

Midlothian Council

Report to Members and the Controller of Audit on the 2010/11 Audit



Prepared for Midlothian Council
October 2011

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

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Key Messages

We have given an unqualified opinion on the financial statements of Midlothian Council for 2010/11. During 2010/11, the Council continued to work hard to manage its budget, resulting in a net underspend of £3.2 million against the final revised budget. At the end of the year a £3.1 million contribution was made to the general fund usable reserve giving a final balance of £12.2 million. £6.4 million has been earmarked for specific purposes, leaving an uncommitted general fund usable reserve of £5.8 million. The ongoing difficult economic environment and consequent constraint on public sector funding means that the Council will need to continue to monitor and review its budget and reserves position on an ongoing basis to ensure it is able to respond appropriately to the economic environment and future reductions in available resources.

The Business Transformation Programme (BTP) has been operating since February 2010 when Council approval was given to commence the programme for a five year period. In the last year the Council has changed its structure, moved from five divisions to three, undertaken a management review, and implemented a voluntary staff release scheme. This has resulted in significant changes at Director and Head of Service level, including a realignment of responsibilities amongst the remaining cohort of senior managers.

The purpose of the BTP and organisational change is to enable the Council to become more effective, efficient and economically viable, thus allowing it to respond in a controlled way to the continuing difficult economic environment and to the reductions in available resources from government and other sources, whilst at the same time maintaining or improving service quality. A revised Business Transformation Strategy was approved by the Council in August 2011 recognising that savings will be achieved in a phased manner and will now take until 2017 to be achieved.

The performance management framework continues to demonstrate how the Council is performing and, based on the 64 statutory performance indicators, 49 showed an improvement, 3 were unchanged, and 12 showed a decline. More statutory performance indicators showed an improvement in 2010/11 compared to 2009/10, particularly in performance indicators for home care. Midlothian Council won the 2011 Care Accolade award from the Scottish Social Services Council for its contribution to the Transformation of Older People's Services in Midlothian.

Outlook

Looking ahead, it is clear that public sector spending in the period 2012/13 to 2014/15 remains very challenging both from a funding and service demand perspective. The successful delivery of the Business Transformation Programme is vital if Midlothian Council is to achieve expenditure reductions to live within forecast funding levels. A report to Council in September 2011 details the projected budget gap for the next three financial years from 2012/13 as: £2.7 million, £8.9 million and £16.4 million. It is expected that the BTP will

generate savings of £3.4 million, £6.6 million and £9.2 million, respectively, leaving a residual shortfall. It is recognised that it may be necessary to accelerate the review programme or increase savings targets to reduce the remaining budget gap.

In the face of such challenges members need to continue to work together now and in the future. As well as potential dissatisfaction amongst some service users the likely scale of budget reductions and organisational change could cause poor morale and motivation amongst staff. The Council recognise this and as well as ensuring robust governance and financial management arrangements, a People Strategy for staff has been developed.

An update to the shared risk assessment and assurance and improvement plan (AIP) was submitted to the Council in June 2011. 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 recommended that a Best Value 2 (BV2) audit should be undertaken in 2011/12 and this will commence in November 2011. With the agreement of the Leader of the Council and the Chief Executive, the report will be considered and published by the Accounts Commission in May 2012, after the local government elections.

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

Introduction

1. This report is the summary of our findings arising from the 2010/11 audit of Midlothian Council (the Council). The purpose of the annual audit report is to set out concisely the scope, nature and extent of the audit and to summarise the auditor's opinions (i.e. on the financial statements) and conclusions, and any significant issues arising. The report is divided into sections which reflect the public sector audit model.
2. A number of reports have been issued in the course of the year, some of which include recommendations for improvement (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 wider review of the Council.
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:
 - The cost of public sector pensions in Scotland
 - How councils work: an improvement series for councillors and officers - Arms-length external organisations
 - Scotland's public finances: responding to the challenges
 - Maintaining Scotland's roads: a follow-up report
 - Physical recreation services in local government
 - An overview of local government in Scotland 2010
 - Community Health Partnerships
 - Improving energy efficiency: a follow-up report
 - Transport for health and social 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 and forms a key part of discussions with the Audit Committee, as soon as possible after the formal completion of the audit of the financial statements. Audit is an essential element of accountability and the process of public reporting.

7. The report will be published on our website after consideration by the Council. The information in this report may be used for the annual overview of local authority audits prepared by the Accounts Commission later this year. The overview report is published and presented to the Local Government and Communities Committee of the Scottish Parliament.
8. Management is responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems. Weaknesses or risks identified by auditors are only those which have come to their attention during their normal audit work, and may not be all that exist. Communication by auditors of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of internal control.

Financial statements

9. Audited bodies' financial statements are an essential part of accounting for their stewardship of the resources made available to them and their performance in the use of those resources.
10. Auditors are required to audit financial statements in accordance with the timescales set by Audit Scotland, which may be shorter than statutory requirements, and give an opinion on:
 - whether they give a true and fair view of the financial position of audited bodies and their expenditure and income
 - whether they have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements.

Auditors review and report on, as appropriate, other information published with the financial statements, including the explanatory foreword, statement on the systems of internal financial control and the remuneration report. Where required, auditors also review and report on the Whole of Government Accounts return. This section summarises the results of our audit of the financial statements Audit Opinion.

11. We have given an unqualified opinion that the financial statements of Midlothian Council for 2010/11 give a true and fair view of the state of affairs of the Council and its group as at 31 March 2011 and of the income and expenditure for the year then ended. We also certify that the accounts have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.
12. We were satisfied that the Remuneration Report, a new requirement, had been properly prepared, and that the Explanatory Foreword was consistent with the financial statements.
13. The Council's unaudited financial statements were submitted to the Controller of Audit by the deadline of 30 June. In the main we were able to obtain working papers and explanations when requested.
14. The accounts were certified by the target date of 30 September 2011 and have been presented to members and are now available on the Council's website.

Accounting issues

15. Local authorities in Scotland are required to follow the Code of Practice on Local Authority Accounting in the United Kingdom 2010/11 (the 2010 Code). The 2010 Code dictated that 2010/11 was the first year in which local authority financial statements were to be prepared fully compliant with International Financial Reporting Standards (IFRS). IFRS financial statements are in many aspects substantially different to those of previous years, including differences to: the main financial statements, accounting policies; and disclosure notes. The transition to IFRS compliant financial statements was a substantial piece of work for Financial Services. It also meant that there was an increase in the volume of material which required to

be audited compared to previous years. We are satisfied that the council prepared the 2010/11 financial statements on an IFRS basis in accordance with the 2010 Code.

