



## Argyll and Bute Council

Annual Report to Members and the Controller of Audit

3 December 2010

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# 1 Introduction

## Scope

- 1.1 The Accounts Commission for Scotland appointed Grant Thornton UK LLP as auditors of Argyll and Bute Council (the Council) under the Local Government (Scotland) Act 1973 (the 1973 Act) for the period of 2006-07 to 2010-11. This document summarises our responsibilities as external auditors for the year ended 31 March 2010 and our approach to issues impacting the Council's activities in that year.
- 1.2 We carry out our audit in accordance with our statutory responsibilities under the 1973 Act and in accordance with the International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board (APB) and the wider responsibilities embodied in Audit Scotland's Code of Audit Practice (the Code).

## Summary of findings

- 1.3 We planned and performed our 2009-10 audit in accordance with our Audit Plan issued in February 2010. The Code objectives and key findings arising from the audit are summarised in Exhibit 1 below.

### Exhibit 1 - Key findings from the 2009-10 audit

	Summary
<b>Financial position</b>	<ul style="list-style-type: none"> <li>The Council reported a surplus for the year of £3.1 million, and the general fund balance increased by £393,000.</li> <li>The General Fund balance as at 31 March 2010 was £33 million, with the un-earmarked balance at £4.5 million (1.7% of net operating expenditure).</li> <li>The Council's net worth decreased by £108.3 million to £46.8 million as at 31 March 2010. This reflects the significant increase in the Council's share of the deficit in the Strathclyde Pension Fund arising from a change in the discount rate applied to the future liabilities of the scheme.</li> <li>The total forecasted budget deficit by 2014 is £34 million, within an expected range of £27 million to £39 million. The Council is undertaking a review of services in order to plan ahead for the challenging financial position as well identifying ways of securing best value in the delivery of services. The service reviews will identify options for services if they had to operate on 15% less budget.</li> </ul>
<b>Financial statements</b>	<ul style="list-style-type: none"> <li>We issued an unqualified report on the Council's financial statements for the year to 31 March 2010.</li> <li>The Council's trading organisations achieved their statutory target of breaking even over the three year period to 31 March 2010.</li> <li>The main accounting issues in the financial statements related to the change in accounting treatment for PFI schemes which led to assets and liabilities of the School's NPDO scheme coming on balance sheet.</li> <li>The Group accounts record significant net liabilities of £174 million, reflecting the Council's share of the liabilities associated with the unfunded police and fire pension schemes.</li> </ul>

	Summary
<b>Governance</b>	<ul style="list-style-type: none"> <li>We have concluded that the Council's systems of internal financial control are operating adequately. The Council continues to develop its financial management and budgetary control arrangements to meet the challenges ahead.</li> <li>The Council created a 'head of internal audit position' in June 2010. Options on the future of the internal audit service remain under review.</li> <li>There is scope to improve the Council's participation in the National Fraud Initiative exercise. The Council has recognised this and is taking action to address the recommendations made in our report on this matter.</li> <li>Our follow up review of the Council's contract management arrangements concluded that the Council has made significant improvements in this area and the new Gateway process is in place and working well for new capital projects. There is evidence of weaknesses in the project management arrangements for some major capital projects (e.g. Port Askaig and Argyll Air Services) commenced prior to the introduction of this new approach, resulting in significant overspends against budget.</li> <li>The Council completed a significant restructure in the year which involved replacing the four Strategic Directors with three Executive Directors, and a realignment of services leading to the creation of 12 new Head of Service posts to replace the previous 15. Our audit concluded that the Council's restructuring process was executed in line with its relevant policies and seems to have bedded in well.</li> </ul>
<b>Performance</b>	<ul style="list-style-type: none"> <li>The Council continues to improve its Best Value arrangements</li> <li>The key building blocks for future improvement are now being embedded, such as the performance management framework, the management restructure and the programme of service reviews.</li> <li>There is evidence that the Council is responding to priorities at a local level, with local community planning and the Forward Together programme representing a key strength.</li> <li>Performance against Statutory Performance Indicators remains mixed, with improvements in waste management, the adult social care and homelessness services. Other indicators, such as those covering asset management and sickness absence rates, record a decline in performance.</li> <li>A key challenge facing the Council in 2010-11 will be development of outcome-based performance measures that allow the Council to demonstrate the difference and impact it will make to its communities.</li> </ul>

### Acknowledgements

- 1.4 We would like to take this opportunity to thank the staff who have been involved in the 2009-10 audit for their assistance and co-operation.
- 1.5 This report is part of a continuing dialogue between the Council and Grant Thornton and is not, therefore, intended to cover every matter which came to our attention. Our procedures are designed to support our audit opinion and they cannot be expected to identify all weaknesses or inefficiencies in the Council's systems and work practices.

- 1.6 The report is not intended for use by third parties and we do not accept responsibility for any reliance that third parties may place on it.

## 2 Financial position

### Income and Expenditure

- 2.1 The Council reported a surplus on the Income and Expenditure account for 2009-10 of £3.1 million (2009: £6 million). The net increase on the general fund was £393,000.

**Table 1: Financial results for 2010 and 2009**

	2010 £'000	2009 (restated) £'000
Net Cost of Service	239,617	231,025
Loss on disposal of fixed assets	562	1,429
Surplus on trading with third parties	-40	-93
Interest payable	18,608	21,927
Interest receivable and investment income	-787	-4,808
Pension interest cost	3,203	-574
Net Operating expenditure	261,163	248,906
Income from taxation and government grants	264,251	254,916
<b>Surplus for the year</b>	<b>3,088</b>	<b>6,010</b>
Net additional amount required by statute and non-statutory proper practices to be (debited) or credited to the General Fund Balance for the year	-2,695	-4,389
<b>Increase in the general fund balance</b>	<b>393</b>	<b>1,621</b>

Source: Argyll and Bute Council 2009-10 financial statements

- 2.2 Net operating expenditure has increased by £9.3 million (3.6%), and income from taxation and government grants has also increased by the same amount. Both interest payable and interest and investment income have fallen significantly in the year due to the Bank of England base rate remaining at historic lows of 0.5% throughout the year.
- 2.3 The Council reported an overall underspend of £1 million against budget (before the impact of audit adjustments). The underspend relates to:
- Net underspend on departmental expenditure of £865,000
  - Overspend in 'non-controllable' costs of £422,000
  - Council tax income in excess of budget by £589,000.

