

Notice of Meeting and Agenda



Audit Committee

Venue: Council Chambers,
Midlothian House, Dalkeith, EH22 1DN

Date: Monday, 24 June 2019

Time: 11:00

Director, Resources

Contact:

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Further Information:

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1 Welcome, Introductions and Apologies

2 Order of Business

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

3 Declaration of Interest

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

4 Minute of Previous Meeting

4.1 Minute of meeting of 28 May 2019 submitted for approval 3 - 10

4.2 Action Log updated 11 - 12

5 Public Reports

5.1 Annual Treasury Management Report 2018-19 - Report by Head of Finance and Integrated Service Support 13 - 42

5.2 Unaudited Financial Statements 2018_19 - Report by Head of Finance and Integrated Service Support 43 - 46

5.3 Audit Committee Annual Report 201819 - Report by Chair of Audit Committee 47 - 64

6 Private Reports

6.1 Chief Executive's Update including Independent Consultant's Report - Report by Chief Executive (To Follow)

7 Date of Next Meeting

The next meeting will be held on Tuesday 24 September 2019

Minute of Meeting

Audit Committee
Monday 24 June 2019
Item No: 4.1



Audit Committee

Date	Time	Venue
Tuesday 28 May 2019	10.00 am	Council Chambers, Midlothian House, Dalkeith, EH22 1DN

Present:

Mike Ramsay (Chair)
Councillor Hardie
Councillor Milligan
Councillor Muirhead
Councillor Alexander (substitute)
Councillor Cassidy (substitute)
Peter de Vink (Independent Member)

In attendance:

Grace Vickers	Chief Executive
Mary Smith	Director of Education, Communities and Economy
Kevin Anderson	Acting Director Resources
Allister Short	Joint Director Adult Health and Social Care
Gary Fairley	Head of Finance and Integrated Service Support
Grace Scanlin	External Auditor, Ernst and Young
Jill Stacey	Chief Internal Auditor
Elaine Greaves	Principal Auditor
Chris Lawson	Risk Manager
Alan Turpie	Legal Services Manager
Peter Arnsdorf	Planning Manager
Janet Ritchie	Democratic Services Officer

1. Welcome and Apologies

The Chair, Mike Ramsay welcomed everyone to the meeting, following which there was a round of introductions.

Apologies were received from Councillors Smaill, Parry and Baird. It was noted that Councillor Cassidy and Councillor Alexander were substituting for Councillors Parry and Baird.

2. Order of Business

The order of business was confirmed as outlined in the agenda.

3. Declarations of interest

No declarations of interest were received.

4. Minutes of Previous Meetings

4.1 The minute of the meeting of 12 March 2019 was submitted and approved as a correct record having been proposed by Councillor Muirhead and seconded by Councillor Hardie.

4.2 The Action log was submitted and the following agreed:

- 1) 'Annual Governance Statement 2017/18' - To note the completion date for this was amended to September 2019.
- 2) 'Briefing – Informal Audit Committee Session' - To note this will take place after today's Audit Committee meeting and this action would then be complete.
- 3) 'Delivering Excellence – Governance Arrangements' - To note this would be addressed through the BTSG and reported back to the Audit Committee, as required
- 4) 'Risk Register – Lothian Buses Pension Fund – To note that a further report would be presented to the Audit Committee in September 2019.

5. Public Reports

Report No.	Report Title	Submitted by:
5.1	Final Internal Audit Report Follow-up Review of Developer Contributions	Chief Internal Auditor
Outline of report and summary of discussion		
A final Internal Audit Report, dated 19 April 2019 was submitted by the Chief Internal Auditor on Follow up Review of Developers Contributions. The Chief Internal Auditor advised the Committee that in March 2016 an Internal Audit report was presented to the Audit Committee on the controls in place over Developer Contributions.		

In total 11 recommendations were made in the report to improve controls within this area focusing on Governance, Monitoring and Procedures. From the 11 recommendations 5 were found to be completed satisfactorily and 6 partially completed although it was noted that improvements had been made. Section 4 of the report provides details on the findings and conclusions of these partially completed recommendations. Section 5 sets out the Recommendations and the timescales for completion. The Audit Committee was asked to review and endorse the recommendations agreed within the report.

Various questions were asked by the Committee with regards to Developers Contributions, Legal Agreements and the Recommendations contained within the report.

The Director of Education, Communities and Economy and the Planning Manager responded to the questions raised by the Committee confirming that all Developer's contributions had now been collected and a late penalty fee had been applied to a Developer for the delay. Also confirmed was that all Recommendations contained within the report were now 100% complete and that all the data was now inputted into the new database system which would allow Officers to monitor Developments and respond to trigger points more quickly.

Following further discussion it was noted that the Director of Education, Communities and Economy would arrange to provide a training session for Members of the Planning Committee to provide further clarity on Developer's Contributions.

Decision

The Audit Committee endorsed the agreed recommendations.

Action

The Director of Education, Communities and Economy

Report No.	Report Title	Submitted by:
5.2	Final Internal Audit Report Performance Management LGBF	Chief Internal Auditor
Outline of report and summary of discussion		
<p>A final Internal Audit Report, dated 11 April 2019 was submitted by the Chief Internal Auditor on Performance Management: Local Government Benchmarking Framework (LGBF). The purpose of the review was to validate the Council's Performance Indicators which are reported on an annual basis to the Improvement Service as part of the Local Government Benchmarking Framework (LGBF).</p> <p>The Chief Internal Auditor presented the report highlighting the main sections within the report and advised that 3 recommendations were made to improve production of figures in a sustainable way. The Audit Committee was asked to review and endorse the agreed recommendations.</p>		

There followed a discussion on the purpose of benchmarking and that there was no consistent approach in collecting information across Councils. The Chief Executive highlighted that she would raise this with COSLA.

Decision

The Audit Committee endorsed the agreed recommendations.

Report No.	Report Title	Submitted by:
5.3	Final Internal Audit Report – Sales to Cash	Chief Internal Auditor
Outline of report and summary of discussion		
<p>A final Internal Audit Report, dated 9 May 2019 was submitted by the Chief Internal Auditor on Sales to Cash. The purpose of the review was to review the adequacy of the control framework over the income collection on the ICON receipting system.</p> <p>The Chief Internal Auditor presented the report highlighting the main sections from within report and advised that 4 recommendations were made. The Audit Committee was asked to review and endorse the agreed recommendations.</p> <p>Thereafter she responded to questions raised by Members of the Committee on the updating of policies regarding anti-money laundering and the processes of refunds.</p>		
Decision		
The Audit Committee endorsed the agreed recommendations.		

Report No.	Report Title	Submitted by:
5.4	Final Internal Audit Report Pupil Equity Fund	Chief Internal Auditor
Outline of report and summary of discussion		
<p>A final Internal Audit Report, dated 14 May 2019 was submitted by the Chief Internal Auditor on Pupil Equity Fund. The purpose of this audit was to assess the arrangements in place to administer the Pupil Equity Fund (PEF) and to ensure that it was being utilised in line with the National Operational Guidance issued by the Scottish Government which was presented to Cabinet in February 2017.</p> <p>The Chief Internal Auditor presented the report highlighting the main sections from within report and advised that 5 recommendations were made. The Audit Committee was asked to review and endorse the agreed recommendations.</p> <p>Thereafter a discussion took place regarding the Council's procurement process and Officers responded to comments and questions raised by the Members of the Committee.</p>		
Decision		
The Audit Committee endorsed the agreed recommendations.		

Report No.	Report Title	Submitted by:
5.5	Internal Audit Report ICT Security Controls	Chief Internal Auditor
Outline of report and summary of discussion		
<p>An Internal Audit Report, dated 26 April 2019 was submitted by the Chief Internal Auditor on ICT Security Controls. The purpose of this audit was to review the framework in place to assess the adequacy of the physical access and environmental controls to ICT (Information Communication Technology) equipment, software and data to prevent unauthorised access / damage, including third party access and Public Services Network (PSN) compliance.</p> <p>The Chief Internal Auditor presented the report highlighting the main sections from within report and advised that 7 recommendations were made. The Audit Committee was asked to review and endorse the agreed recommendations.</p> <p>Thereafter the Head of Finance and Integrated Service Support responded to questions raised by the Members of the Committee. He then advised the Committee that the Council had received two external 2019 accreditations for their Cyber Security.</p>		
Decision		
The Audit Committee endorsed the agreed recommendations.		

Report No.	Report Title	Submitted by:
5.6	Audit Scotland Report Local Government in Scotland Performance and Challenges 2019	Chief Executive
Outline of report and summary of discussion		
<p>The purpose of this report dated 1 May 2019 was to provide the Audit Committee with a summary of the Audit Scotland report, 'Local government in Scotland: Challenges and performance 2019' and the Council's position in relation to the report's findings.</p> <p>The Chief Executive presented this report highlighting the main sections from the report and advised that the report covered the following three areas:</p> <ul style="list-style-type: none"> • Part 1 - The current and future challenges facing councils. • Part 2 – How Council are responding to these challenges. • Part 3 – The impact on performance in key service areas and public satisfaction. <p>Also to assist Councillors the 'Scrutiny tool checklist for Councillors' was attached as appendix 1.</p> <p>The Chief Executive responded to a question raised by Mr de Vink with regards to where Midlothian Council fitted in with other local authorities and advised that there were supporting tables available providing this information and the links would be sent to the Members of the Committee.</p>		

Thereafter a discussion followed and Elected Members raised concerns on the lack of administrative support for Officers and Elected Members and also training requirements on specific areas. It was agreed that the Quality and Scrutiny Manager would facilitate any training requirements for Elected Members.

Decision

The Audit Committee:

- Agreed to send links to comparison information to the Members of the Committee.
- Agreed that the Quality and Scrutiny Manager would facilitate the development of Elected Members training.
- Noted the Audit Scotland report and the position of Midlothian Council in relation to the report's recommendations.

Action

Quality and Scrutiny Manager

Report No.	Report Title	Submitted by:
5.7	Risk Management Update for 1 January – 31 March 2019	Risk Manager
Outline of report and summary of discussion		
<p>There was submitted report, dated 13 May 2019 by the Risk Manager providing the Committee with the 2018/19 Quarter 4 strategic risk management update, covering the period 1 January – 31 March 2019. The Strategic Risk Profile sought to provide a strategic look at the current issues, future risk and opportunities facing the Council.</p> <p>The Risk Manager responded to a comment raised by the Chair with regards to the order of the Risks.</p>		
Decision		
The Audit Committee noted the quarter 4 2018/19 Strategic Risk Profile report and noted the current response to the issues, risks and opportunities highlighted.		

Report No.	Report Title	Submitted by:
5.8	Procurement and Commercial Improvement Programme (PCIP)	Head of Finance and Integrated Service Support
Outline of report and summary of discussion		
<p>The purpose of this report, dated 14 May 2019 was to bring the Audit Committee's attention the Procurement and Commercial Improvement Programme report which was presented to Cabinet on 9 April 2019 and provided an update in relation to the Council's 2018 Procurement and Commercial Improvement Programme (PCIP).</p>		

The PCIP is not a mandatory assessment and it may transpire that some Councils will not take part in the PCIP due to other competing priorities. However, Midlothian Council have taken part, and the output of the assessment will be used by the Procurement Team as a tool for continuous improvement to further develop the Procurement Improvement Plan to ensure the promotion and delivery of efficient, effective procurement.

The Head of Finance and Integrated Service Support presented the report highlighting that the Council achieved a score of 66% which places Midlothian in the banding F2 with regards to procurement performance according to Scottish Government banding (the highest score being F1).

Thereafter the Head of Finance and Integrated Service Support responded to questions and comments raised by Members of the Committee.

Decision

The Audit Committee noted the Council's PCIP assessment outcome of the 2018 assessment.

Report No.	Report Title	Submitted by:
5.9	Internal Audit Annual Assurance Report 2018/19	Chief Internal Auditor
Outline of report and summary of discussion		
<p>The Internal Audit Annual Assurance Report 2018/19 dated 24 April 2019 was submitted by the Chief Internal Auditor. The purpose of this report was to present to the Audit Committee the Internal Audit Annual Assurance Report for the year to 31 March 2019 which included the Chief Internal Auditor's independent assurance opinion on the adequacy of Midlothian Council's overall control environment.</p> <p>The Chief Internal Auditor presented the report to the Committee providing a brief outline of the main sections of the report and highlighted some of the key messages of assurances and areas of improvement contained within the report.</p>		
Decision		
The Audit Committee noted the Internal Audit Annual Assurance Report 2018/19, and assurances contained therein.		

