Fife Council

2016/17 Annual Audit Report

AUDIT SCOTLAND

To Members of Fife Council and the Controller of Audit

28 September 2017

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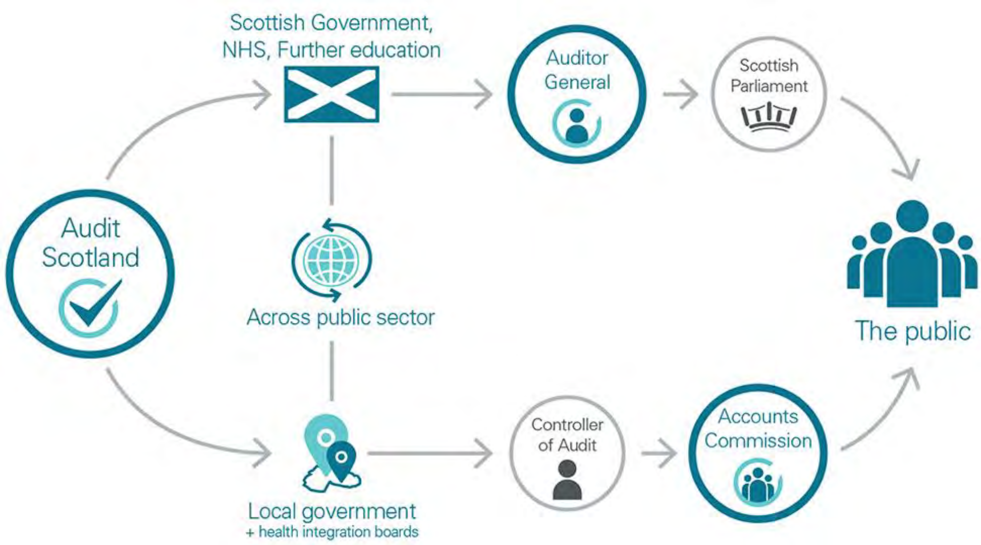
The Auditor General, the Accounts Commission and Audit Scotland work together to deliver public audit in Scotland:

- The Auditor General is an independent crown appointment, made on the recommendation of the Scottish Parliament, to audit the Scottish Government, NHS and other bodies and report to Parliament on their financial health and performance.

- The Accounts Commission is an independent public body appointed by Scottish ministers to hold local government to account. The Controller of Audit is an independent post established by statute, with powers to report directly to the Commission on the audit of local government.

- Audit Scotland is governed by a board, consisting of the Auditor General, the chair of the Accounts Commission, a non-executive board chair, and two non-executive members appointed by the Scottish Commission for Public Audit, a commission of the Scottish Parliament.



About us

Our vision is to be a world-class audit organisation that improves the use of public money.

Through our work for the Auditor General and the Accounts Commission, we provide independent assurance to the people of Scotland that public money is spent properly and provides value. We aim to achieve this by:

- carrying out relevant and timely audits of the way the public sector manages and spends money

- reporting our findings and conclusions in public

- identifying risks, making clear and relevant recommendations.

Contents

Key messages

Audit of the 2016/17 annual accounts

1 **Our audit opinions were all unqualified. These covered the financial statements, management commentary, remuneration report and the annual governance statement. Unqualified opinions were issued for the Charitable Trusts administered by the Council.**

2 **The extent of the identified error in the unaudited accounts in 2016/17 was greater than the previous year. Around 76% of these had no net impact on the accounting statements.**

Financial management

3 **Fife Council delivered services within budget, with service overspends lower than in 2015/16. The outturn was achieved despite failing to deliver all approved savings in year**

4 **Financial management is well developed with a transparent budget setting process and comprehensive monitoring reports submitted to committee.**

5 **Fife Council had a significant underspend against their ambitious capital budget due to delays in delivering projects.**

Financial sustainability

6 **The Council has a relatively low level of usable reserves, but the uncommitted element of the general fund exceeds the minimum strategic amount identified by the Council. The Council is currently increasing its borrowing to fund its capital programme. It has assessed both its borrowing and reserve levels as part of its financial strategy and judged both to be appropriate at this time.**

7 **The Council has a medium term financial plan and a detailed long-term financial planning model.**

8 **The Council recognises that transformational change is required to redesign services and have launched a fresh corporate programme designed to enable this.**

Governance and transparency

9 **The Council has appropriate governance arrangements and is open and transparent in the way it conducts it business.**

Value for money

10 **Fife Council continues to invest in its school estate. It is making improvements to its procurement function but the expected savings are still to be achieved. We will provide the Council with a Best Value Assurance Report in 2018**

Introduction

1. This report is a summary of the findings arising from the 2016/17 audit of Fife Council.

2. The scope of the audit was set out in our Annual Audit Plan presented to the March 2017 meeting of the Audit & Scrutiny Committee. This report comprises:

- an audit of the annual report and accounts
- consideration of the four dimensions that frame the wider scope of public sector audit requirements as shown in Exhibit 1.

Exhibit 1
Audit dimensions

Source: Code of Audit Practice 2016

3. The main elements of our audit work in 2016/17 have been:

- an interim audit of the Council's main financial systems and governance arrangements
- audit work covering the Council's arrangements for securing Best Value relating to financial management, financial sustainability and governance and transparency
- an audit of the Council's 2016/17 annual report and accounts including the issue of an independent auditor's report setting out our opinions

4. Fife Council is responsible for preparing an annual report and accounts that show a true and fair view in accordance with the Local Authority Accounts (Scotland) Regulations 2014. It is also responsible for establishing effective governance arrangements and ensuring financial management is effective.

5. Our responsibilities as independent auditor are established by the Local Government in Scotland Act 1973 and the *Code of Audit Practice 2016* guided by the auditing profession's ethical guidance.

6. As public sector auditors we provide an independent auditor's report on the annual report and accounts. We also review and report on the arrangements within Fife Council to manage its performance and use of resources such as money, staff and assets. Additionally, we report on the Council's best value arrangements. In doing this, we aim to support improvement and accountability.

7. Further details of the respective responsibilities of management and the auditor can be found in the *Code of Audit Practice 2016*.

8. This report raises matters from the audit of the annual report and accounts, risks or control weaknesses. Communicating these does not absolve management from its responsibility to address the issues we raise, and to maintain adequate systems of control.

9. Our annual audit report contains an action plan at Appendix 1. It sets out specific recommendations, responsible officers and dates for implementation.

10. As part of the requirement to provide fair and full disclosure of matters relating to our independence, we can confirm that we have not undertaken non-audit related services. The 2016/17 audit fee for the audit was set out in our Annual Audit Plan and as we did not carry out any work additional to our planned audit activity, the fee remains unchanged.

11. This report is addressed to both the Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk.

12. We would like to thank all management and staff who have been involved in our work for their co-operational and assistance during the audit.

Part 1

Audit of 2016/17 annual report and accounts

Main judgements

Unqualified audit opinions on the Council's annual report and accounts.

Unqualified audit opinion on Fife Council's Charitable trusts accounts administered by the Council.

A significant number of the charitable trusts were not active in the year.

The extent of the identified errors in the unaudited accounts in 2016/17 of £516 million was greater than the previous year. Around 76% of these had no net impact on the accounting statements.

Unqualified audit opinions

13. The annual report and accounts for the year ended 31 March 2017 were approved by the Standards and Audit Committee on 28 September 2017. We reported, within our independent auditor's report:

- an unqualified opinion on the financial statements
- unqualified opinions on the management commentary, remuneration report and annual governance statement.

14. Additionally, we have nothing to report in respect of those matters which we are required by the Accounts Commission to report by exception.

The Council's annual report and accounts are the principal means of accounting for the stewardship of its resources and its performance in the use of its resources.

Audit of charitable trusts administered by Fife Council

15. Due to the interaction of the Local Government in 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 Fife Council are sole trustees, irrespective of the size of the charity.

16. Our duties as auditors of the charitable trusts administered by Fife Council are to:

- express an opinion on whether the charitable trusts' financial statements properly present the charitable 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.

17. We received the charitable trusts' accounts in line with the agreed timetable and after completing our audit we issued unqualified audit opinions on the 2016/17 financial statements of Fife Council Charitable Trusts (FCCT).

18. We noted that a significant cash balance is held by the charitable trusts. The balances should be subject to an annual review with a view to investing any surplus cash to provide a better return to the trusts. This approach has not been followed in 2016/17 and officers have confirmed action will be taken during 2017/18 to redefine the levels that trigger re-investment and the timing for when this will be done.

19. There are 48 charities listed in the FCCT accounts, however only 12 have paid out grants in the year (8 in 2015/16). The Office of Scottish Charity Regulator (OSCR) website states that "in general, if a charity does nothing for a prolonged period, it is unlikely to be providing public benefit and this may result in it failing the charity test". There are currently no plans to reduce the number of trusts held and we have been advised that trustees are aware of the need to promote the use of trusts in local communities to ensure that the public benefit requirement is delivered.

Action Plan (Appendix 1, Point 1)

Submission of the Council's annual report and accounts for audit

20. We received the unaudited annual report and accounts on 30 June 2017, in line with the audit timetable set out in our 2016/17 Annual Audit Plan. The working papers provided with the unaudited report and accounts were of a reasonable standard and staff from the finance team, which has decreased in size in the last 12 to 18 months, provided good support to the audit team during the audit. This helped ensure that the final accounts process ran smoothly.

21. There was an increase in the number of errors identified in the unaudited accounts in 2016/17 (see paragraph 28). Finance staff are, however, developing new procedures for key tasks including accounts preparation to achieve efficiencies and deliver improvements in future years.

22. In 2016/17, for the first time, the Council's group accounts included the financial results of Fife Integration Joint Board (IJB) within its area. The consolidation of the IJB did not cause any delays in the submission of the accounts.

Risk of material misstatement

23. Appendix 2 provides a description of those assessed risks of material misstatement that were identified during the planning process which had the greatest effect on the overall audit strategy, the allocation of resources to the audit and directing the efforts of the audit team. Also, included within the appendix are wider audit dimension risks, how we addressed these and conclusions.

Materiality

24. Materiality defines the maximum error that we are prepared to accept and still conclude that that our audit objective has been achieved (i.e. true and fair view). The assessment of what is material is a matter of professional judgement. It involves considering both the amount and nature of the misstatement.

