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Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee

Annual audit report to Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee and the Controller of Audit

Year ended 31 March 2012

21 September 2012

Contents

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About this report

This report has been prepared in accordance with the responsibilities set out within the Audit Scotland's *Code of Audit Practice* ("the *Code*").

This report is for the benefit of Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee and is made available to Audit Scotland and the Accounts Commission for Scotland (together "the beneficiaries"), and has been released to the beneficiaries on the basis that wider disclosure is permitted for information purposes, but that we have not taken account of the wider requirements or circumstances of anyone other than the beneficiaries.

Nothing in this report constitutes an opinion on a valuation or legal advice.

We have not verified the reliability or accuracy of any information obtained in the course of our work, other than in the limited circumstances set out in the scope and objectives section of this report.

This report is not suitable to be relied on by any party wishing to acquire rights against KPMG LLP (other than the beneficiaries) for any purpose or in any context. Any party other than the beneficiaries that obtains access to this report or a copy and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, KPMG LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the beneficiaries.

We also draw your attention to the following:

- management of Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee are responsible for preparing financial statements that show a true and fair view and for implementing appropriate internal control systems;
- weaknesses or risks identified by us are only those which have come to our attention during our normal audit work in accordance with the Code, and may not be all that exist; and
- communication by us of matters arising from the audit of the financial statements or of risks or weaknesses does not absolve Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee management from its responsibility to address the issues raised and to maintain an adequate system of control.

Executive summary

The financial and operating environment in which the Partnership operates continues to change, particularly in respect of subway modernisation, restructuring, and changes in respect of revenue and capital funding. These changes will result in new and emerging financial and non-financial risks.

We have completed our audit for 2011-12 and have issued unqualified opinions on the financial statements of both Strathclyde Partnership for Transport ("SPT") and Strathclyde Concessionary Travel Scheme Joint Committee ("SCTSJC") , together for the purposes of this report, "the Partnership".

The Partnership produced financial statements in line with the agreed timetable. The quality of information provided by the finance team was good and the process for the preparation of the financial statements has improved compared to 2010-11. Our report to those charged with governance includes minor recommendations to further improve the efficiency of the financial statement preparation process.

SPT prepared a balanced revenue budget for 2011-12 which forecast expenditure of £38.5 million, funded by £37.4 million of receipts from constituent local authorities, £0.9 million Scottish Government grant funding and use of £0.3 million of reserves. Revenue expenditure was below budget, particularly in respect of salary costs and payments to third parties which, together with increased income, facilitated an additional contribution to the subway modernisation fund from a budget of £9.4 million to £14 million.

Capital expenditure was £25.8 million, against a revised budget of £29.3 million (original budget £26.7 million). The majority of expenditure was incurred during February and March 2012. Capital expenditure was mainly funded by Scottish Government grant of £25.5 million, with the remaining expenditure of £0.2 million met from current revenue resources. In March 2012, the Partnership received an additional £15 million capital funding from the Scottish Government which was not utilised as at 31 March 2012.

At the strategy and programme committee meeting on the 27 January 2012 it was proposed that the level of requisition from the 12 funding authorities should be maintained in cash terms over the next two financial years at a base of £37.4 million (the same as the 2011-12 level).

A core revenue budget of £38.5 million has been set for 2012-13 (2011-12: £38.5 million). Scottish Government funding has marginally increased to £1 million (2011-12: £0.9 million).

In producing the 2012-13 budget, the Partnership has taken account of the need to deliver services in line with the approved regional transport strategy, ensuring delivery of the functions and duties of the organisation as well as the affordability of plans to the funding bodies.

As part of its longer term strategy, SPT endorsed the 'modernisation case' as the best way forward for subway modernisation and agreed to prioritise the modernisation of working practices and employee relations as key to delivering this program. The Scottish Government approved the business case in January 2012 and on 26 March 2012, announced that they fully supported the subway modernisation project. This was confirmed in writing on 2 May 2012.

The total planned subway modernisation programme cost is £287.5 million, of which £246 million will be funded by the Scottish Government with the balance met by drawing on the subway modernisation fund (created through current and future revenue savings).

SPT is currently undertaking a tender process for the provision of new trains and system improvements. SPT has employed an external contractor to support the tender process through a series of gateway reviews.

Enhancement works at Hillhead station are largely complete, with additional capital projects across the network planned to progress in 2012-13. It is important that, going forward, management draws on lessons learned from the initial works and apply these to subsequent elements of the project. An overall project board, project delivery group, risk registers and work streams have been established to support effective project governance.

Executive summary (continued)

The staff restructuring programme was ongoing through 2011-12 with proposals for the restructuring of subway services to be phased over the next two years. The trade unions have recently agreed to the subway restructuring plans and proposed revisions to existing terms and conditions of service, including shift working patterns, which were important to ensure continued achievement of the subway modernisation programme on time and within budget.

