

# **Midlothian Integration Joint Board**

**Annual Audit Report to Members  
of the IJB and the Controller of  
Audit - year ended 31 March 2018**

**DRAFT**

6 September 2018

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## About this report

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

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

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

## Complaints

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

# **1. Executive Summary**

## Purpose of this report

In accordance with the Local Government (Scotland) Act 1973, the Accounts Commission appointed EY as the external auditor of Midlothian Integration Joint Board (the IJB) for the five year period 2016/17 to 2020/21.

We undertake our audit in accordance with the Code of Audit Practice (the Code), issued by Audit Scotland in May 2016; Auditing Standards and guidance issued by the Financial Reporting Council; relevant legislation; and other guidance issued by Audit Scotland.

This Annual Audit Report is designed to summarise our key findings and conclusions from our audit work. It is addressed to both members of the IJB and the Controller of Audit, and presented to both IJB management and those charged with governance. After consideration by the IJB, this report is provided to Audit Scotland and published on their website.

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

## Scope and responsibilities

The Code sets out the responsibilities of both the IJB and the auditor. We provided details of these in our Annual Audit Plan, which was presented to the audit and risk committee on 29 March 2018. We summarise these responsibilities of the IJB in Appendix A.

Our Annual Audit Plan set out an overview of our audit scope and approach for the audit of the 2017/18 financial statements. We carried out our audit in accordance with the plan. We applied the following level of materiality to our audit.

- |   |               |
|---|---------------|
| ▶ Materiality for our audit - no change to that reported in our Annual Audit Plan         | £1.2 million  |
| ▶ Tolerable Error is our materiality applied at an individual account balance - no change | £0.9 million  |
| ▶ Reporting threshold, set in line with the requirements of the Code - no change          | £0.06 million |

## Financial statement audit

We are responsible for conducting an audit of the financial statements of the IJB. We provide an opinion on the financial statements as to:

- ▶ whether they give a true and fair view of the financial position of the IJB as at 31 March 2018 and its expenditure and income for the year then ended; and
- ▶ whether they have been properly prepared in accordance with the Local Government (Scotland) Act 1973 and the 2017/18 Code of Practice on Local Authority Accounting in the United Kingdom.

We also review and report on the consistency of the other information prepared and published by the IJB along with its financial statements.

## Wider scope audit

Our responsibilities extend beyond the audit of the financial statements. The Code requires auditors to provide judgements and conclusions on the four dimensions of wider-scope public audit. Our audit work over the wider scope audit dimensions compliments our financial statements audit.

## Key contacts

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## Independence

We confirm that we have undertaken client and engagement continuance procedures, included in which is our assessment of our continuing assessment of our independence to act as your external auditor.

## Financial statements audit

We [have issued] an unqualified audit opinion on the IJB financial statements.

We have concluded satisfactorily in respect of each of the significant risks and audit focus areas identified in our Annual Audit Plan.

The annual accounts, statement of responsibilities, governance statement and remuneration report were received at the start of the audit fieldwork. We made some suggestions to enhance their overall presentation.

## Wider scope audit – key messages

We set out below our key messages in respect of each of the dimensions of public sector audit, along with our overall assessment of each of these in terms of red / amber / green, building on our assessment and recommendations from the 2016/17 audit. We have made two recommendations for management as a result of our work.

<b>Financial management</b>	<ul style="list-style-type: none"> <li>▶ There were a number of significant movements in the financial forecasts during the year, with the outturn position supported by non-recurring funding.</li> <li>▶ The IJB has established its core financial management arrangements, and we are satisfied that these are adequate for the current management of its financial activities.</li> </ul>	<b>Amber</b>
<b>Financial sustainability</b>	<ul style="list-style-type: none"> <li>▶ We have concluded that achieving financial sustainability on an underlying operational delivery basis, excluding non-recurring funding, continues to represent a significant challenge for the IJB.</li> <li>▶ Management has recognised the need to establish longer term financial planning arrangements. The success of these is critical to supporting the achievement of the IJB's strategic objectives. The IJB's Partners have supported this by providing indicative funding allocations through to 2022/23.</li> </ul>	<b>Amber</b>
<b>Governance &amp; transparency</b>	<ul style="list-style-type: none"> <li>▶ We have concluded that the IJB has established a sound basis to demonstrate good governance and transparency in its operational activity.</li> <li>▶ The IJB has continued to develop its approach to risk management, with a risk management strategy approved and the risk register considered regularly by the audit and risk committee.</li> </ul>	<b>Green</b>
<b>Value for money</b>	<ul style="list-style-type: none"> <li>▶ In response to the need to measure performance and progress against the IJB's Strategic Plan, we have concluded that the IJB has identified local improvement goals to measure its performance which are appropriate to the stated national goals. In addition sources of data and information have been identified and reported to the Board.</li> <li>▶ The IJB needs to take further measures to ensure that it produces its annual performance report in line with the timeline requirements of the Act.</li> </ul>	<b>Amber</b>

## **2. 2017/18 financial statements audit**

## 2. Summary of 2017/18 audit opinion



The detailed form and content of our audit report, and the requirements underpinning the report, are set out in guidance issued by Audit Scotland. This covers our reporting requirements in accordance with International Standards on Auditing (UK), plus those matters prescribed by the Accounts Commission.

