint Board noted that ongoing work was needed to develop the draft SCP for consultation. The Shadow Joint Board plan to approve the consultation draft SCP in September, to allow the 12 week consultation period to commence in October. After the consultation period ends the intention is to finalise and approve the SCP in time to ensure full integration is achieved by April 2016.

113. The IJB leadership team is in place and meets regularly to progress integration. Recruitment for two of the seven posts continues as two of the posts are filled on an interim basis. The leadership team have a key role in driving change in advance of April 2016.

114. In conclusion, the council, in partnership with NHS Fife, has made good progress towards health and social care integration. There

remains a risk that the full development of the Strategic Commissioning Plan may be delayed and that the integration arrangements may not be fully in place by the statutory deadline date of 1 April 2016.

Refer action plan, point 3

Welfare Reform

115. The council continues to be well prepared to manage and implement changes resulting from welfare reform. It has both a long term overarching strategy and shorter term tactical processes in place to mitigate the effects of poverty in general and the long term impact of welfare reform.

116. The council is active in keeping its residents informed. It has a mini-web site in operation dedicated to welfare reform in order to share information; and sources of further information with claimants

117. Welfare reform continues to place pressure on the council's resources and will impact on many households within Fife. Since 2013/14, the council has committed for an annual budget of £5.4 million to respond to the service budget pressures arising from welfare reform and to support people most adversely affected by the changes. Within this budget over £3 million was set aside in 2014/15 for the impact of council tax reduction, the implementation of local area action plans and the Fife Employability Intervention Project and these are continuing to be funded in 2015/16.

118. Further challenges lie ahead, including the roll out of Universal Credit, although Fife Council is in the final tranche of the roll out, scheduled for Spring 2016. The council has recognised that the roll out of Universal Credit will bring additional cost burdens to the council. The council is well prepared for meeting these challenges.

Local scrutiny plan

119. The 2015/16 Local Scrutiny Plan (LSP), prepared by the Local Area Network of scrutiny partners for the council, has been published on Audit Scotland's website and was submitted to the Education, Health and Social Care Scrutiny Committee in May 2015.

120. No scrutiny risks were identified requiring additional scrutiny or audit work in 2014/15. A range of nationally driven scrutiny activity will be undertaken in 2015/16, with the outcome of this work reported in due course.

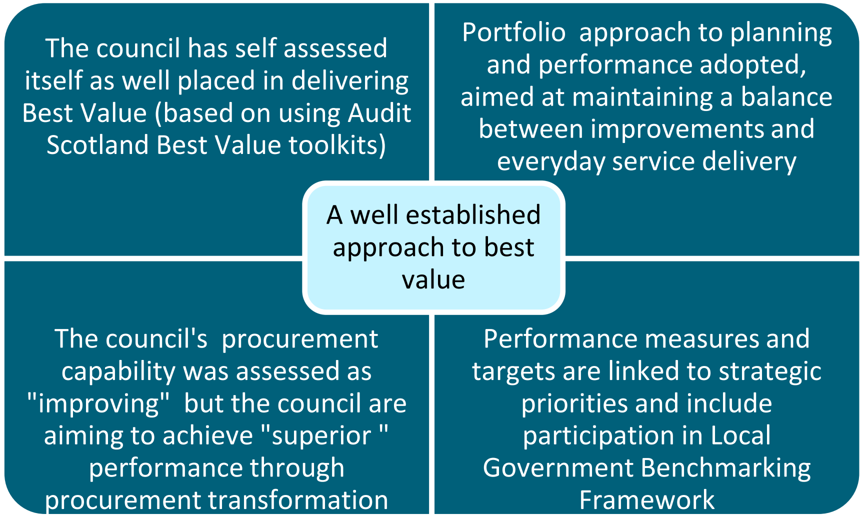
Outlook

121. Councils will continue to operate in a changing environment within continuing financial constraints. Under these circumstances councils will be obliged to consider the delivery of services be different means. Good governance will be particularly important where council resources and service delivery are devolved to third party organisations.

122. It will be crucial that the council continues to ensure that robust assurance and governance arrangements to deliver best value are in place while at the same time ensuring an appropriate level of accountability for public money.