The largest department underspends were recorded in:

- Community Services - an overspend of £657,000 was recorded in Children and Families, mainly arising from Residential Placements, Contact and Welfare and Children affected by a disability. This was offset by savings of £1.3 million from the Service's expenditure restriction exercise.
- Operational Services - £1.2 million savings in facility services arising from lower landfill tonnages was offset by £750,000 overspend in roads and amenity services, mainly arising from exceptionally high winter maintenance costs.

- Development Services - £0.5 million overspent due to lower income from planning and building standards and an underestimate of inflationary charges in respect of bus contracts.

### Balance sheet

- 2.4 The total net worth of the Council at 31 March 2010 was £46.8 million (2009 restated: £108.3 million).

**Table 2: Balance sheet as at 31 March 2010 and 2009**

	31 March 2010	31 March 2009 (restated)
	£'000	£'000
Fixed assets	471,080	452,051
Long term debtors	933	962
Current assets	24,434	33,196
Current liabilities	-50,667	-51,107
Long term liabilities	-289,407	-294,101
Pension liability	-107,969	-32,517
<b>Net assets</b>	<b>48,404</b>	<b>108,484</b>
Revaluation reserve	45,981	36,495
Capital adjustment account	80,297	74,452
Useable capital receipts reserve	2,773	2,762
Capital fund	204	871
Pension reserve	-107,969	-32,517
Financial instruments adjustment account	-6,378	-6,750
Repairs and renewals fund	476	544
General fund	33,020	32,627
<b>Total reserves</b>	<b>48,404</b>	<b>108,484</b>

Source: Argyll and Bute Council 2009-10 financial statements

- 2.5 The significant decrease in the net worth position is due to the actuarial loss on the pension fund for the year of £75.5 million, offset by a gain on fixed asset revaluation of £11.1 million.
- 2.6 The significant increase in the pension liability reflects a change in the discount rate used to adjust the pension fund's liabilities for the time value of money which is based on the rates paid on corporate bonds. The discount rate for 31 March 2010 is 5.5% compared to 6.9% used in the prior year. The fall in the discount rate increases the estimated value of the pension liability.
- 2.7 The other significant changes in the balance sheet reflect the implementation of IFRIC 12, *Service concession arrangements*, in the 2009 SORP, whereby the assets held under the School's NPDO scheme are now accounted for on the Council's balance sheet. Accordingly, the 2010 balance sheet includes £84.6 million of assets related to the five schools under the scheme which were previously considered 'off-balance sheet', and the 2009 balance sheet was restated accordingly.

## Reserves

- 2.8 For the year ending 31 March 2010, the Council had a total general fund reserve balance of £33 million, of which £28.5 million was earmarked for specific purposes, leaving £4.5 million available for new expenditure or to meet the costs of contingencies and unforeseen events. Table 3 below provides a breakdown of general fund balances at 31 March 2010.

**Table 3: General Fund balances as at 31 March 2010 and 2009**

	31 March 2010 £'000	31 March 2009 £'000 (restated)
PPP Smoothing Funds	15,993	14,639
Strategic Housing Fund	6,953	6,032
Grant Income carried forward	1,363	1,585
Budget carried forward	3,706	4,086
Funding committed	-	1,673
<b>Total Earmarked</b>	<b>28,538</b>	<b>28,015</b>
<b>Unearmarked</b>	<b>4,482</b>	<b>4,612</b>
<b>Total General Fund</b>	<b>33,020</b>	<b>32,627</b>

Source: Argyll and Bute Council

- 2.9 The unearmarked proportion of the general fund at 31 March 2010 is 1.7% of net operating expenditure, and within the Council's current reserves policy of maintaining unearmarked reserves of at least 1.5% (£3.9 million).
- 2.10 In the 2010-11 budget setting process, the Head of Strategic Finance presented a report on reserves and balances, which formulates the Council's strategy on maintaining the general fund reserve. In addition, a review of year end reserve balances was presented to the Council in June which provided a review of the outturn against the strategy. Our review of the general fund reserves as at 31 March 2010 highlighted the following:
- The Council continues to earmark a proportion of the general fund to deal with fluctuations in the payment profile of the Waste Management PPP Scheme and the Schools NPDO Scheme. The balance of the fund remains consistent with the Scheme's financial model.
  - The earmarked balance for the Strategic Housing Fund arises from the additional council tax collected on second homes. The fund was £6.9 million (2.6% of net operating expenditure) as at 31 March 2010, which significantly exceeds the Council's target of 1.8% of net operating expenditure. The main reason for the target being exceeded is that, although a number of projects have been approved for funding, not all have drawn down on the fund. At the time of this report, projects with a value of approximately £3 million have been approved, with £1.4 million drawn down. The Council approved a new strategy for the fund in August 2010, to improve the methodology for reviewing and approving bids and to take account of recent changes in Scottish Government funding of social housing projects. The new strategy aims to channel the fund to support registered social landlords in the current financial climate, while recognising the continuing demand for housing in the Argyll and Bute area.
  - Grant income carried forward was £1.3 million (0.5% of net operating expenditure) as at 31 March 2010 which was within the Council's target of 1% of net operating expenditure.



