

Midlothian Council

**Report to Members and the Controller of Audit
on the 2009/10 Audit**

October 2010



 **AUDIT SCOTLAND**

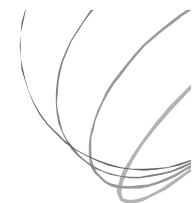


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Key Messages

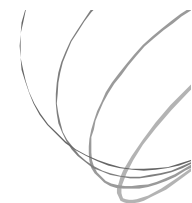
We have given an unqualified opinion on the financial statements of Midlothian Council. However, our opinion draws attention to the failure of one of the statutory trading operation's (Investment Properties) to breakeven on a rolling three year basis. The statutory trading operation has made a deficit as a result of impairments in asset values in 2008/09 and 2009/10.

During the year, the Council worked hard to manage its budget, resulting in a net under spend of £1.9 million. This comprised an overspend on the current level of service of £0.6 million, which was offset by one-off savings and windfall income totalling £2.5 million. At the end of the year a £6.2 million contribution was made to the general fund giving a final general fund reserve of £8.3 million, £7.5 million in excess of the original expected year end balance of £0.8 million. £3.4 million is earmarked for specific purposes leaving uncommitted funds of £4.9million.

However, the ongoing poor economic situation means that, as already planned, the Council will need to continue to monitor and review its reserves position on an ongoing basis to ensure it is able to respond appropriately to the very challenging economic environment and future reductions in revenue support grant.

Formal Council approval was given in February 2010 to commence an ambitious Business Transformation Programme (BTP) over a five year period. The purpose of the BTP is to deliver outcomes that are expected to lead the Council towards becoming more effective, efficient and economically viable. In April 2010 Council approval was given to change the organisational structure from 5 divisions to 3 and this has already taken place. A review of the management structure has been undertaken and 62 posts are to be deleted contributing to the planned £3.2 million recurring savings. Transition costs of £1.5 million are being met from reserves. In addition, at the end of September, the Council held a Seminar attended by Councillors and Senior Officers to consider the prioritisation of services. This, together with the community engagement activities planned for November, will enable Council to provide further direction for the BTP and help identify areas where further savings may be made by deciding on service priorities.

In other areas of performance, there was clear evidence of improvement. For example, the Council has continued to deliver on its house building programme resulting in a further 129 new houses being built during the year. This is part of the successful programme of house building which is planned to deliver 836 new houses by 2011/12, of which 500 had been let by September of this year. In addition, education attainment and achievement for children and adults, continues to show improvement against the targets set for this area. The Council is also progressing a range of shared service initiatives and is actively engaged in talks with East Lothian Council to consider areas where shared services may be appropriate, such as education, social work and back-office services.



Outlook

The most significant challenge the Council faces is the reduction in funding in the years 2011 to 2014, although the exact size of the reduction is unlikely to be known until December 2010. Until the results of the UK government spending review are factored into budgets, a great deal of uncertainty exists.

Midlothian Council has made plans based on available information, for the outcome of reduced government funding. A report was presented to Council in September 2010, detailing a projected budget gap of £5.1 million for 2010/11 rising to £19.9 million by 2013/14. The Council recognises that the successful delivery of the outcomes of the service priorities seminar and the BTP are crucial to the development of further plans to minimise the budget gap, including the need to identify some changes which can be implemented immediately.

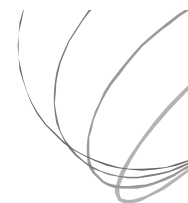
Members need to unite behind these action plans for the good of the authority. The likely scale of the reductions means the Council faces the risk of poor morale and motivation amongst staff as well as dissatisfaction amongst some service users. Never has the case been stronger for sound governance and good financial management.

In June 2010, the final shared risk assessment and assurance and improvement plan (AIP) was submitted to the Council. This document was produced by the local area network (LAN) of scrutiny bodies and describes the work planned on corporate activities over the next three years. The AIP proposes that a Best Value 2 (BV2) audit should be planned for 2011/12, year 2 of the programme. In response the Council has developed a draft Best Value Strategy and is also developing a Best Value Action Plan showing how the Council is working to deliver each of the BV criteria, key actions required to assess the extent to which it is currently delivering best value and the further actions required. The LAN is led by Ian Ronald of HMIE, who in conjunction with Audit Scotland, will keep the Council up-to-date with any changes to the AIP.

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



October 2010



Introduction

1. This report is the summary of our findings arising from the 2009/10 audit of Midlothian Council (the Council) and other relevant work carried out by Audit Scotland. Detailed reports have already been issued in the course of the year, some of which include 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. The report uses the headings of the corporate assessment framework, which we and the other scrutiny bodies used as the structure for the recent shared risk assessment and assurance and improvement plan (AIP). Where relevant, we comment on issues identified in the AIP for investigation or monitoring by the local auditor. For Midlothian Council, these include an assessment of progress made in relation to asset management and procurement, ICT, waste management and the Zero Waste recycling project.
3. Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the Council are:
 - Improving public sector efficiency
 - Overview of local government in Scotland 2009
 - Protecting and improving Scotland's environment
 - Scotland's public finances – preparing for the future
 - Making an impact – overview of best value audits 2004-09
 - The National Fraud Initiative in Scotland 2008/09
 - How Councils work: an improvement series for councillors and officers – roles and working relationships: are you getting it right?
 - Getting it right for children in residential care.
4. All of these reports have been sent to the Council for consideration and we do not consider them in this report. They are available on our website www.audit-scotland.gov.uk.
5. 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 actions and have a mechanism in place to be duly assured that the proposed action has been implemented.

6. 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 the 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

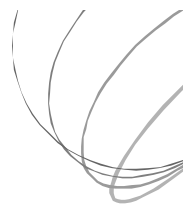
7. In this section we summarise key outcomes from our audit of the Council's financial statements for 2009/10, comment on the significant accounting issues faced, and provide an outlook on future financial reporting issues.

Audit Opinion

8. We have given an unqualified opinion that the financial statements of Midlothian Council for 2009/10 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.
9. We have, however, drawn attention to a failure to comply with the Local Government in Scotland Act 2003. The Investment Property statutory trading operation (STO) failed to breakeven, on a cumulative basis, over a three year period. This was due to impairments in asset values in 2008/09 and 2009/10. However, this does not affect the overall opinion on the accounts
10. 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.
11. The Council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. Working papers to support the 2009/10 accounts have improved since last year. We will continue to liaise with the Financial Services Section to streamline and further improve the timeliness and accessibility of information required for the 2010/11 audit.
12. The accounts were certified by the target date of 30 September 2010 and have been presented to members and are now available on the Council's 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

13. 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). With effect from 2010/11, local government will move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS). Because local government has already adopted some aspects of IFRS, we expect the transition to be fairly smooth. The Financial Services Section



staff plan to complete their work to produce the IFRS 2009/10 shadow accounts in the autumn of 2010.

14. We are confident that Financial Services Section staff will complete this substantial piece of work to a good standard. However, the IFRS work will be ongoing at the same time as the complex budget setting process, post the announcement of the government spending review. In addition, the Financial Services Section has a key role in supporting the Business Transformation Programme (BTP) and the outcome of the Council prioritisation of services seminar. The Financial Services Section has not been exempt from the Management Review, and as such some finance posts have been removed from the staffing establishment. New consolidated posts of Head of Finance and Human Resources and Financial Services Manager have now been filled internally and finance responsibilities have and will continue to be reallocated amongst the remaining staff group in response to the changes. However, there is a potential risk around the capacity of the Financial Services Section to deal with all the significant and evolving demands which they are required to respond to, which includes staff increasing their knowledge in their new areas of responsibility in addition to the day to day activities which need to take place. It is important to ensure that key posts in the establishment are filled to allow senior finance staff to focus on strategic issues. More generally we are also concerned that there is a risk of over reliance on a number of key officers across the Council, during what is likely to be a lengthy and challenging period of complex and significant change.

