

Midlothian Council

Annual Audit Report 2011-12

November 2012

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1. Executive Summary

Introduction

The Accounts Commission for Scotland appointed Grant Thornton UK LLP as auditors to Midlothian Council (the Council) under the Local Government (Scotland) Act 1973 for the period 2011-12 to 2016-17. This is therefore the first year of our appointment. This report summarises the findings from our external audit work for the year ended 31 March 2012.

Overall Conclusions

We use the table below to highlight the key findings emerging from each aspect of our work during 2011-12. This has been our first year of appointment with the Council, and we have found a real desire to improve services and address the budget challenge, but also frustration and difficulties in changing ways of working. It is becoming increasingly clear that there are still significant challenges and difficult decisions ahead.

The Council has set itself a challenging agenda to tackle service performance, budget savings, improved use of assets and economic development within the same timescales. Whilst the scale of the task ahead is significant, the new Administration has a key opportunity to learn from public engagement to prioritise activity to generate quick wins, and ensure that staff and the public see the benefit of early success.

Meeting future challenges

We have identified a number of key challenges in the year ahead. In particular, the Business Transformation Programme must get back on track to deliver required efficiency savings to ensure that services remain sustainable in the medium term. Continuing pressure on Councils' revenue and capital budgets will present a challenge to continuing with current levels of service provision in some areas. We highlight that other cost pressures such as welfare reform will have a significant impact on the financial position of the Council.

The creation of new national police and fire services means there is a developing role to meet revised local accountability arrangements for these services. We were pleased to note that Midlothian will be at the forefront of these developments as a pathfinder.

Revised scrutiny and audit arrangement continue to emphasise the importance of developing community planning arrangements as a mechanism for improve economy, efficiency and effectiveness in service delivery. The Council's proposals for a revised Single Outcome Agreement and Corporate Objectives are therefore critical to ensure that resources are directed to meet the priorities of the Council and partner bodies.

Key Findings

Reporting Area	Our Summary
Financial Position	<ul style="list-style-type: none"> The Council had a general fund balance of £14.2m at the year end. The General Fund increased in the year as a result of a surplus against budget in 2011-12. The uncommitted portion of the General Fund is £6.9m, which exceeds the Council's target for reserve balances by some £3m. Slower than expected progress in delivering savings through the Business Transformation Programme, significant demand led pressures, together with the loss of savings that had been anticipated from shared services for Education, has created a significant short term budget gap in 2013-14.

Reporting Area	Our Summary
Governance	<ul style="list-style-type: none">• Governance arrangements are generally an area of strength for the Council. The Council has well-developed arrangements in place for scrutiny and an effective internal audit function is in place.• The Council's senior management team has been operating with limited capacity due to changes in senior staff appointments during the year. Developing leadership capacity remains a key risk area in the current financial climate.• Our review of internal controls for key financial systems found that they operate effectively.
Performance	<ul style="list-style-type: none">• The Council received a Best Value report from Audit Scotland in June 2012 which indicated that the Council had 'good prospects for future improvement'.• Performance against statutory performance indicators is generally improving, but falls behind the national average in a small number of key areas.• There is scope for the Council to improve how it reports financial and operational performance more generally and to develop more outcome based measures of performance.

2. Introduction

Introduction

The Accounts Commission for Scotland appointed Grant Thornton UK LLP as auditors to Midlothian Council (the Council) under the Local Government (Scotland) Act 1973 for the period 2011-12 to 2016-17. This is therefore the first year of our appointment.

This report has been prepared for the benefit of discussion between Grant Thornton UK LLP and Midlothian Council (the Council).

Our responsibilities

It is a condition of our appointment that we meet the requirements of the Code of Audit Practice, which is approved by the Accounts Commission and the Auditor General for Scotland. The most recent Code was published in May 2011 and applies to audits for financial years starting on or after 1 April 2011.

The Code of Audit Practice highlights the special accountabilities that are attached to the conduct of public business and the use of public money. This means that public sector audit must be planned and undertaken from a wider perspective than the private sector. We are therefore required to provide assurance, not only on the financial statements and annual governance statement, but also on Best Value, use of resources and performance.

Our Annual Report

This report summarises the findings from our 2011-12 audit of Midlothian Council. The scope of our work was set out in our Audit Approach Memorandum, which was presented to the Audit Committee on 14 February 2012.

The main elements of our audit work in 2011-12 have been:

- the audit of the financial statements, including a review of the annual governance statement
- a review of corporate governance arrangements, internal financial controls and financial systems

- the audit of statutory performance indicators
- a review of the council's response to Audit Scotland's national study reports.

The key issues arising from these outputs are summarised in this annual report.

Assurance and Improvement Plan

Midlothian Council's Assurance and Improvement Plan (AIP), was updated and developed by the Local Area Network of external scrutiny bodies, and published in May 2012. The update reflects recent work carried out by local scrutiny partners, including the Best Value audit, and sets out the scrutiny activity proposed for the council for the period up to March 2015.

The Council's AIP Update 2012-15 outlined one significant area of concern at Midlothian Council, relating to the management of the homelessness service. The Scottish Housing Regulator is continuing to follow up scrutiny in this area. The LAN did, however, recognise the council's ongoing commitment to continuous improvement at officer and elected member level.

Reflecting this conclusion, the AIP did not identify plans for any significant additional scrutiny, and we did not identify any additional areas of work as a result of the Shared Risk Assessment process.

The results of the work reported here will be used to inform the next Shared Risk Assessment. The LAN is scheduled to meet in November 2012 to discuss initial assessments.

Acknowledgements

We would like to take this opportunity to record our appreciation for the kind assistance provided by elected members and officers of the Council during our audit.

3. Financial Position

The Council currently has a general fund balance of £14.22m, with £6.93m available for new expenditure or to meet unforeseen costs. The Council recorded a surplus against budget in 2011-12, although the delivery of savings through the Business Transformation programme will continue to be key to meet the budget gap identified over the next four financial years.

Financial Reporting

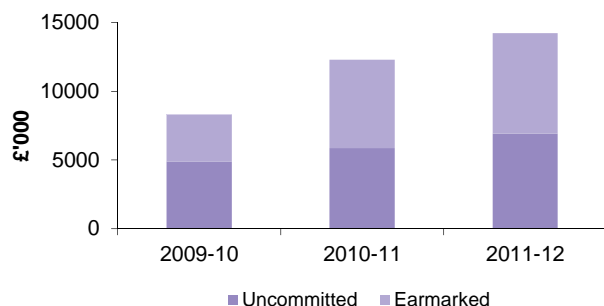
The Statement of Accounts is the key document that the Council uses to report on its financial performance, and to account for the stewardship of resources during the financial year. We use this report on comment on the key messages within the annual accounts, and the impact on the Council's financial plans.

Financial Position

One of the key measures of financial health at a local authority is the level of uncommitted reserves balances. The Council has set a target to maintain reserves at 2% of budget to allow flexibility and the ability to respond to unexpected events.

At 31 March 2012, the Council reported a general fund balance of £14.22 million (2010-11: £12.2 m), of which £6.93 million is uncommitted. A small increase in uncommitted reserves of £0.089 million was achieved, rather than a planned decrease of £0.696 million.

