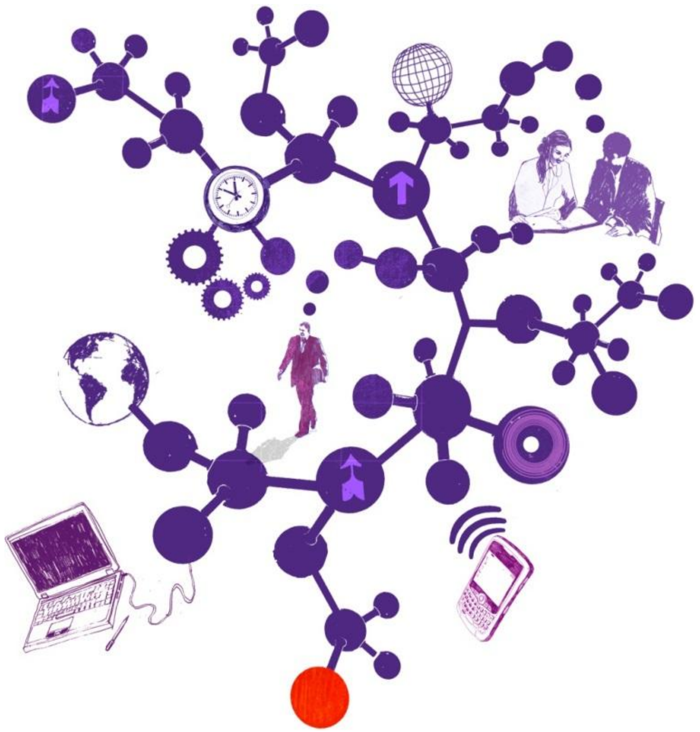
Scotland's Public Finances: Addressing the Challenge
Follow Up Report
Midlothian Council

Year ended 31 March 2013



Executive Summary

Introduction

As part of our audit, we gather a range of information covering the Council's financial position and performance. We use this information to inform our audit reports, to promote improvement in internal control where appropriate and to provide information to Audit Scotland and other stakeholders on the Council's performance in key areas. To promote impact at a local level, we carry out a more targeted review of issues raised in Audit Scotland's national performance reports where the issues of local significance are raised. For 2012-13, we have undertaken a more detailed analysis of the issues emerging from Audit Scotland's report, *Scotland's public finances: Addressing the challenges*, which was published in August 2011.

The aim of the follow up work is to assess the progress that the Council has made in developing sustainable financial plans to meet the scale of budget cuts expected to be faced by local authorities in the period to 2014-15.

Scotland's Public Finances

Audit Scotland's report provided an overview of the scale of budget cuts expected to be faced by the Scottish public sector in the period 2010-11 to 2014-15, and how public bodies were beginning to respond to the challenges of reducing expenditure. In particular, the report highlighted some of the main cost pressures facing public bodies and emphasised the importance of them achieving long-term financial sustainability.

The key messages from the report were:

- The Scottish Departmental Expenditure Limit revenue budget will fall by £2.1 billion (8%) to £23.8 billion between 2010-11 and 2014-15 while the capital budget will fall by £1.2 billion (36%) to £2.1 billion.
- Public bodies will face increasing demand and cost pressures in the future. Increasing demand will be generated as a result of an ageing population and the heightened expectations of the public, while cost pressures arise in areas such as maintenance backlogs and the cost of revenue-financed capital projects.
- Public bodies need to focus on achieving long-term financial sustainability. This requires a clear understanding of the organisation's costs, a clear methodology for setting budgets based on priorities and the outcomes to be achieved, and strong leadership and governance.
- Pay restraint and reducing workforce levels are the most common approaches being taken by public bodies to reduce costs over the next few years. Good workforce planning will be necessary to ensure that the right people and skills are available to deliver effective public services in the future.
- Public bodies are considering how they can work better together as a way to reduce costs, but progress to date has been limited and it is likely to be a number of years before cost savings are realised.

The report did not make any direct recommendations, but provided a checklist setting out a number of key issues and risks which managers, elected members and other leaders of public bodies will need to identify, monitor and manage:

- Reforming public services - including the risk of short-termism, unclear aims and objectives and lack of commitment or constructive challenge.
- Workforce reductions - including the risk of loss of essential skills as a result of key staff leaving and increased workloads for those who remain.
- Financial sustainability - including the risk of unclear priority budget-setting, lack of risk and evidence-based cost-reduction strategies and unforeseen cost pressures.
- Leadership and governance - including the risk of lack of direction and ownership as a result of weak leadership, and inadequate scrutiny and challenge as a consequence of poor governance arrangements.

Our approach

Our follow up work has been based on two questions identified within the report as the key issues for Councils to address:

- does the Council have sustainable financial plans which reflects a strategic approach to cost reduction?
- Do senior officials, elected members and non-executive directors demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

As part of our work in this area, we have also considered the financial resilience of the Council, by benchmarking key financial performance indicators with other Scottish local authorities to assess whether robust financial systems and processes are in place to manage the Council's financial risks and opportunities, and to secure a stable financial position that enables it to continue to operate for the foreseeable future.

We completed a questionnaire provided by Audit Scotland, to ensure consistency of approach across councils, which is attached at **Appendix 1**.

Our work was performed by analysing key financial performance indicators, interviewing officers and reviewing documentation including minutes, plans and performance reports.

We have used a red/amber/green (RAG) rating to assess each area, with the following definitions.

Green	**Arrangements meet or exceed adequate standards**. Adequate arrangements identified and key characteristics of good practice appear to be in place.
Amber	**Potential risks and/or weaknesses**. Adequate arrangements and characteristics are in place in some respects, but not all. Evidence that the Council is taking forward areas where arrangements need to be strengthened.
Red	**High risk**: The Council's arrangements are generally inadequate or may have a high risk of not succeeding