Element of Audit opinion	Nature of opinion and basis for that
<b>Opinion on financial statements</b>	<b>Unqualified opinion</b>
<ul style="list-style-type: none"> <li>▶ Truth and fairness of the state of affairs of the IJB at 31 March 2018 and of the income and expenditure for the year then ended</li> <li>▶ Preparation of the financial statements in accordance with the relevant financial reporting framework</li> </ul>	<ul style="list-style-type: none"> <li>▶ Performance of audit procedures to respond to our assessed risk of misstatement, including significant risks</li> <li>▶ Accounting policies are appropriate and estimates are reasonable</li> <li>▶ Completion of financial statement disclosure checklists / consideration of relevant guidance issued by CIPFA / Audit Scotland</li> </ul>
<b>Conclusions relating to the going concern basis of accounting</b>	<b>No matters to report</b>
<ul style="list-style-type: none"> <li>▶ The use of the going concern basis of accounting used in the preparation of the financial statements is not appropriate</li> </ul>	<ul style="list-style-type: none"> <li>▶ Supported by our core financial statements audit work, supplemented by our wider scope audit procedures in respect of financial sustainability</li> </ul>
<b>Other information in the annual accounts</b>	<b>No matters to report</b>
<ul style="list-style-type: none"> <li>▶ We are required to consider whether the other information in the annual accounts is materially inconsistent with the financial statements or our knowledge obtained in the audit.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Review of committee minutes and papers / discussions with management / understanding of the business / participation in shared risk assessment</li> </ul>
<b>Opinions on matters prescribed by the Accounts Commission</b>	<b>Unqualified opinions</b>
<ul style="list-style-type: none"> <li>▶ The audited part of the Remuneration Report has been properly prepared in accordance with applicable regulations</li> <li>▶ Information in the Management Commentary / Annual Governance Statement is consistent with the financial statements, and prepared in accordance with the relevant guidance</li> </ul>	<ul style="list-style-type: none"> <li>▶ We agreed the form of the report to the regulations and agreed the disclosures to underlying accounting records and supporting schedules</li> <li>▶ We reviewed the content of the narrative statements to the information known to us in the audit, and against the requirements of the guidance</li> </ul>
<b>Matters on which we are required to report by exception</b>	<b>No matters to report by exception</b>
<ul style="list-style-type: none"> <li>▶ Whether there has been a failure to achieve a prescribed financial objective</li> <li>▶ Whether adequate accounting records have been kept</li> <li>▶ Whether financial statements and the audited part of the Remuneration Report are not in agreement with the accounting records</li> <li>▶ Whether we have not received the information we require for our audit</li> </ul>	<ul style="list-style-type: none"> <li>▶ We were provided with all the information we required</li> <li>▶ We have been able to agree information to the accounting records</li> </ul>

## 2. 2017/18 financial statements audit



The Annual Accounts enables the IJB to demonstrate its accountability for the resources at its disposal, and its overall performance in the application of those resources during the year. They also enable the IJB to demonstrate openness and transparency in its governance and remuneration arrangements.

### Financial Statements Preparation 2017/18

#### Compliance with requirements

The Local Authority Accounts (Scotland) Regulations 2014 (the Regulations) set out the statutory requirements on the IJB in respect to the annual accounts, their availability for public inspection and the consideration and signing by the IJB or a committee with an audit or governance remit.

The IJB complied with the relevant requirements. In particular, the unaudited annual accounts were considered by the audit and risk committee on 20 June, prior to their submission to us and in advance of the deadline of 31 August.

#### Opinions on matters prescribed by the Accounts Commission

**Management Commentary:** Required by Regulation 8(2)(a) of the Local Authority Accounts (Scotland) Regulations 2014, under statutory guidance included in Scottish Government Local Government Finance Circular 5/2015. Audit Scotland requires us to read the management commentary and express an opinion on whether the information given is consistent with the financial statements and whether it has been prepared in accordance with the statutory guidance.

We read the management commentary and compared the content against the information in the financial statements and against the statutory requirements. We concluded that the management commentary met the requirements placed on the IJB.

**Remuneration Report:** Required by Regulation 8(2)(d) of the Local Authority Accounts (Scotland) Regulations 2014. Auditors are required by the Code to audit the disclosures of remuneration and pension benefit, pay bands, and exit packages and express a separate opinion within their independent auditor's report on whether they have been properly prepared in accordance with the Regulations.

