Audit Committee
Tuesday 15 March 2016
Item No. 5.1

Midlothian Council

External Audit Plan
For the financial year ending 31 March 2016

February 2016 [Draft for discussion]

Contents

1. Introduction

Our Plan

Audit Scotland appointed Grant Thornton UK LLP as auditor of Midlothian Council (the Council) for the 5-year period 2011-12 to 2015-16. This appointment is made under the Local Government (Scotland) Act 1973.

This Audit Plan sets out an overview of the planned scope and timing of the audit, as required by International Standard on Auditing (UK & Ireland) 260, for the benefit of those charged with governance (the Audit Committee in the case of the Council).

This plan summarises:

- Our responsibilities as external auditors (Section 1)
- Our audit approach (Section 2)
- Our understanding of the Council (Section 3)
- The identification of risk impacting on the audit of the financial statements, and our assessed level of materiality (Section 4)
- Our approach to the audit of governance (Section 5)
- Our approach to reviewing the Council's value for money, financial management and financial sustainability arrangements (Section 6); and
- Audit timings, our team and proposed fees (Section 7).

The Plan is intended to help to aid discussion with the Audit Committee, including the consequences of our work, issues of risk and the concept of materiality, and to identify any areas where you may request us to undertake additional procedures. The contents of this Plan have been discussed with management.

Our responsibilities

We are required to meet the requirements of the Code of Audit Practice ('the Code') which is approved by the Accounts Commission and the Auditor General for Scotland.

The Code requires that we undertake our audit in accordance with:

- relevant legislation (the Local Government (Scotland) Act 1973 and the Local Government (Scotland) Regulations 2014)
- Statements of Auditing Standards and applicable Practice Notes issued by the Auditing Practices Board
- the CIPFA Code of Practice on Local Authority Accounting
- other guidance issued by Audit Scotland

We are required to provide an opinion on the financial statements and confirm the Annual Governance Statement has been prepared in accordance with the Delivering Good Governance in Local Government framework. Under the Code we are also required to review and report on your financial management and sustainability, governance and transparency arrangements, and Best Value and performance. The following sections of this report set out our approach to delivering these responsibilities.

2. Our audit approach

Our audit approach is fully tailored to the wider requirements of public sector audit, including Scottish public sector requirements (as set out in the Code). Set out below is an overview of our approach:

Planning

- Updating our understanding of the Council through discussions with management and review of reports presented to the full Council and Council Committees
- Documenting our understanding of the key risks impacting your financial statements and determining materiality
- Contributing to the Local Scrutiny Plan with other regulators in the Local Area Network
- Working with the Council's internal auditors to ensure that key risks are addressed by audit, but that we do not duplicate areas of work.

Interim Audit Work

- Reviewing the design and implementation of internal financial controls including IT, where they impact the financial statements
- Assessing audit risk and developing and implementing an appropriate audit strategy
- Reviewing governance and performance management arrangements against good practice standards.

Substantive Procedures

- Reviewing and advising on material disclosure issues in the financial statements
- Performing analytical review as appropriate
- Performing sample testing of income and expenditure balances
- Verifying all material income, expenditure and balances, taking into consideration whether audit evidence is sufficient and appropriate
- Performing detailed testing on journals through computer aided audit techniques, using IDEA software to extract large and unusual transactions and to verify the completeness of journal listings.
- Reviewing the Annual Governance Statement for compliance with the CIPFA Code of Practice on Local Authority Accounting and whether disclosures are consistent with information gathered from our audit work.

Completion

- Performing overall evaluation of our work on the financial statements to determine whether they give a true and fair view of the financial position of the Council
- Determining an audit opinion
- Reporting to those charged with governance through our Annual Report to Members and attendance at the Audit Committee.

All of our findings are reported to officers. Material or significant findings are formally reported to the Audit Committee.

3. Understanding Midlothian Council

In planning our audit, we need to consider the key business challenges and opportunities that the Council are facing. We set out a summary of our understanding below.

