Notice of meeting and agenda

Midlothian

Audit Committee

Venue: **Council Chambers - 3.00 pm on on conclusion of the Council meeting,**

Date: **Tuesday, 26 September 2017**

Time: **15:00**

John Blair
Director, Resources

Contact:
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Further Information:

This is a meeting which is open to members of the public.

Audio Recording Notice: Please note that this meeting will be recorded. The recording will be publicly available following the meeting. The Council will comply with its statutory obligations under the Data Protection Act 1998 and the Freedom of Information (Scotland) Act 2002.

1 Welcome, Introductions and Apologies

2 Order of Business

Including notice of new business submitted as urgent for consideration at the end of the meeting.

3 Declarations of Interest

Members should declare any financial and non-financial interests they have in the items of business for consideration, identifying the relevant agenda item and the nature of their interest.

4 Minutes of Previous Meeting

5 Public Reports

6 Private Reports

No private business to be discussed.

Minute of Meeting

Midlothian

Audit Committee

Date	Time	Venue
Tuesday 20 June 2017	2.00 pm	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

Present:

Councillor Baird
Councillor Hardie
Councillor Milligan
Councillor Muirhead
Councillor Parry
Councillor Smaill

In attendance:

Kenneth Lawrie	Chief Executive
John Blair	Director Resources
Gary Fairley	Head of Finance and Integrated Service Support
Alan Turpie	Legal Services Manager
Elaine Greaves	Internal Audit Manager
Heather Mohieddeen	Senior Auditor
James Polanski	Auditor
Kevin Anderson	Head of Housing and Customer Services
Janet Ritchie	Democratic Services Officer

1. Welcome and Apologies

1.1 Independent Chair: The Chief Executive provided the Committee with an update on the position of Independent Chair highlighting that a report would be presented to Council in August with a recommendation regarding this. In the meantime a Chair should be appointed from the Committee who is a non-Cabinet member.

The Chief Executive invited nominations for the position of Chair for this meeting:

Councillor Baird nominated Councillor Parry, no seconded for this nomination

Councillor Milligan nominated Councillor Smaill, seconded by Councillor Hardie.

Councillor Smaill was elected to the position of Chair for this meeting.

1.2 Apologies were received from E.Y., External Auditors. The Chief Executive explained to the Committee that due to miss-communication the external auditors had other commitments so were unable to attend this meeting.

2. Order of Business

The order of business was confirmed as outlined in the agenda that had been circulated.

3. Declarations of interest

No declarations of interest were received.

4. Minutes of Previous Meetings

No previous minutes were submitted to this meeting. The previous minutes of the Audit Committee of 21 March 2017 were submitted and approved at Council on 23 May 2017.

5. Reports

Report No.	Report Title	Submitted by:
5.1	Membership, Terms of Reference and Appointment of Interim Chair	Director Resources
Outline of report and summary of discussion		
There was a report presented to the Audit Committee by Chief Executive bringing the Committee's attention to the Audit Committee's Membership and Terms of Reference. The election of an Independent Chair which is detailed in 1.1.		
Decision		
To note the Report		

Report No.	Report Title	Submitted by:
5.2	Internal Audit Plan 2017/18	Internal Audit

Outline of report and summary of discussion

The Internal Audit Manager presented the Internal Audit Plan 2017/18 to the Committee explaining that this had been approved at the previous meeting of the Audit Committee on 23 March 2017 and this was presented today for information. The Internal Audit Manager gave a brief summary of the contents of the Audit Plan.

Thereafter the Head of Education responded to questions raised by the Committee with regards to the Children and Young People 2014 Act - Named Person and Pupil Equity Funding.

Decision

To note the report.

Report No.	Report Title	Submitted by:
5.3	Internal Audit Annual Assurance Report 2016/17	Internal Audit Manager

Outline of report and summary of discussion

There was a report submitted by Internal Audit which outlines that the Local Authority Accounts (Scotland) Regulations 2014 require that an annual review is undertaken on the effectiveness of the Council's system of internal control and include a statement of this review in the Annual Governance Statement. This report details the results of the review and concludes the Council's framework of governance, risk management and internal controls are of a satisfactory standard but did raise some actions which are included in the Annual Governance Statement.

Decision

The Audit Committee noted:

- The Annual Assurance Report.
- That the weaknesses identified with internal controls in 2016/17 will be followed up in 2017/18 and updates will be provided to the Audit Committee.

Report No.	Report Title	Submitted by:
5.4	Annual Governance Statement	Chief Executive

Outline of report and summary of discussion

The Chief Executive presented a report to the Committee dated 13 June 2017 providing an assessment of the Council's compliance with its Code of Corporate Governance and invites the Audit Committee to note and comment on the attached draft statement which is to be included in the financial statements.

The Chief Executive highlighted the main sections from the report and the Annual Governance Statement attached to this report. Thereafter the Chair of the Committee asked the Internal Audit Manager to provide the Committee with an update on the changes of responsibility in detecting fraud and the Council's role.
Decision
The Audit Committee noted the proposed Annual Governance Statement.

Report No.	Report Title	Submitted by:
5.5	Annual Report from the Independent Chair of the Audit Committee for the year end 31 March 2017	Peter Smaill
Outline of report and summary of discussion		
There was submitted a report from the Independent Chair of the Audit Committee to year end 31 March 2017 to inform the Council of the work carried out by the Audit Committee during the financial year. In preparing the report reference was made to the requirements of the Audit Committee Combined Code (2008) and the 2013 Chartered Institute of Public Finance and Accountancy (CIPFA) document "Practical Guidance for Local Authorities – Audit Committees".		
Decision		
To note the Report.		

Report No.	Report Title	Submitted by:
5.6	Audit Scotland Report Local Government in Scotland Performance and Challenges 2017	Chief Executive
Outline of report and summary of discussion		
The Chief Executive presented the report dated 9 June 2017 to the Committee highlighting that the purpose of the report was to provide the Audit Committee with a summary of the Audit Scotland report, "Local Government in Scotland: Performance and Challenges 2017" and the Council's position in relation to the report's findings. The Audit Scotland Report sets out the current and future challenges facing Councils and some of the progress made by Councils in meeting these challenges and an indication of what Councils should be doing to manage the change and challenges ahead. The Chief Executive highlighted some of the key messages within the Audit Scotland report and outlined that the main recommendations identified are set out in section 3 of his report with some commentary on the position of the Council in relation to these recommendations.		

Councillor Milligan commented on the financial challenges the Council face. The Chief Executive and the Head of Finance and Integrated Service Support responded to questions on Government funding support for local Authorities.
Decision
To note the Audit Scotland Report and the position of Midlothian Council in relation to the report's recommendations.

Report No.	Report Title	Submitted by:
5.7	Risk Management Update for 1 January 2017 - 31 March 2017	Risk Manger
Outline of report and summary of discussion		
There was a report dated 20 May 2017 submitted providing the Committee with the 2016/17 quarter 4 strategic risk management update, covering the period 1 January to 31 March 2017. The Director Resources presented the report to the Committee highlighting the main sections from the report which included the strategic risks in quarter 4: • Fastest Growing Council in Scotland; • UK Decision to leave the European Union following the referendum • Political uncertainty including Education Governance Review. Also highlighted was the importance of the financial stability, the future budget projection of the Council and the Change Programme. Thereafter the Director Resources and Head of Finance and Integrated Service Support responded to questions raised by the Chair which included: • The Budget gap and the Financial Strategy. • The Business Transformation Steering Group governance and assurance that key financial decisions are presented to the Audit Committee. • A request for an audit of Pay and Grading by the end of 2017/18 detailing whether benefits and improvement in flexibility have been achieved .		
Decision		
The Audit Committee noted the quarter 4 2016/17 Strategic Risk Profile report and considered the current response to the issues, risks and opportunities highlighted.		
Action		
Internal Audit Manager		

Report No.	Report Title	Submitted by:
5.8	Update of Midlothian's Devolved School Management Scheme (DSM) to reflect the latest Scottish Government Guidance	Director of Education, Communities and Economy.
Outline of report and summary of discussion		
The purpose of this report was to inform the Audit Committee of actions undertaken to ensure that Midlothian's DSM Scheme complies with the Devolved School Management (DSM) 2012 Guidelines. The Head of Education presented the report to the Committee highlighting the main sections from the report.		
Decision		
The Audit Committee noted the report.		

6. Private Reports

In view of the nature of the business to be transacted, the Committee agreed that the public be excluded from the meeting during discussion of the undernoted item, as contained in the Addendum hereto, as there might be disclosed information as defined in paragraph 6, 8, 9 and 10 of Part I of Schedule 7A to the Local Government (Scotland) Act 1973:-

Report No.	Report Title	Submitted by:
6.1	Internal Audit Report – Review of Utilisation of Assets held under PPP Contracts	Internal Audit Manager
Decision		
The Audit Committee endorsed the agreed recommendations.		

Report No.	Report Title	Submitted by:
6.2	Internal Audit Report – Arrears, Sundry Debt	Internal Audit Manager
Decision		
The Audit Committee endorsed the agreed recommendations.		

Report No.	Report Title	Submitted by:
6.3	Internal Audit Report – Arrears, Rent, Council Tax and Overpaid Housing Benefit	Internal Audit Manager
Decision		
The Audit Committee endorsed the agreed recommendations.		

The meeting terminated at 3.06 pm

Midlothian Council

Year ended 31 March 2017
Annual Audit Report

Audit Committee – 26 September 2017

DRAFT

Building a better working world

Contents

About this report

This report has been prepared in accordance with Terms of Appointment Letter from Audit Scotland dated 31 May 2016 through which the Accounts Commission has appointed us as external auditor of Midlothian Council (the Council) for financial years 2016/17 to 2020/21. We undertake our audit in accordance with the Local Government (Scotland) Act 1973 and our responsibilities as set out within Audit Scotland's Code of Audit Practice (the Code), issued on 26 May 2016.

This report is for the benefit of the Council and is made available to the Accounts Commission, the Controller of Audit and Audit Scotland (together the Recipients). This report has not been designed to be of benefit to anyone except the Recipients. In preparing this report we have not taken into account the interests, needs or circumstances of anyone apart from the Recipients, even though we may have been aware that others might read this report.

Any party other than the Recipients that obtains access to this report or a copy (under the Freedom of Information Act 2000, the Freedom of Information (Scotland) Act 2002, through a Recipient's Publication Scheme or otherwise) and chooses to rely on this report (or any part of it) does so at its own risk. To the fullest extent permitted by law, Ernst & Young LLP does not assume any responsibility and will not accept any liability in respect of this report to any party other than the Recipients.

Complaints

If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with Stephen Reid who is our partner responsible for services under appointment by Audit Scotland, telephone 0131 777 2839, email sreid2@uk.ey.com. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, or with how your complaint has been handled, you can refer the matter to Russell Frith, Assistant Auditor General, Audit Scotland, 4th Floor, 102 West Port, Edinburgh, EH3 9DN. Alternatively you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of Midlothian Council (the Council) for the five year period 2016/17 to 2020/21. We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Auditing Practices Board; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both the members of the Council and the Controller of Audit, and presented to both Council management and those charged with governance, identified at the Council as being the Audit Committee. It will be published on Audit Scotland's website.

We draw your attention to the fact that our audit was not designed to identify all matters that may be relevant to the Council. Our views on internal control and governance arrangements have been based solely on the audit procedures performed in respect of the audit of the financial statements and the other procedures performed in fulfilling our audit plan.

Scope and responsibilities

The Code sets out the responsibilities of both the Council and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the Audit Committee on 21 March 2017. We summarise the responsibilities of the Council in Appendix A.

Our Annual Audit Plan also provided you with an overview of how we intended to carry out our responsibilities as your auditor. We carried out our audit in accordance with this plan.

We planned our procedures using a materiality of £5 million and a Tolerable Error of £2.5 million. We reassessed this using the actual year-end figures, to confirm that the materiality remained appropriate for the audit. Based on this reassessment, we increased our materiality amounts to £6 million and a Tolerable Error of £3 million. The threshold for reporting audit differences is £250,000, in accordance with the Code.

Status of the audit

We have substantially completed our audit of the Council's financial statements for the year ended 31 March 2017. Subject to satisfactory completion of the following outstanding items we expect to issue an unqualified opinion on the Council's financial statements. However until work is complete, further amendments may arise:

- receipt of documentation to enable completion of final testing procedures
- review of the final version of the financial statements
- completion of subsequent events review / receipt of signed management representation letter

Upon completion of these outstanding items and following final approval of the audited financial statements by the Council we will update and finalise this Annual Audit Report.

Key contacts

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John Boyd, Senior Manager
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Acknowledgement

We would like to thank all members of the Council's management and staff who have been involved in our work for their co-operation and assistance during our audit work.

Accounting and audit matters – our reporting on the Council's financial statements

Preparation of financial statements

- The unaudited financial statements were prepared in accordance with statutory timescales. They required significant presentational and disclosure adjustments as a result of the audit. An increased focus is required and management should ensure that there is a robust review process to ensure the completeness and accuracy of the financial statements prior to being made available for audit and public inspection.
- There were two unadjusted audit differences reflecting the chosen accounting treatment of capitalisation of HRA contributions and recognition of Borders railway in year transactions. We concur with management's view that these are not material and we do not consider these require adjustment.

Significant risks

Risk of fraud in income and / or expenditure recognition

- We have not identified any material weaknesses in the design and implementation of controls tested as part of our audit, or evidence of fraud in income and expenditure recognition during the financial year.

Management override of controls

- We are have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.
- Management has included disclosure on the accounting judgements and estimates made, although we consider that there is scope for improvement in the supporting documentation underlying key accounting treatments.

Other inherent risks

Retirement benefits

- Defined benefit pension scheme liabilities have been estimated using actuarial assumptions which we consider to be reasonable and the required disclosures have been provided in the financial statements, including those providing details of the sensitivity of the valuation to changes in the assumptions.
- We have undertaken appropriate testing of underlying data to support the calculation of the liability.

Valuation of property, plant and equipment

- We identified a number of errors in the Council's valuations in the current year. This was mainly due to a lack of robust review and scrutiny of valuations by the in-house team. The cumulative impact of these errors on the carrying value of property, plant and equipment was £7.8 million.
- While appropriate adjustments have been made to the financial statements, management should enhance the existing process to ensure timely consideration of the impact of market movements on valuations.
- The transition to a new asset register was completed for year end. We are satisfied that the new asset register is materially complete and accurate.

Other matters and reporting requirements

- The Expenditure and Funding Analysis has been presented in accordance with guidance and the Movement in Reserves Statement and Comprehensive Income and Expenditure Statement restated accordingly. We consider the disclosures provided to be appropriate to the internal reporting of the Council.
- We identified an audit adjustment to reflect the provision relating to the Council's obligations to the Scottish Government under the Borders Railway agreement. This has been reflected as a prior year adjustment.
- We concluded our work on the opening balances as part of the requirements for initial audit engagements. Management re-presented prior year financial statement balances to reflect clarification of the accounting treatment of grant income. This resulted in a £22.6 million increase to net cost of services.
- We have concluded that the Council has complied with the requirements of the Local Authority Accounts (Scotland) Regulations 2014. In respect of our 'Opinions on other prescribed matters', which includes the management commentary, the auditable part of the remuneration report, and the annual governance statement, our opinion is unqualified. We have not identified any other matters on which we are required to report by exception.

Wider scope audit dimensions – our judgements and conclusions on the Council's arrangements

Financial management – area of audit focus

- Council services have failed to operate within established budgets. This was predominately due to a failure to achieve financial savings planned through the transformation programme and heath and social care demand pressures. Achievement of longer term financial sustainability is dependent on the Council not only identify savings but also ensuring that there is sufficient ongoing challenge and scrutiny to ensure savings proposals are delivered on in-year.
- Robust financial management arrangements are therefore critical for the Council, particularly in a period of a challenging financial environment. While we consider reporting arrangements have been enhanced during the period, these need to be further developed, especially in reporting progress on delivery of the transformational change programme.

We have made three recommendations in the action plan (points 5, 6 and 7), two of which are graded one, in respect of the Council's arrangements.

Financial sustainability – area of audit focus

- The Council faces significant financial challenges over the next five years. Management has forecast a budget funding gap of £44.9 million by 2021/22 and uncommitted general fund balance is currently at its lowest level for a number of years. Work is underway to identify potential options to deliver the required level of savings.
- Based on forecast overspends on the 2017/18 budget it is critical that these plans are developed and evaluated urgently and aligned to the Council's priorities as set out by members.

We have made two recommendations (points 8 and 9) , two of which are graded one, in respect of the Council's arrangements.

Governance and transparency – area of audit focus

- The Council has a comprehensive framework of governance arrangements and shows clear commitment to the core principles.
- Management has undertaken a review of internal audit. Subsequent to the year end the Chief Internal Auditor post is vacant with temporary arrangements in place. There are opportunities to enhance the role and standing of the function within the organisation.

We have made four recommendations (points 10 to 12), one of which is graded one, in respect of the Council's arrangements.

Value for Money

- The Council monitors a suite of performance indicators through the Covalent system. This incorporates external benchmarking, which is embedded within the Council's performance monitoring arrangement.
- The Council recognises areas of performance that require focus and these are clearly reported within internal and publically available performance reports. Areas for improvement and of strategic importance are detailed within the Single Midlothian Plan.

We have not identified any recommendations in respect of the Council's arrangements. We will undertake more detailed work on performance as part of our 2018/19 audit.

Appendices

We set out in the appendices a number of required communications we provide in accordance with auditing and ethical standards. In particular, we have confirmed our continuing independence to act as auditor of the Council. Ongoing non-audit services totalling £49,000 in respect of the Midlothian Zero Waste project have been provided during the year.

We also provide a short accounting and regulatory update highlighting forthcoming changes and their potential impact on the Council.

1. Financial statements and accounting

1. Financial statements and accounting

The Council's Annual Accounts enables the Council to demonstrate accountability for, and its performance in the use of its resources. They are prepared in accordance with proper accounting practice, which is represented by the 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom.

Audit opinion

In respect of the financial statements, we expect to issue an unqualified opinion on the truth and fairness of the state of affairs of the Council and its group at 31 March 2017 and of the deficit on provision of services for the year then ended, in accordance with applicable law and the 2016/17 Code of Practice.

The detailed form and content of our audit report, plus the requirements underpinning the report are contained in the Audit Scotland guidance at: http://www.audit-scotland.gov.uk/uploads/docs/um/tgn_2017_5_local_authorities.pdf.

We have not identified any circumstances to notify the Controller of Audit that a statutory report may be required under the Local Government (Scotland) Act 1973.

Materiality

We planned our procedures using a materiality of £5 million. We reassessed this using the actual year-end figures, to ensure that our level of materiality remained appropriate. Based on the revised year end reporting figures we deemed it appropriate to update our materiality to £6 million as a result. Our audit Tolerable Error for the audit was £3 million and the threshold for reporting audit differences is £250,000.

We also identified areas where misstatement at a lower level than materiality might influence the reader and developed a specific audit strategy for them. They include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits - we applied a materiality of £1,000 based on the potential sensitivity of these disclosures.
- Related party transactions - we considered the nature of these disclosures individually.

Audit differences

We identified two unadjusted audit differences to the draft financial statements which management has chosen not to adjust. We ask that the audit committee and Council note this and that these will be included in the Letter of Representation. The aggregated impact of the unadjusted audit differences would be a £1 million increase to grant income in the comprehensive income and expenditure account. The closing net assets on the balance sheet are correct. We agree with management's assessment that the impact is not material overall to the financial statements.

There were a number of audit differences identified which were adjusted by management. Included within these was a requirement to represent capital grant income in the prior year which resulted in an adjustment to the prior year comparative figures. We provide details of the reasons behind these adjustments within the relevant section of the report.

The overall impact of adjusted audit differences was a £0.5 million decrease to deficit on net cost of services.

Full details can be found in Appendix E - Summary of Audit Differences.

Financial statements preparation

As part of our oversight of the Council's financial reporting process, we report on our consideration of the quality of working papers and supporting documentation prepared predominantly by the finance team to support the audit.

The financial statement preparation process requires improvement. The unaudited financial statements contained a number of errors including those impacting on the primary financial statements. Details of these are included in Appendix E – Summary of Audit differences. Due to errors in year-end accounts working papers, the net cost of services, gross income and expenditure was understated by £42.8 million. A number of disclosure corrections were required to the financial statements.

Accounting for the revaluation of property, plant and equipment

Property, plant and equipment represents over 85% of the Council's total assets. The majority of property, plant and equipment assets are subject to rolling revaluation, and therefore complete and accurate records supporting the revaluation are a critical part of the Council's accounting records. We identified specific issues with the quality of records to support revaluations conducted during the period. In particular, we found:

- transposition errors in the valuation working papers resulting in material errors to the asset valuations disclosed in the draft financial statements
- insufficient documentary evidence to support the rationale for valuation assumptions applied and valuations being applied which had not been undertaken by internal valuation specialists; some valuations were materially overstated in the draft financial statements.

The cumulative impact of these errors on the carrying value of property, plant and equipment was £7.8 million.

Overall, a lack of oversight and scrutiny of the valuations prior to audit resulted in a number of adjustments required to the draft financial statements. We recommend that there is a more robust process to review the accuracy and appropriateness of valuations performed and the quality of the output.

Action plan point – 1

During our audit testing we identified that the Council's property, plant and equipment balances included amounts held relating to HRA contributions to support planned essential infrastructure, principally school capacity. This expenditure does not represent capital expenditure until the infrastructure is developed as there is no commitment or payment to parties external to the Council. Management has chosen not to adjust the financial statements as they are of the view that it is not material to the reported financial result. We concur with management's view and have included an unadjusted misstatement within Appendix E – summary of audit differences.

From a budgetary perspective this impacts on the treatment of capital funding costs through HRA reserves. To address this matter for future periods, management are reviewing options available to ensure that capital costs are appropriately reflected while remaining consistent with financial strategy to support the HRA and general funds. This includes planned consultation with CIPFA on appropriate recognition within the financial statements.

Action plan point – 2

In preparing the financial statements, the Council makes key judgements including areas of judgement or uncertainty. During our audit we found that there was not always clearly documented consideration and review of critical assumptions applied.

Overall there is scope to improve the financial reporting process, and to streamline the format and content of financial statements. The financial statements, including the unaudited financial statements presented for public inspection are an important role in the Council's financial governance arrangements. It is therefore important that the Council establishes more effective oversight and scrutiny arrangements in this area.

Action plan point – 3

1. Financial statements and accounting

Our Audit Plan identified key areas of focus for our audit of the Council's financial statements, including significant risks. This report sets out the results of our audit procedures plus relevant observations, including our views on areas which might be conservative, and where there may be potential risk and/or exposure.

Significant risk – risk of fraud in income and expenditure recognition

What is the risk?

Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We rebutted the risk of improper recognition of revenue in respect of core grant funding from the Scottish Government, as well as in respect of council tax and non-domestic rate income. This is because there is no judgement in respect of the recognition of these income streams.

Results of audit procedures

In relation to income, predominantly fees and charges, and other operating expenses where we had identified a significant risk of material misstatement, we:

- Reviewed and discussed with management any accounting estimates on revenue or expenditure recognition for evidence of bias.
- Reviewed transaction listings for individually material transactions as well as unusual items (debits to income, credits to expenditure etc.) to agree to supporting documentation and third party evidence.
- Tested a representative sample of transactions across the remaining untested income and expenditure population to ensure coverage of testing across all balances.
- Reviewed and tested revenue cut-off around the year end through reviewing manual journals posted to revenue and reviewing material credit notes raised after year end.
- Performed a search for material receipts received after year end and ensured these had been accounted for in the correct period.

Where we are performing procedures to address significant risks to the financial statements we do so to a lower level of materiality than for standard accounts. All procedures outlined above were completed with no material reported audit differences or other matters noted.

Other income and expenditure areas

The most significant area of revenues was taxation and non-specific grant income of £202.6 million. £134.2 million of this related to government grant income which we substantively tested to grant confirmation letters, or release of capital grants in year. The remainder is made up of £31.9 million of NDR redistributions and £36.4 million of council tax income. These were agreed either to funding correspondence, and / or through establishing detailed expectations of income and expenditure, agreeing underlying assumptions to supporting evidence, and comparison to actual income and expenditure recorded by the Council in the year.

For expenditure, £128 million relates to payroll costs. These have been subject to detailed analytical procedures and reconciliation to underlying payroll information. We have agreed PPP transaction costs to the contract and finance models. Depreciation and impairment charges have been subject to detailed audit testing, including reconciliation to the fixed asset register.

Risk of fraud in income and expenditure recognition – what have we concluded?

- We have not identified any material weaknesses in the design and implementation of controls tested as part of our audit, or evidence of fraud in income and expenditure recognition during the financial year.

Significant risk – management override
What is the risk?
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.
Audit procedures performed and what did we find?
Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements We obtained a full list of journals posted to the general ledger during the year, and analysed them to identify any unusual journal types or amounts. We then tested a sample of these journals, understood their purpose and agreed and corroborated them to supporting documentation. We tested the appropriateness of journals and other adjustments made in the preparation of the financial statements.
Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates. We identified and considered the existence of any accounting estimates and their susceptibility to bias. Management has disclosed their consideration of the critical accounting judgements and key estimates in the financial statements. While we have reviewed and agreed these, in line with earlier comments, there is scope to improve the documentation by management of these key judgements.
Evaluate the business rationale for any significant unusual transactions. We did not identify any significant unusual transactions outside the normal course of business.
Review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised. We reviewed expenditure on property, plant and equipment to ensure that expenditure items were not being inappropriately capitalised to defer costs to future years. Likewise we performed analytical procedures and transaction testing of HRA expenditure to ensure that HRA reserves were not being utilised to meet general fund transactions. No issues were identified through our testing.

Risk of fraud through management override – what have we concluded?

- We have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.
- Management have included disclosure on the accounting judgements and estimates made, although we consider that there is scope for better supporting documentation underlying key accounting treatments.

Other inherent risks – valuation of property, plant and equipment (PPE)

What is the risk?

The Council's property portfolio totals £0.6 billion as at 31 March 2016, with the major elements of this being in respect of Council Dwellings, Other Land and Buildings and Infrastructure assets.

Given the size of this balance and the fact that a number of assumptions are made in the valuation, we assigned a higher inherent risk to valuation of property, plant and equipment.

Results of audit procedures

In response to our identified risk around property valuations, we performed the following procedures:

- Through analysis of the source data and through enquiries of management, the appropriateness as to the procedures used by management's specialist to establish whether the source date is complete.
- Assessment of the reasonableness of the assumptions and methods used in the valuation of land and buildings, including their compliance with the Accounting Code of Practice.
- Consideration of the appropriateness of the timing of when the specialist carried out the work.
- Confirmed the substance of the specialist's findings were properly reflected in the financial statements.

Testing of the revaluation exercise completed in the year identified a number of errors in the valuations reflected in the unaudited financial statements. Details of these are included above under the financial statements preparation section and have been included in Appendix E – Summary of Audit Differences. We are satisfied that these adjustments have been reflected appropriately in the updated financial statements.

The Council has a rolling five year programme of valuations. The Code of Practice on Local Authority Accounting requires that the Council carries assets on the balance sheet at fair value. The Council considers material changes in asset valuations through consideration of significant capital additions in the year as well as discussions with in-house valuers around potential asset impairments. This process does not consider the impact of market movements on fair value. While we are satisfied that the Council's valuations have been appropriately reflected within the financial statements, we recommend that management enhance the existing valuation process to ensure that there is a robust process for ensuring that asset valuations do not materially differ from current value over the rolling cycle of valuations.

Action plan point – 4

During 2016/17, the Council replaced the previous fixed asset application, Logotech, with a Capita based platform. It is important that asset valuations and balances transitioned completely and accurately to the new platform and that the application appropriately records property, plant and equipment.

We performed the following procedures over the new fixed asset register:

- Reviewed the reconciliation between the new and old asset registers and confirmed the completeness and accuracy of the data migration.
- Tested the new application to ensure that fixed asset transactions including: depreciation, additions, valuations and disposals were correctly reflected on the register.

We are satisfied that the new asset register is materially complete and accurate.

Other inherent risks, valuation of property, plant and equipment – what have we concluded?

- We identified errors in the Council's valuations due to a lack of robust review and scrutiny of valuations. The cumulative impact of these errors on the carrying value of PPE was £7.8 million. In addition, the existing process to consider the impact of market movements on valuations could be enhanced.
- Testing on the new asset register provided assurance that it is materially complete and accurate.

Other inherent risks – retirement benefits
What is the risk?
The Code and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS). Accounting for the pension fund assets and liabilities involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.
Results of audit procedures
In planning our audit, we identified that pension liabilities at 31 March 2016 were £68.1 million. Following the result of the EU Referendum in June 2016, we saw significant changes in certain economic assumptions used in the valuation of pension liabilities leading to significant increases in reported net pension liabilities by entities with accounting year-ends after June 2016. At 31 March 2017, the Council's net pension liability had increased to £118 million, primarily as a result of changes in the discount rate used to value the pension obligations. Our audit procedures included: ▸ Analysis of the payroll and pensions source data and made inquiries as to the procedures used by management's specialist to establish whether the source date was relevant and reliable. ▸ Utilisation of EY pension specialists to challenge the appropriateness of the assumptions used in deriving the liabilities at 31 March 2017. As part of this work, our specialists considered the work undertaken by PWC on behalf of the public audit agencies to provide assurance over the major actuarial firms involved in preparing IAS 19 valuation reports. Assumptions used by the actuary and adopted by the Council are considered to be within our acceptable range. ▸ Testing of the journal entries for the pension transactions to ensure that they were accurately processed and agreed the required disclosures in the financial statements to relevant information provided by the actuary.

Other inherent risks, retirement benefits – what have we concluded?

- Defined benefit pension scheme liabilities were estimated using actuarial assumptions which we consider to be reasonable and the required disclosures have been provided in the financial statements, including those providing details of the sensitivity of the valuation to changes in the assumptions.
- We have undertaken appropriate testing of underlying data to support the calculation of the liability.

Our Audit Plan identified other audit matters and aspects of our work which arise either in accordance with International Standards on Auditing (UK & Ireland) or in accordance with the Code. These are set out below.

Other audit matters

Expenditure and funding analysis

In 2016/17 there were amendments to the Code of Practice on Local Authority Accounting as a result of the 'Telling the Story' review of the presentation of local authority financial statements. This no longer requires statements or notes to be prepared in accordance with SeRCOP. Instead it requires that the service analysis is based on the organisational structure under which the authority operates, reflecting internal financial reporting structures.

This change impacted the Consolidated Income and Expenditure Statement (CIES), the Movement in Reserves Statement (MiRS) and introduced the new expenditure and funding analysis (EFA), with full retrospective restatement of the CIES and MiRS. Our audit approach has focused on:

- Reviewing the expenditure and funding analysis, CIES and new notes to ensure disclosures are in line with the requirements. Management initially presented the EFA as the first statement within the financial statements. Since it does not form one of the four primary statements, we requested management to make the narrative clear that the EFA, while displayed prominently, is a note to the financial statements.
- Reviewing the analysis of how these figures are derived, the re-mapping of the ledger system to reflect the Council's organisational structure and how overheads are apportioned across the service areas reported.
- Agreement of restated comparative figures back to the Council's segmental analysis and supporting working papers.

Borders Railway

In 2015, the Council entered into an agreement with the Scottish Government, Scottish Borders Council, and the City of Edinburgh Council in relation to the funding of the Borders Railway development. The agreement requires the Council to contribute £11.7 million to the project, of which £3.2 million was an 'in-kind' contribution. Under the terms of the agreement, the Council has a legal commitment to make the remaining contribution of £8.5 million (index linked to £9.3 million as at 31 March 2017) to the Scottish Government.

Under the terms of the agreement, the Council is liable for outstanding contributions. The agreement was entered into by the Council on the basis that contributions would be funded through third party section 75 developer contributions, and this is acknowledged in the agreement. The position has also been confirmed by the Council's Internal legal team.

The Council has section 75 agreements in place with developers for £5.4 million and has also undertaken an analysis of future contributions that are expected to be utilised to meet the obligation. However, until a triggering event is reached, the Council does not have legal entitlement to this funding. In accounting terms, therefore, this cannot be utilised to offset the Council's contractual commitment to the Scottish Government. Management has updated the financial statements to reflect this obligation. As the liability crystallised in 2015 when the agreement was signed, this has been reflected as a prior year adjustment.

The Council has since received developer contributions of £1 million which are payable to the Scottish Government (Transport Scotland). While we are satisfied that the amended financial statements state the closing liability correctly, we have raised an audit difference relating to the treatment of the cash receipt in year. Management do not consider this to be material to the financial statements and we concur.

Other audit matters – what have we concluded?

- The EFA has been presented in accordance with guidance and the MiRS and CIES restated accordingly. We consider the disclosures provided to be appropriate to the internal reporting of the Council.
- We identified an audit adjustment to reflect the liability relating to the Council's obligations to the Scottish Government under the Borders Railway agreement. This has been reflected as a prior year adjustment.