Key risk area 1

15. For the 2009/10 financial statements councils were required to account for PFI projects on an IFRS basis, a complex and significant change in accounting policy. The Financial Services Section responded positively to this, and undertook this work as an in-house exercise, unlike the majority of the other Scottish local authorities. The benefits of this approach are: the Financial Services Section retains the knowledge associated with this exercise and it negated the need for the Council to pay significant consultancy fees. The Financial Services Section produced good working papers in a timely manner. There were no significant accounting issues arising from this process which allowed the audit of this area to progress and be completed in advance of receipt of the draft 2009/10 financial statements.
16. Whole of government accounts (WGA) are also required on an IFRS basis from 2009/10. The draft pack was submitted to the Scottish Government on time. The deadline for the submission of the certified WGA pack to the Scottish Government has been brought forward to the 1st October, instead of the 31st of October. This deadline proved very challenging both for Audit and Financial Services Section to be able to produce and action the schedule of adjustments required to be incorporated into and submitted with the certified WGA pack.
17. We were satisfied that the Council prepared the accounts in accordance with the 2009 SORP.



18. The Council has adjusted the financial statements to reflect audit findings. As is normal practice, immaterial unadjusted errors have been reported to the Head of Finance and Human Resources and the Audit Committee. One significant weakness in the year end accounting and control procedures was identified during the audit which, if undetected, would have resulted in material misstatement of the financial statements. The debtors' balance and the bank overdraft figures per the balance sheet were overstated by £5.8 million, due to the bank reconciliation process failing to detect a misposting due to a timing difference in the final payments run. Management adjusted the 2009/10 balance sheet and will be including guidance as part of the 2010/11 final accounts instructions to ensure the bank and purchase ledger reconciliations deal correctly with timing issues around the year end.

Audit testing

19. 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:
- Payroll
 - Budgetary Control
 - General Ledger / Main accounting system
 - Accounts Receivables
 - Inventories
 - Accounts Payable
 - Council Tax
 - Housing Benefits
 - Treasury Management
20. We relied on the work of internal audit in the following areas to support our work: Housing Rents; Accounts Receivable; Payments (BACS/CHAPs/Cheque); Information Management and Data Security; Cash Income Collection; Social Work Direct Payments; Insurance; Social Care Contracting; Social Housing Programme; Secondary and Primary School Budgets; and Treasury Management. In addition we also took some assurance from their work on: Budgetary control (revenue); Casual and Temporary Employees; Homelessness; Maximising Business Opportunities in Midlothian; and Managing Sickness Absence.

Prevention and detection of fraud and irregularities

21. At the corporate level, the Council has arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include: an anti-fraud and corruption policy; a whistle blowing policy; codes of conduct for elected members and staff; and defined remits for relevant regulatory committees. A revised and updated Staff Code of Conduct was approved by Council in February 2010, with the Council agreeing that a copy of the revised Code be distributed to all existing staff and to all subsequent new starts. As the public sector embarks on a period of significant change and budgetary constraint, this is a time when the efforts and good conduct of its employees are of the utmost importance. Staff and management should take the opportunity to remind themselves periodically of the code of conduct expected from them.



NFI in Scotland

22. 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 outcomes for Scottish public bodies (£21 million during the 2008/09 NFI cycle and £58 million cumulatively up to end March 2010). If fraud or overpayments are not identified in a body, and the NFI exercise has been undertaken properly, assurances may be taken about internal arrangements for preventing and detecting fraud.
23. The most recent data matching exercise collected data from participants in October 2008 and the national findings were published by Audit Scotland in May 2010. The planning and execution of the 2008/09 cycle at Midlothian generally went well and identified around £0.2 million of savings (principally benefit savings). One area of concern identified during the course of the 2008/09 cycle was that the payroll match checking was slow to get started. This was in part due to conflicting pressures on the payroll team when it was involved in implementing Modernising Midlothian (single status). However, plans have been put in place to improve the payroll matching process for the 2010/11 NFI cycle.
24. Instructions for the 2010/11 NFI exercise were issued by Audit Scotland in June 2010 and participants were required to provide the requested data by October 2010. The national report published in May 2010 included a self-appraisal checklist which Midlothian Council has used to inform the process for 2010/11. A plan is in place to manage and report progress on the NFI exercise for 2010/11.

Housing Benefit

25. Audit Scotland took over the inspection responsibilities of the Benefit Fraud Inspectorate in Scotland in April 2008. Our specialist team are carrying out a programme of risk assessments of benefits services in all councils over a two year period.
26. 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. It is anticipated that Midlothian's second benefit risk assessment will be undertaken during the 2010/11 audit year.

Group accounts

27. 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. 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.
28. In 2009/10 the decision was taken not to include SDL in the group accounts as SDL remained largely inactive since the withdrawal of The Miller Group during 2008/09. The Directors of SDL have agreed to wind the company up. Neither we, nor the Council have been provided with draft accounts for SDL for 2009/10 or audited accounts for 2008/09. However, the Head of Finance and Human Resources provided written assurance confirming that the Council's investment in SDL was fully written off in 2008/09 and that no further liabilities arose in 2009/10 or were likely to arise in the future.
29. The remaining group entities 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. We would like to highlight that all bodies within the group received unqualified audit opinions from their external auditors.

Trust funds

30. 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 until 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.
31. 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 2010.

Common good fund

32. In December 2007, Local Authority (Scotland) Accounts Advisory Committee (LASAAC) issued a guidance note for practitioners. The guidance requires the common good fund to be disclosed within the financial statements and a separate common good asset register to be in place by March 2009.
33. 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 and there are no common good fixed assets. The balance was £26k which is included in the overall trust, bequest and community fund balance of £242k as at 31 March 2010.



Pension fund

34. 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 recommended 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 recommended an employer's minimum contribution rate of 17.5% for the three years 2009/10, 2010/11 and 2011/12 with additional employer's contributions of £1 million, £1.3 million and £1.7 million to be made for each of the three years. These amounts relate to the deficit arising from past service costs and are set at a level to maintain, but not reduce, the deficit at the current level. The next actuarial valuation will be at 31 March 2011.
35. The net pension liability disclosed in the Financial Statements, as at 31 March 2010, now stands at £109.2 million (£42.6 million in 2008/09). The liability has been calculated in accordance with FRS 17 – Retirement Benefits and shows the Council's long term underlying retirement benefits commitment. The increase has arisen because the corporate bond rate used as the discount factor as at 31 March 2010 is significantly lower than that used at 31 March 2009, which has contributed to a significant increase in the estimated current value of the pension liability. Also, the Chancellor of the Exchequer announced in his emergency budget in June 2010 that the consumer prices index rather than the retail prices index will be the basis for future pension increases. It is estimated that this change will reduce the value of an average employer's FRS17 liabilities in the fund by around 6-8%.

Legality

36. Through our planned audit work we consider the legality of the Council's financial transactions. In addition the Head of Finance and Human Resources 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

37. A number of changes to financial reporting are expected to apply from 2010/11:
- Full compliance with IFRS. This is not simply a technical accounting matter: the Scottish Government is in discussion with local government about areas where statutory adjustments are required to mitigate the impact on the general fund.
 - Pension funds. Separate statements for pension funds will be required. The Scottish Government is consulting on the requirement for a separate pension fund audit in place of the



current arrangements whereby the statements are audited as part of the administering council's annual audit.

- Carbon trading. From April 2010 a new and complex system for charging for carbon emissions was introduced by the EU. Councils are 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. However, following recent announcements in the Comprehensive Spending Review it is unclear what the future impact will be.



