City of Edinburgh Council

Annual report on the 2010/11 audit

Prepared for Members of City of Edinburgh Council and the Controller of Audit
October 2011

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

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Key messages

2010/11

We have given an unqualified opinion on the financial statements of City of Edinburgh Council. However, our opinion draws attention to the failure of five significant trading operations (direct cleaning, BlindCraft, catering services – school and welfare catering, catering services - other catering, and refuse collection) to breakeven on a rolling three year basis despite action taken by management to address on-going issues. Four of these significant trading operations (STOs) have made deficits for the past four years which, to some extent, have arisen from the settlement of equal pay claims. BlindCraft's services were terminated from Summer 2011 and, in respect of other STO services which failed to meet financial targets, improvements in service delivery are being considered through the council's Alternative Business Models project.

In 2010/11, the council spent £1.7 billion on the provision of public services, with £1.4 billion on revenue services and the remainder on its capital programme. In overall terms, all services managed their budgets with all departments achieving surpluses again this year. This enabled the council to return a surplus of £2.7 million which together with an increase of £13.8 million in earmarked balances assisted the council to increase its general fund to £89.6 million. By 31 March 2011, the council was one year early in achieving plans to restore its unallocated general fund balance to £12.8 million representing 1% of expenditure.

The tram project continued to face disruption during 2010/11 as a result of the ongoing dispute with the contractor. A mediation process was carried out in March 2011 and resulted in a Settlement Agreement which, amongst other things, settled historical claims that had been in dispute and provided terms for a lump sum to complete the off street section of the tram works. Costed options and funding proposals were prepared for elected members and were the subject of council discussions over the period June to September 2011. Political approval was finally reached to progress the line to St Andrew Square and the Settlement Agreement was signed in September 2011. Amendments were made to the financial statements to accrue the historical claims and to provide for impairment of assets for work already undertaken beyond St Andrew Square.

At 31 March 2011, the council had £1.3 billion debt, an increase of £87 million compared to the previous year. Additional funding of £231 million is required for the tram project which will be obtained through prudential borrowing and will cost £15 million per annum to finance.

New governance arrangements for the tram project have still to bed-in. While these have introduced some important changes in terms of roles and responsibilities and provide for prompt escalation of problems, the council will need to be reassured that accountability for delivery is clear and that the arrangements effectively provide for regular reporting and scrutiny of progress and risk.

With the exception of the following matters, we generally found that the council had satisfactory governance arrangements in place.

- The Audit Committee continued to consider its role in terms of scrutiny and is likely to have a monitoring role with regard to the tram project.
- Matters with the Department for Work and Pensions in relation to overpayments arising from previous years audits of the housing benefit subsidy claims have been concluded. Consequently, following consideration by the Secretary of State £2.2 million was recovered from the council between January and April 2011.
- An investigation has been ongoing within the council's property services largely related to its statutory repairs service. It will therefore be important for the council to review and strengthen its governance arrangements and ensure staff are reminded of important policies and the implications for non-compliance.

Outlook

Looking ahead, it is clear that the outlook for public spending for the period 2012/13 to 2014/15 remains challenging. The recently published Scottish Spending Review 2011 indicates that significant budget reductions will continue to be required over the next few years.

City of Edinburgh Council has responded well to the financial pressures in recent years with all services achieving outturns within budget for the second year in a row. Going forward however the council’s overall revenue budget funding projections for the next 3 years continue to indicate a funding shortfall of approximately £90 million. Significant savings are anticipated from procurement activities and the redesign of services within the remit of the Alternative Business Models project.

In May 2011, we concluded our shared risk assessment and assurance and improvement plan (AIP) for the council. This document was produced by the local area network of scrutiny bodies and describes the work planned on corporate activities over the next three years. The Best Value 2 audit is proposed for 2012/13. An important element of the best value audit is the extent of a council's self-evaluation activity. City of Edinburgh Council uses the Edinburgh Improvement Model and is on the second round of reviews. The first round was council wide and comprehensively covered areas across services.

The co-operation and assistance given to us by City of Edinburgh Council members, officers and staff is gratefully acknowledged.

Introduction

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

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

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

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

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

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

Financial statements

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

8. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:

   - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
   - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

9. Auditors review and report on, as appropriate, other information published with the financial statements, including the foreword, annual governance statement, and the remuneration report. This section summarises the results of our audit on the financial statements.

Audit opinion

10. We have given an unqualified opinion that the financial statements of City of Edinburgh Council for 2010/11 give a true and fair view of the financial position and expenditure and income of the council and its group for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

11. We have, however, drawn attention to a failure to comply with the Local Government in Scotland Act 2003. Five significant trading operations (STOs) have failed to breakeven, on a cumulative basis, over a three year period. The STOs are: catering services – school and welfare catering, Refuse Collection (including Trade Waste), BlindCraft, direct cleaning, and catering services - other catering. Although this does not affect the overall opinion on the accounts, for several years now we have reported a failure to comply on these services. While deficits in respect of cleaning and catering services were after meeting the costs of equal pay claims, the inability of these services to meet their financial objectives may be a sign that value for money is not being achieved.

12. After considering options for a number of years, the council decided to terminate BlindCraft's services from Summer 2011. In respect of other STO services which have failed to meet their financial targets, improvements in service delivery and costs are being considered through the council's Alternative Business Models project. This is covered in more detail in paragraphs 80 to 89.

Legality

13. Through our planned audit work we consider the legality of the council's financial transactions. In addition the Acting Director of Finance confirmed that, to the best of her knowledge and belief, and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with relevant legislation and regulations. There are no legality issues arising from our audit which require to be brought to members' attention.

Annual governance statement

14. As part of our annual audit we review the disclosures made in the annual governance statement and the process for obtaining sufficient assurance to inform the content of the statement.

15. During the audit process, the governance statement was revised to give wider consideration of the group by distinguishing improvements required by the council separately from those required by the group.

16. We were satisfied with the disclosures made in the revised governance statement and the adequacy of the process put in place by the council to obtain assurances from service directors. The quality of the statement is improving but should continue to be strengthened in respect of the group. This is particularly important given the prominence the council has correctly given to group accounts within its 2010/11 financial statements.

17. It is important that the disclosures made in the governance statement are supported by action plans setting out how the necessary improvements will be delivered with an emphasis on the next 12 months. Certain matters brought forward from the previous year, for example, review of the scrutiny function of council committees, delivery of a robust procurement strategy and completion of a review of group re-structuring, have not been undertaken. We would suggest that the Audit Committee takes responsibility for monitoring the governance statement and supporting action plans on a more formal basis. (Refer to Governance and Accountability section of this report, paragraph 96).

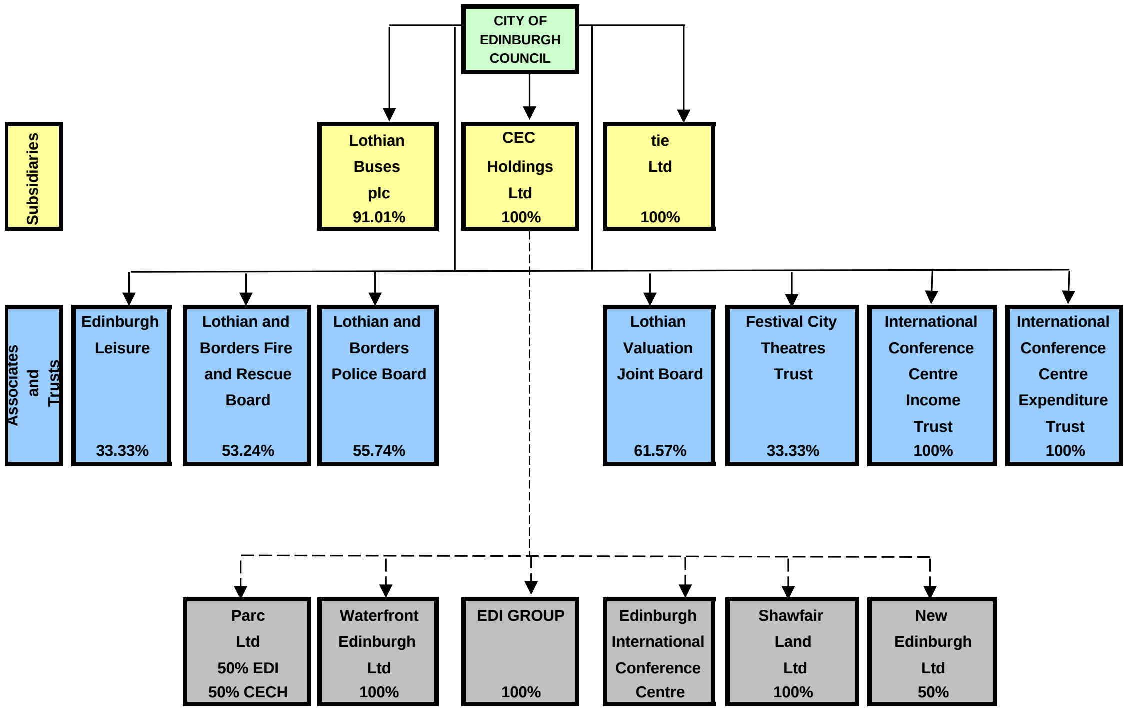
Refer Action Plan No. 1

Remuneration report

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

Group accounts

Exhibit 1 - City of Edinburgh Council Group Structure



19. The council has interests in three subsidiaries and a total of seven associates and trusts which are consolidated in the group accounts. In addition the EDI Group has interests in a further 20 active entities as well a number of dormant companies. All of these interests have been included in group accounts in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 and are shown in Exhibit 1.

