Midlothian Council

Report to Members and the Controller of Audit on the 2007/08 Audit

17 October 2008

Contents

Key Messages

Introduction

In 2007/08 we looked at the key strategic and financial risks being faced by the Council. We audited the financial statements and we looked at aspects of performance management and governance. This report sets out our main findings, summarising key outcomes from the 2007/08 audit and the outlook for the period ahead.

Key outcomes from 2007/08 audit

We have given an **unqualified** opinion on the financial statements of the Midlothian Council. Significant changes were required between the draft and final accounts because the Council's draft unaudited financial statements did not reflect all the changes required by the 2007 SORP in relation to the accounting treatment for financial instruments. Problems with the fixed asset accounting module also resulted in the need for substantial amendments to the final accounts. However, the reporting deadline of 30 September was met.

The Council made a deficit of £18.1million in the provision of services in 2007/08. However, after making statutory adjustments, and taking account of contributions of £1.0 million from the HRA and £3.8 million from the Capital Fund, the General Fund Reserve increased by £1.9million, an improvement on the approved budget. The Council held a General Fund balance of £11.8milion of which £3.4 million was uncommitted as at 31 March 2008, which is broadly in line with its target level.

Significant work has been undertaken by the Council to develop a performance management framework using the Covalent system. Further improvements in performance were reported by the Council during 2007/08, with in excess of 60% of internal targets being met during the year. Progress was reported in addressing a number of priorities set out in the Corporate Plan.

A Best Value and Community Planning audit of the Council was reported in June 2008. This concluded that the Council has an ambitious vision based on its understanding of local needs and issues, but highlighted a number of areas for improvement before it is in a position to fully demonstrate Best Value and continuous improvement. The Council has put in place an improvement plan to address these issues.

During the year, the Council's housing management and homelessness services were inspected by the Scottish Housing Regulator (SHR). The regulator assessed the Council's asset management and repairs service to be good, but its housing management and homelessness services to be poor. The Council has developed an improvement plan and will progress this, alongside the Best Value improvement plan, during 2008/09 and beyond.

The Council's governance systems were generally good and operated well, within a sound control environment. The Council's recent self-assessment of its governance arrangements identified areas where further improvements still require to be made and these are set out in the Corporate Governance Assurance Statement included in the annual accounts.

Outlook

Looking to the future, we identified some of the strategic risks that the Council needs to manage in delivering its corporate objectives and priorities.

The Council faces serious and difficult challenges in balancing revenue and capital demands and ensuring that planned activity is affordable within available resources. Cost pressures will be exacerbated by Equal pay liabilities and the introduction of Single Status, through the Modernising Midlothian Project. While a balanced budget has been set for the 2008/09 financial year, the Council has identified a revenue funding gap of £4.3 million in 2009/10. The Council has also identified a significant affordability gap in relation to its capital spending plans in the current year, as a result of the current economic situation and the slow-down in asset sales. The Council clearly needs to establish a medium term financial strategy that achieves balanced budgets while maintaining effective service delivery and improving underlying performance. This will require difficult decisions to be taken in the period ahead and the Director, Corporate Services has highlighted the urgent need for departments to consider various options for saving money.

The Council has agreed and published a new Corporate Plan setting out its strategic objectives and priorities for 2008 - 2011. This will ensure clarity of purpose in the period ahead, although there is a risk that budget difficulties may limit the progress that is achievable.

In 2008/09, the Council will also be required to deliver on the commitments contained in its Single Outcome Agreement (SOA) between itself and the Scottish Government. The SOA is central to the Concordat between the Scottish Government and COSLA which sets out the terms of a new relationship between the Scottish Government and local government. The Concordat underpins the funding to be provided to local government over the period 2008/09 to 2010/11. The SOA sets out the Council's contribution to the government's 15 key national outcomes as set out in the Concordat. It also reflects established corporate and community planning commitments. In this way progress at a national level will be supported by outcomes at a local level.

The Council agreed its Best Value Improvement Plan with the Accounts Commission in August 2008. Mechanisms now need to be put in place to monitor progress, ensuring that the impact on services and outcomes can be demonstrated.

The co-operation and assistance given to us by Midlothian Council Councillors and staff during the year is gratefully acknowledged.

Audit Scotland

October 2008

Introduction

1. This report summarises the findings from our 2007/08 audit of Midlothian Council, the second year of a five year appointment. Findings are set out in four sections: financial statements; financial position; governance and performance. Within each of these sections we have also provided an outlook setting out key issues and concerns facing the Council going forward.

2. The scope of the audit is set out in our Annual Audit Plan (AAP), which was submitted to the Council in January 2008. The AAP summarises the specific governance and other risks that could affect the Council's financial statements. It describes the work we planned to carry out in response to these risks.

3. As part of the planned work we submitted a Strategic Audit Risk Analysis (SARA) to the Council in April 2008. The SARA set out our views on the key business risks facing the Council and described the work we planned to carry out as part of the annual audit, under the following strategic themes:

   - strengthening governance
   - working effectively with partners
   - funding future improvement
   - managing the workforce
   - challenging and improving performance
   - delivering modern infrastructure for a growing population.

4. Overall conclusions about the Council's management of key risks are discussed throughout this report. Appendix A sets out the key risks highlighted in this report which we wish to draw to the attention of members and the action planned by management to address them.

Financial statements

Introduction

5. In this section we summarise key outcomes from our audit of the Council's financial statements for 2007/08. We comment on the significant accounting issues faced and provide an outlook on future financial reporting issues.

6. We audit the financial statements and give an opinion on:

   - whether they present fairly the financial position of the Council and its expenditure and income for the year; and
   - whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements.

7. We also review the Corporate Governance Assurance Statement by considering the adequacy of the process put in place by the Council to obtain assurances on corporate governance and assessing whether disclosures in the statement are consistent with our knowledge of the Council.

Overall conclusion

8. We have given an **unqualified** opinion on the financial statements of Midlothian Council for 2007/08. The Council's unaudited financial statements were submitted to the Controller of Audit prior to the deadline of 30 June. Final accounts preparation processes and working papers merit some review to ensure there is a comprehensive package of supporting papers available for audit. This would facilitate the audit process by reducing the time required to source the necessary supporting evidence and explanations.

9. Audited accounts were finalised prior to the target date of 30 September 2008 and are now available for presentation to the Council and publication. The financial statements are an essential means by which the Council accounts for its stewardship of the resources made available to it and its financial performance in the use of those resources.

Accounting practice

10. Local authorities in Scotland are required to follow the *Code of Practice on Local Authority Accounting in the United Kingdom – A Statement of Recommended Practice* (the 'SORP'). The 2007 SORP required a number of significant changes to be made to the 2007/08 financial statements to make

them more consistent with the accounts of other public and private sector entities. The major changes include:

- accounting for financial instruments based on FRS25, FRS 26 and FRS 29
- replacement of the fixed asset restatement account and capital financing account by a revaluation reserve and capital adjustment account.

11. The Council had not prepared the accounts entirely in accordance with the revised SORP: the draft accounts did not comply with financial instrument accounting standards and errors were found in relation to capital accounting.

12. The Council adjusted the financial statements to reflect our audit findings. As is normal practice, immaterial unadjusted errors have been reported to the Director Corporate Services and the Performance Review Committee via our letter issued in line with International Standard on Auditing 260 (ISA 260): *Communication of audit matters with those charged with governance.* Details of significant accounting issues arising in the course of our audit are summarised below.

Accounting for financial instruments

13. The major change introduced by the 2007 SORP was the new requirement for the accounting, presentation and disclosure of financial instruments e.g. loans, restructuring debt and 'available for sale' assets. As noted above, the Council did not implement these changes in time to include them in the draft accounts which were submitted for audit in June. As a result, substantial changes were required to the draft accounts which impacted on the completion process and timetable.

14. In respect of the 'available for sale' assets, Midlothian Council holds a 5.5% shareholding in Lothian Buses plc. These are included in the accounts at their nominal value of £350,000 (350,000 £1 shares). New guidance on accounting for financial assets requires equity investments to be valued at fair value. Midlothian Council has not obtained a valuation at fair value for these shares. However management does not consider the fair value would be materially different from the current book value.

Key Risk Area 1

Prudential Code

15. The prudential indicators for 2007/08 were approved by the Council in February 2007, as part of the budget setting process. The indicator for the authorised limit of external debt was set at £132.6 million. As at 31 March 2008, the Council's external borrowing was £153.4 million, some £20million in excess of the agreed authorised limit. This breach was not reported to members.