Due to the shared roles held by the Chief Officer and the Chief Finance Officer, the remuneration report is transparent in disclosing the joint roles held and the remuneration disclosed. No amendments were required to the draft remuneration report to ensure its consistency with underlying records and presentation in accordance with the statutory requirements.

**Annual Governance Statement:** Required by Regulation 8(2)(c) of the Local Authority Accounts (Scotland) Regulations 2014. Auditors are required by the Code to report as to whether the statement is consistent with the financial statements and has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016)

We reviewed the Annual Governance Statement within the financial statements against the required guidance. We were satisfied that it met the requirements and was consistent with both the governance framework and key findings from relevant audit activity.

Section 3 of this report sets out additional procedures we have undertaken in respect to the Governance and Transparency wider scope audit dimension.

#### Impact on audit opinion – unqualified opinion on prescribed matters

#### Other matters

We have not identified any circumstances to notify the Controller of Audit that a statutory report may be required under the Local Government (Scotland) Act 1973. We did not receive any objections to the 2017/18 annual accounts from members of the public.

#### Audit differences

There are no unadjusted or adjusted audit differences arising from our audit.



## 2. Significant audit risks



**Significant risk - risk of fraud in income and expenditure recognition:** ISA (UK) 240 requires us to make a rebuttable presumption that the fraud risk from income recognition is a significant risk. In the public sector, we extend that to consider the risk of material misstatements by manipulation of expenditure.

### Our overall approach

As set out in our Annual Audit Plan, given the nature of funding to the IJB from the Council or NHS body, we rebutted the assumed fraud risk in respect of the income. For expenditure we associated the risk to the assurance over the existence and occurrence of expenditure incurred by the IJB in commissioning services by the Council and NHS Lothian.

### What did we do in response to the significant risk?

- ▶ We challenged management on how the IJB gains assurance over the expenditure it incurs and the basis of payments it makes to its partner bodies to deliver commissioned services. Management took this on board and ensured that the information presented to the IJB stated clearly the source of information provided by the IJB partners. Reports to the IJB at the year end also made clear that the year end outturn represented the approval by the IJB of the final expenditure incurred in commissioning services from the Council and NHS Lothian.
- ▶ As part of the year end process, the IJB obtained confirmation statements from the senior finance professional at NHS Lothian and Midlothian Council of the spend of their respective bodies on delivering services, and hence their request for payment from the IJB to cover those costs. We obtained a copy of those confirmations and agreed to the source.
- ▶ We obtained independent confirmation from the appointed auditor at both Midlothian Council and NHS Lothian of the income and expenditure transactions recorded at their respective audit clients. The confirmations agreed the income and expenditure amounts, as well as the year end debtor/creditor balances which resulted in the IJB have a general fund reserve of £900,000 at the year end.

### What are our conclusions?

Our testing has not identified any material misstatements relating to revenue and expenditure recognition. We did not identify any areas of significant estimation or judgement as part of our audit work in these areas.

## 2. Significant audit risks (cont.)



**Significant risk – misstatement due to fraud or error:** As identified in ISA 240, management is in a unique position to perpetrate fraud in its financial reporting because of its ability to manipulate accounting records directly or indirectly by overriding controls that otherwise appear to be operating effectively.

### We respond to this risk on every engagement

Audit procedures performed	What did we find?
<i>We gave consideration to the risk of fraud, inquiring of management about their assessment of the risks of fraud and the controls put in place to address those risks. We also updated and developed our understanding of the oversight of those charged with governance over management's processes over fraud.</i>	We have not identified any material weaknesses in controls or evidence of material management override.
<i>Test the appropriateness of manual journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements</i>	We obtained all journals posted by management to record the transactions of the IJB, which are hosted on the Midlothian Council financial ledger. All of the journals for the IJB's transactions were posted at the year end and we reviewed all of these in the course of our work.
<i>Review accounting estimates for evidence of management bias, including management's retrospective consideration of prior year estimates.</i>	There are no material accounting estimates included in the financial statements. We confirmed the process for ensuring that there were no claims applicable to the IJB which required provision to be made as part of its participation in CNORIS (Clinical Negligence & Other Risks Indemnity Scheme).
<i>Evaluate the business rationale for any significant unusual transactions</i>	We did not identify any significant unusual transactions outside the normal course of business.
<i>Consistency and application of accounting policies / overall presentation of financial information</i>	We consider the accounting policies adopted by the IJB to be appropriate. There are no significant accounting practices which materially depart from what is acceptable under IFRS or the Code.
<b>What are our conclusions?</b>	
<p>We have not identified any material weaknesses in the design and implementation of controls around journal processing. We did not identify any instances of evidence of management override of controls.</p> <p>There was no disagreement during the course of the audit over any accounting treatment or disclosure. We encountered no significant difficulties in the audit.</p>	

### **3. Wider scope audit & Best Value**

# 3.1 Financial management

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

Amber

- ▶ There were a number of significant movements in the financial forecasts during the year, with the outturn position supported by non-recurring funding.
- ▶ The IJB has established its core financial management arrangements, and we are satisfied that these are adequate for the current management of its financial activities.

