THIS PAPER
RELATES TO ITEM 6
ON THE AGENDA

CLACKMANNANSHIRE COUNCIL

Report to Council of 18th December, 2008

Subject: Annual Audit Report for the Year Ended 31st March, 2008

Prepared by: Muir Wilson, Head of Finance

1.0 SUMMARY

1.1. This report brings to the Council two reports generated by our external auditors Grant Thornton. The first is called 'Report on the 2007/08 Accounts Audit' and is referred to as Appendix 1 in this report, and the second is called 'Report on the 2007/08 Audit', and is referred to as Appendix 2.

1.2. This is the second year of the appointment of our external auditors, Grant Thornton.

1.3. Appendix 1 includes an action plan based on the annual audit. Appendix 2 gives an overview of the financial statements for the year, and also covers Governance and Performance issues.

2.0 RECOMMENDATIONS

2.1. That the Council notes the content of the reports as well as the Action Plan agreed with officers at Appendix 1.

3.0 BACKGROUND

3.1. A full set of the audited accounts for the year ended 31st March 2008 has been distributed to all members, Directors and Heads of Service. The detailed accounts themselves are presented separately on this Council agenda for approval.

3.2. Grant Thornton were appointed as our external auditors for a five year period with effect from 2006/07, and this is their second annual report. This report covers their findings from the annual audit of the financial statements.

3.3. The Action Plan in Appendix 1 highlights 9 recommendations arising from the audit. Management responses, in agreement to these recommendations are also shown.

3.4. Appendix 1 also shows how the Council has progressed against the action plan from 2006/07, with only two of the recommendations that were agreed not being implemented.

3.5. Readers of the accounts will notice that the audit certificate once again expresses an unqualified opinion on the financial statements.

3.6. It is the intention of Grant Thornton to attend this Council meeting to give members the opportunity to ask questions on their reports.

4.0 CHANGING CIRCUMSTANCES

4.1. There are two issues that Grant Thornton have included in their reports which merit further comment, as circumstances surrounding both issues have changed.

4.2. The first is the economy, and the possible effect on the Council's finances of the recession we are now in. Our Auditors have mentioned this in the context of the Council's investments in the financial markets, and also the level of ongoing uncommitted reserves that the Council has to call on to meet unexpected financial pressures. Officers are working on both these issues, and recommendations will be made to members regarding a planned growth in the level of uncommitted reserves over the next three years as part of the budget cycle.

4.3. The second issue which has been mentioned are the issues around the funding of the Council's PPP scheme. The Unitary Charge (UC) payment due to the Special Purpose Vehicle is a significant charge. However, due to changes in the rules used to fund such projects being made since this Council reached Financial Close, the payment of the UC has meant revisiting options with our auditor, financial advisor and ultimately the Scottish Government.

4.4. The issues that have changed are:

- Funding of the £16.35m six months after the school buildings have been completed. Advice received at the time our project was being put together was that we could make these capital payments. These payments will be made, as there is a contractual obligation to make them. However, the value of assets intended to contribute towards this sum has fallen sharply in the last few months, and it would not be value for money for the Council to sell these assets at a significantly reduced price. Officers are in dialogue with our advisors and other Councils who are facing similar issues, and this will likely lead to some further contact with the Scottish Government over this issue.

- Use of Schools Fund Grant. In the lead up to financial close, this Council, along with twelve other Councils, relied on the use of this fund as per instruction given by the Scottish Government in order to contribute towards the payment of the UC. The Scottish Government have since confirmed that this grant is a capital grant, and should therefore not be used to part fund payments towards what is meant to be a revenue project. Realising the difficulties this will cause, the Scottish Government have come up with a compromise that will not fully compensate each of the thirteen Councils, and will only last till the end of the current spending review period, although this will mean paying out just over 95% of the sum required. There are no guarantees being given as what will happen from 2011/12 onwards on projects that will still have some 25 years to run.

- Council Tax increases. The affordability model for this Council's PPP scheme relied on a 1% increase in Council Tax for each of the first twelve and a bit years of the scheme. Council Tax was increased for this purpose in 2006/07 and 2007/08, but we are now in a period of zero increase in Council Tax, and an equivalent figure has had to be top sliced from our block grant to make good the shortfall. No recognition of this commitment, that was entered into with the former Scottish Executive, has been made by the Scottish Government.

5.0 CONCLUSIONS

5.1. This report covers the findings of our external auditors from the audit of our Statement of Accounts for 2007/08. Appendix 1 highlights that nine recommendations have been made for improvement, of which three are classified as high priority, with the remainder classed as medium. These recommendations are all being addressed by management.

5.2. The report shown as Appendix 2 summarises external audit activity during the year, and lists the reports issued.

6.0 SUSTAINABILITY IMPLICATIONS

6.1. N/a

7.0 FINANCIAL IMPLICATIONS

7.1. No direct financial implications from this report, other than an increase in the security of the Council's assets and resources.

6.2. **Declarations**

(1) The recommendations contained within this report support or implement Corporate Priorities, Council Policies and/or the Community Plan:

- **Corporate Priorities (Key Themes)** (Please tick ☑)

Achieving Potential	☐
Maximising Quality of Life	☐
Securing Prosperity	☐

Enhancing the Environment ☐
Maintaining an Effective Organisation √

- **Council Policies** (Please detail)

- **Community Plan (Themes)** (Please tick ☑)

Community Safety ☐
Economic Development ☐
Environment and Sustainability ☐
Health Improvement ☐

(2) In adopting the recommendations contained in this report, the Council is acting within its legal powers. (Please tick ☑) √

(3) The full financial implications of the recommendations contained in this report are set out in the report. This includes a reference to full life cycle costs where appropriate. (Please tick ☑) ☐

____
Head of Service

____
Director

CLACKMANNANSHIRE
COUNCIL

Report to Council

To accompany all Reports to Council

To: Head of Administration And Legal Services

Author:	Muir Wilson, Head of Finance	Date:	19 November 2008
Service:	Finance Services		
Date of Meeting:	18th December, 2008		
Title of Report:	Annual Audit Report for the year ended 31st March, 2008		

Recommendation that the attached report be:

1. Given unrestricted circulation	✓	(tick appropriate box)
2. Taken in private		

By virtue of paragraph ____ of schedule 7A, Local Government (Scotland) Act 1973.

Appendices attached to this report (if none, state "none")

1. 1: Report on the 2007/08 Accounts Audit
2. 2: Report on the 2007/08 Audit
3.
4.

List of Background Papers (if none, state "none")

1. Annual Accounts for the year ended 31st March, 2008
2.
3.
4.

Note: All documents specified must be kept available by the author for public inspection for four years from the date of the meeting at which the report is considered.

Grant Thornton

Clackmannanshire Council

Report on the 2007-08 Accounts Audit

25 September 2008

Appendix 1

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Appendices

1 Executive Summary

1.1 Introduction

Grant Thornton UK LLP has been appointed by the Accounts Commission for Scotland as the external auditor of Clackmannanshire Council (the Council) for the five year period commencing 2006-07. Matters arising from our audit have been summarised in reports issued during the year (Appendix A). This report summarises the key elements of our audit and key messages for members.

We planned and performed our 2007-08 audit in accordance with our Audit Plan issued in February 2008. In accordance with the Code of Audit Practice, we have the following audit objectives:

Code Objective	Key Findings
Financial statements To provide an opinion on the Council's financial statements for the year ending 31 March 2007.	• We gave an unqualified opinion on the Council's 2007-08 financial statements on 30 September 2008. • The Council's finance team prepared well for implementing the 2007 Statement of Recommended Practice (SORP) and the standard of accounts and supporting working papers were generally good. • However, the Council's un-audited accounts included an error which had the effect of overstating income by £0.4 million. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million. • The Council has un-earmarked reserves of £0.4 million, significantly below the Council's policy to maintain a minimum required reserves balance of £1.8 million. • The Council continues to face significant financial pressures which may impact on its ability to meet existing budget commitments and achieve its corporate objectives. The development of a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget and adequate reserves level, continues to represent a key and immediate priority.
Governance To review and report on the Council's corporate governance arrangements, including: systems of internal financial control, arrangements for the prevention and detection of fraud and corruption, standards of conduct and the Council's financial position.	• We have concluded that the Council's systems of internal financial control are generally operating adequately, however, reconciliations between the Council's ledger and subsidiary systems are not always prepared timeously. • The Council prepared well for the May 2007 elections and overall governance arrangements are generally sound. However, there is scope to further develop the role of the scrutiny committee and to develop an assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. • The Council's internal audit section does well in undertaking and reporting its work but has not made sufficient progress in meeting the requirements of the Code of Practice for Internal Audit. In particular, Internal Audit is not fully resourced to deliver its 2007-08 audit plan and a longer term plan is needed for the delivery of a stable and robust internal audit function. • The Council has not sufficiently prioritised participation in the National Fraud Initiative.