Risk / Challenge	Our response
1. Continuing financial pressures • The Council received an update on the Financial Strategy 2016-17 to 2020-21 in February 2016. This paper focuses on the financial projections for 2016-17, in light of the Local Government Settlement announced in December 2015. • The Council have predicted a shortfall of £7.631 million in 2016-17 based on a freeze in Council Tax, the impact of the agreed pay award and inflationary pressures. The Council have identified £3.758 million of savings to date and will present a full budget to the Council on 8th March outlining more savings proposals in detail. • The Council have acknowledged that maintaining services within budget will be increasingly challenging over the next five years. The Delivering Excellence Framework aims to support the repositioning of services while maintaining financial sustainability.	• We will review the in year financial management of expenditure and savings against budget. • We will review the Council's approach to ensuring the Council is financially sustainable through the Delivering Excellence Framework. • We will review the Council's approach to long term financial planning and sustainability. • We will consider management's judgements with regards to the going concern in light of the financial plan and assess for reasonableness.
2. Collection rates • In 2013-14 Internal Audit identified some concerns with regards to the collection of debt due to the Council, particularly relating to Council Tax. • The Council took action to strengthen their income collection policies and maximise income in 2014-15. While Council Tax collection rates improved by 0.3% to 93.82% in 2014-15, they remained below the national average of 95.5% and performance continues to be ranked within the lowest quartile in the Local Government Benchmarking Framework. • The debtor balance outwith Council Tax also contain a proportion of older balances which are provided for in the accounts. The Bad Debt Provision for sundry debtors was 29% of the balance at the year end. • The collection of older debt across all income streams remains an area for improvement at the Council. • In light of the financial pressures facing the Council it will become increasingly important that all income due is received by the Council in a prompt and cost efficient manner.	• We will review the Council's progress and action taken to maximise income and improve the collection of debt. • We will review the Council's approach to providing for doubtful and bad debt. • We will review the reasonableness of management assumptions when providing for bad debt.
3. Political uncertainty • Politics is an integral part of local government and in the coming years there is scope for significant change in the political landscape, with national and local elections occurring in 2016 and 2017 respectively. • The Scottish Parliamentary elections are due to take place in May 2016 and could result in a change of national priorities and financial allocations. • At a local level the elections in 2017 could result in political changes which may make delivery of current plans uncertain. This may make decisions relating to transforming services and savings proposals harder.	• We will review the Council's approach to scenario planning when considering long term financial planning. • As part of our work on governance and transparency we consider the scrutiny and decision making processes at the Council. in respect of medium term financial planning. • We will review the Council approach to reviewing and approving savings options.

Developments relevant to the Council and the audit

In planning our audit work we also consider the impact of key developments in the sector and take account of national audit requirements as set out in the Code and associated guidance

Risk / Challenge	Our response
1. Financial Reporting • The CIPFA Code of Practice on Local Authority Accounting (the CIPFA Code) has been updated for changes in 2015-16. The most significant change relates to the adoption of IFRS 13- Fair Value Measurement which will impact the methodology applied to value surplus assets. Surplus Assets are required to be held at 'Fair Value' which is the price that would be received when selling the asset in an orderly transaction in the principal market. All other assets are held at current value. • The CIPFA Code will be updated in 2016-17 to reflect changes in accounting for highways network assets. The assets have been held at depreciated historic cost in the past, however, CIPFA consider that current value is a more appropriate measurement base and there is an expectation that highways network assets will be measured on a depreciated replacement cost basis from 2016-17. This is likely to have a significant impact on the value of the Council's balance sheet.	We will assess whether: • the Council complies with the requirements of the CIPFA Code through discussions with management and our substantive testing • the Council has liaised with their Valuer to ensure surplus assets are considered in year and have been valued in line with the Code • the Council Valuer provides appropriate assurance at the year end over surplus assets • the Council are making preparations for the changes with regard to highways network assets.
2. Legislation • The Community Empowerment Bill was passed in June 2015 and aims to make provision about the achievement of national outcomes through increased community involvement and collaborative decision making. The Midlothian Community Planning Partnership is developing a plan to identify the needs of community groups and build capacity across the Council. • The Local Government Pension Scheme (Scotland) Regulations 2014 provides for members to accrue pension on a career average revalued earnings basis rather than on a final salary basis. However, there are regulations in place to protect the benefits accrued by members of the scheme before April 2015	• We will monitor progress on the development of the community plan and compliance with the Community Empowerment Bill. • We will discuss the impact of the legislative changes with the Council through our regular meetings with senior management and those charged with governance, providing a view where appropriate.
3. Health and Social Care Integration • The Public Bodies (Joint Working) (Scotland) Act 2014 established a framework for integrating health and social care. A requirement of the Act was that an Integrated Joint Board should be established by 1 April 2016. • The first meeting of the Midlothian Integration Joint Board (the IJB) was in August 2015 and a Chief Officer and Chief Finance Officer have been appointed. • The key driver for the establishment of integrated joint boards is to create a more effective service which will deliver against outcomes. The Council has created a strategic plan which outlines the vision of the IJB and it's priorities for delivery. • The IJB are currently working on due diligence and financial assurance in order to ensure there are adequate budgeting arrangements in place for April 2016.	• We will monitor progress towards integration. • We will review and comment on the governance arrangements for the IJB. • We have been appointed as external auditors to the IJB and will conduct full audit testing on the 2015-16 financial statements of the IJB.
4. Other requirements • The Council completes the following grant claims and returns on which audit certification is required: - Criminal Justice Social Work - Education Maintenance Allowance - Non-Domestic rates - Housing Benefit • The Council submits a Whole of Government Accounts pack each year. In 2014-15 the Council were marginally below the audit threshold, however, we were required to submit an abbreviated assurance statement for the Council	• We will certify grant claims and returns in accordance with the Accounts Commission requirements. • We will review the Whole of Government Accounts guidance in the current year to establish the threshold and audit requirements. If the group accounts exceed the threshold we will conduct a full audit in line with Scottish Government and National Audit Office guidance.