Report No.	Report Title	Submitted by:
5.10	Counter Fraud Annual Report 2018/19	Chief Internal Auditor
Outline of report and summary of discussion		
There was a report dated 24 April 2019 submitted by the Chief Internal Auditor providing an update to the Audit Committee on the Council's counter fraud responsibilities and the activities of the Corporate Fraud team over the past year as part of the arrangements to tackling fraud at the Council.		

The Chief Internal Auditor advised the Committee that this report had been discussed at the Corporate Management Team on 24 April 2019 and the Serious and Organised Crime group on 7 May 2019. The report provided a summary of the Corporate Fraud Team's areas of work and the preventative approach adopted.

Thereafter Officers responded to questions and comments raised by the Members of the Committee regarding the issues around Whistleblowing and appropriate training for staff.

Decision

The Audit Committee considered the counter fraud work undertaken by the Corporate Fraud Team during the year to 31 March 2019, in support of the Council's anti-fraud and corruption policy and strategy, and noted the outcomes.

6. Private Reports

No private business was discussed.

7. Date of Next Meeting

The next meeting will be held on Monday 24 June 2019.

The meeting terminated at 12.25 pm

Actions Log

Audit Committee
Tuesday 24 June 2019
Item No: 4.2



No	Subject	Date	Action	Action Owner	Expected completion date	Comments
1	Annual Governance Statement 2017/18 (2018/19 Areas for Improvement)	19/06/18		Chief Executive	September 2019	Final AGS 2017/18 included within audited Statement of Accounts 2017/18 for 25/09/2018. Management's proposal is to report on Areas of Improvement progress to Audit Committee on a quarterly basis.
2	Briefing – Informal Audit Committee Session(s) - Treasury Management	12/03/19	Agreed that the need for further briefings would be addressed as part of the self-assessment/training needs analysis	Chief Internal Auditor	28/05/2019	Completed
3	Delivering Excellence Programme - Governance	12/03/19	Noted that the Governance arrangement were being addressed through the BTSG and Agreed that they be reported back to the Audit Committee, as required.	Chief Internal Auditor	As Required	

No	Subject	Date	Action	Action Owner	Expected completion date	Comments
4	Risk Register – Lothian Buses Pension Fund	12/03/19	Agreed to seek a further report addressing the potential risks and any possible future financial implications to the Council	Legal Manager/Head of Finance and Integrated Services Support	24/09/2019	

Annual Treasury Management Report 2018/19

Report by Gary Fairley, Head of Finance & Integrated Service Support

1. Purpose of Report

The purpose of the report is to inform members of the Treasury Management activity undertaken in 2018/19 and the year-end position.

2. Background

The main points arising from treasury activity in 2018/19 were:

- Total new long term borrowing taken in the year amounted to £10.700 million, comprising the following:-
 - One £10.000 million Equal Instalment of Principal loan sourced from Deutsche Pfandbriefbank, drawn on 15 November 2018 following loan execution and hedging of interest rate in February 2016.
 - One £0.700 million Equal Instalment of Principal loan sourced from Salix, drawn in two phases on 19 December 2018 (£0.560 million) and 04 March 2019 (£0.140 million), at a rate of 0.00% and offered to the Council to part finance the Non-Domestic Energy Efficiency Framework project;
- Total long term borrowing maturing in the year amounted to £10.452 million, comprising the following:-
 - One £10.000 million Maturity Loan with PWLB matured on 15 November 2018 (original tenor 8.5 years at an interest rate of 3.41%), refinanced by the EIP loan from Deutsche Pfandbriefbank;
 - £0.034 million of PWLB Annuities of various tenors and interest rates;
 - £0.357 million of Annuity loan from Deutsche Pfandbriefbank;
 - £0.061 million of Salix interest free loans.
- No new long term investments were placed;
- The average rate of interest paid on external debt was 3.64% in 2018/19, up from 3.37% in 2017/18 and reflecting the lower average carrying value of temporary loans during the year compared to 2017/18;
- The average rate of return on investments was 0.86% in 2018/19, exceeding the benchmark of 0.79% for the fifteenth year in succession;

- The pooled internal loans fund rate for General Fund and HRA increased marginally from 3.08% in 2017/18 (2nd lowest in mainland Scotland – see Appendix 1) to 3.12% in 2018/19, which is again expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland;
- Were the pooled internal loans fund rate to have equated to the Scottish weighted average of 3.96%, this would have generated loan charges in 2018/19 of £18.8 million. The Council's actual 2018/19 loan charges for General Services and HRA were £16.5 million, representing a cash saving (compared to the Scotland average) of £2.3 million in 2018/19;
- The appointment of interest between HRA and General Fund was changed in 2017/18, with the HRA charged interest at the weighted average interest rate on the Council's long-term debt, removing interest rate risk for the HRA to support the long-term rent setting strategy. The interest charged to the General Fund provides support to the Council's medium term financial strategy and capital plans. This methodology was retained in 2018/19.
- No debt rescheduling was undertaken during 2018/19.

A detailed report "*Annual Treasury Management Review 2018/19*" on the activity during 2018/19 is attached as Appendix 2.

The Treasury Portfolio at the start and end of the financial year is shown in Tables 1 and 2 below.

Table 1: Loan Portfolio at 1 April 2018 and 31 March 2019

Loan Type	Principal Outstanding £000's	Principal Outstanding £000's	Movement £000's
PWLB Annuity	708	674	-34
PWLB Maturity	197,224	187,224	-10,000
LOBO	20,000	20,000	0
Forward Starting Loans	9,821	19,464	+9,643
Temporary Market Loans	13,000	9,000	-4,000
Salix Loans	277	916	+639
Total Loans	241,031	237,279	-3,752

Table 2: Investment Portfolio 1 April 2018 and 31 March 2019

Investment Type	Principal Outstanding £000's	Principal Outstanding £000's	Movement £000's
Bank Call Accounts	0	0	0
Money Market Funds	8,026	9,767	+1,741
Bank Notice Accounts	49,985	49,985	0
Other Local Authorities	15,000	15,000	0
Total Investments	73,011	74,752	+1,741

3. Other Issues

As recommended by the Code, this report will be considered by Audit Committee on 24 June 2019 and Council will be updated verbally on the outcome of the Audit Committee consideration.

4. Report Implications

4.1. Resources

Although benefits from Treasury Management activity continue to accrue there are no direct financial implications or other resource issues arising from this report.

The loan charges associated with Capital Expenditure and Treasury Management activity during 2018/19 are reported in the Financial Monitoring 2018/19 – General Fund Revenue report elsewhere on today's agenda and reflected in the draft Capital Strategy.

4.2. Risk

As the Council follows the requirements of CIPFA Code of Practice and the Prudential Code this minimises the risks involved in Treasury Management activities place. For those risks that do exist there are robust and effective controls in place to further mitigate the level of risks. These include further written Treasury Management Practices, which define the responsibilities of all staff involved.

4.3. Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

5.4 Impact on Performance and Outcomes

The strategies adopted are an integral part of the corporate aim to achieve Best Value as they seek to minimise the cost of borrowing by exercising prudent debt management and investment. This in turn helps to ensure that the Council's capital expenditure is sustainable in revenue terms.

5.5 Adopting a Preventative Approach

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

5.6 Involving Communities and Other Stakeholders

Although no external consultation has taken place, cognisance has been taken of professional advice obtained from Link Asset Services, the Council's appointed Treasury Consultants.

5.7 Ensuring Equalities

There are no equality issues arising from this report.

5.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

5.9 IT Issues

There are no IT issues arising from this report.

5. Summary

Treasury Management activity during the year has been effective in minimising the cost of borrowing and maximising investment income within the parameters set by the strategy for the year.

6. Recommendations

It is recommended that Audit Committee:-

- a) Note the Treasury Management Annual Report for 2018/19 and recommend that the report is submitted to Council for approval;

Date 13 June 2019

Report Contact:

Gary Thomson 0131 271 3230 gary.thomson@midlothian.gov.uk

Appendices:-

Appendix 1: Loans Fund Rate Comparison with other Scottish Local Authorities

Appendix 2: Annual Treasury Management Review 2018/19

Appendix 3: Investment Benchmarking Analysis 2018/19

Appendix 1:-

Loans Fund Pooled Rate Comparison 2017/18

Authority	2017/18
West Dunbartonshire	3.070%
Midlothian	3.078%
Dumfries & Galloway	3.090%
Perth & Kinross	3.247%
East Lothian	3.340%
Aberdeenshire	3.510%
Inverclyde	3.600%
Fife	3.630%
North Lanarkshire	3.660%
Falkirk	3.790%
East Dunbartonshire	3.830%
South Lanarkshire	3.850%
East Renfrewshire	3.860%
Dundee City	3.887%
Scottish Borders	4.010%
Moray	4.010%
Highland	4.010%
West Lothian	4.048%
South Ayrshire	4.090%
Argyll & Bute	4.095%
North Ayrshire	4.177%
Stirling	4.207%
Glasgow City	4.230%
Renfrewshire	4.340%
Angus	4.400%
East Ayrshire	4.700%
Aberdeen City	4.957%
Clackmannanshire	5.060%
Edinburgh City	5.120%

The Pooled Loans Fund Rate combines the interest paid by the Council on money borrowed, with the interest earned by the Council on money invested, along with other charges such as internal interest allowed, premiums written off and treasury-related expenses to arrive at a weighted average “loans fund rate” figure for each authority, as noted in the final column above.

Appendix 2

Annual Treasury Management Review 2018/19

Midlothian Council
June 2019

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This Council is required by regulations issued under the Local Government in Scotland Act 2003 to produce an annual treasury management review of activities and the actual prudential and treasury indicators for 2018/19. This report meets the requirements of both the CIPFA Code of Practice on Treasury Management, (the Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities, (the Prudential Code).

During 2018/19 the minimum reporting requirements were that the full Council should receive the following reports:

- an annual treasury strategy in advance of the year (Council 13/02/2018);
- a mid-year, (minimum), treasury update report (Council 13/02/2018);
- an annual review following the end of the year describing the activity compared to the strategy, (this report);

The regulatory environment places responsibility on members for the review and scrutiny of treasury management policy and activities. This report is, therefore, important in that respect, as it provides details of the outturn position for treasury activities and highlights compliance with the Council's policies previously approved by members.

This Council confirms that it has complied with the requirement under the Code to give prior scrutiny to all of the above treasury management reports by the Audit Committee before they are reported to the full Council.

1. The Council's Capital Expenditure and Financing 2018/19

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

Table 1: Capital Expenditure + Financing			
	2017/18	2018/19	2018/19
	Actual	Budget	Actual
	£000	£000	£000
General Fund			
Capital Expenditure	16,984	36,076	18,209
Available Funding	13,106	24,050	18,045
Borrowing Required	3,878	12,026	164
HRA			
Capital Expenditure	10,571	40,785	14,718
Available Funding	4,989	5,071	11,086
Borrowing Required	5,582	35,714	3,632
General Fund and HRA			
Capital Expenditure	27,555	76,861	32,927
Available Funding	18,095	29,121	29,131
Borrowing Required	9,460	47,740	3,796

2. The Council's Overall Borrowing Need

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's indebtedness. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2018/19 unfinanced capital expenditure (see above table), plus prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLb] or the money markets), or utilising temporary cash resources within the Council.

Reducing the CFR – the Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Scheduled Debt Amortisation (or loans repayment), to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

The total CFR can also be reduced by:

- the application of additional capital financing resources (such as unapplied capital receipts); or
- charging more than the minimum loan repayment each year through an additional revenue charge.

The Council's CFR for the year is shown below, and represents a key prudential indicator.

Table 2: Council's Capital Financing Requirement			
	31-Mar-18	2018/19	31-Mar-19
CFR:	Actual	Budget	Actual
	£000	£000	£000
Opening balance	£ 278,783	£ 285,875	£ 280,511
Add Borrowing Required	£ 9,460	£ 47,740	£ 3,797
Less scheduled debt amortisation	£ (7,969)	£ (8,419)	£ (9,429)
Closing balance	£ 280,274	£ 325,196	£ 274,879

Borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

Gross borrowing and the CFR - in order to ensure that borrowing levels are prudent over the medium term and only for a capital purpose, the Council should ensure that its gross external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year (2017/18) plus the estimates of any additional capital financing requirement for the current (2018/19) and next three financial years. This essentially means that the Council is not borrowing to support revenue expenditure. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs in 2018/19. The table below highlights the Council's gross borrowing position against the CFR. The Council has complied with this prudential indicator.