16. 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 in our 'Report to Those Charged with Governance' (ISA 260 Report). This report was considered by the Audit Committee on the 13th September 2011 and also details the significant adjustments made to the financial statements as a result of the audit process.
17. One of the main findings in our ISA 260 Report, related to the valuation of Midlothian's council houses. During 2009/10, in anticipation of the introduction of IFRS and the changes that would be required to accounting policies, the Council undertook an exercise to re-value all of its housing stock (excluding new build houses). The revaluation increased the value of the housing stock by 33% from £388 million to £554 million as at 31 March 2010. In the absence of comparable information across the country in 2009/10, we were dependent on representations from management that they were satisfied with their local interpretation of the RICS valuing instruction.
18. As at 31 March 2011, Midlothian's total housing stock was valued at £613 million, of which £521 million related to revalued stock. During the process of the 2010/11 audit, Audit Scotland collated average council house values from across Scotland. This showed that Midlothian Council had the highest value per house (approximately £95k) compared to the rest of Scotland (£35k -£50k per property), and was applying one of the lowest discount factors to arrive at the housing stock valuation. Under existing use value - social housing, (the valuation methodology to be used to value social housing under IFRS) the intention is for the value of the housing stock to take account of social rental income streams relative to the alternative private rental market in any council area, as well as the base value. Through the audit process we were able to conclude, with the agreement of the Head of Finance and Human Resources, that the discount factor applied by Midlothian Council did not take sufficient account of the variation between private and social rent levels. It was agreed that the council would proceed to modify their discount factor from 25% to 64.5% to take account of the difference in private and social rent levels in the Midlothian area. This resulted in a substantial reduction in the net book value of the council housing stock, from £613 million to £334 million which has been reflected in the audited financial statements for 2010/11.
19. This change did not impact on the usable general fund reserve. The reduction in the value of council housing stock impacted on the Consolidated Income and Expenditure Statement and the Balance Sheet of the Council, resulting in a reduction in total net assets. Processing this adjustment along with the associated audit adjustments was a substantial piece of work which required to be carried out at the concluding stages of the audit.

Whole of Government Accounts

20. The whole of government accounts (WGA) are the consolidated financial statements for all branches of government in the UK. The Council submitted the unaudited consolidated pack to

the Scottish Government prior to the deadline of 29 July. The deadline for the submission of the certified WGA pack to the Scottish Government was the 1st October. This deadline proved very challenging both for Financial Services and external audit as the pack had to be amended to be brought in line with the audited 2010/11 financial statements. The WGA pack was certified and submitted to the Scottish Government on 6 October 2011.

Audit testing

21. 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
 - Housing Rents
 - Accounts Payable
 - Council Tax
 - Housing Benefits
 - Treasury Management
22. We planned to place reliance on the work of internal audit in assessing the controls in the council's main financial systems of: finance ledger, accounts payable, accounts receivable, and payroll. This work proved to be more time consuming than originally intended, which led to delays in internal audit reporting the outcome of these audits to us. In addition, the work on evaluating the controls in the council's payroll system was not completed in the 2010/11 audit year. Consequently we undertook additional work to allow us to obtain sufficient audit assurance. We relied on the Arrears Management and the Budgetary Control – Capital audits undertaken by internal audit. In addition we also took some assurance from their work on: Procurement - Care at Home Service, Governance – Corporate Improvement Programme/Business Transformation, Control of IT Assets, Follow Up of Electronic Payments, and PP1 and 2 Follow Up.

Prevention and detection of fraud and irregularities

23. 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. As the public sector continues through a period of significant change and budgetary constraint, the good conduct of its employees is of the utmost importance. Staff and management should take the opportunity to remind themselves periodically of the conduct expected, and ensure that appropriate action is taken when poor conduct or fraud or irregularities are proved.

NFI in Scotland

24. 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.
25. The 2010/11 NFI exercise is underway. The council is progressing the matches identified through the NFI process. To date the majority of the matches have been investigated and cleared, leaving a number of cases requiring further investigation to determine whether there has been any error or fraudulent activity. As the NFI exercise takes place over a two year period, it is too early to quantify the potential level of error or fraud. The previous 2008/09 data matching exercise identified around £0.2 million of savings (principally benefit savings) at Midlothian Council. Progress on the 2010/11 NFI exercise is regularly reported to the Audit Committee.

Housing Benefit

26. Audit Scotland undertakes inspections of the council benefits services responsible for administering housing and council tax benefit awards on behalf of the Department of Works and Pensions. This work is undertaken by a specialist team which carries out a programme of risk assessments of benefits services in all councils over a two to three year period.
27. The risks to Midlothian's benefits service were first assessed in May 2008 and a detailed report was issued. The council responded to the risks identified with an action plan. The second risk assessment took place in early summer 2011, and reported some serious concerns over the performance of the council's benefits service and its capacity to deliver improvements going forward. In particular, concerns were expressed around the speed of processing change events and new claims, and the failure to secure all available subsidy income, by minimising administrative delays and errors, for the last two financial years. An action plan has been developed by the benefits service and the Chief Executive to manage the risks identified from the second inspection. The action plan has been agreed with our specialist team. The detailed benefits risk assessment report and agreed action plan were considered by the Audit Committee in October 2011.

Group accounts

28. 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, and

- three associates, i.e. bodies in which the Council has an interest: Lothian and Borders Police Board, Lothian and Borders Fire & Rescue Board and Lothian Valuation Joint Board.
29. 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. We have received written assurances from the Head of Finance and Human Resources that SDL was legally dissolved in February 2011 and that there is no further likelihood of a liability on the council arising.
30. The remaining group entities have all been included in group accounts in accordance with the 2010 Code. 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 in the group received unqualified audit opinions from their external auditors. Trust Fund and Common Good assets have also been consolidated into the group accounts.

Trust funds

31. 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 2013/14. 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.
32. 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 2011.

Common good fund

33. 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.
34. 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 £19k which is included in the overall trust, bequest and community fund balance of £138k as at 31 March 2011.

Pension fund

35. 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 as at 31 March 2011.

36. The net pension liability disclosed in the Financial Statements, as at 31 March 2011, is £63.8 million (£109.2 million in 2009/10). The liability has been calculated in accordance with IAS 19 - Retirement Benefits and shows the Council's long term underlying retirement benefits commitment. The reduction in the council's long term liability compared to the previous year is in part due to the change to how future pension increases are calculated. Pension increases are now based on the consumer prices index (CPI) rather than the retail prices index (RPI) which has resulted in a reduction in employer's pension liabilities. This change had the effect of creating an exceptional accounting negative past service cost of £34 million for Midlothian Council, which was credited to the 2010/11 comprehensive income and expenditure statement.

Statutory Trading Operations

37. Midlothian Council operates two Statutory Trading accounts in respect of building maintenance and roads maintenance. There is a statutory requirement that these activities should break-even over a rolling 3 year period. In 2010/11, both operations achieved the required financial objective.

Legality

38. 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.

Outlook

39. 2010/11 saw significant changes in the accounting requirements for local authorities. Change on such a significant level is not planned for 2011/12.

Carbon Trading

40. From April 2010, a new and complex system for charging for carbon emissions was introduced. 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. No charges were made in 2010/11. The Council has developed a plan for carbon trading going forward.

