INFRASTRUCTURE, GOVERNMENT AND HEALTHCARE

Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee

Annual audit report to members and the Controller of Audit

Year ended 31 March 2010

29 September 2010

AUDIT

AUDIT ▪ TAX ▪ ADVISORY

Contents

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About this report

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

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

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

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

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Executive summary

Financial year 2009-10 has been challenging for the Partnership on several levels and has necessitated responses to: ongoing financial pressures, changes in members and senior staff, allegations made concerning senior staff and receipt of a significant number of Freedom of Information requests. Despite these challenges, the Partnership has produced financial statements in line with the agreed timetable and [we have issued] unqualified opinions on the financial statements of both Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee. The quality of information provided by the finance team during the audit has been good, although in our report to those charged with governance we made a number of recommendations to improve the financial statements production process and key accounting procedures.

SPT's core revenue budget for 2009-10 was £47.642 million, of which £38.313 million was financed from constituent local authorities, with the remaining £9.329 million financed by the Scottish Government and other sources. Scottish Government funding was again higher than in prior years as a result of the decision in 2008-09 to accelerate repayment of debt and an additional £15 million was received and used to repay debt in the year. Revenue expenditure was below budget in a number of areas, however savings were offset by reductions in income. Capital expenditure was £27.048 million, against a revised budget of £27.994 million (initial budget: £34.723 million). This expenditure was funded mainly by grant funding from the Scottish Government (£26.073 million) and Clyde Gateway (£0.170 million) with the remaining £0.805 million being funded from current revenue resources. In addition, £3 million of capital funding has been carried forward into 2010-11 in accordance with SPT's 2009-10 funding allocation letter.

A revenue budget of £39.556 million has been set for 2010-11, against a budget of £47.642 million in 2009-10. This is based on a number of estimates and assumptions and is a significant decrease from the prior year due mainly to lower loan charges following the early repayment of debt. Twenty-eight specific measures were identified as part of the 2010-11 budget proposals to increase revenue or reduce costs. In recognition of the continued cost pressures which the Partnership faces, a report was considered by the Partnership on 20 August 2010 which explained that the Partnership continued to face a number of pressures and noted a number of steps already taken to address these pressures.

As part of its longer term strategy, SPT endorsed the 'modernisation case' as the best way forward for subway modernisation and agreed to prioritise the modernisation of working practices and employee relations as the key to delivering this program. Management has allocated £4 million in the capital programme in 2010-11 for subway modernisation.

There were significant changes in the senior management structure during the year including changes to the positions of chair, vice-chair, chief executive and assistant chief executive. Proposals to restructure the senior management of the organisation were approved by the personnel committee on 14 May 2010 with the aim of saving over £180,000 annually; these proposals have now been implemented.

During 2009-10, a number of complaints about SPT were widely reported in the press concerning the alleged misuse of public funds by SPT and by certain employees and members. SPT reviewed the reported complaints and invited KPMG to conduct an external review. Subsequent to this, and in response to a number of formal complaints made to Audit Scotland, we were requested by Audit Scotland, as SPT's external auditors, to perform an independent review in respect of the formal complaints received by Audit Scotland. A full report of our findings was submitted to management and Audit Scotland during May 2010 and was presented to a special meeting of SPT's audit and standards committee on 2 June 2010. This report is available on SPT's website. As a result of this review we identified some control weaknesses and made a number of recommendations for improvement.

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Executive summary (continued)

Internal audit's annual report, submitted to the audit and standards committee on 11 June 2010 states that, "reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's internal control systems in the year to 31 March 2010".

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

Audit Scotland has confirmed that they will not subject the Partnership to a Best Value inspection during our five-year appointment as external auditors. However, value for money was considered, where appropriate, during internal audit system reviews and in addition, specific value for money reviews of internal transport and subways stores were performed at management's request. In January 2009, the Scottish Government promoted the use of a singe Procurement Capability Assessment tool to all local authorities in Scotland. The Partnership was not involved in this process, but given the significant procurement activity at the Partnership we have recommended that consideration is given to utilising the tool in 2010-11.

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Scope

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

Audit framework

This year was the fourth of our five-year appointment by the Accounts Commission as external auditors of Strathclyde Partnership for Transport ("SPT") and Strathclyde Concessionary Travel Scheme Joint Committee ("SCTSJC"). For the purposes of this report these bodies are referred to collectively as "the Partnership". This report to the members and Controller of Audit provides our opinions and conclusions and highlights significant issues arising from our work. We outlined the framework under which we operate, under appointment by the Accounts Commission, in the audit plan overview discussed with the audit and standards committee earlier in the year.