Performance To review and report on the Council's arrangements to achieve Best Value, other aspects of arrangements to manage performance in the use of resources and arrangements for preparing and publishing statutory performance indicators.	• The Council is making good progress in addressing the key recommendations made in Audit Scotland's report on Best Value issued in September 2007. • The Council recognises that further development of performance and risk management systems is required to support the efficiency and improvement agenda. The Council has agreed to adopt the Public Sector Improvement Framework performance management model and is making good progress in developing its performance and risk management arrangements. • The significant financial constraints referred to above highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

1.2 Independence and robustness

Ethical standards require us to give you full and fair disclosure of matters relating to our independence.

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Ethical Standards of the Auditing Practices Board and therefore we confirm that we are independent and are able to express an objective opninion on the financial statements.

1.3 Acknowledgements

We would like to take this opportunity to thank the staff who have been involved in this review for their assistance and co-operation.

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.

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.

Grant Thornton UK LLP
25 September 2008

2 Executive Summary

2.1 Financial statements

We have given an unqualified opinion on the Council's 2007-08 financial statements and conclude that the financial statements are prepared in accordance with Part VII of the Local Government (Scotland) Act 1973 and the 2007 SORP.

The 2007 SORP introduced significant accounting changes for 2007-08, including the introduction of a UK GAAP compliant revaluation reserve; the creation of a new capital adjustment account; and the introduction of new standards for the accounting and disclosure of financial instruments. The Council has fully complied with the 2007 SORP in its revised 2007-08 financial statements.

This has been a significant achievement by the Council, particularly as a key member of the Council's small finance team was absent on long term sick leave during the accounts preparation and audit process.

Our audit identified a number of presentational amendments and accounts adjustments which have been processed in the Councils draft accounts. The Council's un-audited accounts included an error which had the effect of overstating income by £0.4 million. The error arose as the Council had not correctly updated the financial ledger at the beginning of the financial year to reflect audit adjustments made to the 2006-07 accounts. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million. A summary of audit adjustments is contained at Appendix A.

2.2 Financial results

The Council reported a deficit on the Income and Expenditure account for 2007-08 of £14.3 million (2006-07: £10.8 million). The net increase on the general fund was £1 million (2006-07: £10 million).

The total net worth of the Council has increased by £0.9 million, mainly due to actuarial gains on the Falkirk Council Pension Fund. The reduction in pension liabilities was significantly influenced by the improvement in corporate bond yields during the 2007-08 financial year.

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £4.8 million, of which £4.4 million was earmarked for specific purposes, leaving £0.4 million available for new expenditure or to meet the costs of contingencies and unforeseen events. This is below the Council's target level for un-earmarked reserves of £1.8 million and this presents a risk to the achievement of overall corporate objectives.

The Council has set aside £0.651 million from its 2008-09 budget to increase its level of un-earmarked reserves, however, it is unlikely that the target level of un-earmarked reserves will be met until 2009-10 at the earliest. We note that the target level for reserves has not been calculated as part of a risk based assessment of the balances required to be held to meet contingencies and respond effectively to unforeseen events.

2.3 Internal controls and risk management systems

Our financial statements audit confirmed that the Council's financial systems operate within a generally good control environment, however, our audit identified some weaknesses in the Council's internal control arrangements. We have made two recommendations to improve internal control and risk management:

- the Council should fully test updates in advance of implementation for all IT upgrades; and

- the current volatility within the financial markets increases the risk of failure of investment institutions, and the Council should review its policy on setting counterparty limits as a result.

2.4 Follow up of prior year recommendations

We are pleased to report that the Council has made good progress in implementing the agreed audit recommendations made in our 2006-07 report. Five of the eleven recommendations are fully implemented, three are partially implemented, with progress on a further recommendation ongoing. Further information on the results of our follow-up review is provided at Appendix C.

2.5 Looking Forward

The Council currently faces significant financial pressures which may impact on its ability to meet existing budget commitments and achieve its corporate objectives. As outlined above, the Council's reserve balances are less than the amount that it regards as necessary to respond effectively to contingencies or unforeseen events.

Within this context, the Council faces a number of financial pressures including:

1. Additional cost pressures across all services, linked to higher than expected energy costs and wage inflation. In addition, the higher costs of foster care and residential care is having a significant impact on the costs of social work services.

2. The Government has recently announced its policy to provide free school meals to primary school pupils. The costs of meeting this Government commitment are expected to be met from within the existing local government financial settlement, but have not yet been factored into the Council's budget projections.

3. The Council has yet to formalise agreements with its employees on both equal pay claims and the move to single status. There remains significant risk that the Council may be exposed to higher costs on these issues than is currently allowed for within existing financial projections.

4. The new schools developed as part of the Three Schools PPP Project are due to become operational in 2009. The Council will be required to meet unitary charge payments under the terms of the contract, however, we note that some key issues impacting on the Council's affordability model have yet to be resolved:

- plans to sell existing assets to fund a capital injection into the Project may be affected by a decline in land prices reflecting a decline in the wider UK economy;
- plans to make a capital injection of £16 million into the Project may be prevented by accounting rules which prevent capital receipts from being applied for a revenue purpose;

- plans to increase council tax to fund unitary charge payments may be impacted by the Scottish Government's policy to freeze council tax bills and introduce a local income tax; and
- the Scottish Government has clarified rules on applying Schools Fund Grant and this grant is no longer available for application to PPP schemes.

Grant Thornton UK LLP
25 September 2008

3 Financial results

3.1 Financial results

The Council reported a deficit on the Income and Expenditure account for 2007-08 of £14.2 million (2006-07: (£10.8 million). The net increase on the general fund was £1 million (2006-07: £0.1 million decrease). Table 1 below highlights the financial results for the Council for the year ending 31 March 2008.

Table 1: Financial results for 2008 and 2007

	2007 £'000	2008 £'000
Net Cost of Services	101,693	106,068
Gain on disposal of fixed assets	(6,569)	(720)
Surplus on Third Part Trading	(50)	(245)
Interest payable	7,092	6,495
Interest receivable and investment income	(2,165)	(1,602)
Pension interest cost	223	(88)
Net Operating expenditure	100,224	109,908
Income from taxation and government grants	(89,441)	(95,653)
Deficit for the year	10,783	14,255
Net additional amount required by statute and non-statutory proper practices to be debited or credited to the General Fund Balance for the year	(10,660)	(15,268)
Increase/(Decrease) in the general fund balance	(123)	1,013

Source: Clackmannanshire Council 2007-08 financial statements

The increase in the general fund balance for the year can be attributed to the following key factors:

- higher than expected income from government grants (£1.3 million) and council tax (£0.9 million) due to the impact of the government's revised funding settlement and increased house building in the area which has raised the council tax base;
- a reduction in the provision for bad debts (£0.2 million) to reflect improvements in council tax collection rates;
- the surplus generated from trading activities (£0.5 million) was £0.1 million greater than budget;
- increased income was offset by increased service costs. In particular, social work services costs were £0.75 million greater than budget, largely due to increased costs of residential care and foster care.

Gains on the disposal of fixed assets reduced significantly during the year (from £6.6 million to £0.7 million) due to a reduction in the volume and value asset sales during the financial year.

The Council performed well against budget overall, with outturn expenditure £1 million below budget for the year. This underspend has been carried forward as an earmarked reserve within the 2008-09 general fund.

3.2 Balance Sheet

Table 2: Balance sheet as at 31 March 2008 and 2007

	31 March 2007 £'000	31 March 2008 £'000
Fixed assets	276,006	272,101
Long term assets	5,581	511
Current assets	26,277	35,503
Current liabilities	(20,280)	(19,831)
Long term liabilities	(141,668)	(141,476)
Net assets	**145,916**	**146,808**
Capital adjustment account	173,988	158,288
Useable capital receipts reserve	3,248	3,215
Pension reserve	(41,984)	(22,661)
Financial instruments adjustment account	0	(4,757)
Housing revenue account balance	6,417	7,356
Insurance Fund	489	596
General fund	3,758	4,771
Total reserves	**145,916**	**146,808**

Source: Clackmannanshire Council 2007-08 financial statements

Net Worth

The total net worth of the Council has increased by £0.9 million, mainly due to actuarial gains on the Falkirk Council Pension Fund which has reduced the pension liability from £42 million at 31 March 2007 to £22.7 million at 31 March 2008. The reduction in pension liabilities was significantly influenced by the improvement in corporate bond yields during the 2007-08 financial year.