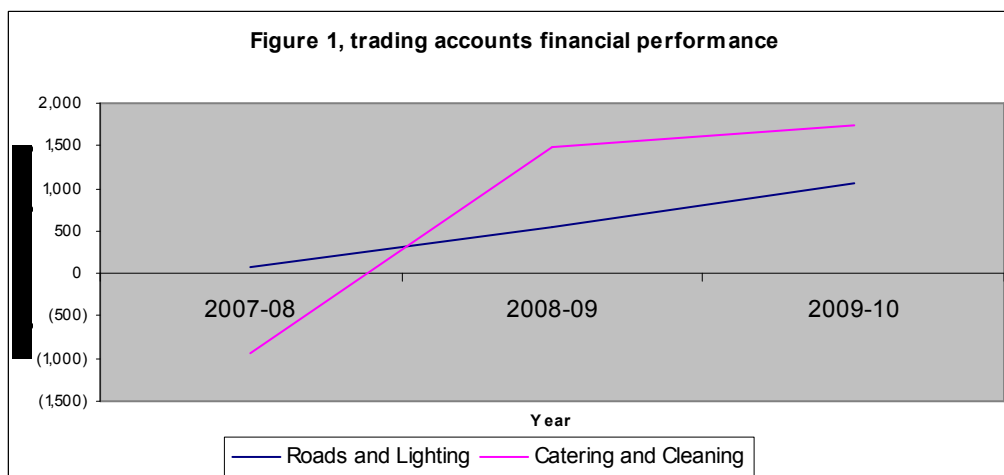


- Budget carried forward was £3.7 million (1.4% of net operating expenditure) as at 31 March 2010. This is above the Council's target of 1% of net operating expenditure, due to the impact of winter maintenance costs carried forward to 2010-11, but below the 2008-09 level. The Council's year end review of the general fund reserve balance included a separate review of each area of budget carried forward to 2010-11, which represents a strengthening of the controls over this area of earmarked reserves. This is reflected in the reduction of budget carried forward as a proportion of net operating expenditure from 2008-09.

2.11 The Council's total cash backed reserves as at 31 March 2010 were £36.4 million. This is the 17th highest of the 32 local authorities in Scotland. Per head of population, this is approximately £400 (6th highest in the country). The relative strength of the Council's cash backed reserves position highlights that it is better placed than many other councils to deal with the current financial challenges facing the public sector.

### Trading accounts

- 2.12 The Council maintains two trading accounts: roads and lighting and catering and cleaning. Section 10 of the Local Government in Scotland Act 2003 requires that local authorities' significant trading organisations break even over a three year rolling period.
- 2.13 Figure 1 below highlights the performance of the Council's two trading accounts over the three year period.



Source: Argyll and Bute Council financial statements

- 2.14 Roads and lighting continues to perform well and has met the three year breakeven target. The surplus for 2009-10 is particularly high due to an audit adjustment to remove the contingency charge between the Council and the trading account for work on prior year repairs (see 3.9 for more detail).

- 2.15 In previous years, the Catering and Cleaning trading account has not met the statutory three year break even target. The recorded deficit largely resulted from the impact of the cost of equal pay claims and implementing single status, which was not accounted for when the budget recharges were originally set. The Council prepared a financial strategy to return the trading account to a break even position and new budget recharges were agreed to better reflect the trading account's cost base. For the past two years the trading account has returned a surplus and at 31 March 2010, the three year break even target was achieved.

### Capital expenditure

- 2.16 Total capital expenditure in the year was £27.2 million versus a budget of £29.7 million, an underspend of £2.5 million (8%). This continues the trend of underspends against the Council's capital budget in recent years, although the level of variation is considered by the Council to be manageable and is a significant reduction on prior years. Table 4 below highlights the trend in capital expenditure over the last two years.

**Table 4: Capital budget position 2010 and 2009**

	31 March 2010 £'m	31 March 2009 £'m
Budgeted capital expenditure	29.7	41.3
Actual capital expenditure	27.2	28.2
Underspend	2.5	13.1
	8%	30%

- 2.17 Although the capital project as a whole is currently behind budget, the costs for current capital schemes is forecast to overspend budget by £2.4 million. The top 3 projects showing overspends are:
- Argyll Air Services - final completion costs at Oban Airport, £636,000
  - Campbeltown Grammar - unforeseen work in the upgrade programme, £438,000
  - Mull and Iona Progressive Care Centre - original budget being reviewed to account for unforeseen elements, £418,000.
- 2.18 Going forward, the Council has a number of ongoing capital projects including the CHORD programme to redevelop the waterfronts in Campbeltown, Helensburgh, Oban, Rothesay and Dunoon. In addition, there are ongoing capital works to improve the transport infrastructure, and plans for a new swimming pool and office in Helensburgh. Completion of these projects will depend on the ability of the Council to finance the ongoing capital plan, which has been made more difficult by the expected reductions in central government financial support. The Council should continue to monitor the progress and sustainability of the capital plan, and has processes in place to do this.

### Treasury management

- 2.19 Local authority capital expenditure and borrowing is regulated by the Prudential Code which requires councils to ensure capital plans are affordable, borrowing is prudent and sustainable, and treasury management arrangements reflect good practice. The Council approved a set of prudential indicators for 2009-10 and managed capital expenditure within these approved limits.

- 2.20 A new treasury management and investment strategy was approved in the year, reflecting the revised CIPFA Code of Practice on Treasury Management, and the Local Government Investment (Scotland) Regulations 2010. The Council also appointed the Resources Spokesperson as the member with responsibility of overseeing the Council's treasury management policy, a requirement of the new Code.