16. The additional borrowing, which was in advance of need, was taken on the grounds of prudence (see also paragraph 46). While this is permitted in the short term by the Prudential Code, the fact that the limit approved by members was breached without reporting to members is not in line with the Code. The Code requires that any potential breach should be reported to the decision-making body to determine if it was prudent to raise the limit or instigate procedures to ensure the limit was not breached. Also related to this, we noted that the 2007/08 Annual Treasury Management Report did not include details of actual performance against each prudential indicator, which would enhance the disclosure provided.

Key Risk Area 2

Classification and valuation of fixed assets

17. A number of issues were identified during the audit of this area: a small number of assets had not been revalued within the required five year time frame; a small number of community assets *were* re-valued, which is contrary to the stated accounting policy and the classification and valuation of surplus assets was not fully in line with FRS 15 requirements. The impact of these issues is not considered material for 2007/08, but the Council has agreed to review the classification and revaluation of assets during 2008/09 to ensure full compliance with prevailing guidance (FRSs and SORP).

18. We noted that a handful of property values in the Fixed Asset Register were updated on the basis of informal valuations from Estates. As these revised valuations recognised impairments in value, we consider that it was prudent for Finance to adjust the accounts for those changes in value. Nevertheless we recommend formal valuations where possible.

Key Risk Area 3

Post Balance Sheet Events

19. In September, considerable market volatility was experienced at a national level in relation to the valuation of investments giving rise to concerns over the security of bank deposits. FRS 21:*Reporting of events after the Balance Sheet date*, requires a body to consider disclosure of such events if significant, even if non-adjusting in nature. Although the Council had significant sums invested with HBOS and Bradford and Bingley, two of the firms most affected, in view of Government assurances, the Council did not consider there was any additional risk and thus no need to add a Note to their accounts.

Key Risk Area 4

Legality

20. In addition to conducting tests to ensure compliance with certain legal requirements, each year we request written confirmation from the Director Corporate Services that the Council's financial transactions accord with relevant legislation and regulations. The Director Corporate Services has confirmed that, to the best of his knowledge and belief and having made appropriate enquiries of the Council's management team, the financial transactions of the Council were in accordance with the relevant legislation and regulations governing its activities.

21. We reported last year that local authorities with registered charitable bodies (i.e. registered trust funds) are required to comply with the requirements of the Charities Accounts (Scotland) Regulations 2006. In effect, this means a full set of financial statements is required for each trust fund, although the date of full implementation has been deferred by the Scottish Charity Regulator. The Office of the Scottish Charities Regulator (OSCR) has indicated that the interim measures introduced in 2006/07 can again be used in 2007/08 and reliance placed on the existing disclosures for trust funds in the Council's financial statements, supplemented by appropriate working papers. Midlothian Council took the opportunity to apply the interim measures for a second year and did not therefore provide additional disclosures in 2007/08. We deemed this approach to be acceptable.

22. There are no additional legality issues arising from our audit which require to be brought to members' attention.

Financial reporting outlook

Changes to the 2008 SORP

23. The 2008 SORP was recently published and introduces a number of substantial changes. In our view the changes that will impact on Midlothian Council include:

    - an explicit statement prohibiting the revaluation of fixed assets on disposal to disposal proceeds
    - the operation of landfill allowance "cap and trade" schemes in Scotland from 1 April 2008
    - additional disclosures in respect of Retirement benefits.

    Management should plan accordingly to ensure accounting records are brought up to date to reflect these changes.

International Financial Reporting Standards

24. Central government and NHS bodies are to move from UK Generally Accepted Accounting Principles to International Financial Reporting Standards (IFRS) with effect from 2009/10. The government also

announced its intention to publish Whole of Government Accounts on an IFRS basis from 2009/10. The intention is that local government will adopt IFRS for 2010/11, although there is a possibility that early adoption may be required in some areas, including the accounting for PFI schemes.

Financial position

Introduction

25. In this section we summarise key aspects of the Council's reported financial position and performance to 31 March 2008, providing an outlook on future financial prospects, including our views on potential financial risks. Our findings and key messages are set out in this section, highlighting the significant challenges being faced by the Council in managing ongoing financial pressures in funding existing service delivery and future improvement.

Council tax and the general fund

Operating performance 2007/08

26. The Council's net operating expenditure in 2007/08 was £178.668 million. This was met by government grants and local taxation of £160.553 million, resulting in an income and expenditure account deficit of £18.115 million. This is 10.14% of the net expenditure for the year. The budget set for 2007/08 was based on a Band D Council tax level of £1,210 with a planned contribution of £0.803 million from the general fund.

27. A number of revisions were agreed to the overall budget position during the year. In his Foreword to the financial statements, the Director Corporate Services highlighted that aggregate expenditure to be met from government grants and local taxation for the year was £158.6 million, £0.86 million, (0.54%) less than the revised budget.

28. Within the overall outturn, there were a number of under and overspends against budget. The most significant divisional variance occurred within Social Work where £0.72 million was overspend on employee costs due to the high numbers of agency staff used at the start of the year to implement the Child Protection action plan and to prepare for the Social Work Inspection Agency fieldwork inspection in May 2008, together with the employee performance factor not being met. However, this was offset by various underspends resulting in a net overspend of £0.44 million. Within Corporate Services there was a net overspend of £0.66 million which was mainly due to an increase in the provision of homelessness accommodation, increased expenditure on legal services and on insurance (due to a higher than budgeted value of claims). There was also a shortfall of £0.18 million against the budget due to corporate efficiencies not being achieved.

Housing Revenue Account

29. The housing revenue account income and expenditure account shows a deficit of £5.356 million for 2007/08. After adjusting for non statutory items and transferring £1 million to the general fund a surplus of £2.231 million for the year was achieved. When this surplus is added to the amount brought forward from 2006/07, the Council has a HRA balance of £9.498 million as at 31 March 2008. This balance is earmarked to fund investment in the New Build Social Housing Programme and in upgrading existing Council Housing stock.

Reserves and balances

30. Table 1 shows the balance in the Council's funds at 31 March 2008 compared to the previous year. At 31 March 2008, the Council had total cash backed funds of £23.041 million, an increase of £4.947 million on the previous year.

Table 1: Reserves and Funds

Description	31 March 2007 £ Million	31 March 2008 £ Million
General Fund	9.825	11.764
HRA Fund	7.267	9.498
Insurance Fund	1.002	1.779
Capital Fund	0	0
	18.094	**23.041**

31. The Council achieved a general fund surplus of £1.939 million during the year, after a contribution of £1 million from the HRA and £3.819 million from the capital fund. Added to the amount brought forward from 2006/07, the Council had a general fund balance of £11.764 million.

32. However, at 31 March 2008, £8.405 million of the general fund balance was earmarked for specific purposes leaving an unallocated balance or contingency of £3.359 million. This amount is broadly in line with the Council's reserve strategy which is to maintain a contingency reserve on the General Fund of 2% of net expenditure (which equates to £3.3 million).

33. Earmarked amounts have been identified for specific divisional reserves through devolved budget management (£7.214million) and a contingency for future equal pay claims of £1.191million.

34. The capital fund can be used to defray capital expenditure or repay loan principal. During the year £3.819 million was transferred into the capital fund from the sale of assets (non-housing). This was transferred to the general fund to support the repayment of debt. The transfer to the general fund from the capital fund was originally budgeted at £6.5million in the capital plan. This reduced a number of times throughout the year, mainly due to a lower than budgeted value of capital receipts.

35. The Council operates an insurance fund to self insure itself against uninsured losses and also to pay premiums on insurance policies. In 2007/08, there was an appropriation of £0.777 million from the general fund to the insurance fund. Where an insurance fund is operated, it is good practice to obtain a regular independent valuation of the cumulative value of the fund relative to its known claims, outstanding liabilities and projection of incidents incurred but not yet reported. Such a review has never been completed despite the insurance fund being in operation for a number of years. There is a risk that the fund is not adequate.

Key Risk Area 5

Statutory Trading operations

36. The Local Government in Scotland Act 2003 replaced compulsory competitive tendering regulations with a duty to maintain and disclose trading accounts for significant trading operations (STOs), which are required to break even over a three year rolling period.

37. The Council has identified three STOs: Building Maintenance, Roads Maintenance and Investment Properties. All three have continued to return a cumulative surplus for the three years to 31 March 2008, although Building Maintenance returned a substantial in-year deficit in 2007/08. There is a risk that it will not achieve break-even in the next 3 year-period.

Key Risk Area 6

Group balances and going concern

38. The widening diversity of service delivery vehicles used by local authorities means that group accounts are required to present fairly all the activities of Councils. The overall effect of inclusion of all of the Council's subsidiary and associates on the group balance sheet is to reduce net assets by £94.45 million, substantially as a result of pension liabilities of the Joint Boards. All group bodies' accounts have been prepared on a going concern basis as pension liabilities will be funded as they fall due through a combination of employee and employer contributions, government grants and Council tax.

