

East Ayrshire Council

**Report to Members and the Controller of Audit
on the 2006/07 Audit**



October 2007

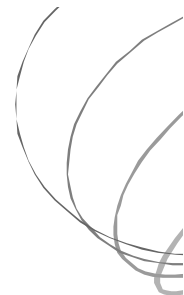


East Ayrshire Council

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on the 2006/07 Audit**

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Key Messages

Introduction

In 2006/07 we looked at the key strategic and financial risks being faced by the council. We audited the financial statements and we looked at aspects of performance management and governance. This report sets out our main findings, summarising key outcomes in 2006/07 and the outlook for the period ahead.

Key outcomes from 2006/07 audit

We have given an unqualified opinion on the financial statements of East Ayrshire Council for 2006/07.

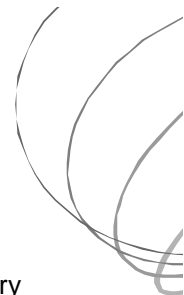
Results for the past financial year produced a surplus of £10.420 million bringing total reserves to £46.543 million. The council is in a healthy position to meet the challenges ahead. Changes to accounting rules had a major impact on the presentation of the 2006/07 financial statements. The council should explore options to review the presentation of its budget and financial results to members and other stakeholders to assist understanding and ensure transparency.

One of the main challenges for 2006/07 was the implementation of the single status agreement. This was achieved by the end of the financial year. Following the settlement of equal pay compensation claims in 2005/06, these two big issues are now, in the main, complete.

A Best Value audit of the council was undertaken during the first half of 2006 and the results reported in September 2006. The report concluded that the council demonstrated “a clear commitment to Best Value” and was “characterised by strong and effective leadership from its senior management” which was “developing a culture of continuous improvement throughout the organisation”. The report noted that progress had been made in performance management and other essential elements of Best Value but further development was also required in areas such as linking service and budget planning and more balanced reporting on service performance.

The council is carrying out a strategic review of its revenue budget with the assistance of an independent specialist in public finance. The importance of this initiative to the council’s finances has increased with the probability of less generous financial settlements on the horizon. Significant progress has already been made.

The council responded positively to the report and management has developed an improvement agenda in response to the issues raised by the Best Value audit. Significant progress has been made in implementing the action plan. Community planning is one of East Ayrshire Council’s strengths and the 2006/07 annual report recorded a high level of achievement against targets.



Based on the work carried out in this, the first year of the audit engagement, the council had satisfactory financial systems in place during 2006/07 that operated within a sound control environment. During 2006/07 the council operated a “Risk and Audit Scrutiny Group”, composed of both senior management and members, which discharged the functions of an audit committee. Following the local council elections in May 2007 the council remitted a “Governance and Scrutiny Committee” to deal with audit matters. The council is now fully compliant with audit committee principles.

Outlook for future audits

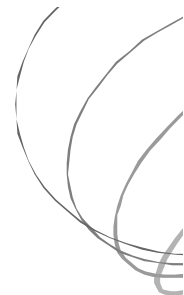
Overall the council is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. It has a record of responding positively to audit issues and changing accounting rules. The financial statements for 2007-08 will include further changes following the issue of the 2007 Code of Practice on Local Authority Accounting.

The council will face additional challenges to deliver on its programme of efficiency savings to meet the target set by the Scottish Government while managing the impact on services, service users and the council’s overall objectives. However, the progress made in its strategic review of the revenue budget provides a solid foundation for improved efficiencies in service provision.

The council is making encouraging progress in embedding asset management into the business planning process. Work has already been done on office accommodation and in due course the strategy is expected to ensure that the council’s asset base is driven by council and Community Plan objectives.

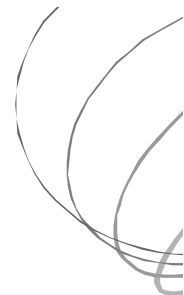
The courteous co-operation and assistance given to us by members and staff of the East Ayrshire Council is gratefully acknowledged.

Audit Scotland
October 2007



Introduction

1. This report summarises the findings from our 2006/07 audit of East Ayrshire Council, the first year of a five year appointment. Findings are discussed in four sections dealing with: performance, financial position, governance, and financial statements. Within each of these sections we have also provided an outlook setting out key issues and concerns facing the council going forward.
2. The scope of the audit was set out in our Audit Risk Analysis and Plan (ARAP), which was submitted to the council's Chief Executive and Risk and Audit Scrutiny Group in April 2007. The ARAP set out our views on the key business risks facing the council and described the work we planned to carry out under the following strategic themes:
 - Governance and accountability
 - Financial planning
 - Workforce planning
 - Procuring and managing assets
 - Community planning.
3. Overall conclusions about the council's management of key risks are discussed throughout this report.
4. We also undertook a number of exercises, for example, an audit review of a number of key financial systems, a review of internal audit, a computer services review and a review of the payroll system. Where appropriate in this report, we refer to key messages from those separate reports for the consideration of members.
5. Appendix A of this report sets out the key risks highlighted in this report which we wish to draw to the attention of members and the action planned by management to address them.



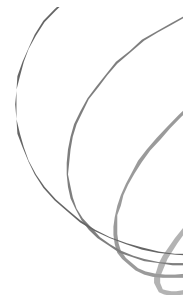
Performance

Introduction

6. In this section we summarise key aspects of the council's reported performance during 2006/07 and provide an outlook on future performance, including our views on the current status of identified risks. We also comment on the Best Value audit which was finalised during the course of the year and the progress which has been made on the resulting improvement actions arising from the audit.

Corporate objectives and priorities

7. East Ayrshire Council has a mission statement which seeks to ensure that East Ayrshire will be a place with strong, vibrant communities where everyone has a good quality of life and access to opportunities, choices and high quality services which are sustainable, accessible and meet people's needs. This statement is the foundation to the council's sovereign planning document, the Community Plan.
8. The Community Plan was, and continues to be, developed in conjunction with the council's planning partners and identifies and prioritises what actions need to be taken to achieve its mission statement, in addition the plan addresses how the council and their partners will achieve these plans. In order to ensure that the Community Planning process is consistent, the Community Plan highlights a number of guiding principles which the council must work towards in order to achieve its goals, namely:
 - to promote social justice and social inclusion
 - to build sustainability
 - to succeed in joint working and involving people
 - to ensure quality and accessibility
 - to deliver continuous improvement and best value.
9. Underpinning these guiding principles are six thematic action plans each having a number of planned actions and outputs and each working towards securing the Community Plan objectives. The themes covered are:
 - promoting community learning
 - improving opportunities
 - improving community safety
 - improving health
 - eliminating poverty
 - improving the environment

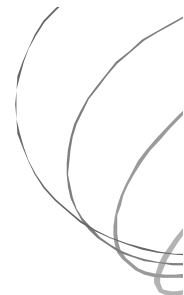


10. Determining whether the council has complied with these action plans and delivered the outputs is crucial to the process. The council's performance in achieving the thematic action plans is measured and reported on both an annual basis, as part of the Annual Performance Report, and in the intervening periods as part of mid term reviews.

11. Performance against the thematic action plans for 2006/07 was reported to members in the Annual Performance Report in June 2007. The council has performed well, delivering in excess of 93% of its planned outputs. In delivering the plans the council set targets against 164 planned actions, with 279 outputs. Of these outputs, 206 were fully achieved, 31 largely achieved and 20 partially achieved. The remaining 19 outputs (less than 7%) were not achieved. The Annual Performance Report highlighted the following as being key achievements:
 - increased access to and use of new technology in communities
 - implementation of the Adult Literacy and Numeracy Action Plan
 - improvement of employment opportunities for 18-25 year olds
 - promoting the use of CCTV throughout East Ayrshire
 - establishment and delivering of men's health services within East Ayrshire
 - development and implementation of environmental education programme for schools
 - supporting the development of credit union activity to enable full access for all people who live or work in East Ayrshire.

12. At the inception of the East Ayrshire Community Plan in April 2003, partners gave a commitment to carrying out a review of the Community Plan and related thematic action plans on a four-yearly basis. This first such review was carried out over 2006/07 to report on achievements and outcomes, and ensure that the Community Plan continued to be fit for purpose. Wide ranging consultation with communities, partners and other key stakeholders confirmed that the vision and the priorities identified in 2003 remain relevant. Therefore, the Community Plan remains current and a review supplement approved by all partners was issued in April 2007, alongside new 4-yearly action plans for each theme. Following the May 2007 elections, the Labour administration of East Ayrshire Council was replaced by a minority Scottish National Party administration. Work is ongoing to identify the degree of convergence between the SNP's local manifesto and the Community Plan.

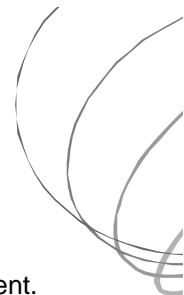
Key risk area 1



Overview of performance in 2006/07

Annual Report

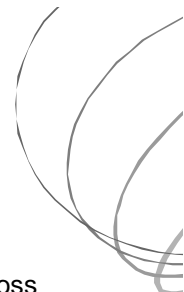
13. East Ayrshire Council publishes its Public Performance Report in November each year. The most recent report published in November 2006 was well structured and presented performance information in a clear and accessible format making good use of graphics. The report provided a brief round-up of the performance of council services during 2005/06 over each of the six thematic action plan areas identified above. It included a joint statement from the Leader of the council and the Chief Executive highlighting the most significant achievements and developments during the year, including comment on the council's positive Best Value report.
14. The report described aspects of performance and achievements across each of the Community Plan themes, including:
 - **Promote community learning** – in May 2006 the HMI Inspectorate for Education published a positive report following the latest inspection of the education service. In addition the council have commented on significant areas of improvement such as pupil attainment, community learning and popular projects such as the bibliotherapy project.
 - **Improving opportunities** – the council has implemented town centre regeneration strategies highlighting a series of short and long term actions to strengthen and diversify Kilmarnock town centre, other important projects include enterprise in education, person centred planning and looked after and accommodated children.
 - **Improving community safety** – the council recently joined the Police and other public sector organisations in signing up to the 'Violence Reduction Alliance' pledge to make Scotland a safer place. Between April 2005 and March 2006 violent crime reduced from 1,703 to 1,347, a reduction of 22%.
 - **Improving health** – the council is committed to improving the physical, mental health and well being of the people of East Ayrshire through the provision of services such as single shared assessments, care at home services, respite and healthy eating programmes.
 - **Eliminating poverty** – in maintaining partnerships with the Citizens Advice Bureau the council have aided an additional 5000 people with debt/benefit related issues. Other projects such as homeless support services and support for carers have contributed to making progress towards the council's targets.
 - **Improving the environment** – the 'Keep Scotland Beautiful' report highlights that East Ayrshire council's performance has improved and now cleanliness exceeds the national average. In addition recycling rates have increased from 2.5% in 2001/02 to 37.2% in 2005/06; this is well above the Scottish Government target of 25% by March 2006.