The purpose of this report is to report our findings as they relate to:

- the **financial statements** and significant accounting matters and decisions;
- **use of resources**, including financial outturn for the year ended 31 March 2010 and financial plans for 2009-10 and beyond;
- arrangements around **governance and accountability**, including risk management, systems of internal control, partnership working and our consideration of the work of internal audit; and
- **performance management arrangements.**

Best Value

Audit Scotland and the Scottish Government have been committed to extending the Best Value audit regime across the whole public sector for some time now, with significant amounts of development work having taken place. Using the Scottish Executive's nine best value principles as the basis for audit activity, Audit Scotland selected five areas as priority development areas (use of resources, governance and risk management, accountability, review and option appraisal, and joint working). As we reported in our audit plan overview, discussed with the audit and standards committee on 26 February 2010, Audit Scotland has confirmed that they will not subject the Partnership to a Best Value inspection during our five-year appointment as external auditors.

Responsibilities of the Partnership and its auditors

External auditors do not act as a substitute for the Partnership's own responsibilities for putting in place proper arrangements to account for the stewardship of resources made available to it and its financial performance in the use of those resources, to ensure the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the effectiveness of those arrangements and, through the accountable officer, to make arrangements to secure Best Value.

Action plan

This report includes an action plan containing areas for development or improvement identified during our financial statements audit fieldwork. We have not repeated recommendations raised in reports issued during our earlier work in respect of our 2009-10 audit. Responsibility for taking action and monitoring progress in response to all our recommendations lies with management.

Acknowledgement

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

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Financial statements

Following approval of the financial statements of SPT and SCTSJC we issued audit reports expressing unqualified opinions on the financial statements for the year ended 31 March 2010.

The quality of information provided, on request, by the finance team has been good. However, in our report to those charged with governance (dated 9 September 2010) we made a number of recommendations to improve the financial statements production process and key accounting procedures.

Key issues arising from our audit of the financial statements were:

- Section 3 of the Transport Scotland (Act) 2006 requires that constituent local authorities meet only SPT's net expenses for each financial year. While SPT continues to press for a change to the legislation with the Scottish Government, it is unable to increase reserves and any surplus must be returned to the constituent local authorities. The draft outturn for the year was a surplus on the general fund balance of £940,000. Due to pressures on the capital programme, management agreed to fund £805,000 of capital expenditure from revenue resources. This reduced the surplus recognised and the remaining amount was recognised as a creditor, to be repaid to funding authorities, which eliminated the surplus on the general fund balance.
- St Enoch's Travel Centre was being held as an operational asset, but it was no longer in use. The building was subsequently reclassified as an investment property, and in accordance with the SORP 2009, was required to be revalued to market value. The value increased to £1.217 million.
- Amounts received from First Scotrail in respect of the originally planned multi-story car park at Croy station were reclassified as a result of the audit process.

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Financial statements (continued)

Reporting arrangements and timetable

We commenced our audit fieldwork on 7 June 2010. We received draft financial statements for SPT and SCTSJC, as agreed, on 10 June 2010. Management included a version of the accompanying narrative statements and the financial statements were substantially complete.

The quality of information provided, on request, by the finance team has been good. However, in our report to those charged with governance (dated 7 September 2010) we made a number of recommendations to improve the financial statements production process and key accounting procedures.

Audit opinion

Following approval of the financial statements of SPT and SCTSJC we issued audit reports expressing unqualified opinions on the financial statements for the year ended 31 March 2010.

Key issues arising during our audit of the financial statements

Our audit plan overview and interim management report highlighted potential key risk areas. We have considered these areas and set out our findings below.

Funding capital from revenue

Section 3 of the Transport Scotland (Act) 2006 requires that, similar to other Regional Transport Authorities, constituent local authorities meet only SPT's net expenses (i.e. the expenses not met by grant or other income) for each financial year. Following discussions with the Scottish Government, Audit Scotland issued guidance in late June 2007 clarifying this position. SPT, having taken legal advice, does not agree with this interpretation of the Act and, during 2009-10, has continued to press for a change to the legislation with the Scottish Government.

Until such times as a change in legislation is enacted, SPT cannot increase reserves, including the general fund balance. The outturn for the year ended 31 March 2010 in the draft financial statements, showed an increase in the general fund balance of £940,000. Due to pressures on the capital programme, management elected to fund £805,000 of capital expenditure from revenue resources which reduced this surplus. The remaining amount was recognised as a creditor, as an amount due to be returned to the constituent authorities at year end, thus eliminating the surplus on the general fund balance.