Other audit matters (continued)
Opening balances
International Standard on Auditing (UK and Ireland) 510: *Initial audit engagements – opening balances* requires auditors to obtain sufficient, appropriate audit evidence that opening balances do not contain misstatements that materially affect the financial statements. The standard also requires auditors to verify that appropriate accounting policies are reflected in the opening balances and that they have been consistently applied in the current period's financial statements. In response, we have: ▸ Held discussions with the former external auditor in respect of previous significant audit issues, corporate governance and general risk assessment. ▸ Reviewed prior year financial statements, annual audit reports and other reports issued by the former external auditor. ▸ Substantively tested opening balances to ensure that they agree both to the prior year audited financial statements and closing trial balance. ▸ Undertaken a mix of testing on balances during 2016/17 which provides assurance on the judgements and estimates made as at 31 March 2016. Management represented the prior year financial statement balances to reflect clarification of the accounting treatment of grant income within the Code of Practice on Local Authority Accounting. The impact of the restatement was to incorporate £22.6 million into Net Cost of Services, previously included within grant income. We are satisfied that the prior year Comprehensive Income and Expenditure Statement has been appropriately updated. There are no other matters to raise with you as a result of our work.
Qualitative aspects of the financial statements
With the exception of the matters discussed specifically elsewhere in this report: ▸ We have reviewed the significant accounting policies, which are disclosed in the annual financial statements, and we consider these to be appropriate to the Council. ▸ There was no disagreement during the course of the audit over any accounting treatment or disclosure. ▸ There were no significant difficulties encountered in the audit.

Other audit matters – what have we concluded?
▸ We concluded our work on the opening balances as part of the requirements for initial audit engagements. Management represented the prior year financial statement balances to reflect clarification of the accounting treatment of grant income. This resulted in a £22.6 million increase to net cost of services

The Local Authority Accounts (Scotland) Regulations 2014 set out the statements which should be included in the Annual Report and Accounts in addition to the financial statements. These items are covered by our independent auditor's report as *Other prescribed matters*, in accordance with the requirements of the Code.

Other reporting requirements
The Local Authority Accounts (Scotland) Regulations 2014 (the Regulations)
Regulations 8 to 10 set out the statutory requirements on the Council in respect to the Annual Accounts, their availability for public inspection and the consideration and signing by the Council or a committee with an audit or governance remit. As required, we received the unaudited Annual Accounts by the 30 June. The Council considered the unaudited Annual Accounts on 27June 2017, in advance of the 31 August deadline. No statutory objections were received on the unaudited financial statements.
Management Commentary
The requirement for the Council to include a management commentary is included in Regulation 8(2)(a). Audit Scotland requires us to read the management commentary and express an opinion on whether the information given is consistent with the financial statements and whether it has been prepared in accordance with the Scottish Government's statutory guidance within Local Government Finance Circular 5/2015. We considered whether the management commentary provided a fair and balanced review of the Council's business; a description of the principal risks and uncertainties; financial and non-financial key performance indicators; a description of the Council's strategy and business model and the main trends and factors likely to affect future developments; performance and position of the Council's business and explanation of the amounts in the financial statements. We made suggestions to provide additional detailed and specific analysis within the management commentary. Management updated the commentary appropriately to reflect key elements of our review.
Remuneration Report
Auditors are required by the Code to audit the disclosures of remuneration and pension benefit, pay bands, and exit packages and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the Regulations. No amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentation in accordance with the statutory requirements. The Council has disclosed appropriately exit packages provided to nine staff totalling £0.5 million (*2015/16: 47 staff totalling £1.4 million*).
Annual Governance Statement
Audit Scotland requires us to read the information in the annual governance statement and express an opinion on whether the information given in the annual governance statements is consistent with the financial statements and whether the statement has been prepared in accordance with *Delivering good governance in local government: framework 2016*. We set out the work undertaken in respect of the Council's annual governance statement as part of the Wider Scope – Governance & Transparency section of this Report.

Other reporting requirements – what have we concluded?

- We have concluded that the Council has complied with the requirements of the Regulations.
- In respect of our 'Opinions on other prescribed matters', which includes the management commentary, the auditable part of the remuneration report, and the annual governance statement, our opinion is unqualified.
- We have not identified any other matters on which we are required to report by exception.

2. Wider scope audit

2.1 Wider scope – Approach to Best Value

Together the Accounts Commission and the Auditor General for Scotland agreed the four dimensions set out in the Code which comprise the wider scope audit for public sector in Scotland. These are: financial sustainability, financial management, governance and transparency, and value for money.

Wider scope audit

Our wider scope audit work, and the judgements and conclusions reached in these areas, contribute to the overall assessment and assurance on the achievement of Best Value. As your external auditor we also participate in the Local Area Network (LAN). The LAN brings together representatives from across different scrutiny bodies to agree a Shared Risk Assessment (SRA) for each local authority. The SRA informs the local scrutiny plan (LSP) ensuring that for any risks identified there is an appropriate scrutiny response.

The 2016/17 LSP reported that while there were no specific areas of scrutiny, outcomes of transformation and improvements to performance reporting were being monitored. The Scottish Housing Regulator were noted as monitoring progress in housing performance. The 2017/18 LSP confirmed no significant risks requiring specific scrutiny by the LAN had been identified. This formed the context for our audit and risk assessment.

Best Value auditing

Under the new approach to Best Value auditing in local government, the Controller of Audit will provide a Best Value Assurance Report (BVAR) for each council at least once in a five year period. The Council was not one of the six local authorities to be subject to a BVAR report in the first year of the new arrangements. We will be in discussion with management as the timetable for future local authority BVAR work becomes more certain.

The annual audit continues to focus on aspects of Best Value over our five year appointment. We have identified an indicative five year Best Value Plan in the table below. This will be subject to ongoing revision as priorities change or emerging risks arise.

The Accounts Commission has announced its strategic audit priorities and these are mapped across, at a high level, to the Best Value audit work planned as shown below.

A. The clarity of council priorities and quality of long-term planning to achieve these.

B. How effectively councils evaluate and implement options for significant changes in delivering services.

C. How effectively councils are ensuring members and officers have the right knowledge, skills and time to lead and manage delivery of the council priorities.

D. How effectively councils are involving citizens in decisions about services.

E. The quality of council public performance reporting to help citizens gauge improvement.

Indicative five year Best Value plan						Mapping to Strategic Audit Priority
	2016/17	2017/18	2018/19	2019/20	2020/21	
Planned BVAR			tbc	tbc	tbc	
Follow up of BVAR				tbc	tbc	
Audit coverage:						
Performance and outcomes		X				B
Improvement			X			-
Leadership, Governance and Scrutiny		X			X	A
Equal Opportunities			X			E
Partnership Working and Empowering Communities			X			C, D
Financial and service planning	X				X	A, C
Financial governance and resource management	X			X		-

2.2 Financial management

Financial management is concerned with financial capacity, sound budgetary processes and whether the control environment and internal controls are operating effectively.

Financial management

In undertaking our work on this audit dimension, at a high level we consider the following aspects:

- Is financial management effective?
- Are the budget setting and monitoring processes operating effectively?
- Is there sufficient financial capacity?

Area of audit focus

Our annual audit plan set out that financial management was a key audit focus area. This was based on:

- the Council forecasting a net overspend of over £1.7 million for 2016/17 due to demand on services exceeding expectation as well as slippages in the transformational savings programme.
- Recognition that in order to effectively manage these its financial challenges, the Council needed to ensure it had effective budgetary processes and robust internal controls that operate effectively.

Overview of 2016/17 financial statements

We provide an overview of key financial statements movements and balances in the table below, including our commentary on whether we consider these to represent a potential risk to the Council. Our detailed analysis over financial management and financial sustainability provides context to these assessments.

Focus on financial statements results	2016/17 £000	Restated 2015/16 £000	Commentary	RAG rating
(Surplus) / deficit on provision of services	**30,406**	7,032	The primary factor in the increased deficit position was due to impairment charged to HRA assets in year and increased depreciation charges as well as service cost pressures.	R
(Surplus) / deficit on General Fund and HRA	**2,132**	(6,847)	2016/17 represented a year of significant cost pressure on the authority across service areas, as well as failure to achieve £1.6 million of planned transformation savings . It is essential that the Council's operating model is financially viable.	R
Uncommitted general fund	**4,587**	16,804	There has been a significant reduction in the uncommitted general fund balance. This uncommitted reserve is below the Council's preferred level to provide a contingency in the context of the continuing challenging and uncertain financial outlook.	R
Earmarked reserves	**13,065**	7,821	The increase in Earmarked reserves reflects additional £3.97 million committed to balance the 2017/18 budget.	A
Net current (liabilities)/assets	**(6,275)**	4,515	Net current liabilities can reflect a potential inability to meet liabilities as they fall due. In practice, good cash flow management will ensure that this is not a risk.	A
Total Usable Reserves	**67,211**	68,523	Relatively small decrease relates to a reduction in General Fund. Partly offset through build up of HRA and capital fund in supporting the Council's planned investment in assets.	A
Total Unusable Reserves	**198,407**	256,597	Reduction predominately reflects increase in pension liability which is subject to volatility. Reserves balance remains strong	A
Net increase / (decrease) in cash	**184**	**(3,627)**	Cash movement reflects additional long term finance received in year**.**	G

2016/17 financial outcomes

The 2016/17 Comprehensive Income and Expenditure Statement (CIES) shows that the Council incurred gross expenditure on the provision of services of £351.9 million (*2015/16: £287.9million*), and incurred an accounting deficit of £59.5million (*2015/16: £91.8 million*) on those services.

The new Expenditure and Funding Analysis (EFA) note to the financial statements provides an explanation of how this expenditure is used and funded by the Council. This is different from the accounting position shown in the CIES in accordance with the Code and, together with the Movement in Reserves Statement, demonstrates how the Council's statutory reserves, including the General Fund, have changed in the year.

As shown in the EFA, the outturn for the financial year against the Council's general fund was a deficit of £2.1 million (*2015/16: surplus of £6.8 million*). In February 2016, the Council approved its 2016/17 revenue budget and provisionally approved its 2017/18 budget. Key financial statement movements and balances are considered below.

2016/17 budget monitoring and outturn

The 2016/17 budget assumed a draw on reserves of £4.5 million. The projected outturn against budget was reported regularly to the Council during the year. The outturn report in June 2017 which supported the preparation of the unaudited annual financial statements is summarised in the table.

Service area	*Budget Net Expenditure £000	Outturn Net Expenditure £000	Over / (under) £000
Management	1,618	1,618	0
Children's services	15,451	15,431	(30)
Communities and Economy	4,301	4,378	77
Education	82,301	82,589	288
Adult Social Care	37,495	38,237	742
Customer and Housing Services	11,932	11,963	31
Commercial Services	16,348	15,850	(498)
Finance and integrated service support	12,263	12,365	102
Properties and Facilities Management	14,009	14,049	40
Lothian Valuation Joint Board	556	560	4
Central and Non-distributable costs	887	1,407	520
Investment income	(300)	(360)	(60)
Transformation savings	(1,611)	-	1,611
Allocations to HRA, Capital Account and others	(4,782)	(4,834)	(52)
Net Service Expenditure - Total	**197,061**	**200,123**	**3,062**

The closing net expenditure position was £3.1 million higher than budget. This was partially offset from higher than forecast Scottish Government grants income of £0.6 million, resulting in a final general fund utilisation of £2.5 million higher than budget.

The most significant factor which led to the budget shortfall in year was the failure to achieve budgeted transformation savings of £1.6 million. These included areas of integrated service support, procurement, education and customer services. Given the need to deliver much more significant savings in future, the inability to deliver savings at this level is a concern for the Council.

In-year budget monitoring reports were provided to the Council on a regular basis, which included forecast outturn. Financial performance reporting has been updated in the period to provide greater explanations for material variances and agreed actions. However, these should be enhanced to have greater focus on addressing issues in year rather than actions focusing on future years activity. Budget forecasts are regularly updated to reflect actual activity with clear explanations as to why changes have been made. Over the last two years, Council services have not met budget. It is critical that in the context of a tight financial operating environment, that the Council has robust financial monitoring arrangements to support the scrutiny and delivery of transformational savings and service expenditure in line with budget.

Action plan point – 5

Reporting on transformation programme

Monitoring reports also included in-year analysis against the transformation programme savings targets. The Council approved utilisation of £7.7 million of the General Fund Reserve to fund costs associated with the ongoing transformation programme. As at 31 March 2017, £3.1 million of this balance had been applied and £0.8 million committed for 2017/18. A residual balance of £3.8 million remains earmarked to support the delivery of future transformation.

The Council has a range of savings plans and transformational programmes in place, including savings identified through delivering excellence activity, transformation programme savings, service level savings, together with additional identified savings approved in year. While we are satisfied that these have been clearly communicated, there is an opportunity for management to consolidate these programmes to provide clearer reporting, oversight and scrutiny of these plans. This will mitigate the risk over the ineffective scrutiny and monitoring of the delivery of required savings and transformation.

Action plan point – 6

Housing Revenue Account

The HRA delivered a surplus of £4.8 million in 2016/17, increasing the HRA reserve to £29.8 million. This represented an underspend of £0.5 million against budget, mainly due to continuous capital investment in existing stock resulting in reduced spending on reactive repairs. There were no significant movements in any rent arrears, losses on void properties or the bad debt provision from the prior year.

2016/17 financial outcomes – capital expenditure

Capital expenditure	Budget £000	Outturn £000	Over / (under) £000
General services capital programme	**35,953**	**31,146**	**(4,807)**

The Council has significant levels of capital investment planned over the coming years, with over £128 million capital expenditure planned to 2021. Of this £31.2 million was incurred during the year primarily across school upgrades and roads. The level of expenditure was below original planned spend of £36 million, due to re-phasing of work to future years due to slippage in the capital programme.

Capital expenditure	Budget £000	Outturn £000	Over / (under) £000
Housing capital programme	**22,449**	**23,907**	**1,458**
The HRA Capital plan covers the next five years to 2021/22. The plan covers a significant level of capital investment in new build housing, During 2016/17 the Council invested £15.8 million on improvement works. The Council received additional subsidiary from the Scottish Government of £4.3 million during the year for site purchases for Phase 2 and 3 of the social housing plan. As a result, the original budget was updated to reflect this with carry forward to 2017/18.			

Overall financing of the capital programme was supported by £32.6 million of capital receipts, grants from government and contributions from third parties and/or existing capital funds; £8.5 million of capital expenditure funded by revenue with the remaining £21.2 million funded by borrowing.

Capacity of finance and standing in the organisation

The Council's section 95 officer is the Head of Finance and Integrated Service Support. We considered the role and status of the section 95 officer and are satisfied that the Council adheres to the principles laid out within CIPFA's *Statement on the role of the Chief Financial Officer in Local Government*. We have reviewed the Council's financial regulations and are satisfied that these are comprehensive and subject to regular update. They are available through the Council's website.

Internal control

It is the responsibility of the Council to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Council has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Our first year audit has been predominantly substantive in nature, and therefore we have not tested the operation of key controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control. We have not identified any such matters to report to you.

During the course of our audit we have identified opportunities to improve the internal control environment. Account reconciliation controls could be enhanced to ensure greater scrutiny and oversight of account balances. Reconciliations take place between feeder systems, interfaces and financial ledger transactions. While we acknowledge that there are controls over journal entries, there is a risk that the absence of fuller reconciliations from the account balances and feeder systems could result in incorrect or fraudulent postings being undetected in a timely manner.

Action Plan point – 7

Financial management – what have we concluded?

- Council services have failed to operate within established budgets. This was predominately due to a failure to achieve financial savings planned through the transformation programme and demand pressures in health and social care. Achievement of longer term financial sustainability is dependent on the Council not only identifying savings but also ensuring that there is sufficient ongoing challenge and scrutiny to ensure savings proposals are delivered on in-year.
- Robust financial management arrangements are critical for the Council, particularly in a period of a challenging financial environment. While we consider reporting arrangements have been enhanced during the period, these need to be further developed, especially in reporting progress on delivery of the transformational change programme.

EY

Financial sustainability interprets auditors' requirements under ISA 570 *Going concern* and looks forward to the medium (two to five years) and longer term (longer than five years) to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

Financial sustainability

The Accounts Commission's overview report on Local Government in Scotland: Performance and Challenges 2017 sets out the increasingly demanding environment facing local authorities. In particular an overall reduction of 9.2% in Scottish Government total revenue funding since 2010/11, demographic changes in particular in respect of aging populations plus a broad range of legislative and policy changes including, for example, integration of health and social care, community empowerment provision and education reform.

Scottish Government funding is distributed to councils using a formula based on factors such as population, deprivation and rurality. This means that not all councils have experienced the same level of reductions in funding. The Council has forecast grant funding reductions similar to that proposed in the draft 2017/18 settlement, with an average 3.25% per annum cash reduction at a national level. This has been partially offset by the impact of the relative growth in the Midlothian population.

Education and social work increasingly make up a greater majority of expenditure in local government. Within the Expenditure and Funding Analysis, in terms of the amount chargeable to the general fund and HRA, 65% of spend was in respect of these areas, within a range nationally of 60 – 80%.

Area of audit focus

We set out in our annual audit plan that financial sustainability was a key audit focus area. This was on the back of the Council's financial strategy paper for 2017/18 which set out significant budget gaps to be met.

- The effectiveness of the financial planning systems and identifying and addressing risks to financial sustainability across shorter and longer terms.
- Whether the Council can demonstrate the affordability and effectiveness of funding and investment decisions that it has made.
- The appropriateness of the arrangements to address identified funding gaps and whether the body can demonstrate that these arrangements are working.

Level of reserves

As shown in the table below, the Council's level of usable revenue reserves as a percentage of net expenditure on cost of services had increased over the last five years. A significant element of this has been the strategy to strengthen the HRA fund in order to finance the investment in new build council housing. General fund reserves had also been increased in recent years.

Analysis of reserves	2012/13 £000	2013/14 £000	2014/15 £000	2015/16 £000	2016/17 £000	%age change
Uncommitted general fund	6,402	11,964	12,843	16,804	4,587*	(28)
Earmarked general fund	7,681	8,547	8,472	7,821	13,064*	70
HRA fund	14,673	18,374	21,376	24,913	29,753	103
Repairs and renewals fund	2,275	2,553	3,073	3,607	3,100	36
Total Usable Revenue Reserves	**31,031**	**41,438**	**45,764**	**53,145**	**50,504**	
As a % of net expenditure on cost of services	**16%**	**16%**	**21%**	**26%**	**23%**	
Capital fund	7,531	10,658	14,853	15,378	16,707	121
Total Usable Reserves	**38,562**	**52,096**	**60,617**	**68,523**	**67,211**	

* £3.97 million of reserves committed as part of the 2017/18 budget have been classed as earmarked

The Council had established a significant uncommitted general fund balance. By 2016, the balance of £16.8 million represented over 8% of net expenditure. By 2017, this balance had fallen to £4.6 million, being 2% of net expenditure. While the use of earmarked balances should also be considered when reviewing the available flexibility to the Council in making budget decisions, the large decrease in available uncommitted reserves represents a significant risk to the Council.

Action plan point - 8

The significant capital and earmarked funds means that reserves in total for the Council are strong. A significant proportion of this fund has been allocated, and is being utilised, to support the significant capital investment currently being made by the Council in both housing and general fund services, thus reducing the amount of additional borrowing required.

Forward financial planning

The Accounts Commission has stressed the need for long-term financial strategies, supported by medium-term financial planning, to provide councils with the ability to respond to the acknowledged demographic and fiscal pressures. The Council has a close alignment of its financial strategy with the period of its five year corporate planning.

The Council has normally set multi-year indicative budgets, regularly reviewing and revisiting financial forecasts. For example, in February 2015 for the three year period 2015/16 to 2016/17 i.e. including the current financial year. In February 2016 and February 2017 this was extended to consider a longer period to 2021/22. This represents good practice.

Financial pressures

The Council faces significant financial challenges over the next five years. As shown in the table below, the budget shortfall increases significantly over the coming years, from 6.6% of net cost of services to 19.6% by 2021/22.

Forecast budget gaps	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Cost of Services	205.1	213.5	221.0	228.6
Council Tax	(45.6)	(46.2)	(46.9)	(47.5)
Scottish Government Grant	(146.0)	(142.7)	(139.4)	(136.3)
Forecast Budget Gap	**13.5**	**24.6**	**34.7**	**44.8**

The financial forecasts are continually reassessed by management. The forecasts currently assume a 1.5% pay rise assumption together with the cost of incremental pay progression, with the assumption that any increases above this level may attract additional government funding. This is a key assumption. Management's assessment is that a 1.5% increase on pay would add a further £7.5 million in cost pressures by 2021/22. Given recent public announcements by the Scottish Government, there will be a need to closely monitor these assumptions for any knock-on impact.

Income assumptions are based on a 3% annual Council tax increase which, coupled with the house building programme in the area, results in the majority of the increase in gross income. The Local Government finance settlement is assumed to show further reductions in 2018/19 through to 2021/22.

The Council continues to face significant challenges as a result of constrained funding combined with demographic and other cost pressures associated with Midlothian's current and projected growth. In addition, managing the impact of a number of government policy and legislative changes places additional demands and reinforces the urgent need to change the way the Council operates. The Council is already experiencing these pressures in 2017/18, with these pressures crystallising earlier than anticipated.

Closing the gap

The Corporate Management Team has been working through savings proposals to meet the forecast budget gaps. The identified areas of savings are still subject to detailed consideration as well as scrutiny and challenge and approval from elected members. The timeline thereafter is to allow for a public engagement exercise to validate proposals to allow for approval of the financial strategy in early 2018. At the current time, the budget proposals are still in the relatively early stages of development and require further analysis and consideration to determine if they are viable, deliverable and sustainable options. The table below summarises the current financial forecasts and identified savings plans.

Forecast budget gaps	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Forecast budget gap	13.5	24.6	34.7	44.8
Transformation programme savings	(4.5)	(8.9)	(13.5)	(19.5)
Asset Management savings	(0)	(0.3)	(0.3)	(0.3)
Operational service savings	(0.6)	(1.5)	(1.8)	(2.2)
Prioritisation savings options	(6.4)	(8.4)	(9.0)	(9.1)
Fees and charges	(0.1)	(0.1)	(0.2)	(0.2)
Council tax	(1.3)	(2.6)	(3.9)	(5.2)
Remaining Budget Gap	**0.5**	**2.8**	**5.9**	**8.3**

Delivering Excellence – transformation

Under the Delivering Excellence framework, the Council has taken a strategic approach in developing its financial strategy. This includes a fundamental review of service delivery models to drive savings. The 'Future Service Delivery Models' identified three key approaches for how the Council works with its communities: preventive intervention; co-production; and capacity building and localising / modernising access to services were used as the basis of the transformation. These have subsequently been extended to cover: asset rationalisation; workforce profile and plans; commissioning and Arms Length External Organisations (ALEOs) and shared services.

The level of unidentified savings remains significant. Since 2010, £32 million of savings have been required in reshaping services under the transformation programme. £7 million of this being delivered in 2017/18. This has been achieved through a series of service reviews, reductions in headcount, consolidation of property and changing service procurement. However, management recognise that more fundamental change is required if the Council is to remain financially sustainable over the medium-term.

Delivering Excellence – transformation (continued)

During 2017/18, the Council reported further cost pressures emerging through the failure to implement transformational change quickly enough. There is a risk that in focusing on short-term financial pressures, the Council may not have the capacity or capability to delivery a service offering that is financially sustainable in the medium to longer-term. In 2017/18, the Council plans to utilise transformation funds to support a severance programme to support immediate removal of head count to meet immediate financial pressures.

Overall, we assessed that the Council fully recognises the need for medium-term financial planning. Significant and urgent work is required to ensure that the Council has robust, fully costed savings plans which align to the Council's key priorities. Furthermore, the Council requires to evaluate planned savings proposals which align to the priorities set out by members to ensure that there is effective consideration and management of the risk of implementing these changes.

Action plan point – 9

Long-term capital programme

In February 2017, the Council approved an updated Capital Programme for the five year period 2016/17 to 2021/22. This forecast capital spend of over £128 million over the period (2016/17 inclusive), including a borrowing requirement of £28.6 million.

In line with the capital plan, the Council continued to invest in general fund assets, with total expenditure of £31.2 million in 2016/17. The level of expenditure was below original planned spend of £36 million, due to re-phasing of work to future years due to slippage in the capital programme. Expenditure included:

- £22 million on school upgrades
- £3.1 million on roads, pavements and street lighting
- £1.7 million on replacing and upgrading the Council's fleet, and
- £0.9 million on centralised property upgrades.

This expenditure was funded by a combination of government grants, capital receipts, Section 75 developer contributions and borrowing. The Council is in the process of undertaking a comprehensive review of the General Service Capital plan alongside a Learning Estate Strategy which is currently being developed and which will set out the long-term plan for delivering denominational and non-denominational school capacity across Midlothian.

Housing capital programme

The HRA Capital plan covers the next five years to 2021/22. The plan covers a significant level of capital investment in new build housing. During 2016/17 the Council invested £15.8 million on improvement works. The Council received additional subsidiary from the Scottish Government of £4.3 million during the year for site purchases for Phase 2 and 3 of the social housing plan. As a result, the original budget was updated to reflect this with carry forward to 2017/18.

Funding requirements

The Council demonstrates a clear alignment between the capital planning programme and revenue budgeting across both general fund and HRA funds. Capital plan affordability is considered against capital spending limits within a prudential framework recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) and endorsed by the Scottish Government. Furthermore, the Council considers the affordability of financing costs across service areas when considering level of capital investment.

Other long-term liabilities

Retirement benefits

We reported earlier on the significant increase in liability assessed at the balance sheet in respect of the Council's obligations for pensions. Individual council obligations, and their corresponding affordability, reflects on a number of factors:

- performance of the pension funds of which they are members
- assumptions made by actuaries of the various funds
- the maturity of the council's membership (average age of pension scheme members)
- decisions made by councils to award discretionary benefits to staff retiring early.

In the financial overview report, the Council had one of the lowest ratio of pension liability to net revenue, at approximately 35%. This ratio has increased substantially to closer to 61%, although as similar movements will have affected all councils, the Council still has one of the lower ratios to net revenue.

PPP liabilities

The Council has entered into four PPP contractual arrangements with the outstanding PPP principal obligations recognised on the balance sheet. The outstanding principal on these contracts totals £53.7 million at 31 March 2017. In line with other long-term leasing obligations, the Council also makes annual payments in respect of interest, lifecycle capital costs and operating costs.

Integration of Health and Social Care

The Public Bodies (Joint Working) (Scotland) Act 2014 established the legal framework for integrating health and social care in Scotland. The Midlothian Integration Joint Board (the MIJB) was legally established in 20 August 2015 and from 1 April 2016 took on the relevant functions and resources delegated to it from both the Council and NHS Lothian.

The Council committed £38.3 million of expenditure to the MIJB in 2016/17 and received direction from the MIJB in respect of use of these resources in the year. In the 2017/18 budget, the Council approved funding of £37.5 million to the IJB.

Edinburgh and South East Scotland City Region Deal

The Council is one of six local authorities within the Edinburgh and South East Scotland City Region Deal. The City Region Deal was approved in July 2017, with commitment from the Scottish and UK Governments to provide significant investment, along with additional investment from the councils as well as universities within the region. This provides opportunity for the Council to work with its partners to use this investment to improve economic performance in the region, deliver services more effectively and tackle inequality and deprivation.

Financial sustainability – what have we concluded?

- The Council faces significant financial challenges over the next five years. Management has forecast a budget funding shortfall of £44.9 million by 2021/22 and uncommitted general fund balance is currently at its lowest level for a number of years. Work is underway to identify potential options to deliver the required level of savings.
- Based on forecast overspends on 2017/18 budget, it is critical that these plans are developed and evaluated urgently and aligned to the Council's priorities as set out by members.

2.4 Governance & transparency

Governance and transparency is concerned with the effectiveness of scrutiny and governance arrangements, leadership and decision-making, and transparent reporting of financial and performance information.

Governance arrangements

During our audit we reviewed the Council's overall governance arrangements. In line with responsibilities of the Council, this has considered the Council's arrangements as they relate to standards of conduct including for the prevention and detection of fraud and error.

During the latter part of 2016/17, the Council was led by a minority SNP administration. Following the May 2017 elections, which returned seven Scottish Labour Party, six Scottish National Party, and five Scottish Conservative and Unionist. The Labour party formed a minatory administration.

The full Council of 18 members meets approximately every six weeks, with most of the Council's important decisions and policies made by the Council Cabinet. The Cabinet is made up of five elected members and is the principal decision-making committee of the Council. Cabinet membership also includes three religious representatives who are appointed, under statute, to be included in all matters relating to education.

The Council has a set of Standing Orders which regulate the way it goes about its business, supported by the Scheme of Administration which sets out the membership, powers and responsibilities for full council, all its committees, sub-committees, working groups, policy development and local area committees. The Financial Regulations contain the Council's arrangements for the proper administration of its financial affairs.

In line with good practice, documents are kept up to date to reflect any external or internal changes.

Member training

The Council offers training to elected members through the year. The content of training was broad and covered a range of subject matters corresponding to the breadth of responsibilities held by elected members.

Following the May 2017 elections, induction training was provided for new and returning members. This covered a range of topics including, members responsibilities, finance and governance. Induction training was also arranged for members of the audit committee. We supported the Council in providing this training however attendance at the training event was low and we understand that the general participation in training events has been mixed. To ensure effective scrutiny and governance it is important that members receive ongoing training and support. The Council plans to offer ongoing formal and informal training to members. It is important that members continue to contribute and fully participate in both identifying training needs and organised training events.

Action plan point - 10

Scrutiny arrangements

The key committees for member scrutiny of the Council's performance and delivery are through the audit committee and performance, review and scrutiny committee. The audit committee receives regular reports from both internal and external audit and we have observed that this is attended by appropriate members of the management team to enable scrutiny and challenge. The committee also plays a key role in the oversight of risk management arrangements at the Council, including regular monitoring of strategic risks. The audit committee has six elected members, currently two each from the three main political parties. An independent chair is also appointed.

The performance, review and scrutiny committee is responsible for reviewing performance against policy objectives and commenting on decisions and policies and their impact. The committee receives regular performance reports that detail progress against the key themes in the Single Midlothian Plan. The Standing Orders make clear that membership of this committee is open to the 13 members who are not members of the Cabinet. We consider this represents good practice in ensuring there are arrangements for appropriate scrutiny and challenge across political groups.

Focus on internal audit

The Council has an in-house internal audit function which is designed to provide members and management of the Council with independent assurance on risk management, internal control and corporate governance processes. As part of our first year appointment, we considered aspects of internal audit's performance with reference to their compliance with Public Sector Internal Audit Standards (PSIAS). Our work in this area was assisted by Internal Audit's own self-assessment against PSIAS. The Council conducted a self evaluation of compliance with the Public Sector Internal Audit Standards. This evaluation demonstrated that the key elements of the Standards were complied with during the year, but identified a small number of areas where performance could be improved. An action plan has been developed to address these issues and the majority have already been acted on.

In line with PSIAS, Internal Audit should have appropriate standing within the organisation to allow them to provide robust, independent scrutiny and challenge of management.

Internal Audit consists of a relatively small size of team which increases the inherent risk around the dependency and reliance on key individuals within the team. In particular, following the retirement of the co-internal audit manager in early 2017, the vacancy is currently being filled on a temporary basis. In light of these changes in the senior internal audit team, management undertook a review during 2016/17. Management is currently considering different service delivery models, including exploring partnership working options with other local authorities.

The delivery of the Council's transformation programme will bring a period of significant change as the Council works to deliver and enhance services for user, while responding to changing demographics and ongoing budgetary and funding constraints. In our view, at such times, it is important that internal audit has the resilience, capacity and skills to respond to changing demands and provide scrutiny and challenge to management, not only in respect of the day to day control environment, but also to support the delivery of the transformation programme. We recommend management consider the skills and capabilities required to reshape the service to both further support challenge and scrutiny and drive improvement across the Council, including through implementation in respect of the transformation programme.

Action plan point – 11

Focus on workforce planning

The Council's current payroll costs represent approximately £137 million or 39% of expenditure. Given the fiscal environment, together with ongoing service delivery pressures, management recognises that the forecast levels of savings required cannot be achieved without payroll cost reductions. It is therefore imperative that human capital is managed as efficiently and effectively as possible. Only through effective workforce planning, will both the Council's Corporate Plan be effectively delivered, the level of transformation achieved and financial sustainability be secured.

In supporting the development of the financial savings plans, Heads of Services have developed draft workforce plans. With the ongoing development of the additional transformational programme savings and service level savings, the Council is looking to develop an overarching Council workforce plan.

The workforce plan should detail workforce strategy, identifying the level of expected staff numbers, skills and capacity required to support the Council deliver it's strategic objectives, in the context of transformation and the challenging financial targets. Development of this needs to be a priority for the Council.

Action plan point – 12

Fraud and irregularity

In line with our responsibilities under the Code, we have considered the Council's high level arrangements as they relate to the prevention and detection of fraud and error. Overall we consider the Council's arrangements to be appropriate.