25. Our initial assessment of materiality for the annual report and accounts was undertaken during the planning phase of the audit. Specifically with regard to the financial statements, we assess the materiality of uncorrected misstatements, both individually and collectively. The assessment of materiality was recalculated following receipt of the unaudited financial statements and is summarised in Exhibit 2.

Exhibit 2

Materiality values

Materiality level	Fife Council Accounts	FCCT Accounts Balances
Overall materiality – This is the calculated figure we use in assessing the overall impact of audit adjustments on the financial statements. For Fife Council it was set at 1% of gross expenditure for the year ended 31 March 2017 and 1% of net assets for charitable trusts.	£13.2 million	£16,475
Performance materiality – This acts as a trigger point. If the aggregate of errors identified during the financial statements audit exceeds performance materiality this would indicate that further audit procedures should be considered. Using our professional judgement we have calculated performance materiality at 25% of overall materiality for Fife council and 70% for FCCT. A lower performance materiality was also set for the FCCT transactions.	£3.3 million	£11,583
Reporting threshold (i.e. clearly trivial) – We are required to report to those charged with governance on all unadjusted misstatements in excess of the 'reporting threshold' amount. This has been calculated at 1% of overall materiality, rounded to a memorable numeric.	£0.1 million	£160

How we evaluate misstatements

26. There were a number of material adjustments to the unaudited financial statements arising from our audit resulting in:

- net cost of services on the Comprehensive Income & Expenditure Statement (CIES) decreasing by £30.6 million (accounting basis)
- net cost of services on the Expenditure and Funding Analysis (EFA) decreasing by £0.8 million (funding basis)
- net assets on the balance sheet increasing by £105.3 million
- adjustments to the prior year figures which reduced total comprehensive income in 2015/16 by £3.7 million and increased net assets by £77.5 million.

27. There were also a number of un-adjusted misstatements identified. Details of these are included in Appendix 3 which if adjusted would have:

- decreased total comprehensive expenditure on the CIES by £2 million (accounting basis)

- decreased net cost of services on the EFA by £2.7 million (funding basis)
- increased net assets by £5.4 million

28. In total these amounts exceeded our performance materiality. During testing we considered whether additional work was required to address the risk of undetected error in the statements. We reviewed all PPP assets (refer paragraph 31) to confirm the accounting treatment was appropriate and found no other issues. All internal transactions (paragraph 32) were identified and subsequently confirmed to be correctly adjusted along with IJB transactions. We undertook further testing of the GRNI account (paragraph 34) and are content that there is no risk of further material error. The majority of other errors were isolated in nature and we concluded that no additional audit procedures were required. The gross value of total errors identified, both adjusted and unadjusted amounted to £516 million, of this £394 million had no net effect on the financial statements. Over 98% (£507 million) of the errors were adjusted in the accounts.

29. It is our responsibility to request that all errors are corrected although the final decision on this lies with those charged with governance taking into account advice from senior officers and materiality. Management do not propose to adjust for the items in Appendix3 as the amounts are not considered material in the context of the financial statements. We agree with this assessment.

Significant findings

30. International Standard on Auditing 260 (UK & Ireland) requires us to communicate to you significant findings from the audit. These are summarised in Exhibit 3 (where a finding has resulted in a recommendation to management, a cross reference to the Action Plan in Appendix 1 has been included).

Exhibit 3
Significant findings from the audit of Fife Council

Issue	Resolution
Valuation of schools **31.** Accounting regulations require privately financed assets (PPP/Hub) to be valued on the same basis as other assets of the same category. All Fife Council schools are valued on a Depreciated Replacement Cost basis, however for all privately financed schools on the balance sheet, a deferred value adjustment was used based on the length of the contract in place. In our judgement such an adjustment is not in line with accounting regulations, leaving the 12 schools including the newly constructed Levenmouth Academy undervalued by approximately £100 million.	Management agreed that the deferred valuation adjustment should not be applied to the schools. Revised valuations were prepared by the Estates team. A prior year adjustment was made to the historic PPP assets, and an in year adjustment done to reflect the revised valuation of Levenmouth Academy. **This has been corrected in the audited financial statements**

Issue	Resolution
Expenditure & Funding Analysis (EFA) and Comprehensive Income and Expenditure Statement (CIES) **32.** The 2016/17 Code introduced major changes to the presentation of the CIES and a requirement for a new EFA disclosure designed to enhance the transparency of the accounts. Following the submission of the unaudited accounts on the 30 June 2017, the finance team provided a revised version of both the EFA and CIES with significant changes to both the figures and presentation. When auditing the revised figures we identified that these: • did not include the funding paid to and received from the Integration Joint Board (IJB) in the gross totals as required by guidance • included approximately £195 million of internal income within the CIES, overstating both income and expenditure	Management adjusted the CIES to: • include the IJB income and expenditure and • remove any internal transactions. **This has been corrected in the audited financial statements**
Group Accounts **33.** Fife Council use Arms Length External Organisations (ALEOs) to deliver certain services. A consolidation procedure is required to remove inter-entity transactions and amalgamate each entities total assets and liabilities as part of the group accounts. Our audit work on the group accounts identified a number of errors in the consolidation process, and differences between the returns submitted by the subsidiaries and their accounts.	Management have accepted these as errors but have decided not to process an adjustment to the 2017/18 accounts We have treated the issue as an unadjusted error in the accounts. See Appendix 3 **Action Plan (Appendix 1, Point 2)**
Historic creditor balances **34.** A review of the Council's creditor accounts identified £3.4 million of Goods Received Not Invoiced (GRNI) balances that were over a year old. These entries occur when, for example, goods or services are marked as received but have not been matched against an invoice when payment is made or when the amounts in GRNI do not match invoices received. There is a risk that these creditors are not valid and have been settled.	The majority of the balances go back to financial year 2014/15 and management are aware of the need to resolve this. The financial operations team are in the process of reviewing all of these transactions and the Council will then write off any balances which are not legitimate outstanding liabilities. We have treated the issue as an unadjusted error in the accounts. See Appendix 3 **Action Plan (Appendix 1, Point 3)**

<table>
<tr><th>Issue</th><th>Resolution</th></tr>
<tr><td>

Provisions – Redundancy & Insurance claims

35. Accounting standards require a degree of certainty over costs before a provision can be created. Our audit testing found that:

- the redundancy provision is calculated based on proposed savings plans, however these plans undergo significant change during the year as evidenced by the high value of reversals in the last two years (around 50%). In order to establish a provision the plan should be relatively certain.
- an element of the insurance provision covers internal claims rather than those held by third parties, this does not meet the definition of a liability.

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ISA37 Provisions, Contingent liabilities and Contingent Assets requires a provision to be recognised only after a detailed formal plan is adopted and has started being implemented, or announced to those affected. Management's view was that this requirement was met and that the changes that arose since the implementation were unforeseen. Overall the redundancy provision amounted to £2 million and was not material. We have accepted the position this year and management have agreed to review the Council's approach next year.

We have treated the insurance fund issue as an unadjusted error See Appendix 3. A review of the operation and accounting for the insurance fund is planned in 2017/18

Action Plan (Appendix 1, Point 4)

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Council Tax Income ring-fenced for Affordable Housing

36. Scottish Government guidance requires that income raised from decreasing discounts for council tax on second and empty homes must be ring-fenced for affordable housing projects. The Council have treated the £4 million of unspent income in the accounts as an accrual. This treatment is not in line with Scottish Government guidance or accounting standards, leading to an over-statement of expenditure and liabilities. This should be treated as a ring-fenced balance within the general fund.

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Management have accepted that the unspent income would be more appropriately treated as a ring-fenced element of the general fund,

This has been corrected in the audited financial statements

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Capital Expenditure year end adjustments

37. As a result of a prior year error, we undertook focused work on year end capital expenditure transactions on the Affordable Housing Programme. We identified one invoice relating to a privately constructed project which had not been correctly accrued. For projects built by building services, costs are capitalised based on monthly valuation certificates and our audit work identified a further 6 projects where the adjustment for work carried out in March 2017 was attributed to the wrong financial year. As a result capital expenditure was understated by £1.6 million.

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Management have accepted these as errors, but have decided not to process an adjustment to the 2017/18 accounts. Year End Procedures will be amended to ensure valuations for affordable housing are received in time and accrued or capitalised accordingly.

We have treated the issue as an unadjusted error in the accounts. See Appendix 3

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Issue	Resolution
Fife Energy Park **38.** Fife Council established a joint operation with Scottish Enterprise to develop Fife Energy Park at Methil. This was included in the asset register under the infrastructure category and depreciated in 2015/16. A negative depreciation charge of £1 million was processed in 2016/17 in preparation for a proposed transfer to Long Term Investments. The transfer was not reflected in the unaudited accounts. Charging negative depreciation is out with accounting standards and the asset would be more appropriately treated as a long term investment.	Management have now removed depreciation and recognised Fife Energy Park as an available for sale financial asset. **This has been corrected in the audited financial statements**

Going concern

39. The financial statements of the Council, its group and the associated charitable trusts have been prepared on the going concern basis. The Council has tax raising powers and we are not aware of any significant change in government policy that might affect the continued provision of services. We concur with management's view that the going concern assumption remains appropriate.

Other findings

40. Our audit identified a number of presentational and disclosure issues which were discussed with management. These issues covered opportunities to both enhance transparency and streamline the accounts. Some of these were adjusted and reflected in the audited annual report and accounts, while others will be considered further for 2017/18.

Action Plan (Appendix 1, Point 5)

Objections and Whole of Government Accounts

41. The Local Authority Accounts (Scotland) Regulations 2014 require a local authority to publish a public notice on its website that includes details of the period for inspecting and objecting to the accounts. This must remain on the website throughout the inspection period which is 15 working days. The Council did not fully comply with the regulations as the accounts were only publically available for 13 working days. The advert should also include details of the auditor and whilst the website identified Audit Scotland as the appointed auditor it did not provide the name of the engagement lead (Brian Howarth for the Council and Pearl Tate for the charitable trusts). However no objections were received within either the advertised period or the longer statutory period.