## 2017/18 financial statements outturn

In our audit plan we highlighted financial management as an audit focus area. The in-year financial reporting had been highlighting significant budget pressures and the need for ongoing recovery action by the Partners up to the year end. At the year-end, the IJB reported a surplus position of £900,000, as set out below.

Expenditure aspect	Budget £000	Outturn expenditure £000	Variance £000
Social care	38,805	38,023	782
Health	99,228	99,100	118
<b>TOTAL - IJB</b>	<b>138,033</b>	<b>137,123</b>	<b>900</b>

## Elements of financial management, and our assessment of the IJB's arrangements

- ▶ Is it clear why budgets have changed during the year, including how income and expenditure have changed since the budget was set at the beginning of the year?
- ▶ How accurate is financial forecasting?

The outturn position reflects a genuine improvement over reported pressures during the year as a result of actions taken in the year. As at quarter 3 reporting, the social care budget was reporting an overspend of £765,000. The community care resource panel is the largest single component of the budget and recovery action was concentrated on improved management and efficiencies in this area.

However, the report of the Chief Finance Officer also notes that achievement of the underspend was underpinned by non-recurring support. In particular, in respect of social care, non-recurring funding of circa £900,000 was made available. In total, the IJB reports an underlying operational position of £(586,000), demonstrating that significant challenges remain in delivering a balanced budget in the year on a recurring basis.

The Integration Scheme sets out the process to be followed for managing both over and underspends. In respect of underspends, the Integration Scheme allows that these are retained by the IJB as reserves where they relate to a direction given by the IJB. In conjunction with the IJB, the Partners have agreed that the underspend position reported relates to funding which should be held as reserves of the IJB. The IJB has earmarked £243,000 of specific funding from Midlothian Council for specific purposes, with the remaining £657,000 held as general un-earmarked reserves. This is in line with the IJB's reserves policy.

- ▶ Are standing financial regulations comprehensive, current and promoted within the body?
- ▶ Are there suitably qualified and experienced officials leading the body's finance team?

Financial regulations have been established for the IJB. In accordance with statutory requirements, the IJB appointed a Chief Finance Officer (CFO). The CFO is employed by NHS Lothian and also holds the post of CFO at East Lothian Integration Joint Board. We are satisfied therefore that the Board has made arrangements for the proper administration of its financial affairs. We note that the incumbent CFO is retiring from 30 September and the IJB has just appointed a replacement to formally take up post from 1 October 2018.

## 3.2 Financial sustainability

Financial sustainability looks forward to the medium and longer term to consider whether the body is planning effectively to continue to deliver its services or the way in which they should be delivered.

### Amber

- ▶ We have concluded that achieving financial sustainability on an underlying operational delivery basis, excluding non-recurring funding, continues to represent a significant challenge for the IJB.
- ▶ Management has recognised the need to establish longer term financial planning arrangements. The success of these is critical to supporting the achievement of the IJB's strategic objectives. The IJB's Partners have supported this by providing indicative funding allocations through to 2022/23.

We identified in our Annual Audit Plan that service redesign and service transformation will be required in the upcoming years to enable the IJB to meet the budget pressures arising from the growth and service demand pressures in the Midlothian area. Consequently, given the identified financial pressures, this was an audit focus area for the year.

### Elements of financial sustainability, and our assessment of the IJB's arrangements

We considered whether:

- ▶ financial balance has or will be achieved?
- ▶ have any short-term financial challenges been identified and addressed through a financial recovery plan?
- ▶ How appropriate are the arrangements put in place to address any identified funding gaps?

The IJB considered its process for financial assurance in March 2018, when considering its 2018/19 budget. It examined the budget propositions from its Partners and applied its two tests - that of fairness and adequacy. At that time a formal offer had been made by Midlothian Council and accepted by the IJB, However, only an indicative position for NHS Lothian was available for consideration. The IJB agreed to accept the NHS Lothian indicative position on the basis that NHS Lothian provided further information on the plans underway to deliver financial balance within the Set Aside budgets and that the final offer was not materially different from the indicative position. The final offer was considered by the IJB at its meeting in June 2018.

The NHS Lothian 2018/19 Financial Plan was approved by the Board of NHS Lothian on 4 April 2018. The Plan presents a projected financial gap of circa £21 million and provides limited assurance on the achievement of a balanced outturn next year. The allocation of funding made to the IJB for 2018/19 was £86.89 million, which excluded the non-cash limited element of the budget. This compares to £90.52 million actual expenditure in health in 2017/18, against an initial £84.7 million budget, when the non-cash limited expenditure is eliminated. Additional funding throughout 2018/19 is anticipated through health, recognising the nature of budgetary arrangements in the NHS.

