

Midlothian Council

2022/23 Annual Audit Report



 AUDIT SCOTLAND

Prepared for the Members of Midlothian Council and the Controller of Audit

October 2023

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Key messages

2022/23 annual accounts

- 1 Audit opinions on the annual accounts of the Council and its group are unmodified.
- 2 The unaudited annual accounts were provided within the agreed timetable and were of a good standard.
- 3 Management made adjustments of £16.1 million to the annual accounts. The most significant adjustments related to the re-measurement of the net defined benefit for the unfunded pension obligations of £7.8 million and the reclassification of £5.9 million debtors and creditors balances.

Financial Management

- 4 The Council has appropriate budget setting and monitoring arrangements in place.
- 5 During 2022/23 the Council managed its budget and ended the year with a net underspend position of £11 million which included a one off repayment of overpaid VAT of £6.8 million.
- 6 The level of usable reserves held by Midlothian Council increased from £86 million in 2020/21 to £91 million in 2022/23. The usable reserves balance of £91 million includes General Fund reserves of £35 million of which £18 million is earmarked for specific purposes, Housing Revenue Account reserves of £32 million, Capital Fund reserves of £20 million and £4 million reserves for repairs and renewals.
- 7 Midlothian Council has an ambitious capital housing programme and spent £42 million on New Social Housing and Market Purchases in 2022/23 (£2021/22: £35 million).

Financial Sustainability

- 8 The latest five-year revenue budget strategy agreed in September 2023 is projecting a budget gap of £34.7 million to 2028/29.
- 9 It is clear that the Council faces heightened financial challenges in delivering balanced budgets and financially sustainable services radical solutions and robust financial plans will be needed to ensure service delivery remains financially sustainable.

- 10** The Council has developed a Transformation Blueprint which aligns with the five-year revenue budget strategy to 2027/28 aims to create a wellbeing economy. However, detailed workforce and digital plans required to deliver transformation continue to be developed but have not yet been finalised. New strategic leads for Digital and Human Resources have been appointed to lead this work.

Best Value

- 11** Midlothian Council has demonstrated ongoing commitment to best value since our Best Value Annual Report 2019. We have noted improvements in performance reporting and medium term financial planning as well as the strengthening of officer member relationships.
- 12** The Council and its partners are actively working to address inequalities. The new Council Leader initiated, and chairs, the cross party Cost of Living Task Force which has moved from taking a crisis intervention approach to a preventative approach and a child poverty strategy and plan has been produced.
- 13** The Council has adopted an ambitious target to be net zero by 2030. Its vision, outcomes and priorities clearly reflect the importance it places on this. But achieving this target brings resourcing and financial risks which the Council is actively managing.

Vision, Leadership and Governance

- 14** Midlothian Council continues to have effective and appropriate governance arrangements in place that support scrutiny of decisions made.

Use of resources to improve outcomes

- 15** The Council has appropriate arrangements in place for improving services and monitoring desired outcomes through a balanced scorecard approach.
- 16** Internal audit conducted a review and published a report on performance management and performance indicators in 2022. The report provided substantial assurance in the reporting of performance indicators.

Introduction

1. This report summarises the findings from the 2022/23 annual audit of Midlothian Council (the Council). The scope of the audit was set out in an annual audit plan presented to the June 2023 meeting of the Audit Committee.

2. This Annual Audit Report comprises:

- significant matters arising from an audit of Midlothian Council's annual accounts.
- conclusions on the following wider scope areas that frame public audit as set out in the Code of Audit Practice:
 - Financial Management
 - Financial Sustainability
 - Vision, Leadership, and Governance
 - Use of Resources to Improve Outcomes.
- conclusions on Midlothian Council's performance in meeting its Best Value duties.

3. This report is addressed to Midlothian Council and the Controller of Audit and will be published on Audit Scotland's website www.audit-scotland.gov.uk in due course.

Audit appointment from 2022/23

4. I, Claire Gardiner, have been appointed by the Accounts Commission as auditor of the Council for the period from 2022/23 until 2026/27. The 2022/23 financial year was the first of my five-year appointment. My appointment coincides with the new [Code of Audit Practice](#) which was introduced for financial years commencing on or after 1 April 2022.

5. My team and I would like to thank councillors, audit committee members, senior management, and other staff, particularly those in finance, for their cooperation and assistance in this year and we look forward to working together constructively over the course of the five-year appointment.

Responsibilities and reporting

6. The Council has primary responsibility for ensuring the proper financial stewardship of public funds. This includes preparing annual accounts that are in accordance with proper accounting practices. The Council is also responsible

for compliance with legislation and putting arrangements in place for governance and propriety that enable it to successfully deliver its objectives.

7. The responsibilities of the independent auditor are established by the Local Government (Scotland) Act 1973 and the [Code of Audit Practice 2021](#), and supplementary guidance and International Standards on Auditing in the UK.

8. Weaknesses or risks identified are only those which have come to our attention during our normal audit work and may not be all that exist. Communicating these does not absolve management of the Council from its responsibility to address the issues we raise and to maintain adequate systems of control.

9. This report contains an agreed action plan at [Appendix 1](#). It sets out specific recommendations, the responsible officers, and dates for implementation.

Auditor Independence

10. We can confirm that we comply with the Financial Reporting Council's Ethical Standard. We can also confirm that we have not undertaken any non-audit related services and therefore the 2022/23 audit fee of £273,550 as set out in our 2022/23 Annual Audit Plan remains unchanged. We are not aware of any relationships that could compromise our objectivity and independence.

11. We add value to Midlothian Council by:

- identifying and providing insight on significant risks and making clear and relevant recommendations.
- providing clear and focused conclusions on the appropriateness, effectiveness and impact of corporate governance, arrangements to ensure the best use of resources and financial sustainability.
- sharing intelligence and good practice identified.

1. Audit of 2022/23 annual accounts

Public bodies are required to prepare annual accounts comprising financial statements and other related reports. These are principal means of accounting for the stewardship public funds.

Main judgements

Audit opinions on the annual accounts of the council and its group are unmodified.

The unaudited annual accounts were provided within the agreed timetable and were of a good standard.

Management made adjustments of £16.1 million to the annual accounts. The most significant adjustments related to the re-measurement of the net defined benefit for the unfunded pension obligations of £7.8 million and the reclassification of £5.9 million debtors and creditors balances.