Action Plan (Appendix 1, Point 6)

42. The Council submitted a consolidation pack for the whole of government accounts audit in September 2017.

Part 2
Financial management

Main judgements

Fife Council delivered services within budget, with service overspends lower than in 2015/16. The outturn was achieved despite failing to deliver all approved savings in year.

In line with previous years, Fife Council had a significant underspend against their ambitious capital budget, due to delays in delivering projects.

Financial management is well developed with a transparent budget setting process and comprehensive monitoring reports submitted to committee.

The Council has appropriate internal controls in place within its main financial systems and our testing confirmed that these were operating effectively. We did not identify any significant internal control weaknesses.

Financial performance in 2016/17

43. In February 2016 the Council approved a budget of £761 million for 2016/17. This included the use of £15 million from balances. During the year the budget was regularly revised, with a final budget of £780 million reported to the Policy & Co-ordination Committee in July 2017. The increased budget was due to:

- Increased Scottish Government funding of £3.5 million
- Additional expenditure to be funded from balances of £15 million

44. Against this budget the Council reported an overall underspend of £13 million, though adjustments made to the audited accounts have increased this to £14 million. The major elements of this can be seen in Exhibit 4.

Exhibit 4

Summary of significant over and under spends against budget

Area	Under/over spend (£m)	Reason(s) for variance
Underspends		
Education & Children's Services	(2.5)	Underspend on Children and Families due to a reduction in purchased/ foster care placements and vacancy management.
Finance & Corporate Services	(2.0)	Housing Benefits: lower than anticipated expenditure and higher than anticipated recovery of overpayments.
Corporate & Democratic Core	(2.4)	Lower than forecasted Equal Pay claims.
Loan Charges	(6.2)	Lower than forecasted external interest payments due to Treasury Management Strategy and capital expenditure underspend.
Council Tax	(2.0)	Increased council tax collection performance leading to a reduction in the bad debt provision and additional council tax on empty homes.
Overspends		
Health & Social Care	2.7	Overspend on council services is £0.7 million due to increased demand, remaining £2 million is due to increased funding to the Integration Joint Board to fund the overall overspend across the partnership.

Source: Revenue Budget 2016-17: Provisional Outturn, report by Executive Director for Finance and Corporate Services to Policy & Co-ordination Committee 6th July 2017

45. The underspend offsets the use of balances in year leaving a £1 million reduction in the general fund as reported in the Movement in Reserves Statement (MIRS). This reduction in general fund position is considerably less than in 2015/16 (see Exhibit 5) due to the settlement of the majority of the Council's equal pay claims that year.

Exhibit 5

Elements of the financial outturn (£million)

	2016/17	*2015/16*
Surplus (against budget)	£13.9m	£16.3m
Expenditure funded from balances	(£15.2m)	(£53.6m)
Reduction in general fund	(£1.3m)	(£37.3m)

Source: Fife Council Annual Accounts 2016-17 and Revenue Budget 2016-17: Provisional Outturn, report by Executive Director for Finance and Corporate Services to Policy & Co-ordination Committee 6th July 2017

46. Expenditure funded from balances is the use of committed or ear-marked elements of the general fund. These are disclosed in Note 6 to the accounts and include previous spending commitments approved by committee along with prior year underspends carried forward through the Council's "*budget carry forward scheme".*

47. Within the Council the scrutiny of the overall financial performance in 2016/17 was delegated to the Executive Committee which received quarterly revenue and capital monitoring reports. More detailed reports were submitted on the same quarterly basis to the two Scrutiny committees. From our review of these reports and attendance at committee we concluded that they provided an overall picture of the budget position at service level. The reports also forecast out-turn position for the year and include good narrative explanations for significant variances against budget and movement since the previous report allowing both members and officers to scrutinise the financial position. We noted, however, that the year end surplus was £7.6 million greater than the last forecast reported to Committee (Exhibit 6).

Exhibit 6

Revenue Budget Monitoring

Period End	Executive / Policy & Coordination Committee	Provisional Outturn General Fund Surplus
3 (June)	20th September 2016	£4.4 million
5 (August)	15th November 2016	£4.6 million
7 (October)	24th January 2017	£3.5 million
9 (December)	28th February 2017	£5.6 million
12 (March)	6th July 2017	£13.2 million

Source: Fife council budget monitoring reports 2016-17

48. The Section 95 officer is the Executive Director with responsibility for finance and corporate services. She is a member of the Council Executive team (CET) and has direct access to the Chief Executive and Council members. We concluded that the Section 95 officer has appropriate status within the Council.

49. Last year's 2015/16 annual audit reported significant overspends in Health & Social Care and Children & Families services. The budget performance for both areas has improved in 2016/17 (see Exhibit 4). The over spend on Health & Social Care was due to the risk share agreement with NHS Fife, which requires partners to cover the IJB overspend in proportion to their share of the budget.

Efficiency savings

50. A 2016/17 budget report by the Executive Director of Finance and Corporate Services in August 2015 estimated a budget shortfall of £21 million. Services were asked to identify savings of 2.5% of budget to address this shortfall. Following the announcement of Scottish Government funding in December 2015, this increased the budget shortfall to £29 million and required services to identify further savings.

51. The 2016/17 budget approved in February 2016 closed the budget gap by

- removing the budget provision for demographic growth: £9 million
- identifying operational savings, with limited impact on service delivery: £5.5 million
- identifying permanent savings through changes to service provision: £11.7 million and
- identifying in-year savings: £13.8 million

52. The nature of the savings are detailed in the published budget documents. The savings identified enabled the Council to make £10.6 million investments in its key priorities – including the implementation of the revised children and families strategy.

53. During the year the Council has established processes for tracking the achievement of savings. Regular summaries of progress were reported to the Executive Committee and more detailed information including a risk assessment of each saving was presented to the scrutiny committees.

54. A report to the Policy and Co-ordination Committee in July 2017 highlighted that 87% of savings had been delivered during the year. In 2015/16, the Council achieved 95% of budgeted savings. Although the Council has a track record of delivering most of the identified savings, the downward trend suggests that savings are becoming harder to achieve. This could have implications for the Council's financial sustainability. The size of the future forecasted budget gaps is examined in greater detail in Part 3 of this report.

Housing Revenue Account

55. 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.

56. The HRA account broke even on a funding basis in 2016/17 and the HRA reserve remains unchanged at £2 million.

Capital programme 2016/17

57. Capital expenditure in 2016/17 was £234 million. This includes expenditure of £42 million for Levenmouth Academy, which was financed through the Hub programme. Capital and interest repayments for this asset are being funded by the Scottish Government's Schools for the Future Programme.

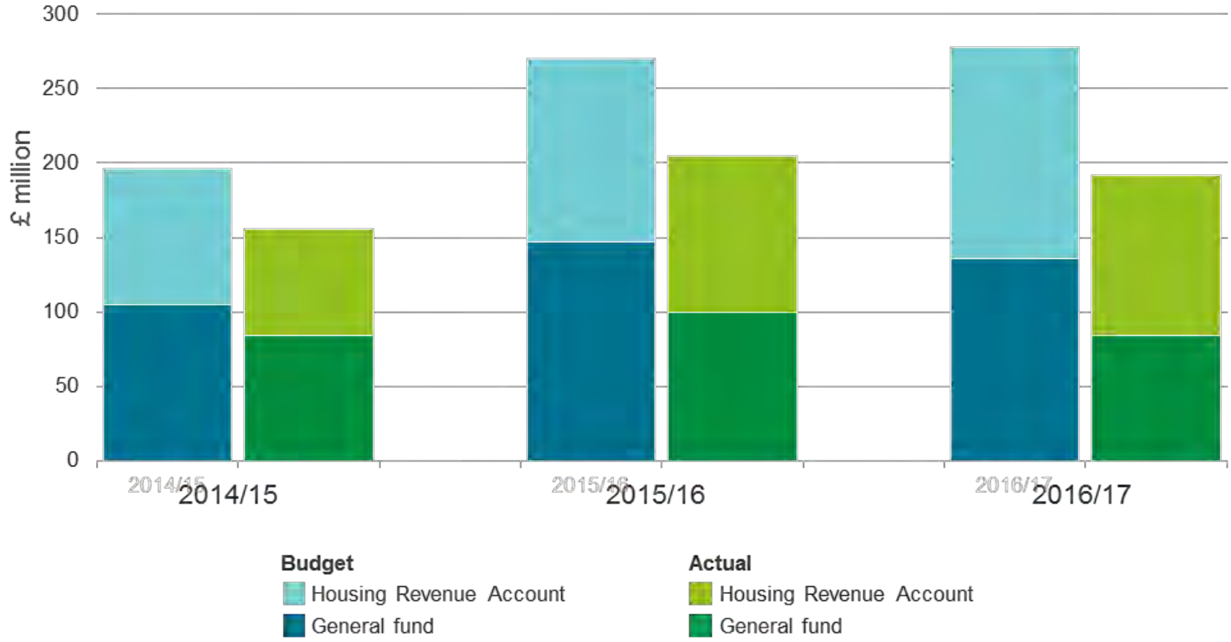
58. The Fife Council capital outturn reported to members was £192 million against a budget £278 million, an underspend of £86 million. The Council has a history of slippage in its capital programme as outlined in Exhibit 7.

59. The outturn against budget was relatively consistent across all services, with slippage generally being due to timing and profiling rather than the cancellation or non-delivery of projects. The major elements of the underspend included:

- affordable housing programme £19 million
- capital expenditure on existing HRA estate £15 million
- future care homes £9 million

60. In 2015/16 the council agreed to include more realistic project spending profiles in its refreshed capital plan in February 2017. We will continue to monitor capital programme delivery as part of our 2017/18 audit.

