



*cutting through complexity*

# Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee

Annual audit report

Audit: year ended 31 March 2013

23 September 2013

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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 ("SPT") and Strathclyde Concessionary Travel Scheme Joint Committee ("SCTSCJC"), and is made available to Audit 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.

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

**In accordance with ISA (UK and Ireland) 260: Communication with those charged with governance, this report summarises our work in relation to the financial statements for the year ended 31 March 2013.**

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

We have completed our audit for 2012-13 of both Strathclyde Partnership for Transport ("SPT") and Strathclyde Concessionary Travel Scheme Joint Committee ("SCTSJC"), together for the purposes of this report, "the Partnership".

Area	Summary observations	Analysis
<b>Service overview</b>		
<b>Business issues and update</b>	<p>The total planned subway modernisation programme cost is approximately £290 million, of which up to £246 million will be funded by the Scottish Government. The contribution by SPT to the subway modernisation fund for 2012-13 was £8.1 million, an increase of £0.2 million from the original budget, but £1.8 million less than forecast at December 2012.</p> <p>In 2012-13 the total expenditure on subway modernisation projects was £14.4 million compared with a budgeted spend of £15.4 million.</p> <p>Hillhead station's value was impaired by £0.6 million following valuation and management have used the District Valuer's valuation to estimate percentage impairments to be recognised at other stations in respect of subway modernisation expenditure. An impairment of £1.1 million is reflected in the 2012-13 financial statements in this respect.</p>	Pages 5 to 6
<b>Financial position</b>	<p>SPT achieved a breakeven position after allocating £8.1 million of income to the subway modernisation fund. An underlying underspend of £5.8 million against the original budget arose during 2012-13, of which £3.3 million was contributed to the pension fund in respect of existing obligations, £2.2 million was used to support capital expenditure and £0.2 million was added to the subway modernisation fund. SPT met its financial targets through effective financial planning and management.</p> <p>As at 31 March 2013 the Partnership had liquid cash balances of £60.8 million. A continued focus on cash flow management and treasury management arrangements is important to ensure security of balances is managed against opportunities for investment.</p> <p>Total expenditure in support of the capital programme was £30.2 million against an initial budget of £37.9 million. The main variance is a £4.3 million underspend to date in respect of the rephasing of the fastlink project.</p> <p>The 2013-14 budget forecasts a breakeven position, with further contributions to the subway modernisation fund of £7.8 million. The 2013-14 capital budget of £45.7 million includes planned over programming of £10 million.</p>	Pages 7 to 11

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Area	Summary observations	Analysis
<b>Performance Management</b>		
Performance management	<p>Internal audit are completing follow up reviews in respect of three Audit Scotland national reports.</p> <p>During 2012-13 we have performed follow-up work in relation to the Audit Scotland national report: Scotland's public finances: Addressing the challenges.</p> <p>Financial monitoring reports are detailed and include comparison of forecast outturn against the original or revised budget, as appropriate.</p>	Page 13
<b>Governance and narrative reporting</b>		
Governance	Over-arching and supporting corporate governance arrangements provide an appropriate framework for organisational decision-making. During 2012-13, a revised audit and assurance structure was implemented.	Page 15
Control observations	Our testing, combined with that of internal audit, of the design and operation of financial controls over significant risk points confirms that controls, in the main, are operating effectively. Four minor control weaknesses were reported in our interim report with appropriate recommendations agreed with management.	Page 15
<b>Financial statements and accounting</b>		
Accounting policies	<p>There have been no significant changes to accounting policies in 2012-13. The impact of adopted IAS 19 (revised), effective next year, has been considered and is not expected to have a material impact on the pensions liability. No other newly effective accounting standards are expected to have a material impact on next year's financial statements.</p> <p>We liaised with management in respect of the consideration of impairments related to infrastructure assets, subway stations and buses.</p>	Page 19
Audit conclusions	We have issued unqualified audit opinions on the 2012-13 financial statements for both SPT and SCTSJ. Two audit adjustments were required to SPT's financial statements.	Page 20 Appendix 2
Year-end process	The full financial statements for both SPT and SCTSJ were received by the agreed date and were well supported by high quality working papers.	Page 20

# Service overview

Our perspective on key business issues and the financial position of the Partnership

**The total planned subway modernisation programme cost is approximately £290 million, of which up to £246 million will be funded by the Scottish Government.**

**The contribution by SPT to the subway modernisation fund for 2012-13 was £8.1 million, an increase of £0.2 million from the original budget, but £1.8 million less than forecast at December 2012.**

**In 2012-13 the total expenditure on subway modernisation projects was £14.4 million compared with budgeted expenditure of £15.4 million.**

### Service overview

As part of its longer term strategy, SPT endorsed the 'modernisation case' as the best way forward for subway modernisation and the project is now underway. The total planned subway modernisation programme cost is approximately £290 million, of which up to £246 million will be funded by the Scottish Government with the balance met by drawing on the SPT's subway modernisation fund (created through current and future revenue savings) and/or borrowing.

The 2012-13 original budget included a £7.9 million contribution to the subway modernisation fund and the December 2012 revenue monitoring report confirmed the approval of the strategy and operations committee to contribute a further £2 million to the subway modernisation fund during 2012-13. The contribution to the subway modernisation fund for 2012-13 was £8.1 million, an increase of £0.2 million from the original budget, but £1.8 million less than forecast at December 2012.

In 2012-13 the total expenditure on subway modernisation projects was £14.4 million compared with budgeted expenditure of £15.4 million. There were a number of variances across different components of the project. The largest variance was an underspend to date of £0.4 million in respect of the replacement of the ticketing system.

The overall subway modernisation programme is underpinned by five work streams comprising; rolling stock and signalling, infrastructure, ticketing, stations and human resources. The partnership received a programme update as at 3 June 2013. Key messages from this update were:

- Rolling stock, signalling, control and associated systems are currently progressing through a competitive dialogue procurement process.