Figure 1: The Council has used reserves to meet the costs of the Change Programme, but uncommitted reserves remain within the target range



Source: Midlothian Council Statement of Accounts

We reviewed some of the key financial ratios against other Scottish Councils within **Appendix B**. We found that the Council has a healthy level of usable reserves in comparison to many Scottish local authorities, although this may reflect factors such as the relative stage reached on the transformation journey.

At the year-end uncommitted reserves stood at 3.6% of net expenditure, and therefore significantly exceed the Council's 2% target.

This achievement reflects underspends against service budgets, of £1.6 million in 2011-12 and £3.2 million in 2010-11, partly as a result of one off savings. As a result, the Council has been able to earmark £2 million of reserves to support the Business Transformation Programme.

Comprehensive Income and Expenditure Statement

The Council reported significant movement in balances between years in its Comprehensive Income and Expenditure Statement, principally as a result of an exceptional adjustment in 2010-11 to impair the value of the housing stock, and pension accounting movements. As Table 1, below, highlights, the Council reported total net comprehensive income in year of £13.5 million (2010-11: expenditure of £239 million).

An exceptional exercise was required by the Council's previous auditors to ensure that the housing stock valuation reflected the difference in private and social rent levels in the Midlothian area. As a result, an impairment of £290 million was made to the carrying value of housing stock within the accounts. This movement last year was partly offset by a one-off past

service gain of £34.4 million relating to accounting entries for the cost of pensions.

As reported last year, during 2010-11, the index used to measure pension inflation was changed from the Retail Price Index (RPI) to the Consumer Price Index (CPI) in 2010-11. CPI is generally lower than RPI and by switching to CPI for measuring pension inflation the value of pension liabilities is reduced. This effect is offset by the impact of the economic recession in lowering long term investment returns to the fund and by the impact of members of the pension scheme who are living longer which is increasing costs.

Pension costs will be met from higher employer and employee contributions over the long term and we expect to see the share of Council expenditure being required to fund staff pensions increasing over time.

Table 1: Financial Results for 2011 and 2012

	2012 £'000	2011 £'000
Net Cost of Services	176,651	210,274
Other operating expenditure	303	823
Financing and investment income and expenditure	12,143	12,670
Taxation and non-specific grant income	(189,512)	(192,913)
(Surplus)/deficit on the provision of services	(415)	30,854
(Surplus)/deficit arising on revaluation of non current assets	(6,157)	213,354
Actuarial (Gains) / Losses on Pension Assets and Liabilities	(6,072)	(9,591)
Other (Gains) / Losses	(856)	(863)
Total Comprehensive (Income) and Expenditure	(13,500)	238,754

Source: Midlothian Council Statement of Accounts 2011-12

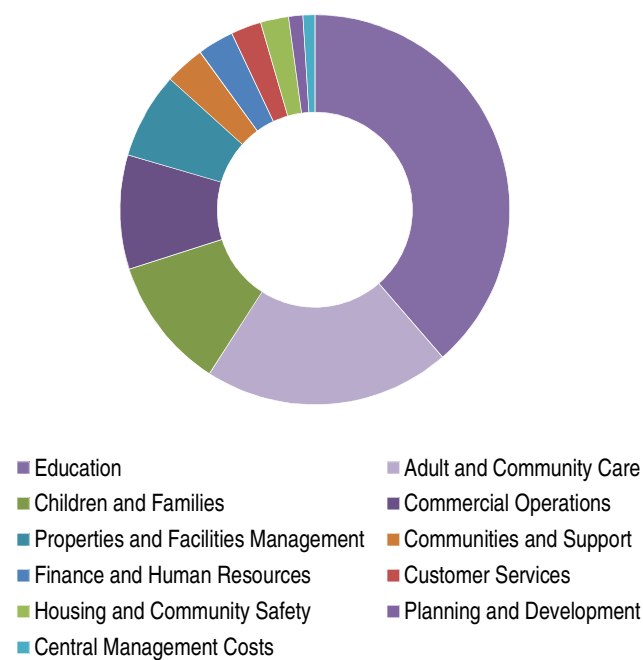
Service expenditure

The Council's services performed well against budget, with an overall underspend of £216k. Significant overspends, totalling £1.25 million, were recorded with Children and Families as a result of higher than anticipated use of out of area placements and fostering

of looked after children. A £431k overspend was also recorded within the Commercial Operations services, as a result of higher than anticipated waste disposal costs, fuel costs and fleet repairs. These overspends were offset by underspends in other services, including a £1.18 million underspend in Properties and Facilities Management. This reflects, in part, a one off windfall in relation to a successful VAT rebate claim for overpaid tax on income from coaching and fitness classes from 1981 - 1989.

Figure 2 outlines the main areas of service expenditure.

Figure 2: The majority of Council expenditure is directed towards Education and Social Care



Source: Midlothian Council Budget Outturn Report June 2012

Significant Trading Organisations

The Council maintains two trading accounts: Building Maintenance and Roads Maintenance. Section 10 of the Local Government in Scotland Act 2003 requires that local authorities' significant trading organisations break even over a three year rolling period. Under the terms

of the Act, the identification of significant trading operations is the responsibility of individual authorities.

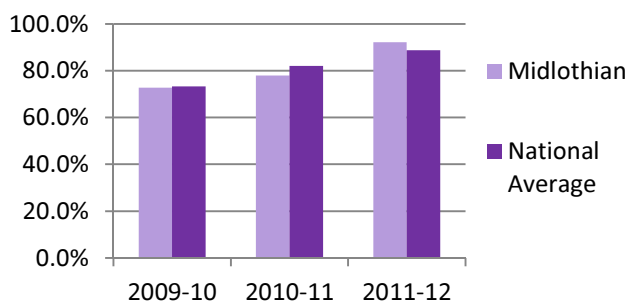
Both of Midlothian's trading accounts delivered surpluses each year over the three year period. We do, however, note that a change to working terms and conditions has resulted in a deterioration in productivity in the first quarter in 2012-13, particularly for the building maintenance STO.

Housing Revenue Account

The Housing Revenue Account (HRA) Income and Expenditure account reported a surplus for the year of £29k (2010-11 £314k), although rent arrears for current tenants and former tenant rose during the year.

For the year ending 31 March 2012, the Council had total HRA reserves of £11.71 million (2010-11: £11.68 million). During 2011-12, £25.3 million, against a budget of £23.8 million. The main reason for the overspend was an acceleration of Phases 1 and 2 of the social housing capital programme. The Council also accelerated the capital investment programme to deliver the Scottish Housing Quality Standard. Additional works on the kitchen and central heating replacement programmes resulted in an overspend of £473k, but Figure 2 highlights that this had a significant impact on the Council's performance in this area.

Figure 2: Key investments meant that the percentage of council dwelling that have modern facilities and services rose above the national average in 2011-12



Source: Audit Scotland Statutory Performance Indicators

Capital Expenditure

General Services capital expenditure totaled £20.03 million in 2011-12, representing a minor overspend of £271k, which reverses a significant underspend in the prior year.