Exhibit 7
Capital slippage compared to budget (general fund and HRA)



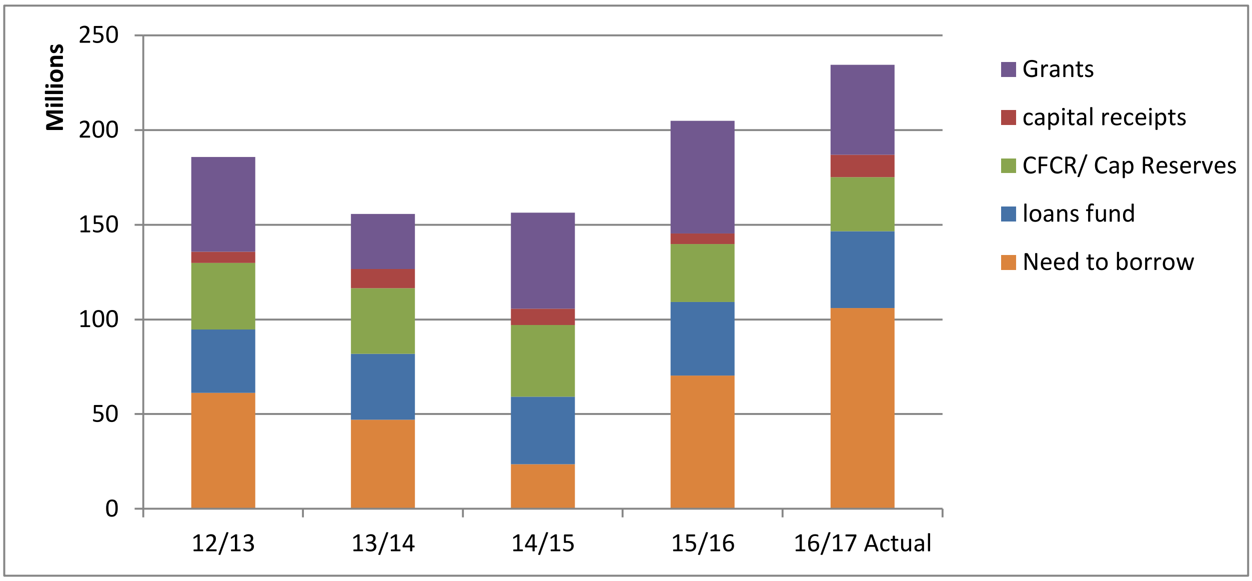
Source: Fife Council Capital Investment Plan Update – Provisional Outturn and Fife Council Accounts

Capital Financing in 2016/17

61. The Council's capital programme is financed from a variety of sources, but most from government grants and external borrowing (typically 57%). As shown in Exhibit 8 the underlying need to borrow has increased significantly over the last two years, with the Council resorting to external borrowing in each of the last five years

62. The Council's net external debt (including PPP/Hub liabilities) increased by £143 million to £1 billion. This included £100 million of long term borrowing with the Public Works loan Board (PWLB). This is in line with the Treasury Management Strategy agreed at the start of the year. Our assessment of the impact on the Council's financial position and sustainability is included in Part 3 of this report.

Exhibit 8
Sources of finance for capital expenditure



Source: Fife Council Accounts 2013-14 – 2016-17

Internal controls

63. As part of our audit we identify and inspect the key internal controls in those accounting systems which we regard as significant for the production of the financial statements. Our objective is to gain assurance that the Council has systems of recording and processing transactions which provide a sound basis for the preparation of the financial statements.

64. Findings were included in our interim audit report that was presented to the Standards and Audit Committee on 21 September 2017. We concluded that the key controls were operating effectively. No significant control weaknesses were identified which could affect the Council's ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

65. Internal Audit has undertaken eight smaller review of the accounts payable system during 2017, three of these have been reported to committee. The reports highlight a number of areas where controls and procedures could be strengthened with particular concern over the creation and maintenance of supplier records.

66. Our year end work on the financial statements also identified an issue with historic creditor balances (see paragraph 34 above). Our findings suggest that there may be further weaknesses in the accounts payables system, with an increased risk of error. We will consider the on-going work being done by finance staff to clear the historic balances along with the completed internal audit reports as part of our 2017/18 planning process.

Prevention and detection of fraud

67. We have responsibility for reviewing the arrangements put in place by management for the prevention and detection of fraud. We reviewed the Council's arrangements including policies and codes of conduct for staff and elected members, whistleblowing, fraud prevention and fraud response plan.

68. Our Governance Report highlighted that fraud awareness training is provided to staff as part of standard induction procedures, and to revenues staff on an ad-hoc basis but a regular programme of on-going sessions for employees in key positions is not currently in operation. The Council's Audit and Risk Management Services are carrying out a fraud risk assessment and training session for the Extended Council Management Team by September 2017.

69. Based on the evidence reviewed by us, we concluded that the Council has adequate arrangements in place for the prevention and detection of fraud. The action agreed in our interim report will further improve the approach.

National Fraud Initiative

70. The National Fraud Initiative (NFI) in Scotland is a counter-fraud exercise co-ordinated by Audit Scotland. It uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify 'matches' that might suggest the existence of fraud or error.

Exhibit 9

National Fraud Initiative

Total number of matches

10,079

Number recommended for investigation

1,552

Completed/closed investigations

1,458 (as at August)

Source: NFI website

71. NFI activity is summarised in Exhibit 9 above. The Council recognises that the NFI is an important tool forming part of their fraud strategy and progress and outcomes are regularly reported to the Standards and Audit Committee by Internal Audit.

72. The Council is making good progress in following up the matches identified in the latest NFI exercise. To date, 20 cases have been concluded as fraud or error, with a cumulative value of £48,000, nearly all of these relating to housing benefit claimants. One case identified a continuing payment to a care home for a deceased resident, the amount has been recovered from the operator.

Part 3

Financial sustainability

Main judgements

The Council has a relatively low level of usable reserves, but the uncommitted element of the general fund exceeds the minimum strategic amount identified by the Council. The Council is currently increasing its borrowing to fund its capital programme. It has assessed both its borrowing and reserve levels as part of its financial strategy and judged both to be appropriate at this time.

The Council has a medium term financial plan and a detailed long-term financial planning model.

The Council recognises that transformational change is required to redesign services and have launched a fresh corporate programme designed to enable this.

Financial position

73. The financial statements show that:

- Fife Council has net assets of £232 million a decrease of £373 million from last year, mainly attributable to:
  - the increase in the pension net liability based on a fall in the applied discount rate (-£338 million)
  - an increase in net borrowing of (-£143 million)
  - an increase in non current assets (+£56 million).
- the Council incurred positive net cash flows from operations (£31 million).
- current liabilities exceed current assets by £159 million as a result of the Council's current treasury management strategy to take advantage of lower rates available in temporary loan markets.

Financial sustainability

74. 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.

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

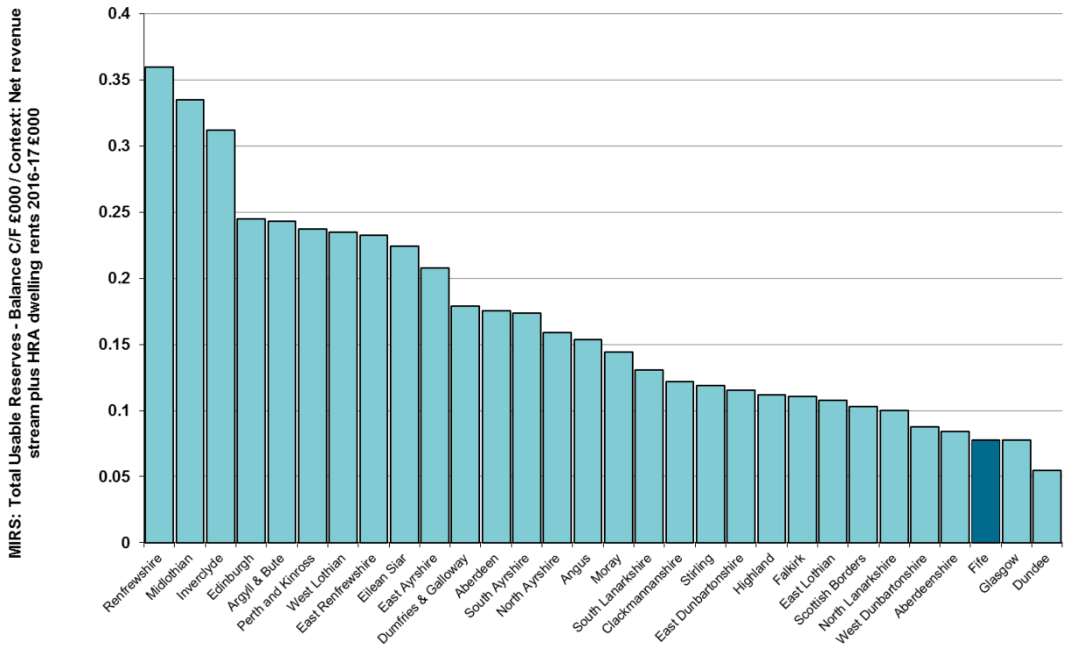
Reserves

75. One of the key measures of the financial health of a local authority is the level of reserves held. The level of usable reserves held by the Council increased from £68 million in 2015/16 to £71 million in 2016/17.

76. As can be seen from Exhibit 10, when compared with other local authorities the Council's level of usable reserves (adjusted by net revenue stream) is one of the lowest for its size.

Exhibit 10

Comparison of useable reserve levels between local authorities



Source: Local Authority Unaudited annual accounts 2016-17

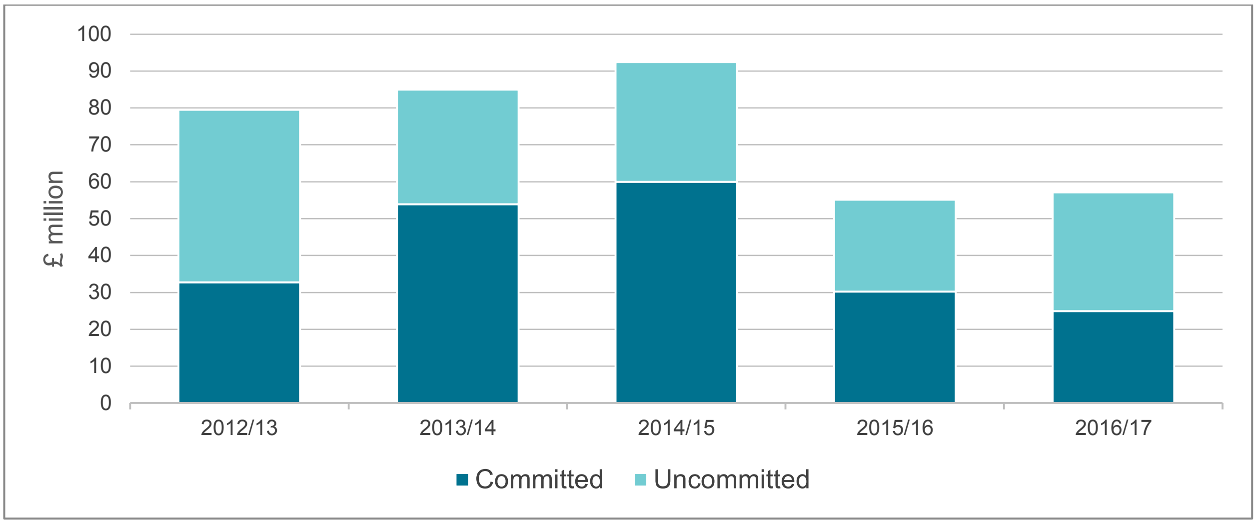
77. The general fund reserve is the largest usable reserve. Its main purpose is to provide a contingency fund to meet unexpected expenditure and as a working balance to help cushion the impact of uneven cash flows. The overall balance on this fund fell by £1 million in year. As part of their financial management arrangements most council's choose to earmark or commit elements of their general fund balance to reflect spending decisions to be applied in future years.