15. One of the key objectives set out by the Chief Executive was to prioritise performance management. This focus gave rise to an enhanced performance framework, monitoring, reporting and accountability. This was evidenced through the Best Value audit process and whilst recommendations were made to improve the current system the overall conclusion from the review was that the council's system for measuring and monitoring its business is based on many sound elements of performance management.

Measuring performance

16. East Ayrshire Council has put in place a performance management framework which covers the essential elements required for Best Value, including diagnosis, measurement, comparison, review, reporting and action planning.
17. The council use the European Foundation for Quality Management (EFQM) Business Excellence Model as an important tool in identifying areas for improvement. It is used to generate annual EFQM continuous improvement plans that are used to inform Best Value reviews.
18. We have reviewed the council's performance management framework and noted that it contains a wide range of procedures aimed at driving up performance. The Performance Framework was reviewed in detail as part of both the Best Value review and the council's internal review mechanisms. Both concluded that there was a need to consolidate the various elements used for managing performance to provide a more consistent and streamlined system including:
 - clearer links between service plans and Community Plan priorities
 - customer feedback and resources
 - better utilisation and development of the executive directors review process.
19. Of the issues identified the council has made good progress in reviewing and enhancing local service related performance indicators to reflect performance against strategic plan objectives, performance against operational objectives and meeting stakeholder expectations.
20. The council is also in the process of developing a range of other measures to improve performance, with pilot projects currently underway which aim to:
 - enhance links between council planning documents
 - provide a summary analysis of consultations with stakeholders
 - make better use of local performance indicators
 - provide an analysis of current and future service pressures
 - enhance public performance reporting.



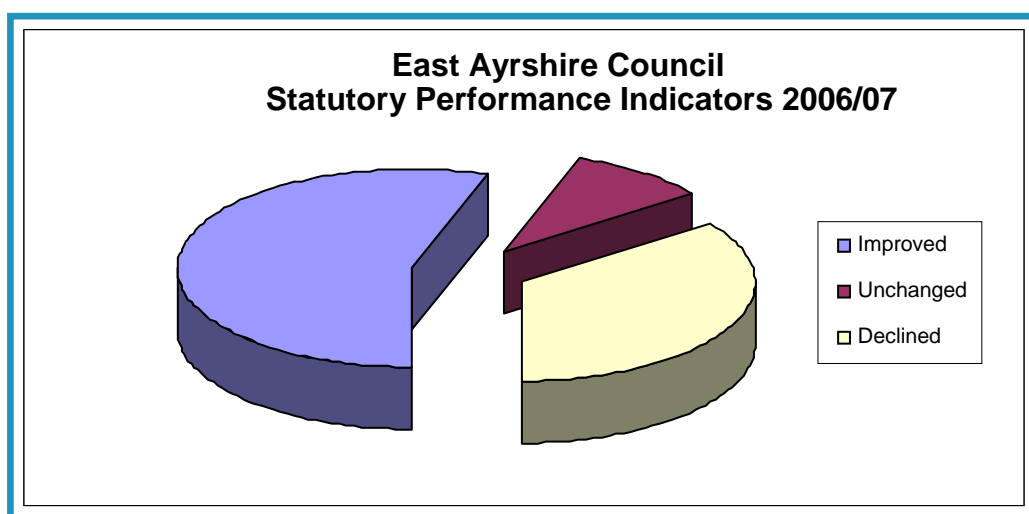
The council expect that current developments resulting from the pilot projects will be rolled out across the council in 2008.

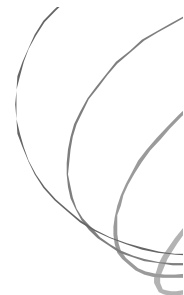
- 21. In line with Best Value guidance the council has also developed and enhanced the content of the performance review template for executive directors, this has included the provision of six additional areas including the residents survey, the efficient government agenda and public performance reporting.
- 22. Although recent developments in the council's performance management framework may not have been considered as part of the 2006 Best Value review it is clear that measuring and monitoring continues to be based on sound elements of performance management and that the council is continually improving its performance management framework.

Statutory performance indicators (SPIs)

- 23. One of the ways of measuring the council's comparative performance is using Statutory Performance Indicators (SPIs). Historically, the council has been well placed in national comparisons for a range of indicators, however, it also recognises that for other indicators, such as those in Development Services, improvements can be made and has placed emphasis in using targets to improve performance in these areas. In 2006/07, the council has reported continued improvement and high performance for a proportion of its SPIs and has set itself targets in areas where improvement is required.

Exhibit 1 – Statutory Performance Indicators 2006/07





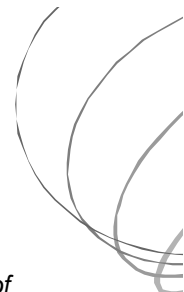
24. Examples of SPIs displaying a sustained improvement trend are:
- the proportion of staff working in residential accommodation who have an appropriate qualifications
 - occupancy percentage levels of the ratio of pupils to places in primary and secondary schools
 - the net cost of refuse collection per premise
 - current tenant rent arrears as a percentage of the net amount of rent due for the year.
25. Reported performance in 2006/07 has, however, declined in a number of areas, notably:
- the average time taken to process new benefits claims has increased by 5.5 days to 36.2 days. (Management have explained that this increase has arisen largely as a result of the implementation of the DWP Verification Framework.)
 - the average time between presentation and completion of duty by the council for homeless assessments has increased by 5.2 days to 16.6 days.
26. Each year we review the reliability of the council's reported SPIs. The council's Internal Audit Service provided invaluable assistance in completing this task. We were able to conclude that the reported figures were reliable.

Best value and community planning

27. The Local Government in Scotland Act 2003 established Best Value and Community Planning as statutory duties for local authorities. In response the Accounts Commission introduced new arrangements for the audit of best value based on a full review by a specialist team once every three years. In the intervening years short follow-up reviews are carried out by the local auditor.
28. The Best Value audit of East Ayrshire Council was carried out in 2006 and the findings published in September 2006. The audit concluded overall that:

“East Ayrshire Council can demonstrate a clear commitment to Best Value. It is focused on meeting the diverse needs of its communities, and is enthusiastic and innovative in working with a range of partners through Community Planning.

The council is characterised by strong and effective leadership from its senior management, which is developing a culture of continuous improvement throughout the organisation.



Progress has been made in performance management and other essential elements of Best Value, but further development is required, such as in linking service and budget planning and more balanced reporting on service performance.

The available evidence suggests there are good services in community care, housing, finance and education, although attainment levels remain a challenge in many schools. Statutory Performance Indicators (SPIs) could improve in a number of areas. The council also needs to ensure that it encourages a positive approach to challenging and discussing areas in need of improvement.

East Ayrshire Council - The Audit of Best Value and Community Planning

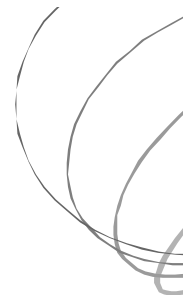
29. The Best Value audit of East Ayrshire Council highlighted fourteen points in the improvement agenda which were accepted at a special meeting of the council on 20 September 2006. On 7 February 2007 the Policy and Resources Committee agreed the detailed improvement action plan and agreed to receive annual update reports in respect of the action plans. Following the post election restructuring of the council's governance structure it was agreed that annual updates would be considered by the Governance and Scrutiny Committee. The improvement plan has been incorporated into the council's ongoing performance management arrangements.
30. Several of the actions in the improvement plan were identified by the council as part of its own strategic self assessment which preceded the Best Value audit. Based on our review and monitoring of reports produced for officers and members, there are some notable examples of service improvement, including:
 - Review of political and management structures. The council has reviewed its management structures to ensure that they are fit for purpose and is in the process of developing a protocol for the operation of multi-member wards, emphasising the focus on addressing community needs. In addition, the council has reviewed the role and function of each element of existing structures and has introduced a cabinet style decision making process.
 - Audit committee. The introduction of a Governance and Scrutiny Committee conforming to audit committee principles.
 - Strategic review of the revenue budget. A fundamental review of council spending and a detailed review of grant aided expenditure. Further comment on this important piece of work is included in the Financial Position section of this report.
31. East Ayrshire Council have made significant progress in the implementation of its improvement plan with recent reports to members highlighting that in excess of 50% of all recommendations have been implemented with the other 50% showing significant (highlighted as good, very good or excellent) progress against the original target implementation date. Whilst the council has largely implemented



the priorities set out in the improvement plan, some slippage has been experienced, largely as a consequence of management and political restructuring. Examples include:

- the production of a public performance reporting strategy for the council
- the development of a protocol for the operation of multi-member wards
- the development of enhanced members training to clarify the roles for elected members and officers in relation to all matters connected with asset management.

32. The council's strategic direction for community based public services is to work closely with its community planning partners in providing fully integrated public services, co-located in shared premises. The first co-location project, the Dalmellington Area Centre, was recognised nationally as a flagship partnership working project. This brought together under one roof, police, health and council services. Since this centre opened in 2001, a further three major co-located projects have become operational throughout the East Ayrshire area. The most recent co-location project, the North West Area Centre, with investment of £9m, was opened during 2006/07.
33. The council is committed to further extending this model of shared service provision to other parts of East Ayrshire. Plans are well advanced for similar developments in East Ayrshire. Building work has commenced on a new co-located centre for Stewarton. Crosshouse and Patna are at design stage and attention is now being turned to Galston and New Cumnock.



Performance outlook – opportunities and risks

Introduction

34. In the course of our audit work we identified some strategic risks to East Ayrshire Council delivering on its stated objectives and priorities in the years ahead. These risks were set out in our Audit Risk Analysis and Plan and grouped into six risk themes. In the following paragraphs, we comment on the progress made by the council during the year and the key risks yet to be fully addressed. Where appropriate, matters arising in a number of these areas are also reported in more detail elsewhere in this report. Risk exists in all organisations which are committed to continuous improvement and, inevitably, is higher in those undergoing significant change. The objective is to be “risk aware”, and have sound processes of risk management, rather than “risk averse”. Indeed, organisations that seek to avoid risk entirely are unlikely to achieve best value.

