

REPORT TO: AUDIT SUB-COMMITTEE 10 JUNE 2002
REPORT ON: OVERVIEW OF THE 2000/2001 LOCAL AUTHORITY AUDITS
REPORT BY: AUDIT SCOTLAND
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OVERVIEW REPORT



Overview of the 2000/01 Local Authority Audits

Controller of Audit's statutory report and
Accounts Commission's findings

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The Accounts Commission

The Accounts Commission is a statutory, independent body, which through the audit process, assists local authorities in Scotland to achieve the highest standards of financial stewardship and the economic, efficient and effective use of their resources. The Commission has five main responsibilities:

- securing the external audit
- following up issues of concern identified through the audit, to ensure satisfactory resolutions
- reviewing the management arrangements which audited bodies have in place to achieve value for money
- carrying out national value for money studies to improve economy, efficiency and effectiveness in local government
- issuing an annual direction to local authorities which sets out the range of performance information which they are required to publish.

The Commission secures the audit of 32 councils and 35 joint boards (including police and fire services). Local authorities spend over £9 billion of public funds a year.

Audit Scotland

Audit Scotland is a statutory body set up in April 2000 under the Public Finance and Accountability (Scotland) Act 2000. It provides services to the Accounts Commission and the Auditor General for Scotland. Together they ensure that the Scottish Executive and public sector bodies in Scotland are held to account for the proper, efficient and effective use of public funds.

About this publication

This publication contains the Controller of Audit's overview report on the 2000/01 local authority audits. The report is preceded by an executive summary.

The Accounts Commission has considered the Controller's report and its findings are set out on page 1.

Commission findings

Completion of audits

It is good to note the continuing improvement in the completion of audits by the Commission's target date. It is, however, a matter of concern that, even with the improvement, only 72% of the audit certificates were completed by the due date.

Governance

In previous years the Commission has expressed its disappointment that a number of councils have not yet adopted Audit Committee principles. It is a matter of concern that only around half of them had in place by 2000/01 Audit Committees or their equivalent as a focus for councillors' important role in audit, scrutiny and performance monitoring.

Proper relationships with bodies which they fund are an important element of sound governance. We welcome Audit Scotland's intention to give detailed consideration to this area which we understand will include a survey of actual practice in Scottish local government. This will enable us to update the Code of Practice on Following the Public Pound.

Financial stewardship

There is continuing concern about weaknesses in fundamental financial controls in some councils. In preparation for the requirement to include a statement on internal financial control systems, councils must now take action to meet these concerns. We also note that some councils are slow to act on audit recommendations, and urge them to respond more quickly.

We note the wide variation in the extent to which councils finance capital expenditure from current revenue. While there is room for local variation depending on the circumstances of individual councils, we think it is noteworthy that some councils see the need to finance up to 60% of their capital expenditure on housing from one year's revenue.

Best Value

We wish to emphasise the importance of councils carefully considering options for ways of delivering services and the financial implications of their decisions.

Housing and council tax benefits

We continue to be concerned about levels of fraud, accepting that this is a complex issue, and we expect the audit process to keep it under review.

DLOs/DSOs

We welcome the continuing improvement in the financial performance of councils' direct labour and direct service organisations.

Council performance

We welcome the general indications of improvement in councils' performance in the past three years. However, we would like to see this information developed further in future years.

Executive summary

Introduction

- 1 This statutory report is prepared under section 102(1) of the Local Government (Scotland) Act 1973 to advise the Accounts Commission of the main issues arising from the 2000/01 local authority audits. It is also made available to all local authorities to enable them to assess their progress in key areas of financial stewardship and performance. It draws on reports prepared by external auditors at the conclusion of their audits and covers all the significant matters arising from the 2000/01 audits of the 32 councils and 35 related local authority bodies, such as police and fire boards.
- 2 The report is in two parts. The first part relates to recurrent general issues and shows the broader results and trends for local authorities in Scotland as a whole. The second part relates to matters arising primarily during 2000/01.