39. The Council has an obligation to meet a proportion of the expenditure of the joint boards of which it is a constituent member. All of these boards (Police, Fire and Valuation) had an excess of liabilities over

assets at 31 March 2008 due to the accrual of pension liabilities. In total the net liabilities amounted to £1,248 million, with the Council's group share being £93.925 million.

Spending on assets and long-term borrowing

Capital performance 2007/08

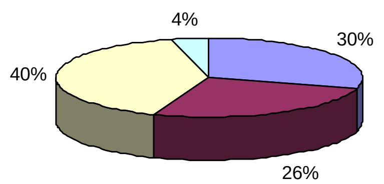
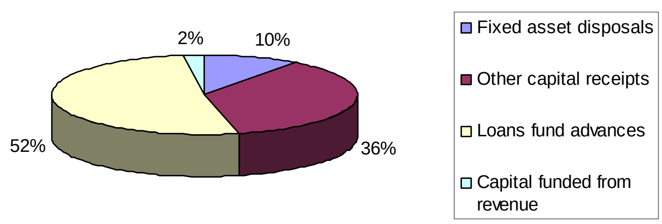
40. Since the introduction of the Prudential Code in April 2004, the Council can decide locally on a capital investment strategy which meets best value requirements as well as being affordable. The Council has used the code to increase significantly its capital expenditure to improve its asset infrastructure.

41. Capital expenditure in 2007/08 totalled £53.067 million, rising from £37.328 million in 2006/07. Capital investment in the last two years was funded as shown in Chart 1.

42. 2007/08 expenditure on the General Services programme was £24.658 million. This was an underspend of £7.122 million against the revised budget due largely to slippage on a number of projects across the services, the most significant of which were the Shawfair Bridges, Dalkeith Town Centre Improvements and the Gorebridge Care Home. There was also significant slippage in the funding side of the General Services programme of some £15.869 million. This was mainly due to delays in the sale of assets and lower than expected developer contributions.

43. Actual capital expenditure on the HRA programme was £28.409 million. This was more than the revised budget of £26.780 million due to better than anticipated progress on the social housing programme and kitchen replacement programme.

Chart 1: Sources of finance for capital expenditure 2007/08

2006/07	2007/08
	

Borrowing and temporary investments

44. In recent years, some councils have held significant amounts of cash and temporary investments to take advantage of favourable interest rates for planned capital programmes. In these circumstances, the early borrowing must be justified in its own right as representing the best time for borrowing the amount required. This should be assessed without regard to temporary investment possibilities, otherwise the action may be judged to be unlawful or to have subjected public money to unnecessary speculation risk.

45. As at 31 March 2008, Midlothian Council held cash and temporary investments totalling £73.949 million (prior year £65.399 million). We have requested and received a specific representation from the Director Corporate Services that all borrowing in advance of immediate requirements has been made for a legitimate purpose in accordance with legislation and has been on-lent in the interests of prudent cash management. In the Director's assessment any early borrowing is justified in its own right as representing the best time for borrowing the amounts required, without regard to temporary investment possibilities and the 'profit' that might arise from these.

46. Just over 92% of long-term borrowing at the year-end matures after more than 10 years. The Council has actively managed its exposure to variable interest rate movements with minimum debt exposed to variable rate risk.

Debt restructuring

47. In 2007/08 the Council increased its total Public Works Loan Board (PWLB) debt from £115.446 million to £133.426 million. This included rescheduling some of its existing loans valued at £30.7 million. The average interest rate on the PWLB debt has reduced from 4.78% to 4.6% and the Council calculates the annual saving as £0.014 million. However, changes to the PWLB's terms in November 2007 limit the Council's ability to make interest rate savings through rescheduling.

48. Overall, long-term borrowings have increased from £130.5 million to £155.2 million. A consequence of this treasury management strategy (to reduce the average debt interest rate) has been an increase in short-term assets, from £32.0 million to £53.0 million. As at 31 March 2008 the investments were spread over eight institutions and the maximum held in any one institute was £15.4million in HBOS. The Council receives independent financial advice from Sector Treasury Services Ltd.

Financial outlook

Council tax freeze

49. The Council is party to the Concordat between the Scottish Government and COSLA. The financial features of this include an agreement to freeze council tax levels for three years in return for some additional funding and the removal of some ring-fencing. The Concordat allows councils to retain their efficiency savings to redeploy against ongoing pressures and to address local priorities. Failure to deliver efficiency savings effectively in future will result in a shortfall in resources to deliver services.. The 2008/09 budget assumes efficiency savings of £2.62 million which is considerably more than was achieved in the previous year. Figures recently provided show cumulative savings for the 3 years ending in 2007/08 of £2.564million against a budget of £2.558 million, of which £1.9 million were achieved prior to 2007/08. There is a risk that the Council cannot identify or achieve further efficiency savings and additional pressure is placed on the service budgets.

See Key Risk Area 8

50. Although the relaxation of some ring fencing gives councils greater flexibility in the allocation of resources, there is also a risk that funds are diverted away from planned activities. Midlothian Council previously received approximately £14.8 million in ring-fenced funds and spending patterns in 2008/09 are closely aligned with previous years in many cases, so that it is unlikely that there will be any significant changes to individual spending areas previously ring-fenced in the current year.

Key Risk Area 7

Current budget

51. The Council's current financial position is challenging as it faces a number of pressures including:

- rising cost of settling equal pay/value claims
- costs associated with implementing the single status agreement (Modernising Midlothian)
- rising energy costs
- delays in capital receipts and developer contributions

52. The most recent financial overview report identified a net overspend in 2008/09 of £2.8 million (after allowing for a £1.1million carry forward into 2009/10). The projected outturn for nearly all services shows overspends against budget. In addition, it is anticipated that loan charges will be £1.3 million more than planned. After settling the cost of equal pay claims in 2008/09, it is forecast that this will push the General Fund reserve into a deficit position at the end of 2008/09.

53. Such is the seriousness of the situation that the Council has recently introduced a selective recruitment freeze and suspended capital projects that are not contractually committed. The Council is also exploring other options, including a review on the operation of the Insurance Fund.

54. A revenue funding gap of £4.3 million for 2009/10 was projected in the Financial Overview report to Cabinet on 5th August. The main contributory factors to this gap are increased costs of servicing debt (resulting from increased borrowing to meet a shortfall in the capital plan – see below), incremental costs associated with Modernising Midlothian and energy price increases.

55. Clearly, the Council faces significant challenges in balancing revenue and capital resources and ensuring that planned activity is affordable within available resources. There are likely to be significant consequences for services and staffing levels if underlying expenditure issues are not addressed.

Key Risk Area 8

Equal pay

56. The 1970 Equal Pay Act makes it unlawful for employers to discriminate between men and women in terms of their pay and conditions where they are doing the same or similar work, work rated as equivalent, or work of equal value. Employees who consider that they have been discriminated against in terms of pay can put forward claims to an Employment Tribunal. Following cases pursued against English councils, the extent of exposure of Scottish councils arising from individual pay claims began to emerge during 2006/07.

57. As at 31 March 2008 £4.215 million of equal pay claims had been settled and a further £3.360 million has been included as a creditor in the balance sheet with regard to outstanding claims. Following a significant number of new claims (and after seeking legal advice), the Council has identified a potential significant funding gap between the estimated cost of settling all claims and what has been provided for. In August 2008 an overall shortfall of £14.052 million in the General Fund reserve earmarked for Equal Pay was reported to members. Funding will be required to meet this shortfall. See paragraphs 58 – 60 below.

Single status

58. In 1999 a Single Status agreement was reached between Scottish local authorities and trade unions to harmonise the terms and conditions of manual and administrative, professional, technical and clerical workers (covering pay, working hours, leave and negotiating mechanisms). There was a presumption that Single Status would be cost neutral with any increased costs being offset by savings arising from changes to other conditions of service or from efficiencies.

59. The original national Single Status agreement specified that implementation should take place by April 2002 but, following difficulties in establishing a model job evaluation scheme, this was extended by agreement between local authorities and unions to April 2004.

60. A number of Scottish councils have either implemented Single Status or have firm plans in place for implementation by 31 December 2008. Midlothian Council is one of a number of Councils that do not expect to implement it until 2009. A significant amount of work has been done in terms of job evaluation and the Council has recently entered in a period of statutory consultation with staff. While this has enabled the Council to estimate initial and ongoing costs, the final cost cannot be reliably calculated until Single Status is implemented. The ongoing delay increases the Council's exposure to further equal pay liabilities, representing a continuing risk.

