



REPORT BY THE CONTROLLER OF AUDIT

S.R. 99/7

**OVERVIEW REPORT ON THE 1997/98 AUDITS
OF LOCAL AUTHORITIES**

**A REPORT BY THE CONTROLLER OF AUDIT TO THE ACCOUNTS
COMMISSION IN TERMS OF SECTION 102(1) OF THE LOCAL GOVERNMENT
(SCOTLAND) ACT 1973**

OVERVIEW REPORT ON THE 1997/98 AUDITS OF LOCAL AUTHORITIES

1. **INTRODUCTION**

1.1 I have made this report in response to a request from the Accounts Commission under Section 102(1) of the Local Government (Scotland) Act 1973. It covers the second financial year (1997/98) of the new councils in Scotland and is based on information drawn from auditors' reports already submitted to individual councils. Currently 11 audits in respect of 1997/98 are still incomplete, largely as a result of auditors experiencing difficulty in resolving issues arising from the audit. Details of the outstanding audits are listed in Appendix 1. In the interests of public accountability I have decided to report on the outcome of audits completed to date. I have also included in my report significant items which I have been advised are likely to feature in auditors' reports on the outstanding audits. Certain councils mentioned by name in my report (S.R. 99/3) on the first (1996/97) year are councils for which I am still waiting for the 1997/98 auditors' reports. If other significant matters arise they will be reported at local level by auditors and, if appropriate, by me under my statutory reporting powers.

2. **STRUCTURE AND CONTENT**

2.1 My report is divided into three sections. The first section refers to issues most commonly identified by auditors; the second section focuses on significant issues which have arisen at individual councils and the final section describes value for money and management arrangements work completed during the year.

2.2 The late completion of 1996/97 audits (the reasons for which were described in my overview report on that year) meant that, in many cases, the succeeding year's audit was carried out a short time thereafter. Many councils did not have sufficient time, in the intervening period between the two years' audits, to implement remedial

action in respect of matters identified during the course of 1996/97 audits. As a result many of the issues reported by auditors in their 1997/98 reports are similar to those reported in 1996/97.

2.3 I have attempted to concentrate on significant changes or new issues arising in 1997/98, without reporting in detail again on issues which arose in 1996/97. My 1996/97 and 1997/98 reports should therefore be read together to obtain a view of the position for the first two years of the new councils. To facilitate cross-reference between the two years' reports I have retained the same sub-headings for the first part of my 1997/98 report.

3. **MATTERS ARISING ACROSS A RANGE OF AUTHORITIES**

3.1 **The Completion of Accounts and Audits**

With a view to improving accountability to the public the statutory date for the lodgement of accounts for audit was brought forward from 31 August to 30 June, with effect from the 1997/98 financial year.

Table 1 shows the dates by which 1997/98 accounts were presented for audit and compares the position with the previous year when the later statutory date of 31 August applied.

TABLE 1
DATE BY WHICH ACCOUNTS WERE AVAILABLE FOR AUDIT

| DATE | CUMULATIVE TOTALS | |
|------------------------------------|---------------------|---------------------|
| | 1996/97 ACCOUNTS | 1997/98 ACCOUNTS |
| 30 June (statutory date 1997/98) | | 23 |
| 31 July | | 25 |
| 31 August (statutory date 1996/97) | 6 | 29 |
| 30 September | 9 | 32 |
| 31 October | 14 | |
| 30 November | 19 | |
| 31 December | 23 | |
| 28 February | 27 | |
| 30 April (or later) | 32 | |

The table shows that in 1997/98 23 councils presented their accounts for audit by the new statutory date of 30 June. The earlier completion date was a commendable achievement by these authorities, although the quality of some accounts was not of an acceptable standard.

The late completion of 1996/97 audits and problems arising from the 1997/98 accounts had a knock-on effect on 1997/98 audit work. Table 2 shows the dates by which 1997/98 audits were completed.