4. Our audit of the financial statements

Introduction

We are required to audit the financial statements and to give an opinion as to:

- whether they give a true and fair view of the financial position of the Council and it's expenditure and income for the period in question
- whether they have been prepared properly in accordance with relevant legislation, applicable accounting standards and other reporting requirements
- The part of the remuneration report which is subject to audit has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014

Determining materiality

In performing our audit, we apply the concept of materiality, following the requirements of International Standard on Auditing (UK & Ireland) (ISA) 320: Materiality in planning and performing an audit.

The standard states that 'misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements'.

As is usual in public sector entities, we have determined materiality for the financial statements as a whole as a proportion of the gross revenue expenditure of the Council.

For purposes of planning the audit we have determined overall materiality to be £4.536 million (being 1.5% of gross revenue expenditure).

ISA 320 also sets out a requirement to consider performance materiality, which is an amount set by the auditor at less than materiality to reduce the probability that the aggregate of uncorrected and undetected materiality exceeds materiality. Performance materiality is the maximum amount of a misstatement that the audit team can accept in an individual account. We would therefore expect any individual misstatement above this level to be adjusted.

At the planning stage we have set our level of performance materiality at £2.721 million (being 60% of overall materiality).

Under ISA 540, auditors also set an amount below which misstatements would be clearly trivial and would not need to be accumulated or reported to those charged with governance because we would not expect that the accumulation of such amounts would have a material effect on the financial statements. "Trivial" matters are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. We have defined the amount below which misstatements would be clearly trivial to be £165k.

We will consider whether the established levels of materiality are appropriate during the course of the audit and will advise you if we revise this.

ISA 320 also requires auditors to determine separate, lower, materiality levels where there are 'particular classes of transactions, account balances or disclosures for which misstatements of lesser amounts than materiality for the financial statements as a whole could reasonably be expected to influence the economic decisions of users'.

We have identified the following items where separate materiality levels are appropriate.

- Cash and cash equivalents: although the balance of cash and cash equivalents is immaterial, all transactions made by the Council affect the balance. It is therefore considered material by nature and differences over £1k will be considered material.
- Disclosures of senior management salaries and allowances in the remuneration report: there is a statutory requirement for these disclosures and they attract a high degree of public interest. Materiality has been set in line with the required disclosure level i.e. any differences which would impact the disclosed bandings will be considered material.
- We consider the materiality of related party transactions from the perspective of the Council and the related party. Transactions which would not be material to the Council but would be material to the related party should be disclosed in the financial statements.

Our identification of significant audit risks

There are two presumed significant risks which are applicable to all audits under ISA (UK &I) 240. However, as shown in the table below, we have rebutted the risk around revenue recognition leaving one significant risk applicable to the Council.

	Significant Risk	Description of risk	Work planned
1	Management override of controls	Under ISA (UK&I) 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.	• Review of accounting estimates, judgments and decisions made by management • Testing of journal entries • Review of unusual significant transactions
2	The revenue cycle includes fraudulent transactions	Under ISA 240 (UK&I) there is a presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	We identified a number of income streams at the Council comprising: taxation and non-specific grant revenues, housing rental income and fees, charges and other income. Each revenue stream has been considered with regard to the risk factors set out in ISA (UK&I) 240 and the nature of the identified revenue streams. We have rebutted the risk of fraudulent revenue recognition for the reasons outlined below. • there is little incentive to manipulate revenue recognition • the tax and non-specific grant amounts are based on set rates collected monthly and the grant revenue aligns to the award letter and payment profile. There is a predictable pattern of revenues which suggests there is limited opportunity to manipulate reported revenues. • housing rents are based on annual rental agreements with a predictable pattern of expenditure. The processes is sufficiently removed from senior management which reduces the opportunity to commit fraudulent activity. • fees, charges and other income are generally managed outwith the finance team but are subject to close monitoring of income levels. The fees and charges are sufficiently removed from senior management to reduce the opportunity for fraudulent activity.
3	Valuation of property, plant and equipment is not correct	The Council revalues it's assets as part of a five year rolling programme. In 2015-16 a new revaluation programme is planned to ensure the requirements of the Code are met in full. The Code requires that the Council ensures the carrying value at the balance sheet date is not materially different from current value. This is a significant judgement which is informed by the Council's in house valuers and should be disclosed accordingly in the financial statements.	• Review of the competence, experience and objectivity of management experts used • Review of the Council revaluation programme to ensure all assets are covered within the 5 year period required by the Code • Review of the valuer's processes and assumptions for the calculation of the estimate • Review instructions issued by the finance team to the valuer and the scope of their work • Discussions with the valuer regarding the basis for the valuations and challenge of key assumptions • Testing of the revaluations in year to ensure correct input into the Council's asset register and financial statements.

Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, either due to size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty

(ISA (UK&I) 315).

Other audit risks identified

Set out below is our response to the other risks of material misstatement which we identified where the likelihood of material misstatement can not be reduced to remote, without gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work. The risk of misstatement is lower than that for a significant risk and they are not considered to be areas that are highly judgemental, or unusual in relation to the day to day activities of the business.

Other reasonably possible risks	Description of risk	Work planned
Operating expenses	**Operating expenses are understated or not recorded in the correct period** The Council is responsible for the delivery of a range of services to the local area such as education, housing and social care. In 2014-15 the cost of delivering these services was £302 million, a 10% decrease on last year. Purchasing is decentralised across service lines with the budgetary responsibility with the heads of service to ensure monies are recorded correctly.	• We will use our interim visit to review and walkthrough the controls and processes in place over purchase ordering, procurement and general payment and recording of expenditure • Reconciliation of the creditors system to the general ledger and financial statements • Testing of year end transactions for unrecorded liabilities.
Employee remuneration	**Employee remuneration expenses are understated** Employee costs is the largest source of expenditure. Payroll represents 39% of gross expenditure in 2014-15. There is a large number of transactions processed throughout the year and the Council relies on numerous controls to ensure that the employee costs are recorded correctly in the financial statements.	• Review and walkthrough the processes and controls in operation for payment of staff • Analytically review payroll expenses in comparison to expectations and investigate any significant variances • Substantive testing of employee remuneration accruals against expectation • Review the relevant disclosures relating to staff costs within the financial statements.
Welfare benefit	**Welfare benefit expenditure improperly computed** In 2014-15 the Council paid £26.8 million for housing benefits. The systems to establish entitlement to housing and council tax benefit are complex and rely on a number of controls to provide assurance that the benefits are awarded and recorded correctly.	• Review and walkthrough of the processes and controls in place to calculate, pay and record benefit expenditure • Analytically review the benefit expenditure in comparison to auditor expectations and investigate any significant variations • Sample testing of housing benefit payments using the HB Count module • Testing the reconciliation between the benefits system and the amounts recorded in the financial statements.

5. Governance and transparency

Introduction

Corporate governance is concerned with structures and processes for decision-making, accountability, control and behaviour within the organisation. The Council is responsible to ensure proper arrangements are in place for:

- compliance with applicable guidance
- ensuring the legality of activities and transactions
- monitoring the adequacy and effectiveness of these arrangements in practice

The Code of Practice gives the auditor a responsibility to review and, where appropriate, report findings on the Council's corporate governance arrangements.

We will review and, where applicable, report findings relating to financial governance, strategic financial planning and financial control. Specifically we will consider:

- the systems of internal control, including its reporting arrangements
- the prevention and detection of fraud and irregularity
- the standards of conduct, and arrangements in relation to the prevention and detection of corruption
- risk management procedures
- the financial position of the Council.

Governance Structures

The Council have developed a local Code of Corporate Governance based on the CIPFA/ SOLACE Framework. Compliance with the Code of Corporate Governance is monitored on an annual basis and in 2014-15 the Council identified a number of areas for improvement including:

- compliance with the new International Framework of Good Governance in the Public Sector
- full compliance against the new CIPFA code of practice on Managing the Risk of Fraud and Corruption.

We will consider the progress made with improving the governance framework as part of our responsibilities under the Code of Practice.

Annual Governance Statement

The Annual Governance Statement (AGS) is the key document that records the governance ethos of the Council, and assurances around the achievement of the vision and strategic objectives of the Council. The AGS summarises the internal control framework, arrangements for risk management, financial governance and accountability. During 2014-15, we concluded that the disclosures within the Council's AGS were clear and comprehensive and included major developments such as the Council's response to gas problems at Newbyres.

Under the Code of Audit Practice, we are required to review and report on the AGS annually. We will assess the Council's external reporting of governance, through the 2015-16 Annual Governance Statement and management commentary in the accounts against best practice.

We will use the Code and the principles from the Delivering Good Governance in Local Government framework, the key source of guidance on governance for local government bodies, to assess compliance against good practice. This will enable us to identify areas where the Council is performing well and areas where there is scope to improve the clarity and impact of reporting.