Key Risk Area 9

Future capital programme

61. The current financial position is such that in July 2008 the Council agreed to suspend approval of all General Fund Services capital projects in the capital plan that were not contractually committed or had not secured funding. It was also agreed that £14.05 million capital receipts (over the period 2008/09 to 2011/12) would be transferred to the Capital Fund and subsequently transferred to the Revenue Account to meet debt repayments, releasing the budget set aside for debt repayments to bolster reserves to meet the costs of equal pay/value and single status instead of financing capital investment. In addition to this, the current economic downturn has adversely affected the Council's ability to generate capital receipts.

62. The overall impact of theses changes is a funding shortfall in the capital plan of some £19.96 million in 2008/09.The Council is currently reviewing options and is acutely aware that alternative sources of capital funding such as additional borrowing will place further pressure on revenue budgets.

Key Risk Area 10

63. The HRA Capital Plan is set to see continued high levels of capital expenditure in 2008/09 and 2009/10 as progress continues on the new social housing programme. However, the Council's ongoing review of its overall financial plan may also impact on the HRA plans.

EC landfill directive

64. The EC Landfill Directive sets limits on the disposal of biodegradable waste to landfill and requires the pre-treatment of waste prior to landfill. There are technical and financial challenges facing the Council in delivering solutions and the implications of landfill penalties could be significant. The Scottish Minister for the Environment has the power to waive penalties in certain circumstances, and he has advised COSLA that he may be prepared to do this for local authorities who have not met targets due

to circumstances outwith their control, but who have made genuine efforts to maximise landfill diversion. From 2008/09 onwards, Scottish Councils will be allowed to trade landfill allowances. If one Council performs better than its targets, it can sell its excess allowances to other Councils.

65. Midlothian Council has been steadily making improvements in its recycling rates, but needs to develop a medium to longer term solution to meet the EC Landfill Directive. The Council does not anticipate exposure to fines until 2010/11 (current estimate is £0.3 million) and is currently exploring options for procuring a residual treatment facility to divert as much residual waste from landfill as possible. The Council is also awaiting guidance from the Scottish Government on the Zero Waste Fund and alternative financing options (non PPP). To date the Council has not traded any landfill allowances, but it is likely to explore this option in the latter half of 2008/09.

Pension liabilities

66. Financial planning and accounting for the costs of pensions presents a difficult challenge. The amounts involved are large, the timescale is long, and the estimation process is complex and involves many areas of uncertainty that are the subject of assumptions. In accounting for pensions, Financial Reporting Standard 17 (Retirement Benefits) is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future. This requirement results in very large future liabilities being recognised in the annual accounts.

67. The Council's estimated pension liabilities at 31 March 2008 exceeded its share of the assets in the Lothian Pension Fund by £12.77 million, reducing from £38.91 million in the previous year. Budgeted contributions rose from 320% of employee contributions including a cash amount for deficit in 2007/08 to 330% in 2008/09, reflecting the actuarial valuation as at 31 March 2005.

68. The next full actuarial valuation will assess the position at 31 March 2008. This will determine contribution rates for 2009/10 and the next two financial years. Recent changes to the Local Government Pension Scheme regulations are expected to release some future financial benefits, while providing additional flexibility to future pensioners.

Governance

Introduction

69. In this section we comment on key aspects of the Council's governance arrangements during 2007/08. We also provide an outlook on future governance issues, including our views on potential risks.

Overview of arrangements in 2007/08

70. Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviours at the upper levels of the organisation. Based on the work undertaken, we concluded that the Council had systems in place that operated well, within a sound control environment.

71. The Council has adopted a local Code of Corporate Governance based on best practice identified jointly by CIPFA and SOLACE. A Statement of Assurance on Corporate Governance is included within the annual financial statements and has been signed by the Leader of the Council and the Chief Executive. The annual self assessment of arrangements is informed by a number of sources including assurance statements from the Chief Executive and each Director. This concluded that Midlothian Council's corporate governance arrangements are of a satisfactory standard, but recognised there were a number of areas where improvements are required. These include:

- implementation of a new pay and grading structure which is financially sustainable and in accordance with equal pay legislation
- further scoping and realisation of efficiencies to assist in realising funding for local priorities and ongoing budget pressures
- review of the internal audit service
- continuation of the rationalisation of property assets
- development of community planning objectives and the governance of partnership working
- implementation of improvement actions arising from both the Best Value audit report and the Scottish Housing Regulator inspection.

Political Governance

72. The political context for Councils changed significantly in 2007, with a new Scottish government and a shift to more coalition and minority administrations in local government. Nearly half of the Councillors

elected in May 2007 were new to local government. This trend is also reflected in Midlothian Council, with 9 out of 18 Councillors being newly elected. See paragraph 107 for further information on the training and development of elected members.

73. The creation of multi-member wards has required new ways of working to support efficient representation and sharing of the workload. The Council has considered the implications of multi-member wards and the Council's local Code of Corporate Governance contains guidance on the effective management of these wards and constituents' approaches to members. The workload is not split geographically; rather, the Council operates a cabinet decision-making structure, with specialism between members at this level (for example, housing, social work etc). However, multi-member wards are still fairly new in Scotland and the practical issues will become clearer as the new arrangements mature.

Audit Committee / Performance Review Committee

74. Effective scrutiny is central to good governance, with a significant role for members to scrutinise performance, hold management to account on service delivery and support the reform and modernisation agenda. During 2007/08, members in Midlothian Council continued to have the opportunity to challenge service activities and performance through the operation of the Performance Review Committee (PRC). The PRC's remit also covers audit issues, rather than there being a separate standalone audit committee.

75. Our Review of Governance Arrangements (issued July 2008) highlighted that while the PRC's current activities broadly comply with audit committee principles there are some areas for improvement. For example, the PRC does not consider the Council's financial statements. In response to this, the Council has recently undertaken a review of the current arrangements against CIPFA guidance on audit committees. This self assessment has identified a number of weaknesses which the Council should address by either establishing a separate audit committee or revising the remit of the PRC. In addition, it is proposed that the committee be provided with additional reports such as an annual statement by Internal Audit on internal control and that it works to a timetable for key audit events. We welcome these developments and will continue to monitor progress in this area.

Internal Audit

76. Internal audit provides an independent appraisal service to management by reviewing and evaluating the effectiveness of the internal control system. We carried out an annual review of the Council's internal audit arrangements. Our overall conclusion was that due to ongoing vacancies within Internal Audit and reduced coverage of key financial systems we were not able place reliance on any new areas of their work for 2007/08.

77. We also highlighted that the lack of coverage of key systems would mean that the Internal Audit Manager would be unable to provide an overall opinion on the effectiveness and adequacy of internal controls across the Council and therefore the Council's annual Corporate Governance Assurance Statement would not be fully supported by the work of Internal Audit. In the event, Internal Audit did not produce an annual report for 2007/08 and hence the assurance provided to support the Corporate Governance Assurance Statement was very limited.

78. Looking forward, the Internal Audit service has recently merged with Risk Management. It is expected that this change will improve the recruitment and retention of staff and also provide an increased capacity to carry out audits. The 2007/08 plan has been rolled forward into 2008/09 and a strategic audit plan will be prepared covering the period 2009 to 2012. Both the auditor and senior auditor vacancies have been filled, leaving the section with one remaining vacancy.

Systems of internal control

79. As part of our work to provide an opinion on the annual financial statements we assessed the extent to which we could gain assurance on a number of the Council's main financial systems. A management letter has been issued identifying weaknesses and recommending improvements. However, overall, we assessed the following central systems as having a satisfactory level of control for our purposes:

- Payroll
- Housing rents
- Main accounting system
- Budgetary control
- Creditors payments
- Council tax
- Benefits

Prevention and detection of fraud and irregularities

80. At the corporate level, the Council has appropriate arrangements in place to help prevent and detect fraud, inappropriate conduct and corruption. These arrangements include a counter fraud and corruption strategy, codes of conduct for elected members and staff and the operation of a standards committee. As raised in our Review of Governance Arrangements, we highlighted that the Council's code of conduct for employees has not been reviewed since 1998.

NFI in Scotland

81. During 2007/08, we continued to monitor the Council's participation in the 2006/07 National Fraud Initiative (NFI). This exercise is undertaken as part of the audits of the participating bodies. NFI

brings together data from councils, police and fire and rescue boards, health bodies and other agencies, to help identify and prevent a wide range of frauds against the public sector. These include housing benefit fraud, occupational pension fraud and payroll fraud. The NFI has generated significant savings for Scottish public bodies (£9.7 million from the 2006/07 exercise and £37 million including previous exercises). Where fraud or overpayments are not identified in a body, assurances can usually be taken about internal arrangements for preventing and detecting fraud.