SPT has formed a joint venture (with Nevis Technologies Limited) which is expected to deliver a cashless, multi-modal, multi-operator transport card which will initially be used on the Glasgow subway. The total project cost is expected to be around £1.1 million. We have highlighted key accounting judgements that need to be considered as the level of activity within the joint venture increases, together with the need to consider the preparation of group financial statements in future years.

Internal audit's annual report, states that, *'reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's internal control systems in the year to 31 March 2012'.*

Overall, our testing, combined with that of internal audit, over the design and operation of controls over significant risk points confirms that, with the exception of the weaknesses highlighted, controls are designed appropriately and operating effectively.

A review of the internal audit team resources was reported to the personnel committee in March 2012. It concluded that risk management should form a more integral part of the internal audit function's role, that the annual audit plan should be more risk based, and that an additional fixed term post should be created to support the business improvement manager role. A new internal audit structure is now in place, with the appointment of a new audit and risk manager and senior internal auditor complete.

Headlines

Our audit work is undertaken in accordance with Audit Scotland's *Code of Audit Practise* ("the *Code*"). This specifies a number of objectives for our audit.

We reported, in our audit strategy, our responsibilities in respect of the audit. The Partnership's responsibilities are set out in appendix two.

This report summarises our work for the year ended 31 March 2012.

We wish to record our appreciation of the continued co-operation and assistance extended to us by Partnership staff during the course of our work.

Financial statements	
Draft financial statements were provided on 6 June 2012, in line with the agreed timetable. The draft financial statements were of a good standard. We have issued unqualified audit opinions on the 2011-12 financial statements.	-
Use of resources	
The Partnership achieved a breakeven position at year end, after allocating £14 million of requisition income to future subway modernisation. The overall contribution to the subway modernisation fund was £4.6 million higher than the original budget as a result of revenue savings and additional income achieved during 2011-12.	Page 5
SPT met its financial targets through effective financial planning and management throughout the year.	Page 5
The 2012-13 budget forecasts a breakeven position, including a further contribution to the subway modernisation fund of £7.9 million.	Page 7
Performance management	
We have considered SPT's response to Audit Scotland's national report *Scotland's public finances: responding to the challenge* and have prepared a short return to Audit Scotland which confirms that management has appropriately considered the report's findings and recommendations.	Page 15
Governance	
Following local government elections, there have been revisions to the membership of the Partnership and its committees. The governance statement continues to confirm the existence of a comprehensive framework of internal control.	Page 16
Arrangements to prevent and detect fraud are embedded in internal controls, including processes to comply with requirements in respect of the National Fraud Initiative.	Page 17
Internal audit completed their plan and did not report any significant risk recommendations during the year.	Page 17
Mandatory communications	
We are required by ethical standards to formally confirm our independence you. We draw your attention to the responsibilities of the Partnership under Audit Scotland's *Code of Audit Practice*.	Appendices two and three

Financial position

SPT achieved a breakeven position after allocating £14 million of income to the subway modernisation fund.

SPT met its financial targets through effective financial planning and management. An additional contribution, over and above the original budgeted level, of £4.6 million was made to the subway modernisation fund as a result of reductions in expenditure and additional income.

Financial position

The original 2011-12 budget forecast a breakeven position; the core revenue expenditure budget was £38.5 million. Of this, £37.4 million was financed through requisition from constituent local authorities, together with £0.9 million funded by the Scottish Government and use of reserves of £0.3 million.

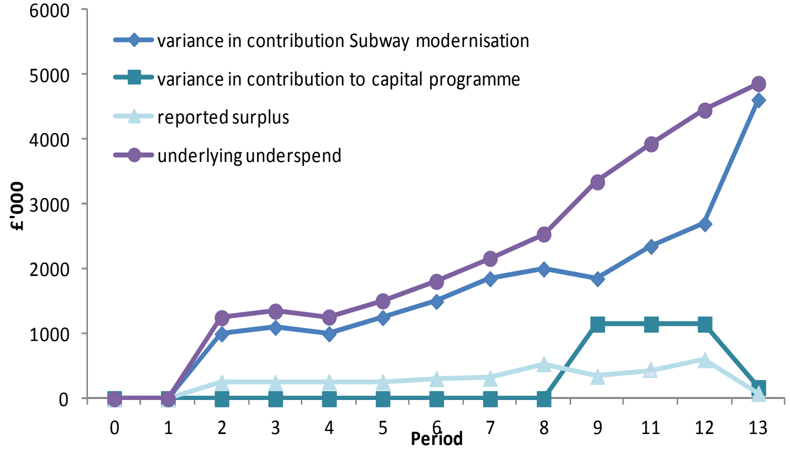
Requisitions from the constituent local authorities was in line with budget. Expenditure was below budget in a number of areas including salaries (£1.9 million), property costs (£0.5 million), supplies and services (£0.5 million), third party payments (£2.3 million). These savings were also supported by increases in subway income (£0.8 million), bus station income (£0.5 million) and bank interest (£0.3 million). Savings arose as a result of staff restructuring, management of bus operator payments and close control of all expenditure lines. These were offset by increase in other employee costs (£1.8 million), as a result of a provision for future staff restructuring and an increased contribution to the subway modernisation fund (£4.6 million).

