Stirling Council

Annual report on the 2010/11 audit

Members of Stirling Council and the Controller of Audit
October 2011

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Key messages

We have given an unqualified opinion on the financial statements of Stirling Council. However, our opinion draws attention to the failure of a significant trading operation (building cleaning) to breakeven on a rolling three year basis. This significant trading operation made a deficit in 2008/09 but has made a small surplus in 2009/10 and 2010/11.

The accounts were certified by the target date of 30 September. They are now available for publication and are an essential means by which the council accounts for its stewardship of public money.

The general fund balance recorded a net increase for 2010/11 of £0.586 million, resulting in a balance of £13.541 million as at 31 March 2011. This balance includes earmarked commitments of £7.759 million and an unallocated general fund balance of £5.782 million. Costs relating to the Customer First and Municipal Buildings works will be funded from this unallocated balance during 2011/12. Uncommitted reserves will remain within the council's target balance of £4.5 million - £5.5 million (2-2.5% of budget).

Capital expenditure for 2010/11 was £31.677 million against planned expenditure of £33.156 million. General Fund capital expenditure was reduced by £3.669 million or 15.8% during the year, representing slippage on capital projects. Housing Revenue Account capital expenditure was £12.222 million against a budget of £10.032 million. The balance of £2.190 million was made up by transfers from earmarked balances, mainly from the Strategic Housing Account.

The council has maintained a broadly consistent level of total reserves since 2007/08. The council has seen increasing pressure while it has managed its overall financial position during this period. Reserve levels provide some scope to manage the financial position in the short term, were this required, but the council has limited opportunity to use its balances to manage any significant reductions in income and recurring expenditure pressures.

We assessed key financial systems as having a satisfactory level of control for our purposes. We were satisfied with disclosures made in the statement on the system of internal financial control and the adequacy of the process put in place by the council to obtain assurances on systems of control. However, it is considered good practice to include an Annual Governance Statement in the financial statements, which covers wider corporate governance areas than the statement on the system of internal financial control. The council plans to introduce this statement in its 2011/12 financial statements.

The council has continued to make progress with its strategic approach to asset management, and has identified considerable planned savings through more efficient use of its assets, for example through rationalisation of its city centre office accommodation. In addition, the Forth Valley wide asset management plan, "Making the most of Property and Assets", was formally launched by the council and its Forth Valley partners in September 2011.

The council has improved its rating from 'non-conformance' to 'conformance' in its annual procurement capability assessment. The revised procurement strategy 2011-2015 states the intention to reach the 'improved' performance rating but there is still much to do to achieve this aspiration.

The council's performance in people management is mixed: its performance in leadership development, employee communications and managing absence is good; it needs to apply performance appraisal and workforce planning more consistently across the organisation.

The statutory duty of Best Value in local government was introduced in the Local Government in Scotland Act 2003, and best value is an important part of the wider scrutiny arrangements in councils in Scotland. Audit Scotland works closely with other local government inspectorates, undertaking a shared risk assessment process for all 32 local authorities, to support the delivery of targeted, risk-based scrutiny. Stirling Council's shared risk assessment, the results of which were reported in the Assurance and Improvement Plan, identified the need for a Best Value audit as a part of the required response to local scrutiny risks.

An audit of Best Value and Community Planning was undertaken between March and August 2011 and the best value audit report will be published in November 2011. We have limited our commentary on the council's overall performance within this annual audit report to avoid unnecessary duplication.

Outlook

Looking ahead, it is clear that the outlook for public spending for the period 2012/13 to 2014/15 remains very challenging. The high level figures for Scotland that were announced in the UK Comprehensive Spending Review indicate that significant budget reductions will be required in these years.

In addition, the Audit Scotland Report "Scotland's public finances: responding to challenges" contained a number of key messages for councils to consider given the financial constraints being faced.

Stirling Council is making good progress in identifying savings to reflect the reduced local government settlements but there is still more to do to realise these savings in future years.

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of Stirling Council. The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit, and to summarise the auditor's opinions (i.e. on the financial statements), conclusions and any significant issues arising. The report is divided into sections which reflect the extent of our public sector audit model.

2. A number of reports have been issued in the course of the year in which we make recommendations for improvements (Appendix A). We do not repeat all of the findings in this report, but instead focus on the financial statements and any significant findings from our wider review of Stirling Council.

3. The report on the Audit of Best Value and Community Planning at Stirling Council is due to be published in November 2011. We will not make significant comment in this report on the issues covered in the best value report, to avoid duplication.

4. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and agreed to take the specific steps in the column headed "planned management action". We do not expect all risks to be eliminated or even minimised. What we expect is that the council understands its risks and has arrangements in place to manage these risks. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to assess progress.

5. This report is addressed to the members and the Controller of Audit and should form a key part of discussions with the scrutiny committee as soon as possible after the formal completion of the audit of the financial statements. Reports should be available to the Scottish Parliament, other stakeholders and the public, where appropriate. Audit is an essential element of accountability and the process of public reporting.

6. This report will be published on our website after consideration by the council. The information in this report may be used for the annual overview of local authority audits to the Accounts Commission later this year. The overview report is published and presented to the Local Government and Communities Committee of the Scottish Parliament.

7. The management of the council is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.

Financial statements

8. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.

9. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

10. Auditors review and report on, as appropriate, other information published with the financial statements, including the explanatory foreword, statement on the systems of internal financial control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit of the financial statements.

Audit Opinion

11. We have given an unqualified opinion that the financial statements of Stirling Council for 2010/11 give a true and fair view of the state of the affairs of the council and its group as at 31 March 2011 and of the income and expenditure for the year then ended.