Audit opinions on the annual accounts are unmodified

12. The council approved the annual accounts for the Council and its group for the year ended 31 March 2023 on 30 October 2023. As reported in the independent auditor's report, in my opinion as the appointed auditor:

- the financial statements give a true and fair view and were properly prepared in accordance with the financial reporting framework
- the audited parts of the Remuneration Report have been properly prepared in accordance with The Local Authority Accounts (Scotland) Regulations 2014
- the information given in the Management Commentary for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with statutory guidance issued under the Local Government in Scotland Act 2003; and
- the information given in the Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements and that report has been prepared in accordance with the Delivering Good Governance in Local Government: Framework (2016).

Overall materiality was assessed as £7.6 million

13. The concept of materiality is applied by auditors to determine whether misstatements identified during the audit could reasonably be expected to influence the economic decisions of users of the financial statements, and hence impact their opinion set out in the independent auditor's report. Auditors set a monetary threshold when considering materiality, although some issues may be considered material by their nature. It is ultimately a matter of the auditor's professional judgement.

14. Our initial assessment of materiality for the Council and its group, was carried out during the risk assessment and planning phase of the audit. This was reviewed and revised on receipt of the unaudited annual accounts and is summarised in [Exhibit 1](#).

Exhibit 1 Materiality values

Materiality level	Council and Group
Overall materiality	£7.6 million
Performance materiality	£4.6 million
Reporting threshold	£0.25 million

Source: Audit Scotland

15. The overall materiality threshold for the audit of the annual accounts of the Council was set with reference to gross expenditure, which we judged as the figure most relevant to the users of the financial statements.

16. Performance materiality is used by auditors when undertaking work on individual areas of the financial statements. It is a lower materiality threshold, set to reduce the probability of aggregated misstatements exceeding overall materiality. Performance materiality was set at 60% of overall materiality, reflecting our risk assessment which was informed by the level of errors in prior years and the control environment in place at the Council.

17. It is our responsibility to request that all misstatements, other than those below our reporting threshold, are corrected, although the final decision on making the correction lies with those charged with governance.

Significant findings and key audit matters

18. Under International Standard on Auditing (UK) 260 we communicate significant findings from the audit to the council, including our view about the qualitative aspects of the body's accounting practices.

19. The Code of Audit Practice also requires all audits to communicate key audit matters within the annual audit report under International Standard on Auditing (UK) 701. These are matters that we judged to be of most significance in our audit of the financial statements. Significant findings and key audit matters are summarised in [Exhibit 2](#).

Exhibit 2

Significant findings and key audit matters from the audit of the annual accounts

Issue	Resolution
<p>1. Restricting the value of pension asset</p> <p>For the first time, the unaudited accounts included a pension asset rather than a liability. This amounted to £188 million and was calculated by the council's actuary.</p> <p>The pension accounting standard (IAS 19) limits any pension asset to the lower of the surplus and what is described as an asset ceiling. The asset ceiling is defined as the present value of any economic benefits available in the form of refunds from the pension fund or reductions in future contributions to the fund.</p> <p>Further guidance on calculating the asset ceiling is provided in IFRIC 14. It refers to the impact of a 'minimum funding requirement' which stipulates a minimum amount of contributions that must be paid over a given period. The existence of a minimum funding requirement limits the ability of a body to reduce future contributions.</p> <p>Where there is a minimum funding requirement for contributions relating to future service, IFRIC 14 explains that the asset ceiling is the present value of the future service cost less the present value of the minimum funding requirement contributions.</p> <p>Where actuaries report that the present value of the minimum funding requirement contributions exceeds the future service cost, IFRIC 14 advises that no asset should be recognised.</p> <p>The Council applied an asset ceiling which restricted the pension asset to a nil balance in the balance sheet as at 31 March 2023.</p> <p>As part of our audit work we identified that the IFRIC 14 calculation did not cover the unfunded pension liability and therefore where the pension asset was restricted to zero the unfunded pension obligation should be netted off against the</p>	<p>We reviewed the actuary's assumptions and the Council's assessment of the actuary's assumptions and calculation in conjunction with IAS 19 and the application of IFRIC 14.</p> <p>The Council included additional disclosures in the audited annual accounts to clearly show the effect of the asset ceiling.</p> <p>The annual accounts were adjusted to reflect a pension asset of zero for the Council's funded obligations, and a pension liability of £7.8 million for its unfunded obligations, for which the IFRIC 14 calculation does not apply.</p> <p>We concluded that, for 2022/23, the Council's approach to recognising a pension asset and applying an asset ceiling in the accounts was appropriate.</p>

Issue	Resolution
restricted balance and included as a liability in the financial statements.	
<p>2. Reinforced Autoclaved Aerated Concrete in council buildings</p> <p>Reinforced Autoclaved Aerated Concrete (RAAC) is a lightweight construction material that was used in the construction of some public buildings like schools and hospitals between the 1950s and 1990s. It was used mostly in flat roofing, but also in some pitched roofs, floors and walls.</p> <p>On 31 August 2023 the UK Department for Education (DfE) announced that any space or area in schools, colleges or nurseries in England, with confirmed RAAC should no longer be open without "mitigations" being put in place.</p> <p>During 2022/23, the Council reviewed of buildings across the school estate and did not identify any RAAC in the surveyed schools. Further surveys are planned on the remaining buildings within the Council's estate.</p>	<p>We are satisfied that the Council has taken appropriate action to address the risk of RAAC within their estate.</p> <p>As no RAAC has been identified we are satisfied that there is no requirement for a post balance sheet event relating to liabilities in relation to remedial works.</p>
<p>3. Remuneration Report disclosures</p> <p>The audit of the Remuneration Report identified a number of errors and other disclosure changes that were required to ensure the reports were fully compliant with applicable guidance. These included:</p> <ul style="list-style-type: none"> the remuneration table did not include a senior councillor who commenced this role in March 2023 there were minor errors in the pension movements for two employees the disclosures around pay bands had been calculated incorrectly in regard to starters and leavers. The bands should be based on actual salaries of all starters and leavers but the whole year equivalent had been used. 	<p>Management have reviewed the disclosures within the Remuneration Report and have updated the information.</p> <p>We are satisfied that the revised Remuneration Report fulfils the disclosure requirements of applicable guidance.</p>
<p>4. Disclosures in the notes to the accounts</p> <p>The notes to the accounts help provide contextual information and detail which will help the reader understand the primary statements. Our audit work identified some areas where the classification of transactions or balances was incorrectly disclosed within the notes to the accounts.</p>	<p>We acknowledge that only one of the misclassifications identified impacted on the figures on the face of the primary financial statements. We are satisfied that management have addressed all significant misclassifications within the notes to the accounts in year.</p>