123. Community planning and health and social care integration will require an ongoing focus on governance and assurance to ensure that the council's priorities are being achieved.

Best Value



124. Best value is a key factor to consider when planning policies, programmes and projects and when taking any spending decisions. 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

125. Overall the council has a well established approach to best value including clear strategic priorities and a strong focus on monitoring and reporting performance.

126. In April 2014 the council introduced a new approach to planning and performance, incorporating a portfolio managed approach. The council believes that this approach will ensure that a balance is maintained between activities to achieve improvements and everyday service delivery. This approach has five portfolio boards, which are overseen by the 'Portfolio Board (CET)', covering Economy; Environment; Inclusion and Opportunities; Organisation Development and Improvement; Service Efficiency; Quality of Life) which oversee the work of the portfolios as the key drivers for delivering council improvements. These boards aim to cut across the traditional structures of the council to deliver better outcomes.

127. In our 2013/14 annual audit report we commented on the council's decision to postpone conducting self evaluation exercises using the Fife Excellence Model (FEM), a self evaluation mechanism based on the Improvement Service's Public Service Improvement. The council are in the process of developing a more streamlined, less resource intensive self evaluation model and as a result no evaluations were conducted using the revised Fife Excellence Model during 2014/15.

Refer action plan, point 4

128. We commend the council for undertaking a self assessment of how it is delivering best value, using a suite of 18 best value toolkits developed by Audit Scotland. The self assessment showed that the council meets advanced practice in three areas (financial management; effective partnership working and risk management) and better practice in the remaining 15 areas (in a scale of 'not meeting basic requirements/ basic/ better/ advanced'). Details of

the 18 Best Value toolkits are available on the Best Value & Scrutiny Improvement page of Audit Scotland's website www.audit-scotland.gov.uk.

Procurement

129. 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. The council's assessed score from the most recent PCA in December 2014 was 57% (2013 score of 52%). This assessment ranked Fife Council as 23rd out of the 32 Scottish local authorities, however the PCA score placed the council in the 'improving' category of assessment.

130. The council has already recognised that transformational change is required in its procurement function if meaningful improvement is to be made and has included Procurement as a strand of its Shared Service Support Service (3S) Programme.

131. The new approach focusses on the identification and realisation of financial (the council aims to generate £7 million of procurement savings over the period 2015-2018) and other benefits including more effective supplier management, robust demand challenge, improved compliance and the adoption of best procurement practice across the organisation. Work is ongoing to finalise and strengthen the revised organisational structure for the Procurement Service to enable it to operate as a strategic function across the whole Council.

Performance management

132. The council has a strong focus on performance management. Although the council has a sound framework for monitoring and reporting performance, following the move to a portfolio based approach, it is currently working on refining the performance measures to ensure that they better reflect performance against the council's priorities.

133. Twice a year each service produces a report on performance and spend which is taken to one of the council's two scrutiny committees.

134. The council participates in the Local Government Benchmarking Framework (LGBF) and has good arrangements to report its performance in accordance with the requirements of the framework.

135. The council produces a high level report on its performance against each benchmark which is made available to the public through the council's website. It also produces a more detailed benchmarking report for use internally by managers, which includes detailed quartile and family group information on each indicator.

136. We are satisfied that appropriate performance management arrangements were in place within Fife Council for 2014/15.

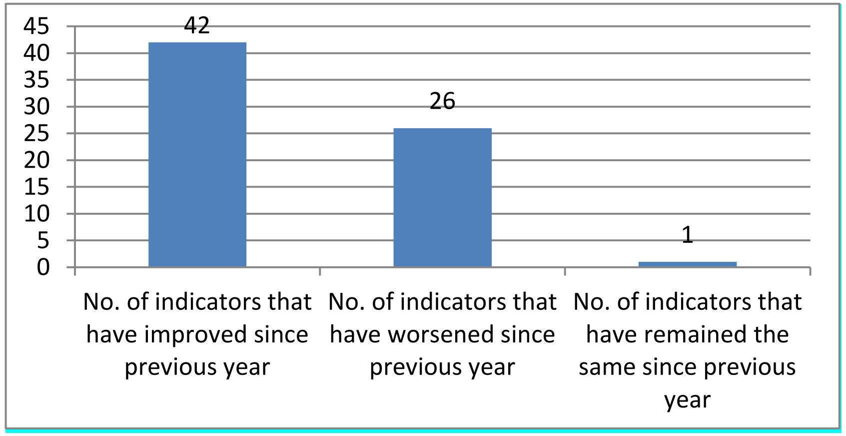
Overview of performance targets in 2014/15

137. The council produces an annual Public Performance Report which reports progress to date in delivering the outcomes set out in the Fife Community Plan 2020 and the Fife Council Plan 2012 to 2017.