Overview of our findings

Risk area	Summary observations	High level risk assessment
Strategic Financial Planning	• The most recent projections indicate that the Council faces a budget gap of £13.5 million by 2016-17. There are currently no clear plans in place to bridge this gap, although the Strategic Leadership Group presented a series of options for consultation to Council in September 2013. • The Council has agreed balanced budgets for 2012-13 and 2013-14, but the level of savings to be achieved under the business transformation programme have not been fully delivered. • The short timescale for meeting these significant savings targets, the lack of a finalised corporate plan for identifying and delivering the required savings, the Council's recent under-performance in managing expenditure and delivering projected savings from efficiency projects, and the low level of reserves available to respond to unforeseen events, presents a significant risk to the future financial sustainability of the Council. • The Finance Team prepare medium term budgets covering the next three financial years, but there is not yet a clear link between resources and Council priorities contained in corporate planning documentation.	Red
Financial governance	• Both members and officers have a clear focus on the Council's financial position with clear engagement in the financial management process, although there remains a need to ensure the approach to delivering savings is clear, transparent and subject to appropriate challenge and review. • Effective budget monitoring and reporting processes are in place to identify variances, but the Council recorded an overspend against revenue budgets in 2012-13, though projections for 2013-14 are currently within budget. • While the Council is beginning to develop a more outward, partnership focus as part of the Future Models of Service Delivery programme, it needs to demonstrate a more robust use of self-evaluation and benchmarking information.	Amber
Key Indicators of Financial Performance	• The Council did not meet its revenue budget in 2012-13, recording an overspend of £1.25m. The Council managed this in 2012-13 by using £2m from its capital fund to pay principal loan repayments originally budgeted to be met from the General Fund. This effectively reduced the Council's ability to fund future capital projects, but maintained unearmarked reserves at £6.4 m, or 3.3% of the net cost of services. Reliance on reserves to fund expenditure in future years will be unsustainable. • The working capital ratio has increased from 0.56 to 0.83, but cash balances have fallen by £12.7m to £8.6m at the year end. • The long term borrowing ratio (as a percentage of tax revenue) has increased by 17% reflecting the Council's increased borrowings to fund its ambitious capital programme. The Council now has amongst the highest borrowing levels of all Scottish local authorities per head of population. • The Council's sickness absence rates have increased over last year for both teaching staff and other employees. While levels remain lower than the national average, we note that the Council is managing acute sickness absence levels within individual services, but has plans in place to respond.	Green

Overall conclusions

The Council is taking forward its approach to achieving the required actions necessary to deliver the required savings of £13.5m by 2017, but the programme for bridging the budget gap is still to be fully developed and agreed. The short timescale for meeting these significant savings targets and the lack of a finalised corporate plan for identifying and delivering the required savings present a risk to the future financial sustainability of the Council.

There is an urgent need for the Council to act quickly to finalise and agree its action plan to achieve savings targets and ensure the Council can continue to meet the objectives outlined in the Corporate Strategy. The Council must also act to strengthen its internal governance and accountability arrangements to better manage budget overspends and fully implement its efficiency programme across all Council services.

We have outlined a number of key areas for improvement which focus on the same areas of challenge that we presented within our Annual Report in 2011-12. Now that the Council has reached a consensus with the Community Planning Partnership on the priorities for the area, the Council and its partners need to be able to demonstrate that these priorities influence resource management and decision making. There is a significant need to finalise and agree a realistic and sustainable plan for savings, and the Council must ensure that each service is subject to robust self-evaluation and benchmarking to ensure that performance is maintained during the period of financial restraint.

Strategic Financial Planning

Does the Council have a Sustainable Financial Plan which reflects a strategic approach to cost reduction?

Introduction

Our assessment against Audit Scotland's questionnaire is presented within Appendix A. We were asked to consider evidence of:

- a balanced financial plan for 2012-13, including plans for cost reduction and efficiency savings
- a clear understanding of costs across the Council and a track record of delivering on budgets
- use of benchmarking to identify the Council's performance compared to other organisations
- long term financial plans, aligned to strategic goals.

In January 2012, the Council agreed a balanced budget for 2012-13. The Council identified a number of national cost pressures such as the reduction in grant support, freeze on council tax and contribution to the Early Year / Early Intervention Change Fund. Local additional pressures such as changing demographics, including complex care of adults and increasing nursery rolls meant that the estimated cost of services grew to £191.45 million in 2012-13 (2011-12: £189.82 million).

A budget gap of £3.107 million was identified between the cost of services, and funding from Scottish Government grants and council tax revenues. Budget papers bridged this gap by projecting savings as follows:

- outcomes from service reviews £2.335 million
- business services review savings £0.372 million
- procurement savings target £0.4 million

Service reviews during 2011-12 had identified £2.09 million of the savings and had therefore been taken into account in the budget setting process. The detailed service review savings are not identified separately within budget documents, and two services subject to service reviews, within Adult & Community Care, and Property & Facilities Management, subsequently reported overspends against budget, although we understand that this was as a result of demographic cost pressures, increased energy consumption and changes in staffing establishments.

Performance against budget

In 2012-13, the Council reported an £1.25 million overspend against service budgets, which contributed to a utilisation of £2.14 million of general fund reserves. Key factors in the overspend include:

- additional demands for elderly and learning disabilities care packages totalling £939k
- slippage in the delivery of planned efficiency savings totalling £741k, including an underachievement of business transformation savings in business services and procurement of £369k.

This performance reverses significant budget underspends within 2010-11 and 2011-12. The overspend, and ongoing equal pay liabilities, necessitated a transfer from the Capital Fund to meet the costs associated with repaying capital debt. This will have an impact on the Council's ability to invest in capital expenditure in future years, but meant that uncommitted General Fund reserves have been preserved at £6.4 million, against an internal minimum level of £4 million.

Medium Term Financial Strategy

The Head of Finance and Human Resources has presented an outline revenue budget over the medium-term, covering three financial years. The revenue budget is reported to the Council on a regular basis. To date, the principal means that the Council has used to meet the challenging financial forecasts have been the Business Transformation Programme (BTP), and financial discipline savings.

In May 2013, the Council identified that the savings within the Business Transformation programme would not be sufficient to bridge the projected budget gap. In the most recent financial update paper to the Council, the Head of Finance and HR reported that the budget gap by 2016-17 now stands at £13.5 million, equating to over 7% of the Council's Cost of Services.

The Business Transformation Steering Group and Strategic Leadership Team considered alternative options, which were presented in a report to the Council in September 2013. In addition to ongoing work on procurement and integrated service support, areas included:

- energy reduction
- customer service
- maximising income collection
- school clusters
- services to communities
- externalisation/in-sourcing options appraisals.

The Council will consult on these proposals as part of a wider consultation on the Single Midlothian plan.

Areas for development

We have made a number of recommendations for improvement within the Action Plan attached in Appendix 2.