The key capital project during 2011-12 was the replacement of Lasswade High School. Construction on the Lasswade campus commenced in November 2010, and was one of the first schools to benefit from the Scottish Government's *Schools for the Future* grant funding programme. The Council has also recently announced that £17 million of funding has been secured from the Scottish Government to support the replacement of Newbattle Community High School.

Other key areas of capital expenditure include work to regenerate the Dalkeith Town Centre, including repair and conservation work on historical buildings. Roads and footways have also been upgraded, and the Council spent £1.67 million on a vehicle replacement programme.

The overspend related to additional work on footways and cycling, walking and safer streets. These initiatives were part funded by Sustrans.

Borrowing

Councils' capital expenditure is governed by the Prudential Code, which requires councils to ensure capital plans are affordable, borrowing is prudent and sustainable, and treasury management arrangements reflect good practice.

The Council approved a set of prudential indicators for 2011-12 and managed capital expenditure within these approved limits. One of the key indicators is the Capital Financing Limit, which is the amount of debt that the Council can afford to service. As Table 2 shows, the Council's net borrowing position left headroom of some £44 million in 2011-12.

Table 2: The Council's Net Borrowing Position was comfortably within the CFL

	31 March 2012 Budget	31 March 2012 Actual
	£'000	£'000
Net Borrowing	197,701	182,103
Capital Financing Limit	234,203	226,296
	(36,502)	(44,193)

Source: Annual Treasury Management Review 2011-12

We also noted that the Council's Treasury Management Strategy is to keep increase borrowing from the Public Works Loans Board to keep interest rates low and to manage the risks of higher inflation and interest rates in the future.

Financial Reporting

The Statement of Accounts is the key method Councils' use to report to elected members and the public on how effectively they use public funds. Local authorities are large and complex organisations, and the nature of the regulatory framework means that large accounting adjustments are made to accounts that can be difficult to explain or understand.

We believe that there is scope to improve the current Explanatory Foreword provided by the Head of Finance and Human Resources. Key information about the financial performance during the year is reported within papers for Council meetings, but this information is not replicated or summarised in the Explanatory Foreword. For example, the Foreword explains that £7.3 million of the General Fund has been earmarked for specific purposes, but no explanation is provided of what the reserves have been earmarked for.

The CIPFA Directors of Finance working group approved a number of financial ratios (**Table 3**), for use within the 2011-12 annual accounts to enhance comparability across Scottish councils. Midlothian Council has not provided this analysis for 2011-12, but

we believe that there is scope to provide this information in future years.

Table 3: CIPFA Director of Finance Agreed Financial Ratios for use in the Explanatory Foreword

- Uncommitted General Fund as a percentage of Annual Budgeted Net Expenditure
- Movement in the Uncommitted General Fund balance
- In year council tax collection rate (%)
- Council tax income as a percentage of overall funding (%)
- Actual outturn compared to budget
- Actual contribution to / from uncommitted General Fund balance (£)
- Capital financing requirement and External Debt levels (refer to Prudential Indicators)
- Ratio of financing costs to net revenue stream
- The impact of capital investment on council tax and housing rent levels

Budget Strategy

In 2010, the Council began preparations to address a significant budget gap for the year 2011-12 to 2014-15 as a result of reductions in government spending, coupled with increased service demands. The budget gap is currently estimated at £5 million for 2013-14, rising to £9million for 2014-15. A package of measures were introduced, which included a voluntary severance programme to support a management restructure and reduction in staff numbers.

The Council is also required to respond to a number of emerging financial pressures such as the implications of welfare reform, health and care integration, police and fire reform and pension scheme auto-enrolment. The Council has also adopted a living wage policy and no compulsory redundancies strategy.

The Implications of Welfare Reform

Welfare Reform presents a significant, and as yet, unquantifiable financial risk to the Council.

The Welfare Reform Act introduces a universal credit, which is an integrated working age benefit to replace existing in and out of work benefits, including housing benefit. The Act also introduces size criteria into the calculation of housing benefit for working age tenants in the social rented sector. Claimants' eligible rent will therefore be restricted if their current social rented property is larger than they need.

The council has an immediate £0.25 million cost to contribute to the funding to implement the revised council tax benefits scheme. However, indirect costs of welfare reform may be significantly higher. Under the current housing benefits system, the benefit is managed between the council and the DWP on behalf of tenants. In future, in all but exceptional cases, the universal credit will be paid directly to the tenant. This means that some tenants may be expected to pay rent to the council for the first time, and may therefore require support around budgeting and personal financial management.

about priority services, but also manage expectations about the financial position of the Council.



Refer to Audit Action Plan Point 2

Current Projections for 2012-13

We have reviewed the Council's projections for 2012-13. The Council continues to predict lower than anticipated savings through the service review programme. We also noted that the Council is experiencing significant financial pressures within the Social Services budget and is taking forward a number of actions to help address the demand-led pressures. The Council has initially outlined a 2.5-5% reduction across all service budgets, and we will therefore continue to monitor performance against the budget throughout 2012-13.

Refer to Audit Action Plan Point 1

The Council's ability to address the budget shortfall from 2012-13 to 2014-15 continues to depend on the delivery of the Business Transformation Programme. However, in September 2012, the Council was told that the achievement of savings has been slower than anticipated. An additional budget gap has emerged as a result of the step back from a shared service for education with East Lothian Council.

The Business Transformation Programme has been refocused to ensure it is more effective at generating savings and tackling the silos approach to services, but a short term savings gap has been identified in 2013-14.

The Council is currently prioritising the systems thinking approach at areas of high spend to meet this challenge. The Chief Executive has also asked all Heads of Service to identify immediate areas for potential saving. It is clear that this exercise will present a number of difficult policy decisions for the Council. The Council must therefore use engagement with the public on the budget on future service models to gain clarity

4. Governance

The Council has an Assurance Framework in place to support its Annual Governance Statement. Risk management arrangements are generally well developed, and the Council has recently agreed to act as a pathfinder to develop local accountability arrangements for the new Scottish Police and Fire & Rescue services.

Annual Governance Statement

The Annual Governance Statement (AGS) is the key document that records the governance ethos of the Council, and assurances around the achievement of the vision and strategic objectives of the Council. The AGS summarises the local code of governance, including the internal control framework, arrangements for risk management, financial governance and accountability.

An AGS is best practice, but not yet mandatory for councils in Scotland. Midlothian Council was an early adopter and has produced a Corporate Governance Statement, and later AGS, since 2005-06.

We reviewed Midlothian's AGS as part of our audit procedures and concluded that the disclosures were in line with our knowledge of the Council. We also subjected Midlothian's 2011-12 AGS to benchmarking data from our annual local government governance review, *High Pressure System*. This review, based on

survey responses from over 100 senior council officers and members, and a desktop review of 200 UK councils' 2010/11 Annual Governance Statements (AGS), evaluates the soundness of existing governance systems for operating in the current high pressure environment.

Figure 4 highlights that we concluded that Midlothian's disclosures are clear and comprehensive, although there was scope to extend the description and purpose of the key elements of the Council's approach to meeting the Good Governance Standard.