Use of resources

Financial results

38. Midlothian Council's gross revenue expenditure in 2009/10 on the provision of public services was £280.2 million (net operating expenditure of £229.2 million). This was met by central government grant and local taxation totalling £190.2 million, and resulted in a deficit of £38.9 million, 16.9% of the net expenditure for the year. The budget set for 2009/10 was based on a Band D council tax level of £1,210 with planned contributions of £1.3 million and £0.6 million from the capital fund and insurance fund respectively. In addition capital expenditure in 2009/10 was £34.4 million.
39. Budgets are set and monitored throughout the year and budget changes are approved by Council. In overall terms, the Council managed its budget well resulting in a net under spend of £1.9 million. This comprised an overspend on revenue services expenditure of £0.6 million against the revised budget which was offset by £2.5 million arising from one-off savings on loan charges and windfall income from Customs and Excise in respect of the recovery of VAT accounted for on sports charges and library fines in previous years
40. During the year, the quality of financial information provided improved. The overall budget is reported to Council on a quarterly basis and includes a detailed 'Material Variances' analysis which includes a description of variance, reason for variance, value of variance, and action taken as a result of the variance. However, in a time of change, it may be useful to reconsider the adequacy and accuracy of the original budgets. In addition, they should continue to be closely monitored throughout the year to highlight issues to enable corrective action to be taken in a timely manner.
41. The following table provides some information about the Council's financial position compared to other Scottish councils.

Ratio	Description	2008/09 Value for Midlothian	2009/10 Value for Midlothian	2009/10 Range for all Scottish Councils
Ratio 1 Working capital (current assets as a ratio of current liabilities)	This is an indicator of the council's ability to pay its current liabilities in the short term.	81% 51,790,000 : 64,037,000	44% 30,216,000 : 68,633,000	33% to 248%
Ratio 2 Useable reserves as a percentage of general revenue expenditure	This shows the proportion of revenue expenditure that could be met from reserves	6.3% *14,000,000 / 219,690,000	8.9% *20,500,000 / 229,201,000	3.7% to 19.6% 2 island councils 196% & 230%



Ratio 3 Long term borrowing compared to tax revenue	This ratio illustrates the proportion of a council's tax and rates related income (CT and NDR) that would be needed to pay off long term debt	213% 142,210,000 / 66,610,000	187% 131,280,000 / 70,129,000	48% to 295% 1 island council 679%
Ratio 4 Long term assets as a percentage of long term borrowing	This gives an indication of the ability to borrow to replace or repair assets	594% 839,528,000 / 141,210,000	755% 991,249,000 / 131,280,000	178% to 755% 1 island council 3812%

* includes HRA reserves of £10m, which are required for housing capital expenditure in future years.

42. These ratios indicate the liquidity and financing position of the Council. In making comparisons between councils, there are a number of factors which affect the indicators. These include the council's group structure, asset management arrangements and financial strategies. We have compiled this information for the first time this year and it establishes a starting point to enable the council's financial stability to be monitored in the future. The council should consider whether the ratios indicate any areas for further consideration within the context of its financial strategies.

Reserves and balances

43. Exhibit 1 shows the balance in the council's cash backed reserves at 31 March 2010 compared to the previous year. At 31 March 2010, the council had total cash reserves of £19.2 million, an increase of £6.2 million on the previous year.

Exhibit 1 Reserves

Description	31 March 2010 £ Million	31 March 2009 £ Million
General Fund	8.3	2.1
Housing Revenue Account Reserve	10.9	10.3
Insurance Fund	0	0.6
	19.2	13.0

44. At the end of the year £6.2 million was added to the general fund giving a final general fund reserve of £8.3 million, £7.5 million in excess of the expected year end balance. Of this balance, £3.4 million is earmarked for specific purposes, with a further £1 million earmarked to pay for one off costs arising from the BTP. This leaves a balance of £3.8 million, which is broadly in line with good practice of



maintaining free reserves at around 2% of net operating expenditure as a minimum. The HRA reserve showed a small increase of £0.6 million.

45. While the position on the general fund has shown significant improvement, the Council could still be exposed to financial risk and have limited capacity to deal with unforeseen costs or losses. The decision to close the insurance fund as at 31 March 2010 may increase this risk.
46. The ongoing poor economic situation means that, as already planned, the Council will need to continue to monitor and review its reserve position on an ongoing basis to ensure it is able to respond appropriately to the very challenging economic environment and respond to any reduction in revenue support grant. A recent report to Council forecasts a budget gap of £5.1million in 2011/12 rising to £19.9 million in 2013/14 and the ability to bridge these gaps will be heavily dependent on the successful delivery of the outcomes of the service priorities seminar and the BTP. These are crucial to the development of further plans which will enable the budget gap to be minimised, including the need to identify some changes which can be implemented immediately.

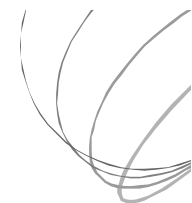
Key risk area 2

Group balances and going concern

47. The overall effect of inclusion of all of the Council's associates on the group balance sheet is to reduce net worth by £156 million to £433 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.
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 2010 due to the accrual of pension liabilities. In total these deficits amounted to £2,041 million (2008/09 £1,307 million), with the council's share being £160.1 million (2008/09 £107.9 million).

Capital performance 2009/10

49. The prudential indicators for 2009/10 to 2011/12 were approved by the Council in February 2009. It was also agreed to grant permission for total borrowing to be taken up to the Capital Financing Requirement set for 2010/11 if market conditions indicated that this was prudent. Capital expenditure in 2009/10 totalled £33.4 million, a reduction of £35.3 million from 2008/09 and £13.6 million less than budget. The Council took a prudent approach in setting its 2009/10 general services capital budget in response to a downturn in the economy. The main reason in 2009/10 for the lower level of capital expenditure compared to budget was slippage in the new house build programme. The Council realised £2.1 million capital receipts during 2009/10 compared to an original budget of £4 million, a



situation which is reflective of the wider economy. There is a continued need for the Council to monitor its capital programme taking account of the current economic downturn.

50. The initial 2010/11 budgets for HRA capital of £35 million and general services capital of £6.7 million were set in December 2009 and January 2010 respectively. As at September 2010 the general services capital budget was revised upwards to £13.6 million. The increase relates to the inclusion of projects carried forward from 2009/10 plus emerging and unavoidable projects, including a budget of £2 million for the BTP (over 4 years), £2 million for road upgrading, and £0.4 million stabilisation works. The housing capital programme budget at September 2010 has also been revised to £27.8 million. Revisions to the capital programme are presented to the Council for approval.
51. During 2009/10 Lasswade High School replacement was identified as being one of the schools which would be supported by the Scottish Futures Trust (SFT). The Scottish Government is to fund two thirds of the value of the capital build of the school, with Midlothian Council being required to fund the remaining one third of the capital expenditure, including any non-educational buildings included on the site. The Council is working in partnership with East Renfrewshire Council to progress the project and preparatory works are already ongoing. The Scottish Government through the SFT has confirmed that the grant available for the construction costs of the new school will be capped at £23 million, with a minimum contribution of £11.5 million from the Council.
52. The Zero Waste Project between City of Edinburgh Council (CEC) and Midlothian Council is intended to treat residual municipal waste that is currently sent to land fill. This project should allow the Council to manage its approach to meeting EC landfill directives and if successful manage the risk of significant fines from not achieving the EC targets. Project progress includes the joint purchase of land at Millerhill with CEC and discussions with Midlothian Innovation and Technology Trust (MITT). In addition a service review of waste management is in progress with a report from a recent seminar on waste management being considered by the Council in September. The Director, Corporate Resources, who is a member of the Zero Waste Project Board, presented an update report to Council in October 2010.
53. The trend in capital investment and sources of funds is illustrated in exhibit 2. This shows that borrowings are reducing in line with capital expenditure.