Table 3: Council's Gross Borrowing Position			
	31-Mar-18	2018/19	31-Mar-19
	Actual	Budget	Actual
	£000	£000	£000
Gross Borrowing	£ 241,032	£ 290,770	£ 237,279
CFR	£ 280,274	£ 325,196	£ 274,879

The authorised limit – this Council has kept within its authorised external borrowing limit as shown by the table below. Once this has been set, the Council does not have the power to borrow above this level.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Table 4: Gross Borrowing against Authorised Limit / Operational Boundary	
	2018/19
Authorised limit - borrowing	£482,021
Operational boundary - borrowing	£325,196
Maximum gross borrowing position	£248,652
Average gross borrowing position	£234,727

3. Treasury Position as at 31 March 2019

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the Purpose section of this report, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2018/19 the Council's treasury (excluding borrowing by PFI and finance leases) position was as follows:

Table 5: Treasury Position						
	31 March 2018 Principal	Rate/ Return	Average Life (Yrs)	31 March 2019 Principal	Rate/ Return	Average Life (Yrs)
Debt						
Fixed Rate Debt						
PWLB	£ 197,933	3.74%	26.87	£ 187,899	3.75%	27.27
Market	£ 28,099	1.92%	20.19	£ 34,380	2.32%	23.20
Total Fixed Rate Debt	£ 226,032	3.51%	26.03958	£ 222,279	3.53%	26.64
Variable Rate Debt						
PWLB	£ -	n/a	n/a	£ -	n/a	n/a
Market	£ 15,000	4.63%	32.71	£ 15,000	4.63%	31.71
Total Variable Rate Debt	£ 15,000	4.63%	32.71	£ 15,000	4.63%	32.71
Total debt/gross borrowing	£ 241,032	3.47%	26.4547	£ 237,279	3.47%	27.02
CFR	£ 280,274			£ 274,879		
Over/ (under) borrowing	£ (39,242)			£ (37,600)		
Investments						
Fixed Rate Investments						
In House	£ 15,000	0.79%	2.00	£ 15,000	1.70%	1.0000
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Fixed Rate Investments	£ 15,000	0.79%	2.00	£ 15,000	1.70%	1.00
Variable Rate Investments						
In House	£ 58,011	0.69%	0.42	£ 59,751	0.96%	0.41
With Managers	£ -	n/a	n/a	£ -	n/a	n/a
Total Variable Rate Investments	£ 58,011	0.69%	0.42	£ 59,751	0.96%	0.41
Total Investments	£ 73,011	0.71%	0.74	£ 74,751	1.11%	0.53
Net Borrowing	£ 168,021			£ 162,528		

The maturity structure of the debt portfolio was as follows:

Table 6: Maturity Structure of Debt Portfolio						
	31-Mar-18		2018/19	31-Mar-19		
	Actual		Original Limits	Actual		
	£000	%	%	£000	%	
Under 12 months	£ 23,034	10%	0% to 50%	£ 18,263	8%	
12 months to 2 years	£ 8,437	4%	0% to 50%	£ 9,266	4%	
2 years to 5 years	£ 9,956	4%	0% to 50%	£ 3,827	2%	
5 years to 10 years	£ 1,609	1%	0% to 50%	£ 5,509	2%	
10 years to 20 years	£ 55,590	23%	0% to 50%	£ 62,653	26%	
20 years to 30 years	£ 9,821	4%	0% to 50%	£ 15,179	6%	
30 years to 40 years	£ 85,535	36%	0% to 50%	£ 75,534	32%	
40 years to 50 years	£ 42,049	18%	0% to 50%	£ 42,048	18%	
50 years and above	£ 5,000	2%	0% to 50%	£ 5,000	2%	
Total	£ 241,031	102%		£ 237,279	100%	

The maturity structure of the investment portfolio was as follows:

Table 7: Maturity Structure of Investment Portfolio		
	31-Mar-18	31-Mar-19
	£000	£000
Investments		
Under 1 Year	£ 58,011	£ 74,751
Over 1 Year	£ 15,000	£ -
Total	£ 73,011	£ 74,751

The exposure to fixed and variable interest rates on debt was as follows:-

Table 8: Fixed/Variable Interest Rate Exposure of Debt Portfolio						
	31-Mar-18		2018/19	31-Mar-19		
	Actual		Original Limits	Actual		
	£000	%	%	£000	%	
Fixed Interest Rate Exposure	£226,032	94%	0% to 100%	£ 222,279	92%	
Variable Interest Rate Exposure	£ 15,000	6%	0% to 30%	£ 15,000	6%	
Total	£ 241,032	100%		£ 237,279	98%	

4. The Strategy for 2018/19

During 2018-19, the Council maintained an under-borrowed position. This meant that the capital borrowing need, (the Capital Financing Requirement), was not fully funded with loan debt, as cash supporting the Council's reserves, balances and cash flow was used as an interim measure. This strategy was prudent as investment returns were low and minimising counterparty risk on placing investments also needed to be considered.

A cost of carry remained during the year on any new long-term borrowing that was not immediately used to finance capital expenditure, as it would have caused a temporary increase in cash balances; this would have incurred a revenue cost – the difference between (higher) borrowing costs and (lower) investment returns.

The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this was kept under review to avoid incurring higher borrowing costs in the future when this authority may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

Against this background and the risks within the economic forecast, caution was adopted with the treasury operations. The Head of Finance & ISS therefore monitored interest rates in financial markets and adopted a pragmatic strategy to avoid taking new long term borrowings based on the Council's capital plans seeing significant rephasing from 2018/19 to 2019/20 and the expectation that longer term interest rates would not increase significantly through 2019/20.

Interest rate forecasts expected only gradual rises in medium and longer term fixed borrowing rates during 2018/19 and the two subsequent financial years. Variable, or short-term rates, were expected to be the cheaper form of borrowing over the period.

Link Asset Services Interest Rate View 2.1.18													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

Investment returns remained low during 2018/19. The expectation for interest rates within the treasury management strategy for 2018/19 was that Bank Rate would rise from 0.50% to 0.75%. At the start of 2018-19, and after UK GDP growth had proved disappointingly weak in the first few months of 2018, the expectation for the timing of this increase was pushed back from May to August 2018. Investment interest rates were therefore on a gently rising trend in the first half of the year after April, in anticipation that the MPC would raise Bank Rate in August. This duly happened at the MPC meeting on 2 August 2018. During this period, investments were, therefore, kept shorter term in anticipation that rates would be higher later in the year.

It was not expected that the MPC would raise Bank Rate again during 2018-19 after August in view of the fact that the UK was entering into a time of major uncertainty with Brexit due in March 2019. Value was therefore sought by placing longer term investments after 2 August where cash balances were sufficient to allow this.

Investment rates were little changed during August to October but rose sharply after the MPC meeting of 1 November was unexpectedly hawkish about their perception of building inflationary pressures, particularly from rising wages. However, weak GDP growth data after December, plus increasing concerns generated by Brexit, resulted in investment rates falling back again.

Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

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Continued uncertainty in the aftermath of the 2008 financial crisis has promoted a cautious approach whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

5. The Economy and Interest Rates

UK. After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

After the Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018, it is little surprise that they have abstained from any further increases since then. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. However, in the February 2019 Bank of England Inflation Report, the latest forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario as the difference between the two figures is now around 1.5%, i.e. a real terms increase. Given the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months.

Brexit. The Conservative minority government has so far, (8.4.19), been unable to muster a majority in the Commons over its Brexit deal. The EU has set a deadline of April 12 for the House of Commons to propose what form of Brexit it would support. If another form of Brexit, other than the proposed deal, does get a majority by April 12, then it is likely there will need to be a long delay to Brexit to allow time for negotiations with the EU. It appears unlikely that there would be a Commons majority which would support a disorderly Brexit or revoking article 50, (cancelling Brexit). There would also need to be a long delay if there is no majority for any form of Brexit. If that were to happen, then it increases the chances of a general election in 2019; this could result in a potential loosening of monetary policy and therefore medium to longer dated

gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a (temporary) boost in consumption in 2018 which generated an upturn in the strong rate of growth; this rose from 2.2%, (annualised rate) in quarter 1 of 2018 to 4.2% in quarter 2, 3.5% in quarter 3 and then back to 2.2% in quarter 4. The annual rate came in at 2.9% for 2018, just below President Trump's aim for 3% growth. The strong growth in employment numbers has fed through to an upturn in wage inflation which hit 3.4% in February, a decade high point. However, CPI inflation overall fell to 1.5% in February, a two and a half year low, and looks to be likely to stay around that number in 2019 i.e. below the Fed's target of 2%. The Fed increased rates another 0.25% in December to between 2.25% and 2.50%, this being the fourth increase in 2018 and the ninth in the upward swing cycle. However, the Fed now appears to be edging towards a change of direction and admitting there may be a need to switch to taking action to cut rates over the next two years. Financial markets are now predicting two cuts of 25 bps by the end of 2020.

EUROZONE. The European Central Bank (ECB) provided massive monetary stimulus in 2016 and 2017 to encourage growth in the EZ and that produced strong annual growth in 2017 of 2.3%. However, since then the ECB has been reducing its monetary stimulus measures and growth has been weakening - to 0.4% in quarters 1 and 2 of 2018, and then slowed further to 0.2% in quarters 3 and 4; it is likely to be only 0.1 - 0.2% in quarter 1 of 2019. The annual rate of growth for 2018 was 1.8% but is expected to fall to possibly around half that rate in 2019. The ECB completely ended its programme of quantitative easing purchases of debt in December 2018, which means that the central banks in the US, UK and EU have all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by purchases of debt. However, the downturn in growth, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), prompted the ECB to take new measures to stimulate growth. With its refinancing rate already at 0.0% and the deposit rate at -0.4%, it has probably reached the limit of cutting rates. At its March 2019 meeting it said that it expects to leave interest rates at their present levels "at least through the end of 2019", but that is of little help to boosting growth in the near term. Consequently, it also announced a third round of TLTROs; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank is making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

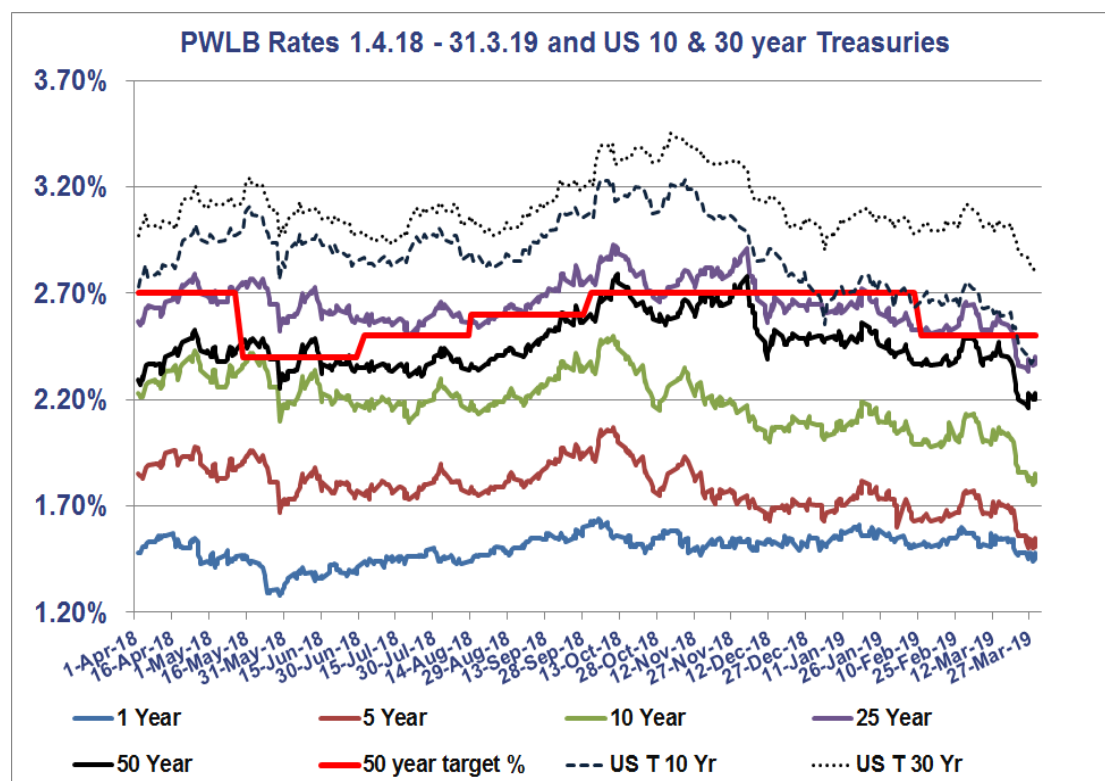
JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Equity markets are currently concerned about the synchronised general weakening of growth in the major economies of the world: they fear there could even be a recession looming up in the US, though this fear is probably overdone.