The IJB is reporting financial pressures of £2.83 million on its overall budget for 2018/19. Actions to bring the budget back into balance are to be developed in accordance with the requirements of the Integration Scheme, and are due to be reported back to the IJB for ongoing monitoring. Both Partners have provided the IJB with indicative funding allocations up to 2022/23, to support medium term financial planning.

#### Recommendation 1

- ▶ Has a reserves strategy been put in place and how does the current level of reserves match that strategy?

The IJB approved its reserves strategy during 2016/17, in recognition of this being one element of best practice in establishing the longer term financial planning process for the IJB. The reserves strategy approved a level of 2% of net expenditure, equating to approximately £1 million.

Actual reserves held as at 31 March 2018 were in line with the strategy, at £0.9 million. It was recognised by IJB management that this arose in the main due to non-recurring resources being made available to the IJB to support overall service transformation as well as specific initiatives.

### Elements of financial sustainability, and our assessment of the IJB's arrangements (cont.)



- ▶ Does the body understand the long-term pressures, including demand pressures, and have these been built into plans and strategies?
- ▶ How effective are the financial planning systems in identifying and addressing risks to financial sustainability across the shorter and longer terms?

The IJB has identified the longer term changes in demographics which will impact on the delivery of its services. In discussion with management, it is clear that there is a full understanding of these challenges and how integration through transformation is essential to bring the greater focus on prevention than intervention in order to manage the long term pressures.

In March 2018, the IJB considered an updated Financial Strategy and Financial Plan, setting out the three year baseline financial position.

The key themes of the financial strategy are:

- ▶ Prioritising the Allocation of Resources
- ▶ Making more efficient use of resources
- ▶ A move from failure demand to prevention
- ▶ A move from hospital care or care homes to community based services
- ▶ A move to improved quality and access
- ▶ A move from working in silos to team working
- ▶ A move from reactive to anticipatory care planning.

Internal audit reviewed the IJB's arrangements in respect of aspects of transformational funding in the year. The area under review comprised five control objectives, of which three received significant assurance, and two limited assurance. Project proposals were created for all transformational funding during the period 2016-18. Not all project plans were provided to the IJB Board, and there was no regular reporting to the IJB Board on project progress throughout the year. However, the IJB was aware of the overall strategy under which the projects were operating.

Management provided responses to the internal audit recommendations, noting that in their view the IJB operates at a higher, and more strategic level, than it would need to do to fully implement the recommendations.

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

Green	<ul style="list-style-type: none"><li>▶ We have concluded that the IJB has established a sound basis to demonstrate good governance and transparency in its operational activity.</li><li>▶ The IJB has continued to develop its approach to risk management, with a risk management strategy approved and the risk register considered regularly by the audit and risk committee.</li></ul>
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## Governance and transparency

The Board and officers of the IJB are responsible for establishing robust governance arrangements. This includes ensuring effective systems of internal control, including arrangements to safeguard public money, and compliance with applicable laws and regulations.

### Elements of governance and transparency, and our assessment of the IJB's arrangements

	<ul style="list-style-type: none"><li>▶ Can the IJB demonstrate that the governance arrangements are appropriate and operating effectively.</li><li>▶ Is there effective scrutiny, challenge and transparency on decision making and financial and performance reports?</li></ul>
	<p>We have reviewed board minutes and papers and found these to set out clearly the matters considered and discussed. Standing orders regulate how the business of the IJB is conducted. These are subject to review, and were recently updated in May 2018. A revised scheme of delegation was also recently considered by the IJB.</p> <p>The audit and risk committee continues to operate with clearly defined terms of reference.</p> <p>Standing orders, financial regulations and registers of interests are made available on the website to provide transparency as to operation of the IJB.</p> <p>A risk management strategy and the accompanying risk register highlights the risks. Mitigating controls, residual risk and accompanying actions have been further developed and reported during the year to the IJB and also to the audit and risk committee, in its oversight role to monitor the IJBs risk management arrangements.</p>
	<ul style="list-style-type: none"><li>▶ Is the governance framework sound and are the governance arrangements effective?</li><li>▶ Is the Governance Assurance Statement complete and does it reflect key findings from audit, scrutiny and inspection?</li></ul>
	<p>Internal audit's opinion for the year was that overall, the IJB's governance arrangements, risk management and systems of internal control are adequate. Internal audit further reported that:</p> <p><i>The IJB operates under good public sector practice governance arrangements through its Board and Committee meetings that support scrutiny and transparency of decisions made. There is good compliance by the MIJB of the requirements of the Act and the guidance through its Directions to Partners but improvements are required to clearly show how they link to the specific objectives stated in the IJB's Strategic Plan.</i></p> <p>We reviewed the Annual Governance Statement within the financial statements against the required guidance. We were satisfied that it met the requirements and was consistent with both the governance framework and key findings from relevant audit activity.</p>

Value for money is concerned with using resources effectively and continually improving services.