12. We have however, drawn attention in our audit report to the fact that the Building Cleaning significant trading operation has failed to break even, on a cumulative basis, over a three year period. This is due to the impact of equal pay costs in previous years. The significant trading operation made a small surplus in 2009/10 and 2010/11. Whilst this is a failure to comply with the Local Government in Scotland Act 2003, it does not impact on the fairness of the financial statements or affect the overall opinion on the financial statements.

13. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. The accounts were certified by the target date of 30 September 2011 and have now been presented to the Governance and Audit Committee and full Council, and published on the Council's website and in the local press. The financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Legality

14. Through our planned audit work we consider the legality of the council's financial transactions. In addition the Head of Governance and Resources has confirmed that, to the best of his knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and

regulations. There are no legality issues arising from our audit which require to be brought to members' attention.

Statement on the system of internal financial control

15. We are satisfied with the disclosures made in the statement on the system of internal financial control and the adequacy of the process put in place by the council to obtain the necessary assurances. In accordance with good practice the council is developing internal processes to enable it to disclose an annual governance statement in the 2011/12 financial statements.

Remuneration report

16. The Local Authority Accounts (Scotland) Act 1985 and Scottish Government finance circular 8/2011 introduced the requirement for a remuneration report to be included in the financial statements from 2010/11. This is a significant change to the level of disclosure required.

17. We are satisfied that the remuneration report has been prepared in accordance with the Local Authority Accounts (Scotland) Act 1985 and Scottish Government finance circular 8/2011. The disclosures within the 2010/11 financial statements include all eligible remuneration for the relevant council officers and elected members.

Accounting issues

18. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the 2010 Code). We are satisfied that the council prepared the 2010/11 financial statements in accordance with the 2010 Code.

Prior year adjustments

19. The 2010/11 financial statements have been prepared in accordance with the 2010/11 Code which is based on International Financial Reporting Standards (IFRS) instead of the previous practice of preparing financial statements under UK Generally Accepted Accounting Practice (GAAP). This transition required a prior year adjustment to the 2009/10 audited financial statements and the restatement of the 1 April 2009 opening balance sheet position. The main areas that required restatement include the treatment of capital grants, the inclusion of an accrual for employee benefits such as annual leave and the classification of leases. These changes resulted in the net asset position of the council as at 31 March 2010 changing from £276.437 million to £342.938 million; however the accounting nature of these adjustments means that there has been no change to the usable reserves of the council.

20. The achievement of full transition to IFRS-based financial statements required a significant input of resources by the council and council officers have responded well to this challenge. We welcome the effort that has gone into improving the presentation of the council's financial statements to make them clearer to the reader.

Pension costs

21. Stirling Council is a member of Falkirk Pension Fund which is a multi-employer defined benefit scheme. In accordance with pensions accounting standard IAS19 'Retirement Benefits' the council has recognised its share of the net liabilities for the pension fund in the balance sheet. The valuation at 31 March 2011 provided by the scheme's actuaries reduced the council's share of the deficit from £198.637 million last year to £125.312 million this year. The large decrease is primarily due to a change in one of the financial assumptions, with future pensions' increases now linked to the consumer prices index (CPI) rather than the retail prices index (RPI).

22. The change in assumption is a consequence of the UK Government’s announcement that CPI is to be used for the indexation of public sector pensions from April 2011, which is expected to lead to a reduction in pension costs over time. This is reflected as non-recurring income of £33.616 million in the Comprehensive Income and Expenditure Statement. Local government accounting rules mean that this is reversed in the Movement in Reserves Statement, but the council will experience the financial benefit of the change as future contribution rates are set.

Impact of economic climate

23. The impact of the economic climate is referred to in the Foreword to the financial statements. The commentary could have been enhanced with more detail, in particular giving a wider range of specific examples of where and how the economic climate and the reduction in available funding have impacted significantly on the accounts. Looking ahead, the Foreword provides a valuable opportunity to explain the implications of reduced funding and set out how the council has managed this.

Action plan no. 1

Outlook

Carbon trading

24. In April 2010 a complex system of charging for carbon emissions was introduced by the EU. The council is now required to purchase and account for carbon credits to cover all of its non transport related energy usage. Incentives and penalties are built into the system to encourage a reduction in carbon emissions. The council's carbon management plan is currently being reviewed. Work is underway to identify energy efficiency targets for 2011/12 and also to commission consultancy support on opportunities from renewable energy.

25. The 2010/11 charge for the council was calculated as £0.195 million (£0.222 million in 2009/10) based on a baseline annual carbon footprint of 16,296 tonnes of CO_2 equivalent (18,510 in 2009/10). Whilst 2010/11 was a practice year and the charge was not actually incurred, it is now expected that the council will have to purchase £0.195 million worth of carbon allowances in April 2012.

Audit appointment for 2011/12

26. Audit appointments are made by the Accounts Commission, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment and we would like to acknowledge good working relationships throughout the term of our appointment and thank officers and members for their assistance during the last five years. The procurement process for the next five years was completed in May 2011. From next year (2011/12) Grant Thornton will be the appointed auditor for Stirling Council. We will be meeting with the incoming auditors as part of a managed handover process.

Financial position

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

28. Auditors consider whether audited bodies have established adequate arrangements and examine:

- financial performance in the period under audit
- compliance with any statutory financial requirements and financial targets
- ability to meet known or contingent, statutory and other financial obligations
- responses to developments which may have an impact on the financial position
- financial plans for future periods.

29. These are key areas in the current economic circumstances. This section summarises the financial position and outlook for the organisation.