- Two of the initial bidders withdrew from the process and while the procurement process remains on schedule, management estimate that a further six to nine months will be required to complete the process. Due to the technical nature of the items being procured the Partnership is currently using two consultants to provide technical advice and expertise.
- The tender for the infrastructure asset renewal was issued during early 2013 but only one tender response was received. It is currently being reviewed and the Partnership is considering an alternative strategy of re-tendering the works based on separate lots. Management expect to incur significant capital expenditure on award of the rolling stock replacement contract and the timing of the decision will have a significant impact on cash flow forecasts.
- In respect of stations, work at Hillhead is complete. Ibrox and Kelvinhall stations are in progress and design work for St Enoch, Buchanan Street and Govan stations is nearing completion. As station work is completed, management will need to continue to consider the value of the station and any indication of impairment, as has been done in respect of Hillhead station.
- Ticketing software development work has been completed as have several stages of initial testing.
- A number of the contracts were awarded in 2012-13 to improve infrastructure and are nearing completion. Subway operations were disrupted between 4 and 8 June 2013 as planned tunnel lining work identified a small area of tunnel which required emergency repairs. Managing the reputational impact from any disruption associated with subway modernisation is important to ensuring its success.

**Hillhead station's value was impaired by £0.6 million following valuation.**

**Management has used the District Valuer's valuation to estimate percentage impairments to be recognised at other stations in respect of subway modernisation expenditure.**

**An impairment of £1.1 million is reflected in the 2012-13 financial statements in this respect.**

As part of the wider programme of activities for subway modernisation, the depot facilities are being upgraded. The contract for the refurbishment of the Broomloan depot was approved by the Partnership on 3 May 2013.

The budget for subway modernisation expenditure in 2013-14 is £11.7 million, of which, £5.7 million will be met from the existing subway modernisation fund. Progress on these projects will be regularly monitored by the strategy and operations committee.

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 in 2011-12 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.

In 2012-13, the District Valuer provided a valuation of the completed station, identifying relative values of respective components which comprise the station asset. This resulted in a further net impairment charge of £0.6 million against the carrying value of the asset in SPT's financial statements.

Management has used the District Valuer's valuation of Hillhead station to estimate potential percentage impairments to be recognised at other stations in respect of individual components of the asset. We have reviewed these impairment charges and are satisfied that they have been calculated on a logical and reasonable basis but they should be reconsidered annually, based on experience in respect of other stations as they are completed. An impairment of £1.1 million is reflected in the 2012-13 financial statements in this respect.

Part of the subway modernisation project includes development of an integrated ticketing system. SPT formed a joint venture, Nevis Technologies Limited, with a technology company 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 and we continue to discuss with management a number of factors for consideration in respect of the associated accounting consequences and highlight key accounting judgements that need to be considered as the level of activity within the joint venture increases. The magnitude of total transactions with the joint venture in 2012-13 was not considered to be material and consequently SPT has not prepared group financial statements.

A review of the internal audit team resources was reported to the personnel committee in March 2012. A revised audit and assurance structure has now been implemented and fully resourced from August 2012. We consider the effectiveness of the internal audit function as part of our general risk assessment of the Partnership. We did not identify any impacts as a result of this restructure that prevented us from relying on internal audit work, as appropriate.

The staff restructuring programme was ongoing in 2012-13. 76 members of staff left the Partnership during 2012-13, of which 41 were in respect of subway staff; staff numbers are expected to remain broadly level in 2013-14.

A review of the approach to subway maintenance is being completed to introduce a balanced maintenance regime which removes peaks and troughs in staff requirements and consider the balance of in-house and outsourced maintenance in the future which could further affect staff requirements.

SPT achieved a breakeven position after allocating £8.1 million of income to the subway modernisation fund.

An underlying underspend of £5.8 million against the original budget arose during 2012-13, of which £3.3 million was contributed to the pension fund in respect of existing obligations, £2.2 million was used to support capital expenditure and £0.2 million was added to the subway modernisation fund.

SPT met its financial targets through effective financial planning and management.

### Financial position

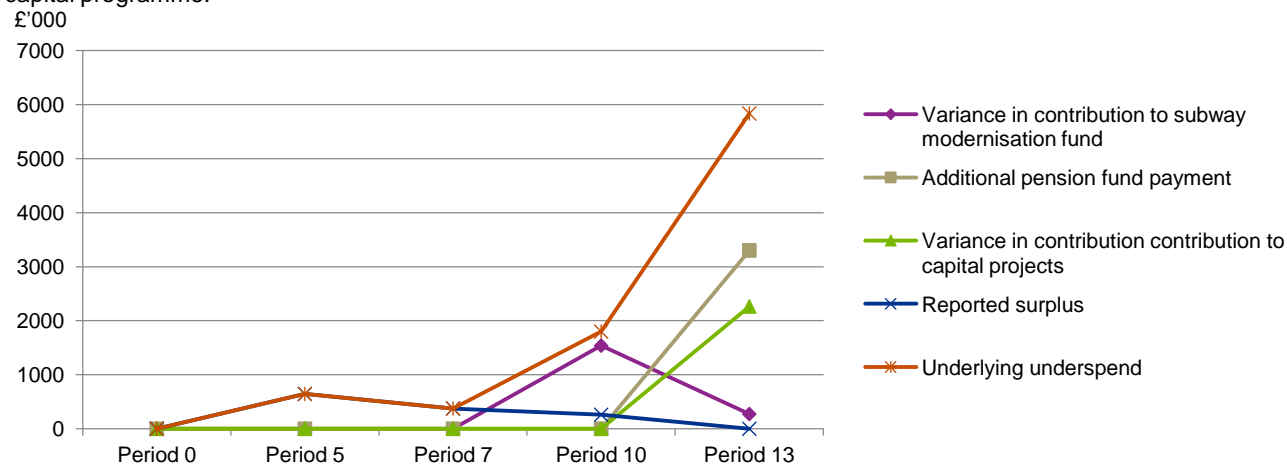
The original 2012-13 budget forecast a breakeven position; the core revenue expenditure budget was £38.4 million. Of this, £37.4 million was financed through requisition from constituent local authorities, together with £1 million funded by the Scottish Government.

