Audit Committee
Tuesday 20 September 2016
Item No 5.1

Grant Thornton
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Midlothian Council

Annual Report to Elected Members and the Controller of Audit for the financial year ended 31 March 2016

20 September 2016

Key messages

Midlothian Council ('the Council') has achieved a small deficit on the provision of services of £0.270m for the year ended 31 March 2016, which is in line with budgeted actual net service expenditure of £193.3m. The financial statements were presented to us in line with the specified deadline and our audit testing has been completed earlier than last year. There have been only a few amendments made to the financial statements resulting from our audit.

The Council's Financial Strategy is interlinked with the Single Midlothian Plan, the Delivering Excellence Programme and the People Strategy and Effective Working in Midlothian (EWiM) Plan. The Strategy recognises the significant challenges facing the Council including Council tax freeze; decreases in grant funding, an ageing population and resultant pressure on services, all of which impact on the projected budget shortfall by 2017-18 of £11.2m, rising to £36.9 million by 2020-21.

The Council recognise that they need to deliver savings of between £6million to £8million per year. Each directorate is working to identify savings proposals of £5m for 2017-18 and beyond to put before Members in autumn this year. Delivering sustainable and significant savings is the biggest challenge facing the Council.

ISA 260 requirements

We intend to issue an unqualified opinion on the 2015/16 financial statements.

We did not have reason to change our audit plan during the year. We did identify a few weakness in the Council's systems of internal control, based on our work undertaken.

We have identified a few amendments to the financial statements which are set out in appendix A.

We have also identified issues on Journal processes (page 17), PPE valuations (Page 12) and Employee Debt (Page 17).

Public Sector Audit impact dimensions

Our external audit work is undertaken in accordance with the Audit Scotland Code of Practice (May 2011). Our annual report is structured to reflect our wider responsibilities under the Code, and this year we have shaped this around the 4 Public Sector impact dimensions reflected in the Audit Scotland Corporate Strategy 2015/ 2018.

Financial management

The Council continues to budget accurately, with the year end position in line with the budget set at the start of the financial year. Budget monitoring reports are provided to Members on a quarterly basis. The monitoring reports would be strengthened with more detailed explanations for the underlying causes of variations together with a sensitivity analysis demonstrating the impact of the changes in key assumptions.

The General Fund Reserve at the 31 March was £24.6m of which £7.8m is earmarked for specific projects with a balance of £16.7m held as a contingency. This represents approximately 8.7% of budgeted net expenditure.

The Council's Transformation Programme Savings target for 2015-16 was not achieved. There remains scope to improve the Council's reporting of savings targets to Members throughout the year and this will become even more vital in the challenging years ahead.

The Finance Team will have a key role to support and challenge future service savings programs. Schemes will need to be appropriately risk assessed, challenged and subject to formal approval with clear milestones set out which are subject to frequent and timely monitoring.

Key growth projects are having a positive impact with funding from Council tax £0.25m above budget and an improvement of in year collection rate to 94.4%. which is an increase of 0.6% from the previous year.

Financial sustainability

The future financial and service sustainability of all local authorities is an on-going area of question, with the Council identifying a £36.9 million funding gap through to 2020-21.

The strategic focus of Finance and Integrated Service Support is on delivering transformational change in service provision as a means to secure financial sustainability and achievement of priority outcomes.

The key programmes which support this are:

- The Review of Local Government Workers Pay and Grading
- Delivering Excellence
- The Council's Financial Strategy

The transformation and repositioning of services is critical to the Council maintaining a sustainable financial and service delivery strategy during a period of continued pressure on public sector finances. As yet the Council does not have a good overall record of delivering savings on a year on year basis, though there is a strong record of delivering savings in some service areas.

The Leadership Team recognise that it will become increasingly difficult for the Council to achieve financial balance without a more fundamental change to the way the Council operates. The Council will need to look into the potential of sharing back office facilities as a method of generating savings to limit the impact on front line services, whilst continuing to secure a shift in culture and behaviours across the Council, adapting and innovating in response to the many challenges services face in the future.

Governance and transparency

The Council has undertaken a review of the effectiveness of its governance arrangements and internal controls to support the Annual Governance Statement, identifying further areas to be strengthened in 2016/17.

The Council's internal auditors review the effectiveness of its governance arrangements and compliance against the Local Code of Governance on an annual basis. We concluded that the Council's Annual Governance Statement is balanced and in line with CIPFA requirements. During the audit process, we asked the Council to disclose the level of assurance that the systems and processes that comprise the Council's governance arrangements can provide. We also requested disclosures on the impact of BREXIT and to add an update on the Newbyres gas incident and replacement houses.

One of the key aspects of the Council's governance framework is the approach to management of risk. During 2015-16 work has been undertaken on the Council's Corporate Risk Register through a benchmarking exercise with other local authorities. A strategic risk profile approach has ben refreshed which has identified current issues and emerging risks that have also been used to inform the revised Risk Register. The Council will need to ensure that this remains a live and dynamic process subject to rigorous scrutiny throughout 2016/17.

The Council's committee structure includes an Audit Committee and Performance Review and Scrutiny Committee which conduct the scrutiny function. Members are increasingly engaged and challenge management appropriately. The Audit Committee is well attended by officers and Members and is well supported. The Audit Committee has an independent Chair, who provides additional perspective and financial acumen.

From the internal audits undertaken in 2015/16, a number of areas that required improvement to the internal controls were identified. While a small number of areas were rated as weak, these were confined to certain control objectives within specific audits for example Developer Contributions and Business Gateway for which follow up audits have been undertaken. The majority of reviews throughout the year have shown either average or good internal controls.

Internal audit is compliant with the requirements under Internal Audit Standards and delivers the specified plan, but as a function it will need to become a more proactive change agent to assist the Council in facing the challenges ahead. This will include undertaking consultancy work to assist with reviewing and commenting on proposals for new ways of delivering services and reviewing savings proposals.

We have no concerns around arrangements currently in place to mitigate against fraud and corruption. We note that significant progress has been made against the 2014/15 NFI matches.

Best value and value for money

The Single Midlothian Plan incorporates the five following overarching thematic groups which support the achievement of outcomes and is used for quarterly performance reporting and the themes are as follows:

- Adult Health, Care – Responding to growing demand for the adult social care and health services;
- Community Safety – Ensuring Midlothian is a safe place to live, work and grow up in;
- Getting it Right for Every Midlothian Child – Improving outcomes for children, young people and their families;
- Improving Opportunities for People in Midlothian – Creating opportunities for all and reducing inequalities;
- Sustainable Growth and Housing – Growing the local economy by supporting business growth and responding to growing demand for housing in a sustainable environment.

During 2015/16 the Council demonstrated significant progress towards these priorities. Reports are presented to the Special Performance, Review and Scrutiny Committee on a quarterly basis. The reports provide details on work undertaken and planned across the themes which is supported by key performance indicators which detail performance against target for the year, and a comparison to prior year outcomes.

Areas of highlight for 2015/16 are:

- The Scottish Government approved the proposed Midlothian Integration Scheme in June 2015. The Midlothian Integration Joint Board met for the first time in August 2015. The Board is responsible for strategic planning in relation to the delivery of Health and Social Care services in Midlothian. In December 2015 it approved a three year strategic plan. From 1st April 2016 Health and Social Care budgets were delegated to the Joint Board and directions on their use were issued by the Board. At an operational level work is ongoing to implement joint management structures. In our view the IJB has made a good start.
- The Borders Rail line opened in September 2015 and passenger numbers have exceeded initial expectations. With the 0.5 million passenger mark having been passed and an average of 23,000 passengers using the line on a weekly basis it is predicted that final passenger numbers for the first year will exceed 1.2 million.
- During the year the Council undertook a Review of Local Government Workers pay and grading arrangements and in June 2016 secured a collective agreement. Implementation is now underway for 1 October 2016.

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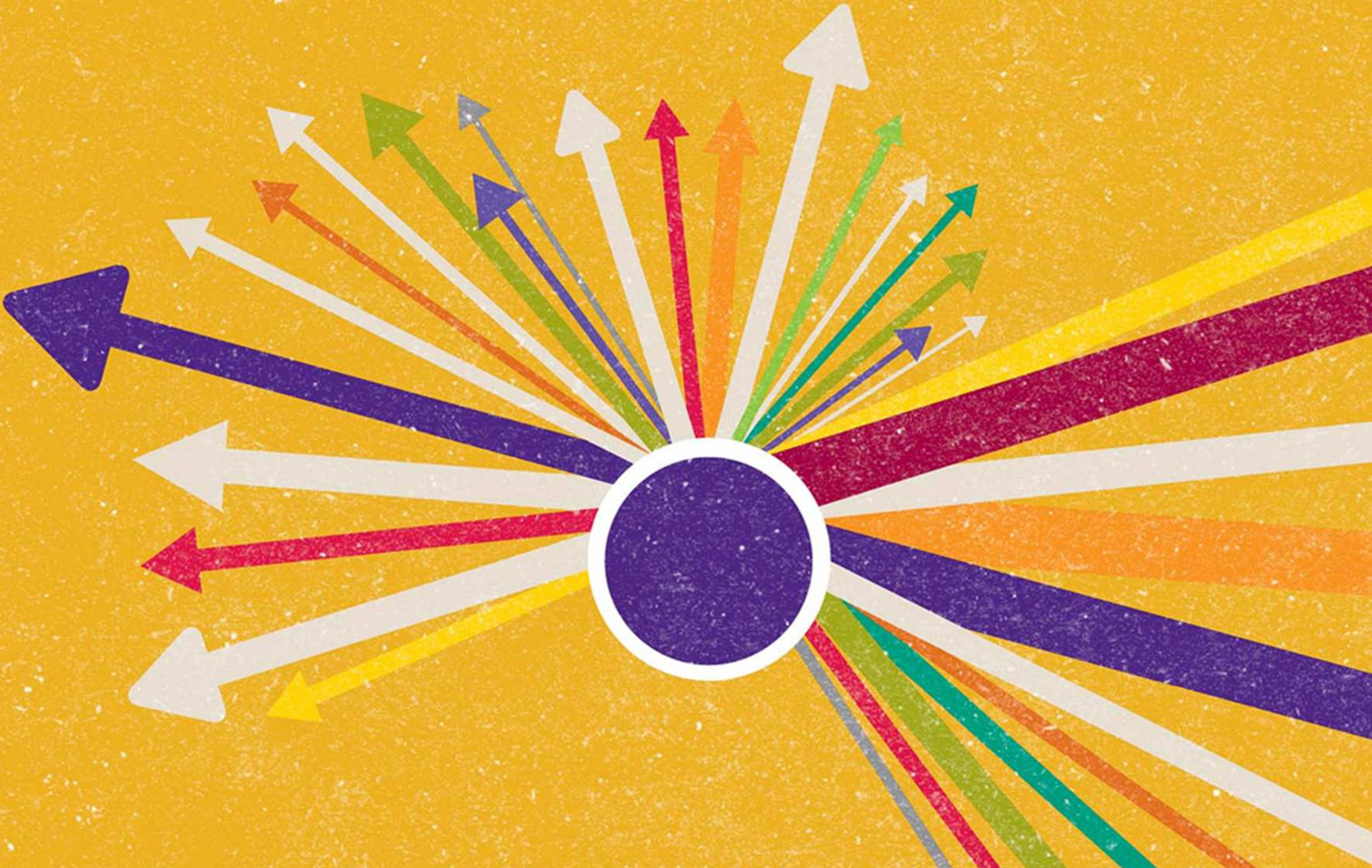


1. Introduction

This report is presented to those charged with governance and the Controller of Audit and concludes our audit of Midlothian Council for 2015/16.

We carry out our audit in accordance with Audit Scotland's Code of Audit Practice. This report also fulfils the requirements of International Standards on Auditing (ISA) 260: Communication with those charged with governance.

Introduction

Purpose of this report

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

Our annual audit report is addressed to those charged with governance at the Council and the Controller of Audit under our Audit Scotland obligations.

In our report, we summarise our opinion and conclusions on significant issues arising from our external audit for the year ended 31 March 2016.

The Council's responsibilities

It is the Council's responsibility to prepare the financial statements in accordance with the CIPFA Code of Practice on Local Authority Accounting in the United Kingdom (the CIPFA Code)

The Council must:

- prepare financial statements which give a true and fair view of the financial position of the Council and its income and expenditure for the year to 31 March 2016
- maintain proper accounting records which are up to date
- take steps to prevent and detect fraud and other irregularities.

The Council is also responsible for establishing proper arrangements to ensure that:

- public business is conducted in accordance with the law and proper standards
- public money is safeguarded and properly accounted for
- economy, efficiency, effectiveness and Best Value are achieved in the use of resources. We note that delivery of best value is a statutory obligation for the Council.