6. Borrowing Rates in 2018/19

Since PWLB rates peaked during October 2018, most PWLB rates have been on a general downward trend, though longer term rates did spike upwards again during December, and, (apart from the 1 year rate), reached lows for the year at the end of March. There was a significant level of correlation between movements in US Treasury yields and UK gilt yields -which determine PWLB rates. The Fed in America increased the Fed Rate four times in 2018, making nine increases in all in this cycle, to reach 2.25% – 2.50% in December. However, it had been giving forward guidance that rates could go up to nearly 3.50%. These rate increases and guidance caused Treasury yields to also move up. However financial markets considered by December 2018, that the Fed had gone too far, and discounted its expectations of further increases. Since then, the Fed has also come round to the view that there are probably going to be no more increases in this cycle. The issue now is how many cuts in the Fed Rate there will be and how soon, in order to support economic growth in the US. But weak growth now also looks to be the outlook for China and the EU so this will mean that world growth as a whole will be weak. Treasury yields have therefore fallen sharply during 2019 and gilt yields / PWLB rates have also fallen.

The graphs and tables for PWLB rates show, for a selection of maturity periods, the average borrowing rates, the high and low points in rates, spreads and individual rates at the start and the end of the financial year.



	1 Year	5 Year	10 Year	25 Year	50 Year
02/04/2018	1.48%	1.85%	2.23%	2.57%	2.29%
29/03/2019	1.48%	1.55%	1.85%	2.40%	2.23%
Low	1.28%	1.50%	1.80%	2.33%	2.16%
Date	29/05/2018	26/03/2019	28/03/2019	26/03/2019	26/03/2019
High	1.64%	2.07%	2.50%	2.93%	2.79%
Date	04/10/2018	10/10/2018	10/10/2018	10/10/2018	12/10/2018
Average	1.50%	1.80%	2.20%	2.66%	2.47%

Short-dated market money:- sourced from other UK public bodies, rates fluctuated throughout the year from 0.23%-0.70% for 1 to 12 month maturities.

7. Borrowing Outturn for 2018/19

New Treasury Borrowing:-

New loans were drawn to fund the net unfinanced capital expenditure and naturally maturing debt.

The loans drawn were:-

Table 9: New Loans Taken in Financial Year 2018/19						
Lender	Date Taken	Principal £000's	Interest Rate	Fixed/ Variable	Maturity Date	Term (Yrs)
Deutsche Pfandbriefbank	15 Nov 2018	£ 10,000	2.73%	Fixed	15 May 2044	25.50
Salix	19 Dec 2018	£ 560	0.00%	Fixed	01 Apr 2024	5.30
Salix	14 Mar 2019	£ 140	0.00%	Fixed	01 Apr 2024	5.05
Market	Various	£ 82,280	0.33%-0.81%	Variable interest rate	Various	0.09-0.18
Total		£ 92,980				

Market loans of £82.280 million reflect an average carrying value of £7.685 million of Temporary Borrowing at an average rate of 0.49%. This compares against a budget assumption of new short-term market borrowing of £39.0 million at an average interest rate of 0.53%.

Medium-long term borrowing of £10.700 million taken at a weighted average rate of 2.55% compares with a budget assumption of new borrowing of £23.576 million at an average interest rate of 2.86%.

Maturing Debt:-

The following table gives details of treasury debt maturing during the year:-

Table 10: Maturing Debt in Financial Year 2018/19						
Lender	Date Repaid	Principal £000's	Interest Rate	Fixed/ Variable	Date Originally Taken	Original Term (Yrs)
PWLB	Various (Annuities)	£ 34	8.72%	Fixed	Various	59.75
PWLB	15 Nov 2018	£ 10,000	3.41%	Fixed	28 May 2010	8.50
Salix	Various	£ 61	0.00%	Fixed	Various	7-8 years
Deutsche Pfandbriefbank	Various	£ 357	2.63%	Fixed	29 Jun 2017	28.00
Market	Various	£ 86,280	0.33%-0.68%	Variable interest rate	Various	0.09-0.18
Total		£ 96,732				

Rescheduling:-

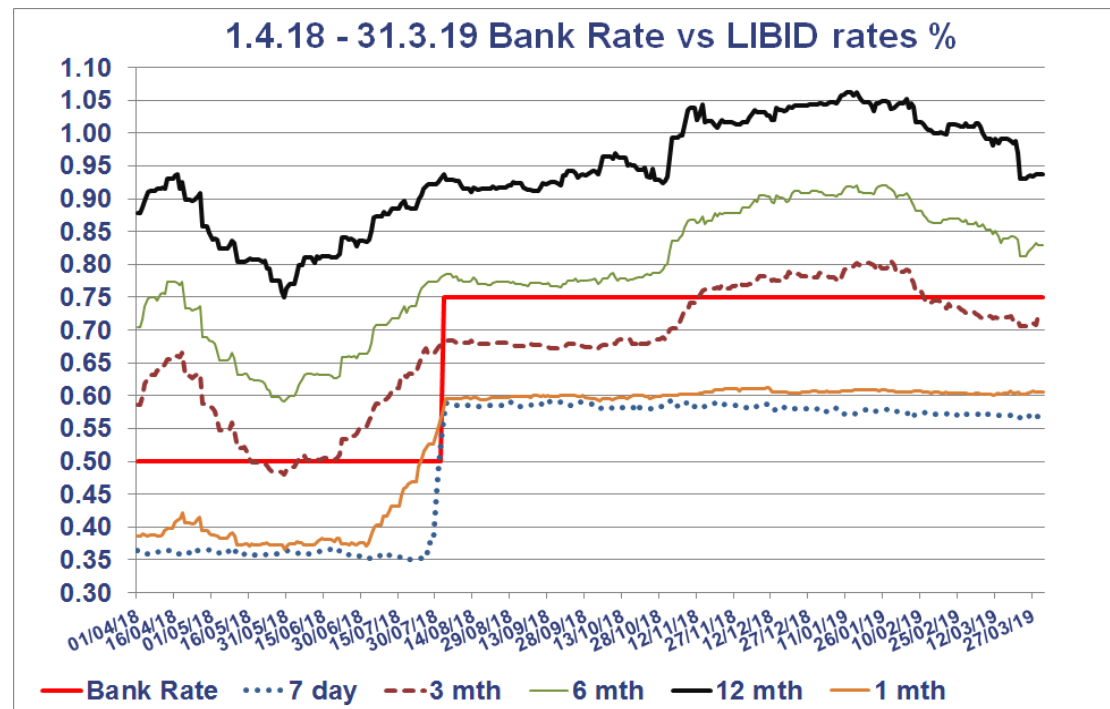
No rescheduling was done during the year as the average 1% differential between PWLB new borrowing rates and premature repayment rates made rescheduling unviable.

Summary of debt transactions:-

The average interest rate payable on external debt increased marginally from 3.57% at the start of 2018/19 to 3.59% at the end of 2018/19. The average life of debt within the loan portfolio lengthened marginally from 26.45 years to 26.96 years.

8. Investment Rates in 2018/19

Money market fund rates started the year between 0.41%-0.46%, trending at base rate levels throughout the year, and mirroring the increase of 0.25% in Base Rate in August before finishing the year at just north of base rate (0.75%-0.78%).



9. Investment Outturn for 2018/19

Investment Policy:-

The Council's investment policy is governed by Scottish Government Investment Regulations, which have been implemented in the annual investment strategy approved by the Council on 13 February 2018. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Investments held by the Council:-

The Council maintained an average balance of £77.0 million of internally managed funds. The internally managed funds earned an average rate of return of 0.86%. The comparable performance indicator is the average 6-month LIBID un-compounded rate, which was 0.79%.

10. Performance Measurement

One of the key requirements in the Code is the formal introduction of performance measurement relating to investments, debt and capital financing activities.

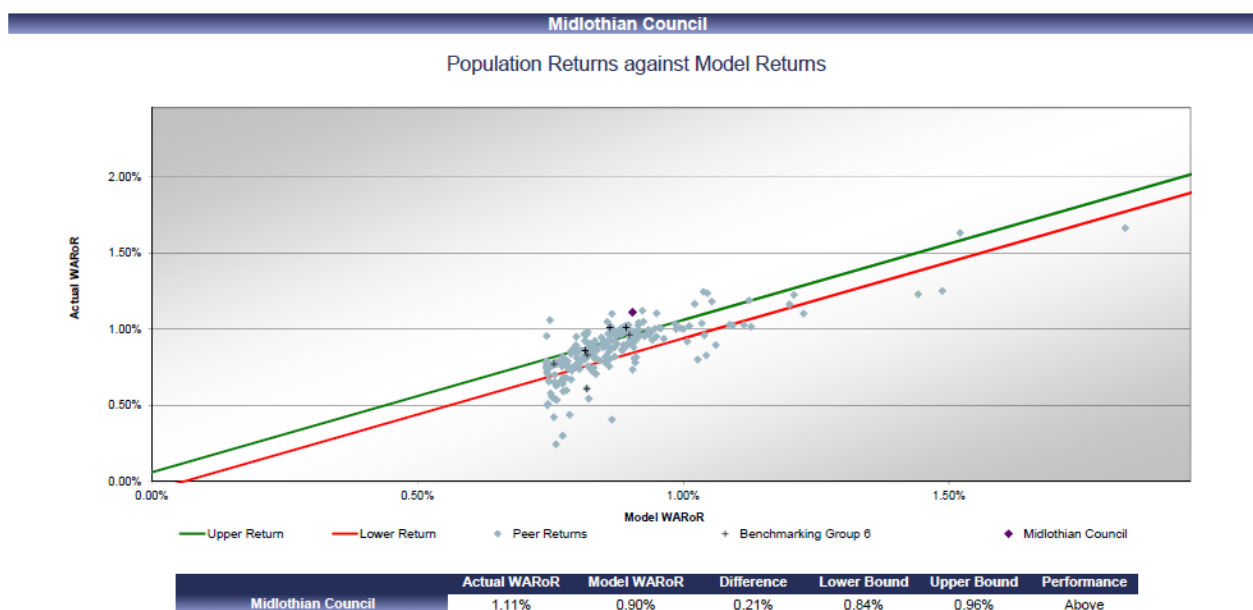
Loans Fund Rate

Combining the interest paid (earned) on external debt (investments) with charges for premiums written off and internal interest allowed into an average Loans Fund Rate, Midlothian's result of 3.08% for 2017/18 was the second lowest Loans Fund Rate amongst all mainland authorities in Scotland (see Appendix 1).

The comparative Loans Fund Rate for 2018/19, of 3.12%, is once again expected to be one of the lowest when benchmarked against all mainland authorities in Scotland (note that at present, these benchmark figures are not yet available).

Investment Benchmarking

The Council participates in the Scottish Investment Benchmarking Group set up by its Treasury Management Consultants, Capita. This service provided by Capita provides benchmarking data to authorities for reporting and monitoring purposes, by measuring the security, liquidity and yield within an individual authority portfolio. Based on the Council's investments as at 31 March 2018, the Weighted Average Rate of Return (WARoR) on investments of 1.11% against other authorities is shown in the graph below:-



** Models for 30 June 2018, 30 September 2018 and 31 December 2018 are attached as Appendix 3.*

As can be seen from the above graph, Midlothian is performing above the Capita model benchmarks (red to green lines), and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

Debt Performance

Whilst investment performance criteria have been well developed and universally accepted, debt performance indicators continue to be a more problematic area with the traditional average portfolio rate of interest acting as the main guide. In this respect, the relevant figures for Midlothian are incorporated in the table in Section 3.

11. Conclusion

The Council's overall cost of borrowing continues to benefit significantly from proactive Treasury Management activity.