Audit Appointments for 2011/12

41. Audit appointments are made by the Accounts Commission, either to Audit Scotland staff or to private firms of accountants for a five year term. 2010/11 is the last year of the current audit appointment for Audit Scotland, and from 2011/12 for the next five years, Grant Thornton has been appointed as the external auditor for Midlothian Council. We would like to thank officers and members for their assistance during the last five years.

Financial position

Financial results

42. Midlothian Council's gross revenue expenditure in 2010/11 on the provision of public services was £312.8 million (net operating expenditure of £244.7 million), excluding the exceptional credit of £34.4 million from the write back of pension costs due to the change from measuring pension costs on a RPI basis to a CPI basis. This was met by central government grant and local taxation totalling £192.9 million, and resulted in a deficit of £30.8 million, 12.6% of the net expenditure for the year. The budget set for 2010/11 was based on a Band D council tax level of £1,210. In addition capital expenditure in 2010/11 was £33.9 million.
43. Budgets are set and monitored throughout the year and changes in the utilisation of reserves are approved by Council. In overall terms, the Council managed its budget well resulting in a net under spend of £3.2 million against the final revised budget. Midlothian Council underwent an organisational restructure during 2010/11. A budget re-alignment between the old and new organisations structures took place to allow the quarter 1 results to be reported to Council, based on the new structure in September 2010. Performance against budget continues to be reported to Council throughout the year and includes a detailed material variance analysis including descriptions of, and reasons for variances, their value and the action taken as a result of the variance. It is important that budget performance continues to be closely monitored throughout the year to highlight issues to enable corrective action to be taken in a timely manner.

Reserves and balances

44. Exhibit 1 shows the balance in the council's cash backed usable reserves at 31 March 2011 compared to the previous year. At 31 March 2011, the council had total cash reserves of £35.6 million, an increase of £14.1 million on the previous year, of which approximately £10 million relates to capital receipts.

Exhibit 1 - Reserves

Description	31 March 2010 £ Million	31 March 2011 £ Million
General Fund	9.1	12.2
Housing Revenue Account Balance	10.9	11.6
Capital Fund	0	9.9
Repairs and Renewal Fund	1.3	1.6
Total	21.5	35.5

45. At the end of the year £3.1 million was added to the general fund giving a final general fund reserve of £12.2 million. Of this balance, £6.4 million is earmarked for specific purposes, £4.7

million in respect of various budget carry forwards, with a further £1.7 million earmarked to pay for costs arising from the BTP. This leaves a general reserve balance of £5.8 million. The Housing Revenue Account (HRA) balance showed an increase of £0.7 million compared to the previous year.

46. The on-going difficult economic environment and constraint on public sector spending means that 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. A recent report to Council (August 2011), projects a net overspend of £0.9 million on the 2011/12 general fund revenue budget and a general fund balance of £6.1 million as at 31 March 2012.
47. Recent projections on the Housing Revenue Account show a small overspend of £18k against a projected outturn of £19.2 million. Any overspend will impact on the Housing Revenue Account Balance.

Key risk area 1

Group balances and going concern

48. The overall effect of inclusion of the Council's associates on the group balance sheet is to reduce net worth by £142 million to £257 million, mainly because of pension liabilities in joint boards. 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 investment and performance 2010/11

49. To meet capital investment plans the Council agrees a capital financing requirement (CFR). The CFR reflects the Council's underlying need to borrow for capital expenditure, and is a gauge of its debt position reflecting actual past capital investment and future planned capital investment decisions. The final CFR for 2010/11 was £207 million, although the Council granted permission for additional borrowings up to the 2013/14 CFR limit of £250 million if considered prudent to do so. However, actual borrowings at 31 March 2011 were £187 million, £20 million below the authorised level.
50. Capital expenditure in 2010/11 totalled £33.9 million (2009/10: £33.4 million), £7.5 million on general fund (GF) services and £26.3 million on housing revenue account (HRA) activities. This was £7.8 million less than planned. The main reason for the underspend was slippage in the 2010/11 programme, for example the Roslin Glen Road project, Dalkeith Town Centre Regeneration and Hopefield Primary School projects. These projects will be carried forward into 2011/12. During 2010/11 the Council realised £12.5 million of capital receipts (£2.1 million in 2009/10) compared to an original budget of £5.4 million. £2.4 million of these were used in 2010/11 and the remainder was transferred to the capital fund to be used in future years. There is a continued need for the Council to monitor its capital programme taking account of changing circumstances.
51. During 2009/10 Lasswade High School replacement was identified as a project which would be facilitated by the Scottish Futures Trust (SFT). The Scottish Government will fund two-

thirds of the project and the council will fund one-third of the project, including any non-educational facilities on the site. The Council has worked in partnership with East Renfrewshire Council and SFT to progress the project. During 2010/11 £0.7 million was spent on preparatory works. The budgeted capital spend in 2011/12 is £9.5 million with a further £30.2 million to be spent over the subsequent 3 years. The Scottish Government has confirmed that the grant available is capped at £23 million. The remainder of the cost of the project is to be met by the Council.

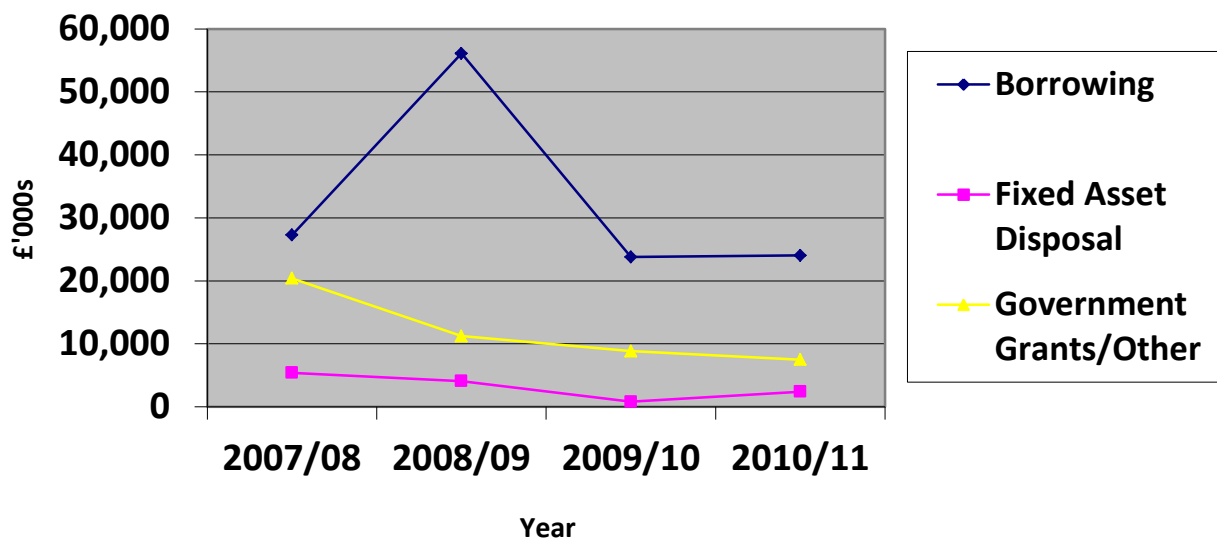
52. Work continues on the Zero Waste Project between City of Edinburgh Council (CEC) and Midlothian Council. The purpose of the project is to treat food waste and residual municipal waste to reduce the amount of waste sent to land fill to meet EC landfill directives. The council is at risk of significant fines if it does not achieve EC targets. Project progress includes the joint purchase of land at Millerhill and the progressing of joint procurement initiatives.
53. The Scottish Government has advised that food waste treatment will be required from 2015 and residual waste treatment from 2017. Once in place these contracts will contribute to the longer term targets of 60% recycling of waste from households by 2020, 70% recycling of all waste by 2025 and no more than 5% of all waste to landfill by 2025.
54. There is evidence to demonstrate that Midlothian Council has been pro-active in its response to waste management and is already meeting the municipal waste recycling target of 50% by 2013: 52% was reported as actual for the first quarter of the current year.
55. The trend in capital investment and sources of funds is illustrated in exhibit 2. This shows the level of borrowing and other sources to fund capital expenditure.

