

Midlothian Council

Report to Members and the Controller of Audit on the 2008/09 Audit

October 2009



 AUDIT SCOTLAND



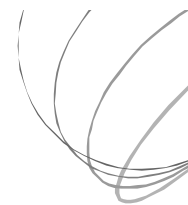
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Key Messages

We have given an unqualified opinion on the financial statements of Midlothian Council.

In overall terms, the Council worked hard to manage its budget in financially challenging times. The actual outturn of the Council was £215.2 million, incurring a deficit of £31.7 million on its income and expenditure account. After taking account of statutory adjustments of £22.0 million, the sum of £9.6 million required to be met from General Fund Reserves. At the end of the year the Council's General Fund Reserve was £2.1 million, £0.5 million less than planned. Although the General Fund Reserve was £2.1 million, £4.4 million has been earmarked for specific purposes, leaving a deficit of £2.3 million. This is being factored into the budget strategy 2010/11, but significant financial risk remains.

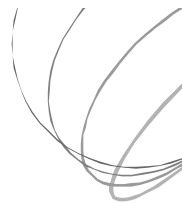
In other areas of performance, there was clear evidence of improvement. For example, follow through reports from SWIA and HMIE indicate that the Council is implementing satisfactorily the improvement programmes identified from earlier inspections. The Council continued to deliver on its house building programme resulting in the release of 317 new council houses during 2008/09. The council house building programme is continuing in 2009/10. A further 4 new replacement schools were also opened during 2008/09.

The economic recession and banking crisis have impacted on the Council and the community it serves. This resulted in a reduction in capital receipts and developer contributions. This has impacted on the Council's reserves, which were to be restored by the transfer of capital receipts, and the 2009/10 capital plan.

Outlook

The Council continues to face significant challenges in matching expenditure commitments to available resources. Less reliance can be placed on non-recurrent capital receipts which provided an additional income stream in previous years. The Council's corporate management team has recognised this and all divisions have responded to requests to identify efficiencies and cost savings in planned expenditure.

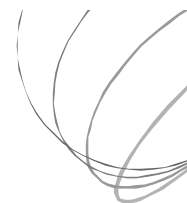
Although during 2008/09 many equal pay claims were settled, some remain outstanding, with £8.1 million being set aside at the year end as a best estimate of the cost of eventually settling these claims. In addition an unquantified contingent liability has been disclosed in respect of further costs which may arise but cannot be estimated at present. Modernising Midlothian (the single status agreement) was implemented in June 2009. This is a major step forward in that it provides the Council with a new pay and grading model with new terms and conditions. However, there is still a risk of low morale and motivation of some staff groups until the appeals process is concluded.



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

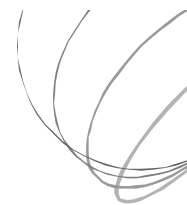


October 2009



Introduction

1. This report is the summary of our findings arising from the 2008/09 audit of Midlothian Council (the Council) and other relevant work carried out by Audit Scotland. A number of detailed reports have already been issued in the course of the year in which we make recommendations for improvements (see Appendix A). We do not repeat all of the findings in this report. Instead we focus on the financial statements and any significant findings that have arisen from our review of the management of strategic risks.
2. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest and relevance to the Council are:
 - The impact of the race equality duty on council services
 - Improving energy efficiency
 - Asset management in councils
 - Overview of drug and alcohol services
 - Mental health overview
 - Civil contingencies planning
 - Strategic procurement.
3. We mention the key findings from these reports and the implications for Midlothian in the performance and use of resources sections of this report. Full copies of the studies can be obtained from Audit Scotland's website at www.audit-scotland.gov.uk.
4. Appendix B is an action plan setting out the high level risks we have identified from the audit. Officers have considered the issues and have agreed to take the specific steps set out in the column headed *Planned Management Action*. We do not expect all risks to be eliminated or even minimised. What we are expecting to see is that the Council understands its risks and has in place mechanisms to manage them. Members should ensure that they are satisfied with the proposed management action and have a mechanism in place to be duly assured that the proposed action has been implemented.
5. This report is addressed to members and the Controller of Audit. It will be published on our website after consideration by the Council. The Controller of Audit may use the information in this report for her annual overview of local authority audits to the Accounts Commission later this year. The overview report is published and it is also presented to the Local Government and Communities Committee of the Scottish Parliament.



Financial statements

Introduction

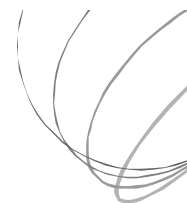
6. In this section we summarise key outcomes from our audit of the Council's financial statements for 2008/09, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit Opinion

7. We have given an unqualified opinion that the financial statements of Midlothian Council for 2008/09 give a true and fair view of the financial position and expenditure and income of the Council and its group for the year. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
8. We were satisfied with disclosures made in the Annual Governance Statement and the adequacy of the process put in place by the Council to obtain assurances on systems of control.
9. The Council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June.
10. As it was not possible to obtain audited accounts for Shawfair Developments Limited, a company in which the Council holds a 50% shareholding, for the year 2008/09, additional management representation was received from the Director, Corporate Services to confirm that the full liability associated with the investment has been recognised in the Council's financial results. We are working in partnership with Finance staff to clarify our requirements and help improve the processes for the preparation and audit of the financial statements in 2009/10.
11. The accounts were certified by the target date of 30 September 2009. They were presented to Members on 27 October 2009 and are available on the Council website. 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 issues

12. 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). No major changes were introduced by the 2008 SORP. In the main, the accounts were prepared in compliance with the 2008 SORP; any departures are noted in the audited Financial Statements and are not material to the outturn reported.



13. The Council has adjusted the financial statements to reflect audit findings. As is normal practice, unadjusted errors have been reported to the Director, Corporate Services and the Performance, Scrutiny and Audit Committee.

Audit testing

14. As part of our work, we took assurance from a number of the Council's main financial systems. We assessed the following central systems as having a satisfactory level of control for our purposes:

- | | |
|--------------------------|--|
| ▪ Budgetary Control | ▪ Council Tax |
| ▪ Main accounting system | ▪ Accounts Payable |
| ▪ Payroll | ▪ Housing Rents – Arrears and Write-offs |

15. We relied on the work of internal audit in the following areas to support our work:

- Housing/Council Tax Benefits
- Housing Rents
- Council Tax - Discounts and Exemptions
- Payroll – Follow Up of Trent Phase 1 Audit
- Accounts Payable

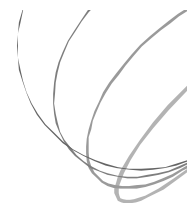
16. We work in partnership with Internal Audit to ensure there is no duplication in areas of work.

Prevention and detection of fraud and irregularities

17. At the corporate level, the Council has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include: an anti-fraud and corruption policy; codes of conduct for elected members and staff; and defined remits for relevant regulatory committees. As raised previously the code of conduct for employees was written in 1998, but it is now undergoing review which is almost complete.

NFI in Scotland

18. The National Fraud Initiative (NFI) in Scotland brings together data from councils, police boards, 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. The NFI has generated significant savings for Scottish public bodies (£40 million to



2008). If fraud or overpayments are not identified in a body, assurances may be taken about internal arrangements for preventing and detecting fraud.

19. The most recent data matching exercise was carried out in October 2008 and national findings will be published by Audit Scotland in May 2010. We are pleased to report that there has been a significant improvement in the arrangements for managing NFI in Midlothian in 2008/09 compared to the last exercise.
20. Benefits matches typically identify potential fraudulent cases. As at 14 September 2009, the Revenues Fraud Team identified £77k of overpaid benefits. The investigation of some cases is still to be concluded, this therefore means that it is possible that more overpayments may be identified. In 2006/07 £3k of overpayment was identified from the NFI matches. The increase in the level of identified fraud is in part due to new sources of information being available against which benefit claims are matched. The Revenues Fraud Team has invested a lot of effort in investigating the NFI matches, but it has been reported to us that, although the results have been useful, in some ways it may have impeded other planned benefit fraud work.

Housing Benefit

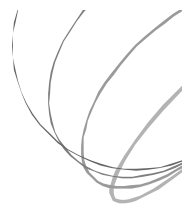
21. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team is carrying out a programme of risk assessments of benefits services in all councils over a two year period.
22. The risks to Midlothian's benefits service were assessed in May 2008 and a detailed report was issued. The Council has responded to the risks we identified with an action plan. We believe the actions will make a positive contribution to improving the benefits service and we will monitor progress in the next inspection cycle, which starts in 2010. The implementation of the action plan is being monitored through the quarterly performance management reports.

Group accounts

23. The diversity of service delivery vehicles used by local authorities means that consolidated group accounts are required to give a true and fair view of a council's income and expenditure.

Joint ventures and companies

24. The Council has interests in:
 - one wholly owned subsidiary, Pacific Shelf 826 Ltd
 - one partly owned (50%) Joint Venture Company, Shawfair Developments Ltd (SDL)



- three associates, i.e. bodies in which the Council has an interest: Lothian and Borders Police Board, Lothian and Borders Fire Board and Lothian Valuation Joint Board.