Issue	Resolution
<ul style="list-style-type: none"> Within short term deposits at 31 March 2022, £50 million was reclassified as cash and cash equivalents. The balance sheet was also revised to correct the misclassification. Within Group investments £5.6 million was reclassified as the Group share of net assets of associates and joint ventures. Within the short term debtors note there was £11.2 million of classification movements between other trade debtors, central government bodies and council tax debtors. Within income £3.2 million was reclassified from fees and charges income to investment income. Within non-current assets £0.7 million was incorrectly classified as assets under construction and land in operation. 	<p>The Council should ensure going forward that control accounts such as trade debtors are reviewed to ensure balances with central government and other public sector bodies are classified appropriately at the year-end.</p> <p>Recommendation 1</p>

Source: Audit Scotland

Our audit work responded to the risks of material misstatement we identified in the annual accounts

20. We have obtained audit assurances over the identified significant risks of material misstatement in the annual accounts. [Exhibit 3](#) sets out the significant risks of material misstatement to the financial statements we identified in our 2022/23 Annual Audit Plan. It also summarises the further audit procedures we performed during the year to obtain assurances over these risks and the conclusions from the work completed.

Exhibit 3

Significant risks of material misstatement in the annual accounts

Audit risk	Assurance procedure	Results and conclusions
<p>1. Risk of material misstatement due to fraud caused by management override of controls</p> <p>As stated in International Standard on Auditing (UK) 240, management is in a unique position to perpetrate fraud because of management's ability to override controls that</p>	<p>Owing to the nature of this risk, assurances from management are not applicable in this instance</p>	<p>We assessed the design and implementation of controls over journal entry processing. Exhibit 5 identifies an opportunity to strengthen the controls over journals.</p> <p>Our testing of journals, year-end transactions, accruals and prepayments did not identify any incidents of</p>

Audit risk	Assurance procedure	Results and conclusions
<p>otherwise appear to be operating effectively.</p>		<p>management override of controls.</p> <p>We did not identify any unusual journal activity.</p> <p>Our assessment of the adequacy of controls in place for identifying and disclosing related party relationship and transactions in the financial statements did not highlight any weaknesses.</p> <p>The methods and assumptions used to prepare accounting estimates were confirmed to be consistent with prior-years.</p> <p>As a result of the above work we are satisfied that there is no material misstatement arising from this risk.</p>
<p>2. Estimation in the valuation of other land and buildings</p> <p>Midlothian Council hold land and buildings (non-housing) with a NBV of £526 million as at 31 March 2022.</p> <p>There is a significant degree of subjectivity and complexity in the valuation of land and buildings. Valuations are based on specialist and management assumptions and changes in these can result in material changes to valuations. Material errors were also identified in the prior year valuation process by the prior year auditor.</p> <p>The 2022/23 revaluation exercise is planned to cover a significant proportion of the estate.</p> <p>Due to the inherent complexity and subjectivity</p>	<p>Council procedures and controls around valuation and accounting.</p>	<p>We did not identify any issues with the information provided to the valuer.</p> <p>Our review of the Council's valuation team's work, and the external valuer, confirmed the appropriateness of the methodology and assumptions used. We did not identify any non-compliance with RICS guidance.</p> <p>We found that management have an appropriate level of involvement and oversight of the valuation process. We concluded that management's assessment that land and buildings not revalued in 2022/23 are not materially misstated, to be reasonable, and found assumptions made to be appropriate.</p> <p>We found that appropriate disclosures have been made</p>

Audit risk	Assurance procedure	Results and conclusions
risks regarding land and buildings' valuations and material errors found in the prior year, a significant risk of material misstatement in the 2022/23 valuations has been identified.		regarding the assumptions in relation to the valuation of land and buildings.

Source: 2022/23 Midlothian Council Annual Audit Plan

21. In addition, we identified “areas of audit focus” in our 2022/23 Annual Audit Plan where we considered there to be risks of material misstatement to the financial statements. The results of our audit procedures and conclusions are set out in [Exhibit 4](#).

Exhibit 4

Identified areas of audit focus

Audit risk	Results and conclusion
<p>Valuation of pension liability</p> <p>The Council is an admitted body of Lothian Pension Fund and recognised a net pension liability of £54 million as at 31 March 2022. The liability requires the use of an actuarial methodology based on a range of assumptions including financial and demographic assumptions. The subjectivity around these assumptions gives rise to a risk of material misstatements in the financial statements.</p> <p>We will assess the scope, independence and competence of the professionals engaged in providing estimates for pensions and review appropriateness of actuarial assumptions and results including comparison with other councils. We will establish officer's arrangements for ensuring the reasonableness of professional estimations and the accuracy of information provided to the actuary by Midlothian Council.</p>	<p>We are satisfied that the pension liability is correctly recognised on the balance sheet at 31 March 2023 and has been accounted for and disclosed correctly in line with International Accounting Standard (IAS) 19 Retirement benefits.</p> <p>We use an auditor's expert to inform our review of the assumptions used in calculating this estimate and management's judgements. We concluded the assumptions are appropriate and within a range which we consider to be acceptable.</p> <p>We are also satisfied the controls in place over the provision of information to the actuary are appropriate.</p>
<p>Teachers' payroll</p> <p>Two pay awards have been granted in 2022/23. The Council is progressing implementing the awards but work in this</p>	<p>We reviewed the design and implementation of controls over changes to pay which includes pay awards. We concluded that the controls over changes were designed appropriately.</p>

Audit risk	Results and conclusion
<p>area is incomplete and calculations for supply teachers can be complex. We will monitor progress in implementing teachers pay awards and test controls in the payroll system to ensure staff costs are complete, valid, and accurate.</p>	<p>We conducted analytical procedures regarding the pay award in year comparing the actual amounts charged as expenditure to our expectation. We identified a variance which indicates that national insurance and pension costs relating to the 2021/22 pay increase were not accrued in the prior year. Accounting standards require the adjustment of material prior period errors only. We are satisfied that this would not be material and therefore no prior period adjustment has been made.</p>
<p>Financial controls cash and bank</p> <p>Material errors in the unaudited cash and bank figures were identified by the previous external auditors.</p> <p>These were identified as relating to the failure of bank reconciliation controls. We will follow up agreed actions and perform a full system review in this area in 2023.</p>	<p>Bank reconciliations were conducted for each month in 2022/23. In addition to this a year end reconciliation was conducted with no issues arising.</p> <p>We are satisfied that the balance reported at the year end is not materially misstated.</p>

Source: 2022/23 Midlothian Council Annual Audit Plan

Identified misstatements of £16.1 million were adjusted in the annual audited accounts

22. Total adjustments of £16.1 million were made to the annual audited accounts. The most significant adjustments related to the re-measurement of the net defined benefit for the unfunded element of pension contributions of £7.8 million and the reclassification of £5.9 million debtors and creditors balances.