Part 1: Annual results and trends

Completion of accounts and audits

- 3 The deadlines for the completion of accounts and audits are challenging. The performance of councils in completing their accounts by the statutory date of 30 June was commendable. The performance of external auditors in completing audits represented an overall improvement over previous years, but there is scope for further improvement.
- 4 The 2000/01 accounts of two of the 32 councils were qualified, an improvement compared with 1999/2000 when four were qualified. One of the 35 'other' local authority bodies' accounts for 2000/01 was qualified.

Corporate governance and financial controls

- 5 The audit committee concept is an integral component of good governance. External auditors reported that councils are increasingly adopting audit committee principles, often as part of a wider review of committee structures and scrutiny arrangements. In 2000/01 about half of the 32 councils had audit committees or their equivalent in place.
- 6 Internal audit is a key element of the internal control system established by a council's management. The Accounts Commission report '*A job worth doing – raising the standard of internal audit in Scottish councils*' (August 2001) identified that some performed significantly better than others but that all had room for improvement. Twenty of the 32 councils complied with over 70% of CIPFA's standards for internal audit.

- 7 It is disappointing that auditors' 2000/01 reports referred to continuing weaknesses in fundamental financial controls including:
- no reconciliations between key financial systems
 - internal control weaknesses in major financial systems such as payroll, housing benefits administration, commercial and industrial rents systems
 - weaknesses in budgetary control and monitoring systems.
- 8 In future local authorities will need to include within their accounts a statement on the internal financial control systems in operation. Such statements are already required in most parts of the public sector and emphasise that the responsibility for sound systems of internal control rests with management. Internal financial control statements within the accounts of local authorities will enable them to set out the framework within which financial control is managed and reviewed and the main components of the system, including the arrangements for internal audit.
- 9 In order to maintain confidence in the conduct of public business it is in the interest of councils to create a culture where significant issues are brought to the attention of management so that corrective action can be taken. External auditors reported that councils are making progress in implementing 'whistleblowing' policies but that some have been slow to take action.

Financial position

- 10 The total value of reserves held by councils at 31 March 2001 was some £586 million, though there were wide variations in the amounts held by individual councils. Auditors have indicated that the statutory basis and purpose of amounts described as 'other reserves' is not always clear.
- 11 Total General Fund capital expenditure in 2000/01 across all councils was £590 million of which £87 million (15%) was financed from current revenue. Housing Revenue Account capital expenditure totalled £356 million of which £118 million (33%) was financed from current revenue. Again, within these overall figures, there was wide variation in the extent to which capital expenditure was financed from current revenue.
- 12 The total amount due to councils (net of bad debt provisions) at 31 March 2001, for the four main account areas relating to charges levied against taxpayers and council tenants, increased to £609 million. This is a 3% increase from 2000 and results from increases in net amounts due for council tax and housing rent arrears, offset by a decrease in net amounts due for community charge and non domestic rates.

DLO/DSO performance

- 13 The Direct Labour/Service Organisation (DLO/DSO) results show further improvement over recent years with 97% of all DLOs/DSOs in Scotland achieving the statutory break-even target with net surpluses totalling £52 million. In 1999/2000 94% achieved break-even with total surpluses of £41 million.
- 14 The Local Government Bill proposes the repeal of Compulsory Competitive Tendering (CCT) and its replacement with a statutory duty of Best Value. In the meantime, councils are reviewing services under the existing Best Value framework. Where these services remain subject to the CCT regime, Best Value initiatives may lead to developments which are not consistent with the existing CCT legislation.

Housing and council tax benefits

- 15 External auditors must be satisfied that councils' housing and council tax benefit subsidy claims are fairly stated and that councils' underlying systems for calculating and paying benefit are sound. In light of the sums and risks involved and the complexity of the system, it is anticipated that housing and council tax benefits will continue to feature significantly in external auditors' work programmes in future years.