Financial results

30. In 2010/11 the council spent £325 million on the provision of public services: £293 million on revenue services and £32 million on capital projects. The Council's net provision of service expenditure in 2010/11 was £208.298 million. This was met by central government and local taxation together totalling £225.959 million, resulting in a surplus of £17.661 million, 8.5% of provision of service expenditure.

31. Overall the council's total spending was in line with the budget set. A service underspend of £0.830 million for 2010/11 was reported to members, although this total includes a £1.6 million overspend by Roads, Transport and Open Space following the harsh winter weather. Corporate budgets were underspent by £2.7 million. This included £0.4 million refund of balances from Central Scotland Joint Fire and Rescue Service, energy procurement savings of £0.7 million, VAT recovery from HMRC of £0.5 million, loan charges savings of £0.8 million, additional council tax income of £0.1 million and other corporate income of £0.2 million.

32. Service and corporate budget underspends, together with an increase in earmarked reserves, offset by severance costs incurred during 2010/11, resulted in an increase in general fund balances of £0.586 million in 2010/11. This resulted in overall general fund balances of £13.541 million which equates to 6.5% of the council's net annual expenditure. Of this balance £7.759 million has been earmarked for specific purposes including: strategic housing account (£1.332 million); loan investment income (£1.326 million); council tax discount on second homes (£0.974 million) and other balances totalling £4.127 million. This leaves an unallocated balance of £5.782 million which is within the council's target range of balances (2.0 - 2.5% of annual revenue budget) to help the council manage any financial risks and unplanned expenditure.

Financial position

33. The council has maintained a broadly consistent level of total reserves since 2007/08 (Exhibit 1). This follows an earlier build up of general fund in the three years from 2005/06. The council has seen increasing pressure while it has managed its overall financial position during this period. Reserve levels provide some scope to manage the financial position in the short term, were this required, but the council has limited opportunity to use its balances to manage any significant reductions in income and recurring expenditure pressures.

34. The following table shows the balance in the council's funds as at 31 March 2011 compared to the previous two years. Funds include a capital fund (Capital Receipts Reserve) which may be used to defray capital expenditure or repay loan principal, and a Repairs and Renewal Fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets. At 31 March 2011 the council had cash backed funds of £16.125 million, a decrease of £0.287 million on the previous year.

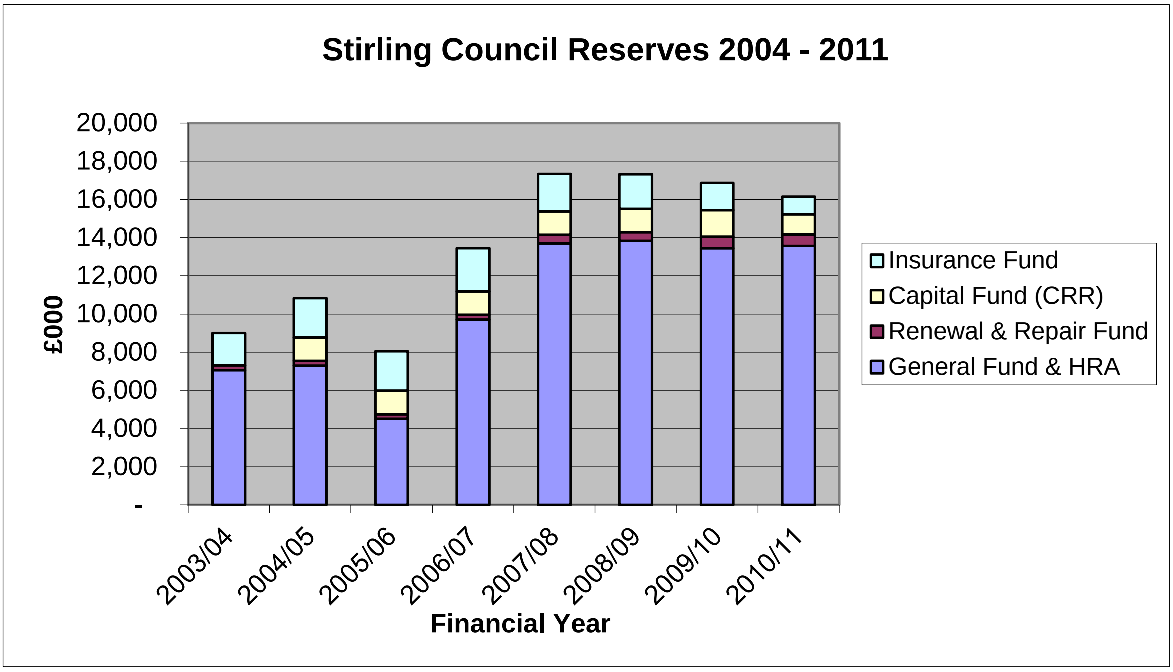
Exhibit 1: Usable Reserves

Description	31 March 2009 £000	31 March 2010 £000	31 March 2011 £000
General Fund	13,249	12,955	13,541
Housing Revenue Account	423	424	28
Capital Receipts Reserve	1,230	1,390	1,053
Repairs and Renewals Fund	450	591	601
Insurance Fund	1,809	1,436	930
Capita Grants Unapplied Account	14,423	785	296
Total Usable Reserves	**31,584**	**17,581**	**16,449**

Source: Stirling Council financial statements

35. The following table, Exhibit 2, shows the make up of the council's cash backed reserves since 2003/04. Increasing financial pressure on the public sector has meant that the council has had to manage its overall financial position tightly over this period. It should be noted that the council commenced accounting for earmarked reserves from 2006/07, resulting in an increased level of general fund balances when compared to prior years.