82. Audit Scotland published a national report on the 2006/07 NFI in May 2008 which identified a small number of organisations, including Midlothian Council whose arrangements for managing the NFI exercise were inadequate. A local audit report was also issued in March 2008 which highlighted the main areas for improvement. The Council is addressing the matters identified and is taking positive steps to bring about improvements prior to the 2008/09 exercise.

Housing Benefit

83. From April 2008, Audit Scotland took over responsibility for inspecting the housing and Council tax benefit functions from the Department for Work and Pensions. We are carrying out risk based inspections on a cyclical basis and all Councils will be inspected during an 18 month period. Midlothian Council was one of the first Councils to be inspected in May 2008.

84. The audit concluded that Midlothian Council's benefits service managers are clear about what the service is aiming to achieve in terms of serving the public, processing benefits claims as quickly and accurately as possible and safeguarding the security of its caseload. It was highlighted that the Revenues & Housing Management Unit's Service Plan 2008/09 includes a range of local targets, but it is not explicit how housing benefits delivery and security arrangements support the Council's priorities or how the benefits service plans to achieve continuous improvement.

85. A detailed audit report was issued which identified specific risks to the continuous improvement of the benefits service. The Revenues Management Team has prepared an action plan to address these risks and will monitor progress. We are satisfied that the planned actions will make a positive contribution to the service and will review progress during our next round of risk assessments within the next two years.

Data handling and security

86. Data handling and security has received increased public and media attention recently as a result of a number of national incidents relating to lost data. The Council shares data with a number of organisations such as the Department for Work and Pensions and other government departments. Information security is now a service delivery issue where a significant failure of controls could lead to loss of stakeholder confidence and opt out from services, higher compliance costs due to enforcement

action, withdrawal of third party services such as payment card processing and legal fees relating to civil and criminal litigation. The Council continues to make progress in information security assessments/practice and recognises the need to take further action to strengthen policy where any of the information is being shared or held outwith the Council network. A “Strategic ICT Risks” report presented to the Corporate Management Team in February 2008 highlighted a number of actions required on the handling of sensitive data, including the implementation of suitable training, procedural and technical counter-measures.

Payment card standards

87. The Payment Card Industry Data Security Standard (PCI/DSS) was developed by major credit card companies as a guideline to assist organisations that process card payments to prevent credit card fraud, hacking and various other security threats. Any organisation processing, storing or transmitting payment card data must be PCI/DSS compliant or risk losing their ability to process credit card payments. The Council undertook a risk assessment and gap analysis in August 2007 regarding PCI compliance and the issues were discussed at various Corporate Services Divisional Management Team meetings. A number of the problem areas have since been addressed and while not fully compliant during 2007/08, the Council now considers the compliance risk fairly minimal.

Governance outlook

Single outcome agreements

88. The concordat between the Scottish Government and COSLA sets out the terms of a new relationship between the Scottish Government and local government. It underpins the funding to be provided to local government over the period 2008/09 to 2010/11. Central to the Concordat is the single outcome agreement (SOA) between each council and the government. The SOA sets out the Council’s contribution to the government’s 15 key national outcomes as set out in the Concordat. It also reflects established corporate and community planning commitments. In this way progress at a national level is supported by outcomes at a local level.

89. The Council submitted the Midlothian SOA to the Scottish Government by the 30 June 2008. The SOA was developed using the recently agreed Community Plan, which included a suite of outcome indicators. The Council engaged with community partners, as appropriate, given the tight timescales. Future engagement with partners is planned with the extent dependent on the timing of the of government guidelines.

90. In future SOA’s will be used to engage partners and to monitor performance. Consequently, the Council has adopted indicators for the SOA, which are already included in the Council’s Corporate

Strategy and the Community Plan, for which performance monitoring procedures exist. The Council also plans to trial the creation of a six-monthly SOA performance report.

Performance

Introduction

91. In this section we summarise how the Council manages its performance. We discuss the overall arrangements before focussing on the specific areas. We comment on the findings of Audit Scotland's national performance studies, relating them to the Council's situation. Finally, we give an outlook on future performance, including our views on the current status of identified risks.

Corporate objectives and priorities

92. The Council's corporate strategy for 2008 – 2011 sets out the key goals and priorities for the Council until 2011 and explains how it plans to achieve these. The plan contains six main objectives:

- Supporting healthy, caring and diverse communities where local needs are met;
- Maximising business opportunities;
- Maintaining Midlothian as a safe place to live, work and visit;
- Conserving and improving Midlothian's natural environment;
- Improving opportunities for people in Midlothian;
- Delivering responsive, efficient and effective services to the people of Midlothian.

Overview of performance in 2007/08

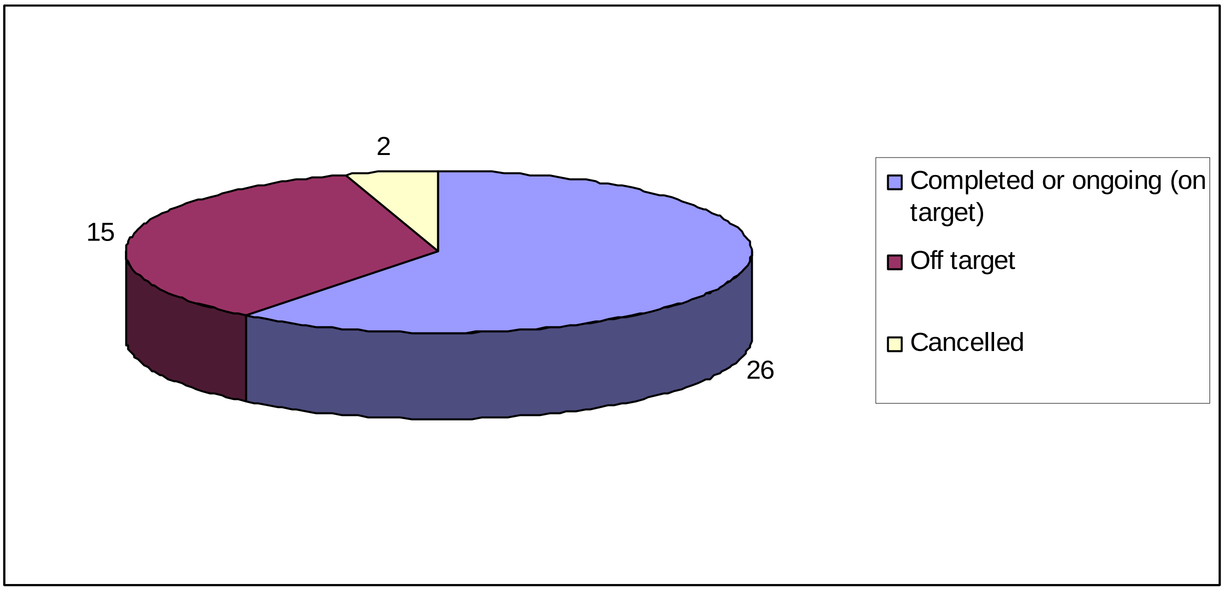
Measuring Performance

93. The Council's performance management framework utilises Covalent software to track the progress of actions in the corporate plan. Performance reports are prepared every three months and are submitted to the Corporate Management Team, Performance Review Committee and Cabinet.

94. In May 2008 the Chief Executive provided the PRC and Cabinet with a full year report detailing progress on the delivery of the key actions for the period April 2007 to March 2008. His report highlighted that, as at 31 March 2008, whilst not all Corporate priorities were due for completion during 2007/08, 62.5% of Corporate/Internal priority actions had been completed and that overall percentage progress on the Corporate Strategy was 85%.

95. The following chart summarises progress over 2007/08 against the delivery of 43 high level priorities:

Chart 2: Achievement of Midlothian Council's key targets 2007/08



Total 43 priorities

96. The 2007/08 performance report also highlighted the Council's major successes over the previous 12 months, major challenges and actions to address these. Key successes that were reported included:

- completion of 8 new primary schools
- opening of Sheriffhall Park and Ride to the public
- target for Council tax collection was exceeded
- continued improvement in recycling levels
- improved levels of education attainment.

97. Looking ahead, the report also highlighted the major challenges facing the Council, including:

- developing a financial strategy to balance the 2009/10 budget
- managing sickness absence levels across the Council
- implementing Modernising Midlothian
- delivering efficiencies
- progressing the roll out of planning and performance management across the Council, including community planning
- improve housing management and homelessness services as recommended in the Scottish Housing Regulator's inspection report.