The Counter Fraud Policy and Strategy, Whistle-blowing Policy and Anti- bribery and Corruption Policy have been updated during the year to allow full compliance against the new CIPFA code of practice on "*Managing the Risk of Fraud and Corruption".*

National Fraud Initiative

The National Fraud Initiative (NFI) is a counter-fraud exercise co-ordinated by Audit Scotland working together with a range of Scottish public bodies, external auditors and overseen by the Cabinet Office for the UK as a whole to identify fraud and error. These exercises are undertaken every two years as part of the statutory audit of the participating bodies. Local authorities were required to submit datasets in autumn 2016 and matches fro investigation and follow-up were released early in 2017.

We reviewed the Council's arrangements for participation in the NFI in support of preparation of a return to Audit Scotland. We were satisfied that the Council had appropriate arrangements to respond to the NFI and had initiated their response to the most recent exercise.

Standards of conduct

Through consideration of the Council's financial regulations, standing orders and scheme of administration, supplemented by consideration of the Code of Conduct for elected members, we are satisfied that the Council has established appropriate arrangements.

Governance and transparency – what have we concluded?

- The Council has a comprehensive framework of governance arrangements and shows clear commitment to the core principles.
- Internal audit is well respected, however, there are opportunities to enhance the role and standing of the function within the organisation.

Value for money is concerned with using resources effectively and continually improving services. This includes consideration of whether resources are being used effectively; services are improving and the Council has appropriate arrangements to demonstrate Best Value.

Performance and improvement

Framework for improvement

The Council delivers its priorities through the Community Planning Partnership (CPP) and the Single Midlothian Plan. The Council's transformation strategy and individual service plans outline how the Council will deliver its contribution to the Single Midlothian Plan.

The CPP undertook a review and engagement process in 2015/16 resulting in refreshed priorities for the three years 2016 to 2019. The key outcomes from this exercise was around the disparity in health and quality of life across the people of Midlothian. As a result the top three priorities for 2016-19 are:

- Reducing the gap in learning outcomes
- Reducing the gap in health outcomes
- Reducing the gap in economic circumstances

The Council uses the Covalent performance management software as their central performance management system. Covalent supports management and reporting of performance and includes functionality for setting and reviewing targets and thresholds to trigger intervention or action from the service.

Council performance is monitored quarterly across the Council predominantly through the performance, review and scrutiny committee. Performance information covers each of the eight services ensuring opportunity for scrutiny and challenge of the performance of all Council services. Each service performance report includes a summary highlighting the successes and challenges during the period of review. The reports also include detailed performance indicators and, where applicable, action plans. These reports also report progress the services are making towards the outcomes in the Single Midlothian Plan and individual service priorities.

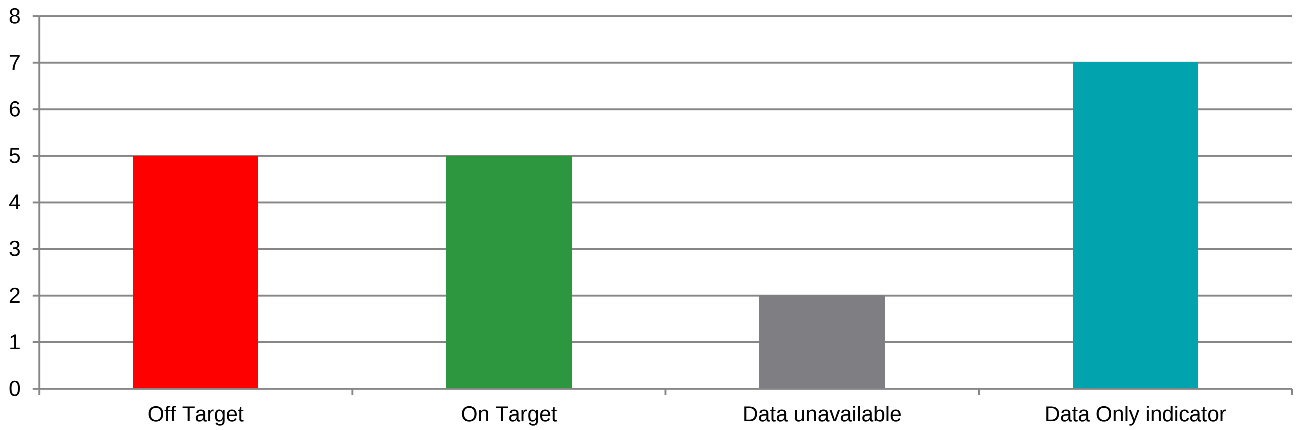
Performance monitoring

Balanced Scorecard

The Council also produces a balanced scorecard report which aims at providing a balanced perspective on the Council's performance over four key perspectives: customer/stakeholder; financial health; internal processes; and learning and growth. The Council has identified a number of key measures and indicators which are monitored on a continuous basis as part of service performance monitoring and collated to produce an overall balanced assessment of the Council's performance.

The table summarises the 2016/17 performance against the 19 Key Priority Indicators. Some of the data was not currently available due to the timing of the information.

Key Priority Indicators 2016/17



Source: Midlothian Council

Performance monitoring (continued)

The Single Midlothian Plan is approved annually by the Community Planning Partnership and sets out planned performance measures each year. Service performance indicators are built in these measures and subject to monitoring by the Senior Management Team and quarterly by the performance, review and scrutiny committee.

Statutory performance indicators

The Accounts Commission places great emphasis on councils' responsibility for public performance reporting. The Commission does not prescribe how councils should report but expects councils to provide citizens with fair, balanced and engaging performance information reporting. The 2015 Direction set out a streamlined and more flexible set of performance information for the 2016/17 financial year that the Commission required councils to collect and report in public. Councils are required to publish the required information from the financial year ending 31 March 2017 each year through to the financial year ending 31 March 2019, according the schedule below. The schedule within the 2015 Direction sets out the required information as:

Achievement of Best Value

SP 1: Each council will report a range of information setting out its performance in:

- improving local public services (including with partners)
- improving local outcomes (including with partners)
- engaging with communities and service users, and responding to their views and concerns
- achieving Best Value, including its use of performance benchmarking; options appraisal; and use of resources

Local Government Benchmarking Framework

SP 2: Each council will report its performance in accordance with the requirements of the Local Government Benchmarking Framework (LGBF)

The Council uses a range of indicators including internal targets, comparators with previous years as well as external benchmarking information in which to establish and monitor performance. This information is reported publically through quarterly service reports as well as through an annual performance report. This incorporates benchmarking information.

From inspection of performance reports throughout the year we found that there is good balance between detailed service level indicators along with high level holistic information. We found that external benchmarking is embedded within the Council's performance monitoring arrangements reflecting good practice. Management continue to refine performance measures to ensure there is clear alignment of service delivery and Council priorities. There are clearly areas that the Council has identified where performance needs to improve and action plans are established to address these.

Value for money– what have we concluded?

- The Council monitors a suite of performance indicators through the Covalent system. This incorporates external benchmarking, which is embedded within the Councils performance monitoring arrangement.
- The Council recognises areas of performance that require focus and these are clearly reported within internal and publically available performance reports. Areas for improvement and of strategic importance are detailed within the Single Midlothian Plan. We will undertake more detailed work on performance as part of our 2018/19 audit.

3. Other audit deliverables

3. Other audit deliverables

Under the terms of our appointment, we provide other assurance activities such as the certification of certain grant claims and the Council's Whole of Government Accounts return, as well as information returns to Audit Scotland.

Other audit deliverables

Aspect of work	What we did and what we found	Expected completion / submission date	Completed / submitted on time
Annual Audit Plan	Reported to audit committee on 13 March 2017.	31 March 2017	Yes
Audit Scotland Fraud Return submission	We submitted fraud returns summarising any reporting to audit committee during the year.	26 May 2017	Yes
Submit NFI return to Audit Scotland	Reviewed the Council's arrangements and completed an information return – see conclusion elsewhere in this report	30 June 2017	No – submitted July 2017 due to EY staff illness
Submit Audit Scotland EU Funding questionnaire return	The purpose of this questionnaire was to support the development of an understanding of Scotland's reliance on EU structural funding arrangements and in particular the extent to which public bodies have been preparing themselves for the consequences of not having access to EU funds in the future. We identified that the Council received £0.7million of EU funds during 2016/17.	30 June 2017	Yes
Submit certified Education Maintenance Allowance return	We have audited the Council's EMA return in line with the guidance set out by Audit Scotland with no matters or exceptions to report.	31 July 2017	Yes
Submit certified Criminal Justice Social Work claim	Audit work has been undertaken with no significant findings arising.	29 September 2017	On target
Whole of Government Accounts assurance statement to NAO	Audit work will be undertaken on updated WGA pack, following audit adjustments made to the financial statements.	29 September 2017	On target
Certify Annual Accounts and submit Annual Audit Report	Pending formal approval of the financial statements	30 September 2017	On target
Submit Best Value Data Return to Audit Scotland	Audit Scotland return summarising our work in respect of the wider scope audit.	2 October 2017	On target
Submit certified Non-Domestic Rates return	Audit work has been undertaken with no significant findings arising.	6 October 2017	On target
Submit certified Housing benefit subsidies claim to DWP	Work is in progress and we will discuss findings with the relevant officers prior to submission of our certification report.	30 November 2017	On target

Appendices

A – The Council’s responsibilities

B – Required communications with the audit committee

C – Auditor independence

D – Accounting and regulatory update

E – Summary of audit differences

F – Action plan

A. The Council's responsibilities

The Code of Audit Practice (the Code) summarises the responsibilities on all audited bodies falling within the public sector audit framework. We summarise these on this page.

Responsibilities of audited bodies	
Corporate governance	Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.
Financial statements and related reports	Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for: ▸ preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation. ▸ maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures. ▸ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority. ▸ maintaining proper accounting records. ▸ preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body. Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework. Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.
Standards of conduct / prevention and detection of fraud and error	Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Financial position	Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to: ▸ such financial monitoring and reporting arrangements as may be specified ▸ compliance with any statutory financial requirements and achievement of financial targets ▸ balances and reserves, including strategies about levels and their future use ▸ how they plan to deal with uncertainty in the medium and longer term ▸ the impact of planned future policies and foreseeable developments on their financial position.
Best Value	Local authority bodies have a statutory duty, under the Local Government (Scotland) Act 1973 and associated statutory guidance, to make arrangements to secure best value through the continuous improvement in the performance of their functions. Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.

There are certain additional communications that we must provide to the Audit Committee, in accordance with ISA 260 and other auditing standards. These are set out below.

Required communication - what is reported?	Our reporting to you
Terms of engagement Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	Audit Scotland Terms of Appointment letter – audit to be undertaken in accordance with the Code of Audit Practice
Planning and audit approach Communication of the planned scope and timing of the audit, including any limitations.	Annual Audit Plan – 21 March 2017
Significant findings from the audit ▸ Our view of the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Any significant difficulties encountered during the audit ▸ Any significant matters arising from the audit that were discussed with management ▸ Written representations we have requested ▸ Expected modifications to the audit report ▸ Any other matters significant to overseeing the financial reporting process ▸ Findings and issues around the opening balance on initial audits	This Annual Audit Report We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements.
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▸ Whether the events or conditions constitute a material uncertainty ▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▸ The adequacy of related disclosures in the financial statements	No conditions or events were identified, either individually or together to raise any doubt about the Council's ability to continue for the 12 months from the date of our report.
Misstatements ▸ Uncorrected misstatements and their effect on our audit opinion ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Significant corrected misstatements, in writing	This Annual Audit Report
Fraud ▸ Asking the Audit Committee whether they have knowledge of any actual, suspected or alleged fraud affecting the Council ▸ Unless all those charged with governance are involved in managing the entity, any fraud identified or information obtained indicating that a fraud may exist involving: (a) management; (b) employees with significant roles in internal control; or (c) others where the fraud results in a material misstatement in the financial statements. ▸ A discussion of any other matters related to fraud, relevant to Audit Committee responsibility.	This Annual Audit Report

Required communication - What is reported?	Our reporting to you
Significant deficiencies in internal controls identified during the audit ▸ Significant deficiencies in internal controls identified during the audit.	This Annual Audit Report
Related parties Significant matters arising during the audit in connection with the Council's related parties including, where applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and/or regulations ▸ Difficulty in identifying the party that ultimately controls the entity	We have no matters to report.
Subsequent events ▸ Where appropriate, asking the Audit Committee whether any subsequent events have occurred that might affect the financial statements.	We have asked management and those charged with governance. We have no matters to report.
Other information ▸ Where material inconsistencies are identified in other information included in the document containing the financial statements, but management refuses to make the revision.	We have no matters to report.
External confirmations ▸ Management's refusal for us to request confirmations ▸ We were unable to obtain relevant and reliable audit evidence from other procedures.	We have received all requested confirmations.
Consideration of laws and / or regulations ▸ Audit findings of non-compliance where it is material and believed to be intentional. This communication is subject to compliance with legislation on "tipping off" ▸ Asking the Audit Committee about possible instances of non-compliance with laws and/or regulations that may have a material effect on the financial statements, and known to the Audit Committee.	We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.
Group Audits ▸ An overview of the type of work to be performed on the financial information of the components ▸ An overview of the group audit team's planned involvement in the component auditor's work on the financial information of significant components ▸ Instances where the group audit team's evaluation of a component auditor's work of gave rise to a concern about its quality. Any limitations on the group audit, for example, where the group engagement team's access to information may have been restricted ▸ Fraud or suspected fraud involving group or component management, employees with significant roles in group-wide controls, or others where the fraud resulted in a material misstatement of the group financial statements.	Annual Audit Plan – 21 March 2017 This Annual Audit Report
Independence ▸ Communication of all significant facts and matters that have a bearing on EY's objectivity and independence.	This Annual Audit Report – Appendix C

C. Independence

Professional ethical standards, and the Terms of our Appointment, require us to communicate all significant facts and matters that have a bearing on EY's objectivity and independence as auditor of the Council.

What we are required to communicate

Communicating key elements of the audit engagement partner's consideration of independence and objectivity such as:

- The principal threats.
- Safeguards adopted and their effectiveness.
- An overall assessment of threats and safeguards.
- Information on the firm's general policies and processes for maintaining objectivity and independence.
- Communications whenever significant judgments are made about threats to objectivity or independence and the appropriateness of safeguards.

Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated 21 March 2017.

We complied with the APB Ethical Standards and the requirements of Audit Scotland's Terms of Appointment. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning of regulatory and professional requirements.

We consider that our independence in this context is a matter which you should review, as well as us. It is important that you and your audit committee consider the facts known to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the audit committee on 26 September 2017.

Summary of fees

As part of our reporting on our independence, we set out below a summary of the fees initially agreed for the year ended 31 March 2017.

As disclosed in our audit plan, we had obtained agreement from Audit Scotland for the continues support we had been provided to the Council and City of Edinburgh Council on the Midlothian Zero Waste project. Financial close had been expected early in 2016. This was delayed. Non-audit fees generated in 2016/17 totalled £49,000.

Auditor remuneration per Annual Audit Plan	£140,080
Audit Scotland central costs	£85,740
Total fee per Annual Audit Plan	£225,810
Non-audit service fees	£49,000
Total fees	**£274,810**

There are a number of new accounting standards and interpretations which will impact on the local authority accounting code of practice in the next two or three years. The following table provides a high level summary of those that have the potential to have the most significant impact on you.

Area	Summary	Potential impact
IFRS 9 – Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year. This new standard will change: ► How financial assets are classified and measured ► How the impairment of financial assets are calculated ► Financial hedge accounting ► The disclosure requirements for financial assets. Transitional arrangements are included within the accounting standard, however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be and whether any accounting statutory overrides will be introduced to mitigate any impact.	Although some initial thoughts on the approach to adopting IFRS 9 have been issued by CIPFA, until the Code is issued and any statutory overrides are confirmed there remains uncertainty. The Council will, however, have to: ► Reclassify existing financial instrument assets ► Remeasure and recalculate potential impairments of those assets; and ► Prepare additional disclosure notes for material items
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ► Leases; ► Financial instruments; ► Insurance contracts; and ► for local authorities, Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. There are transitional arrangements within the standard, however as the 2018/19 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be.	Again CIPFA have issued initial thoughts on the approach to adopting IFRS 15, although uncertainty remains until the Code is issued. For all material income sources from customers the Council will have to: ► Disaggregate revenue into appropriate categories ► Identify relevant performance obligations and allocate income to each ► Summarise significant judgements
IFRS 16 Leases	IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard, IAS 17, for local authorities who lease in a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard, although as the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued it is unclear what the impact on local authority accounting will be or whether any statutory overrides will be introduced.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to classify all of its leases and therefore must ensure that all lease arrangements are fully documented.

E. Summary of Audit Differences

There were a number of significant adjustments processed to the unaudited financial statements as a result of our audit work. The impact of these is summarised below.

No.	Account	Comprehensive income and expenditure statement (Increase) / Decrease £000	Balance sheet (Decrease) / Increase £000
Summary of audit differences – prior period adjustments			
1	*Being prior year adjustment to recognise liability in relation to contributions payable to Scottish Government for Borders Railway*		
	Balance Sheet - Provisions		(8,194)
	Reserves – Capital adjustment account		8,194
2	*Representation of capital grant income from cost of services to taxation and non-specific grant income in the comprehensive income and expenditure statement*		
	CIES – service income	(18,729)	
	CIES – Taxation and specific grant income	18,729	
Summary of audit differences – current year adjustments			
1	*Being net adjustment to correct errors in the revaluation of land and buildings*		
	Balance sheet - Property, plant and equipment		(2,917)
	CIES – Expenditure – Depreciation & Impairment	383	
	Reserves - Capital adjustment account		(45)
	Reserves - Revaluation Reserve		2,579
2	*Being adjustment to correct accounting treatment for land transfers (note CIES costs charged to Capital Fund)*		
	Balance sheet - Property, plant and equipment		(4,897)
	CIES – Expenditure – Depreciation & Impairment	(35)	
	CIES – HRA Expenditure	(840)	
	Reserves - Capital Fund		5,778
3	*Being correction of error of overstatement of Council tax income and corresponding misstatement in Service Income.*		
	CIES – Service Income	(4,730)	
	CIES – Council Tax Income	4,730	
4	*Being reclassification of investments as available for sale financial assets in accordance with the Code*		
	Balance sheet – Long Term investments		(254)
	Balance sheet – Available for sale financial assets		254

Summary of audit differences – current year adjustments (continued)			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease £000**	**Balance sheet (Decrease) / Increase £000**
5	*Being debit balances within creditor accounts*		
	Balance sheet – Debtors		(1,108)
	Balance sheet - Creditors		1,108
6	*Being net adjustments to correct errors in accounts CIES working papers*		
	CIES Service Income	48,006	
	CIES Services Expenditure	(48,006)	

E. Summary of Audit Differences (cont.)

There were a number of differences identified during the course of our audit which management has chosen not to correct. Management do not consider these to be material to the financial statements and we concur with this view.

Summary of audit differences – unadjusted differences			
No.	**Account**	**Comprehensive income and expenditure statement (Increase) / Decrease**	**Balance sheet (Decrease) / Increase £000**
1	*Being adjustments to remove HRA contributions to support planned essential infrastructure within Grants received in advance and corresponding capitalised balance within PPE. This expenditure does not represent capital expenditure until the infrastructure is developed as there is no commitment or payment to parties external to the Council*		
	Balance Sheet - Property, plant and equipment – HRA assets		(2,170)
	Balance sheet – Grants received in advance		2,170
2	*Being adjustment to recognise section 75 developer contributions received in the year relating to Borders Railway contributions through CEIS. Note the closing liability position on the balance sheet is correct. However in year movement misstated due to understatement of brought forward provision.*		
	CIES – Grant Income	1,079	
	Balance sheet – *Opening Provisions*		(1,079)
	Balance sheet – in year movement in provision		1,079
3	*Being adjustment to correct overstatement of accruals and debtor balances at the year end.*		
	Balance sheet - debtors		(1,237)
	Balance sheet – creditors		1,237

F. Action Plan

This action plan summarises specific recommendations included elsewhere within this Annual Audit Report. We have graded these findings according to our consideration of their priority for the Council or management to action.

Classification of recommendations

Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.	**Grade 2:** Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	**Grade 3:** Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
1	**PPE Valuations** During the course of our audit we identified a number of errors in the valuations conducted in year. This resulted in a number of adjustments to the draft financial statements.	We recommend that there is a more robust process to review the accuracy and appropriateness of valuations performed. *Grade 2*	Agreed and implemented
2	**HRA capital contributions** The Council capitalise HRA contributions made to fund planned essential infrastructure, principally school capacity. This expenditure does not represent capital expenditure at the point the Council charge it to HRA as there is no commitment or payment to parties external to the Council. The capitalisation of the costs supports the Council's existing capital financing arrangements and therefore any deviation would impact on this process.	Management, through consultation with CIPFA, should review options available to ensure that capital costs are appropriately reflected while remaining consistent with financial strategy to support the HRA and general funds. This may also require amendments to the financing strategy over HRA funds. *Grade 2*	Accepted. Review will be carried out to enable resolution for the 2017/18 financial statements.
3	**Financial reporting process** The draft financial statements contained a significant number of errors including those impacting on the primary financial statements. The financial statements, including the unaudited financial statements presented for public inspection are an important role in the Council's financial governance arrangements.	Management should ensure that there is effective oversight and scrutiny arrangements over the financial statement preparation process. *Grade 1*	Agreed and will be incorporated into the 2017/18 closure process.
4	**Valuation process** The Council considers material changes in asset valuations through consideration of significant capital additions in the year as well as discussions with in-house valuers around potential asset impairments. This process does not consider the impact of market movements on fair value. In line with Code requirements, the year end values of assets should be assessed to ensure they are not materially different from the carrying value recorded in the financial statements.	Management requires to consider and agree an appropriate process to ensure the valuation cycle is appropriate to take into account potential material movements in key assets, that the valuation remains appropriate as at the 31 March balance sheet. *Grade 2*	Agreed and will be incorporated into the 2017/18 closure process.

No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
5	**Financial management – budget monitoring** Financial performance should be further enhanced to have greater focus on addressing issues in year rather than actions focusing on future years activity. Budget forecasts are regularly updated to reflect actual activity with clear explanations as to why changes have been made. It is critical that in the context of a tight financial operating environment, that the Council has robust financial monitoring arrangements to ensure that transformational savings are delivered and service expenditure is in line with budget.	We recommend that management review financial monitoring reports to ensure that they provide greater focus across in year cost pressures and savings targets *Grade 1*	Accepted. Review of explanations and in year actions to be programmed for Q2 2017/18
6	**Transformational savings** The Council has a range of savings plans and transformational programmes in place including savings identified through Delivering Excellence activity, Transformation Programme savings, service level savings as well as additional identified savings identified and approved in year. While we are satisfied that these have been clearly communicated, there is an opportunity for management to consolidate these programmes to provide clearer reporting, oversight and scrutiny of these plans.	Management should review savings programmes and change programmes to ensure there are clear, measurable financial targets in place to allow members to effectively monitor and scrutinise the progress being made in delivering these. *Grade 1*	Accepted. Refreshed change programme to be presented to Special Council on 10/10/17. Revised monitoring and scrutiny arrangement being developed. Council has already agreed to amend remit of BTSG to have oversight of full change programme.
7	**Account reconciliations** Reconciliations take place between feeder systems / interfaces and ledger transactions. However, there is no regular reconciliation between closing month end account balances and these feeder systems. The ledger is the Council's primary accounting record and should form the basis of the reconciliation to feeder systems such as payroll and council tax. As a result there is a risk that through fraud or error, accounting entries me be made to balance sheet codes without detection.	Management should enhance the account reconciliation process to ensure that part of this includes regularly reconciling feeder systems and applications to the ledger. *Grade 2*	All feeder systems are regularly reconciled to the general ledger and there is oversight that this is carried out. However a review of all the account reconciliation processes currently carried out will be undertaken to reassess the relevance of the current schedule of reconciliations and identify where improvements can be made and resourced which will strengthen the internal control regime

No.	Findings and risk	Recommendation / grading	Management response / Implementation timeframe
8	**Level of uncommitted general fund reserves** The Council has one of the lowest levels of uncommitted general fund reserves of all Scottish local authorities and this reflects a significant deterioration since 2016. While the Council exhibits good in-year financial management, as financial savings become harder to delivery, this low level of reserves reduces the Council's flexibility around budget decisions.	Management should consider whether the target level of uncommitted reserves remains appropriate in the context of approval of the forthcoming medium-term financial strategy. *Grade 1*	Accepted. Key element of Financial Strategy Report to Special Council indicates that preferable to set 2018/19 budget with a contribution to reserves of over £2 million.
9	**Financial sustainability** The Council faces significant financial challenges over the next five years. While initial savings proposals have been identified, these fall short of meeting the identified budget gap. Furthermore, the savings plans are still in the relatively early stage of development and require further analysis and consideration to determine if they are viable, deliverable and sustainable options.	Significant work is required to ensure that Council has robust, fully costed savings plans which align to the Council's key priorities as set by members. Furthermore, the Council should evaluate planned savings proposals to ensure that there is effective consideration and management of the risk of implementing these changes. *Grade 1*	Accepted. Key strand of work required to give assurances on 2018/19 plans.
10	**Member training** Following the May 2017 elections, induction training was provided for new and returning members. To ensure effective scrutiny and governance it is important that members receive ongoing training and support. The Council plans to offer ongoing formal and informal training to members.	The Council should ensure that there are arrangements in place to members continue to contribute and fully participate in both identifying training needs and organised training events. *Grade 2*	Accepted. An ongoing programme of Elected Member Development is currently being developed that will provide a blend of information sharing in relation to the Councillor's role; service information and specific skills that complement the Councillor Competency Framework as defined by the Improvement Service. We have also initiated the Member Training Records on the Committee Management and Information System to ensure that all learning interventions are recorded.

No.	Findings and risk	Recommendation / grading	Management response / Implementation timeframe
11	**Internal Audit** Given the anticipated level of transformational change at the Council, it is important that the Internal Audit function has the resilience and capacity to respond to changing demands and provide scrutiny and challenge to management not only as day to day control environment, but also to any proposed change of the internal control environment. In addition, in line with PSIAS, Internal Audit should have appropriate standing within the organisation to allow them to provide robust, independent scrutiny and challenge of Management. As part of a service review, management recognises the function requires improvement and is currently exploring options to address these.	We recommend that as part of the ongoing consideration for the appointment to the vacant manager position following the recent review that management has undertaken, management considers the skills and capabilities required from the function to ensure that its position and standing within the organisation is such that it can provide robust independent challenge to senior management. *Grade 1*	Accepted. Options to fill the vacant manager post will be informed by the future needs and direction of the service.
12	**Workforce planning** Heads of Services have developed draft workforce plans and work is underway to integrate these into an overarching workforce plan. The absence of a clearly defined workforce plan and strategy creates a risk that workforce decisions are taken in isolation or not clearly aligned to the Council's strategic objectives.	As part of the ongoing development of workforce plans we encourage management to ensure the plans incorporate a detailed workforce strategy, identifying the level of expected staff numbers, skills and capacity required to support the Council deliver it's strategic objectives. This will need to be developed in the context of the Council's financial position, to ensure that the workforce model will support the delivery of the challenging financial targets. *Grade 2*	Accepted. Draft of Workforce strategy to Special Council (10/10/17). Full plans to Council in December 2017.

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Ernst & Young LLP

Midlothian

Financial Statements 2016/17

Report by: Gary Fairley, Head of Finance and Integrated Service Support

1 Purpose of Report

The purpose of this report is to present the Councils audited Financial Statements to Audit Committee and to provide an overview of main changes made during the audit process.

2 Background

2.1 The audited accounts including the audit certificate are attached. There is a separate item on today's agenda containing the External Annual Audit Report.

2.2 The accounts were completed and submitted by the statutory date of 30 June 2017. The audit has been completed within the timescale of 30 September 2017 as set by Audit Scotland.

2.3 The audit certificate on the Council's accounts for the year ended 31 March 2017 is contained within the accounts and concludes that the accounts present a true and fair view of its financial position.

2.4 There were several adjustments made to the accounts during the audit process. The principal changes are noted below:

- An update to the value of the Council's Long Term Investments. At the time of producing the unaudited accounts the 2016 results of Lothian Buses were not public. This information came available during the audit process and using the share of net assets method the value of the Council's shareholding reduced from that presented in June by £0.254 million;
- A reduction in the value of Property, Plant and Equipment shown in the balance Sheet of £4.837 million for land that has been transferred from General Services to the Housing Revenue Account. Consequently there is a reduction in the value of the Capital Fund of £5.778 million and an increase in the Capital Adjustment Account of £0.881 million;
- A reduction to the value of the Council's Property, Plant and Equipment in the Balance Sheet of £2.917 million as a consequence of updated valuations for Newbattle High School, Paradykes and Stobhill land and buildings. This equates to a small reduction of 0.4% in the value of Property, Plant and Equipment from that included in the unaudited accounts;
- Presentational adjustments in the gross to net position in the Comprehensive Income and Expenditure Statement, in Scottish Government funding for the Council Tax Reduction Scheme and in the presentation between Debtors and Creditors for Non Domestic Rates.

2.5 These adjustments have no impact on the General Fund Balance of £17.651 million or the Housing Revenue Account Reserve Balance of £29.754 million. As noted in the second point in section 2.4 above the Capital Fund Balance has reduced by £5.778 million and is now £16.707 million. Although this is a reduction in the Council's Useable Reserves as at 31 March 2017 the revised treatment will result in a corresponding reduction in Loan Charges charged to the General Fund over the coming years.

2.6 The Accounts show a prior year restatement to the Balance Sheet with the opening position for 2016/17 now reflecting the outstanding liability payable to the Scottish Government in respect of the Borders Railway agreement and a corresponding change to the Capital Adjustment Account. This has no impact on useable reserves or the contractual relationships the Council has or will have with developers though section 75 agreements or with the Scottish Government. The Council will continue to collect money from developers on some sites through section 75 agreements and an element of this will be passed on to the Scottish Government to discharge the outstanding liability.

3 Report Implications

3.1 Resource

There are no direct resource implications arising from this report.

3.2 Risk

Section 95 of the Local Government (Scotland) Act 1973 requires all Local Authorities in Scotland to have adequate systems and controls in place to ensure the proper administration of their financial affairs. The Council's Standing Orders and Financial Regulations detail the responsibilities of members and officers in relation to the conduct of the Council's financial affairs.

3.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

☐ Community safety
☐ Adult health, care and housing
☐ Getting it right for every Midlothian child
☐ Improving opportunities in Midlothian
☐ Sustainable growth
☐ Business transformation and Best Value
☒ None of the above

3.4 Key Priorities within the Single Midlothian Plan

The proposals in this report do not directly impact on the delivery of key priorities.

3.5 Impact on Performance and Outcomes

The proposals in this report do not directly impact on performance or outcomes.

3.6 Adopting a Preventative Approach
The proposals in this report do not directly impact on the adoption of a preventative approach.

3.7 Involving Communities and Other Stakeholders
No consultation was required.

3.8 Ensuring Equalities
There are no equality implications arising directly from this report.

3.9 Supporting Sustainable Development
There are no sustainable development issues raised in this report.

3.10 IT Issues
There are no IT issues raised in this report.

4 Recommendation

The Audit Committee is invited to consider and approve the Audited Financial Statements 2016/17.

Date: 22 September 2017

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Midlothian Council

Audited

Financial Statements

2016/17

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Management Commentary by the Head of Finance and Integrated Service Support

The Financial Statements present the financial performance of Midlothian Council for the year to 31 March 2017. They are prepared in accordance with the International Financial Reporting Standards (IFRS) based on the Code of Practice on Local Authority Accounting in the United Kingdom 2016-17 (The Code) and are necessarily technical in places. The management commentary outlines financial performance for the year, financial outlook and risks and also provides non-financial strategic and contextual information about the Council.

Financial Performance

The Council's financial performance is presented in the Comprehensive Income and Expenditure Account (CIES) on page 36. To show the financial position of the Council it is necessary to adjust the CIES for statutory items that require to be taken into account in determining the General Fund and Housing Revenue Account (HRA) balances for the year. These are shown in the Expenditure and Funding Analysis on page 32, the Movement in Reserves Statement on page 34 and in more detail in note 6 on page 54.

<u>General Fund</u>

The General Fund is the statutory fund into which all the receipts of the Council are required to be paid and out of which all liabilities of the Council are to be met, except to the extent that statutory rules provide otherwise. The General Fund is funded by government grants, fees and charges, council tax income, non domestic rates income and interest / returns on investments and is split between uncommitted balances, which are held to manage financial risks and unplanned expenditure, and balances which have been earmarked for specific purposes.

The outturn position for the General Fund compared to budget in 2016/17 is shown in the following diagram and table. Full details were reported to Midlothian Council on 27th June 2017 and are available on the Council's website.

