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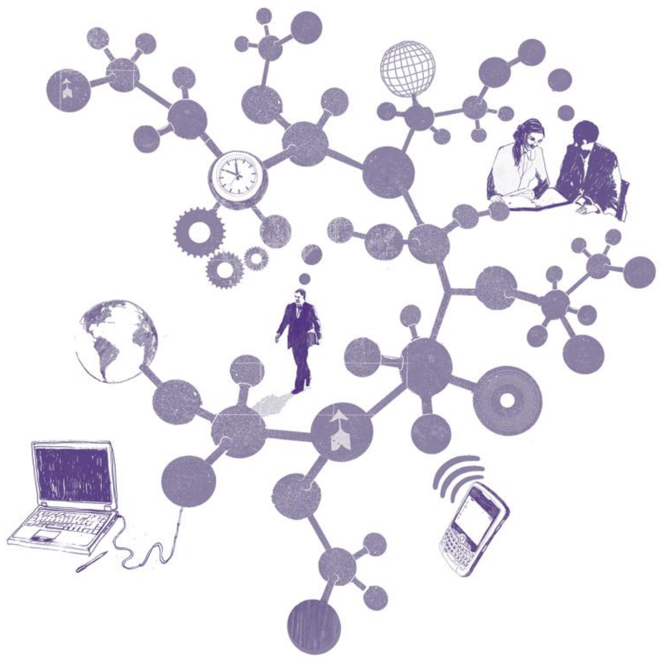
This version of the report is a draft. Its contents and subject matter remain under review and its contents may change and be expanded as part of the finalisation of the report.

Audit Committee
Tuesday 16 September 2014
Item No. 5

The Audit Findings for Midlothian Council

Year ended 31 March 2014

11 September 2014



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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

Contents

Section 1: Executive summary

Executive summary

Purpose of this report

This report highlights the key matters arising from our audit of Midlothian Council's ('the Council') financial statements for the year ended 31 March 2014. It is also used to report our audit findings to the Controller of Audit, management and those charged with governance in accordance with the requirements of International Standard on Auditing 260 (ISA).

Under the Audit Scotland Code of Audit Practice we are required to report whether, in our opinion, the Council's financial statements present a true and fair view of the financial position, its expenditure and income for the year and whether they have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting ("the Code").

Introduction

In the conduct of our audit we have not had to alter or change our planned audit approach, other than the testing of employee remuneration internal controls.

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

- finalisation of adjustments to Property, Plant and Equipment balances
- sample testing and reconciliation of Council Tax debtors
- external confirmation of investment balances
- review of the final version of the financial statements
- obtaining and reviewing the final management letter of representation
- updating our post balance sheet events review, to the date of signing the opinion
- Whole of Government Accounts

We received draft financial statements at the start of our audit, in accordance with the agreed timetable.

Key issues arising from our audit

Financial statements opinion

We anticipate providing an unqualified opinion on the financial statements, subject to finalisation of the outstanding audit areas outlined above.

There are a number of key messages arising from our audit of the Council's financial statements. Firstly, a change has been made to the Code of Practice which requires authorities to ensure that the carrying value of assets is not materially different to the fair value. The majority of the Council's assets relate to housings. The housing stock has not been revalued since 2011, in accordance with the Council's 5 year rolling programme of valuations. We therefore asked the Council to demonstrate that the valuation of housing stock met the changed requirements of the Code. This triggered a desktop valuation of all council dwellings as at 31 March 2014. As a result, an adjustment has been made which reduces the carrying value of the Council's non-current assets by £74.5m, from £374.6m to £300.1m.

We have identified a further 5 adjustments affecting the Council's reported financial position (details are recorded in section 2 of this report). These changes relate to further adjustments made in relation to property, plant and equipment balances, liabilities and investments. Overall, there has been no impact on the Council's revenue reserves.

We have also identified a number of adjustments to improve the presentation of the financial statements. Further details are set out in section 2 of this report.

Whole of Government Accounts (WGA)
We will complete our work in respect of the Whole of Government Accounts in accordance with the national timetable.

Controls

The Council's management is responsible for the identification, assessment, management and monitoring of risk, and for developing, operating and monitoring the system of internal control.

Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we report these to the Council.

We draw your attention to control issues identified in relation to Employee Remuneration, Property Plant and Equipment, and council house building completions in Section 2 of this report.