They have all been included in group accounts in accordance with the SORP. Audit assurances were obtained through review of board minutes, internal audit reports, audited accounts and management representation.

25. During 2008/09 Midlothian's shareholding in SDL increased from 37.5% to 50% following the purchase of 25 shares from Miller Developments Limited who withdrew from the venture. The other 50% is owned by the City of Edinburgh Council. SDL incurred significant losses during 2008/09 following the write-down in value of work in progress. As a result £2.6 million was charged to Midlothian Council's Income and Expenditure Account as their share in the retained losses of SDL.
26. The audit of SDL's financial statements for 2008/09 had not been concluded by the end of September 2009. As a result we sought and received additional assurances from the Director, Corporate Services that all liabilities had been accounted for and disclosed in Midlothian Council's 2008/09 financial statements, and he was satisfied that there were no further liabilities for which Midlothian would need to make provision.
27. Our discussions with Council Officers however, also highlighted a number of significant risks around SDL's governance arrangements:
 - the failure to conclude the audit of the 2007/08 and 2008/09 accounts
 - the Auditors of SDL have expressed concern over the future of the Company and whether they are able to certify the accounts on a going concern basis
 - the 2007/08 Accounts have not been submitted to Companies House in accordance with Companies Law
 - the Board of SDL have met infrequently during a significant period of change for the Company.
28. The costs incurred by SDL relate to work associated with the development of the Shawfair landholding which is partly owned by the Council. The work carried out was to allow future development and investment in the area. It is expected that the accumulated losses from SDL will be recovered from the eventual sale of landholdings.

Key risk area 1

Trust funds and bequests

29. Local authorities with registered charitable bodies are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial



statements is required for each trust fund. However the Office of the Scottish Charities Regulator (OSCR) has deferred the date of full implementation to 2010/11. This means that reliance can be placed on the existing disclosures for trust funds in the Council's financial statements, supplemented by appropriate working papers.

30. Midlothian Council is responsible for managing 21 trusts, bequests and community funds. Three of the bequests are registered charities with a combined value of £6k as at 31 March 2009.

Common good fund

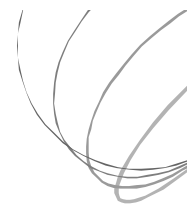
31. In December 2007, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued a guidance note for practitioners. The guidance requires the common good funds to be disclosed within the financial statements and a separate common good asset register to be in place by March 2009.
32. Because of the low values of the sums involved, the common good funds administered by Midlothian Council are disclosed in a note to the main financial statements instead of a separate account. There are two common good funds: Dalkeith and Penicuik. The common good funds' assets comprise cash only, there are no common good fixed assets, and the balance as at 31 March 2009 was £243k.

Pension fund

33. Midlothian Council does not operate its own local government pension fund, but instead is a member of the Lothian Pension Fund which is administered by City of Edinburgh Council. A full actuarial valuation of the pension fund was undertaken as at 31 March 2008. This recommends the employer's contribution rates required by Midlothian Council for 2009/10 to 2011/12 in order to ensure that sufficient funds are available to pay future benefits. The actuary has recommended an employer's minimum contribution rate of 17.5% for the three years 2009/10, 2010/11 and 2011/12. Additional employer's contributions of £1.02 million, £1.35 million and £1.72 million will be made for each of the next three years. These relate to the deficit arising from past service costs and are set at a level to maintain, ie not reduce, the deficit at the current level. The next actuarial valuation will be at 31 March 2011.

Significant trading operations

34. The Local Government in Scotland Act 2003 replaced compulsory competitive tendering regulations with a duty to maintain and disclose trading accounts for significant trading operations (STOs), which are required to break even over a three year rolling period.
35. The Council has three STOs: Building Maintenance, Roads Maintenance and Investment Properties. In the three years to 31 March 2009, the STOs met the statutory target to break even over a three year rolling period. The Investment Properties STO, however, made a loss in 2008/09 due to the



impairment of £0.59m for one of its properties. We have been advised that the status of the Investment Properties STO is under review to consider whether it will remain as an STO in 2009/10.

Legality

36. Through our planned audit work we consider the legality of the Council's financial transactions. In addition the Director, Corporate Services 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 relevant legislation and regulations. There are no additional legality issues arising from our audit which require to be brought to members' attention.

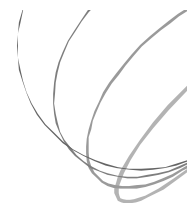
Financial reporting outlook

IFRS adoption

37. Local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2010/11. Because local government has already adopted some aspects of IFRS, we expect the transition to be fairly smooth. Next year, in 2009/10, councils will be expected to account for PFI projects on an IFRS basis and it is important that the Council starts the transition period as soon as possible. A comparative balance sheet as at 1 April 2009 will be required and whole of government accounts will also be required on an IFRS basis from 2009/10.

Carbon trading commitment

38. From April 2010 a dry run will commence for a new and complex system for charging for carbon emissions that is due to be introduced by the EU in 2011/12. The Council will be required to purchase and account for carbon credits to cover all of its non transport related energy usage. Incentives and penalties will be built into the system to encourage a reduction in carbon emissions.



Use of resources

Financial results

39. In 2008/09, Midlothian Council spent £266.9 million on the provision of public services and £71.4 million on capital projects. The Council's net operating expenditure in 2008/09 was £215.2 million. This was met by central government and local taxation of £183 million, resulting in a deficit of £31.7 million, 14% of the net expenditure for the year. The budget set for 2008/09 was based on a Band D council tax level of £1,210 with planned contributions of £1.2 million and £1.1 million from the Capital Fund and Insurance Fund respectively.
40. After taking account of statutory adjustments, £9.6 million was met from reserves, leaving a General Fund balance of £2.1 million. However £4.4 million has been earmarked for specific purposes, leaving a General Fund deficit of £2.3 million.
41. During 2008/09 the Council was provided with quarterly financial monitoring reports which included budget variances. The normal practice of setting council budgets means the budget for the following year is approved in the February before confirmation of the final outturn for the current financial year. As is often the case once the final outturn is known, additional budgetary pressures are identified. These therefore can result in revisions to the original approved budget. Exhibit 1 below highlights the main movements in the 2008/09 budget, from the original 2008/09 set in February 2008, the revised 2008/09 budget as at June 2008 which incorporated the final outturn position from the previous year, and the final revised budget which takes into consideration all the influences on the budget during the financial year.

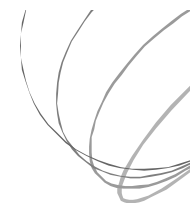


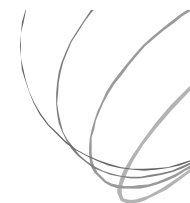
Exhibit 1

Summary of budget movements – net expenditure

Service	Original Budget at Feb 2008 £'000	Revised Budget at June 2008 £'000	Final Revised Budget £'000
Education and Communities	80,154	82,521	84,749
Social Work	41,624	44,586	44,207
Strategic Services	3,165	3,696	2,996
Corporate Services	8,796	10,044	5,162
Executive Services	3,217	3,891	3,352
Commercial Services	26,193	26,529	29,301
Non Distributable Costs	2,800	2,800	2,800
Joint Boards	11,168	11,297	11,260
Total	177,117	185,364	183,827

42. In the course of 2008/09 the extent of the global economic recession became more apparent and there was increasing uncertainty as to what the impact would be on public sector finance. The Council recognised the need to continue to closely manage its budget in anticipation of the financial uncertainty and risk ahead as illustrated by exhibit 1 above.
43. A Budget Review Group was established early in 2008/09. It is a recognised member/officer working group with an agreed remit and mode of operating. In practice this has provided it with a degree of flexibility to consider options for service redesign and the identification of savings. It has no delegated powers and makes recommendations to Council for consideration and decision-making.
44. During much of 2008/09 the Budget Review Group included representation from all political parties in the Council but this is no longer the case. In view of the important role it fulfils, and the continuing financial pressures the Council will encounter, for example, it was announced in September 2009 that there will be a reduction in the Scottish Government Grant to local government, representation from all political groups may strengthen the effectiveness of the Budget Review Group.

Key risk area 2



Reserves and balances

45. Exhibit 2 shows the balances in the Council's cash backed reserves at 31 March 2009 compared to the previous year. At 31 March 2009, the Council had total cash backed reserves of £13 million, a decrease of £10 million from the previous year.