Requisitions from the constituent local authorities were in line with budget. Expenditure was below budget in a number of areas including salaries (£2.2 million) and third party payments (£1 million). There were also increases in subway income (£1.2 million), bus station income (£0.3 million) and bank interest and other finance income (£0.8 million). The increase in subway income is attributable to a fare increase introduced in September 2012. Savings arose as a result of staff restructuring, management of bus operator payments and close control of all expenditure lines. These were offset by an increase in other employee costs (£2.8 million), primarily as a result of a additional pension contributions (£3.3 million) to reduce future contributions, and an increase in capital funded from revenue (£2.3 million), to support the general capital programme.

The original budget, approved by the partnership, included a forecast contribution to the subway modernisation fund of £7.9 million. As a result of the revenue savings and additional income which arose during 2012-13, an additional contribution of £0.2 million was made to the subway modernisation fund to bring the total amount to £18.1 million.

An additional payment of £3.3 million was made to the pension fund in 2012-13 in respect of the historic liability for strain on fund costs associated with compensatory added years for pensioners over the age of 80. As a result, annual payments to the pension fund are expected to be reduced by £0.4 million.

If these transactions had not occurred, then there would have been an underspend of £5.8 million as shown in the graph below.





**As at 31 March 2013 the Partnership had liquid cash balances of £60.8 million. A continued focus on cash flow management and treasury management arrangements is important to ensure security of balances is managed against opportunities for investment.**

As at 31 March 2013 the Partnership had liquid cash balances (cash and short term investments) of £60.8 million. This is a relatively high balance for a public body to hold and based on cash flow forecasts no significant reduction is expected in 2013-14. Management has identified that there is likely to be a significant reduction in 2014-15 when the contract for the provision of new subway rolling stock is signed, as a result of a substantial initial payment. However a decision on whether to utilise cash or borrow to meet these costs is still to be taken by SPT. A continued focus on cash flow management and treasury management arrangements is important to ensure security of balances is managed against opportunities for investment.

The Partnership recognises that many of the constituent local authorities are experiencing reductions in available capital funding. In 2012-13 an additional £2.3 million of capital projects were funded from revenue resources to support local authority capital projects across the Partnership area. The budget for 2013-14 has also been increased as a result.

**Total expenditure in support of the capital programme was £30.2 million against an initial budget of £37.9 million.**

**The main variance is a £4.3 million underspend to date in respect of rephasing of the fastlink project.**

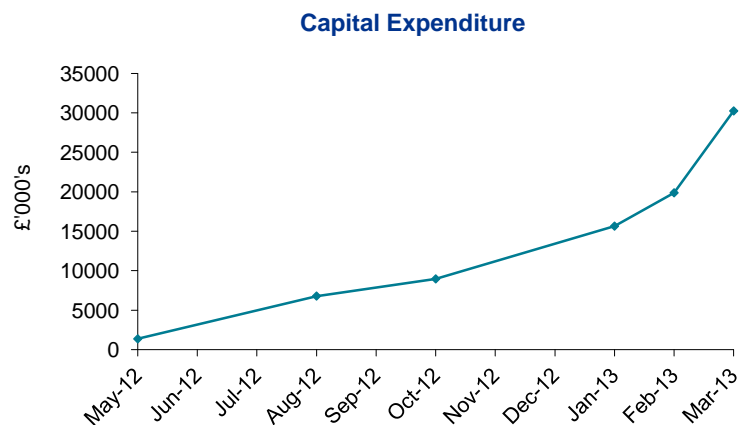
**As a result of close working with local authority partners, and continued focus on capital monitoring, there was a reduction in the proportion of capital expenditure incurred in February and March 2013 compared to previous year.**

### Capital programme

Total expenditure in support of the capital programme was £30.2 million against an initial budget of £37.9 million, approved by the partnership on 30 March 2012. The original budget was revised during the year to £37.7 million. The main variance (£4.3 million underspend) in the delivery of the capital plan relates to the rephased fastlink project. As reported to the strategy and operations committee on 14 June 2013, the project remains on schedule for 2015 completion and the delay was due to the collapse of a quay wall which was not foreseen.

A number of projects were carried forward into 2013-14. The capital programme was mainly funded by known Scottish Government grant funding (£16.7 million), contribution from the subway modernisation fund (£8.4 million), fastlink grant (£0.9 million) and a contribution from revenue (£4.3 million).

The profile of capital expenditure is shown below:



Source: capital monitoring reports from the strategy and operation committee's June 2012 to June 2013

Throughout the year there has been a continued focus on capital programme monitoring. Updates on the delivery of the capital programme were presented to all strategy and operations committee meetings during 2012-13.

As a result of close working with local authority partners, and continued focus on capital monitoring, there was a reduction in the proportion of capital expenditure incurred in February and March 2013 compared to previous year.

Capital expenditure February and March 2013 totalled £10.4 million (34% of annual capital expenditure compared with £14.6 million (57% of annual capital expenditure) in 2011-12. It is important that management continue to remain focused on this issue.

The 2013-14 budget forecasts a breakeven position, with further contributions to the subway modernisation fund of £7.8 million.

### Revenue budget

A revenue budget of £38.4 million for 2013-14 was agreed at the partnership meeting on 15 February 2013. 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 (with inflation factors and services cost pressures being absorbed by SPT). A summary of the budget and variances to the previous years' budget is shown opposite.

The key changes in the 2013-14 budget are:

- reduction in staff costs of £1.4 million (7.8%) – reflecting changes in headcount;
- support to socially necessary services increased by up to £1.1 million (7%); and
- subway operating deficit reduced by £0.3 million (20%) – reflecting ongoing changes to structures and approach to service delivery together with increased income arising from fare changes implemented in 2012-13.

Due to reductions in capital funding received by both SPT and constituent local authorities, SPT have increased the budget for revenue funded capital projects by £0.5 million.