Our responsibilities

We are required to meet the requirements of the Code of Audit Practice ('the Code') May 2011, including consideration of the wider scope of public sector audit.

We provide an opinion on the Financial Statements and Annual Governance Statement. Under the Code we also review and report on the governance arrangements as well as wider financial management, value for money and performance considerations.

International Standard of Auditing (UK and Ireland) ('ISA') 260: Communication with those charged with governance requires us to communicate audit matters arising from the audit of the financial statements to those charged with governance. This annual report, together with other reports to the Audit Committee throughout the year, discharges our ISA 260 commitments.

Acknowledgements

We would like to take this opportunity to record our thanks for the assistance provided by the Head of Finance and Integrated Service Support, the Financial Services Manager, the Finance Team and all other staff who supported us during the course of our work.

Our responsibilities under the Code of Audit Practice:

Financial statements

Provide an opinion on:

- whether the financial statements provide a true and fair view of the financial position of the Council
- whether the financial statements have been properly prepared in accordance with relevant legislation, the applicable accounting framework and other reporting requirements

Review and report on:

- other information published within the financial statements, including the remuneration report

Corporate governance

Review and report on the Council's corporate governance arrangements as they relate to:

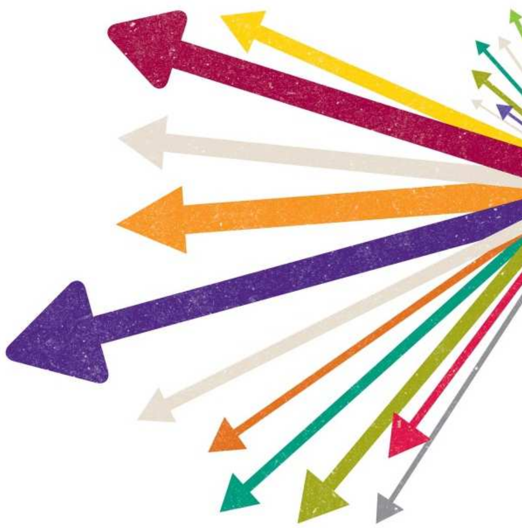
- the Council's overarching corporate governance arrangements and systems of internal control, including reporting arrangements
- the prevention and detection of fraud and irregularity
- standards of conduct and arrangements for the prevention and detection of corruption

Best value and performance

- The Local Government (Scotland) Act 2003 places a statutory duty on the auditors of local government bodies to be satisfied that proper arrangements have been made for securing Best Value and complying with responsibilities relating to community planning
- We are required to review and report on other aspects of the Council's arrangements to manage their performance as they relate to economy, efficiency and effectiveness in the use of resources
- We review and report on the Council's arrangements for preparing and publishing statutory performance information
- In accordance with guidance issued by Audit Scotland, auditors may be requested to participate in a performance audit, an examination of the implications of a particular topic for the Council at a local level or a review of the Council's response to national recommendations. In 2015/16 we have completed a baseline assessment of workforce planning arrangements.

An audit of the financial statements is not designed to identify all matters that may be relevant to those charged with governance. Weaknesses or risks are only those that have come to our attention during our normal audit work in accordance with the Code and may not be all that exist.

Communication of the matters arising from our audit work does not absolve management from its responsibility to address the issues raised and to maintain an adequate system of control.



2. ISA 260 communication to those charged with governance

Draft financial statements were received by 30 June 2016. These were of a good standard supported by adequate working papers

Testing provided reasonable assurance on all identified areas of significant and reasonably possible audit risks as set out at planning.

The Management Commentary is in line with our knowledge of the Council and the guidance issued by the Scottish Government

ISA 260 Requirements

We concluded our audit of the financial statements by the end of August 2016, ahead of the end of September deadline and earlier than the previous year.

We intend to issue a true and fair audit opinion on the financial statements of the Council

The audited parts of the Remuneration Report are free from error

Financial statements overview

Introduction

We have not had to alter or change our audit approach, which we set out in our Audit Plan, which was presented to the Audit Committee on 15 March 2016. However, on receipt of the draft financial statements we updated our materiality calculations (see page 10).

Our audit is substantially complete although we are finalising our procedures in the following areas:

- receipt of direct confirmations in respect of investment balances
- completion of the WGA pack.
- sign off of, Housing Benefit and Non Domestic Rates grant claims
- completion of final review procedures
- obtaining and reviewing the management letter of representation
- updating our post balance sheet events review as part of our concluding procedures, to the date of signing the opinion.

Our review of the financial statements

The draft financial statements continue to improve, although we still identified a few misstatements .

We reviewed the narrative elements of the financial statements (including the Management Commentary, Statement of Responsibilities, Annual Governance Statement and Remuneration Report). We review these statements for compliance with recommended CIPFA Code disclosures, for consistency with other areas of the financial statements and our knowledge of the Council.

Financial statements opinion

Our audit identified 3 misstatements that were above our trivial level of £0.201m. These are set out in Appendix A.

We intend to issue an unqualified opinion on the financial statements for the financial year ended 31 March 2016.

Grants certification

The Criminal Justice Social Work claim was certified within the required timescale during the year, with no issues arising. The Education Maintenance Allowance was certified in the timescale with a very minor amendment.

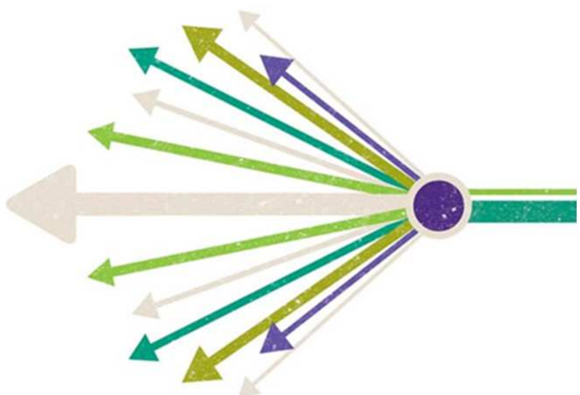
The Non Domestic Rates grant work is well advanced and we expect to certify the claim in September 2016. The Housing Benefit grant claims will be signed following completion of our audit work in September and October 2016..

Whole of Government Accounts

The Council submits a WGA pack for the financial year ended 31 March 2016.

For 2015/16 the Council is below the testing threshold and therefore full audit assurance is not required.

In accordance with the WGA guidance we will complete the required assurance statement and submit that to the National Audit Office (NAO) once this work has been completed.



Our audit plan: a reminder

Scope of the Audit

We consider the inherent risks to the Council and how these may result in a material misstatement in the accounts. We identified three significant risks and three reasonably possible risks, which are outlined on pages 11 to 14.

We conduct a range of audit procedures across all balances above performance materiality, including analytical review, agreement to third party confirmations and sample testing of balances.

At the planning stage our draft materiality level for Council was set at £4.536 million, calculated as 1.5% of 2014/15 gross expenditure during planning. We revised this figure to £4.023 million based on final 2015/16 figures..

Performance materiality was revised to £2.414 million at year end in line with the materiality change (testing limit set to reduce the probability that aggregate of uncorrected/ undetected misstatements exceed materiality)

Unadjusted differences over our de minimus level of £0.201 million are included within Appendix A. All misstatements identified under the limit have been reported to officers.

Reasonably possible risks in Plan relating to

- operating expenses,
- employee remuneration
- welfare benefit expenditure

Significant risks were as follows:

management override of controls (fraud risk). Presumed revenue recognition risk was rebutted. Valuation of Property Plant and Equipment

Change of materiality from Audit Plan

We revised our materiality downwards in the year in line with the reduction in gross expenditure in the 2015/16 unaudited accounts. This resulted in final materiality of £4.023 million and final performance materiality of £2.414 million.

Audit findings against significant and reasonably possible risks

Set out below is our response to the significant risks of material misstatement identified in the Audit Plan. There are two presumed significant risks which are applicable to all audits under auditing standards but, as set out in our plan and below, we rebutted the presumed risk around revenue recognition.

	Significant Risks identified in our audit plan	Work completed	Assurance gained
1	Management override of controls Under ISA 240 there is a presumed risk that the risk of management over-ride of controls is present in all entities.	• Review of accounting estimates, judgements and decisions made by management including pension assumptions and property valuation • Testing of journal entries • Review of unusual and/or significant transactions	Our audit work has not identified any evidence of management override of controls. We have highlighted control issues in relation to journals on page 17.
2	The revenue cycle includes fraudulent transactions Under ISA 240 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.	• Having considered the risk factors set out in ISA 240 and the nature of the revenue streams at the Council, we determined the risk of fraud arising from revenue recognition can be rebutted, because: – there is little incentive to manipulate revenue recognition – opportunities to manipulate revenue recognition are very limited – the culture and ethical frameworks of local authorities, including the Council, mean that all forms of fraud are seen as unacceptable. • The most significant area of revenues was general grant funding from the Scottish Government totalling £123.4 million. We have substantively agreed grant funding to confirmation from the Scottish Government. • The remainder is made up of £32.8 million of NDR redistributions (agreed to funding correspondence and cash receipts), £35.4 million of council tax income (tested analytically and reconciled to Council Tax system) and £38.8million revenue and grants and release of £8.2m capital grants (sample tested to grant agreements and receipt). • In addition, we have conducted sample testing of fees, charges and other income to trace to cash receipts.	Our work confirmed that revenue had been recognised appropriately in the 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).

Audit findings against significant and reasonably possible risks

	Significant Risks identified in our audit plan	Work completed	Assurance gained
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 was planned to ensure the requirements of the Code are met in full. The Code of Practice on Local Authority Accounting requires that the Council ensures the carrying value of assets 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.	• Reviewed the competence, experience and objectivity of management experts used • Reviewed the Council revaluation programme to ensure all assets are covered within the 5 year period required by the Code • Reviewed the valuer's processes and assumptions for calculating the estimate • Reviewed the instructions issued by the Finance Team to the valuer and the scope of their work • Interviewed the valuer regarding the basis for the valuations and challenge of key assumptions • Tested the revaluations in year to ensure correct input into the Council's asset register and financial statements.	Our audit work has confirmed that the valuation of property plant and equipment is materially stated. We identified that the Council applied the incorrect social housing discount factor to additions to housing stock (applying 69% rather than 64.5%). The financial impact of this was to understate the value of the Council Houses by £0.572m which is an unadjusted error. The Council did not carry out a detailed assessment on those assets that had not been valued in the year to determine whether the carrying value at the balance sheet date was not materially different from current value. We requested the Council to undertake this review. The Council used indexes that estimated the potential increase to assets not revalued in the year at£0.640m which equates to 0.1% of the total Property Plant and Equipment value and not material. This is an annual uplift applied to all general fund assets (not subject to revaluation between 1 April 2015 to 31 March 2016. The uplift does not reflect potential changes in asset values for those assets that had not been subject to revaluation between 1 April 2011 to 31 March 2015. Applying the uplift to previous years results in an estimated value well below materiality and therefore no adjustment to the financial statements is required.

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).

Set out below is our response to the other 'reasonably possible' risks of material misstatement which we identified in the Audit Plan.

Transaction cycle	Description of Reasonably Possible Risks	Work completed	Assurance gained
Operating expenses	Creditors understated or not recorded in the correct period • Midlothian Council is responsible for the delivery of a range of services to the local area. • Purchasing is decentralised across service lines with the budgetary responsibility with the senior managers to ensure monies are recorded correctly.	We gained assurance over the risk through: • Review and walkthrough of key processes and controls around creditors cycle • Reconciliation of the creditors system to the general ledger and financial statements • Sample testing of post year end transactions to test for unrecorded liabilities.	We gained sufficient assurance over the operating expenditure control environment and balances to conclude that there is not a material understatement of creditors. Our testing of unrecorded liabilities identified 3 items that had not been accrued for. The Council justified these decisions based on the size of the transactions (the largest item being £108). The rationale of not accruing small items is justifiable, however, there is no documented de-minimis level below which Midlothian Council do not accrue. Implementing a policy would assist officers in making their assessments and documenting judgements.
Employee remuneration	Employee remuneration accruals understated: • Employee costs are the Council's most significant expenditure item in the financial statements. There are a large number of transactions processed throughout the year and the Council relies on numerous controls including monthly reconciliations and segregated duties when compiling employee remuneration batches to ensure that the employee costs are recorded correctly in the financial statements.	We gained assurance over the risk through: • Review and walkthrough of the processes and controls in operation for payment of staff • Substantive testing of employee remuneration accruals at the year end • Testing a sample of 52 employees to the HR system for existence, and recalculating employer costs for accuracy • Undertaking a trend analysis of employee remuneration in comparison to expectations • Review of the relevant disclosures relating to staff costs within the financial statements including the remuneration report.	We gained sufficient assurance over employee remuneration processes to conclude that there are no material misstatements.