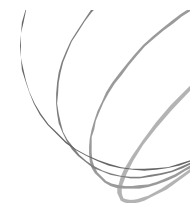
Reserves

Description	31 March 2009 £ Million	31 March 2008 £ Million
General Fund	2,122	11,764
Insurance Fund	634	1,779
Housing Revenue Account Reserve	10,352	9,498
	13,108	23,041

46. The General Fund decreased by £9.6million during the year to a balance of £2.1million. Earmarked funds of £4.4 million needed for specific one-off commitments have also been identified. Taking those into account, the General Fund reserve is, in effect, in deficit by £2.3 million with no reserve available to meet any unforeseen events. The costs arising from the settlement of equal pay costs and the Council's share of the retained losses of SDL contributed to the deficit. As reported to Council in November 2008, the Council's reserve strategy historically was to maintain a contingency reserve broadly equivalent to 2% of net expenditure, around £3-£4 million. During 2008/09 plans were in place which anticipated that the general fund reserve would be replenished through capital receipts. However over the year the extent of the economic recession has become more evident and lower than expected capital receipts received. The Director, Corporate Services has advised Council that the General Fund will not be replenished as had been anticipated. We note that discussions are ongoing between COSLA, the Scottish Government and HM Treasury regarding the potential to capitalise equal pay costs, thus spreading their impact over a longer period of time. But in the meantime with no General Fund Reserve and no date of likely recovery (to the reserve) the Council is exposed to financial risk and has no capacity to deal with unforeseen costs or losses.

Key risk area 3

47. Council approval was given in January 2009 not to recover insurance premiums from Divisions as it was considered appropriate to reduce the level of the fund. After payment of insurance costs, the level of the fund reduced from £1.8 million to £0.6 million. This also meant that services were not charged any insurance premiums in 2008/09 resulting in budget savings of £1.2 million. It is important that the level of insurance fund is monitored to ensure that it does not fall below an acceptable level.



Group balances and going concern

48. The Council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Lothian and Borders Police, Lothian and Borders Fire and Rescue and Lothian Valuation) had an excess of liabilities over assets at 31 March 2009 due to the accrual of pension liabilities. In total these deficits amounted to £1,307 million (2007/08 £1,247 million), with the Council's share being £107.9million (2007/08 £99.5 million).
49. The overall effect of inclusion of all of the Council's subsidiaries, associates and joint ventures on the group balance sheet is to reduce net assets by £100.3 million, mainly because of pension liabilities. However, all group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and council tax.

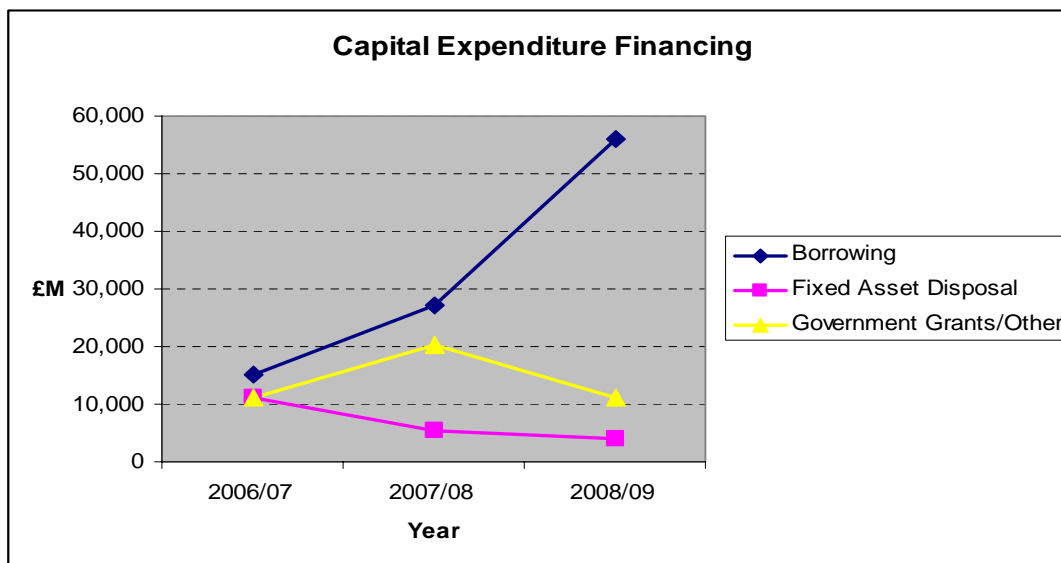
Capital performance 2008/09

50. The Council's prudential indicators for 2008/09 were set in February 2008. Whereas a number of other councils reported significant slippage in their capital programmes during 2008/09 as a result of the recession, Midlothian Council was committed to deliver its planned capital programme. During the year the capital budget was increased by £2.8 million to £76.9 million, and the actual spend was £71.4 million (2007/08: £53.1 million) comprising £28.7 million for General Fund expenditure and £42.7 million relating to housing. A significant proportion of the General Fund expenditure (£26m) during 2008/09 was the completion of the schools plus programme.
51. Looking ahead, the general fund capital plan for 2009/10 has been revised downwards from £19.2 million to £10.8 million. The housing capital programme sits at £36 million. The trend in capital investment and sources of funds is reflected in exhibit 3.

Exhibit 3

Sources of finance for capital expenditure 2006/07 to 2008/09

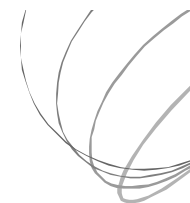
	2006/07 Actual £M	2007/08 Actual £M	2008/09 Actual £M
Borrowing	15,124	27,264	56,090
Fixed Asset Disposal	11,020	5,409	4,076
Government Grants/Other (including Developer Contributions)	11,184	20,394	11,228
Total	37,328	53,067	71,394



52. The world's financial markets are experiencing unprecedented turbulence and uncertainty. Whilst still possible, scope to achieve savings through debt restructuring is more limited. And it is increasingly difficult to forecast interest rate movements as the balance between preventing recession and managing inflation is sought. It is also likely that capital receipts will be more difficult to realise in the medium to long term. This means that the Council will have to continue to review alternative sources of funding to achieve their capital plans.

Treasury management

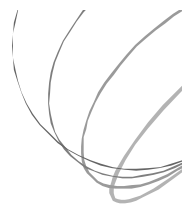
53. In recent years, some councils have held significant amounts of cash and temporary investments to take advantage of favourable interest rates for planned capital programmes. In these circumstances, the early borrowing must be justified in its own right as representing the best time for borrowing the amount required. This should be assessed without regard to temporary investment possibilities, otherwise the action may be judged to be unlawful or to have subjected public money to unnecessary speculation risk.
54. As at 31 March 2009, Midlothian Council held cash and temporary investments totalling £39.8 million (31 March 2008 £74.0 million). We received specific representation from the Director, Corporate Services that all borrowing in advance of immediate requirements was made for a legitimate purpose in accordance with legislation and was on-lent in the interests of prudent cash management. In the Director's assessment any early borrowing is justified in its own right as representing the best time for borrowing the amounts required, without regard to temporary investment possibilities and the 'profit' that might arise from these.



55. The current economic climate means that interest rates on investments are low. However, the Council achieved a better than average return on investments, receiving £2.4 million in investment income this year compared to £2.0 million last year. Borrowing rates are also low, although the Council has a significant proportion of its debt at fixed rates. The Council has taken advantage of the drop in interest rates to reschedule £22 million of debt and repay a further £10 million. This has resulted in net revenue savings of £1 million in the year through discounts and further ongoing revenue savings of around £1 million p.a..
56. In 2008/09 Council approval was sought to increase the prudential limits to allow borrowing to the level required. Council approval was given to allow borrowing up to the 2010/11 limit, if necessary. As disclosed in detail in Note 35 to the accounts, the Council's borrowings increased from £155 million to £178 million over the course of the year.

Financial planning

57. The Council continues to face difficult financial pressures in 2009/10. A revenue funding gap was identified and reported to Council and Cabinet in the summer of 2008 in advance of finalising the budget for 2009/10. Given that council tax remains frozen for 2009/10 and the Council has had to look at other sources of income and reductions in expenditure to balance its budget. The Cabinet and the Corporate Management Team took an active roll in considering how to close the gap. Matters considered included a review of: budget model adjustments; emerging pressures; Corporate and Divisional priorities; efficiency proposals; service reductions and income generation measures.
58. A number of decisions were taken including: changes to staffing establishment, in that certain posts were not filled upon becoming vacant; certain services were re-organised, for example, integration of the Council's transport and fleet functions; some existing charges for services provided were increased, such as burial charges, and charges were introduced for the first time for some services, for example, the introduction of a charge for the issue of 'blue parking badges' to eligible disabled residents of Midlothian. An important consideration for the Council in the run up to finalising the budget for 2009/10 was to consider Social Work funding bids as a result of increasing costs arising from delivering statutory social work services. The Council therefore approved a bid of £1.04 million in additional funding.
59. A balanced budget for 2009/10 was approved by Council on 24 February 2009.
60. The Scottish Government has made it clear that public expenditure will be constrained for the medium term. This means that councils need to plan now for a future where there is a real reduction in funding. Midlothian Council will need to consider medium term financial plans which are integrated with service plans to ensure it is well placed to correlate the impact of reduced funding on service delivery and to



identify areas for potential savings. Savings take time to accrue and the Council will need to take decisions and plan accordingly.