The way forward

Matters arising from the financial statements audit have been discussed with the Head of Finance and Integrated Service Support (ISS).

We have made a number of recommendations, which are set out in the action plan in Appendix A. Recommendations are being considered by the Head of Finance and ISS and the finance team and an action plan is being developed.

Acknowledgment

We would like to take this opportunity to record our appreciation for the assistance provided by the finance team and other staff during our audit.

Grant Thornton UK LLP
11 September 2014

Section 2: Audit findings

Audit Findings

Introduction

In this section we present our findings in respect of matters and risks identified at the planning stage of the audit and additional matters that arose during the course of our work. We set out on the following pages the work we have performed and findings arising from our work in respect of the audit risks we identified in our audit plan, which was presented to the Audit Committee on 18th March 2014.

We also set out the adjustments to the financial statements from our audit work and our findings in respect of internal controls.

Audit opinion

Work is continuing to conclude on key areas that may impact our opinion. At this stage, we anticipate that we will provide the Council with an unmodified opinion conclude that the financial statements are prepared in accordance with Part VII of the Local Government (Scotland) Act 1973 and the Code. Our draft audit opinion is set out in Appendix B.

Changes to the audit plan

During the conduct of our audit, we were required to alter our approach to the audit of employee remuneration. Further details are provided on page 10.

Outstanding matters

Our audit is ongoing as we continue to finalise our audit procedures in the following areas:

- finalisation of adjustments to Property, Plant and Equipment balances
- reconciliation of Council Tax debtors, including sample testing of individual balances at 31 March 2014
- reconciliation and testing of purchase ledger balances within creditors
- external confirmation of investment balances
- review of the final version of the financial statements
- certification of the Housing Benefits and Council Tax Benefits grant claim
- Review of the Council's Whole of Government Accounts submission.

The draft management letter of representation is attached as Appendix C to this report.

Audit findings against significant risks

"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 315).

In this section we detail our response to the significant risks of material misstatement which we identified in the Audit Plan. As we noted in our plan, there are two presumed significant risks which are applicable to all audits under auditing standards.

	Risks identified in our audit plan	Work completed	Assurance gained and issues arising
1.	**Improper revenue recognition** Under ISA 240 there is a presumed risk that revenue may be misstated due to improper recognition	• review and testing of revenue recognition policies • testing of material revenue streams • review of unusual significant transactions	Our audit work has not identified any issues in respect of revenue recognition.
2.	**Management override of controls** Under ISA 240 there is a presumed risk of management over-ride of controls	• review of accounting estimates, judgements and decisions made by management • testing of journal entries • review of unusual significant transactions	Our audit work has not identified any evidence of management override of controls. In particular the findings of our review of journal controls and testing of journal entries has not identified any significant issues. We set out later in this section of the report our work and findings on key accounting estimates and judgments.

Audit findings against other risks

In this section we detail our response to the other 'reasonably possible' risks of material misstatement which we identified in the Audit Plan. Recommendations, together with management responses, are attached at Appendix A.

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Operating expenses	Creditors understated or not recorded in the correct period	We have undertaken the following work in relation to this risk: • Walked through the processes and controls in place over the payment and recording of expenditure • Sample testing of key controls over the purchasing process • Sample testing of expenditure to invoice • Sample testing of year end transactions to test for unrecorded liabilities • Sample testing of creditors to ensure they are accounted for correctly.	To date, our audit work has not identified any significant issues in relation to the risk identified.
Employee remuneration	Employee remuneration accrual understated	• We reviewed and walkthrough the processes and controls in operation for payment of staff • We conducted random sample testing of 25 staff members to contract and recalculation of PAYE, NI and pension contributions • We analytically reviewed payroll expenses in comparison to expectations and investigate any significant variances • We reviewed the relevant disclosures relating to staff costs within the financial statements • We reviewed the treatment and associated disclosures in relation to the pension schemes	Our substantive payroll testing was completed with no errors noted. We also conducted sample testing to check that individuals on the payroll system exist and are paid correctly using contracts to confirm their pay rate and grade. Of 25 staff sampled, we were unable to verify 7 (28%) of the individuals to a signed contract or acceptance of position letter. As a result, we were required to change our approach to gain assurance relating to the existence of employees. We circulated a sample of 25 employees to relevant Heads of Service to verify their existence and that they carried out the role specified. All confirmations were received satisfactorily. We identified a further control weakness, reported within Appendix 1 to this report. Refer to Action Plan recommendations 2 and 3.