### Amber

- ▶ In response to the need to measure performance and progress against the IJB's Strategic Plan, we have concluded that the IJB has identified local improvement goals to measure its performance which are appropriate to the stated national goals. In addition sources of data and information have been identified and reported to the Board.
- ▶ The IJB needs to ensure that it produces its annual performance report in line with the timeline requirements of the Act.

Monitoring of performance and achievement of better outcomes for the resources available is key to the demonstration of value for money. Integration joint boards are required under the legislation to prepare an annual performance report by 31 July. The IJB considered its report for 2016/17 at its meeting on 24 August 2017, which set out how the IJB performed during the year, in particular in making progress against its Strategic Plan 2016-2020.

Internal audit undertook a review of performance reporting within the IJB as part of their work for 2017/18. The report noted that the IJB has received regular updates on the reporting of performance and development of appropriate indicators. During 2017, a suite of local indicators was agreed with the Scottish Government and targets were set to measure the IJB's performance in delivering services. Progress against these targets is reported to the IJB, initially quarterly, however from October 2017 this moved to reporting to every IJB meeting.

A 'high' grade recommendation was made by internal audit that development of the Annual Performance Report for the year to March 2018 should commence at an earlier stage than in 2017/18 in order that the report can be agreed by the IJB before the summer recess. This would enable publication in final form before the reporting deadline of 31 July 2018.

The Annual Performance Report for 2017/18 was only considered for approval by the IJB at its meeting on 23 August 2018. The report did not highlight that the deadline was not being met, however the Chief officer did inform both the IJB and the Scottish Government of the delay and reasons behind it.

### Recommendation 2

The Care Inspectorate undertook both scheduled and unscheduled inspections across a range of IJB services during 2017/18. The Annual Performance Report provides full details of these inspections. Overall, 89% of care services graded 'good' or better in Care Inspectorate inspections, compared to the Midlothian figure of 85% in 2016/17. The Scottish average is reported as 85%.

### Audit Scotland national performance audit

During the year, management supported completion of an auditor information request which is forming part of the key evidence for Audit Scotland's second Health and Social Care Integration report, along with other evidence such as auditors' annual audit reports and the audited accounts.

The overall aim of this audit is to examine the impact public bodies are having as they work together to integrate health and social care services in line with the Public Bodies (Joint Working) (Scotland) Act 2014.

In particular, the audit will consider the following questions:

- ▶ What impact is integration having and what are the barriers and enablers to this change?
- ▶ How effectively are integration authorities planning sustainable, preventative and community based services to improve outcomes for local people?
- ▶ How effectively are integration authorities (IAs), NHS boards and councils implementing the reform of health and social care integration?
- ▶ How effectively is the Scottish Government supporting the integration of health and social care and evaluating its impact?

The report is currently scheduled to publish in November 2018.



## Appendices

- A - Code of Audit Practice: responsibilities
- B - Independence and audit quality
- C - Required communications with the audit and risk committee
- D - Action plan

In our Annual Audit Plan, we provided a summary of the responsibilities on audited bodies falling within the public sector audit framework, as set out in the Code of Audit Practice (the Code).

## Responsibilities of audited bodies

Corporate governance	Each body, through its chief executive or accountable officer, is responsible for establishing arrangements to ensure the proper conduct of its affairs including the legality of activities and transactions, and for monitoring the adequacy and effectiveness of these arrangements. Audited bodies should involve those charged with governance (including audit committees or equivalent) in monitoring these arrangements.
Financial statements and related reports	<p>Audited bodies must prepare an annual report and accounts containing financial statements and other related reports. They have responsibility for:</p> <ul style="list-style-type: none"> <li>▶ preparing financial statements which give a true and fair view of their financial position and their expenditure and income, in accordance with the applicable financial reporting framework and relevant legislation.</li> <li>▶ maintaining accounting records and working papers that have been prepared to an acceptable professional standard and support their financial statements and related reports disclosures.</li> <li>▶ ensuring the regularity of transactions, by putting in place systems of internal control to ensure that they are in accordance with the appropriate authority.</li> <li>▶ maintaining proper accounting records.</li> <li>▶ preparing and publishing, along with their financial statements, an annual governance statement, management commentary (or equivalent) and a remuneration report that are consistent with the disclosures made in the financial statements. Management commentary should be fair, balanced and understandable and also clearly address the longer-term financial sustainability of the body.</li> </ul> <p>Management, with the oversight of those charged with governance, should communicate clearly and concisely relevant information to users about the entity and its financial performance, including providing adequate disclosures in accordance with the applicable financial reporting framework.</p> <p>Audited bodies are responsible for developing and implementing effective systems of internal control as well as financial, operational and compliance controls. These systems should support the achievement of their objectives and safeguard and secure value for money from the public funds at their disposal. They are also responsible for establishing effective and appropriate internal audit and risk-management functions.</p>
Standards of conduct / prevention and detection of fraud and error	Audited bodies are responsible for establishing arrangements for the prevention and detection of fraud, error and irregularities, bribery and corruption and also to ensure that their affairs are managed in accordance with proper standards of conduct by putting proper arrangements in place.
Financial position	<p>Audited bodies are responsible for putting in place proper arrangements to ensure that their financial position is soundly based having regard to:</p> <ul style="list-style-type: none"> <li>▶ such financial monitoring and reporting arrangements as may be specified</li> <li>▶ compliance with any statutory financial requirements and achievement of financial targets</li> <li>▶ balances and reserves, including strategies about levels and their future use</li> <li>▶ how they plan to deal with uncertainty in the medium and longer term</li> <li>▶ the impact of planned future policies and foreseeable developments on their financial position.</li> </ul>
Best Value	<p>Local authority bodies have a statutory duty, under the Local Government (Scotland) Act 1973 and associated statutory guidance, to make arrangements to secure best value through the continuous improvement in the performance of their functions.</p> <p>Specified audited bodies also have to prepare and publish performance information in accordance with directions issued by the Accounts Commission.</p>