"Reasonably possible risks are, in the auditor's judgement, other risk areas which they have identified as an area where the likelihood of material misstatement cannot be reduced to remote, without the need for gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work"

Set out below is our response to the other 'reasonably possible' risks of material misstatement which we identified in the Audit Plan.

Transaction cycle	Description of Reasonably Possible Risks	Work completed	Assurance gained
Welfare benefit	Welfare benefit expenditure improperly computed In 2015-16 the Council paid £26.8 million for housing benefits. The systems to establish entitlement to housing and council tax reductions are complex and rely on a number of controls to provide assurance that the benefits are awarded and recorded correctly.	We gained assurance over the risk through: • 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 investigated any significant variations • Sample testing of housing benefit payments • Testing the reconciliation between the benefits system and the amounts recorded in the financial statements.	We gained sufficient assurance over welfare benefit processes to conclude that there are no material misstatements.

"Reasonably possible risks are, in the auditor's judgement, other risk areas which they have identified as an area where the likelihood of material misstatement cannot be reduced to remote, without the need for gaining an understanding of the associated control environment, along with the performance of an appropriate level of substantive work"

Accounting estimates and significant judgements

Accounting area	Summary of policy	Commentary	Our assessment
Revenue recognition	• **Grants receivable:** Government grants, third party contributions and donations are recognised as due to the Council when there is reasonable assurance that the Council will comply with the conditions attached to the payments. • **Sale of goods:** Recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits will flow to the Council. • **Provision of Services:** Recognised when the Council can measure reliably the percentage of the completion of the transaction. • **Council Tax and Non Domestic Rates:** 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.	• The revenue recognition policies are appropriate under the CIPFA Code of Practice on Local Authority Accounting.	Green
Property, plant and equipment	• The Code of Practice on Local Authority Accounting permits assets to be revalued on a rolling basis. Assets are normally revalued once every five years for each class of assets, provided that carrying amount does not differ materially from that which would be determined using the current value at the end of the reporting period. The Council needs to undertake an exercise to evidence that the carrying values are not materially different from the current value at the end of each reporting period. • During 2015-16, £427.4million (67%) of the other land and buildings was revalued.	• The revaluation policies are in line with requirements. • The Council had not carried out a detailed assessment on those assets that had not been valued in the year to determine whether the carrying value at the balance sheet date was not materially different from current value as part of the accounts preparation process. An analysis was provided during the audit.	Amber

Assessment

- Material accounting policy which could potentially attract attention from stakeholders
- Accounting policy appropriate but scope for improved disclosure
- Accounting policy appropriate and disclosures sufficient

Accounting area	Summary of policy	Commentary	Our assessment
Provisions	• The Council recognises provisions where an event has taken place that gives the Council a legal or constructive obligation that will probably require a settlement by transfer of economic benefits or service potential. • Provisions are charged as an expense to the appropriate service line in the Comprehensive Income and Expenditure Statement in the year the Council becomes aware of the obligation.	• We are satisfied the policy is appropriate under the CIPFA Code of Practice on Local Authority Accounting. • The Council has recognised provisions for two items: – insurance provision (£1.640million) – debtor provisions (£32.468 million). • We have reviewed the reasonableness of management's judgements in line with our knowledge of the Council. • We have conducted a detailed review of the debtors provision, including re-performance of calculations and review of assumptions. • We identified that the Council tax bad debt provision of £16.161m is not based on collection rates or the age of the debt. The Council has agreed that the methodology needs revising for future years. The current provision represents 88% of the outstanding debtor balance of £18,450k so is not materially understated.	Amber
Pension fund valuations and liabilities	• In accordance with International Accounting Standards the Council is required to account for retirement benefits when it is committed to giving them. • This involves recognition in the Balance Sheet of the Council's share of the net pension asset or liability together with a pension reserve. • Estimation of the net liability to pay pensions depends on a number of complex judgements. A firm of consulting actuaries (Hymans Robertson) is engaged to provide the Council with expert advice about the assumptions to be applied.	• We have reviewed the accounting policies and confirmed they are in line with the guidance in the CIPFA Code and IAS 19. • We have reviewed the competence, capability and objectivity of Hymans Robertson, who have been used as management's expert in year. • We have relied on an auditors expert, PriceWaterhouseCoopers (PwC) UK LLP, to provide assurance over the reasonableness of assumptions and judgements applied by the actuary. • We are satisfied pensions have been disclosed appropriately.	Green
Other accounting policies	• We have reviewed the Council's policies against the requirements of the CIPFA Code and accounting standards	• Disclosures were in line with the CIPFA Code and considered reasonable. • Review of the accounting policies noted that there is no capitalisation threshold in place.	Green

Other areas of audit focus

Internal controls

We update our understanding of the Council's key financial controls and overall control environment on an annual basis.

We considered internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate to our financial statements audit, but not for the purpose of expressing an opinion on the effectiveness of internal control. We undertook walkthrough testing related to:

- property plant and equipment valuation
- employee remuneration
- operating expenditure
- welfare expenditure
- journal entries
- IT control environment

We did not identify any significant deficiencies or material weaknesses arising from our limited testing of the financial controls, however we did identify minor deficiencies relating to journals procedures. The deficiencies identified were:

- The use of manual entry of journal numbers, which means that journals are not always consecutive
- Gaps in the journals listings
- Manual entry of who has posted and approved individual journals
- One side journals to correct errors in payroll posting

Control weaknesses over the financial ledger potentially expose the Council to risk of fraudulent journals. While our testing provides assurance that the accounts are not materially misstated, there is a residual risk that the individuals could exploit the system deficiency.

Our testing of Related Party Transactions identified that the Council does not hold a register of interests for senior management, nor have the senor management team been requested to disclose any potential related party interests for disclosure within the financial statements.

An action plan is in place to address our control findings reported.

IT control environment

Our testing identified the following deficiencies relating to the IT control environment which have been reported in a separate letter to the Digital Services Manager.

- The Council should explore the options to relocate the secondary server room to a more remote location. The Council's contingency planning group are aware of this ongoing risk and will explore and consider costed Business cases to mitigate this risk.
- The primary and secondary server rooms should be serviced by an electric generator as this would greatly assist the recovery of IT operations in the event of a power outage. The Council are aware of the risk and considering this as part of the wider IT strategy.
- The Council should test the recovery of the Open revenues, Integra, Tribal and Itrent systems at least on an annual basis. An incremental testing approach is now being considered.
- The Lumension software should be used to restrict access to personal USB sticks from PCs and Laptops. The global policies across the citrix estate have now been updated to restrict personal USB sticks.
- System administrator access is only granted to members of staff that require it to fulfil their job responsibilities. User accounts and access rights have since been updated.
- Login activity, unauthorised access attempts, access provisioning activity created by the Council's systems should be proactively and formally reviewed for the purpose of detecting inappropriate or anomalous activity. The Council plans to evaluate and consider software products and speak to other councils to consider solutions for monitoring audit logs.
- The Council should perform a gap analysis against the requirements of the latest version of PCI-DSS (a proprietary information security standard for any organisation that processes, transmits or stores card holder information). Any gaps identified from this analysis should be subject to remediation work. All card processing is performed using PCI DSS compliant providers, QSA consultant days purchased to review CDE architecture and identify compliance gaps, there is still dependency on third party (card processors) being able to facilitate some of the change.
- Management should perform periodic, formal reviews of the user accounts and permissions within the Active Directory, Integra, Itrent and application databases. The Council proposes to target key systems on an annual basis.

Other areas of audit focus

Employee Debt

The Council continues to employee staff that owe the Council monies. The total amount is estimated at the time of our audit was £999,152 in July 2015. The Council has recently updated their statistics which show:

- Staff debt outstanding has reduced to £897,767
- Staff debt scheduled for collection by mandate is £433,148
- Staff debt on Local Arrangement (not by mandate) is £118,560
- Staff debt non complying cases subject to recovery is £314,917

Our testing identified the following issues with the controls/processes:

- We identified one new employee that the Council had concluded on appointment that they did not owe them money. It transpired that they owed the Council
- One new employee with known debt was allowed to take up their position and was not required to pay back any of their debt to the Council. The rationale for the employee not requiring to pay back the debt was due to the low number of hours that the employee was due to be working at the Council so it was felt it would be unfair to reduce their salary.
- The employee debt spreadsheet was created and maintained by a single employee from a number of records held by the Council. We identified that one employee had their records duplicated within the spreadsheet thus overstating the debt. This gives us concerns on the accuracy of the data.
- The spreadsheet is updated on an adhoc basis. This is because there are no reporting tool or deadlines internally and the process is a labour intensive one. As a result, it is difficult to get an employee debt figure at a single point in time.

Other financial Statement amendments

Our audit also identified the following amendments:

- The Long Term Investments balance of £3.382m within the balance sheet is based on the value of Lothian Buses for which the Council has a 5% shareholding. The balance of £3.382m was based on Lothian Buses prior year financial statements as the current year financial statements were not published until after the Council's draft accounts were submitted. An amendment of £1.807m is required.
- The following amendments were required to the National Non Domestic Rates Return:

– Unoccupied property relief amended by £333,653

– Bad doubtful debts now collected adjustment from £1,165,532

Total increase in contributable amount £0.832m which reduces creditor balance.

Going concern

We considered going concern and obtained assurance through:

- review of financial factors including levels of debt, liabilities, arrears and operating cash flows
- review of financial forecasts and the assumptions which underpin the forecasted figures. The Council business plan sets out indicative financial forecasts through to 2017/18 and beyond

Overall we conclude that it is appropriate for the Council to prepare the financial statements on a going concern basis.

3. Financial management

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Financial management

2015/16 out-turn

The Council approved a balanced 2015/16 budget in February 2015, in accordance with statutory deadlines.

Budgeted Net Services expenditure in 2015-16 was set at £193.3m which equated to the actual net service expenditure for the year. Funding from council tax and grants from the Scottish government resulted in higher than budgeted income of £0.251m.

Financial savings

The 2015-16 budget was set following adoption of the Council's Medium term Financial Strategy. The Financial Strategy, and related transformation delivery plans identified savings of £1.5m

The Business Transformation Steering Group is responsible for monitoring progress against the Transformation Delivery Plan. Updates were also provided within the Financial monitoring reports to Council. The initial budget is detailed in the table below

Area	£m
Integrated Service Support	0.750
Energy	0.151
Income Maximisation	0.075
Education	0.150
Services to Communities	0.050
Children's services	0.350
Total	1.526

The Council approved utilisation of £5.868 million of General Fund Reserves to fund costs associated with the ongoing transformation programmes.

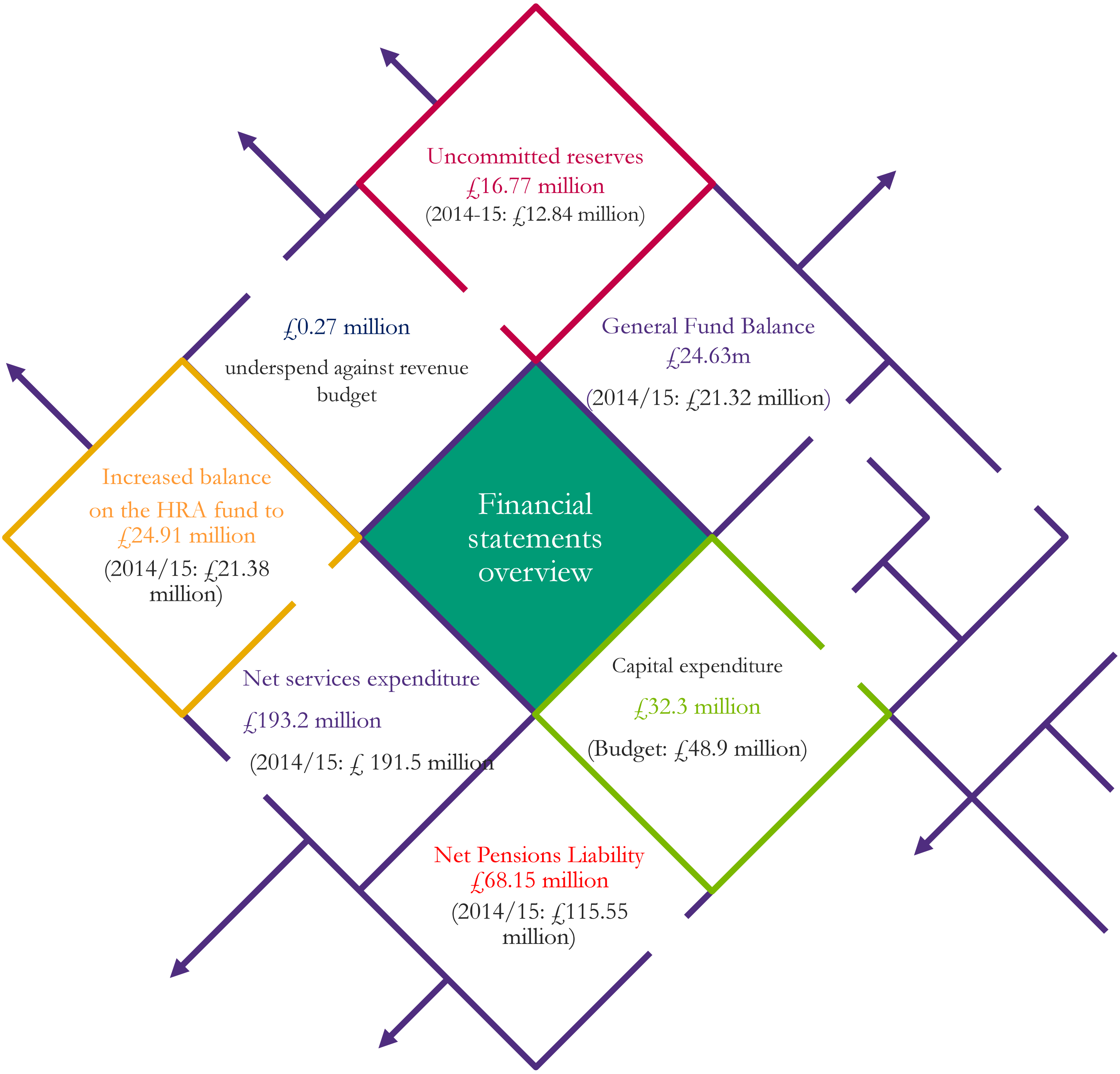
At the year end £2.950 million of this has been applied with future commitments of £0.715 million identified for 2016/17 and 2017/18. This leaves £2.203 million as uncommitted. This balance is within the £5.579m earmarked projects carried forward shown in the table opposite.