Exhibit 2: Cash Backed Reserves



Source: Stirling Council financial statements

36. A suite of financial indicators has been developed in consultation with the CIPFA Directors of Finance working group (see Appendix C). The indicators assist in evaluating the council's financial sustainability and the affordability of financial plans. They also demonstrate the effectiveness of the financial management arrangements. For 2010/11 Audit Scotland is compiling the financial indicators, and they may be published in the Local Government Overview report for 2010/11. However they are not yet available to include with this report, as they are based on the audited financial statements for all councils. The indicators will be issued to the council separately for consideration.

Financial position of group entities

37. The overall effect of inclusion of all of the council's subsidiaries, associates and joint ventures on the group balance sheet is to reduce net assets by £158.5 million, mainly because of pension liabilities. However, all group bodies' accounts (except Venture Forth Ltd) have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax. The accounts of Venture Forth Ltd were not prepared on a going concern basis as the company is expected to be wound up within 12 months of the balance sheet date.

38. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Central Scotland Joint Police Board, Central Scotland Joint Fire and Rescue Board and Central Scotland Valuation Board) had an excess of liabilities over assets at 31 March 2011 due to the accrual of pension liabilities. The council's share of these deficits is £161 million (2009/10 £191 million).

39. Active Stirling Ltd has net liabilities of £0.086 million after inclusion of a retirement benefit pension scheme deficit of £0.916 million. Forth Valley GIS Ltd has net liabilities of £0.497 million after inclusion of a retirement benefit pension scheme deficit of £0.497 million. Stirling Development Agency Ltd has net liabilities of £2.917 million including loans from the council of £5.229 million. The accounts of these companies have been prepared and consolidated on a going concern basis. The auditors of these companies have given an unqualified opinion in each case.

40. We noted last year that the council should keep under review the ability of its group entities to remain as going concerns in current economic concerns, and the implication for the council of any financial difficulties that the group entities may experience. This is still the case, as was highlighted by Raploch Urban Regeneration Company Ltd during the year, who asked the council to approve a change to its planned business activity in order to avoid an audit qualification on its 2010/11 financial statements. If the planned activity (and budgeted expenditure) remained unchanged, the company would struggle to demonstrate that it could remain a solvent going concern in future. The council agreed to the proposed changes and the company's auditor did not qualify their audit opinion for 2010/11.

41. In continuing to review the ability of its arms length companies to continue as going concerns in the current economic conditions, the council will need to consider the extent to which any continuing or additional financial support constitutes best value.

Action Plan no. 2

Capital performance

42. The council's capital expenditure for 2010/11 was £31.677 million against a budget of £33.156 million, an underspend of £1.479 million.

43. The general services capital outturn for 2010/11 was £19.455 million against a budget of £23.124 million, an underspend of £3.669 million (15.9%). The underspends arose from a variety of projects with the most significant being:

- Kildean Infrastructure: works was delayed due to protracted land purchase discussions;
- Cities Growth Fund: environment improvement works scheduled to avoid the Christmas period and was completed in July 2011;
- Roads Resurfacing and Backlog Programme: this was as a result of the winter conditions and priority being given to winter treatment rather than on road repairs; and
- Torbrex House Reprovisioning: delays in agreeing design requirements of the properties led to a delay in site work commencing.

44. The housing capital outturn for 2010/11 was £12.222 million against a budget of £10.032 million. The balance of £2.190 million was made up by transfers from earmarked balances, mainly from the Strategic Housing Account.

Treasury management

45. As at 31 March 2011, the council held cash and temporary investments totalling £7.156 million (£0.348 million in 2009/10). The council's net borrowing position has increased by £5.000 million to £134.801 million as at 31 March 2011.

46. The current economic climate means that interest rates remain relatively low with the council receiving interest of £0.865 million (£1.277 million in 2009/10). Borrowing rates are also low but the council has a significant proportion of its debt at fixed rates. This means that there is considerable certainty regarding the costs of financing debt, but that borrowing costs may remain above prevailing market rates. Ongoing careful management of the council's cash flow, the phasing of capital expenditure and continuing low levels of interest rates resulted in an average Loans Fund interest rate of 5.59%, down from 5.74% the previous year, and savings of £0.831 million during the year.

Financial planning

47. The council has shown a good understanding of the financial challenges it faces and has made good progress in addressing these. In setting its 2010/11 budget the council agreed to freeze its council tax, identifying in-year savings of £2.5 million to meet known spending pressures and planned growth. The council achieved its planned savings of £2.5 million in 2010/11. The council has set a £30 million savings target for the period 2011/12 to 2013/14, at approximately £10 million per year, and is making good progress towards delivery of the 2011/12 savings. Progress towards savings targets is reported to the Council Management Team and Members on a regular basis.

48. The council has improved its medium term financial planning arrangements: a long term financial plan has been drafted; a medium term financial planning and management framework has been introduced, with quarterly progress reported to full council; a cross-party Finance Review Group meets on a regular basis to discuss the financial position and future options available to the council. In addition, budget options papers were available to members in advance of the budget setting council meeting in February 2011, giving more time for consideration of the options than has been the case in previous years.

Asset management

49. The council has continued to make progress with its strategic approach to asset management, but there is more work to be done. The Asset Utilisation workstream of the council's change programme has a £0.5 million savings target to be delivered through more efficient use of the council's assets. One source of savings is rationalisation of the council's city centre office accommodation: staff will move out of the New Viewforth and Drummond House offices in 2013. The council has also worked with other public sector partners to develop a Property and Asset Management Strategy for the Forth Valley area. The council and its partners will undertake settlement-based reviews of public sector property assets within various settlements across the council area and consider the best use of those assets in delivering local services. The council recognises that it needs to continue to develop its asset

management and this is reflected in its Annual Improvement Statement, which outlines the council's priorities for improvement each year.