Exhibit 2 - Sources of finance for capital expenditure 2007 to 2011

	2007/08	2008/09	2009/10	2010/11
	Actual	Actual	Actual	Actual
	£M	£M	£M	£M
Borrowing	27,264	56,090	23,785	24,024
Fixed Asset Disposal	5,409	4,076	821	2,418
Government Grants/Other	20,394	11,228	8,829	7,481
Total	53,067	71,394	33,435	33,923

* source Midlothian Council Financial Statements

Capital Expenditure Financing



Treasury management

56. As at 31 March 2011, Midlothian Council held cash and temporary investments of cash reserves totalling £30.7 million (£14.4 million 31 March 2010). With regards to borrowings and investments, we received specific representation from the Head of Finance and Human Resources that all borrowings have been made for legitimate purposes and temporary investments are made in the interest of prudent cash management.
57. The current economic climate means that interest rates on investments and borrowings are relatively low. The Council holds a significant proportion (92%) of its debt at fixed rates. Its average cost of borrowing over the year was 3.72% (3.61% in 2009/10). The 2010/11 Annual Treasury Management Report for 2010/11 notes that the Council was not able to take advantage of changes in interest rates in 2010/11 to reschedule debt, as it had done in 2009/10; the opportunity to reschedule debt was significantly reduced through a change of policy on PWLB lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75-0.85% without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

Financial planning

58. In April 2010, the Council approved an organisational re-structure to move from five to three divisions. During 2010/11 it undertook and implemented a management structure review resulting in 62 management posts being deleted. For 2011/12, the council tax remains frozen in accordance with the Concordat with Scottish Government, and the Council has approved a 2011/12 general fund revenue budget of £185 million (net expenditure). This includes BTP savings of £4.9 million, arising from the management review, joint board budgets, service reviews, procurement, and staff release. The latest 2011/12 budgetary control report, at August 2011, details a revised general fund revenue budget of £189 million (net expenditure),

a projected overspend of £0.9 million and planned utilisation of £6.3 million of general fund reserve.

59. Recent reporting to Council details the projected budget gap for the next three financial years: £2.7 million, £8.9 million and £16.4 million. The report states that the BTP is considered the principal means of identifying savings options to address the projected budget gaps but that the BTP is not sufficient to completely bridge the gap in later years. It states that it is recognised that it may be necessary to accelerate the review programme and/or increase savings targets.
60. The financial forecast information above is subject to revision once the Scottish Government grant settlement is factored in. However, notwithstanding this, the Council's ability to address the forecast budget gaps is dependent on the successful delivery of the BTP.

Key risk area 1

Asset Management

61. The Council approved a Corporate Asset Management Plan (CoAMP) in December 2009. The multi-stranded CoAMP included a strategic vision for service provision covering six functional areas: Property; Open Spaces; Roads, structures, lighting and water related infrastructure; Housing; Fleet; and IT. An action stemming from the CoAMP was to develop detailed functional asset management plans for each of the six areas. However, during 2010/11 the development of these detailed plans was put on hold as a consequence of the divisional restructure and resourcing issues.
62. One of the changes made as part of the revision to the BT Strategy in August 2011, was to replace the Asset Management work stream with the Effective Working in Midlothian Strategy. The aim of this new strategy is to provide, a modern flexible, efficient and cost effective workplace for council employees that will facilitate effective and efficient working practices, improve service delivery and act as a catalyst for culture change. What this means, in practical terms, is to rationalise office space and resolve issues around buildings in poor condition which are expensive to maintain, thus concentrating resources on protecting jobs and making the best use of the council buildings in better condition. The aim is to close 60% of the current office portfolio by 2017/18, mostly through centralising in Dalkeith, and considering how best to make greater use of flexible working.
63. Although the Effective Working in Midlothian Strategy should deal with the property aspects within the wider CoAMP, progressing effective asset management of the other functional areas still requires development.

Key risk area 2

Procurement

64. 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.

65. The Council has now been assessed twice under the PCA process. The PCA assessment score in the first assessment was 18% in 2009, increasing to 23% in the second assessment in 2010. Although this is an improvement, both scores are assessed as non-conformant and indicate that procurement practices should be improved in the Council. The Council has taken on board the results of the PCA assessments and findings arising from recent Internal Audit reports.
66. Both PCA assessments highlighted as a critical first step the need to enhance the corporate procurement function. The Council is now committed to achieving improvements in purchasing practice: there is support from the top of the organisation, from the Chief Executive, the Corporate Management Team, the Audit Committee and the full Council, to improve procurement practices and activities across the Council. A recent report to the BTP Board shows that a Corporate Procurement Team is being formed, which will be headed by a newly created post of Procurement Manager who will report directly to the Head of Finance and Human Resources. The team will consist of a further four officers: three procurement officers and one assistant procurement officer.
67. Initially the team will be charged with updating the Council's Procurement Strategy, developing a procurement improvement plan, and working to achieve the £0.4 million of procurement savings in the 2011/12 budget. The next PCA assessment is planned for late November 2011, by which time the Council hope to have moved from the non-conformance to the conformance score range. In addition Internal Audit will continue to review the transformation work undertaken thus far. Going forward it is important that the commitment to improve procurement practices become a reality and planned budget savings are realised and maximised.

Key risk area 3

Managing People

68. Staff in Midlothian Council have experienced considerable change in the past few years including an organisational restructure, management review and the introduction of a staff release scheme on a voluntary severance or early retirement basis, not to mention the on-going BTP programme. The impact of those changes have largely been mentioned above, i.e. a reduction in directors from five to three, and a reduction in Heads of Service from fifteen to eleven. Overall 62 posts have been removed from the staffing establishment.
69. In the last year work has been on-going to develop the Council's People Strategy and a detailed action plan to ensure the Strategy is implemented. They were approved by the BTP Board and the full Council in June 2011. The Strategy is designed to develop a supported, engaged and high performing workforce through the coming years of continued change with the intention of delivering the action plan over the next three years. One of the main actions in

the action plan is to roll out the council's new competency framework and performance review and development process. This starts with training in October 2011, leading to formal staff appraisal meetings taking place in May 2012, and culminating in the award of pay increments, if appropriate, in July 2012.