High street land

In 2008-09, land at High Street, Glasgow, was revalued downwards to £3 million following our discussions with management and receipt of an updated director's valuation as at 31 March 2009. At 31 March 2010, the valuation by management has been held at £3 million.

The SPT site forms part of the larger "Collegelands" site of 13 acres. According to the website of the developer there is an approved master plan on the whole site for a mixed use development. We also understand that phase one is now under construction, due to be completed by Autumn 2011. As part of the audit process, the basis of the land valuation was considered and discussed with management and we concluded that the value reflected within the financial statements is reasonable.

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Financial statements (continued)

St Enoch's Travel Centre

Our annual audit procedures include discussion and meetings with SPT's internal valuer in order to consider the basis of property valuations and to discuss significant valuations as at the year end. The valuer completed a review and valuation of investment properties which was used in the draft financial statements. However, following a review of SPT's asset registers, we identified that the St Enoch's Travel Centre was incorrectly recorded and valued as operational land and buildings, when it should have been valued as an investment property following a change in use during 2009-10. The SORP 2009 requires that Investment properties should be included in the balance sheet at the lower of net current replacement cost or net realisable value. In the case of investment properties, net realisable value is generally assessed to be market value. Accordingly, a market valuation was obtained for the St Enoch's Travel Centre at £1.217 million and an audit adjustment processed to reflect the transfer of this asset to investment properties and this subsequent upward revaluation from £0.322 million.

Croy station multi-story car park

SPT previously entered into an agreement with First Scotrail in respect of the development of a multi-story car park at Croy. A subsequent decision during 2008-09 led to the amount of £5.898 million, which had been advanced to First Scotrail, becoming repayable and a debtor was recognised as at 31 March 2009. In early 2009-10 the amount was repaid to SPT. The draft financial statements, however, included the amount as a useable capital receipt and the corresponding debtor remained on the balance sheet. An audit adjustment was therefore processed to eliminate the debtor and useable capital receipt.

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Financial management

SPT's core revenue budget for 2009-10 was £47.642 million, of which £38.313 million was financed from constituent local authorities, with the remaining £9.329 million financed by the Scottish Government and from other sources.

Scottish Government funding was again higher than in prior years as a result of the decision in 2008-09 to accelerate repayment of debt. An additional £15 million was received in 2009-10, with a corresponding amount of debt repaid (2008-09: £25 million). Expenditure was below budget in a number of areas, including electricity costs (£875,000), corporate properties (£300,000) and contributions to local bus operators (£755,000). These savings were mainly offset by reduced subway income which was below budget by £1.411 million, mainly due to a reduction in passenger numbers from 14 million in 2008-09 to 13 million in 2009-10.

Total expenditure in support of the capital programme was £27.048 million against an initial budget of £34.723 million approved by the Partnership on 17 April 2009, which was revised by subsequent Partnership meetings to £27.994 million as at 11 March 2010. The programme was mainly funded by grant funding from the Scottish Government (£26.073 million) and Clyde Gateway (£0.170 million) with the remaining £805,000 being funded from current revenue resources.

SPT's 2009-10 funding allocation letter permits a carry forward of 10% of capital grant funding. Total Partnership capital funding in 2009-10 was £30.048 million, £27.048 million was utilised, with £3 million carried forward to 2010-11, which was within acceptable limits.

A revenue budget of £39.556 million has been set for 2010-11. This is based on the agreement that there will be no increase in requisitions from constituent local authorities and takes into account estimated decreases in Scottish Government funding. It is a significant decrease from the 2009-10 budget (£47.642 million), with the main reduction being in respect of lower loan charges following the repayment of debt. Twenty-eight specific measures were identified as part of the 2010-11 budget proposals to increase revenue or reduce costs.

Recognising the continued cost pressures which the Partnership faces, a report by the assistant chief executive (business support) was considered by the Partnership on 20 August 2010. It explained that the Partnership continued to face a number of pressures and a number of steps have already been taken to address these pressures.

SPT endorsed the 'modernisation case' as the best way forward for subway modernisation and agreed to prioritise the modernisation of working practices and employee relations as the key to delivering the modernisation program. Management has allocated £4 million in the capital programme in 2010-11 for subway modernisation.

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Financial management (continued)

Financial position

SPT's core revenue budget for 2009-10 was determined at a meeting of the strategy and programmes committee on 30 January 2009 and subsequently approved at £47.642 million. Of this, £38.313 million was to be financed through requisition from constituent local authorities and the remaining £9.329 million funded by the Scottish Government. In 2009-10, Scottish Government funding was again higher than in prior years as a result of the decision in 2008-09 to accelerate the repayment of SPT's debt. An additional £15 million was received and used to repay an equal amount of debt during 2009-10 (2008-09: £25 million).