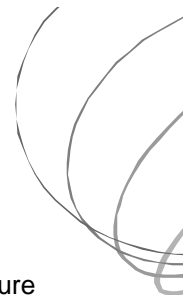
Governance and Accountability

35. In common with many councils, the local government elections in May 2007 resulted in a new administration and a considerable number of new councillors. This has required substantial support from officers to ensure that adequate training and development programmes were provided. Alongside this, the council took the opportunity to review its political management structure and implemented a cabinet arrangement.
36. Effective scrutiny is central to good governance. Governance arrangements were reviewed at East Ayrshire council during 2006/07 and reported to members in the Audit Risk Analysis and Plan (ARAP). The ARAP noted a number of areas where the council was exposed to risk notably the need for:
- the development of options for political management
 - a review of the audit committee arrangements
 - a review of internal audit planning arrangements
 - continued development of members' training and reporting methods.

The council have responded positively to the issues raised and have addressed the first three points in full. Training for members specifically relating to asset management will be progressed as the asset management framework becomes more fully developed.

Financial Planning

37. Proper financial planning is key to the continued provision of effective front line services against a backdrop of the efficient government initiative and the expected tighter fiscal regime. Financial



planning is therefore a key risk area for the council. Service planning must take account of all future developments and cost pressures whilst ensuring that the people, communities and businesses continue to receive an appropriate level of service.

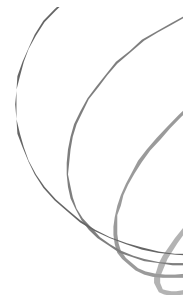
38. Evidence gathered from our Priority and Risk Framework (PRF) review and our improved understanding of financial arrangements following the final accounts audit has established that East Ayrshire Council have made significant progress in mitigating the risks in this area including:
- the strategic review of the revenue budget
 - the development of pilot projects within Leisure Services to improve linkages between community plans and service plans which will be rolled out to all services in 2008
 - the progress in the development of a corporate asset management plan.

Workforce Planning

39. The council recognises that its most important asset is its people, that providing them with the right skills through training and development is key to delivering its long term plans and that workforce planning has a central role to play in delivering improved services. The council has resolved to develop its staff appraisal system around core competencies and develop a more robust approach to longer-term corporate-wide workforces planning.
40. An important achievement in 2006/07 was the completion of the implementation of the single status agreement. Although there are still some issues which will remain outstanding in the short term, principally how the council deals with staff who face a reduction in their remuneration, this was, in our view, a well managed process. East Ayrshire Council has settled this issue considerably in advance of many other councils.
41. The council has acknowledged that the implementation of the workforce plan and the monitoring of future legislative and other developments which may impact future staffing requirements are key risks and have included them in their improvement agenda as part of the review of human resource management. In response to the improvement agenda the council have:
- fully developed a competence and appraisal framework and have commenced its rollout starting with Building and Works in September 2007
 - made good progress in the development of the workforce planning strategy.

Procuring and Managing Assets

42. The council needs facilities and infrastructure that are suitable and sufficient to meet the requirements placed on them in the provision of services and the delivery of council objectives, both now and in the



future. The council is implementing a Corporate Asset Management Strategy and the necessary actions are recognised in the improvement agenda. The main issues are:

- the identification of surplus assets
- enhancing a capital investment/receipts strategy
- improving option appraisal techniques
- implementing asset management software.

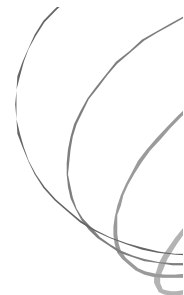
43. The council has made progress in the implementation of its Corporate Asset Management Strategy. The council has implemented its capital receipts strategy and has completed its review of property portfolios from which it has identified its future property requirements and properties available for disposal. Of the other issues noted above the council have made excellent progress with those actions due to be completed and implemented by March 2008.

44. The council's Procurement Section is now within the Administration and Legal Service and provides advice and practical support to all council departments in any matters relating to the procurement of goods, services and works, ensuring that the council complies with all relevant UK and European legislative requirements. In order to further enhance the operations of the procurement function the council has recognised the need to develop further supporting documentation and guidance.

45. Improvements in procurement are also part of the improvement agenda. The council is bound to achieve efficiencies through the application of modern procurement/purchasing methods, including e-procurement and more effective use of consortia arrangements. In response to the agenda the council has:

- determined the budgetary impact and future timescales for implementation of an e-procurement solution
- reviewed central purchasing records to determine the extent and scope for efficiency savings
- reviewed recommendations with a view to the localised implementation of, and future participation in, the McClelland Programme
- reviewed progress against the council's own procurement strategy and ensured that actions are consistent with national and sectoral procurement developments.

The implementation of each of these recommendations demonstrates the council's commitment to its improvement agenda.



Performance Management

46. The council undertook a strategic self-assessment as part of its preparations for the 2006 Best Value audit. This exercise identified a number of key areas for improvement and the council prepared detailed action plans to address these. In the action plan the Chief Executive highlighted a number of specific priority areas, including:

- integrating service and budget planning processes
- linking customer feedback to improvement and public performance reporting
- improving management information on staffing resources and staff views
- introducing personal development and appraisal for directors
- increasing the use of comparative analysis
- standardising performance reporting across the council through an annual consolidated system.

47. The Best Value review recognised the work that had already been completed noting that:

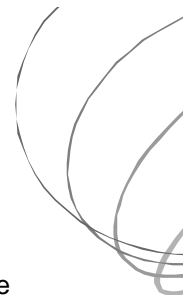
“The council’s system for measuring and monitoring its business is based on many sound elements of performance management. The council recognises the need to consolidate and streamline its approach, and this should result in more consistent links between the different parts of the system and improved scrutiny of performance by members.”

Community Planning

48. East Ayrshire Council has clearly signalled its commitment to a shared vision by its decision to adopt the Community Plan as its strategic plan, with no need for a separate corporate plan. The council believe that it not only reinforces its commitment to partnership working but also gives other benefits, including clarity of purpose across the council and a common framework for coordinated action.

49. The council has a structured review process which ensures Community Plan and associated action plans continue to be relevant to local and national priorities with the effectiveness of the overall partnership process being formally reviewed through the mechanism of a partnership assessment scorecard. In addition, regular planning and review sessions are convened with core Community Planning partners and the Joint Officers’ Group.

50. The council have processes in place to ensure that partnerships deliver the intended improvements in services and wellbeing. We have reviewed these annual reports and conclude that most targets have been met; where this is not the case (around 6% of all targets) explanations have been provided as to why and whether remedial action is required.



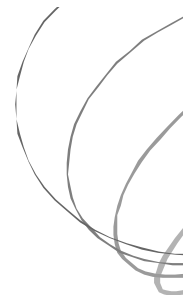
51. As noted in the review of Performance Management and the Best Value sections of this report the council intends to continue to develop and enhance the linkages between the Community Plan and the operational plans for individual services.

National studies

52. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports of direct interest to the council are set out below. Further information on these studies and reports can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk

Sustainable waste management

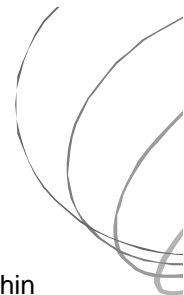
53. There is an increasing awareness of the need to protect the environment and to promote the sustainable use of resources. As a result of UN conventions and EU Directives, the UK government introduced a landfill tax to discourage the disposal of waste in landfill sites and set a (non-statutory) target that local authorities should recycle 25% of household waste by 2000. This target was not achieved by the public sector in the UK.
54. Further EU Directives required member states to "take appropriate steps to encourage the prevention, recycling and processing of waste" and to set out details of measuring processes within waste management plans. Subsequently a series of targets was set over the period to 2020 to reduce the amount of biodegradable waste going to landfill. The EU can impose a fine on the UK of up to £350,000 per day if it fails to meet its targets.
55. The purpose of Audit Scotland's study was to examine the performance of local authorities; the Scottish Environmental Protection Agency (SEPA) and the Scottish Government in reducing the amount of municipal waste being disposed of as landfill, including the impact and value for money achieved by the investment in this area.
56. The key findings from Audit Scotland's national report published in August 2007 highlighted that:
- Significant progress has been made in meeting interim recycling targets. The percentage of municipal waste which is recycled and composted has risen from 7 per cent in 2001/02 to 25 per cent in 2005/06.
 - There has been slow progress in developing facilities to treat waste that is not recycled, this means there is a significant risk that EU Landfill Directive targets may not be met, in particular the 2013 target.
 - The increases in the amount of recycling have led to increased costs.



- There needs to be improvements in agency working and that there is an urgent need to build organisational capacity within councils and in the Scottish Government to achieve this.
57. East Ayrshire Council have made significant improvements in recycling and composting with the report highlighting that the rates were the sixth and eighth highest amongst Scottish local authorities. In addition 67.3% of municipal waste has been disposed in landfill sites the ninth lowest rate in Scotland and better than the average figure of 69%.
58. Developments in recycling, composting and disposal methods have come at a cost with the average cost for refuse disposal, per household, increasing from £45 in 1999/2000 to £86.14 in 2006/07 the highest amongst Scottish local authorities.

Dealing with offending by young people

59. Audit Scotland published reports on *Dealing with offending by young people* in December 2002 and November 2003.
60. Audit Scotland undertook a follow-up study review to ascertain improvements in performance since 2002 of agencies who deal with young people who offend in the context of a changing policy landscape. The key findings from the national study are:
- Councils cannot demonstrate that the increased funding has resulted in an effective use of resources which offers value for money.
 - Weaknesses in performance management arrangements means comprehensive reporting on performance against the national standards cannot yet take place.
 - The introduction of antisocial behaviour orders (ASBOs) as a measure to contain antisocial behaviour has created tensions with other approaches to dealing with offending by young people.
 - The children's hearings system has been put under pressure by increases in referrals.
 - Improvements have been made in the timeliness of police reporting and reporter decision-making.
 - The time taken for social work reporting remains unacceptably long.
 - Youth justice strategy groups are starting to shape strategy and to deliver operational change. However, there remains too much variation in the standard of performance.
61. As a result of the 2003 report the council introduced enhanced management arrangements for youth services to improve the quality of services provided to young people and their families. Youth justice services are subject to rigorous external scrutiny through the Quarterly Youth Justice Reporting Framework.



62. Latest performance reports published during March 2007 highlight the improving performance within the council including:

- a 40% decrease in new incidents by persistent offenders
- a downward trend in the percentage of new persistent offender referrals
- a 15% reduction in the number of persistent offenders, the national figure rose by 6% over the same period
- 67% of all background reports were compiled within 20 days, the national average is 47%.