Procurement

50. Improved procurement practices are an important source of savings. The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and to deliver value for money and increased efficiency through improved structures, capability and processes. In 2009, the Scottish Government promoted the use of an annual procurement capability assessment (PCA) to assess procurement performance in all public sector bodies and as a basis for the sharing of best practice and continuous improvement. Results are summarised as non-conformance, conformance, improved performance and superior performance.

51. In the 2009 PCA, Stirling Council was assessed as being in 'non-conformance' (22 per cent) with the recommendations of the McClelland Report. Improvements in the council's procurement processes were already underway and the actions taken resulted in the 2010 assessment improving to 32 per cent compliance, moving the council into the "conformance" banding. The main areas of improvement are Procurement Leadership and Governance (+26%); Procurement Strategy and Objectives (+21%); Specification of Goods and Services (+20%); and Performance Management (+10%).

52. There is scope to further improve procurement practices at the council, which is recognised in the new procurement strategy 2011-2015, which was approved earlier this year. The Procurement workstream of the council's change programme is expected to deliver £1.25 million of savings in 2011/12.

53. Reporting to the Council Management Team and elected members in relation to procurement focuses on the achievement of efficiency savings by the Procurement workstream of the Change Programme. The 2010 PCA results were not formally reported to elected members. The procurement strategy includes the intention to develop key performance indicators linked to national Best Practice indicators but this is not yet in place. Regular reporting of procurement progress and improvements, including the PCA assessment, to senior management and elected members would give more opportunity for management review and oversight of progress.

Action Plan no. 3

Managing people

54. The council is improving its workforce planning arrangements, but there is scope for further improvement, for example more consistent workforce planning across services. The council has invested in leadership development to better equip its managers to manage change within the organisation; it has revised its absence management policy and 2010/11 absence indicators have improved, although levels are not yet within target. The council anticipates making significant savings, approximately £10 million, through its cost of employment budget workstream. Over 200 posts were released in 2010/11 through a Voluntary Severance

scheme, at a cost of £5 million. This is expected to save over £3 million per year going forward. The council recognises that it needs to improve certain aspects of people management and this is reflected in its Annual Improvement Statement.

Shared services

55. In December 2010 Stirling Council and Clackmannanshire Council reached a shared service agreement in the major service areas of education and social care. This aims to integrate these service areas between the councils, to share good practice and to realise efficiencies.

56. Heads of joint service were appointed for education and social care in March 2011 to work across both councils. The joint service reports separately to the appropriate committee in each council. The councils aim to have joint management structures for both services in place by autumn 2011.

57. Effective management arrangements are in place to oversee this process and involve elected members. A programme board was set up in January 2011 comprising the two chief executives and senior managers with expertise in education, social care, finance and human resources. The programme board reports monthly to a steering group of elected members, and also reports individually to each council.

Governance and accountability

58. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all audited bodies, whether their members are elected or appointed, or whether they comprise groups of people or an individual accountable officer.

59. Through its chief executive or accountable officer, each body is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies usually involve those charged with governance (including audit committees or similar groups) in monitoring these arrangements.

60. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:

- corporate governance and systems of internal control
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption.

61. In this part of the report we comment on key areas of governance.

Scrutiny

Governance and audit committee

62. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda. The current political management arrangements have two scrutiny committees in place. The Governance & Audit Committee acts as the council's audit committee and its remit includes a requirement to monitor the strategy, plan and performance of internal audit and to consider the plans and reports from external audit. The Service Delivery & Performance Committee remit includes scrutinising the decisions of the Executive, overseeing the development of corporate frameworks in relation to Best Value, scrutinising service budgets and operations.

63. The Governance & Audit Committee continues to operate in a very effective manner and makes an excellent contribution to scrutiny in the areas of its remit. It is well attended and its remit and working practices are in accordance with good practice principles.

Internal Audit

64. As required by the Code of Audit Practice, we completed an assessment of the adequacy of internal audit for 2010/11 in conjunction with our risk assessment process. We concluded that internal audit have appropriate documentation, standards and reporting procedures. This satisfactory evaluation allowed us to review and place reliance on aspects of their work during

2010/11 and meant that we could direct our resources to the financial systems and governance areas we assessed as being of higher audit risk.

65. We placed reliance for our financial statements audit work on internal audit's work on National Non-Domestic Rates billing and collection, under the terms of International Statement of Auditing 610 (Considering the Work of Internal Audit). We have reviewed the internal audit files for this area.

66. For the wider governance and performance audit work required under our Code of Audit Practice, we take account of the work of internal audit, particularly in the following areas:

- Performance management arrangements
- Associated companies - governance
- Devolved school management and finance

67. Interim management arrangements have been operating in internal audit following the retiral of the Corporate Governance Manager. The Head of Internal Audit role is a particularly important element of the council's governance arrangements. CIPFA's statement on the role of the Head of Internal Audit in public service organisations emphasises this point:

"The Head of Internal Audit in a public service organisation plays a critical role in delivering the organisation's strategic objectives by:

- championing best practice in governance, objectively assessing the adequacy of governance and management of existing risks, commenting on responses to emerging risks and proposed developments; and
- giving an objective and evidence based opinion on all aspects of governance, risk management and internal control.

To perform this role the Head of Internal Audit:

- must be a senior manager with regular and open engagement across the organisation, particularly with the Leadership Team and with the Audit Committee;
- must lead and direct an internal audit service that is resourced to be fit for purpose; and
- must be professionally qualified and suitably experienced."

68. The council should ensure that it resolves the temporary management arrangements within internal audit, taking appropriate account of the importance of this role within the organisation.