TABLE 2
DATE BY WHICH 1997/98 AUDITS WERE COMPLETED

| COMPLETION DATE | NUMBER OF AUDITS | CUMULATIVE TOTAL |
|---|------------------|------------------|
| 31 October 1998 | 1 | 1 |
| 30 November 1998 | 2 | 3 |
| 31 December 1998 | 1 | 4 |
| 31 March 1999 | 7 | 11 |
| 31 July 1999 (11 audits still to be completed) | 10 | 21 |

Most of the factors which contributed to the delay in the completion of the previous year's audits were again in evidence. Approximately half of the auditors' reports contain references to significant adjustments to the accounts after their presentation for audit, to poor quality working papers and to the absence of bank and other reconciliations.

3.2 **Financial Stewardship**

The majority of 1997/98 auditors' reports again included a wide range of comments on basic accounting and control weaknesses. The most common references were to:

- the absence of bank and other reconciliations
- internal control deficiencies
- weaknesses in the compilation and maintenance of asset registers
- lack of reconciliation between the assessment roll and the valuation roll.

The auditors of five councils referred to the absence of a formal policy relating to fraud and corruption and, in one case, to the absence of a register of members' interests and hospitality.

It is of concern that many of the shortcomings continue to be highlighted by auditors some two years after re-organisation. These are not simply issues of theoretical interest. They constitute real risks to authorities as illustrated by the example in paragraph 4.3 which describes the financial consequences in one council of the absence of a reconciliation between the non domestic valuations included in the valuation roll and those included in the new domestic rate system.

3.3 **Accounting Issues**

Out of the 21 audits completed to date the accounts of 14 councils have been qualified in respect of 15 items. The corresponding figures for all 32 councils in 1996/97 were 24 accounts and 34 items. Most of the qualifications in 1997/98 again related to uncertainty regarding the balances inherited from the former authorities. This is a legacy of local government re-organisation which should cease to be a problem from 1998/99 onwards.

Audit certificates in respect of 14 councils recorded 47 instances of failure to comply with certain statutory requirements. Virtually all of these related to DLOs or DSOs not having achieved their statutory financial target.

3.4 **Internal Audit**

The high incidence of comments by auditors on councils' internal audit arrangements in 1996/97 was repeated in 1997/98. Inadequate resourcing of internal audit sections and the lack of specialist computer audit expertise were recurring themes in 1997/98. The continuing involvement of some internal audit sections in non audit work also featured in auditors' reports. The combination of these factors undoubtedly contributed to the low level of internal audit output identified by auditors at certain authorities. It is clear from auditors' assessments that many authorities have still to take action to improve their internal audit function.

3.5 **Computer Audit**

Overall the incidence of issues reported in 1997/98 has been lower than in the previous year. The most common reference in auditors' reports has been to the absence of business continuity or disaster recovery plans. Other comments have related to:

- the need for an IT strategy
- lack of systems documentation
- absence of backup procedures
- problems in implementing new housing benefit systems.

In anticipation of the difficulties which local authorities might encounter in the transition to year 2000 I issued guidance to auditors in May 1997 advising them to review the arrangements which councils had in place for identifying Year 2000 problems and for taking appropriate action. I reinforced this guidance in May 1998 and encouraged auditors to report their findings to management in each council.

In addition, using information gathered through the audit process, I have prepared a report (S.R. 99/2) on the state of preparedness of councils for Year 2000, as at May 1999. The report findings fed into the national overview by Action 2000. A further exercise to review the progress made by councils since May 1999 is currently ongoing and the findings from this will form the basis of a further report which will provide Action 2000 with an update for the purpose of the National Infrastructure Forum due to take place in October.

3.6 **Following The Public Pound**

There has been a significant reduction in the number of references by auditors to councils' non-compliance with the Code of Practice on Following the Public Pound. A few authorities continue to be slow in adopting or implementing the principles embodied in the Code and the following specific matters have been identified by auditors as requiring to be addressed by certain authorities:

- guidance on when the council should be represented on organisations which have received support from public funds

- the need for organisations to have adequate insurance for directors' and officers' liabilities
- procedures to ensure compliance with requirements for financial and performance monitoring
- eligibility criteria for awarding financial support and undertaking technical and financial assessments
- provision for internal and external audit access to the records of recipient organisations.