The improvement in pension liabilities was offset by movements in the capital adjustment account and financial instruments adjustment accounts, largely reflecting new accounting changes required by the 2007 SORP.

Reserves

There have been significant changes in the Council's reserves, following changes introduced by the 2007 SORP, including:

- the Fixed Asset Restatement Account (FARA) and the Capital Financing Account (CFA) are now replaced by the Capital Adjustment Account (CAA);
- the creation of a revaluation reserve to recognise revaluation gains and losses under UK GAAP principles; and
- the creation of a financial instruments adjustment account following the incorporation of new financial reporting standards for financial instruments (FRS 25, 26 and 29) in the 2007 SORP.

3.3 General Fund

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £4.8 million, of which £4.4 million was earmarked for specific purposes, leaving £0.4 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 2008.

Table 3: General Fund balances as at 31 March 2008 and 2007

	31 March 2007 £'000	31 March 2008 £'000
Total General Fund	3,758	4,771
of which		
Earmarked:		
Devolved Management within Schools	1,243	916
Area Management Boards	300	188
Secondary Schools PPP	196	598
Services Improvement Contracts	275	475
Implementation of Single Status	400	1,200
Specific Revenue Support Grant Funding Streams	0	957
Opening of Rail Link	0	20
Total Earmarked	2,807	4,354
Unearmarked	951	417

Source: Clackmannanshire Council

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £4.8 million, of which £4.4 million was earmarked for specific purposes, leaving £0.4 million available for new expenditure or to meet the costs of contingencies and unforeseen events. This is below the Council's target level for un-earmarked reserves of £1.8 million and this presents a risk to the achievement of overall corporate objectives.

The Council has set aside £0.651 million from its 2008-09 budget to increase its level of un-earmarked reserves, however, it is unlikely that the target level of un-earmarked reserves will be met until 2009-10 at the earliest. We note that the target level for reserves has not been calculated as part of a risk based assessment of the balances required to be held to meet contingencies and respond effectively to unforeseen events.

3.4 Housing Revenue Account

The Housing Revenue Account (HRA) deals with council house management transactions. It ended the year with a deficit of £4.6 million, however, statutory adjustments mean that the HRA balance for the year increased by £0.9 million. This outcome was £0.9 million greater than budget, largely due to lower than expected capital financing costs and higher than expected rental income.

The accumulated balance on the Housing Revenue Account (HRA) was £7.4 million at the year end representing an increase of £1 million from the prior year. The Council has been increasing its HRA reserve balances in recent years following its decision on 8 December 2005 to retain all housing stock and meet or exceed the requirements of the Scottish Housing Quality Standard (SHQS) by 2015 from its own resources.

In accordance with the current Business Plan, the Council anticipates that £3 million will be used from HRA reserves over the next three years to support capital investment in housing stock required to meet the SHQS standard.

4 Financial Statements

4.1 Audit opinion

We have given an unqualified opinion on the Council's 2007-08 financial statements and conclude that the financial statements are prepared in accordance with Part VII of the Local Government (Scotland) Act 1973 and the 2007 SORP.

4.2 The 2007 Statement of Recommended Practice

The 2007 Statement of Recommended Practice (2007 SORP) introduced wide ranging changes to the presentation of local government accounts. These changes are intended to improve the presentation and understanding of the accounts and move local authority accounting towards UK GAAP compliance. Key changes include:

- the incorporation of new financial reporting standards for financial instruments (FRSs 25, 26 and 29); and
- the replacement of the fixed asset restatement account and capital financing account with a capital adjustment account, and the creation of a revaluation reserve under UK GAAP principles.

The changes introduced by the 2007 SORP are treated as prior year adjustments, and the 2006-07 balance sheet has been amended to ensure compliance with the new requirements. The fixed asset restatement account and capital adjustment account are removed from the balance sheet and are consolidated into the 2006-07 opening balance of the capital adjustment account

Several prior year adjustments were also required to process the changes introduced by FRS 26, in particular, any premiums and discounts recorded on the balance sheet were moved from current assets to the financial instruments adjustment account, and other financial liabilities held during 2006-07 were restated at fair value. We also recommended that the Council process some additional prior year accounting adjustments to ensure full compliance with the 2007 SORP-these are summarised at Appendix A.

There is no impact on the reported 2006-07 general reserves balance from these changes as all financial instrument adjustments are processed by statutory adjustments through the Statement on Movement of General Fund Balances.

4.3 Prior Year Adjustments

Following our audit of the Council's 2006-07 Accounts, a number of adjustments were processed to the Accounts to reflect our audit findings. Our 2007-08 audit found that the following audit adjustments, corrected in the 2006-07 Accounts, had not been processed through the Council's ledger:

- reclassification of Supporting People Grant Income - £393,000
- Social Work accruals adjustment - £58,000

The effect of not correcting these adjustments through the Council's ledger has been to overstate income during the 2007-08 financial year, with a consequent overstatement of the level of reported general fund reserves during the year. The correction of this error in the 2007-08 accounts has reduced the reported general fund reserves position in the draft accounts by £0.4 million.

Action plan point 1

4.4 Accounting for Fixed Assets

Non Enhancing Capital Expenditure

Tangible fixed assets are defined in the SORP as those which yield benefits to the local authority and the services it provides for more than one year. Fixed asset accounting is concerned with identifying the real economic cost of using fixed assets rather than with the cost of financing the expenditure on these assets.

Enhancement is defined in the SORP as meaning the carrying out of works which are intended to achieve at least one of the following

- lengthen substantially the useful life of the asset. If the work is needed simply for the asset to last its expected useful life, it is not enhancement work
- increase substantially the market value of the asset
- increase substantially the extent to which the asset can be used. For example, this would be the case where more people can use a leisure facility, or where the quality of the service has improved.

The Council routinely incurs expenditure, particularly on refurbishment programmes for housing stock, which meets the definition of capital expenditure within the SORP but which does not meet the definition of enhancing expenditure as outlined above. Such expenditure can be recognised as capital when regarded as an asset component and depreciated over its useful life, otherwise it is normally written off to revenue as an impairment or offset against revaluation gains in the revaluation reserve.

The Council has agreed to adopt component accounting for fixed assets and this will require an adjustment to the fixed asset register to correctly identify individual components of council house and to ensure assets are correctly depreciated over their useful lives.

Our review identified that the Council had capitalised door replacement work on council houses as capital expenditure with a value of £91k. Our audit concluded that this expenditure did not meet the accounting definition of capital. As a result, an adjustment to recharge this expenditure to the Housing Revenue Account has been made.

Assets Under Construction

We identified one asset with the Asset Under Construction (AUC) category with a value of £99,755 (Paton Mill) whose value has not altered since 2005. The asset forms part of the Townscape Heritage Development Project and had attracted heritage lottery funding for the creation of a museum.

Paton Mill was already owned by the Council prior to refurbishment works the asset has therefore been building incorrectly classified as AUC. Work on re-developing this building has stopped and the Council has not yet brought forward plans for the future of this asset.

The Council has confirmed that the asset is not in use and, as a result, it has been re-classified from AUC to surplus assets, until a decision is made on its future.

In addition, the total assets brought into use from AUC during the year was incorrectly stated as £1.285 million in Note 13 and an amendment to reflect the correct figure of £1.323 million was required.

Action plan points 2 and 3

4.5 Third Party Trading

The Council is empowered to provide goods and services to other public bodies under the Local Authority (Goods and Services) Act 1970. Note 4 to the accounts records the income received by the Council from the provision of these services, but does not record the cost of providing the services. The Council is unable to provide this information as it is currently not recorded separately within the financial ledger and, as a result, the Council is unable to determine if it provides these services at a profit or a loss.

Action plan point 4

4.6 Common Good Funds

The Council acts as sole trustee for 8 charitable trusts and endowments. In addition the Council administers the Common Good Account for towns within the county. The total value of all common good and trust funds at the year end was £0.3 million. The Common Good Funds do not form part of the Council's finances although the Council is responsible for the financial management of the Funds.