Action plan no. 4

Local code of corporate governance

69. The council approved its revised local code of corporate governance in March. The code is based on the 2007 CIPFA/SOLACE framework "Delivering Good Governance in Local Government," which includes six key principles of good governance. The council is expected to comply with the CIPFA/SOLACE framework, including developing and maintaining an up to date local code of governance. The CIPFA/SOLACE framework also requires the publication of an annual governance statement within the financial statements, which is wider in scope

than the statement on the system of internal financial control. The council had originally intended to include a governance statement in the 2010/11 accounts but this was delayed. The council intends to include this statement in the 2011/12 financial statement and is putting processes in place to deliver this.

Action plan no. 5

Section 95 officer role

70. In August 2011 the council agreed to a refinement to the management structure which reduced the number of heads of service in the establishment from eleven to eight. This has resulted in the role of chief financial officer (often referred to as the Section 95 officer) transferring from a head of service to the chief accountant. It also means that the solicitor to the council will assume responsibility as chief governance officer, combining the roles of clerk to the council and monitoring officer. In August 2010 Audit Scotland published a national report in the 'How Councils Work' series[1] which highlighted the vital role that such statutory officers have in supporting good governance and decision making. The council must ensure that the new organisational arrangements do not compromise the effectiveness of these important statutory roles.

Action plan no. 6

National Fraud Initiative in Scotland

71. In 2010/11 Stirling Council took part in the National Fraud Initiative (NFI). This is a counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error.

72. It allows public bodies to investigate these matches and, if fraud or error has taken place, to stop payments and attempt to recover the amounts involved. It also allows auditors to assess the arrangements that the bodies have put in place to prevent and detect fraud, including how they approach the NFI exercise itself.

73. As part of our local audit work we monitor the council's approach to the NFI. The council is proactive in preventing and detecting fraud, including participation in the NFI. The council has systems in place to review NFI data matches for further investigation. However, the council has not assessed itself against the self-appraisal checklist included in the national report on the last NFI exercise, published in May 2010. All NFI participants were recommended to use the checklist prior to NFI 2010/11. In addition, there is no formal reporting on NFI progress and results to the council's management team or to elected members; such reports would give more opportunity to improve management review and oversight of progress.

Action Plan no. 7

1 How Councils Work: an improvement series for councillors and officers - Roles and Working Relationships: are you getting it right. August 2010

74. The council involvement in the 2010/11 NFI includes the review and potential investigation of 5,111 data matches of which 636 are considered high quality. As at September steady progress has been made in the investigation of recommended data matches. Investigated outcomes have uncovered 6 cases of fraud and 1 error totalling £25,453 of which £4,339 is currently being recovered. The cases relate to payroll and pension data matches to housing benefits.

75. The Audit Scotland report 'The National Fraud Initiative in Scotland; making an impact' (May 2010) highlighted that much of the information used in the last NFI round was collected before the recession really took hold. An economic downturn is commonly linked to a heightened risk of fraud, and public bodies need to remain vigilant.

76. The current NFI round is being carried out under new powers approved by the Scottish Parliament in terms of the Public Finance and Accountability (Scotland) Act (as amended) and which came into force from 20 December 2010. These provide for more collaboration with other UK agencies to detect 'cross border' fraud, extend the range of public sector bodies involved, and allow data matching to be used to detect other crime as well as fraud.

Audit testing

77. As part of our financial statements audit work, we took assurance from a number of the council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:

- Payroll
- Accounts receivable
- Housing rents
- Main accounting system
- Miscellaneous income
- Treasury management
- Accounts payable
- Capital accounting
- SWIFT
- Benefits
- Council tax
- Non-domestic rates
- MISC (costing system)
- Budgetary control

78. We reviewed and tested the key internal controls operating in these financial systems in 2010/11. We reported on our findings and agreed an action plan to address the risks identified. We carried out additional testing in these areas during our financial statements audit to gain appropriate assurance to support the audit opinion.

Performance management and improvement

79. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value.

80. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

81. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:

- a performance audit which may result in the publication of a national report
- an examination of the implications of a particular topic or performance audit for an audited body at local level
- a review of a body's response to national recommendations.

82. Auditors may also consider the use of resources in services or functions, where the need for this is identified through local audit risk assessments

83. During the course of their audit appointment auditors should also consider and report on progress made by audited bodies in implementing the recommendations arising from reviews in earlier years.

Best value audit

84. An audit of Best Value and Community Planning was undertaken between March and August 2011. The scoping phase took place during March, with the detailed audit work taking place over April/May 2011 including member, officer and partner interviews, a member survey, staff and trades-unions focus groups, observations and document review.

85. Best value is an important part of the wider scrutiny arrangements in councils in Scotland. Audit Scotland works closely with other local government inspectorates, undertaking a shared risk assessment process for all 32 local authorities, to support the delivery of targeted, risk-based scrutiny. This process results in each council receiving an Assurance and Improvement Plan (AIP) each year which sets out the scrutiny activity that the council can expect to take place over a rolling three year period. The first AIPs, which were published in July 2010, covered the period from April 2010 – March 2013; the most current AIPs were published in May 2011 and cover the period April 2011 to March 2014.

86. The 2010/13 Stirling Council AIP identified the need for a Best Value audit as a part of the required response to local scrutiny risks. This was largely in response to areas of uncertainty

over the council's corporate arrangements, and some aspects of its service delivery, including the economy and environmental services. The 2011/14 AIP update noted that self-evaluation had improved in the council and that the number of areas of uncertainty had reduced. As such the 2011/14 AIP recognised that the scope of this Best Value audit would be narrower than previously anticipated. The audit focused on specific aspects within three main areas of assessment:

- outcomes for communities
- service provision
- the council's corporate arrangements.