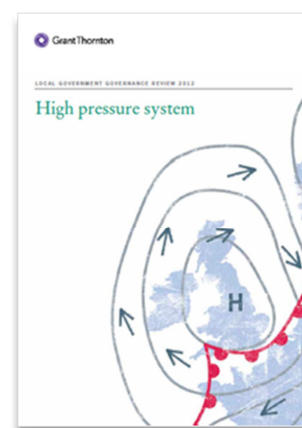
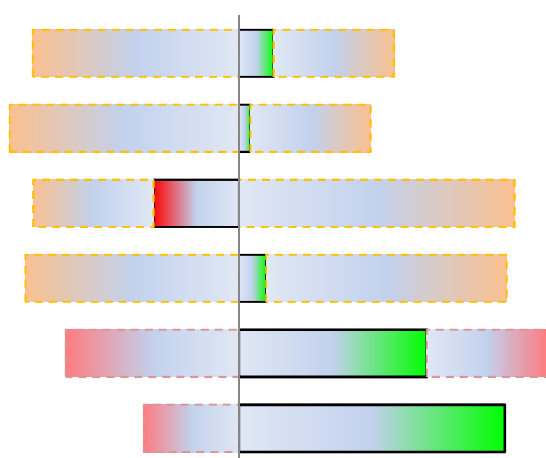


Figure 4: Disclosures within Midlothian Council's AGS exceeds the national average in all but one of our key benchmarks



Balance between comprehensiveness of content and concision and clarity of message

Description of the purpose of the governance framework

Description of systems and processes and stakeholders that comprise the governance framework

Description of process involved in the review of effectiveness of the governance framework

Description of significant governance issues (or the reason if none) described, including whether they are "significant"

Description of the progress made in dealing with prior year issues

Source: Benchmarking Data from Grant Thornton's Annual Local Government Governance Review.

Scrutiny Arrangements

Effective scrutiny is critical to the success of the Council's governance arrangements. Elected members have a key role to hold officers to account for delivering the vision for the area. Following the elections in May 2012, the new administration has continued to operate an Audit Committee, which is comprised of an equal number of administration and opposition elected members. The Committee has recently appointed an independent Chair, and benefits from the financial expertise of another independent, non-voting member.

Early indications are that this body will continue to offer challenge effectively, but we will continue to review the evolving role of the Committee, and the independent Chair.

Fraud monitoring

The Council takes part in the National Fraud Initiative and investigated a small number of potential frauds during the year. In particular, the Council identified that a grant awarded to develop the car park at Bonnyrigg Rose Football Club may not have been fully applied for the purposes intended. The Council asked internal audit to investigate this matter and also reported the matter to the police. The Council has reviewed its arrangements for awarding grants and for monitoring the use of grants monies by third party organisations to prevent a further recurrence.

Risk Management

The Council has a risk management framework in place which highlight respective responsibilities for risk management and sets out requirements at service and corporate level. A Risk Management Group is in place with representatives from each service area. Risks are reviewed by the Council Management Team on a quarterly basis, and the Corporate Risk Register is presented to the Cabinet and Audit Committee twice a year.

The Council also provides a range of support for risk management, including on line training on a dedicated risk management website on the intranet.

During a session with the Audit Committee members we discussed their views on the key risks to the Council (Table 3). We reviewed the corporate risk register and found that two of the key risks were reported within the register, although demographic pressures, which we defined as the ageing population and risks associated with vulnerable people, did not appear on the register.

We also believe that there is scope to make the corporate risk register more user-friendly, and more focused on the key concerns of elected members.



Refer to Audit Action Plan Point 3

Table 3: Key Risks Identified by Midlothian's Audit Committee

- Demographic Pressures
- Funding
- Welfare Reform.



Source: Midlothian Council Audit Committee, 12 June 2012

Community Planning Arrangements

Audit Scotland has recently outlined revised arrangements for the scrutiny of Community Planning Partnerships (CPPs), based on the Scottish Government's aim to strengthen the accountability of CPPs, and support the drive for improved outcomes.

Early audits are underway, and are based on 4 key themes:

- Strategic direction
- Governance and accountability
- Performance management and the use of resources
- Impact and outcomes.

In 2011, Midlothian's Community Planning Partnership undertook a strategic assessment using guidance from the Scottish Government.

The objectives of the strategic assessment are to:

- identify where the priorities should be for Midlothian
- define the resources required to meet these priorities
- deliver results secured through the Single Outcome Agreement.

Current community planning arrangements in Midlothian are well-developed, with thematic partnerships in place to progress the six current outcomes.

Through the strategic assessment process, the Partnership has engaged well and ranked desired outcome for each thematic group. Three overarching priorities have been agreed for the Midlothian area:

- the prevention of child poverty
- positive destinations
- maximising business opportunities.

We do, however, note that within the Single Outcome Agreement Progress report for 2011-12, 33% of outcome indicators were not on target for achievement. These include indicators on educational attainment, positive destinations for school leavers and the level of business gateway support for new businesses.

Midlothian Community Plan Update and Single Outcome Agreement 2012-13 outline 35 high or very high priority actions planned across the 6 thematic groups. Recent Audit Scotland reports, including the *Role of Community Planning Partnerships in Economic Development*, published in November 2011, recognise the difficulty associated with reduced budgets and the removal of ring fenced funding for community planning. They recommend that partners improve their understanding of costs associated with delivering outcomes, and the impact on individual partners' budgets. We would also recommend ensuring that partners resources are distilled to focus only on the key priorities for the area.

Police and Fire Reform

In June 2012, the Police and Fire Reform (Scotland) Bill passed through Parliament and has now received Royal Assent, under this Act the eight current police and fire boards will be abolished and a new single National Police Service and Fire Service established.

The Council has entered a transitional period, where elected members have a duty to ensure that the current services deliver value for money, but also to ensure preparations are being made for the new services, including local governance and accountability. We were therefore pleased to note that in August 2012, the Council agreed to become a pathfinder for the development of local accountability arrangements for the new Scottish Police and Fire and Rescue Authorities.

A Midlothian Police and Fire and Rescue Board has been established, which will operate as a shadow board until 31st March 2013. The Board will oversee the delivery of the Council's Single Outcome Agreement, notably *Ensuring Midlothian is a Safe Place to Live, Work and Visit*.

As a result, the new Board will comprise of 11 members; six elected members and five drawn from the Council's community planning partners.

Internal Controls

As part of our financial statements audit work, we took assurance from our internal control work on the Council's key financial systems. We assessed the following systems as part of our work throughout the year:

- Budgetary control
- Employee remuneration
- Capital accounting
- Accounts receivable
- Operating expenses
- Housing rents
- Treasury management

■ Housing and Council Tax Benefits

■ Information Technology control environment.

We reported on our findings and agreed action plans within our Interim Report and ISA 260 Report on the Annual Accounts. No significant matters were highlighted during this work, although we will follow up progress on actions agreed during our work in 2012-13.

5. Performance

The Council has built on the findings of the Best Value report by producing an improvement plan which draw together a number of improvement strategies. While performance has generally been maintained or improved against the majority of statutory performance indicators, the Council is in the bottom quartile for service performance in a small number of key areas. The pace of change and delivery of the Business Transformation Programme remain key risks for the Council.