Forecast outturn for the year ended 31 March 2012	£'000
Budget outturn	**0**
Salaries	1,878
Other employee costs	(1,844)
Property costs	453
Supplies and services	520
Transport and plant costs	(37)
Third party payments	2,321
Contribution to capital financed from revenue	(171)
Contribution to subway modernisation	(4,612)
Additional income	1,575
Surplus forecast as at 31 March 2012	83

The original budget, approved by the partnership, included a forecast contribution to the subway modernisation fund of £9.4 million. As a result of the revenue savings and additional income which arose during 2011-12, an additional contribution of £4.6 million was made to the subway modernisation fund to bring the total amount to £14 million.

At period nine, revenue savings of £1.2 million were approved for use as a contribution to the capital programme which reflected the pressure on the programme and non-subway capital expenditure. Due to slippage in the capital programme, as at 31 March 2012 £1 million was reallocated to the subway modernisation fund.

The graph below shows the forecast contribution to the subway modernisation fund as reported by management throughout the year. The increase in subway modernisation fund contribution reflects the continuing funding programme as detailed in the subway modernisation outline business case. The business case details the requirement to contribute revenue savings to assist in the overall funding package throughout the life of the project.



Financial position (continued)

Capital programme

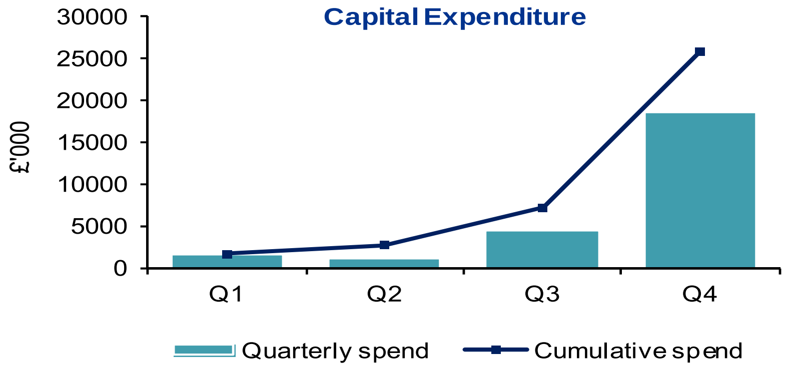
Total expenditure in support of the capital programme was £25.8 million against an initial budget of £26.7 million, approved by the partnership on 11 April 2011. This original budget was revised during the year to £29.3 million.

A number of projects were carried forward into 2012-13. The capital programme was mainly funded by known Scottish Government grant funding (£20.5 million), together with an additional allocation from the Scottish Government of £5 million and £0.2 million being funded from current revenue resource.

SPT incurred significant expenditure on local authority projects and grants (£16.5 million), with £4.1 million of these project grants approved at the March 2012 strategy and programmes meeting and subsequent partnership meeting on 30 March 2012. Due to the timing of the awards, there were some instances in which grant letters were not signed and issued to the local authorities until after the year end.

Recommendation one

The profile of capital expenditure is shown below:



Despite a focus on capital programme monitoring throughout the year, a significant element of the capital grant allocation for 2011-12 was incurred in February and March 2012 (£14.6 million; 56.6%).

SPT has commenced the subway modernisation programme which includes significant capital expenditure. Management should ensure that sufficient focus and resources continue to be applied to capital planning and spending throughout 2012-13 to mitigate the risk of a similar spend profile in 2013-14, which could have a significant impact on SPT's ability to meet their challenging capital programme targets.

Recommendation two

Financial planning

The 2012-13 budget forecasts a breakeven position. With further contributions to the subway modernisation fund of £7.9 million.

Revenue budget

A revenue budget of £38.5 million for 2012-13 was agreed at the partnership meeting on 27 January 2012. Similar to prior years, performance is monitored regularly by the strategy and programmes committee, with reports also presented to partnership meetings. This budget was set on the basis that the level of requisition from the constituent local authorities will be maintained, in cash terms, and takes account of a marginal increase in Scottish Government funding. A summary of the main variances is shown below.

Management recognise that there is a need to support the capital programme as a whole in 2012-13, beyond the subway modernisation programme, providing support to projects across various modes of transport and locations. The 2012-13 budget includes a forecast £2 million contribution to capital, funded from revenue resources.

Caption	Budget 2012-13 (£'000)	Budget 2011-12 (£'000)	Variance (£'000)
Chief executive	1,197	1,118	53
Operations	20,718	21,535	(528)
Corporate	2,073	1,767	231
Business support	4,547	4,682	(320)
Contribution to subway modernisation fund	7,883	9,430	(1,547)
Contribution to capital funded from revenue	2,000	0	2,000
Net expenditure	**38,418**	**38,532**	**(114)**
Requisitions	(37,381)	(37,381)	0
Revenue grant	(1,037)	(933)	104
Reserves	0	(218)	(218)
Funding	**38,418**	**38,532**	**(114)**
(Surplus) / deficit	**-**	**-**	**-**
Inclusive of contribution to subway modernisations (underspend)		**7,883**	**9,430**

Financial planning (continued)

The 2012-13 capital budget forecasts a shortfall position of £14.3 million. With plans to utilise the subway modernisation fund and / or borrowing.