Key areas for development include:

- The development of a financial strategy which links to corporate priorities and is consistent with other key strategies, such as the people strategy and future models of service delivery to release financial targets.
- The financial strategy should include outcome measures, scenario planning, benchmarking, resource planning and details on partnership working. Targets should be set for future periods in respect of reserve balances and prudential indicators.

Financial Governance and Control

Do senior officials and elected members demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

Introduction

The quality of financial governance and leadership is critical in meeting the financial management challenges facing councils, and for securing a sustainable financial position. All local authorities need to manage within their budgets. The Council therefore needs to have a robust way of challenging budget performance and reporting arrangements to ensure they are fit for purpose, and that they can respond to the ever greater need to demonstrate value for money and achieve efficiencies.

Audit Scotland asked us to consider evidence of:

- regular discussion of financial plans across the Council, considering the implications budget changes may have on the service delivered
- the Audit Committee or other scrutiny committee challenging decisions made to ensure that long-term financial plans are sufficient
- monitoring the achievements made in meeting efficiency targets;
- transparency surrounding any decisions made; and
- the Audit Committee and other scrutiny committees playing an appropriate role in the consideration of budget plans and any associated risks.

Our full assessment against the checklist Audit Scotland provided is included within Appendix A.

Financial environment

We found clear evidence of officer and senior management involvement in reviewing the financial environment, and the key actions necessary to manage the financial position.

The Council's Finance Team is well-established and includes very experienced staff, although we note that due to the size of the team, there is a high degree of reliance on a small number of people for complex accounting requirements and issues. Internal and external audit reports have not highlighted significant deficiencies in internal control within the Finance team.

Financial monitoring reports are presented to the Council on an quarterly basis. The reports include detail of action planning and key areas of variance against budget. Elected members on the Business Transformation Steering Group also have the opportunity to scrutinise plans for service improvement and savings to be delivered as part of the business transformation programme. The Transformation Strategy has also been presented to Council meetings.

We were, however, concerned that planned savings have not been delivered as planned, and we were not clear about the impact of service reviews on a number of areas of budget, including Adult and Community Care. The Council has set aside £2 million of earmarked reserves to meet the costs of delivering business transformation changes. As at 31 March 2013, the Council has spent over £2.5 million on business transformation, against delivered savings of £2 million.

Audit Committee Role

The Audit Committee has an important role to play in scrutinising the outcomes of financial plans and risk management arrangements. The use of independent, non-executive members of the Audit Committee provides useful financial understanding and challenge. While officers have provided assurance about actions being taken to address the budget gap, we remain concerned about the pace of change, and the ongoing impact on the scale of the financial challenge.

Scrutiny

Plans for investment and savings are subject to financial scrutiny, but the Council must ensure that it is able to demonstrate best value in its decision making. There have been instances where officer recommendations which would have improved the financial sustainability of services have not been adopted, including the decision to retain all community facilities in addition to the development of an enhanced Newbattle campus and a review of Public Conveniences.

Without a financial strategy, it is difficult for members or officers to share an understanding of priorities and areas that can be used to provide the savings the Council must deliver over the next three years.

Engagement

The Council has held two engagement exercises with the public, including the Midlothian: Meeting the Challenge programme, and public meetings and a budget simulator exercise in 2012-13. These exercises have informed budget proposals. Public consultation is also used to inform key strategic decisions, such as the development of Newbattle High School. In all cases there is a need to balance the feedback obtained from consultation with the leadership role of the Council in delivering priorities for Midlothian.

Areas for development

We have made recommendations for improvement within the Action Plan attached in Appendix 2. Key areas for development include:

- the need to develop a systematic approach to self-evaluation and benchmarking
- reviewing governance and reporting arrangements to ensure that there is sufficient scrutiny and transparency around the achievement of savings.

Key Indicators

Introduction

This section of the report includes analysis of key indicators of financial performance, benchmarked against other Scottish local authorities where this data is available. These indicators include:

- Working capital ratio
- Long term borrowing to tax revenue
- Long term borrowing to long term assets
- Sickness absence levels
- Outturn against budget
- Useable Reserves: Gross Revenue Expenditure

Benchmarking charts are included within Appendix 3.

Key Indicators

Area of focus	Summary observations	Assessment
Liquidity	• The Council's working capital ratio has increased from just 0.56 in 2011-12 to 0.83 in 2012-13. The low level in 2011-12 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. • Cash balances fell from £12.7 million in 2011-12 to £8.6 million in 2012-13. • The Council's percentage of income due from council tax for the year that was received by the end of the year increased slightly from 93.6% in 2011-12 to 93.9% in 2012-13. This compares to a national average of 95.2%.	Green
Borrowing	• The Council's long term borrowing ratio (as a percentage of tax revenue) has increased by 17% (from 1.15 (2011-12) to 1.35 (2012-13). This upward trend reflects the Council's increased borrowing related to its schools and housing capital programme and places the Council within the highest borrowers in Scotland. • The Council's long term borrowing to assets ratio has also increased by 17% from 0.3 in 2011-12 to 0.35 in 2012-13. The majority of Scottish Councils have increased their ratios during the same period.	Amber
Performance Against Budgets: revenue & capital	• The Council's 2012-13 outturn position was a £1.25 overspend against service budgets, largely due to overspends in Adult Community Care and the underachievement of efficiency savings. • Capital spending during 2012-13 totalled £47.3 million against a revised budget of £51.6 million. General Services projects accounted for £29.5 million, and £17.7 million was spent on the Housing Revenue Account. Key projects delivered in 2012-12 include the completion of Phase 1 of the new Council Housing Programme and the completion of Lasswade Community Campus.	Amber
Reserve Balances	• The General Fund now stands at £14.1 million, of which £7.68 million is earmarked for specific purposes, leaving £6.4 million as a contingency (2011-12: contingency of £6.9 million). • The Council transferred £2m from the Capital Fund to meet the costs associated with repaying capital debt. This will have an impact on the Council's ability to invest in capital expenditure in future years, but meant that uncommitted General Fund reserves have been preserved at £6.4 million, against an internal minimum level of £4 million. • The Council's 2012-13 usable reserves to gross revenue expenditure total 0.15, broadly at the midpoint of Scottish Councils.	Green
Workforce	• Days lost per sick leave increased for both teaching staff, and other employees during the year. The number of days lost per employee increased for teachers from 4.8 in 2011-12 days to 5.2 days in 2012-13. Days lost for other local government employees increased from 10 days in 2011-12 to 10.5 days in 2012-13. We do, however, note that these levels remain below the national averages in 2012-13 of 6.6 days for teaching staff, and 10.9 days for other employees.	Green