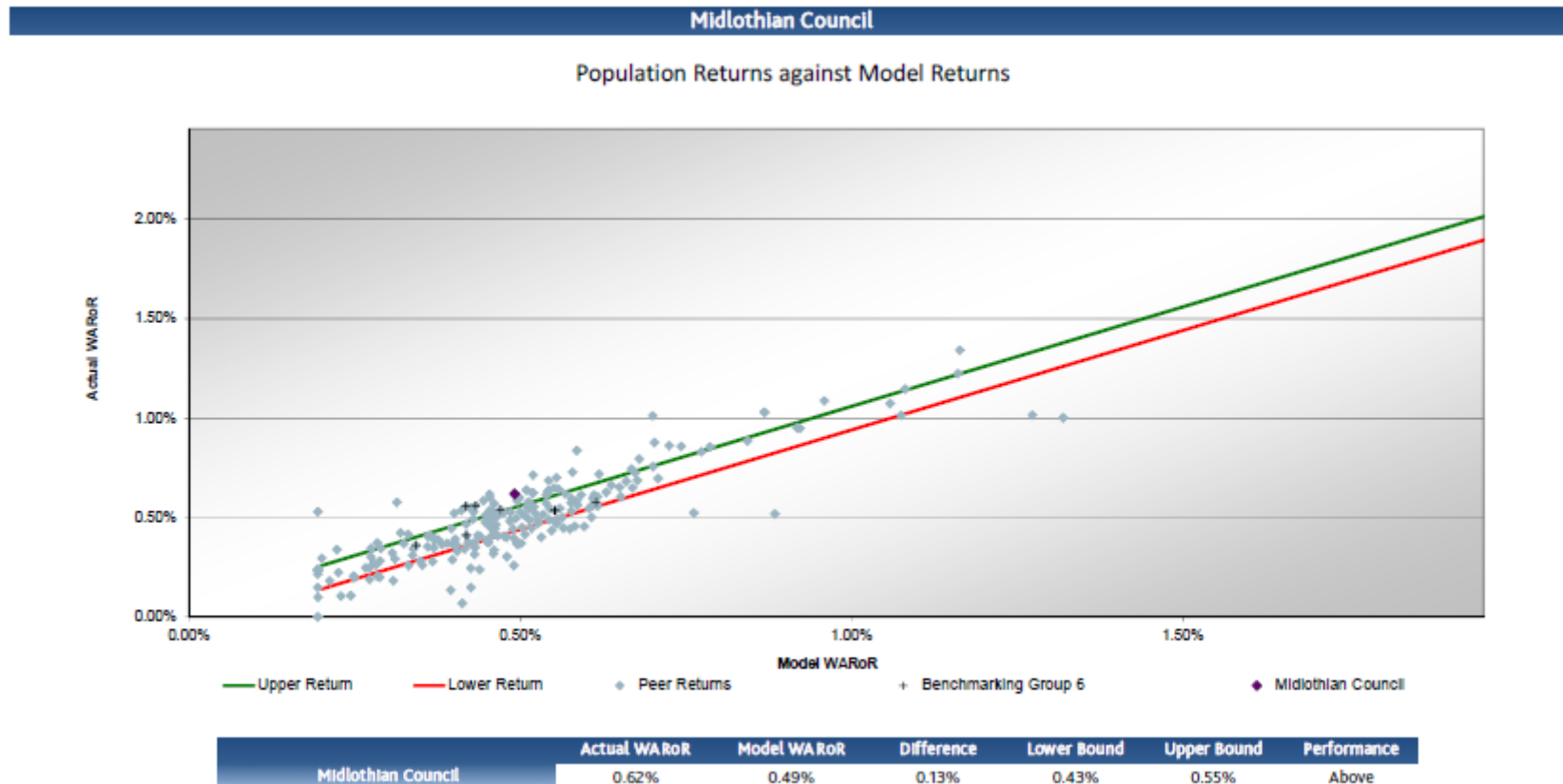
The cost of long term borrowing has been maintained by taking up opportunities to borrow from the PWLB at low interest rates whilst advantage has also been taken of the low rates available for temporary borrowing.

A better than average return on investments has been achieved for the tenth consecutive year and Midlothian continues to perform above the Sector model benchmarks and is achieving one of the highest Weighted Average Rates of Return (WARoR) for the Weighted Average Credit Risk held, not only amongst peer Councils within the Benchmarking Group but also amongst the population of authorities across the UK.

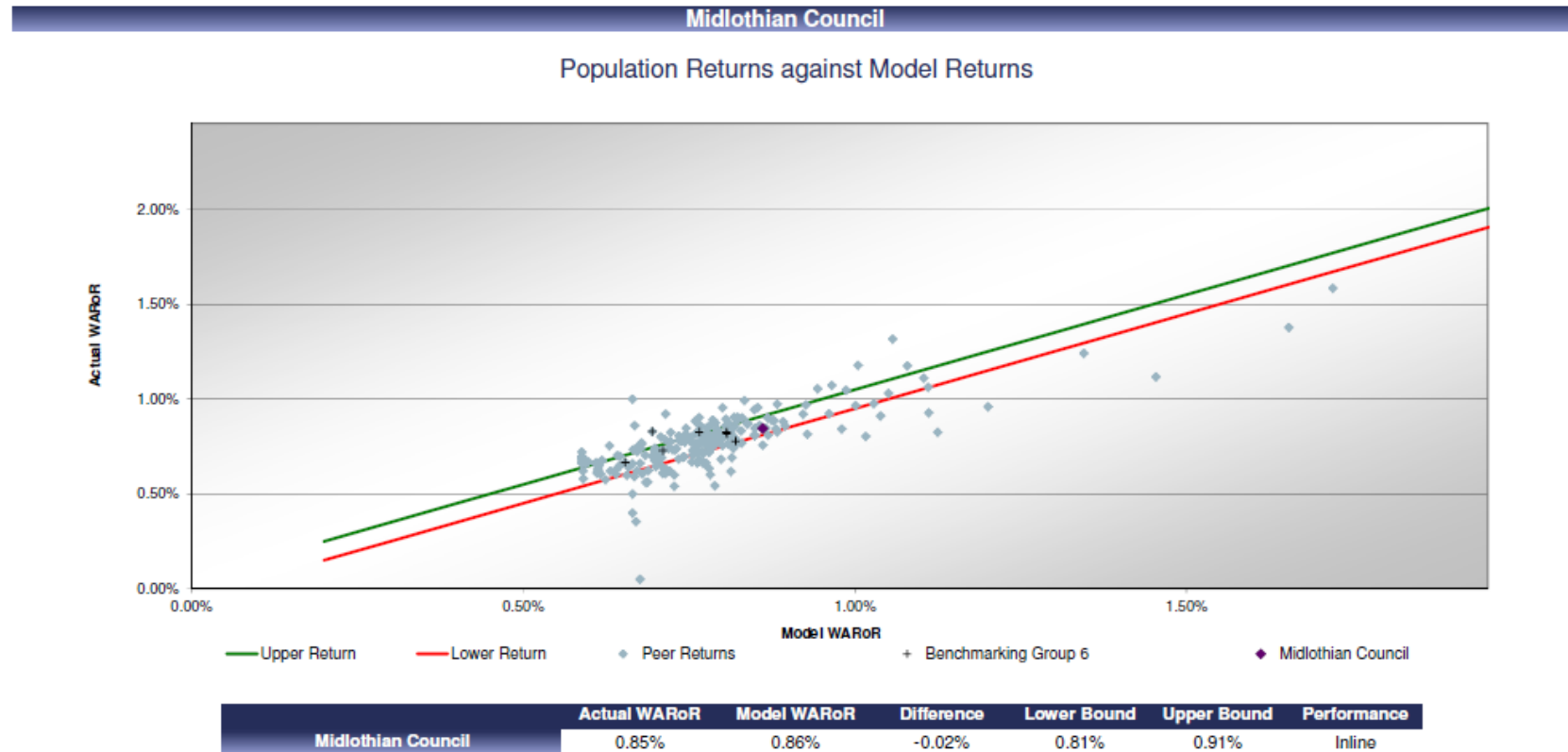
Overall Midlothian's Loans Fund Rate of 3.08% for the year is expected to be one of the lowest when benchmarked against all mainland Authorities in Scotland.

Appendix 3

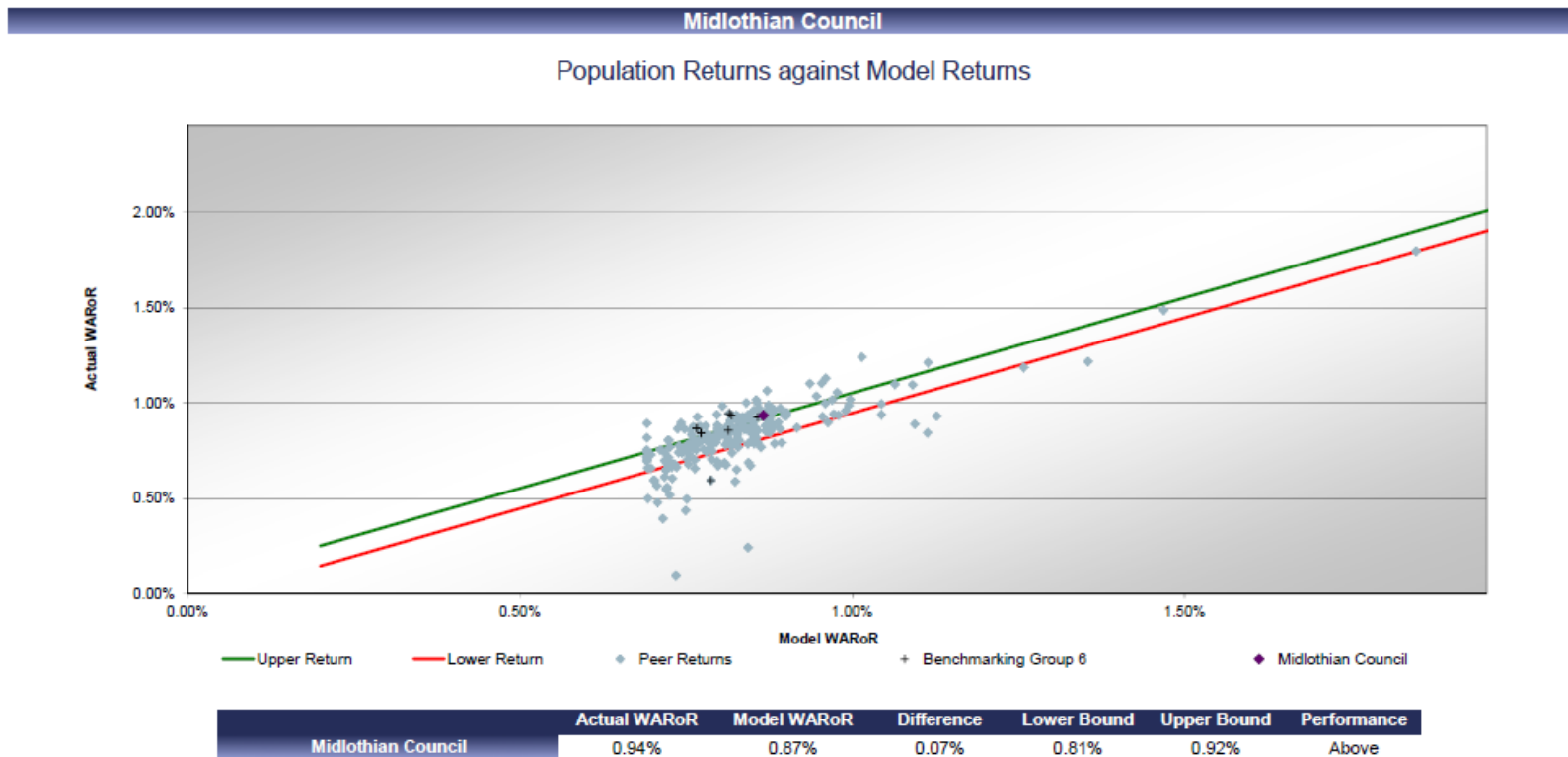
Midlothian Council Investment Portfolio return as at 30 June 2018



Midlothian Council Investment Portfolio return as at 30 September 2018



Midlothian Council Investment Portfolio return as at 31 December 2018



Unaudited Financial Statements 2018/19

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

1 Purpose of Report

The purpose of this report is to enable Audit Committee to consider and comment on the unaudited accounts for 2018/19. A separate presentation will be provided to the committee before it considers this report and the accounts.

2 Background

The Local Authority Accounts (Scotland) Regulations 2014 sets out the requirements in respect of preparation, submission and scrutiny of unaudited accounts as follows, paragraphs 9 and 10 set out the requirements for Audit Committee to consider the unaudited accounts by 31 August 2019.