Caption	Budget 2012-13 (£'000)	Budget 2013-14 (£'000)	Variance (£'000)
Chief executive	616	601	(15)
Operations	19,974	19,913	(61)
Corporate	3,457	3,410	(47)
Business support	3,968	3,674	(294)
Bus residual	520	477	(43)
Contribution to subway modernisation fund	7,883	7,841	(42)
Contribution to capital funded from revenue	2,000	2,500	500
<b>Net expenditure</b>	<b>38,418</b>	<b>38,418</b>	-
Requisitions	(37,381)	(37,381)	-
Revenue grant	(1,037)	(1,037)	-
Reserves	0	0	-
<b>Funding</b>	<b>38,418</b>	<b>38,418</b>	-
<b>(Surplus) / deficit</b>	-	-	-

SPT regularly plans a higher level of capital expenditure as a number of projects will be subject to in-year delays and slippage

The 2013-14 capital budget of £45.7 million includes over programming of £10 million.

**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 2013-14 capital budget, approved on 15 February 2013, includes £45.7 million of projects. Indicative budgets include amounts planned in respect of the subway modernisation programme and the fastlink programme.

The budget for 2013-14 compared to 2012-13 is shown below:

Capital budget	2012-13 £'000	2013-14 £'000
Capital budget	37,920	45,725
<b>Funded by:</b>		
Scottish Government capital grant	10,692	9,337
Subway modernisation funding	6,000	6,000
Fastlink funding	5,000	15,000
ERDF grant	0	2,860
Capital funded from revenue	2,000	2,500
<b>Shortfall</b>	<b>14,228</b>	<b>10,028</b>

Source: Partnership committee 15 February 2013

Scottish Government general funding available in 2013-14 is £15.3 million. The core capital grant award from the Scottish Government includes amounts ring-fenced for subway modernisation and it is therefore 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.

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 the funding plan agreed with the Scottish Government. The capital plans provide a guide to the borrowing needs to ensure SPT can meet its capital spending obligations.

# Performance management

Our perspective on the performance management arrangements, including follow up work on Audit Scotland reports

**Internal audit are completing follow up reviews in respect of three Audit Scotland national reports.**

**During 2012-13 we have performed follow-up work in relation to the Audit Scotland national report: *Scotland's public finances: Addressing the challenges.***

**Financial monitoring reports are detailed and include comparison of forecast outturn against the original or revised budget, as appropriate**

**Best Value and local response to national studies**

In April 2002 the Scottish Ministers introduced a non-statutory duty on accountable officers to ensure there are arrangements designed to secure Best Value. Audit Scotland is committed to extending the Best Value audit regime across the whole public sector. Using the Scottish Executive's nine Best Value principles as a basis for audit activity, Audit Scotland previously selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working).

SPT's internal audit function are completing reviews of three Audit Scotland national reports:

- Scotland's public finances: Addressing the challenges;
- Responding to challenges and changes: An overview of local government in Scotland 2013; and
- Managing early departures from the Scottish public sector.

The exact timings of this work is still to be finalised but it is envisaged that the results will be reported by the end of 2013-14.

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland identified the *Scotland's public finances: Addressing the challenges* for follow-up by local auditors in 2012-13. The aim of the follow-up work is to assess how public bodies are responding to the challenges of public sector budget constraints and their efforts to achieve financial stability. We have used internal audit's work on this report to inform our return

The key findings identified from this follow up are:

- The Partnership approved a financial plan for the period 2012-14 and the Partnership has an effective budget setting process
- There is a long term plan supporting the Subway modernisation and its implications for the Revenue budget exists and is monitored
- The Partnership utilises relevant cost and performance comparisons with other Passenger Transport Executives (PTE's) /Regional Transport Partnerships (RTP's), where they are available.
- Financial plans and monitoring reports are presented to every Strategy and Programmes Committee

**Performance management**

Financial performance of the Partnership is monitored via revenue and capital monitoring reports presented to the strategy and programmes committee. Operational performance relating to transport services is reported to the operations committee. Ultimately, both of the above areas are reported to meetings of the partnership.

Financial monitoring reports are detailed and include comparison of forecast outturn against the original or revised budget as appropriate. Actions required to be taken in response to significant variances are summarised within the reports. SPT previously considered the need to deliver savings in anticipation of a reduction in available funding. The savings delivered in 2011-12 were reported at the strategy and programmes committee in January 2012, but cumulative savings have not been subsequently reported in 2012-13.

# Governance and narrative reporting

Our overall perspective on your narrative reporting, including the remuneration report and annual governance statement

Update on controls findings from our audit

**The Partnership maintains an integrated governance framework to provide an appropriate structure for maintaining decision-making, accountability, control and behaviour.**

**During 2012-13, a revised audit and assurance structure was implemented.**

### Annual governance statement and governance arrangements

The annual governance statement for 2012-13 outlines the governance and risk management arrangements in operation in the financial year. It provides detail on the governance framework, the system of internal control, internal audit, internal financial controls and risk management arrangements and analyses the effectiveness of these elements of the framework. It describes a number of sources of assurance for the accountable officer.

The statement, which is made by the accountable officer, considers the effectiveness of the system of internal control based on information provided by the audit and standards committee and internal audit. The statement identifies that there have been no significant risk-related matters.

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 as well as changes in the chair and vice chair. The partnership is supported by four other committees, with meetings of the partnership receiving the minutes from each of the other committees. As stated in the Annual Governance Statement, audit and standards committee training was delivered during 2012-13, as was training for members and senior staff on roles and responsibilities in respect of governance matters.

During 2012-13, a revised audit and assurance structure was implemented. The internal audit team operated in accordance with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Internal Audit in Local Government in the United Kingdom. We have considered the work of internal audit to inform our risk assessment and relied on their work as appropriate.

Risk management arrangements were further developed during 2012-13; the strategy group has responsibility for overseeing the implementation of the Partnership's risk management policy and strategy. The corporate risk register is reviewed at each strategy group meeting, with reporting lines to the audit and standards committee.

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 review we noted some minor weaknesses, with recommendations agreed with management to address these matters.

We have reviewed the governance statement and have confirmed that it is in line with guidance and reflects our understanding of the Partnership.

We have updated our understanding of the governance framework and documented this through our overall assessment of the Partnership's risk and control environment. This work has formed part of our assessment of the Partnership annual governance statement.