138. The annual report provides information on performance under the three high level outcomes from the Fife Community Plan 2020: reducing inequalities, increasing employment and tackling climate change, as well as performance under the overarching heading of reforming Fife's public services. The 2014/15 report is scheduled to be considered by the Council in November 2015.

139. Based on information currently available, for the 94 indicators to be reported for 2014/15, 25 do not have comparisons with previous years. Exhibit 4 compares the 2014/15 results against 2013/14 for the remaining 69 indicators.

Exhibit 4: Improvements demonstrated by performance indicators



Source: Fife's Performance Report (Draft) 2014/15

140. In comparison to 2013/14, areas with improving indicators include: employment rates; literacy rates for primary 1 children; and percentage agreeing that the council provides high quality services.

141. Indicators where performance has worsened include: the average time taken to deal with householder planning applications; percentage of children who are being looked after in the community; and the percentage of fuel poor households in Fife.

Statutory performance indicators (SPIs)

142. 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.

143. The audit of Statutory Performance Indicators in 2014/15 is a two stage process. The first stage requires auditors to ascertain and appraise councils' arrangements for public performance reporting and the completion of the Local Government Benchmarking Framework indicators. This focuses on three statutory performance indicators (SPIs) namely:

- 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.

144. Overall we have concluded that the council's arrangements were satisfactory.

145. 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 Fife Council was issued to the Leader and Chief Executive in July 2015.

146. The results for Fife Council were very good: the Accounts Commission commended Fife Council for having a well-structured approach to PPR and rated Fife Council highly across all of the assessment criteria.

Local performance audit reports

147. In May 2015, we submitted our report *Major capital investments in councils – a follow-up report* to the Standards and Audit Committee.

148. The report concluded that overall, the council demonstrated some elements of good practice, but there was some scope for improvement including:

- Preparing a formal capital investment strategy, linked to the strategic objectives of the Council Plan and a clear reference to performance and outcomes
- Improved information for elected members on risks and benefits management
- regular review of business cases during the project cycle.

149. An action plan was agreed with the council and will be followed up as part of the 2015/16 annual audit.

150. Although not part of our follow up review, we note that there is continuing member interest in the Dunfermline Flood Prevention Scheme, a scheme which was previously included as a case study in Audit Scotland's 2013 national report on *Major capital investments in councils,* due to its material overspend and project over-runs. The final cost of the scheme was £34.5 million which is £24.7 million above the business case estimate and the scheme was subsequently subject to legal proceedings involving the council, the contractor and the design/management consultants.

151. In late 2014, the Executive Committee requested a report on the scheme. In August 2015, the Committee received a report by the Audit and Risk Management Services Manager setting out his findings. In his report, the Audit and Risk Management Services Manager concluded that the council has acted appropriately at all stages of the project. We note that the report is due to be considered by the Standards and Audit Committee at its meeting on 24 September 2015. Audit Scotland is carrying out follow up work on this project and plan to report on the outcome later in 2015/16.

National performance audit reports

152. 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 direct interest to the council. These are outlined in appendix III. The council has processes in place to ensure that national reports and their impact on the council are considered by members.

Equalities

153. 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 quality of outcomes it has set.

154. In 2015, the council published an Equality and Diversity Annual Review report which sets out how well the council is performing against the equality outcomes that are set out in its Equality and Diversity Scheme. The report also identified areas for improvement which are being addressed by the council.

Outlook

155. In common with other councils, Fife Council faces the key challenges of reducing budgets, an aging population with higher levels of need and the public expectation of high quality services. Savings have been made in recent years largely through service reforms and reductions in the workforce. However, as choices on how to address funding gaps become increasingly difficult, councils will have to focus on making the very best use of all available resources and to challenge existing ways of doing things. The council's regular review of its services and a strong and effective performance management framework will be critical to the success of the council achieving its key priorities and achieving best value.