87. The best value audit report will be published in November 2011. We have limited our commentary on the council's overall performance within this annual audit report to avoid unnecessary duplication.

Public performance reporting

88. The council has a range of performance information publicly available on its website, including 'Stirling Performs' monthly customer facing indicators, statutory performance indicators and the council's annual report. The council plans to ask for residents' views this year on the annual report, which should provide useful feedback to inform future public reporting.

89. The council and its partners formally reported progress against the 2008/09 Single Outcome Agreement (SOA), but they have not reported on the progress made against the 2009/10 SOA. Elected members considered a draft performance report at a council meeting in October 2010, but asked for a simpler, more user friendly report to be produced. At the time of writing this has not been done and Stirling remains the only partnership not to have published an SOA performance report for 2009/10.

Risk management

90. Risk management is a continuous process of identifying, assessing, controlling, monitoring and reviewing risk. The council has refined its risk management process and reports on the council risk register regularly to the Governance and Audit Committee. In addition, the Council Management Team scrutinises the risk register on a regular basis.

Performance management and self evaluation

91. The council has adopted the Public Service Improvement Framework (PSIF) as a model for corporate self assessment. Following the corporate assessment, the council approved the roll-out of PSIF to services. Three services have completed their assessments and feedback has been given to the Management Team to inform the roll-out to other services.

National performance reports

92. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the council are:

- The cost of public sector pensions in Scotland.
- Maintaining Scotland's roads: a follow-up report.
- How councils work: an improvement series for councillors and officers - Arms-length external organisations.
- An overview of local government in Scotland 2010.
- Scotland's public finances – responding to the challenges.
- Transport for health and social care.
- Improving energy efficiency: a follow-up report.
- Physical recreation services in local government.
- Community Heath Partnerships.

93. Recommendations in the national reports are generally directed at all councils so it would be appropriate for elected members to consider findings and ensure that significant matters are being addressed by the council. These reports are not usually presented to council committees. There is scope for the council to consider whether these reports should be referred to the relevant committees. For example, the Accounts Commission is keen for councils to make use of the Overview of Local Government in Scotland report.

Action Plan no. 8

Scotland's public finances: responding to challenges

94. This report provides an overview of the financial environment facing the public sector in Scotland and the cost pressures currently faced. It outlines what the public sector is doing to respond to current and future budget reductions, and highlights a number of key risks and issues that the public sector needs to manage in responding to the challenges. Key messages in the report include the following:

- The budget reductions affect revenue and capital expenditure differently with the capital budget taking the largest cut in percentage terms.
- Public bodies are finding it difficult to plan beyond 2011/12, as they do not have a clear view of their budgets beyond 2011/12. The Scottish Government has published detailed spending plans for years 2012/13 to 2014/15 in September 2011, which should establish a framework that bodies can use to make future spending plans. The most significant issue for councils is the government proposal for a "flat-cash" settlement over the next three years.
- The need to reduce costs provides public bodies with an opportunity to reform and streamline public service delivery. However, in doing so, bodies must focus on long-term financial sustainability.

- Pay restraint and reducing workforce levels are the most common approaches being taken by public bodies to reduce costs over the next few years. Good workforce planning is necessary to ensure that the right people and skills are available to deliver effective public services in the future.
- Public bodies are considering how they can work better together to reduce costs. While a number of initiatives are being planned to increase working together, sharing resources and involving voluntary and private organisations, progress to date has been limited.

95. The council has made good progress to date in identifying efficiency savings through its change programme towards targeted savings of £30 million in the three years 2011/12 to 2013/14. There is still more to do to realise these savings in future years, and continuing to deliver vital public services with a reducing budget will be a significant challenge for the council.

Maintaining Scotland's roads: a follow-up report

96. This report examines the progress on implementing the recommendations contained in the initial report published in November 2004, with particular emphasis on the change in condition of the road network, current expenditure on road maintenance and management arrangements. Key messages in the report include:

- Limited progress has been made to improve the road networks based on an assessment against the recommendations from the 2004 report.
- The condition of Scotland's roads has worsened since the 2004 report despite public spending rising by around 25 per cent. Only 63 per cent of roads are now in an acceptable condition.
- The present levels of spending are insufficient to maintain Scotland's roads, even in their current condition.

97. The council has reported that it is sustaining the roads condition compared to a slight overall decline in roads condition nationally following the harsh winter in 2010. In 2009/10 the percentage of Stirling's road network that should be considered for maintenance treatment was 44.5 per cent for compared to the Scottish average of 36 per cent. This shows a slight improvement on the previous year, and available data for 2010/11 shows continued improvement. However, roads condition remains significantly below Stirling's target to meet the Scottish average. The council recognises that it may need to further increase its investment if it is to meet its target in this area. It will re-evaluate this position after the 2011 road condition survey, including any need for additional revenue and capital expenditure.