In December 2007, the Local Authority (Scotland) Accounts Advisory Committee (LA(S)AAC) published a guidance note for authorities in accounting for Common Good Funds, including:

- specific accounting treatment to be adopted for 2007-08;
- introduction of an asset register for Common Good Funds from 1 April 2008; and
- consideration of registered charitable status by 2010.

Our audit of the draft financial statements found that the Council had not followed the LA(S)AAC guidance for 2007-08 as there was no separate income and expenditure account or balance sheet disclosed for the Common Good Funds, and investments were not carried at market value.

Following our recommendation, the Council has now complied with the guidance note, and prepared a Common Good Income and Expenditure Account and Balance Sheet in Note 35, consolidating the results of all seven funds. Investment assets held by the Funds have now been restated at market value.

Further work will be required by the Council during the 2008-09 financial year to consider the charitable status of trust funds, and to ensure compliance with the registration requirements of the Office of the Scottish Charity Regulator.

Action plan point 5

4.7 Three Schools PPP Project

Capital Receipts

The Three Schools PPP Project is now largely complete with all of the new schools expected to become operational by January 2009. The Council plan to make a significant capital contribution of £16m to the Project funded from capital receipts, once the initial construction phase has been completed.

The 2007 SORP, which sets out proper accounting practice, requires capital receipts to be credited to the usable capital receipts reserve which is operated under powers provided by Schedule 3 of the Local Government (Scotland) Act 1975 (which provides for a capital fund). The capital fund can only be used to fund capital expenditure or loans fund repayments.

Under the terms of the PPP scheme, the schools revert back to the Council's control at the end of the contract for nil consideration. The accounting treatment for PFI schemes requires the Council to recognise the assets it will acquire at this time by building up a residual value to match the asset transfer which will take place in 30 years time. Accordingly, the Council deducts the proportion of residual value that it builds up each year from the service charge in the income and expenditure account and recognises a long term debtor. By the end of the contract, the long term debtor balance will match the value of the schools the Council will receive.

It may be possible, under existing accounting rules, for the Council to apply capital receipts to fund the purchase of the residual schools asset, but only to the value of that asset. As we noted in our 2006-07 Report, the Council will require approval from the Scottish Government if it is to apply capital receipts to fund the Schools PPP scheme more generally.

Planned changes to accounting rules for local government under International Financial Reporting Standards (IFRS) will likely require the PPP schools assets to be reflected on the Council's balance sheet by 2010-11.

Affordability

We note that the value of the land assets the Council had intended to sell to fund the £16 million capital contribution to the PPP scheme has decreased significantly in the last year due to the economic impact of the credit crunch on asset values. This may impact on the affordability of the Project.

In addition, the Project is planned to be part funded from above inflation increases in council tax over the life of the project. The Scottish Government has recently announced an intention to replace council tax with a form of local income tax and is seeking agreement from councils not to increase council tax levels over the three year budget cycle. This approach may have significant funding consequences for the PPP scheme.

The Council's affordability model also incorporated the application of Schools Fund Grant monies to the PPP scheme. Recent changes to the financing arrangements for local government have clarified the arrangements for applying ring fenced grant monies. These arrangements clarify that Schools Fund Grant can only be applied to capital schemes, and the Council is now unable to apply this grant to fund the PPP scheme.

Action plan point 6

4.8 Audit adjustments and unadjusted errors

We have identified some disclosure amendments and reclassifications to improve the presentation of the accounts.

The total value of revenue adjustments made to the accounts was £0.4 million. The net impact of these adjustments is to decrease the General Fund balance by £0.4. million. There are no unadjusted differences to report.

A full summary of adjusted and unadjusted differences is included at Appendix A.

5 Internal controls and risk management systems

5.1 Roles and responsibilities

The Council is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to the Council. In consequence, our work cannot be relied upon necessarily to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might develop.

We have set out the key control and risk observations from our financial statements audit in the sections below, including maters arising from our review of the progress made by the Council in implementing prior year recommendations.

5.2 Financial Markets

At 31 March 2008, the Council held £14 million in cash and short term investments, all of which was deposited in accounts with commercial banks in the UK. The Council has monitoring arrangements in place to assess the credit risk for banks or building societies that it is prepared to lend to. In addition a register of agreed counterparty limits is maintained for each approved bank and building society which sets out the maximum amount that can be deposited by the Council in any single institution and the maximum term of any deposit. The register is reviewed by the Scrutiny Committee and approved by the Head of Finance.

Financial markets have experienced significant uncertainty and volatility over the past 6 months as a result of the impact of the credit crunch on financial institutions, this has also resulted in consolidation within the UK financial industry. We recommend that the Council reviews its arrangements for setting a monitoring counterparty limits to recognise the higher level of risk associated with current market conditions.

Action plan point 7

5.3 Ledger Development

The introduction of the Single Outcome Agreement, combined with a greater focus on performance reporting systems, places a requirement of the Council to improve the level of financial performance reporting across its services. In our 2006-07 interim report, we recommended that the Council develop its ledger system to improve the quality of available financial information and financial reporting more generally.

The Council addressed this issue during the financial year by upgrading its ledger system to improve financial reporting functionality. However, this upgrade had not been fully tested prior to implementation and resulted in a disruption to the operation of the ledger. In particular, the debt management system, although able to generate accurate invoices, was unable to print reminders without some manual intervention to the process. No significant backlog with regard to issues of invoices arose as a result of this. There are system issues which remain to be resolved with regard to correct coding of particular invoices. These are currently being addressed. There were, however, difficulties in processing follow up reminders partly as a result of the system upgrade but also as a result of staff resource issues. These issues are being addressed with a view to bringing the follow up programme up to date.

Action plan point 8

5.4 Follow up of prior year recommendations

We are pleased to report that the Council has made good progress in implementing the agreed audit recommendations made in our 2006-07 report. Five of the eleven recommendations are fully implemented, three are partially implemented, with progress on a further recommendation ongoing. Action to address two of our recommendations remains outstanding and these are listed below:

- the Council has not yet developed a policy for managing consultancy and advisory costs; and
- the Council's business plan for implementing the Scottish Housing Quality Standard has not yet been formalised or approved by the Council.

In addition, further action is required to fully implement the following recommendations:

- the Council should ensure that it has adequate reserves in place to meet contingencies and unforeseen events;
- funding arrangements, and the affordability model, for the Three Schools PPP Project needs further evaluation; and
- the fixed asset register should be circulated to service departments to confirm accuracy and completeness.

Further detail on our follow up work on prior year recommendations is contained at Appendix C.

6 Looking Forward

The Council currently faces significant financial pressures which may impact on its ability to meet existing budget commitments and achieve its corporate objectives. As outlined above, the Council reserve balances are less than the amount that it regards as necessary to respond effectively to contingencies or unforeseen events.

Within this context, the Council faces a number of financial pressures including:

1. Additional cost pressures across all services, linked to higher than expected energy costs and wage inflation. In addition, the higher costs of foster care and residential care is having a significant impact on the costs of social work services.

2. The Government has recently announced its policy to provide free school meals to primary school pupils. The costs of meeting this Government commitment are expected to be met from within the existing local government financial settlement, but have not yet been factored into the Council's budget projections.

3. The Council has yet to formalise agreements with its employees on the move to single status. A number of equal pay claims are outstanding within the Employment Tribunal system. There remains significant risk that the Council may be exposed to higher costs on these issues than is currently allowed for within existing financial projections.

4. The new schools developed as part of the Three Schools PPP Project are due to become operational by January 2009. The Council will be required to meet unitary charge payments under the terms of the contract, however, we note that some key issues impacting on the Council's affordability model have yet to be resolved:

- plans to sell existing assets to fund a capital injection into the Project may be affected by a decline in land prices reflecting a decline in the wider UK economy;
- plans to make a capital injection of £16 million into the Project may be prevented by accounting rules which prevent capital receipts from being applied for a revenue purpose;
- plans to increase council tax to fund unitary charge payments may be impacted by the Scottish Government's policy to freeze council tax bills and introduce a local income tax; and
- the Scottish Government has clarified rules on applying Schools Fund Grant and this grant is no longer available for application to PPP schemes.

In our view, the Council should take urgent action to revise its existing financial plans and assumptions to ensure it has sufficient resource to meet corporate objectives over the period of the existing funding settlement.

We recognise that the Council has already taken action to improve its reserve position, however, further improvement of reserve balances may be necessary to reflect the current higher risk financial environment.