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		
Enterprise Resource Planning The council implemented a new financial management system, Enterprise Resource Planning (ERP), with effect from 1 April 2014. Significant issues have been experienced with the operation of the system since its implementation, which have caused difficulties with the production of robust financial information from the system. Data manipulation and estimating and forecasting outwith the ERP system has been required to produce financial monitoring reports. Other issues arising from ERP implementation include an absence of balanced financial reconciliations, delays in payments to suppliers and breakdowns in stock control. **Risk:** Financial information may not be robust, which could impinge on members' scrutiny role. There may also be an adverse impact on the council's system of internal controls and the preparation and audit of the 2014/15 financial statements.	• Review of the ERP system with a particular focus on understanding and testing of key financial controls. • Review of the process to ensure the accurate and complete transfer of opening balances into the new system from the previous Oneworld financial information system. • Detailed testing of transactions focusing on the areas we consider to be of greatest risk. • Review of the ERP application system controls, including planning and managing, data transfer with other systems and data integrity.	• Identified areas for improvements in controls which have been reported to management. • Detailed testing identified £2.9 million of accounts payable errors in the financial statements. These have been noted in this report as unadjusted financial misstatements at paragraph 20. Apart from this issue no significant issues to report in relation to the financial statements. • No issues found in transfer of opening balances.

Audit Risk	Assurance procedure	Results and conclusions
Accounting for s106 Charitable Trusts The council was required to produce financial statements for its Charitable Trusts for the first time in 2013/14, under the provisions of the Charities Accounts (Scotland) Regulations 2006. The audit proved very challenging as a result of a number of significant issues identified during the audit e.g. the financial statements had not been presented in accordance with the Charities Statement of Recommended Practice, a large number of errors were found in the reported transactions and balances within the financial statements and Governance documentation was not always available to allow us to ensure that the activity of the trust was within the trust's powers. **Risk:** Failure to resolve these issues may result in the 2014/15 financial statements not being produced in accordance with proper accounting practice.	• Discussions with council officers regarding the production of the financial statements. • Monitoring the council's review of governance documentation. • Review of transactions and balances as part of the financial statements audit.	• Improved process for 2014/15. No significant issues to report. Progress made with governance documents and work is ongoing to complete.

Audit Risk	Assurance procedure	Results and conclusions
Fraud risk – income recognition Auditing standard 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. Fife Council receives a material amount of income from sources other than the Scottish Government including council tax, non domestic rates and housing rents. **Risk:** The extent of income means there is an inherent risk that income could be materially misstated. ISA 240 requires auditors to evaluate which types of revenue transactions give rise to such risks.	• Evaluation of the effectiveness of systems of internal control for income recognition and recording including the analytical review of income streams and testing of controls. • Assurance from the work of Audit and Risk Management Services covering systems of income recognition. • Consideration of the fraud investigation work conducted by Audit and Risk Management Services.	• We did not identify any instances of income being materially misstated.
Fraud risk – management override of controls ISA 240 also requires auditors to consider, on all audits, management's ability to manipulate accounting records and prepare fraudulent or biased financial statements by overriding controls that otherwise appear to be operating effectively. **Risk:** Management is in a unique position to perpetrate fraud because of their ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls.	• Detailed testing of journal entries. • Review of accounting estimates for bias.	• No evidence of fraud from our detailed testing of journal entries and our review of accounting estimates for bias.