Published Accounts and Audit

8.—(1) A local authority must ensure that its Annual Accounts are prepared in accordance with these Regulations and, so far as compatible with these Regulations, in accordance with proper accounting practices.

(2) The Annual Accounts must include, in addition to the financial statements required by proper accounting practices, the following statements, which are to be prepared in accordance with proper accounting practices and recognised guidance—

- (a) a management commentary;
- (b) a statement of responsibilities;
- (c) an annual governance statement;
- (d) either—
 - (i) a remuneration report in the style set out in the Schedule to these Regulations, or
 - (ii) a statement that no remuneration report has been prepared because no persons have received remuneration that requires to be included in such a report.

(3) The Annual Accounts must also include such of the following statements and disclosures as are relevant to the functions of the local authority—

- (a) a housing revenue account;
- (b) a non-domestic rate account;
- (c) a council tax account;
- (d) any other statement relating to statutory funds which is required by any statutory provision.

(4) The remuneration report referred to in paragraph (2)(d)(i) must contain the information set out in the Schedule to these Regulations.

(5) The proper officer must ensure that—

- (a) the statement of responsibilities required by paragraph (2)(b) accurately reflects the proper officer's responsibilities; and
- (b) the financial statements give a true and fair view of the financial position of the local authority and its group at the end of the financial year and the transactions of the local authority and its group for that year.

(6) Once the proper officer is satisfied as to the matters set out in paragraph (5), the proper officer must certify these matters by signing and dating the statement of responsibilities and the balance sheets contained within the Annual Accounts and then submit the Annual Accounts to the auditor.

(7) The Annual Accounts must be submitted to the auditor no later than 30th June immediately following the financial year to which the Annual Accounts relate.

(8) The local authority must publish a copy of the Annual Accounts submitted to the auditor, clearly identified as an unaudited version, on a website of the authority from

the date they are submitted until the date on which the audited Annual Accounts are published in accordance with regulation 11.

(9) A local authority or a committee of that authority whose remit includes audit or governance functions must meet to consider the unaudited Annual Accounts as submitted to the auditor.

(10) The meeting referred to in paragraph (9) must be held no later than 31st August immediately following the financial year to which the Annual Accounts relate.

The regulation also provide for public inspection and in this regard public inspection is scheduled during the 23 July 2019.

Accordingly this meeting of Audit Committee is specifically to fulfil the requirements of paragraphs 9 and 10 of the regulations.

3 Financial Performance

Separately on the Council agenda for 25 June 2019 is the Financial Monitoring 2018/19 –General Fund Revenue, Housing Revenue Account Revenue and Capital Final Outturn 2018/19 and General Services Capital Plan 2018/19 Final Outturn. These reports detail financial performance for each area.

4 Financial Statements

The Council's External Auditors, Ernst & Young LLP (EY), made a number of recommendations based on the 2017/18 Financial Statements for action in preparing the 2018/19 statements and these were detailed in the Annual Audit Report presented to Council in the autumn last year. These actions have been progressed and accordingly the expectation is that there will be significantly fewer amendments arising during the audit process.

There are changes to the format and presentation of Midlothian's statements in 2018/19 compared to the prior year. The most significant is that transactions between segments are no longer permit to be reported in the Comprehensive Income and Expenditure Statement (CIES), i.e. they should not be included in income and expenditure in service segments. Accordingly the 2018/19 and comparative information excludes the impact of these internal transactions.

5 Audit and Consideration of audited Accounts

EY will begin the substantive phase of the audit of the accounts during July with a clearance meeting to be arranged during late August 2019. The aim is to complete the audit and for EY to be provided with draft audited accounts by early September 2019.

Thereafter the audited accounts are scheduled to be presented to Audit Committee on 24 September 2019 together with EY annual audit report. The aim is to secure an unqualified audit opinion for financial year 2018/19.

The Local Authority Accounts (Scotland) Regulations 2014 also set out the requirements for completion, approval and signing of the accounts as follows.

Consideration and Signing of Audited Annual Accounts

10.—(1) A local authority, or a committee of that authority whose remit includes audit or governance functions, must—

- (a) meet to consider the audited Annual Accounts; and
- (b) aim to approve those accounts for signature as described in this regulation no later than 30th September immediately following the financial year to which the accounts relate.

(2) That local authority or committee must consider whether the Annual Accounts should be signed, having regard to any report made on those accounts and any advice given by the proper officer or the auditor.

(3) Immediately following the approval of the Annual Accounts for signature, the statements which form part of those accounts are to be signed and dated as follows—

- (a) the management commentary by the proper officer, the Chief Executive and the Leader of the Council;
- (b) the statement of responsibilities by the Leader of the Council and the proper officer, who must also certify the matters referred to in paragraphs (5) and (6) respectively;
- (c) the annual governance statement by the Chief Executive and the Leader of the Council;
- (d) the remuneration report by the Chief Executive and the Leader of the Council; and
- (e) the balance sheets by the proper officer, to authorise publication of the financial statements.

(4) Where a local authority does not have a Chief Executive or a Leader of the Council, the statements that paragraph (3) requires that person to sign are to be signed by such other person as it nominates for that purpose.

(5) The person who signs the statement of responsibilities as Leader of the Council must certify that the Annual Accounts have been approved for signature by, or on behalf of, the authority.

(6) The proper officer must certify that the financial statements give a true and fair view of the financial position of the local authority and its group at the end of the financial year and the transactions of the local authority and its group for that year.

(7) Following the signature of the Annual Accounts, the proper officer must provide the Annual Accounts, including the signed statements, to the auditor.

(8) Any further report provided by the auditor following the signature of the Annual Accounts which relates to those accounts must be considered by the local authority or a committee of that authority whose remit includes audit or governance functions.

Accordingly Audit Committee on 24 September 2019 must consider in accordance with paragraphs 1 and 2 whether the accounts should be signed and thereafter the Leader, Chief Executive and myself as proper officer (S95 officer) will sign the accounts before submission to the Accounts Commission.

6 Report Implications

6.1 Resource

Whilst this report deals with financial issues there are no financial implications arising directly from it.

6.2 Risk

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

6.3 Single Midlothian Plan and Business Transformation

Themes addressed in this report:

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

6.4 Impact on Performance and Outcomes

The decisions taken to balance the budget will have fundamental implications for service performance and outcomes. The Council's Transformation Programme aims to minimise the impact on priority services.

6.5 Adopting a Preventative Approach

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

6.6 Involving Communities and Other Stakeholders

No consultation was required.

6.7 Ensuring Equalities

There are no equality implications arising directly from this report.

6.8 Supporting Sustainable Development

There are no sustainability issues arising from this report.

6.9 IT Issues

There are no IT implications arising from this report.

7 Recommendations

In accordance with The Local Authority Accounts (Scotland) Regulations 2014, set out in section 2 of the report, Audit Committee are asked to consider and comment on the unaudited accounts for 2018/19.

Date: 17 June 2019

Report Contact:

Gary Fairley Tel No: 0131 271 3110

gary.fairley@midlothian.gov.uk

**Appendix 1 Midlothian Council Unaudited Financial Statements 2018/19
(to follow)**

Audit Committee Annual Report 2018/19
Report by Chair of Audit Committee**1. Purpose of the Report**

The purpose of this report is to provide Members with the Audit Committee Annual Report 2018/19 and the annual self-assessments of the Committee against best practice.

2. Background

It is important that the Council's Audit Committee fully complies with best practice guidance on Audit Committees to ensure it can demonstrate its effectiveness as a scrutiny body as a foundation for sound corporate governance for the Council.

The Chartered Institute of Public Finance and Accountancy (CIPFA) issued an updated guidance note Audit Committees Practical Guidance for Local Authorities and Police 2018 Edition (hereinafter referred to as CIPFA Audit Committees Guidance). It incorporates CIPFA's Position Statement: Audit Committees in Local Authorities and Police which sets out CIPFA's view of the role and functions of an Audit Committee. The CIPFA Audit Committees Guidance includes the production of an annual report on the performance of the Audit Committee against its remit for submission to the Council.

3. Audit Committee Annual Report 2018/19 and Self-Assessments

The Audit Committee Annual Report 2018/19, which is appended to this report as Appendix 1 for consideration, is designed both to provide assurance to full Council and to identify areas of improvement which are designed to enhance the Audit Committee's effectiveness as a scrutiny body. Midlothian Council continues to adopt this best practice.

The Audit Committee carried out self-assessments of Compliance with the Good Practice Principles Checklist and Evaluation of Effectiveness Toolkit from the CIPFA Audit Committees Guidance during an Informal Session on 28 May 2019 facilitated by the Chief Internal Auditor. The self-assessments are appended to this report as Appendix 2 (Good Practice Principles) and Appendix 3 (Effectiveness) for consideration.

The outcome of the self-assessments was a medium degree of performance against the good practice principles and a medium degree of effectiveness. Improvements were identified focussing on skills and knowledge competency to fulfil role.

4. Report Implications

4.1 Resource

The Council has provided support and resources to the Audit Committee throughout the year including a Democratic Services Officer as the Minute secretary.

In terms of accountability and independence to ensure conformance with the Public Sector Internal Audit Standards (PSIAS), the Chief Internal Auditor reports functionally to the Audit Committee as outlined within the Internal Audit Charter.

4.2 Risk

The role of the Audit Committee includes the high level oversight of the effectiveness of the Council's systems of internal financial control, internal control and governance, including risk management.

There is a risk that the Audit Committee does not fully comply with best practice guidance thus limiting its effectiveness as a scrutiny body as a foundation for sound corporate governance. The completion of the annual self-assessment and identification of improvement actions as evidenced through this Annual Report will mitigate this risk.

4.3 Single Midlothian Plan

Themes addressed in this report:

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

4.4 Key Priorities within the Single Midlothian Plan

Midlothian Council and its Community Planning Partners include the following areas as key priorities under the Single Midlothian Plan:

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

4.5 Impact on Performance and Outcomes

The members of the Audit Committee have reflected on the performance and outcomes against the remit of the Committee through the completion of annual self-assessments. The identification of improvement actions as evidenced through the Annual Report are designed to enhance its effectiveness as a scrutiny body as a foundation for sound corporate governance for the Council.

The Audit Committee recommends to Council that the Terms of Reference for the Audit Committee be amended, as stated in the final section of the Audit Committee Annual Report 2018/19, to ensure they continue to be relevant to the local government operating environment and best practice and to explicitly address all the core areas identified in CIPFA's Position Statement (2018).

4.6 Adopting a Preventative Approach

Assurances received by the Audit Committee from Management, Internal Audit and External Audit set out the assessment of prevention and detection internal controls and governance arrangements.

4.7 Involving Communities and Other Stakeholders

The Audit Committee in fulfilling its governance role acts as a bridge between the Council and other stakeholders.

4.8 Ensuring Equalities

There are no equalities issues with regard to this report.

4.9 Supporting Sustainable Development

There are no sustainability issues with regard to this report.

4.10 IT Issues

There are no IT issues with regard to this report.

5. Recommendations

The Audit Committee is therefore asked to approve the Audit Committee Annual Report 2018/19 (Appendix 1) and its self-assessments using the CIPFA Audit Committees Guidance (Appendices 2 and 3), and agrees that the Audit Committee Annual Report 2018/19 should be presented to the Council.

Date: 14 June 2019
Report Authors: Jill Stacey, Chief Internal Auditor
E-Mail: Jill.Stacey@midlothian.gov.uk

**MIDLOTHIAN COUNCIL
AUDIT COMMITTEE
ANNUAL REPORT FROM THE CHAIRMAN – 2018/19**

This annual report has been prepared to inform the Midlothian Council of the work carried out by the Council's Audit Committee during the financial year. The content and presentation of this report meets the requirements of the CIPFA Audit Committees Practical Guidance for Local Authorities and Police 2018 Edition (hereinafter referred to as CIPFA Audit Committees Guidance) to report to full Council on a regular basis on the Committee's performance in relation to the terms of reference and the effectiveness of the Committee in meeting its purpose.

Meetings

The Audit Committee has met 9 times during the financial year which included meetings on 1 and 15 May, 18 and 19 June, 28 August, 25 September, 11 December 2018, 29 January and 12 March 2019 to consider reports pertinent to the audit cycle and its terms of reference.