Scotland's school estate

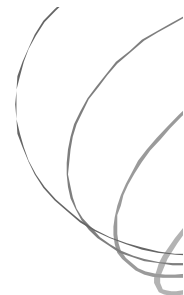
63. A national review of how effective recent investments in the Scottish school estate have been in terms of improving the quality of the learning and teaching environment. The performance of the Scottish Government and local authorities in improving the schools estate within the context of the 2003 strategy 'Building our Future' – Scotland's school estate will be considered.

64. The objectives of the study are to assess:

- How much has been spent so far on improving school buildings, by the Scottish Government and by councils?
- How well the Scottish Government is enabling improvements to school buildings, and to what extent it has implemented the relevant recommendations from Audit Scotland's 2002 'Taking the Initiative' report?
- How much has been achieved with the expenditure and how much remains to be done?
- The quality of the outcomes to date.

The report is currently being finalised and is due for publication during the Spring of 2008.

65. It is likely however that the report will recognise that the council are, in addition to the development of the Public Private Partnership (PPP) schools project, nearing finalisation of plans for a new build Galston Primary School, enhancements to Netherthird Community Campus and extension to Dunlop Primary School new nursery school facilities. Use of the council's own capital programme and the School Fund has seen significant investment in all non PPP secondary and primary schools.



Financial Position

Introduction

66. In this section we summarise key aspects of the council's reported financial position and performance to 31 March 2007, providing an outlook on future financial prospects, including our views on potential financial risks. Under the strategic theme of 'financial planning', our Audit Risk Analysis and Plan recognised the significant challenges being faced by the council both in relation to delivery of its improvement agenda but also with regard to managing ongoing financial pressures such as implementing single status. Our findings and key messages are set out in this section.

Council tax and the general fund

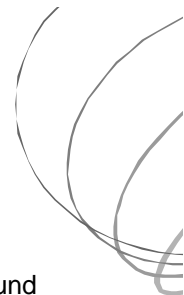
Operating performance 2006/07

67. The council sets an annual budget to meet its service and other commitments for the forthcoming financial year. Funding is from three main sources: general and specific government grant; miscellaneous receipts; and local taxation. Where an unplanned surplus or deficit has been made members will, as part of their monitoring duties, obtain appropriate explanations from relevant officers.

68. East Ayrshire's financial statements for 2006/07 have been prepared in accordance with the SORP. The income and expenditure account discloses the income and expenditure for the year calculated in accordance with UK GAAP. The deficit disclosed on the income and expenditure account represents the amount by which expenditure exceeds income. However, to align the results for the year with the council's budget a number of adjustments must be made. These adjustments are made in the statement of the movement on the general fund. The general fund surplus for the year is disclosed within the statement on the movement of the general fund balance. The figure disclosed is, however, after a significant transfer of balances to other reserves.

69. The budget set for 2006/07 was based on a Band D council tax level of £1,171. The budget was set at break even, that is, there was no planned use of reserves in setting the 2006/07 general fund budget and determining the council tax for the year. During the course of the year the budget was supplemented by some £2.570 million of unallocated general fund balances and a further £1.610 million of allocated balances.

70. The council's net (of general receipts) operating expenditure in 2006/07 was £227.166 million. This was met by government grants and local taxation of £226.949 million, resulting in a deficit of £0.217 million. After making the necessary adjustments, as specified by the SORP, a general fund surplus for the year of £4.154 million has been disclosed on the statement on the movement of the



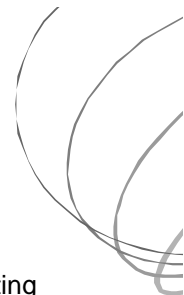
general fund balance. When unbudgeted transfers to reserves are taken into account a general fund surplus for the year of £10.420 million arises.

71. The SORP specifies that the Explanatory Foreword should include, *inter alia*, "Service expenditure, interest payable and other operating costs, income from grants, local taxpayers and other sources, compared in overall terms to the budget". It is our view that the format of the Explanatory Foreword should be reviewed for future years taking account of good practice evidenced in other councils' accounts. We also consider that the surplus/deficit as compared to the council's annual budget should be clearly stated and variance explanations provided in respect of this figure.
72. The council achieved a surplus of £10.420 million against a revised final budget (inclusive of additional funds received). Exhibit 2 sets out the most significant underspends.

Exhibit 2 – Significant underspends 2006/07

Service	Underspend £'million
Education Services	2.864
Development & Property Services	1.164
Provisions	1.200
Central Services	0.942
Debt Charges	0.815

73. Education Services reported a total underspend of £2.864 million, made up of a general underspend of £1.798 million (including £0.652 million retained for carry forward under the devolved school management scheme) and £1.066m grant funding unspent at the year end. Some £1.762 million in unanticipated grant funding was received in year from the Scottish Government, much of this extra grant funding was spent during the year. The final budget monitoring report for 2006/07 disclosed a total employee cost underspend of £1.515 million and explained that the main savings related to employee costs arising mainly from vacancies.
74. Development and Property Services reported a total underspend of £1.164 million. The final budget monitoring report for 2006/07 reported the main elements being greater than anticipated income in respect of building warrants and planning fees (£0.241 million) and for the provision of professional services by Technical Services (£0.454 million). A further £0.253 million allocated to the corporate office strategy budget during the year was not used.
75. Central Services reported significant variances against three different miscellaneous service expenditure heads. The total underspend for this service of £1.459 million (excluding an unused



provision of £1.200 million) is made up of an overspend of £0.886 million on employee costs relating largely to redundancy and pension payments incurred as a consequence of the closure of two care homes. This was offset by underspends amounting to some £1.142 million consisting mainly of £0.551 million unused energy efficiency contingency the balance being made up of underspends on various heads.

76. Building and Works STO received an additional £2.064 million income from housing repairs and capital work, offset by £1.391 million paid to sub-contractors to carry out this work and a £0.193 million pension adjustment required by Financial Reporting Standard 17. The increase in surplus over budget for the STO was £0.614 million.
77. Similar to 2005/06 council tax collection has exceeded the budget by some £0.940 million. The budget setting process and rate of recovery should be reviewed in light of the council's improving performance. Outstanding community charge debt is still being collected. Some £0.101 million was collected in 2006/07 (£0.114 million 2005/06).
78. The council receives significant amounts of grant funding for specific projects. As at 31 March 2007 the council held £3.539 million in unspent grant funding for a range of projects across all services. Notable among these balances were £1.798 million in unspent community projects funding, and £0.703 million for the "Top of the Town" project. In addition, Education Services held £0.707 million and Social Work Services £0.220 million, each for a variety of different projects. These grants have been accrued and carried forward to 2007/08 as part of the general creditors balance.

Reserves and balances

79. At 31 March 2007 the council had total cash backed reserves and funds of £46.543 million (2005/06 £31.640 million).
80. The council reserve strategy is to maintain a general fund balance of between 2% and 4% of net budgeted expenditure. At 31 March 2007, the council had an "unallocated" general fund reserve of some £6.496 million which falls within the parameters set out in the council's reserve strategy. A range of financial issues which could impact on the reserves position is discussed in our Financial Outlook section below.

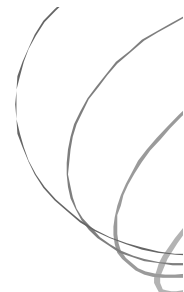


Exhibit 3 - Reserves and funds 2006/07

Description	2006/07	2005/06
	£'million	£'million
General Fund	21.267	17.113
General Fund – HRA balance	1.401	nil
Capital Fund	13.793	8.376
Repair and Renewal Fund	4.508	2.901
Insurance Fund	5.574	3.250
Total Reserves and Funds	46.543	31.640

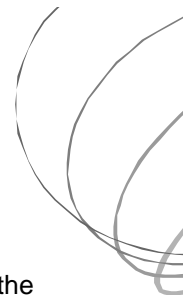
81. Some £14.771 million of the general fund reserve is earmarked as being already allocated for use in future years. Not all of these funds are currently committed. The financial statements of 2005/06 noted that some £8.565 million from a total balance of £17.113 million was already allocated. Only some £1.610 million of this was used in 2006/07. We understand that the Executive Head of Finance and Asset Management is to provide a briefing note to members of the Governance and Scrutiny Committee to clarify the proposals for the use of the allocated funds.
82. Budget holders can carry forward “managed” savings to the next financial year. The current arrangements have evolved over time. We consider that there would be benefit in formalisation and clarification of the current arrangements.

Key risk area 2

83. A report to Committee (24 June 2004) set out a strategy to accumulate, by 31 March 2006, a balance on the Capital Fund of £5.5million. The council also resolved to commit this sum to the PPP project with the fund being replenished from the sale of surplus assets. The current balance on the capital fund is now £13.793 million. The council has not yet agreed a strategy for the application of the balance of this fund.
84. The council operates an insurance fund. The original target was to have a balance on this fund of £5m; the fund now stands at £5.574 million after the transfer of £2.163 million from the 2006/07 surplus. The council should review its strategy in terms of risk, optimum balances and Best Value following the outcome of the recent insurance tender.

Rents and the housing revenue account (HRA)

85. The council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set to at least cover the costs of its social housing provision. The council’s strategy on

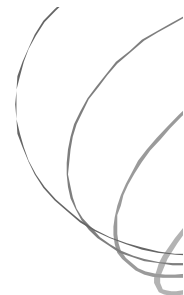


rent levels was set by the Housing Committee in April 2005. In order to fund the achievement of the Scottish Housing Quality Standard by the target date of 2015 the Committee agreed that rents should rise annually by retail price index (RPI) plus 1%.

86. The budget for 2006/07 was approved by the Housing Committee on 25 January 2006. The budget presented to the committee estimated a total expenditure of £32.952 million and income of £31.787 million leaving a shortfall of £1.166 million to be funded by a rent increase. The rent increase for 2006/07 was subsequently set at 3.8% by the Policy and Resources Committee on 8 February 2006.
87. In 2006/07 the HRA repaid to the loans fund £1.375 million in excess of the amount required by the repayment schedule. The Scheme of Delegation provides the Executive Head of Finance and Asset Management with delegated powers in this respect. The £1.375 million was included in a line "Debt Charges £5,200,000" in the annual budget approved by the Housing Committee on 25 January 2006. Where a discretionary element of expenditure is included in the budget this should be made explicit.
88. The Building and Works STO has reported a surplus of £2.379 million (£3.060 million 2005/06). This surplus is transferred to the general fund. The HRA contribution to the Building and Works STO surplus is around £1.400 million (based on a simple pro-rata turnover calculation). This level of contribution from the HRA to the general fund should be re-examined by officers and the consequences of the charging policy should be made explicit to members.