Audit Risk	Assurance procedure	Results and conclusions
Change to the accounting of group accounts The 2014 Code of Practice on Local Authority Accounting in the United Kingdom has adopted new group accounts standards. The new standards revise the previous definition of control for the purposes of group accounting. The council is currently considering the implications of the new standards to the council's current group structure. **Risk:** The group financial statements may not fully comply with the requirements of the Code.	• Review of the financial statements of the council and its group to ensure that all appropriate entities have been included and are correctly classified and accounted for.	• Reviewed the annual accounts against the code. Changes were made to the accounts through the audit process to ensure group accounts and disclosures are compliant with the Code.
New accounting regulations - consideration and approval of financial statements The Local Authority Accounts (Scotland) Regulations 2014 introduces a number of new requirements relating to the Financial Statements. These include changes to the approval processes for the annual financial statements. For 2014/15, unaudited financial statements are required to be considered by those charged with governance by 31 August and audited financial statements approved by 30 September. **Risk:** The financial statements may not be considered and approved in accordance with the new regulations.	• Planning meetings with officers to ensure financial statements are submitted in sufficient time to allow approval by the due dates.	• We examined the key requirements of the 2014 Regulations to ensure that the Council complied with its requirements. No issues to report.

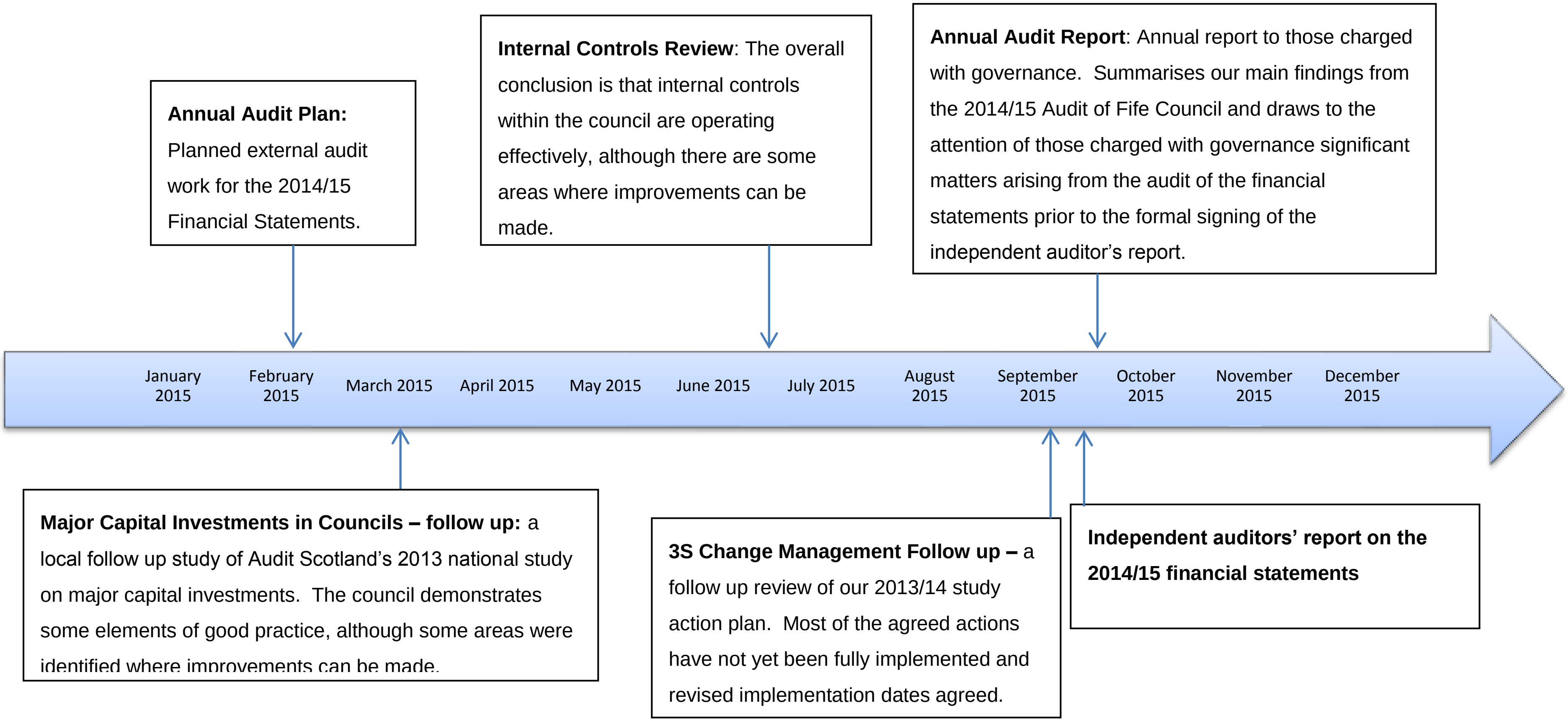
Audit Risk	Assurance procedure	Results and conclusions
Common good assets We have previously raised the issue of omissions of fixed assets from the Common Good Account. Although the omissions had been rectified, this casts doubt on the completeness of the Common Good fixed asset register. We have also reported in previous years on the difficulties in reconciling the Common Good fixed assets register to the financial information system. Management advised us that a review of common good assets was to be completed in 2014/15. This review would also include asset usage and common good rental arrangements. **Risk:** The Common Good Account may not comply with proper accounting practice.	• Monitoring of the progress of the review of common good assets being conducted by council officers. • Detailed testing of common good transactions and balances as part of the financial statements audit.	• Transactions following the council's review of its Common Good assets have been included in the 2014/15 financial statements. There are no issues to report following our testing of these transactions.