Movement on General fund reserve	£milion
Reserve at 1 April 2015	21.315
Less earmarked reserves utilised in 2015/16	- 5.851
Planned Enhancement	2.764
Supplementary estimates	- 0.315
Scottish govenrment funding previously earmarked	1.339
Transformation costs	- 0.368
One off costs VSER	- 0.376
Workforce reduction	0.056
Finance discipline	0.416
Earmarked budgets carried forward	5.579
Boarders rail	- 0.181
Other	- 0.023
Underspend	0.270
Total	24.625

The Council continues to budget accurately, with the year-end surplus in line with budget monitoring reports in the year. The Council has sought to continue to build reserves, with uncommitted general fund reserve as at 31 March 2016 representing 8.7% of annual net budget. The Council is continuing to focus on achieving savings over and above those needed to balance the budget. This will allow for further investment in the Council's strategic priorities and provide financial support for any emerging cost pressures.

Overall the Council's financial position for 2015/16 has strengthened and the Council are in a comparatively good position going into 2016/17. We note that the reserves position has been built in recognition of the greater challenges that face the Council in future years. The scale of the savings required mean that careful monitoring will continue to be key to ensure delivery against increasingly challenging savings targets. As yet the Council does not have a good overall record of delivering savings on a year on year basis, though there is a strong record of delivering savings in some areas, and 2016/17 represent a challenging position, albeit one buffered by strong reserves.

Key Financial Statement highlights for the financial year ended 31 March 2016 were:



Finance position – Budget against actual

The Council has a good track record of delivering its revenue budget. During 2015/16, routine budget monitoring reports presented remained within 0.7% of the revised budget and final outturn.

Service Area	Budget 2015-16 £000s	Outturn 2015-16 £000s	Variance 2015-16 £000s
Children Services	14,863	15,558	695
Communities and Economy	4,633	4,235	- 398
Education	77,653	76,957	- 696
Adult Social Care	36,894	37,234	340
Customer and Housing Services	12,004	12,400	396
Commercial Services	15,753	15,304	- 449
Finance and integrated support	12,100	12,304	204
Properties and Facilities Management	13,608	13,166	- 442
Investment income	- 180	- 300	- 120
Loan charges	7,493	7,077	- 416
Other Expenditure/ income	- 1,541	- 675	866
Net service outturns	**193,280**	**193,260**	- **20**
Council Tax Income	- 40,000	- 40,251	- 251
Scottish Government Grant	- 156,320	- 156,320	-
Total Net Expenditure	- **3,040**	- **3,311**	- **271**

As at 31 March 2016 there was a £0.271 million underspend against the net cost of services budget. The main variances include:

– Underachievement of other expenditure/income £0.866m due to higher insurance costs and under achievement of savings targets.

– An overspend of £0.695 million on children's services for both residential and secure placements and due to the duration of secure placements continuing longer than anticipated.

– An underspend of £0.696m on Education due to a number of factors, including a lack of availability of supply teachers. This has led to staff absence being covered by school management staff resulting in underspends. In addition, the unit cost of utilities used within PPP was lower than expected.

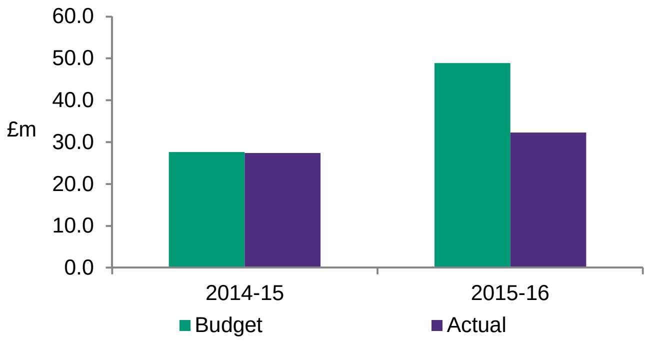
– An underspend of £0.449m on commercial services due to additional income from external jobs and lower fuel prices.

– An underspend of £0.442m on properties due to increased income from the ski slope and reductions in catering costs.

– An underspend of £0.416m on loan charges due to re-phasing of projects which has allowed deferral of long-term borrowing, reduction in borrowing costs through lower than forecast interest rates, and increase in projected investment returns through utilisation of higher yield investment products.

Capital programme

The Council incurred capital expenditure of £32.313 million, for the year with main projects being new school builds, road maintenance improvements and introduction of energy-efficient street lighting.



Due to the underspend, £14.287 million will be required to be carried forward to 2016/17 this was caused by:

- Contaminated land issues and necessary remediation works on New Social Housing Phase 2 sites have resulted in delays within the programme and resulted in slippage of £5.257 million.
- £0.162 million is required to be carry forward for New Social Housing Phase 1 for Solar Panel Replacements.
- Difficulties in gaining access to a number of properties to carry out works will result in slippage of the Sanitary Ware Replacement Programme of £3.754 million.
- General slippage in the SHQS Repairs Programme, Upgrades of Central Heating Systems and Energy Efficiency Programme of £3.114 million, £1.164 million and £0.264 million.

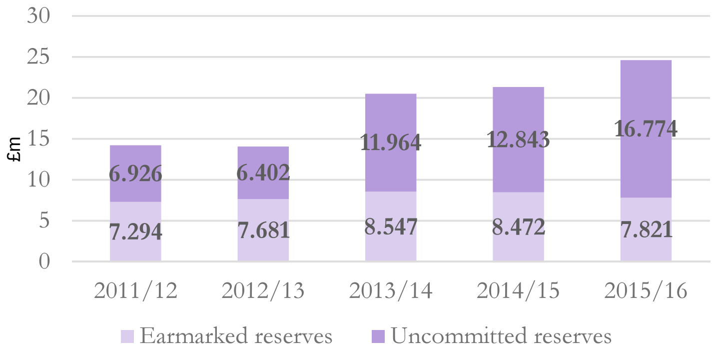
Housing Revenue Account

Expenditure in 2015/16 totalled £27.8 million (2014/15 £55.7 million), including impairment and depreciation charges of £15.6 million (2014/15 £43.5 million). Income has increased 10.8% year on year as a result of approved rent increases and additional grant income. The net surplus is £3.5m (2014/15 £3.0m).

Reserves position

Un-earmarked reserves as at March 2016 were £16.774 million which was an increase on prior year (£12.84 million).

The earmarked element of the General Fund decreased in year to £7.821 million (2014/15: £8.472 million).

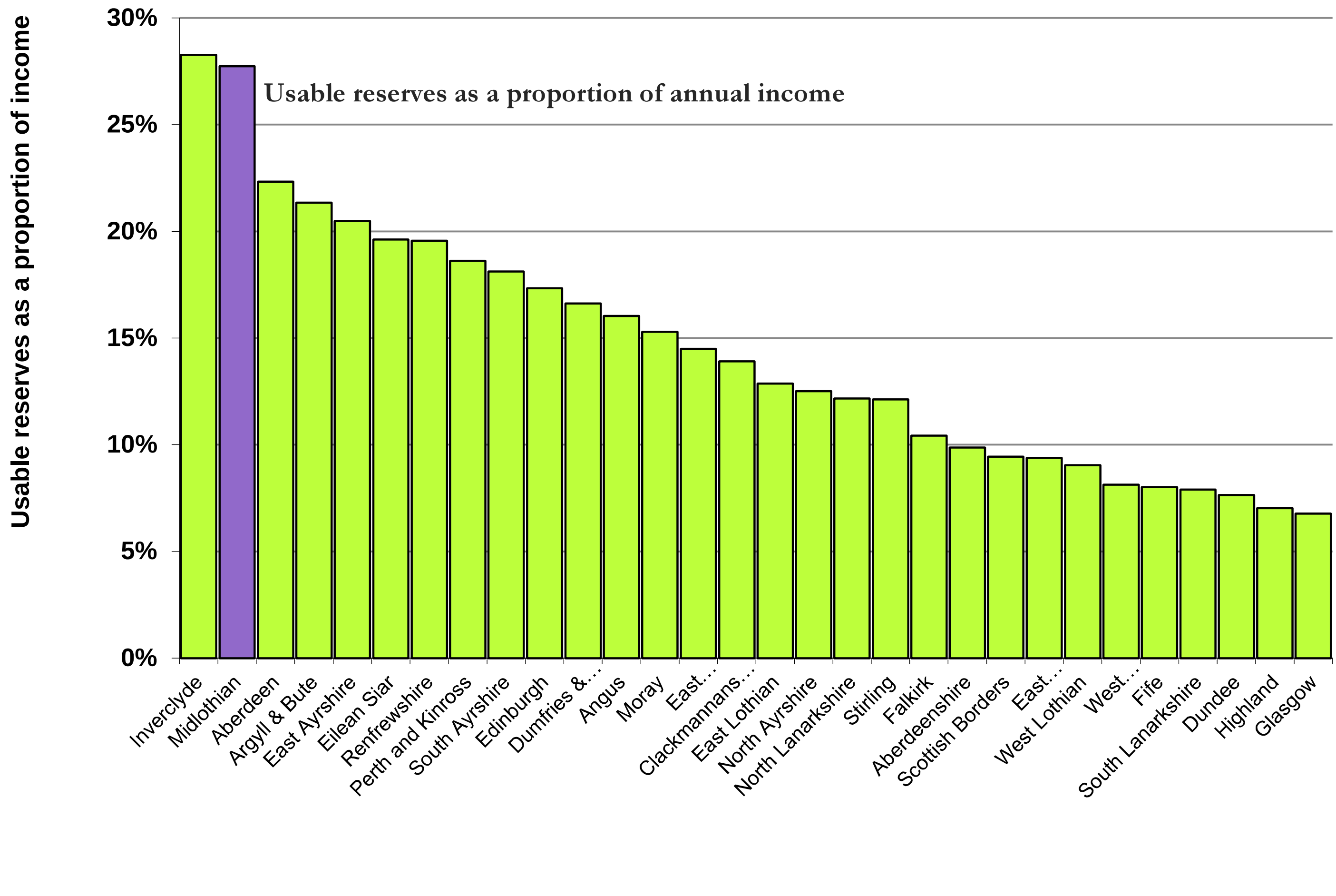


Source: Midlothian Council Abstract of Accounts 2011/12 to 2015/16

Earmarked purposes include:

- Ring fenced funding from partner organisations of £2.811m.
- Budgets provided for specific purposes where funding has slipped into 2016/17 of £1.747m
- Budgets for schools in accordance with the Scheme of Devolved School Management of £1.020m
- Funding to support the transformation program of £2.203m
- Funding to support the economic development opportunities offered by the opening of Boarders Rail line of £0.069 million.

We note below that the level of usable reserves as a proportion of income is within the upper range of Councils in Scotland. However, those Council's that have a HRA Reserve will be at the higher end. Midlothian has a £24.9m HRA Reserve, almost all of which is committed to support new house building.