23. Adjustments made in the audited accounts reduced the total comprehensive income and expenditure deficit by £1.4 million and reduced net assets in the balance sheet by £6.3 million.

24. We identified two misstatements which were not corrected by management in the audited accounts. Management considered the size, nature and circumstances leading to all uncorrected misstatements, individually and in aggregate, and concluded that these were not material.

25. The unaudited annual accounts were received in line with our agreed audit timetable on 30 June 2023. The working papers provided with the unaudited accounts were of a good standard and finance and other council staff provided good support to the audit team during the audit.

26. Covid-19 has had a considerable impact on the delivery of audits and we are working to deliver timely audits while maintaining quality. In order to

preserve the quality of our work in year the audit was delayed against our planned timetable with the accounts being signed on 30 October 2023. This allowed the statutory deadline for publication to be met.

2. Financial management

Main judgements

The Council has appropriate budget setting and monitoring arrangements in place.

During 2022/23 the Council managed its budget and ended the year with a net underspend position of £11 million which included a one off repayment of overpaid VAT of £6.8 million.

The level of usable reserves held by Midlothian Council increased from £86 million in 2020/21 to £91 million in 2022/23. The usable reserves balance of £91 million includes General Fund reserves of £35 million of which £18 million is earmarked for specific purposes, Housing Revenue Account reserves of £32 million, Capital Fund reserves of £20 million and £4 million reserves for repairs and renewals.

The Council operated within budget in 2022/23

27. The Council approved its 2022/23 budget in February 2022. The budget was set at £251 million with a projected funding gap of £9 million. The Council agreed the deferral of debt repayments to secure an additional £6.4 million of funding with the remainder of the budget gap funded from a transfer from reserves. These measures enabled the Council to set a balanced budget for 2022/23.

28. During 2022/23 the Council managed its budget and ended the year with a net underspend position of £11 million which included a one off repayment of overpaid VAT of £6.8 million. The remaining underspend relates to savings in loan charges and vacant posts, lower spend in education and higher than anticipated funding from previously undistributed Scottish Government Grants. The General Fund Balance increased from £32 million at 31 March 2022 to £34 million at 31 March 2023.

29. The Council previously approved the use of a financial flexibility permitting the use of capital receipts to fund projects designed to transform service delivery or reduce costs. Capital Receipts in 2021/22 of £0.6 million were set aside for this purpose. For the flexibility to apply funding must have been utilised by 31st March 2023.

30. The following projects were funded from the use of financial flexibilities, enabling funds to be freed up to cover increases in salary costs:

- Building Maintenance Review (£0.14 million)- radical service redesign and modernisation of all processes within the Building Maintenance Service with the purpose of raising the business efficiency and effectiveness at all levels across the organisation.
- Customer Services Project (£0.19 million) - in 2022/23 the multi-year project developed and delivered new Freedom of Information Registrar and Contact Us modules designed to provide significant service enhancement and efficiency.
- School Week Transformation Drive (£0.04 million) - transformational change in the design and delivery of the curriculum within secondary schools taking into account national development and digital solutions.
- Climate Change (£0.03 million) - Zero Carbon External support to develop the Council's ambition to make the Council's activities net carbon zero by 2030.
- The unused balance of £0.16 million was appropriately added to the capital fund.

Housing revenue account operated within budget

31. The Council is required by legislation to maintain a separate housing revenue account and to ensure that rents are set a level which will at least cover the costs of its social housing provision.

32. During 2022/23 the Council overspent by £0.9 million on repairs and maintenance and housing rents were £0.9 million less than budgeted. However, total income was £4 million more than expenditure for the year and the balance on the housing revenue account reserve increased to £32 million at 31 March 2023 (2021/22: £28 million).

33. This balance is committed to fund the Council's ambitious capital investment plan to build further new housing stock and continue to improve and upgrade its existing stock, particularly through Scottish Housing Quality Standards (SHQS) improvement and Energy Efficiency Standard for Social Housing (EESH) works.

The Council has appropriate budget setting and monitoring arrangements.

34. We performed a review of the Council's annual budget setting arrangements. The budget process implemented by the Council appears to be well established and officers and Finance Business Partners partners are very clear about their responsibilities and time frames. The process involves appropriate scrutiny arrangements, with the Business Transformation Steering Group and Council both having opportunities to scrutinise the budget and consider opportunities to reduce any emerging budget gap.

35. The budget setting document includes realistic financial assumptions and it offers good information regarding where there are projected over and underspends. It also gives brief explanations and context setting as appropriate.

36. We observed that senior management and members receive regular and accurate financial information on the Council's performance against budgets.

Capital expenditure increased in 2022/23

37. Total capital expenditure in 2022/23 was £74 million of which £23 million related to general services and £52 million to the housing revenue account.

38. The Council has an ambitious capital housing programme and spent £42 million on New Social Housing and Market Purchases in 2022/23 (2021/22: £35 million). The capital housing programme consists of five phases:

- phases 1 and 2 are complete and provided 1,353 additional houses within Midlothian over a period of 7 years with a total budget of £185 million
- phases 3 & 4 combined - the original plan was for 729 units to be constructed with a budget of £166 million but this has reduced to 645 units due to actual costs being greater than initial estimates. The increase in costs have arisen through various factors, namely, war in Ukraine, EU exit and Covid-19 impacting on building costs over recent years
- phase 5 has a current approved budget of £78 million however projected budget variations on previous phases and an increase in the Scottish Government Affordable Housing Supply Programme (AHSP) grant allocation means that there is potential for a further £6 million to be utilised for New Social Housing.

39. A total of 214 homes have reached completion in 2023 calendar year; 300 homes are on site at various stages of construction; and a further 115 homes are on site but undergoing final snagging and in the process of final handovers.