20. Audit assurances were obtained through reviews of board minutes, correspondence and legal documents, and audited accounts. In accordance with ISA 600 'Using the work of another auditor', we completed this work through a mix of audit questionnaires and meetings with external auditors responsible for the audits of the higher risk entities within the group to discuss their approach and outcome of their audits. This provided useful context and assurance to enable us to conclude our audit of the group.

21. At 31 March 2011, the group balance sheet shows net assets of £909 million. Overall the pension liabilities account for £1.436 billion of which £904 million relates to Lothian & Borders Police. As a constituent member, the council has an obligation to meet a proportion of the expenditure of the joint boards and with regard to Lothian & Borders Police, its pension liabilities are £1.622 billion of which the group's share amounts to £904 million (55.7%). Pension liabilities will be funded as they fall due through employee and employer contributions and revenues generated from pension fund investments.

22. Following the conclusion of our audit of the group financial statements, we would like to highlight the following issues:

- In accordance with recommended accounting practice, key policies for component bodies such as pension costs and the valuation of non-current assets at market value have been aligned with the council's accounting policies.
- Overall, we feel there is scope to strengthen the existing accounting and auditing arrangements for individual entities to support earlier closure of the audited group accounts. Currently, the conclusion of audits of component companies runs into September each year resulting in late changes to the council's group accounts. From 2011/12 audits, we will fully comply with ISA 600 in respect of group accounts by earlier engagement with other auditors at the planning stage of the audit so that more direction on the assurances required for component bodies can be agreed.
- On 27 September 2011, the board of Transport Edinburgh Limited (TEL) approved the termination of its operating agreement with the council. As a result, the boards of TEL and tie Limited were reduced to the statutory minimum but the companies will continue as legal entities for contractual reasons. This decision was made following certification of tie Limited's accounts in August 2011. The auditor included an emphasis of matter paragraph in tie Limited's audit opinion to highlight the uncertainty of the tram project pending the council decision in September 2011. Consequently, no going concern issues were identified as the company continued to be supported by council guarantees. In order to reflect the impact of the council decision and the reduction in TEL and tie Limited's activities, this matter together with an estimate of the associated costs, featured as a post balance sheet event in the council's group accounts.
- With the exception of tie Limited (mentioned above) and Festival City Theatres Trust, all bodies within the group received unqualified audit opinions from their external auditors. Similar to tie, the Theatres Trust has an emphasis of matter paragraph to highlight going concern issues in the current economic climate.
- The council commenced a review of its group structure in 2008/09 with a view to streamlining governance arrangements. In 2009/10, the focus was on stabilising the financial position of EDI and Waterfront Edinburgh Limited and in 2010/11, the council's attention has been absorbed in developing options for the future of the tram project. Consequently, the council has not concluded its review of its group structure.

Refer Action Plan No. 2

23. Issues arising associated with group governance arrangements are discussed within the Governance and Accountability section of this report.

Accounting issues

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

Accounts submission

25. The council's financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources. The council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Overall, working papers have continued to improve although there are areas where audit trails and explanations could be strengthened, for example, service debtors and creditors, and notes to the accounts such as related parties and grant income.

26. The accounts were certified by the target date of 30 September 2011. They were presented to council on 27 October 2011 and are now available for publication.

Presentational and monetary adjustments to the unaudited accounts

27. On conclusion of the audit, there were a number of presentational changes made to the accounts. Each year there are also a number of changes to the group accounts to reflect the audited results submitted by group companies in September. A number of matters were identified during the audit, including further clarification on the future of the tram project, and the consequent adjustments to the accounts had the net effect of increasing the surplus for the year shown in the group comprehensive income and expenditure statement by £67 million. The resulting impact on the group net assets position was an associated increase of £39 million.

28. The most significant items related to:

- An increase in non-current assets of £59.9 million, revenue of £6.7 million and provisions of £67 million to reflect payment in 2011/12 of an amount to clear disputed historical claims in respect of the tram project. With the change in accounting for capital grants required by the 2010 Code, the associated grant was all reflected in the comprehensive income and expenditure account. This matter is covered in more detail later at paragraph 35.
- An increase in accruals of £1.2 million for redundancy costs to reflect the council's decision in 2010/11 to terminate BlindCraft's activities. The Code requires that such costs are accrued when the decision is made and clear plans exist for staff departure rather than the date employment ceases.
- An increase in bad debt provisions amounting to £0.5 million in respect of outstanding debt arising from statutory repairs activities. The overall provision is discussed in paragraph 44.

Prior year adjustments

29. The 2010/11 financial statements have been prepared in accordance with the 2010 Code which is based on International Financial Reporting Standards (IFRS) instead of the previous practice of preparing financial statements under UK Generally Accepted Accounting Practice (GAAP). The implementation of IFRS had been on a phased basis with full compliance from 2010/11. For example, in the previous year, the council brought school PPP assets onto the balance sheet, identified a range of leases and reclassified investment properties. However, the transition to full compliance required prior year adjustments to the 2009/10 audited financial statements and the restatement of the 1 April 2009 opening balance sheet position. The main areas that required restatement included the treatment of capital grants and the inclusion of an accrual for employee benefits such as annual leave.

30. We undertook an initial review of the restated balance sheets earlier in the year and found that significant work had been undertaken by Finance's Corporate Accounts team to develop an approach, and prior year adjustments were robust and well supported. These adjustments resulted in the net asset position of the council as at 31 March 2010 changing from a negative position of £155 million to a positive position of £286 million, a movement of £441 million. However, the accounting nature of these adjustments means that there has been no change to the usable reserves of the council. Overall, there were no significant concerns arising from the audit of the prior year adjustments.

31. In addition, a prior year adjustment was also required to the council's group statements in respect of an error identified in the methodology used by the actuary for Police and Fire boards in previous years, to calculate the pension liability associated with injury benefits. In prior years this had been calculated by the actuary on the basis of benefits currently in payment but in 2010/11, the basis changed to include an estimate of active scheme members who may be paid benefit in the future. As this represented a change in accounting policy, it required a prior year adjustment to be made which impacted on both the prior year comparatives and in-year movements on the group balance sheet. The overall impact of this adjustment was to reduce the net asset position on the group balance sheet by £54 million (2009/10 £61 million).

Tram infrastructure

32. Costs associated with the tram project have been reflected as capital expenditure in the council's accounts and are disclosed in non-current assets as infrastructure assets (e.g. tram infrastructure, utilities work) and assets under construction (e.g. depot, tram cars). Over the past 12 months in particular, the project has been subject to dispute with little on-road activity progressing. Throughout 2010/11, reports to council were anticipated which would provide options with full costs. However, the detail was not available until June 2011. Efforts were made to resolve matters but, with no progress, a mediation process involving the council, tie Limited and the consortium members was initiated in March 2011 to reach a conclusion on the next steps for the project.

33. Following mediation, the council, tie and the consortium members entered into a prioritised works agreement in May 2011 which provided for the re-commencement of infrastructure works in certain priority locations and the transfer of materials and equipment to council ownership. Officers spent the following weeks calculating the detail for the amount to be paid and costing different options for the future of the project in order that a decision could be made by council. The costs for the preferred option to St Andrew Square were estimated at £776 million with a substantial element of the outstanding sum being the clearance of historical claims. Following approval by council of the option to St Andrew Square in September 2011, the parties entered into a settlement agreement to make the agreed changes to the contractual arrangements with the consortium and to settle historical claims which had been in dispute.

34. We gave particular consideration to the accounting treatment of the historical claims in the accounts for 2010/11 and to ensure distinction between those costs which could correctly be charged to capital and those which were revenue in nature. Accounting practice set out in International Accounting Standards and supported by the 2010 Code requires that abnormal costs arising from inefficiencies (e.g. delays and design faults) should not be capitalised.

35. An amount of £67 million was identified in relation to historical claims. In considering the accounting treatment, there were two main issues to resolve. Firstly, to ensure that the historical claims were accrued in the 2010/11 accounts, either as capital or revenue and secondly, to consider the impact for the council in terms of identifying funding streams to support this expenditure. To address this matter, an additional £59.9 million was added to non-current assets as capital expenditure and £6.7 million was charged to revenue. Government grant was also accrued in line with existing funding patterns as Transport Scotland's grant offer letter describes eligible costs as any cost associated with the tram project. The main matters reflected in the above amendments to the accounts involved:

- Impairment of assets for costs incurred beyond St Andrew Square
- Aborted costs in respect of line 1b now charged to revenue
- Communication costs in respect of additional media contact now charged to revenue.

36. In addition, a further sum of £2.3 million representing legal costs associated with dispute resolution and mediation was separately identified and charged to revenue. This was considered to be beyond normal costs associated with a project of this nature and should therefore be charged to revenue.

Utilities work

37. All utilities works to date have been included as part of the tram infrastructure costs; under international accounting standards capital expenditure costs associated with a project may include other incremental costs to an entity that would have been avoided only if the tangible asset had not been constructed or acquired.

Tram cars

38. At 31 March 2011, all 27 tram cars were constructed but were undergoing technical and safety checks by the contractor. In terms of the accounts these are valued at £32 million within assets under construction. With the council's decision to terminate the line at St Andrew Square only 17 trams will be operationally required. Different options are being investigated by the council to lease the trams elsewhere but no deal has yet been concluded. If no options for alternative use are forthcoming and especially once the council takes delivery of the tram cars, there is a need for an impairment review to be considered in regard to the surplus cars.

Refer Action Plan No. 3

Equal pay claims and the implementation of single status

39. At 31 March 2011, the council had a provision of £48 million in respect of Equal pay compensation costs, an increase of £12 million on the previous year. In addition, the council had earmarked balances of £8.7 million to fund equal pay claims and the contingent liabilities note reflects the potential additional liability for pay protection cases with the implementation of Single Status with effect from October 2010. During 2010/11, the council paid out £18 million bringing the total payments to date to £90 million.