Source: Audit Scotland Technical Database July 2016

3. Financial Sustainability

Financial Sustainability

2016/17 and 2017/18 Budget

The 2016/17 budget was approved by Council on 8 March 2016. The budget was balanced, but included utilisation of £2.668 million from reserves. The Financial Strategy for 2016-17 to 2020-21 was presented to and approved by the Council on 22 September 2015. The strategy was revised in June 2016. For 2017-18 the Strategy projects a budget shortfall of £11.2m, rising to £36.9 million by 2020-21. Throughout the course of the plan, the deficit position is expected to grow with some savings identified, but significantly more will need to be done in this area in order to achieve budgetary balance.

The Council continue to review the longer term financial plans and are relatively flexible at adapting to changes as notified by the Government. When the funding settlement was announced for 2016/17 the Council acted and found the necessary savings by re-assessing plans and utilising reserves.

Cumulative savings proposals of £3.172 million have been identified for consideration through its part of the plan. These are shown in the table below

Service	2017 /18	2018 /19	2019/ 20	2020/ 21
	£m	£m	£m	£m
Children's Services	0.076	0.350	0.350	0.350
Services to communities	0.200	0.800	1.050	1.050
Education	0.269	0.292	0.765	0.765
Customer Service	0.175	0.175	0.350	0.350
Integrated Service Support	1.555	1.555	1.555	1.555
Totals	2.275	3.172	3.172	3.172

In addition to these options, work is ongoing to identify further options to bridge the financial gap. With the growing deficit, careful monitoring of savings against targets and actions to address shortfalls will be a key to ensure the stability of the financial position.

The expectation is that the Scottish Government will publish its budget proposals in the autumn of 2016 covering the three years 2017/18 to 2019/20. However given the shift in responsibility for tax revenues and the result of the EU referendum there is a significant likelihood that the Government's budget may be published later in 2016 and or that it will only be a one year budget encompassing 2017/18. The central planning assumption adopted for the Scottish Government grant projections is based on a reduction, similar to that experienced in the current year, of 3.3 % per annum. It is also assumed that government will continue to direct resources to Integrated Health and Social Care Boards via the NHS.

The Council does not have a strong overall record of delivering savings, but recognises that 2016/17 needs to be a year when savings start to come through. We believe it now has the leadership from both officers and Members to drive this forward but it will happen quicker in some parts of the Council than others

Given the extent of savings anticipated to secure a balanced budget for 2017/18 and the continued challenge for later years the Chief Executive has instructed each Director to bring forward as a minimum savings proposals of £5 million for consideration by the Strategic Leadership Group (SLG) in the autumn. Proposals, once agreed by SLG will then be presented to the Business Transformation Steering Group (BTSG) for their consideration before being presented to Council.

Our national work with local authorities has identified that Local Government is, so far, continuing to deliver despite significant financial challenges. This is replicated at Midlothian Council, but the Leadership Team recognise that maintaining services within budget will become increasingly challenging over the next five years. The Delivering Excellence Framework aims to support the repositioning of services while maintaining financial stability.

Delivering Excellence

The Delivering Excellence framework aims to reposition services to have a greater emphasis on the priorities and outcomes within the Single Midlothian Plan. Delivering Excellence is supported by an updated Financial Strategy, which provides initial budget projections to 2020-21. Based on the assumptions set out within the Financial Strategy, the projected budget gap over the period is estimated at £37 million.

To achieve financial sustainability in the context of the projections requires the repositioning of services and a focus on priorities. The framework recognises that the achievement of savings of this level will be dependent on policy decisions taken by the Council. Key decisions will be needed to prioritise services and identify others that will no longer be funded or will be provided by alternative approaches. To deliver excellence across the organisation, leadership and culture will be critical.

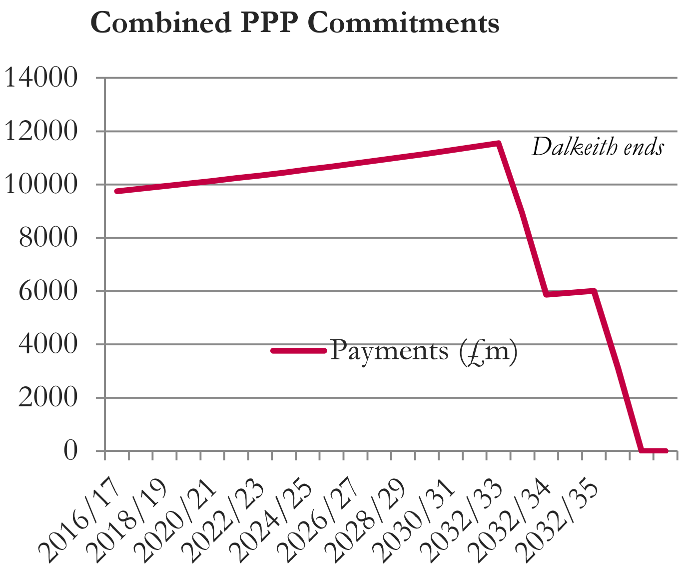
PPP and PFI contracts

The Council entered into Public Private Partnerships for Dalkeith School Campus and Primary Schools the value of the assets and liabilities are held on the Council's balance sheet.

The Council pays a unitary charge which covers service costs, interest payments and repayment of debt. The total annual unitary charge for 2015/16 was £10.2 million of which a proportion is met by Scottish Government within the overall grant settlement. Over the remaining life of these contracts, the Council expects to pay £210 million in charges. This represents a significant portion of the overall budget settlement and is built into long-term financial plans to ensure that the unitary charge can be afforded over the life of the contract.

PPP Commitments over life of the contract

Element	Dalkeith Campus £m	Primary Schools £m	Total £m
Principal charge	24.4	31.7	56.1
Interest charge	29.1	32.1	61.2
Service Charge	40.5	52.1	92.6
Unitary Charge	**94.0**	**115.9**	**209.9**



Workforce Planning

As part of our wider Code work during the year we were required to complete a return on Workforce Planning for the Council. This took the form of a follow-up to the November 2013 report published by Audit Scotland. A number of good practice areas were identified in the report, such as the Council have reviewed good practice and held conversations with other Councils and Audit Scotland the results of which are being incorporated into the Council's Workforce Plan.

From our work we identified that there is currently no organisation wide workforce plan to support the people strategy, but this is in development. Heads of Service will be using workforce plans as a central part of their short and long term vision and planning with SLG sessions from September to October 2016 helping form a new set of workforce plans resulting in wider organisational plans for late 2016, early 2017.

The relevance of workforce planning will increase as the shape of the organisation evolves and the budgetary pressures increase. There has been a focused approach over the last year with the Integration of Health and Social Care where workforce planning has been essential in the planning and delivery of integrated services

The Council are developing the workforce strategy first at a service level and then will pull together into an organisation wide plan. The Plan will need to include:

- Forecast expected staff numbers, skill needs and costs on a rolling basis.
- The impact of any service redesign on the workforce needs to be measured and monitored within the plan
- There will need to be scenario planning completed at a formal level or included in the plans.
- The plan will need to be evaluated and reviewed

Performance against other local authorities

Audit Scotland complete an annual analysis of all 32 local authorities based on the unaudited financial statements against a series of measures. Our review noted that performance against other local authorities was generally in the middle of the range, but there were some areas the Council were considered as an outlier.

These included:

- Second highest Usable Reserves as a proportion of net revenue as noted on page 23 and eleventh highest in the movement within the year on the same ratio. We note that those Council's that have a HRA Reserve will be at the higher end. Midlothian has a £24.9m HRA Reserve, almost all of which is committed to support new house building.
- The Council were the highest for movement on the HRA balance in 2015/16 as a proportion of dwelling rents. This is mainly due to decreases in expenditure (impairment and depreciation) charges in 2015/16. The Council has the largest balance on HRA carried forward as a percentage of dwelling rents.
- The Council has the lowest amount of capital expenditure financed from general fund as a proportion of net income in 2015/16.
- Top quartile for capital financing requirement as a proportion of net external debt. The provision for repayment of debt as a proportion of net external debt is lower than the majority of other Councils.
- The Council has one of the lowest proportions interest payable and similar charges as a proportion of gross external debt. This is recognition that the Council has obtained favourable rates with lenders.

In their Overview of Local Government in Scotland 2015, Audit Scotland stated that most of the local authorities, like Midlothian, are reporting funding gaps. At this stage, the Council, in common with other Local Authorities, faces continued uncertainty over whether planned savings will be sufficient to cover gaps.

We have followed up against each key area highlighted below:

Issue raised	Impact on Midlothian
Spending more money than planned	Cost control and management of resources remains a key area of focus for the Council. Budgets will need to closely monitored. In 2015/16 the performance generally tracks closely to budgets. Budget monitoring information for services and budget managers across the Council are prepared and discussed on a monthly basis. As part of this any potential risk areas are picked up and acted upon. However, as at the end of August 2016 there have not been any summary budget monitoring reports presented to Council for 2016-17. The first quarter report will be presented in September.
Not making savings as planned	This will be a key area of focus for Midlothian.
Having to compromise unexpectedly on the quality of services they deliver, without having worked with service users to review and evaluate other options	Both quality of service and community engagement are key pillars of the Council approach. Consideration will need to be given to a variety of savings options and there will need to be consultation with key stakeholders.
Being unable to meet increasing demand for future services	The Council remain focused on medium and long-term financial planning and incorporate forecast increases in demand for future services into these plans.
Not having enough money in their reserves that they can use if required	This will need to be a clear area of focus for the Council, with a strategic focus on ensuring long term financial stability.

4. Governance and transparency

Governance and transparency

Annual Governance Statement

Elected Members and senior management are responsible for the governance of the business affairs of the Council and have 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.

The framework includes a requirement that an Annual Governance Statement (AGS) should be prepared; that this be included as part of the Financial Statements; and that the AGS be authorised by the Leader of the Council and Chief Executive.

The level of compliance with the Code of Corporate Governance is monitored by requiring Heads of Service (including the statutory post of Section 95 Officer) to complete a self-assessment against the key elements of the Code. Input from the Monitoring Officer is also sought. Internal Audit independently reviews a sample of control elements from the Code, as well as using evidence from its own reviews of Council performance undertaken during the year. Internal Audit concluded that the Council's framework of governance, risk management and control over the period 2015/16 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.

We reviewed the Council's AGS as part of our audit procedures and concluded that the disclosures were in line with the CIPFA Code and our knowledge of the Council. The statement is sufficiently balanced, reflecting key aspects of the Council's governance structure as well as key areas for future development. We recommended some minor changes in relation to disclosure of BREXIT, Newbyres gas incident and an indication of the level of assurance that the systems and processes that comprise the Council's governance arrangements can provide.

Audit committee

In June 2015, the Audit Committee conducted a self-assessment of its effectiveness against CIPFA's Audit Committee - Practical Guidance for Local Authorities.

The self-assessment found a strong level of compliance against the guidance. Specific amendments were highlighted relating to the Committee's Terms of Reference relating to ethics, the Committee's role in Treasury Management and specific service reviews. In addition, individual Audit Committee members have been asked to complete a Core Knowledge Self-Assessment to allow any training needs to be identified.

Our own observations of the Audit Committee are good. The Committee is well-attended, both by members and by senior Council officers. The Committee is also supported by internal audit, and by the Independent Chair, who provides additional perspective and financial expertise to the Committee.

Scrutiny arrangements

Scrutiny arrangements are in place with the lead taken by Audit Committee and Performance Review and Scrutiny Committee. The performance review and scrutiny committee receives regular performance reports that detail progress against the key themes in the Single Midlothian Plan.

Internal Audit

The Council has an in-house Internal Audit function and they confirmed compliance with Public Sector Internal Audit Standards as part of their Annual Report.

For the majority of the year (April 2015 to early March 2016) the Internal Audit Section has had a resource of 4 and is led by the Internal Audit Manager, who reports to the Chief Executive and has direct access to the Chair of the Audit Committee and Audit Committee members. The Internal Audit Section also took over responsibility for the two Accredited Counter Fraud Specialist officers who, from October 2015, have been used to review and identify the threats of Corporate Fraud and to provide support to the Internal Audit team and assist with the National Fraud Initiative. The Internal Audit Manager is also the Chief Internal Auditor for the IJB.

Internal Audit is required to provide an annual opinion to the Audit Committee on the assurance framework. In 2015/16 the Internal Audit Manager issued the following opinion:

"It is my view that overall the Council's framework of governance, risk management and control over the period 2015/16 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".

From the Audits undertaken in 2015/16, Internal Audit have identified a number of areas that required improvement to the internal controls. While a small number of areas were rated as weak, these were confined to certain control objectives within specific audits (for example Developer Contributions). The majority of reviews have shown either average or good internal controls.

Recognising the increasing financial constraints of the Council, and the change programmes that will need to take place in the foreseeable, it is even more important that internal audit activity remains aligned to the strategic risks facing the Council.