Funding received from constituent local authorities in 2009-10 was in line with budget and funding from the Scottish Government was above budget due to the increased funds for debt repayment.

Expenditure was below budget in a number of areas, including electricity costs (£875,000), corporate properties (£300,000) and contributions to local bus operators (£755,000). These savings were mainly offset by reduced subway income which was below budget by £1.411 million, mainly due to a reduction in passenger numbers from 14 million in 2008-09 to 13 million in 2009-10. The result for the year and movement on the general fund balance are summarised below.

Income and Expenditure account	£'000
Net cost of services	24,815
Interest payable and similar charges	1,620
Interest receivable	(400)
Pension cost and expected return on assets	1,401
Net operating expenditure	**27,436**
Funding received from constituent local authorities	(38,179)
Funding from Scottish Government	(22,586)
Surplus for the year	**(33,329)**

Statement of movement on the General Fund Balance	£'000
Surplus for the year	**(33,329)**
Net additional amount required by statute to be debited or credited to the general fund balance for the year	33,329
Increase in general fund balance for the year	-
General fund balance brought forward	(12,526)
General fund balance carried forward	**(12,526)**

Capital programme

Total expenditure in support of the capital programme amounted to £27.048 million against an initial budget of £34.723 million approved by the Partnership on 17 April 2009, which was revised at subsequent Partnership meetings to £27.994 million as at 11 March 2010. A number of projects were carried forward into 2010-11, together with the associated programme underspend (£0.946 million). The capital programme was mainly funded by Scottish Government grant funding (£26.073 million), Clyde Gateway grant funding (£0.170 million) with the remaining £805,000 being funded from current revenue resource.

In 2007-08, as part of a funding arrangement entered into with other Regional Transport Authorities, SPT received £3.689 million. In 2008-09, £1.8 million was repaid and in 2009-10 a further £354,000 was repaid. The remaining £1.564 million will be repaid at a time to be agreed between the respective bodies.

SPT's 2009-10 funding allocation letter permits a carry forward of 10% of capital grant funding. Total Partnership capital funding in 2009-10 was £30.048 million; £27.048 million was utilised as above with £3 million carried forward to 2010-11, which was within acceptable limits.

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Financial management (continued)

Financial planning

A revenue budget of £39.556 million for 2010-11 was agreed at a Partnership meeting on 22 January 2010. Similar to prior years, performance is monitored regularly by the strategy and programmes committee, with reports also presented to the Partnership. This budget has been set on the basis that there will be no increase in requisitions from the constituent local authorities and takes account of estimated decreases in Scottish Government funding. The 2010-11 budget represents a significant decrease on the 2009-10 budget. A summary of the main variances is shown below.

Caption	Budget 2009-10 (£'000)	Budget 2010-11 (£'000)	Variance (£'000)
Cabinet & support	1,314	1,147	(167)
Customer services	22,929	21,926	(1,003)
Business support	6,890	6,399	(491)
Loan charges / subway modernisation	17,754	8,930	(8,824)
Corporate	(1,776)	631	2,407
Bus Company residual	531	523	(8)
Expenditure	**47,642**	**39,556**	**(8,086)**
Requisitions	(38,313)	(38,458)	(145)
Core costs	(1,220)	(1,098)	122
Government funding	(8,044)	-	8,044
Travel planners	(65)	-	65
Funding	**(47,642)**	**(39,556)**	**8,086**

The largest budget reduction is in respect of loan charges from £17.754 million in 2009-10 to £8.930 million in 2010-11. This is due to the early repayment of debt during 2008-09 and 2009-10, which has substantially reduced the ongoing loan charges and interest costs and associated government funding. SPT intends to utilise some of these savings to help fund the subway modernisation project. Operationally, there are forecast reductions in subway income from £15.983 million in 2009-10 to £14.665 million in 2010-11 which is associated with reductions in patronage in the current economic climate. There are also reductions to income and expense budgets associated with the cessation of the SPT funded Renfrew to Yoker ferry service on 31 March 2010.

The 2010-11 capital budget was approved on 26 February 2010. It includes £34.005 million of high priority projects, together with indicative figures of £48.790 million for 2011-12 and £34.288 million in 2012-13. Both 2011-12 and 2012-13 indicative budgets include £15.000 million in respect of subway modernisation. Funding available in 2010-11 is £20 million before carry forwards and additional grant income being sought by the Partnership. SPT regularly plans for higher capital expenditure as a number of projects will be subject to in-year delays and slippage.