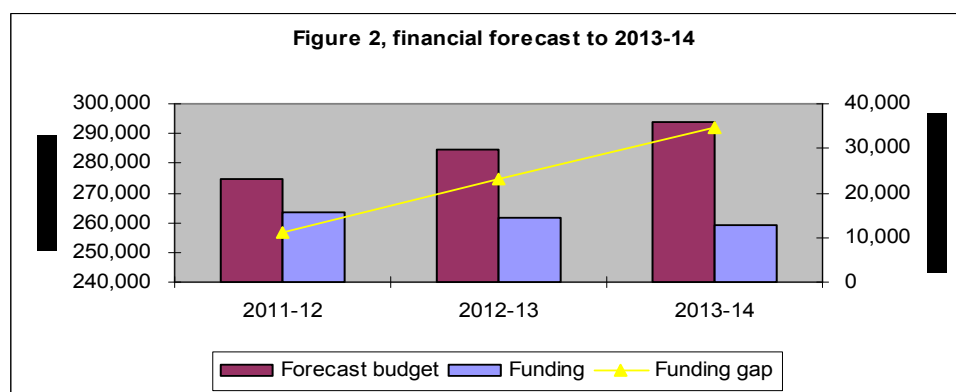
### Looking forward

- 2.21 The Scottish public sector is facing a period of sustained financial austerity with the financial year 2009-10, likely to represent the peak year for public spending for some time to come. COSLA recommends that local authorities should assume that the starting point for financial planning for 2011-12 to 2013-14 is a 12% real terms reduction in Scottish government grant funding over this period. The Council has asked services to perform service reviews to identify options if they had to operate on 15% less budget. The public sector will not know the full impact of budget cuts until the Scottish Government responds to the Comprehensive Spending Review announcement, in November 2010.
- 2.22 Like other local authorities, Argyll and Bute Council faces significant budget cuts in line with the rest of the public sector. We have considered the Council's financial projections and its plans to ensure it can continue to deliver services in light of significant budget cuts.

### Projected financial position

- 2.23 The Council has been analysing the impact of reductions in central government support, and performing scenario planning to determine the likely impact on its financial position.

Figure 2 below highlights the current financial forecasts, taking into account the Council's assumptions on future reductions in central government grants, and inflationary and demand pressures.



Source: Argyll and Bute Council (as at August 2010)

- 2.24 The total forecasted budget deficit by 2014 is £34 million, within an expected range of £27 million to £39 million depending on variation of the assumptions. The size of the budget deficit highlights the significant financial pressures on the Council's financial position, and is major challenge in sustaining current levels of service provision and quality.

**Service reviews**

- 2.25 The Council is currently undertaking a review of services in order to plan ahead for the challenging financial position as well identifying ways of securing best value in the delivery of services. The aim is to review the baseline budget of each service, benchmark services with similar service providers, identify future challenges and cost pressures and identify options for meeting a 15% savings target. A project team is appointed to carry out each review and this is led by the head of each service. All reports are reviewed and approved by the Council's Transformation Board.
- 2.26 The Council has currently reviewed around half of all services, and a more robust methodology has been developed to ensure consistency across the reviews from 2009-10 and onwards.
- 2.27 The service reviews are a useful start for identifying the Council's approach to reducing the funding gap identified. Feedback from the budget consultation may identify areas for prioritisation or protection and the Council will feed these into the budget process. We note that the Council has also explored alternative methods of service delivery through the shared services stream of its transformation programme.

## 3 Financial statements audit

### Introduction

- 3.1 We have audited the Council's 2009-10 accounts in accordance with our Audit Plan issued in February 2010. The key messages arising from our financial statements audit are contained in our Report on the 2009-10 Accounts Audit, issued on 10 September 2010, and summarised below.

### Audit opinion

- 3.2 We gave an unqualified opinion on the Council's 2009-10 financial statements on 30 September 2010.
- 3.3 Our Report on the 2009-10 Accounts Audit highlighted a number of audit adjustments to the draft accounts. The impact of the audit adjustments was to increase the surplus on the income and expenditure account for 2009-10 by £1.4 million, and to increase the general fund balance by £0.9 million. Prior year adjustments increase the surplus on the income and expenditure for 2008-09 by £202,000, with no impact on the general fund balance for that year.
- 3.4 There was one unadjusted misstatement, and there would be no impact on the reported surplus for the year, or on the general fund balance if it had been adjusted.

### Significant accounting issues

#### Changes in the accounting arrangements for PFI schemes

- 3.5 The most significant change to the SORP for 2009-10 is in respect of the accounting requirements for private finance initiative and similar contracts which are no longer based on Financial Reporting Standard 5 but on an interpretation of IFRIC 12 'Service concession arrangements' contained in the Government Financial Reporting Manual.
- 3.6 The Council currently has 2 schemes which will be impacted by this change: the Waste Management PPP Scheme and the School's NPDO Scheme. The waste management PPP scheme remains off balance sheet, as the Council is not deemed to control the services and prices charged by the provider in 3rd party transactions, and as there is no qualifying asset being built up over the contract which will transfer back to the Council when the scheme ends. We have reviewed the Council's analysis of the waste management PPP scheme, and consider the treatment as off-balance sheet to be appropriate.
- 3.7 The School's NPDO has been brought on balance sheet as the control tests have been met. We have reviewed the accounting for the restatement of the Schools NPDO scheme, and subject to the correction of two errors in the split of liabilities and the unitary charge, we agreed the restatement entries. We noted that the Council did not include the rolled up interest costs of approximately £8 million in the costs capitalised on initial recognition.

3.8 Our view is that the amount to be paid for the property is the total capital cost charged by the operator to the authority for the asset and this would normally include all costs they incurred on constructing the asset in line with International Accounting Standard 17, *Leases*, on initial recognition. The Council has considered whether rolled up interest should be included in the construction costs, but has determined that the SORP does not require such finance costs to be included. We have agreed that this approach is reasonable and consistent with the approach adopted by other local authorities, although we would highlight that it does not wholly capture the full economic costs of the project.

#### **Provision for road repairs**

3.9 Poor weather over the Winter of 2009-10 had a significant impact on the road network in Argyll and Bute and the quality of repair work carried out in that period. A provision of £900,000 was recognised in the draft accounts in respect of future repairs that will be required to rectify the work carried out in poor weather conditions. Our initial view was that there was no present obligation arising from the repair work and we recommended that the Council review the basis for the provision and consider whether it met the criteria set out in Financial Reporting Standard 12, *Provisions, Contingent Liabilities and Contingent Assets*. Following their review, the Council decided to reverse the accrual and the underspend in the department will be reallocated to the general fund balance and earmarked for spending on roads maintenance in the 2010-11 financial year.

#### **Group accounts**

3.10 The Council's group accounts consolidate the following bodies:

- Strathclyde Police Joint Board
- Strathclyde Fire and Rescue Joint Board
- Strathclyde Partnership for Transport
- Concessionary Fares
- Dunbartonshire Argyll and Bute Valuation Joint Board
- Oban Common Good Fund
- Campbeltown Common Good Fund.