Group balances and going concern

89. The council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. The accounts of East Ayrshire Council and its group have been prepared on a going concern basis. For the year ending 31 March 2007 the group balance sheet discloses net assets of £136.127 million after taking account of the council's share of the net liabilities of its associates totalling £192.755 million. This position reflects, in the main, the combined deficit on the pension schemes operated by Strathclyde Joint Police Board and Strathclyde Joint Fire and Rescue Board.
90. The Executive Head of Finance and Asset Management has reviewed the group's ability to continue as a going concern and is of the opinion that it is reasonable to assume continuing funding streams to joint boards, increased pension contributions and continuing local government finance settlements. He has, accordingly, taken the view that it is appropriate that the financial statements be prepared on a going concern basis.



Spending on assets and long-term borrowing

Capital performance 2006/07

91. Following the introduction of the “Prudential Code” in April 2004 councils can decide locally on a capital investment strategy which meets Best Value affordability criteria. The council’s prudential indicators for 2006/07 were set in February 2006 at which point the council anticipated using £53.868 million to improve its asset infrastructure.
92. During the early part of the year the council re-profiled £17.704 million of planned general services expenditure to 2007/08. Subsequent revisions to the general services programme resulted in an adjusted total allocation for the year to £28.298 million. At year end the housing services programme, with a capital budget of £12.079 million, was largely on target, reporting expenditure of £11.446 million. The general services capital programme did not progress so well, reporting actual expenditure of £21.479 million, which represents completion of 76% of the revised general fund plan and 54% of the original.

Key risk area 3

93. Capital investment in the last two years was funded as shown in the bar charts at exhibit 4. Capital expenditure in 2005/06 totalled £24.410 million compared to the 2006/07 total of £32.925 million, an increase of 35%. Although the council has supported its increased capital spending by using a larger proportion of borrowing, actual long term debt has remained broadly static at £190.785 million in 2006/07 (£191.355 million 2005/06).
94. Almost 98% of long-term borrowing at the year-end matures after more than 10 years. The council has actively managed its exposure to variable interest rate movements with minimum debt exposed to variable rate risk.
95. As noted above, the housing services capital programme was delivered as planned, while the general services experienced slippage across a number of services. Significant slippage of between £0.744 million and £0.868 million were reported by Education, Social Work and Neighbourhood Services. The Development and Property Service reported a slippage of £4.779 million, the largest single contributor to which was delay of £2.451 million expenditure on the Galston Flood Prevention Scheme, due to a major redesign being required to meet unanticipated site constraints.

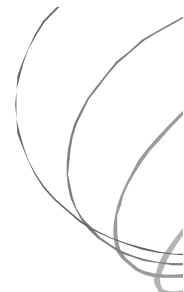
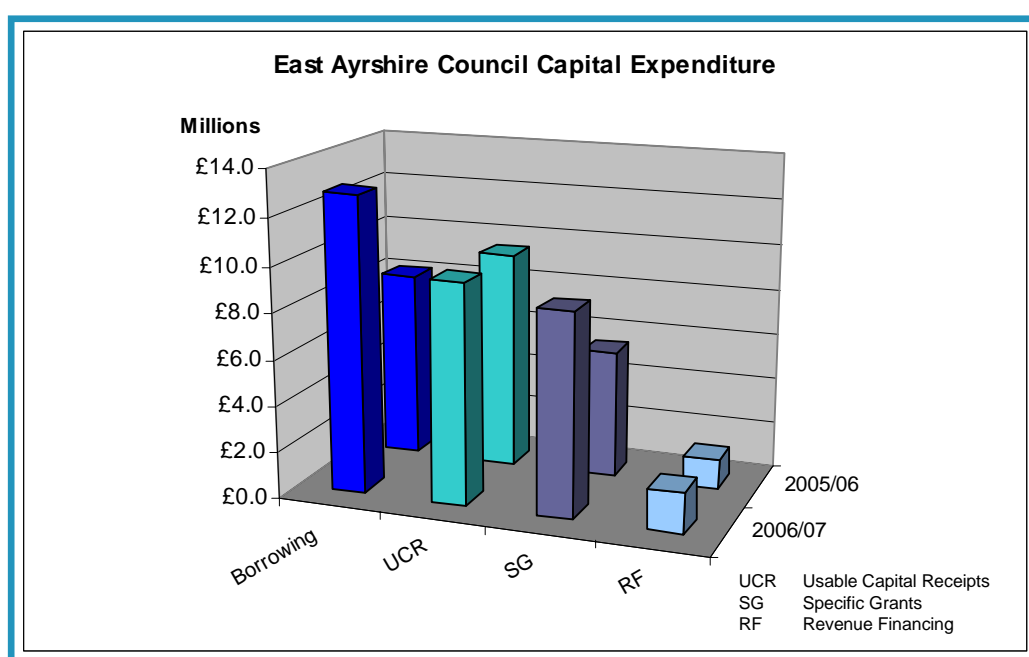
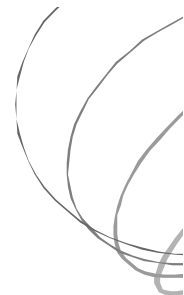


Exhibit 4 - Sources of finance for capital expenditure 2006/07



Forward capital programme

96. General services capital plans for 2007/08 and 2008/09 anticipate annual capital expenditure of £42.817 million and £17.499 million respectively. The 2007/08 plan includes significant amounts of work carried forward from previous years' programmes; resources will have to be applied very effectively to ensure that such an extensive programme can be delivered. The forward capital programme is expected to be funded from a number of sources including capital receipts, grants and other contributions and further increases in borrowing totalling £35.149 million over the two years.
97. As at period 5 of 2007/08 the council was anticipating slippage of £8.242 million in the general services capital programme. This is largely due to delays to a small number of major projects being undertaken for Social Services and Neighbourhood Services, including the redesign of the Rosebank Resource Centre and consultation on the Trading Services depot.
98. The CIPFA Directors of Finance Section published (October 2006) new guidance on option appraisal which has been considered by the council in the development of its own option appraisal procedures. A target date of March 2008 has been set for roll out to services.



Current investments

99. East Ayrshire Council discloses £54.000 million of current investments in the 2006/07 balance sheet (2005/06 £48.750 million). We reviewed the position as part of our audit of the financial statements and concluded that the current investment is largely attributable to the usable reserves held on the balance sheet.

Significant trading operations

100. The Local Government in Scotland Act 2003 requires Significant Trading Operations (STOs) to break even over a three year rolling period. The second three year period ended in 2006/07. During 2006/07 seven of the ten STOs reported in the 2005/06 accounts were re-designated as non-statutory.

101. The council's three remaining STOs, Building and Works, Vehicle Maintenance and Roads achieved their statutory financial objectives for the period ending 31 March 2007.

102. As noted above seven STOs operating in 2005/06 were re-designated non STOs for 2006/07. Two of the former STOs (catering and building cleaning) failed to meet the statutory financial target in 2005/06; largely as a result of the impact of the settlement of equal pay cases. A management review of STOs was carried out during 2006/07 and this is to be followed up with Best Value reviews as part of the council's normal service review cycle. This will be followed up as part of the 2007/08 audit.

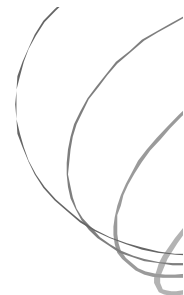
Financial outlook

Current budget

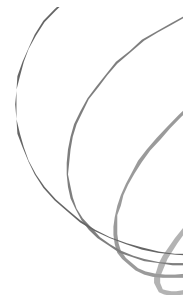
103. The Comprehensive Spending Review (CSR) announcement made by the Chancellor of the Exchequer on 9 October will set the financial framework for the Scottish Government for the next three years. The settlement is expected to impose restrictions on the Scottish Government's budget and although the allocation to councils has not yet been made it is expected to be a tough settlement and councils will be faced with some hard choices on where to allocate scarce resources, in the face of pressures from increasing numbers of elderly people, children with complex needs and a demanding environmental agenda.

Key risk area 4

104. East Ayrshire Council's revenue budget for 2007/08 was approved in February 2007. The budget is based on a band D council tax level of £1,189 which is an increase of 1.5% over 2006/07. There were no proposals in the budget to augment or apply any of the reserves in setting the budget.



105. In his report to the Policy and Resources Committee of 7 February 2007 the Executive Head of Finance and Asset Management outlined some of the pressures being faced by the council. Increases to service budget were restricted to additional costs arising from unavoidable legislative and policy issues and areas of high risk. These areas are mainly confined to Education and Social Work Services.
106. The report also noted that the absence of three year grant figures from the Scottish Executive/ Government meant that certain assumptions had to be made to estimate income levels for 2008/09 and 2009/10. The assumptions made for the planning of the 3 year cycle were of increases to revenue support grant (RSG) and council tax of 2.5% and continuing efficiency gains generating some £3.250 million in each of the three years.
107. As part of its best value improvement agenda the council is carrying out a strategic review of its revenue budget (SRRB) under the guidance of Professor Arthur Midwinter, an independent specialist in public finance. Fundamental to the council's SRRB initiative was to compare the council's spending on services with its expenditure needs as measured by grant aided expenditure (GAE). The review is a groundbreaking initiative designed to ensure that the council receives its fair share of national resources and that the resources available are directed in a way that supports the aims of the Community Plan.
108. The importance of the SRRB initiative to the council's finances has increased with the probability of less generous financial settlements on the horizon. Significant progress has already been made and examples of the key issues identified so far, include:
- anomalies in some of the council's needs based allocation of grant from the Scottish Government
 - nine significant GAE service programmes have been identified as spending significantly higher than service level GAE, with no clear evidence of distinctive local need factors driving the excess
 - the council have secured additional childcare strategy GAE assessment and related funding in excess of £200,000 per year from 2008/09
 - potential redistribution for the first stage of the SRRB is estimated to be in the region of £4.542 million.
109. The next milestone in the SRRB process is March 2008. It is intended that by this date service planning and budgeting processes will be fully integrated, in line with core council business and the Community Plan priorities.



Equal pay

110. Equal pay compensation packages were agreed with relevant staff during 2005/06 and £4.701 million was recognised in that year's accounts. The council continues to face potential additional equal pay claims from further groups of employees. No further provision has been made in respect of these potential claims, however, the Executive Head of Finance and Asset Management has recognised the possibility of a contingent liability in a note to the accounts.