Action plan point 9

A Summary of Accounting Adjustments

Adjusted differences

	I&E Account/SMGFB		Balance Sheet	
	Dr £000s	Cr £000s	Dr £000s	Cr £000s
Adjustments to meet the reporting requirements for accounting for financial instruments:				
• adjustment to reflect accounting for writing off premiums on loans	313	313		
• adjustment for interest charges	(101)	(101)		
• restatement of *prior year* premiums transferred to the Financial Instruments Adjustment Accounts			4,907	4907
Correction for Government Grants incorrectly recorded in debtors			246	246
Transfer of Assets Under Construction to Surplus Assets			100	100
Adjustment to reflect administration costs in calculating gains on fixed asset disposals	96	96		
Adjustment to reflect HRA non-enhancing capital expenditure	91			91
Coding Errors in Brought Forward Balances.	393		58	393

Overall Impact

The overall impact of these audit adjustments is to reduce the general fund balance reported in the draft accounts from £5.2 million to £4.8 million. The level of un-earmarked reserves correspondingly falls from £0.8 million in the draft accounts to £0.4 million in the revised accounts.

Unadjusted differences

The are no unadjusted differences to report.

B Action Plan

No	Finding	Priority	Recommendation	Management Response	Implementation date and responsible officer
Prior Year Adjustments					
1	Audit adjustments corrected in the 2006-07 Accounts, had not been processed through the Council's ledger. This has overstated income during the 2007-08 financial year by £0.4 million, with a consequent overstatement of the level of reported general fund reserves during the year.	**High**	The Council should ensure agreed audit adjustments are corrected in the ledger timeously.	Agreed. Audit adjustments will be processed in the ledger as soon as the previous year's accounts are signed off by External Audit.	Head of Finance December 2008
Accounting for Fixed Assets					
2	The Council had made no adjustment for non-enhancing capital expenditure in its draft accounts and had not used component accounting for fixed assets.	Medium	The Council should amend its asset register to record the component elements of fixed assets. In particular, expenditure on kitchens and bathroom replacement programmes in council houses should be recorded separately within the asset register. The Council should review expenditure coded to capital at least annually, to identify non-enhancing capital expenditure.	Agreed. The review of expenditure will be undertaken annually.	Head of Finance June 2009

No	Finding	Priority	Recommendation	Management Response	Implementation date and responsible officer
3	We identified one asset with a value of £99,755 whose value has not altered since 2005. Work on re-developing the building has stopped and the Council has not yet brought forward plans for the future of this asset.	Medium	The Council should bring forward plans for utilising the re-developed building at Paton Mill.	Agreed. This particular building was included in a paper to Council dated 24th April 2008, where it was recognised that a decision on this building could be tied into the future of Kilncraigs. Given current market conditions, the resolution to this issue may now take longer than envisaged.	Head of Property Services September 2009
Third Party Trading					
4	The accounts record the income received by the Council from third party trading but does not record the cost of providing the services. As a result the Council is unable to determine if it provides these services at a profit or a loss.	Medium	The Council should review its arrangements for accounting third part trading and should consider setting up separate trading accounts within the ledger for these activities.	Agreed. The Council will endeavour to match the relevant costs against third party trading income.	Head of Finance June 2009
Common Good Funds					
5	Further work will be required by the Council during the 2008-09 financial year to consider the charitable status of trust funds, and to ensure compliance with the registration requirements of the Office of the Scottish Charity Regulator.	Medium	The Council should review its Trust Funds to ensure that adequate procedures are in place to comply with the registration requirements of the Office of the Scottish Charity Regulator.	Agreed. The Council will endeavour to comply with the registration requirements of the Office of the Scottish Charity Regulator.	Head of Finance June 2009

No	Finding	Priority	Recommendation	Management Response	Implementation date and responsible officer
Three Schools PPP Project					
6	The Council set out the affordability model for the Three Schools PPP Project based on information available at the planning stages of the Project. A number of significant issues have emerged which will require the Council to revise its affordability assumptions.	High	The Council should review the affordability model for the Three Schools PPP Project in light of new information.	Agreed. Some of the issues raised do not affect this Council in isolation. However, the figures will be reviewed to ensure the project remains affordable.	Head of Finance March 2009
Financial markets					
7	Financial markets have experienced significant uncertainty and volatility over the past 6 months as a result of the impact of the credit crunch on financial institutions, this has also resulted in consolidation within the UK financial industry.	Medium	The Council should review its arrangements for setting a monitoring counterparty limits to recognise the higher level of risk associated with current conditions within financial markets.	Agreed. The Council will undertake this review in conjunction with our Treasury Management advisors.	Payments Manager December 2008

No	Finding	Priority	Recommendation	Management Response	Implementation date and responsible officer
Ledger Development					
8	The Council has recently upgraded its ledger system to improve financial reporting functionality but did not fully test the upgrade prior to implementation. Management have confirmed that this was an isolated incident, and will ensure future upgrades are fully tested in line with existing practice.	Medium	The Council should fully test upgrades to IT systems prior to implementation.	Agreed, although we note that this was an exceptional case.	N/A
Looking Forward					
9	Since the production of the three year budget for 2008-09 to 2010-11, significant budgetary pressures have been identified that may impact on projected outturn figures.	**High**	The Council should review its financial plans and target reserve levels to ensure underlying financial assumptions remain valid, take account of emerging financial pressures and reflect the higher risk financial environment.	Agreed. Target reserve levels will be recalculated in light of emerging financial pressures.	Head of Finance January 2009

C Follow up of prior year recommendations

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
Financial Position					
1	At 31 March 2007 the Council had only £1 million of reserves which had not been earmarked to fund existing commitments. This does not meet the policy requirement to retain £1.8 million of unearmarked reserves. The current level of the Council's unearmarked reserves presents a significant risk that financial plans will not be achievable.	High	The Council should ensure it has sufficient reserves available to fund both existing commitments and unforeseen circumstances.	Agreed. Steps will be taken during the next few budget cycles to replenish reserves to an adequate level.	**In Progress** The Council's reserves at the end of the 2007-08 financial year was £x, which remains below the target level of £1.8m. The Council is taking action during the current financial year to increase the level of un-earmarked reserves.
Financial Management and Budgetary Control					
2	The decision not to include significant elements of expenditure within the Council budget represents a significant weakness in governance and financial reporting arrangements.	High	The Council should, in future ensure all planned income and expenditure is incorporated within its annual budget presented to members for approval.	Agreed, although these costs were regularly monitored during the year	**Implemented** The Council now includes all costs within budget estimates.

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
3	The Council had difficulty controlling the overall cost for financial advice for the Three Schools PPP Project and the contract was awarded on the basis of open ended day rates. This meant that the Council bore the majority of the contractual risk should the project be delayed or negotiations become more complex than anticipated	High	The Council should develop a policy for managing consultancy and advisory costs. In particular, the Council's contracting arrangements should ensure an adequate balance of risk is achieved between the supplier and the Council. The Council should only enter into day rate contracts for advisor's services on an exceptional basis and with appropriate safeguards to manage total project costs within agreed budgets.	Agreed	**Not Implemented** The Council has not yet developed a policy for managing consultancy and advisory costs. We note that the Council's contract for internal audit services was awarded on a day rate basis.
Three Schools PPP Project					
4	Under current local government financing regulations, the Council cannot apply capital receipts to a revenue purpose.	High	The Council should seek authorisation from the Scottish Government to apply capital receipts to the Three Schools PPP Project, before proceeding to implement its financing model.	Agreed. There seems to be a general anticipation that these projects will eventually feature on Councils' Balance Sheets, but in the meantime the Scottish Government will be approached	**Partially Implemented** Further discussions have been held with the Scottish Government. We will work with the Council over the coming year to evaluate proposals for funding the Three Schools PPP Project.

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
5	The Scottish Government has recently announced an intention to replace council tax with a form of local income tax, and is seeking agreement from councils to not increase council tax levels for 2007-08. This approach, if implemented, may have significant funding consequences for the Three Schools PPP Project.	Medium	The Council should review its funding model and affordability assumptions for the Three Schools PPP Project should a change in local government finance arrangements be agreed.	Agreed. The funding model will be reviewed, but with several other Councils in the same position we await advice from the Scottish Government about how these commitments are going to be financed.	**Partially Implemented** The Council's funding model has been reviewed, however, issues around affordability in light of restrictions on council tax increases have not been fully resolved.
Scottish Housing Quality Standard					
6	The Council has undergone a detailed process to assess how it will meet the Scottish Housing Quality Standard (SHQS), but has not yet formalised and approved its business plan to demonstrate how it will achieve this policy objective. This increases the risk that the Council will not have sufficient resources available to fully upgrade its housing stock by the 2015 deadline set by SHQS.	Medium	The Council should formalise its business plan to demonstrate how it will achieve its policy objective to meet and exceed the SHQS standard by 2015.	Agreed. Business Plan will be submitted to Council for approval	**Not Implemented** The Council's business plan for meeting the SHQS has not yet been formalised or approved by the Council.