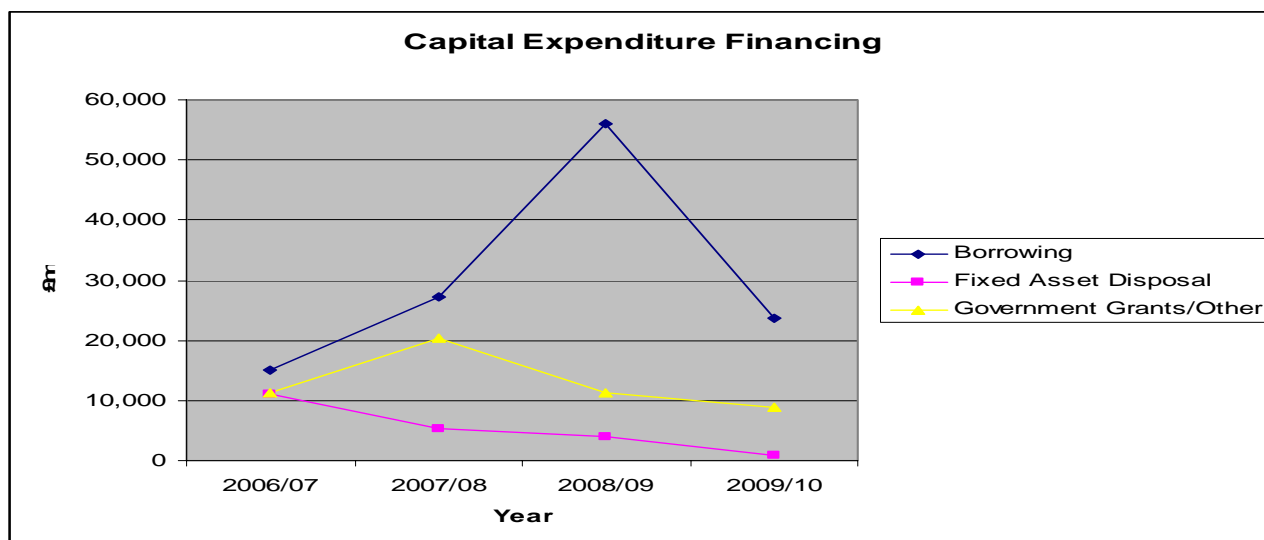
Exhibit 2

Sources of finance for capital expenditure 2006 to 2010

	2006/07 Actual £M	2007/08 Actual £M	2008/09 Actual £M	2009/10 Actual £M
Borrowing	15,124	27,264	56,090	23,785
Fixed Asset Disposal	11,020	5,409	4,076	821
Government Grants/Other	11,184	20,394	11,228	8,829



Total	37,328	53,067	71,394	33,435
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Treasury management

54. 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.
55. As at 31 March 2010, Midlothian Council held cash and temporary investments totalling £14.4 million (31 March 2009 £39 million). We received specific representation from the Head of Finance and Human Resources 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. The representations received from the Head of Finance and Human Resources stated that, in his 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.
56. The current economic climate means that interest rates on investments are low – the Council received £0.5 million in investment income this year compared to £2.4 million last year. Borrowing rates are also low, but the Council has a significant proportion of its debt at fixed rates and its average cost of borrowing over the year was 3.61%. The Council has taken advantage of the drop in interest rates to reschedule £20 million of debt. This has resulted in a net saving of £0.6 million. During 2009/10 the



Council was able to generate a one-off saving in loans charges of £1.1 million which was used to bolster the general fund.

57. Internal Audit undertook a review of the adequacy of the controls over treasury management. They were able to conclude that the operation of the treasury management function within the Council complies with CIPFA guidance, but made some recommendations for improvements. Consequently, steps have been taken to address the audit findings.

Financial planning

58. For 2010/11, the Council again froze the council tax in accordance with the concordat with Scottish Government. The latest budgetary control report, at September 2010, includes planned savings of £1.3 million, and is projecting a net under spend of £1.4 million after the utilisation of £4.5 million of the general fund reserve carried forward from 2009/10. However, in common with other councils, Midlothian is forecasting a reduction in funding of 12% by 2013/14. The exact size of the reduction is unlikely to be known until December 2010. Midlothian Council has responded to this in a number of ways. Formal Council approval was given in February 2010 for the development of a Business Transformation Programme, (BTP), the framework to be used to take business transformation forward over a five year period to deliver outcomes that are expected to lead the Council towards becoming more effective, efficient and economically viable. The programme covered the following six workstreams: organisational review, service reviews, asset rationalisation, customer reviews, shared services and procurement.
59. In April 2010, the Council gave approval to change the organisational structure from 5 divisions to 3. It has undertaken and implemented a management structure review which at August 2010 report that 62 posts are to be deleted contributing to the planned £3.2 million of recurring savings in 2010/11. A range of service reviews is also underway. There are plans to merge the remaining workstreams with the Corporate Improvement Plan to create a single, comprehensive Corporate Improvement and Business Transformation Strategy and Plan. In addition, at the end of September 2010 the Council held a Seminar attended by Councillors and Senior Officers to consider the prioritisation of services. This, together with the community engagement activities planned for November, will enable Council to provide further direction for the BTP and help identify areas where further savings may be made by deciding on service priorities. Progress is also being made with shared service initiatives, through the establishment of a Shared Services Board and a Joint Liaison Group. A Memorandum of Understanding has been signed by the two Council Leaders and two Chief Executives and a shared services workplan developed to consider further areas where shared services may be appropriate.
60. Until the results of the UK government spending review is factored into the Scottish Government budget a great deal of uncertainty exists. As mentioned in paragraph 58, Midlothian Council has made plans based on available information for the outcome of reduced government funding.



61. The Revenue Budget 2011/12 to 2013/14 identifies that so far £3.2 million of savings have been identified for 2011/12, leaving a budget gap of £5.1 million. The Council recognises the need to take immediate action to reduce costs for future years and key decisions are imminent. Savings take time to accrue and the Council needs to take action now to be sure of achieving savings in the future.

Key Risk Area 2

Asset Management

62. Effective management of council assets helps the council achieve its objectives and get best value from its investment in property and other assets. The current economic situation has implications for the management of the Council's property assets. Reflective of current economic and market conditions the value of surplus property assets reduced by £11.9 million (48%) over the financial year, reducing the Council's ability to fund its capital programme from receipts.
63. In 2009, we published *Asset Management in Councils*. Our study found that strategic asset management was not well developed in most councils. For Scottish councils as a whole, over a quarter of all properties were in poor condition and slightly less than that were not suitable for the services being delivered from them. The results of this study together with other benchmarking data were used to determine how Midlothian was performing relative to other councils and to help identify areas for improvement. The Council continues to use benchmarking information through membership of an Asset Management benchmarking group.
64. The Council approved its Corporate Asset Management Plan (CoAMP) in December 2009. The multi-stranded CoAMP includes a strategic vision for service provision covering six functional areas (Property; Open Spaces; Roads, structures, lighting and water related infrastructure; Housing; Fleet; and IT). While we welcome this development, approval of the CoAMP is just the starting point, the next stage being to ensure the plan is implemented and used. It was necessary to put the development of the detailed functional asset management plans (AMP) on hold as a consequence of the divisional restructure and resourcing issues. Work has started on developing the detailed plan for property.
65. Asset management has been incorporated into the BTP as one of the main work streams. This highlights the importance placed by the Council on good asset management, and demonstrates that the Council understands that asset management is fundamental to securing the future financial viability of the Council. In addition use is already being made of the BV2 Asset Management toolkit. The plan is to develop an action plan which will be used in determining further how the Council takes forward asset management generally and as part of the wider BTP.
66. Until the detailed functional AMPs are developed, there is a risk that all the costs associated with managing and rationalising the Council's asset base are not clearly demonstrated. Appropriately



costed detailed asset management plans are likely to be important in allowing robust decisions to be taken across the Council as a whole, and within each of the six functional asset areas.