Single status

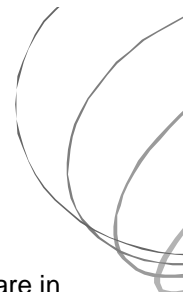
111. In 1999 a single status agreement was reached between Scottish local authorities and trades unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a national presumption that single status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.

112. The council made excellent progress in introducing single status during the year and by mid-March 2007 had completed the exercise and consulted on the outcome. Implementation of the single status scheme was approved by council on 22 March 2007. The scheme provided for backdating salary and wage adjustments to 1 April 2006, the 2006/07 accounts include a charge of some £1.800 million in respect of backdated awards.

Efficient government

113. As part of the continuing drive to improve the efficient use of resources committed to delivering public services, the Scottish Government expect public sector organisations to apply the principles of the efficient government initiative in their day-to-day operations with an aspiration to achieve recurring efficiency gains of £1.5 billion by 2007/08. In the case of councils, efficiency savings were incorporated into the annual financial settlement provided to councils by the Scottish Government. The principles of the efficient government initiative encourage the delivery of services at a lower unit cost without compromising the quality of service provision.

114. During 2006, councils across Scotland recognised that as part of their partnership arrangement with the Scottish Government, they had a responsibility to report efficiencies on the five key operational themes as set out in "Building a Better Scotland" (procurement, absence management, asset management, shared services and streamlining bureaucracy) on a consistent basis. As a result, the Improvement Service was commissioned to devise a set of standard measures which would allow councils to publish un-audited efficiency statements on a common basis. Guidance was issued to all councils in May 2007.



115. East Ayrshire Council has recognised the need to demonstrate efficient government. Strategies are in place to manage the process and regular meetings are held with budget holders to identify efficiencies and manage their achievement.

116. The council submitted its efficient government monitoring return to CoSLA in June 2007. The return states that the council achieved total efficiency gains of £4.363 million (£2.403 million cashable and £1.960 million non-cashable) in 2006/07. These are summarised against the Scottish Government's efficient government themes at exhibit 5.

Exhibit 5 - Claimed efficiencies in 2006/07

Efficient Government	Cashable	Non cashable	Total efficiency
	<i>£'million</i>	<i>£'million</i>	<i>£'million</i>
Procurement	0.697	0	0.697
Streamlining bureaucracy	0.055	0	0.055
Other	1.651	1.960	3.611
Total efficiencies	2.403	1.960	4.363

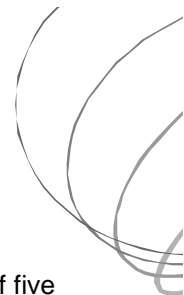
117. Overall, the council has complied with the Improvement Service guidance in preparing its efficient government monitoring return for 2006/07. There was no requirement for the statement to be audited in 2006/07.

118. A significant element of the saving is derived from changes in delivery models and procurement. The efficiencies reported for the year include £0.905 million in respect of "no allowance for inflation in budget lines".

119. It will be a challenge for the council to demonstrate achievement of these efficiencies whilst continuing to deliver high quality services. However, the progress made in its strategic review of the revenue budget, discussed above, provides a solid foundation for improved efficiencies in service provision.

Asset management

120. Scottish councils control land, property and equipment valued at around £22 billion. Capital assets are the second highest cost incurred by local authorities after staffing. The Local Government in Scotland Act 2003 now places a duty on a local authority to determine and keep under review the maximum amount which it can afford to allocate to capital expenditure.



121. The Scottish Government's Efficient Government Initiative identified asset management as one of five key areas for achieving efficiency improvements. Proper asset management is a key driver to ensure there are:

- strategies to reduce maintenance costs
- proactive asset disposal policies
- long-term capital planning and budgeting
- robust asset management monitoring information.

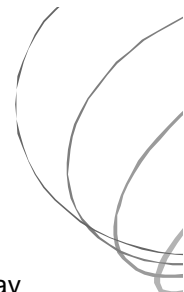
122. The council is making encouraging progress in embedding asset management into the business planning process. The council agreed a strategy for asset management, consistent with CIPFA best practice guidance, during 2005. Work has already been done on office accommodation; in due course the strategy is expected to ensure that the council's asset base is driven by council and Community Plan objectives. In a further development of the corporate asset management effort the function has been transferred to the Finance Service. The council has purchased corporate asset management software and is in the process of populating the database.

Pension liabilities

123. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long and the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. A recent Audit Scotland report on public sector pension schemes highlighted that the combined funding shortfall and unfunded liabilities of the six local government pension schemes in Scotland may be as high as £53 billion. The Local Government Pension Scheme (LGPS) has been the subject of a number of changes over the past year and further proposals to amend the scheme to reduce ongoing cost are currently out to consultation.

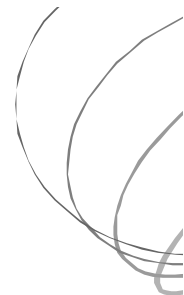
124. In accounting for pensions, Financial Reporting Standard 17 (Retirement benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement for councils results in very large liabilities being recognised in the financial statements.

125. The council's estimated pension liabilities at 31 March 2007 exceeded its share of the assets in the Strathclyde Pension Fund by £52.153 million, a reduction of some £37.863 million over the 2005/06 figure of £89.989 million. A full actuarial valuation of the Strathclyde Pension Fund was carried out as at 31 March 2005 by Hymans Robertson. The next full valuation of the scheme is due as at 31 March 2008. Factors such as volatile stock markets and increasing life expectancy resulted in a funding level of 97% as at 31 March 2005 (calculated as the ratio of fund assets to past service liabilities).



Hymans Robertson was commissioned to review the funding level again in 2006, and as at 18 May 2006, the funding level had improved to 100.4%. The actuary is required to make a 3-year assessment of the contributions that should be paid by employing authorities to maintain the solvency of the fund. The latest assessment indicates that employer contributions are expected to rise from 240% of the employees' contribution in 2004/05 to 280% by 2008/09.

126. Changes to the Local Government Pension Scheme (LGPS) permit employees retiring on or after April 2006 to take an increase in their lump sum payment on retirement in exchange for a reduction in their future annual pensions. Hymans Robertson, the Strathclyde Pension Fund actuaries have assumed that 25% of employees retiring after 6 October 2006 will take advantage of this change to the pension scheme. This assumption has resulted in a reduction of the council's pension liabilities by £4.681 million for 2006/07. The longer term impact of this change to the LGPS regulations on the council's accounts will remain uncertain until a discernable trend can be established.



Governance

Introduction

127. In this section we comment on key aspects of the council's governance arrangements during 2006/07. We also provide an outlook on future governance issues, including our views on potential risks.

Overview of arrangements in 2006/07

128. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Based on the work undertaken, we concluded that East Ayrshire Council had systems in place that operated well within a sound control environment.

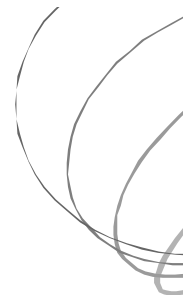
129. A Corporate Governance Assurance Statement is included within the annual financial statements which provides a commentary by the Leader of the Council and the Chief Executive on progress made during the year in taking forward issues to ensure compliance with the Code of Corporate Governance. There has been significant activity during the year to review the council's corporate governance arrangements and updating the risk management strategy.

Governance and Scrutiny Committee

130. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account on service delivery and support the reform and modernisation agenda.

131. Our annual plan of work includes a review of the governance and scrutiny arrangements of the council. The review was reported to members as part of the Audit Risk Analysis and Plan (the ARAP) in April 2007 and noted that 'The council does not have an audit committee, as such. It operates a scrutiny group consisting of both members and senior management. The "Audit Committee Principles in Local Authorities in Scotland" guidance issued by CIPFA sets out a number of principles for audit committees and notes that it is good practice for these to be formally constituted committees reporting directly to council. In our view there is a risk that the status of the group may not promote the most effective level of scrutiny of governance and performance.'

132. At the first full council meeting following the Local Government Elections on the 3 May 2007, members were asked to evaluate and decide upon a new decision making structure. The model chosen was a cabinet model where a limited number of members (8-10) formulate council policy and make all key strategic and service delivery decisions. The membership of the cabinet was determined by the council as no single party had overall control of the council.



133. One key feature of the cabinet model was the introduction of the Governance and Scrutiny Committee, comprised only of elected members, responsible for overall scrutiny and review of the council and its executive. The formation of the Governance and Scrutiny Committee is a significant step forward from previous scrutiny arrangements under the Risk and Scrutiny Group and means that the council are now fully compliant with audit committee principles.

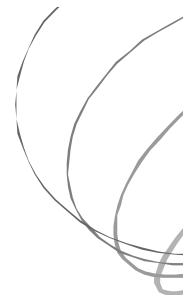
134. To date Governance and Scrutiny Committee have met twice since its formation and under these circumstances it is difficult for us to comment on its performance. The success of the committee will be dependant on its members, particularly the chair and vice-chair. Following our attendance at the committee we have noted an encouraging level of scrutiny with members questioning officers and requesting further details on pertinent issues. This bodes well for the future.

Internal Audit

135. The environment in which internal audit functions operate has changed markedly since the publication of CIPFA's Code of Practice for Internal Audit in Local Government in 2003. To ensure that the Code's requirements continue to be fit for purpose, CIPFA's Audit Panel published a revised Code in December 2006. The revisions, in the main, brought the Code into line with existing good practice and current professional standards.

136. We carried out an annual review of the council's internal audit arrangements and found that the function produces high quality reports backed up by excellent supporting files demonstrating a rigorous approach to the execution of the work. As a result of our review, the Internal Audit Service (IAS) have given greater priority to coverage of the core financial systems and adopted a strategic approach to planning audit coverage for 2007/08. We were, therefore, able to place partial assurance on the work of the IAS.

137. One development worthy of note is the council's IAS involvement in cross-boundary assignments involving the three Ayrshire councils and NHS Ayrshire and Arran. The "All-Ayrshire" integrated services project proposed three cross-boundary exercises in 2006/07 and East Ayrshire Council's IAS acted as the lead in the review of absence management. A report was published in August 2007 which compared and contrasted the managing absence strategies of the Ayrshire partners. It is hoped that this exercise will contribute to improved arrangements through the sharing of good practice. We highly commend this co-operative effort as an example of best practice in joint-working and service sharing.