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
Devolved School Management					
7	The Council holds £1.2 million of reserves devolved to schools for local education projects. This balance has increased each year since it was established in April 2003.	Medium	The Council should bring forward spending plans to ensure that this fund is used for the purposes intended, and for the benefit of local education services.	Agreed.	**Implemented** The Council has brought forward plans for apply devolved school management funds. Balances held under this scheme have fallen to £0.9 million during the financial year.
Trading Accounts					
8	The Property Contracts trading operation has a target to achieve a surplus of £0.25 million annually, but has not achieved this target for each of the last 3 years.	Medium	The Council should review its performance expectations in light of the recent financial performance of this trading operation.	Agreed	**Implemented** Property Contracts achieved its trading objective for the year and reported a surplus of £0.4 million significantly above target.

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
Council Tax Debtors					
9	The Council has provided for £5.5 million of council tax debt, calculated on the basis of 3.5% or 3% of income for each year. This approach may not sufficiently provide for potential bad debts.	Medium	The Council should undertake a review of council tax debtors to assess likely recoverability based on size and age of debt, and past collection performance, to ensure bad debts are sufficiently provided for within the Council's accounts.	Agreed.	**Implemented** The Council has reviewed its council tax debtors during the financial year, including its provision for bad debts.
Fixed Asset Register					
10	During the financial year, the Council identified two buildings in its ownership that had not been recorded within its asset register. This has resulted in an understatement of its fixed assets in prior years and in a lack of maintenance planning for these buildings.	Medium	The Council should review its fixed assets register against the register of ownership held by its legal department to ensure the fixed asset register is fully up to date. The Council should also circulate its asset register to services and request confirmation of its accuracy and completeness.	Agreed	**Partially Implemented** The Council reviewed the completeness of its asset register during the financial year. No unrecorded assets have been identified. The Council has not yet, however, circulated its asset register to services to confirm accuracy and completeness

No	Finding	Priority	Recommendation	Management Response	Position as at September 2008
Accounts Clearance Process					
11	There is no formal accounts approval process for submission of the draft accounts and this increases the risk of error in the draft financial statements. Scrutiny committee meetings were not scheduled to receive the draft accounts for approval, or to receive and review the external auditor's report on the draft accounts or the report from the Chief Internal Auditor on the systems of internal financial control. This represents a weakness in overall governance arrangements.	High	The Council should develop a policy for approving and submitting its draft accounts to the Accounts Commission and for ensuring appropriate scrutiny arrangements are in place prior to the accounts being signed and published.	Agreed	**Implemented** The Council has reviewed its accounts clearance process during the year and scheduled Council meetings to receive and review the draft external auditors report on the accounts and the internal auditors annual report on the systems of internal control.

Clackmannanshire Council

Report on the 2007-08 Audit

30 October 2008

Appendix 2

Contents **Page**

Appendices

1 Executive Summary

1.1 Introduction

This report summarises the outcome of our audit and key messages for members. We planned and performed our 2007-08 audit in accordance with our Audit Plan issued in February 2008. The Code of Audit Practice objectives and key findings for the audit are summarised in Exhibit 1 below.

Exhibit 1 - Key findings from the 2007-08 audit

Code Objective	Key Findings
Financial statements To provide an opinion on the Council's financial statements for the year ending 31 March 2008.	• We gave an unqualified opinion on the Council's 2007-08 financial statements on 30 September 2008. • The Council's finance team prepared well for implementing the 2007 Statement of Recommended Practice (SORP) and the standard of accounts and supporting working papers were generally good. • However, the Council's un-audited accounts included an error which had the effect of overstating income by £0.4 million. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million. • The Council has un-earmarked reserves of £0.4 million, significantly below the Council's policy to maintain a minimum required reserves balance of £1.8 million. • The Council continues to face significant financial pressures which may impact on its ability to meet existing budget commitments and achieve its corporate objectives. The development of a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget and adequate reserves level, continues to represent a key and immediate priority.
Governance To review and report on the Council's corporate governance arrangements, including: systems of internal financial control, arrangements for the prevention and detection of fraud and corruption, standards of conduct and the Council's financial position.	• We have concluded that the Council's systems of internal financial control are generally operating adequately. • The Council's governance arrangements are generally sound. There is scope to further develop the role of the scrutiny committee and to develop an assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. • The Council's internal audit section has undergone significant change in the past year. Internal audit continue to face a challenge in remaining fully resourced to deliver the 2008-09 audit plan, and a longer term plan is needed for delivery of a stable and robust internal audit function.
Performance To review and report on the Council's arrangements to achieve Best Value, other aspects of arrangements to manage performance in the use of resources, and arrangements for preparing and publishing statutory performance indicators.	• The Council is making good progress in addressing the key recommendations made in Audit Scotland's report on Best Value issued in September 2007. • The Council recognises that further development of performance and risk management systems is required to support the efficiency and improvement agenda. The Council has agreed to adopt the Public Sector Improvement Framework performance management model and is making good progress in developing its performance and risk management arrangements. • The significant financial constraints referred to above highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

1.2 Action needed by the Council

Our audit identified the following key actions for the Council in the coming year. The Council should:

- review arrangements for updating the ledger to ensure complete and accurate financial reporting to members during the financial year, and consistency with the draft accounts prior to submission for audit

- take urgent action to develop a sustainable medium term financial strategy, aligned to corporate priorities that delivers a balanced budget, incorporates anticipated efficiency savings, and maintains reserves at an acceptable level

- develop both the role of the scrutiny committee and the framework which supports it. In particular, the Council should move towards arrangements which would support an annual Statement on Internal Control, including strengthening internal audit, improving risk management arrangements and developing more tailored training for scrutiny committee members

- prioritise the development of a performance management framework across all Council services.

Detailed action plans have been agreed with the Council and included in our audit reports issued during the year (Appendix A).

1.3 Acknowledgements

We would like to take this opportunity to thank the staff who have been involved in the 2007-08 audit for their assistance and co-operation.

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.

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.

Grant Thornton UK LLP
30 October 2008

2 Financial Statements

2.1 Introduction

We have audited the Council's 2007-08 accounts in accordance with our Audit Plan issued in February 2008. The key messages arising from our financial statements audit are contained in our Report to those Charged with Governance, issued in September 2008 and summarised below.

2.2 Audit opinion

We gave an unqualified opinion on the Council's 2007-08 financial statements on 30 September 2008.

The Council's un-audited accounts included an error which had the effect of overstating income by £0.4 million. The error arose as the Council had not correctly updated the financial ledger at the beginning of the financial year to reflect audit adjustments made to the 2006-07 accounts. The correction of this error in the audited accounts reduced the Council's reported general fund balance from £5.2 million to £4.8 million.

2.3 Accounting requirements

The 2007 SORP introduced significant accounting changes for 2007-08, including the introduction of a revaluation reserve, the creation of a new capital adjustment account, and the introduction of new standards for the accounting and disclosure of financial instruments. The Council complied with the 2007 SORP in preparing its accounts. This was a significant achievement, particularly as a key member of the Council's small finance team was absent on long term sick leave during the accounts preparation and audit process.

2.4 International Financial Reporting Standards

The Council will be required to adopt International Financial Reporting Standards (IFRS) in the preparation of the 2010-11 accounts. The Council's 2009-10 accounts will also require to be re-stated under IFRS accounting rules to provide appropriate comparative information.

The adoption of IFRS is likely to have a significant impact on the way the Council's financial results are reported in the future, in particular it is likely that the assets leased as part of the Three Schools PPP scheme will require to be recorded on the Council's balance sheet.

Grant Thornton provides an annual training workshop for the Council's finance staff on developments in accounting and auditing standards and we will continue to work closely with the Council's finance team over the period of our appointment. It is important, however, that the Council prepares early for IFRS implementation.

2.5 Financial results

The Council reported a deficit on the Income and Expenditure account for 2007-08 of £14.2 million (2006-07: £10.8 million). The net increase on the general fund was £1 million (2006-07: £0.1 million decrease).

