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Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee

Annual audit report to Strathclyde Partnership for Transport and Strathclyde Concessionary Travel Scheme Joint Committee and the Controller of Audit

Year ended 31 March 2011

30 September 2011

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About this report

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

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

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

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

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Executive summary

Financial year 2010-11 has been challenging for the Partnership on several levels and has necessitated responses to: ongoing financial pressures and subway modernisation. Despite these challenges, the Partnership 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 was good, although in our report to those charged with governance we made some recommendations to improve the financial statement production process.

SPT's core revenue budget for 2010-11 was £39.556 million, of which £38.458 million was financed by receipts from constituent local authorities, with the remaining £1.1 million received from the Scottish Government. Revenue expenditure was below budget in a number of areas, however savings were offset by increases in financing costs as a result of subway modernisation and increases in payments to bus operators. Capital expenditure was £26.349 million, against a revised budget of £26.621 million (initial budget: £34.658 million). This expenditure was funded mainly by grant from the Scottish Government (£23.861 million), with the remaining £1.885 million being funded from current revenue resources.

A revenue budget of £38.532 million has been set for 2011-12, compared to a 2010-11 revenue budget of £39.556 million. Management has reported that this represents a net reduction of 2.6% in cash terms, however this masks the impact of inflation and other cost base changes which result in a real reduction of around 7.5%. The Partnership has identified measures to reduce costs across all areas, while maintaining frontline services and making total savings of £2.661 million. In producing the 2011-12 budget, the Partnership has taken account of affordability and the constituent local authority funding has been reduced in cash terms by 2.8% to £37.381 million, while Scottish Government funding has been reduced by 15% to £0.993 million.

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 a key to delivering this program. In 2010-11 management allocated £4.865 million of requisition income to future subway modernisation. Management has allocated £9.4 million in the capital programme in 2011-12 for subway modernisation.

The Partnership commenced a significant restructuring programme during 2010 which involved implementing structural changes across a number of functions including human resources, communications, projects and policy and strategy. The consultation is now complete and the new structures implemented. The principle drivers for change were a focus on service delivery for the benefit of the public and constituent local authorities, efficiency and cost reduction.

During 2009-10, a number of complaints concerning SPT were widely reported in the press concerning the alleged misuse of public funds by SPT and by certain employees and members. 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. During 2010-11 we performed a follow up review of the expenses report published in 2009-10 and concluded that the main recommendations had now been implemented.

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. In January 2009, the Scottish Government promoted the use of a single Procurement Capability Assessment tool to all local authorities in Scotland. The Partnership was not involved in this process, but have made arrangements for a PCA exercise to be undertaken, supported by internal audit.

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 2011".

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.

Headlines

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.

This report summarises our work for the year ended 31 March 2011.