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Financial management (continued)

Management has considered the impact of the current economic climate as part of the budget setting process for 2009-10 and 2010-11. Financial stability proposals presented to a Partnership meeting on 12 December 2008 addressed the forecast budget deficit of £500,000 for 2009-10 and £2.5 million in 2010-11. A number of actions to address the budget shortfall in 2009-10 were agreed along with proposals for reviews to identify savings and efficiencies for 2010-11.

Management agreed a number of actions to address the budget shortfall in 2009-10 and proposals for reviews to identify savings and efficiencies for 2010-11. A subsequent report by the chief executive was presented to SPT on 12 June 2009 which provided an update on the status of these recommendations.

Twenty-eight specific measures have been identified in the 2010-11 budget proposals to increase revenue or reduce costs. We have considered these measures and consider that they:

- ✓ are sufficiently detailed to explain the proposed operational change;
- ✓ detail the effected directorate;
- ✓ note the effected Regional Transport Strategy priority; and
- ✓ detail the expected saving from implementing the change.

Management has also considered the impact of its budget proposals on the 15 national outcome targets set by the Scottish Government.

Recognising the continued cost pressures which the Partnership faces, a report by the assistant chief executive (business support) was considered by the Partnership on 20 August 2010. It explained that the Partnership continues to face a number of pressures including:

- potential increased costs due to inflationary increases (£3.6 million over the next three years);
- risk of increased demand for services or maintenance costs;
- current predictions of an additional £2.2 million of savings to be achieved over the next three years;
- £1.8 million funding gap in respect of the concessionary travel scheme; and
- expected reductions in capital funding.

The Partnership is already taking a number of positive steps to address these pressures including:

- ✓ initiatives to reduce the current cost of services;
- ✓ implementation of the revised senior management structure;
- ✓ further expected savings from the voluntary severance scheme (£2 million);
- ✓ review of discretionary spending;
- ✓ review of the bus subsidy guidance criteria; and
- ✓ implementation of the subway modernisation programme and review of subway expenditure.

While the Partnership has demonstrated good practice to date, achieving financial stability is a risk going forward. It is recommended that regular progress reporting continues against all of the initiatives in place to achieve financial stability.

Recommendation one

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Financial management (continued)

Subway modernisation

The Glasgow subway system is largely reliant on Victorian infrastructure and therefore has high annual maintenance costs. The system was last substantially updated in the 1970's when the stations and train cars were refurbished and replaced. An outline business case for the future refurbishment and development of the subway system was presented to a meeting of the Partnership on 16 April 2010. Four options were proposed:

- Status quo – this scenario was considered as a reference point assuming no capital funding was available. The key outcomes would be increased congestion, the expected loss of £230 million in transport, economic and connectivity benefits, job losses and other impacts on Glasgow and the surrounding areas.
- Base case – this scenario represented the current situation in which the assets are maintained on a like-for-like basis within the limits of short-term funding; a 'do minimum' option.
- Modernisation – this scenario involves strategic investment to enhance the operational and financial efficiency of the system, with improvements for customers, the environment and the Partnership.
- Blue sky – this case considered the potential to expand the system, involving major capital contributions.

SPT endorsed the 'modernisation case' as the best way forward and agreed to prioritise the modernisation of working practices and employee relations as the key to delivering the programme. SPT also approved a best practice design guide and the strategy for taking forward funding as outlined in the report. The 2010-11 capital programme includes £4 million in relation to subway modernisation. This is a significant project for SPT and has been identified by management as key to the future of the Glasgow subway system. There is adetailed risk register for the project.

We recommend that a comprehensive implementation plan for the project is established to supplement the detailed risk register and that regular updates are provided to members in due course.

Recommendation two

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Corporate governance arrangements

During 2009-10, there has been significant change in the senior management structure. On 26 February 2010, the Partnership approved the appointment of councillor Jonathan Findlay as chair, replacing councillor Alistair Watson. At the same time, councillor Denis McKenna was appointed vice-chair, replacing councillor David McLachlan. In addition, on 9 April 2010, the chief executive, Ron Culley, retired on ill-health grounds. Gordon Maclennan, the assistant chief executive (operations) and deputy chief executive, was appointed interim chief executive for a period of one year on 16 April 2010. Subsequently, a proposal to restructure the senior management of the organisation was approved by the personnel committee on 14 May 2010. The proposals aim to save over £180,000 annually and following a period of staff consultation have now been implemented.