Public performance reporting

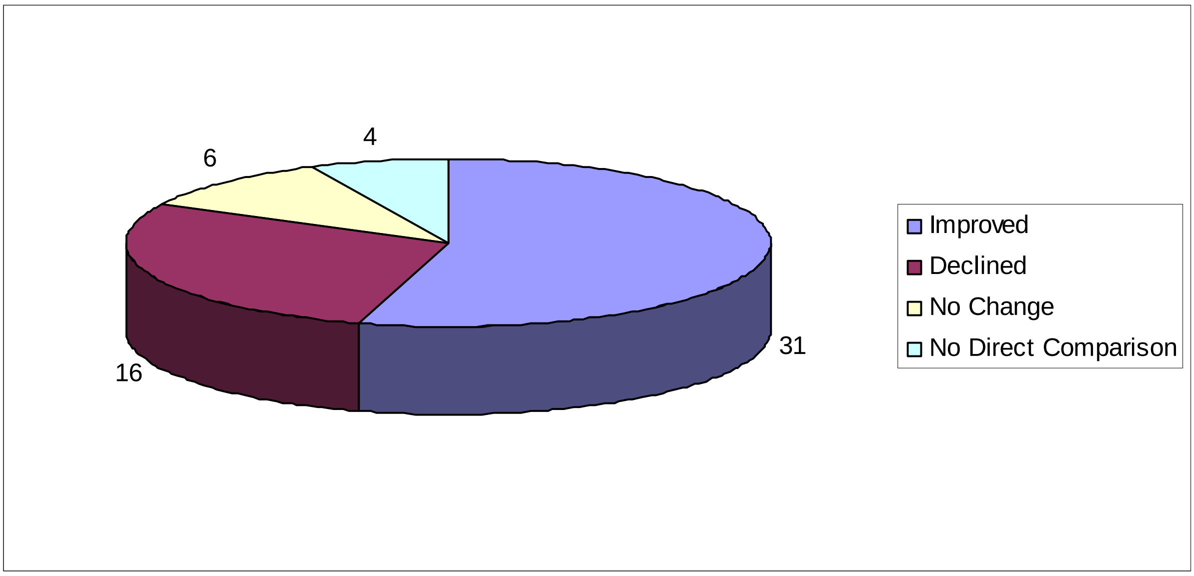
98. The Council issues a quarterly publication *Midlothian News* to Midlothian residents which highlights some of the Council's key developments. In previous years, an annual performance supplement has been included with the September issue to provide residents with a summary of the Council's performance in the preceding year. However, we note that the September edition of Midlothian News was not produced in 2008 a special schools edition was published in July. Arrangements to produce a separate performance leaflet for distribution to council buildings, receptions and libraries, as well as the Council website were agreed instead. This process is currently underway.

Statutory performance indicators

99. One of the ways of measuring Councils' performance is through the statutory performance indicators (SPIs). We note that the council previously reported SPI performance separately to elected members but now integrates appropriate SPI performance into its comprehensive quarterly performance reports. Furthermore, SPIs are currently under review nationally and it is likely that the current approach will change significantly to align with SOA and future Best Value requirements.

100. A total of **57 SPIs** were required in 2007/08. The following chart confirms that the Council has made improvements in a number of areas.

Chart 3: Improvements demonstrated by SPIs (Total 57 indicators)



101. Each year we review the reliability of the Council's arrangements to prepare SPIs. This year we assessed the arrangements for each indicator as being reliable. Improvements were made to the basis for calculating indicators relating to equal opportunities and changes to the method of calculating the measures for the provision of respite care required restatement of the prior year comparatives.

Best Value audit

102. The Local Government in Scotland Act 2003 established Best Value and Community Planning as statutory duties for local authorities. In response the Accounts Commission introduced new arrangements for the audit of best value based on a full review by a specialist team once every three years. In the intervening years short follow-up reviews are carried out by the local auditor.

103. The Best Value audit of Midlothian Council was carried out in 2007 and the findings published in June 2008. Overall conclusions from the audit are included in Table 2.

Table 2 : Conclusions from the Best Value Audit – June 2008

Midlothian Council has a vision clearly based on an understanding of local needs and issues, and effective engagement with its communities, but it has not yet developed a sufficiently clear focus on Best Value. It needs to improve corporate working and establish a stronger culture of challenge and continuous improvement. Partnership working has contributed to some positive outcomes for communities, but the Council needs to adopt a more strategic approach to Community Planning. The Council has many processes in place to support performance management and continuous improvement, but needs to apply these more rigorously if it is to deliver its priorities and improve services. Arrangements are generally effective in managing finances within budget and to support risk management, equalities and sustainability. Improvements in scrutiny need to be sustained to ensure that elected members are well informed about service weaknesses. Improvements are needed in people management, medium-term financial planning, asset management, procurement and in demonstrating competitiveness. The Council generally knows where it needs to improve and has work under way in most of these areas. The Council's service performance is mixed. It is investing heavily to improve the quality of its school estate and to build new affordable homes, but it still needs to improve below average educational attainment and weaknesses in housing and homelessness services. It is responding positively to serious weaknesses identified in its child protection services and social work services more generally. Customer care is inconsistent in delivering accessible services and requires significant improvement. The Council faces a challenging improvement agenda with limited resources. Past improvement plans have proved unrealistic and it now needs to set clearer priorities linked to available resources to meet its responsibilities to deliver Best Value.

104. In response to the report the Council prepared a Best Value Improvement Plan in August 2008 which sets out actions to be completed and associated timescales. Review of progress against the

improvement plan will be undertaken as part of future audits. Comments on a number of the areas covered by the improvement plan are provided throughout this report.

Performance outlook – opportunities and risks

Introduction

105. In the course of our audit work we identified some of the strategic risks facing Midlothian Council in delivering its stated objectives and priorities in the years ahead. These risks were set out in our SARA and grouped into six risk themes. In the following paragraphs, we comment on the progress made by the Council during the year and the key risks yet to be fully addressed. Risk exists in all organisations which are committed to continuous improvement and, inevitably, is higher in those undergoing significant change. The objective is to be ‘risk aware’, and have sound processes of risk management, rather than ‘risk averse’. Indeed, organisations that seek to avoid risk entirely are unlikely to achieve best value.

Strengthening governance

106. Good governance strengthens credibility and confidence in public services and is necessary to enable the Council to pursue its vision effectively as well as underpinning that vision with mechanisms for the control and management of risk. The Council’s 2007/08 Corporate Governance Assurance Statement highlighted a number of areas where work can be done to enhance the control environment and support governance. See paragraph 71 for further details.

107. As previously reported, the Council needs to ensure that it adequately supports all elected members in fulfilling their roles and responsibilities. All 18 elected members in Midlothian Council have been offered a Personal Development Planning meeting which includes a training needs assessment. There was high take-up of this offer which results in an individual PDP summary for each elected member and the development of a composite training programme. The Council monitors the update of training by members and assesses the impact through training needs assessment interviews with members. Training is being provided in a range of areas including scrutiny and financial training (interpretation of the Council’s balance sheet and the impact of the adoption of IFRS).

108. Further commentary on developments in the Council’s governance arrangements over the past year, including internal audit and scrutiny arrangements are included in the Governance section of this report.

Funding future improvement

109. As outlined in the Financial Position section of this report, the Council's current financial position presents serious challenges. Capital investment plans are in jeopardy following serious restrictions in the availability of funding.

110. The Council is currently reviewing its overall financial plan and developing strategies to manage budget pressures. The capital plan has been restricted to committed and essential projects until the funding position improves. This will be closely related to the implementation of the single status agreement, by which time the position and value of equal pay/value claims will be more certain. The capital receipts position is subject to regular monitoring to ensure that it is adjusted to reflect changes in economic conditions.

111. During the year a procure-to-pay process improvement review was completed. The findings from the review were reported to the Council in August 2008 and the business case for e-procurement is currently being prepared. The review identified a number of areas where process improvements could be made which would result in savings.

Challenging and improving performance

112. Effective performance management is vital for the success of the corporate plan. As previously reported, performance management arrangements in Midlothian Council are established at corporate and divisional levels, and are in place for 50% of sub-divisional teams. The Council is still working towards a full roll out by December 2008, including ensuring the use of the Covalent performance management software by all teams. Arrangements for community planning performance management include the submission of a community planning performance report to the Community planning Steering Committee in November 2008, with six-monthly performance reporting thereafter.

113. The Council introduced specialist software ("Covalent ") during 2007. This has led to improved reporting and access to performance information. Risk management reporting has been integrated into the Covalent system and in August 2008 it was agreed to change the way performance in this area is reported. The performance management system therefore continues to be refined so it can be used as a tool to support improvement and address areas of poor performance across the Council.

114. Over the past couple of years the Council's performance has been subject to a number of inspections and audits. During the year, the Council has made progress in implementing agreed actions from a critical HMIE inspection of child protection services.