40. A provision should be recognised when there is a present obligation at the end of the reporting period as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate of the amount can be calculated.

41. In calculating the provision, the council has made a range of assumptions about the level of payments likely to arise in respect of different categories of claims. Actual liabilities are, however, dependent on the outcome of tribunals and legal opinion on settlement and may produce a different outcome. The council should compare its actual payments for particular groups against original assumptions to determine the level of accuracy in its estimates. Such outcomes should influence existing and future assumptions.

42. We acknowledge that the calculations for the equal pay provision are complex and the council has been thorough in its approach. However, in our view the council has been overly prudent in estimating the level of provision required at 31 March 2011. We recommend that practices and assumptions for estimating provisions and identifying contingent liabilities are reviewed in preparation for the 2011/12 financial statements.

Refer Action Plan No. 4

Statutory Repairs

43. An investigation has been ongoing for approximately six months into alleged improper practices in the council's statutory repairs service. We had anticipated that this might lead to an increase in the number of legal claims raised against the council for which some provision may be required in the financial statements. We have obtained management assurances to confirm that all appropriate disclosures have been made in the financial statements. For example, given the potential risks identified around this service and recent publicity, it was considered prudent to include a contingent liability within the accounts to reflect the possibility that the council may be exposed to claims for compensation.

44. As part of our overall work on debtors, we considered the collectability of outstanding debt in relation to this service. At 31 March 2011, outstanding debt in relation to statutory repairs amounted to £12 million of which £3 million is older than 12 months and there was a further £29 million of accrued income still to be billed. In total, the council has a provision for non-collection amounting to £1.25 million. We are concerned that the provision against non-collection of debts is understated. The adequacy of the provision should be kept under review with the level of unbilled works closely monitored.

Refer Action Plan No. 4

Pension costs

45. City of Edinburgh Council is a member of the Lothian Pension Fund which is a multi-employer defined benefit scheme. In accordance with pensions accounting standard IAS19 'Retirement Benefits', the council has recognised its share of the net liabilities for the pension fund in the balance sheet. For 2010/11, this has decreased from £680 million to £336 million based on the latest annual IAS19 valuation for accounting purposes undertaken by the actuary. This considers the long term view for the council in meeting its future commitments having taken employers' contribution rates and revenues generated from investments into account.

46. The decision to uprate pensions in line with the Consumer Price Index (CPI) rather than the Retail Price Index (RPI), announced by the Chancellor of the Exchequer in the June 2010 emergency budget has resulted in a one-off past service gain of £183 million in the Comprehensive Income and Expenditure Statement in 2010/11. This has substantially reduced employee costs and the net liability from 2009/10. This treatment is consistent with accounting requirements and we are satisfied that this has been accurately reflected in the 2010/11 financial statements.

47. Exhibit 2 shows the decrease in Edinburgh's net liability deficit compared to previous years. This deficit does not require an immediate cash injection but is intended to be funded by increased contributions over the long term.

Exhibit 2 - IAS19 Net pension liability/deficit

	2010/11 £000	2009/10 £000	2008/09 £000
Fair value of assets	1,507,428	1,417,285	1,038,933
Liabilities - present value of defined benefit obligation	(1,843,330)	(2,096,893)	(1,315,114)
Net pension liability/Deficit	(335,902)	(679,608)	(276,181)
Discount rate	5.5%	5.5%	6.9%

Trust funds

48. Charitable bodies are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006 (Charities Regulations), meaning a full set of financial statements is required for each trust fund. However, the Office of the Scottish Charities Regulator (OSCR) has largely deferred full implementation of these requirements until 2013/14, allowing the council to rely on its existing disclosures for trust funds in the council's financial statements, supplemented with additional working papers.

49. City of Edinburgh Council has been moving forward with restructuring its trusts, and in improving its governance arrangements, the council has for several years been preparing a separate annual report and accounts for its Trust Funds. The assets held by the Trust Funds now exceed OSCR's thresholds and therefore a full audit in accordance with Charities Regulations has been requested in respect of 2010/11. We will therefore carry out this audit and provide a separate audit opinion by December 2011 in accordance with prescribed timescales.

50. OSCR's feedback on the 2009/10 submissions from each local authority allocates councils to one of four categories: fully compliant (0 councils), above average (2 councils), average (20 councils) and below average (8 councils). Edinburgh's submission fell into the average category.

Common good fund

51. In December 2007, the Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued guidance covering the common good fund. The council complies with this guidance as it prepares a separate statement in the council's financial statements and maintains a fixed asset register.

52. The guidance note also states that local authorities should take reasonable steps to ensure that common good asset registers support the assets shown in the common good balance sheet. The council's view remains that reviewing the title deeds at point of sale represents "reasonable steps" for maintaining the asset register as a title deeds search of all council assets would be time consuming and prohibitively expensive.

53. Restrictions over the alienation or disposal of common good assets continue to be governed by the law of common good. No issues were identified through our routine audit activity during 2010/11 in relation to the treatment of common good assets.

Outlook

Audit appointment for 2011/12

54. Audit appointments are made by the Accounts Commission, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment and we would like to thank officers and members for their assistance during the last five years. The procurement process for the next five years was completed in May 2011. From next year (2011/12) Audit Scotland will again be the appointed auditor for City of Edinburgh Council although the engagement lead and senior audit manager will change.

Financial position

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

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

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

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

Financial results

58. In 2010/11, City of Edinburgh Council spent £1.7 billion on the provision of public services. Almost £1.4 billion was on revenue services and the remainder was spent on capital, resulting in an accounting surplus of £0.2 billion on the council's comprehensive income and expenditure account.

Budgetary control

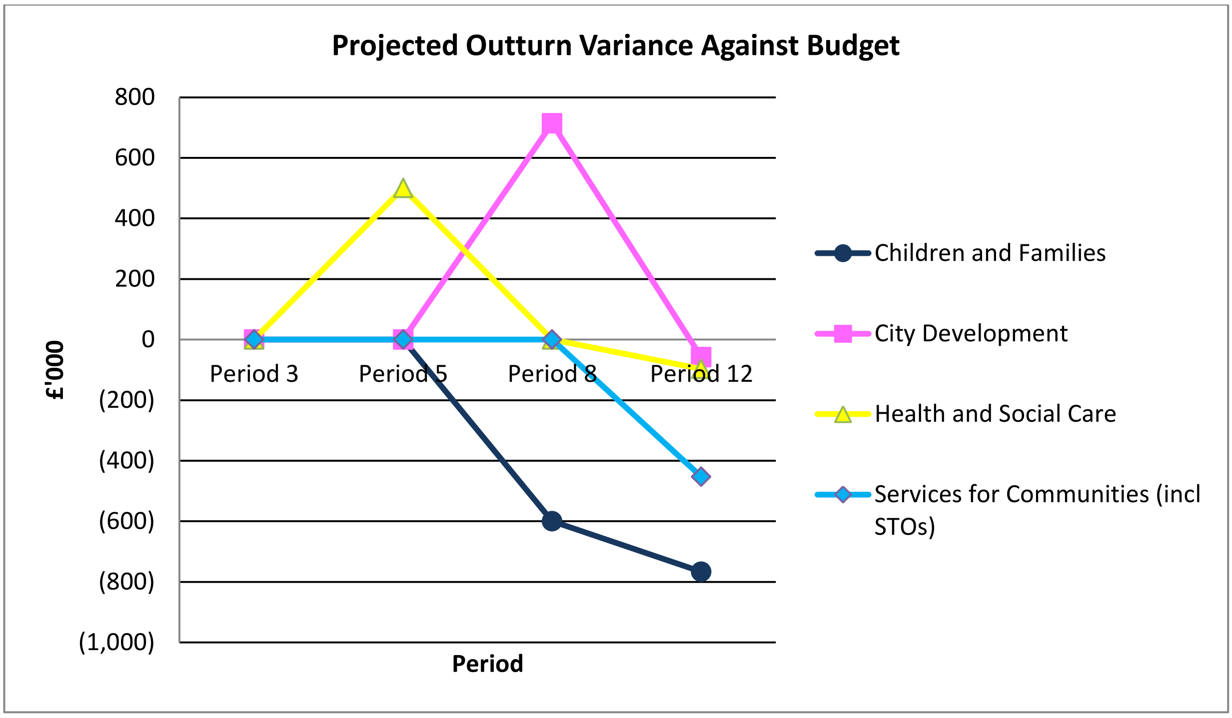
59. A favourable outturn of £2.7 million was made by the council for 2010/11 with all six departments returning underspends for a second year. In relation to the council's key frontline services, Exhibit 3 demonstrates the underspend trend in the last few years.

Exhibit 3 - Service (underspend)/ overspend

	2010/11 £million	2009/10 £ million	2008/09 £ million	2007/08 £ million
Children and Families	(0.8)	(0.3)	2.3	4.1
City Development	(0.1)	(0.5)	0.7	0.6
Health and Social Care	(0.1)	(0.9)	(0.4)	5.0
Services for Communities	(0.5)	(1.7)	(1.6)	(0.8)

60. Exhibit 4 shows the departmental projected results as reported on a regular basis to members and highlights the on-going attention to savings during the year. It should be noted that the level of variance is low in percentage terms for each department.

Exhibit 4 - 2010/11 projected outturn figures



61. Exhibit 5 shows that the council funded additional expenditure of £8 million between setting its budget in February 2010 and its revised budget position in January 2011. The council received additional government grants of £3.8 million, transferred £5.9 million from the capital fund for debt repayment which enabled some budget spend to be made available to cover additional equal pay costs, and used £1.8 million to increase its unallocated general fund balance.