Capital budget

SPT regularly plans a higher level of capital expenditure as a number of projects will be subject to in-year delays and slippage. The 2012-13 capital budget, approved on 30 March 2012, includes £38 million of high priority projects. Indicative budgets include amounts planned in respect of the subway modernisation programme and the Fastlink programme.

Capital budget	2012-13 £'000	2013-14 £'000	2014-15 £'000
Capital budget (high priority projects)	37,920	87,559	58,349
Funded by:			
Scottish Government capital grant	10,692	9,337	16,524
Subway modernisation funding	6,000	6,000	6,000
Fastlink funding	5,000	20,000	10,000
Capital funded from revenue	2,000	2,500	0
Shortfall	**14,228**	**49,722**	**25,825**

Funding available in 2012-13 is £16.7 million, inclusive of £6 million earmarked for subway modernisation. An additional £5 million will be made available to support Fastlink, to reflect the arrangement agreed with the Scottish Government in 2011-12 to use £5 million of general capital funding to support the Fastlink project.

The core capital grant award from the Scottish Government includes amounts ring-fenced for subway modernisation and Fastlink and it is important that management continues to monitor capital expenditure against these projects as part of their monthly monitoring to ensure the terms of the capital grant are met.

As the level of capital grant available to SPT is reducing considerably over 2012-13 and 2013-14, SPT proposes using savings arising from the revenue budget to support capital expenditure on non-subway related transport projects.

A significant element of the remaining shortfall will be met through utilisation of the subway modernisation fund, or borrowing to support subway modernisation plans. This is consistent with discussions ongoing with the Scottish Government. The capital plans provide a guide to the borrowing needs to ensure SPT can meet its capital spending obligations.

The treasury management function ensures that the Partnership's cash is managed in accordance with the relevant professional codes, so that sufficient cash is available to meet service needs. The trend observed in 2011-12 of incurring significant capital expenditure in the last two months of the financial year creates a risk that management will not achieve the planned outturn and that SPT fails to organise the required borrowing facilities or borrows more than their capital financing requirement.

Recommendation two

Delivery of savings

Delivery of saving plans

SPT previously considered the need to deliver savings in anticipation of a reduction in available funding over the last two years of 19% to £38.5 million in 2011-12 (2009-10: £47.6 million). SPT's initial savings plan highlighted the need to deliver savings across the organisation to meet reduced cash levels, while maintaining services.

The savings delivered in 2011-12 were reported at the strategy and programmes committee in January 2012 and are shown in the table below:

Description	Amount (£'000)	% reduction
Staff costs	1,600	6.3
Other business support costs	500	12
Subway maintenance	150	6
Property costs	140	6
Supplies and services	1,000	33
	3,390	

During the last two years, consistent with the subway modernisation business case, it was necessary to generate savings to maintain front line services and at the same time contribute to the subway modernisation fund to avoid incurring substantial debt in the future.

Cumulative savings, achieved over the past two years against the savings and efficiency plan, have not been fully reported to the strategy and programmes committee. It is recommended that SPT enhances the reporting and monitoring of the delivery of savings, to mitigate the risk that planned savings are not realised and recurring savings are not achieved on a recurring basis.

Recommendation three

Audit focus areas

Risks were identified around subway modernisation; accounting for reserves; non-current assets; balance sheet ; Nevis Technologies Limited; capital funding; and changes to the Code 2011-12.

An audit adjustment in respect of non-current assets, associated with the subway modernisation programme was required. An impairment charge of £1.4 million was recognised in the comprehensive income and expenditure statement.

Issue	Key risk and implications	KPMG comment
Subway modernisation	The partnership endorsed the 'modernisation case' as the best way forward in respect of the requirement to significantly upgrade the subway system. The final business case was presented to the Scottish Government in January 2012. The overall programme is underpinned by five workstreams comprising; rolling stock and signalling, infrastructure, ticketing, stations and human resources. SPT is currently undertaking a tender process for the provision of new trains and system improvements. Capital work has commenced at Hillhead station with additional capital projects across the network planned.	As part of our interim fieldwork, we obtained a copy of the final business case which was submitted to the Scottish Government and considered its contents to further inform our understanding of SPT's proposals. We met with senior members of staff involved in leading the project to understand the project governance arrangements. A project board, risk register and workstreams have been developed. SPT's revenue budget includes an amount to be set aside each year for subway modernisation (funding) and the capital plan includes a number of subway modernisation projects. Expenditure in respect of the subway modernisation project is rising quickly. There are a number of financial and non-financial risks and challenges which will continue to emerge, such as those associated with tendering significant capital projects. Project and programme risk registers have been developed, to capture financial and non-financial risks, and where appropriate, risks are captured in the corporate risk register. The main risks identified are: speed of external communication; complying with disability legislation and project delivery within the specified timelines. All risks are allocated to a responsible officer. During 2011-12, expenditure of £2.1 million was incurred in respect of enhancements at Hillhead station and preparatory work for other stations as part of the subway modernisation programme. Following discussions with management, it was agreed that an impairment of £1.5 million should be recognised against the related assets as the value of the station was not expected to increase by £2.1 million. Management has already undertaken reviews to indentify lessons in respect of various stages of initial projects. It is important that management learn from initial subway modernisation projects, such as the enhancement of Hillhead station and that a formal valuation of the station is obtained once the enhancements are complete. ***Recommendation four***