78. The Council reviews the level of its uncommitted reserves when setting the budget each year and as part of its regular monitoring exercises. The most recent reserves strategy specified that uncommitted reserves should be a minimum of 2% of net expenditure (£15.7 million). The level of uncommitted general fund reserves as at 31 March 2017 was £32.2 million (4%) which is above the minimum level.

79. Exhibit 11 provides an analysis of the Council's general fund reserve over the last five years split between committed and uncommitted reserves. This shows a notable fall in reserves last year when these were used to fund the Council's equal pay claims, although uncommitted reserves have remained reasonably consistent over the last four years.

Exhibit 11

Analysis of general fund over last five years



Source: Fife Council Annual Accounts

80. The reserves strategy has recently been reassessed as part of the 2018-21 medium term financial strategy approved by the Policy & Co-ordination Committee on 13th September 2017. A more sophisticated approach has been applied to assessing the adequacy of the reserves. This involved creating a financial risk register, identifying the significant financial risks, estimating the financial impact and detailing mitigating actions to reduce the likelihood and impact. The Executive Director for Finance and Corporate Services (EDFCS) then makes a judgement about the adequacy of the uncommitted general fund.

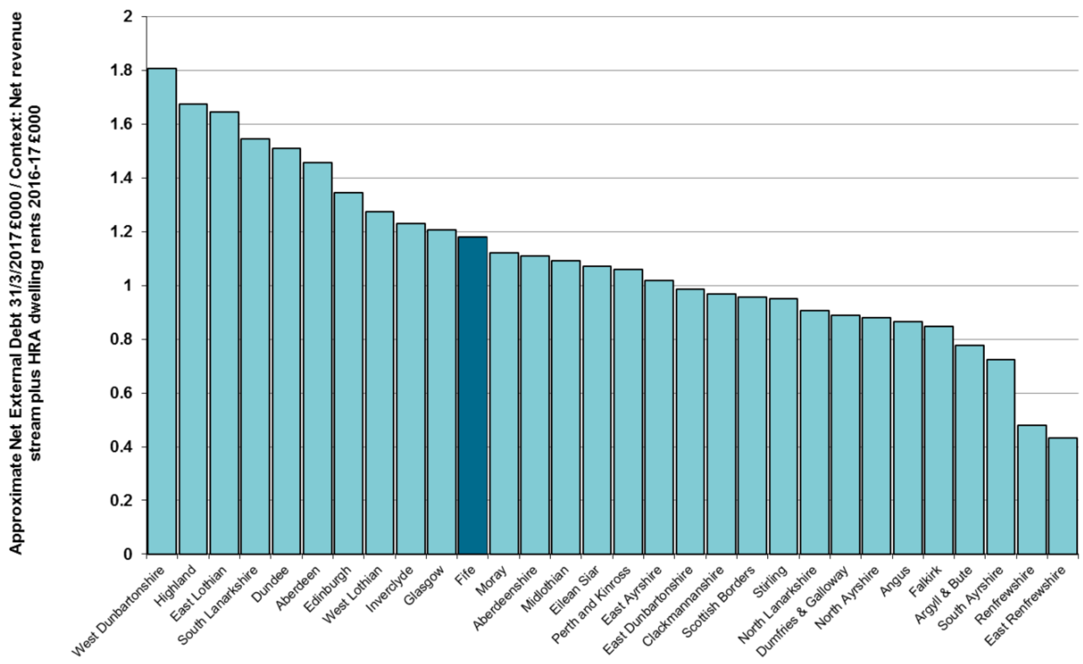
81. An uncommitted general fund balance at the end of 2017/18 of £30 million has been forecast. This covers 58% of the estimated risk and the EDFCS has assessed this level as “adequate”.

Treasury Management

82. At 31 March 2017, the Council’s net external debt was £1 billion. This increased by £143 million in the year and was used to fund the capital programme. The level of total borrowing is just above average in comparison to other local authorities (Exhibit 12).

Exhibit 12

Net external debt relative to the size of councils' net revenue



Source: Local Authority Unaudited annual accounts 2016-17

83. The Council's treasury management strategy was approved by the Executive Committee in February 2016. Total external debt (which includes the Council's long term liabilities) was within the authorised limit and operational boundary set by the strategy. The cost of servicing the debt is 7.6% of net revenue streams. The current borrowing position appears sustainable.

2017/18 Budget Position

84. The 2017/18 budget was approved in February 2017. Savings were agreed to close the forecasted budget gap in the period to 2019-20 (Exhibit 13). A late Scottish Government decision to provide additional funding for the year of £9 million improved the Council's position and should allow it to make a small surplus in 2017/18.

Exhibit 13

Identified funding gaps 2017/18 – 2019/20

	Prior to 2017-18 Budget	Savings Agreed in 2017/18 Budget	Remaining Budget Gap	Revised Budget Gap September 2017
	£m	£m	£m	£m
2017-18	19.5	29.9	-	-
2018-19	74.2	38.4	38.8	10.6
2019-20	109.2	65.7	46.8	9.7
2020-21				49.4

Source: Fife Council proposed Revenue Budget 2017-2020 (Feb 17), General Fund Revenue Budget 2018-21 (Sept 17)

Transformational Change

85. The savings above were split between those already identified by services and those to be achieved via the Council's latest transformation programme – *Enabling Change*. In 2016 the Council acknowledged that the scale of potential funding gaps required a renewed attempt to redesign services, increase income generation and embrace digital solutions as a means to deliver savings. The programme was agreed by the Council Executive Team in December 2016 and it has set out the scope, governance arrangements and appointed key project management posts.

86. The initial transformational savings target agreed in the budget aims to generate £7 million of savings in 2017/18, with £2 million of these being from within the Council's Health & Social Care Services. The Council is already reporting difficulties with achieving these in-year savings. Responsibility for delivering these savings has now been assigned to individual services.

87. The Council has completed two previous transformational programmes to date. The Shared Support Services (3S) programme closed in 2016. This focused on administrational changes in the Council's back-office functions. The most recent benefit realisation report issued in April 2017 confirmed that, by the end of 2016-17, £4.5 million of recurring savings had been achieved against a target of £9.4 million, with most of the shortfall in procurement (see paragraph 130). In the closure report produced in May 2016 the expected cumulative benefits of the programme over a five year period through to 2018/19 was £37 million. It is now highly unlikely that this target will be met.

Action Plan (Appendix 1, Point 7)

Medium and long term financial planning

88. The Council is facing a number of challenges in maintaining a sustainable financial position in the future. These include rising demands for services, increasing costs of services and reductions in central government funding.

89. It is important that long-term financial strategies (typically covering five to ten years) are in place which link spending to the Council's strategies, supported by indicative future spending plans (covering three years at least) that forecast the impact of relevant pressures on the Council.

90. For several years officers have developed a budgeting model to forecast expenditure and income levels over the next 10 years. The model makes use of population data from the National Office of Statistics and the expertise of service staff to predict increasing or decreasing demands for services. While income forecasts are limited by the availability of UK and Scottish Government spending plans, the Council has calculated best case, worst case and a medium case scenario for funding levels. A detailed Long Term Financial Planning Briefing covering the period 2018-2027 was presented to members at the Policy & Co-ordination Committee in September 2017. As a result of this work the forecasted budget gaps have been now been revised downwards (Exhibit 13 above).

91. In September 2017 the Executive Director of Finance and Corporate Services presented a Medium Term Financial Strategy covering the period 2018-2021 to the Policy and Co-ordination Committee for approval. The strategy recommended a number of changes to the budget process and a revised approach to the reserves policy (see paragraph 80). The document sets out the indicative budget reduction for each directorate over the three year period. Services have been asked to develop proposals on how they will operate within the "reduced resource envelopes" which will be set out in service change plans to be approved by members. The £35 million savings attributed to the Enabling Change programme in the 2017/18 budget will be formally identified as part of this process. The programme team will work with services to help identify and deliver savings.

Overall opinion on financial sustainability

92. The Council has a relatively low level of usable reserves, but the uncommitted element of the general fund exceeds the minimum strategic amount identified by the Council. The Council is currently increasing its borrowing to fund its capital programme. It has assessed both its borrowing and reserve levels as part of its financial strategy and judged both to be appropriate at this time. It has a well developed approach to long and medium financial planning.

93. The Council has a proven track record of delivering savings identified by services, though there is evidence that this is becoming harder and savings attributed to corporate change programmes have not always been achieved. The revised medium term financial strategy will implement a new approach to managing budgets and identifying the savings needed to close the forecasted funding gap. These changes will need to be implemented successfully for the Council to remain financially sustainable over the medium term.

Part 4

Governance and transparency

Main Judgements

The Council has a clear vision and has been working with a plan that focuses on outcomes for the last five years.

Adequate arrangements exist for standards of conduct, we have recommended improvements to registers of interest procedures

The council has appropriate governance arrangements in place that support scrutiny of decisions and it conducts its business in an open and transparent manner

Vision/ strategic plan

94. The Council's current plan was approved in 2013, covering the period through to the end of 2017. The document included 20 outcomes across the Council's key priorities. These outcomes form the basis of the annual performance reports. The 2016/17 performance report is due for publication in December 2017.