3.7 **Housing And Council Tax Benefits**

Frequent references by auditors to housing and council tax benefit issues indicates that there was little change in the position between the completion of 1996/97 audits and the 1997/98 audits.

Most references again were to inadequacies in the arrangements for the detection of fraud and the recovery of benefit overpayments. The absence of a formal anti-fraud policy and failure to adopt the DSS verification framework featured in several auditors' reports. These matters point to the need for a significant improvement in this aspect of housing benefits administration.

In 1997/98 auditors drew attention to the fact that two councils, seeking to harmonise the administration of housing benefit and council tax benefit, had used applications for one of these benefits to award or review the other benefit. The auditors have drawn the matter to the attention of the Department of Social Security (DSS) which has confirmed that, in terms of the underlying Regulations, applicants must apply separately for each benefit. This requirement can, however, be satisfied by an authority using a single claim form which clearly indicates that it is in respect of both benefits. It is understood that at both authorities claimants were indeed entitled to both benefits.

It would appear that any awards made in the absence of a specific claim will not be eligible for central government subsidy. If this is the case, the amounts involved could be quite substantial. I understand that a similar problem may have arisen at other authorities. It will be unfortunate if the authorities and the DSS are unable to identify a solution to this problem that will avoid the loss of subsidy, for what might

be considered to be a technical breach of the procedures for claiming and awarding benefit, rather than because of any inherent ineligibility relating to applicants' circumstances.

I understand that the DSS will shortly issue guidance to all local authorities, clarifying the Regulations in this area, at which time auditors will require to identify the extent to which other authorities have not followed the proper procedure.

3.8 **Direct Labour And Direct Service Organisations**

The 1997/98 financial year was characterised by the failure of a significant number of Direct Labour/Direct Service Organisations (DLOs/DSOs) to achieve the statutory financial objective. The largest financial deficits were incurred by the building and works DLOs at North Lanarkshire and East Ayrshire Councils. Following special investigations carried out by the auditors at these two Councils I undertook further detailed inquiries into the position at each authority and prepared a separate statutory report on each council (S.R.s 98/2 and 98/6). My report findings were endorsed by the Accounts Commission.

Both Councils reacted positively to the findings and, as a result, the Accounts Commission decided that it was not necessary to hold a hearing in respect of either Council. The Commission has requested me to report back to them on the progress achieved by both authorities in improving the management of their DLOs and in achieving their statutory financial objectives. I will be reporting back to the Commission later this year.

As a result of the problems at North Lanarkshire, East Ayrshire and at other councils I initiated a review of the high level management and financial controls in place for DLOs/DSOs across all authorities and prepared a statutory report (S.R.98/1). My report identified a range of issues which many authorities required to address to improve the performance of their DLOs, including the preparation of explicit business plans, the timeous production of sound management information, the availability of adequate financial expertise and improved monitoring. The report also emphasised the importance of members and chief executives taking an active interest in the performance of their trading organisations.

A follow-up exercise to assess the progress which councils have made in addressing the issues identified in my report has recently been completed and I have submitted a further report to the Accounts Commission.

3.9 **Rent Arrears**

There has been a much higher incidence of comments by auditors in their 1997/98 reports on the level of rent arrears and associated matters. In most cases arrears were higher than the 7% average for all authorities. Percentages of 9.2% to 11.7% have been reported by auditors. It would appear that the deterioration in the position has occurred since local government reorganisation. The principal factors identified by auditors as having contributed to the position are:

- the absence of formal rent recovery policies
- no arrears recovery timetable
- delays in pursuing arrears
- no action in respect of former tenants' arrears.