Appendix 1: Audit Scotland Checklist

1. Does the Council have sustainable financial plans which reflect a strategic approach to cost reduction?

Sub-question		Evidence	Conclusion
1.1	Does the organisation have a balanced financial plan for 2012-13 which sets out: ▪ Assumptions about sources of income and cost pressures? ▪ What cost reductions and other efficiency savings will need to be made, and how they are to be delivered? ▪ Risks to service delivery as a consequence of the need to reduce costs and deliver identified efficiency savings?	Budget reports are presented to Council during the budget process which set out key cost pressures, including pay and conditions, and the impact of welfare reform. Financial monitoring reports are presented to the Council on a quarterly basis and highlight changes to assumptions, and explanations for material variances within budgets. Since 2010, the Council has adopted a Business Transformation Programme to ensure that the Council's response to the constraint in public sector funding, and subsequent budget reductions are managed and lead to service improvement. During 2010, the Council's Organisational Management Review resulted in a reconfigured council structure, with significant reductions in the number of senior managers. This delivered recurring budget savings of £3.2 million. Since then, business transformation savings have not been delivered as planned, which has placed additional pressure on the Council's budget in future years, and has therefore increased the scale of the challenge. The financial health of the Council is one of the top three risks identified within the Corporate Risk Register. Budget papers highlight ongoing risks relating to factors such as inflation, unknown events, and national pay award settlements that the Council cannot control.	The Council approved a balanced budget for 2012-13, but the outturn an overspend of £1.25m (0.6% of budget) due to a number of factors including: ▪ a continuing overspend on adult social care ▪ actual business transformation savings significantly less than planned The Council has reviewed the approach to achieving savings, and has presented alterative plans to bridge the budget gap, based on options appraisal and financial management. Until fully developed plans for delivering savings are articulated and approved, we regard this as a significant risk to the financial sustainability of the Council. **Refer to Recommendation 1**

Sub-question		Evidence	Conclusion
1.2	Does the organisation have a clear budget-setting process which: - Demonstrates a clear understanding of its costs and how costs vary with activity? - Takes into account previous years' service delivery performance and where improvements need to be made? - Takes into account the body's track record on delivering against budgets and analysis of the reasons for previous years' under/overspends? - Allocates resources according to a clear understanding of its priorities, including which services or activities are expected to contribute most and least to the achievement of the organisation's outcomes?	In 2012-13, the Council recorded an overspend of £1.25 million against budget. This reverses significant underspends in 2011-12 (£1.6 million) and 2010-11 (£3.2 million), although both of these underspends can be attributed in part to one off windfalls or saving. The budget setting process incorporates updated information on levels of demand, and monitoring reports provide analysis of reasons for material over or underspends. The budget book outlines key reasons for annual variations in budget across services. We were able to identify some links between the priorities within the Corporate Strategy and resource allocation, such as the continuing capital investment in social housing and schools estate. Public consultation in 2010-11, *Midlothian Meeting the Challenge*, and a budget simulator exercise during 2012-13 supported maintaining resources in community care and education.	The Finance Team has a clear understanding of costs and analysis of service under and overspends. The budget setting process is therefore comprehensive and clear. We do, however, note that the Council faces a continuing challenge to articulate fully developed and clear priorities and plans to address the increasing budget gap. **Refer to Recommendation 2**

Sub-question		Evidence	Conclusion
1.3	Is there a clear evidence base to cost reduction plans? If yes: • Does the organisation undertake a programme of service reviews designed to identify the scope to reduce costs? • Do cost reduction plans provide adequate detail on how savings are to be made and over what timeframe? • Do cost reduction plans state who within the organisation is accountable for their delivery? • Do cost reduction plans give adequate consideration to the impact of reduced expenditure/ changes to service delivery arrangements on service performance and outcomes? • Are clear baselines established against which savings can be measured?	The Council adopted a programme of service reviews in 2010-11 as part of the Business Transformation Programme. In 2012-13, the programme was revised to focus on high value/high demand services. We expressed concern during 2011-12 that the programme of service reviews had not delivered savings as intended. Clear governance procedures have been established for the Business Transformation, including the Business Transformation Board and Business Transformation Steering Group. There are guidelines in place to ensure that reported savings are verified. We noted that within the 2012-13 budget, savings of £2.095 million identified within service reviews were used to bridge the immediate budget gap. We did note that a number of the services affected recorded overspends at the year end, although overspends were not directly attributable to the actions arising from the reviews. Further business transformation activity was anticipated to deliver savings of £693k in 2012-13, within Procurement and Business Services. Actual savings delivered were £324k.	The budget for 2013-14 has significantly revised the level of savings expected to be achieved from business transformation. Budget papers presented to the Council in January 2012 anticipated savings of £6.1 million from the programme. The latest projection is for savings of £2.9 million. The principal variations related to a shortfall in service review savings of £1.4 million, plans for shared services of £1 million and business services of £0.4 million. Outline plans to address the resulting budget gap for the period to 2017 were presented to Council in September 2013. While we are satisfied that the Business Transformation Steering Group provide oversight and scrutiny to the programme, there is scope to improve the transparency of reporting against the achievement of savings to Council. **Refer to Recommendation 3**

Sub-question		Evidence	Conclusion
1.4	Does the Council regularly use benchmarking to compare its costs and performance with other organisations, including public bodies in other sectors and other non-public sector bodies? Can the Council demonstrate real and measurable benefits from its benchmarking activities in terms of cost and/or quality improvements?	All Councils in Scotland participate in the Local Government Benchmarking Framework (formerly SOLACE benchmarking). This allows the Council to identify how they perform compared to others against key performance indicators. We have not identified any systematic use of cost benchmarking to highlight areas for improvement.	There is scope to make better use of cost information and benchmarking with other Scottish Councils. **Refer to Recommendation 4**
1.5	Does the organisation have a longer term financial strategy which: - Takes into account planned changes to service delivery arrangements and anticipated changes in demand for services? - Sets out how financial resources will be matched to strategic goals? - Demonstrates that current cost reductions and efficiency savings are in line with longer term strategic objectives?	The Head of Finance and Human Resources presents an outline revenue budget over the medium-term, covering three financial years. The budget analysis includes an assessment of demographic factors and changes in demand. Updates on the revenue budget projections are presented to the Council on a regular basis. The Business Transformation Steering Group is charged with ensuring that cost reductions and efficiency savings are in line with longer term strategic objectives.	While the Corporate Strategy makes links to resources, there is scope to articulate priorities for resource management within a medium-term financial strategy. This should link to other Council strategies, such as the Future Models of Service Delivery, and the People Strategy to outline resource planning, details on partnership working and interim financial targets. **Refer to Recommendation 2**

2. Do senior officials and elected members demonstrate ownership of financial plans and are they subject to sufficient scrutiny before approval?