Risk Management

138. As noted in the Risk Management Strategy the council has identified the following key challenges to advancing risk management:

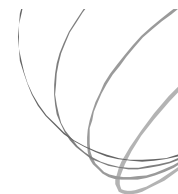
- promoting the effective utilisation of the new electronic risk management system in the embedding of a risk management culture
- re-tendering of the insurance portfolio including options with regard to the level of self insurance
- ensuring an effective risk management partnership is established with the new insurance provider
- maximising the benefits and opportunities arising from the establishment of the Risk Management Centre.

Systems of internal control

139. In his annual report for 2006/07 the Chief Internal Auditor provided his opinion that, based on the internal audit work undertaken during the year, the council's corporate governance arrangements were adequate and operating effectively, with three exceptions. He drew attention to planned areas of improvement in the development of systems of performance management, progressing the council's Corporate Asset Management Strategy and weaknesses identified within the control environment of Social Services. The Chief Internal Auditor has confirmed that 51 of the 56 action plan points arising from the Internal Audit Service Social Services reviews have now been implemented.

140. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on a number of the council's main financial systems. As this is the first year of the audit we have yet to fully review all of the council's main financial systems however, our audit plan included the review of the central payroll system which was assessed as having a satisfactory level of controls which were operating effectively. In addition we have undertaken high level testing on the following systems:

- | | |
|------------------------------------|-----------------------------|
| ▪ Budgetary control | ▪ Non domestic rates income |
| ▪ Capital accounting | ▪ Cash income |
| ▪ Housing rents | ▪ Creditors |
| ▪ Main accounting | ▪ Debtors |
| ▪ Council tax income | ▪ Payroll |
| ▪ Housing and council tax benefits | ▪ Treasury management |



Prevention and detection of fraud and irregularities

141. At the corporate level, the council has appropriate arrangements in place to prevent and detect fraud, inappropriate conduct and corruption. These arrangements include 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.

National Fraud Initiative (NFI) in Scotland

142. In 2006/07 the council again took part in the National Fraud Initiative (NFI) in Scotland. The exercise is undertaken as part of the audits of the participating bodies. NFI brings together data from councils, police and fire and rescue boards, health bodies and other agencies to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. For 2006/07 councils were asked to submit further specified datasets where the risks merited their inclusion. The NFI has generated significant savings for Scottish public bodies (some £27 million to 2005).

143. The NFI 2006/07 results (data matches) were made available to councils in January 2007 via a new secure web-based application. Participating bodies follow up the matches, as appropriate, and record the outcomes of their investigations in the application. We monitored the council's involvement in NFI during the course of our audit.

144. The council has taken a positive approach to the ongoing NFI exercise and significant progress has been made in following up referrals and, where appropriate, taking action to prevent further loss and to recover fraudulent payments. Matches have been prioritised and the council has concentrated on the higher priority cases. Some lower priority risk-based matches, where the returns are likely to be small in relation to the effort required, have not yet been examined. The council may decide not to follow up potential matches in areas, such as creditors, where work previously undertaken has given adequate assurance.

145. Excluding creditors, a total of 1789 matches were made including 237 individuals who appeared more than once. By early October, 690 referrals had been investigated with 26 in the process of being followed up. Eleven frauds have been discovered totalling £36,480.

146. Members and senior managers are aware of the exercise and results will be reported to members at the end of the exercise. Progress reports can also be accessed direct from the NFI web-based application by staff involved and by audit.

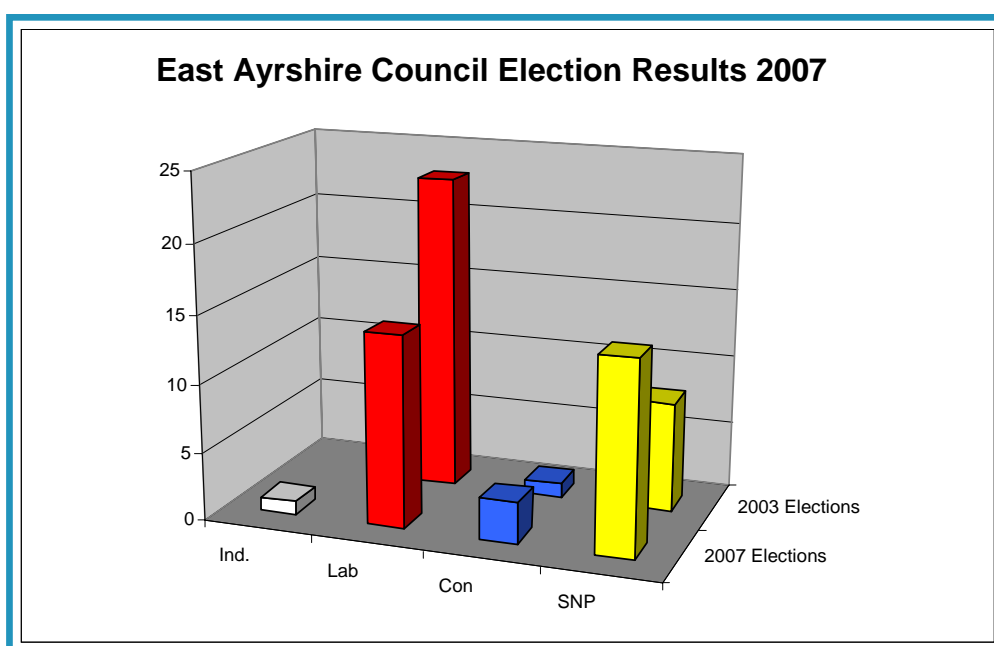


Governance outlook

Impact of the 2007 elections

147. Following the May 2007 elections, the former Labour administration of East Ayrshire Council has been replaced by a Scottish National Party minority administration with both the Scottish Labour Party and the Scottish National Party having an equal number of members – see exhibit 6.

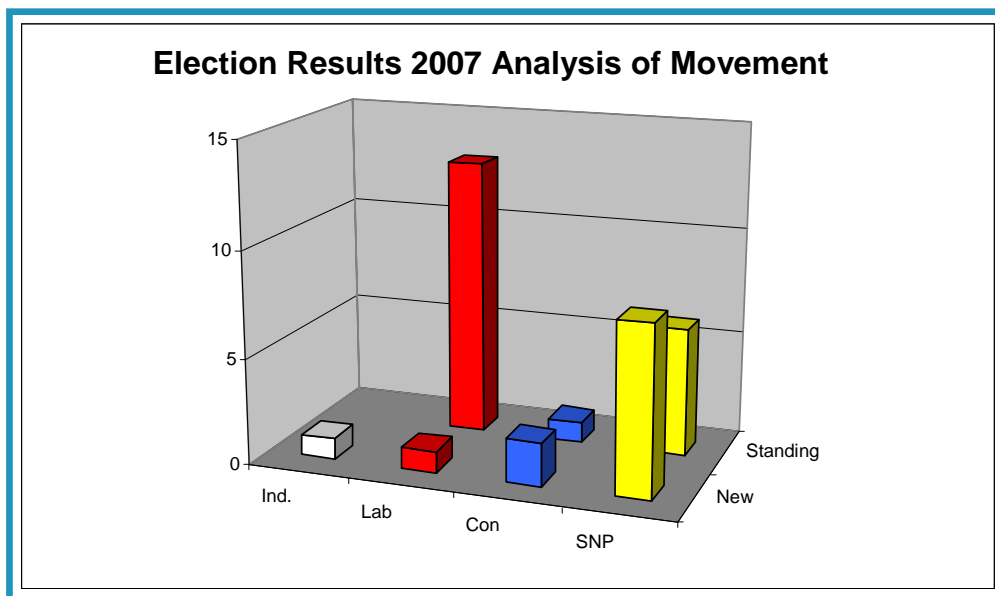
Exhibit 6 – Council election results 2007 and 2003



148. In total 12 new members were elected across the four political parties with the majority (8 from 12) representing the Scottish National Party—see exhibit 7. We reviewed the level of support and training given to members as part of our PRF review and made comment on the issue in the ARAP: “*The council has sought to enhance the level of scrutiny by providing specific members training, standardising reports and developing methods to present financial data to members.*” Such developments in member training, standardised reports and innovative presentational methods have facilitated the transition between administrations and aided new members in fulfilling their responsibilities.



Exhibit 7 – Movement in council political composition



149. During the course of the financial year members considered and agreed to a number of changes in the council's management structure. These changes had the effect of reducing the number of departments from four to three and deletion of a number of senior management posts releasing savings of some £0.300 million.

Future outlook

150. In July 2007 CIPFA/SoLACE published Delivering Good Governance in Local Government – Framework (2007). The framework document is intended to be followed as best practice for developing and maintaining a local code of governance and for discharging accountability for the proper conduct of public business. A guidance note has been developed to accompany the framework. It provides practical assistance to authorities in:

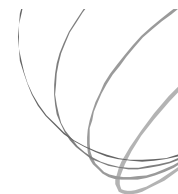
- considering how they might go about reviewing their governance arrangements
- developing and updating their own local codes of governance
- demonstrating compliance with the principles of good governance.

151. The guidance note outlines how good governance principles have evolved and looks at how the 'governing bodies' operate in local government. The guidance note also provides good practice examples and case studies, and includes examples of the systems, processes and documents that might be cited by an authority as evidence of compliance with good practice. Further help is also



offered on developing and maintaining effective audit and standards committees, the scrutiny function and risk management.

152. Management are considering the impact of the framework on the council's current arrangements and whether amendments to current processes and practices are required.



Financial Statements

Introduction

153. In this section we summarise key outcomes from our audit of the council's financial statements for 2006/07. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues. We audit the financial statements and give an opinion on:

- whether they present fairly the financial position of the council and its expenditure and income for the year
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

154. We also review the Statement of Internal Financial Control by considering the adequacy of the process put in place by the council to obtain assurances on systems of governance and internal financial control and assessing whether disclosures in the statement are consistent with our knowledge of the council.

Overall conclusion

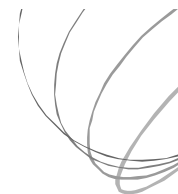
155. We have given an unqualified opinion on the financial statements of East Ayrshire Council for 2006/07.

156. The Local Government in Scotland Act 2003 requires councils to maintain and disclose trading accounts for Significant Trading Operations (STOs), which are required to break-even over a three year rolling period. The council's three STOs achieved their statutory targets.