Key risk area 4

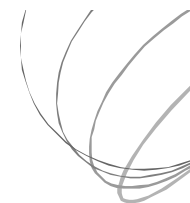
Budgetary Control

61. This year, because of the heightened importance of good budgetary control, we paid particular attention to how the Council set and managed its budgets. We found that the process for budget setting had elements of good practice. Budget reports presented to Council in August 2009 for 2009/10 already reflect some budget revisions, and outturn figures which are in excess of the revised budgets. We note that the original agreed budgets are not included in reports to Council, only the revised budget. The presentation of information in budget reports can vary between reports, such as the order of services. This can make it more difficult to compare information and trends as the financial year progresses.
62. Budgetary control reports to members routinely comment on variances/virements but they tend to explain why the variance has occurred rather than focus on the impact on service delivery. It would be helpful if the budgetary control reports routinely identified the service impact of the variance as well as the implications for the final outturn.

Key risk area 5

Asset Management

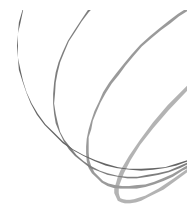
63. Effective management of council assets helps the council achieve its objectives and get best value from its investment in property. Effective management benefits service delivery by making council buildings work better for staff and service users now and in the future. It also reduces the opportunity cost of money locked up in surplus property and reduces the council's carbon footprint.
64. In 2009, we published *Asset Management in Councils*. Our study found that strategic asset management was not well developed in most councils. The report was presented to the Performance Scrutiny and Audit Committee on 9th June, by the Director of Strategic Services who provided a resume of the report and outlined what the Council was currently doing in the key areas and how they would respond to the report findings. The Director of Strategic Services will be reporting back to the Performance, Scrutiny and Audit Committee in the autumn of 2009 with an update on the report findings and the planned response. Strategic Services are reviewing study data to determine how Midlothian is performing relative to other councils and to help identify areas for improvement. They are making use of the report and benchmarking information already accessed through its membership of an Asset Management benchmarking group.



65. We commented in last year's Report to Members that although asset plans were in place for some services, there was no overall corporate Asset Management Plan which linked into the Council's service and corporate plan or capital investment plan. We are pleased to note the progress made since then: a strategic asset management vision has been agreed and a finalised Asset Management Strategy approved by the Corporate Management Team in April 2009.

Procurement

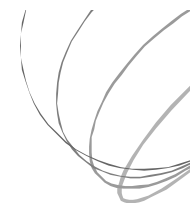
66. Local authorities spend significant sums of money annually on purchasing goods and services and as part of the efficient government initiative, the Scottish Government anticipated that scope existed for significant financial savings through improved procurement procedures and practices. The McClelland report on procurement published in March 2006 confirmed that significant savings were possible but concluded that public sector procurement processes still had weaknesses in resources, skills, organisational structures and practices.
67. In response to the McClelland report the Scottish Government introduced the Public Procurement Reform Programme (the Programme) in April 2006. In July 2009, Audit Scotland reported the extent to which the Programme had progressed nationally. This report concluded that while some significant steps had been made, more work was required before the Programme could achieve its full potential. The key findings of the report were that while the wider impact of the Programme appears positive:
- there was no systematic basis for reporting savings directly attributable to the Programme
 - savings from collaborative contracts, a key feature of the Programme, are being achieved more slowly than expected
 - there are wide variations across public bodies in the quality of purchasing data, practice and skill levels.
68. Midlothian Council participates with the national centres of procurement expertise. In common with all councils across Scotland however, the majority of local authority procurement is still arranged and processed within individual councils. In light of this, Audit Scotland recently surveyed Scottish local authorities to establish the nature of information held by councils on procurement processes. Questions also sought information on some key procurement statistics as well as establishing if individual councils had plans to implement key recommendations from the McClelland report.
69. The results of the Audit Scotland survey demonstrate that compared to some other councils, Midlothian's procurement function is more fully developed. Some examples of good procurement practice in Midlothian include having a Corporate Procurement Strategy and Procurement Policies and Procedures in place. Also in place and developing further is a contracts register detailing live contracts in which the Council is engaged. During the 2008/09 audit we conducted a separate review of aspects of Midlothian's procurement function and some risks to continuous improvement were



identified. However, the identified risks should be considered against the backdrop that Midlothian Council has put in place a sound procurement base from which it can move forward. We will be issuing a separate report on procurement for the November 2009 Performance, Scrutiny and Audit Committee.

Managing People

70. During 2008/09 work was ongoing to ensure Modernising Midlothian (Single Status) was implemented by the planned date, 29th June 2009. There were many practical implications involved in implementing Modernising Midlothian, such as issuing all relevant staff with new contracts and terms and conditions and amending the payroll system to reflect the new pay and grading structures. Also during 2008/09 a vacancy review board was set up to scrutinise recruitment plans. As a result non-essential vacancies were left unfilled. Difficulties, however, were experienced in recruiting and retaining technical and professionally qualified staff. The combination of such workforce issues could have a negative impact on staff morale, therefore succession planning and effective management of staff sickness absence will continue to be important.
71. The Council's People Strategy aims to establish the key elements of workforce planning through defining a planned approach to recruitment, deployment, retention and motivation of the workforce. The People Strategy is to be reviewed after implementation of Modernising Midlothian. Other pieces of work to be undertaken following the implementation of Modernising Midlothian are the development and implementation of a competency framework and a revised PDP process. These are two important initiatives which should be progressed and concluded.
72. As at 31 March 2009 £5.44 million of equal pay claims had been settled. However, at the end of March 2009 there were a significant number of equal pay claims which were still in the employment tribunal system, and an estimate of £8.14 million was set aside to meet the cost of settling outstanding claims. In addition an unquantified contingent liability has been included in respect of further costs which may arise but cannot be estimated at present. In order to mitigate the level of potential ongoing liability Midlothian Council undertook a Bonus Buyout, prior to implementation of Modernising Midlothian, to those staff that had previously benefited from bonus payment arrangements. The implementation of Modernising Midlothian should help reduce the risk of further equal pay claims from June 2009 onwards.
73. A staff survey has not been carried out for a number of years. It is important that the Council understands the issues of importance to staff. The implementation of Modernising Midlothian in June 2009 had a negative impact on the morale of some groups of staff. This also suggests that a staff survey would provide useful information to assist the Council to engage with all groups of staff.



ICT

74. The Council makes good use of ICT to support and deliver services. Although it does not have a documented ICT strategy, it has formally identified the individual applications and ICT infrastructure deemed critical. The Customer First Programme Board which meets quarterly drives the ICT strategy and has broad officer/ member representation. Work around business continuity and ICT resilience include identification of critical services and applications. An action plan to improve resilience has been prepared and a number of resilience measures have now been implemented. Consideration of resilience issues is ongoing with residual ICT risks and outstanding actions regularly reported to the Corporate Management Team.

Data handling and security

75. Data handling and security has received increased public and media attention recently as a result of a number of national incidents relating to lost data. The Council shares data with a number of organisations such as the Department for Work and Pensions and other government departments. Information security is now a service delivery issue where a significant failure of controls could lead to loss of stakeholder confidence and opt out from services, higher compliance costs due to enforcement action, withdrawal of third party services such as payment card processing, and legal fees relating to civil and criminal litigation.
76. Internal Audit carried out a review of data handling and security and found that corporate policies and procedures are in place, including a number of technical measures. However, it is recognised by the Council that there is need to ensure these measures are adhered to. Although policies and procedures are in place, a lack of staff awareness and/or breach of the policies could expose the Council and its data to risk. Measures introduced to improve and maintain data handling include a Designated Information Security Officer being in post and the establishment of an Information Management Group. There is however a need for service managers to take greater ownership of information security issues, raise awareness and ensure their staff are aware of and adhere to corporate policies and procedures.

Key risk area 7

Shared Services

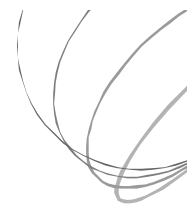
77. The Accounts Commission commented on the lack of progress in developing shared services in its *Overview of the local authority audits 2008*. They recommended that councils should give this high priority in the light of financial pressures and the drive for efficiency. Midlothian Council is a member of ELB, a forum of 6 local authorities: Edinburgh, three Lothians, Scottish Borders and Fife, who have combined to look at shared services. It is attended by the six chief executives. In May 2009 the



Corporate Management Team considered a report detailing various shared service activities and options. Midlothian Council has already established joint working initiatives in some areas e.g. social work and transport. It is important that opportunities to share services continue to be rigorously reviewed to identify cost savings and efficiencies.

Outlook

78. Clearly we are in a period of reduced economic growth with significant implications for the Council's resources and the demand for services. The Council needs to remain alert to the impact of the recession on the community it serves and what that means for its own objectives and services. At the same time as the Council tries to support its local economy and provide best value services, it is likely to face a reduction in resources, such as a reduction in Scottish Government Grant funding and reduced capital receipts. We note that the Council has benefited from a reduction in the cost of housing construction, and this will be a cost reduction the Council will seek to sustain, and even improve upon, in the course of its house construction programme.
79. Despite the uncertainty that has surrounded levels of funding over the past 18 months and for the foreseeable future, the council should continue to have medium and long term plans which integrate service delivery with financial plans. We recognise that the Council is having to respond to shorter term grant settlements, but it nevertheless does not want to lose sight of its longer term objectives to ensure short term decisions are not incompatible with them.