Audit focus areas (continued)

Issue	Key risk and implications	KPMG comment
Accounting for reserves	Section 3 of the Transport Scotland (Act) 2005 requires that, similar to other Regional Transport Authorities, constituent local authorities meet only the Partnership's net expenses (i.e. the expenses for the year not met by grant or other income) for each financial year. Audit Scotland has confirmed that they do not believe the Partnership has the powers to make in year surpluses and hence increase reserves. In 2010-11 SPT requisitioned £38.458 million from the 12 local authority partners. Only £33.593 million was recognised in the comprehensive income and expenditure statement. The remaining balance, £4.865 million, was recognised as deferred income. For the year ended 31 March 2012 SPT forecast a significant additional contribution to the subway modernisation fund, in addition to that planned when the initial budget was set.	At the date of our report there has been no change in the legislative position. We will continue to work with management We reviewed management's treatment of revenue and capital under spend and ensured the current accounting treatment was in compliance with the statutory requirements and the Code. We have advised management that they must continue to obtain confirmations from the constituent local authorities in respect of the accumulated deferred income balance.

Audit focus areas (continued)

Issue	Key risk and implications	KPMG comment
Non-current assets – investment property revaluation	Property market conditions mean that SPT's investment properties may continue to be subject to fluctuations in value. We are also aware of a number of changes in let property tenancies and rent reviews.	During 2011-12, a portion of SPT's offices at Consort House were let to a third party and the related asset was transferred from operation land and buildings to investment property. As part of our final audit procedures, we performed additional testing and discussed the basis of the valuation with the internal valuer. In respect of investment property valuations we concluded the values were appropriate.
Non-current assets – revaluation reserve	In 2011-12 management implemented a new asset management module which includes the ability to record original asset cost, current asset value and the impact of valuations in intervening periods, together with associated reserve balances.	We suggested to management a number of matters that should be clarified in implementing the system by year end; including which asset values should be recorded and tests which should be completed before relying on the system. We reviewed the year end adjustments to the revaluation reserve and concluded the treatment applied by management was in compliance with statutory requirements and the Code.
Nevis Technologies Limited	Following agreement by the partnership in April 2011, a company was established in October 2011. SPT has subscribed to 4,999 shares in the company at a cost of £4,999 and the commercial partner has subscribed to the remaining 5,001 shares.	We reviewed expenditure by SPT in respect of transactions with the company which amounted to £305,000 in 2011-12 and confirmed that these were the company's only transactions. On this basis, we have agreed with management's view that the entity is not material to SPT's financial statements and consequently, it has not been consolidated in the 2011-12 financial statements. It is recommended that management consider the impact that the joint venture will have on the preparation of the 2012-13 financial statements, including a review of the relevant accounting standards, consideration of the basis of consolidation and any accounting adjustments which will be required, together with the revisions to the format of the financial statements necessary in 2013-14. ***Recommendation five***

Audit focus areas (continued)

Issue	Key risk and implications	KPMG comment
Code 2011-12	The Partnership is required to prepare financial statements in accordance with the Code. The Code 2011-12 has been updated and a number of changes that will require to be considered by management for any impact on the reporting requirements and financial statements	We discussed changes to the Code with management. The main changes impacting the financial statements were: ▪ applicability of FRS 30 *Heritage Assets;* ▪ additional guidance added in respect of leases; ▪ new disclosure requirement in respect of exit packages; and ▪ new requirement for a specific statement in the annual governance statement / statement on the system of internal financial control on whether financial management arrangements conform with the governance requirements of the statement on "the role of the chief financial officer in local government." During our final financial statement audit, we confirmed that these changes had been appropriately applied to the annual report and financial statements. Following completion of the Code disclosure checklist and consideration of Audit Scotland 's Notes for Guidance, we recommended some minor enhancements to financial statement disclosures.
Balance sheet	As part of our audit of the 2010-11 financial statements we identified a number of audit adjustments to the balance sheet captions, where reclassification of balances was required.	As part of our final audit fieldwork, we performed additional testing of accounts receivable, accounts payable and accruals and prepayments. We did not identify any audit adjustments as a result of the additional testing carried out.