<p>Annual report, including the explanatory foreword</p>	<p>The financial statements form part of the annual report of the Partnership for the year ended 31 March 2013. We are also required to consider the explanatory foreword for consistency with the financial statements.</p> <p>We are satisfied that the information contained within the explanatory foreword is consistent with the financial statements.</p>
<p>Remuneration report</p>	<p>Scottish Statutory Instrument 2011 number 64, <i>The Local Authority Accounts (Scotland) Amendment Regulations 2011 amended the Local Authority Accounts (Scotland) Regulations 1985</i> added the requirement for local authority bodies to prepare a remuneration report.</p> <p>The remuneration report was provided at the commencement of the audit, and supported by good quality information in respect of the disclosures given.</p> <p>We considered the contents of the remuneration report and reviewed this against the requirements of the regulations. We have reviewed the exit packages awarded to confirm they are correctly stated and in line with SPT's policy.</p> <p>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.</p> <p>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, we remain of the view that it is inconsistent with our experience of good practice in other sectors and Scottish Government guidance.</p>
<p>Internal audit</p>	<p>As set out in our audit plan and strategy, we liaised with internal audit to maintain an understanding of their approach to ensure duplication of effort was minimised. We also reviewed internal audit reports to inform our risk assessment and to better understand the key audit issues.</p> <p>Internal audit has completed their agreed plan and their annual report concludes that "reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's framework of governance, risk management and control in the year to 31 March 2013".</p> <p>The general programme of work was reviewed for significant issues to support our general work in assessing the corporate governance statements and statements of system of internal financial controls. We have relied on the work of internal audit in the completion of our return to Audit Scotland as part of the follow up on the report "Scotland Public Finances: addressing the challenges"- see Appendix four.</p>

<p><b>Prevention and detection of fraud</b></p>	<p>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.</p> <p>Management has confirmed that no significant fraud or irregularities have been identified during the year.</p>
<p><b>National Fraud Initiative (“NFI”)</b></p>	<p>The National Fraud Initiative (“NFI”) is a data matching exercise which compares electronic data within and between participating bodies in Scotland to prevent and detect fraud. This exercise runs every two years and provides a secure website for bodies and auditors to use for uploading data and monitoring matches.</p> <p>We are required to complete an NFI questionnaire and submit this to Audit Scotland by 31 January 2014, assessing the Partnership's engagement with the 2012-13 NFI exercise. We will complete this in liaison with management later in the year.</p>

# Financial statements and accounting

Our perspective on the preparation of the  
financial statements and key accounting  
judgements made by management

There have been no significant changes to accounting policies in 2012-13. All accounting policies have been applied consistently.

There have been no substantive changes to the Code in 2012-13.

The financial statements have been prepared on a going concern basis.

We liaised with management in respect of the consideration of impairments related to infrastructure assets, subway stations and buses.

Accounting framework and application of accounting policies	
Area	KPMG comment
<b>Financial reporting framework</b>	<ul style="list-style-type: none"> <li>• The 2012-13 financial statements have been prepared in accordance with the Code of practice on Local Authority Accounting in the United Kingdom 2012-13 (“the Code”) which is based upon International Financial Reporting Standards (“IFRS”).</li> <li>▪ During the year there have been no substantive changes in financial reporting requirements, and consequently there are no material changes to the Partnership’s accounting policies.</li> <li>▪ We are satisfied that the accounting policies adopted remain appropriate to the Partnership.</li> </ul>
<b>Impact of revised accounting standards</b>	<ul style="list-style-type: none"> <li>▪ Disclosure has been included in the financial statements highlighting accounting standards which have been adopted but not yet applied.</li> <li>▪ The amended version of IAS 19 comes into effect for financial years beginning on or after 1 January 2013. SPT will apply the amended IAS 19 from financial year 2013-14.</li> <li>▪ No other newly effective accounting standards are considered to have a material impact on SPT’s financial statements.</li> </ul>
<b>Going concern</b>	<ul style="list-style-type: none"> <li>▪ The financial statements of the Partnership have been prepared under the assumption that the organisations are a going concern.</li> <li>▪ SPT has net assets as at 31 March 2013 of £160 million. The Partnerships main sources of funding are government grants, funding from constituent local authorities and subway generated income. Government grants and local authority requisitions are agreed in advance of 2013-14 and therefore there is reasonable certainty over those sources of income.</li> <li>▪ We are satisfied that it is appropriate for the Partnership to prepare the financial statements under the going concern assumption.</li> </ul>
<b>Mandatory communications</b>	<ul style="list-style-type: none"> <li>▪ There were two audit adjustments required, summarised in appendix two.</li> <li>▪ There are no significant matters in respect of (i) auditor independence and non-audit fees; and (ii) management representation letter content, as reported in appendix one.</li> </ul>
<b>Impairments</b>	<ul style="list-style-type: none"> <li>▪ In our interim management report we identified that management should continue to consider the impairment of existing subway infrastructure assets as part of their year end processes.</li> <li>▪ We liaised with management in respect of the consideration of impairments related to infrastructure assets, subway stations and buses. Following extensive discussions, a number of impairments were agreed and are summarised on page 21.</li> </ul>

**We issued unqualified audit opinions on the financial statements.**

**The financial statements and draft governance statement were made available on a timely basis and were accompanied by high quality working papers.**

### Audit conclusions

Following approval of the financial statements by the Partnership, we issued unqualified opinions on the financial statements of both Strathclyde Partnership for Transport (“SPT”) and Strathclyde Concessionary Travel Scheme Joint Committee (“SCTSJC”). There are no matters identified on which we are required to report by exception.

In gathering the evidence for our opinion we have:

- performed a mixture of substantive and controls testing to ensure an efficient approach that covers all the key risks;
- liaised with internal audit and reviewed their reports to ensure all key risk areas having a potential financial statements impact have been considered;
- reviewed and challenged the assumptions and judgements made by management and considered these for appropriateness;
- considered if the financial statements may be affected by fraud through discussions with senior management and internal audit to gain a better understanding of their work in relation to prevention and detection of fraud with the potential to impact on the financial statements; and
- attended the audit and standards committee to communicate our findings to those charged with governance, but also to update our understanding of the key governance processes and obtain key stakeholder insights.