95. The Community Empowerment (Scotland) Act 2015 placed a requirement on Community Planning Partnerships to create a Local Outcome Improvement Plan (LOIP) for their area. In February 2017 the Fife Partnership Board agreed a more integrated approach to strategic planning and the draft LOIP "*A Plan for Fife*" was approved as a basis for formal consultation by the Policy & Co-ordination Committee in September 2017.

Fife Council Plan 2017

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

96. The Council has a range of activities in place designed to maintain standards of conduct including Codes of Conduct for members and officers. There are established procedures for preventing and detecting bribery and corruption including an Anti Fraud, Theft and Corruption policy and response plan.

97. During 2016/17 we reviewed the Council's register of interests and found it met basic requirements in all areas. There are some areas of good practice with annual returns required for all senior managers and clear guidance issued to assist them in identifying conflicts and actions to be taken to address this. The process is less well defined for members and we have identified some areas where improvements could be made including:

- members have a responsibility to update the register when a potential conflict emerges but there is no annual return that provides confirmation that no changes have occurred
- once a member declares an interest there is no action plan in place, setting out how the conflict should be handled.
- members returns should also consider potential conflicts involving friends and family members as part of the Council's process for identifying related party disclosures in the annual financial statements

Action Plan (Appendix 1, Point 8)

98. Based on our review of the evidence, we concluded that adequate arrangements are in place for standards of conduct and the prevention and detection of bribery and corruption.

Transparency

99. Transparency means that the public, in particular local residents, have access to understandable, relevant and timely information about how the Council is taking decisions and how it is using resources such as money, people and assets.

100. Members of the public can attend meetings of the full Council and any of its committee meetings. Minutes of these meetings along with supporting papers are readily available on the Council's website.

101. The website allows the public to access a wide range of information including current consultations and surveys, arrangements for the hearing of petitions and how to make a complaint. In addition, the website provides details of the Fife's peoples' panel and how to join it. The panel gives opinions and observations on a number of public services. The Council also operated an online budget consultation prior to the 2017/18 budget.

102. Overall, we concluded that the Council conducts its business in an open and transparent manner.

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making and transparent reporting of financial and performance information.

Governance arrangements

103. The Council is required to establish governance arrangements to ensure that its business is conducted in accordance with law and proper standards, that public money is safeguarded and that the adequacy and effectiveness of these arrangements is monitored.

104. Our review of the governance arrangements in operation during 2016/17 concluded that they were adequate, allowing for effective decision making based on a good standard of information with an appropriate level of scrutiny and challenge.

105. Following the May 2017 election, Fife Council has a Joint Administration (Labour and SNP) and an expanded committee structure. The Scheme of Administration has been updated and sets out the new committee structure outlining the terms of reference for each committee. There are now five service aligned committees and one over-arching Policy & Co-ordination committee. These 6 committees replaced the previous Executive Committee. The Standards & Audit Committee remains, with one scrutiny committee instead of the previous two.

106. It is still early days for the structure, however we have concluded that the changes continue to support good governance.

107. The council elections in May 2017 returned a high proportion of new councillors. The 2015/16 audit report on Governance and Accountability recommended a more robust member development programme and in response to this a more expansive induction programme was agreed by the CET. The induction training is still on-going but we have concluded that the content of the programme is appropriate and initial attendance figures have been encouraging.

Internal Audit

108. Internal audit provides senior management and elected members with independent assurance on the Council's overall risk management, internal control and corporate governance processes.

109. The internal audit function is carried out by Fife Council's Audit and Risk Management Service (ARMS). We carried out a review of the adequacy of the internal audit function and concluded that it operates in accordance with the Public Sector Internal Audit Standards (PSIAS) and has sound documentation standards and reporting procedures in place.

110. To avoid duplication of effort we place reliance on the work of internal audit wherever possible. In 2016/17 we placed formal reliance on internal audit's work in the following areas: payments to social care providers and members' expenses. We also considered all internal audit report findings relevant to our wider dimension work.

Correspondence referred to the auditor by Audit Scotland

Lender Option Borrower Option

111. During the year we received correspondence on a number of council's using Lender Option Borrower Option (LOBO) loans. A LOBO loan is typically a long term loan where the interest rate is initially fixed but the lender has the option to propose or impose on pre-determined future dates, a new fixed interest rate. The borrower has the option to either pay the revised interest rate or to repay the loan.

112. Fife Council has around £278 million of standard LOBOs within its market debt portfolio making up around 25% of its external debt. The level of LOBO debt has fallen by £50 million during the year following the decision by one counter party to convert their loans to a fixed rate basis. In addition Fife Council also has a £20 million inverse LOBO, where the interest rate paid varies in relation to a specified market rate. The inverse LOBO was taken out in 2012 to mitigate the Council's exposure to potential rising interest rates.

113. In following up this correspondence we have held discussions with council officers and reviewed supporting papers including an analysis of the LOBOs held by the Council and comparable PWLB rates of interest and review of the Council's treasury management policies and controls.

114. Based on our audit work we have concluded that:

- the use of LOBOs has been undertaken in line with the Council's treasury management policy, which is reviewed and approved annually by councillors
- the interest rates applied to the standard LOBOs were broadly comparable to PWLB rates available at the time.
- the option to propose or impose a new fixed interest rate has never been exercised by the lenders
- the potential for debt restructuring is kept under regular review by the Council as part of its treasury management arrangements.

Local scrutiny plan

115. The 2017/18 Local Scrutiny Plan (LSP) prepared by the Local Area Network (LAN) of scrutiny partners for the Council was issued to Fife Council in May 2017, following engagement with the Council Executive Team. To date this plan has not been considered by the Council or a committee. The LAN did not identify any new scrutiny risks in the year which would require specific scrutiny work during 2017/18 although a range of nationally driven scrutiny activity as set out in the LSP will be carried out.

Equalities

116. The Equality Act 2010 introduced a public sector general duty that encourages public bodies to mainstream equality, that is, ensure it is part of their 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.

117. We reviewed the current (Feb 2017) equalities report and concluded the Council has met its statutory duty to:

- publish information on progress made in mainstreaming equality within the Council
- report on progress made towards achieving equality 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 updated gender pay gap information.

Equal Pay in Scottish Councils

118. In September 2017, the Accounts Commission published its findings from an audit of equal pay across local government.

119. The audit found that councils underestimated the challenges involved in implementing the Single Status Agreement (SSA), and some of the approaches taken by councils did not always prioritise pay equality and were later found to be discriminatory. Fife council implemented single status in April 2007 and reports that between 2004/05 and 2015/16 it has spent £83 million compensating workers who had been unfairly paid and settling equal pay claims.

120. Almost 27,000 equal pay claims across Scotland remain live. Fife Council had 3,664 claims outstanding as at September 2016 and the majority of these have since been settled. Workers could potentially still make new claims therefore councils needs to be confident that there are fair and transparent pay arrangements in place and take the necessary action, such as regular equal pay audits, to deliver pay equality in line with their public sector equality duty.

121. We have concluded, on the basis of evidence reviewed, that the Council is proactive in ensuring that equality is mainstreamed.

Part 5

Value for money

Main judgements

Fife Council continues to invest in its school estate.

Fife Council is making improvements to its procurement function but the expected savings are still to be achieved.

We will provide the Council with a Best Value Assurance Report in 2018.

Best Value

122. The Accounts Commission agreed the overall framework for a new approach to auditing Best Value in June 2016. Best Value will be assessed over the five year audit appointment, as part of the annual audit work. In addition a Best Value Assurance Report (BVAR) for each council will be considered by the Accounts Commission at least once in this five year period. The BVAR report for Fife Council is currently scheduled for publication in 2017/18.

123. The Best Value audit work carried out this year focussed on the Council's arrangements for demonstrating Best Value in financial and service planning, financial governance and resource management. The effectiveness of the Council's Best Value arrangements in other areas will be assessed and reported throughout our audit appointment.

Value for money is concerned with using resources effectively and continually improving services.

Capital Project Management – Building Fife’s Future

124. One significant area of capital investment is the Council’s school building programme – Building Fife’s Future. The programme has been on-going since 2009 and to date has delivered five secondary and two primary schools. The Council has worked closely with the Scottish Government and Scottish Futures Trust taking advantages of Hub procurement frameworks for construction.

125. The programme is overseen by the School Estates Development Board, an officer led body chaired by the Executive Director for Education and Children’s Services with representatives from legal, planning, finance, education, IT and internal audit. The board receives regular updates on progress for all projects along with separate financial reports. Each school project has appropriate project documentation in place including a business case approved by the Executive Committee and a risk register. Business cases include options appraisals comparing the costs and benefits of new build facilities against refurbishment or maintenance of existing buildings. The governance and project management arrangements in place are appropriate for a programme of this size and complexity.

126. Two of the most recent projects (Windmill Community Campus, Kirkcaldy and Waid Academy, Anstruther) have used the community campus model.

Alongside the school facilities the sites also provide library and local office services.

127. One project which is still on-going is a replacement for Madras College in St. Andrews. Proposals have been in place for over a decade but problems with site selection, planning regulations and local opposition led to delays and increased costs. A court decision to quash the planning approval for building the school at Pipeland's Farm was passed in March 2016. Following the revival of negotiations with the University of St. Andrews, fresh plans, locating the school at Langlands, are being advanced and a revised business case is being prepared.

128. With the exception of Madras College, the programme has a strong track record of delivering schools on time and with minimal budget over runs. The Council has announced its intention to build three further replacement secondary schools as part of the programme but will require Scottish Government assistance with funding before these can proceed.

Procurement

129. A new procurement strategy and revised scheme of tender procedures is being drafted

130. The Council's 3S programme included a "Transforming Procurement" project to create a centralised procurement service with dedicated category managers. This was largely achieved, though local procurement teams remain in Building Services and Health and Social Care. The project was a cornerstone of the 3S programme and was anticipated to identify £6 million of savings by the end of 2016/17. Only £1.7 million has been achieved to date, with the shortfall covered by the Council's contingency budget in 2016/17. These savings targets have now been re-distributed to service areas by the new medium term financial strategy. Outwith these figures the project has contributed savings to the capital budget and Housing Revenue Account.