70. In respect of equal pay claims, as at 31 March 2011, the Council had settled £8.6 million of equal pay claims. As at 31 March 2011, a number of equal pay claims remain to be resolved, thus a provision of £3.7 million has been set aside. In addition an unquantified contingent liability has been disclosed in the accounts in respect of a number of ongoing employment tribunal cases in respect of equal pay.

Key risk area 4

ICT

71. Making good use of ICT is vital in supporting and delivering services. The IT service was affected by organisational change in 2010/11. Under the old structure there was a Head of IT, and under the new structure, the Head of Customer Services became responsible for IT matters.
72. As under the previous IT structure, the new structure retained three teams; Infrastructure; IT Business Services; and Support and Development. While the Head of Customer Services is responsible for IT from a strategic perspective, the IT Business Services Manager became formally responsible for the operational management of the service.
73. A noticeable improvement during 2010/11 was the re-launched council's website. The new website provides much more functionality and better navigation than the previous website, enabling timely information to be made available to the citizens of Midlothian and other interested parties. During 2010/11 a significant incident in the corporate IT back-up regime occurred which could have significantly affected IT business continuity at a council-wide level. The issue took several months to resolve.
74. Given that the structure is relatively new, the effectiveness of the IT structure, the delivery of services, the adequacy of resources and the management of on-going and emerging risks, should therefore be monitored, to ensure the IT service continues to support and deliver all activities.

Key risk area 5

Data handling and security

75. Data handling and security has received increased public and media attention in recent years 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 control 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, not to mention concern and anxiety which could be caused if personal and sensitive information is inappropriately accessed, lost or issued to the incorrect recipient.

76. During 2010/11 and 2011/12 to date, there have been a number of data handling and security issues which have been reported. The nature of the issues highlight that the inherent risks around data handling, including protecting information used by the Council and all its staff does not lie solely with the Information Security Officer and the Information Management Group, but that 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 at all times.

Key risk area 6

Shared Services

77. Whilst wider shared services and partnership activities with neighbouring authorities are in place, the main focus of the Shared Services BTP work stream is to progress a shared service with East Lothian Council with the aim of improving and sustaining services for children and young people.
78. Joint working initiatives have already been established with East Lothian Council in certain areas through a Shared Services Board: Joint Adult and Child Protection Committees and a Joint Liaison Group; a shared 'Out of Hours' service for calls managed by East Lothian Council's call centre, for community care alarms, tele-care and antisocial behaviour matters. A formal Memorandum of Understanding with East Lothian Council was signed to take these initiatives forward.
79. Both councils are to consider, in November 2011, options for shared service arrangements for strategic management and operational support services for Education and Children's Services. If the decision is taken by both councils to pursue a particular shared service option, Midlothian plans to engage with local communities, parent councils, voluntary organisations and other interested groups in a consultation and engagement programme scheduled for 2012 to discuss the preferred option, before progressing further with the initiative.
80. The report to Council on the Revised Business Transformation Strategy in August 2011 shows indicative costs and savings from the Shared Services work stream. The cost to date is £52,200, with anticipated cumulative savings of £1.3 million being achieved by the end of 2016/17, with 2013/14 being the first year in which savings start to accrue.
81. 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 all potential costs, savings and service efficiencies. It is also important to ensure that the current governance arrangements around such complex projects remain fit for purpose.

Key risk area 7

Outlook

82. The challenging economic environment with constraints on public sector spending looks set to continue, at a time when service demands are likely to increase. The Council must strive to deliver best value through implementation of its Business Transformation Programme, tight financial planning and identification of cost effective and innovative ways of working, in particular with local government partners. At the same time it must continue to support and stimulate the local economy. A particular risk is if there are delays to the BTP and consequent delay in the realisation of required cost savings.

Governance and accountability

Introduction

83. Corporate governance is about direction and control of organisations. Councils are large complex organisations and so good governance is critically important. The three fundamental principles of corporate governance of openness, integrity and accountability, apply to all public sector bodies, including Midlothian Council. Through the Chief Executive, the Council is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The Audit Committee, as the group charged with governance, is responsible for monitoring the arrangements.
84. The Council's Code of Corporate Governance was updated in February 2010 to bring it further in line with the CIPFA/SOLACE guidance: Delivering Good Governance in Local Government. Again further work is planned to review the document to ensure that it continues to be appropriate and accurately reflects the new organisation structure.
85. Consistent with the wider scope of public audit, auditors have a responsibility to review and report on audited bodies' corporate governance arrangements as they relate to:
- corporate governance and systems of internal control
 - the prevention and detection of fraud and irregularity
 - standards of conduct and arrangements for the prevention and detection of corruption.
86. In this part of the report we comment on key areas of governance.

Scrutiny

87. 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. Previously, 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. During the early summer of 2010, these arrangements were reviewed against current best practice standards. The review noted that membership of the committee 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 was revised to remove audit-related topics, but with no change to the membership or chair.

88. The new Audit Committee has six members from across the different political groupings and has met on eight occasions during the last year since September 2010. It was originally intended that it would meet four times per year. However, after taking into consideration the volume of reports and matters which it considers, the decision was taken to increase the frequency of the meetings, to try to ensure that sufficient time was made available to consider reports and matters brought to its attention. In addition, in the last year an independent non-voting member has been appointed.
89. We are pleased to report that the Audit Committee meetings are generally well attended by the members, senior officers of the Council, internal audit and external audit, commonly with active participation by the members of the committee. Most of the Members of the Committee also attended specific audit committee training in February 2011. Treasury Management training was provided to all Council members in May 2011, however, this training was not particularly well attended by members, but some of the Audit Committee members were able to attend. Training needs and take up of opportunities is an area which the committee should keep under review. This is of particular importance with the likely arrival of new committee members following the local government elections in May 2012.

Key risk area 8

90. The new Audit Committee has requested regular reports on the implementation of action plans, to be assured that recommendations are being actively considered and implemented.
91. 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

92. 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.
93. A report entitled Elected Member Continuous Professional Development (CPD) Programme, was considered by the Council in March 2011. Following a review and evaluation of the previous learning and development programmes, including consultation with the political group leaders, it was approved that the Elected Member CPD Programme for 2011/12 be delivered in three strands:
- A monthly Elected Member briefing note highlighting key changes in relation to Council Policy, Health and Safety and any other relevant matters. This will provide a list of key pieces of information with points of contact should further information be required.
 - Access to the National Elected Member Portal and the e-learning CPD Framework. This will include access to MILO which is the Midlothian e-learning programme available for employees of Midlothian Council

- Essential briefing and training sessions in relation to the range of Council committees, sub-committees and panels as set out in “The Midlothian Council Standing Orders and Scheme of Administration”. This will include reference to “The Councillors’ Code of Conduct” as published by the Standards Commission for Scotland.
94. The Accounts Commission report entitled “Roles and working relationships: are you getting it right?”, as part of “How Councils work: an improvement series for councillors and officers”, published in August 2010 was considered by the Standards Committee in November 2010. This resulted in a short life working group being formed to consider the contents of the report and to evaluate the council’s practices against self-assessment tools included in the report. A further report including an action plan arising from the work undertaken by the working group is being presented to the Standards Committee in November 2011. The committee are being invited to: consider and approve the draft action plan agreed by the working group, to note that the training issues identified with regard to councillors through the work undertaken by the working group will be addressed through the revised Elected Member training programme, and to refer the report and action plan for approval by the full Council.
95. The contents of the elected members training report to Council and the reports to the Standards Committee provide evidence that the Council is putting in place arrangements which provide elected members with opportunities to undertake training. However, taking part and making use of the opportunities provided is important, and may become more challenging as the Council moves towards the local government elections in 2012.