3.11 The net worth of the Group is a deficit of £174 million compared to the Council's individual net worth of £48.4. The difference reflects the Council's share of deficits in the pension schemes of the Strathclyde Police Joint Board and the Strathclyde Fire and Rescue Joint Board, both of which are unfunded schemes.

3.12 In 2009-10, it was noted that the new police and fire pension schemes were not covered by the Local Government Pension Reserve Fund (Scotland) Regulation 2003. As a result, Councils were unable to reverse out the pension costs applicable under FRS 17, *Retirement Benefits*, and replace them with the actual pension contributions paid out of the general fund. The Scottish Ministers have passed Regulations, the Local Government Pension Reserve Fund (Scotland) Amendment Regulations 2010, which have now regulated the accounting treatment of the police and fire pension schemes

#### **Looking forward**

##### **International Financial Reporting Standards (IFRS)**

3.13 Local government bodies will be required to prepare their accounts on the basis of IFRS from 2010-11. A transition period is currently underway whereby the Council is preparing a shadow balance sheet under IFRS as at 31 March 2009. In addition, the 2009-10 accounts will be restated under IFRS. The Council has engaged the services of

- PwC-CIPFA to assist in the IFRS restatement exercise. An initial assessment of the key areas for the Council to consider has already been prepared and an action plan for future actions has been developed.
- 3.14 The transition to IFRS is complex process, and requires detailed project planning to ensure the Council is able to fully implement the standard in line with the planned timetable. It should also be noted that the process requires Council wide co-operation, which will be critical for the success of the project.
- 3.15 We have held an initial planning meeting with the Council to discuss the progress in implementing IFRS and the results from the initial assessment. In addition, we ran a workshop for finance staff on the implementation of IFRS. One of the main areas of implementation under IFRS was introduced in the 2009 SORP is in respect of the accounting requirements for private finance initiative and similar contracts (see paragraph 3.5). Key areas for the Council in converting to IFRS are: leases which may be classified as finance leases; and holiday pay and flexi-time accruals.
- 3.16 We have continued to liaise with the finance team on issues relating to the implementation of IFRS as they arise. A key task for the Council in the next few months will be to finalise an opening balance sheet as at 1 April 2009, and prepare shadow accounts based on the 2009-10 accounts.
- 3.17 The Council is also aware that the Scottish Government is currently considering what statutory adjustments are required to mitigate any impact arising from IFRS on the general fund.

#### **Charity Accounts**

- 3.18 The Council currently administers a number of charitable trusts and common good funds, some of which are charities registered on the Scottish Charity Register maintained by the Office of the Scottish Charity Regulator (OSCR). There have been significant changes to charity law in Scotland in the last few years, and there are new audit and accounting regulations in place for Scottish charities.
- 3.19 OSCR has reviewed the compliance of charities administered by local authorities, and concluded that all authorities have some work to do in order to achieve full compliance with the new legal requirements. Argyll and Bute Council's current arrangements are considered satisfactory by OSCR, although more work is required in order to move to full compliance.



## 4 Governance

### **Introduction**

4.1 In accordance with the 2009-10 Audit Plan we have reviewed key aspects of the Council's governance arrangements. The detailed findings from our governance review are contained in our interim reports issued as follows:

- Core Financial Systems
- Governance follow up
- Contract management follow up.

### **Core Financial Systems**

4.2 During the year we reviewed the effectiveness of the Council's core financial systems and financial management and budgetary control arrangements.

4.3 Our overall conclusion is that the core financial systems continue to operate effectively, with only low risk recommendations identified.

4.4 We reviewed the Council's progress in implementing agreed recommendations to improve financial planning and budgetary control arrangements. Overall, we concluded that the Council continues to closely monitor its finances and the impact of the deterioration of the wider public sector finances. We have provided commentary on the Council's updated outlook position at Section 2.25.

### **Contract management**

4.5 As part of our 2007-08 audit, we reviewed the contract management of the Argyll Air Services project and identified a number of weaknesses in the Council's arrangements. Since then, the Council has significantly revised its contract management arrangements, particularly by adopting the Gateway model for feasibility and business plans.

4.6 During our 2009-10 audit, we reviewed the Council's progress in implementing agreed action plan points in relation to new projects that have been processed under the Gateway model, and for specific action plan points in relation to the Argyll Air Services project.

4.7 Our audit has confirmed that the Council has made significant improvements to its contract management procedures since our last review. In particular, we noted that the Gateway process has now been implemented and was followed for the five new projects included in our sample. We recommended that the Council integrate the post completion reviews of key projects into the Gateway process timetables.

4.8 The Argyll Air Services project has encountered some difficulties during the year due to disruptions to air travel generally and the failure of the PSO contract provider, Highland Airlines. The Council has appointed a new provider, Hebridean Air Services, to run the services until the contract is due for re-tender in September 2010. We have recommended that the Council completes the business plan for the airports, and carries out a post completion review of the project.

#### **The CHORD programme**

The CHORD programme refers to the Council's programme of regeneration and economic development in five of its waterfront towns (Campbeltown, Helensburgh, Oban, Rothesay and Dunoon). In November 2008, the Council agreed to allocate approximately £30 million to the programme. Each town has its own CHORD project board which decides on what projects to award based on the individually assessed needs for each town.

Our review of the revised contract management arrangements focused on a number of proposed CHORD projects to determine whether they were planned and processed under the new Gateway process. Our review covered:

- CHORD- Oban Bay/Harbour
- CHORD- Campbeltown Kinloch Road Regeneration
- CHORD- Campbeltown THI

Our review concluded that the Gateway process was followed for each specified project with Initial Business Case, Outline Business Case, Project Implementation Document, (PID) and Full Business Case all produced and reviewed by the Project Board.

We noted that the process has been effective in focusing project boards on the capital and revenue costs of individual projects, and for ensuring all projects are thoroughly assessed before being approved. The Oban CHORD project board recently rejected the Oban Bay Marine project proposal based on the outcomes of the initial business case reviews undertaken as part of the Gateway process. This demonstrates the importance of the Gateway process to achieving best value in significant capital projects.