157. The council's un-audited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation processes and working papers were generally very good and this enabled the audit to progress smoothly. The independent auditor's report (opinion) was issued prior to the target date of 30 September 2007. The financial statements are now available for presentation to the council and publication. The financial statements are an essential means by which the council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Accounting practice

158. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice (the SORP). The 2006 SORP



required a number of significant changes to be made to the 2006/07 financial statements to make them more consistent with the accounts of other public and private sector entities. These included:

- replacement of the traditional consolidated revenue account with a conventional income and expenditure account
- a new statement that reconciles the income and expenditure account surplus or deficit for the year to the general fund surplus or deficit
- replacement of the statement of total movement in reserves with a statement of total recognised gains and losses
- similar changes to the housing revenue account
- parallel changes to the group accounts that would result in them being easier to understand and have a common format to single entity statement of accounts.

159. The changes introduced by the 2006 SORP were considerable and required significant effort in preparation by the Finance Service staff of the council. Overall, we were satisfied that the council had prepared the accounts in accordance with the revised SORP.

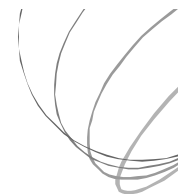
160. During the course of all audits, errors and misstatements are found. Most can be regarded as non-significant or trivial. We did identify several areas where after discussion with the Executive Head of Finance and Asset Management it was agreed that amendments to the un-audited accounts provided for public inspection would be made. The net effect of the adjustments made was to increase the deficit for the year by £2.080 million and increase reserves by £2.180 million. Details of significant accounting issues arising in the course of our audit are summarised below.

Provisions

161. The main change covering some £1.749 million related to the creation of provisions which management revised after discussion with auditors.

162. The principal element was a provision in the un-audited accounts of £1.401 million for ordered housing repairs not yet started at the balance sheet date. We took the view that this provision did not meet the Financial Reporting Standard (FRS 12) criteria for the creation of provisions and that the expenditure should not have been recognised until the repairs had been completed. The Executive Head of Finance and Asset Management agreed to reverse the provision. The impact on the HRA is that expenditure is £1.401 million less than that reported in the un-audited accounts.

163. In amending the accounts for the housing repairs provision the opportunity was taken to reverse a further (net) £0.370 million provision for future expenditure.



Homeless fund balance

164. During the course of the audit a “homeless fund” balance was noted in the accounts. Briefly, in order to fund future continuation of the furnished tenancy scheme the council previously resolved to collect an extra £1 per week per tenancy. The accumulated balance on the fund of £0.310 million was included in the creditors balance in the un-audited accounts. The Executive Head of Finance and Asset Management agreed that this balance should more properly have been treated as an earmarked portion of reserves and the appropriate change was made.

Bad debt provision

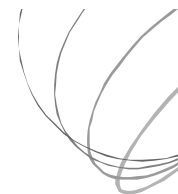
165. The council makes provision against the non-collection of various types of debt. Depending on the nature of the debt, the increase/decrease in a provision is charged or written back to the appropriate account each year. Our view is that the level of bad debt provision in the balance sheet for council tax, council tax statutory additions, housing benefit overpayments and housing rechargeable repairs could be reduced. This is borne out by the collection rates already available for 2007/08. Management have agreed to review this area for 2007/08.

Disclosure

166. The annual financial statements are the principal mechanism by which the council demonstrates its financial stewardship and performance to its stakeholders. The financial statements are of interest to a number of constituencies, including local taxpayers, members, staff, the Accounts Commission and the Scottish Government. These constituents will have varying degrees of expertise in interpreting annual accounts and have limited access to supplementary information. It is therefore incumbent on the council to ensure that disclosure, consistent with promoting a good understanding of its performance in financial terms, is made in the accounts. This is particularly so given the changes to council reporting brought by the SORP 2006.

167. The SORP states that “...interpretation and explanation of the accounts is considered to be extremely important. The SORP requires that there should be an Explanatory Foreword to the Statement of Accounts. The Explanatory Foreword should explain the more significant features in the accounts. It should be based on the information contained in the Statement of Accounts and local authorities should ensure that it does not contain material inaccuracies or misleading statements in relation to the Statement of Accounts.”... and goes on to say “The SORP represents the minimum requirement for disclosure and presentation (subject to materiality) and is not intended to prejudice the provision of further information by authorities.”

168. The SORP specifically states that the Explanatory Foreword should include, *inter alia*, “Service expenditure, interest payable and other operating costs, income from grants, local taxpayers and



other sources, compared in overall terms to the budget". In this respect the disclosure made in the Explanatory Foreword, in our view, requires to be further strengthened. The Executive Head of Finance and Asset Management has undertaken to review the format of the Explanatory Foreword for future years taking account of good practice evidenced in other councils' accounts.

169. Further disclosure areas were discussed and agreed with Finance Service staff during the course of the audit. The council should consider reviewing all areas of its financial statements, in terms of disclosure, against best practice and ensure that its disclosure regime meets or exceeds minimum standards.

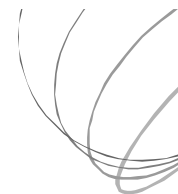
Key risk area 5

Investment properties

170. The council's balance sheet includes a line titled "Investment Properties" of £14.389 million. Our view is that these are not, in terms of the guidance, investment properties. This is a national issue which will be resolved through discussion with the Local Authority Scotland Accounts Advisory Committee (LASAAC). It should be noted that the incidence of rental income does not necessarily mean that the asset is an investment property; it would be deemed an investment property only if the asset is held solely for investment purposes and did not support the service or strategic objectives of the authority.

Legality

171. Each year we request written confirmation from the proper officer that the council's financial transactions accord with relevant legislation and regulations. The Executive Head of Finance and Asset management has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the council's management team, the financial transactions of the council were in accordance with the relevant legislation and regulations governing its activities.
172. Local authorities with registered charitable bodies (i.e. registered trust funds) are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In essence a full set of SORP compliant financial statements is required for each relevant trust fund. The preparation of separate accounts for all registered charities will consume a considerable amount of staff time and resources. Discussions are ongoing between the CIPFA Directors of Finance Section and the Office of the Scottish Charities Regulator (OSCR) to explore the way forward.
173. There are no additional legality issues arising from our audit which require to be brought to members' attention.



Financial reporting outlook

174. Overall the council is well placed to continue to prepare annual financial statements in accordance with accounting and statutory requirements. It has a record of responding positively to audit issues and to changing accounting rules. Challenges ahead include a number of changes that have been made to the 2007 SORP.

175. The most significant change to the 2007 SORP requires authorities to comply with financial reporting standards (FRS) 25 and 26 in respect of loans, from 2007/08. At present, councils are able to write off premiums over the period (up to 60 years) of the replacement loan. The regulations restrict the write off periods for new premiums incurred on LOBOs from 1 April 2007 to a maximum of 20 years. The most visible effect will be a charge to the income and expenditure account in respect of premiums on rescheduled loans. Statutory guidance mitigates the impact on council tax by requiring authorities to reverse the entries in the statement of movement on the general fund.

176. Other changes include:

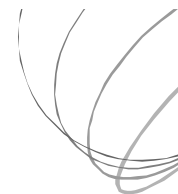
- changes to capital accounting requirements to introduce a revaluation reserve and capital adjustment account
- a requirement for further information to be disclosed in respect of charitable funds.

177. Central government and NHS bodies are to move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2008/09. The government also announced its intention to publish Whole of Government Accounts on an IFRS basis from 2008/09. It was recognised that there would need to be discussions with CIPFA/ LASAAC about the introduction of IFRS-based accounts for local government. Of particular note is that IFRS do not address PFI accounting in the public sector. The Treasury are therefore currently considering the most appropriate accounting treatment for PFI public sector transactions. If IFRS principles, or similar, were applied in the public sector then many PFI assets are likely be brought onto public sector balance sheets.



Final Remarks

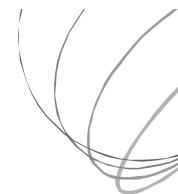
178. We have made a number of recommendations in reports issued during the course of the year and have obtained assurances from officers that action will be taken as appropriate.
179. Attached to this report is an action plan setting out the key risks identified by the audit. In response, officers have considered the issue and have agreed to take the specific steps set out in the column headed 'planned management action'. On occasion, officers may choose to accept the risk and take no action. Alternatively, there may be no further action that can be taken to minimise the risk. Where appropriate, the action plan sets out management's response to the identified risks.
180. The co-operation and assistance given to us by East Ayrshire Council members and staff is gratefully acknowledged.



Appendix A: Action Plan

Key risk areas and planned management action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1	12	<p>Community Planning</p> <p>Work is ongoing to develop an updated community plan for 2007-2012. Upon completion of the plan the council will review the revisions and ensure that there are appropriate linkages with other supporting service plans.</p> <p>Risk: The priorities of the new Community Plan are not linked to supporting business/ service plans.</p>	The integration of service planning and budgeting processes, in line with core council business and Community Plan priorities is part of the Improvement Agenda arising from the audit of Best Value and community Planning.	Executive Head of Finance and Asset Management	Dec 2008
2	82	<p>Carry Forward of 'Managed' Savings</p> <p>Budget holders can carry forward "managed" savings to the next financial year. The current arrangements have evolved over time.</p> <p>Risk: Lack of formal arrangements permits inappropriate retention of unspent budget.</p>	A review of arrangements will be undertaken as part of the 2008/09 budget process.	Executive Head of Finance and Asset Management	Feb 2008
3	92	<p>Capital programme</p> <p>There was substantial slippage in the general services capital programme during the year.</p> <p>Risk: The council may not deliver its capital projects on time, which are required to respond to the infrastructure needs of its communities.</p>	Close monitoring of all projects will be undertaken in conjunction with services and reported to members on a regular basis. Reasons for slippage which can include unavailability of technical resources, changes in political strategy, contractor performance and poor weather will be included.	Executive Head of Finance and Asset Management	Done



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
4	103	<p>Financial pressures in the medium term</p> <p>It is not yet clear what impact the new Scottish Government may have on local government finance, and in particular, on the local government settlement and council tax funding.</p> <p>Risk: The council may not be able to deliver on its Community Plan objectives if the financial settlements do not reflect the council's expectations.</p>	The budget process for 2008-2011 has been approved by the Cabinet and the level of grant funding will be a key factor in the decision making process.	Executive Head of Finance and Asset Management	Feb 2008
5	169	<p>Disclosure</p> <p>The council must ensure that disclosure, consistent with promoting a good understanding of its performance in financial terms, is made in the accounts. The council should consider reviewing all areas of its financial statements, in terms of disclosure, against best practice and ensure that its disclosure regime meets or exceeds minimum standards.</p> <p>Risk: Users of the accounts may not understand the financial position where information is not presented clearly.</p>	Examples of accounts from other UK councils will be examined and good practice identified.	Executive Head of Finance and Asset Management	June 2008