62. In overall terms the council achieved a surplus of £2.7 million against its revised budget which together with an increase of £13.8 million in earmarked balances largely increased the general fund balance from £73.1 million to £89.6 million. At 31 March 2011, the council had total funds of £123 million and, as Exhibit 6 demonstrates, this is a decrease of £14 million compared to the previous year largely due to the reduction in the Capital Grants Unapplied Account. Other funds include a capital fund which may be used to defray capital expenditure or repay loan principal, and a renewal and repairs fund to finance expenditure incurred in repairing, maintaining, replacing and renewing fixed assets.

Exhibit 5 - Outturn against budget 2010/11

	Outturn	Revised Budget	Approved Budget - Feb 2010	Outturn variance
	£000	£000	£000	£000
Key front-line services				
Children and Families	383,020	383,787	377,137	(767)
City Development	17,785	17,843	20,385	(58)
Health and Social Care	172,499	172,596	168,458	(97)
Services for Communities	146,715	147,168	144,413	(453)
Total General Fund Services	867,619	869,278	854,539	(1,659)
Total expenditure to be funded	992,085	995,448	987,141	(3,363)
Funding	(994,815)	(995,448)	987,141	(633)
General Fund Surplus	(2,730)	0	0	(2,730)

Exhibit 6: Reserves

Description	31 March 2011 £ million	31 March 2010 £ million
General Fund (including earmarked balances)	89.6	73.1
Capital Fund	16.4	22.5
Capital Grants Unapplied Account	1.5	27.2
Renewal and Repairs Fund	15.4	13.8
Total	**122.9**	**136.6**

63. Included in the general fund balance is £77 million which has been earmarked for specific purposes, for example, equal pay, insurance and unspent grant income received in advance of planned expenditure. This leaves an unallocated balance of £13 million (2009/10 £9 million) to cope with risks and deal with unforeseen costs or losses. The council had a strategy in place to restore its free balances to £12.8million by 31 March 2012 (approximately 1% of net expenditure). This was achieved by 31 March 2011, a year ahead of schedule.

64. A suite of financial indicators has been developed in consultation with the CIPFA Directors of Finance working group. The indicators are intended to assist in evaluating the council's financial sustainability and the affordability of financial plans. In future years the Chief

Financial Officer is to consider reporting these indicators as part of the financial statements. For 2010/11, Audit Scotland is compiling financial indicators for publication in the Local Government Overview report in the next few months. Exhibit 7 sets out examples of the likely indicators.

Exhibit 7 - CIPFA Directors of Finance Group: financial indicators

Ratio	Description	City of Edinburgh Council 2010/11	Range for mainland Scottish Councils
Movement in the uncommitted General Fund balance 2010/11	Reflects the extent to which the local authority is increasing/using its Uncommitted General Fund Reserve.	44% (13,025 / 9,025) -1	-10% to +100%
Actual capital financing requirement* as a proportion of net debt	Measurement of Prudence in relation to Borrowing Levels - Borrowing Only to Invest in Capital *includes leasing	1.07 (1,412,064/ 1,314,956)	0.71 – 1.5

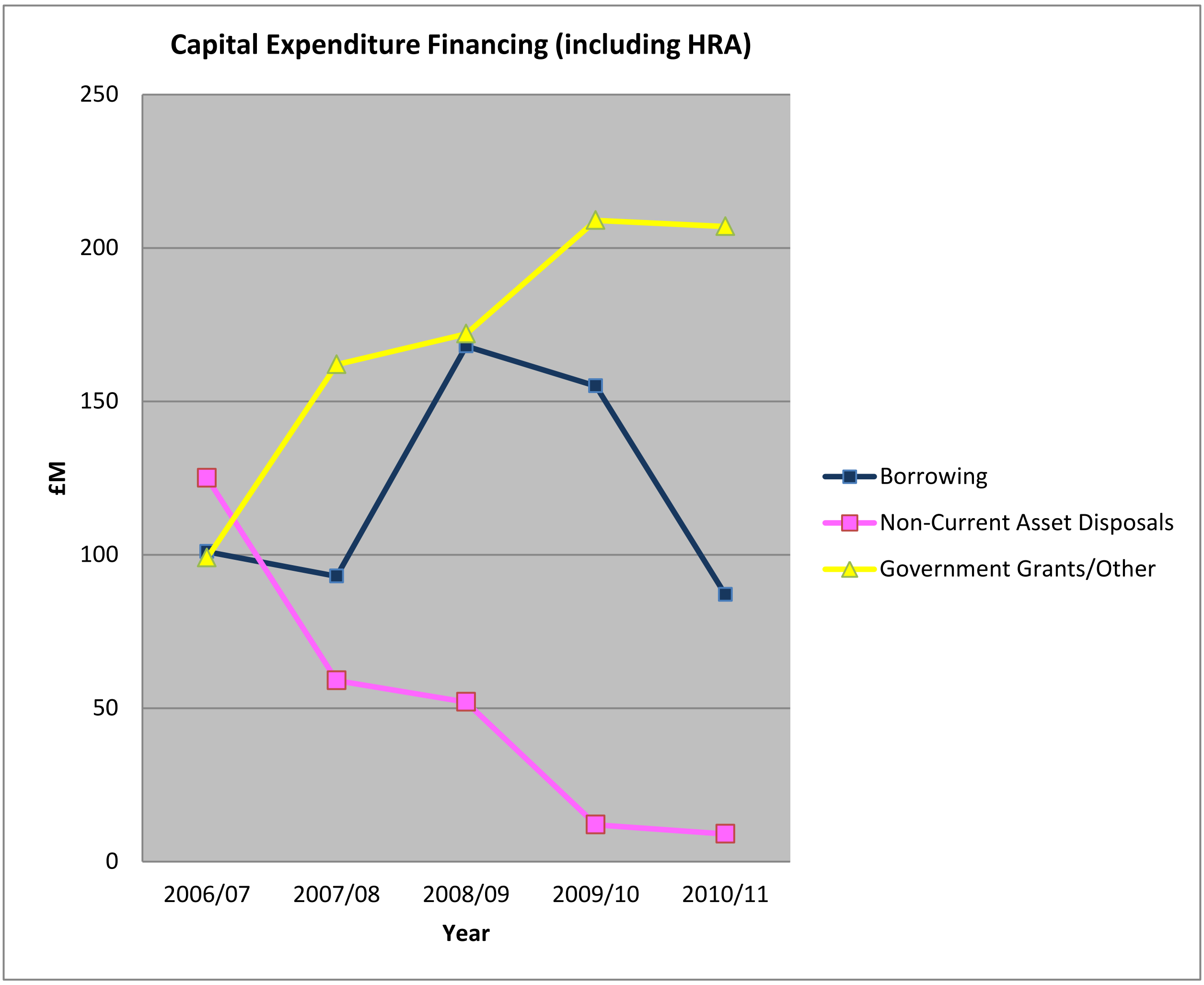
Capital investment and performance 2010/11

65. The financial statements show additions to the council's property, plant and equipment of £258 million, the majority of which relates to roads and other infrastructure including the tram project. Including non-asset creating expenditure of around £45 million, this produces a total for capital expenditure in 2010/11 of £303 million. This is a reduction of £75 million from 2009/10 and represents slippage of £70 million against the capital plan. The council's practice has been to manage its capital programme by over programming projects in the knowledge that all projects will not proceed in accordance with plans.

66. For 2010/11 while this practice continued, members agreed to a reduction of £25 million in the programme following an identified funding gap of £55 million for the period 2009-13. There was also the ongoing impact of the economic recession as the council continued to face difficulties in generating the anticipated level of capital receipts.

67. The trend in sources of funding for capital financing is reflected in Exhibit 8. It should be noted that government grants includes Transport Scotland's funding towards the tram project.

Exhibit 8 - Sources of finance for capital expenditure 2006/11



Tram Project

68. A significant element of the council's capital programme will continue to relate to the tram project. Throughout 2010/11 tie Limited and the contractors were entrenched in a dispute about historical claims for work done. In the meantime, infrastructure construction was largely at a standstill. In a final attempt to move matters forward, a mediation process was initiated in March 2011. The amounts and principles agreed during this process were developed in subsequent months resulting in significant reports to council in June, August and September 2011. These are summarised in Exhibit 9.

Exhibit 9 - Reports to City of Edinburgh Council on the tram project

Date	Details
30 June 2011	Costs and risks provided for three main options - completion under the terms of the existing contract; separate and terminate the existing contract; progress the line to St Andrew Square. A sub option of progressing to Haymarket only was also briefly referred to but as it failed to meet key objectives was not considered as a viable option. Decision - to progress to St Andrew Square subject to funding was considered the most viable option. Terminating the contract was not considered appropriate due to the impact of charging a one-off significant cost for aborting the project to revenue and similarly the cost of continuing with existing plans to Newhaven was not considered affordable.
25 August 2011	Costs and revised risk factors provided. The funding envelope would be £742 million with a risk factor of £34 million giving an overall total of £776 million. This would require additional funding of £231 million over the previous budget of £545 million to be funded through prudential borrowing. Decision - to progress to Haymarket only.
2 September 2011	Following notification that Transport Scotland would withdraw final funding of £72 million, the decision on 25 August 2011 was reversed and council agreed to proceed to St Andrew Square. Cost envelope set at £776 million with council approval for £231 million additional prudential borrowing.

69. In drawing up cost estimates to support different outcomes for the project, as listed in Exhibit 9, the council worked with a range of experts who provided independent external validation of costs and risks. We have not undertaken an examination of the figures reported to council between June and September 2011. However, we have reviewed the reports provided by independent experts to the council e.g. Faithful and Gould, McGrigors and Atkins; and confirmed that their conclusions are in line with the information provided to council supporting the different options for the project.