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

Strategic objectives and risks	
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We have issued unqualified audit opinions on the 2010-11 financial statements.	-
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Use of resources	
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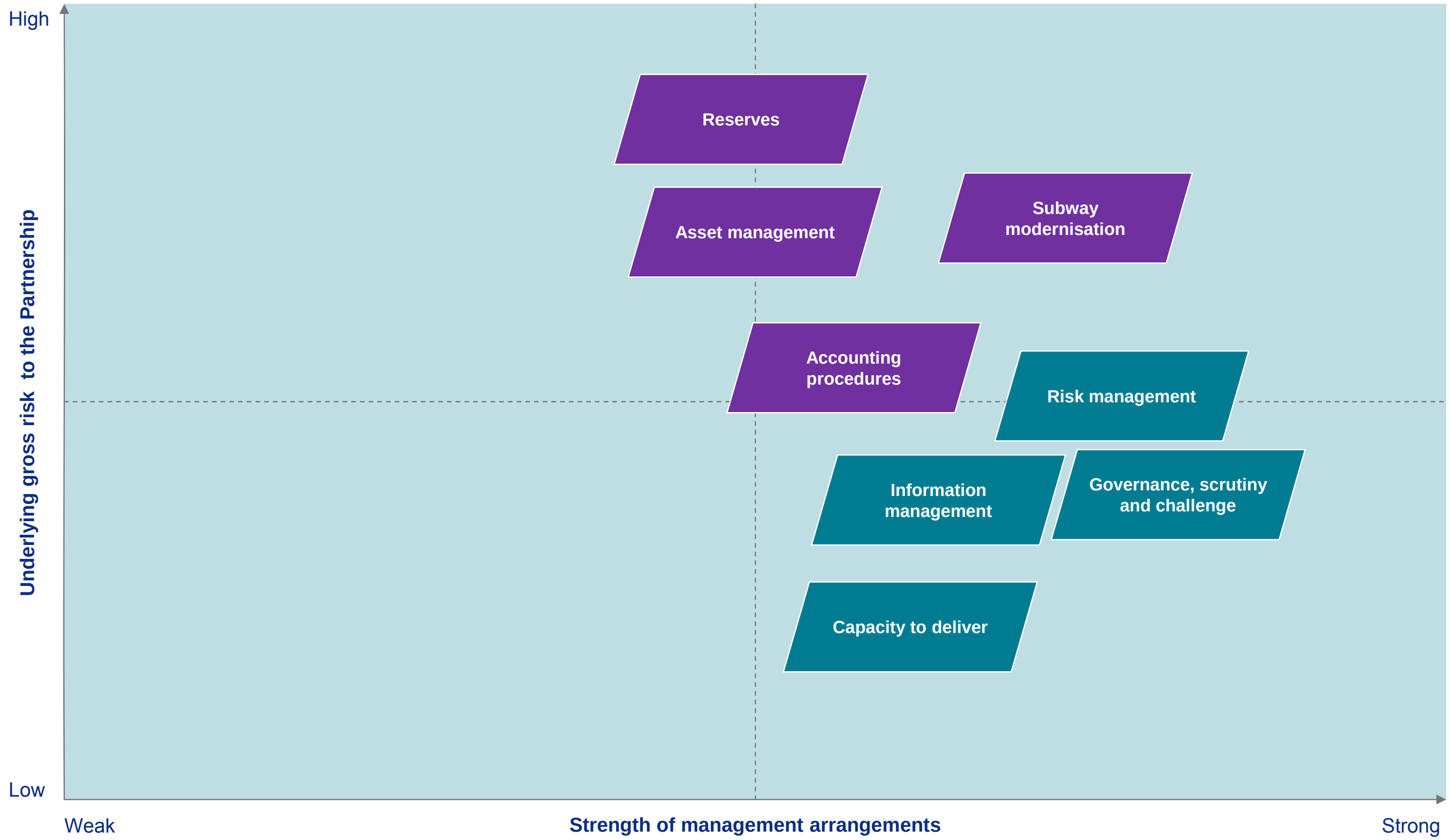
Arrangements to prevent and detect fraud are embedded in internal controls, including processes to comply with requirements in respect of the National Fraud Initiative.	Page 14

Summary of arrangements

Competing risks and pressures continue to present new and recurring challenges. Overall, the impact of sector priorities present a lower risk while the impact of operational and strategic objectives lead to higher risks.

The diagram summarises the potential underlying risks to achievement of strategic objectives, compared to the strength of management arrangements to mitigate these risks. The following pages summarises those areas where we believe that significant risks for Strathclyde Partnership for Transport ("SPT") and Strathclyde Concessionary Travel Scheme Joint Committee ("SCTSJC"), together for the purposes of this report, "the Partnership", exist, together with those where management arrangements are likely to mitigate or eliminate these risks to a greater or lesser extent.