Sub-question		Evidence	Conclusion
2.1	Do senior officials and elected members demonstrate ownership of financial plans: - Are high level financial targets and the overall financial position of the organisation discussed regularly at board level meetings? - In setting financial plans, do members adequately consider the impact of budget reductions on service quality and outcomes?	We found evidence that the Strategic Leadership Group are highly engaged with the scale of the financial challenge ahead. The SLG and Corporate Management Team have used financial discipline measures to make savings necessary to build a balanced budget for 2012-13. Plans for investment and savings are subject to financial scrutiny, but the Council must ensure that it is able to demonstrate best value in its decision making. There have been instances where officer recommendations regarding savings have not been adopted, including the decision to maintain all community facilities in addition to the development of an enhanced Newbattle campus. This will resulted in an additional £694k budget shortfall on revenue expenditure. Other decisions, such as the review of public conveniences, approved within the 2013-14 budget, has been considered at two Cabinet meetings, the Performance and Review Committee and Council. The approved budget proposed a saving of £85k in 2013-14 and £177k per annum thereafter. The Council's amended decision has an additional budget impact of £76k in 2013-14 and £72k in 2014-15 and future years.	Elected members and the Strategic Leadership Group demonstrate awareness of the financial position. Members offer scrutiny to the business transformation process through involvement in the Steering Group. We were, however, unable to demonstrate that a cohesive financial strategy is in place to balance the budget gap. We also believe that there is scope for greater transparency in plans for savings to be achieved via the Business Transformation programme. **Refer to Recommendations 2 and 3**

Sub-question		Evidence	Conclusion
2.2	Do senior officials and elected members provide: - Sufficient focus on strategy and performance? - Adequate challenge on longer-term financial plans? - Regular consideration of financial risks? - Adequate monitoring of the achievement of efficiency targets?	We found evidence that both elected members and officers across the Council understand the scale of the financial challenge facing the Council and the risks associated with the budget gap. The Senior Leadership Team demonstrate an eagerness to change and to deliver improved outcomes alongside the required savings. Business Transformation governance arrangements are in place to ensure that savings are reliable, and specific risk management arrangements have been adopted to review the risks associated with non-delivery of savings.	While elected members and officers have a shared understanding of the scale of the financial challenge, we cannot yet point to a comprehensive and agreed strategy to bridge the budget gap. **Refer to Recommendation 2**
2.3	Is there appropriate transparency and accountability of decisions about cost reduction measures and future organisational plans: - Is there appropriate consultation with the public and other stakeholders over cost reduction plans which identify various options and their impact on service delivery and outcomes? - Do financial and corporate plans adequately spell out the consequences of reduced budgets on the organisation's ability to deliver services and outcomes?	The Council has used consultation with the public in 2010-11, and a budget simulator exercise during 2012-13 to inform proposed budgets. Public consultation is used for key strategic decisions, such as the development of Newbattle High School. Financial monitoring reports to the Council and Audit Committee highlight the impact of decisions on the budget gap.	There is no financial strategy that outlines the consequences of failing to achieve savings targets. The budget gap for 2016-17 currently stands at £13.5 million, equivalent to over 7% of the cost of services in that year. **Refer to Recommendations 1 and 2**

Sub-question		Evidence	Conclusion

2.4	Do audit committees and other scrutiny committees play a suitably prominent role in the consideration of budget plans and risks to service delivery:
	- Are audit and other scrutiny committees sufficiently involved in the consideration of budget plans, including:
	  • the impact of budget reductions on service delivery
	  • the Council's track record of delivering against budgets?
	  • reasons for previous years' under/overspends against budget?
	- Do audit and other scrutiny committees undertake a regular programme of reviews of business areas to examine issues such as the achievement of value for money and service delivery?
	- Do audit and other scrutiny committees regularly assess areas such as financial risks and efficiency savings?
	- Are reports from audit and other scrutiny committees on budget plans and risks to service delivery given proper consideration by officials, with recommendations being promptly acted upon?
	- Do the audit and other scrutiny committees receive reports on the extent to which cost reductions and efficiency savings have impacted on service delivery?
		Both the Council and Audit Committee receive financial monitoring reports that outline the cause and impact of budget over and underspends.
		
		The Business Transformation Steering Group provides scrutiny of plans and the achievement of savings. However, this group meets in private and the outcome of discussions are not reported to Council or to the Audit Committee.
		
		The Audit Committee has shown increasing interest in the financial performance of the Council during 2013-14, and a training session on the core financial statements and the impact of the audit committee in June 2013 was well-attended. The Committee provide oversight of the corporate risk register, which includes financial risk. There is, however, no systematic programme of value for money reviews in place. The Midlothian Excellence Framework, which is based on the Public Service Improvement Framework model of self-evaluation, has not been rolled out across services, in the way envisaged at the time of Audit Scotland's Best Value report in June 2012.
			Although governance arrangements are in place to review plans for savings, and financial monitoring reports provide evidence of the impact on the financial position of the Council, we believe there is scope to improve accountability for the achievement of savings and ability of the Council to demonstrate it is delivering best value.
			