70. In 2009/10, the council reported that the funding envelope of £545 million was likely to be exceeded and as a result a contingency was agreed which would bring the total project budget up to £600 million. During Summer 2011, a revised funding envelope for completion of the line to St Andrew Square of £776 million was agreed.

71. Exhibit 10 sets out a comparison of the revised envelope of £776 million against the actual spend in May 2011 of £461 million and the original budget in May 2008 of £510 million. Overall, the revised envelope is £231 million greater than the original amount of £545 million and will be required to fund the following:

- the requirements of a Settlement Agreement concluded following the mediation process which agreed terms for payment of historical claims and a lump sum to complete the off street section of the line.

- the cost of completing the line to St Andrew Square.

72. While a risk factor has been built into the council's calculations, utilities works have still to be completed and the work required to complete the line to St Andrew Square will continue to be based on the terms of the existing contract i.e. fixed rates with certain exceptions which may lead to the use of a schedule of rates. Problems which existed in the past around interpretation of the contract may therefore still continue to be a source of disagreement. While the new governance arrangements recently implemented by the council for the tram project have been designed to escalate issues more effectively, there is a risk that further disagreement will result in additional costs for the council. The revised budget and risk factors will therefore require to be closely monitored by the council and other stakeholders. The revised governance structure for the tram project is described in paragraphs 104 to 106.

Refer Action Plan No. 5

Exhibit 10 - The tram project comparison of costs

Areas of Expenditure	Budget 2008 £million	Actual May 2011 £million	Estimated to completion £million
Infrastructure	243	197	399
Tram Vehicles	58	48	62
Utilities	49	70	73
Land	20	5	5
Project Management	81	80	102
Other resources	-	25	65
Design	27	33	33
Traffic Management	-	3	3
Contingency/Risk	32		34
Total	**510**	**461**	**776**

Treasury management

73. All borrowing undertaken by the council should be in accordance with the Prudential Code which requires the council to demonstrate that it is affordable and sustainable. At 31 March 2011, the council had £1.3 billion debt, an increase of £87 million compared to the previous year.

74. For 2010/11, the council incurred loan charges (which included interest and repayments of debt) of £99 million which represents 10% of the council's net operating expenditure.

75. The council has a significant level of debt which needs to be monitored as part of its overall financial strategy. Repayment plans are kept under review to ensure that the council is in a position to continue to demonstrate that its level of borrowing is both affordable and sustainable. The council's decision in September 2011 to terminate the tram line at St Andrew Square was supported by a funding package which will require an additional £231 million to be funded largely by borrowing. The annual cost of this additional borrowing is estimated at £15 million per annum for 30 years. This will put increased pressure on the council's budget setting process which is already seeking to deliver savings to meet the long term funding gap of £90 million.

Refer Action Plan No. 6

76. As at 31 March 2011, the City of Edinburgh Council held cash and temporary investments totalling £269 million of which £218 million related to the council and the remainder was held on behalf of joint boards and the tram project. For the council this represents an increase in cash held at the year end of £90 million compared to the prior year. This is largely due to the council's decision to take advantage of low interest rates and borrow £65 million in two tranches during the second half of the financial year.

77. We received specific representation from the Acting Director of Finance that all borrowing in advance of immediate requirements was largely made to support the cash flow needs of the capital programme. The council's view is that any early borrowing is justified in its own right as representing the best time for borrowing the amounts required.

Financial planning to support priority setting and cost reductions

78. In preparation for the 2011/12 budget, an initial tranche of savings totalling £16 million was approved by council in September 2010 with further tranches considered as part of the budget setting process. As detailed below, the Alternative Business Model aims to implement major service redesign and improvement whilst securing significant savings in the longer term.

Workforce reduction

79. The council's voluntary severance policy was approved in January 2010 and became effective from February 2010. Twenty staff were approved to leave under the scheme in March 2010, with a further 182 either leaving during 2010/11 or having their applications approved before the year end. Costs of approximately £6 million associated with the scheme were appropriately accrued in the 2010/11 accounts. In addition, provision of £1.2m was made for the redundancy costs associated with the closure of BlindCraft following the council's decision in February 2011.

Other change management programmes - Alternative Business Models

80. In 2009, due to unprecedented financial pressures, the council initiated a major project to examine Alternative Business Models (ABM) for provision of some of its services. There was recognition that the scale of change required by the council to meet its shortfall needed substantial savings from major initiatives. This led to the ABM programme which explored options through a structured tendering process known as Competitive Dialogue. Where there

is a convincing business case, the council plans to deliver some services using Strategic Partnerships or Joint Ventures with private sector partners.

81. Based on the 2010/11 baseline budget, services being explored through the competitive dialogue process represent £91.5 million and cover the following areas:

- Corporate & Transactional Services (CAT services) - £20.7 million including revenues and benefits, human resources, payroll and procure to pay
- Integrated Facilities Management - £33.2 million covering building maintenance and design, catering, cleaning, janitorial, porterage and security services
- Environmental Services - £37.6 million including refuse collection, street cleansing, road maintenance and design and ground maintenance.

82. We adopted an integrated approach with the council's internal audit team to review this project. We considered high level aspects of governance while the internal audit work examined the competitive dialogue proposals for the integrated facilities management work stream.

83. Overall we found that the Alternative Business Models programme has to date been implemented largely in line with the original project plan and timetable and we noted there were six monthly progress reports to council and other reports on specific issues to the Policy and Strategy Committee. We drew attention to areas of concern highlighted by independent Office of Government Commerce Gateway reviews undertaken at stages in the project relating to communication and availability of information to members and other stakeholders.

84. The first Gateway review on the project in July 2010 made recommendations about keeping members and other stakeholders informed during the process and managing their expectations through clear briefings. Since then, there has been a concerted effort to keep members of all political groups informed and appraised of the ABM progress in a number of different ways, for example, reports to council, briefings from officers and opportunities to meet with bidders.

85. Final decisions had been expected from August 2011 but were re-scheduled to be taken from October 2011. Additional time was provided to ensure elected members were fully briefed and had received all explanation necessary to make an informed decision.

86. The date for the decision on the Environmental Services contract was therefore revised to October 2011. A range of information including a full business case assessing the proposals from the preferred bidder and the Public Sector Comparator (PSC) was made available to elected members via a data room. This mechanism provided members with access to sensitive information which could not be included in the report to council but which officers considered necessary to provide members with balanced information. Prior to the council meeting, 29 of the 58 councillors examined the additional information provided. At the meeting, council decided to delay the decision by a month pending a request for further information on areas of concern and for further examination of the PSC.

87. In making its decision, the council needs to be assured that the final outcome will demonstrate value for money. The supporting evidence therefore needs to provide councillors with a robust fully costed options appraisal. While the project has remained within its agreed budget, £3.3 million has already been invested in developing the project to the current stage and this needs to be recouped through future service improvement.

Refer Action Plan No. 6

88. It is recognised that these will be difficult decisions for members especially in the current economic climate and, understandably, there are political sensitivities around third party service delivery vehicles and the potential impact for council staff. However, the ABM process was embarked upon in full knowledge of those challenges.

89. We will continue to monitor the decisions taken by council in relation to this project as part of the 2011/12 audit and review the consequent impact on the council's long term financial plan.

Governance and accountability

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

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

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

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

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

Scrutiny

Processes and committees

94. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda. The City of Edinburgh Council's Audit Committee has 13 elected members, split between the administration's 7 members and the opposition's 6 members which includes the chair. The committee's remit includes risk management, IT security and anti-fraud reporting. The committee also has a wider role in terms of promoting, monitoring and developing continuous improvement.

95. The committee is well attended and in overall terms its remit and working practices are in accordance with good practice principles.

96. We would highlight the following observations as areas for improvement for the committee:

- We worked with officers to raise the committee's profile on the financial statements. With the implementation of IFRS there was a significant change in the disclosures required in the financial statements. The trail between the budget outturn and the financial statements is also quite complicated. In the past, the committee has not seen the accounts until September when the matters arising from the audit are discussed. This has not provided sufficient opportunity for dedicated time to be permitted on the agenda to consider the content of the accounts themselves. For the first time, the unaudited accounts were therefore submitted to the Audit Committee in June to provide the opportunity for more discussion and understanding of the accounting requirements. In advance of the committee meeting, a training session was scheduled to provide the context, however it had to be abandoned due to poor attendance by members and an effort was made to summarise key messages within the committee meeting itself.

- Further training should be provided to enable elected members to become more engaged with the content of the financial statements and the linkages with the budget monitoring outturn information so that members are better placed to challenge officers on reported figures.
- The annual governance statement is an important statement within the financial statements intended as an overarching report on the effectiveness of governance within the council and its group. Year on year we have worked with officers to improve the content of the statement. While a self-assessment is undertaken by departments each year, it is unclear how the actions and improvements to be progressed are monitored. We would therefore recommend that the Audit Committee takes ownership of the governance statement, ensures that a robust self-assessment is undertaken, supporting action plans are put in place and that regular monitoring is undertaken by the committee to confirm that tasks are completed and improvement implemented.
- The governance statement reflects the position for the council and its group. We understand that CEC Holdings Limited will take a greater role in holding its interests to account. It would also be appropriate for the committee to consider if it has a wider role for scrutinising the performance of the council's subsidiaries and associates and other arm's length external organisations.
- The committee has regularly discussed how it can keep track of critical issues and action points arising from the business of the committee. Although we have commented in the past on this matter, there is still scope for a more formal process of tracking and follow up by the committee to ensure it obtains all necessary assurances.