Key risk area 3

Procurement

67. The Public Procurement Reform Programme aims to drive continuous improvement in public sector procurement and to deliver value for money and increased efficiency through improved structures, capability and processes. In 2009, the Scottish Government promoted the use of an annual procurement capability assessment (PCA) to assess procurement performance in all public sector bodies and as a basis for the sharing of best practice and continuous improvement. Results are summarised as non-conformance, conformance, improved performance and superior performance.
68. All councils have been assessed by Scotland Excel and scored as either conformant (9) or non-conformant (23). This suggests that improvements could be made and that councils may not always be achieving best value across their procurement activities. In response, in December 2009, councils agreed to participate in a national procurement improvement programme. The programme addresses the following areas:
- The role of procurement in the organisation: the key issue facing most procurement functions is lack of influence across the organisation.
 - Getting the right people doing the right things: there is a need to be clear on the structure of procurement across the organisation and its accountability to the procurement leader.
 - Adoption of a strategic approach to sourcing: this means making money out of all aspects of the contract life cycle, not just by getting the best price.
 - Embedding new systems and processes.
 - Conformance: councils with the lowest scores can access an experienced procurement professional to help work with their procurement leader on the improvement plan for their council.
69. In line with many other councils, Midlothian's score was in the non-conformance range. The results of the PCA assessment provide an opportunity for organisations to determine how they wish to take forward their procurement activities in the future. A non-conformance score suggests that the organisation concerned could be open to a risk of legal challenges due to the lack of visibility and control over procurement across the organisation. The level of change required, as indicated by the PCA results, suggest significant resource as well as active senior management support will be required to move from non-conformance to conformance. We will monitor the situation and the ongoing commitment by the organisation to improving the situation.

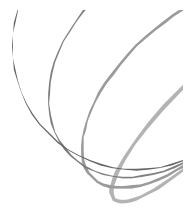


70. In March 2010 the Council approved an updated Procurement Strategy for the period 2010-14 which sets out to achieve a 1% year on year saving in recurring expenditure. Procurement savings are difficult to predict accurately due to unquantifiable inflationary and service pressures. In addition approval was given to implement a range of IT enhancements to improve procurement-related information systems and processes. In light of its importance to transformation, procurement is also one of the main work streams of the BTP and as such current procurement activities will be reviewed to identify potential areas for financial savings and cost effectiveness, including areas for more cost effective purchasing and process improvements. An update to Council in September 2010, noted that the anticipated procurement savings translate into budget reductions of £1.2 million by 2013/14.

Key risk area 4

Managing People

71. Staff in Midlothian Council have experienced considerable change and upheaval in the past two years. Modernising Midlothian (Single Status) was implemented on 29th June 2009, which involved issuing relevant staff with new contracts, new terms and conditions and implementing a new pay and grading structure. In April 2010 Council approval was given to change the organisational structure from five divisions to three, which meant that the number of Directors reporting to the Chief Executive reduced from five to three. In addition a review of the management structure has been undertaken and implemented. As a result, at August 2010 it was reported that 62 posts have or will be deleted from the staffing establishment. A Staff Release scheme was approved by Council in June 2010 to enable the release of staff on a voluntary severance or early retirement basis subject to meeting qualifying criteria of business need and affordability.
72. The recent organisational changes have resulted in substantial changes at the Head of Service level with a reduction in numbers to eleven and consequent reallocation of responsibilities. For example under the new organisational structure, the new Head of Finance and Human Resources, is now the "responsible financial officer", under the terms of S95 of the Local Government Act (Scotland) 1973. To illustrate the nature of the changes under the previous structure the S95 officer responsibilities rested with the then Director, Corporate Services, with more of the day to day finance duties being undertaken by the Head of Finance. Other changes from Director to Head of Service include the new Head of Customer Services becoming the designated Monitoring Officer; and the Head of Planning and Development is the Chief Planning Officer.
73. 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. Following the implementation of Modernising Midlothian, the Council intended to review its People Strategy, including the development and implementation of a competency framework and a revised professional appraisal and development review process. The People Strategy has subsequently been taken under the umbrella of the BTP and as such is one of the key work streams which will therefore



be addressed within the approved BTP governance framework. Given the Council's restructuring, it is important that staff performance and development is supported.

74. It is important that the Council understands the issues of significance to staff. The implementation of Modernising Midlothian in June 2009 had an impact on the morale of some groups of staff. Some appeals are ongoing in relation to individual staff members or groups of staff who were not content with their new pay and grading under Modernising Midlothian. In addition the organisational and management review are likely to have an effect on the morale of the workforce. Staff surveys can provide useful information to assist the Council to build morale, and we are pleased to note that the Council launched its own staff survey in October 2010.
75. As at 31 March 2010 £7.6 million of equal pay claims had been settled. However, at the end of March 2010, a number of equal pay claims were still to be resolved, and an estimate of £4.6 million was set aside to meet the cost of settling outstanding claims. In addition an unquantified contingent liability has been disclosed in respect of a number of ongoing employment tribunal cases in respect of equal pay.

Key risk area 5

ICT

76. Making good use of ICT is very important in supporting and delivering services. The IT service has not been exempted from the organisational changes. Under the old structure, there was a Head of IT. Under the new organisational structure, there is a consolidated post of Head of Customer Services, with responsibilities which includes IT matters, making this a more wide ranging post.
77. A revised IT structure was approved by the Council in June and an IT strategy was approved by the Corporate Management Team in October. As under the previous IT structure, the new structure has retained three teams, Infrastructure; IT Business Services; and Support and Development. While the Head of Customer Services is responsible for IT from a strategic point of view, the IT Business Services Manager is now formally in charge of the operational management of the service.
78. Going forward, the successful delivery of IT at a strategic and operational level is fundamental in enabling the Council to deliver services on a day to day basis and in supporting and delivering the BTP. Due to the evolving nature of IT the new structure should therefore be monitored to ensure it continues to support and deliver all activities in the most effective way.

Key risk area 6



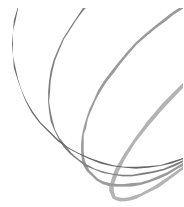
Data handling and security

79. 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.
80. Internal Audit, in 2008/09, 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 a 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. The designated Information Security Officer and the Information Management Group continue to work to manage the inherent risks around data handling. However, the responsibility to manage and protect information used by the Council does not lie solely with the Information Security Officer and the Information Management Group - it lies with all staff throughout the entire organisation. It is the responsibility of all managers to take, and maintain ownership of information security issues, to raise awareness and to ensure their staff are aware of and adhere to corporate policies and procedures.

Key risk area 7

Shared Services

81. Shared services is one of the BTP strands which gives an indication of the level of shared services activity being considered and progressed by the Council. Midlothian is a member of ELBF, a forum of 6 local authorities: Edinburgh, East, West and Midlothian, Scottish Borders and Fife, who have combined to look at shared services in areas such as mobile and flexible working, payroll, internal audit and roads maintenance.
82. Midlothian Council is actively pursuing areas of cooperation and joint working with East Lothian Council and is currently engaged in talks to consider areas where shared services may be appropriate, such as education, social work and back-office services. Agreement to appoint a joint Shared services officer has been obtained and a senior Scottish Government officer has been seconded for 6 months to develop a shared services model for education between the two Councils.
83. Joint working initiatives have already been established in some areas. These include establishing a Shared Services Board, Joint Adult and Child Protection Committees and a Joint Liaison Group. In addition, during October 2010, the councils will begin to share an 'Out of Hours' service whereby calls outwith normal office hours will be managed by East Lothian Council's call centre, for such matters as



community care alarms, telecare and antisocial behaviour. A formal Memorandum of Understanding with East Lothian Council has now been signed to take these initiatives forward.

84. While we welcome the progress Midlothian Council has made with shared service initiatives, it is important that opportunities to share services continue to be rigorously reviewed to identify cost savings and efficiencies.

Key risk area 8

Outlook

85. Clearly we are in a period of reduced economic growth with significant implications for the Council's resources and the demand for 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 severe reduction in resources. The Council needs to plan for reduced resources over the medium term. It needs to make decisions soon to be able to deliver cost reductions in a managed way.
86. Although the Council's use of resources shows elements of good practice, there is still scope for improvement. In particular, we would suggest that there is scope for greater progress on procurement to deliver further savings.