Assessment of significant risks

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. The Partnership endorsed the 'modernisation case' as the best way forward in June 2010. Capital expenditure has commenced in respect of the long term project with work at Hillhead station started in July 2011 and increased infrastructure enhancement work.	This is a significant project for the Partnership. A project board, risk registers and workstreams have been developed. The Partnership's revenue budget includes an amount to be set aside each year for subway modernisation (funding) and the capital plan includes a number of subway modernisation projects. Key stages in the programme include the appointment of contractors, following the completion of standard internal procedures and tender processes.
	■ In our view significant risks exist; but actions have been identified which are likely to address the risks.	
Reserves	Section 3 of the Transport Scotland (Act) 2005 requires that, similar to other Regional Transport Authorities, constituent local authorities meet only the Partnership's net expenses (i.e. the expenses for the year not met by grant or other income) for each financial year. Audit Scotland has confirmed that they do not believe the Partnership has the powers to make in year surpluses and hence increase reserves. As a result, we identified a significant risk that if this situation was not resolved by year end, the Partnership would not have the statutory authority to declare a surplus and increase reserves.	In 2010-11 SPT requisitioned £38.458 million from the 12 local authority partners. Only £33.593 million was recognised in the comprehensive income and expenditure statement. The remaining balance, £4.865 million, is recognised as deferred income (representing a receipt in advance) as at 31 March 2011. Constituent local authorities will require to consider whether a corresponding payment in advance is recognised in their financial statements. This treatment is in line with the Scottish Government's guidance to regional transport partnerships in 2007.
	■ In our view significant risks exist; but actions have been identified which are likely to address the risks. ■ We have recommended that management continue to keep constituent local authorities aware of the use of funding and continue to obtain written consent to retain balances for subway modernisation in future years.	

Assessment of significant risks (continued)

Asset management	Management implemented a new financial ledger in 2009-10 which incorporates a fixed asset module. During 2010-11, all of the Partnership's property and land assets were subject to revaluation by the district valuer, in line with accounting policies. The previous external valuation of operational land and buildings was in 2006. This process included the Partnership obtaining detailed component valuations in respect of assets, in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom 2010 ("the Code").	We have previously made a number of recommendations to management in respect of capital accounting records where there is scope for improvement. A number of adjustments were required to the draft financial statements to correctly account for the updated property valuations obtained.
	■ In our view risks exist; actions have been identified, but these are taking time to implement.	
Accounting procedures	The Partnership's finance team comprises three qualified accountants, together with a number of assistants. There are detailed financial regulations and instructions available to staff, including instructions regarding the operation of the financial ledger.	Most expected financial controls are designed, implemented and operate effectively, such as those in respect of income, expenditure and staff costs. We continue to make a number of recommendations in our report to those charged with governance in respect of accounting procedures and processes. Management has recognised the need for additional staff training.
	■ In our view risks exist; we continue to make recommendations annually, for improvement in accounting records and transactional procedures.	

Financial statements preparation and audit process

2010-11 is the first year the Partnership was required to prepare financial statements in accordance with "the Code".

A number of technical accounting matters arose in relation to land and building valuations and reserves which have had a impact on the financial position at 31 March 2011.

Technical accounting issues

Conversion to IFRS

The 2010-11 financial statements have been prepared in accordance with the *Code of practice on Local Authority Accounting in the United Kingdom 2010 ("the Code")* which is based upon International Financial Reporting Standards (IFRS). As part of the transition to IFRS, there was a requirement for the Partnership, to restate the 2009-10 financial statements to provide prior year comparatives on an IFRS basis.

- Management had considered our recommendations in respect of IFRS conversion from our report dated 17 March 2011.
- We reviewed the accounting policies prepared by management and agreed a final version. We also discussed the layout, presentation and disclosures in the financial statements of both SPT and SCTSJC to ensure compliance with the Code, together with best practice.

Retirement benefit assumptions

The government announced on 8 July 2010 that they would in future use the consumer prices index ("CPI") in place of the retail prices index ("RPI") as the index for determining pension increases for public sector pension schemes. We understand that this will affect minimum required increases, applying to both current and future pension payments.

- We considered the Local Authority Accounting Panel bulleting (number 89) which set a presumption that the change in inflation measure would be accounted for as a change in benefit with respect of local government pension schemes.
- We are satisfied with management's assessment that scheme members expected inflationary increases to be in line with RPI and therefore that the change be accounted for as a change in benefits in the comprehensive income and expenditure statement.
- The statement of comprehensive income and expenditure includes a credit of £14.4 million in respect of the change in pension benefits from RPI to CPI.

Third party assets

The draft financial statements included £13.5 million in respect of additions to third party assets, such as local authority capital projects.

- In line with the Code, there is legislative provision for grants to other bodies to be funded from capital resources, to be classified as such even when it does not result in an asset being carried on the body's balance sheet.
- An adjustment was made to the financial statements to ensure that no asset is recorded as created, and subsequently disposed in year, in respect of grants given to third parties for capital projects.