Refer Action Plan Nos. 1, 2 and 7

97. During the course of the year the committee played an important role in the investigation into the council's tendering for care and support services. In September and October 2010, officers were invited to attend the committee for a number of evidence sessions. The process was considered to be effective and as a result, the committee recommended that a thorough review of the council's scrutiny function be undertaken. This was considered by a Cross-Party Working Group in March 2011 and has now been taken over by the Director of Corporate Governance's review of governance. In some cases members of the committee were replaced by substitute members for the investigation sessions. While these members may have been more informed on the subject, there is a risk the committee's independence is weakened. Good practice principles for audit committees requires the business to be carried out apolitically.

98. More recently the committee has been identified for a monitoring role within the new governance structure for the trams project. This is referred to in paragraph 106.

Governance and Internal control

99. While auditors concentrate on significant systems and key controls in support of the opinion on the financial statements, their wider responsibilities require them to consider the financial systems and controls of audited bodies as a whole. However, the extent of this work should also be informed by their assessment of risk and the activities of internal audit.

100. No material weaknesses in the accounting and internal control systems were identified during the audit which could adversely affect the ability to record, process, summarise and report financial and other relevant data so as to result in a material misstatement in the financial statements.

101. As part of our work, we took assurance from key controls within the council's financial systems, with some of the controls being tested by internal audit, for example, payroll and financial ledger. On an annual basis, we also agree with internal audit that they undertake a review of a sample of housing benefit overpayments which is helpful in assisting our audit of the housing benefit subsidy claim.

The tram project

102. In February 2011, the Auditor General's interim report on the tram project stated that the governance arrangements for the project are complex and are intended to allow the work of tie Limited to be subject to scrutiny while keeping all elected members informed of the project's progress. Transport Scotland considered that its need to be represented on the Tram Project Board, the project's main governance body, ended in June 2007. Some members of the Project Board are also members of tie's own board.

103. With the appointment of the council's new chief executive there was a change in emphasis in the leadership of the project from January 2011. She took a leading role in the mediation process in March and in subsequent discussions with the contractors. The mediation process also prompted a review of project management arrangements which led to a decision to bring the management of the project within the direct responsibility and control of the council. Turner & Townsend were appointed by the council and are largely responsible for day to day project operational management.

104. Proposals for new governance arrangements for the tram project were initially shared with council in June 2011. The new structure demonstrated in Exhibit 11 has only recently been implemented and in terms of scrutiny, continues to evolve.

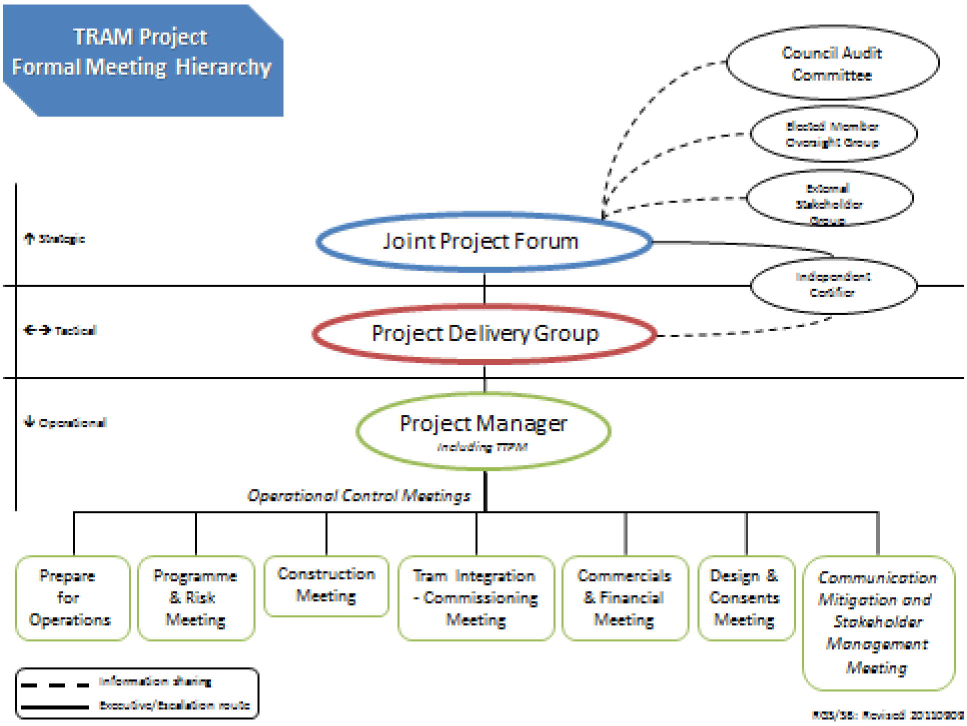
105. While the new governance arrangements have still to bed-in, it is too early for us to comment on their effectiveness. However, given the continuing media and public interest in the trams project and the risks outlined in paragraph 72 associated with its delivery, the council will wish to reassure itself that the following key requirements are in place:

- Clear leadership and direction for the project with named people being accountable for its successful delivery
- Regular, timely and accurate reporting of the project’s costs and delivery, including the management of risks

- Effective scrutiny of the project's progress and risk management arrangements by people not directly involved in its delivery but with sufficient skills and experience to challenge what is being reported
- Effective communications with elected members and the general public on the project's progress.

Refer Action Plan No. 8

Exhibit 11- New governance arrangements for the tram project



106. There are however important changes in the new arrangements which were initiated through the mediation talks. For example,

- a Joint Project Forum with senior representation from all key parties involved in delivery of the project and chaired by the council's chief executive. This is intended to provide improved strategic direction and enable prompt decision making thus removing the need to refer or consult elsewhere
- the Project Delivery Group is responsible for the operational delivery, reporting on progress and where necessary, promptly escalating performance issues to the Joint Project Forum
- Transport Scotland are now also represented in the new arrangements
- project management is largely undertaken by Turner & Townsend who were appointed in Summer 2011 and are supported by a small number of council staff and former tie Limited staff

- scrutiny arrangements have recently been implemented and need to bed-in. There is a Member Oversight Group with all party representation and chaired by the Leader of the council. It will meet monthly with effect from October 2011. The Audit Committee also has a scrutiny role with regard to the trams. While the committee will undertake scrutiny activity on a quarterly basis, the detail of the arrangements continues to evolve.

Housing benefit subsidy

107. In previous reports to members, we stated that our testing of cases in connection with the audit of the council's housing benefit subsidy claims for 2007/08 and 2008/09 had identified that processing staff were incorrectly classifying benefit overpayments. This meant that the council had incorrectly overclaimed subsidy. Due to the extent of errors found in our case review, we gave a qualified opinion on the subsidy claims in respect of both financial years. Following our reports to the Department for Work and Pensions (DWP), examination of further cases was undertaken in response to their enquires. In November 2010, we concluded our correspondence with DWP on this matter when it was agreed that based on an extrapolation of the errors found in the cases examined, the extent of the overpayment of subsidy for the two years was £2.2 million.

108. Thereafter, the DWP submitted their case to the Secretary of State for consideration. In making his decision, the Secretary of State felt that the subsidy claimed in excess of entitlement at a cost to the public purse was a failing by the council to exercise due care in discharging its functions. The decision was therefore made to recover the full amount of £2.2 million which was carried out over the period January to April 2011 by deduction from ongoing payment of subsidy to the council.

109. Improvements in benefit processing arrangements were made by the council following our initial report in respect of the 2007/08 claim. No significant issues were identified from our audit of the 2009/10 claim and, in respect of 2010/11, our audit work is currently in progress but we do not anticipate any major concerns.

Procurement

110. In 2009, the Scottish Government promoted the use of an annual procurement capability assessment (PCA) to assess procurement performance in all public sector bodies and as a basis for the sharing of best practice and continuous improvement. Results are summarised as non-conformance (weak - less than 25%), conformance (acceptable - 25 to 49%), improved performance (good/adding value - 50 to 74%) and superior performance (superior - 75 to 100%). The City of Edinburgh Council is a conforming council with an overall score of 37%. This is an increase from the 2009 position of 25% which was above the Scottish average of 22.6%.

111. While Edinburgh's position is improving, local government's performance overall is behind the health sector with regard to procurement activities. The PCA assessments commenced in the health sector one year ahead of local government. The 2010 updates shows that, for example, both NHS Lothian and NHS Glasgow and Clyde were assessed as superior (75 to 100%) following the 2010 update. It would be beneficial for the council to make contact with procurement staff in these bodies to learn where improvements can be made. For example, good practices demonstrated by these boards included:

- direction and support for procurement from the top of the organisation with a procurement steering group/board representing and co-ordinating activity across the organisation and reporting performance to the management team
- procurement staff lead on good practice by hosting workshops on tendering procedures and contract management
- a savings tracker which charts progress on achieving targets is distributed on a quarterly basis for monitoring purposes. This provides details of savings initiatives and targets as well as an assessment of the likelihood of targets being achieved
- key performance indicators are regularly monitored and benchmarking activity undertaken.

Refer Action Plan No. 6

112. One of the main initiatives being addressed by the council during 2011 has been a revised procurement strategy for 2011-14. This has yet to be approved by members. The new strategy anticipates that services will be more involved in procurement to ensure increased contract compliance across the council and less purchasing at local levels.

113. Planned procurement savings for 2010/11 of £4 million were largely delivered through the adoption of Procurement Scotland's contracts for the supply of utilities. The council however anticipates significant savings from procurement in the longer term up to 2015 and 2020 and will therefore need to develop plans to meet these important targets.