Governance and accountability

Introduction

87. 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)* complied with the CIPFA/SOLACE *'Delivering Good Governance in Local Government: Guidance Note for Scottish Authorities'*. We concluded that Midlothian Council's 2007 *'Code of Corporate Governance'* almost fully complied with the best practice principles set out in the CIPFA/SOLACE guidance. We identified a few areas for improvement. The outcome of this audit was reported to the Performance, Scrutiny and Audit Committee in October 2009.
88. Subsequent to this, in February 2010 the Council approved an updated Code of Corporate Governance. The update was made to bring the Code in line with the CIPFA/SOLACE guidance: *Delivering Good Governance in Local Government*.

Scrutiny

89. 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 of scrutiny included the Performance Scrutiny and Audit Committee (PSAC) and its remit included risk management, audit and a role in terms of promoting, monitoring and developing continuous improvement. The committee was well attended each month, and in overall terms its remit and working practices were in accordance with the good practice principles. For example: the committee was formally constituted with clear terms of reference reporting directly to Council; met in public with regular attendance by appropriate senior officers of the Council; considered internal and external audit plans, reports and respective annual reports; reviewed the audit certificate and considered matters arising from the audit of the annual accounts.
90. During the early summer, the arrangements the Council had in place to deal with performance review, scrutiny and audit matters by the PSAC were reviewed against current best practice standards. The review noted that membership did not reflect the political make up of the Council and that mixing the three requirements of audit, scrutiny and performance review could have the potential to dilute each other and reduce effectiveness. As a result, in June 2010, the Council approved the creation of a separate Audit Committee and a separate Performance Review and Scrutiny Committee. The Performance Review and Scrutiny Committee remit has been revised to remove audit-related topics, but with no change to the membership or chair.



91. The new Audit Committee has six members from across the different political groupings and will meet 4 times per year. In addition, the Council approved the proposal that the Chief Executive, working with the Audit Committee, should identify a suitable person to act as a non-voting observer. The first Audit Committee meeting took place in September 2010.
92. We are pleased to report that the meeting was well attended by the new members, senior officers of the Council, internal audit and external audit, with active participation by the members of the committee, some of whom had not been members of the previous PSAC. The committee are keen to undertake their duties as effectively as possible and have requested additional training to be provided. As a result the new committee will be provided with training in advance of the second meeting in December 2010. Beyond this 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. This is an area which the committee should keep under review.
93. The committee will continue to receive all internal audit and external audit reports. They have also requested regular reports on the implementation of action plans, thus receiving assurance that recommendations are being actively considered and implemented.
94. The Accounts Commission issue a range of national study reports and an overview of local government each year. The national studies will continue to be brought to the attention of the Audit Committee by external audit as recommendations are generally directed at all councils. This is to ensure the committee are aware of the reports, to enable them to be satisfied that significant matters are being addressed by the Council.

Roles and relationships

95. In May 2010 the Council considered a report from the Chief Executive on progress on the Elected Member Learning and Development Plan which had been agreed by Council in May 2009 for completion in 2009/10. The report advised that attendance at the sessions held in 2009/10 had been variable and at times the training sessions and attendance had been affected by their proximity to other meetings of the Council. The report also included the learning and development proposals for 2010/11. The Council approved the plan for 2010/11 and agreed that going forward the programme should be made more flexible to accommodate training requests from Members during the year. The Accounts Commission recommends that councils give priority to the continuous professional development of its members and the success or otherwise of the Elected Member Learning and Development Plan should continue to be reviewed on a regular basis.
96. The Accounts Commission has recently published a report entitled "Roles and working relationships: are you getting it right?", as part of "How Councils work: an improvement series for councillors and



officers” . The report, which includes a tool for assessing progress and relevant questions for members and officers, is available on Audit Scotland's website.

Partnership Working

97. Midlothian Council shows evidence of good partnership working. Community planning structures are well developed at council and local levels with appropriate political, official and community representation on each. The community plan is the keystone of the Council's strategic planning framework and the single outcome agreement (SOA) is supported by all partners. The SOA is viewed as a stepping stone to deliver the priorities set out in the community plan.

Community engagement

98. Midlothian Council and its community planning partners have adopted the national standards for community engagement. The Community Planning Partnership has developed a number of ways of seeking community views including consultation exercises, citizen surveys and more recently locality planning. In addition, details on community planning are issued via the Council newsletter and occasional press release and through update of the Council website.

99. The need for input from citizens is also considered to be important as part of the BTP. The means of achieving this is through a specific BTP workstream of Programme Communication. This work stream includes communication to and from, staff, management, elected members, trade unions and local citizens. Part of the communication programme is likely to be a community engagement plan to facilitate engagement with a wide range of stakeholders to help inform the setting of service priorities and the Council budget. The October issue of Midlothian News, the community newspaper of the Council, has advised local communities of the financial difficulties ahead for the Council. It also advises that in the near future, the Council will launch a full programme of consultation to make sure all options are considered.

Public performance reporting

100. The Council produces an annual performance report. It is published on the Council's website and is available in hard copies in public libraries and council offices. In the last year significant improvements have been made to the Council's website. The website content is more current and is being used as a means of informing local citizens of important events. Council and committee agendas, reports, and minutes from previous meetings, are made available in advance of all scheduled public meetings via the website. In addition quarterly performance reports for the Council and each division and service are available on the Council Website. This is an important means of demonstrating openness and accountability. Funding has been identified and work is ongoing to develop the Council website further.



Governance and internal control

101. The PSAC and now the Audit Committee receive reports from internal audit and external audit which include details of governance and internal control issues. The Audit Committee will also be receiving updates on the implementation of agreed management responses arising from audit findings in order that they can take action where necessary if agreed management responses are not being implemented. However, the significant changes which the Council has been experiencing and will continue to experience, as a result of the structural organisational changes, the management review and the subsequent reduction in staff numbers, increase the risk of the effective operation of internal control being compromised. It is important that management remain vigilant and devise compensating controls where necessary to manage the risk around breaches of internal control and potential financial loss, to an appropriate level.

Key risk area 9

Outlook

102. We recognise the challenges posed by the SOAs. 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.

103. 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

104. We believe that 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 backed up by clear plans and strategies to secure improvement, with resources aligned to support their delivery. Effective councils have a performance management culture which is embedded throughout the organisation. The assurance and improvement plan concluded that Midlothian Council did not have any significant weaknesses in this area. This section provides a high level overview of performance management in Midlothian Council.

Vision and Strategic Direction

105. As previously mentioned, the community plan is at the centre of the Council's planning framework and cascades to service plans. The Community Plan and the SOA link to the Council's corporate strategy which includes six objectives and sets priorities and actions for their achievement. Service plans sit beneath the Corporate Strategy and outline the key priorities for each service and how they will be delivered. Every action in the plan is fully costed to ensure the plans are deliverable within budget. Therefore the Council (and its partners) present a clear vision for the future of the area. However, with the imminent reduction in funding in the years 2011 to 2014, the outcome of the prioritisation of services seminar in September, and subsequent consultation with local citizens, it is highly likely that the Council will have to alter its vision and strategic direction as a consequence. It was reported to Council in September 2010 that the SOA requires consideration in the current round of budget discussions as the commitments entered into by all the community planning partners may require to be revised in light of the decision each partner makes in responding to budget reductions. Going forward integrated and long term financial planning is becoming increasingly important in the achievability of the plans.

Performance management

106. The Council uses Covalent to provide a series of divisional performance reports. The reports include an overall summary of major successes and challenges, a performance indicator summary and corporate / divisional priorities action update. The reports are prepared every quarter and are considered by senior divisional management, Directors and the Chief Executive prior to being submitted to the Performance, Scrutiny and Audit Committee (now Performance Review and Scrutiny Committee) and the Cabinet for review. There continues to be central co-ordination for the production



of the reports through the Corporate Improvement Team, under the new organisational structure (previously the Policy and Performance Team).