Internal audit will play a key role in highlighting to officers gaps in controls as well as importantly highlighting areas of over-control, or where controls may not be proportionate to the level of risk. This will help Officers re-direct support to areas of under control, within the total available resources they have, strengthening the control environment. As the Council's risk management arrangements are further developed, internal audit can place greater emphasis of these arrangements to drive the annual and 3 year strategic plan, whilst still ensuring compliance with PSIAS .

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Across all areas of the Council there will need to be an increasing focus on delivering services more efficiently. Internal audit should continue to review the level of resourcing in place aligned to outcomes, continuing to look at whether reviews can be done more efficiently in fewer days, for example through increased use of analytics; reviewing annual vs. every 3 year coverage and also considering the time spent on management and oversight of the internal audit function.

As set out in our audit plan we reviewed the work of Internal Audit to inform our audit approach. However, we did not place reliance on any specific Internal Audit work undertaken in 2015/16.

Overall Internal Audit have completed their plan for 2015/16 as agreed with the Audit Committee and have provided detailed regular updates to Committee.

Internal Audit have followed up a sample of 40 recommendations during 2015/16 that have been signed off as complete to determine whether they had been implemented satisfactorily and thus give assurance over the ongoing improvement of internal control.

The majority of audit actions have been completed satisfactorily. From the 40 recommendations tested, 26 (65%) were found to have been completed satisfactorily, 1 (2.5%) was found to be unsatisfactory and 13 (32.5%) were partially completed.

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Prevention and detection of fraud and irregularity

The Council has a Fraud and Corruption Strategy which is designed to promote an anti-fraud and anti-corruption culture. This is supplemented by the Council's Public Interest Disclosure (Whistleblowing) Policy. The Council recently appointed a Fraud and Audit Officer to support and further develop the Council's arrangements, including an update of the current Fraud and Corruption strategy (December 2015) and this is reflected in the Annual Governance Statement as a future area of focus.

Audit Scotland published a National Fraud Initiative (NFI) report in June 2016. Key findings were:

- since last reported in the June 2014 fraud and error outcomes valued at £16.8 million have been recorded and the cumulative outcome is now £110.6 million for Scotland
- the 2014/15 review included 104 Scottish bodies across three sectors, with 585 datasets submitted generating 347,715 data matches for further investigation.
- There are 2,522 investigations in progress and action being taken to recover £4.2 million of overpayments.

Internal Audit have a designated resource for counter-fraud and as part of the duties this involves carrying out the checks on the National Fraud Initiative matches.

Our enquiries of management and the Council's internal audit identified a total of £16,153 in overpaid benefits and discounts. The total from the previous review was £38,556

There were 6,073 matches with 5,987 cleared, 60 were errors and 26 referred to fraud officers for investigation.

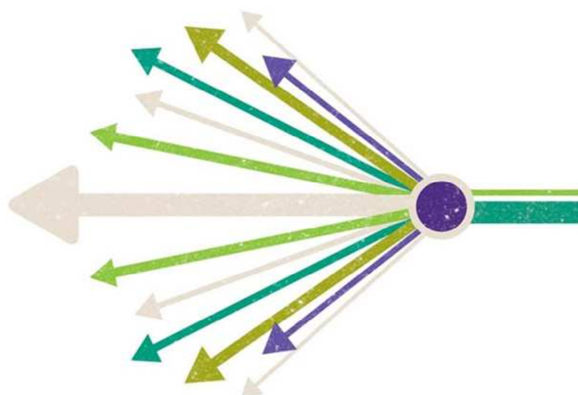
2016/17 National Fraud Initiative

The 2016/17 process will shortly be commencing, with data submission between October and December 2016 and matches being made available to the Council for investigation from late January 2017. Key changes for the 2016/17 return include:

- Council tax reduction scheme data is an additional dataset required for the NFI 2016/17 exercise
- Housing waiting list data is an additional dataset required for the 2016/17 exercise
- Council tax and electoral register data is now required the same year as the main exercise, but on a slightly different timescale.

Arrangements for maintaining standards of conduct

In line with the Ethical Standards in Public Life etc (Scotland) Act 2000, the Council has established a Code of Ethical Standards and the specific Code of Conduct for Councillors as approved by the Scottish Government. A register of interests is available for each Councillor on the Council's website, and declarations of interest are made at each Council meeting. We have no concerns about the arrangements currently in place.



5. Best value and value for money

Best Value / Value for money

Performance against agreed outcomes are included within the Single Midlothian Plan. Detailed performance reports are prepared on a quarterly basis to update progress.

Audit Scotland's report on Public Performance Reporting found that the Council is largely in the mid range in respect of SPI's.

The Council continues to place communities at the forefront of its vision for finding new and different ways for ongoing engagement.

Service performance in a national context remains mixed.

The Council has deliberately set challenging targets in order to drive continuous improvement going forward.

The focus on Health and Social Care integration now needs to be on embedding the agreed structures and a focus on what future outcomes are to be achieved.

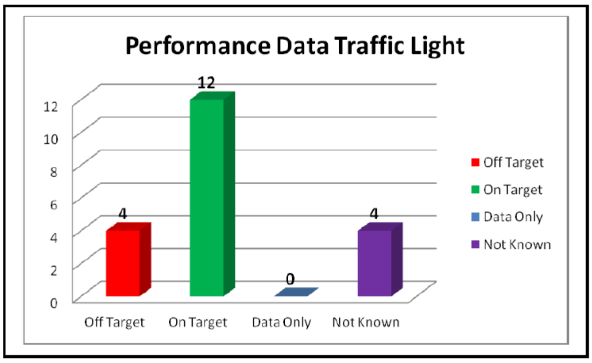
Achieving Best Value

Single Midlothian Plan

The 2015/16 plan year saw the end of a 3 year cycle of prioritising working together to improve outcomes for young people leaving school, improve lives of children in early years and their families, and improve the local economy. The Community Planning Partnership priorities for 2015/16 have shown steady improvement across Early Years, Positive Destinations and Economic Development and these areas will be further developed in 2016-19.

As part of the ongoing strategic review of planning and performance management, officers looked at revisiting the use of the Balance Scorecard which had been on the periphery of performance management previously, but had not been fully embedded. This exercise ensured a future focus on delivering against outcomes which require a different way of conceiving and using performance measures.

The review further noted that outcome indicators should show the overall benefit of the Council's work and not simply be a measure of day-to-day activities and outputs. The Council has 20 key performance indicators identified for the Single Midlothian Plan and under each of the perspective headings of the Balanced Scorecard. Detailed performance data is available in the quarterly service performance reports. The performance report for the final quarter for 2015/16 for the indicators.



The four indicators off target are:

- Town Centre vacancy rates are 6.7% although performance is below the target vacancies have reduced.
- New business start ups of 173 is below target of 200
- The number of looked after children and young people placed out of area of 55 is above target of 51, but Significant work has been done in this area and as at the end of quarter four there were no young people in secure accommodation.
- Increase percentage of school leavers in positive destinations to 93% from 89.2% slightly off target.

The Community Planning Partnership has undertaken a review and engagement process in 2015 /16 resulting in changed priorities for the next three years 2016-19. Taking into consideration evidence about the comparative quality of life of people living in Midlothian, where it is clear that less well off residents experience poorer health, have fewer or no choices in how they use low incomes, and where there is an proven relationship between these factors and their learning; as a result the top three priorities for 2016-19 that were determined were:

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

Three approaches to how the council works with its communities have been agreed – preventive 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

This vision and three year outcomes will only be achieved through close interagency working with the wider Community Planning Partnership and through genuine partnership working and capacity building with local communities.

Ambitious Midlothian: Midlothian Economic Recovery Plan (MERP)

The economic recession that started in mid/late 2008 and the economic downturn that followed created enormous challenges for CPP partners such as the Council, Scottish Enterprise, Edinburgh College, the Federation of Small Businesses, and Midlothian and East Lothian Chamber of Commerce. Whilst significant progress has been made in Midlothian in terms of addressing the adverse socio-economic impact of the economic downturn, challenges still remain – not least the ongoing impact of public sector budget cuts.

At a national level, the Scottish Government (SG) reacted to the economic and budgetary challenges through the launch of a refreshed SG Economic Strategy in March 2015. This refreshed strategy sets out an overarching framework for a more competitive and a fairer Scotland.

Achieving Best Value

The strategy reaffirms the commitment to creating a more successful country with all of Scotland to flourish through increasing sustainable economic growth. It sets out an overarching framework for achieving the two mutually supportive goals of increasing competitiveness and tackling inequality

The strategy is underpinned by the following four priorities:

- Investing in our people and our infrastructure in a sustainable way
- Fostering a culture of innovation and research and development
- Promoting inclusive growth and creating opportunity through a fair and inclusive jobs market and regional cohesion
- Promoting Scotland on the informational stage to boost trade and investment, influence and networks.

Following the launch for the SG Economic Strategy in September 2011, Ambitious Midlothian: Midlothian Economic Recovery Plan was prepared by the Council and CPP Partners. This followed extensive engagement/consultation with the business communities of Midlothian. Ambitious Midlothian is the overarching strategic economic recovery plan for Midlothian, shaping the current and future economic development work of the Council and its CPP Partners.

Key topics included within the plan include:

- Maximising the socio-economic benefits of the construction of the Borders Railway
- Support the local economy through implementation of the plan
- Promote Midlothian to visitors and business
- Maximise next generation broadband roll-out
- Support the development of Easter Bush as a world class scientific research centre
- Support town centre regeneration

Community Engagement

The Council has actively sought to increase community engagement in the community planning process. The CPP engages with local communities through Neighbourhood Planning arrangements, a bi-annual Citizens Panel, and stakeholder joint planning. Service users also help to shape services through formal user groups within community care and community learning and development services.

Midlothian Moving Forward, the Community Planning Partnership, is committed to placing communities at the heart of community planning, and has committed itself to developing and delivering Neighbourhood Plans in each of the sixteen Community Council areas within Midlothian. The objectives of Neighbourhood Plans are to:

- Support delivery of real change and improvements at local level.
- Engage with and involve communities in identifying and addressing local priorities.
- Provide a focus for action on local priorities.
- Encourage effective service delivery by Council
- Services and Community Planning partners, working singly or jointly, whichever ensures best results.
- Encourage services to work together.

The neighbourhood planning process is designed to help a variety of agencies to work together with local people to build strong, safe and attractive communities. As the future financial pressures will impact on the way that the Council delivers future services to the community it will be vital that open, honest and timely engagement continues with all key stakeholders.

Shaping Our Future is a major community engagement drive as part of the Delivering Excellence programme. The Council are asking residents to tell them what the priorities are for them, their families and their communities – in order to help the Council reshape services to meet those priorities.

Health and Social Care Integration

The Council has made good progress on delivering Integrated Health and Social Care, with its partners in NHS Lothian. Partnership working has historically been strong, and the Midlothian Community Planning Partnership has met national delayed discharge targets in recent years.

In August 2015, the inaugural meeting of the Midlothian Integrated Joint Board (IJB) was held, which formally appointed the Chief Officer. The Board has two categories of members, voting members and non-voting members. The voting members are nominated representatives from key partners as follows:

- Midlothian Council: 4 members
- NHS Lothian: 4 members

The Board has formed an Audit and risk Committee that meets on a regular basis. The IJB had no financial allocations made to it in 2015/16 by either Midlothian Council or NHS Lothian. The IJB did not expend nor direct any expenditure and there are, therefore, no financial transaction for 2015/16. Accordingly, the IJB did not keep any books of account. The notional financial resources expended to support the IJB in 2016/17 have been identified.

The main task of the IJB in 2015/16 was the preparation, agreement and publication of its Strategic Plan. As required, the IJB set up a Strategic Planning Group which met during the financial year. This plan lays out the ambitions for the delivery of the functions delegated to the IJB by the partners per the Integration Scheme. The goals of the IJB's Strategic Plan are in line with the Scottish Government's nine national outcomes are will be delivered through :

- Shifting the balance of care to provide more care delivered at home or in a homely setting rather than in hospital or other institutions.
- Ensuring care is person centred, with a focus on the individual and not just specific health and social care needs.
- Further improving the joined up approach to working across professions and bodies delivering health and social care functions
- Ensuring citizens, communities and staff involved in providing health and social care services will have a greater say in how these services are planned and delivered.

The Strategic Plan, having been consulted on as required by the regulations, was agreed by the IJB at its meeting of 10th December 2015. The Council has made a budgetary offer for 2016/17 to the IJB along with an indicative position for 2017/18 and 2018/19.

NHS Lothian have not, made a further, 'formal' offer to the IJB for 2016/17. NHS Lothian have now submitted their LDP (Local Development Plan – basically the financial plan) to the Scottish Government which is not balanced and has a gap of about £20m. It not yet clear how much of this gap relates to the services delegated to the IJB nor what, if any, proposals NHS Lothian will make to manage this financial risk.