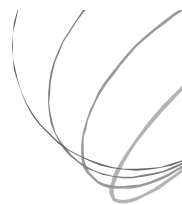
Governance and accountability

Introduction

80. An effective council is committed to high standards of probity and can demonstrate high standards of governance and accountability. It has effective political and managerial structures and processes to govern decision-making and the exercise of authority within the organisation, supported by mature and effective relationships between members and officers. An effective council is committed to public performance reporting as a key element of public accountability. It clearly sets out service standards which reflect the needs of local people and other stakeholders, and is balanced in its presentation of the council's strengths, weaknesses and challenges for the future.

Structure and policies

81. Corporate governance is about direction and control of organisations. Councils are large complex organisations and so good governance is critically important. During the 2008/09 audit year we assessed the extent to which Midlothian Council's '*Code of Corporate Governance*' (2007) complies with the CIPFA/SOLACE guidance using the CIPFA/SOLACE '*Delivering Good Governance in Local Government: Guidance Note for Scottish Authorities*' (2008) which is intended to support Scottish local authorities in complying with the Framework.
82. We concluded that Midlothian Council's '*Code of Corporate Governance*' (2007) almost fully complies with the best practice principles set out in the CIPFA/SOLACE guidance. We only identified a few weaknesses, in relation to community planning and partnership working arrangements, engaging with local people and other stakeholders to ensure robust public accountability, and developing the capacity and capabilities of members and officers to be more effective. The outcome of this audit was separately reported to the Performance, Scrutiny and Audit Committee in October 2009.
83. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account and support the modernisation agenda. The Council's framework for scrutiny includes the Performance, Scrutiny and Audit Committee (PSAC). The PSAC has a wide ranging remit which includes:
- reviewing performance across the Council, including the planning and performance management framework and external inspection reports
 - making recommendations to and commenting on decisions and policies made by the Cabinet
 - agreeing and monitoring Internal Audit's strategies, plans and reports



- reviewing external audit's strategies, plans and reports.
84. There is scope for further learning and development opportunities so that members are appropriately supported and equipped to challenge officers and increase the effectiveness of the committee's work. In particular, we would highlight the following matters as areas of work where the committee could focus more attention:
- there can sometimes be gaps in attendance at the PSAC by some of its members
 - the draft financial statements were not presented to the PSAC for its consideration
 - due to the wide ranging remit of the PSAC, there is a risk that sufficient time is not given to the various important matters which need to be discussed at each meeting
 - internal and external audit plans are prepared on the basis of risks identified. The committee needs to be assured that audit plans have been completed and where slippage has been experienced that significant risks have been addressed
 - the Accounts Commission issue a range of national study reports and an overview of local government each year. Recommendations are generally directed at all councils so it would be appropriate for the PSAC to continue to consider findings and ensure that significant matters are being addressed by the Council.

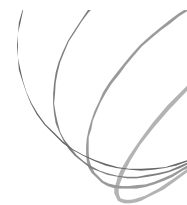
Key risk area 8

Roles and relationships

85. The Accounts Commission recommends that councils give priority to the continuous professional development of its members. The creation of multi-member wards has required new ways of working to support efficient representation and sharing of the workload. In 2008 two members of Midlothian Council were found to be in breach of the Councillor's Code of Conduct and were suspended for a period of time. Officers and members ought to work together to determine the training appropriate to members' varying needs, to arrange for it to be provided and to ensure that those opportunities be taken up by members, as appropriate.

Partnership Working and Community Engagement

86. Midlothian Council has made progress in developing good partnership working. Community planning continues to mature at council and local levels with appropriate political, official and community representation on each. During the year, the community planning partnership (CPP) worked effectively to develop a single outcome agreement, a real milestone for effective partnership working. The community plan is the keystone of the Council's strategic planning framework. The SOA is viewed as a stepping stone to deliver the priorities set out in the community plan.



87. However, as noted in the recent Internal Audit report on Community Planning some weaknesses were identified in the operation of the CPP. They included:

- not all partners have signed off the agreements
- not all group action plans are complete or linked back to outcomes
- detailed responsibilities for planned actions are not clearly defined as not all partnership subgroups have terms of reference consistent with the partnership agreement template
- performance report on progress towards achievement of outcomes has not been published as required by the Local Government in Scotland Act 2003
- reasons for changes to the Community Plan that are a result of the annual review are not always clearly documented
- there is no assessment of the effectiveness of the relationships in the Community Planning Partnership
- the Working Group is charged with ensuring that the funding is spent in accordance with financial rules of the partners and yet it does not have control over the direct funding that Strategic Groups can receive directly from the government. It could however be argued that due to the complexity of the partnership structure it is not reasonable to expect that the Working Group could tightly coordinate all funding received but it instead provides a general direction for the partnership.

88. The Internal Audit report on Community Planning matters commented on community engagement. It noted that Midlothian Council and its community planning partners have adopted the national standards for community engagement and that the CPP has developed a number of ways of seeking community views including community conference, citizen surveys and more recently locality planning. In addition, details on community planning are issued via newsletter and occasional press release and through update of the Council web site. However the report also identified areas where improvement could be made.

89. An action plan was agreed with management which when fully implemented will allow the Council to demonstrate further examples of good partnership working. Most of the actions arising from this part of the report were actioned and cleared by the time the report was issued to the PSAC.

90. In August 2009 Audit Scotland published a study entitled "*Improving civil contingencies planning*", examining how public sector bodies were responding to the duties placed upon them by the Civil Contingencies Act 2004 (CCA). This established a new legislative framework for civil protection across the United Kingdom. Civil contingencies arrangements are about having effective arrangements in place to prepare for, respond to, and recover from major emergencies. The Audit Scotland study found that, overall, the act has reinforced multi-agency working and organisations are

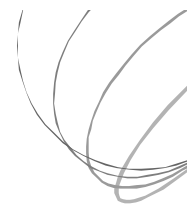


generally co-operating well with each other. Progress is being made to meet the main duties under the CCA, but further improvements could be made and the pace of change could be accelerated in certain areas. The Act requires a broader, more integrated approach to be taken to civil contingencies planning. The study found that traditional aspects, such as response arrangements for emergencies, still tend to dominate. Arrangements for recovery and the continued delivery of service are less well developed.

91. Midlothian Council is a member of the Lothian and Borders Strategic Co-ordinating Group which provides strategic direction on all relevant matters in relation to the CCA requirements. The Council is represented usually by the Chief Executive or the Head of Performance and HR. The Strategic Group informs the work of the Lothian and Borders Tactical Group which is responsible for implementing all practical matters covered by the CAA. The Council is represented at this group by the Emergency Planning Officer. The Council is also represented on a number of other working groups which contribute to contingency planning.
92. Internally the Council directs its civil contingency planning and business continuity planning arrangements through the Business Co-ordination Group. The Group is chaired by the Chief Executive and each Division is represented on the group. The Council's in-house civil contingencies arrangements are detailed in various plans and procedures including the Midlothian Emergency Plan, Midlothian Pandemic Plan and MIDCON Emergency Procedures.
93. It is recognised in the national report that the arrangements for civil contingencies planning, which include business continuity planning, are increasingly complex and clarity is needed about leadership, roles and responsibilities, and priorities. More needs to be done to engage elected members in relation to civil contingencies planning and to communicate effectively with the public. It may therefore be appropriate for Midlothian Council to review its civil contingency and business continuity arrangements and the remit and membership of the Business Co-ordination Group to ensure they continue to be relevant. This type of group is important for ensuring that emergency planning and business continuity are embedded across the Council, and to ensure that all staff are aware of their roles and responsibilities in the event of an incident.
94. Much emphasis is placed on planning for major emergencies and issues around business continuity. An important factor in this process is testing such plans. Although it is not always practical to fully test plans, it the Council should consider the most appropriate means of testing plans to ensure that plans are appropriate.

Public performance reporting

95. It has been previously identified that the Council's public performance reporting arrangements could be improved to ensure meaningful, up to date, balanced performance information is more accessible



to the public. Part of this improvement would be to the Council's website, including improvements to the search facility for committee minutes and reports. The Council has decided to take forward improvements in this area but there has been no significant progress to-date.

Key risk area 9

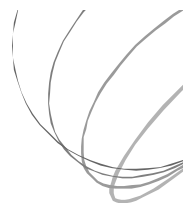
Governance and internal control

96. During the 2008/09 audit year we reviewed governance arrangements, conducted preliminary systems evaluations and undertook routine audit testing of the main financial systems. The results of this audit were detailed in our interim management letter, 'Review of Governance Arrangements and Main Financial Systems' which was presented to the PSAC in August 2009. The audit identified areas for improvement which resulted in an agreed action plan with management. We could conclude from this work that generally Midlothian Council has put in place a sound framework for internal control which includes: standing orders, financial directives, a procurement strategy and procurement policies and procedures and robust risk management arrangements. However, one of the recurring findings arising from our audit work was that the internal control framework was not always being complied with. It is important that all relevant staff and management adhere to the Council's internal control framework, in order that Midlothian Council can demonstrate that it has discharged its responsibilities appropriately.