Audit Risk	Assurance procedure	Results and conclusions
Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
Health and social care integration A Shadow Integration Joint Board (SIJB) has been set up by the council and NHS Fife and work is currently ongoing to develop an integration scheme and strategic plan. The integration scheme requires to be submitted to the Scottish Government by 31 March 2015 for ministerial approval. Recent Scottish Government guidance recommends that Audit Committees (or equivalent) should obtain assurances over key financial arrangements prior to the integration shadow period (1 April 2015) and that audit committees are provided with a report, produced jointly by the Health Board and Local Authority Chief Internal Auditors, on the assurance work carried out. **Risk**: agreement between Fife Council and NHS Fife may not be obtained by early 2015, which could jeopardise submission to the Scottish Government for approval by 31 March 2015 (integration arrangements must be fully in place by 1 April 2016). In addition, the Standards and Audit Committee may not obtain appropriate assurances on the financial arrangements prior to the integration shadow period.	• Review of progress with the health and social care integration, including internal audit reports in this area. • Review of minutes and reports to the Shadow Integration Board.	• Progress is continuing with priority being given to finalising the Strategic Plan to ensure the integrated arrangements are in place by the deadline of 1 April 2016. Internal audit work on the financial assurance process is scheduled for 2015/16.

Audit Risk	Assurance procedure	Results and conclusions
Change management – 3S Programme In November 2014 we issued a report following our review of the change management processes in place for the implementation of the 3S Programme. The programme is a key enabler for the transformation in the way the council delivers services and we identified some areas in the change management processes where the council was exposed to risk. We also noted that the council will need to be clear about the business model they are implementing and carefully manage the cultural change required to realise the vision and the anticipated benefits from the system. An action plan was agreed by management and is being taken forward over the coming months. **Risk:** The council may not achieve all the benefits anticipated from the model which may impact on the future delivery of services.	• Follow up our 2014 report and action plan to assess progress with improvements.	• Identified areas where progress has not been made as intended. Revised implementation dates agreed.

Audit Risk	Assurance procedure	Results and conclusions
ICT and Change Partnership In December 2012 the council awarded a four year framework agreement contract to Capgemini for the provision of ICT and Change Partnership services. The arrangement involves the introduction and implementation of new systems and processes to support the council's transformation work. Development of the ERP system has been a significant initiative under the contract and has required significant input from the ICT partner to find solutions to the difficulties encountered in implementing the system. Knowledge transfer was also a key element of the agreement and in our 2013/14 Change Management report on the 3S programme we noted that the council did not have a systematic and structured programme to transfer skills and knowledge against which it can measure progress. Risk: The council may not achieve the benefits envisaged under the contract and may not be achieving best value.	• Review of partnership arrangements and operation of contract.	• Work currently being completed and draft report being compiled. Final report will then be submitted and presented to the Standards and Audit Committee.