			Refer to Recommendation 4

Appendix 2: Action Plan

Number	Area of review	Our finding	Risk Assessment	Management response
1.	**Budget gap**	The Strategic Leadership Group outlined proposals to bridge the projected budget gap to the Council in September 2013. Until fully developed plans to meet the financial challenge are in place, we regard this as a significant risk to the financial sustainability of the Council.	**High**	The Head of Finance and Human Resources and the Business Transformation Manager are formulating a fully developed delivery plan building on the proposals presented to Council in September 2013. This will be presented to Council in February 2014.
2.	**Financial Strategy**	The Finance Team prepare budgets for the medium term, covering three financial years. However, there is no clear strategy in place to link resources to articulated Council priorities. There are also no clear links between financial plans and other key strategies such as the Future Models of Service Delivery, or the People Strategy.	**High**	The Head of Finance and Human Resources and the Business Transformation Manager are formulating a fully developed delivery plan building on the proposals presented to Council in September 2013. This will be presented to Council in February 2014. In addition, work continues through the CPP to better define the resource focussed on the delivery of the CPP key priorities
3.	**Transparency of reporting**	Governance arrangements have been established to ensure that the Business Transformation Programme is effectively managed and subject to member scrutiny. We did, however, note that there is scope to improve the transparency of reporting against savings to Council.	**Amber**	The financial monitoring reports will be enhanced to improve the reporting of performance against savings proposals.
4.	**Self-evaluation**	Although the Council participate in the Local Government Benchmarking Framework , there is no programme of value for money reviews in place and cost benchmarking systematically to highlight areas for improvement. The Midlothian Excellence Framework has not been rolled out to services in the way envisaged at the time of the Best Value report in June 2012.	**Amber**	Steps have already been taken to further develop these elements in the Service plans and in the Planning and Performance Management framework for 2014-15. This will in turn lead to VFM reviews and highlight areas for improvement which will be set out in the service plans

Appendix 3: Key Indicators of Financial Performance

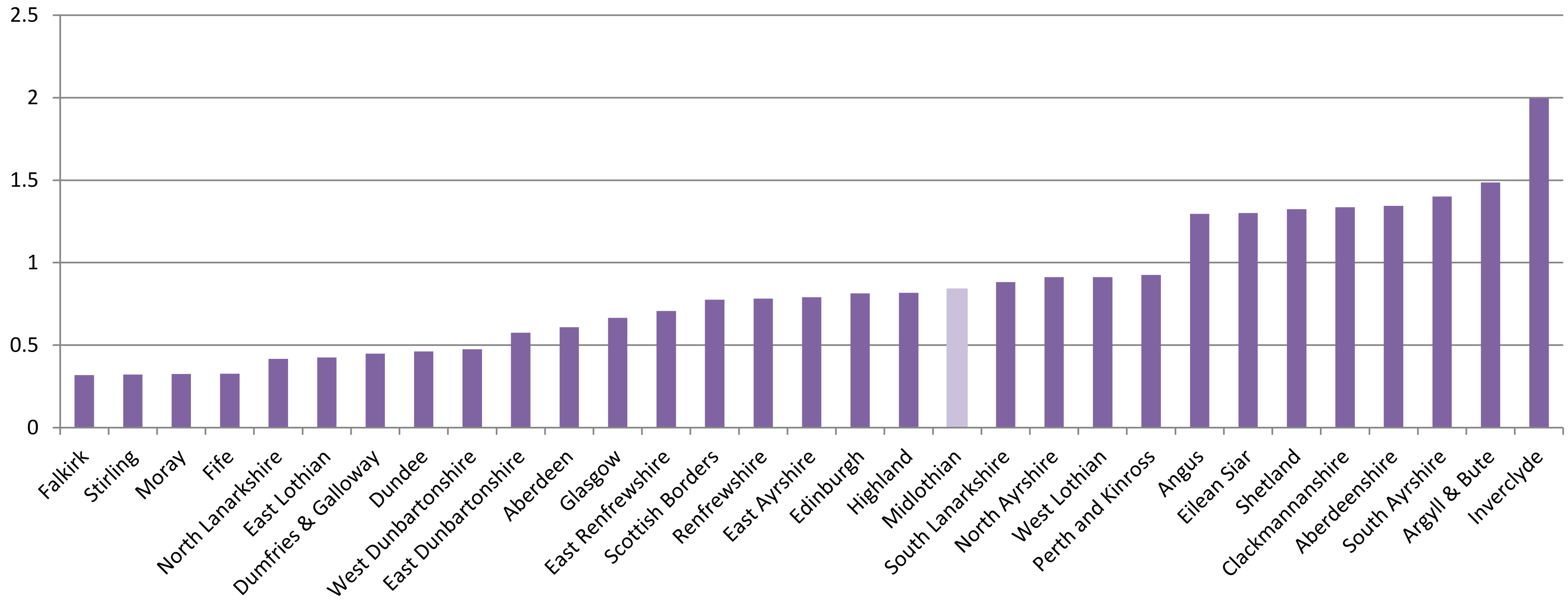
Working Capital Ratio

Definition

The working capital ratio indicates if an authority has enough current assets, or resources, to cover its immediate liabilities - i.e. those liabilities to be met over the next twelve month period. A ratio of less than one - i.e. current liabilities exceed current assets - indicates potential liquidity problems. It should be noted that a high working capital ratio is not always a good thing; it could indicate that an authority is not effectively investing its excess cash.

Findings

The Council's 2012-13 working capital ratio is 0.84.