Graph 1 - 2016/17 Net Expenditure by Council Service £'000

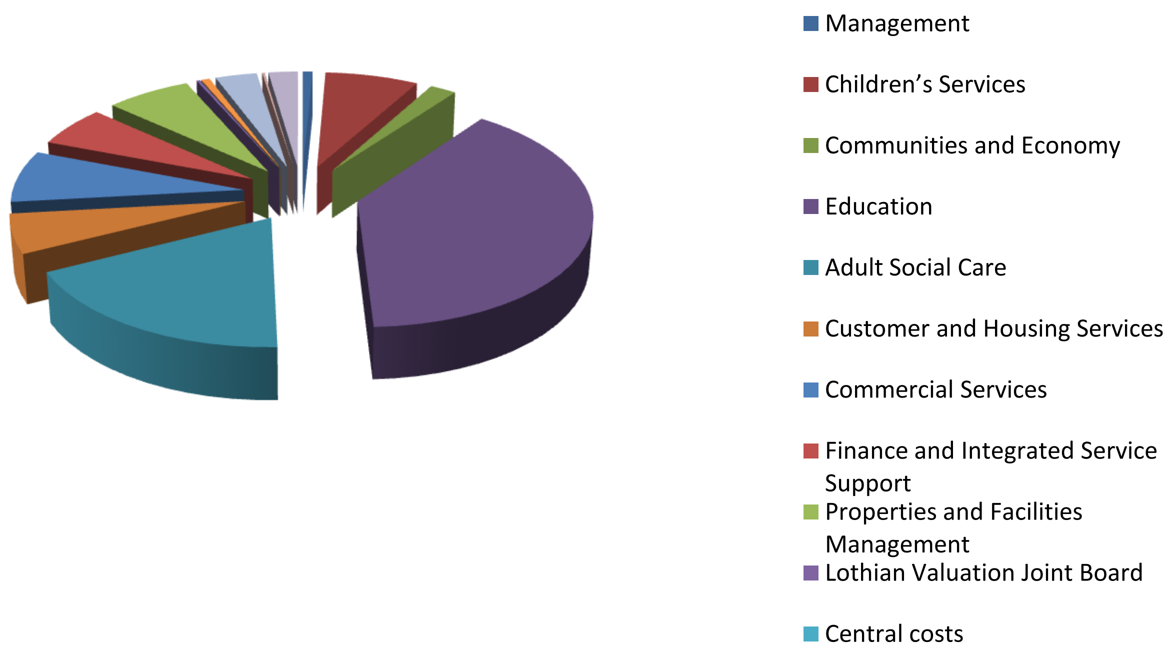
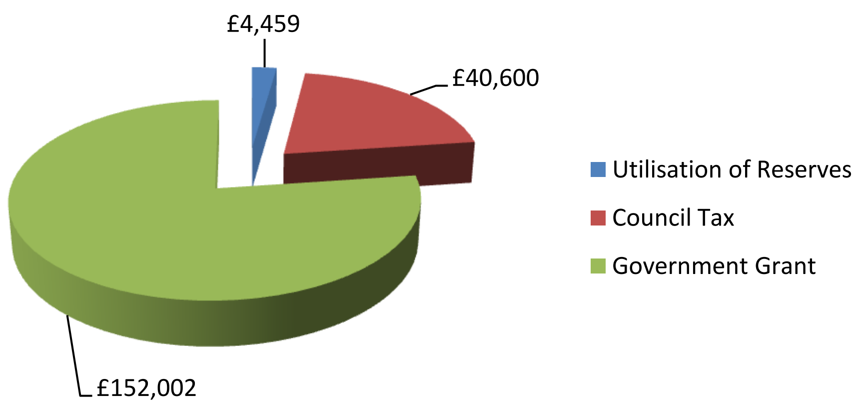


Table 1: General Fund – Performance against Budget

	Budget	Net Expenditure	(Under) / Overspend
Service Area	**£000**	**£000**	**£000**
Management	1,618	1,618	0
Children's Services	15,461	15,431	-30
Communities and Economy	4,301	4,378	77
Education	82,301	82,589	288
Adult Social Care	37,495	38,237	742
Customer and Housing Services	11,932	11,963	31
Commercial Services	16,348	15,850	-498
Finance and Integrated Service Support	12,263	12,365	102
Properties and Facilities Management	14,009	14,049	40
Lothian Valuation Joint Board	556	560	4
Central costs	-452	0	452
Non-distributable costs	1,339	1,407	68
Loan charges	6,583	6,870	287
Investment Income	-300	-360	-60
Transformation programme savings targets	-1,611	0	1,611
Allocations to HRA, Capital Account etc.	-4,782	-4,834	-52
Net General Fund Expenditure	**197,061**	**200,123**	**3,062**
Less Funding:			
Scottish Government Grant	152,002	152,002	0
Council Tax Income	40,600	41,146	-546
General Fund Utilisation of Reserves	**4,459**	**6,975**	**2,516**

Graph 2 - 2016/17 General Fund Revenue £'000



The most significant factors which led to the variance from the budget were a shortfall in the achievement of transformation savings targets for Integrated Service Support, procurement activity, tactical reductions in contracted hours, Customer Services and Education. The combined effect of these resulted in a £1.611 million overspend. There were also continued high levels of demand pressures within Adult Social Care, particularly the Community Care Resource Panel and in Home Care which overspent by £1.436 million, partially offset by service user income and non-recurring funding, resulting in a net overspend of £0.742 million. There was less slippage in capital programmes than anticipated in the budget for loan charges. This meant that borrowing was higher than planned resulting in an £0.287 million overspend.

Actual net service expenditure for the year was £200.123 million representing 101.55% of the £197.061 million budget. General Fund services showed a net overspend against budget of £2.516 million. Funding through council tax was £0.546 million more than budgeted. The sustained increase in housing in Midlothian outstripped the level of council tax income growth built into budgets and in-year collection improved to 94.5% which is an increase of 0.1% from the previous year. Direct debit now accounts for 86% of total Council Tax income collection which is an increase of over 12% on 2015/16.

The General Fund reserve at the start of the year was £24.625 million, of which £7.821 million was earmarked for specific purposes in 2016/17. The position at 31st March 2017 is a reserve of £17.651 million of which £9.094 million was earmarked for specific purposes leaving £8.557 million. A further £3.970 million was utilised to balance the 2017/18 budget, this leaves £4.587 million available as a contingency.

The earmarked element of the reserve includes ring-fenced funding from partner organisations of £1.975 million, budgets provided for specific purposes where spend has slipped into 2017/18 of £1.660 million, budgets for schools in accordance with the Scheme of Devolved School Management of £1.425 million and funding to support the Council Transformation Programme of £3.838 million.

In line with previous Council decisions a number of specific initiatives were funded from uncommitted reserves during the year including staff severance costs (£0.125 million), decriminalising the control of parking within the county (£0.100 million) and master planning work regarding the economic development opportunities presented by Borders Railway line (£0.200 million).

Housing Revenue Account

The Council has a statutory obligation to maintain a revenue account for its housing provision in accordance with the Housing (Scotland) Act 1987. The HRA records all income and expenditure relating to the Council's own housing stock. Revenue expenditure on housing management, repairs and maintenance is funded from rent paid by tenants.

The HRA showed a surplus of £4.841 million in 2016/17 and this increased the reserve to £29.754 million. There was an underspend of £0.469 million against budget mainly due to continuous capital investment in existing stock resulting in a decrease in spend on reactive repairs, delays in refurbishing works at Pentland and Midfield House resulting in an underspend on caretaking costs and lower than anticipated borrowing costs.

The council has an ambitious capital investment plan to build further new housing stock and continues to improve and upgrade its existing stock, particularly through Scottish Housing Quality Standards (SHQS) improvement works. The majority of this plan is funded through prudential borrowing with the costs of borrowing met from rental income and planned utilisation of the HRA reserve.

In 2016/17 £15.8 million was invested in new council houses and £6.4 million on SHQS improvement works. In the period to 31 March 2022 it is planned to invest a further £62 million on new council houses and £24 million on SHQS improvements.

Capital

The Council continues to make significant capital investment in its non housing assets spending £31.2 million in 2016/17. This included £22.0 million on school upgrades, £3.1 million on roads, pavements and street lighting, £1.7 million on replacing and upgrading the Council's fleet and £0.9 million on centralised property upgrades. This expenditure was funded by a combination of government grants, capital receipts, Section 75 developer contributions and borrowing. A full analysis of capital expenditure and financing is provided in note 30 to the financial statements.

The Council is able to regulate its own capital spending limits within a prudential framework recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) and endorsed by the Scottish Government, provided it operates within a series of indicators. The Council's capital expenditure is a key driver of treasury management activity and these indicators are relevant for the purposes of establishing an integrated treasury management strategy which demonstrates that the Council's capital investment plans are affordable, prudent and sustainable.

The Capital Financing Requirement represents the Council's underlying need to borrow for capital expenditure. It is not allowed to rise indefinitely and statutory controls exist to ensure debt is affordable and repaid over a reasonable timeframe. The Council's underlying need to borrow for 2016/17 at the time the budget was set was £310.934 million. The actual position was £276.334 million with total debt at 31st March 2017 of £257.303 million demonstrating that the Council maintains its intention to have an under borrowed position. This means that the Council's capital borrowing requirement has not been fully funded by loan debt and is using cash from reserves and balances to support capital programmes whilst investment returns are low.

During the year the Council's aggregate external debt was contained within both the operational boundary and the authorised limit. The authorised limit of £334.260 million for 2016/17 reflects a level of debt which could be affordable in the short term but may not be sustainable in the long term. The operational boundary of £310.933 million for 2016/17 is an estimate of the most likely maximum debt requirement and represents the limit beyond which external debt is not expected to exceed.

The ratio of financing costs to net revenue stream represents the proportion of the budget that is allocated to the financing of capital expenditure and highlights the trend in this allocation through financial years. Actual figures for General Services were 3.56% which is in line with approved strategy and 34.59% for HRA which is reflected in long term HRA financial plans to 2029/30.

The measure of the impact of capital investment on council tax and weekly rents shows the change in council tax and rents necessary to support increased spending on capital plans and helps to illustrate their affordability. In 2016/17 there was a reduction of £3.49 per Band D dwelling for General Services which was a consequence of lower than planned Capital Expenditure coupled with a low average cost of borrowing. The impact on house rents was a reduction of £1.47 per week which again falls well within long term HRA plans.

The General Services capital plan for future years will see further major investment in school infrastructure including the finalisation of the construction of the new Loanhead Centre to accommodate Paradykes primary school, Loanhead library and Loanhead leisure centre, the replacement of Roslin primary school, a new primary school at Hopefield and the replacement and expansion of Danderhall primary school. There will also be capital investment to complement the new Design, Build, Finance & Maintain (DBFM) projects for the Newbattle Centre and the Zero Waste Residual Treatment Facility. There will also be investment in the roads infrastructure and ongoing asset management replacement plans for buildings, fleet and information technology. There will also be investment in the construction of a new depot to replace the existing Stobhill depot and Council office accommodation.

Long-term Borrowing

The council borrowed money throughout the year to meet actual and anticipated capital expenditure requirements and to refinance maturing loans after allowing for debt repayments. At 31st March 2017 long term borrowing amounted to £208.816 million. During 2016/17 new long term borrowing of £20.000 million was taken from the Public Works Loans Board (PWLB). Interest rates on new borrowing remained at historically low rates and also benefited from a 0.2% discount that was offered by the Treasury. The average rate of interest paid on all external debt decreased to 3.32% in 2016/17 from 3.61% in 2015/16. The internal loans fund rate decreased from 3.28% in 2015/16 (lowest in mainland Scotland) to 3.24% in 2016/17 and is again expected to remain one of the lowest amongst Scottish mainland Local Authorities.

The borrowing strategy is prepared in accordance with the Code of Practice on Treasury Management in Local Authorities. The majority of the Council's borrowing comes from the PWLB. Further details are provided in note 15 to the Financial Statements.

Assets and Liabilities

The Balance Sheet on page 38 summarises the Council's assets and liabilities as at 31st March 2017. Total net assets decreased by £59.502 million from the position at 31st March 2016.

Non-current and Current Assets

Operational and non operational assets increased in value by £10 million mainly due to the construction of new schools and housing. Short term investments increased by £10 million and cash and cash equivalents remained at a similar level.

Net Pension Liability

The net pension liability of the Council as at 31st March 2017 was calculated in accordance with the requirements of International Accounting Standard 19 (IAS 19) and amounts to £118.041 million which is a increase of £49.896 million from 31st March 2016. The main reason for this is the result of a reduction in the net discount rate over the period. IAS 19 is based on the principle that an organisation should account for retirement benefits at the point at which it commits to paying them, even if the actual payment will be made years into the future.

It should be noted this is a snapshot of the position at 31st March 2017. The actuarial valuation of the Lothian Pension Fund, which takes a longer term view, will consider the appropriate employer's contribution rates and this, together with employee contributions and revenues generated from the Pension Fund investments, will be used to meet the fund's commitments as they arise. The last actuarial valuation at 31st March 2014 showed a funding level of 93% of liabilities which is a reduction from 98% funding at the previous valuation at 31st March 2011. This has no immediate impact on the council budget until 2018/19 where a 0.5% increase in employer's contribution rate is anticipated.

Provisions, contingencies and write offs

The Council has made provisions for potential liabilities in respect of unsettled insurance claims of £1.463 million.

The provision for non collection of debt at 31st March 2017 was £33.9 million which is a slight increase on the position a year ago. There were a number of immaterial write offs approved by Cabinet during the year.

Financial Outlook and Key Risks

The current economic climate impacts on the Council and the services it provides in a number of ways. From a financial perspective 2016/17 saw continued demographic pressures particularly around people with learning disabilities, elderly care and population growth in Midlothian. It is expected that these pressures will be sustained and they present a considerable challenge to the Council in both financing them and transforming services to improve ways of preventing some of these pressures arising. Welfare reform, the integration of health and social care and the implementation of the Children Act 2014 as well as the planned expansion in early learning and childcare are major policy developments that will not only impact on the council budgets but also change the way services are provided.

For 2016/17 and again for 2017/18 the Scottish Government published a one year budget and grant settlement, as such Councils are currently unaware of the level of funding that will be available to them beyond 2017/18. The UK Government budget faces the impact of very tough spending reductions and all indications are that for the public sector in general and Local Government in particular this will continue. It is therefore inevitable this will have an adverse impact on the amount of central funding available to the Council.

In February 2017 the Council set a budget for 2017/18 which included savings of £6.907 million, increases in council tax funding of £1.554 million and a £3.970 million utilisation of reserves.

In the context of reduced funding and growth in demand for services the Council have a considerable challenge to ensure future expenditure plans are sustainable. Latest projections for 2018/19 show a remaining budget gap of approximately £8.5 million with potential for a significant increase when extending the timeframe into the next decade.

The Council continues to work within approved Financial Strategies. Despite some slippage in achieving savings targets the Council's transformation plan continues to deliver efficiencies and is regularly refreshed to ensure its scope and ambition remains focused and is in line with corporate aims.

Treasury Risk

Financial year 2016/17 saw the UK vote to exit the European Union with a subsequent decrease in the Bank of England's Base Rate from 0.50% to 0.25%, the first movement in Base Rate since March 2009. The Council continues to mitigate any risks associated with the security of cash deposits through use of only institutions approved as counterparties in accordance with the Capita credit scoring methodology and operating with restrictions on funds that can be placed with each institution. Regular and detailed advice is provided by the Council's treasury advisers ensuring that any market changes impacting on the approved investment strategy can be acted upon immediately.

Treasury strategy is updated regularly following discussion with treasury advisers to ensure that the Council maintains adequate cash balances to support investment plans and that any movements in current or forecast borrowing rates are reflected.

Strategic Plans and Performance

Midlothian Council delivers its priorities through the Community Planning Partnership and the Single Midlothian Plan. Community Planning partners have agreed the vision for Midlothian as "Midlothian – a great place to grow".

Taking into consideration the comparative quality of life of people living in Midlothian, it is clear that less well off residents experience poorer health, have fewer or no choices in how they use low incomes and also that there is a proven relationship between these factors and their learning. The top three priorities for 2016-19 and selected key performance measures for 2016/17 are:

Reducing the gap in learning outcomes

- Average primary school attendance was 95%, up from 94.08% in 2015/16.
- Average secondary school attendance was 90.24%, up from 89.8% in 2015/16.
- There were 419 exclusions from school, down from 458 in 2015/16.
- The percentage of Midlothian residents with no qualifications was 6.4% against a target of 9.4%.

Reducing the gap in health outcomes

- 395 mental health assessments were carried out through the new Gateway pilot project against a target of 200
- The percentage uptake of 27-30 month checks was 84.6% against a target of 86.7%

Reducing the gap in economic circumstances

- The percentage of school leavers securing a positive destination was 95.1% against a target of 95%.
- Midlothian Citizen Advice Bureaux delivered income maximisation of £3.8 million against a target of £2.5 million.
- The percentage of young people working with the Homeless Prevention Service that went on to present as homeless was 33% against a target of 50%.

Three approaches to how the Council works with its communities have also previously been agreed – preventative intervention, co-production and capacity building and localising / modernising access to services.

In addition to the three key priorities and three approaches the Council will also focus on reducing the gap between outcomes for residents living in parts of the county which for many years have shown a significant gap between their outcomes and the average outcomes for Midlothian and

Scotland as a whole. The areas targeted are Dalkeith Central/Woodburn; Mayfield/Easthouses and Gorebridge.

The Single Midlothian Plan incorporates five overarching thematic groups which support the achievement of outcomes. The thematic approach is used for quarterly performance reporting and the themes and selected performance measures for 2016/17 are discussed below.

Adult Health Care – Responding to growing demand for the adult social care and health services;

- The percentage or people who say they are able to look after their health or who say they are as well as they can be was 83% compared to 83% in 2015/16
- The percentage of falls which resulted in hospital admission for clients aged 65+ was 5.03% compared to 4.79% in 2015/16 and a target of 10%
- The percentage of people who say that they have a say in the way their care is provided was 78% compared to 78% in 2015/16

Community Safety – Ensuring Midlothian is a safe place to live, work and grow up in;

- The proportion of MAPPA clients convicted of a Group 1 or Group 2 offence was 0% against a target of 2%
- The percentage of street light repairs completed within 7 days was 98.5% compared with 96.2% in 2015/16

Getting it Right for Every Midlothian Child – Improving outcomes for children, young people and their families;

- The number of children adopted was 11 compared with a target of 6
- The number of children in residential placements was 10 compared with a target of 12
- The increase in the number of children achieving the expected level in reading, writing and numeracy was 6% compared with a target of 2%

Improving Opportunities for People in Midlothian – Creating opportunities for all and reducing inequalities;

- The number of activities offered by Ageing Well programmes was 23 compared to a target of 16
- The Tonezone retention rate was 55.25% compared with a target of

  55%

Sustainable Growth and Housing – Growing the local economy by supporting business growth and responding to growing demand for housing in a sustainable environment.

- The percentage of premises with access to next generation broadband was 98.1% compared with 78.5% in 2015/16 and a target of 98%
- The street cleanliness score was 97.5% compared with a target of 93%

During 2016/17 the Council demonstrated significant progress towards their priorities and this is documented in more detail in the Midlothian Council Annual Performance Report – 2016/17, presented to Performance Review and Scrutiny Committee on Tuesday 20th June 2017 and can be viewed on the Council website.

Structure of Council Leadership and Council Staff

Throughout 2016/17 the political makeup of the Council was 8 Labour members, 8 SNP members, 1 Green party member and 1 independent member. The SNP together with the independent member had formed the administration until the later part of the year when this arrangement ended. At this point the SNP continued as a minority administration. During the year the Leader of the Council was Catherine Johnstone and the Provost was Joe Wallace. The Scottish local government elections took place on Thursday 4th of May 2017. The political makeup of the Council changed to 7 Labour members, 6 SNP members and 5 Scottish Conservative and Unionist members. A new minority administration was formed by the Labour Party with the Leader of the Council being Derek Milligan and the Provost being Adam Montgomery. The Council's Chief Executive is Kenneth Lawrie and it is structured in 3 Directorates:

- Health and Social Care (Director, Eibhlin McHugh);
- Resources (Director, John Blair);
- Education, Communities and Economy (Director, Mary Smith).

Emerging Issues, Service Changes and Future Developments

Moving into 2017/18 and beyond the Council will continue the application of the Delivering Excellence framework – A programme for change which looks at how we do things, with a focus on improving outcomes for our residents and our communities within the context of the financial and other challenges ahead. To do this, we consider:

- What our priorities are;
- What we can change or do differently;
- Which services can be improved;
- Which services we can stop.

Employee engagement and empowerment is at the core of the Delivering Excellence framework with every council service being asked to look at what it does, how much it costs, how it performs and how it could be changed and improved. A key element of the framework is how we engage with our communities to inform and support changing the way we do things at Midlothian Council and ensure that services are fit for the future. We want residents to tell us what the priorities are for them, their families and their communities - and we want them to help us reshape our services to meet those priorities.

Health and Social Care Integration continues to move forward with consultation on the 2017-18 Directions document issued to NHS Lothian and the Council and work on a refreshed strategic plan is underway. Two Heads of Service with responsibility for Primary Care and Older People and Adult Services now manage services across health and social care and whilst work is underway to review the management structure, integration at a service level is progressing with for example nurses appointed to work in Newbyres Care Home. There is a continuing requirement to seek major efficiencies despite the growing demand, particularly in relation to older people and those with complex needs. The move towards an integrated budget through the establishment of the Integration Joint Board provides an opportunity to make better use of collective resources.

The preparations for the implementation of the delivery of 1,140 hours of early years education and childcare by 2020 are ongoing. Whilst challenging this remains a key focus, Midlothian Council has been successful in receiving funding from the Scottish Government to carry out a trial to develop a blended approach to expansion in the Mayfield area. The new Woodburn Hub was recently recognised as good practice in the recently published Scottish Govt report “A blueprint for 2020”.

The construction of the new Newbattle Community Campus commenced in January 2016 and continues on programme and on budget for an opening in May 2018. This new facility will provide enhanced educational and leisure facilities for Newtongrange, Mayfield, Gorebridge and the surrounding communities. New primary schools in Roslin and Loanhead were opened in August 2017.

The Scottish Child Abuse Inquiry is a significant piece of work with a project team in place to deal with requests for information and a working group now in place to write new protocols/ policies around how we manage any potential future claims. A significant amount of time and resources are being deployed at this time to ensure that Midlothian Council complies with the requests for information within the agreed time scales.

The implications of Brexit for the Council in terms of potential changes to procurement, data protection, planning, environmental legislation, employment law and grant funding are being actively considered. The Council’s strategic risk register includes some initial analysis of the potential impact on the Council from the triggering of Article 50, this will clarify as negotiations progress at a UK level and the final agreement is reached.

Conclusion

2016/17 was a challenging year from a financial perspective, with continued demand pressures and reduced funding being the dominant issues. Despite this the Council continues to invest for the future in its asset base, particularly to provide the essential infrastructure to support the growing population. Very significant financial and service challenges lie ahead and work continues to prepare for these and to deliver a Financial Strategy that ensures the Council’s financial sustainability.

I would like to acknowledge the significant effort in producing the Financial Statements and express my thanks to my own team and also to colleagues throughout the Council for the significant dedication and commitment shown throughout the year to financial matters.

Signed:

Gary Fairley

Head of Finance and Integrated Service Support

Date:

Statement of Responsibilities for the Financial Statements

This sets out the respective responsibilities of the Council and the Head of Finance and Integrated Service Support (Chief Finance Officer).

The Council's Responsibilities

The Council is required:

- To make arrangements for the proper administration of its financial affairs and to secure that one of its officers has the responsibility for the administration of those affairs. In this Council, that officer is the Head of Finance and Integrated Service Support;
- To manage its affairs to secure economic, efficient and effective use of resources and safeguard its assets.
- Ensure the Annual Accounts are prepared in accordance with legislation (The Local Authority Accounts (Scotland) Regulations 2014), and so far as is compatible with that legislation, in accordance with proper accounting practices (section 12 of the Local Government in Scotland Act 2003).
- To approve the Statement of Accounts.

I confirm that these Annual Accounts were approved for signature by Midlothian Council Audit Committee at its meeting on the 26th of September 2017.

Signed on behalf of Midlothian Council

Councillor Derek Milligan

The Head of Finance and Integrated Service Support's Responsibilities

The Head of Finance and Integrated Service Support is responsible for the preparation of the Council's statement of accounts in accordance with proper practices as required by legislation and as set out in the IFRS Based Code of Practice on Local Authority Accounting in the United Kingdom (the Code).

In preparing this statement of accounts, the Head of Finance and Integrated Service Support has:

- Selected suitable accounting policies and then applied them consistently;
- Made judgements and estimates that were reasonable and prudent;
- Complied with the Code (in so far as it is compatible with legislation), except where stated in the policies and disclosure notes.

The Head of Finance and Integrated Service Support has also:

- Kept proper accounting records which were up to date;
- Taken reasonable steps for the prevention and detection of fraud and other irregularities.

These Financial Statements present a true and fair view of the financial position of the Council at 31 March 2017 and its income and expenditure for the year then ended.

Signed:

Gary Fairley

Head of Finance and Integrated Service Support

Date:

Annual Governance Statement

Midlothian Council is responsible for ensuring that its business is conducted in accordance with the law and proper standards. This is to allow public funds and the assets at its disposal to be safeguarded and used efficiently and effectively in pursuit of best value.

Elected Members and senior management are responsible for the governance of the business affairs of Midlothian Council. This includes: setting the strategic direction, vision, culture and values of the Council; and establishing appropriate and cost effective systems, processes and internal controls to allow the strategic objectives to be delivered.

In order to achieve this, the Council has developed a Code of Corporate Governance based on the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Society of Local Authority Chief Executives' (SOLACE) framework and guidance on Delivering Good Governance in Local Government: Framework (2016). The Code has been reviewed and updated in line with the new International Framework of Good Governance in the Public Sector which was implemented on 1 April 2017. The Council also has a number of officials in statutory posts who monitor governance and the supporting processes during the year. These are the Head of the Paid Service, the Monitoring Officer, the Chief Finance Officer and the Chief Social Work Officer.

The Code of Corporate Governance details 7 core principles which are supported by 20 sub-principles and 91 behaviours and actions that demonstrate good Governance. A draft copy of the revised Local Code of Corporate Governance is pending approval by the Council. Elements of good governance included are:

- Ensuring members and officers behave with integrity and lead a culture where acting in the public interest is visibly and consistently demonstrated thereby protecting the reputation of the Council;
- Creating the conditions to ensure that the statutory officers, other key post holders, and members, are able to fulfil their responsibilities in accordance with legislative and regulatory requirements;
- Providing clear reasoning and evidence for decisions in both public records and explanations to stakeholders and being explicit about the criteria, rationale and considerations used. In due course, ensuring that the impact and consequences of those decisions are clear;
- Developing formal and informal partnerships to allow resources to be used more efficiently and outcomes achieved more effectively;
- Establishing a clear policy on the type of issues that the Council will meaningfully consult with or involve communities, individual citizens, service users and other stakeholders to ensure that service (or other) provision is contributing towards the achievement of intended outcomes;
- Having a clear vision, which is an agreed formal statement of the Council's purpose and intended outcomes containing appropriate performance indicators, which provide the basis for the Council's overall strategy, planning and other decisions;
- Considering and balancing the combined economic, social and environmental impact of policies and plans when taking decisions about service provision;
- Ensuring decision makers receive objective and rigorous analysis of a variety of options indicating how intended outcomes would be achieved and associated risks. Therefore ensuring best value is achieved however services are provided;

- Establishing and implementing robust planning and control cycles that cover strategic and operational plans, priorities and targets;
- Ensuring the medium term financial strategy integrates and balances service priorities, affordability and other resource constraints;
- Developing and maintaining an effective workforce plan to enhance the strategic allocation of resources;
- Developing protocols to ensure that elected and appointed leaders negotiate with each other regarding their respective roles early on in the relationship and that a shared understanding of roles and objectives is maintained;
- Implementing robust and integrated risk management arrangements and ensuring that they are working effectively;
- Making decisions based on relevant, clear objective analysis and advice pointing out the implications and risks inherent in the Council's financial, social and environmental position and outlook;
- Aligning the risk management strategy and policies on internal control with achieving objectives ;
- Evaluating and monitoring risk management and internal control on a regular basis;
- Ensuring effective counter fraud and anti-corruption arrangements are in place;
- Ensuring additional assurance on the overall adequacy and effectiveness of the framework of governance, risk management and control is provided by the internal auditor;
- Ensuring an audit committee or equivalent group/ function, which is independent of the executive and accountable to the governing body: provides a further source of effective assurance regarding arrangements for managing risk and maintaining an effective control environment and that its recommendations are listened to and acted upon;
- Ensuring financial management supports both long term achievement of outcomes and short-term financial and operational performance;
- Ensuring robust arrangements for assessing the extent to which the principles contained in the Framework have been applied and publishing the results on the assessment, including an action plan for improvement and evidence to demonstrate good governance (the annual governance statement); and
- Ensuring that recommendations for corrective action made by external auditor are acted upon.

Midlothian Council's financial management arrangements conform to the requirements of the CIPFA Statement on the role of the Chief Financial Officer in Local Government. The Chief Financial Officer has overall responsibility for the Council's financial arrangements and is professionally qualified and suitably experienced to lead the Council's finance function.

The Council is responsible for conducting, each financial year, a review of the effectiveness of its governance framework, including risk management and the systems for internal control and financial control. The review of the effectiveness of the Council's governance framework is informed by:

- The work of the Corporate Management Team;
- The work of Council managers and Financial Services staff;
- The annual assurance questionnaires that are provided by all Heads of Service;
- An annual review, by Internal Audit, of compliance with the Council's Local Code of Corporate Governance;
- The Internal Audit Manager's annual report which is based on internal audit reports from across the range of Council services;
- Reports from the Council's external auditor; and
- Reports from other external review bodies, agencies and inspectorates.

The key governance arrangements and controls are set out in the local Code of Corporate Governance. Each year, using an assurance template, Internal Audit samples elements in the code to determine whether these are working effectively and that therefore the governance framework is working effectively.

In addition each Head of Service is required to undertake an annual self assessment of their area of responsibility using an assurance template where key elements of governance are examined.

Neither of these assessments highlighted any issues that would impact on the level of effectiveness of the Council's governance framework. A small number of improvements were identified and these are noted below in the action plan.

The statement has also been informed by the work undertaken by Internal Audit who, following the requirements of the Local Authority Accounts (Scotland) Regulations 2014, conducted an annual review of the effectiveness of the Council's system of internal control. The Internal Audit Manager's overall Audit Opinion for the Annual Governance Statement is included within the Internal Audit Annual Assurance Report for 2016/17 and concludes that overall the Council's framework of governance, risk management and internal control over the period 2016/17 are of a satisfactory standard and have been implemented and are monitored by management in line with Financial Directives, Council Policy and the other key essentials of a robust Internal Control Environment.

The programme of Internal Audit work undertaken in respect of 2016/17 was sufficient in breadth and depth to allow a robust and balanced opinion to be formed.

The Head of Audit (the Internal Audit Manager) has responsibility for the Council's Internal Audit function and reports functionally to the Audit Committee and operationally to the Chief Executive to allow appropriate independence. There have been no threats to the independence of the internal audit activity during the period.

The Internal Audit Manager is professionally qualified and suitably experienced to lead and direct the Internal Audit team.

The Public Sector Internal Audit Standards (PSIAS) require that an external assessment be conducted at least once every 5 years by a qualified, independent assessor from outside the organisation over the level of compliance against PSIAS by the Internal Audit Section. An external assessment was not undertaken in 2016/17 but will be undertaken in 2017/18 as part of the reciprocal assessments by the Scottish Local Authority Chief Internal Auditors' Group (SLACIAG). However, an assessment of Internal Audit's work is undertaken each year by the Council's external auditor as part of their annual audit. Their report in 2015/16 found this to be satisfactory.

A self evaluation of compliance with the Public Sector Internal Audit Standards by Midlothian Council's Internal Audit Section was undertaken by the Internal Audit Manager. This evaluation demonstrated that the key elements of the Standards were complied with during the year, but identified a small number of areas where performance could be improved. An action plan has been developed to address these issues and the majority have already been acted upon.

A number of risks were effectively managed in 2016/17 and Midlothian Council continues to support the Integration Joint Board with its approach to risk management.