Prevention and detection of fraud and irregularities

114. Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. While auditors are not responsible for the prevention and detection of fraud and other irregularity, they are expected to review the arrangements in place as part of their consideration of the audited body's overall control environment. City of Edinburgh Council's framework to help prevent and detect fraud, inappropriate conduct and corruption includes: an anti-fraud and corruption policy and response plan; a whistle blowing policy; codes of conduct for elected members and staff; and defined remits for relevant regulatory committees.

Property investigation regarding statutory repairs

115. For six months there has been an investigation by Deloitte, on behalf of the council, regarding the Property Conservation Service which has also extended further into other aspects of property services i.e. Property Care, Property Services and Client Services. This has involved a range of activities including forensic accounting and verification of repairs undertaken by contractors. The council's internal audit service has supported the investigation through a range of data analysis. There is also an investigation by Lothian & Borders Police. There are key concerns about customer care, procurement, project management and financial monitoring within these services. It will be important for the council to review and strengthen its framework for preventing and detecting fraud and inappropriate conduct and ensure this has sufficient profile across the council both in terms of its existence but also the implications for non-compliance. Audit Scotland will have an interest in the outcome of the investigation

both in terms of improved governance but also the extent of any loss incurred on the public purse.

Refer Action Plan No. 9

NFI in Scotland

116. The National Fraud Initiative (NFI) is a counter-fraud exercise that uses computerised techniques to compare information about individuals held by different public bodies, and on different financial systems, to identify circumstances (matches) that might suggest the existence of fraud or error. An economic downturn is commonly linked to a heightened risk of fraud, and public bodies need to remain vigilant.

117. The current NFI round spans 2010/11 and 2011/12 and is being carried out under new powers approved by the Scottish Parliament in terms of the Public Finance and Accountability (Scotland) Act (as amended) which came into force from 20 December 2010. These provide for more collaboration with other UK agencies to detect 'cross border' fraud, extend the range of public sector bodies involved, and allow data matching to be used to detect other crime as well as fraud.

118. Our local audit work is still ongoing and will inform a national report by the Accounts Commission in 2012. We found that services were well supported by internal audit in setting strategies and investigating potential matches. However, information to demonstrate the work undertaken was not well recorded and, in some cases, the services with large numbers of matches did not appear to have a strategy in place for dealing with the data. In due course we will verify a sample of the savings identified by the follow up of Edinburgh's 2011 matches and this will be collated across councils for the national report.

Outlook

119. It is becoming routine for councils to identify savings through workforce reduction schemes such as voluntary early release or redundancy schemes. With the departure of experienced staff and the restructuring of services, there will be challenges for services in reaching decisions over priorities and attainable outcomes. Certain tasks may be seriously delayed or no longer carried out. This provides a strong case for robust governance arrangements and clear lines of accountability.

Refer Action Plan No. 10

Best Value, use of resources and performance

120. Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value while the auditor has a duty to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning.

121. As part of their statutory responsibilities, the Auditor General and the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in work which results in the publication of a national report and/or view a council's response to national recommendations.

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

123. This section includes a commentary on the Best Value/ performance management arrangements within the council and comments on any relevant national reports.

Management arrangements

Vision and strategic direction

124. Over the past 12 months there have been important changes in the council's management team. In September 2010, a new chief executive was appointed who came into post in January 2011. This allowed for some handover with the previous chief executive who retired in December 2010. In September 2011, a Director of Corporate Governance was appointed. This is a new post for the council and will bring together two existing departments; corporate services and finance. The previous directors of those services retired in April and June 2011 respectively and, as an interim measure, a head of service from each of the departments was allocated acting up responsibility at director level. This interim arrangement will continue until the Director of Corporate Governance completes his review of the proposed structure for the new merged service at the end of the year.

125. The statutory officer for finance (also known as the section 95 officer) was previously part of the Director of Finance's remit. With the change in structure, this role will now be carried out at the level of Head of Service. The section 95 officer is fundamental to ensuring sound financial management and has an important role in establishing and maintaining internal financial controls and in providing professional advice to elected members. In the current financial climate, this role is increasingly important in influencing the strategic direction of the council. For City of Edinburgh Council, we note that the section 95 officer is a member of the council's corporate management team and we understand that this will form a permanent feature going forward.

Refer Action Plan No. 11

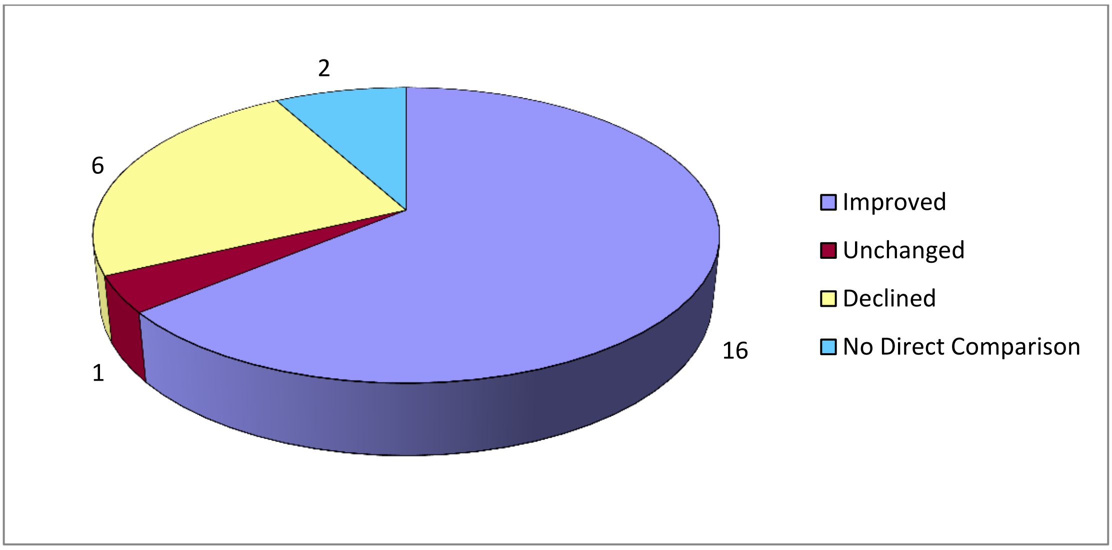
Overview of performance in 2010/11

126. Self-evaluation is being promoted nationally as a means for councils to effectively demonstrate service improvement and such activity is essential in informing the scope of Best Value 2 (BV2) audits. The council has adapted the Public Sector Improvement Framework (PSIF) to develop the Edinburgh Improvement Model (EIM) as its self-evaluation model. The first round of service reviews across the council was completed in autumn 2010 and an evaluation of the process was considered by the corporate management team earlier this year. Each review resulted in an improvement plan which will be revisited during the second round of reviews which is currently underway.

Statutory performance indicators (SPIs)

127. In 2010/11, a total of 25 SPIs were required and these indicated an improving picture of performance for the council as demonstrated by Exhibit 12 below.

Exhibit 12: Improvements demonstrated by SPIs (Total 25 indicators)



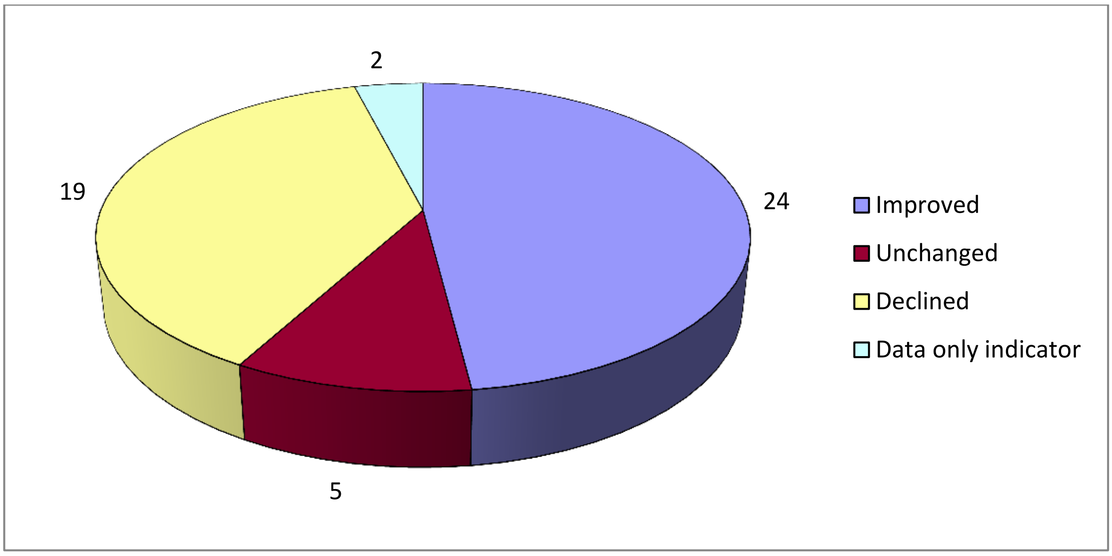
Source: Edinburgh's SPI data returns

128. The improved indicators include sickness absence levels, progress towards implementation of Scottish Housing Quality Standards and waste management. The declines were observed in, for example, homelessness services and noise complaints.

Council defined performance indicators

129. In 2010/11, a total of 50 performance indicators were set by the council and these indicated a more mixed picture of performance. This is illustrated in Exhibit 13.

Exhibit 13 - Improvements demonstrated by council defined performance indicators (Total 50 indicators)



Source: Edinburgh's SPI data returns

130. The improved indicators include procurement, home care and respite care in adult social work while there has been a fall in performance in, for example, responsiveness to communities i.e. measures of residents' satisfaction, roads and lighting.

National performance reports

131. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports in the last year of direct interest to Edinburgh are detailed in Exhibit 14. In all cases these have been shared with the council's Audit Committee and in many cases, especially the 'how councils work' series, there are useful checklists for the consideration of members.