Appendix II: Summary of local audit reports 2014/15

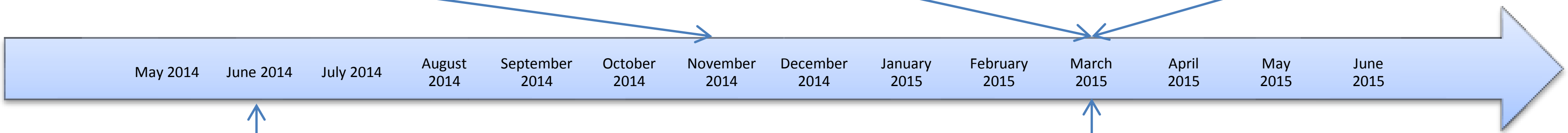


Appendix III: Summary of Audit Scotland national reports 2014/15

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

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.

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. 16/33	**Overspend within services' revenue budgets** Although the council achieved a net surplus of £14.8 million in 2014/15, service expenditure was overspent by £7.0 million. Like 2013/14, the net surplus was only achieved as a result of underspends against budget on corporate activities. **Risk:** Continuing overspends on service delivery could impact on longer term financial sustainability. Savings on other corporate activities may not be sustainable in the long run. **Recommendation:** The council should review its service delivery to ensure that all services are put on a sound financial footing within reducing resources.	All Services are continually reminded and advised of the need to contain expenditure within the resources available to them. Sustainable budget strategies have been developed and approved for Children and Families, and Older People services'. These strategies will take a number of years to come to fruition and change the way services are delivered at a reduced cost. By implementing these strategies, we will endeavour to place these services on a sound financial footing. Other Services continue to closely monitor expenditure, identify and implement mitigating actions as appropriate.	Executive Director (Finance and Corporate Services)	Ongoing

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
2. 22/73	**Financial management and sustainability** The council faces budget cuts of up to £75 million by 2018/19. Transformational change will be required as recognised in the Executive Director, Finance and Corporate Services report to the Executive Committee on 18 August 2015 which stated that "…services cannot continue to be delivered in the same way as they currently are". **Risk:** The council may not be able to generate sufficient efficiencies and cost savings to bridge the funding gap and may find itself delivering reduced services. **Recommendation:** The council should ensure that it has robust medium to long term financial plans to address the anticipated budget gap. This may require transformational change for service delivery.	The financial strategy for dealing with the budget gap has two strands. • Recognising the need to generate savings in the short term, services have been given savings targets. • In respect of the longer term strategy, a group of officers known as Budget Support and Challenge group has been supporting services in the development of transformational ideas. Once all ideas have been assessed these will used to formulate a change programme to close the budget gap. In addition, the long term budget model is continually reviewed to ensure that all assumptions are up to date and as robust as they can be.	Chief Executive	Ongoing for Efficiency Savings. Transformational Programme agreed by March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
3. 27/114	**Health and Social Care Integration** Although the council, in partnership with NHS Fife, has made good progress towards health and social care integration, the Strategic Commissioning Plan is still being developed for implementation by 1 April 2016. **Risk:** The Strategic Commissioning Plan may be delayed resulting in integration arrangements not being fully in place by the statutory deadline date of 1 April 2016. **Recommendation:** The council should continue to work jointly with NHS Fife in finalising arrangements for the integration of health and social care.	We will ensure that sufficient resources are available to complete the Strategic Plan on time.	Director of Health and Social Care	March 2016

No. Page/para	Issue/risk/Recommendation	Management action/response	Responsible officer	Target date
4. 30/127	**Self evaluation and FEM** We were advised in 2013/14 that the council had postponed the reintroduction of its self evaluation mechanism, the Fife Excellence Model (FEM), as a result of resources being diverted to implement new initiatives. Although we were advised that the council would recommence the FEM programme, as a less resource intensive but effective product in April 2015, currently the revised self evaluation model is still being developed. **Risk:** There may be a dilution of key evidence to provide support that council activity is achieving best value. **Recommendation:** Management should recommence the revised self evaluation model as soon as practicable.	The Fife Excellence Model will be modified to combine this existing evidence into a single self assessment approach which is resource sustainable. This evidence will include:- • Annual Corporate Best Value Toolkit Audits based on Audit Scotland guidance (in place) • Annual EFQM based Service Governance Audit (in place) • PSIF/EFQM based Performance Scorecard Assessment (in development) • Employee Survey repurposed annually to collect evidence against PSIF/EFQM model (in development) • Community Planning Strategic Assessments (in place)	Team Leader, Planning, Performance and Diagnostics	April 2016