Audit findings against other risks continued

Transaction cycle	Description of risk	Work completed	Assurance gained & issues arising
Welfare expenditure	Welfare benefit expenditure improperly computed	• We reviewed and walked through the processes and controls in place to calculate, pay and record benefit expenditure • We analytically reviewed the benefit expenditure in comparison to auditor expectations and investigated significant variations • We have conducted initial sample testing of housing benefit payments using the HB Count module • We have tested the reconciliation between the benefits system and the amounts recorded in the financial statements.	Our initial sampling of housing benefit payments has identified 9 errors to date. Two relate to a system parameter error, and therefore no further testing is required but the error will be extrapolated. The remaining 7 errors, 6 will result in 40+ testing on each case, therefore requiring a total of 240 cases further to be tested. Under HB Count methodology, all errors identified will be extrapolated and may, therefore impact on the level of subsidy that the Council receives. Refer to Appendix A, Action Plan recommendation 13.
Housing Revenue Account	Revenue transactions not recorded	• We conducted a detailed analytical review of revenues in comparison to expectations and investigation of any significant variances • We undertook sample testing of 25 payments to check analysis and calculation • We reviewed the completeness of the billing list compared to number of properties on the system • We conducted sample testing of debtors balances at the year end • We carried out cut-off testing around year end billed amounts • Review of the bad debt provision calculation and the assumptions underpinning the methodology	Our audit work has not identified any issues in the administration of the Housing Revenue Account. We will, however, continue to monitor the impact of the Newbyres Crescent situation and therefore the resilience of the Account. During the audit we agreed that the five houses that are void have been impaired as a result of known issues at the year end date. The Council has agreed to make additional disclosures relating to the current likely position within the Post Balance Sheet Events note to the accounts.

Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Accounting area	Summary of policy	Comments	Assessment
Revenue recognition	• The predominant source of revenue for the Council is from Grants and Taxation. Revenue for this category of receipts is recognised when the amounts become due. • Revenue from goods and services is recognised when it is certain that the Council will receive cash, and only recognised in the year in which it has provided the service to earn the revenue.	• the revenue recognition policies are appropriate under the CIPFA/LASAAC Code of Practice • in a small number of cases, judgements are made regarding levels of accrued income, and no issues have been found with this from the audit. • the draft accounts did not disclose accounting policies for Council Tax or Non-Domestic Rates.	Green ●
Judgements and estimates	• Key estimates and judgements include: – useful life of assets and capital equipment – pension fund valuations and settlements – revaluations – impairments – provisions	For all material items, we have reviewed: •the appropriateness of your policies under the CIPFA / LASAAC Code of Practice •the extent of judgement involved •the potential financial statement impact of different assumptions •the adequacy of disclosure of the accounting policy We have no concerns to highlight to the Audit Committee.	Green ●

Assessment

● Red - Marginal accounting policy which could potentially attract attention from regulators ● Yellow - Accounting policy appropriate but scope for improved disclosure
● Green - Accounting policy appropriate and disclosures sufficient

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Accounting policies, estimates & judgements

In this section we report on our consideration of accounting policies, in particular revenue recognition policies, and key estimates and judgements made and included with the Council's financial statements.

Accounting area	Summary of policy	Comments	Assessment
Judgements and estimates - PPE	• Page 29 of the accounts sets out the authority's rolling programme of revaluations. This shows that the date of valuations vary because the Council has a rolling programme of valuations over a 5 year period. This approach is similar to many other authorities and we are satisfied that the carrying amount of Property, Plant and Equipment (based on these valuations) does not differ materially from the fair value at 31 March 2014. In our view, however, this rolling programme does not fully meet the Code's requirement in paragraph 4.1.2.35 to value items within a class of property, plant and equipment simultaneously. • This paragraph of the Code, which is based on IAS 16 Property, Plant and Equipment, does permit a class of assets to be revalued on a rolling basis provided that: - the revaluation of the class of assets is completed within a 'short period' - the revaluations are kept up to date	• In our view, we would normally expect this 'short period' to be within a single financial year. This is because the purpose of simultaneous valuations is to 'avoid reporting a mixture of costs and values as at different dates'. This purpose is not met where a revaluation programme for a class of assets straddles more than one financial year. • We have made a recommendation within Appendix A to support the Finance Team as it continues to formalise its relationship with the Council's valuers (refer to Action Plan recommendation 4). These requirements can therefore clarified and documented as part of that process.	Green ●
Other accounting policies	• We have reviewed the Council's policies against the requirements of the CIPFA Code and accounting standards.	• Our review of accounting policies has not highlighted any issues which we wish to bring to your attention. Minor additional disclosures were made as part of the audit.	Green ●