Our work with internal audit

Each year, we consider the work of the Council's internal auditors to ensure that our audit approach takes account of the risks identified and the work they have conducted, subject to our review of the internal audit function.

We also seek to ensure that we co-ordinate our work and avoid duplication of effort. The internal audit plan for 2015-16 covers key areas within governance and risk and internal control systems including:

- Financial strategy
- Welfare reform
- Tendering of contracts

We have not identified any areas in the current year where we will seek to place reliance on the work of internal audit. We have, however, reviewed the internal audit reports issued to date and note that their work has not identified any weaknesses which would impact our audit approach.

Fraud and Irregularity

The term fraud refers to intentional acts of one or more individuals among management, those charged with governance, employees or third parties involving the use of deception that result in a material misstatement of financial statements. In assessing risks, the audit team is alert to the possibility of fraud at the Council.

As part of our audit work we are responsible for:

- identifying and assessing the risks of material misstatement of the financial statements due to fraud
- designing and implementing appropriate audit testing to gain assurance over our assessed risks of fraud
- responding appropriately to any fraud or suspected fraud identified during the audit.

It is the Council's responsibility to establish arrangements to prevent and detect fraud and other irregularity. This includes:

- developing, promoting and monitoring compliance with standing orders and financial instructions
- developing and implementing strategies to prevent and detect fraud and other irregularity
- receiving and investigating alleged breaches of proper standards of financial conduct or fraud and irregularity.

Throughout the audit we work with the Council to review specific areas of fraud risk, including the operation of key financial controls. We also examine the policies in place, strategies, standing orders and financial instructions to ensure that they provide a strong framework of internal control.

6. Value for money, financial sustainability and financial management

Best Value

Accountable Officers are required to demonstrate economy, efficiency and effectiveness and the achievement of 'Best Value' in the use of resources. The objective of Best Value is to ensure that bodies deliver better and more responsive public services by:

- balancing the quality of services with cost
- continuously improving the services provided
- being accountable and transparent
- achieving sustainable development in how the Council operates
- ensuring equal opportunities in the delivery of services.

Audit Scotland are currently working on a revised approach to auditing Best Value across the sector. As this is the final year of the Audit Scotland appointments we will focus on ensuring a smooth transition and preparing for the new approach. A key element to this will be a baseline survey provided by Audit Scotland covering all key areas of Best Value.

Following the Public Pound

A Ministerial Direction issued under Section 51 of the Local Government (Scotland) Act 2003 outlines that local authorities have a statutory responsibility to comply with the Code of Guidance on Funding External Bodies and Following the Public Pound (the Following the Public Pound Code).

The principles of the Following the Public Pound Code are aligned to the broader duty to achieve Best Value. As auditors we have a responsibility to consider the Council's arrangements to comply with the Following the Public Pound Code. This will become increasingly important as local authorities look into alternative delivery models.

In 2014-15 we noted that the Council had established a Co-Production Panel to conduct an exercise to review the grant allocation to community groups. The panel also reviewed the monitoring arrangements to ensure alignment with the Single Midlothian Plan priorities. The Panel developed a range of recommendations and an implementation plan.

We will continue to review and comment on the Council's work against the requirements of the Following the Public Pound Code in 2015-16.

Local Scrutiny Plan

The Local Area Network (LAN) of external scrutiny bodies continues to work together to develop a shared risk assessment and Local Scrutiny Plan for the Council. The Local Scrutiny Plan 2015-16 was published in March 2015 and confirmed that there were no significant concerns relating to Midlothian Council.

We are currently engaged, with the LAN, in a refresh of the Council's Local Scrutiny Plan. The shared risk assessment and scrutiny plan is being reviewed based on all recent work undertaken by scrutiny partners, including our findings within our Annual Report to Members 2014-15.

Performance Information

Audit Scotland continues to stress the critical role of self-evaluation and good quality performance information in allowing councils to demonstrate that they are delivering efficient and effective services.

Statutory Performance Indicators (SPIs) are one of the key ways that council performance is measured and reported to the public. In 2014-15 the Council's performance indicators showed a mixed performance with some service areas meeting all targets and others with 'alerts' on the performance targets.

The Council also report on the Local Government Benchmarking Framework indicators. In 2013-14 the results showed a mixed picture with the Council attaining results evenly across each performance quartile. The 2014-15 results were published in February 2016 and have not yet been considered by the Council.

As part of our audit we are required to consider the arrangements for collecting and publishing information on SPIs. Our work is informed by the Statutory Performance Indicators Direction.

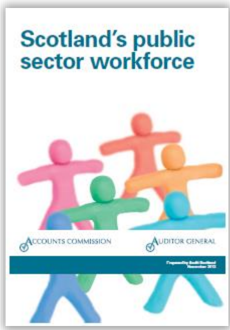
The Accounts Commission is currently considering the strategy for the local audit of SPIs and aims to issue the new Direction by 31 December 2015. We will conduct our audit in line with the guidance issued by Audit Scotland.