The increase in the general fund balance for the year can be attributed to the following key factors:

- higher than expected income from government grants (£1.3 million) and council tax (£0.9 million) due to the impact of the government's revised funding settlement and increased house building in the area which has raised the council tax base
- a reduction in the provision for bad debts (£0.2 million) to reflect improvements in council tax collection rates
- the surplus generated from trading activities (£0.5 million) was £0.1 million greater than budget
- increased income was offset by increased service costs. In particular, social work services costs were £0.75 million greater than budget, largely due to increased costs of residential care and foster care.

The Council performed well against budget overall, with outturn expenditure £1 million below budget for the year. This underspend has been carried forward as an earmarked reserve within the 2008-09 general fund.

2.6 General Fund

For the year ending 31 March 2008, the Council had a total general fund reserve balance of £4.8 million, of which £4.4 million was earmarked for specific purposes, leaving £0.4 million available for new expenditure or to meet the costs of contingencies and unforeseen events. This is below the Council's target level for un-earmarked reserves of £1.8 million.

The Council has set aside over £0.65 million from its 2008-09 budget to increase its level of un-earmarked reserves, however, it is unlikely that the target level of un-earmarked reserves will be met until 2009-10 at the earliest. We have recommended that the Council develops a medium term financial strategy which ensures it meets the target level of un-earmarked reserves as soon as practical.

We note that the Council's target level for reserves has not been calculated as part of a risk based assessment of the balances required to be held to meet contingencies and respond effectively to unforeseen events.

2.7 Housing Revenue Account

The Housing Revenue Account (HRA) ended the year with a deficit of £4.6 million, however, statutory adjustments mean that the HRA balance for the year increased by £0.9 million. This outcome was £0.9 million greater than budget, largely due to lower than expected capital financing costs and higher than expected rental income.

The accumulated balance on the HRA was £7.4 million at the year end (2006-07: £7.3 million). The Council has been increasing its HRA reserve balances in recent years to meet its commitment to exceed the requirements of the Scottish Housing Quality Standard (SHQS) by 2015.

2.8 Capital Expenditure and the Prudential Code

The Council incurred gross capital expenditure of £19.1 million during the year (2007: £22.6 million), reflecting a continued high level of spending on council housing (£9.3 million) to meet the SHQS, further development of the schools estate (£2.2 million) and upgrading of Kilncraigs (£1 million) in addition to a wide range of other capital development and improvement projects. The Council's outstanding debt rose from £95.2 million in 2006-07 to £110.9 million at 31 March 2008.

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. In February 2006 the Council approved an increase in the authorised limit for external debt to £161.1 million, with an increased operational boundary of £145 million. However, we note that the three year Capital Plan approved by the Council in February 2008 will result in net borrowing falling to less than half of the approved level for 2009-10 by 2010-11.

The planned increase in the Council's debt levels will result in a significant long term financial commitment to meet higher interest payments and repay the debt over time. The Council should fully consider these additional costs when developing a medium term financial strategy to address the cost pressures referred to above.

2.9 Three Schools PPP Project

The Council contracted for three replacement secondary schools to be built under a 'Public Private Partnership' (PPP) agreement during the 2007-08 financial year. This agreement commits the Council to pay an annual charge of £6.7 million (adjusted each year for inflation), over a 30 year contract period, in return for the construction of the schools which have a capital value of some £67 million.

The construction of the three schools has progressed well and they are all expected to become operational during the 2008-09 financial year. As part of the PPP contract, the Council has agreed to make a significant capital contribution of £16.35 million in three tranches, 6 months after each of the schools becomes operational. This means that these payments will be due in 2008-09.

The Council's financial model for the Project sets out an expectation that the capital injection would be funded from capital receipts generated mainly from the sale of surplus land from the replaced school sites. We note that recent changes in economic conditions have deflated property prices across the UK and, as a result, the Council is unlikely to generate the level of capital receipts anticipated. This will create a funding gap and will require the Council to re-visit its financial model for the PPP Project.

The Council had also planned to part-fund the Project from above inflation increases in council tax for 12 years of the contract. The Scottish Government has confirmed its intention to replace council tax with a form of local income tax and has reached an agreement from councils not to increase council tax levels as part of the 'concordat' with local government. We note that the financial settlement for the Council does not incorporate an allowance to meet the existing commitment to fund the PPP Project.

In addition, the Council had planned to use £0.2 million per annum from Schools Fund grant to fund the Project. Recent changes to the funding arrangements for local government now mean that this grant can no longer be applied to fund PPP Projects.

As we reported in 2006-07, PPP Projects are set up as contracts for the provision of services and are revenue in nature. Under current local government financing regulations, the Council cannot apply capital receipts to a revenue purpose. Our 2006-07 report recommended that the Council seek formal authorisation from the Scottish Government to apply capital receipts to the Project before proceeding to implement its existing financing model. We note that formal authorisation has not yet been obtained.

2.10 Single Status and Equal Pay

The Council has recognised that its current pay structure is not consistent with the requirements of the Equal Pay Act 1970 and this is reflected in compromise payments of £0.4 million to some categories of employees during the financial year.

In addition, the Council set aside £1.2 million from its 2006-07 and 2007-08 budgets for costs associated with the implementation of the Single Status Agreement (Red Book) which contains national conditions of service for local government employees.

As we reported in 2006-07, the Council has not yet implemented a new pay and grading model or made an offer to employees on the implementation of single status. It remains important that the Council formalise agreements on single status and equal pay issues with employees in the near future, to establish financial certainty over the likely costs associated with implementing the new agreements, to resolve existing claims for compensation, and to limit the potential for future claims to emerge.

2.11 Key actions going forward

In summary, the key recommendations arising from our audit of the financial statements are that the Council should:

1. Address the underlying financial position of the Council

- take urgent action to ensure un-earmarked reserves reach their target level as soon as practicable
- develop a sustainable medium term financial strategy, aligned to corporate priorities, that delivers a balanced budget, as a key and immediate priority
- formalise agreements on single status and equal pay issues with employees in the near future
- re-visit the affordability model for the Three Schools PPP Project to ensure it reflects the Council's current financial circumstances and wider economic conditions. In particular, the Council should formalise financing arrangements for the contracted capital injection to the Project.

2. Prepare for the 2008-09 accounts and future year's accounts

- take early action to prepare for the implementation of International Financial Reporting Standards
- review arrangements for updating the ledger to ensure complete and accurate financial reporting to members during the financial year, and consistency with the draft accounts prior to submission for audit

A detailed action plan has been agreed with the Council to address these key issues and is contained in our ISA260 Report on the 2007-08 Annual Accounts issued in September 2008.

3 Governance

3.1 Introduction

In accordance with the 2007-08 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 report issued in September 2008. Key messages are summarised below.

3.2 Overview of arrangements in 2007-08

We have concluded that the Council's systems of internal financial control and governance arrangements are generally operating adequately. Key findings from our review included:

- the Council generally has good arrangements for financial management and budgetary control. However, we noted that there is scope to align departmental budgets more clearly with corporate priorities

- the Council is required to achieve efficiency savings of 2% of budget (around £2 million) to meet government targets. In addition, financial pressures will require additional savings of around £1 million to deliver a balanced budget for 2008-09. The Council currently monitors efficiency savings generated through the involvement of the Business Improvement Team through the Customer First Project Steering Group, and is in the process of developing its arrangements for monitoring and reporting efficiency savings through that Group, but does not yet have a systematic approach to monitoring, measuring or reporting the achievement of efficiency savings generated through the budget process.

- the current volatility within the financial markets increases the risk of failure of investment institutions, and the Council should review its treasury management policy as a result.

3.3 Audit Committee arrangements

CIPFA recommends that all local authorities have an audit committee in place. In Clackmannanshire Council, the audit committee role is mainly undertaken by the Scrutiny Committee although the full Council has sole responsibility for reviewing and approving the financial statements. Our review found that the Scrutiny Committee complies with a number of the good practice principles outlined in the CIPFA guidance. However, we identified some areas where arrangements could be improved, including:

- reviewing and updating the committee's remit to ensure it incorporates all the areas recommended by CIPFA

- completing an annual self-review of the effectiveness of the committee, particularly in relation to its role as the Council's audit committee

- establishing a formal training programme tailored to meet the needs of Scrutiny Committee members

3.4 Internal Audit

As part of our 2006-07 audit, we reviewed the Council's internal audit department against the eleven standards set out in the Code of Practice for Internal Audit.