During 2009-10, a number of complaints concerning SPT were widely reported in the press. The matters concerned the alleged misuse of public funds by SPT and by certain employees and members. SPT reviewed the reported complaints and invited KPMG to conduct an external review. Subsequent to this, and in response to a number of formal complaints made to Audit Scotland, we were requested by Audit Scotland, as SPT's external auditors, to perform an independent review in respect of the formal complaints received by Audit Scotland. A full report of our findings was submitted to management and Audit Scotland during May 2010 and was presented to a special meeting of the audit and standards committee on 2 June 2010. This report is available on SPT's website. As a result of this review we identified some control weaknesses and made a number of recommendations for improvement.

Internal audit's annual report, submitted to the audit and standards committee on 11 June 2010 states that, *"reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's internal control systems in the year to 31 March 2010".*

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

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour. The three fundamental principles of corporate governance – openness, integrity and accountability – apply to all bodies.

Through its assistant chief executive (business support), the Partnership is responsible for establishing arrangements for ensuring the proper conduct of its affairs, including compliance with relevant guidance, the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. The *Code* requires auditors to review and report on corporate governance arrangements as they relate to:

- the Partnership's review of its systems of internal control, including its reporting arrangements;
- the prevention and detection of fraud and irregularity; and
- standards of conduct and arrangements for the prevention and detection of corruption.

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Corporate governance arrangements (continued)

Governance framework

The Regional Transport Strategy, 'A Catalyst for Change 2008-2021' was approved and provided by SPT to the Scottish Government by 31 March 2008, as required by the Transport (Scotland) Act 2005. It forms the basis of the Partnership's activity. The Partnership appoints between seven and nine of its members with the permission of the Scottish Government, with a further 20 members appointed from the 12 constituent local authorities.

In 2008-09, the Partnership approved a number of policies which form its governance manual. This included the procedural standing orders, contract standing orders, financial regulations, schemes of financial and non-financial delegations, codes of conduct, anti-fraud and whistle blowing policies. This manual was reissued to senior staff during 2009-10.

The financial regulations include guidance on how to contribute to a positive control environment, procedures for identifying risks and responsibilities for establishing adequate controls and procedures to mitigate those risks.

SPT has the following committees which support its governance framework:

- the partnership;
- chairs;
- strategy and programmes;
- operations;
- audit and standards committee;
- personnel committee; and
- personnel appeals sub-committee.

A high level of detail is provided to committee members and the minutes and papers are published on the Partnership's website.

Organisational change

During 2009-10, there has been significant change in the senior management structure. On 26 February 2010, the Partnership approved the appointment of councillor Jonathan Findlay as chair, replacing councillor Alistair Watson. At the same time, councillor Denis McKenna was appointed vice-chair, replacing councillor David McLachlan.

In addition, on 9 April 2010, the chief executive, Ron Culley, retired on ill-health grounds. Gordon Maclennan, the assistant chief executive (operations) and deputy chief executive, was appointed interim chief executive for a period of one year on 16 April 2010. Subsequently, a proposal to restructure the senior management of the organisation was approved by the personnel committee on 14 May 2010. The proposals aim to save over £180,000 annually and following a period of staff consultation have now been implemented.

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Corporate governance arrangements (continued)

Systems of internal control

Statement of systems of internal financial control

The statement provides details of the internal financial control environment and risk management and control framework. Management highlights that the system of internal financial control is based on a framework of guidance and regular management information, financial regulations, administrative and authorisation procedures, management supervision and a system of delegation and accountability. The statement is informed by officers, the audit and standards committee, and the work of internal and external audit. The content of the statement is consistent with our understanding of SPT.

Corporate governance statement

SPT has adopted a corporate governance framework which is based on the best practice framework developed jointly by the Society of Local Authority Chief Executives and the Chartered Institute of Public Finance and Accountancy. The statement summarises SPT's performance during the year, together with highlighting areas for development. The content of the statement is consistent with our understanding of SPT.

SCTSJC utilises the systems and controls of SPT in carrying out its business. SCTSJC has therefore included a corporate governance statement and statement of system of internal financial control which explain this and reproduces the content of SPT's statements.

Internal audit

Our planned audit approach seeks, wherever possible, to place reliance on the work completed by internal audit to minimise duplication of effort and ensure maximum benefit from the combined audit resource. In accordance with our audit plan overview we placed reliance on the following internal audit reviews:

- main accounting system;
- subway station visits;
- travel centre visits;
- budgetary control;
- subway income;
- payment procedures;
- income collection; and
- regularity audits.

We also visited a travel centre and subway station with internal audit to understand their inspection role and re-performed a detailed procedure to follow subway station cash collection from the subway station through to the cash counting and banking procedures.