Achieving Best Value

The Council received its Best Value 2 report in June 2012. The report concluded that the Council has good prospects for future improvement. The People Strategy had put the building blocks of good people management in place, arrangements for partnership working are strong and the Business Transformation Strategy provided a clear focus and direction for efficiency.

The Best Value report also pointed to a number of key areas for improvement. Service performance was still below average for a number of areas. The council also needed to be more systematic in learning from customer consultation, and learning from other authorities. The report also highlights the key risk associated with delivering the Business Transformation Strategy to planned timescales.

Since then, as we highlight in the *Financial Position* Section, the Business Transformation Programme has been refocused but to date has not delivered the planned savings or improvements in performance.

The Council has adopted a Best Value Improvement Plan to ensure that each recommendation is addressed, although we note that a number of the planned actions are not framed in SMART terms and the timescales give a limited sense of prioritisation of actions. Progress against the action plan will be reported to the Council in December 2012 and May 2013.

Business Transformation Programme

The Improvement Plan is based on the Council's existing strategies for improvement within the Business Transformation Programme:

- Future Models of Service Delivery
- People Strategy
- Customer Strategy
- Effective Working in Midlothian
- Shared Services
- Service Review Programme

The Council has recently revised the programme to adopt a Systems Based Approach, based on the Vanguard model. A Business Transformation Board is in place to co-ordinate each improvement strategy, but we believe there is a risk of initiative overload – both in carrying staff with the programme, but also in terms of management capacity within the Council. There is also a risk that, the transformation programme is not sufficiently coordinated to deliver against a sufficiently clear vision of the organisational change required.

The Chief Executive's vision for the Council will require a different way of working for all employees. A lack of clarity about the focus or success of the programme may mean that staff become disengaged. We do, however, note that plans are in place to ensure that systems thinking forms part of the management development programme, and that staff engagement is a key element of the Vanguard approach.

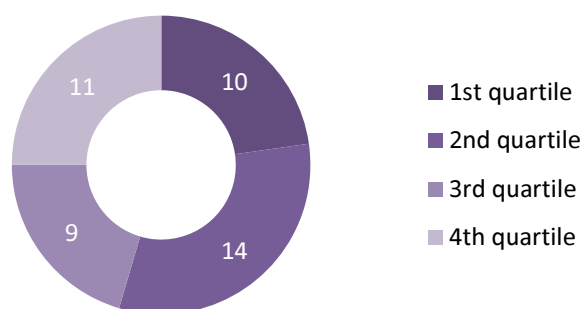
Statutory Performance Indicators

One of the key ways that members of the public can measure council performance is through the statutory performance indicators (SPIs). The Accounts Commission direction requires that councils report:

- a range of sufficient information to demonstrate best value in relation to corporate management (SPI 1)
- a range of information sufficient to demonstrate best value in relation to service performance (SPI 2).

Our review of SPI data submitted to Audit Scotland found that performance continues to be mixed across services. Figure 5 highlights that although 55% of individual indicators are in the top two quartiles, 11 indicators are within the bottom quartile across councils in Scotland.

Figure 5: 55% of the Council's statutory performance indicators are within the top two quartiles across Scottish Councils



Source: Midlothian Council Statutory Performance Indicators

Indicators within the bottom quartile include:

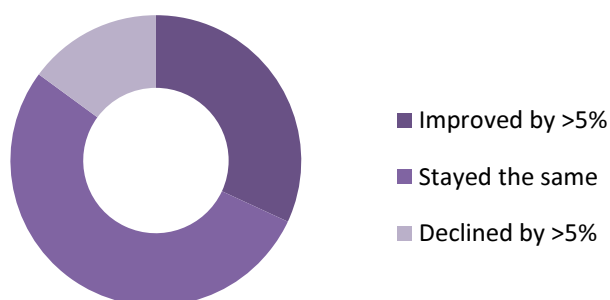
- the percentage of households presenting as homeless who are housed in permanent accommodation. At 18.8%, the Council's performance is the lowest in Scotland.
- The cost of refuse collection per household is amongst the highest in Scotland, although we note that the cost of refuse disposal is relatively low.
- The level of Council Tax collected in year is 93.6%, compared to a nation average of 95.1%.

- The level of housing response repairs undertaken within target timescales is also one of the lowest of authorities who provide this service.

We did, however, find that performance was maintained or improved for around 85% of the specified indicators (Figure 6).

Areas of improved performance include the overall percentage of the road network that should be considered for maintenance, and the number of council houses that meet Scottish Housing Quality Standards.

Figure 6: The Council improved or maintained performance in 85% of specified indicators



Source: Midlothian Council Statutory Performance Indicators

Areas where performance declined in year include the percentage of top earners in the council who are women, and the time taken to assess homeless applications for temporary accommodation.

Performance management arrangements

Midlothian Council has a Planning and Performance Management Framework in place which ensures that all services report on their performance on a quarterly basis. Performance is scrutinised by the Corporate Management Team, and the Performance Review and Scrutiny Committee. The Council also has a dedicated performance website to report to members of the public.

The Best Value report noted that the Council has improved its approach to performance management and scrutiny, but that it could be more systematic in the collection and use of customer feedback and

benchmarking with other authorities. The Council has developed an improvement action to respond, but we would urge officers to consult with elected members to ensure that the format of performance reporting meets their needs and expectations. For example, the current performance reports include a significant volume of text on key achievements and challenges, but it is not clear how balanced or easy to interpret this information is.

The Council has adopted a number of indicators across services to allow comparisons and corporate results to be reported. We do, however, believe there is scope for the indicators to be more outcome-focused. For example, the only indicator reported under the Outcomes and Customer Feedback theme is the percentage of feedback complaints completed within 10 working days, rather than a measure of customer satisfaction or level of service standard.

We also noted that a recent internal audit report on local performance indicators found a number of weaknesses including:

- the absence of central guidance on compiling performance indicators
- the lack of written local procedures of performance indicators, or supporting working papers
- inconsistency in the verification of indicators
- inaccuracies in some of the reported indicators.



Refer to Audit Action Plan Point 4

Audit Scotland's recent How Councils Work series, *Managing Performance: are you getting it right?* continues to stress the critical role of self-evaluation and good quality performance information in allowing councils to demonstrate that they are delivering efficient and effective services.

The report highlights the



role of elected members in setting priorities and ensuring that useful, high-level indicators are in place to help members assess performance at a corporate level.

During 2012-13 we will follow up the report to ensure that elected members have access to the information they require to fulfill their role, and that performance management arrangements reflect the priorities of the Council.

We also note that revised arrangements for the LAN shared risk assessment mean that the council will have the opportunity to provide self-assessment evidence. The quality and openness of self-evaluation materials may therefore influence the level of external scrutiny. We understand that the Midlothian Excellence Framework is being revised in light of the changes to the Business Transformation Programme. We would therefore recommend that the Council continues to ensure that its approach to self-evaluation is fit for purpose.

National Studies

Audit Scotland carries out a national performance audit programme on behalf of the Accounts Commission and the Auditor General for Scotland.

Audit Scotland ask us to ensure that local government bodies review the national studies relevant to them and action them accordingly.

Midlothian Council has introduced a protocol to summarise national reports for the Audit Committee. This allows the Committee members to ask for further work to be done, or for copies of the full reports.