115. The Council's housing management and homelessness services were inspected by the Scottish Housing Regulator (SHR) in early 2008. The regulator assessed the Council's asset management and

repairs service to be good, but its housing management and homelessness services to be poor. The Council needs to tackle significant weaknesses in delivering its housing management and homelessness services. The Council has developed an improvement plan and will progress this, alongside the Best Value improvement plan during 2008/09 and beyond.

116. The Council's social work services have recently been inspected by the Social Work Inspection Agency (SWIA). The results of the inspection are due to be reported in November 2008.

117. The Council's Customer First Strategy sets out a programme for customer improvements and modernisation. A key part of this strategy is the operation of a contact centre, Contact Midlothian. Contact centre performance is improving, with a comprehensive telephony system now in place to support effective monitoring

Working effectively with partners

118. Councils also have a statutory duty under the Local Government in Scotland Act (2003) to initiate and facilitate community planning in their areas, working with other public sector organisations, local communities and the voluntary and business sectors. In Midlothian this is delivered by the Midlothian Community Planning Partnership (CPP). The Best Value audit reported that the Council needs to take a more strategic approach to Community Planning.

119. The Community Planning Partnership reviewed its community planning arrangements in 2007, resulting in a simpler structure and clearer objectives which have a stronger link to the Council's corporate plan. The Partnership should manage the revised arrangements to ensure that opportunities are taken to accelerate the pace of community planning across the Midlothian area. CPP outcomes will be demonstrated by the six-monthly performance reports.

120. The Council is involved in a wide range of partnership opportunities, such as the South East Regional Transport Partnership and Lothian & Borders Community Justice Authority. Other partnership key developments during the year include:

- the outline business case for the Lothian & Borders Waste Management PPP Project was rejected by the Scottish Government in early summer. As noted in paragraph 66, the Council is currently considering other options for a post collection waste management solution which is likely to still involve neighbouring Councils.
- during the year, the Waverley Railway project made progress with the project being handed over to the national transport agency, Transport Scotland. The delivery timetable was announced in August. The Council will continue to work with partners to ensure that the scheme is delivered on time and to budget.

121. For all partnerships it is critical that strong frameworks are implemented including good direction and leadership, robust decision making processes and agreed performance targets to ensure that the success of the arrangements can be measured.

Managing the workforce

122. People play the key role in the delivery of high performing services and the Council should ensure that it has plans in place to provide the right skills, in the right place, at the right time.

123. As highlighted in the Financial Position section of this report, the Council's progress in implementing the single status agreement has been slow. In addition to the financial risks associated with the single status agreement, the Council is exposed to risks in relation to reduced staff morale, potential industrial relations difficulties and the impact of any revised pay and grading structures on performance.

124. One of the Council's corporate and divisional priorities for the year was to increase the proportion of employees covered by a personal development plan (PDP). A target was set that all employees would have a PDP by April 2008, but this was not achieved. In 2008/09 the target has been revised to 80% and currently 72% of employees are covered by a PDP. The coverage of PDP will be addressed through the implementation of a competency framework, via the Modernising Midlothian project.

125. Another corporate and divisional priority of the Council is to improve absence management. In 2007/08 a target was set to reduce the overall level of sickness absence to 5%, but despite an overall reduction from the prior year, this target was not achieved. In 2008/09 the target has been revised to 4.75% and based on recent statistics, the Council is performing much better in this area with an absence rate of 4%.

126. The Council's People Strategy was approved in September 2006, providing a clearer strategic link between managing people resources and achieving corporate goals. The Strategy's action plan aims to establish the key elements of workforce planning through defining a planned approach to recruitment, deployment, retention, development and motivation of the workforce by March 2009. The People Strategy will be revisited in 2009 once the single status project, Modernising Midlothian, is implemented to ensure the overall focus is appropriate.

Delivering modern infrastructure for a growing population

127. Council facilities and infrastructure must be suitable and sufficient to achieve service delivery and the delivery of Council objectives in the future.

128. During the year, the Council completed a number of major capital projects such as the opening of 8 new primary schools and the Park-and-Ride facility at Sheriffhall. Good progress was also made on the house building project, the first major Council house building project in Scotland for many years. The initial phase of 27 homes is now complete and the second phase of 426 homes should be ready for occupation by mid-2009. Good progress has also been made with the kitchen replacement programme with more than 700 homes fitted with new kitchens. The kitchen designs comply with the Scottish Housing Quality Standard which the Council expects to achieve by 2015.

129. Effective project management is essential to ensure the successful delivery of projects. The Council introduced a corporate project management framework in 2007 and has since provided training to all identified project managers. This should ensure consistency across the Council and minimise the risk of significant overruns in cost or time budgets.

130. As highlighted in the Financial Position section of this report, the Council's current capital plan is not affordable. Consequently a number of projects which were originally included in the capital programme have been suspended until the Council's financial position improves. These include the new Rosewell Primary School, Dalkeith Town Centre Improvements, the upgrading of leisure facilities (Tone Zone) as well as various IT projects.

Asset management

131. As part of this year's audit we have reviewed the Council's asset management arrangements, focusing on operational properties. Although asset plans are in place for some individual services, there is no overall corporate asset management plan which links into the Council's service and corporate plans or capital investment plan. The Council is working towards this, but does not have a defined timescale.

132. The following services are without asset management plans or simple service-based asset management strategies:

- social work
- libraries, leisure centres
- commercial services depots.

133. The Council has a risk register in place for property strategy which we found to be comprehensive and up to date. In our view, the following three areas need to be addressed:

- the Council does not have a formally approved maintenance plan. The current maintenance regime is mainly reactive, with backlog maintenance estimated at £20 million. Reactive maintenance is not cost effective in the long term. Over the past couple of years, the Council has made progress in completing property condition surveys. The Council should ensure there is a clear link between condition surveys and its maintenance programme.

- to ensure the best and most sustainable use is made of the council's property assets, decisions on asset management require wide consultation involving service users, staff and community planning partners. The Council's approach is currently underdeveloped in this respect.

Key risk area 11

National studies

134. Audit Scotland carries out a national study programme on behalf of both the Accounts Commission and the Auditor General for Scotland. Reports published in the last year of direct interest to the Council are described below. Further information on these studies and copies of the reports can be obtained from Audit Scotland's web page at www.audit-scotland.gov.uk

Sustainable waste management

135. Collecting household waste is a vital and universal service. In recent years significant new investment has been made to reduce the amount of waste sent to landfill. Our national report on sustainable waste management, published in September 2007, highlighted that:

- Significant progress has been made in meeting interim recycling targets, but the rate varies considerably between Councils. The percentage of municipal waste recycled and composted increased from 7% in 2001/02 to 25% in 2005/06. Co-mingled collections appear to achieve higher recycling rates
- There has been slow progress in developing facilities to treat residual waste and there is a significant risk that EU landfill directive targets might not be met
- Increased recycling has led to increased costs for Councils
- All parties need to work more effectively together to make progress in waste minimisation, recycling and waste treatment.

136. One of the Council's corporate priorities is to reduce the environmental impact of waste and work towards a "Zero Waste Midlothian". The Council's current recycling rates are relatively high (37%), but continued efforts are required to achieve the Scottish Government target of 40% by 2010. As noted in paragraph 66, the outline business case for the Lothian & Borders Waste Management PPP Project was rejected by the Scottish Government in early summer . The Council is currently considering other options for a post collection waste management solution which is likely to still involve neighbouring Councils.

Free personal and nursing care

137. Since July 2002, all Councils have had systems in place to deliver free personal and nursing care (FPNC). People of all ages living in care homes are entitled to free nursing care and people over 65, living in any setting, are entitled to free personal and nursing care. Our national report about the financial implications of FPNC, published in September 2007, found that:

- Councils have interpreted the legislation and guidance relating to food preparation differently across Scotland
- Councils should improve their information systems to enable them to collect comprehensive and accurate information on FPNC and other aspects of care and support services
- Councils should provide clear information to older people on what is covered by FPNC
- Councils should work with local health partners to evaluate the longer term consequences of reducing domestic homecare services.

138. Within Midlothian, the delivery of Free Personal and Nursing Care to older people continues to place budgetary pressure on the Council. In 2007/08 the Council spent £4.4 million on providing this care. Demand is managed by assessing need against the Council's eligibility criteria based on whether there is a substantial or critical risk to an individual's ability to live independently. The Sutherland Review is anticipated to allocate additional funding to Councils in 2009/10.