#### **Port Askaig**

- 4.9 Internal audit carried out a review of the Port Askaig redevelopment project during the year, and a report was submitted to the audit committee in September 2009 highlighting the findings. The project relates to redevelopment of the harbour and associated facilities in Port Askaig on the island of Islay.
- 4.10 The report made a number of recommendations on contract management and the approval process for capital projects, the majority of which are addressed by the new Gateway procedures and the role of the Council's Asset Management Board.
- 4.11 There are however a number of ongoing issues with the project, including a dispute with Caledonian Macbrayne on the compatibility of the ferry used for the Islay-Jura route. We intend to liaise with internal audit to update our review of this project in our 2010-11 audit.

#### **Internal audit**

- 4.12 We have continued to follow up our recommendations following our 2006-07 review of the Council's internal audit department against the requirements The Code of Practice for Internal Audit in Local Government in the United Kingdom (the Code) issued by CIPFA. In addition, in our 2008-09 audit, we recommended that the Council perform a review of the future strategic direction of internal audit and consider the best way of providing the service.
- 4.13 In June 2010, the Council appointed a 'head of internal audit' to lead the internal audit department, and this implements one of the main areas of previous non-compliance with the Code.
- 4.14 The Council is currently undertaking a best value review of the internal audit department and as part of this, will consider the future structure and direction of the service. We will continue to monitor the Council's future strategy for internal audit and consider ongoing compliance with the Code of Practice.

- 4.15 Our audit confirms that internal audit generally operates to a good standard, however, we noted the potential for the independence of internal audit to be compromised when they become involved in operational management activity. We have recommended that when internal audit staff are involved in the set up or development of systems, a plan should be drawn up setting up how independence will be maintained.

#### **The National Fraud Initiative**

- 4.16 The National Fraud Initiative (NFI) is a nationwide data matching exercise run jointly by Audit Scotland and the Audit Commission. The NFI covers a two year cycle and for the latest cycle, 2008-09, Audit Scotland's national report has identified total cumulative frauds in the Scottish public sector of £58 million. The role of external audit in NFI is to review the Council's procedures for managing the exercise and the progress in pursuing potential frauds highlighted by the data matching exercise.

- 4.17 The Council did not identify any frauds as a result of the exercise, however several errors were investigated and the following issues were identified:

- overpayments of approximately £50,000 in housing benefit and council tax benefit payments
- errors in the administration procedures for blue badge parking permits whereby 190 permits were matched to deceased individuals.

- 4.18 Our audit found that the Council has improved its participation in the NFI exercise over the year, but that further improvements are still required if the Council is to participate and benefit fully from the Initiative. In particular we have recommended that:

- The Council should prioritise the review and processing of the highest quality data matches and ensure these are processed in a timely manner
- Staff in relevant departments should be assigned responsibility to review and process the NFI matches
- The Council should consider submitting creditors data for the next NFI exercise
- The key contact should review the required access to the NFI system for the 2010-11 exercise and ensure only appropriate staff have been given access.

#### **Audit Committee arrangements**

- 4.19 In 2008-09, we carried out a review of the audit committee's compliance with best practice, as set out in the CIPFA guidance note, *Audit committee principles in local authorities in Scotland: a guidance note*. The Council have now implemented the majority of our recommendations following this review.

- 4.20 For 2009-10, overall we found that the audit committee operates effectively, however the results of the self assessment show that there is still progress to be made, in particular with regard to induction training for new members.

- 4.21 A new Vice Chair was recently appointed to the audit committee. We note, however, that the current audit committee Chair (a lay member) is scheduled to retire from the committee on 31 March 2012. It will be important for the Council to plan effectively to fill this key position to maintain the committee's development and progress.

### **Corporate restructuring**

- 4.22 During the year, the Council completed a significant restructuring of the Strategic Management Team and service heads. This involved replacing the four Strategic Directors with three Executive Directors, and a restructure of the services, with a realignment of services leading to the creation of 12 new services to replace the previous 15. As such, there was a reduction in the number of heads of service from 15 to 12.
- 4.23 Our audit concluded that the Council's restructuring process was executed in line with its relevant policies and seems to have bedded in well. The next stage of the Council's restructuring is underway, and the Council is seeking participants in a voluntary redundancy scheme for all other Council employees. We will continue to provide audit scrutiny in this area in our 2010-11 audit.

## 5 Performance

### Introduction

- 5.1 In accordance with the Audit Plan we have reviewed key aspects of the Council's performance arrangements during 2009-10. During 2009-10, the Accounts Commission developed a new "Best Value 2" (BV2) approach, which introduces a risk-based and proportionate approach to the audit. The framework has been developed around strong baselines, robust measures of performance, challenging targets and comparability with others.
- 5.2 The timing of Argyll & Bute Council's inspection will be determined by the shared risk assessment agreed by external audit and inspection bodies in the Assurance and Improvement Plan (AIP).

### Assurance and Improvement Plan

- 5.3 Under the National Scrutiny Plan for Local Government 2010-11, Scotland's scrutiny agencies work together to develop a shared risk assessment and AIP for each council area. As part of our 2009-10 audit, we have followed up the progress made by the Council, both in addressing the improvement agenda and against specific areas of risk or uncertainty identified by scrutiny partners.
- 5.4 The detailed findings from our performance review are contained in our Best Value Follow-up Report, issued in October 2010. Our key findings during the year are summarised below:

### Best Value

- 5.5 The Council has been on a significant and rapid improvement journey since the appointment of the Chief Executive in September 2008. Overall, we are satisfied that the approach the Council has taken to address Best Value has been planned and systematic, and has delivered real improvement. In light of the challenges facing the Council, initial work centred on the process of delivering services. The key building blocks for future improvement are now being embedded, such as the planning and performance management framework and the transformation programme, which incorporates the management restructure and review of corporate resources, the exploration of shared services, the programme of service reviews and the Best Value agenda.
- 5.6 There is evidence that the Council understands and is responding to priorities at a local level, with local community planning and the *Forward Together* programme representing a key strength. The Council's service review programme process has also been improved to ensure that findings are robust and lead to quantifiable savings.
- 5.7 Key challenges facing the Council in 2010-11 include the development of outcome-based performance measures that allow the Council to demonstrate the difference they make to their communities. The Improvement Service has developed a menu of outcome indicators with definitions to help in this respect. Use of nationally agreed indicators may help the Council compare performance nationally through benchmarking groups. The ongoing budget consultation, and aim of delivering a policy-based budget will be a further challenge to the Council, but the honest and

detailed information provided to the public should help to generate a positive response.