Financial systems of internal control

40. From our review of the design and implementation of systems of internal control (including those relating to IT) relevant to our audit approach. We did not identify any issues with the design of the controls which would increase the risk of a material misstatement in the financial statements. However, we identified three areas where controls could be improved:

Exhibit 5

Key findings from review of key controls

Audit finding	Additional audit procedures
1. Journals	
The Council's financial ledger is the system for recording all transactions and preparing the	We reviewed the journals across the year to identify those which had been posted by those with a higher level of

financial statements. Journal entries are how the council's financial ledger is manually updated. We conducted controls testing over this area and identified the following issues:

- To minimise the risk of error and fraud we would expect each journal entry to be prepared and authorised by different members of staff. This control is not in operation for a small number of staff within the finance team. The ability of officers to approve their own journals increases the risk that invalid, erroneous or fraudulent journals could be posted to the financial ledger.
- Access to the ledger requires to be tightly controlled to mitigate the risk of fraudulent mis-postings. We identified in year that access rights were not regularly reviewed. We also found there were some users with a high level of access rights which had not been timeously removed.
- We tested a sample of 17 journals to ensure the approvals process had been followed. There was insufficient evidence of authorisation for one of the sample.

access. We identified some journals which relate to former employees, however, they relate to interfaces with the ledger which are not actually posted but are automatic journals. The user recorded is the user who created the interface. We are satisfied that there are compensating controls within the overall IT access rights which would prevent ex-employees accessing the ledger.

Our journals testing across the year reflected the increased risk arising from self-approval of journals and we did not identify any issues.

Recommendation 2 (refer [Appendix 1, action plan](#))

Journals procedures should be reviewed to minimise the risk with the ability of members of the finance team to approve their own journals.

2. Bank reconciliations

Bank reconciliations are a critical control to ensure that cash is accurately recorded in the ledger. We found that bank reconciliations were performed for each month of the year but the reconciliations completed for periods 10 to 12 were not completed timeously.

In addition at the year-end we identified over 20 bank accounts (mainly imprest accounts) with small balances which were not reconciled to the ledger on a regular basis.

We are satisfied that a reconciliation was conducted at the year end with no issues arising.

The bank letter at the year-end confirmed that the smaller imprest accounts were below our trivial level and did not represent a risk of material misstatement. We note that a number of accounts have a zero balance.

Recommendation 3 (refer [Appendix 1, action plan](#))

Bank reconciliations should be conducted on a monthly basis for all accounts which are in use. The Council should also consider the bank accounts held and if they are still required.

3. Payroll reconciliations

The Council undertakes a reconciliation between the ledger and the payroll system on a monthly basis in line with good practice. We reviewed an example of one month's reconciliation in 2022/23 and found limited

We reviewed the year-end reconciliation between the ledger and payroll system and concluded that the employee costs included in the ledger at the year-end were appropriate.

evidence that the discrepancies between the ledger and payroll were not being followed up or investigated on a timely basis.

Recommendation 4 (refer [Appendix 1, action plan](#))

The Council should ensure any work conducted in reconciling the ledger to payroll is appropriately evidenced.

Source: Audit Scotland

41. Our work has been undertaken to provide an audit opinion on the annual report and accounts, and in response to our additional responsibilities set out in the Code of Audit Practice. The control deficiencies reported here are limited to those we identified while completing our audit work for these purposes.

Standards of conduct and arrangements for the prevention and detection of fraud and error were appropriate

42. In the public sector there are specific fraud risks, including those relating to tax receipts, welfare benefits, grants and other claims made by individuals and organisations. Public sector bodies are responsible for implementing effective systems of internal control, including internal audit, which safeguard public assets and prevent and detect fraud, error and irregularities, bribery and corruption.

43. The Council has adequate arrangements in place to prevent and detect fraud or other irregularities.

3. Financial Sustainability

Main judgements

The latest five-year revenue budget strategy agreed in September 2023 is projecting a budget gap of £34.7 million to 2028/29.

It is clear that the council faces heightened financial challenges in delivering balanced budgets and financially sustainable services radical solutions and robust financial plans will be needed to ensure service delivery remains financially sustainable.

The Council has developed a Transformation Blueprint which aligns with the five-year revenue budget strategy to 2027/28. However, detailed workforce and digital plans required to deliver transformation continue to be developed but have not yet been finalised. New strategic leads for Digital and Human Resources have been appointed to lead this work.

The level of General Fund reserves remains significantly higher than pre-pandemic levels

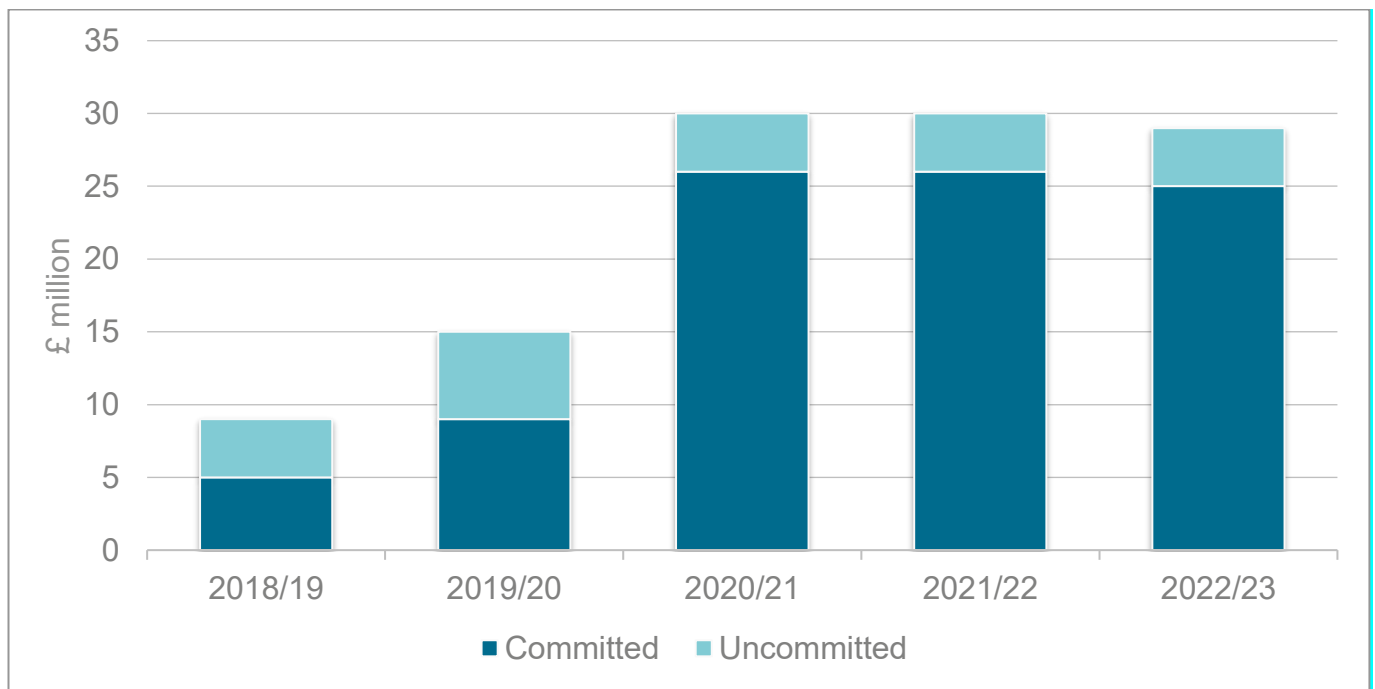
44. One of the key measures of the financial health of a body is the level of reserves held. The level of usable reserves held by Midlothian Council increased from £86 million in 2020/21 to £91 million in 2022/23. The usable reserves balance of £91 million includes General Fund reserves of £35 million of which £18 million is earmarked for specific purposes, Housing Revenue Account reserves of £32 million, Capital Fund reserves of £20 million and £4 million reserves for repairs and renewals.