Assessment

- ● Marginal accounting policy which could potentially attract attention from regulators
- ● Accounting policy appropriate but scope for improved disclosure
- ● Accounting policy appropriate and disclosures sufficient

Adjusted misstatements

A number of adjustments to the draft financial statements have been identified during the audit process. We are required to report all misstatements to those charged with governance, whether or not the financial statements have been adjusted by management. The table below summarises the adjustments arising from the audit which have been processed by management.

Impact of adjusted misstatements

All adjusted misstatements are set out below along with the impact on the primary statements and the reported financial position.

	Detail	Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
1	**Valuation of Housing Assets Brought Into Use** Due to a change in the Code we asked the Council to consider whether they could demonstrate that the carrying value of housing assets was not materially different to the fair value. The Code requires that Social Housing properties are valued at Existing Use Value less a social housing discount. The Council has therefore undertaken a desktop valuation exercise, supported by internal valuers, to revalue all housing assets currently carried at depreciated historic cost. The carrying value in the draft statements of HRA properties carried at depreciated historic cost was £96.3m. A further £14.9m was carried at cost within Assets Under Construction where the review found that the assets had actually been brought into use. The overall impact is a reduction in the carrying value of council housing assets of £74.5m.	Dr Housing Revenue Account I & E £74,450	Dr Capital Adjustment Account £73,850 Dr Revaluation Reserve £600 Cr Property, Plant and Equipment £74,450	Cr Movement in Reserves Statement £74,450
	Overall impact carried forward	**£74,450**	**£74,450**	**£74,450**

Adjusted misstatements continued

	Detail	Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
2	**Valuation of Newbattle High School** During testing, we noted that Newbattle High School had been subject to accelerated depreciation in prior years due to plans for demolition. The school was revalued in 2013-14, given a value of £12,865k, reassigned a five year life and depreciated by £2,490k to give a closing carrying value of £9,960k. Following discussion with the valuer, we agreed that the valuation did not reflect current plans to replace the school in summer 2016. An adjustment was therefore made to ensure that the value of school reflects its likely useful economic life. This has reduced the PPE valuation in the Balance Sheet by £5,463k.	Cr I & E Education £2,490	Dr Revaluation reserve £5,463 Cr Property, Plant and Equipment £5,463 Dr Capital Adjustment Account £2,490	Dr Movement in Reserves £2,490
3	**Double counting of PPP assets** Following queries, the Council identified that land associated with schools in one of the Council's Public Private Partnerships was carried as a single asset in the Council's asset register at £3,085k. Land values were also included in the register as part of the individual school valuations, so the land was effectively double-counted. The PPE valuation has been reduced by £3,085k to correct this error.	Dr I & E Education £3,085	Dr Capital Adjustment Account £3,085 Cr Property, Plant and Equipment £3,085	Cr Movement in Reserves £3,085
	Impact	**£595k**	**£8,548**	**£595**
	Overall impact carried forward	**£75,045**	**£82,998**	**£75,045**

Adjusted misstatements

	Detail	Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
4	**Mauricewood capital receipt** The Council has not fully accounted for the deferred element of the Mauricewood capital receipt. An adjustment has therefore been made to credit the Comprehensive Income and Expenditure Account with the gain/loss on disposal of non-current assets.	Cr Other Operating Income and Expenditure £2,100	Dr Other LT Liabilities £2,100 Cr Capital Fund £2,100	Dr Movement in Reserves Statement £2,100
5	**Valuation of Lothian Buses** The revaluation of Lothian Buses was treated as a prior period adjustment in the draft financial statements. However, the revaluation related to a change in estimation technique and therefore under IAS 8 should be accounted for in the year, with no prior period adjustment.		Dr Available for Sale Financial Instruments Reserve £349 Cr Investments £349 Dr Investments £1,996 Cr Available for Sale Financial Instruments Reserve £1,996 (to reinstate prior year adjustment)	
	Impact	£2,100	-	£2,100
	Overall impact carried forward	**£72,945**	**£82,998**	**£72,945**