The Audit Committee is a key component of Midlothian Council's corporate governance. It provides an independent and high-level focus on the audit, assurance and reporting arrangements that underpin good governance and financial standards. The purpose of the audit committee is to provide independent assurance to elected members of the adequacy of the risk management framework and the internal control environment. It provides independent review of Midlothian Council's governance, risk management and control frameworks, and oversees the financial reporting and annual governance processes. It oversees internal and external audit, helping to ensure efficient and effective assurance arrangements are in place.

The Audit Committee scrutinised the Annual Report and Accounts of the Council at appropriate times in accordance with its terms of reference, which also includes the promotion of good governance, and financial and ethical standards. The Audit Committee also reviewed the Annual Governance Statement in order to assess whether it properly reflects the risk environment and whether the content is consistent with its evaluation of the internal controls and governance arrangements based on evidence received during the year.

The Audit Committee approved the terms of reference for Internal Audit (Internal Audit Charter) and the Internal Audit Strategy and Annual Plan. It considered Internal Audit's reports arising from each review setting out findings, audit opinions, good practice and recommendations. It monitored the implementation of agreed actions through receipt of two reports during the year from Internal Audit to ensure that audit recommendations had been fully implemented to its satisfaction. It monitored Internal Audit's performance including progress against annual plan, conformance with Public Sector Internal Audit Standards (PSIAS), and quality assurance and improvement plan (QAIP) within Internal Audit mid-term performance and annual assurance reports, and considered the statutory annual audit opinion within the Internal Audit Annual Assurance Report.

The Audit Committee has reviewed the External Audit Strategy and Plan Overview for Midlothian Council, considered External Audit reports including the annual report to Members and the Controller of Audit on the annual audit of the Council, reviewed the main issues arising from the External Audit of the Council's statutory accounts, and monitored the implementation of agreed actions arising.

The Audit Committee considered the effectiveness of the risk management process throughout the Council through the receipt of periodic reports from the Risk Manager during the year on corporate risks and mitigations and the appropriate challenge of Senior Management to ensure that the most significant risks are being identified, evaluated and managed.

The Audit Committee considered the adequacy and effectiveness of the Council's counter fraud arrangements by way of an annual report which set out the counter fraud activity and outcomes, and received assurances from Auditors on fraud risks and counter fraud controls.

The Audit Committee is the body responsible for scrutiny of the treasury management strategy, mid-term and annual performance reports prior to their presentation to Council for approval. An additional meeting was arranged to accommodate the reporting cycle and consideration by the Committee in advance of Council approval, in response to an Internal Audit recommendation, though the sequencing of reports presentation was inconsistently applied during the year and this scrutiny role was not effectively fulfilled.

The minutes of Audit Committee meetings were presented for approval by the Council, and any exceptional items or recommendations were referred to the Council in accordance with the remit.

Membership

The Membership of the Audit Committee is part of the approved Midlothian Council's Standing Orders (amended June 2017) namely being six Members of the Council and two non-voting members appointed from an external source. Two of the six Elected Members on the Audit Committee are in the Cabinet (Committee with executive decision-making powers). However, this is considered as difficult to avoid in a small Council and the Audit Committee operates with an independent Chair and independent member and there is therefore effective independence and challenge. The two non-voting external members were appointed from the community following a recruitment and selection process carried out during 2017. This enhances the robustness and independence of the Audit Committee's role in the scrutiny process of internal controls and governance.

The Committee membership during the year included Mr M Ramsay (Chair), Councillors K Baird, A Hardie, D Milligan, J Muirhead, K Parry and P Smaill, and Mr P De Vink.

The attendance by each member at the Committee meetings throughout the year was as follows:

Member	1 May 2018	15 May 2018	18 Jun 2018	19 Jun 2018	28 Aug 2018	25 Sep 2018	11 Dec 2018	29 Jan 2019	12 Mar 2019
Mr M Ramsay (Chair)	√	√	√	√	√	√			√
Cllr K Baird	√	√	√			√			√
Cllr A Hardie	√	√		√	√	√	√	√	√
Cllr D Milligan		√	√	√	√	√	√	√	√
Cllr J Muirhead	√	√	√	√	√	√	√	√	√
Cllr K Parry									√
Cllr P Smaill	√	√	√	√	√	√	√	√	√
Mr P De Vink	√	√	√	√	√	√	√	√	√

Every meeting of the Audit Committee in 2018/19 was quorate (i.e. at least three elected members present). At the two meetings when Mr M Ramsay was unavailable, Cllr P Smaill was Chair of the meetings following approval by the Committee. Cllr Parry was on maternity leave during the year.

All other individuals who attended the meetings are recognised as being "In Attendance" only. The Chief Executive, Directors, Head of Finance and Integrated Support Services (Section 95 Officer), External Audit (EY), and Internal Audit attend all Audit Committee meetings, and other senior officers also routinely attend Audit Committee meetings. The Council has provided support and resources to the Audit Committee throughout the year including a Democratic Services Officer as the Minute secretary.

Skills and Knowledge

Given the wider corporate governance remit of Audit Committees within local government and the topics now covered by the external and internal audit functions, it is noteworthy that there is a range of skills, knowledge and experience that Audit Committee members bring to the committee, not limited to financial and business management. This enhances the quality of scrutiny and discussion of reports at the meetings. No one committee member would be expected to be expert in all areas.

Self-Assessment of the Committee

The annual self-assessment was carried out by members of the Audit Committee on 28 May 2019 during an Informal Session facilitated by the Chief Internal Auditor using the Good Practice Principles Checklist and Evaluation of Effectiveness Toolkit from the CIPFA Audit Committees Guidance. This was useful for Members to ensure the Committee can demonstrate its effectiveness as a scrutiny body as a foundation for sound corporate governance for the Council.

The outcome of the self-assessments was a medium degree of performance against the good practice principles and a medium degree of effectiveness. Improvements were identified focussing on skills and knowledge competency to fulfil role. In summary these are: Members Briefings / Seminars on Statutory Accounts and Treasury Management to help their understanding of these technical areas; utilise the CIPFA Skills and Knowledge toolkit; Informal Sessions to enable the members of the Committee to meet privately and separately to raise any matters with the External and Internal Auditors; obtain feedback on its performance from a range of Directors and others who interact with the Committee on a regular basis; and understand the effectiveness of other Committees fulfilling their remits on which the Audit Committee places reliance.

Assurance Statement to the Council

The Audit Committee provides the following assurance to the Council:

- The Council has received the Minutes of the Audit Committee throughout the year.
- The Audit Committee has operated in accordance with its agreed terms of reference, covering the themes of Governance, Risk and Control, Internal Audit, External Audit, Financial Reporting, and Accountability Arrangements, and accordingly conforms to the Audit Committee principles within the CIPFA Position Statement for Audit Committees, with the exception of scrutiny of Treasury Management arrangements whereby the sequencing of reports presentation was inconsistently applied during the year and this scrutiny role was not effectively fulfilled.
- It focused entirely on matters of risk management, internal control and governance, giving specialist advice to the Council on the value of the audit process, on the integrity of financial reporting and on governance arrangements, and acted as a bridge between the Council and other stakeholders. It did this through material it received from Internal Audit, External Audit, other Audit bodies, and assurances from Management relevant to audit cycle of reporting.
- A theme that has repeated in a number of specific reports this year and was stated in the Internal Audit Annual Assurance Report 2018/19 presented to the Committee on 28 May 2019 refers to the inadequacy of Management monitoring the effectiveness of their internal controls and governance arrangements, and this will continue to be an area of focus for the Audit Committee.
- In December 2018 the Audit Committee received an update report to enable them to monitor progress with the implementation of Internal Audit recommendations arising from May 2018 Report. Monitoring their implementation in full to enhance the effectiveness of internal controls and governance will continue to be an area of focus for the Audit Committee.
- The Audit Committee will review the unaudited Annual Accounts 2018/19 of the Council at its meeting on 24 June 2019. Specifically, to consider whether appropriate accounting policies have been followed and whether there are concerns arising from the financial statements. It will review the draft Annual Governance Statement prior to approval and consider whether it properly reflects the risk environment and supporting assurances. It will review the final audited accounts at its meeting on 24 September 2019 alongside the External Audit report on their annual audit 2018/19 to consider whether there are concerns arising from the financial statements or from the audit that need to be brought to the attention of the Council, and in order to decide whether to recommend to the Council that they be adopted.

- The Audit Committee has reflected on its performance during the year, and has agreed areas of improvements to enable it to fulfil its scrutiny and challenge role and to enhance its effectiveness.

Recommendation of the Terms of Reference for the Audit Committee for the coming year

The Audit Committee recommends to Council that the Terms of Reference for the Audit Committee be amended as follows, to ensure they continue to be relevant to the local government operating environment and best practice and to explicitly address all the core areas identified in CIPFA's Position Statement (2018):

3. To review the council's corporate governance arrangements against the good governance framework and consider annual governance reports and assurances, relating to the council's service delivery models including partnership and collaboration, to ensure that the highest standards of probity, public accountability and ethical standards are demonstrated.
6. To consider the council's framework of assurance, relating to the council's service delivery models including partnership and collaboration, and ensure that it adequately addresses the risk and priorities of the council.
7. To monitor the effective development and operation of risk management in the council relating to the council's service delivery models including partnership and collaboration.
12. To monitor controls operating over Treasury Management, through the scrutiny of the treasury management strategy, mid-term and annual performance reports prior to their presentation to Council for approval, and the Council's approach to establishing ethical standards.
19. To consider the Chief Internal Auditor's annual report:
 - a) The statement of the level of conformance with the Public Sector Internal Audit Standards and Local Government Application Note (including code of ethics) and the results of Assurance and Improvement Programme that supports the statement – these will indicate the reliability of the conclusions of internal audit.

Mike Ramsay
Chairman of Audit Committee
14 June 2019

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Midlothian Council Audit Committee – self-assessment of Good Practice at 28 May 2019

Audit committee purpose and governance	Yes/Partly /No	Comments
Does the authority have a dedicated audit committee?	<input type="text" value="Yes"/>	Standing Orders approved by the Council includes the remit of the Audit Committee.
Does the audit committee report directly to full council?	<input type="text" value="Yes"/>	All Minutes of Audit Committee are circulated to full Council for noting and approval of any of their recommendations. An annual report is submitted by the Chair of the Audit Committee to full Council.
Do the terms of reference clearly set out the purpose of the committee in accordance with CIPFA's Position Statement?	<input type="text" value="Yes"/>	Terms of Reference in place and periodically reviewed against CIPFA's best practice by the Chief Internal Auditor.
Is the role and purpose of the audit committee understood and accepted across the authority?	<input type="text" value="Yes"/>	Role of Audit Committee is set out in the Council's Standing Orders. Senior Management and Elected Members have access to Standing Orders on the Council's Intranet. The Chief Executive, Directors and Section 95 Officer, External Audit (EY) and Internal Audit attend all Audit Committee meetings.
Does the audit committee provide support to the authority in meeting the requirements of good governance?	<input type="text" value="Yes"/>	Audit Committee carries out the role set out in the Terms of Reference contributing to the Council's governance framework.
Are the arrangements to hold the committee to account for its performance operating satisfactorily?	<input type="text" value="Yes"/>	All Minutes of Audit Committee are circulated to full Council for noting and approval of any recommendations. An annual report is submitted by the Chair of the Audit Committee to full Council. It sets out the activities to enable stakeholders to understand how the Audit Committee has discharged its duties and identifies areas of improvement to fulfil its remit. MLC continues to be a lead authority in adopting this best practice.

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Midlothian Council Audit Committee – self-assessment of Good Practice at 28 May 2019

Functions of the committee

Yes/Partly
/No

Comments

Do the committee's terms of reference explicitly address all the core areas identified in CIPFA's Position Statement?

- good governance

Yes

Functions in Terms of Reference Nos. 1, 3 & 4

- assurance framework, including partnerships and collaboration arrangements

Partly

Assurance Framework Function in Terms of Reference No. 6. Assurance reflecting partnerships and collaboration is a new requirement in 2018 guidance. Propose to include explicit references to these service delivery models in Nos. 3, 6 & 7.

- internal audit

Yes

Functions in Terms of Reference Nos. 13-24

- external audit

Yes

Functions in Terms of Reference Nos. 25-29

- financial reporting

Yes

Functions in Terms of Reference Nos. 30-31

- risk management

Yes

Functions in Terms of Reference Nos. 6-8

- Value for money or best value

Yes

Function in Terms of Reference No. 5

- Counter-fraud or corruption

Yes

Functions in Terms of Reference Nos. 9-11

- Supporting the ethical framework

Partly

Function in Terms of Reference No. 12 Treasury Management. This is a new requirement in 2018 guidance. Propose to include explicit references to ethics in Functions 3 & 19.