Scotland's school estate

139. A major programme of school building renewal started at the end of the 1990s and is continuing today. The programme aims to create a school estate that achieves the government's vision for 21st century schools that are well designed, well built and well managed. Our national study reviewed what has been achieved so far, how much it is costing, how effective the improvements are and how well the Scottish Government and Councils are working together to manage improvements to the schools estate. One of the main conclusions of our report, published in March 2008, is that the current rate of progress will take up to 20 years to remove all schools from poor or bad condition. The report recommends actions for the Scottish Government and Councils to help improve arrangements and support future achievements. These include:

- Better planning by Councils and the Scottish Government to set specific, measurable and meaningful targets for the school estate strategy.
- Greater use of the Scottish Government guidance by Councils to make sure future school design strikes a good balance for the comfort of everyone who uses the building.
- Making environmental sustainability a key element of school design.

- Doing more to identify and share good (and bad) practice in school design and estate management.
- Estimating pupil rolls for at least ten years ahead with a minimum annual review.
- Within Midlothian, the Schools Plus Programme will deliver a number of new primary and nursery schools through PPP, traditional capital and developer funding. Proposals for the future of Lasswade and Newbattle High schools are being developed, though are reliant on additional funding from The Scottish Government and development of the Scottish Futures Trust as a replacement for PPP funding.

Overview of sport in Scotland

140. Public bodies spend on average £558 million a year on sport in Scotland. Councils are responsible for 90% of this expenditure. Most of the money is spent on providing and maintaining facilities as well as programmes to encourage participation and support individual athletes. Our national report, published in April 2008, found that:

- The provision of sports facilities and other services is fragmented, with no clear links between the government's national strategy for sport and Councils' investment. The development of single outcome agreements is an opportunity to clarify and align the links between national and local strategies.
- The level of participation and funding in sport has been declining and participation by younger people falls short of targets.
- Sportscotland estimates that an additional £110 million a year is needed for the next 25 years to bring sports facilities up to an acceptable standard.
- Arrangements to deliver the 2014 Commonwealth Games are still being developed. These will be critical in ensuring the success of the games and safeguarding the large sums of public money that will be invested.

141. One of the Council's priorities is to increase the usage of sport and leisure services across Midlothian. The Council has a local target to increase attendance at pools and indoor sports and leisure facilities by 5% in 2008/09. However, a number of sport and leisure capital investment projects (e.g. upgrading of 3 tone zones) have been suspended as a result of the current funding constraints on the Council's capital programme.

Risk area 12

Final Remarks

142. We have made a number of recommendations in the various reports we have issued during the course of the year and have obtained assurances from officials that action will be taken as appropriate.

143. Attached to this report is an action plan setting out the key risks identified by the audit which we are highlighting for the attention of members. In response, officers have considered the issues and have agreed to take the specific steps set out in the column headed 'planned management action'. On occasion, officers may choose to accept the risk and take no action. Alternatively, there may be no further action that can be taken to minimise the risk. Where appropriate, the action plan clearly sets out management's response to the identified risks.

144. Appropriate mechanisms should be considered and agreed by members for monitoring the effectiveness of planned action by officers. We will review the operation of the agreed mechanism as part of the 2008/09 audit.

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

Appendix A: Action Plan

Key Risk Areas and Planned Management Action

Action Point	Refer Para No	Risk Identified	Planned Management Action	Responsible Officer	Target Date
1.	13-14	***Financial Instruments –*** The Council's draft unaudited accounts did not fully comply with the 2007 SORP, i.e. the new accounting treatment and disclosures requirements for financial instruments. ***Risks: without due planning and preparation the unaudited financial statements ,may not comply with the requirements of the 2008 SORP***	The 2008/09 final accounts project plan will be developed to deal with SORP 2008 requirements well in advance of the financial year end and will include lessons learned from the 2007/08 SORP changes.	D Gladwin	31 March 2009
2.	15-16	**Prudential Code - monitoring and reporting arrangements** During the year the authorised limit for external debt was breached and not reported to members. ***Risks: the Council does not meet the requirements of the Prudential Code; members are not sufficiently aware of significant treasury management decisions; the Council exposes itself to too great a burden with excessive borrowings.***	The Council approved capital plans and prudential indicators spanning three years. The totals for the three years have not been exceeded but borrowing has been undertaken to finance future capital expenditure when interest rates were attractive. This is considered to be prudent and in accordance with advice from the Council's Treasury advisors. Reporting will be improved to ensure, in future, members are aware of any deviation from the approved strategy.	S Humphries	ongoing
3	17-18	**Fixed assets – valuation and classification** A number of issues were identified during the audit. ***Risk: non compliance with the SORP and, ultimately, material misstatement of the value of fixed assets.***	The Finance Unit are continuing to work with the provider of our Fixed Asset accounting system to ensure that is it fully SORP compliant. The Finance Unit also have a planned meeting with Estates to ensure that the issues identified during the 07/08 audit are adequately dealt with in 08/09.	V Struthers	30 May 2009

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4	19	**Post-balance Sheet events** The Council elected not to refer to significant market volatility in investment valuations in September as a post-balance sheet event. ***Risk: non-compliance with FRS 21; readers of the accounts may not be fully apprised of significant post-balance sheet events.***	Noted – no additional risk.	n/a	n/a
5	35	**Insurance Fund** An independent valuation of the cumulative value of the Council's insurance fund relative to its current and future liabilities has never been carried out. ***Risk: that the fund is not adequate which would result in increased pressure on service accounts in the medium to longer term.***	Review of Insurance Fund is already underway (Cabinet 5/8/08).	A Jamieson	30/11/08
6	36-37	**STOs--**Building Maintenance failed to make a surplus in 2007/08. ***Risk - There is a risk that it will not achieve break-even in the next 3 year-period.***	The approved budget for 2008/09 shows a small in-year surplus for Building Maintenance which if achieved will achieve the 3 year break even target. Performance against this target is monitored quarterly in the Financial Monitoring reports prepared for Council.	J Blair	Ongoing
7	50	**Removal of ring-fenced funding-** while this may allow the Council greater flexibility, there is a danger that funds are diverted away from planned activities. ***Risk – the Council may fail to deliver its planned outcomes.***	A key part of the Council's Budget process is matching resources with priorities. This underpins the 2008/09 and 2009/10 budget process. No additional action is deemed necessary	n/a	n/a
8.	49, 51-55	**Financial position** The Council faces significant challenges in balancing revenue and capital resources and ensuring that planned	Regular reports are being prepared for Council which are intended to move towards the objective of balancing the Council's short and medium term financial plans and ensuring that	Ian Jackson	Ongoing

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		activity is affordable within available resources. In addition to the current financial year pressures, the Council faces challenges in setting balanced budgets for 2009/10 and beyond, A significant net overspend is predicted in 2008/09 which will result in a general fund deficit for the first time in a number of years. ***Risk: financial plans are unsustainable; the Council is unable to achieve budgeted efficiencies effectively resulting in a funding shortfall; the Council is unable to maintain effective service delivery and achieve improvements in performance within current resources; the Council does not have cash reserves to fall back on in the event of unforeseen circumstances;***	cash reserves are at an acceptable level.		
9.	58-60	**Single status** Single status has not yet been implemented. ***Risk: Costs may be in excess of expected levels*** ***industrial relations problems may arise; legal challenges may prolong implementation further.***	Progress the planned implementation of Modernising Midlothian. Which will include a comprehensive report to Council before Christmas	T Muir	December 2008
10.	62	**Affordability of the capital plan** Despite taking the decision to suspend uncommitted capital projects, a significant affordability gap has been identified in relation to the Council's existing capital spending plans. ***Risk: capital plans are not affordable or sustainable; the Council cannot invest***	Capital plan affordability is a short term issue, funding from capital receipts identified in later years. Action has already been taken to improve affordability in the short term and regular monitoring and review is in place.	Ian Jackson	n/a

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		in identified priorities; service redesign cannot be progressed.			
11.	131 - 133	**Asset management planning** Although asset plans are in place for some services, there is no overall corporate Asset Management Plan which links into the Council's service and corporate plans or capital investment plan. The Council is working towards this, but does not have a defined timescale. ***Risk: assets are not being efficiently and effectively managed and potential savings are not realised.***	CMT to provide a vision for services not currently included in the Asset Management plan. A full Asset management plan is a corporate priority targeted for completion by 31 March 2009.	Ian L Young	31/3/09
12	142	**Leisure facilities** The Council has a local target to increase attendance at pools and indoor sports and leisure facilities by 5% in 2008/09 ***Risk: Target may not be achieved as a number of sport and leisure capital investment projects have been suspended as a result of the current funding constraints on the Council's capital programme.***	The planning and performance management framework has the flexibility to enables Directors to amend priorities and targets in light of the changes in the capital plan. This process maintains the relationship between budgets and priorities	n/a	n/a