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Adjusted misstatements

	Detail	Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Impact on total net expenditure £000
6	**Accounting for Financial Instruments** The Council has not fully accounted for the Effective Interest Rate applicable to Lender Option Borrower Options (LOBOs). The carrying value of borrowings within Balance Sheet is correct but we found errors in postings to the Comprehensive Income and Expenditure Statement and Movement in Reserves Statements, leading to interest payable being overstated by £637k.	Cr Interest Payable £637		Dr Movement in Reserves Statement £637
	Impact	£637		
	Overall impact to the financial statements	**£72,308**	**£82,998**	**£72,308**

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Misclassifications & disclosure changes

The table below provides details of misclassification and disclosure changes identified during the audit which have been made in the final set of financial statements.

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
1	Misstatement	-	Movement in Reserves Statement Capital Adjustment Account Revaluation Reserve	Within the draft accounts, adjustments to the Capital Adjustment Account and Revaluation Reserve did not reconcile to Note 10, the Property, Plant and Equipment Note, or to the Movement in Reserves Statement.
2	Misstatement	£9,100	HRA Income and Expenditure Account	The draft accounts disclosed an impairment within the HRA I & E account, which was not reflected within the Council's balance sheet. The impairment was a presentational error, and the accounts and the associated presentational entry in the Capital Adjustment Accounts has therefore been amended.
3	Misstatement	£2,100	Cash Flow Statement	In the draft accounts, the Council had not credited £2,100k deferred capital receipt on Mauricewood to the Comprehensive Income and Expenditure Account. This necessitated the insertion of a line in the cash flow statement "Movement resulting from new balance sheet liability created to offset new capital debtor £2,100k" in Note 25. This line was removed when the cash flow statement was restated to fully account for the deferred capital receipt.
4	Misstatement	£4,500	Assets Held for Sale	During testing we noted that land at Shawfair was carried within Property, Plant and Equipment. We agreed with the Finance Team that the land met the Code criteria for Assets Held for Sale. The accounts have been adjusted to transfer this balance to Assets Held for Sale.
5	Disclosure	-	Post Balance Sheet Event	The Council has updated their assessment of the likely impact of the Newbyres Crescent situation within the Post Balance Sheet Events section.

Misclassifications & disclosure changes continued

	Adjustment type	Value £'000	Account balance	Impact on the financial statements
6	Disclosure	-	Accounting policies	During our review of the draft accounts we noted a small number of inconsistencies between the draft accounting policy and treatment in the accounts. We also noted that there were no revenue recognition policies for Council Tax and Non Domestic Rates.
7	Disclosure	-	Investments	The Council has made additional disclosures to explain the impact of the change in estimation technique used to value its share of Lothian Buses.
8	Disclosure	-	PPE valuation programme	The Council has made additional disclosures to explain its approach to valuing non-current assets, including a change in estimation technique for the valuation of school land.
9	Disclosure	-	Financial Instruments	Our review against the Code's disclosure checklist highlighted a number of additional disclosure requirements, including PPP Liabilities. Minor adjustments were made to fully account for the Effective Interest Rate applicable to Lender Option Borrower Options (LOBOs).
10	Disclosure	-	Pension disclosures	The draft accounts did not fully restate 2012-13 comparatives in the cash flow statement to reflect the impact of IAS 19 changes. This meant that the 2012-13 deficit on provision of services within the cash flow did not agree to the Comprehensive Income and Expenditure Statement. Further adjustments were necessary to 2012-13 comparatives to take account of 2012-13 audit adjustments.
11	Disclosure	-	Council Tax Income Account	The draft accounts did not disclose the impact of the Council Tax Reduction Scheme in line with the requirements of the Code.
12	Disclosure	-	Gain/Loss on disposal of non-current assets	Disclosure of treatment of gain/loss on disposal of non-current assets in Note 5 to the draft accounts did not comply with Guidance. Under the Code guidance notes, it is recommended that the elements of the net gain and loss are separately identified in this analysis.