Partnership Working

96. Midlothian Council continues to show 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.
97. In the Community Plan update of February 2011 the council and its partners make reference to the Midlothian Strategic Assessment, and note that their Community Planning Partnership was the first in Scotland to complete this work. This resulted in a set of recommendations which the council and its partners, through the six Community Planning thematic groups, are reviewing to assess what actions can be taken to address them. Furthermore the update also outlines an approach that the council and its partners have begun on a neighbourhood planning process. This is being rolled out to 16 community council areas in Midlothian on a five year cycle. Partnership working arrangements are developing and suggest good practice elements such as progressing its approach to neighbourhood planning and multi-agency training programmes.

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. This can be seen in the updated Business Transformation Strategy approved by Council in August 2011. It notes in the strategy that there are excellent examples across the authority where citizens are fully engaged in identifying needs, designing and delivering services, and that the Council is assessing how to embed this approach across everything they do.
100. Making appropriate, timely and effective use of community engagement is likely to prove essential in the coming years as the Council transforms how it delivers its services. We are pleased to note that this is recognised already by the Council and that plans are being made to make more use of community engagement activities.

Public performance reporting

101. The Council produces an annual performance report. It is published on the Council's website and is available in hard copy in public libraries and council offices and includes statutory performance indicators. 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.
102. Quarterly performance reports for the Council and each service are available on the Council website. This is an important means of demonstrating openness and accountability. Information is also made available to the citizens of Midlothian via the Midlothian News, which is a monthly community newspaper. It is intended that the Midlothian News will provide the opportunity to link people and groups across the council area, including providing information on council services. Paper copies are sent to 40,000 households, with additional copies distributed through schools, libraries and leisure centres, as well as being available on the Council website.

Governance and internal control

103. Each year the Annual Accounts include an Annual Governance Statement. The purpose of this is to provide assurances that the business of the Council is conducted in accordance with its Code of Corporate Governance, and in accordance with law and proper standards. Part of the process in preparing the annual governance statement is to obtain signed assurance statements from each Head of Service to confirm that robust financial stewardship is operating in Service Divisions in accordance with the Council's Financial Regulations and Directives, and to raise any matters which may need to be addressed to improve financial control. It is

important that these are collated on a timely basis for the purpose of concluding the annual accounts.

104. Organisational change, which will continue for the foreseeable future, coupled with a reduced staffing establishment increases the risk to the effective operation of the internal control environment. It is important that management, including each Head of Service, maintain vigilance around the effectiveness of the control environment within their remit, and ensure appropriate controls are operating to minimise the risk financial loss and fraud.

Key risk area 9

Outlook

105. Effective governance and accountability mechanisms are important at all times. However, the effectiveness of arrangements becomes even more important in times of changes and reduced resources. Management and Members need to remain vigilant to ensure that the Council's corporate governance arrangements provide the necessary assurances and safeguards.

Best value, use of resources and performance

Introduction

- 106.** Audited bodies have a specific responsibility to ensure that arrangements have been made to secure Best Value. Auditors of local government bodies also have a responsibility to review and report on the arrangements that specified audited bodies have made to prepare and publish performance information in accordance with directions issued by the Accounts Commission.
- 107.** As part of their statutory responsibilities, the Accounts Commission may procure, through Audit Scotland, examinations of the use of resources by audited bodies and publish reports or guidance. Auditors may be requested from time to time to participate in:
- a performance audit which may result in the publication of a national report
 - an examination of the implications of a particular topic or performance audit for an audited body at local level
 - a review of a body's response to national recommendations.
- 108.** 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 update 2011-14 concluded that there were no significant concerns for Midlothian Council in this area. This section provides a high level overview of performance management in Midlothian Council.
- 109.** This section includes a commentary on the Best Value and performance management arrangements within the council. We also note any headline performance measures used by members and comment on any relevant national reports.

Vision and Strategic Direction

- 110.** 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. Therefore the Council (and its partners) present a clear vision for the future of the area. However, with the continuing difficult economic environment and likely reductions in government funding in future years it is possible that the Council may have to evolve its vision and strategic direction as a consequence. Going forward integrated and long term financial planning is becoming increasingly important in the achievability of the plans.

Performance management

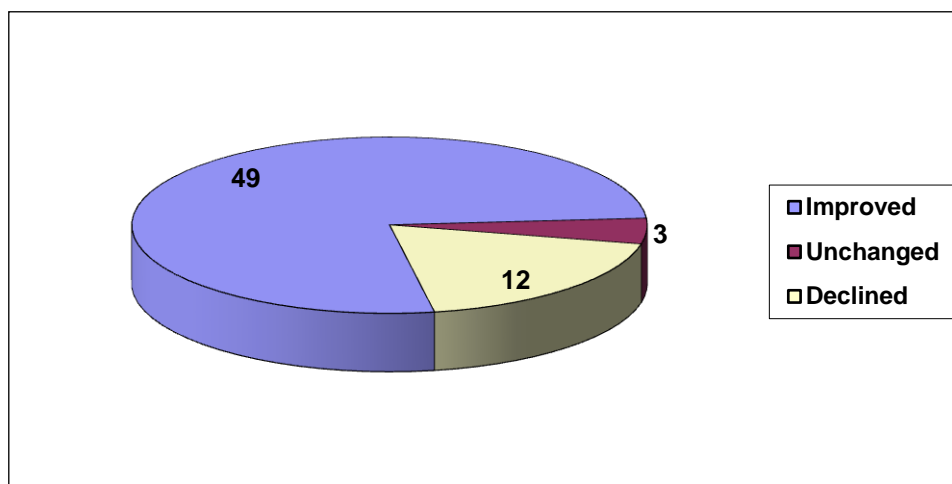
111. The Council uses Covalent to provide a series of divisional performance reports. As described previously, the performance reporting structure was re-aligned with the new organisational structure enabling quarterly reports to reflect the new structure. The reports include an overall summary of major successes and challenges, a performance indicator summary and corporate / divisional priorities action update. The reports are considered by senior divisional management, Directors and the Chief Executive prior to being submitted to the Performance Review and Scrutiny Committee and the Cabinet. There continues to be central co-ordination for the production of the reports through the Corporate Improvement Team.