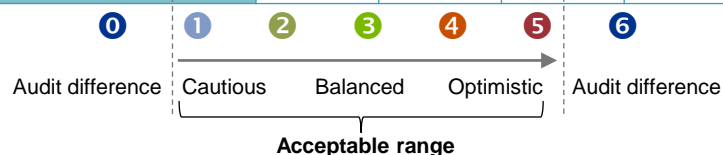
### Financial statements preparation

Preparation of the financial statements

- High quality working papers and full draft financial statements were provided at the start of the audit fieldwork on 3 June 2013. This included the remuneration report, explanatory foreword and governance statement.
- In advance of our audit fieldwork, we issued a ‘prepared by client’ request setting out a list of required analyses and supporting documentation. The standard of documentation was very good and there was evidence of accountability and ownership of working papers across the finance department.
- Throughout the course of the year we have had regular correspondence with the Partnership’s finance team on key accounting issues. For example, we attended discussions prior to the final audit visit to discuss the proposed impairments and the valuations of non-current assets that had been completed during 2012-13. Both ourselves and the Partnership’s finance team found this approach beneficial and the approach has supported an accelerated completion of the audit process.

Overall, in respect of the key judgements made in the preparation of the financial statements, we are satisfied that management's judgements are generally balanced, and do not represent either an overly optimistic, or overly cautious, position.

Assessment of subjective areas										
Asset/liability class	Current year	Prior year	Balance (£m)	KPMG comment						
Valuation of property	3	3	(0.8)	We have reviewed the valuations in respect of Hillhead station and Hamilton bus station, the basis upon which they were made and subsequent accounting entries. We are satisfied that the valuations were carried out by suitably qualified valuers and that the valuers' instructions were in line with the requirements of the Code.						
Impairments	3	2	(4.7)	<p>We have had extensive discussions with management in respect of various non-current asset impairments and considered the evidence provided by management and their review of each relevant asset category. We reviewed the calculation of impairments and management's underlying assumptions.</p> <p>We challenged management on the validity of the assumptions underlying the impairment charges and, following a number of amendments, are satisfied with management's justification. Overall the impairments are considered to represent a fairly balanced approach which is slightly cautious (tends to assume a slightly greater impairment).</p> <p>The impairment is comprised:</p> <table border="0"> <tr> <td>Track (due to be replaced 2015-16)</td> <td style="text-align: right;">£3.4 million</td> </tr> <tr> <td>Buses (which have worn out faster than anticipated)</td> <td style="text-align: right;">£0.2 million</td> </tr> <tr> <td>Subway modernisation (stations)</td> <td style="text-align: right;">£1.1 million</td> </tr> </table>	Track (due to be replaced 2015-16)	£3.4 million	Buses (which have worn out faster than anticipated)	£0.2 million	Subway modernisation (stations)	£1.1 million
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<b>Pensions</b> IAS 19 pension deficit <b>Level of prudence</b>	3	3	(25)	We reviewed the assumptions used by the actuary in calculating the pension deficit. The assumptions are within the acceptable range of the guideline assumptions that KPMG actuaries have calculated. Overall, the assumptions are considered to represent a balanced approach to valuation of the net pension deficit.						



Cautious means a smaller asset or bigger liability; Optimistic is the reverse

Each of the assumptions used to value the Partnership's net pension deficit are within an acceptable range of KPMG's expectations.

We are of the view that this therefore represents a reasonable and balanced approach, in accordance with the requirements of IAS 19.

Defined benefit pension liability																							
Value (£000s)		KPMG comment																					
2012-13	2011-12																						
(24,978)	(23,970)	In line with our established practice and in advance of the audit fieldwork, our actuarial specialists reviewed the approach and methodology of the actuarial assumptions used in the IAS19 pension scheme valuation.  Details of key actuarial assumptions are included in the table, along with our commentary.																					
			<table border="1"> <thead> <tr> <th>Assumption</th> <th>Partnership</th> <th>KPMG central</th> <th>Comment</th> </tr> </thead> <tbody> <tr> <td>Discount rate</td> <td>4.5%</td> <td>4.25%</td> <td>Acceptable - the Partnership's rate is weaker (lower liability) than KPMG's central rate and is at the top end of the range we consider acceptable</td> </tr> <tr> <td>RPI inflation</td> <td>3.6%</td> <td>3.6%</td> <td>Acceptable</td> </tr> <tr> <td>CPI inflation</td> <td>2.8% RPI - 0.8%</td> <td>2.6% RPI - 1%</td> <td>Acceptable – the Partnership's assumption is more prudent (higher liability) than KPMG's central rate, and is within the acceptable range.</td> </tr> <tr> <td>Salary growth (long term)</td> <td>5.1% 1.5% above RPI</td> <td>1-2% above RPI/CPI inflation</td> <td>Acceptable – the Partnership's assumption reflects the extension of the public sector pay freeze to 2016, followed by a long term assumption of RPI plus 1.5%.</td> </tr> </tbody> </table>	Assumption	Partnership	KPMG central	Comment	Discount rate	4.5%	4.25%	Acceptable - the Partnership's rate is weaker (lower liability) than KPMG's central rate and is at the top end of the range we consider acceptable	RPI inflation	3.6%	3.6%	Acceptable	CPI inflation	2.8% RPI - 0.8%	2.6% RPI - 1%	Acceptable – the Partnership's assumption is more prudent (higher liability) than KPMG's central rate, and is within the acceptable range.	Salary growth (long term)	5.1% 1.5% above RPI	1-2% above RPI/CPI inflation	Acceptable – the Partnership's assumption reflects the extension of the public sector pay freeze to 2016, followed by a long term assumption of RPI plus 1.5%.
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		The overall assumptions applied by management are considered to be reasonably balanced for a scheme with a liability duration of around 17 years.  The closing deficit increased by £1 million from 2011-12, primarily due to the application of an updated discount rate. A reconciliation from opening to closing deficit is included on the next page.																					

The table opposite shows the reconciliation of the movement in the balance sheet.

The main elements of volatility are in respect of the discount rate, which drives the valuation of the liabilities.