Audit focus areas (continued)

Issue	Key risk and implications	KPMG comment
Capital funding	The 2011-12 capital budget was approved by the partnership in April 2011, against known capital grant funding of £20.5 million from the Scottish Government. This included a ring-fenced amount of £6 million to support subway modernisation. The Scottish Government awarded SPT an additional £5 million in capital funding during 2011-12. This funding was used to accelerated projects which were proposed as part of the 2012-13 capital plan, such as park and ride schemes. An additional £15 million was awarded by the Scottish Government to SPT on the 30 March 2012. This funding is to be used for the project as outlined in the final business case for subway modernisation.	The additional £5 million capital funding allocated in respect of 2011-12 is part of an overall funding package of £40 million, which will be phased over the next four financial years to fund the Fastlink project. As significant works on Fastlink are not programmed to start until 2012-13, SPT notes that the Scottish Government has agreed that the 2011-12 allocation can be treated as a general capital grant. This permission is given on the condition that an additional £5 million is used on Fastlink in future years from SPT's general grant allocation. The additional £15 million capital funding allocated in respect of 2011-12 is part of the overall funding package of £248 million, to fund subway modernisation. As the grant was received on the 30 March 2012 the unspent amount is carried forward as an advance of the total funding to be applied in future periods. As part of our final audit procedures we carried out detailed testing to ensure that the terms and conditions associated with capital funding were met and concluded that accounting treatment applied by management was in compliance with the Code.

Audit Scotland national reports

As part of our annual audit process, we consider the Partnership's arrangements in respect of performance management and response to national studies.

Audit area	Overview	Findings
Local response to national studies	The Accounts Commission for Scotland and Audit Scotland periodically undertakes national studies on topics relevant to the performance of local government bodies. To ensure that added value is secured through the role of the Accounts Commission for Scotland, Audit Scotland and its appointed auditors, auditors will continue to ensure that audited bodies respond appropriately to national performance audits.	We have considered the SPT's response to the national report *Scotland's public finances: responding to the challenge* and have prepared a short return to Audit Scotland which confirms that management considered the report's findings and recommendations.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance and internal control arrangements	The Partnership maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour. Although there has been no changes in the overall governance framework, there have been a number of changes in partnership composition during the year. The 31 May 2012 partnership meeting provided members with details of plans for member induction and training relevant to the work, role and responsibilities of the Partnership. Members were invited to consider the proposed training plan and identify any additional areas they considered would assist them. In their *Overview of local government in Scotland*, published in March 2012, the Accounts Commission included a checklist for new and returning elected members to use to assess their own understanding and training needs which could be used as a tool to inform training needs or review the effectiveness of the Partnership's arrangements. ***Recommendation six*** Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls are designed appropriately and operating effectively. However, during our interim and final reviews, we noted that minor weaknesses exist and recommendations have been agreed with management to address these matters.
Governance statement	The governance statement provides details of the purpose of the framework of internal control, along with an analysis of its effectiveness. It describes a number of sources of assurance for the accountable officer and identifies areas for improvements to be focussed in the future. We have reviewed the governance statement and have confirmed that it is in line with guidance and reflects our understanding of the Partnership
Remuneration report	Scottish Statutory Instrument 2011 number 64, *The Local Authority Accounts (Scotland) Amendment Regulations 2011 amended the Local Authority Accounts (Scotland) Regulations 1985* added the requirement for local authority bodies to prepare a remuneration report. The Local Government Finance Circular number 8/2011, issued by the Scottish Government, provides guidance that the remuneration report is a statement in its own right and not a note to the financial statements. While there is no statutory prescription on its placement in the financial statements, it suggests a suitable placement would be after the governance statement. SPT continues to include the remuneration report after the primary statements and notes, at the back of the financial statements. While not out of line with some other local authorities, it is inconsistent with our experience of good practice in other sectors and the Scottish Government guidance. ***Recommendation seven***

Corporate governance framework and supporting arrangements (continued)

Prevention and detection of fraud	Procedures and controls related to fraud are designed and implemented effectively. The Partnership has appropriate arrangements to prevent and detect fraud, inappropriate conduct and corruption, including policies and codes of conduct for staff and partnership members. These are supported by a fraud prevention policy and response plan. Management has confirmed that no significant fraud or irregularities have been identified during the year.
Internal audit	As set out in our audit plan and strategy, we have evaluated the work of internal audit and concluded that we can rely, where appropriate, on their work. The content of the internal audit plan is in line with our expectations. We have reviewed internal audit's files and placed reliance on a number of reports, including those in respect of tendering, subway ticketing income and expenses. These reports do not make any 'critical' recommendations, but the subway ticketing income report and the tendering report highlighted a number of control weaknesses and made a number of recommendations. Internal audit has reported that *"in our opinion the Partnership has a framework of controls in place that provides reasonable assurance regarding the effective and efficient achievement of the organisation's objectives and key risks. Proper arrangements are in place, in the areas we have reviewed, to promote value for money, deliver best value and secure regularity and propriety in the administration and operation of the organisation."* A review of the internal audit team resources was reported to the personnel committee in March 2012. It concluded that risk management should form a more integral part of the internal audit function's role, that the annual audit plan should be more risk based, and that an additional fixed term post should be created to support the business improvement manager role. A new internal audit structure is now in place, with the appointment of a new audit and risk manager and senior internal auditor.