Financial relationships with external parties

- 16 External auditors assessed the extent to which councils comply with '*The Code of Guidance on Funding External Bodies and Following the Public Pound*' and found a mixed picture of the reliability and adequacy of such arrangements. In view of auditors' reports of difficulties at councils in achieving compliance with the existing Code, and the increasing use by councils of arms-length arrangements, Audit Scotland intends a more detailed review of this area.

Audit follow-up

- 17 Where external auditors conclude that action needs to be taken, they agree action plans with the local authority which they then monitor and follow up. In cases where remedial action has not been agreed or where the local authority has been slow to implement agreed action, Audit Scotland may pursue the matter directly with the authority. The Controller of Audit may also report formally to the Accounts Commission on any matter arising from an audit. The various measures available in terms of follow-up of audit findings provide a flexible framework for action in relation to the annual audit of accounts, stewardship of funds and governance matters.

Part 2: Matters arising during the year

Statutory reports

- 18 During 2001, the Controller of Audit prepared four statutory reports for consideration by the Accounts Commission, including last year's overview report. Two were follow-up reports on the progress being achieved at Inverclyde Council in addressing weaknesses in accounting procedures and financial administration. The fourth report, on Scottish Borders Council, was concerned with the financial management of the council's education budget.

General accounting issues

- 19 The main accounting issues reported by auditors related to councils' compliance with the capital accounting regime and the implications of new requirements for pensions accounting. Auditors highlighted the potential pressures faced by fire boards in funding firefighters' pensions.
- 20 There are a number of public/private partnerships (PPP) and private finance initiative (PFI) contracts at various stages of completion in councils in Scotland. External auditors review the processes by which councils progress their interests in these schemes and, where appropriate, provide preliminary views on the proposed accounting treatment. Audit Scotland is examining the value for money of recent Private Finance Initiative schools deals in Scotland with a view to making recommendations to help promote good practice in the preparation and delivery of PFI schemes.

Matters arising at individual councils

- 21 The auditors of Clackmannanshire Council expressed serious concerns about the council's lack of progress in reviewing its financial interests in external bodies. At Comhairle nan Eilean Siar (Western Isles Council) the auditors reported that the Building Maintenance and Roads DLOs failed to achieve break-even with deficits of £321,000 and £253,000 respectively. These are significant in terms of the level of DLO activity, representing over 10% of turnover in each case. The external auditor of Midlothian Council referred to a contract for an extension to a school in which there had been a £560,000 (over 30%) overspend. At South Lanarkshire Council the auditor expressed concerns about a contract for debt recovery services.

Value for money studies

- 22 The Accounts Commission approves an annual programme of value for money studies undertaken centrally by Audit Scotland. Reports on 2000/01 study topics related to: pre-school education; property risk management in schools; internal audit; and homecare services for older people.

Best Value

- 23 Best Value was introduced in Scotland in 1997. It requires councils to provide high quality services that meet the needs of their customers and communities, and achieve value for money. Councils must also demonstrate that they are accountable and delivering continuous improvement. The Scottish Executive is expected to introduce legislation that will place a statutory duty on councils to deliver Best Value. The Accounts Commission published a progress report in December 2001 ('*Making Progress with Best Value*') that provided a snapshot of councils' performance management and planning arrangements.

Performance Indicators

- 24 The Local Government Act 1992 places upon the Accounts Commission an annual duty to direct local authorities to publish information which will, in the Commission's opinion, assist in the making of appropriate comparisons. By reference to the criteria of cost, economy, efficiency and effectiveness, comparisons can be made between the standards of performance achieved by different authorities in a financial year and the standards of performance achieved by individual authorities in different financial years. In 2000/01 councils, fire brigades and police forces were required to report their standards against 76 statutory performance indicators covering a wide range of services.
- 25 The statutory performance indicators are only one means by which the performance of councils can be measured and need to be interpreted in a broader context. Nevertheless, it is encouraging to note that the general trend is one of overall improvement, with the majority of councils improving on most indicators between 1998/99 and 2000/01.