A number of governance improvements were highlighted in the 2015/16 self assessment and progress has been made in 2016/17 on the following:

Area for Improvement identified in 2015/16	Action Undertaken in 2016/17
Key priorities and Financial Strategy To continue to progress the Council's key priorities and deliver the Financial Strategy	A Financial Strategy update, including recommendations for the 2017/18 budget was considered by Council on 7 February 2017. Action is ongoing to develop the longer term financial strategy and develop a change programme to address the identified financial challenge. As part of this work, updates are provided through regular reports to Council.
Procurement To update all procedures and processes to comply with the new procurement legislation	Procedures and processes have been updated for all legislative changes that have taken place in the last year.
Compliance with new Code of Corporate Governance Updating the Code of Corporate Governance to allow full compliance with the new International Framework of Good Governance in the Public Sector	Following implementation of the framework with effect from 1 April 2017 this action has been addressed and a draft revised Code of Corporate Governance is currently pending approval.
Standing Orders Updates are required to Standing Orders and the associated documents (Scheme of Administration and Scheme of Delegation) caused by the recent management review and subsequent changes to the Council Directorates	The review of Standing Orders and associated documents was presented and approved by Council in September 2016.
Compliance against the new CIPFA code of practice on Fraud and Corruption Review the current Counter Fraud Policy and Strategy, Whistle-blowing Policy and create a separate Anti-bribery and Corruption Policy to allow full compliance against the new CIPFA code of practice on "Managing the Risk of Fraud and Corruption"	Partially complete. Policies updated and approved by the Audit Committee in December 2016. Still to be approved by Cabinet.
Serious Organised Crime and Corruption Undertake a high level assessment of the Council's readiness in relation to the risks posed by Serious Organised Crime and Corruption. An improvement plan for recording, managing, and addressing areas of potential risk exposure has been developed and an Integrity Board will be convened to take this forward.	The Serious and Organised Crime Integrity Group has been established for Midlothian with a range of partners. The group focuses on the principles of the national agenda to deter, disrupt, divert and deter criminality and potential areas of activity. A parallel Prevent Strategy group is also focussed on the counter terrorism agenda. The Council is working closely with Police Scotland and is represented on the Police Division Serving Organised Crime Group.
Disaster recovery plans Ensure that disaster recovery plans have been adequately tested and to monitor the on-going testing of these.	This action remains an area for improvement following the return of the annual assurance questionnaires completed by Heads of Service, however a new Business Continuity Policy

Area for Improvement identified in 2015/16	Action Undertaken in 2016/17
	incorporating consideration of disruptions to service through impacts on buildings, people, system, and infrastructure etc has been drafted and is scheduled to be presented to CMT for approval.
Adoption of audit recommendations To adopt the recommendations made by Internal Audit on the areas where significant weaknesses in control have been identified during the year (including Developer Contributions and Business Gateway)	Internal Audit periodically reviews whether recommendations have been implemented and reports the outcome of this to the Corporate Management Team and the Audit Committee. A review of overdue recommendations was undertaken in December 2016 and in June 2016 a sample of 40 recommendations recorded as 'completed' by management were reviewed to confirm the adequacy of the actions taken. This confirmed that management have acted on Internal Audit recommendations and therefore controls have been strengthened. This exercise will be repeated in 2017 and the results will be reported to the Audit Committee.
Brexit To consider the effects on the Council if Article 50 of the Treaty on the European Union is triggered and to consider plans to ensure the Council's readiness and to minimise risk to the Council in terms of the resultant changes to procurement, data protection, planning, environmental legislation, employment law and grant funding.	A report to Council in November 2016 set out an initial assessment of the impact on Midlothian of the decision to leave the European Union. It concentrated on the loss of European Union grant aid, leaving wider questions of economic and social policy impact for a later report when it is clearer what the new relationship with the European Union will be. The Quarter 4 2016/17 Strategic Risk Register will also include some initial analysis of the potential impact on the Council from the triggering of Article 50, this will clarify as negotiations progress at a UK level and the final agreement is reached.

Those actions which are underway but which have not yet been fully concluded will continue to be progressed in 2017/18.

The following table sets out improvements to the governance framework which are to be progressed in 2017/18:

Area for Improvement	Proposed Action in 2017/18
Code of Corporate Governance	Midlothian Council's Code of Corporate Governance has been updated but this is still in draft and requires approval by Council.
Workforce Plans	Draft workforce plans have been developed but they require updating and a Council wide plan is required.
Post Project Implementation Reviews	Although end of project post implementation reviews are completed for some projects, these are required to be completed for all projects.
Business Continuity Policy	The Council's current Incident Response Plans focus heavily on disruption to service delivery associated with building availability. A Business Continuity Policy, detailing the Council's approach to ensuring

Area for Improvement	Proposed Action in 2017/18
	critical services and outcomes can be delivered during periods of business disruption, has been created and once approved by CMT, training and Business Continuity Plans will be rolled out across the Council.
Register of Interests	A Register of Interests for Council Officials requires further development.
Gifts and Hospitality	A standalone Gifts and Hospitality policy requires to be developed.
Internal Audit Plan	The service review of Internal Audit should be completed and any subsequent changes to the Internal Audit Plan (if any) require approval by the Audit Committee.

On the basis of the Council's assurance system, and the elements of governance at its disposal, we are satisfied that overall, Midlothian Council's systems of internal control, risk management and governance arrangements are of a satisfactory standard. We are aware of areas where improvements are required and steps will be taken in the forthcoming year to address these areas, allowing the Council to advance its corporate governance arrangements and seek continuous improvement.

Signed:

Derek Milligan, Leader of the Council / Kenneth Lawrie, Chief Executive

Date:

Remuneration Report

The Remuneration Report provides details of the Council's remuneration policy for its senior employees and senior councillors and states how remuneration arrangements are managed. Senior employees within the Council are defined as those having the responsibility for the management of the Council to the extent that they can direct or control the major activities and/or have statutory responsibilities.

As well as providing details of the Council's remuneration policy, the remuneration report also details:

- Remuneration paid to senior employees and senior councillors of the Council for 2016/17;
- The number of employees whose remuneration was £50,000 or more, disclosed in pay bands of £5,000;
- The number and total cost of exit packages, disclosed in pay bands of £20,000;
- The Council's senior employees who participate in the Local Government Pension Scheme, administered by the Lothian Pension Fund, and the benefits provided under the scheme.

Audit of Remuneration Report

All information disclosed in the tables in this report will be audited by Ernst & Young LLP and all other sections of the Remuneration Report will be reviewed to ensure that they are consistent with the financial statements.

Employees Remuneration Policy

The salary of senior employees is set by reference to national arrangements. The Scottish Joint Negotiating Committee (SJNC) for Local Authority Services sets the salaries for the Chief Executives of Scottish local authorities. For 2016/17 the salaries of the Directors were 87% of the Chief Executive's salary.

The salaries of all other employees are set by reference to:

a) Teaching Staff – The Scottish Negotiating Committee for Teachers (SNCT);
b) Other staff – Scottish Joint Negotiating Committee for Local Authority Services (SJNC).

Councillors Remuneration Policy

The remuneration of councillors is regulated by the Local Governance (Scotland) Act 2004 (Remuneration) Regulations 2007 (SSI No 2007/183) as amended. The Regulations provide for the grading of councillors for the purposes of remuneration arrangements, as either the Leader of the Council, the Civic head, senior councillors or councillors. The Leader of the Council and the Civic head cannot be the same person for the purposes of payment of remuneration. A senior councillor is a councillor who holds a significant position of responsibility within the Council's political structure.

The salary that is to be paid to the Leader of the Council is set out in the regulations and for 2016/17 this was £28,157. The regulations permit the Council to remunerate one civic head, the Provost. The regulations set out the maximum salary that may be paid to the Provost and Council policy is to pay this salary which for 2016/17 was £21,118.

The regulations also set out the remuneration that may be paid to senior councillors and the total number of senior councillors the Council may have. The maximum yearly amount that may be paid to a senior councillor is 75% of the total yearly amount payable to the Leader of the Council. The total yearly amount payable by the Council for remuneration of all of its senior councillors shall not exceed £147,548. The Council is also able to exercise local flexibility in the determination of the precise number of senior councillors and salary within these maximum limits. The Council policy is to divide the remainder of this sum after the Provost remuneration equally and pay each of the 6 senior councillors a salary of £21,072.

The Local Authority Accounts (Scotland) Amendment Regulations 2011 (SSI No. 2011/64) require local authorities in Scotland to prepare a Remuneration Report as part of the Financial Statements. This report provides details of the Council's remuneration policy for senior employees and senior councillors.

In addition to the senior councillors of the Council the regulations also set out the remuneration payable to councillors with the responsibility of a Convener or a Vice-Convener of a Joint Board. The regulations require the remuneration to be paid by the Council of which the Convener or Vice-Convener is a member. The Council is also required to pay any pension contributions arising from the Convener or Vice-Convener being a member of the Local Government Pension Scheme. The Council is reimbursed by the Joint Board for any additional remuneration paid to the member from being a Convener or Vice-Convener of a Joint Board.

Pension Entitlement

The Council's senior employees and senior councillors can participate in the Local Government Pension Scheme administered by the Lothian Pension Fund. This is an average salary pension scheme which means that pension benefits are based an average of the pay over the number of years that a person has been a member of the scheme. The scheme's normal retirement age for employees is 65.

From 1 April 2009 a five tier contribution system was introduced with employee contributions rates applied in tiers ranging from 5.5% to 12% depending on the member's rate of pensionable pay at the end of the preceding year. This is designed to give more equality between the cost and benefits of scheme membership.

The tiers and employees contributions rates for 2016/17 remain at the 2015/16 rates, and are as follows:

Actual Pensionable Pay	Contribution rate (%)
On earnings up to and including £20,500	5.5%
On earnings above £20,500 and up to £25,000	7.25%
On earnings above £25,000 and up to £34,400	8.5%
On earnings above £34,400 and up to £45,800	9.5%
On earnings above £45,800	12%

Using these tiers average employee contribution rates are calculated for any given pensionable pay and these range from 5.5% to 12%. If an employee works part-time their contribution rate is worked out on the whole time pay rate for the job, with actual contributions paid on actual pay earned.

There is no automatic entitlement to a lump sum on retirement. Pension scheme members may opt to commute pension for a lump sum payment up to the limit set by the Finance Act 2004. The accrual rate guarantees a pension based on 1/60th of final pensionable salary and years of pensionable service. Prior to 2009, the accrual rate guaranteed a pension based on 1/80th and a lump sum based on 3/80ths of final pensionable salary and years of pensionable service.

The value of the accrued benefits has been calculated on the basis of the age at which the person will first become entitled to receive a pension on retirement without reduction on account of its payment at that age, without exercising any option to commute pension entitlement into a lump sum, and without any adjustment for the effects of future inflation.

Remuneration by Pay Band

Details of the Council's employees receiving more than £50,000 remuneration for the year, excluding employer's pension and national insurance contributions, are as follows:

Total Employees 2015/16	Remuneration Band	Non- Teaching Employees 2016/17	Teaching Employees 2016/17	Total Employees 2016/17
56	£50,000 - £54,999	18	51	69
25	£55,000 - £59,999	14	12	26
5	£60,000 - £64,999	4	4	8
4	£65,000 - £69,999	4	3	7
7	£70,000 - £74,999	2	2	4
4	£75,000 - £79,999	6	1	7
0	£80,000 - £84,999	0	0	0
1	£85,000 - £89,999	0	1	1
0	£90,000 - £94,999	0	0	0
3	£95,000 - £99,999	3	0	3
0	£100,000 - £104,999	0	0	0
0	£105,000 - £109,999	0	0	0
0	£110,000 - £114,999	0	0	0
1	£115,000 - £119,999	1	0	1
106	**TOTAL**	**52**	**74**	**126**

Exit Packages by Band

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary redundancy. They are charged on an accruals basis to Services in the Comprehensive Income and Expenditure Statement when the Council is demonstrably committed to either terminating the employment of an officer or making an offer to encourage voluntary redundancy. The Council is only demonstrably committed to a termination when it has a detailed formal plan for the termination and it is without realistic possibility of withdrawal.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits and to replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Details of the cost to the Council of voluntary redundancy packages for the year are as follows:

Number of Employees	Total Cost £000	Package Band	Number of Employees	Total Cost £000
2015/16	**2015/16**		**2016/17**	**2016/17**
15	190	£0 - £19,999	1	17
24	713	£20,000 - £39,999	3	91
8	454	£40,000 +	5	351
47	**1,357**	**TOTAL**	**9**	**459**

Remuneration paid to Senior Employees

The table below details remuneration paid to senior employees within the Council.

For year to 31 March 2016		For year to 31 March 2017		
Total Remuneration	**Name and Post Title**	**Salary, Fees & Allowances**	**Non Cash Benefits**	**Total Remuneration**
£112,887	K Lawrie,	£114,015	-	£114,015
	Chief Executive			
£4,174	K Lawrie,	£5,485	-	£5,485
	Returning Officer			
£98,531	J Blair,	£95,186	£4,146	£99,332
	Director Resources			
£49,176	E McHugh,	£49,668	-	£49,668
	Joint Director Health & Social Care (1)			
£98,353	M Smith,	£99,336	-	£99,336
	Director Education, Communities and Economy			
£76,386	G Fairley,	£73,524	£3,586	£77,110
	Head of Finance & ISS			
	G Vickers	£73,149	£3,430	£76,579
	Head of Education (2)			
£53,107	A Turpie,	£52,936	-	£52,936
	Legal Services Manager			
£492,614	**Total**	**£563,299**	**£11,162**	**£574,461**

Pension Entitlement of Senior Employees

The table below details employer's pension contributions made in respect of senior employees within the Council.

For year to 31 March 2016	Name and Post Title	For year to 31 March 2017
£21,850	K Lawrie, Chief Executive	£23,176
£843	K Lawrie, Returning Officer	£1,108
£19,037	J Blair, Director Resources	£19,228
£9,519	E McHugh, Joint Director Health & Social Care (1)	£9,614
£19,037	M Smith, Director Education, Communities and Economy	£19,228
£14,704	G Fairley, Head of Finance & Integrated Service Support	£14,852
	G Vickers	
0	Head of Education (2)	£14,420
£10,279	A Turpie, Legal Services Manager	£10,693
£95,269	**Total**	**£112,319**

1 Post joint funded 50:50 with NHS Lothian. Full time equivalent salary £99,336. Full time equivalent employer's pension contributions £19,228.

2 The role of Chief Education Officer was created by the Education (Scotland) Act 2016 and effective from 01/04/2016

Accrued Pension Benefits

Name and Post Title	As at 31 March 2017 Pension £000	As at 31 March 2017 Lump Sum £000	Difference from 31 March 2016 Pension £000	Difference from 31 March 2016 Lump Sum £000
K Lawrie, Chief Executive	37	62	3	1
J Blair, Director Resources	44	91	3	1
E McHugh, Joint Director Health & Social Care	43	90	2	1
M Smith, Director Education, Communities & Economy	28	43	3	1
G Fairley, Head of Finance & ISS	34	71	2	1
G Vickers, Head of Education	3	0	0	0
A Turpie, Legal Services Manager	22	44	2	1
Total	**211**	**401**	**15**	**6**

All senior employees shown in the tables above are members of the Local Government Pension Scheme. The pension figures shown relate to the benefits accrued as a consequence of total local government service, not solely the current appointment.

Remuneration of Senior Councillors

The following table provides details of the remuneration paid to senior councillors of Midlothian Council.

For year to 31 March 2016		For year to 31 March 2017		
Total				**Total**
Remuneration	**Name**	**Salary**	**Expenses**	**Remuneration**
£2,981	O Thompson, Leader (1)	0	£143	£143
£26,777	C Johnstone, Senior Councillor/Leader (1)	£28,157	£30	£28,187
£21,020	B Constable, Depute Leader	£21,072	£175	£21,247
£21,185	J Wallace, Provost	£21,118	£179	£21,297
£21,073	A Coventry, Depute Provost	£21,072	£203	£21,275
£21,516	J Bryant, Senior Councillor	£21,072	£176	£21,248
£21,319	D Rosie, Senior Councillor	£21,072	£764	£21,836
£10,981	K Parry, Senior Councillor (2)	£21,072	£0	£21,072
£21,396	D Milligan, Opposition Leader	£21,072	£507	£21,579
£0	M Russell (3)	£2,917	£162	£3,079
£168,248	**Total**	**£178,624**	**£2,339**	**£180,963**

The Council paid £0.342 million (2015/16 £0.333 million) salaries to Councillors and expenses of £0.004 million (2015/16 £0.005 million). The annual return of Councillor's salaries and expenses is available on the Council Website.

Pension Entitlement of Senior Councillors

In-year employer's pension contributions

For year to 31 March 2016	Name	For year to 31 March 2017
£4,214	B Constable, Depute Leader	£3,631
£4,224	J Wallace, Provost	£3,639
£4,214	D Rosie, Senior Councillor	£3,631
-	C Johnstone, Senior Councillor/Leader (1)	£4,048
£4,214	A Coventry, Depute Provost	£3,631
£2,218	K Parry, Senior Councillor (2)	£4,257
£19,084	**Total**	**£22,837**

1 O Thompson stood down as Council Leader on 8th May 2015, being replaced by C Johnstone. Full time equivalent salary for the Council Leader £27,878 for 2015/16.

2 K Parry was elected to Council and took up the post of Senior Councillor 11th September 2015. Full time equivalent salary £20,863 for 2015/16.

3 M Russell was appointed Vice Convenor of the Lothian Valuation Joint Board from the 6th of February 2017, full remuneration for the year was £17,374.

Accrued Pension Benefits as at 31 March 2017

Name and Post Title	As at 31 March 2017 Pension £000	As at 31 March 2017 Lump Sum £000	Difference from 31 March 2016 Pension £000	Difference from 31 March 2016 Lump Sum £000
B Constable, Depute Leader	3	1	0	0
J Wallace, Provost	2	0	0	0
D Rosie, Senior Councillor	2	0	0	0
C Johnstone, Senior Councillor	2	0	0	0
A Coventry, Depute Provost	2	0	1	0
K Parry, Senior Councillor	0	0	0	0
Total	**11**	**1**	**1**	**0**

Signed:

Derek Milligan
Leader of the Council

Kenneth Lawrie
Chief Executive

Date:

Expenditure and Funding Analysis

For the year ended 31 March 2017

The Expenditure and Funding Analysis shows how annual expenditure is used and funded from resources (government grants, rents, council tax and business rates) by the Council in comparison with those resources consumed or earned in accordance with generally accepted accounting practices. It shows how this expenditure is allocated for decision making purposes between the Council's services. Income and expenditure accounted for under generally accepted accounting practices is presented more fully in the Comprehensive Income and Expenditure Statement.

2015/16 Net expenditure chargeable to the General Fund and HRA balances	2015/16 Adjustments between the funding and accounting basis	2015/16 Net Expenditure in the Comprehensive Income and Expenditure Statement	Service	2016/17 Net expenditure chargeable to the General Fund and HRA balances	2016/17 Adjustments between the funding and accounting basis	2016/17 Net Expenditure in the Comprehensive Income and Expenditure Statement
£000	£000	£000		£000	£000	£000
1,605	88	1,694	Management	1,574	146	1,721
15,677	-109	15,568	Children's Services	15,431	509	15,940
3,835	407	4,242	Communities and Economy	4,334	690	5,024
68,045	14,196	82,242	Education	75,810	21,129	96,939
36,893	965	37,857	Adult Social Care	38,237	1,596	39,833
7,323	472	7,795	Customer and Housing Services	5,305	441	5,746
14,704	5,484	20,188	Commercial Services	15,850	6,151	22,001
16,088	-10	16,078	Finance and Integrated Service Support	11,159	375	11,534

13,536	3,804	17,339	Properties and Facilities Management	13,943	5,740	19,683
-16,431	15,565	-866	Housing Revenue Account	-13,621	13,102	-519
560	0	560	Joint Boards	560	0	560
1,500	-92	1,409	Non-Distributed Costs	1,407	42	1,449
163,335	**40,770**	**204,106**	**Net Cost of Services**	**169,989**	**49,921**	**219,911**
8,866	-8,035	831	Other Income and Expenditure	8,002	-9,857	-1,855
12,556	3,771	16,328	Financing and Investment Income and Expenditure	12,477	2,437	14,915
-191,605	-22,627	-214,232	Taxation and non-specific grant income	-188,336	-14,229	-202,565
-6,848	**13,879**	**7,032**	**(Surplus) or Deficit on Provision of Services**	**2,132**	**28,272**	**30,406**
42,691			**Opening General Fund and HRA Balance**	**49,538**		
-6,847			**Less/Plus (Surplus) or Deficit on General Fund and HRA Balance in year**	**2,132**		
49,538			**Closing General Fund and HRA Balance at 31 March 2017**	**47,406**		

Movement in Reserves Statement

This statement shows the movement in the year on the different reserves held by the Council, analysed into 'usable reserves' (i.e. those that can be applied to fund expenditure) and other 'unusable reserves'. This statement shows how the movements in year of the Council's reserves are broken down between gains and losses incurred in accordance with generally accepted accounting practices and the statutory adjustments required to return to the amounts chargeable to council tax and rents for the year. The Net Increase/Decrease line shows the statutory General Fund Balance and Housing Revenue Account Balance movements in the year following these adjustments.

2015/16 – Previous year comparison (restated)	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	**Total Usable Reserves**	**Unusable Reserves**	**Total Council Reserves**
		£000	£000	£000	£000	**£000**	**£000**	**£000**
Balance at 1 April 2015		**(21,315)**	**(21,376)**	**(14,853)**	**(3,073)**	**(60,617)**	**(172,712)**	**(233,329)**
Total Comprehensive Expenditure and Income	CIES	(2,092)	9,124	0	0	7,032	(98,823)	(91,791)
Adjustments between accounting basis and funding basis under regulations	6	(1,752)	(12,661)	(525)	0	(14,937)	14,937	0
Net increase/ (decrease) before transfers to other statutory reserves		**(3,844)**	**(3,537)**	**(525)**	**0**	**(7,906)**	**(83,885)**	**(91,791)**
Transfers to/(from) other statutory reserves		**534**	**0**	**0**	**-534**	**0**	**0**	**0**
Increase/(Decrease) in year		**(3,310)**	**(3,537)**	**(525)**	**(534)**	**(7,906)**	**(83,885)**	**(91,791)**
Balance at 31 March 2016		**(24,625)**	**(24,913)**	**(15,378)**	**(3,607)**	**(68,523)**	**(256,598)**	**(325,121)**

2016/17 – Current Financial Year	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	**Total Usable Reserves**	**Unusable Reserves**	**Total Council Reserves**
		£000	£000	£000	£000	**£000**	**£000**	**£000**
Balance at 1 April 1 April 2016		**(24,625)**	**(24,913)**	**(15,378)**	**(3,607)**	**(68,523)**	**(256,598)**	**(325,121)**
Total Comprehensive Expenditure and Income	CIES	20,972	9,434	5,778	0	**36,184**	**23,317**	**59,501**
Adjustments between accounting basis and funding basis under regulations	6	(13,492)	(14,275)	(7,106)	0	(34,873)	34,873	0
Net increase/ (decrease) before transfers to other statutory reserves		**7,480**	**(4,841)**	**(1,328)**	**0**	**1,311**	**58,190**	**59,501**
Transfers to/(from) other statutory reserves		-507	0	0	507	0	0	0
Increase/(Decrease) in year		**6,973**	**(4,841)**	**(1,328)**	**507**	**1,311**	**58,190**	**59,501**
Balance at 31 March 2017		**(17,651)**	**(29,754)**	**(16,706)**	**(3,100)**	**(67,211)**	**(198,408)**	**(265,620)**

Comprehensive Income and Expenditure Statement

For the year ended 31 March 2017

This statement shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation or rents. The Council raises taxation and rents to cover expenditure in accordance with statutory requirements; these differ from the accounting cost. The taxation position is shown in both the Expenditure and Funding Analysis and the Movement in Reserves Statement.

Following clarification within the Cipfa Code of Practice on Local Authority Accounting over the recognition of capital grants, the Council has represented the 2015/16 figures to ensure these are consistent each year. £22.627 million of capital grant income previous recognised in service income has been reflected in grant income for 2015/16. This results in a decrease in net costs of service but has no impact on total operating income and expenditure or general fund.

Restated 2015/16 Gross Expenditure £000	**Restated 2015/16 Gross Income £000**	**Restated 2015/16 Net Expenditure £000**	**Service**	Notes		**2016/17 Gross Expenditure £000**	**2016/17 Gross Income £000**	**2016/17 Net Expenditure £000**
1,758	-64	1,694	Management		£	1,787	-66	1,721
15,660	-92	15,568	Children’s Services		£	16,079	-139	15,940
6,371	-2,129	4,242	Communities and Economy		£	6,996	-1,972	5,024
83,964	-1,722	82,242	Education		£	98,842	-1,903	96,939
52,305	-14,448	37,857	Adult Social Care		£	95,628	-55,795	39,833
39,233	-31,438	7,795	Customer and Housing Services		£	36,730	-30,984	5,746
22,151	-1,963	20,188	Commercial Services		£	24,051	-2,050	22,001

Restated 2015/16 Gross Expenditure £000	Restated 2015/16 Gross Income £000	Restated 2015/16 Net Expenditure £000	Service	Notes	2016/17 Gross Expenditure £000	2016/17 Gross Income £000	2016/17 Net Expenditure £000
16,319	-241	16,078	Finance and Integrated Service Support		£ 11,886	-352	11,534
24,650	-7,311	17,339	Properties and Facilities Management		£ 27,173	-7,490	19,683
23,580	-28,345	-4,764	Housing Revenue Account		£ 30,739	-31,258	-519
560	0	560	Joint Boards		£ 560	0	560
1,409	0	1,409	Non-Distributed Costs	7	£ 1,449	0	1,449
287,960	**-87,753**	**200,208**	**Cost of Services**		**351,920**	**-132,009**	**219,911**
		831	Other Operating Expenditure	8			(1,855)
		16,328	Financing and Investment Income and Expenditure	9			14,915
		(210,334)	Taxation and non-specific grant income	10			(202,565)
		7,032	**(Surplus) or Deficit on Provision of Services**				**30,406**
		(41,027)	(Surplus) or Deficit on revaluation of non-current assets				(15,364)
		(55,787)	Re-measurement of the net defined benefit liability	33			44,365
		(2,009)	Other (Gains) / Losses				95
		(98,823)	**Other Comprehensive (Income) and Expenditure**				**29,096**
		(91,791)	**Total Comprehensive (Income) and Expenditure**				**59,502**

Balance Sheet
As at 31 March 2017

The Balance Sheet shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Council. The net assets are matched by reserves which are reported in two categories. The first is 'usable reserves' which are available to the Council to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use. The second category of reserves are those that the Council is not able to use to provide services. This includes reserves that contain unrealised gains and losses where amounts would only become available to provide services if the assets are sold; and reserves that hold timing differences shown in the Movement in Reserves Statement line "Adjustments between accounting basis and funding basis under regulations".

31 March 2015	31 March 2016			31 March 2017
£000	**£000**		**Notes**	**£000**
611,295	640,904	Property, Plant and Equipment	11	651,696
1,187	1,073	Intangible Assets	12	766
26	27	Heritage Assets	14	68
3,382	5,189	Long Term Investments	16	4,935
3,073	3,639	Long Term Debtors	17	3,136
618,963	**650,832**	**Long Term Assets**		**660,601**
40,152	55,007	Short Term Investments	15	65,072
800	2,535	Assets held for Sale	13	1,950
987	826	Inventories		811
20,658	18,292	Short Term Debtors	17	19,641
14,337	10,710	Cash and Cash Equivalents	18	10,894
76,934	**87,370**	**Current Assets**		**98,368**
44,237	41,073	Short Term Borrowing	15	51,270
25,468	23,747	Short Term Creditors	19	28,998
1,750	1,640	Provisions	20	1,431
18,049	16,395	Grants Receipts in Advance	28	22,944
89,504	**82,855**	**Current Liabilities**		**104,643**
193,143	198,917	Long Term Borrowing	15	208,816
179,921	131,309	Other Long Term Liabilities	21	179,892
373,064	**330,226**	**Long Term Liabilities**		**388,707**
233,329	**325,121**	**Net Assets**		**265,619**
60,617	68,523	Usable Reserves	6&22	67,211
172,712	256,598	Unusable Reserves	23	198,408
233,329	**325,121**	**Total Reserves**		**265,619**

Gary Fairley, Head of Finance and Integrated Service Support

Unaudited Accounts were authorised for issue on 27th June 2017 and the audited accounts were authorised for issue on 28th September 2017.

Cash Flow Statement

For the year ended 31 March 2017

This statement summarises the inflows and outflows of cash arising from the transactions with third parties on both day-to-day revenue transactions and expenditure on capital activities. The statement shows how the Council generates and uses cash and cash equivalents by classifying cash flows as operating, investing and financial activities. For the purpose of this statement, cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

2015/16			**2016/17**
£000	**Revenue Activities**	**Notes**	**£000**
(7,032)	**Net surplus or (deficit) on the provision of services**		**(30,406)**
45,672	Adjustment to surplus or deficit on the provision of services for non cash movements	24	64,498
15,005	Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities	24	13,172
53,645	**Net Cash Flows From Operating Activities**		**47,264**
(58,717)	Net cash flows from investing activities	25	(65,902)
1,445	Net cash flows from financing activities	26	18,822
(3,627)	**Net Increase or Decrease in Cash and Cash Equivalents**		**184**
14,337	Cash and cash equivalents at the beginning of the reporting period		10,710
10,710	**Cash and cash equivalents at the end of the reporting period**		**10,894**

Notes to the Financial Statements

The notes to the Financial Statements present information about the basis of preparation of the Financial Statements and the specific accounting policies used. It discloses the information required by The Code that is not presented elsewhere in the Financial Statements together with other explanatory information.

1. Statement of Accounting Policies

1.1 General Principles

The Statement of Accounts summarise the Council's transactions for the 2016/17 financial year and its position as at 31 March 2017. The Council is required to prepare an annual Statement of Accounts in accordance with the Local Authority Accounts (Scotland) Regulations 2014. Section 12 of the Local Government in Scotland Act 2003 also requires the Statement of Accounts to be prepared in accordance with proper accounting practices. These practices comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (The Code) and the Service Reporting Code of Practice 2016/17 (SeRCOP), supported by International Financial Reporting Standards (IFRS) and statutory guidance issued under section 12 of the Local Government in Scotland Act 2003.

Accounting Concepts and Principles

The accounting concepts followed in the application of accounting policies are:

- Accruals - sums due to or from the Council during the year are included, whether or not the cash has actually been received or paid in the year.

- Going concern - this assumes that the Council will continue in existence for the foreseeable future.

The accounting concepts are supported by qualitative characteristics prescribed by the International Accounting Standards Board's Conceptual Framework for Financial Reporting:

- Two fundamental characteristics (relevance and faithful representation); and

- Four enhancement characteristics, which complement the fundamental characteristics (comparable, verifiable, timely and understandable).

Faithful representation has three characteristics:

- Completeness - the financial statements should include all information necessary for a user to understand them, including all necessary descriptions and explanations;

- Neutrality - the financial statements should be without bias in the selection or presentation of financial information; and
- Free from material error - there should be no errors or omissions in descriptions, or in the selection or application of the process used to produce the reported information.

1.2 Summary of Significant Accounting Policies

1.2.1 Accruals of Income and Expenditure

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- Revenue from the provision of services is recognised when the Council can reliably measure the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council;
- Revenue from Council Tax and Non Domestic Rates is recognised when it is probable that the economic benefits or service potential associated with the transaction will flow to the Council, and the amount of revenue can be measured reliably. Revenue is measured at the full amount receivable (net of any impairment losses) as they are non-contractual, non-exchange transactions and there can be no difference between the delivery and payment dates.
- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption, they are carried as inventories on the Balance Sheet;
- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made;
- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract;
- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or a creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

1.2.2 Prior Period Adjustments, Changes in Accounting Policies and Estimates and Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e., in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council’s financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period

A prior period adjustment has been made in 2016/17 relating to the liability the Council has to the Scottish Government for contributions towards the Borders Railway. This is now recognised as a long term liability of £8.193 million in Balance Sheets as at 31st March 2015, 31st March 2016 and 31st March 2017 with a corresponding reduction in the Capital Adjustment Account.

1.2.3 Charges to Revenue for Non-Current Assets

Services and support services are debited with the following amounts to record the cost of holding non-current assets during the year:

- Depreciation attributable to the assets used by the relevant service;
- Revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off;
- Amortisation of intangible non-current assets attributable to the service.

The Council is not required to raise Council Tax to fund depreciation, revaluation and impairment losses or amortisations. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement by way of loans fund principal charges. Depreciation, revaluation and impairment losses and amortisations are therefore replaced by the contribution in the principal repayment when determining the movement in the General Fund Balance by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

1.2.4 Employee Benefits

Benefits Payable during Employment

Short-term employee benefits are those due to be settled within 12 months of the year-end. They include such benefits as salaries, paid annual leave and flexi-time balances. They are recognised as an expense for services in the year in which employees render services to the Council. An accrual is made for the cost of holiday entitlements earned by employees but not taken before the year-end which employees can carry forward into the next financial year. The accrual is charged to the surplus or deficit on the provision of services, but then reversed out through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday absence occurs.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary severance and are charged on an accruals basis to the Non Distributed Costs line in the CIES when the Council is demonstrably committed to the termination of the employment of an officer or group of officers or making an offer to encourage voluntary severance.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post Employment Benefits

Employees of the Authority are members of two separate pension schemes:

- The Teachers' Pension Scheme, administered by the Scottish Public Pensions Agency (SPPA);
- The Local Government Pensions Scheme, administered by the Lothian Pension Fund operated by the City of Edinburgh Council.