## B. Independence and audit quality



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

### What we are required to communicate

The FRC Ethical Standard requires that we provide details of all relationships between Ernst & Young (EY), its directors and senior management and affiliates, and you, including all services provided by us and our network to you, and other services provided to other known connected parties that we consider may reasonably be thought to bear on our integrity or objectivity, including those that could compromise independence and the related safeguards that are in place and why they address the threats.

There are no relationships from 1 April 2017 to the date of this report, which we consider may reasonably be thought to bear on our independence and objectivity.

### Confirmations

We confirm that there are no changes in our assessment of independence since our confirmation in our Annual Audit Plan, dated 29 March 2018.

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

We consider that our independence in this context is a matter which you should review, as well as us. It is important that management and members of the IJB consider the facts known collectively to you and come to a view. If you would like to discuss any matters concerning our independence, we will be pleased to do this at the meeting of the audit and risk committee on 6 September 2018.

### Audit fees - payable to us in the respect of the year ended 31 March 2018

Component of fee:	2017/18	2016/17
<b>Total agreed auditor remuneration</b>	<b>£16,470</b>	<b>£19,800</b>
Audit Scotland fixed charges:		
Pooled costs	<b>£1,460</b>	£1,040
Performance audit and best value	<b>£5,020</b>	£3,790
Audit support costs	<b>£1,050</b>	£710
<b>Total fee</b>	<b>£24,000</b>	<b>£25,340</b>

### Audit Quality

International Standard on Quality Control (UK and Ireland) 1 (ISQC1) requires that a system of quality control is established, as part of financial audit procedures, to provide reasonable assurance that professional standards and regulatory and legal requirements are being complied with and that the independent auditor's report or opinion is appropriate in the circumstances.

The EY 2017 UK Transparency Report, volumes one and two, can be accessed on our website at [www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017](http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017). This material is published to provide a timely and relevant source of information about EY in general, and our audit business in particular.

The disclosures are extensive. For example, they explain our outlook and how we are structured and governed, including the role of our Independent Non-Executives and how we apply the requirements of the UK's Audit Firm Governance Code. We refer to the quality of our audits and our commitment to recruiting, developing and diversifying our people and talent pool. We also explain how we manage our risks and remain innovative and technologically advanced in what we do and how we do it.

Maintaining high audit quality across all of our engagements is of paramount importance to us. Our transformational Audit Quality Programme continues and is a part of the global EY Sustainable Audit Quality Programme (SAQ).

Our Audit Quality Board (AQB) continues to oversee all matters relating to audit quality and sets the agenda for the Audit Quality programme. The AQB meets monthly and also holds an annual strategy session. The AQB reports to the EY UK Board. The AQB receives regular updates on regulatory matters, results of internal and external reviews, results of root cause analysis, resourcing, the SAQ programme and pursuit approvals, as well as a comprehensive dashboard on quality measures.

Our Audit Quality Support Team (AQST), which started within the SAQ programme, reviews 40 to 50 audits each audit cycle providing challenge and guidance to the engagement teams. These are in-depth reviews carried out by experienced auditors independent of the audit team. AQST reviews enhance the quality of both the audit under review and other audits on which team members apply the lessons learned. The AQST has now become a business-as-usual function.

### Audit Scotland – Audit Quality Framework / Annual Audit Quality Report

Audit Scotland's Appointments and Assurance Team are responsible for applying the new Audit Quality Framework across all financial audits and performance and Best Value audits. This covers the quality of audit work undertaken by Audit Scotland staff and appointed firms. The team are independent of audit delivery and provide assurance on audit quality to the Auditor General and the Accounts Commission.

We support Audit Scotland in their commitment to reporting on audit quality through responding to requests for information and providing the results of internal quality reviews undertaken in respect of relevant public sector audits in Scotland.