45. [Exhibit 6](#) provides an analysis of the general fund over the last five years split between committed and uncommitted reserves. The significant increase in committed reserves in 2020/21 aligned with the impact of Covid-19 and the increased funding provided by the Scottish Government late in March 2020, leading to a significant increase in reserves.

46. This trend has continued to 2022/23 with levels of committed reserves remaining significantly higher than pre-Covid-19 times.

Exhibit 6

Analysis of general fund balance



47. Almost 90% of committed reserves represent efficiency savings or unspent grants achieved by individual services and carried forward for their use in future years. The council has a scheme of devolved budget management and services can carry forward unspent grants for their use in following years. Services are not able to carry forward general underspends, which would be included within uncommitted reserves carried forward. All savings carried forward have to be reviewed and approved by the section 95 officer.

48. The balance of committed reserves include £3m to support repairs to Public Realm, £2m committed to support Transformation work and £1 million set aside to balance the 2023/24 budget.

49. The level of uncommitted reserves has increased in 2022/23 providing £10 million contingency funds for future years.

The five-year revenue budget strategy agreed in September 2023 is projecting a budget gap of £34.7 million to 2028/29

50. In February 2023, the Council agreed a five-year revenue budget strategy for the period 2023/24 to 2027/28. At that time the strategy was projecting a cumulative budget gap of £15 million by 2027/28. The Council updated the five-year revenue budget strategy in September and the cumulative projected budget gap has increased significantly to £24 million to 2027/28.

51. Savings proposals to bridge the budget gap were previously considered in the annual budget setting meetings but are now considered by the Business Transformation Steering Group (BTSG). This enables savings proposals to be agreed so that the Council is able to invest in its vision and corporate priorities.

52. Midlothian is the fastest growing local authority in Scotland and this presents challenges in terms of increased service demand within its funding allocation. The Council is exploring whether the growth in population is

accurately reflected in government funding to mitigate the increase in cost pressures on services, particularly those which are demand led.

53. It is clear that the council faces heightened financial challenges in delivering balanced budgets and financially sustainable services radical solutions and robust financial plans will be needed to ensure service delivery remains financially sustainable. The council recognises that transformation is essential to ensure service delivery remains financially sustainable and has published a Transformation Blueprint for Midlothian. The Transformation Blueprint which aligns with the five-year revenue budget strategy to 2027/28 aims to create a wellbeing economy. However, detailed workforce and digital plans required to deliver transformation continue to be developed but have not yet been finalised. New strategic leads for Digital and Human Resources have been appointed to lead this work.

2023/24 Projected Outturn

54. The latest budget monitoring report reported to the Council in November 2023 is projecting overspends across several services and highlights that £1.096 million of Medium Term Financial Strategy cost reductions have still to be finalised or fully implemented. A number of these are taking longer than planned to implement with an impact on the 23/24 financial position.

55. The most significant projected overspends relate to:

- Pupil transport - £0.9 million due to the volume and value of school pupil transport invoices higher than budgeted.
- Sport and Leisure - £0.7 million due to a shortfall in the agreed income target.
- Fleet costs - £0.7 million due to ageing vehicles and higher volumes of external contracting than planned.

56. The budget monitoring report is also projecting a reduction in the General Fund balance from £34.9 million at 31 March 2023 to £11.4 million at 31 March 2024. The most significant reduction of £16 million is expected result from the application of Budgets carried forward from 2022/23 for use in 2023/24.

4. Best Value

Councils have a statutory duty to make arrangements to secure continuous improvement in the performance of their functions.

Main judgements

Midlothian Council has demonstrated ongoing commitment to best value since our Best Value Annual Report 2019. We have noted improvements in performance reporting and medium term financial planning as well as the strengthening of officer member relationships.

The council and its partners are actively working to address inequalities. The new Council Leader initiated, and chairs, the cross party Cost of Living Task Force which has moved from taking a crisis intervention approach to a preventative approach and a child poverty strategy and plan has been produced.

The Council has adopted an ambitious target to be net zero by 2030. Its vision, outcomes and priorities clearly reflect the importance it places on this. But achieving this target brings resourcing and financial risks which the Council is actively managing.

Best value audit work is now fully integrated within our annual audit work

57. Local government bodies have a duty under the Local Government in Scotland Act 2003 to make arrangements which secure Best Value. Best Value is continuous improvement in the performance of the body's functions, having regard to:

- efficiency
- effectiveness
- economy
- the need to meet equal opportunity requirements.

58. Under the new Code of Audit Practice, the audit of Best Value in councils is fully integrated within the annual audit work performed by appointed auditors and their teams. Auditors are required to evaluate and report on the performance of councils in meeting their Best Value duties. There are four aspects to auditors' work:

- follow-up and risk-based work
- service improvement and reporting
- thematic reviews
- contributing to Controller of Audit reports.

Leadership of the development of new local strategic priorities

59. Annual thematic Best Value work is set by the Accounts Commission. For the 2022/23 financial year, auditors were asked to focus on the councils' leadership of the development of new local strategic priorities. The results of this work were reported to elected members at the Audit Committee in December 2023. This report will be published on the Audit Scotland website.

60. The key findings in this report are:

Council vision and priorities

- Midlothian Council has demonstrated ongoing commitment to best value since our Best Value Annual Report 2019. We have noted improvements in performance reporting and medium term financial planning as well as the strengthening of officer member relationships.
- The Council works well with its community planning partners and citizens and this has facilitated the creation of the Single Midlothian Plan and a clear vision for Midlothian to create “a great, green place to grow” over the next four years.