Exhibit 14: A selection of National performance reports 2010/11

- Management of the Scottish Government's capital investment programme
- Edinburgh trams interim report
- The cost of public sector pensions in Scotland
- Community Health Partnerships
- Scotland's public finances: responding to the challenges
- Transport for health and social care
- Physical recreation services in local government
- An overview of local government in Scotland 2010
- Maintaining Scotland's roads: a follow-up report
- How councils work: an improvement series for councillors and officers - Arm's-length external organisations

Scotland's public finances: responding to challenges

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

- the budget reductions affect revenue and capital expenditure differently with the capital budget taking the largest cut in percentage terms
- public bodies are finding it difficult to plan beyond 2011/12. The Scottish Government published detailed spending plans for years 2012/13 to 2014/15 in September 2011, which should establish a framework that bodies can use to make future spending plans
- the need to reduce costs provides public bodies with an opportunity to reform and streamline public service delivery. However, in doing so, bodies must focus on long-term financial sustainability
- pay restraint and reducing workforce levels are the most common approaches being taken by public bodies to reduce costs over the next few years. Good workforce planning is necessary to ensure that the right people and skills are available to deliver effective public services in the future
- public bodies are considering how they can work better together to reduce costs. While a number of initiatives are being planned to increase working together, sharing resources and involving voluntary and private organisations, progress to date has been limited.

133. The Audit Committee meeting of 29 September 2011 noted the key messages contained in the report and the action already taken by the council in these areas.

Maintaining Scotland's roads: a follow-up report

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

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

135. The report highlights that City of Edinburgh, East Lothian, Midlothian, West Lothian, Fife and Scottish Borders councils discuss common issues through a joint forum. In June 2010, the forum identified five specific areas that offered greatest potential for shared services and long-term savings. These were payroll, procurement, road maintenance, mobile/flexible working and integrated audit functions. Scottish Borders Council is leading on road maintenance. Development is at an early stage but proposals include sharing best practice, sharing equipment, and providing staff to cover shortages in other areas.

Progress against audit risks identified in the Shared Risk Assessment

136. The aim of the annual Shared Risk Assessment (SRA) is to focus scrutiny activity where it is most needed and to determine the most proportionate scrutiny response over a three year period. The shared assessment is undertaken by the Local Area Network (LAN) which involves local representatives of the main scrutiny bodies.

137. The updated assurance and improvement plan for 2011-14 published in May 2011 reported an improving situation. Only the trams project continued to be assessed as an area of significant risk. There were however some important areas of uncertainty such as financial management and the council's plans to address the budget shortfall of £90 million, the impact of ongoing equal pay claims and the negotiations in respect of the dispute with the refuse collection service. These matters have largely been referred to elsewhere in this report.

Outlook

138. The LAN also proposed that the BV2 audit should be scheduled for 2012/13. This would be an appropriate time to consider the impact and extent of improvement arising from the council's self-evaluation activity and would provide for sufficient time to have elapsed to enable the new management team to have integrated and be making an impact. The Assurance and Improvement Plan also includes activity by other scrutiny bodies over the next three years including:

- HMIE – Educational Psychology Service inspection (2011/12)
- SWIA – Initial Scrutiny Level Assessment (ISLA) review (2011/12).

Appendix A: audit reports

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan – City of Edinburgh Council	March 2011	April 2011
Shared Risk Assessment/ Assurance and Improvement Plan	May 2011	June 2011
Review of opening IFRS balance sheet as at 31 March 2009	May 2011	Not applicable
Review of progress on the 2009/10 Action Plan	June 2011	June 2011
Overview of Alternative Business Models Project	September 2011	September 2011
Progress reports for the Audit Committee	Quarterly	Each cycle
Report on financial statements to those charged with governance	September 2011	September 2011
Audit opinion on the 2010/11 financial statements	September 2011	September 2011
Audit opinion on 2010/11 Whole of Government Accounts (WGA) return	October 2011	Not applicable

Appendix B: action plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	17 and 96	Responsibility for monitoring actions and improvements identified in the governance statement should be clarified. Audit Committee should become responsible for monitoring progress of actions. ***Risk - If governance arrangements are weakened, this may lead to ineffective practices and/or poor management and fraud.***	Regular reports on the implementation of the agreed actions and improvements will be provided to the Committee	Chief Internal Auditor	On-going
2	22 and 96	Improve scrutiny and audit arrangements for group companies including completion of the group restructuring review. ***Risk - If group companies are not adequately monitored, this could lead to non-compliance with companies legislation of the group may not be delivering on its objectives*****.**	CEC Holdings is progressing the appointment of one external auditor for the companies within its group. This will strengthen the existing auditing arrangements. Internal Audit has been requested by the Audit Committee to review the arrangements in place that ensure the companies continue to deliver the council's objectives. CEC Holdings is also increasing its role in scrutinising its subsidiary companies by, for example, inviting representatives of group subsidiaries to board meetings.	Corporate Finance Manager Chief Internal Auditor Director of City Development	31 December 2011 31 March 2012 31 March 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			Company restructuring will be taken forward as part of the review of overall governance arrangements.	Director of City Development	30 June 2012
3	38	The council needs to give formal consideration to impairment reviews of its assets especially in the current economic climate. ***Risk - In the absence of effective impairment, the net asset financial position of the council may be overstated.***	Impairment reviews are carried out annually on the property estate, as part of the annual valuation processes. **Vehicles, Plant and Equipment** - process will be introduced to seek reassurance from Principal Finance Managers (Business Support) that all assets, including tram vehicles, will be subject to an annual impairment review. **Infrastructure** - introduction of expected changes in Code in 2013 will ensure that appropriate valuations and impairments are carried out.	Property Manager (Property Management and Development) Principal Finance Manager (Corporate Accounts) Professional Officers (Transport)	30 April 2012 30 April 2012 31 March 2013
4	42 and 44	Ensure provisions are in line with accounting requirements. Review use of provisions, earmarked balances and contingent liabilities. ***Risk - If there is an overstatement of provisions, the net asset financial position of the council is overstated.***	Earmarked balances are reviewed annually, as part of the budget process. This review is reported to Committee during the budget process. Contingent liabilities and provisions are reviewed annually, as part of the preparation of the Financial Statements. Working papers will be strengthened to ensure that provisions and contingent liabilities are appropriate and comply with the Code.	Principal Finance Managers (Corporate Accounts and Business Support)	31 May 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
5	72	With utilities works still to be completed for the tram project and the works to St Andrew Square subject to a schedule of rates there is scope for further disagreement on the cost of the works. ***Risk - If there is weak project monitoring, significant additional costs are more likely to arise.***	The on-street works will be subject of a comprehensive cost recording system that will form part of the project governance going forward. This should alleviate the scope for disagreement as any issues will be captured on a regular basis.	Tram Project Manager	On-going
6	75, 87 and 111	Affordability - the council has a significant shortfall in its long term financial plan, more efficiencies need to be delivered through procurement, it has a significant level of borrowing which requires to be funded and there are difficult decisions to be made about the services linked with the Alternative Business Models project. ***Risk - If the council is unable to deliver sufficient savings and efficiencies, its financial plans may not be affordable in the long term.***	Long Term Financial Plan is reviewed on a regular basis. Budget Group established to consider available options. Regular budget reports will be provided to members on the financial position. Revised procurement strategy has been prepared. Procurement is included in the Corporate and Transactional Services element of the ABM work programme. Robust business cases are being prepared to inform recommendations to the Council on the ABM work programme.	Chief Financial Officer	28 February 2012
7	96	There is scope to improve the effectiveness of the Audit Committee and clarify its additional scrutiny roles. ***Risk - If the committee is not committed to continuous improvement, scrutiny arrangements***	The Director of Corporate Governance is currently reviewing governance arrangements and scrutiny will form an integral part of this review.	Director of Corporate Governance	31 March 2012

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		within the council may be insufficient.			
8	105	The council needs to bed-in its revised governance arrangements for the tram project and be reassured on accountability for delivery, and that arrangements provide for regular reporting and effective scrutiny. ***Risk - If there is inadequate accountability and scrutiny, this may lead to escalating costs and further dispute situations.***	The revised governance procedures for the tram project are in place and will be kept under review. The revised governance arrangements have an escalation process such that if any issues occur they can be escalated to principal decision makers for discussion to alleviate matters going into formal dispute.	Director of City Development	On-going
9	115	The council should review and strengthen arrangements to prevent and detect fraud and ensure staff are reminded of relevant policies and the implications of non-compliance. ***Risk - If lessons learnt are not used to inform tighter internal controls across the council, there may be further weaknesses in governance.***	The council will review its arrangements to prevent and detect fraud and will ensure all staff are made of aware of these arrangements.	All Directors supported by Chief Internal Auditor	31 December 2011
10	119	Workforce reduction schemes provide opportunities for cost savings but result in significant experience being lost leading to certain tasks being delayed or ceasing as they are no longer considered priories. ***Risk - If there is a lack of***	The consequences and risks associated with the reductions included in the approved savings were clearly set out in the papers compiled as part of the 2011-2014 budget process. These papers were scrutinised by members and officers as part of the budget process prior to approval.	All Directors	On-going

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		clarity across the council of the impact of posts being vacated or removed, important tasks may not be completed or priorities ignored.	This process will continue going forward. Workloads will be kept under review.		
11	125	Section 95 officer will now operate from a lower tier within the council ***Risk - If the S95 officer does not sit at the top table, there may be insufficient financial advice provided to officers and members.***	Section 95 officer will attend Corporate Management Team and access to members and senior management will be unaltered. These arrangements are in compliance with CIPFA guidance.	Director of Corporate Governance	On-going