131. Procurement continues to be viewed as a key area for generating further efficiency savings through the commercialisation work stream of the current transformation programme *Enabling Change*. However some procurement related savings included in the 2017/18 budget are already being marked as "red" with doubt over their in-year delivery.

132. The new Procurement and Commercial Improvement Programme (PCIP) came into effect on 18 April 2016. An assessment took place in June 2017 and the Council was awarded a score of 54. An improvement action plan is being drawn up.

133. Fife Council currently make use of Scotland Excel (SE) framework agreements for approximately 12% of spend, with its own procurement arrangements accounting for 80%.

134. Overall we conclude that the Council is committed to continuous improvement, however there is a risk that savings attributed to procurement are being over-estimated in financial plans.

Action Plan (Appendix 1, Point 7)

Following the public pound

135. Local authorities have a statutory responsibility to comply with the Accounts Commission/COSLA Code of Guidance on funding external bodies and following the public pound.

136. Internal Audit carried out a review of the Council's compliance with the guidance in 2016 and concluded that it was broadly in compliance with the code but that there were some areas for improvement.

137. Audit Scotland is currently carrying out a performance audit of Scottish councils' use of ALEOs and has selected Fife, alongside a number of other councils, for a more in depth look at the arrangements. The report is due to be published in spring 2018.

Overview of performance targets

138. The Council participates in the *Local Government Benchmarking Framework* (LGBF). The framework aims to bring together a wide range of information about how all Scottish councils perform in delivering better services to local communities, including the cost of services and how satisfied citizens are with them.

139. The most recent *National Benchmarking Overview Report 2015/16* by the Improvement Service was published in February 2017 and covered the 2015/16 reporting period. This report was not yet been submitted to the Policy & Co-ordination Committee.

140. The Council's Annual Public Performance Report which reports progress in delivering the outcomes and targets set out in the Fife Community Plan 2020 and the Fife Council Plan 2012 to 2017, will not be available until December 2017. We are unable, at this stage to report an assessment of the Council's performance against its targets for 2016/17. Fife Council's performance management arrangements and overall service performance levels will be assessed and reported in our BVAR due in 2018.

Statutory performance indicators (SPIs)

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

142. For 2016/17 two (SPIs) were prescribed:

- SPI 1: covering a range of information relating to areas of performance such as improving local outcomes, engaging with communities and achieving Best Value
- SPI 2: relates to the reporting of performance information as required by the Local Government Benchmarking Framework.

143. Overall we concluded that the Council's arrangements for publication are satisfactory.

National performance audit reports

144. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. During 2016/17, a number of reports were issued which are of direct interest to the Council. These are outlined in Appendix 4.

145. Fife Council has a system in place for reviewing national reports and disseminating relevant reports to senior managers, however there is no formal mechanism to ensure they are presented to members through consideration at committees.

Health and Social Care Integration

146. Audit Scotland's publication *Health and Social Care Integration* published in December 2015 highlighted the significant risks which need to be addressed if integration is to fundamentally change the delivery of health and care services. Fife Council and the IJB are in on-going discussions on how to redesign community services across Fife. Delivering on these on-going challenges will be key to the success of integration services.

147. Audit Scotland, as part of a series of reports, will be reporting on integration authorities' progress after the first year of IJBs being established.

Appendix 1

Action plan 2016/17

2016/17 recommendations for improvement

Para no.	Issue/risk	Recommendation	Agreed management action/timing
19	1. **Charitable Trusts** Only 12 of the 48 charitable trusts have paid out grants in the year. **Risk** The charitable trusts do not meet the charity test as they are not providing public benefit	Consideration should be given to whether the existing charitable trusts are providing public benefit and consider whether any could be amalgamated or closed	The profile of trusts, application process and funds available will be raised with local community groups. A limited review of existing trusts and reasons for lack of spend will be undertaken. **Head of Democratic Services.** ***March 2018***
33	2. **Group Accounts** Our audit work on the group accounts identified a number of errors relating to the information provided by subsidiaries and the consolidation procedures performed by the council **Risk** The group accounts are materially misstated due to consolidation issues.	The Council should review the group accounts process and ensure they have sufficient arrangements in place to support the preparation of the group accounts.	Consolidation procedures for the whole of Group Accounts will be reviewed and updated accordingly **Finance Operations Manager** ***March 2018***
34	3. **Historic Creditor Balances** Our audit work identified £3.4 million of balances in creditor accounts that were over a year old. It is not clear whether they represent legitimate liabilities or arose from processing errors in the accounts payable system **Risk** Expenditure and liabilities may be overstated	The Council should review the balances and confirm whether they remain as liabilities or should be written off. The accounts payable process should be reviewed to identify if there are systemic issues which need to be addressed	Work has commenced on investigation and taking corrective action on GRNI balances. Backlog will be cleared by end December 2017 and regular housekeeping undertaken **Finance Operations Manager** ***March 2018***

Para no.	Issue/risk	Recommendation	Agreed management action/timing
35	**4. Redundancy Provision & Insurance Fund** Before a provision for future costs can be recognised, accounting standards (IAS37) requires the following: • a present obligation (legal or constructive) as a result of a past event • payment is probable and • the amount can be estimated reliably Our assessment is that Fife Council's plans for workforce change are insufficient to meet the criteria of a provision. Accounting standards do not allow for an internal liability to be recognised in the accounts. There are elements of the Insurance provisions relating to internal claims. **Risk** There is a risk that the Council are over stating liabilities.	The accounting treatment for: • the redundancy provision and • the operation of the insurance fund should be re-assessed with reference to accounting standards	The accounting treatment of provisions and insurance fund will be fully reviewed **Finance Operations Manager** ***March 2018***
40	**5. Accounts disclosures and streamlining** The accounts document was 144 pages long. We identified a number of areas where the overall document could be streamlined. **Risk** There is a risk that users are unable to identify material elements of financial position and performance in such a long document.	The Council should review all disclosure issues identified by us in 2016/17 and we will assist officers with a review of whether some disclosures could be removed or reduced for the 2017/18 accounts.	All disclosures will be reviewed, Best Practice will be sought and compliance with the Code ensured. **Finance Operations Manager** ***June 2018***
41	**6. Accounts notice** There are legislative	The Council should take steps to ensure the advert for the 2017/18 accounts is in	Year End Timetable and Closure process will be reviewed to ensure we

Para no.	Issue/risk	Recommendation	Agreed management action/timing
	requirements relating to the advertisement of the annual accounts. We identified that the advert did not identify the certifying auditor by name and that the accounts were only available for 13 working days instead of the required 15 days. **Risk** There is a risk that the Council is failing to comply with legislation.	line with legislation	comply with appropriate legislation. **Finance Operations Manager** ***March 2018***
87, 134	**7. Missed transformation savings targets** The Council's previous transformation project (3S) was expected to identify and deliver £9.4 million recurring savings by 2016-17. Only £4.5 million had been achieved, with most of the shortfall in the procurement project. £5 million of savings forecasted to be delivered in 2016/17 were postponed and had to be covered by contingency budgets. The Council is already reporting difficulties with achieving 2017/18 in-year savings. **Risk** Failure to deliver planned savings presents a risk to the Council's financial sustainability in the medium and long term.	The Council should ensure all savings plans are subject to robust challenge to ensure they are deliverable.	The strategy developed for change programme savings moving forward is based on services owning change through their service change plans. Procurement are working in partnership with services to identify opportunities through the commercialisation element of the change programme **Executive Director of Finance and Corporate Services** ***March 2018***
97	**8. Register of Interests** Currently Fife Council procedures to identify and record member and officer registers of interest reflect basic practice overall with aspects of good practice in relation to officers returns. There is scope, however, to	We recommend that members, in line with the approach for officers: • complete an annual return • include details of any conflict of interests involving friends and family, and • once a potential conflict is	Democratic Services have a process in place to remind elected members, on a six-monthly basis, of the need to update their entry in the Register of Interests, as recommended by the Standards Commission. In terms of conflicts of interests of family and friends, these issues are only likely to arise

Para no.	Issue/risk	Recommendation	Agreed management action/timing
	improve the process. **Risk** Robust procedures for maintaining a register of interest and responding to conflicts of interests increases transparency and reduces the risk of fraud and corruption are not fully in place	identified the Council should produce an action plan detailing how the conflict will be handled.	on an ad hoc basis at committee meetings and councillors can seek advice at any time from officers in relation to the need to declare interests at committee, details of which are then formally recorded. **Head of Democratic Services** ***Not applicable***

Appendix 2

Significant audit risks identified during planning

The table below sets out the audit risks we identified during our planning 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
Risks of material misstatement in the financial statements			
1	**Risk of management override of controls** ISA 240 requires that audit work is planned to consider the risk of fraud, which is presumed to be a significant risk in any audit. This includes the risk of management override of controls in order to change the position disclosed in the financial statements.	• Detailed testing of journal entries. • Review of significant management estimates and evaluation of the impact of any variability in key assumptions. • Focused testing of accruals and prepayments. • Evaluation of significant transactions that are outside the normal course of business.	**Results** – Our work on journals, accounting estimates, accruals and prepayments did not identify any evidence of management interference and there were no significant transactions outside the normal course of business. **Conclusion** – No issues were identified that indicate management override of controls.
2	**Risk of fraud over income** Fife Council receives a significant amount of income from sources other than Scottish Government funding including from council tax, non domestic rates and housing rents. The extent and complexity of income means that, in accordance with ISA240, there is an inherent risk of fraud that requires an audit response.	• Detailed testing of controls within income systems. • Analytical procedures on income streams. • Detailed testing of revenue transactions.	**Results** – We did not identify any significant issues from our testing of income controls and transactions. **Conclusion** – No fraud issues were identified.