Audit Scotland national reports: impact

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

Each year, Audit Scotland ask us to review the local impact of national studies at each local government body. There is an expectation that the Council will review national reports at a committee level and action them accordingly. As external audit we are required to consider:

- whether the Council has discussed the national report at committee level
- whether the Council has carried out a self-assessment against the national report
- whether an action plan has been developed as a result of any self- assessment.



In 2015-16 auditors are expected to report on a targeted follow-up of Scotland's Public Sector Workforce report, which was published in November 2013, on selected public sector bodies. We are awaiting confirmation that the Council are included in the targeted follow-up work. Any follow up work will be based o a pro-forma questionnaire provided by Audit Scotland.

National Fraud Initiative

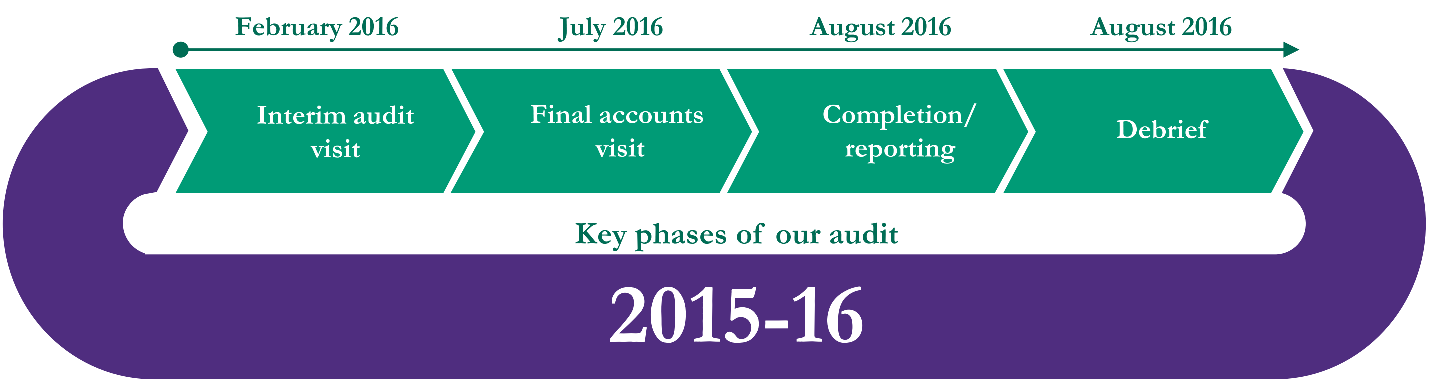
The Council is participating in the NFI 2014-15. Data was submitted data in late 2014 and matches were received for investigation in early 2015. Our Annual Audit Report noted the Council had investigated 95% of the 3,302 matches from the NFI exercise.

Audit Scotland has asked us to monitor the Council's participation and progress during 2014-15 and 2015-16. We have been asked to complete an NFI audit questionnaire for each body participating in the NFI by 29 February 2016.

The information provided by auditors will form the basis of Audit Scotland's NFI report to be published in May 2016.

7. Logistics and our team

The audit cycle



Our team

Paul Dossett Partner **T** 07919 025 198 **E** paul.dossett@uk.gt.com	**Raul Rodriguez** IT Audit Specialist T 0131 659 8534 E raul.rodriguez@uk.gt.com
Claire Gardiner Manager **T** 0131 659 8563 **E** claire.l.gardiner@uk.gt.com	**Mitchell Collins** Audit Associate T 0131 659 8531 E mitchell.j.collins@uk.gt.com
Rowena Roche In-charge Auditor T 0131 659 8583 E nicholas.smith@uk.gt.com	**Chloe Johnston** Audit Associate T 0131 659 8559 E chloe.johnston@uk.gt.com
	Cynthia Pang Audit Associate T 0131 659 8556 E cynthia.pang@uk.gt.com

Date	Activity
December 2015	• Planning
February 2016	• Issue Audit Plan to Officers
February 2016	• Interim site visit • Submit National Fraud Initiative return and current issues return to Audit Scotland
15 March 2016	• Audit Plan presented to Audit Committee
May 2016	• Submit annual fraud return to Audit Scotland
July 2016	• Year end fieldwork
July 2016	• Certify Education Maintenance Allowance and Criminal Justice Social Work Grants
July 2016	• Submit technical database return to Audit Scotland
August 2016	• Audit findings clearance meeting with Director of Finance • Annual Audit Report issued to officers
20 September 2016	• Report audit findings to those charged with governance (Audit Committee) • Sign financial statements opinion • Submit Statutory Performance Indicators pro-forma and minimum dataset to Audit Scotland • Submit WGA Assurance statement
October 2016	• Certify Non-Domestic Rates Return
November 2016	• Certify Housing Benefit Grant Claim

Fees, non audit services and independence

Fees

	£
Midlothian Council (including Grant certification)	241,760
Total audit fees	**241,760**

Fees for other services

Service	Fees £
None	Nil

2015-16 Audit Fee

The audit fee is calculated in accordance with guidance issued by Audit Scotland for determining the fee level for local government bodies. Audit Scotland requires that the agreed fee is within the limits of the indicative fee range.