Key risk area 10

97. Included within the Financial Statements is an Annual Governance Statement which provides an overall opinion on the appropriateness of the governance arrangements operated within Midlothian Council during 2008/09. This statement is signed by the Leader of the Council and the Chief Executive, who concluded that "we are satisfied that overall, Midlothian's corporate governance arrangements are of a satisfactory standard and that we are aware of areas where improvement is required. We will endeavour in the next year to take steps to continue to advance our corporate governance and continuous improvement arrangements." It is noted in the Annual Governance Statement that some governance improvements identified in the 2007/08 statement have been satisfactorily dealt with, whereas some require longer term solutions and have been carried forward.
98. We note that of the thirteen improvement areas identified, eight have been brought forward from 2007/08 and fall into the category of requiring a longer term solution. There is a risk that due to the high number of improvement actions which have been brought forward from previous years there is a loss of focus on prioritisation and conclusion of improvement actions, both old and new.

Key risk area 11



Outlook

99. The Accounts Commission acknowledges that SOAs are still at an early stage of development. At this stage in the evolution of this new approach to planning, we are interested in the processes rather than the outcomes. The Council has kept pace with its peers in its approach to the SOA. In 2010/11, we expect to see further developments in clarifying accountability, governance and public performance reporting.
100. As the SOA demonstrates, partnership working is critical to the Council's success. We are developing our approach to the audit of partnerships through the new approach to best value. In future, we shall increasingly be looking at the contribution of partners as well as the Council's own contribution to the delivery of outcomes.



Performance management and improvement

Introduction

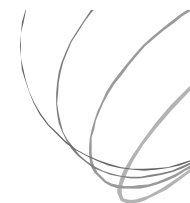
101. An effective council has a clear and ambitious vision for what it wants to achieve for its locality and communities to secure high quality services and effective outcomes for local people. The vision is effectively promoted by the member and officer leadership of the council and supported by staff and partners. It will be backed up by clear plans and strategies to secure improvement, with resources aligned to support their delivery. An effective council has a performance management culture which is embedded throughout the organisation. The council's performance management framework will be comprehensive and integrated with service planning and delivery. Staff will have a "customer first" culture. The council is able to demonstrate significantly improved outcomes for citizens and more effective and efficient services because of its performance management arrangements.

Vision and Strategic Direction

102. The Council and its partners present a clear vision for the future of the area in their Single Outcome Agreement (SOA). The SOA has been developed using high level key indicators from the Community Plan 2008-2011 - "Midlothian Moving Forward" and the Council's Corporate Strategy 2008-11, which sets out its mission statement and values. The Corporate Strategy and Corporate Priorities were updated in 2009. Divisional priorities reflect corporate objectives and are linked to the SOA and other relevant documents including the Best Value Strategy. Each division has a Divisional Management Team comprising the Director, Heads of Service and other Senior Managers which meets monthly to focus on key issues including discussing key objectives in service plans. The Council's Code of Corporate Governance (October 2007) is due to be reviewed in October 2009.

103. A report on SOA outcomes was presented to the Council and to the Community Planning Steering Committee in February 2009 and a subsequent version has recently been submitted to the Scottish Government.

104. The Council and its partners regularly seek views from the community. One of the methods used is via a Citizens' Panel Survey where 1000 residents are consulted and views sought. The results of these consultations are presented to the Council and published around 3 to 4 times a year.



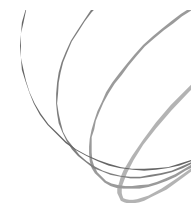
Performance management

105. Internal Audit conducted a review of performance reporting during 2008. The report was presented to the PSAC in December 2008. The report noted that Midlothian Council has devoted significant resource to developing a performance management framework using third party software provided by Covalent. There is central co-ordination for the production of the reports through the Policy and Performance Team and each division has appointed a Performance Officer who is responsible for the divisional submission.
106. A series of reports has been developed for each division which includes: an overall summary of performance (including successes and challenges); an action report; statutory and local performance indicators; making the best use of resource; improving for the future; divisional priorities and high risk reports. These reports are published on a quarterly basis and distributed to senior divisional management, Directors and the Chief Executive prior to being passed to the Performance, Scrutiny and Audit Committee and Cabinet for review.
107. It is noted in the Internal Audit report that further work is required in a number of areas before this reporting tool, associated data capturing routines and internal validation may be regarded as robust. However, overall the audit concluded that management had made significant progress towards implementing a performance management system which provides accurate, timely and relevant performance information through the development and roll out of the Covalent reporting tool for Management, the Performance, Scrutiny and Audit Committee, and Cabinet. An action plan was agreed with management with a number of the agreed actions being implemented during the course of the audit.
108. A robust performance management system is an integral tool for any organisation which is dedicated to continuous improvement. We suggest that the Council keeps this area in focus to ensure that appropriate key indicators are used and information is reported timeously in order to inform the decision-making process. It may also be useful to include an overall numerical summary showing the number of targets achieved, numbers of actions on or off target, tracking changes to implementation dates, and, where possible, linking this to achievement of outcomes.

Key risk area 12

Statutory performance indicators

109. One of the ways of measuring council performance is through the statutory performance indicators (SPIs). Within Midlothian Council, key SPIs are already included within performance reports. The 2008/09 SPIs were published by 30 September 2009 and submitted to Midlothian Council. SPIs



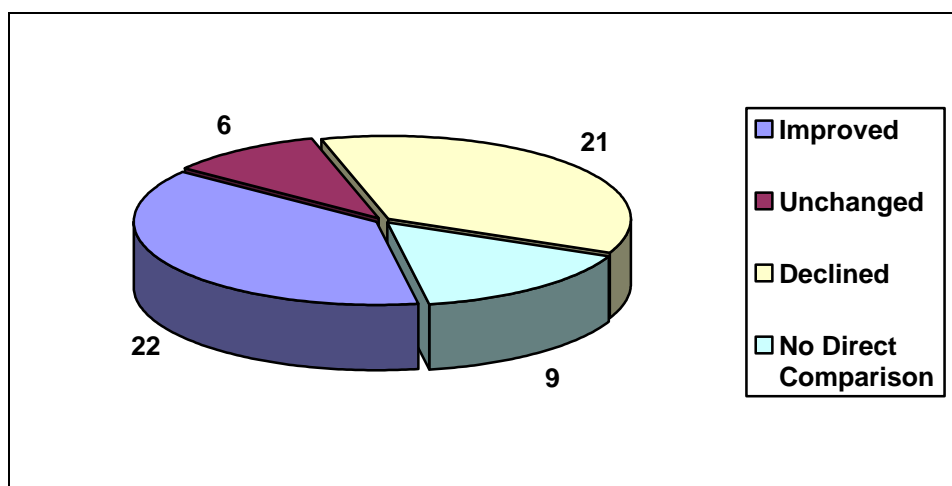
provide a consistent form of measurement for councils to review their performance over time and to make comparisons with other councils.

110. Each year we review the reliability of the Council's arrangements to prepare SPIs. Overall, the quality of working papers provided to support the SPIs was satisfactory and we assessed the arrangements for collating data for each indicator to be reliable.

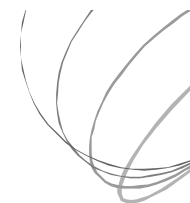
111. Exhibit 4 illustrates the Council's performance, with improvement being achieved in a number of areas.

Exhibit 4

Improvements demonstrated by SPIs (Total 58 indicators)



112. Although SPIs appear to have declined in a significant number of areas, many of the variances are slight and can be easily impacted by small sample numbers. Areas where performance has declined include attendance at pools and leisure facilities, academic achievement in looked after children (where numbers are small), rent losses due to voids and time taken to re-let houses, and food hygiene inspection levels. The indicator for the time taken to deal with non-domestic noise complaints showed a dramatic increase but this was entirely due to one protracted case skewing the results. Refuse collection costs remain very high and a separate exercise to review the compilation of this indicator is underway. The fall in attendance at leisure facilities is largely due to the economic climate whereas visitor numbers at the mining museum increased significantly. Occupancy levels at schools continue to improve as does the time taken to process children's hearing reports and address supervision requirements. Performance against SPIs is monitored regularly by the Performance, Scrutiny and Audit Committee (PSAC).

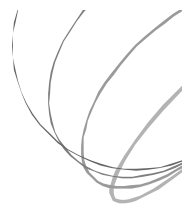


Equality and Diversity

113. Diversity and equality are widely recognised as fundamentally important factors in the sound management of a modern, effective organisation. Equalities legislation has developed piecemeal since the 1970s and there are several pieces of discrimination legislation, guidance and statutory codes of practice. The legislation that may apply in a particular set of circumstances is not always obvious. The November 2008 Accounts Commission report '*The impact of the race equality duty on council services*' found that while councils have developed policies on race equality they now need to ensure that these have a positive impact on people from minority ethnic communities. The report concludes that councils need to build a better understanding of the needs of their minority ethnic communities; mainstream their approach to race equality; and give more priority to race equality in delivering services.
114. Midlothian Council has introduced measures to promote diversity and equalities in response to the developing anti-discrimination laws governing employment and the provision of goods and services, together with specific public sector duties relating to race, gender and disability. As a result the Council has put in place policies, procedures and training. Training is provided to staff and elected members. The Council has established an Equalities Working Group which is remitted to oversee equalities work in the Council and has recently introduced a Disabled Employees' Forum. In addition the Community Planning Equalities Forum operates within the community planning structures to promote equalities.