Citizen and community

- Partnership working continues to be a strength for the council. It has effectively involved its communities in developing shared priorities. Officers and elected members are aware of community needs and have established a cost of living task force chaired by the Council Leader to support citizens.

Reducing inequalities and tackling climate change

- The Council and its partners are actively working to address inequalities. The new Council Leader initiated, and chairs, the cross party Cost of Living Task Force which has moved from taking a crisis intervention approach to a preventative approach and a child poverty strategy and plan has been produced.
- The Council has adopted an ambitious target to be net zero by 2030. Its vision, outcomes and priorities clearly reflect the importance it places on this. But achieving this target brings resourcing and financial risks which the Council is actively managing.

Alignment of delivery plans

- The latest five-year revenue budget strategy agreed in September 2023 is projecting a budget gap of £34.7 million to 2028/29. The council recognises that transformation is essential to ensure service delivery remains financially sustainable and has published a Transformation Blueprint for Midlothian. The Transformation Blueprint which aligns with the five-year revenue budget strategy to 2027/28 aims to create a wellbeing economy. However, detailed workforce and digital plans required to deliver transformation continue to be developed but have not yet been finalised. New strategic leads for Digital and Human Resources have been appointed to lead this work.

Leadership

- We have observed improved constructive relationships between members and officers which have facilitated the creation of the Cost of Living Taskforce and the Transformation Blueprint.
- The council has taken steps to improve decision-making and encourage scrutiny. Midlothian Council has an appropriate approach to ensuring there is sufficient knowledge at a member level to support the decision making and scrutiny.

Controller of audit reports

61. The Controller of Audit also reports to the Accounts Commission on each council's performance in meeting its Best Value duties at least once over the five-year audit appointment. The programme of Controller reports will commence in October 2023. There are therefore no such reports required for 2022/23 audits. Based on the current provisional timetable, the Controller of Audit will report on the Midlothian Council's performance in meeting its Best Value duties in financial year 2026/27. If the timetable is changed, the auditor will update the Council.

5. Vision, leadership and governance

Public sector bodies must have a clear vision and strategy and set priorities for improvement within this vision and strategy. They work together with partners and communities to improve outcomes and foster a culture of innovation.

Main judgements

Midlothian Council continues to have effective and appropriate governance arrangements in place that support scrutiny of decisions made.

The Council has a clear vision, strategy and priorities

62. The [Accounts Commission Strategy 2021-26](#) sets out its priorities to focus on inequalities, funding, communities and recovery. The Code of Audit practice sets out the Best Value work required to report on these priorities.

63. Over our 5-year audit appointment, a separate management report from auditors will be issued each year that details the outcome of thematic Best Value work. It should be recognised that much of Best Value work overlaps with the wider-scope elements. For 2022/23, our management report concludes on the effectiveness of the council's leadership of the development of the council's strategic priorities, following the 2022 local government elections.

64. The Best Value section of this report highlights that the new Single Midlothian Plan sets out a clear vision for Midlothian and also identifies success measures to monitor performance.

Midlothian Council has appropriate governance arrangements in place to support effective scrutiny, challenge and informed decision making.

65. The governance transparency arrangements we consider in reaching our conclusions include:

- Council and committee structure and conduct
- overall arrangements and standards of conduct including those for the prevention and detection of fraud, error, bribery and corruption. This includes action in response to the National Fraud Initiative
- openness of Council and committees

- reporting of performance and whether this is fair, balanced and understandable.

66. The Council's governance arrangements have been set out in the annual governance statement in the annual accounts. We have reviewed these arrangements and concluded that they are appropriate and effective. Our observations at committee meetings have found that these are conducted in a professional manner and there is a reasonable level of scrutiny and challenge by members.

67. We consider that governance arrangements remain appropriate and support effective scrutiny, challenge and decision making.

Climate change arrangements

68. The Scottish Parliament has set a legally binding target of becoming net zero by 2045 and has interim targets including a 75% reduction in greenhouse gas emissions by 2030. The public sector in Scotland has a key role to play in ensuring these targets are met and in adapting to the impacts of climate change.

69. The Council recognises the strategic risks of fulfilling the requirements of the Climate Change Act including staffing and significant financial investment and began actively managing the risks in 2019. The Council declared a climate emergency in December 2019 and published its Climate Change Strategy and action plan in August 2020.

70. A Carbon Charter and action plan for Midlothian Businesses has been created and includes local, national and international resources to support business become more energy and carbon efficient.

71. A Climate Emergency Group has been established to monitor progress of the Council's ambitious targets. The group consists of elected members, individuals and representatives of the community councils and community groups, national government agencies, third sector organisations, local chamber of commerce, landowners and Midlothian Energy Ltd.

72. Failure to adapt to climate change is included in the Council's corporate risk register and is actively monitored through the corporate risk management process. We will continue to review progress against actions identified to mitigate the risks.

73. The Auditor General and Accounts Commission are developing a programme of work on climate change. This involves a blend of climate change-specific outputs that focus on key issues and challenges as well as moving towards integrating climate change considerations into all aspects of audit work.

6. Use of resources to improve outcomes

Public sector bodies need to make best use of their resources to meet stated outcomes and improvement objectives, through effective planning and working with strategic partners and communities.

Conclusions

The Council has appropriate arrangements in place for improving services and monitoring desired outcomes through a balanced scorecard approach.

Internal audit conducted a review and published a report on performance management and performance indicators in 2022. The report provided substantial assurance in the reporting of performance indicators.

Midlothian Council has an appropriate performance management framework in place

74. The Council has a revised Planning and Performance Management Framework (PPMF). The framework sets out arrangements to ensure the Council can demonstrate a focus on outcomes while continuing to reflect statutory performance reporting requirements set out in the Statutory Performance Information Direction 2021.

75. In response to the 2019 BVAR, the council implemented a digital dashboard performance management system, Pentana Browser, where elected members can access up-to-date performance data.

76. The CPP Board monitors performance of the Single Midlothian Plan every six months with the annual report highlighting success stories arising from the achievement of outcomes. The council use a separate balanced scorecard to track the performance indicators for the services it is directly responsible for.

77. There are 21 key indicators presented as relating to the SMP and these are split between the SMP's three stated outcomes (Individuals and Communities have Improved Health and Learning Outcomes, No Child or Household Living in Poverty, Significant Progress is made towards Net Zero Carbon Emissions by 2030). In 2022/23, 12 were reported as on target, 4 off target, 2 data only and 3 no data available. Results for all perspectives are detailed below.