	£000	Deficit / loss	Surplus / gain	Impact	Volatility	Commentary
	Opening surplus/(deficit)			(23,970)	-	The opening IAS19 deficit for the Scheme at 31 March 2012 was £23.970 million, this agrees to the 2011-12 audited accounts
I & E	Service cost			(3,114)	●	The scheme is open to accrual. The service cost represents the value of new benefits built up over the year.
	Curtailments			(820)	●	This represents the loss on curtailment in 2012-13
	Net finance charge			328	●	This is the difference between the expected return on assets of £8.521 million and the interest on the defined benefit obligation of £8.192 million.
Cash	Contributions			7,685	●	The Partnership made cash contributions of £7.685 million.
TCIE	Change in assumptions gain/(loss)			(5,087)	●	This represents an actuarial loss due to changes in assumptions, primarily due to the reduction in the discount rate.
	Closing surplus/(deficit)			(24,978)	-	

Key: ● Low ● Medium ● High

Source: KPMG analysis of scheme valuation movements. Volatility assessment based on KPMG's market experience.

I&E – impacts on surplus/(deficit)

Cash – cash-flow impact

TCIE – charged through total comprehensive income and expenditure



# Appendices

There were two changes to the core financial statements and there are no unadjusted audit differences

Area	Key content	Reference
<p><b>Adjusted audit differences</b></p> <p>Adjustments made as a result of our audit</p>	<p>There were two audit adjustments required to the draft financial statements. These were:</p> <ul style="list-style-type: none"> <li>reduction in the impairment charged to net cost of services of £344,000 with a corresponding increase of £344,000 in the impairment charged against the revaluation reserve; and</li> <li>a presentational adjustments in respect of the debtors and creditors balances.</li> </ul> <p>The capital commitment disclosure in note 21 of the financial statements was overstated by £110,000 and was also adjusted. A number of other minor numerical and presentational adjustments were made to the financial statements notes.</p>	Appendix two
<p><b>Unadjusted audit differences</b></p> <p>Audit differences identified that we do not consider material to our audit opinion</p>	<p>We are required by ISA (UK and Ireland) 260 to communicate all uncorrected misstatements, other than those which are trivial, to you.</p> <p>There are no unadjusted audit differences.</p>	-
<p><b>Confirmation of Independence</b></p> <p>Letter issued by KPMG to the Audit Committee</p>	<p>We have considered and confirmed our independence as auditors and our quality procedures, together with the objectivity of our audit director and audit staff.</p>	Appendix three
<p><b>Schedule of Fees</b></p> <p>Fees charged by KPMG for audit and non-audit services</p>	<p>There were no non-audit fees in 2012-13.</p>	
<p><b>Draft management representation letter</b></p> <p>Proposed draft of letter to be issued by the Partnership to KPMG prior to audit sign-off</p>	<p>There are no changes to the standard representations required for our audit from last year. The one specific representation required for 2012-13, where we have requested representation from management in respect of contingent liabilities.</p>	-

There are two adjusted audited differences to the financial statements.

### Adjusted audit differences

We are required by ISA (UK and Ireland) 260 to communicate all corrected and uncorrected misstatements, other than those which are trivial, to you. There are two adjusted audit differences. These are shown separately below:

Adjusted caption	Nature of difference	Balance Sheet (£'000)	Comprehensive Income and Expenditure Statement (£'000)
Comprehensive Income and Expenditure Statement - (Surplus) or deficit on the provision of services Revaluation reserve	The impairment charge charged to the surplus or deficit on the provision of services line on the comprehensive income and expenditure statement was overstated by £344,000 as the impaired assets had associated balances in the revaluation reserve.	-	(344)
Balance sheet -short term debtors / creditors	The Partnership raised £29.6 million of invoices on 27 March 2013 which related to 2013-14 services and reflected a corresponding debtor. As the income (yet to be received) would relate to 2013-14, correctly, it was not recognised as income and an associated creditor was created.  We agreed a presentational adjustment with management to offset the corresponding debtor and creditor balance as a net 'nil' amount within debtors. This had the effect of reducing debtors and creditors in respect of those invoices.	-	-
<b>Net impact</b>		<b>0</b>	<b>(344)</b>

**Auditing standards require us to consider and confirm formally our independence and related matters in our dealings with the Partnership.**

**We have appropriate procedures and safeguards in place to enable us to make the formal confirmation in our letter included opposite.**

### **Auditor independence**

Professional ethical standards require us to provide to you at the conclusion of an 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 letter 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 and its related entities for professional services provided by us during the reporting period. 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 Audit Directors 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 APB Ethical Standards. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Regular 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 12 August 2013, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the audit and standards committee and should not be used for any other purpose.

Yours faithfully

KPMG LLP

As part of its targeted approach to following-up a small number of performance audit reports each year, Audit Scotland has identified Scotland's public finances: Addressing the challenges for follow-up in 2012-13.

We carried out follow-up work to consider the Partnership's response to the report.

## 1. Do public bodies have sustainable financial plans which reflect a strategic approach to cost reduction?

Does the organisation have a balanced financial plan for 2012-13 which sets out:

- Assumptions about sources of income and cost pressures?
- What cost reductions and other efficiency savings will need to be made, and how they are to be delivered?
- Risks to service delivery as a consequence of the need to reduce costs and deliver identified efficiency savings?

The Partnership approved a financial plan for the period 2012-14. This detailed the revenue budget for 2012-13 and draft budget for 2013-14 (the 2013-14 draft budget has since been finalised). The financial plan sets out: sources of income and cost pressures, efficiency savings and how they are to be delivered, and the risks to service delivery.

There is also a long term plan supporting the Subway modernisation setting out its implications for the revenue budget.

Does the organisation have a clear budget-setting process which:

- Demonstrates a clear understanding of its costs and how costs vary with activity?
- Takes into account previous years' service delivery performance and where improvements need to be made?
- Takes into account the body's track record on delivering against budgets and analysis of the reasons for previous years' under/over spends?
- Allocates resources according to a clear understanding of its priorities, including which services or activities are expected to contribute most and least to the achievement of the organisation's outcomes?

The Partnership has an effective budget setting process which demonstrates an understanding of its costs, financial pressures and the impact of proposed savings.

The Partnership's financial position is monitored throughout the year by the strategy and programmes committee. The budget setting process takes account of previous years financial performance and where any over/under spends occurred.