Appendix A

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Review of adequacy of internal audit	6 April 2011	17 May 2011
Shared Risk Assessment/ Assurance and Improvement Plan	26 May 2011	Not presented to committee
IFRS Restated opening balance sheet	16 June 2011	28 June 2011
Education Maintenance Allowance grant claim	22 June 2011	N/A
Central Scotland Safety Camera Partnership grant claim	27 June 2011	N/A
Criminal justice social work services grant claim	6 July 2011	N/A
Review of Covalent performance management system	8 August 2011	27 September 2011
Review of main financial systems	24 August 2011	27 September 2011
Report on financial statements to those charged with governance (ISA260 report)	27 September 2011	27 September 2011
Audit opinion on 2010/11 financial statements	27 September 2011	27 September 2011
Improving public sector purchasing: follow up	28 October 2011	On agenda for 8 November 2011

Appendix B: action plan

Key risk areas and planned management actions

Action point	Para No.	Risk identified	Planned management action	Responsible officer	Target date
1	23	**Financial Statements Foreword** The Foreword provides a valuable opportunity to explain the implications of reduced funding, and the council's response to this. The commentary could have been enhanced with more detail. *Risk: The accounts are not transparent and therefore difficult for readers to follow.*	The Explanatory Foreword will continue to reflect the impact of external economic factors on the Council and its activities. The Foreword will be updated each year to take account of the prevailing financial conditions at the time of preparing the final accounts.	Chief Finance Officer	June 2012 and annually thereafter
2	41	**Financial position of group entities** The council will need to keep under review the ability of its group entities to remain as going concerns in current economic concerns and the implication for it of any financial difficulties that they may experience. *Risk: Financial difficulties experienced by group entities have a negative impact on service delivery and/ or the council's finances.*	Council Officers will continue to monitor and provide updates to Governance and Audit Committee on the financial positions of these entities through their involvement on the respective Boards and Management Executives. The Council is currently carrying out a review of its group entities with a view to determining their continued existence. It is anticipated that some entities will be wound up in the foreseeable future.	Chief Finance Officer	Ongoing

Action point	Para No.	Risk identified	Planned management action	Responsible officer	Target date
3	53	**Procurement Reporting** Results of the Procurement Capability Assessment and progress against the Procurement Strategy and work plan are not reported regularly to members or management. *Risk: Delays in progress are not recognised and improvements are not delivered as planned.*	PCA - expand the current informal reporting of the outcome of each annual assessment to formal reporting to management and members once the outcome is agreed and has been reported to the Chief Executive by Scotland Excel. Strategy Progress - undertake an annual review of progress in implementing the approved Procurement Strategy and report on progress and delays to management and members.	Procurement Manager	On receipt of each annual assessment Normally period between Sep-Feb Dec 2011 and annually thereafter
4	68	**Head of Internal Audit role** Temporary arrangements for the Head of Internal Audit role have been in place during 2011. This is a particularly important role and the council should make arrangements for resolving this situation. *Risk: internal audit is not given an appropriate level of importance in the organisation and corporate governance is weakened.*	The post is being considered by the Vacancy Management Panel week commencing 17 October 2011, and subject to agreement, will be advertised thereafter. It is expected that the recruitment process will be completed by the end of the calendar year.	Head of Governance and Resources	Dec 2011

Action point	Para No.	Risk identified	Planned management action	Responsible officer	Target date
5	69	**Annual governance statement** The council had originally intended to include an annual governance statement in the 2010/11 financial statements but this was delayed. A governance statement is planned for inclusion in the 2011/12 financial statements. *Risk: the council does not follow good practice in governance arrangements and financial statements disclosure.*	The Internal Audit Team has been progressing work on an annual governance statement. It is expected that a draft statement 'template' will be presented to Council in March 2012 for approval, with a view to including the new statement in the 2011/12 draft accounts due for completion by 30 June 2012.	Internal Audit Manager Chief Finance Officer	June 2012
6	70	**Section 95 officer** The section 95 officer (chief finance officer) role has transferred from a Head of Service to the Chief Accountant; the council should ensure that the new S95 officer has adequate authority and profile so that the importance of this role is not compromised. *Risk: the s95 officer role is not given an appropriate level of importance in the organisation and financial probity and stewardship is weakened.*	The Council agrees that the S95 officer should have adequate authority and profile so that the importance of this role is not compromised. It can be confirmed that the S95 officer is a member of the Council Management Team, has direct access to the Chief Executive and has the authority to report to Council on any financial matters requiring their consideration.	Chief Executive	Ongoing

Action point	Para No.	Risk identified	Planned management action	Responsible officer	Target date
7	73	**National Fraud Initiative** There is no reporting of NFI progress and results to CMT and members; The council would benefit from using the self-appraisal checklist included in the national report on the last NFI exercise. *Risk: insufficient ownership of NFI activity devalues the importance of preventing and detecting fraud.*	Quarterly NFI progress reports will be prepared and submitted to CMT on an ongoing basis; Arrangements will be agreed for NFI reports to Committee / Council, as appropriate Review of NFI arrangements against self-appraisal checklist will be carried out.	Chief Finance Officer	December 2011 March 2012 March 2012
8	93	**National reports** The council does not formally present national performance reports to elected members. The council should consider how it addresses the issues included in these reports and ensure that the issues raised are subject to an appropriate degree of scrutiny. *Risk: the council does not take account of national recommendations or good practice examples and does not follow good practice.*	The manager of the Chief Executive's Office will review the reports by Audit Scotland from the national performance audit programme and will arrange for these to be presented to the Governance and Audit Committee for their consideration of report findings and recommendations. Considerations will take into account the Council's planned strategic and improvement priorities and workplans and the views of senior management where appropriate.	Manager of the Chief Executive's Office	March 2012

Appendix C: Financial ratios

Reserves

Uncommitted general fund reserve as a proportion of annual budgeted net expenditure

Movement in the uncommitted general fund balance

Council Tax

In-year collection rate

Ratio of council tax income to overall level of funding

Financial Management

Actual outturn net service expenditure compared to budgeted net service expenditure

Actual contribution to/from unallocated general fund balance compared to budget

Debt/Long Term Borrowing

Capital financing requirement for the current year

External debt level for the current year

Ratio of financing costs to net revenue income

Impact of capital investment on council tax and weekly rents