During 2011-12, Audit Scotland asked us to follow up the following reports:

- Maintaining Scotland's Roads
- Modernising the Planning System
- Transport for Health and Social Care.

We review whether the council has considered the national report at a council committee and whether the Council has carried out a self-assessment against the national report and plans to take forward any improvements.

Maintaining Scotland's Roads

Audit Scotland has published two national reports on Maintaining Scotland's Roads, in November 2004 and February 2011. The second, follow-up, report was published after the severe winter of 2009-10 and examined changes in the condition of the roads network across Scotland since the publication of the original report.

The follow-up report found that nationally little progress had been made to improve road maintenance since the first report was published. Less than half of councils reported their backlog maintenance to elected members, and only a third of councils had a Road Asset Management Plan in place. The condition of the roads

had also worsened. In March 2012, only 63.6% of Scotland's roads were in an acceptable condition.

In Midlothian, Figure 7 highlights that the roads condition has generally improved over recent years, and now exceeds the national average in each category, partly as a result of an additional investment of £1 million on the condition of roads and footpaths.

The service has developed a Road Asset Management Plan, although it has not yet been ratified by the Council. The Plan includes a description of the size and value of the roads assets, as well as an analysis of current performance and future demands. We identified one area for further work, relating to the development of a programme of consultation with road users and communities.

Figure 7: The condition of Midlothian's roads is generally improving, and exceeds the national average



Source: Audit Scotland Statutory Performance Indicators

Modernising the Planning System

This report aimed to assess whether recent reform and modernisation of the planning system is making it more economic, efficient and effective. Audit Scotland evaluated the overall progress made by public bodies in modernising the planning system and the impact that modernisation is having on councils' performance in managing planning applications. They found that despite the modernisation and falling numbers of applications, few councils are performing well against timescales set for processing planning applications.

We understand that the Scottish Government and Heads of Planning Scotland are currently working together to develop a new comprehensive framework for measuring, benchmarking and reporting planning performance. Midlothian Council's Planning service has developed and implemented a comprehensive performance framework for Planning Services comprising a balanced set of indicators covering customer service, processes and resources, with a focus on continuous improvement and customer satisfaction.

Midlothian Council's SESPlan partners have also agreed to engage with other SDPA authorities to develop a standard approach to the recommendations.

Transport for Health and Social Care

The availability of transport is an essential part of making health and social care services work efficiently. Older people, those with long-term health or social care needs and people who live in remote and rural areas may need support to get to a hospital appointment or to access services such as their local day centre. This includes help with paying for transport or getting to their appointment in transport provided by the ambulance service, councils, NHS boards or the voluntary sector.

Audit Scotland found that nationally transport services for health and social care are fragmented and there is a lack of leadership and monitoring of the services provided. Public services are not working together effectively to deliver transport for health and social care or making best use of available resources. They conclude that improved joint planning could lead to more efficient services, and there is scope to save money by better planning and management of transport for health and social care without affecting quality.

We found that transport had already been identified as an area for review with Midlothian Council's partners. NHS Lothian's Strategic Transport Group has set up a working group to improve joint working and co-ordination throughout the Council area.

6. The challenges ahead

This has been the first year of our appointment at Midlothian Council and we have observed a Council with a real desire to improve services, and to deliver economic success for the area. We use this section to outline the key challenges for the next financial year to support the delivery of this ambition. We look forward to working with the Council in 2012-13, and hope to support you on the next stage of your journey

1 Articulation of a **vision and key priorities for the area** that informs policy decisions about the allocation of resources

A new Administration took up office in May 2012. The change in political leadership is beginning to bed in, but must now make some difficult decisions about prioritising limited resources.

The Council continues to face a significantly challenging financial position. The loss of the anticipated savings from shared services, and significant demand led pressures, increases the financial and operational challenge for the Council, but also provides an opportunity to reform existing service provision. The Business Transformation reform agenda has not delivered the change or savings at the level anticipated in the last year and financial pressures in areas like Welfare Reform present a funding gap for the next three years. It is therefore becoming clear that future policy decisions will be increasingly about choices, and about doing less in some areas. The challenge for the Administration is to ensure that public consultation and engagement is used to manage expectations, and reach a consensus about priorities for the area.

2 Development of leadership capacity

The Business Transformation Programme has, rightly, been refocused to ensure that it delivers more effective challenge and changes to the way services are configured, and in delivering savings. Managing a large number of strands of the BTP also creates a management capacity issue at a time when the leadership team is stretched. Leadership capacity will therefore be critical in supporting changes to working practices and ensuring the success of the programme.




3 Continuing focus on performance management arrangements that support robust self-evaluation and improvement



During the year, we have analysed the Council's progress against targets within the Single Outcome Agreement, Statutory Performance Indicators, and the quarterly performance reports. We found that the Council's performance in delivering services is improving in many areas, but still lags behind other councils in some key areas.

The Council's performance management framework must support high quality self-evaluation and scrutiny to give the senior management team and elected members assurance that corporate priorities will be delivered. The Framework should be supported by an intervention programme for services that are failing to deliver the Council's vision for the area.


Appendix A: Action Plan

Key to assessment of recommendations

-  Critical impact on the Council's corporate priorities
-  Significant impact on the Council's corporate priorities
-  Low impact on the Council's corporate priorities

	Assessment	Issue and risk	Recommendation
Welfare Reform			
1		While responding to the introduction of the Universal Credit is primarily a service risk, and the Council's Working Group is making good preparations, there remains a financial risk to the Council associated with the predicted increase in demand for services and increasing rent arrears.	<p>We recommend that work is undertaken to model the likely impact of Welfare Reform on the financial position of the Council as a matter of urgency.</p> <p>Management response: Agreed. This will remain a priority issue for the Council. An update report is being considered by the Council in December 2012 and increased provision has been made in the budget for 2013/14 in the light of the most up-to-date analysis.</p>
Business Transformation Programme			
2		We recognise that the recent refocusing exercise will improve the effectiveness and impact of the Business Transformation Programme. We do, however, highlight that the failure to secure anticipated savings or increase the pace of change will place significant pressure on the Council's budgets and achievement of corporate objectives.	<p>We recommend that the Council reviews the current scope of the Business Transformation to ensure that it is focused on clear priorities for change, and that there is sufficient management capacity for delivery.</p> <p>Management response: Agreed. Following the Council's consideration of the report on 'Future Models of Services Delivery' in December 2012, a revised Business Transformation Strategy is planned for Council in early 2013.</p>