Efficiency

115. Efficiency savings are built into the Council's annual budget process along side the budget adjustments, cuts and changes that are required. Council officers report that during 2008/09, total efficiency savings amounted to £2.18 million in cashable savings. In addition, non-cashable savings of £1.54 million were achieved. It is noted that the efficiencies have primarily resulted from reducing inputs as detailed above; there has been no impact on the community. The Council is also looking ahead to 2010/11, building the efficient government savings target into the integrated financial/service planning process.
116. The Council is under increasing pressure to deliver ambitious efficiency gains to meet the Scottish Government efficiency targets for Local Government but also to provide existing services when there are constraints on available financial resources. Midlothian Council aimed to achieve an annual efficiency saving of £2.6 million, which was revised to approximately £2m in 2008/09. £2m plus is being targeted for 2009/10.
117. In September 2008 the outcome of the Shared Services Diagnostic Project was reported to Cabinet. The study identified the scale of opportunity to simplify, standardise and share activities. The project



also enabled a strategic view to be taken of potential improvements and efficiency savings that could be redirected to frontline services. A list of opportunities for service improvement and efficiency was determined. It was concluded that the results of this review, on the whole, related to ongoing or planned improvement activity already outlined in the Council's Efficient Government Plan.

118. Seven areas were identified for potential efficiency savings, from which the Corporate Management Team selected five projects. These are now underway: asset rationalisation, management structures, customer access and contact, social work external shared services and information management. The Efficient Government Plan identified a further four projects: asset management, managing sickness absence, procurement and transportation. Asset management and asset rationalisation have been merged. The Integrated Improvement Programme Quarter One, 2009/10 Update Report to Cabinet on 1st September 2009 details progress in the areas identified.
119. The extent of the savings achievable and the costs of implementing the change necessary to release these savings are to be quantified as outline business cases are developed. Further reports, with detailed cost implications, are to be presented to Cabinet as appropriate.
120. Tackling climate change and making the best use of resources require the efficient use of energy. In 2008, we published a report on this subject: *Improving Energy Efficiency*. Our report concluded that the public sector in Scotland has made progress in using energy more efficiently, recording a 5% decrease in energy consumption in councils for the three years to March 2007. However, the amount spent on energy, over the same period, increased by 47% due to price increases. Public bodies are recommended to develop and implement robust energy strategies and to encourage the necessary changes to culture and behaviour. In the case of Midlothian Council the *Improving Energy Efficiency* report and its implications have been discussed on a number of occasions within the Commercial Services Division. There is an intention to submit the report together with a completed Carbon Reduction Plan to the PSAC in due course.

Progress on delivery of the Council's best value improvement plan

121. A full review of best value and community planning was published in 2008. Over the past few years Midlothian Council has been inspected by various bodies including the Food Standards Agency, Her Majesty's Inspectorate of Education (HMIE) 2007, Social Work Inspection Agency (SWIA) 2008, and the Scottish Housing Regulator (SHR) 2008.
122. Actions plans have been agreed following these inspections and the implementation of the actions are being monitored through the quarterly performance monitoring framework. An Integrated Improvement Programme has been developed to ensure no action will be overlooked. Progress on the Programme was reported to Cabinet in September 2009.



123. We note however, that the quarterly performance monitoring reports which are presented to the PSAC and Cabinet show some delays in the implementation of some of the improvements the Council is committed to. This suggests that there is a need to review priorities, especially in light of ongoing budget pressures, in order to focus resources on those areas identified as in most critical need of improvement.

Key risk area 12

Risk Management and Internal Audit

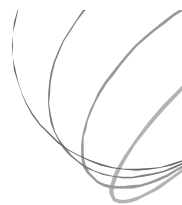
124. Risk is the threat that an event, action or inaction will adversely affect an organisation's ability to achieve its objectives. Risk management is the process of identifying, evaluating and controlling risks. Risk management supports decision making and contributes to performance.

125. A review of risk management was undertaken during the 2008/09 audit year, as part of our work on governance. Our report 'Review of Local Code of Corporate Governance, Internal Audit and Risk Management' was presented to the PSAC in October 2009. We were able to conclude that the Council's risk management function is well embedded and operates effectively. It should also be noted that the Midlothian risk management function is highly regarded and as such has been recommended to several other councils as an example of good practice.

126. Risk management is an evolving function. It is important that the impetus is maintained to ensure that risk management continues to be used effectively and continues to inform the decision making processes of the Council.

127. From our audit work, and as previously noted in our Annual Audit Plan 2008/09, the Internal Audit function has improved significantly as the resourcing issues of the last few years have been addressed. This has resulted in an improved level of audit coverage in 2008/09 enabling us to place reliance on an increased number of audits and areas of work carried out by Internal Audit. This included systems evaluation and housing benefit casework.

128. We have been able to conclude from our audit of governance matters that Internal Audit and Risk Management functions are managed effectively by the Risk and Audit Manager, who devotes 50% of time to each activity. Historically best practice suggested it was better to have these functions separated but it is now becoming more common to manage them jointly as benefits of integrated services are recognised. We are satisfied that the current arrangements are working successfully as an appropriate level of resource and attention is given to each of these functions. However, as such an arrangement requires careful management, we therefore advise that the joint arrangement is reviewed on a regular basis and reported accordingly to the PSAC. Such a review should also include consideration of the managerial reporting lines for the Audit and Risk functions. Best practice



indicates that the Head of Internal Audit should report directly to a member of CMT, preferably the Chief Executive.

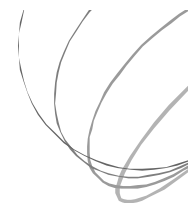
Key risk area 13

Outlook

129. We have already mentioned the importance of developing the governance aspects of the SOA; the performance management aspects are also important. The long term and complex nature of many of the outcome targets pose many challenges for performance management. For example, how can the Council tell if its allocation of resources is making a difference? We recognise the challenges and whilst we have no plans to audit the outcome progress reports in 2009/10, we will pay attention to the systems Midlothian Council has in place to monitor progress and take remedial action.

130. We are currently developing our approach to Best Value 2 by working with five pathfinder councils. Details of our new approach can be found at www.audit-scotland.gov.uk. From April 2010, we shall be rolling out the new approach to all Scottish councils. The timing of Midlothian's best value audit will be determined by risk assessment.

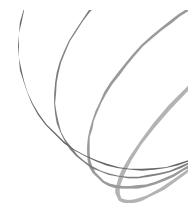
131. A shared risk assessment will be carried out in conjunction with other scrutiny bodies. That means that not only will it determine the timing and scope of the Best Value 2 audit of Midlothian Council, but it will also identify the timing and scope of other scrutiny work. Along with the other bodies, we intend to publish, in spring 2010, an assurance and improvement plan for each council covering all scrutiny activity for the following three year period.



Appendix A

External audit reports and audit opinions issued for 2008/09

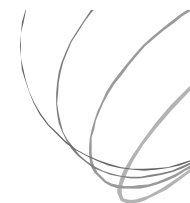
Title of report or opinion	Date of issue	Date presented to PSAC
Mine Water Grant Claim	11/12/08	n/a
Strategic Audit Risk Analysis	April 2009	12 May 2009
Computer Services Review – Progress Report	August 2009	11 August 2009
Review of Governance Arrangements and Main Financial Systems – Interim Management Letter	30/07/09	11 August 2009
Education Maintenance Allowance	30/04/09	n/a
Statutory performance indicators	31/8/09	n/a
Criminal Justice claim certification	30/9/09	n/a
Report to those Charged With Governance	01/09/09	8 September 2009
Audit opinion	30/09/09	27 October 2009
Review of Local Code of Corporate Governance, Internal Audit and Risk Management	1/10/09	13 October 2009
Procurement	tbc	10 November 2009
Report to Members	30/10/09	10 November 2009
Housing and Council Tax Benefits Subsidy Claim	By 30/11/09	n/a