NHS Lothian and Midlothian Council have now set operational budgets for their services and the Partnership is finalising its financial plan which, having achieved its efficiency schemes, projects a break-even position in 2016/17. It should be noted that additional (albeit non-recurrent) resources have been made available to support the GP Prescribing budget which was the Partnership's most significant financial pressure.

Its clear from the financial plans and statements that there are significant financial challenges in 2016/17 for both NHS Lothian and Midlothian Council and, therefore, for the functions that both these bodies have delegated to the IJB. The national financial outlook for 2017/18 and beyond will, in financial terms, present an even greater challenge.

The key issues for the IJB in 2016/17 will be :

- Ensuring that the impact of efficiency schemes planned by the partners in 2016/17 will not impact on the ability of the IJB to deliver its strategic plan
- Ensuring that the social care fund resources are used in line with the ambitions of the Scottish Government in a way that will build additional capacity in the system and allow redesign and the ability to improve the cost base in future years
- Ensure that the IJB can take the financial planning lead for those functions for which it is now responsible for.

Edinburgh and South East Scotland City Region Deal

The Council and five of the other local authorities that make up the Edinburgh and South East Scotland City region are working collectively on a bid to the UK and Scottish Governments for a City Region Deal.

The City Region Deal is a mechanism for accelerating growth by pulling in significant government investment. By investing this funding in infrastructure, skills and innovation our economic performance will be significantly improved, which will not only generate funds to pay back this initial investment but also draw in significant additional funding from the private sector. It is also about greater autonomy and decision making powers for the region to help deliver public services more effectively and to tackle inequality and deprivation. The ambition is to secure £1bn of funding and it is estimated that an additional £3.2bn worth of private sector investment could be leveraged if the bid is successful. The Council will need to work with its partners to ensure proposals meet the expectations of Midlothian in the areas of infrastructure, housing, skills and innovation. The Council should also have alternative strategies in place should the deal not be approved.

.Review of Local Government Workers Pay and Grading

The overarching aims of the proposed local government working Pay and Grade package is to:

- Tackle in-work poverty;
- Positioning Midlothian as an employer of choice in the employment market;
- The need to ensure that the Council has a pay and grading structure which can sustain future increases in the Living Wage and which maintain differentials across pay grades;
- Adopting terms and conditions and an HR Policy Framework which supports and facilitates service change, ensuring that services can be adapted to continue to meet customer needs;
- Adopting terms and conditions and an HR Policy Framework which will bring improvements in attendance and productivity across the Council.

Increasing the hourly rate for staff at the lower end of the pay structure will directly alleviate the impact of low pay and also facilitates a shift away from a culture in some service areas where regular overtime is the norm, in order to support service provision and to supplement contractual earnings.

The review of pay and grading builds upon this increase with a proposal to improve the minimum pay point to £8.97 per hour from 1 October 2016, together with increases in hourly pay rates for approximately 1,900 staff across grades one to four. Overall the minimum pay point will have increased by £1.32 per hour compared with the hourly rates which were in place on 24 March 2015.

The scope of the review included securing specific changes in the organisational culture that facilitates greater flexible working, the delivery of 24/7 services and an improved customer experience. This complements the Council's approved People Strategy, reflecting the employee proposition - 'The give and the get', designed to support positive change across the workforce.

The pay and grading changes mentioned above would put significant pressure on the Council pay bill but they would not fail to address issues around flexibility. They would in all likelihood however, continue to support a culture where service provision is reliant on overtime working. As such the negotiations with the Trade Unions have sought to identify a number of changes to the terms and conditions which go some way to making the overall cost more sustainable and also facilitate significant improvements in flexibility.

The proposed changes are as follows:

- A reduction to four recognised public holidays (two at Christmas and two at New Year) with the remaining five public holidays becoming part of employees annual leave entitlement.
- Contracted Saturday and Sunday working are paid at the standard hourly rate (except 10pm – 6am) rather than the current time and a fifth.
- Contractual night working between the hours of 10pm to 6am continues to be paid at time and a fifth.
- Raising the threshold before overtime premium applies from 36 hours to 40 hours in any week.
- Reducing the overtime premium paid for hours worked above 40 hours per week from time and a half to time and a quarter.
- Annual Leave entitlement enhanced by one additional day.

On 25 May 2016, after introducing changes to the pay protection arrangements, agreement was reached with all three Trade Unions that they would ballot their members on whether to enter into a collective agreement in respect of the pay and grading strand of the review only. All three ballot results supported acceptance of the proposal.

Having secured a collective agreement, arrangements are now being progressed to prepare for the implementation effective from 1 October 2016. In this respect an Implementation Board Chaired by the Chief Executive has been set up.

Newbyres incident

In prior years we reported that the Council faced a significant challenge, relating to carbon dioxide gas affecting houses in Newbyres Crescent.

In 2014-15, the Council considered the results of an options appraisal for the future of the site and, based on recommendations from technical advisors, opted to demolish the site and rebuild the housing as part of the Phase 2 social housing programme.

The demolition of the properties commenced in March 2016. The majority of the waste generated, such as the brick, timber and plastic, will all be recycled. Appropriately designed, installed and verified gas defence systems will be included within the building structures and within the site itself to avoid a risk of CO_2 exposure. All affected households have been supported by the council to find suitable accommodation. In addition, those required to be rehoused are being offered the opportunity to return to a new build development once completed. The next development in Gorebridge on Stobhill Road is due to be completed spring 2017.

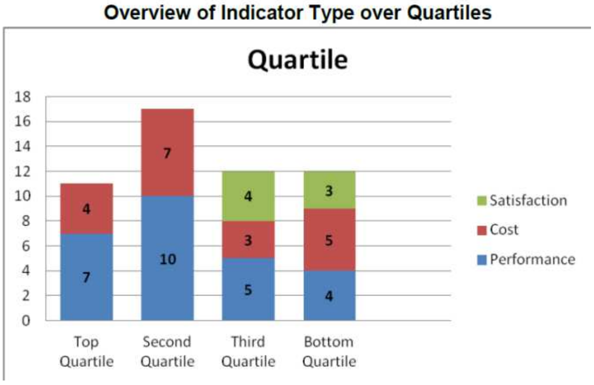
The Council is currently pursuing a claim in the Court of Session against three companies for losses which arises from the demolition of the 64 houses. The claim is at a preliminary stage but is likely to proceed to a substantive hearing in financial year 2017/2018.

Local Government Benchmarking Framework

As required by the Local Government Act 1992 Publication of Information (Standards of Performance) Direction 2013, the Council has collected and reported information on Corporate Management (SPI 1), Service Performance (SPI 2) and the Local Government Benchmark Framework (LGBF SPI 3).

The LGBF comprises a suite of performance indicators which are collected for all councils across Scotland to create a database of comparable data. The Council's performance data, which was reported into the 2014/15 LGBF is available on the Council website. In 2014/15 there were 55 indicators as part of the LGBF and the Council has showed mixed results with a much greater proportion falling in quartiles 1 and 4 than noted in the 2013/14 analysis performed last year.

Overview of Indicator Type over Quartiles

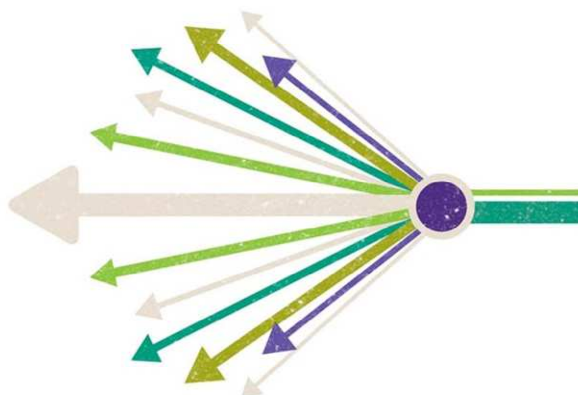


Scottish ranking	Percentage of indicators falling within each quartile	
	2014/15	2013/14
Top quartile (ranked 1-8)	21% (11/52)	24% (12/51)
2nd quartile (ranked 9-16)	33% (17/52)	31% (16/51)
3rd quartile (ranked 17-24)	23% (12/52)	25% (13/51)
bottom quartile (ranked 25th and below)	23% (12/52)	20% (10/51)

This chart highlights that indicators in a national context remains mixed with 21% in the first quartile (2013/14 24%), but 23% within the bottom quartile (2013/14 20%).

Areas performing well include: The Gross Cost of "Children Looked After" in Residential Services, Proportion of Pupils Entering Positive Destinations, Teacher Sickness Absence Days, Net cost of waste collection per premises.

Indicators in the bottom quartile include Older Persons Home Care Costs, Percentage of Pupils Gaining 5+ Awards at Level 6, Gross Cost of Children Looked After in a Community Setting, Proportion of internal floor area of operational buildings in satisfactory condition, Corporate and democratic core costs per 1,000 population and Percentage of income due from council tax received by the end of the year



Appendices

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Appendix A: Identified misstatements

We are required to report to those charged with Governance any identified adjustments, over and above our trivial level of £0.201 million, which we have reported to Officers but have not subsequently been reflected in the final version of the Financial Statements. We have 1 adjusted item and 2 uncorrected adjustments to report, which are outlined below.

Adjustment type	CIES £m	Balance sheet £m	Reserves £m	Account balance	Reason for not adjusting
Adjusted					
The Long Term Investments balance of £3.382m within the balance sheet is based on the value of Lothian Buses for which the Council has a 5% shareholding. The balance of £3.382m was based on Lothian Buses prior year financial statements as the current year financial statements were not published until after the Council's draft accounts were submitted. An amendment of £1.807m is required.	-	1.807	- 1.807	Dr Investments Cr Reserves	Not applicable
The following amendments were required to the National Non Domestic Rates Return: • Unoccupied property relief amended by £333,653 • Bad doubtful debts now collected adjustment from -£1,165,532 Total increase in contributable amount £0.832m which reduces creditor balance.	0.832	0.832		Dr Creditors Cr Income and Expenditure	Not Applicable
Unadjusted					
The Council applied the incorrect social housing discount factor to the new build housing stock (applying 69% rather than 64.5%). The financial impact of this was to understate the value of the Council dwellings by £0.572m.		0.572	0.572	Dr Council House Cr Revaluation Reserve	Not applicable
Net impact	**0.832**	**3.211**	**2.379**		

Appendix B: Action plan

	Issue and risk	Priority	Recommendation
1	**Journal control weaknesses** During our testing on journals, we identified the following control weaknesses: • The manual entry of journal numbers, which means that they are not always consecutive • Gaps in the journals listing • Manual entry of who has posted and approved individual journals • One side journals to correct errors in payroll posting **Risk** The existence of control weaknesses over the financial ledger exposes the Council to a risk of fraudulent journals. While our testing provides assurance that the accounts are not materially misstated, there is a risk that individuals could exploit the weaknesses for personal benefit.	Low	**Recommendation** The Council needs to strengthen journal controls to ensure completeness, and accuracy over entries onto the financial ledger. **Management response:** The issue of manually entering journal numbers and failing to have consecutive numbers was as a consequence of a system glitch. An upgrade to the ledger system due to be applied in the autumn will provide opportunity to improve workflow management and control. Responsible Officer: David Gladwin. Implementation date: 31st December 2016
2	**Errors in accruals** During testing of unrecorded liabilities we identified 3 items that had not been accrued for. The Council justified these decisions based on size of the transactions (the largest item being £108). The rationale of not accruing small items is justifiable, however, there is no documented de-minimis level below which the Council do not accrue. **Risk** There is a risk of inconsistency and inefficiency in processing of accruals during the year end processes.	Medium	**Recommendation** The Council should implement a de minimus level to assist officers in making their assessments and documenting judgements. **Management response:** The accruals policy will be reviewed as part of the preparation for the 2016/17 accounts. The current absence of guidance on de-minimus values is to recognise that in some areas a very small value will be material to the budget holder. Responsible Officer: David Gladwin Implementation date: 28th February 2017.
3	**Capitalisation Policy** Our review of the accounting policies identified that there is no capitalisation de-minimis threshold in place. Our testing identified one low value item that could have been regarded as revenue expenditure. **Risk** There is risk that revenue expenditure is inappropriately capitalised.	Low	**Recommendation** Implement a de-minimis capitalisation policy. Ensure this is disclosed within the Council's accounting policies and that all officers are made aware of the policy and comply with the requirements. **Management response:** The lack of a de-minimis capitalisation policy is to provide maximum flexibility to class items as Capital as materiality for budget holders varies greatly. We currently review all transaction posted to Capital to ensure they meet the proper definition of Capital Expenditure. Consideration will be given to the suitability of introducing a de-minimus policy in 2016/17. Responsible Officer: David Gladwin. Implementation Date: 28th February 2017.
4	**Cash flow Statement** The Council were unable to balance their cash flow statement which included a balancing item of £0.244m. **Risk** Three is a risk that the cash balance is not fairly stated.		**Recommendation** The Council should ensure that the cash flow statement is completely reconciled. **Management response:** We will ensure that the cash flow is fully reconciled in future years Responsible Officer: David Gladwin. Implementation Date: 30 June 2017