	Audit risk	Assurance procedure	Results and conclusions
3	**Risk of fraud over expenditure** The Code of Audit Practice expands the ISA assumption on fraud over income to aspects of expenditure. Fife Council incurs significant expenditure in areas such as welfare benefits, social care payments and grants.	• Audit work on the National Fraud Initiative matches. • Detailed testing of controls over social care payments. • Assessing the overarching controls within grant schemes. • Detailed testing of expenditure and housing benefit transactions.	**Results** – We did not identify any significant issues in our testing of expenditure controls and transactions or our work on National Fraud Initiative matches. This identified around £48,000 errors in relation to a number of housing benefits and one case relating to a care home payment. Almost all of this money has been repaid. We took assurance from work done by Internal Audit on social care payments. **Conclusion** – Limited fraud issues were identified from the NFI work.
4	**Estimation and judgements** There is a degree of subjectivity in the measurement and valuation of the material account areas of pensions, non-current assets, accruals and provisions. This subjectivity represents an increased risk of misstatement in the financial statements.	• Completion of 'review of the work of an expert in accordance with ISA500' for the professional valuer and actuary. • Substantive testing of provisions focusing on the appropriateness of the valuation for equal pay.	**Results** – We identified a material issue with the valuation methodology for privately financed assets which led to an adjustment in the accounts. We challenged management on the validity of their redundancy and insurance claims provisions. **Conclusion** – We were content with the adjustment to the asset valuation and no further issues were identified regarding the work of the valuer or actuary. Management have agreed to review their approach to the redundancy and insurance provisions in 2017/18 neither of which are material in value.
5	**Consolidation of Fife Health & Social Care Integration Joint Board (FIJB)** FIJB will be consolidated into the accounts of Fife Council for the first time in 2016/17. As this adjustment is being made for the first time, there is a risk of errors in accuracy and disclosure.	• Consider whether the process for consolidation is in line with the integration scheme. • Agree the consolidation adjustment is accurate and correctly disclosed. • Confirm balances have been agreed by the partner bodies.	**Results** – Funding to and from the IJB was not included in the gross income and expenditure totals in line with the guidance. The IJB was incorrectly consolidated into the group accounts. **Conclusion** – Management included IJB funding as income and expenditure in the final version of the accounts and made the necessary adjustments to the Group accounts

	Audit risk	Assurance procedure	Results and conclusions
6	**Revised financial statement formats** From 2016/17 the Code of practice on local authority accounting in the UK requires authorities to present their service segments on the face of the Comprehensive Income and Expenditure Statement (CIES) based on the way in which they operate and manage services rather than the service expenditure analysis in the Service expenditure reporting code of practice There is a risk that current and restated prior year figures are not correctly classified.	• Review work done on mapping the audited 2015/16 CIES to the new service structure to ensure completeness, accuracy and categorisation of comparative information.	**Results** – The unaudited accounts were revised to restate gross income and expenditure figures. Our audit work confirmed that the final disclosure was complete and accurate and that the categorisation was consistent with internal reporting. **Conclusion** – We are content with the format and accuracy of the audited financial statements
7	**Loans Fund Accounting** The Local Authority (Capital Finance and Accounting) (Scotland) Regulations 2016 came into force on 1 April 2016. The Regulations set out the powers of local authorities to borrow and maintain a loans fund and result in a change in accounting treatment from 2016/17. There is a risk that Fife Council do not have arrangements in place to comply with the new accounting practices.	• Review the arrangements in place to comply with the new loans fund accounting requirements. • Detailed audit testing of loans fund transactions within the financial statements.	**Results** – We are satisfied that arrangements for the loans fund comply with the accounting requirements. We did not identify any significant issues in our testing of loans fund arrangements and transactions. **Conclusion** – No issues were identified from our audit work.
8	**Accounts preparation** The Finance Operations Division, which has responsibility for the preparation of the financial statements for the council and charitable trusts, was restructured during 2016/17. This has resulted in changes to the key staff involved in the accounts preparation process. As staff involved are new to the process there is a risk of omissions or errors in the accounts preparation which could impact on the completeness and accuracy of the financial statements.	• Ongoing communication with finance staff to ensure they are aware of changes impacting on the 2016/17 accounts. • Review of disclosure checklists. • Review of account closedown procedures. • Extensive testing of charity transactions.	**Results** – There was an increase in the number of errors identified in the unaudited accounts in 2016-17, including a number of high value adjustments to the CIES and errors in group accounts preparation. The nature of the majority of these did not indicate the issues arose primarily as a result of changes to key staff. **Conclusion** – The finance team processed adjustments to correct all material errors. The accounts are not materially misstated and the Council has agreed to review the group consolidation arrangements for next year.
9	**Capital accruals** An error of £5.2 million, relating	• Targeted testing of capital accruals and closing balances in respect of	**Results** – We completed focused testing on year end adjustments to capital. We found errors

	Audit risk	Assurance procedure	Results and conclusions
	to a capital accrual for an affordable housing contract, was identified during the 2015/16 audit. The previous auditor also noted that there was a lack of documentation to support the year end values for affordable housing projects under construction. There is a risk that fixed asset balances and capital accruals are incorrect.	affordable housing projects.	across 7 projects with a total value of £1.6 million. After considering the amount involved management decided not to process an adjustment in 2016/17 **Conclusion** – We have treated this issue as an unadjusted error (see Appendix 3). Our work covered all uncompleted affordable housing projects so we are satisfied that there are no further undetected errors of this nature.
10	**Highways network assets (HNA)** HNA are to be recognised for the first time in the 2017/18 financial statements of councils. While this is not a risk to the 2016/17 financial statements, this is a new and complex area and there is a risk that Fife Council does not have sound arrangements in place for adoption in 2017/18.	• Assess the arrangements in place to implement the new requirements. • Review and assess the valuation methodology for HNA. • Assess the accuracy and completeness of road dimensions and categorisations.	**Results** – At its meeting in March, the CIPFA/LASAAC Code Board decided not to proceed with the introduction of HNA into the financial reporting requirements for councils. **Conclusion** – No requirement to recognise HNA in the accounts.
	Risks identified from the auditor's wider responsibility under the Code of Audit Practice		
11	**Financial sustainability** The Council's latest estimates of funding gaps for the next 3 years, as at January 2017, are as follows: 2017/18 £32.2 million 2018/19 £80.6 million 2019/20 £118.5 million Financial challenges are unlikely to reduce and there is a risk that budget gaps will not be addressed.	• Undertake specific audit work on financial planning and governance. This will include assessing the robustness of long term financial planning.	**Results** – We completed our review of the financial planning arrangements. **Conclusion** – We concluded in our interim report and in Part 3 above that Fife Council has an approved medium term financial strategy for ensuring sustainability and a robust approach to long term planning.
12	**Financial management** As at the end of January 2017, the Council was reporting a forecast surplus of £3.5 million against the 2016/17 budget. Forecast service overspends are expected to be offset by central underspends. The general fund is estimated to decrease by £17 million (31%) due to the use of previously earmarked balances (£13.6 million), delayed	• Review financial monitoring reports and the financial position. • Undertake specific audit work on financial governance and resource management.	**Results** – We reported the results of our work on financial management in our interim report and Part 2 of this report **Conclusion –** There was an improvement in Fife Council's financial position by the end of the year. We have concluded that there are effective financial management arrangements in place, though we note that some planned savings have not been

	Audit risk	Assurance procedure	Results and conclusions
	implementation of savings (£6.8 million) and the surplus of £3.5 million noted above. There is a risk that the council will not achieve planned savings targets for the current year.		achieved.
13	**User access controls** The council's main financial system, ERP, has a high volume of responsibilities with enhanced access and over 3,500 users are assigned these responsibilities. There is also a lack of regular user access review and scrutiny of user actions. There is a risk of unauthorised transactions being processed.	• Detailed testing of user access controls. • Review of internal audit work on the payables element of the ERP system (purchase to pay).	**Results** – Our testing of user access controls was reported in our Governance Report. Our financial statements audit work did not identify any suspicious transactions **Conclusion** – We recommended improvements to access controls in the Governance Report.

Appendix 3

Summary of unadjusted errors

We report all uncorrected misstatements that are individually greater than our reporting threshold of £100,000.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. We are satisfied that these errors do not have a material impact on the financial statements.

No.	Account areas	Comprehensive income and expenditure statement		Balance sheet	
		Dr £000	Cr £000	Dr £000	Cr £000
1	**There was an overstatement in the redundancy provisions due to a working paper error**				
	Cost of Services		116		
	Provisions			116	
2	**Capital Expenditure recognised in the wrong year**				
	Cost of Services		1,267		
	Property, Plant & Equipment			1,670	
	Short Term Creditors				403
3	**Insurance fund provisions includes internal claims**				
	Cost of Services		954		
	Provisions			954	
4	**Housing Benefit Overpayment recovery recognised as income**				
	Gross Income	1,760			
	Gross Expenditure		1,760		
5	**Council dwelling revaluation based on incorrect stock figures**				
	Deficit on revaluation of non-current assets	740			
	Property, Plant & Equipment				740

No.	Account areas	Comprehensive income and expenditure statement		Balance sheet	
6	**Accruals processing error**				
	Short Term Debtors				227
	Short Term Creditors			585	
	Cost of Services		358		
7	**Historic accrual balances**				
	Short Term Creditors			3,400	
	General Fund				3,400
Net impact – Net expenditure			**2,695**		
Net impact – Other comprehensive expenditure		**740**			
Net impact – Net Assets				**5,355**	
8	**Group Accounts inter-subsidiary balances**				
	Short Term Debtors				4,008
	Short Term Creditors			4,008	
No impact on Group Net Assets					

Appendix 4

Summary of national performance reports 2016/17

2016/17 Reports

Apr			
May	Common Agricultural Policy Futures programme: an update		
Jun	South Ayrshire Council: Best Value audit report	The National Fraud Initiative in Scotland	
Jul	Audit of higher education in Scottish universities	Supporting Scotland's economic growth	
Aug	Maintaining Scotland's roads: a follow-up report	Superfast broadband for Scotland: a progress update	Scotland's colleges 2016
Sept	Social work in Scotland	Scotland's new financial powers	
Oct	Angus Council: Best Value audit report	NHS in Scotland 2016	
Nov	How councils work – Roles and working relationships in councils	Local government in Scotland: Financial overview 2015/16	
Dec	Falkirk Council: Best Value audit report	East Dunbartonshire Council: Best Value audit report	
Jan			
Feb	Scotland's NHS workforce		
Mar	Local government in Scotland: Performance and challenges 2017	i6: a review	Managing new financial powers: an update

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