We found that the internal audit section did well in undertaking and reporting its work but had not made sufficient progress in meeting the Code of Practice on Internal Audit requirements since Audit Scotland's national review in 2001. Key findings from our review included:

- internal audit was not sufficiently resourced to deliver its audit plan effectively
- the skills and competency levels required for each grade of auditor had not been defined and formal annual performance appraisals had not been undertaken
- internal audit work was not prioritised by risk, and audit resources were not systematically targeted to areas of highest risk. This reduced the effectiveness of internal audit work
- there were no formal performance measurements or targets assigned to internal audit.

Since our report, the Council's Internal Audit department has experienced significant change as two key members of staff left the department in 2007-08. The Head of Finance contracted with Scott-Moncreiff to provide additional internal audit resource during the financial year to help deliver the audit plan and a new senior auditor was appointed in May 2008.

Internal audit continue to face a challenge in remaining fully resourced to deliver the 2008-09 audit plan and a longer term plan continues to be needed for the delivery of a stable and robust internal audit function.

In light of the significant change undergone within the internal audit department, we have agreed to follow up the progress made in addressing the key recommendations made in our 2006-07 report during our 2008-09 audit.

3.5 Statement of Internal Financial Control

The Head of Finance's 'Statement on the Systems of Internal Financial Control' (SIFC) is included within the annual accounts and concludes that reasonable assurance can be placed on the adequacy and effectiveness of the Council's internal financial control systems. This conclusion is supported by the work of Internal Audit.

As we reported in 2006-07, the Council should plan to replace the SIFC with an annual Statement on Internal Control (SIC) in its financial statements in order to the meet best practice in governance and in the presentation of its financial statements. The SIC provides assurance on the adequacy and effectiveness of all of the Council's systems (including those covering risk and performance) and is not restricted to financial systems only.

The Council should develop an appropriate assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts. This framework should include effective risk management arrangements, an extension of the role of internal audit to provide assurances on the operation of non-financial systems, and arrangements to enable Directors to provide signed 'statements of assurance' each year confirming the effective operation of systems of internal control.

3.6 National Fraud Initiative

The Council participates in the National Fraud Initiative (NFI) exercise, and has identified significant savings following its 2007-08 review. We found a number of areas for improvement in the Council's arrangements for participating in the NFI exercise, in particular the need to update the key contact and co-ordinator roles, and for improved documentation of progress monitoring of case matches.

3.7 Follow up of prior year recommendations

We are pleased to report that the Council has made good progress in implementing the agreed audit recommendations made in our 2006-07 report. Five of the eleven recommendations are fully implemented, three are partially implemented, with progress on a further recommendation ongoing. Further information on the results of our follow-up review is reported in our ISA 260 Report issued in September 2008.

3.8 Key actions going forward

In summary, the key recommendations arising from our governance audit are that the Council should:

- review its treasury management policy to ensure it adequately reflects the higher risk of failure of investment institutions in the current financial climate

- review the role and remit of the scrutiny committee to ensure it continues to meet corporate governance objectives and incorporates all the areas recommended by CIPFA

- develop a longer term plan for internal audit to ensure it remains fully resourced to meet audit plan commitments

- develop an appropriate assurance framework to support the inclusion of a Statement on Internal Control in the Council's annual accounts.

A detailed action plan has been agreed with the Council to address these key issues and is contained in our Interim Report issued in September 2008.

4 Performance

4.1 Introduction

In accordance with the 2007-08 Audit Plan we have reviewed key aspects of the Council's performance arrangements during 2007-08. The detailed findings from our performance review are contained in our Interim Report and Best Value follow-up Report issued in October 2008. The key findings from these audits of the Council's performance arrangements are summarised below.

4.2 Best Value

Audit Scotland issued its report on Best Value to the Council in September 2007. The report found that the Council faces a number of significant challenges arising from the relatively small scale of its operations, the social, economic and geographical circumstances of the Clackmannanshire area, and the lack of good transport links. Audit Scotland recommended improvement in the following key areas if the Council is to achieve best value:

- more effective leadership by elected members;
- sharper articulation of priorities and policies with a clearer linkage to resource decisions;
- greater consistency between community, corporate and service plans;
- improved political structures which give clarity on roles and responsibilities;
- a clearer approach to competition in relation to service delivery mechanisms; and
- development of a human resources strategy.

The Council issued its Best Value Improvement Agenda Action Plan in February 2008 which set out how it would respond to the recommendations made by Audit Scotland. As part of our 2007-08 audit, we followed up the Council's progress in addressing the issues raised by Audit Scotland.

We found that the Council has responded positively to the Best Value report and is making good progress in implementing the Action Plan developed to address Audit Scotland's recommendations. Key developments have included:

- development, together with community planning partners, of the Single Outcome Agreement (SOA) to direct improvement activity and investment
- further development of the Council's corporate plan and community plans, building on the SOA, to improve clarity and consistency of corporate aims and objectives
- the Council has agreed to adopt the Public Service Improvement Framework (PSIF) methodology as a basis for improving performance monitoring and reporting arrangements

- agreement of a new 'Scheme of Delegation' to clarify the roles and responsibilities of members and officers.

We issued our draft report on our follow-up review to the Council in October 2008 and we are in the process of agreeing this report with management. Our findings will be reported to the Scrutiny Committee when this process is complete.

4.3 Efficient Government

The efficient government initiative is a central part of the government's programme of investment, reform and modernisation. The Efficient Government Plan sets targets for local government bodies to achieve 2% cash-releasing savings by 2010-11, for Clackmannanshire Council this equates to a savings target of around £2 million over the three year reporting period.

In order to claim an efficiency, the Council needs to demonstrate that service outcomes have been maintained or improved and this can only be achieved through a robust performance management system that captures information and baseline data covering both cost and quality aspects of service provision. As we reported in 2006-07, the Council is currently at an early stage in developing such a system.

The Council recognises the need to further develop its performance systems to support the 'efficiency statement' it is required to submit annually to the Scottish Government. In particular, the Council produces limited information on service quality and volume.

In its 2007-08 'efficiency statement', the Council estimates that it achieved cash releasing efficiency savings of £3.4 million (representing 3.4% of its net cost of services) for that year and forecasts that additional savings of up to £1 million will be required for the 2008-09 financial year.

The significant financial constraints referred to earlier in this report highlight the priority need to bring forward a programme of efficiency reviews across all Council operations.

4.4 Performance Management

The Council is in the process of developing its performance management framework, including the adoption of the PSIF framework as outlined above, and recognises that much work needs to be done in this area, including:

- further development of performance targets and milestones that are aligned to corporate priorities

- improved arrangements for monitoring performance against targets, benchmarks and over time

- more focus on key performance information requirements, including information on service outcomes including measures of quality and volume

- further development of performance management reporting arrangements, including the frequency and format of reports for members and all levels of management

- clearer arrangements for identifying and tackling poor performance.

The Council is required to prepare statutory performance indicators (SPIs) in accordance with a direction issued annually by the Accounts Commission. We audit these indicators to ensure they are prepared in accordance with the guidance. In the absence of locally determined performance measures, SPIs represent the main source of performance information for the Council.

The Council's has generally satisfactory arrangements for producing SPI information, but has been unable to produce reliable performance information for one of the 78 SPIs relating to the number of low demand houses remaining un-let at year end and the number of days and average time that these houses had been un-let at year end. The Council is taking action to ensure the information for this SPI is available for 2008-09.

4.5 Key actions going forward

In summary, the key recommendations arising from our performance audit are that the Council should:

- further develop its performance and risk management systems to support the efficiency and improvement agenda within the Council and to better monitor and manage the performance of the Community Planning Partnership

- there is a priority need to bring forward a programme of efficiency reviews across all Council operations.

A detailed action plan has been agreed with the Council to address these key issues and is contained in our Interim Report and Best Value Follow Up Report issued in October 2008.

Grant Thornton UK LLP
30 October 2008

Appendix A

Audit Reports Issued During the Year

A summary of the audit reports issued during 2007-08 is provided below:

Report Title	Key Topic	Month Issued
Annual Audit Plan	Summary of the 2007-08 planned audit work, demonstrating how we will discharge our responsibilities under Audit Scotland's Code of Audit Practice.	February 2008
Interim Report	Review of the operation of the Council's key financial systems and governance arrangements.	September 2008
Report on the 2007-08 Accounts Audit	Summary of key issues emerging from the audit of the Council's financial statements.	September 2008
Annual Report to Members	Summary of the key issues emerging from the 2007-08 audit.	October 2008
Follow-Up Review of Best Value	Summary of the Councils progress in addressing the recommendations made in Audit Scotland's Best Value Report issued in September 2007.	October 2008