Internal audit's annual report, submitted to the audit and standards committee on 11 June 2010 states that, *"reasonable assurance can be placed upon the adequacy and effectiveness of the Partnership's internal control systems in the year to 31 March 2010".*

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Corporate governance arrangements (continued)

We understand that a member of the internal audit team was responsible for the preparation of the cash flow statement in the draft financial statements. The CIPFA internal audit code of practice states that internal auditors should have no operational responsibility as it compromises their objectivity and independence. Whilst we note that in this instance the code was not breached and the risk was minimal, we recommend that staff are reminded that, to ensure their objectivity and independence continues to be maintained, internal audit should not be given operational tasks.

Recommendation three

Internal controls

Our interim management report (submitted to the audit and standards committee on 12 June 2009) made one new recommendation in respect of internal audit sample sizes and six in relation to key financial controls, including one graded as 'significant'. In addition, we reported that four recommendations previously made in relation to IT controls had yet to be implemented.

In our report to those charged with governance (dated 7 September 2010) we made a number of recommendations to enhance the financial statements production process and key accounting procedures, primarily in relation to balance sheet accounting entries and journals.

A new financial ledger system was implemented during 2009-10 and subsequently subject to a review by internal audit. A number of recommendations were made and it is important these are addressed by management to ensure that financial information is maintained accurately, management reporting is accurate and that decisions taken are based upon robust information. Our interim management report also included some recommendations on the new financial ledger and related procedures.

Complaints investigation

During 2009-10, a number of complaints concerning SPT were widely reported in the press. The matters concerned the alleged misuse of public funds by SPT and by certain employees and members. SPT reviewed the reported complaints and invited KPMG to conduct an external review. Subsequent to this, and in response to a number of formal complaints made to Audit Scotland, we were requested by Audit Scotland, as SPT's external auditors, to perform an independent review in respect of the formal complaints received by Audit Scotland.

A full report of our findings was submitted to management and Audit Scotland during May 2010 and was presented to a special meeting of the audit and standards committee on 2 June 2010. This report is available on the Partnership's website. As a result of this review we identified some controls weaknesses and made a number of recommendations for improvement.

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

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Prevention and detection of fraud and irregularity;

Prevention and detection of fraud and irregularity

The financial regulations state that: *"The Assistant Chief Executive (Business Support) must ensure the Partnership has an effective anti-fraud and corruption policy and whistle blowing procedures. It should be backed up by a culture that does not tolerate fraud or corruption"*. The anti-fraud strategy sets out what to do if fraud or any other irregularity is suspected. The strategy forms part of the Partnership's procedures for handling suspicions, allegations or evidence of fraud or other irregularities and includes a fraud response plan.

The formal whistle blowing policy governs procedures to be followed in the event of a fraud or suspected fraud. We have previously considered the policy against the Public Interest Disclosure Act requirements and the Public Concern at Work: Best Practice notes and have not identified any significant variations.

During 2009-10 eight reports were made through SPT's fraud reporting helpline. Two reports related to other organisations and were forwarded appropriately. Two related to operational issues and were dealt with by relevant departments. The remaining four allegations were investigated by internal audit. The chief internal auditor reported to the Partnership on 11 June 2010 that no material fraud or corruption was identified during 2009-10.

National Fraud Initiative

We submitted a completed questionnaire to Audit Scotland in February 2010 to inform the national report on local authorities' participation in the National Fraud Initiative ("NFI"). This included consideration of the Partnership's arrangements for responding to matches identified, arrangements for reporting results internally and compliance with Audit Scotland guidance. We highlighted good practice in record keeping and standard audit programs used by internal audit, but noted that the results of a number of reviews of creditor matches had, at that time, not been uploaded into the NFI application. This has subsequently been addressed.

The chief internal auditor reported to the Partnership on 11 June 2010 noting the progress in respect of NFI and that no frauds or errors had been identified from matches investigated to date.

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Performance management

During 2009-10, all internal audit system reviews considered value for money, where appropriate. In addition, specific value for money reviews of internal transport and subway stores were performed at management's request. The Partnership also monitors its service performance against the subway passenger charter, service standards and the impact of its advertising on the public through market research.

Audit Scotland has confirmed that they will not subject the Partnership to a Best Value inspection during our five-year appointment as external auditors.

In January 2009, the Scottish Government promoted the use of a singe Procurement Capability Assessment tool to all local authorities in Scotland. The Partnership was not involved in this process. Given the significant procurement activity at the Partnership we have recommended that consideration is given to utilising the tool in 2010-11.