The Commission's published performance information for 1997/98 shows that, across all authorities, current tenants' arrears ranged from 1.5% to 15%, with the average being 6.9%, and that former tenants' arrears at March 1998 amounted to almost £16m.

4. **SPECIFIC ISSUES**

In addition to issues which were common to a number of councils the following matters arose at individual councils and, in my opinion, are sufficiently material to warrant specific reference in this report.

4.1 **Dumfries and Galloway Council**

The audit of this authority for 1997/98 has not yet been completed but the auditors have indicated that they will be reporting on a significant breakdown in financial management within the Social Services Department of the Council. This resulted in an overspend of £2.2m by the Department on residential care purchased from the independent sector. Auditors are likely to attribute this situation to:

- ineffective financial monitoring of expenditure
- a lack of clarity over responsibilities for budgets
- a poor or inadequate basis for the preparation of budgets
- a lack of clarity in the Council's purchasing strategy with resulting high net costs for the Council
- poor controls over the recording and collection of income from service users.

In my 1996/97 report I referred to the Council's efforts to recover a contribution of £8m from the Crichton Endowment Trust, following legal advice that it was unlikely that the Council had the necessary statutory powers to make the contribution. The financial support was to enable the Trust to develop and maintain the Crichton site.

The Council has now recovered the initial £8m contribution and is currently negotiating with the Trust to recover a further sum to take account of the appreciation in value of the funds during the period they were held by the Trust.

A number of other significant matters are likely to feature in the auditors' report. I will review the overall position at this Council when the auditors' final report is to hand.

4.2 **East Dunbartonshire Council**

The auditors' final report on the 1997/98 accounts of East Dunbartonshire Council is not yet available. I am unable, therefore, to assess whether the range of matters referred to in my 1996/97 overview report recurred in 1997/98. I am aware, however, that the administration of housing and council tax benefits continued to give rise to concern. Because of this the authority requested the auditors to undertake additional work on this topic. The auditors have recently reported to the Council on this work and an action plan setting out remedial action to be taken by the authority is currently under discussion.

4.3 **Fife Council**

As a result of the overstatement of rateable valuations for non-domestic properties there was an error in the information submitted to The Scottish Office for the purpose of determining the level of Revenue Support Grant (RSG) due to the Council in respect of 1997/98. This led to the understatement of the Councils RSG entitlement and the underpayment of £10.8m. This situation remained undetected initially because there was no reconciliation between the valuations held by the Assessor's Department and those used by the Finance Department.

The underpayment of £10.8m will be recovered in due course, as part of RSG adjustments, but it is uncertain at this stage whether the interest foregone as a result of the late receipt of this sum will be recovered. The auditor will be reporting further on the position in due course and I will reconsider the matter at that stage.

4.4 **Grampian Fire Board**

Grampian Fire Board experienced significant accounting problems in 1996/97 and these continued into 1997/98. In addition the Board incurred an overpayment of £22,000 as a result of the manner in which it handled a contract for the supply of fire fighters' uniforms. Having considered the standard of overall financial management at the Board I decided to make a formal report (S.R. 99/4) to draw my concerns to the Board's attention.

My report highlighted the importance of:

- having in place financial standing orders which lay down the financial management arrangements and the responsibilities of the "proper officer" and other managers
- effective accounting and budgetary control systems
- regular reconciliation of key accounts
- testing computerised financial systems and providing adequate training for staff.

The auditors' recent reports indicate that action has been taken by the current management of the Board to address the issues identified in my report.

4.5 **Inverclyde Council**

The 1997/98 audit of Inverclyde Council is not yet complete but the auditors have provided me with an interim note of the main issues which have arisen from the audit to date. These indicate that the Council, apparently, made little progress in addressing the issues identified in respect of 1996/97. The auditors have again commented on errors and differences in the financial statements and the poor quality of the documentation provided to support the accounts generally. Other comments relate to the unreliability of the fixed assets valuation included in the accounts and to the unsatisfactory state of control arrangements in a number of key areas, including bank reconciliations.