Appendices

Action plan

The action plan summarises specific recommendations, together with related risks and management's responses.

Priority rating for recommendations		
Grade one (significant) observations are those relating to business issues, high level or other important internal controls. These are significant matters relating to factors critical to the success of the organisation or systems under consideration. The weaknesses may therefore give rise to loss or error.	**Grade two** (material) observations are those on less important control systems, one-off items subsequently corrected, improvements to the efficiency and effectiveness of controls and items which may be significant in the future. The weakness is not necessarily great, but the risk of error would be significantly reduced if it were rectified.	**Grade three** (minor) observations are those recommendations to improve the efficiency and effectiveness of controls and recommendations which would assist us as auditors. The weakness does not appear to affect the availability of the control to meet their objectives in any significant way. These are less significant observations than grades one or two, but we still consider they merit attention.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
1 Awarding capital grants		**Grade three**
SPT incurred significant expenditure on local authority projects and grants (£16.5 million), with £4.1 million (30.7%) of these project grants approved at the March 2012 strategy and programmes meeting and subsequent partnership meeting on 30 March 2012. Due to the timing of the awards, there were some instances in which grant letters were not signed and sent to the local authorities until after the year end.	We recommend that in future years all grant letters are signed and issued to local authorities on a timely basis and well in advance of the year end.	Agreed. **Responsible officer:** Director of Finance & HR, Director of Projects, Senior Legal Advisor **Implementation date:** Immediate

Action plan (continued)

The action plan summarises specific recommendations, together with related risks and management's responses.

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
2 Capital planning		**Grade two**
Due to delays in approval of local authority capital projects, SPT utilised the capital grant allocation in 2011-12 through significant (£14.6 million, 56.6%) expenditure in February and March 2012.	It is recommended that continued focus and resources are applied to capital planning and spending throughout 2012-13 to mitigate the risk of a similar spend profile in 2013-14, which could have a significant impact on SPT's ability to meet their challenging capital programme targets and undermine effective treasury management.	Agreed. **Responsible officer:** Director of Finance & HR, Director of Projects **Implementation date:** Immediate
3 Efficiency savings		**Grade two**
Cumulative savings, achieved over the past two years against the savings and efficiency plan, have not been fully reported to the strategy and programmes committee. It is recommended that SPT enhances the reporting and monitoring of the delivery of savings, to mitigate the risk that planned savings are not realised and recurring savings are not achieved on a recurring basis.	It is recommended that SPT continues to report and monitor the delivery of all savings to date, against the original efficiency plan, to mitigate the risk that planned savings are not realised and recurring savings are not achieved on a recurring basis.	Agreed, savings achieved to date will be reported as part of the budget setting process for 2013-14. **Responsible officer:** Director of Finance & HR **Implementation date:** 28 February 2013

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
4 Subway modernisation		**Grade two**
Expenditure in respect of the subway modernisation programme is rising quickly. There are a number of financial and non-financial risks and challenges which will continue to emerge, such as those associated with tendering significant capital projects. During 2011-12, expenditure of £2.1 million was incurred in respect of enhancements at Hillhead station and preparatory work for other stations as part of the subway modernisation programme. Following discussions with management, it was agreed that an impairment of £1.5 million should be recognised against the related asset as the value of the station was not expected to increase by £2.1 million. Management has already undertaken reviews to indentify lessons in respect of various stages of initial projects.	It is recommended that management continue to build on lessons learnt from initial subway modernisation projects through a formal review process following completion of the Hillhead enhancements, including: ■ obtaining a formal valuation of the completed station to inform future impairment decisions; ■ consideration of the threats to project delivery that arose, but were not identified during the initial risk assessment; ■ identification of what went well, and what went not so well; and ■ preparation and distribution of a report of lessons learned, together with an action plan to inform future projects.	Agreed, various reviews and lessons learned have been completed as the Hillhead project progressed, with the results already feeding into other projects. An overall lessons learned will be completed once the project has been signed off. **Responsible officer:** Director of Projects **Implementation date:** 31 March 2013
5 Nevis Technologies Limited		**Grade two**
We reviewed expenditure by SPT in respect of transactions with the Nevis Technologies Limited which was £305,000 in 2011-12 and confirmed that these were the company's only transactions. On this basis, we have agreed with management's view that the entity is not material to SPT's financial statements and was, therefore, not consolidated in the 2011-12 financial statements.	It is recommended that management consider the impact that the joint venture will have on the preparation of the 2012-13 financial statements and review the relevant accounting standards, basis of consolidation, accounting adjustments and the format of the financial statements required in 2013-14.	Agreed, the value of projected transactions for 2012-13 will be reviewed and discussions over materiality will take place with KPMG well in advance of producing the 2012-13 financial statements. **Responsible officer:** Director of Finance & HR **Implementation date:** 31 December 2012