Financial statements preparation and audit process (continued)

Areas of HIGH audit risk			
	Value (£'000)		
Area	2010	2011	KPMG comment
Property - valuation	119,037	87,623	Following a revaluation exercise of all property assets as at 31 March 2011, carried out by the district valuer, under instruction by the Partnership, there was a net reduction in the value of operational and investment properties of £36 million. In the draft financial statements, the full downward revaluation movement had been recognised against the revaluation reserve. ■ The Code requires that consideration is given to the reasons for the fall in value and previous valuation movements before the current fall in value can be attributed as a charge to the revaluation reserve or comprehensive income and expenditure statement. ■ We recommended that management review the accounting treatment of the fall in asset values. This required a significant investment of time by management to review and update the asset register for previous transactions. ■ An additional charge of £10.7 million was made to the comprehensive income and expenditure statement (there was no impact on the general fund balance).
Prepayments and accruals	9,849	12,380	Consistent with prior years, we identified a number of matters in respect of accruals and prepayments. The majority of errors arose from inaccurate processing of agency balances. Management recognise the need for additional staff training and we note that year end reconciliations had been performed which identified a number of these errors, however no action had been taken to correct the errors following completion of the reconciliation, therefore controls were not fully effective. ■ The balance sheet was adjusted by £0.4 and £0.3 million in respect of accruals and prepayments, respectively. ■ The statement of comprehensive income was charged with an additional £192,000.

Financial statements preparation and audit process (continued)

Systems and controls

Preparation of the financial statements

- Draft financial statements and supporting documentation were provided on 10 June which was in line with the agreed timetable.
- We worked closely with management to obtain relevant supporting documentation and explanations which were provided in a timely manner, though there is some scope for further information to be available in advance of the commencement of year end fieldwork.
- Narrative statements were provided at the same time as the draft financial statements and were substantially complete and consistent with our understanding of the Partnership.

Control environment

- The majority of financial controls are designed, implemented and operating effectively.
- We have previously made recommendations for improvement in respect of capital accounting records, including the recording of assets, funding basis and valuations. A number of adjustments were required in respect of property valuations and there continues to be scope for enhancement in this area.
- We have previously made recommendations for improvement in respect of controls around prepayments and accruals. While there is evidence that management has implemented some revised controls, these did not operate wholly effectively and a number of audit adjustments were required to correctly state balances as at 31 March 2011. We continue to recommend that there is greater management oversight and review of more junior members of staff work to assist with their development.
- Overall, management's approach to preparing the financial statements is efficient, but improvements could be made in respect of capital accounting, accruals and prepayments.

Financial position

Revenue

SPT's core revenue budget for 2010-11 was £39.556 million. Of this, £38.458 million was to be financed through requisition from constituent local authorities, with the remaining £1.1 million funded by the Scottish Government.

Funding received from constituent local authorities in 2010-11 was in line with budget and £4.865 million has been allocated for future subway modernisation.

Expenditure was below budget in a number of areas, including employee costs (£1.440 million) electricity costs (£550,000), supplies and services (£400,000) and increase in subway income and bank interest (£338,000). These savings were mainly offset by increase in other financing costs (£2 million) as a result of contributions to subway modernisation and an increase in payment to bus operators (£634,000). The result for the year and movement on the general fund balance is summarised below.

Comprehensive income and expenditure statement	£'000
Net cost of services	50,444
Net financing and investment income and expenditure	(3,660)
Taxation and non-specific grant income	(59,335)
Surplus on provision of service	**(12,551)**
Deficit of revaluation of fixed assets	24,253
Actuarial gains on pension assets/liabilities	(14,140)
Other comprehensive expenditure	441
Total comprehensive income and expenditure	**(1,997)**

Movement of general fund balance	£'000
Surplus on provision of service	(12,551)
Net additional amount required by statute to be debited or credited to the general fund balance for the year.	12,551
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 £26.380 million against an initial budget of £34.658 million approved by the Partnership on 22 January 2010. This was revised to £26.621 million as at 25 March 2011. A number of projects were carried forward into 2011-12. The capital programme was mainly funded by Scottish Government grant funding (£23.861 million), together with £1.885 million 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 from other regional transport partnerships. 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.