The administration of housing and council tax benefits again featured in the auditors' comments, specifically in relation to the absence of a formally agreed fraud policy and of a specifically designated Benefit Fraud Officer. A significant number of other benefit issues arose from both external audit work and the inspection carried out by the Benefit Fraud Inspectorate.

DLO/DSO accounting arrangements and the failure of a number of trading activities to achieve their financial objective also attracted audit comment.

When the auditors' final report for 1997/98 is available I will review it and decide whether I require to take further action.

5. **VALUE FOR MONEY**

5.1 **Introduction**

The Accounts Commission has a statutory duty to carry out studies of value for money in the provision of services by audited bodies. National studies are often linked to local studies to promote improvements by individual audited bodies. During 1997/98, four topics were reviewed locally by auditors as part of the follow up of national studies:

- Cost of managers
- Charging for services

- Early retirement
- Financial management in the police service.

The first three of these studies were based on central development work carried out by the Commission's Local Government Studies Directorate. The work on police financial management was based on a study conducted jointly with Her Majesty's Inspectorate of Constabulary. With the exception of the cost of managers, the results of these studies have already been published separately. The main issues covered by each are set out below.

5.2 **Cost of Managers**

Councils' management structures were sometimes implemented in haste following local government reorganisation. Councils wanted to minimise disruption to services during the reorganisation period. Many have been taking a look at their management structures and costs in a more objective way.

Auditors and councils have been provided with benchmarking information to support reviews of management costs. Through the local audit process, profiles of costs of managers have been prepared for each council covering housing, social work, libraries and finance services. These have been made available on a software package called COMPARE, which will assist councils to compare their costs with those of other councils in similar circumstances. The audit was undertaken in all councils.

The costs of managers in many councils are comparable with the cost in other councils in similar circumstances, but in a handful of councils the cost differs substantially from what might be expected. Councils will be expected to take action to remove any unnecessary management overheads. Conversely where they are under-managed, councils will need to ensure that they have sufficient management capacity to deliver Best Value. Auditors may repeat the benchmarking exercise locally in about 18 months' time, and will be checking what action councils have been taking. A national report, '*Three tiers*', on this study is about to be published.

5.3 **Charging for Services**

Over £300 million a year is currently raised by councils in Scotland from fees and charges - about £60 per head of population. With the continuing financial restrictions, councils wish to look more closely at income generation. A national report, *'The Challenge of Charging'*, was published in March 1998. The study encouraged councils to manage charges in a structured way, having regard to their wider policy objectives. Auditors reviewed councils' approaches to charges as part of this year's audit round. The local audit was undertaken in all 32 councils. The local audit findings were consistent with the picture painted in the national report.

5.4 **Early Retirement**

In *'Bye now, pay later'* we reported that more than three-quarters of all council staff who retire do so before reaching normal retirement age. The number of staff retiring due to ill-health was double the number retiring normally. There was a sharp increase in retirements in 1995/96 and 1996/97 due to large numbers of redundancies arising from local government reorganisation. The full cost of these early retirements was about £190m, excluding redundancy payments. The cost will be spread over several years to come, and there will also be savings from reductions in staff.

The cost of an early retirement is about £32,000 more than the cost of a normal retirement, but only about half this extra cost has typically been taken into account by councils when making decisions. We recommended that councils should tighten the procedures they use to approve early retirements, and take account of the full cost. Local audits were undertaken in all councils and reports have been finalised in 25. The audit reports show that councils are acting on the national report's recommendations, particularly those on ill-health retirement and calculating the cost of early retirements.

5.5 Police Financial Management

The eight police forces in Scotland spend over £680 million a year. The Scottish Office has issued guidance on delegation in the police service and the study looked at the extent to which that guidance has been implemented. Different forces have different levels of financial delegation from their police authority to the chief constable, and from the chief constable to divisional and sub-divisional commanders.