Action plan (continued)

Finding(s) and risk(s)	Recommendation(s)	Agreed management actions
6 New member training		**Grade three**
Although there has been no changes in the overall governance framework, there have been a number of changes in partnership composition during the year. The 31 May 2012 partnership meeting provided members with details of plans for member induction and training relevant to the work, role and responsibilities of the Partnership. Members were invited to consider the proposed training plan and identify any additional areas they considered would assist them.	It is recommended that the new and returning member checklist, included as part of the *Overview of local government in Scotland*, published in March 2012 by the Accounts Commission, is used by members as a tool to inform training needs or review the effectiveness of the Partnership's arrangements. .	Agreed. **Responsible officer:** Assistant Chief Executive (Business Support) **Implementation date:** Immediate
7 Remuneration report		**Grade three**
SPT continues to include the remuneration report after the primary statements and notes, at the end of the financial statements. While not out of line with some other local authorities, it is inconsistent with our experience of good practice in other sectors and the Scottish Government guidance.	It is recommended that SPT considers whether the existing presentation of the remuneration report demonstrates a continued commitment to transparency. Consideration should be given to including it in the financial statements, after the governance statements, as recommended by the Scottish Government.	Agreed, the placement of the remuneration report will be given some consideration. **Responsible officer:** Assistant Chief Executive (Business Support) **Implementation date:** Immediate

Auditor's Independence

We are required by ethical standards to formally confirm our independence you.

There are no specific matters which have impinged on our independence.

Professional ethical standards require us to provide to you at the conclusion of the audit a written disclosure of relationships, (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed. This statement is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence.

We have considered the fees paid to us by the Partnership for professional services provided by us during the reporting period. There were no fees payable other than in respect of our audit.

We are satisfied that our general procedures support our independence and objectivity.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners and staff annually confirm their compliance with our ethics and independence policies and procedures including in particular that they have no prohibited shareholdings. Our ethics and independence policies and procedures are fully consistent with the requirements of the Ethical Standards issued by the UK Auditing Practices Board. As a result we have underlying safeguards in place to maintain independence through:

- instilling professional values;
- communications;
- internal accountability;
- risk management;
- independent reviews.

Please inform us if you would like to discuss any of these aspects of our procedures in more detail. There are no other matters that, in our professional judgement, bear on our independence which need to be disclosed to the Partnership.

Confirmation of audit independence

We confirm that as of 19 September 2012, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of Stephen Reid and audit staff is not impaired.

This report is intended solely for the information of the Partnership and should not be used for any other purposes.

Yours faithfully

KPMG LLP

Audit Scotland code of audit practice – responsibilities of the Partnership

Financial statements

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. Audited bodies are responsible for:

- ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority;
- maintaining proper accounting records;
- preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the relevant financial reporting framework (eg, the Financial Reporting Manual or an Accounting Code of Practice);
- preparing and publishing with their financial statements an annual governance statement, statement on internal control or statement on internal financial control and a remuneration report; and
- preparing consolidation packs and, in larger bodies, preparing a Whole of Government Accounts return.

Systems of internal control

Audited bodies are responsible for developing and implementing systems of internal control, including risk management, financial, operational and compliance controls. They are required to conduct annual reviews of the effectiveness of their governance, systems of internal control, or internal financial control, and report publicly that they have done so. Such reviews should take account of the work of internal audit and be carried out by those charged with governance, usually through bodies' audit committees.

Prevention and detection of fraud and irregularities

Audited bodies are responsible for establishing arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions;
- developing and implementing strategies to prevent and detect fraud and other irregularity;
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity; and
- participating, when required, in data matching exercises carried out by Audit Scotland.

Standards of conduct and arrangements for the prevention and detection of bribery and corruption

Audited bodies are responsible for ensuring that their affairs are managed in accordance with proper standards of conduct and should put proper arrangements in place for:

- implementing and monitoring compliance with appropriate guidance on standards of conduct and codes of conduct for members and officers;
- promoting appropriate values and standards; and
- developing, promoting and monitoring compliance with standing orders and financial instructions.

Audit Scotland code of audit practice – responsibilities of the Partnership (continued)

Financial position

Audited bodies are responsible for conducting their affairs and for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:

- such financial monitoring and reporting arrangements as may be specified;
- compliance with any statutory financial requirements and achievement of financial targets;
- balances and reserves, including strategies about levels and future use; and
- the impact of planned future policies and foreseeable developments on their financial position.

Best Value

Achievement of Best Value or value for money depends on the existence of sound management arrangements for services, including procedures for planning, appraisal, authorisation and control, accountability and evaluation of the use of resources. Audited bodies are responsible for ensuring that these matters are given due priority and resources, and that proper procedures are established and operate satisfactorily.

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