Both schemes provide defined benefits to members (retirement lump sums and pensions), earned as employees work for the Council.

However, the arrangements for the teachers' scheme mean that liabilities for these benefits cannot be identified to the Council. The scheme is therefore accounted for as if it were a defined contribution scheme – no liability for future payments of benefits is recognised in the Balance Sheet and the education service revenue account is charged with the employer's contribution payable to teachers' pensions in the year.

In relation to retirement benefits, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, this means that there are appropriations to and from the Pension Reserve to remove the notional debits and credits for retirement benefits and replace them with debits for cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pension Reserve thereby measures the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cash flows rather that as benefits are earned by employees.

The Local Government Pension Scheme

The Local Government Scheme is accounted for as a defined benefits scheme:

- The liabilities of the Lothian Pension Fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method – i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates etc and projections of earnings for current employees;
- Liabilities are discounted to their value at current prices;
- The assets of Lothian Pension Fund attributable to the Council are included in the Balance Sheet at their fair value. Quoted securities at current bid price, unquoted securities at professional estimate, unitised securities at current bid price and property at market value.

The change in the net pensions liability is analysed into seven components:

- Current service cost – the increase in liabilities as a result of years of service earned this year – allocated in the CIES to the services for which the employees worked;
- Past service cost – the increase in liabilities arising from current year decisions whose effect relates to years of service earned in earlier years – debited to the Surplus or Deficit on the Provision of Services in the CIES as part of Non Distributed Costs;

- Net interest on the net defined liability (asset), i.e. net interest expense for the authority – the change during the period in the net defined benefit liability (asset) that arises from the passage of time charged to the Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement – this is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability (asset) at the beginning of the period – taking into account any changes in the net defined benefit liability (asset) during the period as a result of contribution and benefit payments.;
- The return on plan assets – excluding amounts included in net interest on the net defined liability (asset) – charged to the pensions reserve as other comprehensive income and expenditure;
- Actuarial gains and losses – changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions – charged to the Pensions Reserve as other comprehensive income and expenditure;;
- Contributions paid to the Lothian Pension Fund – cash paid as employer's contributions to the pension fund in settlement of liabilities; not accounted for as an expense.

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff (including teachers) are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme

1.2.5 Events After the Balance Sheet Date

Events after the balance sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Financial Statements are authorised for issue. Two types of events can be identified:

- Those that provide evidence of conditions that existed at the end of the reporting period – the Financial Statements are adjusted to reflect such events;
- Those that are indicative of conditions that arose after the reporting period – the Financial Statements are not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Financial Statements.

1.2.6 Financial Instruments

Financial Liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the CIES for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For most of the borrowings that the Council has this means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest); and interest charged to the CIES is the amount payable for the year according to the loan agreement.

Where premiums and discounts have been charged to the CIES, regulations allow the impact on the General Fund or HRA Balances to be spread over future years. The Council has a policy of spreading the gain or loss over the term that was remaining on the loan against which the premium was payable or discount receivable when it was repaid.

The reconciliation of amounts charged to the CIES to the net charge required against the General Fund Balance is managed by a transfer to or from the Financial Instruments Adjustment Account in the Movement in Reserves Statement.

Gains and losses on the repurchase or early settlement of borrowing are credited and debited to the Financing and Investment Income and Expenditure line in the CIES in the year of repurchase/settlement. However, where repurchase has taken place as part of a restructuring of the loan portfolio that involves the modification or exchange of existing instruments, the premium or discount is respectively deducted from or added to the amortised cost of the new or modified loan and the write-down to the CIES is spread over the life of the loan by an adjustment to the effective interest rate.

Financial Assets

Financial assets are classified into two types:

- Loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market;
- Available-for-sale assets – assets that have a quoted market price and/or do not have fixed or determinable payments.

Loans and Receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For most of the loans that the Council has made, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made, the asset is written down and a charge made to the relevant service (for receivables specific to that service) or the Financing and Investment Income and Expenditure line in the CIES.

The impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate.

Any gains and losses that arise on the de-recognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

Available for Sale Assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value. Where the asset has fixed or determinable payments, annual credits to the Financing and Investment Income and Expenditure line in the CIES for interest receivable are based on the amortised cost of the asset multiplied by the effective rate of interest for the instrument. Where there are no fixed or determinable payments, income (eg, dividends) is credited to the CIES when it becomes receivable by the Council.

Assets are maintained in the Balance Sheet at fair value. Values are based on the share of net assets basis as a proxy for quoted market prices.

Changes in fair value are balanced by an entry in the Available-for-Sale Reserve and the gain/loss is recognised in the Surplus or Deficit on Revaluation of Available-for -Sale Financial Assets. The exception is where impairment losses have been incurred – these are debited to the Financing and Investment Income and Expenditure line in the CIES, along with any net gain or loss for the asset accumulated in the Available-for-Sale Reserve.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made (fixed or determinable payments) or fair value falls below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the CIES. If the asset has fixed or determinable payments, the impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate. Otherwise, the impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

Any gains and losses that arise on the de-recognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES, along with any accumulated gains or losses previously recognised in the Available-for-Sale Reserve.

1.2.7 Interests in Companies and Other Entities

The Council has an interest in companies and other entities that have the nature of subsidiaries, associates and jointly controlled entities. In the Council's own single-entity accounts, the interests in companies and other entities are recorded as the share of net assets.

1.2.8 Long Term Contracts

Long term contracts are accounted for on the basis of charging the Surplus or Deficit on the Provision of Services with the value of works and services received under the contract during the financial year.

1.2.9 Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment

Recognition

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset's potential to deliver future economic benefits or service potential (i.e., repairs and maintenance) is charged as an expense when it is incurred.

Measurement

Assets are initially measured at cost, comprising:

- The purchase price;
- Any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be its fair value, unless the acquisition does not have commercial substance (i.e. it will not lead to a variation in the cash flows of the Council). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the Council.

Assets are carried in the Balance Sheet using the following measurement bases:

- Council Houses are valued using the Beacon principle based on valuations carried out by the Council's Property Investment Manager. The main valuation basis used in is existing use – social housing. Gross valuations are reduced by applying a discount factor which is designed to reflect that houses are only available for social use. Any new build housing and newly purchased houses are valued at historic cost;
- Land and operational properties, including schools, have been valued at current value, determined as the amount that would be paid for an asset in its existing use;
- Community and Infrastructure assets are valued at depreciated historic cost;
- Vehicles, Plant and Equipment have been valued at depreciated historic cost;
- Assets Under Construction are held at historic cost;
- Surplus Assets are valued at open market value;
- Heritage Assets are valued at insurance replacement value where available, otherwise assets are held at depreciated historic cost since the cost of obtaining a valuation would outweigh the benefits to users of the financial statements.

Where there is no market-based evidence of current value because of the specialist nature of an asset, depreciated replacement cost (DRC) is used as an estimate of current value.

Where non-property assets that have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for fair value.

Assets included in the Balance Sheet at fair value are re-valued sufficiently regularly to ensure that their carrying amount is not materially different from their fair value at the year-end, but as a minimum every five years. As part of the Council's plan for revaluation, a move has been made to revalue all items in a specific category in the same year, if one of the assets in the category has been re-valued. Increases in valuations are matched by credits to the Revaluation Reserve to recognise any unrealised gains. Exceptionally, gains might be credited to the CIES where they arise from the reversal of a loss that has been previously charged to a service.

Where decreases in value are identified, they are accounted for by:

- Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

- Where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains);
- Where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the CIES.

Where an impairment loss is reversed subsequently, the reversal is credited to the Revaluation Reserve or the relevant service line(s) in the CIES, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for on all Property, Plant and Equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e., freehold land and certain Community Assets) and assets that are not yet available for use (i.e., assets under construction).

Deprecation is calculated on the following bases:

- Dwellings and other buildings – straight-line allocation over the useful life of the property as estimated by the valuer;
- Vehicles, plant and equipment – straight-line allocation over the useful life of the assets in the Balance Sheet, as advised by a suitably qualified officer;
- Infrastructure – straight-line allocation.

The following useful lives are used in the calculation of depreciation for the categories of assets, except where the useful life is known to be different from these as a consequence of a Council decision:

- Council Dwellings – 40 to 60 years;
- Buildings – 10 to 30 years;
- Vehicles, Plant and Equipment – 5 to 10 years;
- Infrastructure – 15 years.

Where an item of Property, Plant and Equipment asset has major components whose cost is significant in relation to the total cost of the item, the components are depreciated separately. Council policy is to only consider any asset with a gross book value of £1.5 million or above. The assessment of which components of these assets require to be recognised and depreciated separately is based on the cost of each component. Significance is determined by comparing the cost of components against the overall cost of the asset. This threshold is set at 15% or more of the overall cost of the asset.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and Non-Current Assets Held for Sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset Held for Sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the CIES. Gains in fair value are recognised only up to the amount of any previous losses recognised in the Surplus or Deficit on Provision of Services. Depreciation is not charged on Assets Held for Sale.

If assets no longer meet the criteria to be classified as Assets Held for Sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as held for sale; adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as Held for Sale, and their recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as Assets Held for Sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether Property, Plant and Equipment or Assets Held for Sale) is written off to the Other Operating Expenditure line in the CIES as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the CIES also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal in excess of £10,000 are categorised as capital receipts. The balance of receipts is required to be credited to the Capital Fund via the Capital Receipts Reserve, and can then only be used for new capital investment or to defray debt. Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement.

The written-off value of disposals is not a charge against Council tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

1.2.10 VAT
Income and Expenditure excludes any amount relating to Value Added Tax (VAT), as all VAT is payable to H.M. Revenue & Customs and all VAT is recoverable from them.

2. Accounting Standards that have been issued but not yet adopted

The Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new standard that has been issued but not yet adopted. This applies to the adoption of the following new or amended standards within the 2017/18 Code.

The following Adopted International Financial Reporting Standards (IFRS) have been issued but have not been applied in these financial statements. Their adoption is not expected to have a material effect on the financial statements unless otherwise indicated.

IAS 26 Amendment to the reporting of pension scheme transaction costs.

IAS 26 Amendment to the reporting of investment concentration.

3. Critical Judgements in Applying Accounting Policies

In applying the accounting policies set out in Note 1, the Council has had to make certain judgements about complex transactions or those involving uncertainty about future events. The critical judgements made in the Statement of Accounts are:

- There is a high degree of uncertainty about future levels of funding for Local Government, however, the Council has determined that this uncertainty is not yet sufficient to provide an indication that the assets of the Council might be impaired as a result of a need to close the facilities and to reduce levels of service provision.
- Accounting for public-private partnerships. The council is deemed to control the services provided under the agreement for the provision of educational establishments in accordance with IFRC12. The council controls the services provided under the scheme and ownership of the schools will pass to the council at the end of the contract. The schools are therefore recognised on the council's balance sheet.

4. Assumptions made about the future and other major sources of estimation uncertainty

The Financial Statements contain estimated figures that are based on assumptions made by the Council about the future or events that are otherwise uncertain. Estimates are made taking into account historical experience, current trends and other relevant factors. However, because balances cannot be determined with certainty, actual results could be materially different from the assumptions and estimates.

The items in the Council's Balance Sheet as at 31 March 2017 for which there is significant risk of material adjustment in the forthcoming year are as follows:

4.1 Property, Plant and Equipment

Uncertainties

Assets are depreciated over useful lives that are dependent on assumptions about the level of repairs and maintenance that will be incurred in relation to individual assets. The current economic climate makes it uncertain that the Council will be able to sustain its current spending on repairs and maintenance, bring into doubt the useful lives assigned to assets.

Effect if Actual Results Differ from Assumptions

If the useful life of assets is reduced, depreciation increases and the carrying amount of the assets falls. It is estimated that the annual depreciation charge would increase by £2.936 million for every year that useful lives had to be reduced.

4.2 Pension Liabilities

Uncertainties

Estimation of the net liability to pay pensions depends on a number of complex judgements relating to the discount rate used, the rate at which earnings are projected to increase, changes in retirement ages, mortality rates and expected returns on pension fund assets. Hymans Robertson LLP are engaged to provide the Council with expert advice about the assumptions to be applied.

Effect if Actual Results Differ from Assumptions

The following table shows the sensitivity of the results to the changes in assumptions used to measure the scheme liabilities. Approximate percentage changes and monetary values are shown below:

	Approximate % increase to Employer Obligation	Approximate monetary amount £000
Sensitivities at 31 March 2017		
0.5% decrease in Real Discount Rate	11%	65,789
0.5% increase in the Salary Increase Rate	4%	22,136
0.5% increase in the Pension Increase Rate	7%	41,677

In addition it is estimated that a one year increase in life expectancy would approximately increase the Employer’s Defined Benefit Obligation by around 3-5%.

4.2 Collectability of debtors

A provision for bad debt is used to estimate the collectability of debtors. This is calculated as a percentage of debt outstanding using historical debt collection rates.

5. Note to the Expenditure and Funding Analysis

Adjustments from General Fund to arrive at the Comprehensive Income and Expenditure Statement Amounts	Adjustments between Funding and Accounting Basis			2016/17
	Adjustments for Capital Purposes	Net change for the pension adjustments	Other Differences	Total Adjustments
	£000	£000	£000	£000
Service				
Management	71	35	41	147
Children's Services	136	187	186	509
Communities and Economy	440	133	117	690
Education	18,283	1,953	893	21,129
Adult Social Care	647	473	476	1,596
Customer and Housing Services	295	0	146	441
Commercial Services	5,472	351	328	6,151
Finance and Integrated Service Support	771	-695	299	375
Properties and Facilities Management	4,693	498	549	5,391
Housing Revenue Account	12,942	160		13,948
Joint Boards	0	0	0	0
Non-Distributed Costs	0		42	42
Net Cost of Services	**43,750**	**3,094**	**3,077**	**49,921**
Other income and expenditure from the Expenditure and Funding Analysis	**-24,078**	**2,437**	**-8**	**-21,649**
Difference between General Fund Surplus or Deficit and Comprehensive Income and Expenditure Statement Surplus or Deficit on the Provision of Services	**19,672**	**5,531**	**3,069**	**28,272**

Adjustments from General Fund to arrive at the Comprehensive Income and Expenditure Statement Amounts	Adjustments for Capital Purposes	Net change for the pension adjustments	Other Differences	2015/16 Total Adjustments
	£000	£000	£000	£000
Service				
Management	71	47	-30	88
Children's Services	10	0	-119	-109
Communities and Economy	7	478	-78	407
Education	11,658	2,915	-377	14,196
Adult Social Care	628	644	-307	965
Customer and Housing Services	362	218	-108	472
Commercial Services	5,025	679	-219	4,475
Finance and Integrated Service Support	590	-369	-231	-10
Properties and Facilities Management	4,159	0	-356	3,803
Housing Revenue Account	15,565	0	0	15,565
Joint Boards	0	0	0	0
Non-Distributed Costs	0	0	-92	-92
Net Cost of Services	**38,075**	**4,612**	**-1,917**	**40,770**
Other income and expenditure from the Expenditure and Funding Analysis	**-26,884**	**0**	**-7**	**-26,891**
Difference between General Fund Surplus or Deficit and Comprehensive Income and Expenditure Statement Surplus or Deficit on the Provision of Services	**11,191**	**4,612**	**-1,924**	**13,879**

6. Adjustments between accounting basis and funding under regulations

This note details the adjustments that are made to the total Comprehensive Income and Expenditure Statement recognised by the Council in the year in accordance with proper accounting practice to the resources that are specified by statutory provisions as being available to the Council to meet future capital and revenue expenditure.

2015/16	**General Fund Reserve £000**	**HRA Balance £000**	**Capital Fund £000**	**Usable Capital Receipts Reserve £000**	**Total Useable Reserves £000**	**Movement in Unusable Reserves £000**
Adjustments Primarily involving the Capital Adjustment Account						
Reversal of items debited or credited to the CIES						
Charges for depreciation of non-current assets	(25,444)	(6,737)	0	0	**(32,181)**	**32,181**
Amortisation of intangible assets	(115)	0	0	0	**(115)**	**115**
Revaluation losses on PPE and assets held for sale	3,050	(8,827)	0	0	**(5,777)**	**5,777**
Net gain or loss on sale of non-current assets	(1,103)	273	0	0	**(831)**	**831**
Statutory Provision for the financing of capital investment	5,040	3,283	0	0	**8,323**	**(8,323)**
Adjustments primarily involving the Capital Grant Unapplied Account						
Application of grants to capital financing transferred to the CAA	22,627	0	0	0	**22,627**	**(22,627)**
Adjustments primarily involving the Capital Fund						
Disposal of Non-Current Assets / Capital Sales	0	0	0	(525)	**(525)**	**525**
Transfer of cash sale proceeds credited as part of the gain / loss on disposal of non-current assets	0	0	(525)	525	**0**	**0**

Adjustments involving the Financial Instruments Adjustment Account						
Amount by which finance costs charged are different from finance costs chargeable in year in accordance with statutory requirements	7	0	0	0	**7**	**(7)**
Adjustments primarily involving the pensions reserve						
Reversal of items relating to retirement benefits debited or credited to the CIES	(19,530)	(653)	0	0	**(20,183)**	**20,183**
Employers Pension contributions and direct payments to pensioners payable in the year	11,800	0	0	0	**11,800**	**(11,800)**
Adjustments primarily involving the Employee Statutory Adjustment Account						
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	1,917	0	0	0	**1,917**	**(1,917)**
Total Adjustments	**(1,751)**	**(12,661)**	**(525)**	**0**	**(14,937)**	**14,937**

2016/17	General Fund Reserve £000	HRA Balance £000	Capital Fund £000	Usable Capital Receipts Reserve £000	Total Useable Reserves £000	Movement in Unusable Reserves £000
Adjustments Primarily involving the Capital Adjustment Account						
Reversal of items debited or credited to the CIES						
Charges for depreciation of non-current assets	-27,894	-7,098	0	0	**-34,992**	**34,992**
Amortisation of intangible assets	-187	0	0	0	**-187**	**187**
Revaluation losses on PPE and assets held for sale	-1,449	-12,388	0	0	**-13,836**	**13,836**
Net gain or loss on sale of non-current assets	51	1,804	0	0	**1,855**	**-1,855**
Statutory Provision for the financing of capital investment	4,840	3,661	0	0	**8,501**	**-8,501**
net revenue expenditure financed from capital under statute (REFFCUS)	-22	0	0	0	**-22**	**22**
Adjustments primarily involving the Capital Grant Unapplied Account						
Application of grants to capital financing transferred to the CAA	19,516	0	0	0	**19,516**	**-19,516**
Adjustments primarily involving the Capital Fund						
Disposal of Non-Current Assets / Capital Sales	0	0	-13,089	5,983	**-7106**	**7,106**
Transfer of cash sale proceeds credited as part of the gain / loss on disposal of non-current assets	0	0	5,983	-5,983	**0**	**0**

Adjustments involving the Financial Instruments Adjustment Account						
Amount by which finance costs charged are different from finance costs chargeable in year in accordance with statutory requirements	8	0	0	0	**8**	**(8)**
Adjustments primarily involving the pensions reserve						
Reversal of items relating to retirement benefits debited or credited to the CIES	-17,729	-254	0	0	**-17,983**	**17,983**
Employers Pension contributions and direct payments to pensioners payable in the year	12,452	0	0	0	**12,452**	**-12,452**
Adjustments primarily involving the Employee Statutory Adjustment Account						
Amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements	-3,077	0	0	0	**-3,077**	**3,077**
Total Adjustments	**-13,492**	**-14,275**	**-7,106**	**0**	**-34,871**	**34,871**

7. Non-distributable costs

2015/16		2016/17
£000		**£000**
1,409	Pension Costs	1,449
1,409	**Total Non-distributable Costs**	**1,449**

8. Other operating income and expenditure

2015/16		2016/17
£000		**£000**
831	(Surplus)/Deficit on sale of non current assets	(1,855)
831	**Total Other Operating Income and Expenditure**	**(1,855)**

9. Financing and investing income and expenditure

2015/16		2016/17
£000		**£000**
13,292	Interest payable and similar charges	13,983
3,771	Pension interest cost on defined benefit obligation and interest income on plan assets	2,437
(735)	Interest received and similar income	(1,505)
0	Investment Losses	0
16,328	**Total**	**14,915**

10. Taxation and specific grant income

2015/16		2016/17
£000		**£000**
35,364	Council Tax Income	36,415
32,821	Non Domestic Rates Income	31,945
123,420	Non-Specific Government Grants	119,976
18,729	Capital grants	14,229
210,334	**Total Taxation and Non-Specific Grant Income**	**202,565**

11. Movement in non-current assets, property, plant and equipment

The Council carries out a rolling programme which ensures that the Property, Plant and Equipment required to be measured at current value, Council Dwellings, Land and Buildings and Surplus Assets, undergoes revaluation at least every five years. Professionally qualified valuers (RICS: Royal Institute of Chartered Surveyors) employed within the Council's Asset Management Team carry out valuations of all property-based assets held by the Council

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	£000	£000	£000	£000	£000	£000	£000	£000
Cost or Valuation as at 31 March 2015	**298,551**	**283,423**	**16,557**	**25,226**	**54,838**	**7,893**	**7,187**	**9,390**	**703,065**
Additions	6,084	3,104	0	2,896	4,017	0	15,352	21	31,474
Disposals	(1,792)	(1,282)	(558)	(1,099)	0	0	0	0	(4,731)
Reclassification	6,746	(704)	(1,285)	0	0	0	(6,392)	0	(1,635)
Revaluation to I&E	(8,783)	4,001	(876)	0	0	0	0	(119)	(5,777)
Revaluation to Revaluation Reserve	8	17,988	1,436	0	0	(206)	0	(1,205)	18,021
Gross Book value at 31 March 2016	**300,814**	**306,530**	**15,274**	**27,023**	**58,855**	**7,687**	**16,147**	**8,087**	**740,417**

Depreciation as at 31 March 2015	**(20,232)**	**(26,916)**	**0**	**(16,133)**	**(28,271)**	**(221)**	**0**	**2**	**(91,771)**
Depreciation Charge for the Year	(6,643)	(19,805)	0	(2,602)	(3,077)	(55)	0	0	(32,182)
Disposals	222	313	0	998	0	0	0	0	1,533
Revaluation to Revaluation Reserve Depreciation	0	22,907	0	0	0	0	0	0	22,907
Depreciation as at 31 March 2016	**(26,653)**	**(23,501)**	**0**	**(17,737)**	**(31,348)**	**(276)**	**0**	**2**	**(99,513)**
Net book value as at 31 March 2015	**278,319**	**256,507**	**16,557**	**9,093**	**26,567**	**7,672**	**7,187**	**9,392**	**611,294**
Net book value as at 31 March 2016	**274,161**	**283,029**	**15,274**	**9,286**	**27,507**	**7,411**	**16,147**	**8,089**	**640,904**

	Houses	Buildings	Land	Vehicles, Plant & Equipment	Infrastructure Assets	Community Assets	Under Construction	Surplus Assets	Total
	£000	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
Cost or Valuation as at 31 March 2016	**300,814**	**306,530**	**15,274**	**27,023**	**58,855**	**7,687**	**16,147**	**8,087**	**740,417**
Additions	8,170	2,447	35	3,207	3,628	346	31,229	26	49,088
Disposals	(4,422)	(214)	(315)	(1,050)	0	0	0	0	(6,001)
Reclassification	11,783	503	(5,720)	0	0	0	(5,866)	(700)	0
Revaluation to I&E	(11,542)	(292)	(2,600)	0	0	(11)	0	0	(14,445)
Revaluation to Revaluation Reserve	(846)	(7,191)	4,634	0	0	(363)	0	(1,400)	(5,166)
Gross Book value at 31 March 2017	**303,957**	**301,783**	**11,308**	**29,180**	**62,483**	**7,659**	**41,510**	**6,013**	**763,893**
Depreciation as at 31 March 2016	**(26,653)**	**(23,501)**	**0**	**(17,737)**	**(31,348)**	**(276)**	**0**	**2**	**(99,513)**
Depreciation Charge for the Year	(7,098)	(20,931)	0	(2,885)	(3,345)	(534)	0	(696)	(35,489)
Disposals	243	0	0	946	0	0	0	0	1,189
Reclassification	0	0	0	0	0	0	0	0	0
Revaluation to I&E Depreciation	0	457	0	0	0	0	0	650	1,107
Revaluation to Revaluation Reserve Depreciation	133	20,046	0	0	0	330	0	0	20,509
Depreciation as at 31 March 2017	**(33,375)**	**(23,929)**	**0**	**(19,676)**	**(34,693)**	**(480)**	**0**	**(44)**	**(112,197)**
Net book value as at 31 March 2016	**274,161**	**283,029**	**15,274**	**9,286**	**27,507**	**7,411**	**16,147**	**8,089**	**640,904**
Net book value as at 31 March 2017	**270,582**	**277,854**	**11,308**	**9,504**	**27,790**	**7,179**	**41,511**	**5,969**	**651,696**

12. Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the Council as a result of past events (eg software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the Council.

Internally generated assets are capitalised where it is demonstrable that the project is technically feasible and is intended to be completed and the Council will be able to generate future economic benefits or deliver service potential by being able to sell or use the asset. Expenditure is capitalised where it can be measured reliably as attributable to the asset and is restricted to that incurred during the development phase.

Intangible assets are measured initially at cost. Amounts are only revalued where the fair value of the assets held by the Council can be determined by reference to an active market. In practice, no intangible asset held by the Council meets this criterion, and they are therefore carried at amortised cost. The depreciable amount of an intangible asset is amortised over its useful life to the relevant service line(s) in the CIES. An asset is tested for impairment whenever there is an indication that the asset might be impaired – any losses recognised are posted to the relevant service line(s) in the CIES. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the CIES.

Software licences are held for a number of systems operated by the Council which cost £1.595 million (2015/16 £1.429 million). This cost is being written off over 3 or 5 years depending on the life of the licence. A total of £1.174 million has been written off (2015/16 £0.987 million).

The Council is required to participate in the Carbon Reduction Commitment Energy Efficiency Scheme. The Council is required to purchase allowances either prospectively or retrospectively, and surrender them on the basis of emissions. The Council currently holds £0.345 million of allowance as intangible assets (2015/16 £0.631 million), all of which were purchased as additions during 2014/15. £0.286 of the original allowances was surrendered in line with the scheme during the year.

2015/16		**2016/17**
£000		**£000**
2,059	**Gross carrying amount at start of year**	**2061**
(872)	Accumulated amortisation	(988)
1,187	**Net carrying amount at the start of year**	**1,073**
313	Additions – purchased	166
0	Disposals	0
(312)	Surrender of CRC Allowance	(286)
(115)	Amortisation	(187)
1,073	**Net Book Value at Year End**	**766**

13. Movement in assets held for sale

2015/16		2016/17
£000		**£000**
800	**Balance Outstanding as at 1 April**	**2,535**
1,635	Transfers from Non Current Assets during the year	0
100	Revaluations and Restatements	0
0	Additions	40
0	Impairments	0
0	Assets declassified as held for sale	0
0	Asset Disposal - Other	-625
2,535	**Balance Outstanding as at 31 *M*arch**	**1,950**

All assets included above would come under the fair value hierarchy category of Level 2 – Fair Value measured using inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly.

14. Heritage assets

The Council's chain of office is the main heritage asset and has been included in the Balance Sheet at reinstatement cost, obtained from the Council's insurer. There has been expenditure of £0.041 million on heritage assets. Heritage assets are valued at £0.068 million (2015/16 £0.027 million).

15. Financial instruments

The code requires that financial instruments are to be shown at fair value which is defined as the amount for which an asset could be exchanged for or a liability settled, assuming the transaction was negotiated between parties knowledgeable about the market in which they are dealing and willing to buy / sell at an appropriate price, with no other motive in their negotiations other than to secure a fair price.

The Council has adopted CIPFA's Treasury Management in the Public Services Code of Practice and set treasury management indicators to control key financial instrument risks in accordance with CIPFA's Prudential Code.

Financial Instrument Balances

31 March 2016 Long Term £000	31 March 2016 Current £000		31 March 2017 Long Term £000	31 March 2017 Current £000
		Financial Liabilities		
198,917	41,073	External Borrowings at amortised cost	208,816	51,270
54,972	1,208	PPP Liability (see Note 33)	53,659	1,313
0	16,070	Creditors	0	15,960
253,889	**58,351**	**Total Financial Liabilities**	**262,475**	**68,543**
		Financial Assets		
0	55,007	Loans and Receivables	0	65,072
5,189	0	Available-for-sale Financial Assets	4,935	0
0	10,710	Cash and Cash Equivalents (see Note 18)	0	10,894
0	10,363	Debtors	0	10,458
5,189	**76,080**	**Total Financial Assets**	**4,935**	**86,424**

Long Term borrowing as shown in the Balance Sheet of £208.816 million fully comprises principal to be repaid later than 12 months (PWLB Maturity Loans of £187.225 million, PWLB Annuity Loans of £0.708 million, LOBO Loans of £20.606 million and Salix Loans of £0.277 million). Lender Option Borrower Options (LOBO's) of £20.606 million have been included in long term borrowing (inclusive of the Effective Interest Rate adjustment), this reflecting the contractual period to maturity for these instruments, given the unlikelihood of call within the next 12 months.

Short Term borrowing as shown in the Balance Sheet of £51.270 million comprises accrued interest of £2.169 million, the LOBO Effective Interest Rate adjustment to be amortised in 2017/18 of £0.008 million and principal to be repaid within 12 months of £49.093 million (£39.000 million Temporary Loans; £10.000 million PWLB Maturities; £0.062 million Salix Loan, £0.031 million PWLB Annuities).

Gains and Losses on Financial Instruments

There were no gains on Available for Sale Financial Assets recognised in the Comprehensive Income and Expenditure Statement for the year.

Total Interest Income/Expense

Total interest income and total interest expense (calculated using the effective interest method) for financial assets and liabilities that are not at fair value through profit or loss for 2016/17 was £7.822 million [equating to £8.476 million interest paid on external borrowings less £0.654 million interest received on loans and receivables and cash and cash equivalents].

Fee Income and Expense

Total fee expense for financial assets and liabilities that are not at fair value through profit or loss for 2016/17 was £0.107 million.

Fair Value of Assets and Liabilities Carried at Amortised Cost

The fair value of each class of financial assets and liabilities which are carried in the balance sheet at amortised cost is disclosed below.

The fair value of an instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms-length transaction. It is determined by calculating the Net Present Value (NPV) of future cash flows, which provides an estimate of the value of payments in the future in today's terms.

The discount rate used in the NPV calculation is the rate applicable in the market on the date of valuation for an instrument with the same structure, terms and remaining duration. For debt, this will be the new borrowing rate since premature repayment rates include a margin which represents the lender's profit as a result of rescheduling the loan; this is not included in the fair value calculation since any motivation other than securing a fair price should be ignored.

The rates quoted in this valuation were obtained by Capita, the Council's treasury management consultants, from the market on 31 March 2017.

The calculations are made with the following assumptions:

- Fair values have been calculated for all financial instruments in the portfolio;
- The fair value of trade and other receivables is taken to be the invoiced or billed amount.
- Interpolation techniques have been used between available rates where the exact maturity period was not available;
- The valuation of Loans Receivable is made by utilisation of the prevailing benchmark market rates;
- The valuation of fixed term deposits (maturity investments) is made by comparison of the fixed term investment with a comparable investment with the same/similar lender for the remaining period of the deposit;
- For PWLB debt, the discount rate used is:-
    - the "Standard New Loan Rate (net of certainty rate discount) for new borrowing ["Fair Value (New Loan)" column of table below]; and
    - the Premature Repayment Rate ["Fair Value (Premature Redemption)" column of table below]; as per rate sheet number 128/17 issued by PWLB on 31 March 2017;
- For Fixed Rate market debt the discount rate used is:-
    - the New market Loan Rate for an instrument with the same terms from a comparable lender ["Fair Value (New Loan)" column of table below]; and
    - the Premature Repayment Rate ["Fair Value (Premature Redemption)" column of table below]; as per rate sheet number 128/17 issued by PWLB on 31 March 2017;
- For non-fixed rate LOBO debt the discount rate used is:-
    - The relevant Gilt Rate plus 70 basis points ["Fair Value (New Loan)" column of table below]; and
    - the Premature Repayment Rate ["Fair Value (Premature Redemption)" column of table below]; as per rate sheet number 128/17 issued by PWLB on 31 March 2017; For PWLB debt, the discount rate used is:-

Fair values of financial liabilities (where available) are calculated as:

31 March 2016				31 March 2017					
Carrying Amount	**(a) Fair Value**	**(b) Fair Value**	**Liability**	**Principal Outstanding**	**Add LOBO Accounting Adjustment**	**Add Accrued Interest**	**Carrying Amount**	**(a) Fair Value (New Loan)**	**(b) Fair Value (Premature Redemption**
£000	**£000**	**£000**		**£000**	**£000**	**£000**	**£000**	**£000**	**£000**
181,804	215,897	249,548	PWLB	197,963	0	1,895	199,858	249,228	292,610
20,899	26,657	33,354	LOBO	20,000	614	271	20,885	31,707	38,458
36,886	36,886	36,891	Short Term Borrowing	39,000	0	4	39,004	39,001	39,006
400	355	388	Salix	339	0	0	339	318	331
239,989	**279,795**	**320,181**	**Total**	**257,302**	**614**	**2,170**	**260,086**	**320,254**	**370,405**

Fair values of assets are calculated as:

31 March 2016			31 March 2017			
Carrying Amount	**Fair Value**	**Investments**	**Principal Advanced**	**Add Accrued Interest**	**Carrying Amount**	**Fair Value**
£000	**£000**		**£000**	**£000**	**£000**	**£000**
10,710	10,710	Cash and Cash Equivalents	10,794	100	10,894	10,895
55,007	55,049	Short Term Investments	64,985	87	65,072	65,060
65,717	**65,759**	**Total**	**75,779**	**187**	**75,966**	**75,955**

Nature and extent of risks arising from Financial Instruments

The Council's management of treasury risks actively works to minimize the Council's exposure to the unpredictability of financial markets and to protect the financial resources available to fund services.