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Midlothian Council Audit Committee – self-assessment of Good Practice at 28 May 2019

Functions of the committee (cont'd)	Yes/Partly /No	Comments
Is an annual evaluation undertaken to assess whether the committee is fulfilling its terms of reference and that adequate consideration has been given to all core areas?	Yes	Annual self-assessment undertaken on 28 May 2019 against CIPFA good practice checklist and effectiveness toolkit with the outcome / output referenced as part of the annual report submitted by the Chair of the Audit Committee to full Council.
Has the audit committee considered the wider areas identified in CIPFA's Position Statement and whether it would be appropriate for the committee to undertake them?	Yes	The Audit Committee is responsible for scrutiny of the treasury management strategy, mid-term and annual performance reports prior to their presentation to Council for approval (Audit function no. 12). The sequencing of reports presentation was inconsistently applied during the year and this scrutiny role was not effectively fulfilled, thus the Internal Audit recommendation to address this governance matter is not yet fully implemented.
Where coverage of core areas has been found to be limited, are plans in place to address this?	Yes	Terms of Reference covers core areas.
Has the committee maintained its non-advisory role by not taking on any decision-making powers that are not in line with its core purpose?	Yes	Terms of Reference is limited to governance, risk and control; it is non-decision-making though does have an advisory function to recommend improvements to Council within its remit.

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Midlothian Council Audit Committee – self-assessment of Good Practice at 28 May 2019

Membership and support	Yes/Partly/No	Comments
<p>Has an effective audit committee structure and composition of the committee been selected?</p> <p>This should include:</p> <ul style="list-style-type: none"> • separation from the executive • an appropriate mix of knowledge and skills among the membership • a size of committee that is not unwieldy • consideration has been given to the inclusion of at least one independent member 	Partly	<p>No (1st bullet) - Two of the six Elected Members on the Audit Committee are in the Cabinet (Committee with executive decision-making powers). However this is considered as difficult to avoid in a small Council and the Audit Committee operates with an independent Chair and independent member and there is therefore effective challenge.</p> <p>Yes (2nd 3rd and 4th bullet points) – Committee comprises of six Elected Members and two independent members (one of which is the Chair) who have a mix of skills, knowledge and experience.</p>
Have independent members appointed to the committee been recruited in an open and transparent way and approved by the full council?	Yes	An external recruitment, selection and appointment process was undertaken in 2017 for independent members on the Audit Committee.
Does the chair of the committee have appropriate knowledge and skills?	Yes	The independent Chair of the Audit Committee has previous experience of chairing meetings and a previous career within the financial sector.
Are arrangements in place to support the committee with briefings and training?	Partly	The previous year's improvement action to undertake briefings / seminars on Statutory Accounts and Treasury Management to enhance skills and knowledge was progressed during the year though further briefings are needed as outlined at meetings and during the 2018/19 self-assessment process. The Committee also needs to understand the effectiveness of other Committees fulfilling their remits on which the Audit Committee places reliance.
Has the membership of the committee been assessed against the core knowledge and skills framework and found to be satisfactory?	No	The previous year's improvement action to utilise the CIPFA Skills and Knowledge toolkit is not yet fulfilled.
Does the committee have good working relations with key people and organisations, including external audit, internal audit and the chief financial officer?	Yes	The Chair meets with Chief Internal Auditor (CIA) in advance of each Audit Committee meeting and has option to meet with External Auditors, EY, in private. Prior to each Audit Committee meeting the Chair has pre-meeting with Chief Executive, CIA, Director Resources, and Section 95 Officer. The previous year's improvement action to arrange Informal Sessions with Internal and External Auditors for all Audit Committee members is not yet fulfilled.
Is adequate secretariat and administrative support to the committee provided?	Yes	A Democratic Services Officer is assigned to the Audit Committee.

CIPFA 'audit committees' Practical Guidance for Local Authorities and Police 2018 Edition

Midlothian Council Audit Committee – self-assessment of Good Practice at 28 May 2019

Effectiveness of the committee	Yes/Partly/No	Comments
Has the committee obtained feedback on its performance from those interacting with the committee or relying on its work?	Partly	External Audit comment on Audit Committee as part of Governance within the Annual Audit Report. As an improvement the Audit Committee will obtain feedback on its performance from a range of Directors and others who interact with the Committee on a regular basis.
Are meetings effective with a good level of discussion and engagement from all members?	Yes	As reflected in the Minutes of the Committee.
Does the committee engage with a wide range of leaders and managers, including discussion of audit findings, risks and action plans with the responsible officers?	Yes	The Chief Executive, Directors, and Section 95 Officer attend all Audit Committee meetings and respond to members' questions as appropriate for the business being considered by the Committee to ensure action findings and action plans are acted upon. The Risk Manager presents a quarterly update on the Corporate Risk Register to the Committee setting out the corporate risks, evaluation and mitigations.
Does the committee make recommendations for the improvement of governance, risk and control and are these acted on?	Yes	Recommendations are made by the Committee to Council in accordance with the business considered by the Committee. The previous year's improvement action to establish an Action Tracker for Audit Committee was progressed during the year to monitor completion of their recommended actions.
Has the committee evaluated whether and how it is adding value to the organisation?	Yes	The Audit Committee carries out an annual self assessment of performance against the CIPFA good practice checklist and the effectiveness toolkit from the CIPFA guidance 2018 'audit committees', the latter enabling evaluation of how effectively it fulfils its Audit functions. The 2018/19 self-assessment was carried out on 28 May 2019 during an Informal Session.
Does the committee have an action plan to improve any areas of weakness?	Yes	As part of its annual self-assessment 2018/19 the Committee has recognised where it could improve in respect of its scrutiny and challenge role to fulfil its remit and to further add value. Improvements are set out within the Audit Committee Annual Report 2018/19.
Does the committee publish an annual report to account for its performance and explain its work?	Yes	The Audit Committee Annual Report is presented to the Council each year. It sets out the activities to enable stakeholders to understand how the Committee has discharged its duties. MLC continues to be a lead authority in adopting this best practice.



Areas where the Audit Committee can add value by supporting improvement	Examples of how the audit committee can add value and provide evidence of effectiveness	Self-evaluation, examples, areas of strength and weakness	Overall assessment 5-1 See key below
1. Promoting the principles of good governance and their application to decision making	Supporting the development of a local code of governance. Providing robust review of the Annual Governance Statement (AGS) and the assurances underpinning it. Working with key members/governors to improve their understanding of the AGS and their contribution to it. Supporting reviews/audits of governance arrangements. Participating in self-assessments of governance arrangements. Working with partner audit committees to review governance arrangements in partnerships.	Committee scrutinised Local Code of Corporate Governance, and recommended it for Council approval, and scrutinised AGS within Annual Report and Accounts. Chair met with Chief Executive, Director Resources and S95 officer on a regular basis. Committee supports the role of audit in improving internal control and governance. Committee considered Audit Scotland toolkits for Councillors. Opportunity to liaise with other Audit Committees to share practice.	4 (2017/18 3)
2. Contributing to the development of an effective control environment.	Actively monitoring the implementation of recommendations from auditors. Encouraging ownership of the internal control framework by appropriate managers. Raising significant concerns over controls with appropriate senior managers.	Committee received periodic progress reports from Auditors e.g. follow-up activity. Directors attended Committee meetings to discuss progress with Audit actions. Audit Committee Action Tracker introduced in-year to hold Management to account.	4 (2017/18 3)
3. Supporting the establishment of arrangements for the governance of risk and for effective arrangements to manage risks.	Reviewing risk management arrangements and their effectiveness, e.g. risk management benchmarking. Monitoring improvements. Holding risk owners to account for major/strategic risks.	Committee received periodic reports from Risk Manager on corporate risks and mitigations. Directors attended meetings to respond to questions on risks and mitigations. Members were not aware when the Risk Management Policy and Strategy was most recently reviewed and scrutinised by the Committee.	3 (2017/18 3)

Areas where the Audit Committee can add value by supporting improvement	Examples of how the audit committee can add value and provide evidence of effectiveness	Self-evaluation, examples, areas of strength and weakness	Overall assessment 5-1 See key below
4. Advising on the adequacy of the assurance framework and considering whether assurance is deployed efficiently and effectively.	Specifying its assurance needs, identifying gaps or overlaps in assurance. Seeking to streamline assurance gathering and reporting. Reviewing the effectiveness of assurance providers, e.g. internal audit, risk management, external audit.	Annual Strategies and Plans and periodic progress Reports received from Auditors. Induction programme outlined Governance and Assurance Framework and Audit Cycle. Reliance on other Committees fulfilling their remits; need to understand effectiveness.	4 (2017/18 3)
5. Supporting the quality of the internal audit activity, particularly by underpinning its organisational independence.	Reviewing the audit charter and functional reporting arrangements. Assessing the effectiveness of internal audit arrangements, providing constructive challenge and supporting improvements. Actively supporting the quality assurance and improvement programme (QAIP) of internal audit.	Committee considered and approved the Internal Audit Charter. Committee considered and approved the Internal Audit Strategy and Plan, and considered regular Reports raising queries and endorsing Internal Audit recommendations. Committee received Internal Audit QAIP and PSIAS conformance within mid-term performance and annual assurance reports.	4 (2017/18 4)
6. Aiding the achievement of the authority's goals and objectives through helping to ensure appropriate governance, risk, control and assurance arrangements	Reviewing how the governance arrangements support the achievement of sustainable outcomes. Reviewing major projects and programmes to ensure that governance and assurance arrangements are in place. Reviewing the effectiveness of performance management arrangements.	Committee received National Reports from Audit Scotland on governance arrangements for transformation, sustainability, and performance management, including lessons learned and sharing best practice. Reliance on other Committees fulfilling their remits; need to understand effectiveness.	4 (2017/18 3)
7. Supporting the development of robust arrangements for ensuring value for money.	Ensuring that assurance on value for money arrangements is included in the assurances received by the audit committee. Considering how performance in value for money is evaluated as part of the AGS.	Auditors provided assurance on value for money arrangements e.g. transformation, sustainability, and performance management. AGS sets out the Governance Framework including arrangements for best value.	4 (2017/18 3)

Areas where the Audit Committee can add value by supporting improvement	Examples of how the audit committee can add value and provide evidence of effectiveness	Self-evaluation, examples, areas of strength and weakness	Overall assessment 5-1 See key below
8. Helping the authority to implement the values of good governance, including effective arrangements for countering fraud and corruption risks.	<p>Reviewing arrangements against the standards set out in the Code of Practice on Managing the Risk of Fraud and Corruption (CIPFA, 2014).</p> <p>Reviewing fraud risks and the effectiveness of the organisation's strategy to address those risks.</p> <p>Assessing the effectiveness of ethical governance arrangements for both staff and governors.</p>	<p>Committee received Counter Fraud Annual Report and update on National Fraud Initiative, and note Anti-Fraud Policy and Strategy is scheduled for review.</p> <p>Auditors provided assurance reports on fraud risks and counter fraud controls, and recommended improvements which were endorsed by the Committee.</p>	4 (2017/18 3)
9. Promoting effective public reporting to the authority's stakeholders and local community and measures to improve transparency and accountability.	<p>Improving how the authority discharges its responsibilities for public reporting; for example, better targeting at the audience, plain English.</p> <p>Reviewing whether decision making through partnership organisations remains transparent and publicly accessible and encourages greater transparency.</p> <p>Publishing an annual report from the committee.</p>	<p>Committee scrutinised Annual Report and Accounts 2017/18, though not prior to publication and audit, and scrutinised Treasury Management Strategy prior to Council approval though not TM monitoring reports prior to Council consideration in-year.</p> <p>Audit Committee Annual Report presented to Council in public.</p>	3 (2017/18 2)

Assessment key	
5	Clear evidence is available from a number of sources that the committee is actively supporting improvements across all aspects of this area. The improvements made are clearly identifiable.
4	Clear evidence from some sources that the committee is actively and effectively supporting improvement across some aspects of this area.
3	The committee has had mixed experience in supporting improvement in this area. There is some evidence that demonstrates their impact but there are also significant gaps.
2	There is some evidence that the committee has supported improvements, but the impact of this support is limited.
1	No evidence can be found that the audit committee has supported improvements in this area.