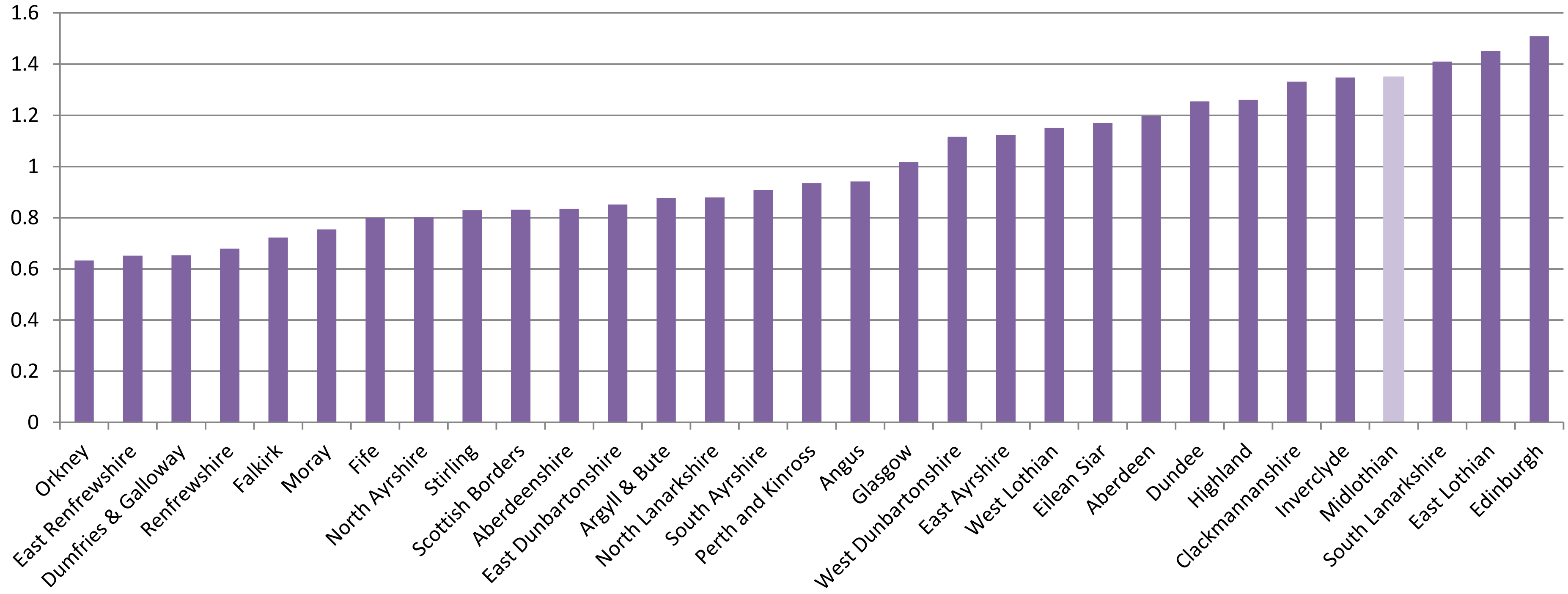
Long Term Borrowing to Tax Ratio

Definition

Shows long tem borrowing as a share of tax revenue. A ratio of more than one means that long term borrowing exceeds council tax revenue.

Findings

The Council's 2012-13 long term borrowing ratio as a proportion of tax revenue is 1.35 placing the Council as the fourth highest level of borrowing in Scotland. This reflects the substantial building programme adopted by the Council, and the business cases therefore in place to support the level of borrowing.



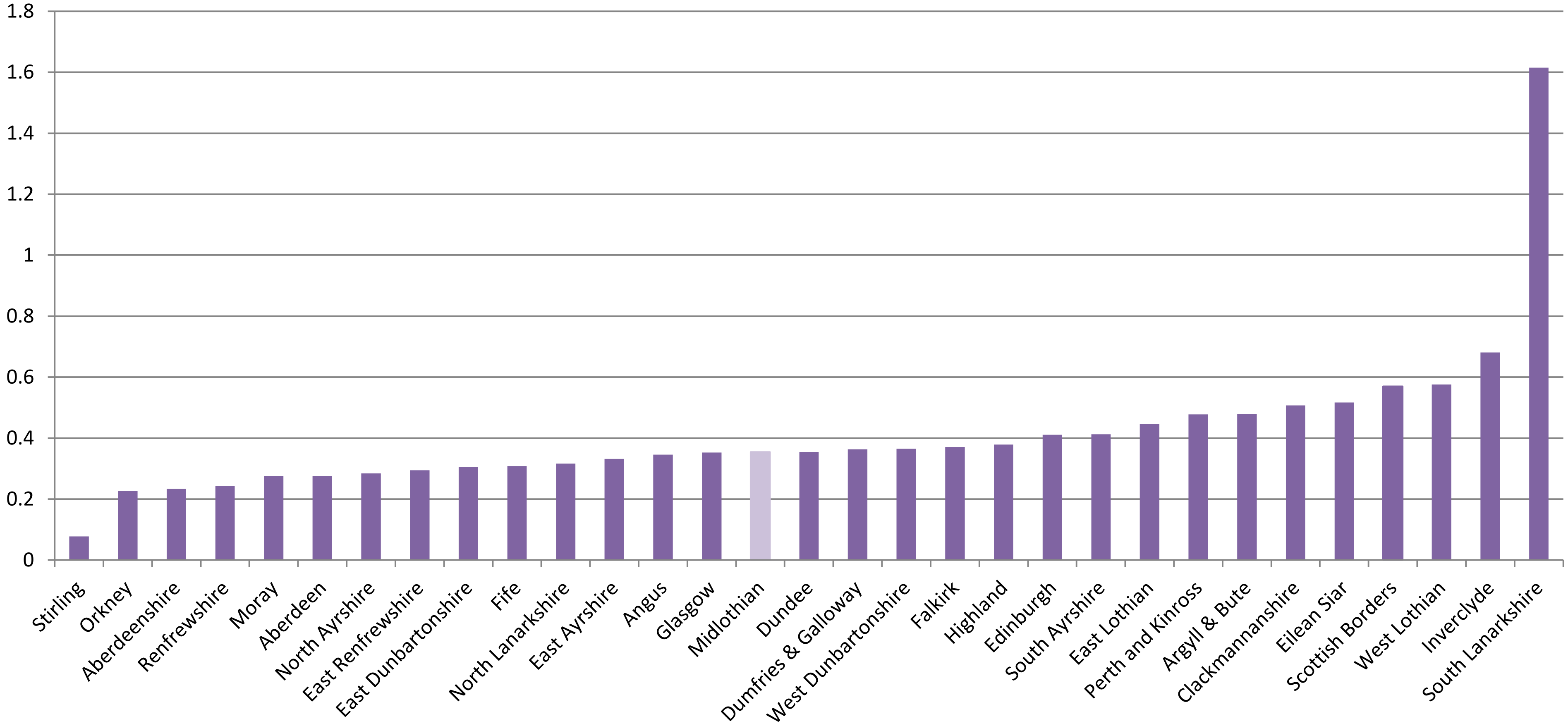
Long Term Borrowing to Long Term Assets

Definition

This ratio shows long term borrowing as a share of long term assets. A ratio of more than one means that long term borrowing exceeds the value of long term assets.

Findings

The Council's 2012-13 long term borrowing to long term assets ratio is 0.35, placing it in the middle of authorities in Scotland.