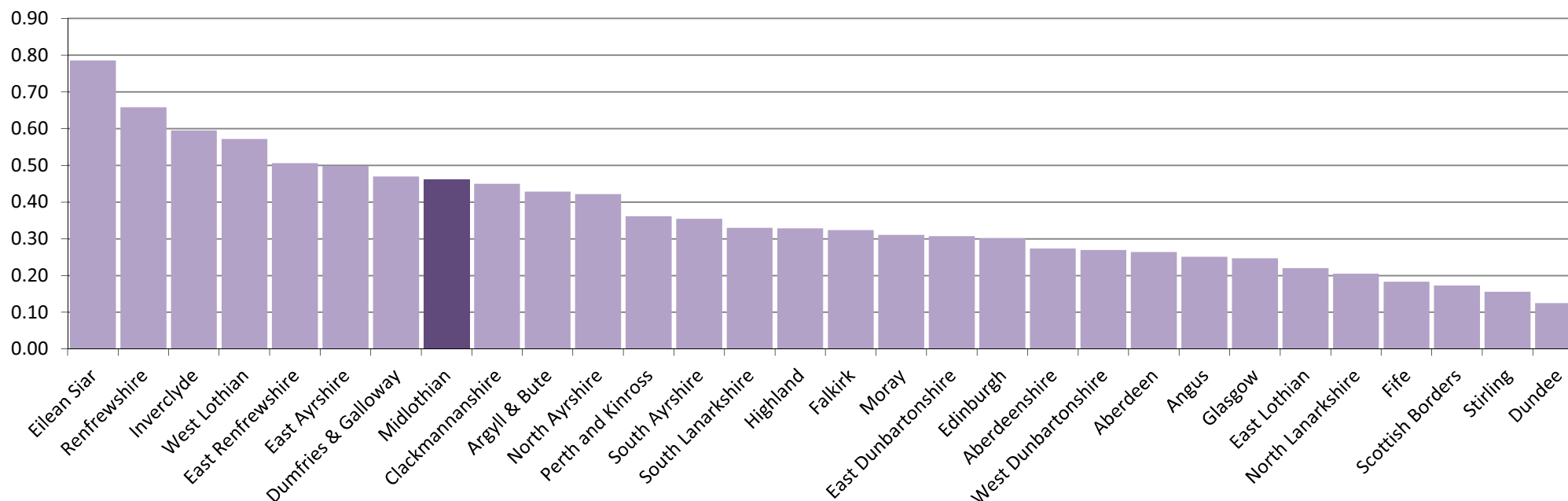
	Assessment	Issue and risk	Recommendation
Risk management arrangements			
3	●	<p>We understand that risk management arrangements are currently being reviewed at the Council. There is scope to improve the corporate risk register to ensure that risks are presented in a prioritised basis.</p> <p>Elected members should be consulted to ensure that they receive sufficient information on the management of risks to meet their scrutiny requirements. .</p>	<p>We recommend that the Council consults elected members as part of the review of risk management arrangements, to ensure that reporting arrangements meet their requirements</p> <p>Management response: ‘Agreed. A draft revision to the Risk Management Policy, Strategy and Framework has been scrutinised and endorsed by the Audit Committee. The revision, and a mid-year monitoring report, is going to be presented to Cabinet on 8 January 2013. The monitoring report will include an update on the Annual Risk Control Programme, Risk Management PIs and a display of how managers assess risk across corporate priorities, major projects and services. The Corporate Risk Register continues to be reviewed by the Audit Committee, but has been revised in terms of transparency and focus on major issues. A review of risk registers is currently under way as is the robustness of risk management statements in reports presented to elected members. The recommendation will inform this approach.</p>

	Assessment	Issue and risk	Recommendation
Performance management arrangements			
4		<p>We understand that the Council is reviewing its performance reporting arrangements in response to the Best Value report. During our work, we noted that there is scope to improve the outcome focus of quarterly performance reports. We also noted weaknesses highlighted by internal audit in the preparation of performance reports.</p>	<p>We recommend that the performance reporting processes are reviewed in consultation with elected members to ensure that reports are user-friendly, and focused on key areas of concern.</p> <p>Management response: A Strategic review of Planning and Performance Management arrangements is planned addressing cultural and structural changes required, as well as ensuring the content is appropriate and that performance reporting reflects stakeholder needs and expectations. This will build on the changes to performance reporting agreed by the Council in August 2012.</p>

Appendix B: Financial Ratios

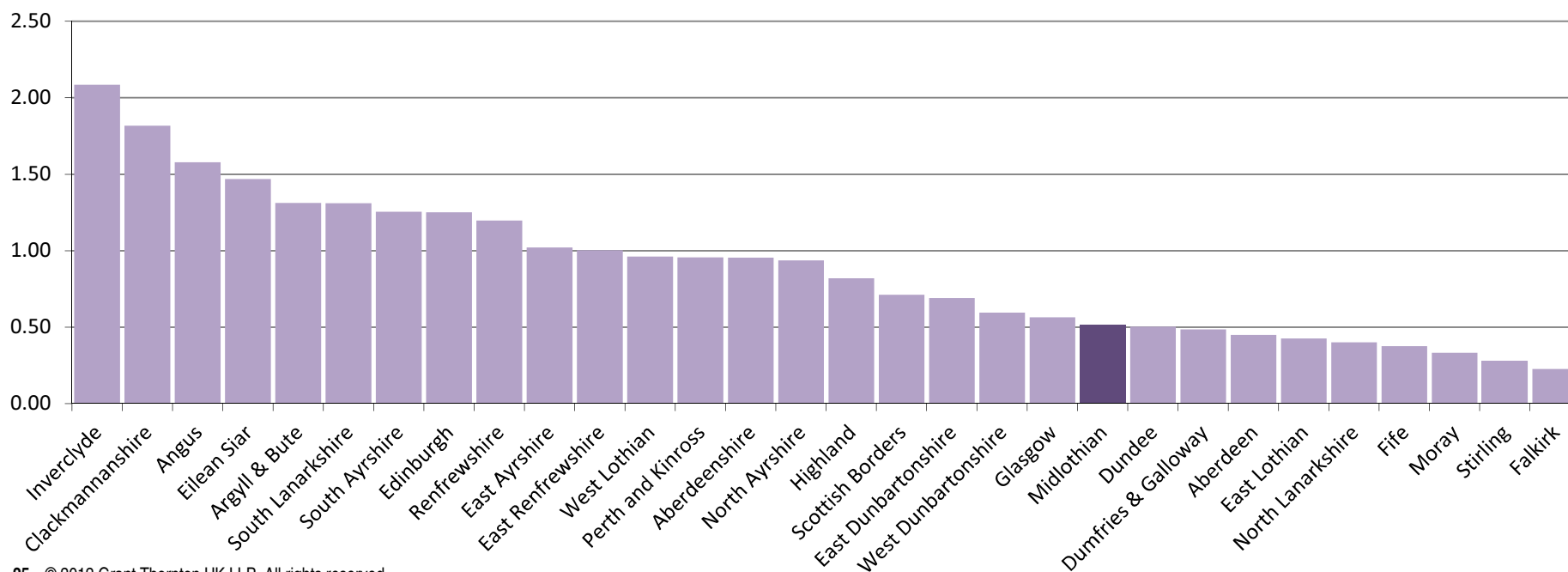
1. Usable Reserves per head of population

How it is calculated	What it means	Midlothian Council's position
Usable balance at year end / estimated head of population	Usable reserves are those reserves that councils can use to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use.	While Midlothian is currently within the top quartile of mainland local authorities in Scotland, the predicted budget gap for 2013-14 to 2014-15 would eliminate all of the Council's unearmarked reserves .