- 5.8 The Roads Service Review will be key to the long term planning of the roads network. In a period of budget cuts clearing the significant backlog roads will present a considerable challenge. In a period of budget cuts clearing such a significant backlog will present a considerable challenge.

### Statutory Performance Indicators

- 5.9 The Council measures its performance against other Scottish authorities by using Statutory Performance Indicators (SPIs). In 2009-10, the Accounts Commission made a significant change to the SPI Direction, replacing the 78 indicators reported in 2008-09 with two key requirements:

- that councils report a range of sufficient information to demonstrate best value in relation to corporate management (SPI 1)
- that councils report a range of information sufficient to demonstrate best value in relation to service performance (SPI 2).

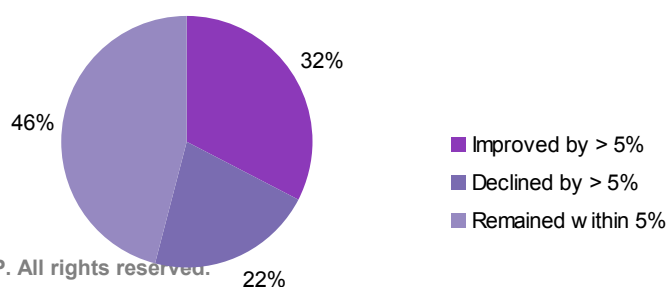
- 5.10 In reporting against these requirements, all councils are required to report performance against 25 specified indicators. The Council must also supplement this information by reporting on a range of non-specified indicators to allow users to make a judgement on whether the Council can demonstrate that it is achieving Best Value.

- 5.11 Argyll & Bute Council has a range performance reporting mechanisms in place to allow them to meet the requirements of the SPI Direction, without requiring additional resources. Under the Planning and Performance Management Framework, performance against indicators within each Department's Scorecard is reported to the Executive. These reports are also available on the Council's internet site. The Council has also reported on progress against the targets within the Single Outcome Agreement, achieving the Scottish Government deadline for publication. The Council also has plans to produce an Annual Performance report which will draw on these indicators, but also key achievements against the Corporate Plan. Clear definitions are applied for all indicators and the Council's internal auditors have a role to verify the robustness of indicators reported both internally and to the public.

- 5.12 The Council's own reports on performance highlight some key areas of progress. The Council's CHORD waterfront and town centre regeneration programme and development of a schools estate strategy appear to be on course. The Council has also recorded improvements in educational attainment and responding to homelessness, despite the impact of the recession. We understand that future reports on performance will allow greater analysis of outcomes for communities.

- 5.13 An analysis of the 2009-10 nationally specified statutory performance indicators records variations in performance (Figure 3). The Council has made significant improvement in areas such as the level of home care service provided to elderly people and the performance of the homelessness service, despite the impact of the recession.

Figure 3: Overall performance against specified SPIs



Source: Argyll & Bute Statutory Performance Indicators

Note: The 25 specified indicators comprise of a number of components. The results above therefore report on a total of 37 individual indicators. The Council does not report on 5 housing-related indicators as they do not manage housing stock.

### Sickness absence

5.14 SPI data highlights that sickness absence rates at the Council have increased substantially, particularly for teachers (a rise of 32%). However, Figure 4 shows that this brings the Council in line with the 2008-09 national average for teachers absence, and is below the national figures for other staff. Sickness absence rates are monitored at department level, and for the council as a whole in the quarterly scorecards.

Figure 4, Sickness Absence Rates

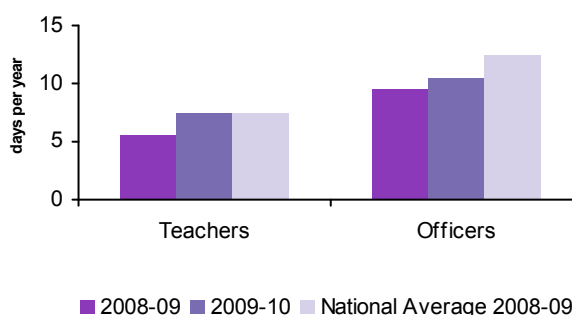
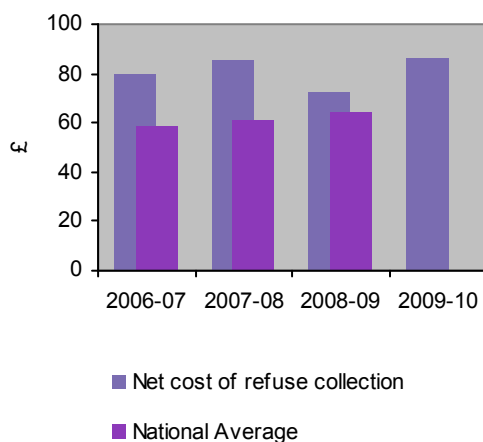


Figure 5, cost of refuse collection per dwelling



### Cost of refuse collection

5.15 A number of the indicators relating to cost rose during 2009-10, including the cost of collecting council tax per dwelling. Figure 5 highlights that refuse collection costs rose in year, meaning that the reduction achieved in 2008-09 was not sustained. Refuse collection is an area of high cost for the Council due to the rurality and geography of the location. Costs are consistently higher than national average.