Exhibit 7

Summary of 2022/23 Balance Scorecard Results

Perspective	On Target	Off Target	Data Only	No Data available
SMP Key Indicators	12	4	2	3
Customer/Stakeholder	16	8	26	3
Financial Health	1	1	16	0
Internal Processes	2	2	7	0
Learning and Growth	1	0	9	0

Source: Midlothian Council Balance Scorecard 2022/23

78. The Accounts [Commission's 2021 Statutory Performance Direction](#) defines the performance information that councils must publish. The Direction states that each council will report a range of information covered by the following two indicators:

- Statutory Performance Indicator 1: Improving local services and local outcomes
- Statutory Performance Indicator 2: Demonstrating Best Value

79. The commission does not prescribe how councils should report this information but expects them to provide the public with fair, balanced and engaging performance information.

Improving local services and local outcomes

80. We have evaluated Midlothian Council's arrangements for fulfilling the above requirements and concluded that appropriate arrangements are in place for improving services and monitoring desired outcomes through a balanced scorecard approach. The balanced scorecard approach was approved at the June 2023 Midlothian Council meeting alongside the council service plans. There are 113 indicators set out in a dashboard format. A RAG status is included to show how many indicators are on target and areas where data is missing. The balanced scorecard enables comparison over time and with other similar authorities by providing comparable figures for a 6 year period and performance against other councils forms part of the benchmarking. Citizens can view the scorecards and performance reports on the council website.

81. Internal audit conducted a review and published a report on performance management and performance indicators in 2022. The report provided substantial assurance in the reporting of performance indicators though it did

highlight that there was scope for improving the audit trail in some limited areas, in relation to Local Government Benchmarking Framework indicators. This was a low risk recommendation which had been accepted for action by Executive business Managers.

Demonstrating Best value

82. Best value principles have been built into the PPMF and the document highlights the importance of evaluating and scrutinising performance to ensure continuous improvement. In particular it highlights that there will be:

- a balance in reporting areas of improvement that have been achieved and not achieved. This is demonstrated in the annual scorecard report published by the Council
- that the reporting will be undertaken in a timely manner - quarterly reports on performance are timely as seen through the committee minutes
- easy access to its performance information for all of its citizens and communities, with such information presented in an accessible style – there are links provided on the Council website.

83. It is clear that best value considerations are taken into account throughout the council and have been considered at a strategic and local level when drawing together corporate priorities, assessment and action, with some reports drawing attention to specific best value principles where appropriate. Best Value principles are embedded within the Council. This is supported through the introduction of a Best Value framework in May 2023.

Appendix 1. Action plan 2022/23

2022/23 recommendations

Issue/risk	Recommendation	Agreed management action/timing
<p>1. Review of control accounts for classifications</p> <p>Our audit work identified some areas where the classification of transactions or balances was incorrectly disclosed within the notes to the accounts.</p> <p>Risk – the notes to the accounts do not reflect the underlying categories of the transactions.</p>	<p>The Council should ensure going forward that control accounts such as trade debtors are reviewed to ensure balances with central government and other public sector bodies are classified appropriately at the year-end.</p> <p>Exhibit 2,4</p>	<p>A further layer of internal review will be implemented for the 2023/24 accounts to ensure that the accuracy of Balance Sheet and Disclosure note classification is enhanced.</p> <p>Chief Financial Officer</p> <p>March 2024</p>
<p>2. Journals</p> <p>We reviewed the journals across the year to identify those which had been posted by those with a higher level of access. We identified some journals which relate to former employees, however, they relate to interfaces with the ledger which are not actually posted but are automatic journals.</p> <p>Risk – there is a risk of fraud or error.</p>	<p>Journals procedures should be reviewed to minimise the risk with the ability of members of the finance team to approve their own journals.</p> <p>Exhibit 5,1</p>	<p>We operate a control environment where staff at a designated level of seniority do not require counter signature. This being a reflection of the trust placed in senior employees and also to maintain a degree of practicality. I feel this is an acceptable risk for journal entries as non-cash transactions.</p> <p>Chief Financial Officer</p> <p>October 2023</p>
<p>3. Bank reconciliations</p> <p>Bank reconciliations were performed for each month of the year but the</p>	<p>The Council should ensure bank reconciliations are performed and reviewed in a timely manner. The Council should also consider the bank</p>	<p>There was a period during 2022/23 where reconciliations were not completed in line with normal established timescales due to staff</p>

Issue/risk	Recommendation	Agreed management action/timing
<p>reconciliations completed for periods 10 to 12 were not completed timeously.</p> <p>In addition at the year-end we identified over 20 bank accounts (mainly imprest accounts) with small balances which were not reconciled to the ledger on a regular basis.</p> <p>Risk – there is a risk that errors may not be picked up and corrected timeously. There is also a risk that the Council is operating a number of bank accounts which are no longer required.</p>	<p>accounts held and if they are still required.</p> <p>Exhibit 5,2</p>	<p>unavailability. Since then reconciliations have returned to a normal cycle.</p> <p>Chief Financial Officer</p> <p>October 2023</p>
<p>4. Payroll reconciliations</p> <p>The Council undertakes a reconciliation between the ledger and the payroll system on a monthly basis in line with good practice. We reviewed an example of one month's reconciliation in 2022/23 and found limited evidence that the discrepancies between the ledger and payroll were not being followed up or investigated on a timely basis.</p>	<p>The Council should ensure any work conducted in reconciling the ledger to payroll is appropriately evidenced.</p> <p>Exhibit 5,3</p>	<p>Agreed.</p>

Appendix 2. Summary of uncorrected misstatements

We report all uncorrected misstatements in the annual report and accounts that are individually greater than our reporting threshold of £250,000.

The table below summarises uncorrected misstatements that were noted during our audit testing and were not corrected in the financial statements. Cumulatively these errors are below our performance materiality level as explained in [Exhibit 1](#). We are satisfied that these errors do not have a material impact on the financial statements.

Narrative	Account areas	Comprehensive Income and Expenditure Statement		Balance Sheet	
		Dr £m	Cr £m	Dr £m	Cr £m
1. Asset addition recognised in incorrect period	Payables				0.312
	PPE			0.312	
2. Expenditure reclassification	CIES	0.631			
	PPE additions				0.631

Midlothian Council

2022/23 Annual Audit Report

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