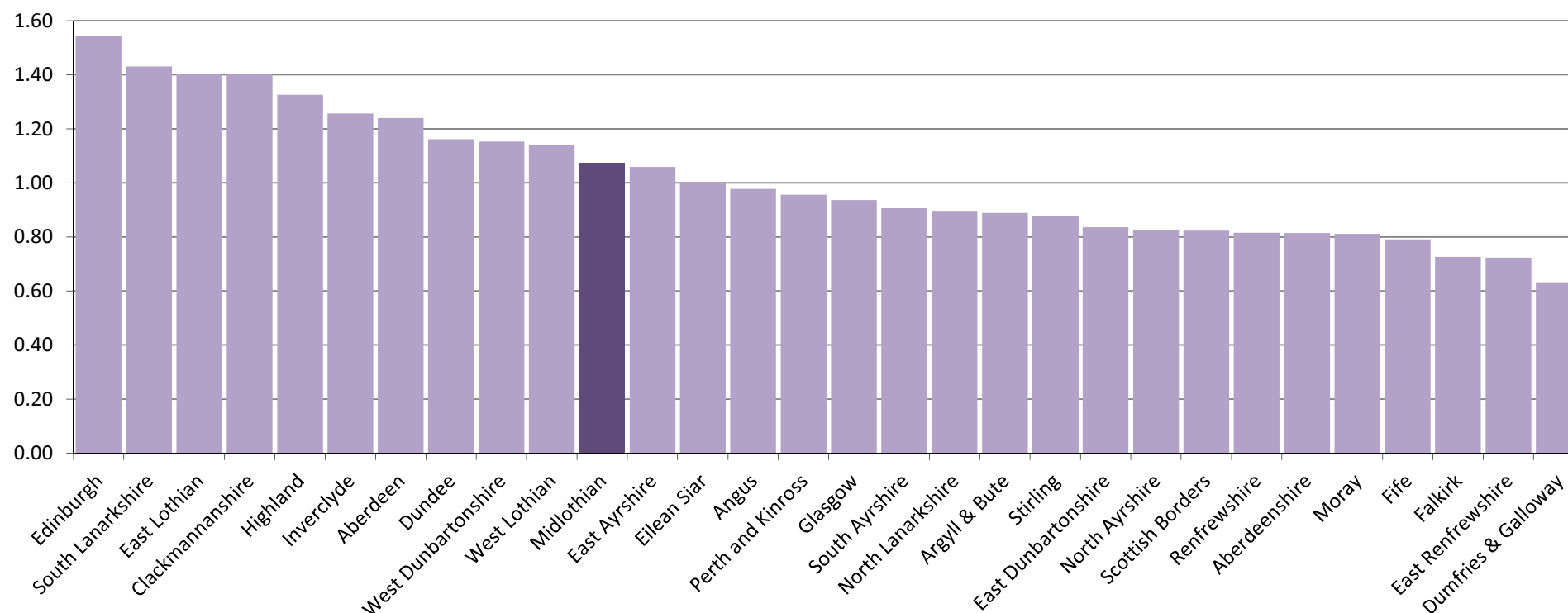
2. Working Capital Ratio

How it is calculated	What it means	Midlothian Council's position
Current assets / current liabilities	<p>Indicates if a council has enough current assets to cover its current liabilities.</p> <p>A ratio of less than one means that current liabilities exceed current assets.</p> <p>A high working capital ratio is not always a good thing; it would indicate that an authority is not investing their excess cash.</p>	<p>Midlothian has a relatively low working capital ratio. This can partly be explained by the Council's treasury management strategy to use cash balances, earning minimal interest, to reduce reliance on borrowing with higher interest rates.</p>



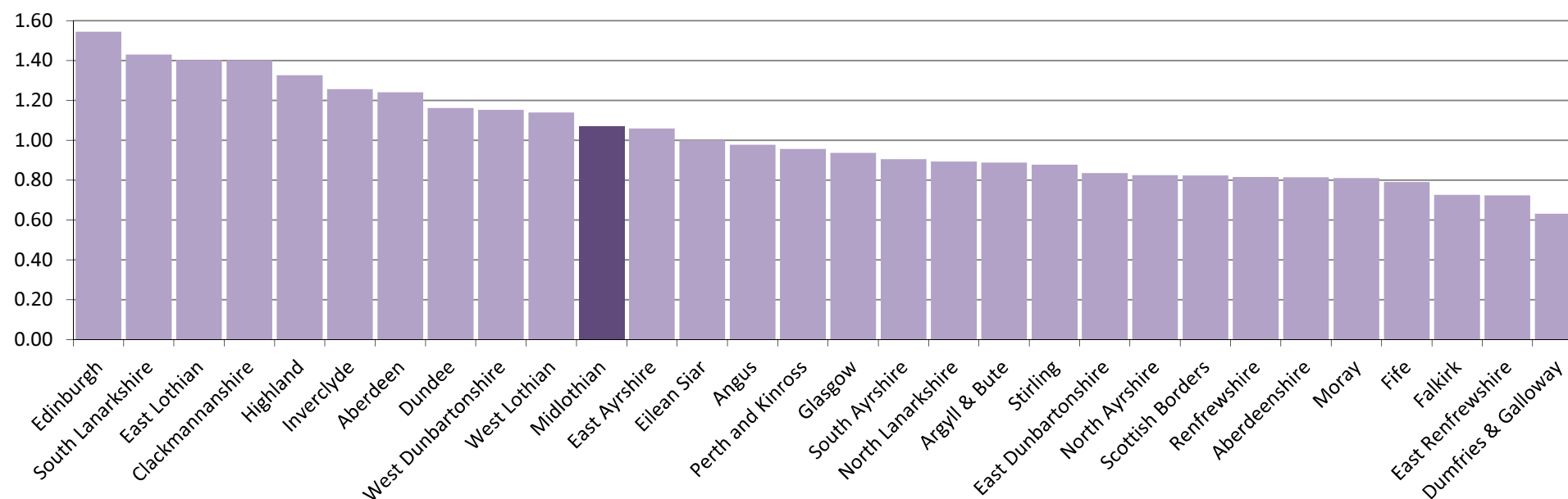
3. Long Term Borrowing: Tax Revenue

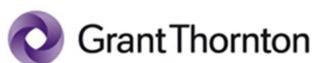
How it is calculated	What it means	Midlothian Council's Position
Long term borrowing / tax revenue	Councils with high levels of long-term borrowing need to ensure that their medium term financial strategies adequately reflect the repayment profile for that borrowing to ensure that any future impact on service delivery is minimised. A ratio of more than one means that long term borrowing exceeds tax revenue.	Midlothian Council has a ratio of 1.1, which is slightly higher than other councils in Scotland. This reflects the level of capital works undertaken on the schools and social housing building programmes.



4. Long Term Borrowing: Long Term Assets

How it is calculated	What it means	Midlothian Council's Position
Long term borrowing / Long term assets	Councils need to understand the historical reasons for high levels of long-term borrowing. The relationship between borrowing and assets should be considered year-on-year, to assess the potential implications of changes in the ratio for the medium-term financial strategy. A ratio of more than one means that long term borrowing exceeds long term assets.	Midlothian Council's long term borrowing slightly exceeds assets, at a ratio of 1.1:1. This reflects the significant capital programme to invest in social housing and schools.





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