Unadjusted misstatements

The table below provides details of adjustments identified which we request be processed but which have not been made within the final set of financial statements. The Audit Committee is required to approve management's proposed treatment of all items recorded within the table below:

	Detail	Comprehensive Income and Expenditure Account £'000	Balance Sheet £'000	Reason for not adjusting
1	During testing we noted that none of the additions to Property, Plant and Equipment had been revalued when they were transferred from Assets Under Construction to individual categories of assets. The Council has processed an adjustment to revalue housing assets. This adjustment relates to other assets transferred in the year.		Dr Capital Adjustment Account £403 Cr Property, Plant and Equipment £403	The difference in the carrying value at depreciated historic cost, and revalued amount is not considered to be material.
2	The revaluation of HRA assets did not include one site at Cuiken, in error. This site would result in a further downward revaluation estimated at £1m.		Dr Capital Adjustment Account £1,000 Cr Property, Plant and Equipment £1,000	The difference in the carrying value at depreciated historic cost, and revalued amount is not considered to be material.
3	During the audit, we noted that the historical practice at the Council has been to charge a full years depreciation on revalued assets. This has the effect of understating Property, Plant and Equipment balances. The effect is not material on an annual basis, but in future years we would recommend that this practice is reviewed.		Dr Property, Plant and Equipment £3,417 Cr Revaluation Reserve £3,417	The difference is not considered to be material.
	Overall impact if adjustments were processed	**£-**	**£2,014**	

Internal controls

The purpose of an audit is to express an opinion on the financial statements.

Our audit included consideration of internal controls relevant to the preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of internal control. The matters reported here are limited to those deficiencies that we have identified during the course of our audit and that we have concluded are of sufficient importance to merit being reported to you in accordance with auditing standards.

These and other recommendations, together with management responses, are included in the action plan attached at Appendix A.

	Assessment	Issue and risk	Recommendations
1.	Yellow ●	We noted a number of control weaknesses relating to Employee Remuneration: •We were unable to confirm 7 of a sample of 25 individuals on the Council's payroll system to signed contracts or contract variations •We noted that the Payroll department can post to a code which does not appear on trial balance or system. This results in unbalanced journal entries. •We noted that some employees have two bank accounts listed against payroll records. Others have more than one employee reference within the payroll system.	•All employees should have signed evidence of their current contract on HR file. •The Council should ensure that controls are in place to prevent the posting of unbalanced journals. •The Council should review payroll records to ensure that individuals have only one bank account and employee reference.
2.	Yellow ●	We noted two control weaknesses relating to the general ledger: •The Finance Team identified additional revenue from housing benefit overpayment recoveries that had not been included in the ledger during the year. •Journal numbers are not always used sequentially, presenting a risk that not all journals are monitored or controlled.	• The Council should ensure that all Revenue systems are fully reconciled to the financial ledger where appropriate. • The Council should ensure that all journals are monitored and sequential.

Assessment

● Significant deficiency – risk of significant misstatement

● Deficiency – risk of inconsequential misstatement

Other communication requirements

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

	Issue	Commentary
1.	**Matters in relation to fraud**	• We have previously discussed the risk of fraud with the Audit Committee and been made aware of specific fraud risks relating to the use of fuel. 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.
2.	**Matters in relation to laws and regulations**	• We are not aware of any significant incidences of non-compliance with relevant laws and regulations. The Council has, however, disclosed a Post Balance Sheet Event reflecting the public health situation at Newbyres.
3.	**Written representations**	• A letter of representation has been requested from the Council. • Representations will be requested from management in respect of the significant assumptions used in making accounting estimates.
4.	**Disclosures**	• Our review found no material omissions in the financial statements. Additional disclosures required during the audit are listed within Section 2. .
5.	**Matters in relation to related parties**	• We are not aware of any related party transactions which have not been disclosed.
6.	**Going concern**	• Our work has not identified any reason to challenge the Council's decision to prepare the financial statements on a going concern basis.

Section 3: Fees, non audit services and independence

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Fees, non audit services and independence

We confirm below our final fees charged for the audit.

Fees

	Per Audit plan £	Actual fees £
Council audit	237,000	237,000
Total audit fees	**237,000**	**237,000**

Fees for other services

Service	Fees £
None	Nil

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.

Section 4: Communication of audit matters

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Communication of audit matters to those charged with governance

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

The Audit Plan outlined our audit strategy and plan to deliver the audit, while this Audit Findings report presents the key issues and other matters arising from the audit, together with an explanation as to how these have been resolved.