Appendix B: Action plan

	Issue and risk	Priority	Recommendation
5	**Employee Debt** Our testing identified that Council employees owe the Council approximately £1m. There are weaknesses in the processes and controls to prevent, identify, collect and report these debt balances. **Risk** There is a risk that the balances are misstated, debt continues to accumulate with increased financial and reputational loss for the Council.	High	**Recommendation** Internal audit should consider undertaking a full review of the controls and processes over employee debt. **Management response:** This is already included in Internal Audits Plan for 2016/17. Responsible Officer: Elaine Greaves Implementation date: March 2017
6	**Fair Value accounting** The Council revalued its Property Plant and Equipment assets as at 31 March 2016 in accordance with their five year rolling programme. For those asset that have not been revalued in the year, the Code of Practice on Local Authority Accounting requires that the Council make an assessment on whether the fair value of these assets is different from current value at 31 March 2016 (baring in mind some of these assets would not have been valued for a few years). The process the Council undertook and judgements made in determining that there was no material change to the value of these assets was not formally documented for us as auditors to challenge the methodology and assumptions. The Council has since used the Buildings Research Index to determine the estimated annual increase to all assets not valued in the year and prove the misstatement is not material. However, the process undertaken did not account for the fact that some assets have not been valued in the last 2-4 years. The consideration of the change in value needs to cover all years since the last revaluation of the asset. We appreciate that property and land values for general fund assets at Midlothian is unlikely to have moved significantly over the last few years, but this could well change in the future as the local area is regenerated. **Risk** Fair value valuations have the potential to be materially different from the current value.	High	**Recommendation** The Council needs to undertake an assessment of assets not valued at 31 March each year to determine whether the fair value is not materially different from the current value. The judgements and assumptions that the Council make in determining this assessment should be documented and provided within the working papers to the auditor prior to the start of the audit. **Management response:** The Councils non current asset valuation policy will be reviewed for 2016/17. It will also be discussed with incoming External Auditors to ensure expectations are aligned with council policy and practice. Responsible Officer: David Gladwin Implementation Date: 28th February 2017
7	**Supporting Documentation** The Council were unable to provide invoices to support two items selected as part of our expenses sample as the invoices had been lost. We were satisfied both items have been paid. **Risk** There is a risk of misstatement of expenditure	Medium	**Recommendation** Supporting primary documentation for all invoices and accruals needs to be retained by the Council. **Management response:** None
8	**Segregation of duties** One item selected in our expenses testing identified that the same officer registered and processed the same invoice. We tested the transaction which was appropriate and paid to the correct counterparty. **Risk** Without appropriate segregation of duties there is an increased risk of fraud or error occurring.	Medium	**Recommendation** Segregation of duties in respect of creditor payments need to be strengthened. **Management response:** None

Appendix C: Follow-up of prior year actions

Set out below is our follow up of the 2014/15 Annual Report to members recommendations.

	Issue and Risk prior year	Priority	Follow up
1	Errors in accruals During testing for unrecorded liabilities, we identified three errors from an extended sample of 20 transactions. The largest item not accrued for was £604. Our review of accruals highlighted that there is no de minimus policy in place to provide clarity on the minimum value of an item to be accrued for. Our analysis of accruals found 3,835 items were accrued for transactions less than £1,000, which accounted for around £0.8 million. Risk There is a risk of inconsistency and inefficiency in processing of accruals during the year end processes.	Low	**Implementation ongoing:** Our testing of unrecorded liabilities in 2015/16 identified the same issue. The Council has yet to implement an accruals policy. We have raised this as a recommendation in Appendix B
2	Journal control weaknesses During our testing on journals, we continue to note a number of control weaknesses including: • The manual entry of journal numbers, which means that they are not always consecutive • Gaps in the journals listing • Manual entry of who has posted and approved individual journals Risk The existence of control weaknesses over the financial ledger exposes the Council to a risk of fraudulent journals. While our testing provides assurance that the accounts are not materially misstated, there is a risk that individuals could exploit the weaknesses for personal benefit.	Low	**Implementation ongoing:** Our testing of the journal processes in 2015/16 identified the same issue so we have raised this as a recommendation in Appendix B.
3	Future accounting considerations – Fair Value accounting The change in accounting for fair value will have a significant impact on the Council's balance sheet. Finance should consider the implication of this change, particularly the implications for the revised revaluation programme being developed with the Valuation Team. Risk Fair value valuations may not be undertaken, leading to a potential material misstatement in 2015-16	High	**Implementation ongoing:** The Council have reviewed their 5 year revaluation policy and have revalued all assets that were due for revaluation in 2015/16. However, the Council did not undertake an assessment as to whether the fair value of the assets is materially different from current value. This has been raised as a recommendation in appendix B.
4	Future accounting considerations – Infrastructure assets The change in accounting for infrastructure assets will have a significant impact on the Council's balance sheet. Finance should continue to consider the implication of this change, with a view to considering the balances for 2015-16 and we will continue to work proactively with Finance in this area Risk Prior work may not be undertaken in respect of infrastructure assets leading to an impact on 2016- 17 financial statements	Medium	**In progress:** We have reviewed the arrangements in place in preparation for this inclusion in the 2016/17 balance sheet and our view was that the Council is making reasonable progress in this area

	Recommendation	Priority	Follow up
5	Accuracy of financial forecasting As in 2013-14, we noted a significant movement in the forecasts within financial monitoring reports and the final outturn. Risk Significant, and unexpected fluctuations in financial performance mean that it can be difficult for elected members to fulfil their financial scrutiny role.	Medium	**Implemented**. During 2015/16, routine budget monitoring reports presented remained within 0.7% of the revised budget and final outturn. We have made a recommendation with regard to the timing of budget monitoring reports.
6	Long term financial planning Our review of the Council's Financial Strategy and supporting documents against Audit Scotland's best practice criteria highlighted areas for improvement including the use of scenario planning. Risk The Council is aware of the risk of not achieving savings, such as the business transformation savings, but has not prepared for significant fluctuations in key assumptions, such as the outcome of the review of Council tax arrangements.	Medium	**Partially implemented**: The Council has made clear in their reports the implications of movements in Scottish Government Grant Funding and Council tax has on the budgets. A detailed analysis of best and worse case scenarios including achievement of savings plans will be required in the future.
7	Audit Committee Workplan The reduction of meetings provides the opportunity to improve the planning and focus of the work of the Audit Committee, by identifying priorities for the year and ensuring that key papers to support the priorities are planned in advance. Risk There is a risk that the Audit Committee may not achieve key priorities for scrutiny	Low	**Implemented:** The Committee met formally five times in the year. The Committee is also conversant with Audit Scotland's reports on Midlothian and its publications generally regarding local government in Scotland. The Audit Committee receives regular reports from Council officers presenting the actions taken against these reports. The Members also review and have input to the Council's Annual Governance Statement.
8	Performance reporting to members could be better focused on key outcomes There is scope to improve the quality of performance reporting to Committee by: • making performance reports shorter, sharper and more clearly focused on the priorities within the Single Midlothian Plan • focusing on improvement actions Risk There is a risk that current performance reports focus on operational issues, and therefore prevent full scrutiny of progress against the outcomes in the Single Midlothian Plan.	Low	**Partially implemented:** The format of performance reporting throughout 2015/16 remains consistent with previous years. The reports are fairly lengthy with a significant number of key performance indicators. However, the Council has recently implemented a balanced score card approach which will help focus on the monitoring of the key performance indicators within the plan.
9	Public Performance Reporting could be improved to reflect best practice Midlothian Council achieved full compliance with 16 out of 18 priorities in the Statutory Performance Indicators. There was scope for improvement in reporting aspects of managing people and procurement. The Accounts Commission also noted that reporting on customer satisfaction and community engagement could be improved. Risk The performance information available for the listed indicators may be insufficient for the public needs to allow them to understand the services in those areas.	Low	**Implemented:** There was submitted report by the Chief Executive, updating the Committee on Audit Scotland's assessment of the Council's Public Performance Reporting (PPR). The report advised that Audit Scotland placed Midlothian in the top quartile of all Councils in respect of public performance reporting. The key areas for improvement were Employees, Procurement, Effective use of customer satisfaction information, Dialogue with the public and Accessibility The report incorporated an improvement plan to address the areas for improvement.

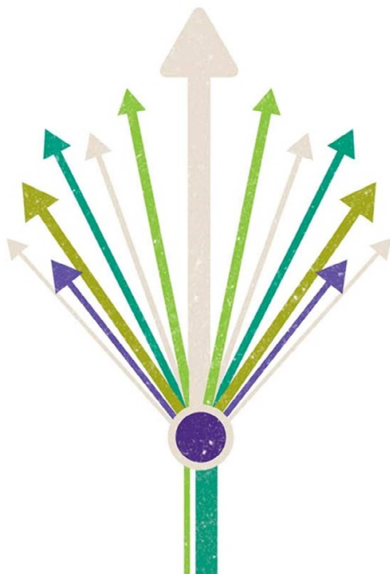
Appendix D: Compliance with statutory duties

We have reviewed the Council's compliance with the Local Authority Accounts (Scotland) Regulations 2014 and have monitored compliance against the key aspects below.

Aspect of the regulations	Compliance	Status
The Chief Financial Officer must ensure that the annual accounts give a true and fair view of the authority 's financial position and transactions.	Complied - signed off within unaudited accounts as at 28 June 2016	✓
	On track - will sign off in final audited accounts.	●
The Chief Financial Officer must certify and submit the annual accounts to the appointed external auditor no later than 30 June 2016.	Complied – submitted 28 June 2016.	✓
The Council must publish the unaudited annual accounts on the website of the authority until the date on which the audited annual accounts are published.	Complied – unaudited accounts are available on the website.	✓
The Council (or a committee whose remit includes audit or governance) must consider the unaudited accounts at a meeting by 30 September 2016.	Complied – presented to Council on 28 June 2016 and will go to Audit Committee on 20 September	✓
The Council must give public notice of the right of interested persons to inspect and object to its accounts.	Public notice given in July advising of the availability of the Financial Statements and associated documents for inspection at Midlothian House and of the rights conferred by section 101 of the act	✓
The Council (or a committee whose remit includes audit or governance) must aim to approve the audited annual accounts for signature no later than 30 September 2016.	On track - will be presented to Audit Committee on 20 September 2016 for approval.	●

✓ Fully compliant at date of this report

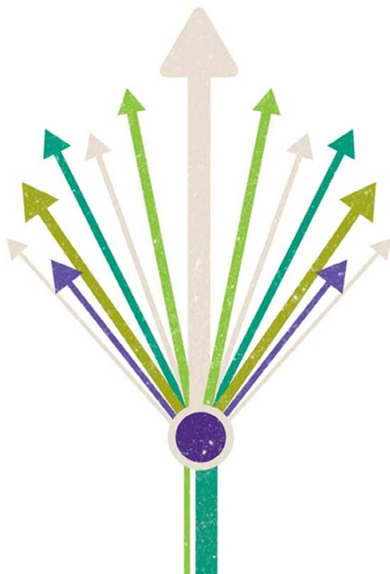
● On track to comply



Appendix E: Other communication requirements

We set out below details of other matters which we, as auditors, are required by auditing standards to communicate to those charged with governance.

	Issue	Commentary
1	Written representations	• A letter of representation has been requested from the Council • In particular, representations will be requested from management in respect of: – significant assumptions used in making accounting estimates, including those measured at fair value, are reasonable – responsibility for the design and implementation of internal control to prevent and detect error and fraud – related party relationships and transactions being appropriately accounted for and disclosed in accordance with the requirements of the CIPFA Code – all events subsequent to the date of the financial statements and for which the CIPFA Code and International Financial Reporting Standards requires adjustment or disclosure having been adjusted or disclosed
2	Disclosures	• Our audit work identified no material omissions in the financial statements
3	Matters in relation to fraud	• We have not been made aware of any other incidents in the period and no other issues have been identified during the course of our audit procedures
4	Matters in relation to laws and regulations	• We are not aware of any significant incidences of non-compliance with relevant laws and regulations
5	Matters in relation to related parties	• We are not aware of any related party transactions which have not been disclosed
6	Going Concern	• We have considered managements assessment of going concern. Our work has identified no significant issues in relation to going concern



Appendix F- Fees, non audit services and independence

We confirm below our final fees charged for the audit and confirm there were no fees for the provision of non audit services.

Fees

	Per Audit plan £	Actual fees £
Midlothian Council (including grant certification)	241,700	241,700
Total audit fees	**241.700**	**241,700**

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.

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

Fees for other services

Service	Fees £
20/20 vision delivered October 2015	5,000