Financial position (continued)

Financial planning

A revenue budget of £38,532 million for 2011-12 was agreed at a Partnership meeting on 11 February 2011. 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 a 2.8% reduction in requisitions from the constituent local authorities and takes account of estimated decreases in Scottish Government funding. The 2011-12 budget represents a 2.6% decrease on the 2010-11 budget. A summary of the main variances is shown below:

Caption	Budget 2011-12 (£'000)	Budget 2010-11 (£'000)	Variance (£'000)
Cabinet & support	1,018	1,147	(129)
Customer services	22,202	22,469	(267)
Business support	4,784	5,836	(1,049)
Loan charges / subway modernisation	9,430	8,930	500
Corporate	575	651	(76)
Bus Company residual	523	523	0
Expenditure	**38,532**	**39,556**	**(1,023)**
Requisitions	(37,381)	(38,458)	1077
Core costs	(933)	(1,098)	165
Funding	**(38,314)**	**(39,556)**	**1,242**
Inclusive of contribution to subway modernisations (underspend)	**9,430**	**7,480**	

The approved budget for 2011-12 requires utilisation of £218,000 from reserves. This maintains the level of reserves within approved levels. The use of reserves is unsustainable in the longer term and the Partnership will continue with ongoing organisational changes to ensure that future budgets do not require the use of reserves.

The 2010-11 capital budget approved on 15 April 2011 was £38.1 million and includes £26.7 million of high priority projects, together with indicative figures of £27.7 million for 2012-13 and £29.6 million in 2013-14. Both 2012-13 and 2013-14 indicative budgets include amounts planned in respect of the subway modernisation programme. Funding available in 2011-12 is £20.5 million, before additional grant income being sought by the Partnership, this includes £6 million earmarked for subway modernisation. The Partnership regularly plans a higher level of capital expenditure as a number of projects will be subject to in-year delays and slippage.

Audit Scotland national reports

Improving public sector purchasing

Audit Scotland's corporate plan 2009-12 reinforces a commitment to maximising the impact of their work and to providing more evidence of impact. As part of this process auditors are required to provide information on how bodies respond to national performance audit reports.

In 2010-11 a more targeted follow-up was required in respect of the Partnership's actions following publication of the joint Accounts Commission / Auditor General for Scotland report, "Improving Public Sector Purchasing" published in July 2009 ("the Report").

Our work centred around the answers to three questions to facilitate analysis of the Partnership's arrangements. Overall, taking into account the size and nature of the Partnership, we found that processes are appropriate and mitigate the issues highlighted by the report. There are some areas where the Partnership should consider the potential for improvement, but management note that benefits must be weighed against any financial implications.

Corporate governance framework and supporting arrangements

Over-arching and supporting corporate governance arrangements remain primarily unchanged and provide a sound framework for organisational decision-making.

Corporate governance framework	The Partnership maintains an integrated governance framework to provide an appropriate structure for maintaining decision-marking, accountability, control and behaviour. The integrated governance framework includes four governance sub-committees of the Partnership: audit and standards, strategy and programmes, operations and personnel. The terms of reference for each committee detail decision-making powers and delegated responsibility. A high level of detail is provided to committee members and the minutes and papers are published on the Partnership's website.
Statement on internal control	The statement of internal control 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 the Partnership.
Internal controls	Our interim management report dated 25 May 2011 made one new recommendation in respect of subway income and highlighted five recommendations previously made in relation to key financial controls that had yet to be implemented. In our report to those charged with governance, 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.
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: debtors, creditors and treasury management. Internal audit's annual report, submitted to the audit and standards committee 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 2011".*
Fraud and irregularity	We evaluated the procedures and controls related to fraud to be designed and implemented effectively. The Assistant Chief Executive (Business Support) has overall responsibility for monitoring arrangements. During 2010-11, the Partnership organised a fraud awareness week in January 2011 to raise awareness of fraud risks facing SPT, encouraging staff to participate in delivery of SPT's anti-fraud strategy and publicise details of SPTs whistle blowing and fraud reporting lines. The Partnership is participating in NFI for the third year in 2010-11. From the 2011 data, the Partnership had seven payroll and 700 creditor matches. Internal audit has investigated all of these, and no frauds have been identified.

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