The Partnership operates a two-year rolling budget, using the previous years budget with appropriate adjustments as a comparator for the following year.

The budget reflects expected requisition levels proposed for constituent local authorities and is adjusted for inflationary and other cost pressures. Member seminars were held throughout the budget setting process.

<p>Is there a clear evidence base to cost reduction plans? If yes:</p> <ul style="list-style-type: none"> <li>■ Does the organisation undertake a programme of service reviews designed to identify the scope to reduce costs?</li> <li>■ Do cost reduction plans provide adequate detail on how savings are to be made and over what timeframe?</li> <li>■ Do cost reduction plans state who within the organisation is accountable for their delivery?</li> <li>■ Do cost reduction plans give adequate consideration to the impact of reduced expenditure/ changes to service delivery arrangements on service performance and outcomes?</li> <li>■ Are clear baselines established against which efficiency savings can be measured?</li> </ul>	<p>The Partnership continues to review its services in line with best value principles. These reviews focused on cost reduction and service redesign which supported decisions taken to reduce workforce numbers.</p> <p>Each review outlines a model for delivering sustainable services given the expected level of requisition.</p>
<p>Does the organisation regularly use benchmarking to compare its costs and performance with other organisations, including public bodies in other sectors and other non-public sector bodies?</p> <p>Can the organisation demonstrate real and measurable benefits from its benchmarking activities in terms of cost and/or quality improvements?</p>	<p>The Partnership utilises relevant cost and performance comparisons with other Passenger Transport Executives and Regional Transport Partnerships, where they are available.</p> <p>The Partnership is not able to explicitly demonstrate any measurable benefits achieved from these benchmarking activities but there is evidence that benchmarking information is considered along with the Partnership's own performance information.</p>
<p>Does the organisation have a longer term financial strategy which:</p> <ul style="list-style-type: none"> <li>■ Takes into account planned changes to service delivery arrangements and anticipated changes in demand for services?</li> <li>■ Sets out how financial resources will be matched to strategic goals?</li> <li>■ Demonstrates that current cost reductions and efficiency savings are in line with longer term strategic objectives?</li> </ul>	<p>The Transport (Scotland) Act 2005 placed a statutory duty on the Partnership to produce a Regional Transport Strategy ("RTS").</p> <p>The RTS influences all of the future plans and activities of the organisation and informs future national and local transport strategies.</p> <p>One of the significant areas of expenditure for the Partnership over the coming years is the subway modernisation project. This project is supported by a long term plan which includes financial considerations. Also, progress against this project is reported to the strategy and programmes committee.</p>

**2. Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?**

Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans:

- Are high level financial targets and the overall financial position of the organisation discussed regularly at board level meetings?
- In setting financial plans, do members adequately consider the impact of budget reductions on service quality and outcomes?

Members are involved in the budget setting process and this is evidenced through committee minutes. In addition, a number of member seminars were held throughout the budget setting process. In the budget setting process, Partnership officers met with the Chair and Vice-Chairs and presented financial plans including efficiency savings and their impact.

High level financial targets and the overall financial position of the partnership are discussed regularly at various different partnership committees. Specifically, financial plans and monitoring reports are presented to every strategy and programmes committee.

Do senior officials, elected members and non-executive directors provide:

- Sufficient focus on strategy and performance?
- Adequate challenge on longer-term financial plans?
- Regular consideration of financial risks?
- Adequate monitoring of the achievement of efficiency targets?

Senior officials, elected members and non-executive directors provide sufficient focus on strategy and performance and provide adequate challenge on longer-term financial plans.

In terms of the consideration of financial risks and monitoring of the achievement of efficiency targets, financial plans and monitoring reports are presented to every strategy and programmes committee. Additionally, the financial climate is recognised by senior officers and members, and is formally recorded on the corporate risk register ("CRR"). The CRR is reviewed (and updated) at every strategy team meeting (4-weekly) and is then presented to each meeting of the audit & standards committee.

Is there appropriate transparency and accountability of decisions about cost reduction measures and future organisational plans:

- Is there appropriate consultation with the public and other stakeholders over cost reduction plans which identify various options and their impact on service delivery and outcomes?
- Do financial and corporate plans adequately spell out the consequences of reduced budgets on the organisation's ability to deliver services and outcomes?

During the budget setting process the SPT consulted with its key stakeholders. The Partnership receives the majority of its income from the constituent local authorities who are a primary stakeholder group. Partnership budget proposals were shared with the constituent local authorities as part of the budget setting process.

As part of the development of the financial plan, the impact on service delivery was considered.

Do finance/resource committees and other scrutiny committees play a suitably prominent role in the consideration of budget plans and risks to service delivery:

- Are finance/resource and other scrutiny committees sufficiently involved in the consideration of budget plans, including:
  - the impact of budget reductions on service delivery
  - the organisation's track record of delivering against budgets?
  - reasons for previous years' under/over spends against budget?
- Do finance/resource and other scrutiny committees undertake a regular programme of reviews of business areas to examine issues such as the achievement of value for money and service delivery?
- Do finance/resource and other scrutiny committees regularly assess areas such as financial risks and efficiency savings?

Are reports from finance/resource and other scrutiny committees on budget plans and risks to service delivery given proper consideration by officials, with recommendations being promptly acted upon?

- Do finance/resource and other scrutiny committees receive reports on the extent to which cost reductions and efficiency savings have impacted on service delivery?

There is effective scrutiny of budget plans by the strategy and programmes committee which is sufficiently involved in the consideration of the budget plans.

There is evidence that the budget setting process includes consideration of potential impacts on service delivery and that the Partnership's past financial performance is suitably considered in setting subsequent years budget plans.

The strategy and programmes committee regularly assesses financial risks and performance. Although updates on performance against efficiency plans could be more formally reported.

This monitoring is completed through the financial update reports which are presented to the strategy & programmes committee throughout the year. These reports cover progress on revenue plans as well as capital programmes.

Based on our review of committee minutes we are satisfied that the various Partnership committees give proper consideration to papers presented relating to financial matters and suitable recommendations are made and acted on by the Partnership.





*cutting through complexity*

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