Statutory performance indicators (SPIs)

112. 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 in 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 2010/11 SPIs were published by 30 September 2011.

113. With regard to 2010/11, a total of 64 SPIs were included in the 2010/11 return. Exhibit 3 demonstrates that the Council has made improvement in a number of areas.

Exhibit 3 - SPIs (Total 64 indicators)



114. Improvement in performance could be seen across a number of indicators such as the home care indicators and dealing with planning applications. In addition there has been improvement in the indicators measuring the Scottish Housing Quality standards. However, in contrast the indicator measuring the percentage of housing response repairs completed within target showed a small decline. Last year we noted that the sickness absence measures for teachers and for all other employees showed a decline compared to the previous year, and encouragingly the 2010/11 indicators show an improvement. Going forward, these indicators,

and others, should continue to be monitored closely to ensure corrective measures are taken where necessary, to manage evolving situations.

115. Related to the improvement in performance in home care indicators is Midlothian Council's success in winning the 2011 Care Accolade award from the Scottish Social Services Council. This was for its contribution to the Transformation of Older People's Services in Midlothian in the category described as "The Chair's Award" which is drawn from across all categories and finalists. Midlothian was also given a special commendation in the category "Adults and Older People" in recognition of how the Council has developed and transformed its work with older people.

Equality and Diversity

116. Midlothian Council has introduced measures to promote diversity and equalities in response to the equalities legislation 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 which is provided to staff and elected members. The Council has a Single Equalities Scheme in place setting out actions to tackle inequality. The Council's Equality Working Group and the Joint East and Mid Lothian Community Planning Equalities Forum are responsible for the delivery of the Single Equality Scheme. One of the key strands of the strategy is a programme of implementation of equalities impact assessments for all functions and policies.

Business Transformation

117. The Business Transformation Programme (BTP) is referred to throughout this report, but due to the importance of the programme further comment is noted below.
118. A governance framework was 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. The BTP has been developing since it was first approved in February 2010, and a revised Strategy was approved in August 2011 extending the original timeline to 2017. As noted previously, one further notable change is one of the original work streams, asset management, has now been replaced by the effective working in Midlothian strategy.
119. The August 2011 revision to the BTP also includes some changes to the governance arrangements and importantly the creation of an outcomes plan which articulates a small set of outcomes which are expected to be delivered by the BTP. The original BTP budgets, approved in February 2010, were £2 million for capital and £1 million for revenue activities. In June 2011 Council approved an additional £1 million for revenue activities stemming from the BTP process.
120. The revised BTP strategy includes the following six work streams: customer service; people; effective working in Midlothian; procurement; service reviews (various); and shared services. At August 2011 it was reported that £1.6 million has been spent from the business transformation fund and the indicative cumulative savings planned by 2016/17 were £12.6

million, with the caveat this represents indicative minimum savings which are likely to be subject to change.

121. As we commented in our 2009/10 report, 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. The overarching vision for the BTP is to “support Midlothian Council to be an excellent and ambitious council, working with you to improve quality of life and provide first class, sustainable services”. Significant risks are inherent in any business transformation programme, and there is evidence to suggest that measures have been put in place to manage the risks. However, 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. If the BTP does not deliver the anticipated savings, the Council may have to consider other alternative measures which enable it to deliver services with reduced resources.

Key risk area 10

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

122. 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 with a follow up report in September 2011. Follow-up audits have also been undertaken by both HMIE and SWIA since their initial inspections. In addition the Care Inspectorate published a joint inspection report of services to protect children and young people in Midlothian in August 2011.
123. Actions plans are agreed following inspections and progress in implementing agreed actions is routinely monitored through the performance management framework process, which reports quarterly to Committee and Cabinet. The Shared Risk Assessment – Assurance and Improvement Plan 2011-14 (AIP), recognises the Council’s on-going commitment to continuous improvement and their positive approach to scrutiny.
124. The updated AIP showed ten categories where the risk assessment had changed from the previous year and seven of these, including financial planning showing an improvement from the previous year. Categories showing a higher risk than the previous year all related to uncertainties surrounding shared service and continued partnership working. The updated AIP for 2011-2014 identified the need for a Best Value audit to take place during 2011/12. Consequently a second Best Value audit will be undertaken commencing in November 2011. With the agreement of the Leader of the Council and the Chief Executive, the report will be considered and published by the Accounts Commission in May 2012, after the local government elections.
125. Over the last year the Council has made progress in their preparation for the Best Value 2 round of audits. The Public Sector Improvement Framework (PSIF) - a self-assessment

methodology has been embedded within the Council and is referred to as the 'Midlothian Excellence Framework'. In addition use has been made of the Audit Scotland BV toolkits, as part of the Council's approach to continuous improvement and in its preparation for its BV2 audit. In June 2011 the Council approved its 'Best Value Framework' which is an update to the Council's original Best Value Strategy approved in 2007. The Framework document details information about how the Council plans to deliver improvement, to ensure activities are relevant to the Council and generate real improvements and provides more guidance for managers and all employees about the practical requirements of ensuring Best Value.

126. The precise scope of the BV2 audit is being developed and will be agreed with the Council prior to the commencement of the detailed fieldwork.

Risk Management and Internal Audit

127. 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.
128. The Council has a well-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. The Council will be requesting their risk consultants to undertake a review of the corporate register later in the year to obtain assurance as to the appropriateness of the risks detailed and the measures in place to manage them. We welcome this approach.
129. 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.
130. Internal Audit in the main works effectively, performing reasonably 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, with direct access to the Chief Executive as required. The Risk and Audit Manager as part of the organisational changes has been given management responsibility for emergency planning and insurance. We have been advised that arrangements have been 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.
131. 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. The Audit Committee maintains an oversight of the risk and audit processes operated, including approving changes to the strategy, policy and plans. A number of staffing changes have taken place within the internal audit section since then, and while there has been no overall reduction in the level of available resource, there has been an inevitable loss of knowledge and experience.

Outlook

132. There are challenging times ahead for Midlothian Council, similar to the challenges which are being encountered across the wider public sector. Effective performance management processes will prove invaluable through significant periods of change and beyond.
133. The ability of the Midlothian Council to continue to deliver quality services to its citizens without making significant cuts to frontline services is dependent on the success of the Business Transformation Programme. If the programme does not deliver the planned outcomes in the planned timeframe, then the Council may have to explore alternative options to enable it to deliver services in a financially sustainable way.