The Council has fully adopted CIPFA's Code of Treasury Management Practices and has written principles for overall risk management as well as policies and procedures covering specific areas such as credit risk, liquidity risk and market risk.

Credit Risk

Credit risk arises from the short-term lending of surplus funds to banks, building societies and other local authorities as well as credit exposures to the Council's customers. It is the policy of the Council to place deposits only with a limited number of banks and building societies whose credit rating is independently assessed as sufficiently secure by the Council's treasury advisers and to restrict lending to a prudent maximum amount for each institution. The Council also has a policy of limiting deposits to £15 million per institution, other than for UK Nationalised and Part Nationalised institutions where this maximum is extended to £30 million.

The following analysis summarises the Council's potential maximum exposure to credit risk based on past experience and current market conditions. No credit limits were exceeded during the financial year and the Council expects full repayment on the due date of deposits placed with its counterparties.

	Amounts at 31 March 2017	Historical experience of default	Historical experience adjusted for market conditions as at 31 March 2017	Estimated maximum exposure to default and non collectable amounts
	£000	**%**	**%**	**£000**
Cash & Cash Equivalents & Short Term Investments	83,808	0	0	0

No credit limits were exceeded during the reporting period and the Council does not expect any losses from non-performance by any of its counterparties in relation to deposits.

An age analysis of cash and cash equivalents and short term investments is shown in the table below:-

Age Analysis

31 March 2016		31 March 2017
£000		**£000**
10,710	Less than 3 months	18,735
25,001	3 to 6 months	35,069
30,006	6 months to 1 year	30,004
0	More than 1 year	0
65,717	**Total**	**83,808**

Liquidity Risk

The Council has access to a facility to borrow from the PWLB. As a result there is no significant risk that the Council will be unable to raise finance to meet its commitments under financial instruments.

Furthermore, the Council has safeguards in place to ensure that a significant proportion of its borrowing does not mature for repayment at any one time in the future to reduce the financial impact of re-borrowing at a time of unfavourable interest rates.

An age analysis of external borrowings is shown in the table below:-

Age Analysis

31 March 2016		31 March 2017
£000		£000
38,970	Less than 1 year	49,031
10,093	1 to 2 years	10,034
27,096	2 to 5 years	17,733
2,798	5 to 10 years	2,256
51,632	10 to 20 years	55,665
4,100	20 to 30 years	0
60,700	30 to 40 years	80,534
36,883	40 to 50 years	37,049
5,000	Greater than 50 years	5,000
237,272	**Total**	**257,302**

Market Risk

The Council is exposed to interest rate risk in two different ways; the first being the uncertainty of interest paid or received on variable rate instruments, and the second being the effect of fluctuations in interest rates on the fair value of an instrument.

The current interest rate risk for the council is summarised below:

- Decreases in interest rates will affect interest earned on variable rate investments, potentially reducing income credited to the CIES;
- Increases in interest rates will affect interest paid on variable rate borrowings potentially increasing interest expense charged to the CIES. However, the Council has partially hedged against this risk for an element of its loan portfolio by entering into two forward starting loan transactions, where loans will be drawn at pre-defined future dates and where the interest rate was fixed at the point of execution of the loans in February 2016. The first of these loans will be drawn in June 2017 and the second in November 2018;
- The fair value of fixed rate financial assets will fall if interest rates rise. This will not impact on the balance sheet or the CIES for the majority of assets held at amortised cost, but will impact on the disclosure note for fair value. It would have a negative effect on the balance sheet for those assets shown on the balance sheet at fair value;
- The fair value of fixed rate financial liabilities will rise if interest rates fall. This will not impact on the balance sheet or CIES for the majority of liabilities held at amortised cost, but will impact on the disclosure note for fair value.

The Council has a number of strategies for managing interest rate risk. Policy is to aim to keep a maximum of 30% of its borrowings in variable rate loans. During periods of falling interest rates, and where economic circumstances make it favourable, fixed rate loans will be repaid early to limit exposure to losses.

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget and which is used to update the budget quarterly during the year. This allows any adverse changes to be accommodated. The analysis will also advise whether new borrowing taken out is fixed or variable.

According to this assessment strategy, at 31 March 2017, if interest rates had been 1% higher with all other values held constant, the financial effect would have been:

Interest Rate Risk

	£000	£000
Increase in interest payable on variable rate borrowings	419	
Increase in interest receivable on variable rate instruments	(845)	
Increase in government grant receivable for financing costs	0	
Impact on CIES	**(426)**	
Share of overall impact credited to the HRA	**(250)**	

	A	B
Decrease in fair value of fixed rate investment assets (no impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive income & Expenditure)	**(1)**	**(1)**
Decrease in fair value of fixed rate borrowing liabilities (no impact on the Surplus or Deficit on the Provision of Services or Other Comprehensive income & Expenditure)	**(41,628)**	**(54,080)**

Note: Column A reflects the decrease in fair value of fixed rate investment assets & borrowing liabilities using the “New Loan” rate measurement of Fair Value. Column B reflects the decrease in fair value of fixed rate investment assets & borrowing liabilities using the “Premature Repayment” rate measurement of Fair Value.

The impact of a 1% fall in interest rates would be as above but with the movements being reversed.

Price Risk

The Council has a 5.5% shareholding in Lothian Buses which is available for sale to other company shareholders. The Council also have a 10% pin-point equity stake in the Newbattle DBFM Co. There is no price risk associated with either of these.

Foreign Exchange Risk

The Council has no financial assets or liabilities denominated in foreign currencies so has no exposure to loss arising from movements in exchange rates.

16. Long Term Investments

Midlothian Council holds a 5.5% shareholding in Lothian Buses plc, a company incorporated in January 1986 under the terms of the Transport Act 1985 to operate buses in the City of Edinburgh and its surrounding area.

The valuation basis for the Council's shareholding (350,000 £1 ordinary shares) is calculated as net share of assets. In line with the published results of Lothian Buses this resulted in a reduction in the value of the investment of £0.254 million, from £5.189 million in 2015/16 to £4.935 million in 2016/17.

The most recent published results of the company are as follows:-

Year to 31 December 2015		**Year to 31 December 2015**
£000		**£000**
142,453	Turnover	146,915
8,958	Profit before taxation	13,995
(2,525)	Taxation	(2,013)
6,433	Profit after taxation	11,982
5,494	Ordinary dividend	6,592
33,045	Transfer to / (from) reserves	(4,645)
94,870	**Net assets at end of year**	**90,225**

17. Debtors

The debtors balance consists primarily of debts in respect of Council Tax, House Rents and other recoverable accounts.

Short Term Debtors

2015/16	2015/16		2016/17	2016/17
£000	£000		£000	£000
28,898		Council Tax and Community Charge	29,539	
(26,609)		Less: bad debt provision	(27,590)	
	2,289			1,949
	2,539	Central Government Bodies		4,766
	1,296	Other Local Authorities		208
	-7	Public Corporations and Trading Funds		0
	0	NHS Bodies		1,097
	2,668	Rents		2,625
15,366		Grants, External Debtor accounts and other Income due	15,260	
(5,859)		Less: bad debt provision	(6,264)	
	9,507			8,996
	18,292	**Net Debtors**		**19,641**

Long Term Debtors

2015/16		2016/17
£000		£000
3,607	Prepayment to PPP Contractor	3,100
32	Pacific Shelf	36
3,639	**Total Long Term Debtors**	**3,136**

18. Cash and cash equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are investments that mature in three months or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

Cash and cash equivalents at the end of the reporting period as shown in the statement of cash flows can be reconciled to the related items in the Balance Sheet as follows:

2015/16		2016/17
£000		**£000**
53	Cash and Bank Balances	54
13,368	Short Term Deposits Considered to be Cash Equivalents	18,681
(2,711)	Bank Overdraft	(7,841)
10,710	**Total Cash and Cash Equivalents**	**10,894**

19. Creditors

The creditors balance consists primarily of amounts due in respect of payroll costs, external interest payments and other sundry creditors.

2015/16		2016/17
£000		**£000**
5,234	Payroll Costs Due	2,601
3,291	Accumulated Absences	6,368
(255)	Central Government Bodies	1,631
368	Other Local Authorities	425
0	NHS Bodies	71
4	Public Corporations and Trading Funds	0
(3,098)	NDR/Council Tax	735
15,588	Trade Crebtors	15,467
2,615	Other Entities and Individuals	1,700
23,747	**Total Creditors**	**28,998**

20. Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the Council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the CIES in the year that the Council becomes aware of the obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

A provision for potential uninsured losses arising from claims is also made and this amounted to £1.431 million at 31 March 2017 (2015/16 £1.640 million) and is shown in other provisions.

21. Other long term liabilities

2015/16 £000		2016/17 £000
68,145	Net Pension Liabilities	118,041
54,971	PPP Liabilities	53,657
8,193	Borders Railway liability	8,193
131,309	**Total Long Term Liabilities**	**179,891**

The Borders Railway opened to the public on Sunday 6th September 2015 running from Tweedbank in the Scottish Borders through Midlothian to Waverley Station in Edinburgh. There are four stations in Midlothian at Gorebridge, Newtongrange, Eskbank and Shawfair. Midlothian's contribution to the project was capped at £11.673 million, of which £3.209 million is an in-kind contribution and £8.464 million (at 2012 prices and subject to BCIS inflation) is payable to the Scottish Government in planned instalments over the coming years. At the Balance Sheet date the indexed value of future year payments is £9.273 million. £1.080 million has been collected leaving a further liability of £8.193 million. This has been recognised as a prior-year adjustment in the accounts. Further contributions totalling £5.464 million have been secured through legally binding Section 75 planning agreements. This would leave a potential liability to the Council of £2.729 million at the Balance Sheet date. This balance, whilst not underpinned by legal agreements is however secured though the Midlothian Local Development Plan and associated supplementary guidance which stipulates the sites for which a contribution from housing developers to Borders Railway will apply.

22. Usable reserves

Reserves are created by appropriating amounts out of the General Fund Balance in the Movement in Reserves Statement. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus or Deficit on the Provision of Services in the CIES. The reserve is then appropriated back into the General Fund Balance in the Movement in Reserves Statement so that there is no net charge against Council tax for the expenditure.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, retirement and employee benefits and do not represent usable resources for the Council – these reserves are explained in the relevant policies.

The Council operates a Capital Fund under the terms of Schedule 3 to the Local Government (Scotland) Act 1975 and an Insurance Fund in accordance with Schedule 13 of the Local Government etc. (Scotland) Act 1994.

Movement in the Council's usable reserves are detailed in the Movement in Reserves Statement and in note 6.

31 March 2016 £000		**31 March 2017 £000**
(24,625)	General Fund Reserve	(17,651)
(24,913)	HRA Balance	(29,753)
(15,378)	Capital Fund	(16,707)
(3,607)	Repairs and Renewals Fund	(3,100)
(68,523)	**Total Usable Reserves**	**(67,211)**

23. Unusable reserves

31 March 2016 £000			**31 March 2017 £000**
(208,227)	22.1	Capital Adjustment Account	(202,329)
(117,635)	22.2	Revaluation Reserve	(118,403)
68,145	22.3	Pension Reserve	118,041
3,291	22.4	Employee Statutory Adjustment Account	6,368
2,667	22.5	Financial Instruments Adjustment Account	2,500
(4,839)	22.6	Available for Sale Financial Instruments Reserve	(4,585)
(256,598)		**Total Unusable Reserves**	**(198,408)**

23.1 Capital Adjustment Account

The Capital Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for the consumption of non-current assets and for financing the acquisition, construction or enhancement of those assets under statutory provisions. The account is debited with the cost of acquisition, construction or enhancement as depreciation, impairment losses and amortisations are charged to the Comprehensive Income and Expenditure Statement (with reconciling postings from the Revaluation Reserve to convert fair value figures to a historical cost basis). The account is credited with the amounts set aside by the Council as finance for the costs of acquisition, construction and enhancement.

The Account also contains revaluation gains accumulated on property, plant and equipment before the 1st of April 2007, the date that the Revaluation Reserve was created to hold such gains.

Note 6 provides further details of transactions posted to the Account.

2015/16		2016/17
£000		**£000**
(204,047)	**Restated Balance at 1st April**	**(208,227)**
	Reversal of items relating to capital expenditure debited or credited to the Comprehensive Income and Expenditure Statement:	
32,182	- Charges for Depreciation of non-current assets	34,992
5,777	- Charges for Downward Revaluation of non-current assets	13,837
115	- Amortisation of intangible assets	187
4,731	- PPE non-current assets written off on disposal or sale	6,001
(1,533)	- PPE depreciation written off on disposal or sale	(1,189)
0	- AHFS non-current assets written off on disposal or sale	0
(487)	- Adjusting amount written out to Revaluation reserve	(13,907)
(12,170)	- Accumulated gains on assets sold or scrapped	
0	Net revenue expenditure financed from capital under statute (REFFCUS)	22
	Other movements	(45)
(175,432)	**Net written out amount of the cost of non-current assets consumed in year**	**(168,329)**
	Capital Financing for the year:	
(1,843)	- Use of Capital Receipts to finance new Capital expenditure	(5,983)
(22,627)	- Capital Grants and Contributions credited to the CIES	(19,516)
(8,325)	- Statutory Provision for the financing of capital investment	(8,501)
0	- Capital expenditure charged against the General Fund and HRA	0
0	- Application of grants to capital financing from the Capital Grants Unapplied Account	0
0	- Capital Grants and Contributions moved to the Capital Grants Unapplied Account	0
(208,227)	**Balance at 31st March**	**(202,329)**

23.2 Revaluation Reserve

The Revaluation Reserve contains the gains made by the Council arising from increases in the value of its Property, Plant and Equipment (and Intangible Assets). The balance is reduced when assets with accumulated gains are revalued downward or impaired and the gains are lost, used in the provision of services and the gains are consumed through depreciation, or disposed of and the gains are realised. The reserve contains only revaluation gains accumulated since 1st April 2007, the date that reserve was created. Accumulated gains arising before that date are consolidated into the balance on the Capital Adjustment Account.

2015/16		2016/17
£000		**£000**
(89,266)	**Restated Balance at 1st April**	**(117,635)**
(40,937)	(Upward) / downward Revaluation of Assets	5,367
12,080	Downward revaluation of assets and impairment losses not charged to the Surplus / (Deficit) on the provision of services	-20,510
	Adjusting amount from Capital Adjustment Account	13,907
488	Accumulated losses on assets sold	423
0	Other movements	45
(117,635)	**Balance at 31st March**	**(118,403)**

23.3 Pension Reserve

The Pension Reserve absorbs the timing differences arising from the different arrangements for accounting for post employment benefits and for funding benefits in accordance with statutory provisions. The Council accounts for post employment benefits in the CIES as the benefits earned by employees accruing years of service, updating the liabilities recognised to reflect inflation, changing assumptions and investment returns on any resources set aside to meet the costs. However, statutory arrangements require benefits earned to be financed as the Council makes employer's contributions to pension funds or eventually pays any pensions for which it is directly responsible. The debit balance on the Pension Reserve therefore shows a substantial shortfall in the benefits earned by past and current employees and resources the Council has set aside to meet them. Statutory arrangements will ensure that funding will have been set aside by the time benefits come to be paid.

2015/16		2016/17
£000		**£000**
115,549	**Balance at 1st April**	**68,145**
	Return on Pension Assets	
(55,787)	Actuarial (gains) / losses arising on changes in financial assumptions	44,365
	Actuarial (gains) / losses arising from other experience	
20,183	Reversals of items relating to retirement benefits debited or credited to the surplus or deficit on the provision of services in the CIES	17,983
(11,800)	Employer's pension contributions	(12,452)
68,145	**Balance at 31st March**	**118,041**

23.4 Employee Statutory Adjustment Account

The Employee Statutory Adjustment Account absorbs the differences that would otherwise arise on the General Fund Balance from accruing for compensated absences earned but not taken in the year. An example of this is annual leave entitlement carried forward at 31st March. Statutory arrangements require that the impact on the General Fund Balance is neutralised by transfers to or from the account. The amount by which officer remuneration charged to the CIES on an accruals basis is different from remuneration chargeable in the year in accordance with statutory requirements was £3.078 million (2015/16 £1.197 million).

2015/16		2016/17
£000		£000
5,208	**Balance at 1st April**	**3,291**
(5,208)	Settlement or cancellation of accrual made at end of preceding year	(3,291)
3,291	Amounts accrued at the end of the current year	6,368
3,291	**Balance at 31st March**	**6,368**

23.5 Financial Instruments Adjustment Account

The Financial Instruments Adjustment Account absorbs the timing differences arising from the different arrangements for accounting for income and expenses relating to certain financial instruments and for bearing losses or benefiting from gains per statutory provisions.

2015/16		2016/17
£000		£000
2,876	**Balance at 1st April**	**2,667**
(7)	Proportion of equivalent interest rate calculation on lender option / borrower option loans	(7)
(202)	Change in share of equivalent interest rate calculation	(160)
2,667	**Balance at 31st March**	**2,500**

23.6 Available for Sale Financial Instruments Reserve

The Available for Sale Financial Instruments Reserve contains the gains made by the Council arising from increases in the value of its investments that have quoted market prices or otherwise do not have fixed or determinable payments. The balance is reduced when investments with accumulated gains are revalued downwards and the gains are lost or disposed of and the gains are realized

2015/16		2016/17
£000		£000
(3,032)	Balance at 1st April	**(4,839)**
(1,807)	Revaluation of investments	254
(4,839)	**Balance at 31st March**	**(4,585)**

24. Cash Flow Statement – operating activities

2015/16		2016/17
£000		**£000**
7,032)	**Net surplus or (deficit) on the provision of services**	**(30,406)**
	Adjustment to surplus or deficit on the provision of services for noncash movements	
32,181	Depreciation	34,992
5,688	Impairment & downward revaluations (& non-sale derecognitions)	13,836
115	Amortisation	187
(202)	Reduction in Fair Value of non PWLB Concessionary Loans	0
451	Adjustment for internal interest charged	482
161	(Increase)/Decrease in Inventories	15
(393)	(Increase)/Decrease in Debtors	(1,164)
305	(Increase)/Decrease in Interest and Dividend Debtors	(31)
(7)	Adjustment for effective interest rates	(8)
(3,904)	Increase/(Decrease) in Creditors	5,366
50	Increase/(Decrease) in Interest Creditors	74
8,383	Movement in Pension Liability	5,531
3,198	Carrying amount of non-current assets sold	5,457
(110)	Contributions to Other Reserves/Provisions	(209)
(244)	Other non-cash movements and transfers to investing activities	(31)
45,672		**64,497**
	Adjust for items included in the net surplus or deficit on the provision of services that are investing and financing activities	
40,000	Proceeds from short-term (not considered to be cash equivalents) and long-term investments (includes investments in associates, joint ventures and subsidiaries)	40,000
(2,368)	Proceeds from the sale of PP&E, investment property and intangible assets	(7,312)
(22,627)	Capital grants included in Service expenditure and "Taxation & non-specific grant income"	(19,516)
15,005		**13,172**
53,645	**Net Cash Flows from Operating Activities**	**47,264**
	Operating activities within the cash flow statement include the following cash flows relating to interest	
779	Interest Received	262
(14,258)	Interest Paid	(13.435)
300	Dividends Received	361

25. Cash Flow Statement - investing activities

2015/16		2016/17
£000		**£000**
(31,018)	Purchase of PP&E, investment property and intangible assets	(49,459)
(54,985)	Purchase of Short Term Investments (not considered to be cash equivalents)	(50,000)
3,573	Proceeds from the sale of PP&E, investment property and intangible assets	7,141
23,713	Other Receipts from Investing Activities	26,417
(58,717)	**Net Cash flows from Investing Activities**	**(65,902)**

26. Cash Flow Statement - financing activities

2015/16		2016/17
£000		**£000**
220,269	Cash Receipts from Short and Long Term Borrowing	429,000
(1,121)	Cash payments for the reduction of the outstanding liability relating to a finance lease and on-Balance Sheet PFI contracts	(1,208)
(217,703)	Repayment of Short and Long Term Borrowing	(408,970)
1,445	**Net Cash flows from Financing Activities**	**18,822**

27. Audit fees

The anticipated fee payable to Audit Scotland in respect of external audit services undertaken in accordance with the Code of Audit Practice for 2016/17 is £0.222 million (2015/16 £0.242 million). There was additional expenditure of £49,000 in respect of non-audit services provided by the appointed auditor.

28. Capital grants received in advance

The Council has received a number of grants and contributions that have yet to be recognised as income as they have conditions attached to them that will require the monies to be returned to the grantor. All monies held in the Capital Grants Received in Advance account are as a result of developers contributions, the balances are as follows:

2015/16		2016/17
£000		**£000**
18,049	**Balance at 1April**	**16,395**
6,596	New capital grants received in advance, conditions of use not met	11,611
(8,250)	Amounts released to CIES, conditions of use met	(5,062)
16,395	**Balance at 31 March**	**22,944**

29. Related parties

The Scottish Government

The Scottish Government has significant influence over the general operations of the Council, being responsible for providing the statutory framework within which the Council operates. The Scottish Government also provides the majority of the Council's funding in the form of grants and prescribes the terms of many of the transactions that the Council has with other parties (such as Council Tax bills and Housing Benefits).

Officers

There are no related party transactions with Officers of the Council.

Elected Members

Elected members of the Council have direct control over the Council's financial and operating policies. The total of members' allowances paid in 2016/17 is shown in the Remuneration Report. There are no other related party transactions with members of the Council.

Entities Controlled or Significantly Influenced by the Council

During the year the Council entered into material transactions with the Lothian Valuation Board. This amounted £0.560 million (2015/16 £0.560 million).

Midlothian Integration Joint Board

Midlothian Integration Joint Board was established on 20 August 2015 and resources were delegated to the Board by the Council with effect from 1 April 2016. The Council delegated resources totalling £38.237m to the Board. These resources were allocated to the Council for the provision of Adult Social Care services.

The Council provides assistance in kind in terms of Board staff (Chief Officer) and administrative support for the operation of the Board. In addition no charge is made for central support functions provided over and above the resources delegated which relate specifically to Adult Social Care.

30. Capital expenditure and capital financing

The total amount of capital expenditure incurred in the year is shown in the table below (including the value of assets acquired under finance leases and PFI/PPP contracts), together with the resources that have been used to finance them.

2015/16	2015/16		2016/17	2016/17
£000	£000		£000	£000
	311,209	**Opening Capital Financing Requirement**		**310,204**
		Capital Expenditure		
31,475		Property, Plant and Equipment	54,949	
314		Intangible Assets	166	
0		Revenue Expenditure funded from capital under statute	434	
	32,313			**55,549**
		Capital Financing		
(1,843)		Capital Receipts	(11,761)	
(12,701)		Government Grants	(13,952)	
(9,926)		Contribution from Other Bodies	(5,975)	
(8,324)		Loans Fund and Lease Repayments	(8,501)	
	(33,318)			**(40,189)**
	310,204	**Closing Capital Financing Requirement**		**325,564**
	(1,005)	**Increase in Capital Financing Requirement**		**15,360**

31. Commitments under capital contracts

As at 31 March 2017, the Council was contractually committed to capital works which amounted to £10.062 million (31 March 2016 equivalent £17.194 million).

The value of work completed as at 31 March 2017 has been established using a stage of completion methodology based on Contract Administrator's Certificates obtained at year end.

The main capital contracts the Council is committed to are as follows:-

- The new Loanhead hub. £13.879 million original contractual commitment; £6.227 million remaining commitment outstanding;
- The replacement for Roslin primary school. £6.400 million original contractual commitment; £1.354 million remaining commitment outstanding;
- HRA Phase II Housing: Site 51b, Stobhill Road, Gorebridge. £3.134 million original contractual commitment; £0.861 million remaining commitment outstanding.

The total value of retentions held as at 31 March 2017 amount to £1.352 million.

32. Public-private partnership

PFI and similar contracts are agreements to receive services, where the responsibility for making available the property, plant and equipment needed to provide the services passes to the PFI contractor. As the Council is deemed to control the services that are provided under its PFI schemes, and as ownership of the property, plant and equipment will pass to the Council at the end of the contracts for no additional charge, the Council carries the assets used under the contracts on its Balance Sheet as part of Property, Plant and Equipment.

The original recognition of these assets at fair value (based on the cost to purchase the property, plant and equipment) was balanced by the recognition of a liability for amounts due to the scheme operator to pay for the capital investment.

Non-current assets recognised on the Balance Sheet are re-valued and depreciated in the same way as property, plant and equipment owned by the Council.

The amounts payable to the PFI operators each year are analysed into five elements:

- Fair value of the services received during the year – debited to the relevant service in the CIES;
- Finance cost – an interest charge of 9.69% on the outstanding Balance Sheet liability for Dalkeith Schools PPP and 7.29% for Midlothian Primary Schools, debited to the Financing and Investment Income and Expenditure line in the CIES;
- Contingent rent – increases in the amount to be paid for the property arising during the contract, debited to the Financing and Investment Income and Expenditure line in the CIES;
- Payment towards liability – applied to write down the Balance Sheet liability towards the PFI operator (the profile of write-downs is calculated using the same principles as for a finance lease);

- Lifecycle component replacement costs – proportion of the amounts payable is posted to the Balance Sheet as a prepayment and then recognised as additions to Property, Plant and Equipment when the relevant works are eventually carried out.

The Council has entered into four Public Private Partnerships.

- The first is for the provision and facilities management of the Dalkeith School Campus and is a 30 year contract with Dalkeith SPV Ltd. When the agreement ends in 2034 the Campus facilities will transfer to the Council with a guaranteed maintenance-free life of five years. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with one contract month's notice.

- The second is a contract with Midlothian Schools Ltd for the provision and facilities management of Stobhill, Gorebridge, Tynewater, Moorfoot, Loanhead and St Margaret's, Lawfield and Strathesk Primary Schools. When the agreement ends in 2037 the facilities will transfer to the Council in a useable condition as defined by the contract. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with 6 months notice.

- The third is for the provision and lifecycle maintenance of the Newbattle Centre and is a 25 year contract with hubCo. The contract is currently in the construction phase with an anticipated opening date of 31 March 2018. When the agreement ends in 2043 the facilities will transfer to the Council in a useable condition as defined by the contract. The contractor does not have any right of renewal on contract expiry. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with variable notice periods as defined in the contract.

- The fourth is for the provision of a food waste treatment plant at Millerhill, jointly procured between Midlothian and the City of Edinburgh Council. The contract is for 20 years and at the end of the concession period in 2036, the asset will not revert back to the partner Councils and will remain under the full control of the DBFO operator, who has the option to continue to operate the asset from year 20 through to year 40, paying a market rent for the lease of the land over this period. At the end of the 40th year, the asset will be decommissioned and the decommissioned site shall be transferred back to the ownership of the Councils. Termination of contract is either at contract end date or following the issue of a contractor default notice or voluntary termination with 40 days notice.

The assets used to provide the services at the Dalkeith Schools Community Campus and the Primary Schools PPP are recognised in the Council's Balance Sheet under the Property, Plant and Equipment category.

The value of assets held under PFI arrangements at 31 March 2017 is £65.388 million (2015/16 £65.369 million). The movement is in year depreciation of £1.237 million, written back depreciation on revaluation £2.929 million, revaluation £1.718 million and additions £0.045 million (2015/16 £1.167 million depreciation, £2.899 written back depreciation, £5.111 million revaluation and £0.035 million additions). There is a deferred liability at 31 March 2017 for the financing of these assets of £54.972 million (2015/16 £56.180 million). Details of payments to be made under PFI arrangements are:

During the year a total of £1.208 million (2015/16 £1.121 million) was paid in relation to finance lease liabilities under the PFI contracts.

Dalkeith Campus

	Liability	Interest	Service Charge	Total
Period	**£000**	**£000**	**£000**	**£000**
Within 1 year	635	2,292	1,893	4,820
Within 2 to 5 years	3,218	8,489	8,058	19,765
Within 6 to 10 years	6,119	8,515	11,259	25,893
Within 11 to 15 years	9,716	4,918	12,739	27,373
Within 16 to 20 years	3,964	522	4,239	8,725
Within 21 to 25 years	0	0	0	0
Total Contract	**23,652**	**24,736**	**38,188**	**86,576**

Primary Schools

	Liability	Interest	Service Charge	Total
Period	**£000**	**£000**	**£000**	**£000**
Within 1 year	701	2,268	1,883	4,851
Within 2 to 5 years	3,353	8,520	8,013	19,886
Within 6 to 10 years	5,765	9,077	11,196	26,038
Within 11 to 15 years	8,197	6,645	12,667	27,509
Within 16 to 20 years	11,655	3,187	14,331	29,173
Within 21 to 25 years	1,419	103	1,585	3,107
Total Contract	**31,090**	**29,801**	**49,673**	**110,564**

33. Retirement benefits

The Council participates in two different pension schemes which meet the needs of employees. Both schemes provide members with defined benefits related to pay and service.

Teachers

The Scottish Teachers Superannuation Scheme is an unfunded scheme administered by the Scottish Government. The scheme is excluded from the accounting requirements of IAS 19 as it is a national scheme which does not allow for the identification of pension liabilities consistently and reliably between participating authorities. The accounts, therefore, only include the payments made by the Council to the scheme in year and do not reflect the estimated pension assets or liabilities of the scheme. The exception to this are payments in relation to unfunded pension enhancements for members of the scheme as they are administered through the Local Government Pension Scheme and are taken into consideration in accounting for pension costs under IAS 19.

In 2016/17 the Council paid 5.851 million (2015/16 £5.457 million) to the Scottish Government in respect of teachers' pension costs. The rate of contribution was 17.2% (2015/16 17.2%).

Local Government Pension (Scotland) Scheme

Employees other than teachers are eligible to join the Local Government Pension Scheme. The pension costs charged to services in respect of these employees have been calculated under IAS 19 – Retirement Benefits.

In 2016/17 the Council paid an employer contribution of £12.452 million (2015/16 £11.800 million) into the Lothian Pension Fund, representing 21.8% (2015/16 22.9%) of pensionable pay. This is the expenditure met from Government Grants and Local Taxation. It is estimated that the employer contribution for the period to 31 March 2018 will be £11.854 million.

The Council recognises the cost of retirement benefits in the net cost of services when they are earned by employees, rather than when the benefits are eventually paid as pensions. The following transactions have been made in the CIES and the Movement in Reserves Statement

CIES

2015/16 £000		2016/17 £000
	Net cost of services:	
16,204	Current Service Cost	15,448
208	Past Service Costs (including curtailments)	98
	Net operating expenditure:	
15,865	Interest cost	16,332
(12,094)	Expected return on scheme assets	(13,895)
20,183	**Net charge to CIES**	**17,983**

Adjustment between accounting basis & funding basis under regulation

(20,183)	Reversal of net charges made for retirement benefits in accordance with IAS 19	(17,983)
11,800	Employers contributions payable to pension fund	12,452

The service cost figures include an allowance for administration expenses of 0.3% of payroll.

In addition to the recognised gains and losses included in the CIES, actuarial losses of £44,365 million (2015/16 gain of £55.787 million) were included in other comprehensive income and expenditure in the CIES.

Assets and Liabilities in relation to retirement benefits

2015/16	Reconciliation of present value of the scheme liabilities:	**2016/17**
£000		**£000**
493,662	Opening Balance	464,544
16,204	Current Service Costs	15,448
15,865	Interest Cost	16,332
3,109	Contribution by Members	3,374
(49,226)	Actuarial losses/(gains)	120,235
208	Past Service Costs (including curtailments)	98
(888)	Estimated Unfunded Benefits Paid	(798)
(14,390)	Estimated Benefits Paid	(13,265)
464,544	**Balance at 31 March**	**605,968**

2015/16	Reconciliation of fair value of the scheme assets:	**2016/17**
£000		**£000**
378,112	Opening Balance	396,398
12,094	Expected return on Assets	13,895
3,109	Contributions by Members	3,374
10,912	Contributions by the Employer	11,654
888	Contribution in respect of unfunded benefits	798
6,561	Actuarial gains	75,870
(888)	Unfunded Benefits paid	(798)
(14,390)	Benefits paid	(13,265)
396,398	**Balance at 31 March**	**487,926**

The expected return on scheme assets is determined by considering the expected returns available on the assets underlying the current investment policy. Expected yields on fixed interest investments are based on gross redemption yields as at the balance sheet date.