The study of police financial management was undertaken in collaboration with Her Majesty's Inspectorate of Constabulary. The national report, '*Credit to the Force*', was published in November 1998. It encouraged good practice in delegating financial management in the police service. Each police force was visited as part of the study and received its own report from the joint study team. Local auditors and HMIC have liaised on monitoring the action taken by each force in implementing improvements.

6. MANAGEMENT ARRANGEMENTS

The new approach introduced in 1996/97 to the audit of management arrangements, based on self assessment, action planning and continuous improvement, was followed up in 1997/98 by the release of the second of the Commission's management arrangements modules: '*Managing people*'.

'*Managing people*' was based around four inter-related aspects of good management practice:

- identifying how many people are needed to deliver services
- retaining and recruiting people, and
- managing and improving the performance of people.

All councils assessed themselves against the guidance in '*Managing people*' and agreed action plans for improvement with their auditors. Common areas for improvement identified by many councils included:

- developing good performance information for managing people
- improving internal communication with employees

- introducing and developing performance review and development schemes for employees, and
- improving induction procedures for new staff.

Progress in implementing these actions will be followed up through the audit process.

7. CONCLUSION

It is disappointing that 11 of the 1997/98 audits are still incomplete. From the audits which are complete it is clear that many councils were still experiencing significant problems with their financial accounting and management, some two years after local government re-organisation.

The issues which have emerged from auditors' reports in 1997/98 are broadly similar to those reported in 1996/97. While there was a commendable effort by authorities to achieve the earlier date for the presentation of accounts for audit, with two-thirds of councils meeting the new statutory date of 30 June and most of the remainder being available by 31 August, in some cases this appears to have been at the expense of the accuracy of the accounts. This inevitably led to delays due to authorities having to process audit adjustments and to auditors having to re-schedule their work programmes.

The main themes arising in 1997/98 again relate to the quality of the records underlying the accounts, the absence of bank and other reconciliations, weaknesses in the administration of housing and council tax benefits (particularly in relation to action to combat fraudulent claims and overpayments) and the under performance and management of some DLOs/DSOs.

While some authorities will have made progress since the 1997/98 audit was reported those which still have problems need to take positive action to address them. Council members have a responsibility to take an active interest in how their Council is approaching this task, by reviewing, at regular intervals, the progress which officers are making. It is important that there are adequate internal audit resources available to assist members in this role and to provide an acceptable level of scrutiny across the authority as a whole. There should be formal mechanisms

within the overall governance arrangements, in the form of an Audit Committee or similar structure, to allow members to discharge this responsibility.

I would hope that my overview of the 1998/99 financial year which I intend to produce in December will indicate that authorities which failed to achieve an acceptable standard by 1997/98 are able to demonstrate a significant improvement in the quality of their financial stewardship in 1998/99.

It is in the nature of the audit process that I am obliged in a report such as this to concentrate on the problems and shortcomings in the governance and financial stewardship of local authorities. Whilst there are important and serious problems still to be resolved, there are many local authorities where the financial management arrangements are sound. I am also pleased to report that, in local government generally, there is positive action by councils in response to national and local value for money reports and the audit of management arrangements.

A handwritten signature in black ink that reads "Robert W Black". The signature is written in a cursive, slightly stylized font.

ROBERT W BLACK

31 August 1999

Eleven 1997/98 Council audits that are outstanding

| Audit | Auditors |
|-------------------------------|---------------------------|
| Aberdeenshire Council | Ernst & Young, Aberdeen |
| Argyll and Bute Council | PricewaterhouseCoopers |
| Clackmannanshire Council | Scott-Moncrieff |
| Dumfries and Galloway Council | Deloitte & Touche |
| Dundee City Council | Henderson Loggie |
| East Dunbartonshire Council | KPMG |
| City of Edinburgh Council | P Tait, Chief Auditor |
| Highland Council | P Johnston, Chief Auditor |
| Inverclyde Council | PricewaterhouseCoopers |
| West Dunbartonshire Council | PricewaterhouseCoopers |
| West Lothian Council | P Tait, Chief Auditor |



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