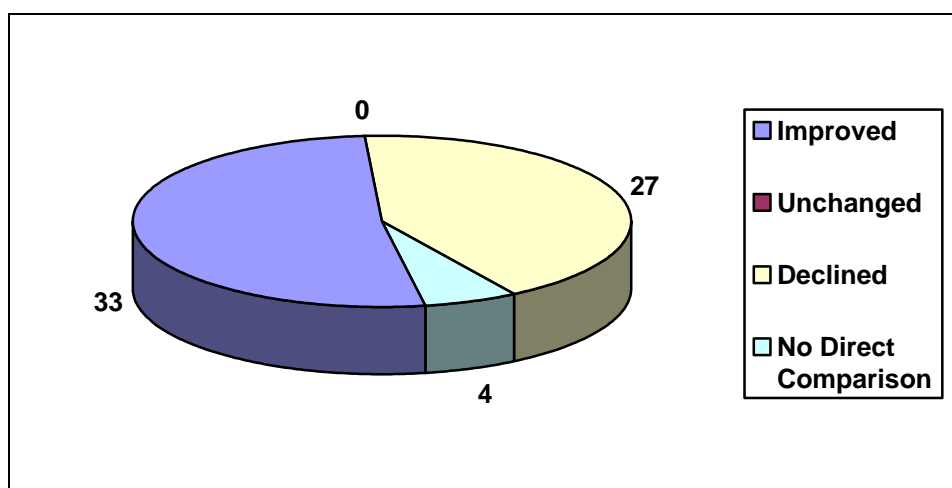
107. Work has been ongoing within Covalent to amend the system to reflect the new organisational structures at Midlothian Council. The next series of quarterly reports to the Performance Review and Scrutiny Committee and Cabinet will be aligned with the new organisational structure.

Statutory performance indicators

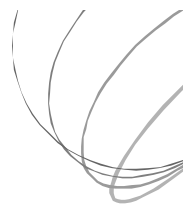
108. One of the ways of measuring council performance is through the statutory performance indicators (SPIs). SPIs provide a form of measurement for councils to review their performance over time and to make comparisons with other councils. Within Midlothian Council, key SPIs are included within service performance reports which are reported as part of the quarterly performance reporting cycle. Each year we review the reliability of the arrangements to prepare SPIs. Overall, we assessed the arrangements for collating data for the SPIs to be reliable and the 2009/10 SPIs were published by 30 September 2010.

109. With regard to 2009/10, a total of 64 SPIs were included in the 2009/10 return. Exhibit 3 demonstrates that the Council has made improvement in a number of areas.

Exhibit 3
Improvements demonstrated by SPIs (Total 64 indicators)



110. Improvement in performance can be seen in some of the homelessness indicators. For example there is an improving trend in the percentage of applicants housed in permanent accommodation and in the percentage of applicants sustaining a permanent tenancy after a year. The improvement in this area of performance reflects the Council's efforts to improve the outcomes for homeless persons, such as the "spend to save" programme to secure more appropriate accommodation for homeless



people and the “one-stop shop”, offering a single enquiry point for advice and support for the homeless.

111. The sickness absence measures for teachers and for all other employees both showed a decline compared to the previous year. There were particular factors for this which were outwith the Council's control. However, going forward, these indicators, and others which have declined are likely to be ones which should be monitored closely to ensure corrective measures can be taken if necessary, to manage the situation.

Equality and Diversity

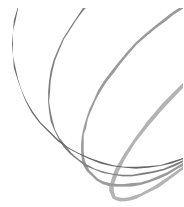
112. Midlothian Council has introduced measures to promote diversity and equalities in response to the developing anti-discrimination laws governing employment and the provision of goods and services, together with specific public sector duties relating to race, gender and disability. As a result the 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 introduced a Disabled Employees' Forum. In addition the Community Planning Equalities Forum operates within the community planning structures to promote equalities. Work is nearing completion on a single equalities scheme which incorporates all of the equalities strands. It is currently with relevant stakeholders for their input.

Business Transformation

113. As stated in paragraph 58, Council approval was given in February 2010 for the establishment of the Business Transformation Programme, (BTP), the framework that will be used to take business transformation forward over a five year period to deliver outcomes that are expected to lead the Council towards becoming more effective, efficient and economically viable. The BTP is in part a response to the very significant challenge the Council is facing as a result of reduction in funding in the years 2011 to 2014. This is made more challenging as the exact scale of the reduction will not be known until December 2010. As stated previously, the outcome of the September service prioritisation seminar will provide further direction for the BTP and help identify areas for further savings.

114. The Business Transformation Programme has been developing since the Council approved the programme in February 2010. A governance framework has been put in place which includes defined groups with defined remits and responsibilities. There is a reporting structure to the Corporate Management Team and the Council, and the BTP also has its own approved revenue and capital budgets (see paragraphs 44 and 50).

115. It is clear that the members of the Council and senior officers are under no illusion as to the importance of the successful delivery of the BTP, in terms of making savings to minimise the budget



gap identified thus far, and to ensure the successful delivery of services to the citizens of Midlothian. Significant risks are inherent in any business transformation programme, and there is evidence to suggest that measures have been put in place to manage some of the risk. However, it is vital that vigilance is maintained to ensure that current risks and emerging risks are managed appropriately, in addition to ensuring that the outcomes expected of the BTP are actually delivered in a timely manner, so that corrective action can be taken if necessary.

Key risk area 10

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

116. A full review of best value and community planning at Midlothian was published in June 2008. Over recent years Midlothian Council has been inspected by various bodies including the Food Standards Agency, Her Majesty's Inspectorate of Education (HMIE) 2007, the Social Work Inspection Agency (SWIA) 2008, and the Scottish Housing Regulator (SHR) 2008.
117. Actions plans were agreed following these inspections and progress in implementing agreed actions is routinely monitored through the performance management framework process, which reports quarterly to Committee and Cabinet. Follow-up audits have also been undertaken by both HMIE and SWIA since their initial inspections. It is noted in the Shared Risk Assessment – Assurance and Improvement Plan 2010-13 (AIP) that overall, the Council has responded positively to recommendations arising from the various inspections on service delivery and has introduced a number of improvements.
118. The AIP did not note any high risks in the areas typically inspected by HMIE and SWIA for the first year of scrutiny, which would warrant inspection within a short time frame. A routine follow up by the SHR will be undertaken around January 2011.
119. There is evidence to suggest the Council is making good progress in their preparation for the Best Value 2 round of audits. One of the work streams under the BTP relates to Public Sector Improvement Framework (PSIF) - a self-assessment methodology - and Best Value 2 (BV2). Work has commenced on putting processes in place to embed PSIF which has now been formally launched within the Council as the 'Midlothian Excellence Framework'. To date relevant staff have been briefed on how the process works and three pilot reviews have commenced. In addition use is being made of each of the Audit Scotland BV toolkits, as part of the Council's approach to continuous improvement and its preparation for its BV2 audit.
120. The work on the original BV audit took place before and after the May 2007 local government election, with the report being published in June 2008. This meant that agreement of the report involved both



administrations, contributing to the time taken to finalise the report. Going forward with the BV2 audit process, officers and members are mindful that the next round of local government elections will be taking place in May 2012. As a result it is important that the timescale for Midlothian's BV2 audit should be carefully considered to ensure that it does not span the local government election period.

Risk Management and Internal Audit

121. 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.

122. The Council has a developed approach to managing risk. The Risk and Audit Manager maintains the policy and strategy and an inclusive approach to risk management is promoted through the corporate risk management working group. This group meets regularly to update the risk register and all services are represented on the group. With the change in the organisational structure and change at Head of Service level the opportunity has been taken to revisit the risk registers, to reduce the number of registers and review the risks identified.

123. 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.

124. Internal Audit continues to work effectively, performing well against its audit plan and responding to changes as a result of emerging risks. The Risk and Audit Manager, under the new organisational structure reports to the Head of Finance and Human Resources, and continues to have direct access to the Chief Executive, meeting every six weeks. The Risk and Audit Manager as part of the organisational changes has been given management responsibility for emergency planning and insurance. Arrangements are being put in place to ensure that this does not have an impact on the independence of the audit function and its ability to conduct reviews in these areas.