The most recent audit quality report which covers our work at the IJB since appointment can be found at: [www.audit-scotland.gov.uk/uploads/docs/report/2018/as\\_audit\\_quality\\_1718.pdf](http://www.audit-scotland.gov.uk/uploads/docs/report/2018/as_audit_quality_1718.pdf).

Required communication	Our reporting to you
<b>Terms of engagement / Our responsibilities</b> Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties. Our responsibilities are as set out in our engagement letter.	Audit Scotland Terms of Appointment letter - audit to be undertaken in accordance with the Code of Audit Practice
<b>Planning and audit approach</b> Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Annual Audit Plan
<b>Significant findings from the audit</b> <ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures</li> <li>▶ Significant difficulties, if any, encountered during the audit</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management</li> <li>▶ Written representations that we are seeking</li> <li>▶ Expected modifications to the audit report</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process</li> </ul>	This Annual Audit Report  We request written representation from you in respect of key matters arising during the course of our audit, and in accordance with auditing standards. A copy of this letter is provided for your consideration and signature at the time of approval of the financial statements.
<b>Going concern</b> Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	No conditions or events were identified, either individually or together to raise any doubt about the IJB's ability to continue for the 12 months from the date of our report.
<b>Misstatements</b> <ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Corrected misstatements that are significant</li> <li>▶ Material misstatements corrected by management</li> </ul>	This Annual Audit Report
<b>Fraud</b> <ul style="list-style-type: none"> <li>▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	This Annual Audit Report
<b>Consideration of laws and regulations</b> <ul style="list-style-type: none"> <li>▶ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>▶ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of</li> </ul>	Annual Audit Report  We have asked management and those charged with governance. We have not identified any material instances or non-compliance with laws and regulations.

Required communication	Reference
<p><b>Related parties</b></p> <p>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</p> <ul style="list-style-type: none"> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	<p>No significant matters have been identified.</p>
<p><b>Independence</b></p> <p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	<p>Annual Audit Plan</p> <p>This Annual Audit Report - Appendix B</p>
<p><b>Internal controls</b></p> <p>Significant deficiencies in internal controls identified during the audit</p>	<p>This Annual Audit Report - no significant deficiencies reported</p>
<p><b>Subsequent events</b></p> <ul style="list-style-type: none"> <li>▶ Where appropriate, asking the audit committee whether any subsequent events have occurred that might affect the financial statements.</li> </ul>	<p>We have asked management and those charged with governance. We have no matters to report.</p>
<p><b>Material inconsistencies</b></p> <p>Material inconsistencies or misstatements of fact identified in other information which management has refused to revise</p>	<p>This Annual Audit Report</p>

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

Classification of recommendations			
Grade 1: Key risks and / or significant deficiencies which are critical to the achievement of strategic objectives. Consequently management needs to address and seek resolution urgently.		Grade 2: Risks or potential weaknesses which impact on individual objectives, or impact the operation of a single process, and so require prompt but not immediate action by management.	Grade 3: Less significant issues and / or areas for improvement which we consider merit attention but do not require to be prioritised by management.
No.	Findings and / or risk	Recommendation / grading	Management response / Implementation timeframe
1	The IJB is reporting financial pressures of £2.83 million on its overall budget for the year. Actions to bring the budget back into balance are to be developed in accordance with the requirements of the Integration Scheme, and are due to be reported back to the IJB for ongoing monitoring.	While the IJB has taken forward its financial strategy, significant work is still required to ensure that actions to address both the in-year position, as well as the forecast pressures over the next three years, are addressed.  <i>Grade 2</i>	Management accepts there is work to be done in addition to the work that has already been delivered. The financial strategy and the financial plan are being developed and three reports have already gone to the IJB with a further paper going in September 2018. The financial strategy lays out the fundamental financial principle which is that the IJB will use the totality of its resources to deliver its Strategic Plan emphasising that a sustainable financial model is a key deliverable and then describes the transformational process.  In 2018/19, actions have been taken which have significantly reduced the in-year financial risk. The IJB has a reserve and has indicated that, if required, additional resources can be used to support the in-year position.
2	The Annual Performance Report for 2017/18 was only considered for approval by the IJB at its meeting on 23 August 2018. The report did not highlight that the 31 July deadline was not being met.	Earlier planning is needed to ensure that the annual performance report for 2018/19 can be considered and approved at an IJB Board meeting in June, to allow publication by the deadline.  <i>Grade 2</i>	The annual report relies on activity and measurement data from information provided by NSS. This information was not received in time to allow the draft annual report to be presented to the IJB at its June meeting.  This was reported to the IJB by the Chief Officer and approval was also sought from the Scottish Government to reflect that the annual report would not be delivered by the deadline due to the issues noted above.  Going forward for 2018/19 reporting arrangements are being made to ensure all data required for the annual report is received in time to report to the IJB in line with the 31 July deadline.

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