Appendix A

External audit reports and audit opinions issued for 2010/11

Title of report or opinion	Date of issue	Date presented to Audit Committee
Annual Audit Plan	February 2011	8 February 2011
Review of Governance Arrangements and Main Financial - Systems	May 2011	16 August 2011
Shared Risk Assessment – Assurance and Improvement Plan Update, 2011-14	June 2011	14 June 2011
Report to those charged with governance (ISA 260)	September 2011	13 September 2011
Follow up of Audit Scotland National Study – Procurement	August 2011	18 October 2011

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	47&60	<p>General Reserve & Budget Gap</p> <p>It is good practice for councils to state their policy on their preferred level of non-earmarked General Fund reserves. As at 31 March 2011 there was an unallocated balance of £5.8 million. Whilst it is recognised that the BTP may bring forward further savings options in future, currently it has not identified sufficient savings to meet projected shortfalls over the next 3 years.</p> <p><i>The Council could still be exposed to financial risk and have limited capacity to deal with unforeseen costs or losses. As savings take time to accrue there is a risk that the Council may need to rely further on its reserves if sufficient savings are not identified and</i></p>	<p>Financial monitoring is in place and effective monitoring and governance is also in place for the Business Transformation Programme. Reserves are at sustainable levels</p> <p>No additional action proposed at this time, however it is recognised that the transformation programme will need to remain flexible and be adapted as the financial position is clarified over the coming months.</p>	Head of Finance and Human Resources	-

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>realised.</i>			
2	63	<p>Corporate Asset Management Plan – detailed functional plans</p> <p>Although the Effective Working in Midlothian Strategy should deal with the property aspects within the wider CoAMP, progressing effective asset management of the other functional areas still requires further attention.</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>A detailed action plan has been prepared. This sets out key actions and milestones required to complete the functional and service AMP's.</p> <p>A report setting out governance structure programme management and resource requirements to implement the cross divisional action plan is being finalised.</p> <p>Approval for this will be sought by year end, and implementation will follow.</p>	Property Strategy Manager	31/12/11
3	67	<p>Procurement</p> <p>It is important that the commitment to improve procurement practices become a reality and planned budget savings are realised.</p> <p><i>If the planned improvements in procurement are not</i></p>	<p>Procurement is a key strand of the Business Transformation Programme and work will continue to improve the procurement function and deliver savings.</p> <p>Action - The next key milestone is the 2011</p>	Procurement Manager	31/12/11

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
		<i>implemented timeously and effectively there is a risk that savings may not materialise.</i>	Procurement Capability Assessment where our aim is to achieve conformance status.		
4	70	<p>People Strategy</p> <p>It is important that focus is maintained on the delivery of the People Strategy Action Plan, and if necessary, the plan revised in response to changing circumstances, over the coming years.</p> <p><i>There is a risk that due to constant upheaval, there could be low morale and a lack of confidence held by staff which could result in resistance against the BTP thus impact, ultimately, on service delivery.</i></p>	<p>The People Strategy has been developed specifically to militate against the risk identified. It has sufficient flexibility built into it to be responsive to changes in national or local circumstances.</p> <p>The People Strategy has an agreed action plan, the implementation of which will be monitored through the existing Business Transformation governance arrangements.</p> <p>No additional action proposed.</p>	Human Resources Advisory Services Manager	-
5	74	<p>IT Structure</p> <p>The effectiveness of the new IT structure, the delivery of its services, adequacy of resources and management of on-going and emerging risks, should be monitored, to ensure it continues to support and deliver all IT</p>	<p>There is no evidence to support the conclusion that there are any greater risks associated with the IT structure than any other aspects of the management review. It has been demonstrated well over the period since the management review,</p>	Head of Customer Services	-

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		<p>activities.</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 revised operational structure is found not to be effective as initially planned.</i></p>	<p>that the current IT management structure works well. The split of duties between the three managerial posts covers everything which needs done and any perceived risk has not materialised. The lead/liaison role that the IT Business Services Manager plays in the senior management team within Customer Services is extremely effective and has been embraced with no difficulty. Other than monthly Performance Management and Risk Review meetings (routinely scheduled in diaries), this needs no further planned management action.</p>		
6	76	<p>Data Handling and Information Security</p> <p>Responsibility to manage and protect information used 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</i></p>	<p>The IT service leads on data handling and information security, providing the necessary documentation, procedures and guidance for staff across all Divisions. IT co-ordinates the Information Management Group at a corporate level and plays an important role</p>	Information Security Officer	31/03/12

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		<i>procedures are not adhered to by all of those involved in processing and managing information. There is also a risk of significant fines if the Information Commissioner concludes there has been a breach of data protection legislation.</i>	in facilitating the Divisional IMG groups too. IT will continue to provide guidance and support to Divisions, and to lead on the preparation of the Information Management Action Plan for 2012/13 (current plan is only for 2011/12).		
7	81	Shared Services It is important that opportunities to share services continue to be rigorously reviewed to identify costs, savings and service efficiencies. It is also important to ensure that the governance arrangements around such complex projects remain fit for purpose. <i>There is a risk that opportunities are missed or efforts misdirected thus postponing realisation of savings and/or service efficiencies.</i>	The Outline Business Case prepared for June 2011 has been reviewed and a Joint Business Case is currently being developed with an associated joint report to be considered by both East Lothian and Midlothian Councils in November 2011. A Joint Project Team was formed in June 2011 and has worked under the joint leadership of both Directors of Education from each Council. The Business case will present a clear rationale for governance options, with outcomes, anticipated impact statements and a	Director Education and Children's Services	30/11/11

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			planned approach with timescale for next steps.		
8	89	<p>Audit Committee - Elected Member Training</p> <p>Training and development opportunities enhance the effectiveness of the Audit Committee. This will be particularly important after the local government election in May 2012.</p> <p><i>There is a risk that the effectiveness of the Audit Committee may diminish if training and development opportunities are not in place, especially for new members.</i></p>	<p>Elected Member learning and development was reviewed in October 2011 and a revised programme is to be presented to Council in November. This comprehensive programme includes Audit Committee training. The programme also recognises the importance of learning and development post-elections, for which a programme is being developed.</p>	Risk and Audit Manager	30/11/11
9	104	<p>Internal Control – in times of change and staff reductions</p> <p>It is important that management including each Head of Service, maintain vigilance around the effectiveness of the control environment within their remit, and ensure appropriate controls are operating to minimise the risk financial loss and fraud.</p> <p><i>The significant</i></p>	<p>Meetings are scheduled in Quarter 3 with Heads of Service to discuss any internal control, risk and governance concerns.</p> <p>There will be a focus on potential fraud, waste and error, a composite risk which is registered in every unit risk register.</p> <p>The Internal Audit Plan continues to cover the main financial and IT</p>	Risk and Audit Manager	31/12/11

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		changes which the Council has been and will continue to experience, increases the risk that internal control could be compromised.	system where residual risk could exist.		
10	121	<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 and savings expected of the BTP are actually delivered in a timely manner.</p> <p><i>If the BTP does not deliver the anticipated savings, the Council may have to consider other alternative measures which enable it to deliver services with reduced resources.</i></p>	<p>We are continuing to monitor and evaluate and drive the Business Transformation Programme through the existing governance arrangements.</p> <p>BTP risk registers are in place, are subject to regular review and risk is being reported accordingly.</p> <p>Council has recently appointed a Business Transformation Programme Manager to strengthen our capacity to deliver.</p>	Business Transformation Programme Manager	-