125. In May 2010 Midlothian Council internal audit was awarded a highly commended Cliff Nicholson award by CIPFA, in recognition of excellence within public sector audit.

126. Previously, the Performance Scrutiny and Audit Committee, now the new Audit Committee maintains an oversight of the risk and audit processes operated, including approving changes to the strategy, policy and plans.

Outlook

127. 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. We recognise the challenges and whilst we have no plans to audit the outcome progress reports in 2010/11, we will pay attention to the systems Midlothian has in place to monitor progress and take remedial action.

128. The Accounts Commission approved a new approach to the audit of best value in July 2010. Details of our new approach can be found on Audit Scotland's website. The timing of Midlothian's Best Value 2 audit, as suggested by the AIP may be in 2011/12. The AIP also includes scrutiny activity by other scrutiny bodies over the next three years, principally in the areas of child protection, education and social work.



Appendix A

External audit reports and audit opinions issued for 2009/10

Title of report or opinion	Date of issue	Date presented to PSAC or Audit Committee
Annual Audit Plan	February 2010	9 March 2010
Review of Governance Arrangements and Main Financial - Systems	11 May 2010	14 September 2010
Shared Risk Assessment – Assurance and Improvement Plan	June 2010	14 September 2010
Report to those charged with governance (ISA 260)	9 September 2010	14 September 2010
Review of Governance Arrangements and Main Financial – Testing	4 August 2010	14 December 2010
Financial Statements Management Letter	November 2010	-



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.	14	<p>Finance Workload</p> <p>The work demands on the finance function are significant arising from: the requirement to produce IFRS compliant financial statements; supporting BTP; supporting service reviews; and supporting the Council prioritisation seminar, in addition to normal duties.</p> <p>There is a potential risk around the capacity of Finance to deal with all the significant and evolving demands. And a risk of over reliance on a number of key finance officers.</p>	<p>This is an ever present risk for all of service areas. The structure for Finance and HR approved by Council in June reflect the predicted demands.</p> <p>In addition Council has already recognised that resources are required to deliver change by setting aside Business Transformation Funds. The Head of Finance and Human Resources has already, and will continue to access these funds to support the evolving demands.</p>	Head of Finance and Human Resources	Complete
2.	46 & 61	<p>General Reserve & Budget Gap</p> <p>Good practice for councils is to maintain free reserves of around 2% to 4% of net expenditure where possible (2% would equate to £3.8 million for 2009/10 for Midlothian). As at 31/03/10 there was an unallocated balance of £4.9 million, with £1m of this to be set aside for one off costs associated with the BTP. A projected budget gap of £5.1 million for 2011/12 rising to £19.9 million by 2013/14 has been identified.</p> <p>The Council could still be exposed to financial risk and have limited capacity to deal with unforeseen costs or losses. The decision to close the insurance fund as at 31 March 2010 could</p>	<p>The level of reserves is above the ideal level and as such provides added capacity in a time of significant change.</p> <p>Council has been provided with projections on grant settlements however the actual funding gap will only become clear once the Local Government Grant settlement is announced. and the implications will be reported to Council.</p> <p>Meanwhile Council continues to be provided with updates on other significant cost pressures that arise or savings that are achieved from the BTP as it works towards setting the 2011/12 budget.</p>	Financial Services Manager	March 2011



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>increase this risk. As savings take time to accrue there is a risk that the Council may need to rely on its reserves if sufficient savings are not identified.</i>			
3.	66	<p>Corporate Asset Management Plan – detailed functional plans</p> <p>Work on the six detailed functional asset plans stemming from the Corporate Asset Management Plan have still to be developed.</p> <p><i>Without detailed and costed functional AMPs there is a risk that this could weaken the asset rationalisation decision making process across the Council and consequently compromise budget saving efforts.</i></p>	<p>Asset Management is recognised as a key element of the transformation agenda and is incorporated within and is being progressed through the Business Transformation Programme.</p> <p>Completion dates for each of the detailed work plans are still to be settled and in some respects the plans are and will continue to evolve to reflect the other elements of the Transformation Agenda.</p> <p>The Governance arrangements in place for BTP are robust and will ensure that all six of the functional asset plans progress and are resourced.</p>	Gareth Davies	Complete
4.	70	<p>Procurement</p> <p>The Procurement Strategy and the Scotland Excel review identified areas for improvement. Responsibility for implementing improvements should rest with all key staff and members involved in procurement across the whole Council, now and on an ongoing basis. All options should be considered to deliver maximum benefits as quickly as possible.</p> <p><i>If the planned improvements in procurement are not implemented timeously and effectively there is a risk that savings may not</i></p>	<p>The Procurement Strategy is in place and arrangements are also in place to progress the actions within the Strategy, some of which are well underway for example savings delivered to date.</p> <p>Self assessment is currently underway for the second round of PCA assessments scheduled for November 2010.</p> <p>Management Action: PCA self Assessment</p>	Head of Finance and Human Resources	November 2010



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>materialise.</i>			
5.	75	<p>Staff morale Staff at Midlothian have experienced significant changes due to regrading, organisational restructuring and continual upheaval. This can have an adverse impact on morale.</p> <p><i>There is a risk that service delivery could be affected, and there could be resistance against the BTP, which could impact on how successful the process is.</i></p>	<p>The impact of change and the need for effective engagement and communication with staff is recognised in the BTP.</p> <p>People Strategy is one of the strands of the Transformation Programme and a Staff Survey is already underway</p> <p>Management Action:- Complete Staff Survey</p>	HR Advisory Services Manager	December 2010
6.	78	<p>IT Structure The strategic and operational structure of IT has changed significantly, thus the current arrangements should be kept under review.</p> <p><i>There is a risk that the IT function may not be able to support and deliver all activities in the most effective way if the new operational structure is found not to be effective as initially planned.</i></p>	Revised IT structure implemented and IT strategy agreed by CMT	Head of Customer Services	Complete
7.	80	<p>Data Handling and Information Security The responsibility to manage and protect information used by the Council does not lie solely with the Information Security Officer and the Information Management Group. It lies with everyone in the organisation including, staff, managers, members and partners.</p> <p><i>There is a risk that information could be lost or compromised if policies and procedures are not adhered to by all of those involved in processing and managing</i></p>	Arrangements are robust and will be continually reviewed	Head of Customer Services	Complete



Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>information.</i>			
8.	84	<p>Shared Services</p> <p>It is important that opportunities to share services continue to be rigorously reviewed to identify cost savings and efficiencies.</p> <p><i>There is a risk that opportunities are missed or efforts misdirected.</i></p>	<p>The Council is leading the way with shared services and significant work, supported by the Scottish Government is already underway with East Lothian Council</p>	<p>Head of Business Transformation</p>	<p>Complete</p>
9.	101	<p>Internal Control – in times of change and staff reductions</p> <p>Management need to remain vigilant and devise compensating controls where necessary to manage the risk around breaches of internal control and potential financial loss.</p> <p><i>The significant changes which the Council has been and will continue to experience, increases the risk that internal control could be compromised.</i></p>	<p>Management are always vigilant and the existing arrangements, including a strong audit team are considered robust enough to manage risk in relation to change and internal control.</p>	<p>CMT</p>	<p>Complete</p>
10.	115	<p>BTP</p> <p>It is vital that vigilance is maintained to ensure that current and emerging risks are managed appropriately, in addition to ensuring that the outcomes expected of the BTP are actually delivered in a timely manner.</p> <p><i>There is a significant risk that if the BTP does not deliver what is planned in terms of budget reductions, this will compromise the Council's service delivery priorities.</i></p>	<p>Robust risk management arrangements are in place and these include the BTP itself.</p> <p>The BTP programme also has robust governance arrangements in place.</p>	<p>Head of Finance and Human Resources/Head of Business Transformation</p>	<p>Complete</p>