## Asset Management

- 5.16 Asset management can be defined as ensuring that the asset portfolio is making the maximum possible contribution to achieving the council's objectives. This involves strategic considerations including the number, type and location of assets that are required to meet council objectives. It also involves the day to day maintenance and running of the assets. Good asset management helps to ensure that services are delivered in the most efficient and effective way. It can also reduce the cost associated with surplus property and reduce the council's carbon footprint.
- 5.17 During the year we reviewed the progress that the Council has made to implement recommendations on Audit Scotland's May 2009 report *Asset Management in Local Government*. The Council's Corporate Asset Management Plan was approved in March 2010. This has sought to strengthen the link between the service planning process and the aims and objectives within the Corporate Plan. Individual Service Asset Management Plans have been produced to demonstrate how these relationships will

Figure 5, condition and suitability of council buildings



work in practice.

- 5.18 In 2009-10, the SPIs reported a reduction in the condition and suitability of the Council's assets. We understand that the condition of the schools estate and roads network are key concerns. The Council has a number of strategies in place to improve performance, and therefore deliver efficiencies, in this area. An Asset Management Performance Measurement Project has been established to implement a robust performance management framework across the Council.
- 5.19 The Corporate Asset Management Plan also includes a number of key targets and dates for delivery. We understand that the Council is to review the number and distribution of Council office locations. This will include a review of the centralised versus decentralised nature of services. SPI information highlights that the number of buildings from which the Council delivers services to the public increased from 83 in 2005-06 to 99 in 2008-09, a rise of 19% in three years.

## Procurement

- 5.20 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.



- 5.21 All councils have been assessed by Scotland Excel and scored as non-conformant. This means that councils are not achieving best value across their procurement activities. In response, in December 2009, councils agreed to participate in a national procurement improvement programme. The programme addresses the following areas:
- The role of procurement in the organisation: the key issue facing most procurement functions is lack of influence across the organisation.
  - Getting the right people doing the right things: there is a need to be clear on the structure of procurement across the organisation and its accountability to the procurement leader.
  - Adoption of a strategic approach to sourcing: this means making money out of all aspects of the contract life cycle, not just by getting the best price.
  - Embedding new systems and processes.
  - Conformance: councils with the lowest scores can access an experienced procurement professional to help work with their procurement leader on the improvement plan for their council.
- 5.22 The latest assessment for Argyll and Bute Council (October 2010), provided a score of 36%, which takes it into the 'conformance' banding. This compares to 22.6% for the national average across Scotland. This is a good result for the Council, but it should continue to build on the solid foundations that it has in place to achieve better value for its customers. The Council should consider the full results of the review when they become known with a view of updating procurement strategy for the issues raised. We will continue to monitor the Council's progress and review the results of the follow up PCA.

### **Climate Change and Environmental Targets**

- 5.23 Ensuring that Scotland's environment is protected and improved is central to the Scottish Government's aim of achieving sustainable economic growth. This is directly linked to the council's duty to deliver sustainable development under Best Value.
- 5.24 In addition to the long term risk of failing to protect and improve the environment, there are more immediate financial risks associated both with waste management costs, and the potential impact of fines in relation to European environmental laws and targets. Tourism forms one of the key industries in Argyll & Bute, and is dependent on the quality of the environment. The relative importance of the environment is reflected within Corporate and Community Plans, including the key theme of delivering an *outstanding environment*.
- 5.25 A key action to support the economy at a local level includes developing Argyll & Bute as a premier location for the renewable energy industry by fostering inward investment and the development of related infrastructure, for example the Hunterston to Kintyre subsea cable as a connector to offshore windfarms.
- 5.26 The Council's performance against waste management SPIs has improved and the target to recycle 40% of waste has been achieved in 2009-10. However, Audit Scotland's January 2010 report *Protecting and improving Scotland's environment* notes that councils plans collectively are not sufficient to meet landfill and recycling targets beyond 2010. By 2025, councils will have to collect, recycle and compost 70% of municipal waste. This will require additional waste management facilities such as recycling and composting centres. The Council will address collection treatment and disposal options as part of the service review and waste plan.

### **Future developments**

- 5.27 The Council has a programme of work to align the Corporate Plan and Single Outcome Agreement with the revised vision for the area. As part of this work, the Council and its partners are looking to develop outcome based performance measures. This will be critical in demonstrating that the Council is achieving Best Value, and in reducing the level of scrutiny further in future years.
- 5.28 Audit Scotland have highlighted<sup>1</sup> that going forward, financial outturn information linked to activity levels and performance information should be a major source of information to scrutinise future budget proposals. Service cost information provided in the *Difficult Choices for Difficult Times* budget consultation is important to stakeholders and citizens, providing additional context for the assessment of performance. However, the Council must begin to measure unit costs routinely via the scorecards to make best use of this information. This will be a key area for development in 2010-11.

<sup>1</sup> *Scotland's Public Finances: Preparing for the Future*, Audit Scotland, November 2009

## A Audit reports issued during the year

Audit Area	Target Delivery	Outturn
<b>Financial statements</b>		
Interim report- core financial systems	31 May 2010	Completed
Interim report- implementation of IFRS	30 June 2010	1st review of implementation completed, review of PFI schemes underway
Report on the 2008-09 financial statements audit	10 September 2010	10 September 2010
Audit opinion on the 2009-10 financial statements	30 September 2010	30 September 2010
Whole of Government accounts return	30 September 2010	30 September 2010
<b>Governance</b>		
Report to Audit Scotland on the National Fraud Initiative	28 February 2010	Completed
Interim report - governance follow up	31 May 2010	30 September 2010
Interim report- contract management follow up	30 June 2010	30 July 2010
<b>Performance audit</b>		
Shared Risk Assessment	30 April 2010	Completed
Audit and Assurance Improvement Plan	30 April 2010	Completed
Statutory Performance Indicators	30 September 2010	Completed
Best Value Follow Up	31 August 2010	11 October 2010
National Performance Studies - impact assessments	Throughout the year	Asset management return submitted in May 2010

<b>Grant claim audits</b>		
Education maintenance allowance	31 July 2010	Completed
Housing Benefit and Council Tax Benefit subsidy	30 November 2010	Ongoing
Non Domestic Rates	15 February 2011	Not yet due
Grant overview report	31 March 2011	Not yet due
<b>Overall audit</b>		
Report to members and the Accounts Commission for Scotland	31 October 2010	15 October 2010 (in draft)



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