The liabilities show the underlying commitments the Council has in the long term to pay retirement benefits. The total liability of £605.968 million has a substantial impact on the net worth of the Council as shown in the Balance Sheet, resulting in a net liability of £118.042 million.

However, under pension regulations, contribution rates are set to meet 100% of the overall liabilities of the fund. The fund's actuary reported that, at 31 March 2014, the funding level was 93% and that a period of 20 years has been adopted in assessing the level of contribution required to fund that deficiency. The employers contribution in 2016/17 was 348% of employees contributions.

Basis for estimating assets and liabilities

Liabilities have been assessed on an actuarial basis using the protected unit credit method, an estimate of the pensions that will be payable in future years are dependent on assumptions about mortality rates, salary levels etc. The pension fund liabilities have been assessed by the actuary and are based on the latest full valuation of the scheme as at 31 March 2017.

The main assumptions used by the actuary have been:

2015/16		2016/17
	Longevity at 65 for current pensions (Mortality):	
22.1	Men (years)	22.1
23.7	Woman (years)	23.7
	Longevity at 65 for future pensions (Mortality):	
24.2	Men (years)	24.2
26.3	Woman (years)	26.3
2.2%	Inflation / Pension Increase Rate	2.4%
4.2%	Salary Increase Rate	4.4%
3.5%	Discount Rate	2.6%
50%	Take up of options to convert Annual Pension into Retirement Lump Sum – Services to April 2009	50%
75%	Retirement Lump Sum - Services post April 2009	75%

The Pension Funds Assets consist of the following categories, by proportion of the total assets held:

31/03/2016		31/03/2017
62%	Equity Securities	62%
9%	Debt Securities	11%
4%	Private Equity	14%
9%	Real Estate	6%
10%	Investment Funds and Unit Trusts	2%
6%	Cash and Cash Equivalents	5%
100%		**100%**

Projected defined benefit cost for the period to 31 March 2018

Analysis of projected amount to be charged to operating profit for the period to 31 March 2018

Period ended 31 March 2018	Assets £(000)	Obligations £(000)	Net Liability / (asset) £(000)	% of pay
Projected Current Service cost *		21,387	(21,387)	(37.5%)
Past service cost including curtailments		-	-	-
Effect of settlements	-	-	-	-
Total Service Cost	-	21,387	(21,387)	(37.5%)
Interest income on plan assets	12,699		12,699	22.3%
Interest cost on defined benefit obligation		15,881	(15,881)	(27.9%)
Total Net Interest Cost	12,699	15,881	(3,182)	(5.6%)
Total Included in Profit and Loss	12,699	37,268	(24,569)	(43.1%)

*The current service cost includes an allowance for administration expenses of 0.3% of payroll. The monetary value is based on a projected payroll of £57.002 million.

The contributions paid by the Employer are set by the Fund Actuary at each triennial valuation (the most recent being as at 31 March 2014), or at any other time as instructed to do so by the Administering Authority. The contributions payable over the period to March 2018 are set out in the Rate and Adjustments certificate. Employers contributions for the period to 31 March 2018 will be approximately £11.854 million..

Investment Returns

Actual Returns from 1 April 2016 to 31 December 2016	17.1%
Total Returns from 1 April 2016 to 31 March 2017	22.6%

Local Government legislation provides that Local Authorities have an obligation to meet their share the expenditure of the Joint Boards of which they are constituent members. At 31st March 2017 the liability for Pensions sits at £12.395 million. As a consequence the Council has additional liabilities arising from the pension deficit of the Lothian Valuation Joint Board.

34. Contingent liability

The council recognises the potential for compensation claims deriving from the Scottish Government's Limitation (Childhood Abuse) (Scotland) Bill which will remove the three-year time limit on claims of child abuse. Some claims will be historic and relate to Lothian Regional Council, Midlothian District Council or their predecessors some will date post-reorganisation and relate to Midlothian Council.

Whilst the Council has settled the majority of Equal Pay claims and made appropriate provision for those outstanding, the Council recognises the potential for additional unknown liabilities resulting from this process.

35. Contingent assets

The Council procured the completion of 64 council houses in Newbyres Crescent and Gore Avenue in 2009. In September 2013 it was discovered that the homes contained high levels of carbon dioxide due to the ingress of ground gasses from disused mine workings beneath the properties. The houses had been built without an adequate ground gas defence system. Due to public health concerns, the Council decided in June 2014 to move residents out of the properties. The houses were subsequently demolished in March 2016. The Council has lodged a formal legal claim in the Court of Session against certain contractors and consultants in an effort to recover its losses. The claim is currently progressing through the court.

36. Midlothian council trusts, bequests, common good fund and community funds

There are some 18 active trusts, bequests and community funds of varying size managed by the Council, each of which has specific objectives and conditions. None of the funds are currently registered charities.

The main funds are:

31/03/2016		31/03/2017
£000		£000
14	Dalkeith Common Good	14
2	Penicuik Common Good	2
134	Community Mining Funds	94
67	Other Funds	60
217	**Total**	**170**

A total of £0.081 million has been committed to be spent from these funds.

The funds do not represent assets of the Council and are included in the Balance Sheet as creditors except the Community Mining Funds which are held in separate bank accounts.

37. Post balance sheet events

There are no post balance sheet events.

Housing Revenue Account

Income and expenditure account

The HRA reflects the statutory requirement to account separately for local authority housing provision, as defined in the Housing (Scotland) Act 1987. The Income and Expenditure Statement reports the net cost for the year and shows how these costs were funded from rents and other income. The Movement in HRA balances reconciles the financial position shown in the Comprehensive Income and Expenditure Statement to the movement in the HRA reserve for the year.

For the year ended 31 March 2017

The following statement shows how much the Council spent in fulfilling its statutory responsibility to provide, improve and manage its Housing Stock.

2015/16		2016/17	per house per week
£000		£000	£
	Income		
23,271	Gross dwelling rents	24,966	70.17
517	Non dwelling rents	541	1.52
3,942	Other Income	5,751	16.16
27,730		**31,258**	**87.85**
	Expenditure		
5,104	Repairs and Maintenance	5,407	15.20
4,892	Supervision and Management	4,692	14.59
6,737	Depreciation of Non-Current Assets	6,252	19.95
8,826	Impairment of Non-Current Assets	12,388	34.82
2,061	Other Expenditure	1,940	5.45
240	Increase / (Decrease) in Bad Debt Provision	60	0.17
27,860		**30,739**	**90.18**
130	**Net Cost of HRA services per the whole Council Comprehensive Income and Expenditure Account**	**519**	**-2.33**
250	HRA share of Corporate and Democratic Core	-250	0.70
380	**Net Cost of HRA Services**	**269**	**-1.62**
	HRA share of the operating income and expenditure included in the whole Council accounts		
(273)	Loss / (Gain) on sale of HRA non-current assets	(1,804)	-5.07
5,041	Interest Payable and similar charges	5,091	14.31
(184)	Interest and Investment Income	-222	-0.62
3,898	Capital Grants Applied	5,698	16.02
262	Net Defined Benefit Liability and Expected Return on Pension Asset	94	0.26
9,124	**Deficit / (Surplus) for the year on the HRA Services**	**8,588**	**26.52**

Movement on the HRA Statement for year ended 31 March 2017

This statement shows how the balance for the year on the HRA Comprehensive Income and Expenditure Account reconciles to the balance for the year on the Housing Revenue Account.

2015/16 £000		2016/17 £000	per house per week
	Deficit for the year on the HRA Income & Expenditure Account		
9,124	**Items included in the HRA Income & Expenditure Account but excluded from the movement on HRA balance for the year**	**8,588**	**26.52**
273	Gain/(loss) on sale of HRA non-current assets	1,804	5.07
(12,280)	Transfer to/(from) Capital Adjustment Account	(14,979)	(44.48)
(653)	HRA share of contributions to/from pension reserve	(254)	(0.71)
(3,536)	**(Surplus) or deficit for the year on the Housing Revenue Account Income and Expenditure Account**	**(4,841)**	**(13.60)**
(21,376)	Housing Revenue Account Balance brought forward	**(24,913)**	**(70.02)**
(24,913)	**Housing Revenue Account Balance carried forward**	**(29,754)**	**(83.63)**

Notes to the Housing Revenue Account

1. General

This account reflects the statutory requirement to account for local council housing provision, as defined in the Housing (Scotland) Act 1987. It shows the major elements of housing revenue expenditure and capital financing costs, and how these are met by rents and other income.

2. Housing Stock

At 31 March 2017 the Council had 6,842 houses (31 March 2016 6,835) which can be analysed as follows:

2015/16 Number	Type of Dwelling	2016/17 Number
822	1 Bedroom	855
3,814	2 Bedroom	3,798
1,865	3 Bedroom	1,863
324	4 Bedroom	316
10	5 / 6 Bedroom	10
6,835	Total	**6,842**

3. Rent Arrears

At the end of the year rent arrears amounted to £2.573 million (2015/16 £2.572 million) for which a provision for bad and doubtful debts of £1 million (2015/16 £0.940 million) exists.

4. Void Properties

The total value of uncollectable void rents for main provision properties amounted to £0.402 million (2015/16 £0.521 million).This has been netted against rental income.

Council Tax Income Account

Income and expenditure account

For the year ended 31 March 2017

Councils raise taxes from residents by way of a property tax – the Council Tax – which is based on property values. Each dwelling in a local Council area is placed into one of eight valuation bands, A to H. The Council declares a tax for band D properties and all other properties are charged a proportion of this, lower valued properties pay less; higher valued properties pay more. The Council Tax Income Account (Scotland) shows the gross income raised from Council taxes levied and deductions made under statute. The resultant net income is transferred to the Comprehensive Income and Expenditure Statement of the authority.

The Council Tax Reduction Scheme was introduced in 2013/14 by the Scottish Government. This scheme replaced Council Tax Benefits, with funding being provided through the General Revenue Grant. Prior to 2013/14, funding for Council Tax Benefit was provided by the Department for Works and Pensions (DWP).

2015/16		2016/17
£000		£000
46,513	Gross Council Tax levied and Contributions in Lieu	47,474
	Less :	
4,988	Discounts	5,039
4,888	Council Tax Reduction Scheme	4,730
1,239	Write-off of Uncollectable Debts and Allowances for Impairment	1,267
35,398		**36,438**
(34)	Adjustments to previous years Community Charge and Council Tax	(23)
35,364	**Transfers to the General Fund**	**36,415**

Notes to the Council Tax Income Account

Calculation of the Council tax base for the year 2016/17

	Property Bands								
	A	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**Total**
Properties	982	12,480	10,738	5,259	4,782	3,239	2,030	169	39,679
Disabled relief	42	14	-29	5	-12	-4	-15	-1	0
Less									
Exemptions	69	445	252	95	193	45	26	4	1,129
Discounts (25%)	141	1,440	904	365	238	100	56	3	3,245
Discounts (50%)	1	6	5	2	2	3	2	0	19
Other Discounts	4	24	23	11	5	4	4	1	76
Council Tax Reduction Scheme	255	2,603	1,444	268	114	28	21	0	4,733
Effective properties	556	7,977	8,082	4,523	4,217	3,056	1,906	160	30,478
Ratio to band D	6/9	7/9	8/9	9/9	11/9	13/9	15/9	18/9	
Band D equivalents	370	6,205	7,184	4,523	5,155	4,415	3,176	320	31,348
Contributions in lieu – Band D equivalents									202
Total Council Tax Base									**31,550**
Provision for non payment									-1,004
Total									**30,546**

Number of 'effective' properties and charges for each band

Band	**A**	**B**	**C**	**D**	**E**	**F**	**G**	**H**	**Total**
Numbers	555	7,977	8,082	4,523	4,217	3,056	1,906	160	30,477
£	807	941	1,076	1,210	1,479	1,748	2,017	2,420	

Non-Domestic Rates Income Account

Income and expenditure account

For the year ended 31 March 2017

The rates collected from non-domestic ratepayers during the year are shown below. Any difference between the rates collected and the amount the Council is guaranteed to receive under the National Pooling arrangements is adjusted via the Government's Revenue Support Grant to the Council. The non-domestic rate income is redistributed from the national pool in proportion to the resident population of each local Council and therefore bears no direct relationship with the amount collected by those authorities.

2015/16		2016/17
£000		**£000**
37,494	Gross rates levied	39,024
	Less:	
8,169	Reliefs and other deductions	7,380
0	Interest paid	0
	Write-offs of uncollectable debts and allowance for impairment	
464		500
3,411	Adjustments to previous years	2,291
25,450	**Net Non Domestic Rate Income**	**28,853**
0	Non-Domestic Rate Income Retained by Authority (BRIS)	0
25,450	**Contribution to Non-Domestic Rate Pool**	**25,853**
	Allocated:	
25,529	Contribution to national non-domestic rates pool	28,933
(79)	Midlothian Council	(81)
25,450		**28,853**

Notes to the Non-Domestic Rates Income Account

1. The amount distributed to Midlothian Council from the national non-domestic rate income pool in the year was £32.026 million (2015/16 £29.468 million).

2. Occupiers of non-domestic properties pay rates based on the valuation of the property within the valuation roll for Midlothian. The non-domestic rate poundage is determined by the Scottish Government, and was 48.4p per £ (2015/16 48p per £) where the rateable value was less than or equal to £29,000 and 51p per £ (2015/16 49.3 per £) where the rateable value exceeded £35,000.

3. Small Business Bonus Scheme - From 1 April 2010, a ratepayer who occupies or is entitled to occupy one or more non-domestic properties which have a combined rateable value of £18,000 or less then they may be eligible for a discount of between 25% and 100% on their bill. In addition, where the cumulative rateable value of a businesses properties falls between £18,000 and £25,000, the Scheme will offer 25% relief to individual properties with a rateable value of up to £18,000.

4. Rateable Value as at the start of the year

Number 2015/16	Rateable Value 2015/16 £000		Number 2016/17	Rateable Value 2016/17 £000
1,693	44,984	Shops, Offices and Other Commercial Subjects	1,699	45,934
900	14,720	Industrial and Freight Transport	928	14,609
292	16,956	Miscellaneous (Schools etc)	295	17,391
2,885	**76,660**		**2,922**	**77,934**

The Business Rate Incentivisation Scheme (BRIS) permits the authority to retain half of the NDR income which exceeds the income target set by the Scottish Government

Group Movement in Reserves Statement

This statement shows the movement in the year on the different reserves held by the Council, subsidiaries, associates and joint ventures, analysed into 'usable reserves' (i.e. those that can be applied to fund expenditure) and other 'unusable reserves'. This statement shows how the movements in year of the Council's reserves are broken down between gains and losses incurred in accordance with generally accepted accounting practices and the statutory adjustments required to return to the amounts chargeable to council tax and rents for the year. The Net Increase/Decrease line shows the statutory General Fund Balance and Housing Revenue Account Balance movements in the year following these adjustments.

2015/16 – Previous year comparison (restated)	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	**Total Usable Reserves**	**Unusable Reserves**	**Total Council Reserves**	Authorities Share of the reserves of subsidiaries, associates and joint ventures	**Total Reserves**
		£000	£000	£000	£000	**£000**	**£000**	**£000**	£000	**£000**
Balance at 1 April 2015		**(21,315)**	**(21,376)**	**(14,853)**	**(3,073)**	**(60,617)**	**(172,712)**	**(233,329)**	**0**	**(233,329)**
Total Comprehensive Expenditure and Income	CIES	(2,092)	9,124	0	0	7,032	(98,823)	(91,791)	**274**	**(91,517)**
Adjustments between accounting basis and funding basis under regulations	6	(1,752)	(12,661)	(525)	0	(14,937)	14,937	0	0	0
Net increase/ (decrease) before transfers to other statutory reserves		**(3,844)**	**(3,537)**	**(525)**	**0**	**(7,906)**	**(83,885)**	**(91,791)**	**274**	**(91,517)**
Transfers to/(from) other statutory reserves		**534**	**0**	**0**	**-534**	**0**	**0**	**0**	0	0
Increase/(Decrease) in year		**(3,310)**	**(3,537)**	**(525)**	**(534)**	**(7,906)**	**(83,885)**	**(91,791)**	**274**	**(91,517)**
Balance at 31 March 2016		**(24,625)**	**(24,913)**	**(15,378)**	**(3,607)**	**(68,523)**	**(256,598)**	**(325,121)**	**274**	**(324,847)**

2016/17 – Current Financial Year	Note / source	General Fund Reserve	HRA Balance	Capital Fund	Repairs and Renewals Fund	Total Usable Reserves	Unusable Reserves	Total Council Reserves	Authorities Share of the reserves of subsidiaries, associates and joint ventures	Total Reserves
		£000	£000	£000	£000	**£000**	**£000**	**£000**	£000	**£000**
Balance at 1 April 1 April 2016		**(24,625)**	**(24,913)**	**(15,378)**	**(3,607)**	**(68,523)**	**(256,598)**	**(325,121)**	**274**	**(324,847)**
Total Comprehensive Expenditure and Income	CIES	20,972	9,434	5,778	0	**36,184**	**23,317**	**59,501**	**593**	**60,094**
Adjustments between accounting basis and funding basis under regulations	6	(13,492)	(14,275)	(7,106)	0	(34,873)	34,873	0	0	0
Net increase/ (decrease) before transfers to other statutory reserves		**7,480**	**(4,841)**	**(1,328)**	**0**	**1,311**	**58,190**	**59,501**	**593**	**60,094**
Transfers to/(from) other statutory reserves		-507	0	0	507	0	0	0	0	0
Increase/(Decrease) in year		**6,973**	**(4,841)**	**(1,328)**	**507**	**1,311**	**58,190**	**59,501**	**593**	**60,094**
Balance at 31 March 2017		**(17,651)**	**(29,753)**	**(16,706)**	**(3,100)**	**(67,211)**	**(198,408)**	**(265,520)**	**867**	**(264,752)**

Group Comprehensive Income and Expenditure Statement

For the year ended 31 March 2017

This statement shows the accounting cost in the year of providing services in accordance with generally accepted accounting practices, rather than the amount to be funded from taxation or rents. The Council raises taxation and rents to cover expenditure in accordance with statutory requirements; these differ from the accounting cost. The taxation position is shown in both the Expenditure and Funding Analysis and the Movement in Reserves Statement.

Restated 2015/16 Gross Expenditure £000	Restated 2015/16 Gross Income £000	Restated 2015/16 Net Expenditure £000	Service	Notes		2016/17 Gross Expenditure £000	2016/17 Gross Income £000	2016/17 Net Expenditure £000
1,758	-64	1,694	Management		£	1,787	-66	1,721
15,660	-92	15,568	Children's Services		£	16,079	-139	15,940
6,371	-2,129	4,242	Communities and Economy		£	6,996	-1,972	5,024
83,964	-1,722	82.242	Education		£	98,842	-1,903	96,939
52,305	-14,448	37,857	Adult Social Care		£	95,628	-55,795	39,833
39,233	-31,438	7,795	Customer and Housing Services		£	36,730	-30,984	5,746
22,151	-1,963	20,188	Commercial Services		£	24,051	-2,050	22,001
16,319	-241	16,078	Finance and Integrated Service Support		£	11,886	-352	11,534
24,650	-7,311	17,339	Properties and Facilities Management		£	27,173	-7,490	19,683
23,580	-24,446	-866	Housing Revenue Account		£	30,739	-31,258	-519
560	0	560	Joint Boards		£	560	0	560

1,422	0	1,422	Non-Distributed Costs	7	£	1,449	0	1,499
287,973	**-83,854**	**204,119**	**Cost of Services**			**351,920**	**-132,009**	**219,961**
		57	Share of operating results of associates					14
		831	Other Operating Expenditure	8				(1,855)
		16,328	Financing and Investment Income and Expenditure	9				14,915
		(214,232)	Taxation and non-specific grant income	10				(202,565)
		7,046	**(Surplus) or Deficit on Provision of Services**					**30,470**
		(41,027)	(Surplus) or Deficit on revaluation of non-current assets					(21,142)
		(55,787)	Re-measurement of the net defined benefit liability	33				44,365
		0	Change in Capital Fund					5,778
		(2,591)	Other (Gains) / Losses					625
		(99,405)	**Other Comprehensive (Income) and Expenditure**					**29,625**
		(92,359)	**Total Comprehensive (Income) and Expenditure**					**60,095**

Group Balance Sheet
As at 31 March 2017

The Balance Sheet shows the value as at the Balance Sheet date of the assets and liabilities recognised by the Council. The net assets are matched by reserves which are reported in two categories. The first is ‘usable reserves’ which are available to the Council to provide services, subject to the need to maintain a prudent level of reserves and any statutory limitations on their use. The second category of reserves are those that the Council is not able to use to provide services. This includes reserves that contain unrealised gains and losses where amounts would only become available to provide services if the assets are sold; and reserves that hold timing differences shown in the Movement in Reserves Statement line “Adjustments between accounting basis and funding basis under regulations”.

Restated 31 March 2015 £000	Restated 31 March 2016 £000		Notes	31 March 2017 £000
611,295	640,904	Property, Plant and Equipment	11	651,696
1,187	1,073	Intangible Assets	12	766
26	27	Heritage Assets	14	68
3,382	5,189	Long Term Investments	16	4,935
0	56	Investments share of net assets of associates		-1,037
3,073	3,639	Long Term Debtors	17	3,136
618,963	**650,888**	**Long Term Assets**		**659,564**
40,152	55,007	Short Term Investments	15	65,072
800	2,535	Assets held for Sale	13	1,950
987	826	Inventories		811
20,658	18,292	Short Term Debtors	17	19,641
14,337	10,710	Cash and Cash Equivalents	18	10,894
76,934	**87,370**	**Current Assets**		**98,368**
44,237	41,073	Short Term Borrowing	15	51,270
25,468	23,530	Short Term Creditors	19	28,828
1,750	1,640	Provisions	20	1,431
18,049	16,395	Grants Receipts in Advance	28	22,944
89,504	**82,638**	**Current Liabilities**		**104,473**
193,143	198,917	Long Term Borrowing	15	208,816
179,921	131,309	Other Long Term Liabilities	21	179,892
373,064	**330,226**	**Long Term Liabilities**		**388,708**
233,329	**325,394**	**Net Assets**		**264,752**
60,617	68,270	Usable Reserves	6&22	67,438
172,712	257,124	Unusable Reserves	23	197,314
233,329	**325,394**	**Total Reserves**		**264,752**

Gary Fairley, Head of Finance and Integrated Service Support

Notes to the Group Accounts

The Code of Practice on Local Council Accounting in the United Kingdom 2016/176 (The Code) requires local authorities to consider their interests in all types of entity. This includes other local authorities or similar bodies defined in section 106 of the Local Government (Scotland) Act 1973 e.g. statutory bodies such as Integration Joint Boards and Valuation Boards. Authorities are required to prepare a full set of group accounts in addition to their own Council's accounts where they have a material interest in such entities. The Group Accounts of Midlothian Council are prepared in accordance with the accounting policies of the Council with the additions and exceptions shown below. The Group Accounts consolidate the results of the Council with five other entities. These organisations are entirely independent of the Council under law and for taxation.

Valuation of Property, Plant and Equipment
The basis of valuation across the combining entities is in accordance with the Code and there are no material inconsistencies with the policies adopted by Midlothian Council. The Integration Joint Board has no Property, Plant or Equipment.

Depreciation
The basis of valuation across the combining entities is in accordance with the Code and there are no material inconsistencies with the policies adopted by Midlothian Council

Goodwill
The Council has not paid any consideration for its interests and thus no goodwill is involved in the acquisition.

Basis of Consolidation
Subsidiaries are consolidated on a line-by-line basis. All other entities are accounted for under the accounting conventions of the "acquisition basis" using the equity method – the Council's share of the net assets or liabilities of each entity is incorporated and adjusted each year by the Council's share of the entities' results and its share of other gains and losses (recognised in the Group CIES). All entities have the same reporting date as the Council.

Restrictions on transfer of funds
The Council's share of the reserves of its associate and joint ventures is unusable i.e. it cannot be used to fund the Council's services or to reduce taxation. Further details for each entity are as follows:

	Share	Share of Assets	Share of Liabilities	Share of Revenues	Share of (Profit)/Loss
	%	£000			
Subsidiaries					
Trusts, bequests, common good fund and community funds	100	170	170	(2)	47
Pacific Shelf 826 ltd	100	0	556	0	3
Associates					

Lothian Valuation Joint Board	9.15	220	1,221	(1,511)	542
Midlothian Integration Joint Board	50	0	0	(67)	0

The information above agrees to the group accounts after the elimination of inter-company transactions.

Combining Entities

The following table provides further details about the entities incorporated into the Council's Group Accounts:

Subsidiary	**Nature**	**Accounts Available from**
Trusts, bequests, common good fund and community funds	To award grants across Midlothian.	Midlothian Council, Midlothian House Dalkeith
Pacific Shelf 826 ltd	Property Development	Midlothian Council, Midlothian House Dalkeith
Associates		
Lothian Joint Valuation Board	Maintains the electoral, council tax and non-domestic rates registers for the Edinburgh, Midlothian, West Lothian and East Lothian Councils	The Treasurer, Lothian Joint Valuation Board, Edinburgh Council, Waverley Court, Edinburgh
Midlothian Integration Joint Board	Its purpose is to improve the well being of families, our communities and of people who use health and social care services. The Integration Scheme determines when the Council will have shared responsibility for additional funding with NHS Lothian and is linked to demographic shifts and demand volumes linked to service delivery.	Midlothian Council, Midlothian House Dalkeith

Non-material interests in other entities

In addition to the organisations outlined above, the Council also has an interest in the following organisations:

Seemis Group LLP who provide Scottish Local Authorities with an Education Management system. Midlothian have a 1.81% interest in Seemis. Net assets at 31st March 2017 were £2.384 million which would equate to a share of £0.430 million for Midlothian.

Independent Auditor’s Report

Independent auditor’s report to the members of Midlothian Council and the Accounts Commission

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 120 of the Code of Audit Practice approved by the Accounts Commission, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Report on the audit of the financial statements

Opinion on financial statements

We certify that we have audited the financial statements in the annual accounts of Midlothian Council (“the council”) and its group for the year ended 31 March 2017 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the group and council-only Comprehensive Income and Expenditure Statements, Movement in Reserves Statements, Balance Sheets, and Cash-Flow Statements, the council-only Housing Revenue Income and Expenditure Account, the Council Tax Income Account, and the Non-Domestic Rate Income Account, and notes to the Financial Statements and noted to the Group accounts, including a summary of significant accounting policies. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2016/17 (the 2016/17 Code).

In our opinion the accompanying financial statements:

- give a true and fair view in accordance with applicable law and the 2016/17 Code of the state of affairs of the council and its group as at 31 March 2017 and of the deficit on the provision of services of the council and its group for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2016/17 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973, The Local Authority Accounts (Scotland) Regulations 2014, and the Local Government in Scotland Act 2003.

Basis of opinion

We conducted our audit in accordance with applicable law and International Standards on Auditing in the UK and Ireland (ISAs (UK&I)). Our responsibilities under those standards are further described in the Auditor’s Responsibilities for the Audit of the Financial Statements section of our report. We are independent of the council and its group in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK including the Financial Reporting Council’s Ethical Standards for Auditors, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Responsibilities of the Head of Finance and Integrated Service Support for the financial statements

As explained more fully in the Statement of Responsibilities, the Head of Finance and Integrated Service Support is responsible for the preparation of financial statements that give a true and fair view in accordance with the financial reporting framework, and for such internal control as the Head of Finance and Integrated Service Support determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's responsibilities for the audit of the financial statements

Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable legal requirements and ISAs (UK&I) as required by the Code of Audit Practice approved by the Accounts Commission. Those standards require us to comply with the Financial Reporting Council's Ethical Standards for Auditors. An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the circumstances of the council and its group and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Head of Finance and Integrated Service Support; and the overall presentation of the financial statements.

Our objectives are to achieve reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK&I) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

Other information in the annual accounts

The Head of Finance and Integrated Service Support is responsible for the other information in the annual accounts. The other information comprises the information other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and we do not express any form of assurance conclusion thereon except on matters prescribed by the Accounts Commission to the extent explicitly stated later in this report.

In connection with our audit of the financial statements in accordance with ISAs (UK&I), our responsibility is to read all the financial and non-financial information in the annual accounts to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Report on other requirements

Opinions on other prescribed matters

We are required by the Accounts Commission to express an opinion on the following matters.

In our opinion, the auditable part of the Remuneration Report has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014.

In our opinion, based on the work undertaken in the course of the audit

- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003; and
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

Matters on which we are required to report by exception

We are required by the Accounts Commission to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the auditable part of the Remuneration Report are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- there has been a failure to achieve a prescribed financial objective.

We have nothing to report in respect of these matters.

Stephen Reid, for and on behalf of Ernst & Young LLP
Ten George Street
Edinburgh
EH2 2DZ
29 September 2017

Glossary of Terms

While much of the terminology used in this report is intended to be self-explanatory, the following additional definitions and interpretation of terms may be of assistance.

1. Gross Expenditure

This includes all expenditure attributable to the service and activity including employee costs, expenditure relating to premises and transport, supplies and services, third party payments, support services and capital charges.

2. Gross Income

This includes the charges to individuals and organisations for the direct use of the Council's services.

3. Corporate and Democratic Core

Corporate and Democratic Core costs include the costs of policy making and all other Councillor based activities together with costs which relate to the general running of the Council. The Best Value Accounting Code of Practice stipulates that such costs are to be excluded from the "total cost" relating to service activity.

4. Non Distributable Costs

Non Distributable Costs represent costs which cannot be allocated to specific services and again, under the Best Value Accounting Code of Practice, are excluded from the total cost relating to service activity. Examples of Non Distributable Costs are charges for added pension years and early retirement.

5. Employee Costs

This includes salaries, wages, overtime, bonus, enhancements, employer's pension and national insurance contributions, travelling and subsistence expenses and other employees' allowances.

6. Property Costs

This includes rents and rates, property insurance, repairs and maintenance of property, upkeep of grounds, heating and lighting, furnishings and fittings and allocations of central support for accommodation costs.

7. Supplies and Services

This includes food, materials, books, uniforms and protective clothing, the purchase and maintenance of equipment and tools and various services carried out by external contractors.

8. Transport Costs

This includes the costs of operating vehicles and plant such as fuel, repairs and maintenance, tyres, licenses, insurance and procurement of transport for school children.

9. Administration

This includes printing and stationery, advertising, postages, telephone costs and central support services allocations for administration.

10. Financing Costs

This includes the annual costs of financing the sums borrowed by the Council to finance its capital repayment of loans, interest charges and debt management expenses, as well as external repayments for operational leases.

11. Capital Charges

A charge to service revenue accounts to reflect the cost of non-current assets used in the provision of services.

12. Payments to Other Bodies

This includes grants to individuals and organisations, bursaries and payments to other local authorities, Health Boards, Joint Boards and organisations and agencies providing services complementing or supplementing the work of the Council.

13. Capital Financed from Current Revenue

This heading covers the costs of creating, acquiring or improving assets where the expenditure is charged directly to the Revenue Account

14. Other Costs

This heading covers items of expenditure which cannot be accommodated in any of the other categories.

15. Specific Government Grant

This includes grants received from Central Government in respect of a specific purpose or service e.g. housing benefit, education, community regeneration and community services.

16. Capital Expenditure

This is expenditure incurred in creating, acquiring or improving assets where the expenditure is normally financed by borrowing with repayment over a period of years, or by utilising the income from the sale of existing assets.

17. Intangible Assets

These are non-financial assets that do not have any physical substance but are identifiable and are controlled by the Council through custody or legal rights.

18. Non-Current Assets

These are created by capital expenditure incurred by the Council. This includes buildings and property, vehicles, plant and machinery, roads, computer equipment etc.

19. Revaluation Reserve

The Revaluation Reserve records unrealized revaluation gains arising (since 1 April 2007) from holding non-current assets.

20. Capital Adjustment Account

The Capital Adjustment Account provides a balancing mechanism between the different rates at which assets are depreciated under the Code.

21. Useable Capital Receipts Reserve

The Useable Capital Receipts Reserve represents the capital receipts available to finance capital expenditure in future years, after setting aside the statutory amounts for the repayment of external loans.

22. Pension Reserve

This represents the difference between accounting for pension costs in line with UK Accounting Standards, and the funding of pension costs from taxation in line with statutory requirements, and is equal to the change in the pensions liability, i.e. the commitment to provide retirement benefits.

23. Associate

An entity other than a subsidiary or joint venture in which the reporting Council has a participating interest and over whose operating and financial policies the reporting Council is able to exercise significant influence.

24. Entity

A body corporate, partnership, trust, unincorporated association, or statutory body, that is delivering a service, or carrying on a trade or business, with or without a view to profit. It should have a separate legal personality and is legally required to prepare its own single-entity accounts.