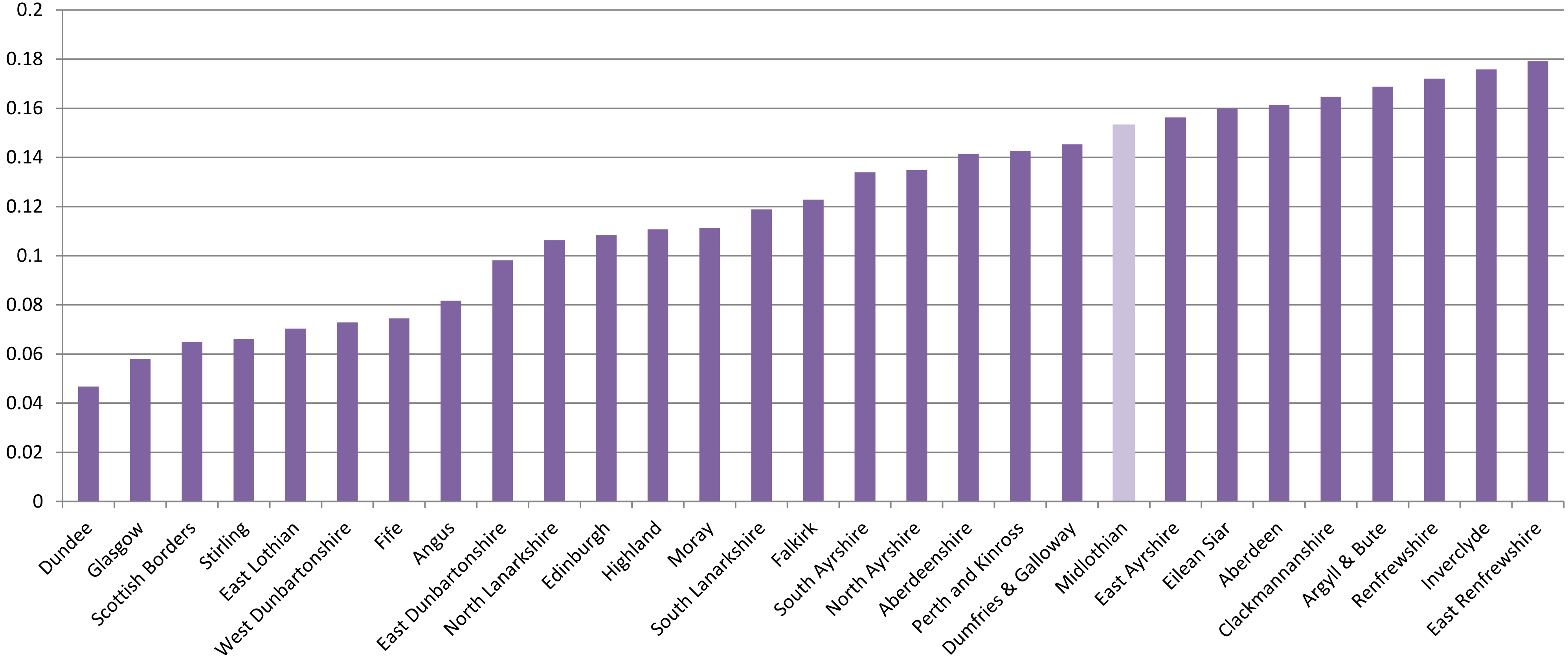
Usable Reserves to Gross Revenue Expenditure

Definition

This ratio shows the Council's reserves which are available for use as a proportion of gross revenue expenditure. A higher ratio indicates the Council has a greater ability to fund expenditure from available reserves.

Findings

The Council's 2012-13 usable reserves to gross revenue expenditure total 0.15, broadly at the midpoint of Scottish Councils.



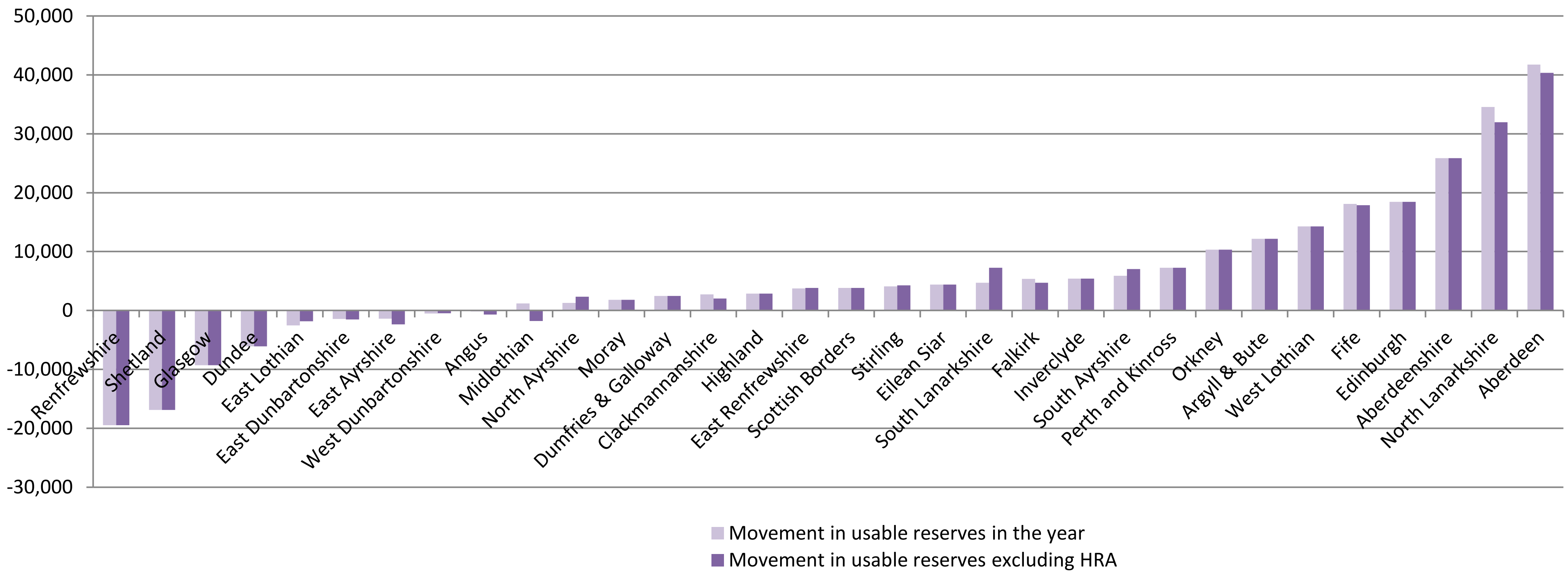
Movement in Usable Reserves

Definition

We considered the overall movement in reserves, both including HRA balances, and without, to refer those councils who no longer retain housing stock.

Findings

Excluding the HRA balances, Midlothian Council was one of ten Councils in Scotland that reported a reduction in usable reserves in 2012-13.



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