Your fee for the 2015-16 external audit is £241,760 representing a 1% increase compared to the prior year. This is below the rate of inflation and therefore represents a decrease of 0.6% in real terms.

Our fee assumptions include:

- our fees are exclusive of VAT
- supporting schedules to all figures in the accounts are supplied by the agreed dates and in accordance with the agreed upon information request list
- the scope of the audit, and the Council and its activities have not changed significantly
- The Council will make available management and accounting staff to help us locate information and to provide explanations.
- the Council will not provide more than 3 versions of the accounts – 1) first completed draft of the full financial statements and annual report 2) second version including all our agreed adjustments (financial and disclosure) for us to validate and 3) final version for approval/signing. If more than 3 versions are produced and we are required to review these, and this leads to inefficiencies and additional costs being incurred for our team, as well as inefficiencies from your perspective. We reserve the right to charge you an additional fee to reflect this time, if the upfront timetable agreed with you, is not met

Independence and ethics

We confirm that there are no significant facts or matters that impact on our independence as auditors that we are required or wish to draw to your attention. We have complied with the Auditing Practices Board's Ethical Standards and therefore we confirm that we are independent and are able to express an objective opinion on the financial statements.

Full details of all fees charged for audit and non-audit services will be included in our Audit Findings report at the conclusion of the audit.

We confirm that we have implemented policies and procedures to meet the requirements of the Auditing Practices Board's Ethical Standards.

We are required by auditing and ethical standards to communicate any relationships that may affect the independence and objectivity of the audit team. Whilst we are independent of the Council, we draw attention to our external audit appointments to local authorities in Appendix A of this report who may be in receipt of funding. At all times during the audit, we will maintain a robustly independent position in respect of key judgement areas.

Communication of audit matters with those charged with governance

International Standards on Auditing (ISA) 260, as well as other ISAs, prescribe matters which we are required to communicate with those charged with governance, and which we set out in the table below.

Our communication plan	Audit Plan	Annual Audit Report
Respective responsibilities of auditor and management/those charged with governance	✓	
Overview of the planned scope and timing of the audit. Form, timing and expected general content of communications	✓	
Views about the qualitative aspects of the entity's accounting and financial reporting practices, significant matters and issues arising during the audit and written representations that have been sought		✓
Confirmation of independence and objectivity	✓	✓
A statement that we have complied with relevant ethical requirements regarding independence, relationships and other matters which might be thought to bear on independence. Details of non-audit work performed by Grant Thornton UK LLP and network firms, together with fees charged. Details of safeguards applied to threats to independence	✓	✓
Material weaknesses in internal control identified during the audit		✓
Identification or suspicion of fraud involving management and/or others which results in material misstatement of the financial statements		✓
Non compliance with laws and regulations		✓
Expected modifications to the auditor's report, or emphasis of matter		✓
Uncorrected misstatements		✓
Significant matters arising in connection with related parties		✓
Significant matters in relation to going concern		✓

9. Appendices

Contents	Page

Appendix A-An audit focused on risks

We undertake a risk based audit, focussing audit effort on those areas where we have identified a risk of material misstatement in the financial statements. The table below shows how our audit approach focuses on the risks we have identified through our planning and review of the national risks affecting the sector. Definitions of the level of risk and associated work are given below:

Significant – Significant risks are typically non-routine transactions, areas of material judgement or those areas where there is a high underlying (inherent) risk of misstatement. The International Standards on Auditing identify two overall significant risks inherent in any financial statements. These are separately disclosed in the significant risks table on page 9.

Other– Other risks of material misstatement are typically those transaction cycles and balances where there are high values, large numbers of transactions and risks arising from, for example, system changes and issues identified from previous years audits. We will assess controls and undertake extended substantive testing. Cycles where we have identified a reasonably possible risk of material misstatement are outlined in full on page 10 along with full details of the proposed testing

None – Our risk assessment has not identified a risk of misstatement. We will undertake substantive testing of material balances. Where an item in the financial statements is not material we do not carry out detailed substantive testing.