Respective responsibilities

This Audit Findings Report has been prepared in the context of the Statement of Responsibilities of Auditors and Audited Bodies issued by Audit Scotland.

We have been appointed as the Council's independent external auditors by the Accounts Commission, the body responsible for appointing external auditors to the Local Government sector in Scotland. As external auditors, we have a broad remit covering finance and governance matters.

Our annual work programme is set in accordance with the Code of Audit Practice ('the Code') issued by Audit Scotland on behalf of the Accounts Commission and includes nationally prescribed and locally determined work. Our work considers the Council's key risks when reaching our conclusions under the Code.

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business, and that public money is safeguarded and properly accounted for. We have considered how the Council is fulfilling these responsibilities.

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

Appendices

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Appendix A: Action plan

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
1.	**Quality of working papers** During the audit, we identified a number of areas where the quality of working papers could be improved. This would enhance the Finance Team's own quality assurance of the accounts, and reduce the level of audit queries for the Finance Team. For example, there was a lack of audit trail for the Movement in Reserves Statement and key entries for the disposal of non-current assets, and postings to the Capital Adjustment Account were not fully supported. For other areas, such as creditors, we were unable to obtain a full listing of balances to support working papers. In 2014-15 we have therefore recommended that we hold a joint session to better explain our requirements for the audit, and to deliver training on best practice for working papers.	Deficiency	Accepted. Where required working papers will developed and improved.	31 December 2014 Financial Services Manager
2.	**Employee Remuneration – signed contracts** As part of our audit procedures, we select a sample of 25 individuals from the Council's payroll system and agree their role and identify to signed contracts or contract variations. For 7 of the sample of 25, we were unable to find a signed contract. In one case there was no HR file available for the individual. We would recommend that the Council ensures that sufficient contract confirmation is held for each member of staff to provide clarity where any disputes or discrepancies emerge.	Significant deficiency	Accepted. Consolidation and improvement of HR services is ongoing.	31 December 2014 Employment and Reward Manager

Priority
Significant deficiency – risk of significant misstatement
Deficiency - risk of inconsequential misstatement

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
3.	**Employee Remuneration – identifying data** During testing we noted that some employees have two bank accounts listed against their payroll records. One account listed as active and another inactive. There are also cases where an employee with more than one position has an employee reference for each position rather than one employee reference for a number of positions. We would recommend that employees have only one bank account and employee reference for the purposes of data protection and data-matching exercises.	Deficiency	Accepted. Currently being reviewed and will be resolved.	31 December 2014 Employment and Reward Manager
4.	**Property, Plant and Equipment – Instructions for Valuers** In common with most Councils, the Finance Team places a significant reliance on the work of internal valuers to estimate the value of their asset base. We would recommend that the Council further formalises the relationship with internal valuers to ensure that the information provided allows the Finance Team to make professional judgements on the reasonableness of the valuations, and meets the requirements of the Code.	Deficiency	Accepted. Arrangements with Internal Valuers will be developed further in preparation for the 2014/15 Final Accounts.	31 December 2014 Financial Services Manager
5.	**Property, Plant and Equipment – transfers** The Council should review controls in place to identify completed assets under construction. Current arrangements may not be robust enough to ensure that the revised requirements of the Code are met.	Deficiency	Accepted. The requirement to identify assets falling into this category will be incorporated into an enhanced formal arrangement with internal valuers.	31 December 2014 Financial Services Manager

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Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
6.	**Property, Plant and Equipment – transfers** The Council should review controls in place to identify completed assets under construction. Current arrangements may not be robust enough to ensure that the revised requirements of the Code are met.	Deficiency	Accepted. The requirement to identify assets falling into this category will be incorporated into an enhanced formal arrangement with internal valuers.	31 December 2014 Financial Services Manager
7.	**Property, Plant and Equipment – additions** During testing we identified two matters relating to additions. Firstly, the fixed assets register is not updated for additions during the year. Instead, additions are processed once the audit is complete. We also noted that where constructed assets have been brought into use in year, expenditure in the financial year has been shown as direct additions to the asset category they have been transferred to. This is a presentational issue only, but in future years we would recommend that it is accounted for correctly.	Deficiency	Accepted. A review of process for changes to the Asset Register will take place.	31 December 2014. Financial Services Manager
8.	**Council Tax Debtors** The Council was unable to provide a list of Council Tax debtors as at 31 March 2014. We were therefore unable to directly reconcile the overall debtors figure, totalling £27m, to the Revenues system. In future years, we recommend that a download of debtors is taken as at 31 March, to support the annual accounts working papers.	Deficiency	Accepted. The request for a compete list of debtors will be highlighted in Final Accounts guidance issued.	31 December 2014. Business Applications Manager