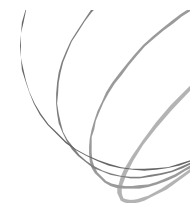
Appendix B: Action Plan

Key Risk Areas and Planned Management Action

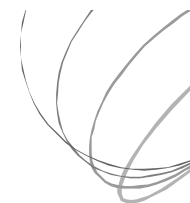
Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1.	28	Shawfair Development Ltd – Governance The governance arrangements for SDL appear to be no longer appropriate. <i>Risk: Without robust governance, issues could go unresolved and could expose the Council to legal and financial challenge.</i>	The City of Edinburgh Council has taken over the administrative responsibilities from The Miller Group and is actively addressing the issues identified. It is expected that SDL will become a dormant company and so there will be little or no activity for the Board to consider.	K Lawrie Chief Executive	31/3/10
2.	44	Budget Review Group The effectiveness of this Group may be enhanced if all political parties were represented on it. <i>Risk: A non-representative Budget Review Group could slow down the identification of areas for service redesign and cost savings, and require a duplicate forum for open discussion.</i>	Invitations have gone out to those political groups not currently represented and have been declined. An alternative, more traditional model to consider budget gaps will be proposed by the Director, Corporate Services, at the Council meeting of 27 October 2009.	Recommendation no longer considered relevant	n/a
3.	46	General Fund Reserve The closing general fund reserve is fully committed, and more. <i>Risk: Without a minimum level of general fund reserve, the Council could find that it is unable to respond to unexpected demands.</i>	The Council is fully aware of this and considers that there is little more that it can do to enhance general fund reserves in the short term. This situation is constantly under review and regularly reported to Council.	I Jackson, Director, Corporate Services	Ongoing
4.	60	Medium Term Financial Plans Midlothian Council will need to consider medium term financial plans which are integrated with service plans to ensure it is well	The Council already has medium term plans for the capital accounts and the HRA revenue account. The projected reduction in government grant over the next three year settlement is	I Jackson, Director, Corporate Services	31/3/10



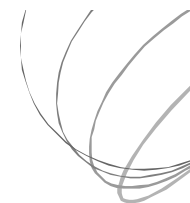
Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		placed to be able to understand the impact of reduced funding and to identify areas of potential saving. Risk: The Council may not be able to respond to funding constraints and be able to identify savings timeously.	well documented and part of the general fund budget considerations for 2010/11. Three year financial modelling will be reinstated when three year grant figures are given		
5.	62	Budgetary Control Reports The original agreed budgets are not included in budget reports presented to Council, only the most recent revised budgets, and the layout of budget information presented to Council can vary between reports. Budget reports also do not identify the impact on services of budget virements and variances. Risk: Members may find it difficult to track actual outturn in the course of a year to original budgets, thus impacting on their ability to make fully informed decisions.	Disagreed. Members are kept fully informed, and indeed approve any revisions to budget. We consider it more informative to include amended budgets in the course of the year, for comparison to actual outturn. To-date the layout of budget information has not been a source of difficulty for users.	G Fairley Finance Manager	-
6.	73	Managing People Work on the People Strategy, staff competence framework and the PDP process could not be concluded until after the implementation of Modernising Midlothian. Furthermore a staff survey has not been carried out for a number of years. Risk: there is a risk that standard best practice HR management processes are overlooked after such a big exercise as MM, resulting in a sense of a loss of engagement with the staff.	1) <u>Competence Framework</u> The Lead Officer for the development of the competence framework has recently been appointed and work will commence shortly. In conjunction with divisions and trade unions, it is targeted to have a framework, definitions, PDP assessment methodology and training pack developed in this timeframe. 2) <u>PDP Programme Rollout</u> Target all	C Sneddon, Head of Performance & HR C Sneddon	31/09/10 30/4/2011



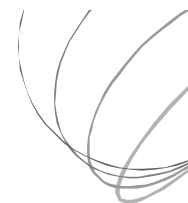
Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			<p>employees to have a current PDP in place for April 2011. Programme in place for 6 month review and annual assessment/ revision.</p> <p>3) Conduct an Employee Attitude Survey to follow on from the conclusion of the Modernising Midlothian Appeals process.</p> <p>4) <u>People's Strategy</u> – Revision of the people's strategy – to be informed by the Employee Attitude Survey and the development of Workforce Planning Strategy</p>	<p>C Sneddon</p> <p>C Sneddon</p>	<p>30/6/10</p> <p>30/9/10</p>
7.	76	<p>Data Handling and Security</p> <p>There is a need for service managers to take greater ownership of information security issues, raise awareness of the issues and ensure their staff are aware of and adhere to the corporate policies and procedures.</p> <p><i>Risk: Without an awareness of good data handling and security measures the Council could be in breach of data protection legislation.</i></p>	<p>Information Management Group leading on this. A database is compiled which is intended to list all major data systems and where data is shared/transferred to third parties.</p> <p>Data security awareness sessions are ongoing.</p>	D Kinnaird, Head of IT	31/03/10
8.	84	<p>Performance Scrutiny and Audit Committee</p> <p>We have highlighted some matters for consideration in the operation of the Committee.</p> <p><i>Risk: Without regular review of membership and remit, the PSAC's effectiveness could be impaired.</i></p>	<p>1. <u>Review of Terms of Reference for PSA Committee</u> – coverage to include membership, order of business, time management/ availability to ensure rigour in activities</p> <p>2. <u>Annual Report on Outstanding Audit Actions</u> – prepare report to PSA annually on all outstanding audit actions</p>	K Lawrie, Chief Executive	31/03/09



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
			to ensure compliance is tracked and unaddressed risks are noted.		
9.	95	Public Performance Reporting We have raised concerns in the past regarding the Council's public performance reporting framework. A particular concern has been the Council's website. The planned improvements and initiatives identified to improve the public performance framework are important measures which need to be put in place as planned, to enable the Council to demonstrate accountability to its citizens. Risk: Without an effective public performance reporting framework the Council could fail to meet the needs of its local citizen.	1) <u>Council web-site</u> – Carry out review leading to redevelopment of web content and functionality. 2) <u>Midlothian News</u> – Publish annual performance report to every household in Midlothian via the special edition of the Council Newspaper. Insert key performance information on range of topics in each monthly issue. 3) <u>Employee Performance Reports</u> – Ensure employees are provided with key quarterly performance information at team, divisional and corporate level via team briefing. 4) <u>Covalent Publishing Modules</u> – expand the use of publishing options on the covalent system to feed performance data online.	K Lawrie, Chief Executive C Sneddon, Head of Performance & HR CMT C Sneddon	To be defined 30/11/09 February 2010 (quarter 3 information) 31/03/10
10.	96	Internal Control A recurring finding arising from our audit work was that staff did not always apply the approved internal control procedures. It is important that all relevant staff and management adhere to the Council's internal control framework and sanctions are imposed when serious breaches are confirmed. Risk: Non adherence to the internal control	Internal Control is recognised as a strategic and corporate risk and, as such, is discussed/reviewed every six weeks by CMT.	I Jackson, Director, Corporate Services	In place.



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>framework could expose the Council to financial loss and prevent it from demonstrating that it has discharged its responsibilities appropriately.</i>			
11.	98	Improvement Programme We note that of the thirteen improvement areas identified in the Annual Governance Statement, eight have been brought forward from 2007/08 and fall into the category of requiring a longer term solution. Risk: Due to the high number of improvement actions brought forward from previous years, the improvement programme may not be delivered timeously and new priorities may be overlooked.	1) <u>Review of corporate and divisional priorities</u> – engage elected members in annual review of priorities to inform the Integrated Improvement Programme (IIP) 2) <u>Review of IIP</u> – Annual confirmation of IIP focus, priorities for improvement efforts and lower priority areas to be set aside. 3) <u>Quarterly monitoring of the Integrated Improvement Programme by PSA</u> – to monitor progress and consider changing priorities and emergent issues.	C Sneddon, Head of Performance & HR C Sneddon C Sneddon	28/02/10 30/04/10 Ongoing - quarterly
12.	108 & 123	Performance Management and Improvement Programme The quarterly performance management reports do not provide an overall numerical summary showing the number of targets achieved, on target, and off target. Information which tracks revisions to implementation dates or linkages to outcomes are also not provided. The Council should keep it performance targets under review to ensure that appropriate key indicators are used and information is reported timeously in order to inform the	1) <u>Quarterly monitoring reports</u> – revise format to provide high level summary of progress. 2) <u>Elected member development</u> – provide training and development opportunities to PSA members to improve scrutiny skills. 3) <u>Review of priorities for improvement action</u> – see action 11(2) above. 4) <u>Assess Relevance of Performance Measures and Targets</u>	C Sneddon, Head of Performance & HR C Sneddon CMT/ Performance Officers	30/04/10 31/03/10 31/03/09 and annually



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<p>decision-making process.</p> <p><i>Risk: Performance management information may lose relevance if the targets being reported on are inappropriate, are not periodically considered for their continued relevance and importance, including against emerging factors.</i></p>			
13.	128	<p>Internal Audit and Risk Management</p> <p>A mechanism is not in place to periodically review and report on the management arrangements of the joint Internal Audit and Risk functions. Such a review could also consider the managerial reporting lines for the Internal Audit and Risk functions. Best practice indicates that the Head of Internal Audit should report directly to a member of CMT, preferably the Chief Executive.</p> <p><i>Risk: the effectiveness of the Internal Audit and Risk Management functions could be undermined if a mechanism is not in place to periodically review and report on the effectiveness of the management arrangements.</i></p>	<p>Quarterly meetings to be arranged between the Chief Executive, Director Corporate Services and the Risk and Audit Manager. Reporting lines to be remain the same at this time but to be kept under review. First meeting to be held by 31/12/09.</p>	K Lawrie, Chief Executive	31/12/09