Section of the financial statements	Material (or potentially material) balance?	Description of Risk	Inherent risk	Material misstatement risk identified?	Inherent Risk Assessment	Will substantive testing be carried out?
Net Cost of Services Operating Expenditure	Yes	Operating expenses are understated	Medium	Other	Net cost of services was in 2014-15 was £302m (including staff costs) with a high volume of transactions being processed through the system. We have therefore assessed the inherent risk as medium.	✓
Net Cost of Services Staff Cost	Yes	Employee Remuneration accruals are understated	Medium	Other	The Council reported staff costs of £118m (56% of the net cost of services). There is therefore a high number of monthly transactions which represents a significant proportion of running costs. Based on this information we have assessed the inherent risk as medium.	✓
Net Cost of Services Housing Benefit	Yes	Welfare benefit improperly computed	Medium	Other	During 2014-15 we identified some inaccuracies in the processing of housing benefit claims. The inherent risk has therefore been assessed as medium.	✓
Net cost of services and other revenues	Yes	Revenue is fraudulently recognised	Low	None	We have considered the nature of the revenue streams at the Council and concluded that risk of fraud arising from revenue recognition can be rebutted.	✓

An audit focused on risks

Section of the financial statements	Material (or potentially material) balance?	Description of Risk	Inherent risk	Material misstatement risk identified?	Inherent Risk Assessment	Will substantive testing be carried out?
Net Cost of Services Housing Rents	Yes	Operating expenses are misstated	Low	None	Housing Rents are made up of a high volume of transactions at a low value. The inherent risk of material misstatement is therefore deemed to be low.	✓
Surplus/ Deficit on the revaluation of non-current assets	Yes	Revaluation measurements not correct	Low	None	The values of fixed assets are updated as part of the year end processes which comprises a low volume of high value transactions. We have therefore assessed inherent risk of material misstatement as low.	✓
Return on Pension Assets	Yes	Fair value measurements not correct	Low	None	Actuarial valuations are provided at the year end and are recorded in the ledger through a low volume of high value transactions. The risk of material misstatement is therefore deemed to be low.	×
Actuarial losses on Pension Assets and Liabilities	Yes	Fair value measurements not correct	Low	None	Actuarial valuations are provided at the year end and are recorded in the ledger through a low volume of high value transactions. The risk of material misstatement is therefore deemed to be low.	✓
Property, Plant and Equipment	Yes	Valuation measurements are not correct	High	Significant	Property, Plant and Equipment is valued on a rolling five year programme with the potential for material movement in the value of assets. Given prior year adjustments we have assessed the inherent risk associated with revaluation of assets as high.	✓
Heritage Assets	No	Valuation measurements are not correct	Low	None	The balance is below materiality therefore risks are deemed to be low.	×
Intangible Assets	No	Allowance for amortisation not adequate	Low	None	The balance is below materiality therefore risks are deemed to be low.	×
Long term investments	No	Fair value measurements not correct	Low	None	The balance is below materiality therefore risks are deemed to be low.	×

An audit focused on risks

Section of the financial statements	Material (or potentially material) balance?	Description of Risk	Inherent risk	Material misstatement risk identified?	Inherent Risk Assessment	Will substantive testing be carried out?
Inventories	No	Inventory prices and quantities are not valid	Low	None	In the 2014-15 accounts the balance disclosed was below materiality and therefore the risk is deemed to be low.	×
Debtors (long and short term)	Yes	Recorded debtors are misstated	Low	None	Debtors is comprised of a high volume of routine low value transactions. We therefore assess the inherent risk associated with debtors to be low	✓
Assets held for sale	No	Revaluation measurements are not correct	Low	None	The balance is below materiality therefore risks are deemed to be low.	×
Cash and cash equivalents	Yes	Cash misappropriated	Low	None	Handled cash is comprised of a high volume of low value transactions therefore we have deemed inherent risk to be low.	✓
Borrowing (long and short term)	Yes	Debt obligations not reflected accurately	Low	None	Borrowing is comprised of a low volume of high value transactions. We therefore assess the inherent risk of material misstatement to be low.	✓
Trade and Other Payables	Yes	Creditors understated or not recorded in the correct period	Medium	Other	Creditors in 2014-15 were £25m with a significant of transactions occurring around the year-end. The creditors figure is comprised of a number of accruals with a high value and requiring management judgements. We have therefore deemed the inherent risk to be medium.	✓
Provisions	No	Provision is not adequate	Low	None	In the 2014-15 accounts, the amount disclosed for provisions was below materiality, with the risk deemed to be low.	×
Pension Liability	Yes	Fair Value measurements are not correct	Low	None	Actuarial valuations are provided at the year end and are recorded in the ledger through a low volume of high value transactions. The risk of material misstatement is therefore deemed to be low.	✓
Reserves	Yes	Reserves are not correctly recorded	Low	None	The balance is comprised of a very low volume of high value transactions therefore inherent risk is deemed to be low.	✓