Rec No.	Recommendation	Priority	Management response	Implementation date & responsibility
9.	**Revenues reconciliations** As part of preparations for the financial statements, the Finance Team identified additional Housing Benefit overpayment recoveries totalling over £800k. The Council must ensure that all where appropriate, Revenues systems are fully reconciled to the main financial ledger.	Significant deficiency	Accepted. Work is underway to resolve issues identified during the accounts closure process and also to ensure that all information in Revenues systems is accurately reflected in financial systems.	31 December 2014. Revenues Services Manager
10.	**Journals – unbalancing journals** As we noted in prior years, it is possible for the Payroll department to post transactions for Statutory Maternity Pay to a code that does not appear on trial balance or system. This results in unbalanced journal entries, although they are automatically flagged within the financial ledger. We therefore recommend that the Council reviews arrangements to ensure that this is restricted in future.	Deficiency	Accepted. Data structure in Itrent will be reviewed to eliminate this issue. Unbalanced entries are automatically picked up following posting and corrected.	31 December 2014. Employment and Reward Manager.
11.	**Housing Benefits** Our testing undertaken to date on housing benefits has identified 9 errors. Further testing will be undertaken on another 240 cases, as required under the DWPs HB Count methodology. The large number of errors indicates the likelihood of DWP recovering subsidy paid to the Council. Errors may also have a detrimental impact on claimants within Midlothian.	Significant deficiency	Accepted. Ongoing work will determine the extent of this issue and potential consequences on Housing Benefit Subsidy received from DWP.	31 December 2014. Revenues Services Manager.

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Appendix B: Audit opinion

We anticipate we will provide the Council with an unmodified audit report

Independent auditor's report to the members of Midlothian Council and the Accounts Commission for Scotland

We certify that we have audited the financial statements of Midlothian Council for the year ended 31 March 2014 under Part VII of the Local Government (Scotland) Act 1973. The financial statements comprise the Comprehensive Income and Expenditure Statement, Movement in Reserves Statement, Balance Sheet, and Cash-Flow Statement, the Housing Revenue Account Income and Expenditure Statement, the Movement on the Housing Revenue Account Statement, the Council Tax Income Account, and the Non-Domestic Rate Account and the related notes.

The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, and as interpreted and adapted by the Code of Practice on Local Authority Accounting in the United Kingdom 2013/14 (the 2013/14 Code).

This report is made solely to the parties to whom it is addressed in accordance with Part VII of the Local Government (Scotland) Act 1973 and for no other purpose. In accordance with paragraph 125 of the Code of Audit Practice approved by the Accounts Commission for Scotland, we do not undertake to have responsibilities to members or officers, in their individual capacities, or to third parties.

Respective responsibilities of the Responsible Financial Officer and auditor

As explained more fully in the Statement of Responsibilities, the Responsible Financial Officer is responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland) as required by the Code of Audit Practice approved by the Accounts Commission for Scotland. Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error.

This includes an assessment of: whether the accounting policies are appropriate to the body's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Responsible Financial Officer; and the overall presentation of the financial statements.

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view in accordance with applicable law and the 2013/14 Code of the state of the affairs of the group and of the body as at 31 March 2014 and of the income and expenditure of the group and the body for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union, as interpreted and adapted by the 2013/14 Code; and
- have been prepared in accordance with the requirements of the Local Government (Scotland) Act 1973 and the Local Government in Scotland Act 2003.

Opinion on other prescribed matters

In our opinion:

- the part of the Remuneration Report to be audited has been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 1985; and
- the information given in the Explanatory Foreword for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we are required to report by exception

We are required to report to you if, in our opinion:

- adequate accounting records have not been kept; or
- the financial statements and the part of the Remuneration Report to be audited are not in agreement with the accounting records; or
- we have not received all the information and explanations we require for our audit; or
- the Annual Governance Statement does not comply with the 2013/14 Code; or
- there has been a failure to achieve a prescribed financial objective.

We have nothing to report in respect of these matters.

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