Performance management

The *Code* requires that, in accordance with guidance provided by Audit Scotland, we consider the Partnership's arrangements in relation to Best Value and other aspects of the arrangements to manage performance in relation to economy, efficiency and effectiveness in the use of resources.

The responsibility to ensure that the Partnership has appropriate arrangements to manage and monitor performance lies with management and the members of SPT and SCTSJC.

During 2009-10, all internal audit system reviews considered value for money, where appropriate. In addition, specific value for money reviews of internal transport and subways stores were performed at management's request. Performance of SPT services, such as the subway, is monitored against specific performance targets. For the subway, these are outlined in the subway passenger charter and performance against the targets is displayed in stations. SPT also sets out the way in which it will deal with the public in its service standards.

Another area where the Partnership monitors performance is in respect of the impact of advertising. One of the key aims of the Partnership and its advertising strategy is to encourage "modal shift". This means encouraging the public to switch from private to public transport. Since SPT does not operate the majority of public transport options and suppliers do not readily share their passenger data the impact of their campaigns cannot be easily measured. However, the Partnership employs consultants to undertake market research and guage the spontaneous awareness of SPT by the public. Their work indicates that spontaneous brand awareness has increased from around 5% to 80% over the last two years.

Best Value

The Local Government in Scotland Act (2003) established Best Value and Community Planning as statutory duties for local authorities. In response to these duties, the Accounts Commission introduced specific arrangements for the audit of Best Value and Community Planning. Audit Scotland has confirmed that they will not subject the Partnership to a Best Value inspection during our five-year appointment as external auditors.

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Performance management (continued)

Procurement Capability Assessment

The Public Procurement Reform Programme was established following the McClelland review of procurement in 2006. The programme aims to drive continuous improvement in public sector procurement and to deliver value for money and increased efficiency through improved structures, capability and processes. In January 2009, the Scottish Government promoted the use of a single Procurement Capability Assessment ("PCA") to assess procurement performance in public sector bodies and as a basis for the sharing of best practice and continuous improvement across the public sector in Scotland.

All of Scotland's 32 local authorities took part in the first round of PCAs in late 2009, but the Partnership was not invited to be involved. There is significant procurement activity within the Partnership and it is recommended that management consider whether the Partnership should become involved and utilise the Procurement Capability Assessment tool.

Recommendation four

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Appendix one – action plan

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

No.	Issue and recommendation	Management response	Officer and due date
1	The Partnership agreed a number of actions to address the budget shortfall in 2009-10 and proposals for reviews to identify savings and efficiencies for 2010-11. A subsequent report by the chief executive was presented to the Partnership on 12 June 2009 which provided an update on the status of these recommendations. It is recommended that further progress updates are presented to the Partnership together with the progress in implementing the specific 2010-11 budget proposals which were detailed in the budget setting paper in February 2010. This will minimise the risk that savings are not achieved as required to ensure financial stability. *Grade one*	An update was presented to the Partnership on 13 August 2010 and further updates will be presented on a regular, periodic basis.	Assistant Chief Executive (Business Support) Ongoing
2	The Partnership endorsed the 'modernisation case' for subway modernisation. The committee paper stated that it is important that initial funding is secured to enable the commencement of modernisation and sets out a range of options. A detailed risk register has been put in place for the project. We recommend that a comprehensive implementation plan for the project is established to supplement the detailed risk register and that regular updates are provided to members in due course. *Grade two*	A detailed implementation plan will be established once approval and funding for the project has been agreed.	Director of Projects Due date will be set once approval has been agreed.

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Appendix one – action plan (continued)

No.	Issue and recommendation	Management response	Officer and due date
3	We understand that a member of the internal audit team was responsible for the preparation of the Partnership's cash flow statement in the draft financial statements for the year ended 31 March 2010. The CIPFA internal audit code of practice states that internal auditors should have no operational responsibility as it compromises their objectivity and independence. Whilst we note that in this instance the code was not breached and the risk was minimal, we recommend that staff are reminded that, to ensure their objectivity and independence continues to be maintained, internal audit should not be given operational tasks. *Grade three*	Agreed in principle. The involvement of the staff member in the task concerned had a minimal risk of compromising independence.	Director of Finance Immediate
4	All of Scotland's 32 local authorities took part in the first round of PCAs in late 2009, but the Partnership was not involved. There is significant procurement activity within the Partnership and it is recommended that management consider whether the Partnership should become involved and utilise the Procurement Capability Assessment tool. *Grade two*	SPT will investigate the procurement capability assessment tool and consider utilisation of the tool thereafter.	Director of Finance 31 December 2010

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